INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/184

SEYCHELLES

August 2021

REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SEYCHELLES

In the context of the Request for an Extended Arrangement Under the Extended Fund Facility, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 29, 2021of the staff report.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 29, 2021, following discussions that ended on July 6, 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 July 20, 2021.
- A **Statement by the Executive Director** for Seychelles

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR21/234

IMF Executive Board Approves US$105.63 Million Extended Arrangement Under the Extended Fund Facility for Seychelles

FOR IMMEDIATE RELEASE

- The COVID-19 pandemic severely hit Seychelles' economy. The authorities responded with exceptional measures to mitigate the economic fallout on businesses and households, but fiscal and external balances deteriorated.
- The IMF Executive Board approved today a 32-month extended arrangement under the Extended Fund Facility (EFF) for Seychelles, with access equivalent to US$ 105.63 million. The Board's approval allows for an immediate disbursement equivalent to US$34.26 million.
- The program aims to support the government's policy and reform efforts aimed at reinforcing the country's recovery from the pandemic, preserving macroeconomic stability, and sustaining inclusive long-term growth. Key policy actions under this program will focus on reducing debt sustainability risks.

Washington, DC – July 29, 2021: On July 29, 2021, the Executive Board of the International Monetary Fund (IMF) approved a 32-month extended arrangement under the Extended Fund Facility (EFF) for Seychelles for SDR 74 million (US$105.63 million), or 323 percent of Seychelles' quota. The Board's approval allows for an immediate disbursement equivalent to US$ 34.26 million.

Seychelles was hit hard by the COVID-19 crisis. The authorities reacted swiftly, by locking down the economy, thereby keeping infection and fatality rates low. However, the travel restrictions and global economic downturn triggered unprecedented economic contraction. The authorities responded with measures to mitigate the economic fallout on businesses and households. But the public debt ratio increased sharply, reflecting the primary balance deterioration, exchange rate depreciation, and GDP contraction. As soon as vaccines became available, Seychelles led the world in vaccination coverage and reopened its borders. With tourist arrivals bouncing back, a V-shaped recovery is now expected.

The key objective of the proposed program is to support the authorities' efforts to restore macroeconomic stability and debt sustainability while strengthening the post COVID-19 recovery. The program would support the authorities' ambitious fiscal consolidation efforts and reduce debt sustainability risks through a three-pillared, frontloaded adjustment comprising fiscal adjustment, a liability management operation (LMO), and external support. The authorities successfully completed the LMO, which seeks to significantly reduce the rollover risks, immediately after the conclusion of the program discussions.

At the conclusion of the Executive Board's discussion, Mr. Tao Zhang, Deputy Managing Director and Chair stated:

"The Seychelles' economic outlook is positive, but risks remain high. Tourist arrivals since March 2021 point to a strong recovery. Nonetheless the outlook is uncertain and contingent on the pandemic path, the effective rollout of vaccines in Seychelles' key tourist markets, and the expected recovery in external demand.

"The new arrangement under the Extended Fund Facility will support Seychelles' post-pandemic recovery, anchor reform implementation and catalyze additional external financing.

"The key strategy focuses on maintaining the recovery momentum while reducing the risks to debt sustainability. Advancing the reform agenda through an ambitious fiscal adjustment, reinforced debt management, strengthened fiscal governance frameworks, and financial sector development and inclusion are essential priorities to sustain the post-COVID-19 recovery and generate high, sustainable, and inclusive growth.

"Enhancing public financial debt management, and improving governance of state-owned enterprises, will reduce fiscal vulnerabilities. Modernizing and revamping the banking resolution and emergency liquidity assistance frameworks will help safeguard financial stability. Further reforms to modernize the financial sector, including through digital finance, and improve the business environment will help support private sector development and foster sustainable and inclusive growth. The capacity development strategy aligned with the program is an important tool to achieve reform potential."

Seychelles: Selected Economic and Financial Indicators

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Act.	Act.	Act.	Act.	Prel.			Proj.			
					(Annual percent change, unless otherwise indicated)						
National income and prices											
Nominal GDP (millions of Seychelles rupees)	18,989	20,858	21,540	22,192	20,021	23,585	26,219	28,889	31,235	33,781	36,464
Real GDP (millions of Seychelles rupees)	8,423	8,843	8,960	9,132	7,957	8,506	9,160	9,780	10,266	10,781	11,297
Real GDP	4.4	5.0	1.3	1.9	-12.9	6.9	7.7	6.8	5.0	5.0	4.8
CPI (annual average)	-1.0	2.9	3.7	1.8	1.2	10.0	3.7	3.2	3.0	3.0	3.0
CPI (end-of-period)	-0.2	3.5	3.4	1.7	3.8	8.6	3.9	3.5	3.2	3.0	3.0
GDP deflator average	-0.8	4.6	1.9	1.1	3.5	10.2	3.2	3.2	3.0	3.0	3.0
Money and credit											
Broad money	12.1	16.4	7.7	13.9	29.2	…	…	…	…	…	…
Reserve money (end-of-period)	14.5	18.9	4.5	22.7	40.4	…	…	…	…	…	…
Velocity (GDP/broad money)	1.4	1.3	1.3	1.1	1.1	…	…	…	…	…	…
Money multiplier (broad money/reserve money)	4.6	4.5	4.6	4.3	3.9	…	…	…	…	…	…
Credit to the private sector	10.3	17.8	11.5	22.3	20.2	9.1	16.6	17.7	18.7	16.5	15.6
					(Percent of GDP, unless otherwise indicated)						
Savings-Investment balance											
External savings	20.6	19.6	18.9	16.1	29.5	25.7	22.0	19.8	17.8	16.9	15.5
Gross national savings	9.6	9.2	7.8	10.3	-6.2	2.3	5.7	8.1	8.8	9.5	10.8
Of which: government savings	3.8	3.7	4.3	4.6	-13.8	-6.1	-1.1	2.6	3.7	5.3	5.8
private savings	5.8	5.5	3.5	5.7	7.7	8.4	6.7	5.4	5.1	4.2	5.0
Gross investment	30.2	28.9	26.7	26.4	23.4	28.0	27.7	27.8	26.6	26.4	26.3
Of which: public investment [1]	5.0	4.3	5.2	3.9	5.9	9.0	8.7	7.3	6.1	5.9	5.5
private investment	25.2	24.6	21.5	22.5	17.5	19.0	19.0	20.5	20.5	20.5	20.8
Private consumption	47.1	50.9	52.6	52.6	49.9	54.9	56.1	54.8	52.7	53.4	52.1
					(Percent of GDP)						
Government budget											
Total revenue, excluding grants	36.7	35.0	37.1	37.6	35.7	30.7	33.1	34.3	36.2	36.8	37.2
Expenditure and net lending	38.2	36.4	38.8	37.7	57.1	48.4	43.6	39.2	38.1	38.0	37.9
Current expenditure	33.2	32.1	33.6	33.8	50.1	38.9	35.4	33.0	33.1	32.0	31.9
Capital expenditure [1]	5.0	4.3	5.2	3.9	5.9	9.0	8.7	7.3	6.1	5.9	5.5
Overall balance, including grants	-1.4	0.1	0.7	-0.9	-19.5	-13.6	-7.7	-2.9	-0.4	0.2	0.7
Primary balance	0.0	0.0	0.0	0.0							
Primary balance	3.4	3.1	3.0	2.8	-16.3	-9.7	-5.0	-0.4	2.8	3.0	3.2
Total government and government-guaranteed debt [2]	72.8	65.7	62.3	61.8	100.8	87.7	87.6	83.0	77.2	71.2	64.5
External sector											
Current account balance including official transfers (in percent of GDP)	-20.6	-19.6	-18.9	-16.1	-29.5	-25.7	-22.0	-19.8	-17.8	-16.9	-15.5
Total external debt outstanding (millions of U.S. dollars) [3]	4,299	4,475	4,682	4,874	5,093	5,452	5,823	6,147	6,362	6,588	6,830
(percent of GDP)	301.5	292.8	303.7	308.5	447.7	346.7	331.8	314.8	297.6	281.2	264.0
Terms of trade (-=deterioration)	-13.8	-2.9	-3.3	6.7	10.6	-3.6	-4.1	-0.4	0.9	0.9	0.0
Real effective exchange rate (average, percent change)	-0.1	-3.2	...	...	...	...	...	...	...	...	...
Gross official reserves (end of year, millions of U.S. dollars)	522.6	546	548	581	561	670	743	815	816	824	848
Months of imports, c.i.f.	3.7	3.5	3.7	5.2	4.5	4.6	4.4	4.4	4.0	3.8	3.9
In percent of Assessing Reserve Adequacy (ARA) metric	113.3	112.6	110.9	112.4	111.9	114.4	115.9	117.4	111.1	107.0	104.6
Exchange rate											
Seychelles rupees per US$1 (end-of-period) [4]	13.5	13.8	14.0	14.1	21.6	…	…	…	…	…	…
Seychelles rupees per US$1 (period average) [4]	13.3	13.6	14.0	14.0	17.6	…	…	…	…	…	…

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.

[4] As to 2020, exchange rate measured as of July 14, 2020.

INTERNATIONAL MONETARY FUND

SEYCHELLES

July 20, 2021

REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

EXECUTIVE SUMMARY

Context. Seychelles was hit hard by the COVID-19 crisis. The authorities reacted swiftly, by locking down the economy, thereby keeping infection and fatality rates low. However, the travel restrictions and global economic downturn triggered unprecedented economic contraction. The authorities responded with measures to mitigate the economic fallout on businesses and households. But the public debt ratio increased sharply, reflecting the primary balance deterioration, exchange rate depreciation, and GDP contraction. As soon as vaccines became available, Seychelles led the world in vaccination coverage and reopened its borders. With tourist arrivals bouncing back, a V-shaped recovery is now expected.

Program modalities. The government, which took office in late October 2020, has indicated its commitment to sound fiscal policy and structural reforms and has requested a Fund arrangement in support of its efforts. A new EFF arrangement is proposed to assist the country in facing structural balance of payments needs exacerbated by the unprecedented external shock of the COVID-19 pandemic. The key objective of the proposed program is to support the authorities' efforts to restore macroeconomic stability and debt sustainability while strengthening the post COVID-19 recovery. The program would support the authorities' ambitious fiscal consolidation efforts and reduce debt sustainability risks through a three-pillared, frontloaded adjustment comprising fiscal adjustment, a liability management operation (LMO), and external support. The authorities successfully completed the LMO, which seeks to significantly reduce the rollover risks, immediately after the conclusion of the program discussions. A 32-month EFF arrangement with access of SDR 74 million (323 percent of quota; around USD 107 million) is necessary to close the financing gap over 2021-23.

Program policies. Significant and frontloaded fiscal consolidation will reduce risks to debt sustainability. A cumulative fiscal adjustment of 15.8 percentage points of GDP is envisaged during 2021-23, with the adjustment achieved primarily through unwinding COVID-related measures, reducing non-priority spending, and increasing revenue. The authorities have also committed to governance, transparency, and other structural reforms.

Staff views: The authorities' policies and ownership of the program are set out in the Letter of Intent and Memorandum of Economic and Financial Policies. The environment remains highly uncertain, however, and program risks arise from a resurgence of the COVID-19 pandemic both domestically and in overseas markets, climate disasters, and other sources. Program design takes these considerations into account and, should such risks materialize, contingency measures are envisaged to help safeguard the program objectives.

Approved By
Vivek Arora (AFR) and Anna Ilyina (SPR)

Program discussions were held virtually during June 23-July 6. The staff team comprised Boriana Yontcheva (head), Aissatou Diallo, Erin Nephew, and Shijia Luo (all AFR), Hanife Yesim Aydin and Arindam Roy (both MCM), and Kyungsuk Lee (SPR). Raveesha Gupta provided research support and Danielle Bieleu provided assistance with the preparation of this report.

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APPENDIX

BACKGROUND

1. **Before the COVID-19 outbreak, Seychelles' economic performance was solid and the outlook promising.** Growth was robust, the fiscal and external positions were strengthening, and tourism receipts were increasing steadily. Banks were adequately capitalized and liquid, and inflation remained subdued. The primary fiscal surplus reached 2.8 percent of GDP in 2019, slightly overperforming the authorities' target. Gross international reserves (GIR) outperformed staff's projections. The public debt-to-GDP ratio had fallen to around 60 percent of GDP by end-2019 (from around 200 percent in 2008). Reflecting the authorities' reform efforts, performance under previous IMF-supported programs was strong and all pre-COVID targets were met.

2. **Seychelles was hit hard by the COVID-19 crisis.** After the first COVID-19 cases were identified, the government swiftly introduced a lockdown in April 2020, which kept infection and fatality rates low. However, travel restrictions and the global economic downturn brought an unprecedented economic contraction[1]. The authorities responded with measures to mitigate the economic fallout on businesses and households. The Fund provided support through the Rapid Financing Instrument (RFI) in May 2020, amounting to SDR 22.9 million. Such support helped alleviate the impact of COVID-19 on the economy and support mitigating measures amidst fiscal pressures.

Source: National Bureau of Statistics Seychelles.

3. **The COVID crisis weakened fiscal and external balances significantly.** The current account deficit rose to 30 percent of GDP in 2020, and the nominal exchange rate depreciated by 35 percent (yoy). The contraction in tourism-related activities shrank revenues while expenditures ballooned to 57.1 percent of GDP. As a result, the primary balance turned into a deficit in 2020, estimated at 16.3 percent of GDP.

Text Table. Seychelles: Actual cost of COVID-19 related expenditures
(In percent of GDP)

	2020	2021
Wage subsidies	6.3	0.8
Seychelles Employee Transition Scheme	0.1	0.1
PMC and HFC Housing Loan Repayment Scheme	0.1	0.1
COVID-19 Micro and Small Business Support Fund	0.1	...
Total Cost	6.7	0.9

Sources: Authorities; and IMF staff estimates.

4. **The public debt ratio increased sharply, reflecting the primary balance deterioration, exchange rate depreciation, and GDP contraction.** Public and publicly guaranteed debt increased from 62 percent of GDP in 2019 to 100 percent in 2020. Of this increase, the fiscal deterioration and GDP contraction each contributed 15.2 percentage points, and the exchange rate depreciation 7.6 percentage points Gross financing needs (GFNs) increased from 29 percent of GDP in 2019 to 50 percent in 2020.

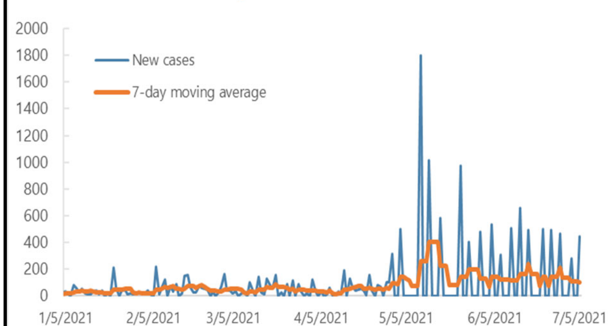
[1] Tourism and its related sectors account for about two-thirds of Seychelles' GDP.

5. Against this background, the authorities requested an arrangement under the Extended Fund Facility (EFF). The EFF is intended to support post-COVID recovery amid structural balance of payments weaknesses. As an island economy, dependent on tourism, Seychelles has experienced structural balance of payments weaknesses that were exacerbated by the COVID-19 crisis. With the drop in tourist receipts, and uncertainty around future tourism flows, both current account and investment inflows weakened. The arrangement will support the authorities' reform plans, which aim at reducing debt sustainability risks through a three-pillared, frontloaded adjustment comprising fiscal consolidation, a liability management operation, and external support.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

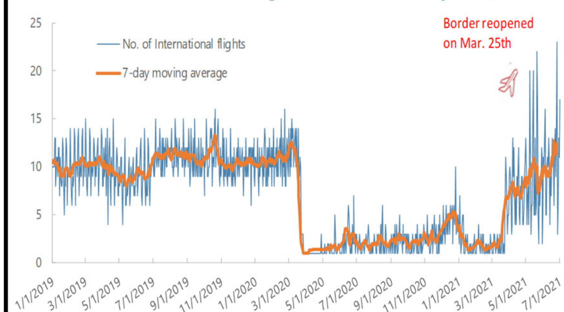
6. Tourist arrivals bounced back as borders reopened in late March 2021, pointing to a V-shaped recovery. Seychelles was the first country to vaccinate more than 60 percent of its population, allowing a reopening of borders that resulted in a rebound of tourist arrivals starting in April 2021.[2] New markets have emerged since the start of the pandemic, with tourists from Russia, Israel, and UAE offsetting the interruption in tourism from Europe. Domestic containment measures were put back in place in May to limit another flare-up of COVID cases, but were lifted at the end of that month after case numbers peaked and started dropping rapidly.

No. of daily new active COVID-19 cases



Source: JHU COVID-19 Data.

No. of international flights arrivals to SEZ airport 1/



Source: Flightradar24.
1/ SEZ stands for Victoria Seychelles International Airport.

7. Market sentiment improved in recent months. Following the reopening of the border, market sentiment has improved. The currency has appreciated by 26 percent against the U.S. dollar since March 25 from about 21.5 rupees per dollar to almost 16 by end-June 2021, offsetting almost all the depreciation in 2020. The better sentiment is also reflected in a recovery in the demand for T-bills and a reduction in average yields (by 42 bps) for the one-year tenor during March-June 2021. Following the announcement on June 30, 2021, of a structural downward shift of the interest rate

[2] A border closure during March-July 2020 initially kept the number of reported infections low but brought the economy to a halt. After a tentative, partial reopening in August 2020, restrictions were reinstated following a second infections wave starting in December 2020.

corridor to align policy rates to macroeconomic fundamentals, the one-year yield on T-Bills further compressed by 115 bps as of July 2, 2021.[3]

8. **Banks remain highly liquid on account of stable deposit levels and reduced demand for credit.** There was only a slight increase in the nonperforming loan (NPL) ratio from 3.3 percent at end-December 2020 to 5.1 percent as of May 2021, in part reflecting some regulatory forbearance. Reported capital adequacy ratios increased from January 2021 to April 2021, primarily due to a reduction in risk-adjusted assets, following the appreciation of the domestic currency in April 2021.

9. **The outlook is positive but with downside risks.** The substantial recovery in tourist arrivals since March 2021, and in hotel and resort reservations for later this year bode well for tourism earnings. Given the quick return of tourists to Seychelles' shore and the upcoming holiday season in Q4, tourist arrivals are projected to rebound at 40 percent in 2021 and 50 percent in 2022 including tourists from both traditional and new markets. Airlines and hotels are operating without capacity constraints in the near term. Expenditure per visitor is also expected to increase post COVID-19 as seen during the past months. Staff expect the 2019 real GDP level to be regained in 2022, and tourism earnings to increase further in the medium term as arrivals from the new source countries complement the recovery in traditional markets. Vaccines are expected to be widely available in Seychelles' major markets (Europe, Middle East) by mid-summer 2021, while a faster-than-expected global recovery from the pandemic, driven by the U.S. and China, is expected to underpin global demand. Downside risks include a prolonged impact of the COVID-19 outbreak – whether in the Seychelles or in its partner countries – on domestic activity and tourism, especially if vaccines prove less effective than expected; natural disasters; and higher NPLs in the banking sector if the economic recovery falls short of expectations.

Text Table. Seychelles: Selected Economic Indicators, 2020-21

	2020	2021, Projection
Real economic activities(annual percentage change, unless otherwise indicated)		
Tourist arrivals	-70.1	40.0
Real GDP	-12.9	6.9
Fiscal position(percent of GDP)		
Overall balance, including grants	-19.5	-13.6
Primary balance	-16.3	-9.7
Total government and government-guaranteed debt	99.6	87.7
Balance of payments(percent of GDP)		
Current account deficit	29.5	25.7

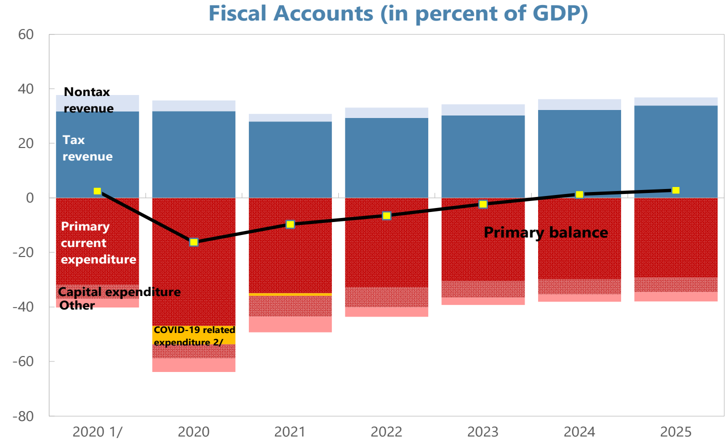
Sources: Seychellois authorities and IMF staff estimates and projections.

[3] The policy announcement resulted in an equivalent transmission effect on the 365-day tenor of T Bills, with the yields declining to 4.9 percent for the auctions held on July 2, 2021, from 6.0 percent for the previously held auction on June 25, 2021.

KEY POLICIES SUPPORTED BY THE PROGRAM

10. The authorities' reform agenda – described in their Letter of Intent and Memorandum of Economic and Financial Policies (MEFP) – aims at supporting post-COVID recovery and reducing risks to debt sustainability. An ambitious, growth-friendly fiscal consolidation is necessary to reduce debt sustainability risks by tackling structural fiscal weaknesses, such as lack of a medium-term fiscal framework, and weak debt and state-owned enterprise (SOE) management. In addition, the authorities envisage a liability management operation that reduces rollover risks while preserving financial sector stability.

Fiscal Accounts (in percent of GDP)



Source: IMF staff estimates.
1/ Forecast of 2020 fiscal accounts that was made at the time of the 4th review under the PCI.
2/ Include wage subsidies, Seychelles Employee Transition Scheme and PMC and HFC Housing Loan Repayment Scheme.

A. Policies: Supporting the Recovery and Reducing Fiscal and Debt Risks

Fiscal Policy

11. The program envisages a substantial consolidation, following the pandemic-related fiscal expansion in 2020. In line with Seychelles' strong policy track record, the authorities are committed to reduce debt sustainability and fiscal risks by returning to a primary surplus of 2.8 percent in 2024 (equivalent to its 2019 level: MEFP ¶. 32). A total adjustment of 15.8 percent is planned during the period of 2020-23, to be achieved through a combination of lower expenditure and higher revenue. 5.8 percent will come from the unwinding of COVID-related spending, 5.2 percent from the implementation of new structural fiscal measures and 4.8 percent from the recovery in revenues/decline in transfers due to the economic rebound. The adjustment would protect vulnerable groups through strengthened social safety nets.

Near Term Fiscal Policy

12. The authorities intend to pass a supplementary budget to reflect the revised outlook and fiscal framework before end-September 2021. Given the nascent recovery in tourism, the government has already begun unwinding some COVID-related measures. The draft supplementary 2021 budget is in line with the program target of a primary deficit of 9.7 percent of GDP, and assumes a pick-up in growth during the second half of the year, withdrawal of the COVID-19 fiscal support package, and a reduction in transfers to SOEs, including Air Seychelles (MEFP ¶33).

13. The revised 2021 budget sets a realistic revenue target of 30.7 percent of GDP. Tax revenue as a percent of GDP would contract from 31.8 percent of GDP in 2020 to 28 percent in 2021, due to deferred losses in business taxes, abolishment of Corporate Social Responsibility (CSR) tax, and the amnesty program[4]. Revenues are projected to pick up again from 2022, based on the recovery of the economy and tangible measures to strengthen revenue administration (structural benchmark for end-September 2023; MEFP ¶. 36), proposed tax policy measures, including the limitation of tax exemptions (structural benchmarks for end-November 2021 and end-September 2022), unified profit taxation, and measures to prevent the erosion of the corporate tax base through international profit shifting, as per the OECD's recommendation (structural benchmark for end-September 2021).

14. Most of the envisaged expenditure reduction is driven by current expenditures. COVID 19-related expenditures represented a significant part of transfers in 2020. Their reduction has already started in 2021 (from 6.7 percent of GDP in 2020 to 0.9 percent in 2021). The Government of Seychelles (GOS) has also introduced further expenditure-saving measures in the 2021 budget (MEFP ¶ 36). New recruitments are expected to be limited to key positions in certain ministries and departments (savings of SCR 38.3 million, about 0.2 percent of GDP). A public service reform is expected to yield savings of SCR 279.1 million (1.2 percent of GDP), by capping salaries and allowances (MEFP ¶36). The GOS is reviewing services currently being outsourced to identify areas of savings. The GOS is also negotiating with landlords for reductions on rental and office accommodation costs of 25 percent (savings of SCR 36 million, about 0.2 percent of GDP). Finally, the authorities intend to optimize the use of virtual meetings to reduce travel costs (savings of SCR 34.2 million, about 0.2 percent of GDP).

15. Capital expenditures will also be moderated, without expected to have an immediate effect on growth. As tourism and private investment drive much of the country's economic activity, public investment may have to be deprioritized until the immediate COVID-related crisis is overcome.[5]

16. In case downside risks materialize, including regarding revenues, the authorities are committed to additional spending cuts. They will identify non-priority spending and investment infrastructure projects that could be dropped while protecting education, health, and social protection spending. The authorities are committed to further discuss such spending cuts during the first review.

Medium-Term Fiscal policy: Boosting Credibility

17. The authorities will adopt a Medium-Term Fiscal Framework (MTFF) to bolster the credibility of their planned post-program fiscal targets. Authorities have started technical

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[4] The significant losses that companies recorded in 2020 will be reflected in the 2021 business taxes.

[5] The decline in capital expenditure in the medium term comes after a jump in capital expenditure in 2021, driven by a bunching of external grants this year. Capital expenditure in the medium term is expected to be closer to its historical level as such grants are expected to taper off as the country recovers.

discussions with IMF staff and an expert from AFRITAC SOUTH. They are committed to start work immediately on supporting reforms such as strengthening fiscal forecasting, reporting, budget institutions, fiscal risk analysis, and enforcement of budget ceilings. The objective is to adopt a MTFF by the end of the program (MEFP ¶. 37).

Text Table. Seychelles: Fiscal Adjustment

	2020	2021	2022	2023	2024	2025	2026
	In Percent of GDP	In Percent of GDP	In Percent of GDP	In Percent of GDP	In Percent of GDP	In Percent of GDP	In Percent of GDP
Total revenue, excluding grants	35.7	30.7	33.1	34.3	36.2	36.8	37.2
Tax	31.8	28.0	29.3	30.3	32.2	33.8	34.2
Of which							
Excise tax	6.3	5.6	5.9	6.2	6.4	6.7	6.7
VAT	10.6	11.1	11.3	11.7	11.7	11.7	11.7
Business tax	6.0	4.2	4.5	4.8	5.3	6.0	6.1
Nontax	3.9	2.8	3.8	4.0	4.0	3.0	3.1
Expenditure and net lending	57.1	48.4	43.6	39.2	38.1	38.0	37.9
Primary current expenditure	46.9	35.0	32.7	30.6	29.9	29.3	29.4
Wages and salaries	14.2	12.6	12.0	10.9	11.0	11.0	11.0
Goods and services	14.6	13.3	12.5	11.6	11.3	10.9	10.9
Transfers	18.0	8.9	8.1	7.9	7.2	7.0	7.1
Wage subsidies	6.3	0.8	…	…	…	…	…
Seychelles Employee Transition Scheme	0.1	0.1	…	…	…	…	…
PMC and HFC Housing Loan Repayment Scheme	0.1	0.1	…	…	…	…	…
Covid-19 Micro and Small Business Support Fund	0.1	…	…	…	…	…	…
Air Seychelles	1.2	0.6	…	…			
Capital expenditure	5.2	7.6	7.4	6.0	5.5	5.3	5.0
Others	5.1	5.8	3.5	2.7	2.7	3.4	3.5
Primary balance	-16.3	-9.7	-5.0	-0.4	2.8	3.0	3.2
Fiscal adjustment		6.6	4.7	4.5	3.2	0.2	0.2
Unwinding of the COVID-related spending		4.8	0.9	-	-	-	-
New structural fiscal measures		1.0	1.6	2.6	1.2	0.1	0.1
Recovery in revenues/decline in transfers due to the economic rebound		0.7	2.2	1.9	2.0	0.1	0.1

Sources: IMF staff estimates

Text Table. Seychelles: Fiscal Measures Incorporated in the 2021 Budget

	SR'million	% of GDP
Revenue Side		
Tax Reform; Amnesty Program July to Dec 2021	20.0	0.09%
Abolishment of CSR Tax from April 2021	-58.6	-0.25%
Sub-Total	**-38.6**	**-0.16%**
Expenditure Side		
Public Sector Reforms	279.1	1.19%
Abolishment of the FA4JR Scheme from 1st April 2021	1082.0	4.62%
Abolishment of the SETS program from 1st March 202´	7.0	0.03%
Abolishment of the Unemployment Relief Scheme from 1st April 2021	29.6	0.13%
Sub-Total	**1397.7**	**5.97%**

Source: IMF staff estimates.

18. **On the revenue side, the priority is the return to pre-crisis collection levels and further modernize the tax administration.** The government has proposed a number of tax and customs reforms. These include improving the effectiveness of the Value Added Tax (VAT) and Goods and Services Tax (GST) and eliminating numerous tax exemptions (table 6), scaling down of the extensive

concessional business tax regime, and implementing the ASYCUDA World system to strengthen internal controls in customs (MEFP ¶. 35 and 36; structural benchmark for end-September 2023).

19. **Improving the efficiency of government spending will also be key to ensuring fiscal sustainability and enhancing growth prospects over the medium term.** The authorities intend to improve public procurement with assistance from the World Bank. A Public Investment Management Assessment (PIMA) planned for FY22 will help identify opportunities to increase the efficiency of public investment, including expanding the scope for the procurement system to support PPPs. With technical assistance from the Fund, further upgrading of public financial management is planned (MEFP ¶ 41 and 42). PIMA and Integrated financial management information systems (IFMIS) missions planned for FY22 are included in the AFS/FAD work plan. Savings measures also include better targeting of social welfare programs and streamlining spending on goods and services and capping nominal growth in wages and salaries. Finally, the authorities are committed to the transparency of COVID emergency-spending, specifically the conduct of an audit, which is underway, and the publication of information on awarded companies.

20. **The government is committed to implement medium-term projects for climate-change adaptation and digitalization.** Priority climate change adaptation investments have been identified in the areas of critical infrastructure, tourism and coastal management, food security, biodiversity, water security, and the blue economy (MEFP ¶29). Digitalization, particularly in the areas of government service delivery and financial services, are pursued with high priority (MEFP ¶ 28, 68, and 69).

21. **Vulnerable groups will be protected by strengthening social safety nets**. The GOS has requested World Bank support in reforming the social protection system to ensure its sustainability, including by enabling working-age beneficiaries to participate in the labor force. The reform objectives are to improve the efficiency and effectiveness of social protection programs, notably by better targeting them. Such reform would allow to improve the quality-of-service delivery but also expand the number of the beneficiaries at lower costs. A key reform will be the increase of the minimum retirement age to 65 in 2023 (MEFP ¶ 39).

B. Monetary and Exchange Rate Policy

22. **The Central Bank of Seychelles' (CBS) accommodative monetary stance remains appropriate in view of the weak credit growth to the economy and the need to realign domestic markets rates.** Bank credit to the private sector started weakening in April 2021. The accommodative monetary policy stance in response to the crisis in 2020 has been further eased in 2021 to better align domestic policy rates and support private sector credit.[6] The announcement led

[6] After a reduction of the policy rate by 100 bps in the second quarter of 2021, the policy rate was further reduced by an equivalent amount in the third quarter. The latest reduction in the policy rate was accompanied by a structural downward shift of the short-term interest rate corridor. The width of the corridor narrowed from 5 percent to 3 percent. The announcement also reaffirmed the possibility to reduce the Minimum Reserve Requirement on local currency deposits by 3 percentage points should liquidity conditions warrant such an adjustment. As a result, the spread between 365-day and 91-day T-Bills narrowed to 151 bps on July 2, 2021, from 242 bps in the previous week.

to a flattening of the short-term yield curve, which may also transmit to the longer-term segment of the bond curve. Second-round effects of the significant exchange rate depreciation in 2020, combined with one-off technical effects associated with a recalculation of the CPI basket, have contributed to inflationary pressure in recent months. However, the sharp currency appreciation in April is expected to partially reverse this effect albeit with a lag.[7] The CBS stands ready to act decisively if inflationary pressures do not subside. To help anchor inflation expectations, staff encouraged the CBS to expand the survey of inflation expectations. Technical assistance by AFRITAC South on improving the inflation forecasting framework will be continued.

23. The CBS continues to implement its relatively new monetary policy framework, having recently switched from reserve money targeting to interest rate targeting. Ongoing efforts include developing an interbank market and fine-tuning communications policy. Resumption of repurchase operations with Fund technical assistance and the introduction of a Master Repurchase Agreement would strengthen CBS' liquidity management capacity. The functioning of the interbank market could be improved through the planned initiation of horizontal repo operations.

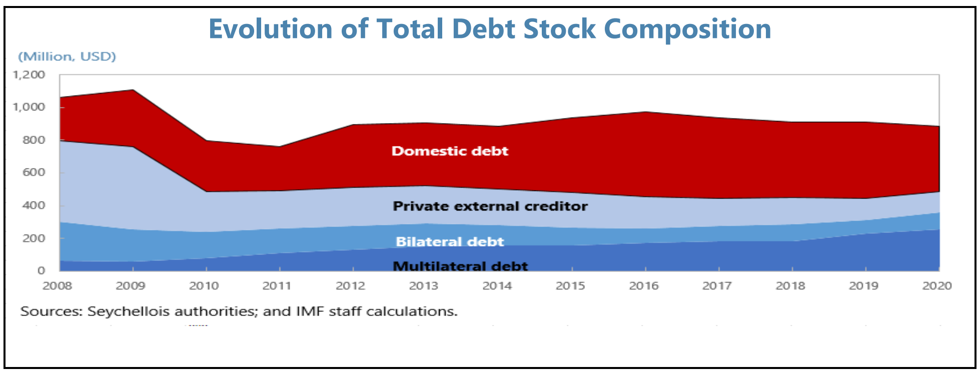
24. The use of the exchange rate as a shock absorber remains appropriate. The CBS remains committed to allow the market to determine the exchange rate, with interventions only used to limit disorderly market conditions and to build external buffers (MEFP ¶54). Staff encouraged the authorities to enhance the monitoring of banks' open positions and FX exposures, particularly focusing on the changes in the repayment capacity of borrowers in response to exchange rate fluctuations. In future reviews, staff will advise the authorities to impose differentiated capital requirements based on the currency denomination of loans and the hedged positions of debtors. Efforts to introduce FX swaps and forward products in consultation with the Seychelles Banking Association could help strengthen risk management by private entities and impart more stability to the forex market. Broadening the central bank's' toolkit to include FX swaps for intervention purposes could also help restore orderly market conditions in the foreign exchange market.

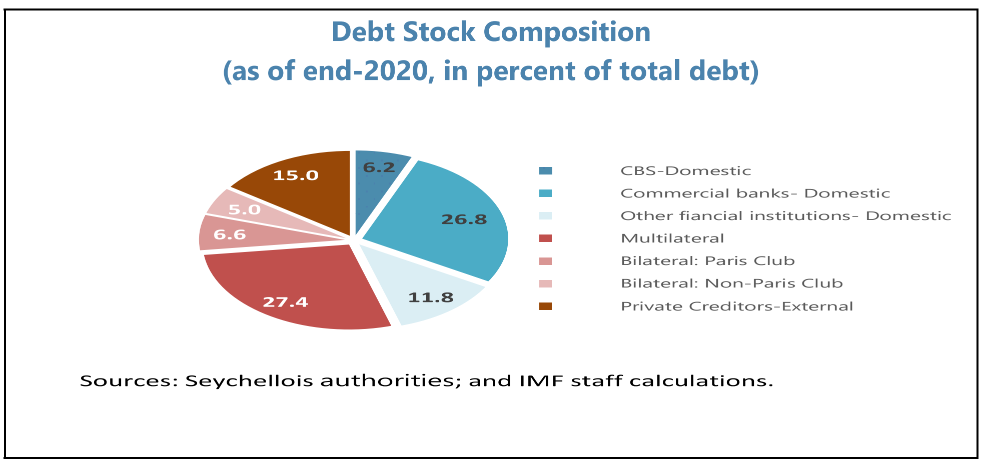
C. Debt Reduction Strategy

25. The authorities are committed to mitigate the significant risks to debt sustainability. Staff assesses debt to be sustainable but with significant risks related to macroeconomic shocks and Air Seychelles (DSA, Annex I). This assessment is predicated on a steadfast implementation of fiscal consolidation over the medium term, a strong rebound in growth, greater reliance on the low-cost financing, and extension of the maturities of domestic public debt through active debt management. The authorities' commitment to steadfast implementation of the ambitious debt reduction strategy (including through achieving a primary surplus of 3.2 percent of GDP in 2026, growth recovery, and optimized debt management) is expected to bring public debt down to below 65 percent of GDP by end-2026.

[7] An empirical analysis based on monthly inflation in Seychelles since 2007 indicates that for every 10 percent depreciation of the local currency, inflation increased by 5 percentage points within one year (Refer to Annex V on Exchange Rate Pass-Through to Inflation).

26. The GOS aims to reduce rollover risks through a debt management strategy that seeks to lengthen the debt maturity and reduce its cost (MEFP 46). They plan to achieve this through: (i) increased recourse to cheaper external debt with longer maturities, which would replace relatively expensive short-term domestic debt; and (ii) a liability management operation (LMO) conducted in July (see below) which will be further supported by an issuance strategy that better balances T-bill and bond issuances. This would result in a sharp decline in GFNs from 50 percent of GDP in 2020 to below 15 percent by 2024. Overall, the stock of T Bills is estimated to decline from a historical high of 28 percent of GDP in 2020 and stabilize to around 6 percent during 2022-26.The average annual level of bond issuance during 2022-26 is projected at 5 percent of GDP compared to actual issuance in 2020 amounting to 7 percent of GDP. They also intend to modernize debt management to keep risk premia low. Substitution of T-bills with external finance amounting to an annual average of 2.3 percent of GDP during 2021-23 would require sterilization measures from the CBS which would incur costs, thereby reducing the net savings from cheaper external finance.





27. The authorities successfully executed an LMO that significantly reduces the rollover risks. Given favorable market conditions, the GOS announced the LMO on July 6, 2021, immediately after conclusion of the program consultations. The authorities discussed the design of the LMO with Fund staff. The LMO offered to exchange up to SCR 1.5 billion of outstanding T-bills (6.4 percent of GDP) for 3, 5, and 7-year bonds in equal proportion. The T-Bills covered in the LMO comprised 182 and 365-day bills accounting for one-third of the total stock of T-Bills. The bids for bonds were based on an auction mechanism that included both competitive and non-competitive bids, with competitive bidding available only to banks. The LMO was held on a voluntary basis and closed on July 14, 2021. The LMO switched SCR 1.2 billion (5.2 percent of GDP) of T-Bills into bonds. The shares of the 3, 5 and 7-years bonds allocated in the auction amounted to 38 percent, 33 percent and 29 percent, respectively. The LMO has extended the average maturity of the participating debt portfolio by 4.8 years compared to the current maturity of less than 1 year. As a result of the LMO, fiscal consolidation and low-cost external financing, combined with strong growth, the GFNs would sharply decline from 44 percent of GDP in 2021, to 24 percent in 2022. The weighted average yields on the LMO for the bonds are lower by 125-150 bps compared to the previously issued rates and contribute to mitigate rollover risks.

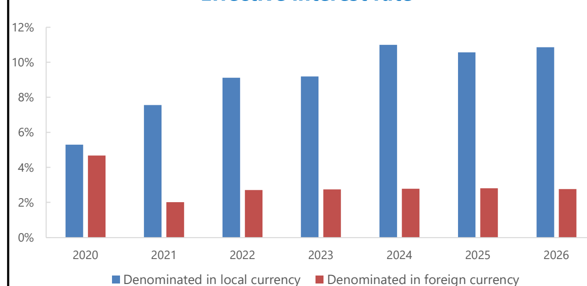
Text Table. Seychelles: Gross financing needs and financing sources
(in percent of GDP, unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026
Gross financing needs		**43.6%**	**23.4%**	**15.7%**	**13.3%**	**12.7%**	**12.7%**
Fiscal deficit		13.4%	9.0%	4.3%	1.2%	0.7%	0.5%
Amortization		30.6%	14.8%	11.9%	12.1%	12.0%	12.2%
Privatization (+=inflow)		0.4%	0.4%	0.4%	0.0%	0.0%	0.0%
Financing sources		**43.6%**	**23.4%**	**15.7%**	**13.3%**	**12.7%**	**12.7%**
Domestic ST		13.1%	6.9%	4.9%	5.1%	5.9%	5.6%
Domestic MLT		11.2%	4.6%	1.7%	6.7%	5.4%	5.7%
Foreign		19.3%	11.9%	9.0%	1.7%	1.4%	1.2%
Residual		0.0%	0.0%	0.1%	-0.1%	0.0%	0.2%
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
T-bills outstanding	28.1%	13.1%	6.9%	4.9%	5.1%	5.9%	5.6%
Reduction in T-bills		10.7%	4.9%	1.4%	-0.6%	-1.2%	-0.1%
Outstanding (in billions of SCR)	5.6	3.1	1.8	1.4	1.6	2.0	2.0

Source: Authorities and IMF staff estimates.

28. The authorities are accelerating their efforts to reform the primary market for government securities. Access to the primary market competitive auctions should be limited to a selected group of market participants. The auction frequency will be reduced, and more long-term securities issued within the auction mechanism (MEFP ¶48.). Activation of repos on government securities, along with the establishment of trading platforms, would enhance the ability of the government to issue long-term securities and support the effectiveness of the LMO.

Effective interest rate



Sources: CBS; and IMF staff estimates.

29. Debt management capacity will need to be strengthened. Technical Assistance (TA), including from the Fund, will help develop a strategic approach for debt management instead of the current practice of issuing T-bills to meet weekly cashflow needs. With targeted TA from the Fund, the authorities plan to strengthen the debt management functions in the Ministry of Finance and the CBS to: (i) establish a medium-term debt management strategy (MTDS; MEFP ¶. 46: structural benchmark for end-March 2022) and execute it through developing an annual borrowing plan (ABP; MEFP ¶. 46, structural benchmark for end-March 2022); (ii) improve government cash flow forecasting capacity to support better debt management (MEFP ¶, structural benchmark for end-March 2022); and (iii) set up a market-determined auction mechanism for long-term securities and initiate trading platforms. The MTDS would ensure that the government's financing needs, and its payment obligations, are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk. The debt strategy will be supported by enhanced transparency on debt operations through quarterly reporting by the Ministry of Finance on its website (MEFP ¶. 46: structural benchmark for end-September 2021).

D. Financial Sector Policies

30. Banks entered the pandemic with high reported capital and profits, and a low level of NPLs, but the banking system is exposed to increasing risks from the COVID-19 outbreak. NPL levels increased moderately from 3.3 percent of total loans in December 2020 to 5.1 percent in May 2021, but regulatory forbearance measures (relaxed credit classification) are likely to be masking a larger deterioration in asset quality. The increase in reported capital adequacy ratios from January 2021 to April 2021 is due primarily to a reduction in risk adjusted assets, following the rupee appreciation in April 2021. Regulatory data shows that around 22 percent of the total loan portfolio in the banking system is currently being granted regulatory accommodation in terms of asset classification. The authorities are committed to ensure that banks' loan classification correctly reflects the asset quality of the banking system and temporary COVID-19 related measures will be prudently withdrawn over time (MEFP ¶. 60). Once these measures are withdrawn, recognition of NPL levels and loan-loss coverage ratios are likely to rise, creating pressure on banks' asset quality, capital adequacy, provisioning levels, and profitability. Given the likely impact of regulatory forbearance and economic recession on bank balance sheets, the CBS is resolved to remain vigilant toward any emerging risks to the financial sector. Staff is supportive of the temporary restrictions on dividend distributions which help preserve the capital position of banks.

31. The CBS remains committed to ensuring a stable and well-capitalized banking system that can support the recovery by effectively monitoring and supervising the health of the financial system and taking relevant early intervention measures where necessary (MEFP ¶60)**.** Given the possibly high level of forborne loans in banks' balance sheets, the CBS requires banks to differentiate nonviable borrowers from viable ones with temporary liquidity shortages and to ensure that banks' loan classification correctly reflects the asset quality of the banking system. Borrower support measures should be gradually unwound, and any remaining measures should be targeted and time bound. Loan quality should be assessed based on applicable accounting and prudential standards, with losses recognized and provisioned timely and accurately. The CBS will provide guidance on prudential treatment of moratoria and NPL management strategies, and develop detailed reporting templates for restructured and rescheduled loans and for monitoring the impact of COVID-19 measures on the asset quality of banks (MEFP ¶ 63).

32. The authorities recognized the need to have a robust crisis management, bank resolution and safety net framework, grounded in legislation establishing clear objectives and the scope of the resolution regime. They intend to strengthen the legal basis of the Financial Stability Committee and enhance macroprudential tools (MEFP ¶. 64; structural benchmark for end-November 2021). The legal framework for crisis management, bank resolution, and safety net should enhance the powers of the resolution authority as well as the coordination and cooperation mechanisms between relevant authorities, in alignment with international best practices and tailored to the financial system of Seychelles (MEFP ¶ 65; structural benchmark for end-June 2023).

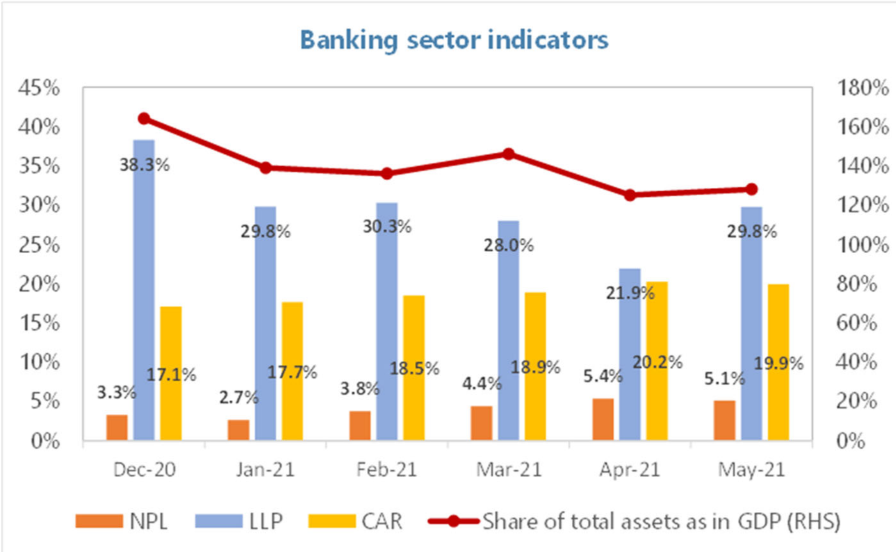
33. CBS stands ready to take relevant and timely early intervention and enforcement actions where necessary, including further suspension of dividend payments (MEFP ¶ 60). Staff underscored the need to be prepared for asset quality problems if the economic recovery is more protracted than envisaged. Additionally, viable but undercapitalized banks would be required to submit capital plans while the nonviable ones would be resolved.

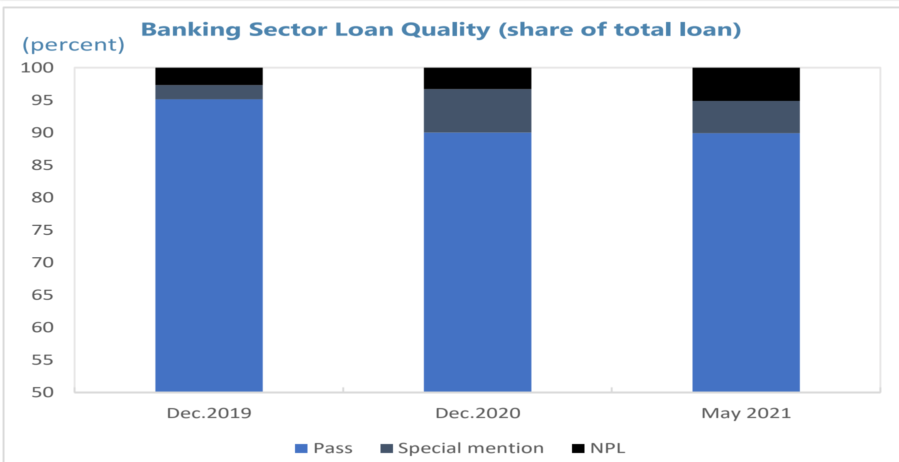
34. In August 2020, the new AML/CFT Act and Regulations came into force. The revised Act aims to improve the effectiveness of the supervisory authorities (MEFP ¶ 71).

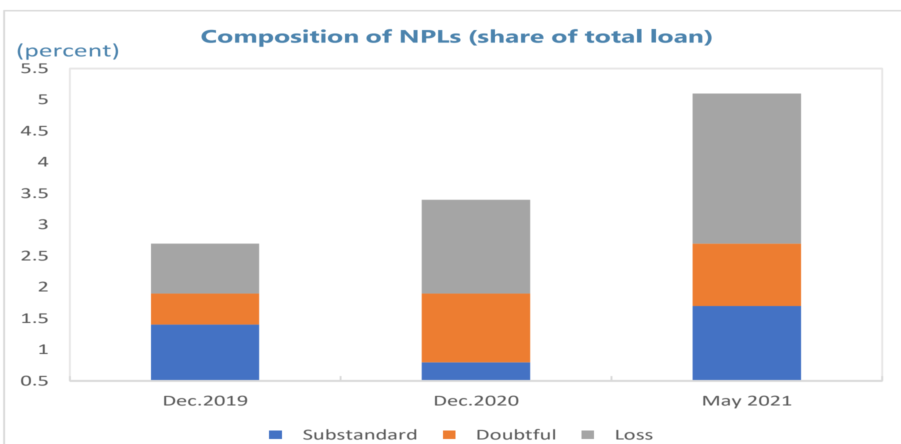
35. In line with the new AML/CFT Act, the CBS has assumed the responsibility for AML/CFT supervision for institutions under its purview. The CBS also continues to assist with the national AML/CFT strategy, which was approved in August 2020. In consultation with the World Bank, a risk-based supervision framework, sectoral supervisory strategies, and the supervision manual are also being developed.

36. In August 2020, the new Beneficial Ownership Act and Regulations came into force. The Act provides for identification and verification of beneficial ownership of legal persons and legal arrangements, in addition to the requirement to establish and maintain an up-to-date register of beneficial owners by resident agents. The centralized database has been launched in July 2021. Domestic and foreign entities will have to submit their information before year-end. The Beneficial Ownership Act and Regulations are also being amended in 2021 to further facilitate communication (MEFP ¶ 73).

37. The authorities will pursue their efforts to enhance the legislative framework for National Payment Systems, adopt innovative financial services, promote digital financial literacy, and enhance financial consumer protection. Staff welcomes the CBS' commitment to implementing an enhanced credit information system and the supporting legal framework to extend the coverage of credit information. Nonetheless, given the intense reform agenda and capacity constraints, staff advised the authorities to prioritize the actions to be taken towards modernizing the financial system and deepening the financial sector while preserving the efforts on financial stability, such as the draft legislation for crisis management and bank resolution and the financial stability act.


Banking sector indicators
45%
40%
35%
30%
25%
20%
15%
10%
5%
0%
180%
160%
140%
120%
100%
80%
60%
40%
20%
0%
38.3%
29.8%
30.3%
28.0%
21.9%
29.8%
3.3%
17.1%
2.7%
17.7%
3.8%
18.5%
4.4%
18.9%
5.4%
20.2%
5.1%
19.9%
Dec-20
Jan-21
Feb-21
Mar-21
Apr-21
May-21
NPL
LLP
CAR
Share of total assets as in GDP (RHS)


Banking Sector Loan Quality (share of total loan)
(percent)
100
95
90
85
80
75
70
65
60
55
50
Dec.2019
Dec.2020
May 2021
Pass
Special mention
NPL


Composition of NPLs (share of total loan)
(percent)
5.5
5
4.5
4
3.5
3
2.5
2
1.5
1
0.5
Dec.2019
Dec.2020
May 2021
Substandard
Doubtful
Loss

E. Structural Reforms to Enhance Inclusive Growth

38. To promote inclusive growth, the authorities plan further reforms to improve the business environment and modernize the financial sector. A key input will be submission of a policy paper on draft amendments to the Companies Act to the Cabinet by end-November 2022. To improve financial inclusion, fintech, and consumer protection, the authorities are reviewing the effectiveness of existing SME schemes (including those introduced in response to the pandemic shock) and making progress in formulating a National Fintech Strategy (MEFP ¶68). Reforms also include the drafting of a Financial Consumer Protection law.

39. The pandemic has highlighted the need to upgrade and diversify the fisheries industry. The authorities intend to intensify their efforts, including further developing the Iles du port area and building of new handling facilities (MEFP ¶20). Staff also encouraged the authorities to follow up on the SWIOfish 3 project (see 2019 Article IV Staff Report).

40. Climate-change adaptation remains a priority for the authorities. Priority climate change adaptation investments have been identified in the areas of critical infrastructure, tourism and coastal management, food security, biodiversity, water security, and the blue economy (MEFP ¶23). Seychelles is recognized for its adaptation to climate change and management of the associated challenges. The authorities are preparing projects to reduce disaster risks, such as setting up/completing an early warning system and boosting coastal resilience. The GOS plans to mainstream climate adaptation in Seychelles' post-pandemic recovery plan. Also, a careful cost-benefit analysis of climate change-related projects is being undertaken as the government prioritizes its spending.

F. Data Issues

41. Data inadequacies continue to hamper understanding of key macroeconomic aggregates. Fund technical assistance continues to support the National Bureau of Statistics (NBS) in revising its annual GDP estimates at current and constant prices as well as in developing quarterly GDP estimates, while addressing large inconsistencies in historical GDP series. Staff emphasize that for this assistance to yield sustainable capacity improvements it is important to ensure that NBS resources are adequate and to increase the number of staff working on national accounts compilation. Staff welcome the authorities' commitment to improve the quality of government financial statistics and debt data and external sector statistics (MEFP ¶ 58).

PROGRAM MODALITIES

42. Program monitoring will be based on semi-annual reviews. The program will be monitored in semiannual reviews through quantitative performance criteria (PCs), indicative targets (ITs), and structural benchmarks (SBs) (Table 7 and MEFP, Tables 1–2). The PCs are set on the: (i) the primary fiscal balance; (ii) net domestic financing of the government; (iii) total revenue; (iv) net international reserves of the CBS; and (v) non-accumulation of new external and domestic payment arrears. The PCs and ITs are defined in the TMU.

43. The program and associated reform agenda will help addressing the structural balance-of-payments gaps and structural balance of payments weaknesses. Structural benchmarks (MEFP, Table 2) in the near-term focus on fiscal sustainability, revenue mobilization, and debt management. The scope of the structural agenda will be expanded in future reviews as necessary to support program objectives.

44. The program is fully financed. There are firm commitments for financing through July 2022, with good prospects for financing thereafter. Fund support would help catalyze international assistance. The IMF and other IFI support, together with significant additional bilateral support secured by the authorities, would help the CBS maintain reserves at around 4 months of import cover—an appropriate level, given the country's vulnerabilities.

- **Access from the Fund** is proposed at SDR 74 million (about $107 million; 323 percent of quota). Disbursements would be frontloaded in the first six months of the program (totaling SDR 48 million or about $70 million in 2021), reflecting large near-term financing needs against the backdrop of the COVID-19 shock and strong upfront commitments at program approval on the fiscal stance, revenue mobilization, debt management, fiscal transparency and structural reforms. Subsequent disbursements would be evenly distributed.

Text Table. Seychelles: Financing Gap and Sources of Financing

	2021	2022	2023
Current account balance	**-331.3**	**-385.6**	**-384.0**
(In percent of GDP)	*-21.1%*	*-22.0%*	*-19.7%*
Balance of goods and services	-262.2	-313.5	-276.5
Balance on primary income	-67.6	-77.2	-104.1
Balance on secondary income	-1.4	5.1	-3.4
Capital and Financial account balance	**236.81**	**310.6**	**343.8**
Capital account, net	52.8	51.7	53.8
Financial account , net	184.0	258.9	290.0
Direct investment, net	182.4	208.0	258.7
Portfolio investment, net	6.5	3.1	3.4
Other investment, net	-4.9	47.8	27.9
Overall balance	**-94.5**	**-75.0**	**-40.3**
Change in gross official reserves (increase: –)	-109.5	-73.1	-71.4
Financing gap (1)	**-204.0**	**-148.1**	**-111.6**
(In percent of GDP)	*-13.0%*	*-8.4%*	*-5.7%*
Expected budget support (2)	**140.5**	**134.5**	**105.0**
World Bank	53.0	17.0	25.0
African Development Bank	20.0	30.0	30.0
Bilateral Budget Support	67.5	72.5	35.0
Other Budget Support	0.0	15.0	15.0
Residual Financing gap (1-2)	**-63.5**	**-13.6**	**-6.6**
Change in liabilities to IMF, net	**63.5**	**13.6**	**6.6**
EFF Purchases	69.4	18.9	19.0
(In percent of GDP)	*4.4%*	*1.1%*	*1.0%*
Repurchases	5.9	5.4	12.4

Source: Authorities and IMF staff estimates.

- **Financing needs** during 2022 and 2023 are expected to be met by financing from the IMF, other multilateral/bilateral donors, and external commercial sources (External Financing text table).[8]

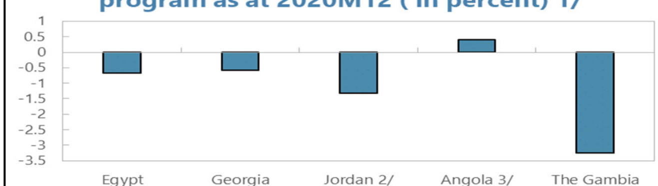
- **Use of resources**. Throughout the program, Fund resources are expected to be on-lent by the CBS to the Ministry of Finance for budget support. A MoU, in line with the one designed for the RFI, will govern the on-lending procedures.

- **Capacity development** the capacity development strategy is aligned with the program's reform priorities, including through assistance in virtual mode. Priorities focus on revenue mobilization, public financial management, and debt management

45. The proposed global SDR allocation of US$650 billion, if approved by the IMF Board of Governors, is estimated to lead to a US$30 million allocation for Seychelles. The allocation—captured under the program through an adjustor on the NIR target—would primarily be used to increase reserves. In case budget financing fails to materialize or the financing costs are higher than planned, discussions during the EFF's first review could assess whether some of the SDR allocation could help to meet the emerging financing gap without undermining program objectives (MEFP, ¶. 39).

46. Seychelles' capacity to repay the Fund is adequate but subject to higher than usual risks. Fund credit-to-GDP will peak at 9 percent in 2021, higher than in most recent EFF cases (excluding European exceptional access cases) and reflects Seychelles' small GDP size. The Fund credit to GIR ratio is projected to peak at 18 percent in 2022. Obligations to the Fund relative to exports of goods and services will peak at 1.1 percent in 2024. Risks to Fund repayment will be mitigated by: (i) significant fiscal consolidation; (ii) an increase in repayment capacity with the return of tourists to the country, which is underway; and (iii) the authorities' commitment to the program and a strong track record of servicing debts to the IMF and other creditors. Air Seychelles poses a significant risk to debt sustainability and the program.

T-Bill yields change after selected IMF program as at 2020M12 (in percent) 1/



Source: CB; IFS; and IMF staff calculations.
1/ the sample is restricted to countries without major geopolitical changes.
2/ as at 2020M10.
3/ as at 2020M11.

47. Safeguards assessment. An updated safeguards assessment was finalized in June 2021. The CBS continues to develop its safeguards framework. External audit arrangements remain robust and financial reporting practices broadly adhere to international standards. While steps have been taken to improve the internal audit function, further efforts and enhanced oversight are needed to ensure adequate capacity and internal audit coverage. The CBS' legal framework should be amended to strengthen oversight and autonomy (MEFP ¶. 75), and central bank advances to the

[8] Other budget support refers to additional official support that has a good prospect of materializing

government and involvement in COVID-19-related lending to banks and other financial institutions need to be revisited to safeguard the CBS' financial autonomy.

STAFF APPRAISAL

48. **The COVID-19 pandemic severely disrupted economic activity.** Before the COVID-19 outbreak, Seychelles' economic performance was strong, the outlook promising, and performance under IMF-supported programs excellent. As global travel came to a halt, tourism receipts plummeted, resulting in an unprecedented economic contraction. The authorities took exceptional measures to support livelihoods, but public debt increased sharply, reflecting the deterioration of the primary fiscal balance, exchange rate depreciation and GDP contraction.

49. **The outlook is positive, but risks remain high.** Tourist arrivals bounced back since April 2021. The authorities and staff expect a V- shaped recovery, while inflation will be contained and the current account deficit will slowly narrow, supported by a recovery in external demand and private investment. The execution of the LMO has already reduced rollover risks on government debt significantly while the exchange rate appreciation contributed to a decline in debt levels by mid-2021, thereby supporting debt sustainability. Risks—particularly from a weaker than expected recovery in external demand, resurgence of lockdown measures, delayed reform implementation, or climate challenges—could dampen the outlook.

50. **The proposed EFF-arrangement supports the authorities' priorities.** It focuses on maintaining the recovery momentum while reducing the risks to debt sustainability. Advancing the reform agenda through an ambitious fiscal adjustment, a liability management operation that seeks to preserve financial sector stability, and strengthening the governance framework and financial sector development and inclusion are essential priorities to sustain the post-COVID 19 recovery and generate high, sustainable and inclusive growth.

51. **Strong fiscal adjustment is the cornerstone of the government's recovery plan** Staff considers the large and frontloaded fiscal consolidation both feasible and essential to reduce risks to public debt sustainability. Preserving and better targeting social spending, limiting transfers to SOEs, and reforming the civil service are also critical to meeting Seychelles' targets.

52. **Prudent debt management is important to reduce vulnerabilities**. Seychelles' debt is sustainable but with significant risks. In view of these vulnerabilities, it is important that every effort be made to strengthen debt management, including the welcome extension of maturities through the recently completed LMO and through regular bond issuance and supported by the fiscal consolidation strategy.

53. **Monetary policy accommodation remains appropriate in view of the still large negative output gap.** At the same time, the central bank should stand ready to act if inflationary pressures do not subside. The use of the exchange rate as a shock absorber should continue, with foreign exchange interventions limited to smoothing disorderly exchange rate fluctuations.

54. Financial stability risks should be minimized. The banking system appeared well capitalized and liquid at end-2020, but regulatory forbearance measures may have masked some asset quality deterioration. Progress made in enhancing oversight of systemic banks and strengthening on-site risk-based supervision is welcome. Close monitoring of restructured loans should continue while prudential and accounting requirements should be strictly adhered to. Any new loan restructuring extension should be temporary and targeted. Modernizing and revamping the banking resolution and emergency liquidity assistance frameworks would help safeguard financial stability.

55. Advancing on the governance reform agenda—as well as financial sector inclusion—is crucial for private sector development. The publication of information on the use of COVID-19 funds on the basis of an independent audit is important. Faster progress in enhancing the effectiveness of the AML/CFT framework—including through the operationalization of the database of beneficial owners--would be important. Fostering faster financial inclusion—including through digital finance— is instrumental for boosting private sector development.

56. In view of Seychelles' external financing needs and the authorities' strong policy commitments, staff supports the authorities' request for the extended arrangement under the EFF with access equivalent to SDR 74 million (323 percent of quota).

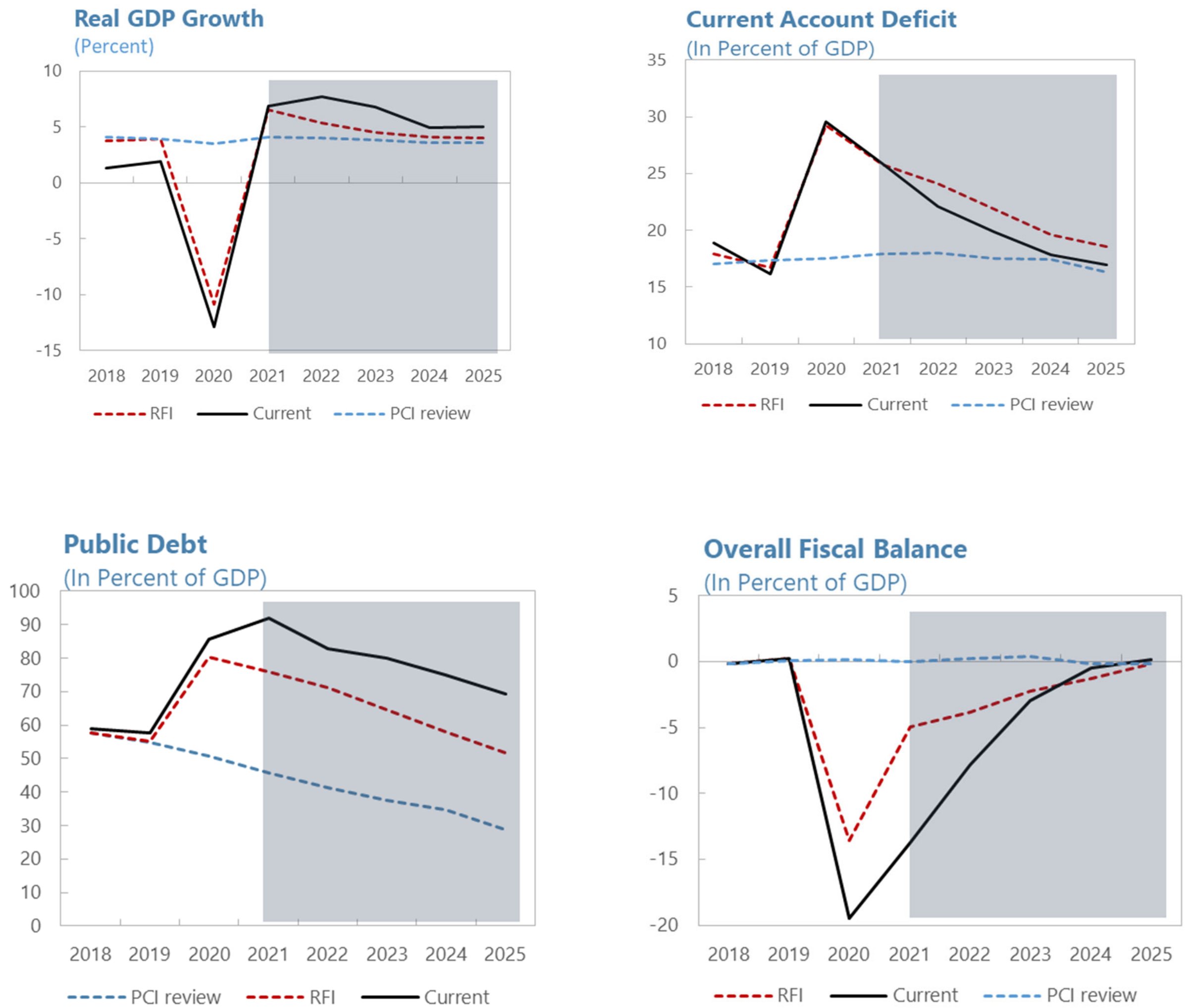
Box 1. Air Seychelles

The COVID-19 pandemic has affected Air Seychelles, as flights were grounded, and passenger traffic evaporated. Air Seychelles was a loss-making enterprise even before the crisis, necessitating regular transfers from the government and accumulating debt. The airline was part-owned by the Government of Seychelles (60 percent) and Etihad (40 percent) through EAG Investment Holding Company.

Etihad relinquished its 40 percent shareholding to the Government of Seychelles in March 2021, and the government has taken over US$11.4 million of the unsecured debt to be repaid until 2024. However, an outstanding Air Seychelles box bond of US$ 71.5 million is still under negotiation with the bondholders.

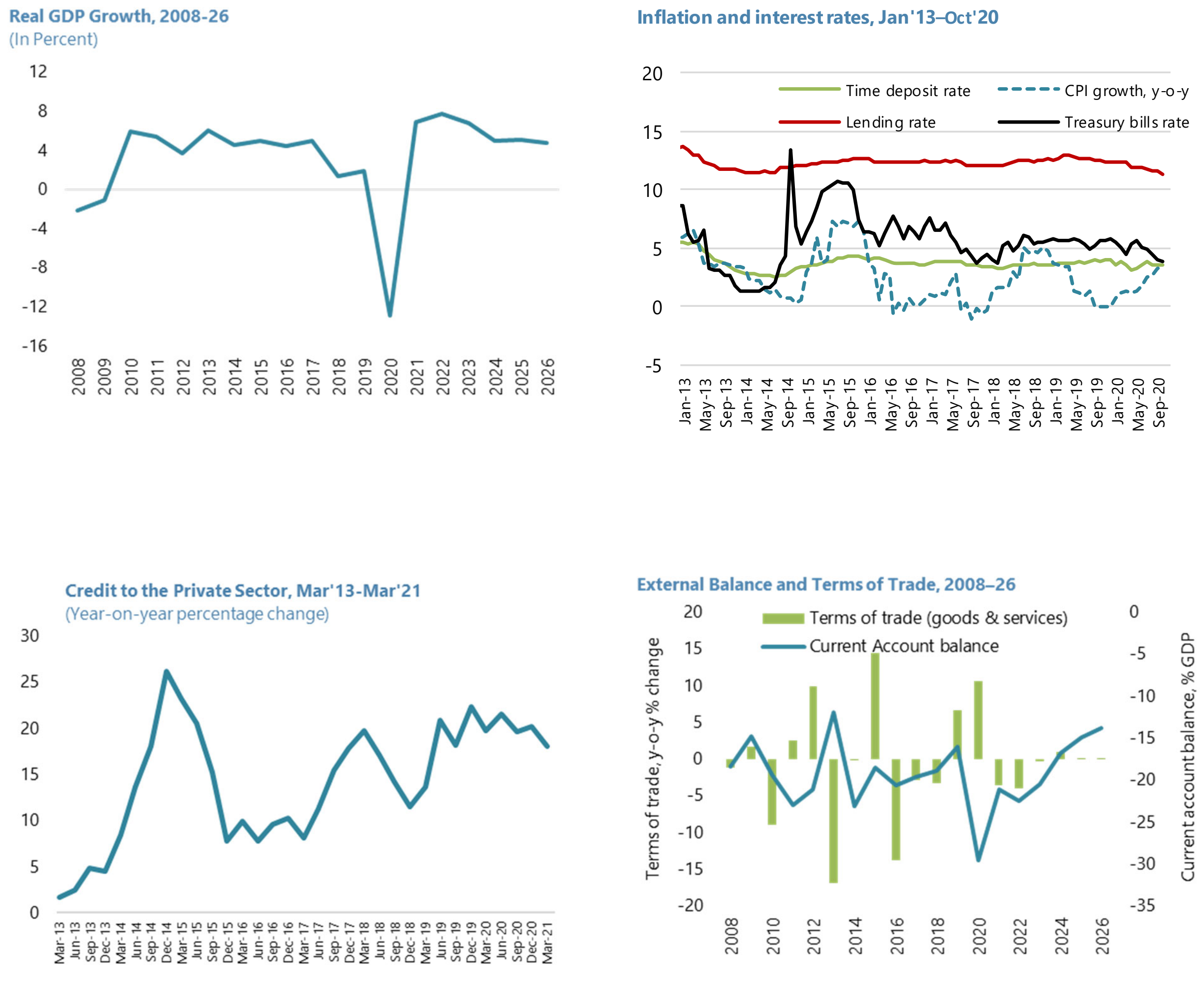
The GOS is actively searching for a viable solution that would limit the cost of Air Seychelles to the government budget. The GOS has worked with the World Bank and identified that the least costly scenario would be the liquidation of Air Seychelles. Discussions between the authorities and bondholders are taking place. The legal implications of liquidation and avenues for employee protection are currently being assessed by the Government (structural benchmark for end-September 2021).

Figure 1. Seychelles: Indicators of Economic Activity



Sources: Seychelles authorities, and IMF Staff calculations.

Figure 2. Seychelles: Macroeconomic Indicators – 2008-26

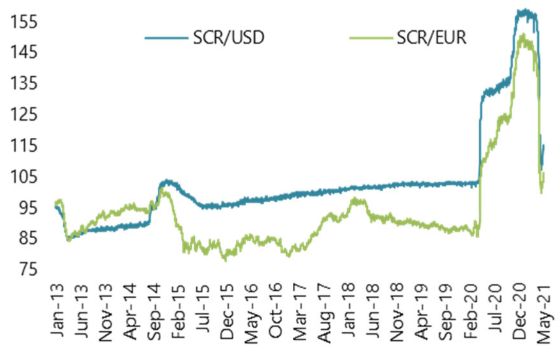


Sources: Seychelles authorities, and IMF Staff calculations.

Figure 3. Seychelles: Macroeconomic Developments and Projections – Program

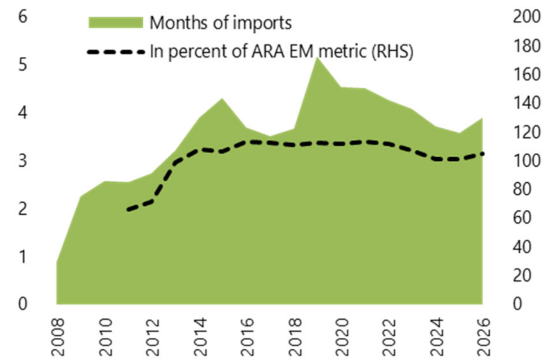
Recent appreciation partly offset the 2020 depreciation....

Daily exchange rates index, Jan'13-May'21
(December 31, 2011 = 100)



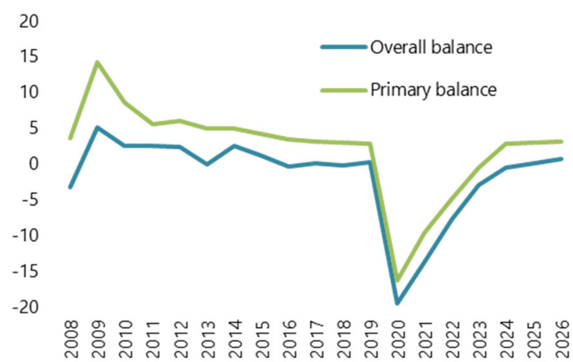
Reserves remained strong....

Reserves Adequacy, 2008-26 [1]



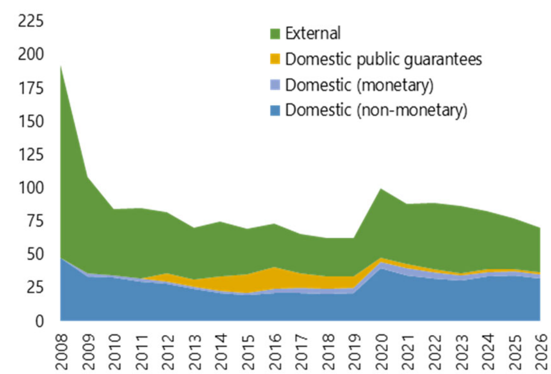
Ambitious fiscal consolidation...

Fiscal balances, 2008–26
(Percent of GDP)



...will restore debt sustainability....

Stock of public debt, 2008–26
(Percent of GDP)



Sources: Seychelles authorities, and IMF Staff calculations.

[1] Data for the ARA EM metric are not available prior to 2011.

Table 1. Seychelles: Selected Economic and Financial Indicators, 2016-26

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Act.	Act.	Act.	Act.	Prel.			Proj.			
	(Annual percent change, unless otherwise indicated)										
National income and prices											
Nominal GDP (millions of Seychelles rupees)	18,989	20,858	21,540	22,192	20,021	23,585	26,219	28,889	31,235	33,781	36,464
Real GDP (millions of Seychelles rupees)	8,423	8,843	8,960	9,132	7,957	8,506	9,160	9,780	10,266	10,781	11,297
Real GDP	4.4	5.0	1.3	1.9	-12.9	6.9	7.7	6.8	5.0	5.0	4.8
CPI (annual average)	-1.0	2.9	3.7	1.8	1.2	10.0	3.7	3.2	3.0	3.0	3.0
CPI (end-of-period)	-0.2	3.5	3.4	1.7	3.8	8.6	3.9	3.5	3.2	3.0	3.0
GDP deflator average	-0.8	4.6	1.9	1.1	3.5	10.2	3.2	3.2	3.0	3.0	3.0
Money and credit											
Broad money	12.1	16.4	7.7	13.9	29.2	...	...	...	...	...	...
Reserve money (end-of-period)	14.5	18.9	4.5	22.7	40.4	...	...	...	...	...	...
Velocity (GDP/broad money)	1.4	1.3	1.3	1.1	1.1	...	...	...	...	...	...
Money multiplier (broad money/reserve money)	4.6	4.5	4.6	4.3	3.9	...	...	...	...	...	...
Credit to the private sector	10.3	17.8	11.5	22.3	20.2	9.1	16.6	17.7	18.7	16.5	15.6
	(Percent of GDP, unless otherwise indicated)										
Savings-Investment balance											
External savings	20.6	19.6	18.9	16.1	29.5	25.7	22.0	19.8	17.8	16.9	15.5
Gross national savings	9.6	9.2	7.8	10.3	-6.2	2.3	5.7	8.1	8.8	9.5	10.8
Of which: government savings	3.8	3.7	4.3	4.6	-13.8	-6.1	-1.1	2.6	3.7	5.3	5.8
private savings	5.8	5.5	3.5	5.7	7.7	8.4	6.7	5.4	5.1	4.2	5.0
Gross investment	30.2	28.9	26.7	26.4	23.4	28.0	27.7	27.8	26.6	26.4	26.3
Of which: public investment [1]	5.0	4.3	5.2	3.9	5.9	9.0	8.7	7.3	6.1	5.9	5.5
private investment	25.2	24.6	21.5	22.5	17.5	19.0	19.0	20.5	20.5	20.5	20.8
Private consumption	47.1	50.9	52.6	52.6	49.9	54.9	56.1	54.8	52.7	53.4	52.1
	(Percent of GDP)										
Government budget											
Total revenue, excluding grants	36.7	35.0	37.1	37.6	35.7	30.7	33.1	34.3	36.2	36.8	37.2
Expenditure and net lending	38.2	36.4	38.8	37.7	57.1	48.4	43.6	39.2	38.1	38.0	37.9
Current expenditure	33.2	32.1	33.6	33.8	50.1	38.9	35.4	33.0	33.1	32.0	31.9
Capital expenditure [1]	5.0	4.3	5.2	3.9	5.9	9.0	8.7	7.3	6.1	5.9	5.5
Overall balance, including grants	-1.4	0.1	0.7	-0.9	-19.5	-13.6	-7.7	-2.9	-0.4	0.2	0.7
Primary balance	3.4	3.1	3.0	2.8	-16.3	-9.7	-5.0	-0.4	2.8	3.0	3.2
Total government and government-guaranteed debt [2]	72.8	65.7	62.3	61.8	100.8	87.7	87.6	83.0	77.2	71.2	64.5
External sector											
Current account balance including official transfers (in percent of GDP)	-20.6	-19.6	-18.9	-16.1	-29.5	-25.7	-22.0	-19.8	-17.8	-16.9	-15.5
Total external debt outstanding (millions of U.S. dollars) [3]	4,299	4,475	4,682	4,874	5,093	5,452	5,823	6,147	6,362	6,588	6,830
(percent of GDP)	301.5	292.8	303.7	308.5	447.7	346.7	331.8	314.8	297.6	281.2	264.0
Terms of trade (-=deterioration)	-13.8	-2.9	-3.3	6.7	10.6	-3.6	-4.1	-0.4	0.9	0.9	0.0
Real effective exchange rate (average, percent change)	-0.1	-3.2	...	...	...	...	...	...	...	...	...
Gross official reserves (end of year, millions of U.S. dollars)	522.6	546	548	581	561	670	743	815	816	824	848
Months of imports, c.i.f.	3.7	3.5	3.7	5.2	4.5	4.6	4.4	4.4	4.0	3.8	3.9
In percent of Assessing Reserve Adequacy (ARA) metric	113.3	112.6	110.9	112.4	111.9	114.4	115.9	117.4	111.1	107.0	104.6
Exchange rate											
Seychelles rupees per US$1 (end-of-period) [4]	13.5	13.8	14.0	14.1	21.6	...	...	...	...	...	...
Seychelles rupees per US$1 (period average) [4]	13.3	13.6	14.0	14.0	17.6	...	...	...	...	...	...

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.

[4] As to 2020, exchange rate measured as of July 14, 2020.

Table 2. Seychelles: Balance of Payments, 2016-26

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Est.	Est.	Est.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In millions of US dollars, unless otherwise indicated)										
Current account balance (+ surplus; - deficit)	-294	-300	-291	-255	-336	-331	-386	-384	-378	-393	-397
(percent of GDP)	-20.6	-19.6	-18.9	-16.1	-29.5	-25.7	-22.0	-19.8	-17.8	-16.9	-15.5
Balance of goods and services (+ surplus; - deficit)	-146	-168	-186	-189	-256	-262	-313	-277	-251	-260	-252
Exports of goods	459	536	572	483	420	479	506	565	600	651	706
Of which: oil re-exports	131	150	183	153	96	133	122	151	158	166	175
Of which: tuna exports	270	268	286	203	252	267	283	303	322	345	369
Imports of goods	991	1,155	1,188	1,120	853	964	1,122	1,246	1,390	1,537	1,677
Of which: oil imports	162	209	238	204	164	189	208	248	259	272	301
Exports of services	894	998	1,107	1,126	670	743	937	1,168	1,353	1,506	1,653
Of which: tourism earnings	414	483	559	590	221	247	378	525	610	696	787
Imports of services	507	548	677	678	493	520	635	763	814	880	934
Balance on primary income (+ surplus; - deficit)	-134	-136	-106	-59	-66	-68	-77	-104	-126	-135	-147
Of which: interest due	40	25	27	30	33	34	38	39	56	54	61
transfers of profits and dividends	19	17	22	17	11	4	20	20	20	20	20
Balance on secondary income (+ surplus; - deficit)	-15	5	1	-6	-14	-1	5	-3	-1	3	2
Of which: general government, net	50	42	37	28	18	9	14	11	11	11	10
Capital and financial account	300	315	321	324	290	377	445	449	398	412	434
Capital account	54	52	50	38	21	53	52	54	54	42	43
Financial account	246	263	272	286	270	325	393	395	344	369	391
Direct investment, net [1, 2]	119	208	318	236	182	182	208	259	297	335	356
Abroad	-78	-79	-10	-8	-7	-7	-7	-7	-7	-7	-7
In Seychelles	41	129	308	228	175	175	201	251	290	328	350
Of which: offshore sector	0	0	0	0	0	0	0	0	0	0	0
Portfolio investment, net	-52	-57	30	-11	-64	7	3	3	3	6	6
Other investment, net	179	112	-77	61	151	136	182	133	43	28	29
Government and government-guaranteed	-49	-23	27	-10	5	137	137	103	-21	-26	-25
Disbursements	5	-2	61	22	43	179	190	156	35	32	31
Project loans	5	0	61	22	12	38	55	51	32	32	31
Program loans	10	8	0	0	31	141	135	105	3	0	0
World Bank					21	53	17	25	3	0	0
African Development Bank					10	20	30	30	0	0	0
Bilateral Budget Support						68	73	35			
Other Budget Support							15	15			
Amortization	-54	-19	-34	-32	-38	-42	-53	-52	-56	-57	-56
Private sector	228	135	-104	71	147	-1	45	30	64	54	53
Net errors and omissions	-17	0	0	0	0	0	0	0	0	0	0
Overall balance	6	15	30	69	-45	46	60	65	20	19	37
Financing	11	-15	-30	-69	45	-46	-60	-65	-20	-19	-37
Change in net international reserves (increase: –)	11	-15	-30	-69	45	-46	-60	-65	-20	-19	-37
Change in gross official reserves (increase: –)	14	-17	-24	-62	20	-110	-73	-71	-1	-9	-23
Change in liabilities to IMF, net	-4	2	-6	-7	25	64	14	7	-19	-10	-14
Purchases/drawings	0	7	0	0	32	69	19	19	0	0	0
Repurchases/repayments	4	5	6	7	7	6	5	12	19	10	14
Other net foreign assets (increase: –)	0	0	0	0	0	0	0	0	0	0	0
Exceptional financing	0	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	4.3	13.4	9.4	-4.2	-32.3	12.2	18.0	20.1	12.7	10.4	9.3
Tourism growth, percent	5.4	16.7	15.8	5.5	-62.5	11.5	53.0	39.1	16.2	14.1	13.0
Exports of goods volume growth, percent	-10.0	6.9	-2.9	-8.0	4.6	-1.7	2.3	11.4	6.4	8.7	6.8
Imports G&S growth, percent	5.5	13.6	9.6	-3.6	-25.1	10.3	18.3	14.4	9.7	9.7	8.0
Imports of goods volume growth, percent	9.8	9.8	-3.3	-3.7	-17.1	0.9	17.6	11.2	10.7	9.8	8.2
Exports G&S, percent of GDP	94.9	100	109	102	96	95	82	89	92	93	92
Imports G&S, percent of GDP	105	111	121	114	118	115	100	103	104	104	102
FDI, percent of GDP [1, 2]	8.4	13.6	20.6	15.0	16.0	11.6	11.9	13.2	13.9	14.3	13.8
Gross official reserves (stock, e.o.p.)[3]	523	546	548	581	561	670	743	815	816	824	848
(Months of imports of goods & services)	3.7	3.5	3.7	5.2	4.5	4.6	4.4	4.4	4.0	3.8	3.9
Percentage of IMF reserve adequacy metric	113	113	111	112	112	114	116	117	111	107	105
Government and government-guaranteed external debt	454	446	449	443	498	714	882	992	950	912	871
(Percent of GDP)	31.8	29.2	29.1	28.1	53.7	45.4	50.2	50.8	44.5	38.9	33.7
GDP (Millions of U.S. dollars)	1,426	1,528	1,542	1,580	1,138	1,572	1,755	1,953	2,138	2,343	2,588

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

[1] 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 significantly overestimated.

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

[3] The level of GIRs computed from the BOP includes the budget support

Table 3a. Seychelles: Consolidated Government Operations, 2016-26
(Millions of Seychelles Rupees)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Act.	Act.	Act.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Millions of Seychelles rupees)										
Total revenue and grants	7,205	7,475	8,274	8,435	7,543	8,209	9,422	10,506	11,779	12,901	14,048
Total revenue	6,965	7,302	7,997	8,341	7,156	7,252	8,677	9,899	11,307	12,430	13,580
Tax	6,188	6,600	7,083	7,425	6,369	6,601	7,688	8,739	10,070	11,419	12,466
Personal income tax	939	900	965	975	1,023	1,014	1,163	1,328	1,536	1,639	1,806
Trade tax	359	285	315	313	260	285	345	431	570	648	746
Excise tax	1,144	1,312	1,281	1,385	1,268	1,317	1,549	1,778	2,009	2,247	2,437
Goods and services tax (GST) / VAT [2]	1,996	2,151	2,495	2,594	2,117	2,618	3,058	3,394	3,646	3,965	4,278
Business tax [3]	1,039	1,364	1,376	1,397	1,204	1,002	1,189	1,389	1,662	2,027	2,220
Corporate Social Responsibility Tax (CSR) [3]	87	95	106	109	102	82	92	101	109	118	156
Marketing Tourism Tax (MTT) [3]	45	60	70	71	62	27	31	34	86	133	136
Other	581	434	474	580	334	215	262	284	452	642	688
Nontax	777	702	914	916	787	652	989	1,160	1,237	1,011	1,114
Fees and charges	403	349	335	340	263	291	457	504	545	499	539
Dividends from parastatals	330	280	426	477	414	285	341	445	481	301	365
Other	44	72	153	99	110	76	191	210	210	210	210
External grants	240	173	277	94	387	957	745	607	473	471	467
Expenditure and net lending	7,277	7,455	8,318	8,379	11,440	11,411	11,441	11,333	11,911	12,824	13,810
Current expenditure	6,295	6,687	7,231	7,509	10,037	9,166	9,284	9,537	10,331	10,821	11,648
Primary current expenditure	5,581	6,056	6,541	6,950	9,397	8,254	8,569	8,839	9,333	9,886	10,717
Wages and salaries [4]	2,002	2,074	2,268	2,507	2,845	2,962	3,137	3,158	3,442	3,717	4,015
Goods and services [4]	2,489	2,562	2,800	2,793	2,915	3,148	3,268	3,361	3,525	3,697	3,991
Transfers [4]	1,063	1,380	1,443	1,612	3,607	2,108	2,129	2,281	2,255	2,351	2,582
Social program of central government	130	114	114	162	1,512	449	190	193	201	209	242
Transfers to public sector from central government	80	97	55	92	435	224	344	468	409	443	478
Benefits and programs of Social Security Fund	853	1,169	1,273	1,358	1,660	1,436	1,595	1,620	1,645	1,699	1,861
Other	27	41	31	39	31	35	35	38	112	121	130
Interest due	714	631	689	559	640	912	715	698	998	935	930
Foreign interest	190	218	227	237	292	355	309	340	589	567	544
Domestic interest	524	413	463	322	348	557	406	359	409	367	386
Capital expenditure	909	747	954	671	1,032	1,797	1,946	1,719	1,724	1,790	1,813
Domestically financed	644	564	455	225	599	606	748	895	967	1,048	1,090
Foreign financed	265	183	499	446	432	1,191	1,198	825	757	742	723
Net lending	35	-1	86	149	222	397	161	27	-194	164	295
Contingency	38	21	47	50	149	50	50	50	50	50	54
Primary balance	642	650	646	615	-3,257	-2,289	-1,304	-129	866	1,012	1,168
Overall balance, commitment basis [5]	-72	19	-43	56	-3,897	-3,201	-2,019	-827	-132	77	238
Change in float	-201	3	194	-252	-189	0	0	0	0	0	0
Overall balance, cash basis (after grants)	-273	22	151	-196	-4,086	-3,201	-2,019	-827	-132	77	238
Financing	273	-22	-151	196	4,086	3,201	2,019	827	132	-77	-238
Foreign financing	-304	-407	-35	-45	652	3,669	2,251	1,632	-594	-522	-551
Disbursements	287	11	305	352	1,176	4,546	3,125	2,596	519	459	441
Project loans	25	11	305	352	46	704	828	752	475	459	441
Program/budget support	262	0	0	0	1,130	3,842	2,297	1,844	44	0	0
Of which RFI	0	0	0	0	535	0	0	0	0	0	1
Scheduled amortization	-591	-418	-340	-397	-523	-878	-873	-964	-1,114	-981	-993
Of which Paris Club buy-back	-269	…	…	…							
Domestic financing, net	578	316	-272	237	3,176	-555	-334	-931	726	445	313
Bank financing	389	419	-571	110	2,700	-500	-300	-999	654	401	282
CBS	-191	438	88	185	1,071	0	0	0	0	0	0
Commercial banks	579	-19	-659	-75	1,629	-500	-300	-999	654	401	282
Nonbank financing	190	-103	299	126	476	-56	-33	68	73	45	31
Privatization and long-term lease of fixed assets	76	82	0	0	0	88	101	127	0	0	0
Statistical discrepancy	-77	-12	156	5	257	0	0	0	0	0	0
Memorandum item:			0								
External debt service due	781	636	567	634	816	1,233	1,182	1,304	1,702	1,549	1,537

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] From 2015 onwards, wage and salaries and goods and services (to be) spent by government agencies other than Ministries are reclassified into these items from transfers.

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

Table 3b. Seychelles: Consolidated Government Operations, 2016-26

(Percent of GDP)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Prel.	Proj.	Prel.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percent of GDP, unless otherwise indicated)										
Total revenue and grants	37.9	35.8	38.4	38.0	37.7	34.8	35.9	36.4	37.7	38.2	38.5
Total revenue	36.7	35.0	37.1	37.6	35.7	30.7	33.1	34.3	36.2	36.8	37.2
Tax	32.6	31.6	32.9	33.5	31.8	28.0	29.3	30.3	32.2	33.8	34.2
Personal income tax	4.9	4.3	4.5	4.4	5.1	4.3	4.4	4.6	4.9	4.9	5.0
Trade tax	1.9	1.4	1.5	1.4	1.3	1.2	1.3	1.5	1.8	1.9	2.0
Excise tax	6.0	6.3	5.9	6.2	6.3	5.6	5.9	6.2	6.4	6.7	6.7
Goods and services tax (GST) / VAT [2]	10.5	10.3	11.6	11.7	10.6	11.1	11.7	11.7	11.7	11.7	11.7
Business tax	5.5	6.5	6.4	6.3	6.0	4.2	4.5	4.8	5.3	6.0	6.1
Corporate Social Responsibility Tax (CSR)	0.5	0.5	0.5	0.5	0.5	0.3	0.3	0.3	0.3	0.3	0.4
Marketing Tourism Tax (MTT)	0.2	0.3	0.3	0.3	0.3	0.1	0.1	0.1	0.3	0.4	0.4
Other	3.1	2.1	2.2	2.6	1.7	0.9	1.0	1.0	1.4	1.9	1.9
Nontax	4.1	3.4	4.2	4.1	3.9	2.8	3.8	4.0	4.0	3.0	3.1
Fees and charges	2.1	1.7	1.6	1.5	1.3	1.2	1.7	1.7	1.7	1.5	1.5
Dividends from parastatals	1.7	1.3	2.0	2.2	2.1	1.2	1.3	1.5	1.5	0.9	1.0
Other	0.2	0.3	0.7	0.4	0.5	0.3	0.7	0.7	0.7	0.6	0.6
External grants	1.3	0.8	1.3	0.4	1.9	4.1	2.8	2.1	1.5	1.4	1.3
Expenditure and net lending	38.3	35.7	38.6	37.8	57.1	48.4	43.6	39.2	38.1	38.0	37.9
Current expenditure	33.2	32.1	33.6	33.8	50.1	38.9	35.4	33.0	33.1	32.0	31.9
Primary current expenditure	29.4	29.0	30.4	31.3	46.9	35.0	32.7	30.6	29.9	29.3	29.4
Wages and salaries [3]	10.5	9.9	10.5	11.3	14.2	12.6	12.0	10.9	11.0	11.0	11.0
Goods and services [3]	13.1	12.3	13.0	12.6	14.6	13.3	12.5	11.6	11.3	10.9	10.9
Transfers [3]	5.6	6.6	6.7	7.3	18.0	8.9	8.1	7.9	7.2	7.0	7.1
Social program of central government	0.7	0.5	0.5	0.7	7.6	1.9	0.7	0.7	0.6	0.6	0.7
Transfers to public sector from central government	0.4	0.5	0.3	0.4	2.2	0.9	1.3	1.6	1.3	1.3	1.3
Benefits and programs of Social Security Fund	4.5	5.6	5.9	6.1	8.3	6.1	6.1	5.6	5.3	5.0	5.1
Other	0.1	0.2	0.1	0.2	0.2	0.1	0.1	0.1	0.4	0.4	0.4
Interest due	3.8	3.0	3.2	2.5	3.2	3.9	2.7	2.4	3.2	2.8	2.6
Foreign interest	1.0	1.0	1.1	1.1	1.5	1.5	1.2	1.2	1.9	1.7	1.5
Domestic interest	2.8	2.0	2.1	1.4	1.7	2.4	1.5	1.2	1.3	1.1	1.1
Capital expenditure	4.8	3.6	4.4	3.0	5.2	7.6	7.4	6.0	5.5	5.3	5.0
Domestically financed	3.4	2.7	2.1	1.0	3.0	2.6	2.9	3.1	3.1	3.1	3.0
Foreign financed	1.4	0.9	2.3	2.0	2.2	5.0	4.6	2.9	2.4	2.2	2.0
Net lending	0.2	0.0	0.4	0.7	1.1	1.7	0.6	0.1	-0.6	0.5	0.8
Contingency	0.2	0.1	0.2	0.2	0.7	0.2	0.2	0.2	0.2	0.1	0.1
Primary balance	3.4	3.1	3.0	2.8	-16.3	-9.7	-5.0	-0.4	2.8	3.0	3.2
Overall balance, commitment basis [4]	-0.4	0.1	-0.2	0.3	-19.5	-13.6	-7.7	-2.9	-0.4	0.2	0.7
Change in arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in float	-1.1	0.0	0.9	-1.1	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, cash basis (after grants)	-1.4	0.1	0.7	-0.9	-20.4	-13.6	-7.7	-2.9	-0.4	0.2	0.7
Financing	1.4	-0.1	-0.7	0.9	20.4	13.6	7.7	2.9	0.4	-0.2	-0.7
Foreign financing	-1.6	-2.0	-0.2	-0.2	3.3	15.6	8.6	5.6	-1.9	-1.5	-1.5
Disbursements	1.5	0.1	1.4	1.6	5.9	19.3	11.9	9.0	1.7	1.4	1.2
Project loans	0.1	0.1	1.4	1.6	0.2	3.0	3.2	2.6	1.5	1.4	1.2
Program/budget support	1.4	0.0	0.0	0.0	5.6	16.3	8.8	6.4	0.1	0.0	0.0
Of which RFI		0.0	0.0	0.0	2.7	0.0	0.0	0.0	0.0	0.0	0.0
Scheduled amortization	-3.1	-2.0	-1.6	-1.8	-2.6	-3.7	-3.3	-3.3	-3.6	-2.9	-2.7
Of which Paris Club buy-back	-1.4	...	...								
Domestic financing, net	3.0	1.5	-1.3	1.1	15.9	-2.4	-1.3	-3.2	2.3	1.3	0.9
Bank financing	2.0	2.0	-2.6	0.5	13.5	-2.1	-1.1	-3.5	2.1	1.2	0.8
CBS	-1.0	2.1	0.4	0.8	5.3	0.0	0.0	0.0	0.0	0.0	0.0
Commercial banks	3.1	-0.1	-3.1	-0.3	8.1	-2.1	-1.1	-3.5	2.1	1.2	0.8
Nonbank	1.0	-0.5	1.4	0.6	2.4	-0.2	-0.1	0.2	0.2	0.1	0.1
Privatization and long-term lease of fixed assets	0.4	0.4	0.0	0.0	0.0	0.4	0.4	0.4	0.0	0.0	0.0
Statistical discrepancy	-0.4	-0.1	0.7	0.0	1.3	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Nominal GDP (millions of Seychelles Rupees)	18,989	20,858	21,540	22,192	20,021	23,585	26,219	28,889	31,235	33,781	36,464
Public domestic debt [5]	36.9	32.5	29.9	29.6	42.7	36.5	32.6	28.3	29.4	29.3	28.2
Excluding t-bills issued for monetary purposes	20.7	21.3	20.4	20.6	39.7	33.9	30.3	26.2	27.5	27.5	26.5
Publicly guaranteed domestic debt	3.6	3.5	3.2	4.1	4.3	5.9	4.8	3.9	3.4	2.9	2.6

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] From 2015 onwards, wage and salaries and goods and services (to be) spent by government agencies other than Ministries are reclassified into these items from transfers.

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

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

Table 4. Seychelles: Depository Corporations Survey and Central Bank Accounts, 2016-21

	2016	2017	2018	2019	2020	2021	2021
						Mar.	Jun.
	Act.	Act.	Act.	Act.	Prel.	Proj.	Proj.
	(Millions of Seychelles rupees)						
Depository corporations survey							
Net foreign assets	9,817	10,754	11,948	12,647	18,612	18,390	17,463
Central bank	6,550	6,982	7,248	7,807	11,685	11,218	10,838
Deposit money banks	3,267	3,771	4,700	4,841	6,927	7,172	6,626
Net domestic assets	3,831	5,134	5,166	6,847	6,566	10,561	12,081
Domestic credit	7,110	8,476	8,620	10,562	14,609	13,751	14,691
Net claims on the government	1,791	2,209	1,699	1,882	4,175	3,349	3,391
Of which : Government deposits at the Central Bank	-3,355	-3,355	-2,829	-2,513	-1,638	-2,463	-2,421
Of which : Change in monetary debt [1]	-191	670.0	394.1	219.2	149.0	0.0	0.0
Credit to the economy	5,319	6,267	6,921	8,680	10,434	10,402	11,299
Of which : credit to the private sector	5,122	6,032	6,727	8,229	9,888	9,855	10,753
Other items, net	-3,279	-3,342	-3,453	-3,715	-8,043	-3,190	-2,609
Broad money	13,648	15,888	17,115	19,494	25,179	28,951	29,545
Currency in circulation	1,026	1,116	1,169	1,228	1,460	1,442	1,485
Foreign currency deposits	5,029	6,115	7,060	7,987	11,810	14,172	14,455
Local currency deposits	7,592	8,657	8,886	10,278	11,909	13,338	13,605
Central bank							
Net foreign assets	6,550	6,982	7,248	7,807	11,685	11,218	10,838
Foreign assets	7,059	7,560	7,731	8,191	12,144	11,743	11,271
Foreign liabilities	508	578	483	384	458	525	434
Net domestic assets	-3,558	-3,423	-3,528	-3,242	91	-2,188	-2,692
Domestic credit	-2,855	-2,629	-2,651	-2,318	4,247	1,056	-402
Government (net)	-2,170	-1,731	-1,644	-1,328	-453	-1,278	-1,236
Commercial banks	-610	-705	-845	-873	4,865	2,500	1,000
Other (parastatals)	-75	-192	-162	-117	-166	-166	-166
Other items, net	-703	-794	-877	-925	-4,156	-3,244	-2,289
Reserve money	2,992	3,559	3,720	4,564	6,408	9,030	8,146
Currency in circulation	1,026	1,116	1,169	1,228	1,460	1,442	1,485
Commercial bank reserves (includes cash in vault)	1,966	2,443	2,551	3,336	4,947	7,589	6,661
Of which : vault cash	193	212	...	...	...	...	...
Of which : excess reserves (excl. bank vault cash)	9	182	...	...	...	...	...
Of which : required reserves in foreign currency [2, 3]	703	841	924	924	924	1,735	1,770
required reserves in domestic currency [2]	1,061	1,208	1,346	1,595	1,844	1,874	1,924
Memorandum items:							
Gross official reserves (millions of U.S. dollars) [4]	523	546	548	580	561	588	616
Foreign currency deposits (millions of U.S. dollars)	372	442	503	567	638	775	800
Broad money growth (12–month percent change)	12.1	16.4	7.7	13.9	29.2	...	...
Credit to the private sector (12–month percent change)	10.3	17.8	11.5	22.3	20.2	...	...
Reserve money (end-of-period; 12–month percent change)	14.5	18.9	4.5	22.7	40.4	...	...
Reserve money (daily average over quarter; 12–month percent change	10.4	19.0	...	...	...	...	...
Money multiplier (broad money/reserve money)	4.6	4.5	4.6	4.3	3.9	...	...
Velocity (GDP/broad money; end-of-period)	1.4	1.3	1.3	1.1	1.1	...	...

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

[1] Negative shows accumulation, positive shows retiring (debt that is not rolled over)

[2] 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.

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

Table 5. Seychelles: Financial Soundness Indicators for the Banking Sector, 2013–2020[1]

	2013	2014	2015	2016	2017	2018	2019	2020
	(Percent, end-of-period)							
Capital adequacy								
Regulatory capital to risk weighted assets	26.7	21.7	25.5	26.6	23.5	20.5	19.5	17.1
Regulatory tier 1 capital to risk weighted assets	21.0	16.3	18.1	20.4	18.1	16.8	16.2	14.1
Capital to assets (net worth)	9.7	8.5	11.0	11.8	11.0	10.1	9.9	8.4
Net tangible capitalization [2]	9.8	8.6	11.2	12.0	11.2	10.1	10.0	8.5
Asset quality								
Foreign exchange loans to total loans	18.7	23.8	28.6	25.0	27.7	24.2	26.0	36.4
Non-performing loans to gross loans	9.4	8.2	7.6	6.8	7.1	3.5	2.7	3.3
Provision as percentage of non-performing loans	39.2	43.9	41.1	37.4	31.9	19.2	25.1	38.3
Provisions as percentage of total loans	3.7	3.6	3.1	2.5	2.3	0.7	0.7	1.3
Earnings and profitability								
Return on assets (annualized)	1.9	3.3	3.8	3.8	3.9	3.7	2.5	1.0
Return on equity (annualized)	19.6	38.2	34.7	32.7	35.1	35.7	24.0	11.5
Interest margin to gross income	56.6	57.5	60.1	62.7	53.1	54.5	62.6	58.3
Noninterest expense to gross income	65.1	50.3	52.9	45.5	49.7	55.9	57.7	55.3
Net interest margin (annualized) [3]	3.2	2.8	4.3	4.6	4.1	4.2	9.4	7.4
Net noninterest margin (annualized) [4]	-0.4	0.0	-0.4	-1.0	-0.2	-0.8	-3.1	-1.7
Expense to income	54.5	52.6	50.3	55.2	54.2	61.4	63.7	60.7
Interest expense to gross income	15.3	10.7	11.1	10.7	12.5	14.4	16.6	13.6
Liquidity								
Core liquid assets to total assets [5]	41.6	40.8	33.0	28.6	38.2	45.2	44.1	44.1
Broad liquid assets to total assets [6]	54.7	54.2	49.1	47.9	55.4	58.2	55.3	57.3
Liquid assets (broad) to short term liabilities	61.2	60.0	55.9	55.0	62.4	63.7	60.6	62.3
Liquid assets (broad) to total liabilities	60.6	59.2	55.2	54.3	62.2	64.7	61.6	62.5
Liquid assets to deposit liabilities	64.3	62.7	59.5	57.8	65.7	68.5	65.3	67.8
Foreign exchange exposure								
Net open foreign exchange position to capital	8.9	8.8	1.9	3.0	0.0	3.4	2.4	-0.1

Source: Central Bank of Seychelles.

[1] Data from 2015 onwards include 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: Fiscal Measures in the Medium-Term 2022-26
(Amount in SCR million or percent of GDP)

	2022		2023		2024		2025		2026	
Revenue Side										
Business tax rate reform	-69.0	-0.3								
Increase rate CSL from 1.5% to 3% effective 2023			78.0	0.3	38.0	0.1	2.0	0.01	2.0	0.01
Reform in taxation to include all securities dealers			63.2	0.2	23.0	0.1	5.0	0.01	5.0	0.01
Arrears collection plan	75.0	0.3	75.0	0.3	28.0	0.1	4.0	0.01	4.0	0.01
Digital economy taxation	60.0	0.2	73.0	0.3	32.0	0.1	5.0	0.01	5.0	0.01
Transfer pricing reforms										
Tourism concessions clawback										
Increase in PT to 3%			150.0	0.5	79.0	0.3	11.0	0.03	11.0	0.03
VAT Reforms (Review exemptions and deffered VAT, Review VAT threshold, Improved compliance wholesale/retail sector)					90.0	0.3	4.0	0.01	4.0	0.01
Customs and Excise (Customs digitalisation plan, customs post clearance audit, review of excise tax)	75.0	0.3	75.0	0.3	10.0	0.0	1.0	0.00	1.0	0.00
Taxation of Super Yachts					25.0	0.1	3.0	0.01	3.0	0.01
Sub-Total	**6.0**	**0.5**	**514.2**	**1.8**	**325.0**	**1.0**	**35.0**	**0.1**	**35.0**	**0.1**
Expenditure Side										
Public Sector Reforms	279.10	1.06	224.00	0.78	54.70	0.18	12.00	0.04	10.00	0.03
Abolishment of wage subsidies	192.00	0.73	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Abolishment of Seychelles Employee Transition Schem	15.00	0.06	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Abolishment of PMC and HFC Housing Loan Repayment Scheme	15.00	0.06	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Sub-Total	**501.10**	**1.91**	**224.00**	**0.78**	**54.70**	**0.18**	**12.00**	**0.04**	**10.00**	**0.03**

Sources: Authorities and IMF staff estimates.

Table 7. Seychelles: Proposed schedule of Purchases Under the EFF Arrangement

Date Available	Amount	% of Quota	Conditions Necessary for Disbursement
July 29, 2021	SDR 24 million	104.8	Executive Board approval of the EFF arrangement.
December 1, 2021	SDR 24 million	104.8	Observance of end-July 2021 performance criteria, and completion of the first review under the arrangement.
June 1, 2022	SDR 6.5 million	28.4	Observance of end-December 2021 performance criteria, and completion of the second review under the arrangement.
December 1, 2022	SDR 6.5 million	28.4	Observance of end-June 2022 performance criteria, and completion of the third review under the arrangement.
June 1, 2023	SDR 6.5 million	28.4	Observance of end-December 2022 performance criteria, and completion of the fourth review under the arrangement.
December 1, 2023	SDR 6.5 million	28.4	Observance of end-June 2023 performance criteria, and completion of the fifth review under the arrangement.
Total	SDR 74 million	323	

Source: IMF staff estimates.

Table 8. Seychelles: Indicators of Capacity to Repay Fund Credit, 2016-32

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
			(Millions of SDR)														
Existing Fund credit																	
Stock [1]	28.0	29.3	24.8	19.7	37.6	33.6	29.9	21.4	8.2	1.2	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Obligation	2.9	4.0	5.1	5.6	5.5	4.5	4.0	8.8	13.4	7.0	0.8	0.4	0.0	0.0	0.0	0.0	0.0
Principal (repayments/repurchases)	2.6	3.6	4.5	5.1	5.0	4.1	3.7	8.5	13.2	7.0	0.8	0.4	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.3	0.4	0.5	0.5	0.5	0.4	0.3	0.3	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Disbursements	...	4.9			22.9	...	...	...	...	...	...	...	...	...	...	...	...
Prospective Fund credit																	
Disbursement	0.0	0.0	0.0	0.0	0.0	48.0	13.0	13.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock [1]	0.0	0.0	0.0	0.0	0.0	48.0	61.0	74.0	74.0	74.0	65.5	54.8	42.4	30.1	17.8	5.4	1.6
Obligations [2]	0.0	0.0	0.0	0.0	0.0	0.4	1.4	1.8	1.8	1.5	10.2	12.0	13.1	12.7	12.6	12.5	3.8
Principal (repayments/repurchases)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.5	10.7	12.3	12.3	12.3	12.3	3.8
Charges and interest	0.0	0.0	0.0	0.0	0.0	0.4	1.4	1.8	1.8	1.5	1.6	1.2	0.8	0.4	0.3	0.2	0.1
Stock of existing and prospective Fund credit [1]	28.0	29.3	24.8	19.7	37.6	81.6	90.9	95.4	82.2	75.2	65.9	54.8	42.4	30.1	17.8	5.4	1.6
In percent of quota	122.2	128.0	108.2	86.0	164.3	356.2	396.8	416.6	358.9	328.5	287.6	239.1	185.2	131.4	77.6	23.7	7.2
In percent of GDP	2.8	2.7	2.3	1.8	4.7	9.2	7.5	7.1	5.6	4.7	3.7	2.9	2.1	1.4	0.7	0.2	0.1
In percent of Government Revenues					12.5	26.3	21.3	19.9	15.2	12.5	9.9	7.6	5.5	3.6	2.0	0.6	0.2
In percent of exports of goods and services	2.9	2.7	2.1	1.8	4.9	9.7	9.1	8.0	6.1	5.0	3.5	2.7	2.0	1.3	0.7	0.2	0.1
In percent of gross reserves	7.6	7.6	6.5	4.9	9.6	17.6	17.8	17.3	15.2	14.0	11.7	9.0	6.4	4.2	2.3	0.7	0.2
Obligations to the Fund from existing and prospective Fund arrangements																	
Disbursements	0.0	4.9	0.0	0.0	22.9	48.0	13.0	13.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Obligations	2.9	4.0	5.1	5.6	5.5	4.8	5.4	10.5	15.2	8.5	11.0	12.4	13.1	12.7	12.6	12.5	3.8
Principal (repayments/repurchases)	2.6	3.6	4.5	5.1	5.0	4.1	3.7	8.5	13.2	7.0	9.4	11.1	12.3	12.3	12.3	12.3	3.8
Charges and interest	0.3	0.5	0.5	0.5	0.5	0.8	1.7	2.1	1.9	1.6	1.6	1.2	0.8	0.4	0.3	0.2	0.1
In percent of quota [3]	12.7	17.6	22.1	24.5	23.9	21.2	23.5	45.9	66.2	37.1	48.0	54.0	57.2	55.6	55.1	54.5	16.8
In percent of GDP	0.3	0.4	0.5	0.5	0.7	0.5	0.4	0.8	1.0	0.5	0.6	0.6	0.6	0.6	0.5	0.5	0.1
In percent of Government Revenues					1.8	1.6	1.3	2.2	2.8	1.4	1.6	1.7	1.7	1.5	1.4	1.3	0.4
In percent of exports of goods and services	0.3	0.4	0.4	0.5	0.7	0.6	0.5	0.9	1.1	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.1
In percent of gross reserves	0.8	1.1	1.3	1.4	1.4	1.0	1.1	1.9	2.8	1.6	1.9	2.0	2.0	1.8	1.6	1.5	0.4

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.

[3] Effective February 2016, the new quota of SDR 22.9 million is applied.

Annex I. Debt Sustainability Analysis

After years of steady improvement in public debt dynamics, Seychelles' public debt situation significantly worsened due to the economic fallout of the COVID-19 pandemic. With the severe economic recession, the public debt level increased by around 40 percentage points (compared to pre-COVID projections) to 100.8 percent of GDP in 2020. Assuming the authorities will steadfastly implement a strong debt reduction strategy with a view to achieving a primary surplus of 3.2 percent of GDP in 2026, and by relying more on low cost external financing, and the economy will suffer no further major negative shocks, public debt is expected to decline again steadily over the medium term. Public debt is expected to fall below 70 percent (64.5 percent) of GDP by end-2026. As a small island economy, Seychelles remains vulnerable to macroeconomic shocks, particularly interest and exchange rate shocks. Continued progress in reducing the public debt stock through a steadfast implementation of fiscal consolidation over the medium term, relying on more low-cost financing, and extending the maturities of domestic public debt are therefore warranted. Staff assesses debt to be sustainable but with significant risks.

1. **Prior to the COVID-19 pandemic and the concomitant travel restrictions, public debt had been on a steady decline.** Public debt continued to decline from 72.8 percent of GDP in 2016 to 61.8 percent in 2019, thanks to ongoing fiscal consolidation. Gross financing needs were manageable. Based on the 2019 results, public debt was projected to decline to 57.3 percent of GDP in 2020.

2. **Debt levels and gross financing needs rose sharply in 2020 as a result of the COVID-19 shock**. The level of end-2020 nominal gross public debt stock is much higher than previously projected (100.8 percent of GDP against 57.3 percent in the pre-COVID projections), owing mostly to a severe recession with GDP projected to contract by about 12.9 percent instead of growing by 3.5 percent, and a much-deteriorated primary balance that reached a deficit of 16.3 percent of GDP in 2020 (compared with a surplus of 2.5 percent of GDP in the pre-COVID projections). Gross financing needs (GFNs) reached 50.8 percent of GDP in 2020. However, they would decrease gradually under the fund program over the 2021-26 period to fall below 15 percent of GDP (12.7 percent). The high GFNs are mainly driven by a higher level of domestic debt, which is more costly with higher interest rates and shorter maturities. Therefore, the switch from expensive domestic debt towards low cost external financing, the planned fiscal consolidation, and a Liability Management Operation (intended to lengthen the domestic debt maturities) will help Seychelles to reduce GFNs significantly over the medium term.

Text Table. Seychelles: Total debt composition (as of end-2020, in percent of total debt)

Domestic	**44.8**
By creditor	
Central Bank	6.2
Domestic commercial banks	26.8
Other creditors	11.8
External	**55.2**
By creditor	
Multilateral	27.4
Bilateral	11.6
Paris Club	6.6
Non-Paris Club	5.0
Commercial Banks	2.2
Private	12.8
By currency	
USD	34.8
EUR	14.3
CNY	2.0
SAR	1.6
AED	1.3
GBP	0.6
JPY	0.5

Sources: Authorities and IMF staff calculations.

3. **Macroeconomic and fiscal assumptions:** The assumptions underpinning the DSA reflect the severe economic shock triggered by the COVID-19 outbreak. Real GDP contracted by -12.9 percent in 2020. The recovery in tourist arrivals, expected to begin in October 2020 at the time of the RFI, has now been pushed out to mid-2021. As vaccines are expected to be widely available in Seychelles' and major markets (Europe, Middle East) by mid-summer 2021, and a faster-than-expected global recovery from the pandemic, driven by the United States and China, is expected to underpin global demand, staff expect that the 2019 real GDP level will be reached in 2022. Therefore, real GDP growth is expected to reach 6.9 percent in 2021 and remain at around 6 percent over the medium term. Inflation in 2020 is estimated at a lower rate compared with the previous DSA (3.8 percent against 4.2 percent) to reflect the latest actual data. The primary fiscal balance is expected to reach a surplus of 3.2 percent in 2026, which is close to the 2019 primary balance (+2.8 percent).

4. **The baseline scenario suggests that Seychelles' public debt (including government guarantees) is currently above the high-risk benchmark but is expected to continue falling steadily below the benchmark as the authorities implement the fiscal consolidation under the program.** Unlike the previous DSA assumptions, the present DSA considers that the fiscal and growth impacts from the COVID shocks would continue into the first half of 2021. Assuming the primary balance path to a surplus of 3.2 percent of GDP by 2026, the public debt ratio under the Fund program is projected to decline steadily to 64.5 percent of GDP by 2026. Meanwhile, the gross financing needs to GDP ratio, having increased from 29.3 per-cent in 2019 to 50.3 percent in 2020, would also decline steadily to reach 12.7 percent by 2026, thanks to the strategy to lengthen maturities and lower debt costs. The impact of all shock scenarios on the public debt-to-GDP ratio under the program is smaller compared with the previous DSA, given the strong debt reduction strategy envisaged.

5. **Since the COVID-19 pandemic, public debt is more vulnerable to macroeconomic shocks.** Under the real exchange rate shock (real depreciation by around 16 percent after 2020), the debt-to-GDP ratio would peak at around 97 percent in 2022 and fall thereafter at around 71 percent in 2026. One-time shocks to real GDP growth (lower than the baseline by 2 percent during 2021–22) would lead to a similar debt path as under the real exchange rate shock. The debt-to-GDP ratio would peak at around 99 percent in 2023 and fall thereafter to around 80 percent in 2026. Under the primary balance shock scenario, the debt-to-GDP ratio would decline at a slower pace from the peak in 2021 and would reach 68 percent in 2026. A combined macro-fiscal shock would send the debt-to-GDP ratio to 113 percent of GDP in 2026, much above the critical value of 70 percent. The combined macro-fiscal shock is an aggregation of the shocks to real growth, the interest rate, the primary balance and the exchange rate. The asymmetric fan chart also highlights that a persistently looser fiscal position would keep debt at an elevated level and could prevent the authorities' planned debt reduction from being attained in the foreseeable future. Also, gross financing needs increase under various shocks, especially under the combined macro-fiscal shock or the real interest rate shock throughout the period of projection. While the steadfast implementation of fiscal consolidation will help to reduce gross financing needs, further measures to extend the average

maturity of domestic issuance wherever possible, and reliance on external low-cost financing would also reduce rollover risks.

6. **Air Seychelles poses significant risks to debt sustainability.** In 2012, the government assumed liabilities and obligations of Air Seychelles amounting to around 5 percent of GDP. Meanwhile, Air Seychelles' project box bond of $71.5 million (around 6 percent of GDP) owed to Etihad could pose rollover risks to the company in 2021. This DSA therefore provides a scenario where SOEs' external debts of a similar magnitude (6 percent of GDP) are assumed by the government in 2021. Under this scenario, the public debt-to-GDP ratio at the end of the projection period (2026) would reach 66.4 percent, higher than under the baseline scenario (64.5 percent). This highlights the need to mitigate any risk arising from Air Seychelles. The government held some discussions with both Etihad and the bond holders. The different parties reached some agreements that could allow a reduction in government guarantees in 2020 (from $42.5 million to $5 million) but would increase the transfers to Air Seychelles in 2020 from $6 million to $41.7 million. Such agreements were not finally implemented in 2020, and discussions are still ongoing. The GOS is actively searching for a viable solution that would limit the cost to the government budget. The GOS has worked with the World Bank and identified that the least costly scenario would be the liquidation of Air Seychelles. Discussions between the authorities and bondholders are taking place. The government lawyers are assessing the legal implications of unwinding the company and ways to protect employees.

7. **The authorities are urged to steadfastly implement fiscal consolidation to reduce the public debt vulnerability.** As illustrated by the heat map, significant vulnerabilities arise from the large gross financing needs resulting from the high level of public debt and the short maturity of domestic debt[2]. In addition to the fiscal consolidation, the authorities would need to extend the maturities of the domestic debt, where possible, to mitigate the risks arising from the high gross financing needs. Staff advised the government to examine the possible scope for further privatization of some SOEs, including Air Seychelles, to reduce the fiscal risks and improve economic efficiency over the medium term.

8. **Staff estimates that 32-months EFF arrangement to address the structural balance of payment needs aggravated by the pandemic, and support reaching the authorities' ambitious fiscal targets and bring the public debt on a sustainable path would require an access of 323 percent of quota**. The 32-months EFF would be used as budget support and cover early 2021 end 2023 with access of 323 percent of quota ($ USD 107 million: USD 69 million to be disbursed in 2021; USD 19 million in 2022; and USD 19 million in 2023). It is assumed that this EFF access would catalyze external budget support loans from the World Bank ($85 million in 2021-23), AFDB ($80 million), UAE (USD 75 million) and Qatar (USD 100 million). With the above-mentioned EFF access and the primary balance path as foreseen under the Fund program scenario, the public debt and gross financing needs are projected to decline significantly. Under this hypothetical program scenario, the public debt-to-GDP ratio will decline steadily from about 87.7 percent at end-2021 to about 64.5 percent by end-2026. The GFN-to-GDP ratio is also expected to decline considerably by 2026 to around 12.7 percent (under the baseline scenario). This noticeable improvement in GFNs is

due to the LMO and the interest rate differential with external budget support loans, expected to cover most of the fiscal financing under the program scenario.

9. **The results of the updated external DSA reveal that the total external debt increased significantly following the outbreak's adverse shock and the ratio of external debt to GDP remains elevated in the range of 282.1–214.1 percent of GDP throughout the projection period.** Tourism receipts, which account for about 50 percent of exports of services and 35 percent of exports of goods and services, declined by 63 percent in 2020, in comparison with a pre-pandemic growth rate of 7 percent. As a result, the current account deficit reached 29.6 percent of GDP. Most of the expected FDI, which has been the major source of financing of the current account deficit, were postponed to 2021 and beyond. Such developments have led to a deterioration of the external indicators. However, the risks continue to be mitigated by the maturity profile of the external debt: as of end-2020, about 12 percent of the country's external debt is medium to long-term government borrowing, largely from official sources and at favorable interest rates and maturities.

10. **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 lead to a spike in the external debt-to-GDP ratio to around 396 percent in 2022, however such a ratio would decrease steadily and would equal around 300 percent by the end of the projection period, compared to about 214 percent under the baseline scenario. The interest rate, growth and current account shocks would have a more muted, yet very significant effect on the country's external debt profile. A permanent ¼ standard deviation shock to either growth or the current account (excluding interest payments) would lead to a gradual increase in the external debt-to-GDP ratio to around 300 percent by the end of the projection period.

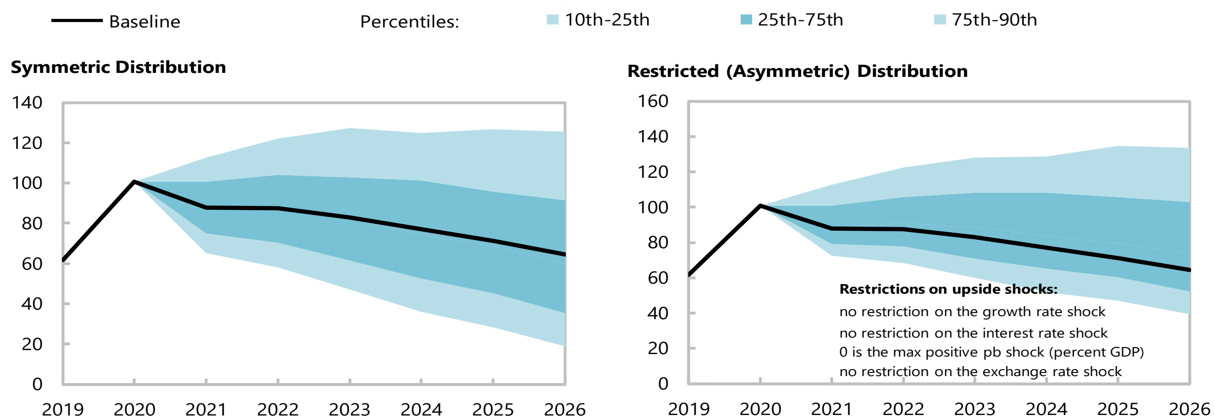
Figure 1. Seychelles : Debt Profile Vulnerabilities

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

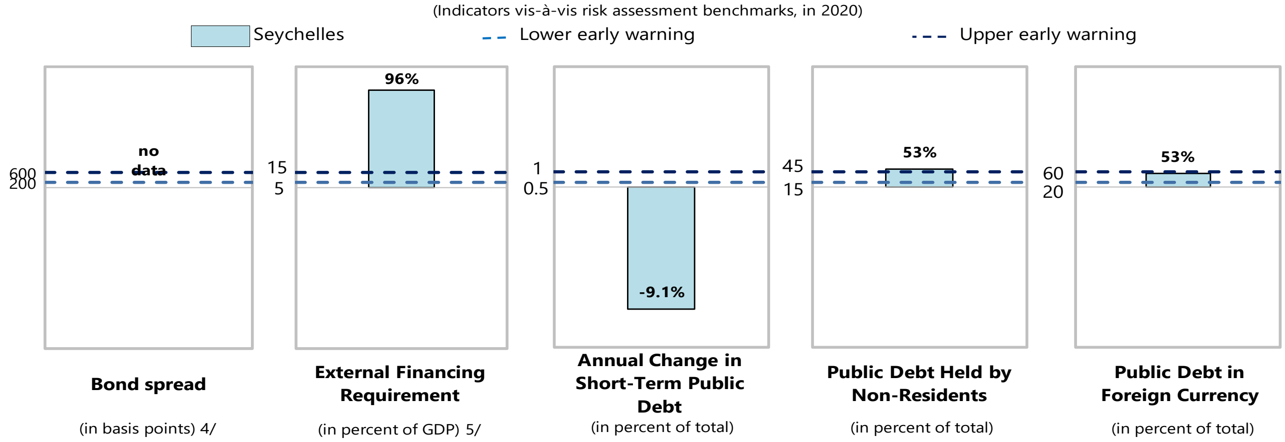
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



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.

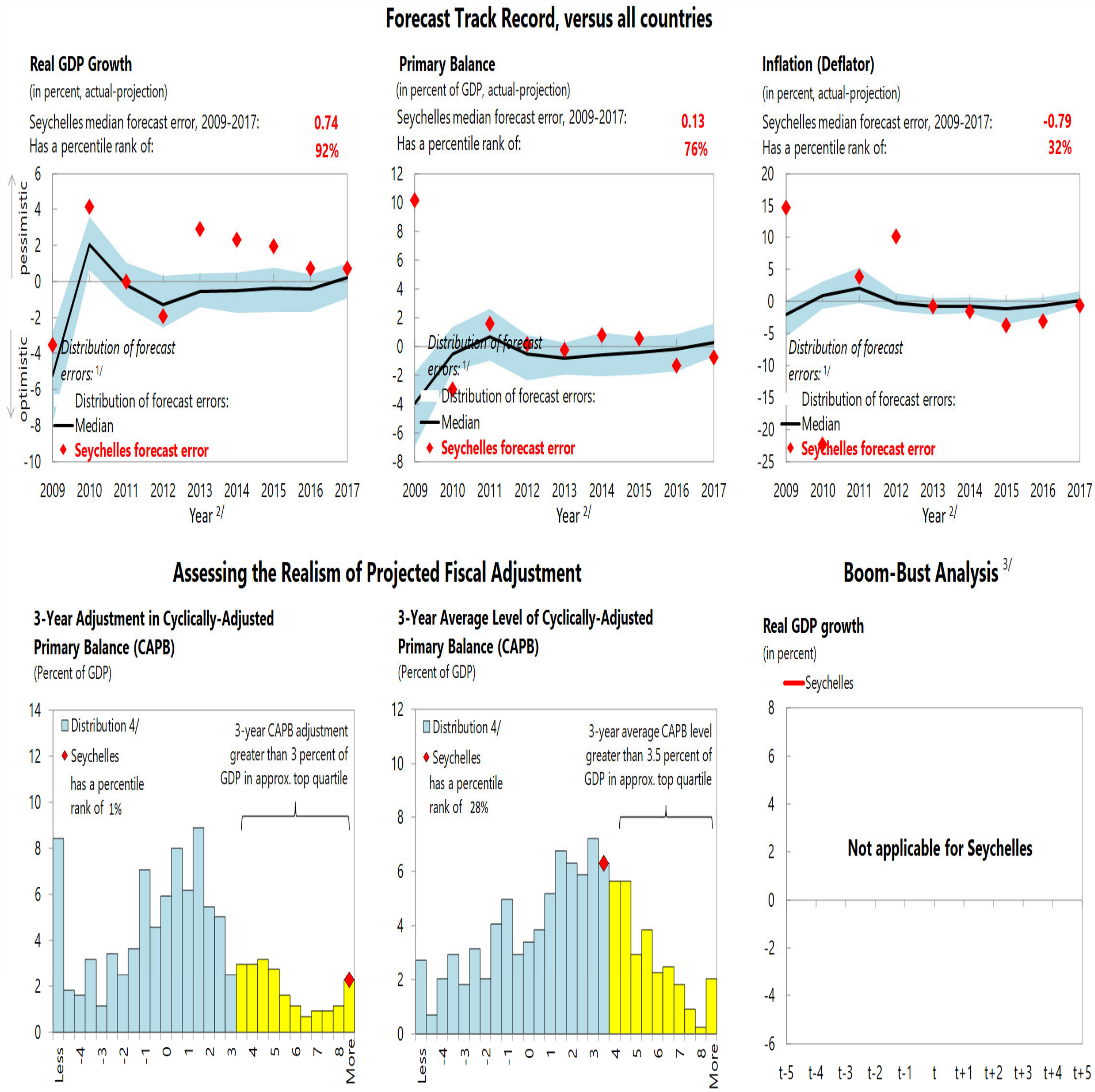
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, 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 U.S. bonds, an average over the last 3 months, 21-Jan-20 through 20-Apr-20.

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.

Figure 2. Seychelles: Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

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

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

3/ Not applicable for Seychelles, as it meets neither the positive output gap criterion nor the private credit growth criterion.

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.

Figure 3. Seychelles: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2010-2018 [2/]	2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	74.5	61.8	100.8	87.7	87.6	83.0	77.2	71.2	64.5
Of which: guarantees	2.4	4.1	4.3	5.9	4.8	3.9	3.4	2.9	2.6
Public gross financing needs	26.1	29.3	50.8	44.0	23.8	16.2	13.3	12.7	12.7
Net public debt		52.8	97.8	85.2	85.3	81.0	75.3	69.4	62.8
Real GDP growth (in percent)	4.6	1.9	-12.9	6.9	7.7	6.8	5.0	5.0	4.8
Inflation (GDP deflator, in percent)	2.6	1.1	3.5	10.2	3.2	3.2	3.0	3.0	3.0
Nominal GDP growth (in percent)	7.3	3.0	-9.8	17.8	11.2	10.2	8.1	8.2	7.9
Effective interest rate (in percent) [4/]	5.1	4.4	5.0	4.5	5.5	5.1	5.4	5.5	5.9

As of April 20, 20

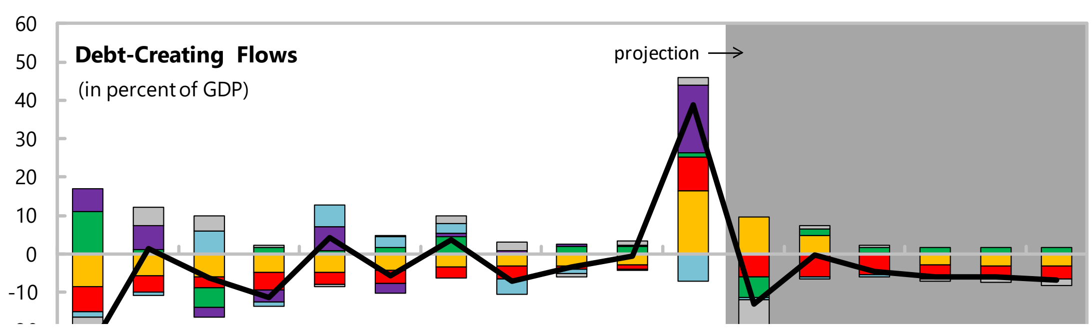
Sovereign Spreads	
EMBIG (bp) 3/	
5Y CDS (bp)	

As of June 2021

Ratings	Foreign
Moody's	Baa2
S&Ps	BB
Fitch	B

Contribution to Changes in Public Debt

	Actual			Projections							
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026	cumulative	debt-sta
Change in gross public sector debt	-5.5	-0.5	39.0	-13.1	-0.2	-4.5	-5.8	-6.0	-6.7	-36.3	prim
Identified debt-creating flows	-4.0	-1.9	37.0	-2.1	0.1	-4.0	-4.9	-4.9	-4.6	-20.4	balar
Primary deficit	-4.8	-2.7	16.4	9.7	5.0	0.4	-2.8	-3.0	-3.2	6.2	-1
Primary (noninterest) revenue and gra	37.6	37.9	37.6	34.8	35.9	36.4	37.7	38.2	38.5	221.5	
Primary (noninterest) expenditure	32.7	35.2	53.9	44.5	40.9	36.8	34.9	35.2	35.3	227.7	
Automatic debt dynamics [5/]	-0.1	1.0	27.6	-11.4	-4.5	-4.0	-2.1	-1.9	-1.4	-25.3	
Interest rate/growth differential [6/]	-1.5	0.8	10.1	-11.4	-4.5	-4.0	-2.1	-1.9	-1.4	-25.3	
Of which: real interest rate	2.0	2.0	1.3	-5.5	1.6	1.4	1.7	1.7	1.8	2.6	
Of which: real GDP growth	-3.5	-1.2	8.8	-5.9	-6.1	-5.4	-3.8	-3.6	-3.2	-27.9	
Exchange rate depreciation [7/]	1.4	0.2	17.4	...	...	...	...	...	...	...	
Other identified debt-creating flows	1.0	-0.2	-6.9	-0.4	-0.4	-0.4	0.0	0.0	0.0	-1.2	
Privatization proceeds (negative)	-0.5	0.0	0.0	-0.4	-0.4	-0.4	0.0	0.0	0.0	-1.2	
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	1.5	-0.2	-6.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-1.5	1.3	2.0	-12.5	0.8	0.3	-0.4	-0.7	-1.8	-14.3	



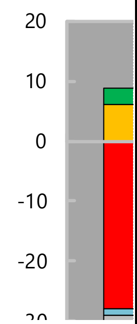
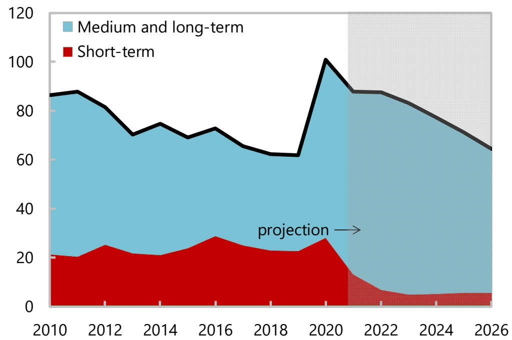


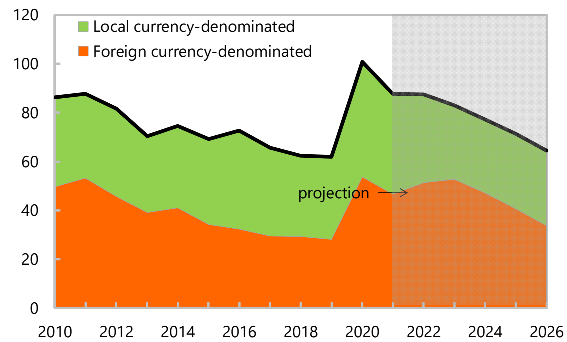
Figure 4. Seychelles: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



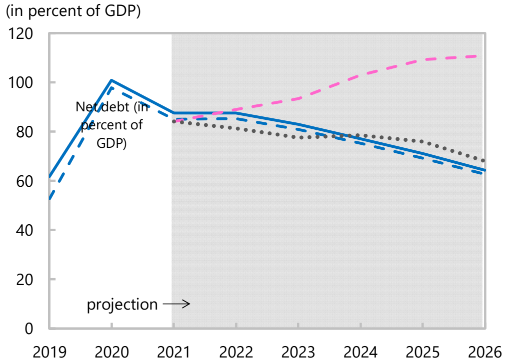
By Currency
(in percent of GDP)



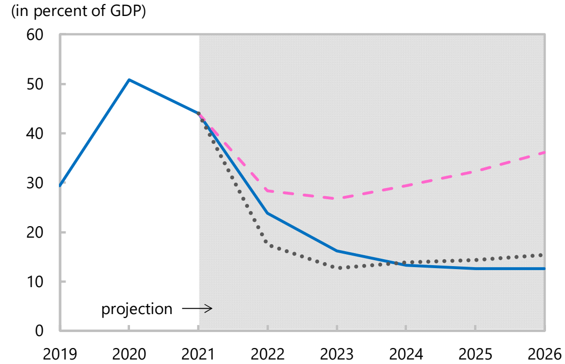
Alternative Scenarios

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)

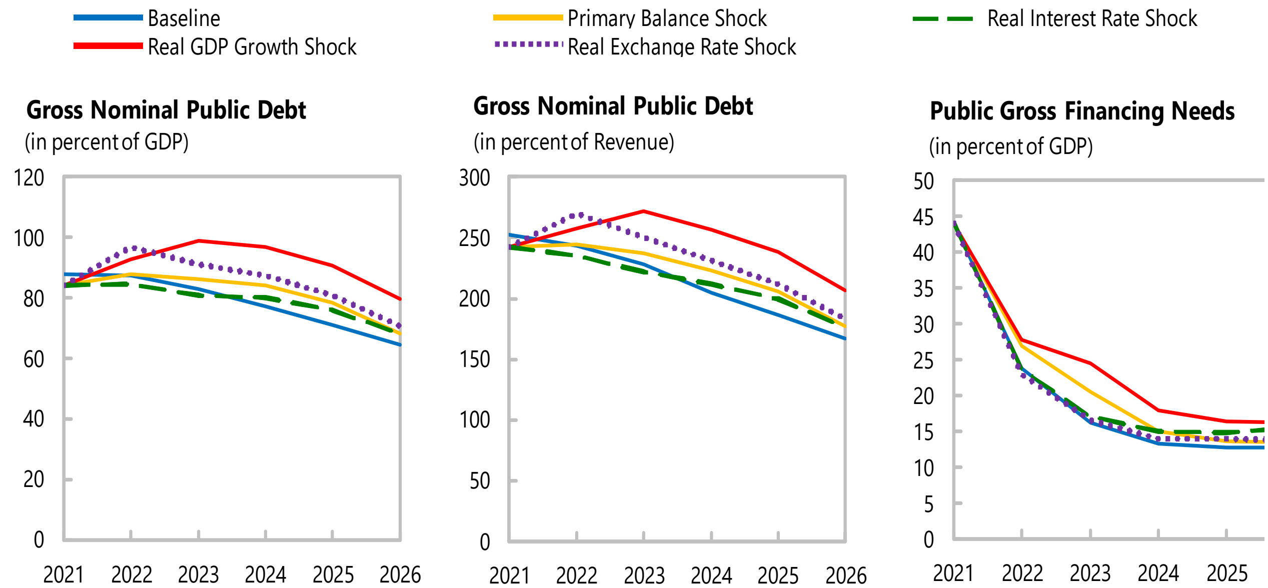
Baseline Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	6.9	7.7	6.8	5.0	5.0	4.8
Inflation	10.2	3.2	3.2	3.0	3.0	3.0
Primary Balance	-9.7	-5.0	-0.4	2.8	3.0	3.2
Effective interest rate	4.5	5.5	5.1	5.4	5.4	5.9
Constant Primary Balance Scenario						
Real GDP growth	6.9	7.7	6.8	5.0	5.0	4.8
Inflation	10.2	3.2	3.2	3.0	3.0	3.0
Primary Balance	-9.7	-9.7	-9.7	-9.7	-9.7	-9.7
Effective interest rate	4.5	5.6	5.1	5.2	5.2	5.5

Historical Scenario	2021	2022	2023	2024	2025	2026
Real GDP growth	6.9	2.4	2.4	2.4	2.4	2.4
Inflation	10.2	3.2	3.2	3.0	3.0	3.0
Primary Balance	-9.7	2.1	2.1	2.1	2.1	2.1
Effective interest rate	4.5	5.6	5.5	5.9	5.7	6.1

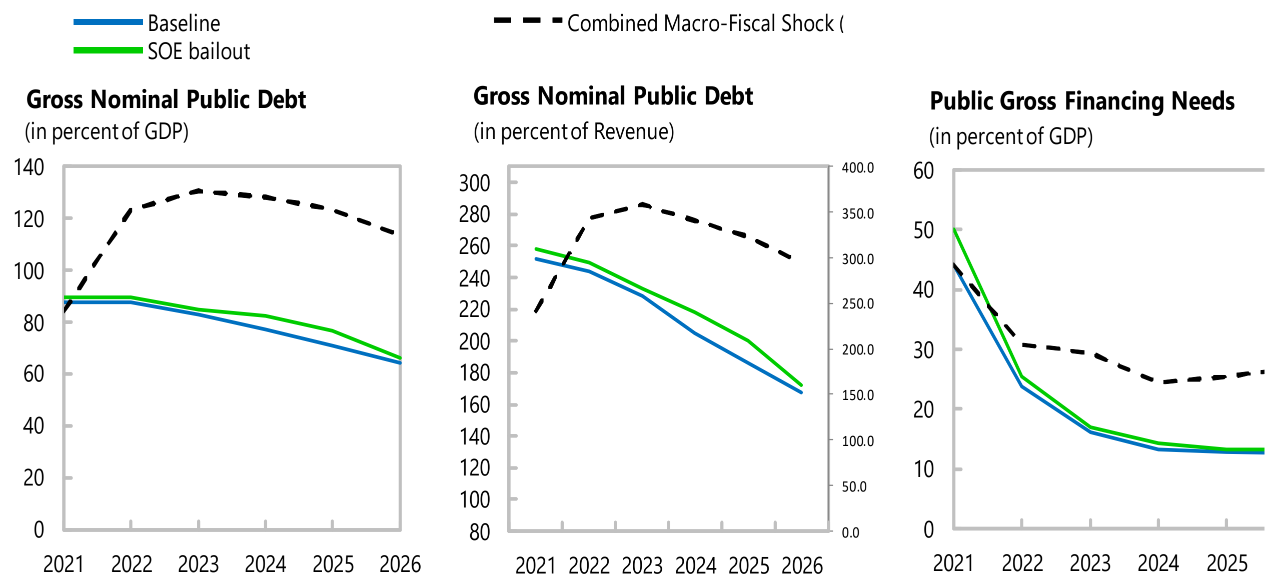
Source: IMF staff.

Figure 5. Seychelles: Public DSA – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2021	2022	2023	2024	2025	2026
Real GDP growth	6.9	7.7	6.8	5.0	5.0	4.8

Real GDP Growth Shock	2021	2022	2023	2024	2025
Real GDP growth	6.9	2.1	1.2	5.0	5.0

Table 1. Seychelles: External Debt Sustainability Framework, 2015-2026

(In percentage of GDP, unless otherwise indicated)

	Actual						Projections						
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	303.1	301.5	292.8	303.7	308.5	446.7	**282.1**	**269.9**	**255.7**	**241.1**	**227.6**	**214.1**	**-23.3**
2 Change in external debt	18.7	-1.5	-8.7	10.9	4.8	138.3	-164.7	-12.2	-14.2	-14.6	-13.5	-13.5	
3 Identified external debt-creating flows (4+8+9)	-9.6	9.0	-14.8	3.2	3.4	243.7	-4.6	-4.5	-3.8	-1.5	-1.9	-1.7	
4 Current account deficit, excluding interest payments	18.1	19.2	19.2	18.5	15.5	27.8	16.1	16.8	14.9	12.8	12.2	11.2	
5 Deficit in balance of goods and services	-197.3	10.2	11.0	12.1	12.0	22.5	13.6	14.5	11.5	9.6	9.1	7.9	
6 Exports	94.2	94.9	100.4	108.9	101.8	95.8	63.3	66.9	72.3	74.4	75.0	74.2	
7 Imports	-103.2	105.1	111.4	121.0	113.8	118.3	76.9	81.5	83.8	84.0	84.0	82.2	
8 Net non-debt creating capital inflows (negative)	7.5	-9.1	-14.1	-9.8	-5.7	-2.2	-3.7	-3.0	-3.5	-4.3	-4.5	-4.2	
9 Automatic debt dynamics 1/	-35.2	-1.1	-19.9	-5.5	-6.4	218.1	-17.0	-18.3	-15.3	-10.0	-9.6	-8.7	
10 Contribution from nominal interest rate	0.4	1.4	0.4	0.4	0.6	2.2	1.2	1.2	1.1	1.7	1.5	1.2	
11 Contribution from real GDP growth	-12.2	-13.2	-14.0	-3.8	-5.7	67.5	-18.2	-19.4	-16.4	-11.6	-11.0	-9.9	
12 Contribution from price and exchange rate changes 2/	-23.4	10.7	-6.3	-2.1	-1.3	148.4	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	28.4	-10.5	6.1	7.7	1.4	-105.4	-160.1	-7.7	-10.4	-13.1	-11.7	-11.9	
External debt-to-exports ratio (in percent)	321.8	317.7	291.6	278.8	302.9	466.5	445.6	403.2	353.8	324.0	303.5	288.4	
Gross external financing need (in billions of US dollars) 4/	328.4	453.6	389.0	359.9	368.4	394.6	433.1	450.2	452.6	458.7	467.4	444.5	
in percent of GDP	23.8	31.8	25.5	23.3	23.3	34.7	22.4	20.9	18.9	17.5	16.2	14.0	
Scenario with key variables at their historical averages 5/							**281.6**	**298.9**	**313.9**	**324.1**	**334.9**	**348.1**	**-5.9**
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	4.9	4.4	5.0	1.3	1.9	-12.9	6.9	7.7	6.8	5.0	5.0	4.8	
GDP deflator in US dollars (change in percent)	9.0	-3.4	2.1	0.7	0.4	-32.5	58.8	3.7	4.2	4.3	4.3	5.4	
Nominal external interest rate (in percent)	0.2	0.5	0.1	0.1	0.2	0.4	0.4	0.5	0.5	0.7	0.7	0.6	
Growth of exports (US dollar terms, in percent)	-5.5	4.3	13.4	9.4	-4.2	-32.3	12.2	18.0	20.1	12.7	10.4	9.3	
Growth of imports (US dollar terms, in percent)	-10.3	5.5	13.6	9.6	-3.6	-25.1	10.3	18.3	14.4	9.7	9.7	8.0	
Current account balance, excluding interest payments	-18.1	-19.2	-19.2	-18.5	-15.5	-27.8	-16.1	-16.8	-14.9	-12.8	-12.2	-11.2	
Net non-debt creating capital inflows	-7.5	9.1	14.1	9.8	5.7	2.2	3.7	3.0	3.5	4.3	4.5	4.2	

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).

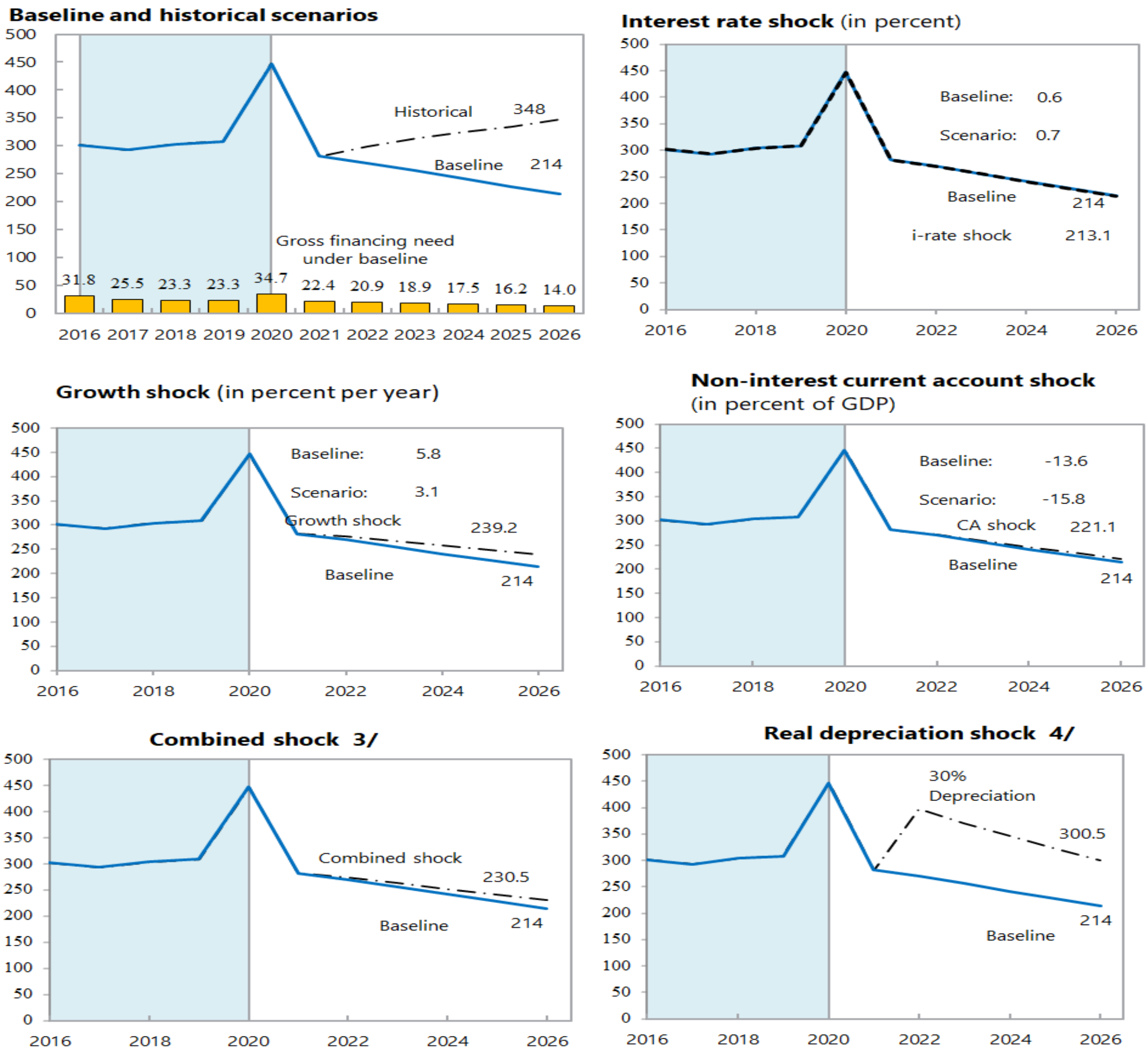
3/ For projection, line includes the impact of price and exchange rate changes.

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.

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



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ 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 2022.

Annex II. Seychelles: Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood/ Time Horizon	Excepted Impact if Realized	Recommended Policy Response
		External Risks	
Protracted delay in tourism recovery-from traditional markets.	**Medium** **Short to Medium term**	**High** A protracted delay in tourism arrivals from the main European countries could hamper the planned tourism and economic recovery during the first half of 2021.	Develop a contingency plan that would lower the impact of a delayed economic recovery: Authorities could consider further fiscal consolidation and reliance on low cost financing in case such risk materialize.
Protracted delay in tourism recovery-from new markets.	**Medium** **Short to Medium Term**	**High** An unexpected drop in tourism arrivals from new markets (Israel, Russia) could hamper the planned tourism and economic recovery during the first half of 2021.	Develop a contingency plan that would lower the impact of a delayed economic recovery: Authorities could consider further fiscal consolidation and reliance on low cost financing in case such risk materialize.
Shortfall of external financing	**Medium** **Short Term to Medium Term**	**High** A shortfall of external financing could imply high GFNs for several years.	Develop a contingency plan that would lower the impact of a shortfall in external financing: Authorities could consider further fiscal consolidation and debt restructuring.
		Domestic Risks	
Vaccines could prove less effective than expected	**Low** **Short to Medium Term**	**Medium** Low effectiveness in vaccines could further disrupt domestic activity and tourism recovery.	Rely predominantly on low cost financing; optimize debt portfolio; adjust public investment level to reduce borrowing needs, if necessary
Natural disasters related to climate change could happen.	**Low** **Short to Medium Term**	**Medium** The materialization of risks related to natural disasters could trigger further public expenditures and alter the planned reduction of public debt.	Prioritize the implementation of projects related to climate change.
Higher NPA levels in the banking sector	**Medium** **Short to Medium Term**	**Medium** Higher NPA levels in the banking sector which is currently not recognized due to the regulatory forbearance could escalate further in case the economic recovery falls short of expectations.	Encourage and facilitate prudent restructuring of loans and enhance management and monitoring of NPLs: Authorities should provide guidance on prudential treatment of moratoria and NPL management strategies, assess their implementation, and monitor the relevant reclassification of loans. Authorities should further develop detailed reporting templates for restructured and rescheduled loans and for monitoring the impact of COVID-19 measures on the asset quality of banks.
Materialization of contingent liabilities from Air Seychelles	**Medium** **Short to Medium Term**	**Medium** The materialization of contingent liabilities from Air Seychelles could alter the planned reduction of public debt.	Finalize discussions with shareholders and continue the collaboration with the World Bank to identify and implement the least costly scenario.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 and 3 years, respectively.

Annex III. Seychelles: External Balance and Reserve Adequacy

Seychelles' external position in 2020 was weaker than the level implied by fundamentals and desirable policy settings. The reserve adequacy assessment indicates that international reserves at end-2020 were within the advisable range of international reserves.

A. External Balance Sheet

1. Background. Seychelles' International Investment Position (IIP) for end-2020, indicates that Seychelles' net international investment position decreased by 57 percentage points of GDP during 2020. The net international investment position (NIIP) decreased to -171 percent of GDP at end-2020 from -114 percent of GDP at end-2019 mainly driven by the sharp decline in real GDP and the depreciation of local currency, an increase in external government debt, and a drawdown of private sector net foreign assets. At end-2020, direct investment was about 41 percent of gross assets and 69 percent of gross liabilities while portfolio investment was about 19 percent of gross assets and about 3 percent of gross liabilities.

2. Assessment. The external balance sheet is a source of risk for Seychelles. Gross non-FDI liabilities were 176 percent of GDP and total external debt stood at 453 percent of GDP at end-2020. Risks are mitigated, however, due to the favorable debt composition and maturity profile. External debt is comprised mostly of public and tourism sector borrowing at favorable interest rates and long maturities. The authorities closely monitor global financial conditions given Seychelles' openness. The External Sustainability (ES) approach suggested substantially weaker position of the external sector in 2020.

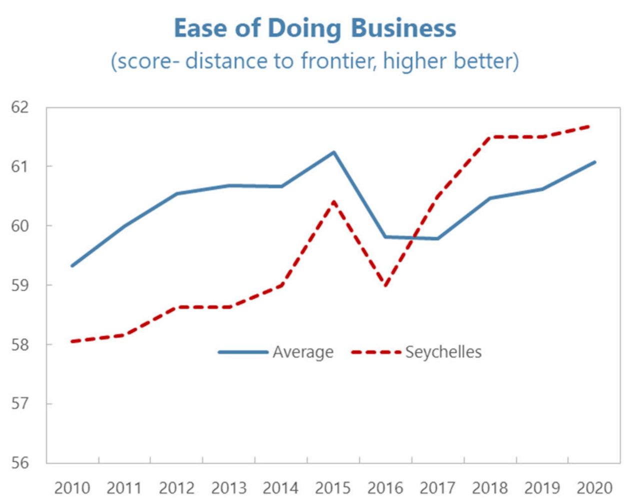
B. Current Account

3. Background. Seychelles' external current account deficit widened significantly from 16.1 percent of GDP in 2019 to 29.6 percent of GDP in 2020. This was driven primarily by plummeted tourism receipts as global travel came to a halt in 2020, amid the COVID-19 pandemic. The current account deficit is expected to narrow over the medium-term, mainly thanks to a recovery in global tourism industry and fiscal consolidation.

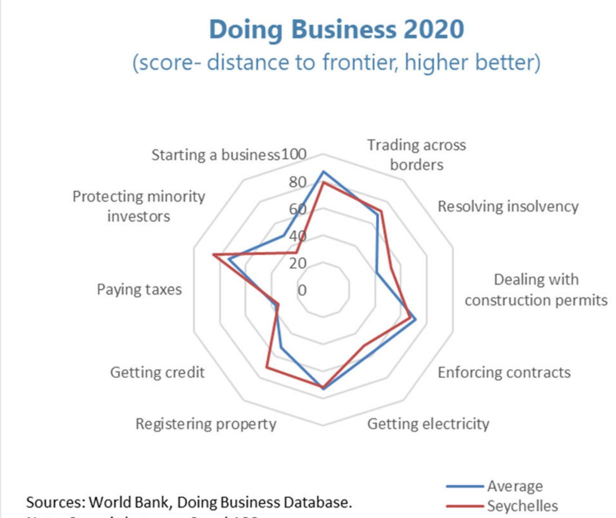
4. Non-EBA-lite (Indicators-based) Assessment: Staff analysis suggests that Seychelles' external position in 2020 was weaker than the level implied by fundamentals and desirable policy settings. This assessment comes from complementing the ES with non-EBA quantitative indicators of Seychelles' competitiveness, which point to Seychelles' relatively strong competitiveness compared to peers.

5. As an economy with a strong dependence on the tourism sector, Seychelles is a special case for external assessment.[1] EBA-lite model regression results do not control for factors unique to countries like Seychelles. Seychelles depends on a concentrated source of income in tourism, and FDI in the tourism sector have significant import content (around 80percent). This significant driver of persistent deficits is not considered in the EBA-lite regressions, leading to persistently poor fit of the models.

6. Staff's indicators-based analysis compares Seychelles' external competitiveness indicators to a group of small tourism-dependent island economies.[2] Seychelles' tourism sector has performed well, as tourist arrivals have been stronger than the comparator group average, and its share in the overall tourist arrival numbers has increased in recent years (see attached figure below). The World Bank's Doing Business Indicators show that Seychelles continues to surpass its peers since 2017. According to Doing Business Indicators 2020, Seychelles performs better than peers especially in registering property, paying taxes, and resolving insolvency, while there is room to improve in protecting minority investors and starting a business. Price competitiveness significantly improved in 2020: (i) The "Week-at-the-Beach[3]" index for Seychelles declined substantially in 2020, compared to its peers, and the gap with peers has narrowed by 40 percent in December 2020 compared to December 2019; (ii) The REER depreciated by 38 percent over 2020, reaching in December 2020 its lowest level since January 2010. Seychelles' current account deficit has traditionally been volatile and larger than comparators but has stabilized at around -17percent before 2020. Net FDI to Seychelles has been much stronger than the peer average over recent years.



Sources: World Bank, Doing Business Database.
Note: Score is between 0 and 100.
Average inludes ATG, BHS, BLZ, BRB, CPV, DMA, JAM, KNA, LCA, MDV and MUS.



Sources: World Bank, Doing Business Database.
Note: Score is between 0 and 100.
Average inludes ATG, BHS, BLZ, BRB, CPV, DMA, JAM, KNA, LCA, MDV and MUS.

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[1] Ter-Martirosyan, A et al. External Assessments in Special Circumstances, IMF, 2014

[2] Comparator group includes Antigua and Barbuda, Bahamas, Barbados, Belize, Cabo Verde, Dominica, Jamaica, Maldives, Mauritius, St. Kitts and Nevis, and St. Lucia.

[3] The "Week-at-the-Beach" index uses price data on hotels, beer, coffee, taxis and food to create an index of tourism costs.

7. **Assessments based on EBA-Lite Models**: The EBA-lite methodology does not provide conclusive results. The current account (CA) model implies a sizable CA gap of 17.3 percent of GDP and an over-valuation of the exchange rate by 21.0 percent (Table 1), but the real effective exchange rate index (IREER) model shows a sizable under-valuation of the exchange rate (-45.4 percent). These discrepancies appear to be largely explained by country-specific circumstances, as pointed out in the Non-EBA-lite assessment above.

8. **According to the CA model, the CA gap is estimated at -17.3 percent of GDP, indicating a deviation of Seychelles' current account balance from the norm, which is an estimated deficit of -1.4 percent of GDP.** Using the estimated current account elasticities, this implies an REER misalignment (overvaluation) of about 21 percent (see table below). Out of the total CA gap, the relative policy gap is assessed to contribute -7.6 percent of GDP, mainly due to fiscal expansion. The residual, reflecting factors not captured by EBA-Lite, is responsible for -9.7 percent of GDP, after application of the COVID-19 adjustor on tourism and oil trade balances (10.1 percent of GDP).

Seychelles: Model Estimates for 2020 (in percent of GDP)

	CA model	REER
CA-Actual	**-29.6**	
Cyclical contributions (from model) (-)	-0.8	
COVID-19 adjustor (+) 1/	10.1	
Additional temporary/statistical factors (+)	0.0	
Natural disasters and conflicts (-)	0.0	
Adjusted CA	**-18.7**	
CA Norm (from model) 2/	**-1.4**	
Adjustments to the norm (+)	0.0	
Adjusted CA Norm	**-1.4**	
CA Gap	**-17.3**	**37.3**
o/w Relative policy gap	-7.6	
Elasticity	-0.82	
REER Gap (in percent)	**21.0**	**-45.4**

1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on oil trade balances ([-1.47] percent of GDP) and on tourism ([11.55] percent of GDP).

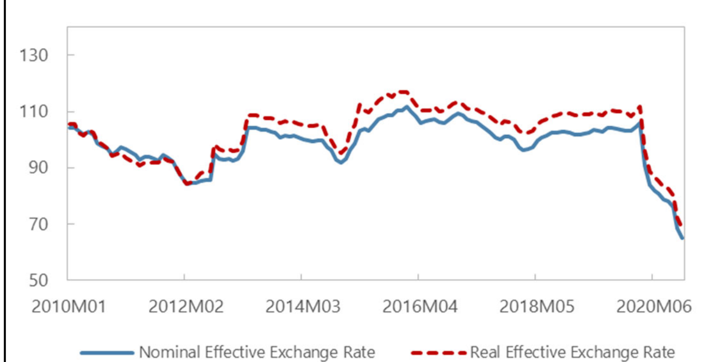
2/ Cyclically adjusted, including multilateral consistency adjustments.

9. **The IREER model on the other hand suggests that the REER is widely undervalued, estimating the REER gap at -45.4 percent.** This is driven by the difference between the fitted and actual REER values. The policy gap only contributes 3percent to the REER gap.

C. Real Exchange Rate

10. **Background.** The real effective exchange rate (REER) depreciated by 37.6 percent year-on-year (y-o-y) in 2020, in line with a 36.9 percent y-o-y nominal effective exchange rate (NEER) depreciation. This followed slight appreciations of the REER by 0.4 percent and the NEER by 0.7 percent over 2019. In 2021, the currency has substantially appreciated since

Real Effective Exchange Rate (Index, 2010=100)



Sources: Seychellois authorities; and IMF staff calculations.

March 25, from almost 22 rupees per dollar to almost 16, offsetting most of the depreciation in 2020. The REER appreciated by around 27 percent from December 2020 to April 2021. This is mainly due to strong rebound in tourist arrivals in April 2021, since reopening of the border on March 25, 2021.

11. Assessment. Staff analysis based on non-EBA-lite indicators suggests that the REER is weaker than the level implied by fundamentals and desired policies. Continued flexibility in exchange rate movement would be essential to guard against an erosion of the country's price competitiveness in the context of an already large external current account deficit. The ES model suggests that the REER gap is 13.1 percent and thus, the corresponding CA gap is -10.7 percent.

Seychelles: EBA-lite Exchange Rate Assessment (REER Model)

Ln(REER) Actual	4.52
Ln(REER) Fitted	5.00
Ln(REER) Norm	4.98
Residual	-0.48
REER Gap	-45%
Policy Gap	2.5%
Natural Disasters and Conflicts	-0.1%

Sources: Seychellois authorities; and IMF staff calculations.

D. Capital and Financial Flows

12. Background. Seychelles has an open capital account. In 2020, net capital and financial inflows fell short of the current account deficit, necessitating a decline in gross international reserves (GIR) compared to an accumulation of GIR in 2019. A sharp decline in FDI and larger portfolio outflow was largely offset by an increase in official inflows, including the Fund's emergency lending, and a drawdown of private sector net foreign assets.

13. Assessment. The capital and financial account is expected to strengthen over the medium terms as reinvigoration of structural reforms along with achievement of macro-economic stability, supported by the EFF-supported program aimed at improving competitiveness and the investment climate, would stimulate and sustain FDI flows and financial support from other official creditors.

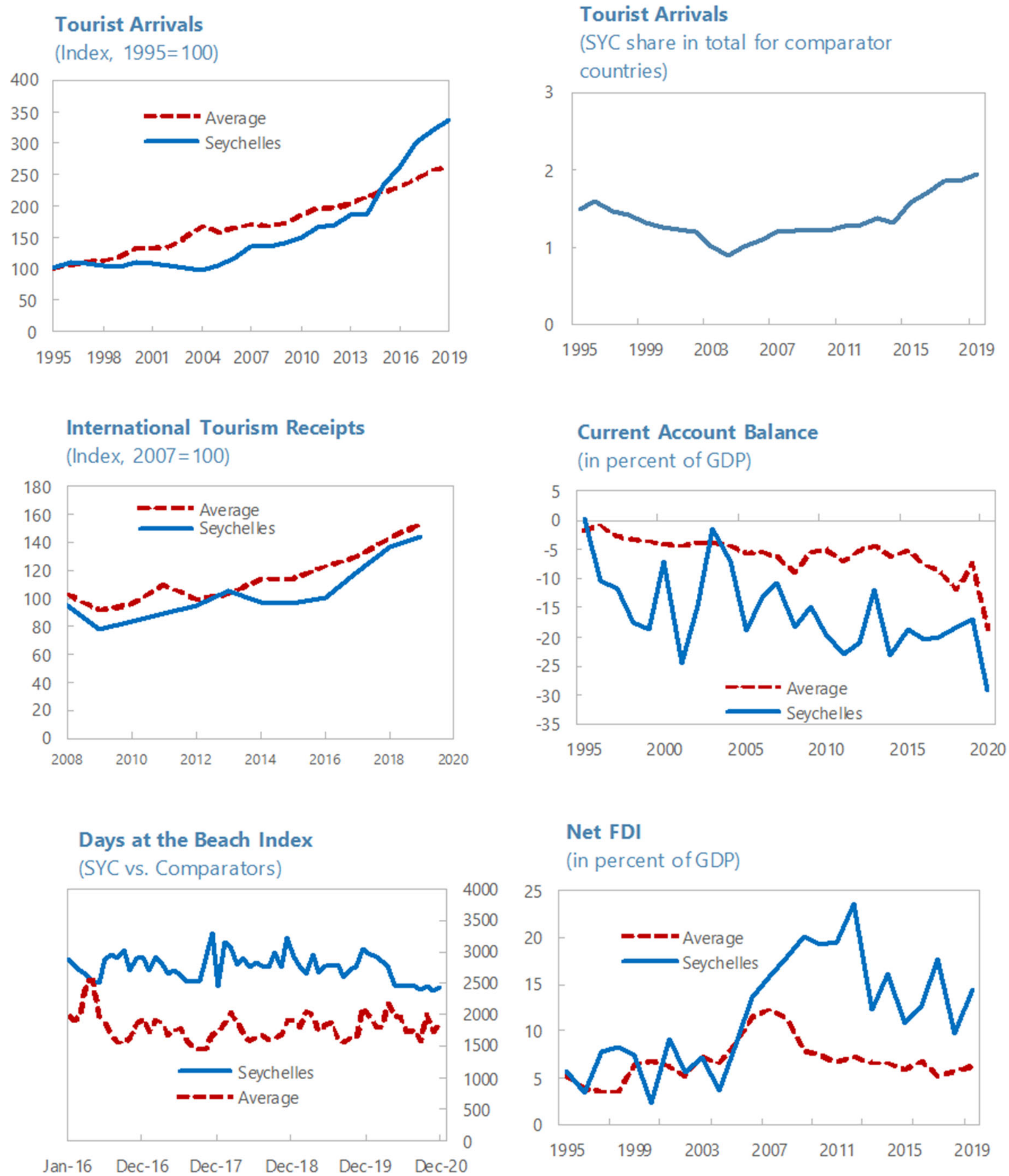
E. Reserve Adequacy

14. Background. The exchange rate regime of Seychelles is classified as floating and foreign exchange interventions are aimed at addressing disorderly market conditions and maintaining an adequate level of international reserves. Gross international reserves (GIR) remained at 4.5 months of prospective imports of goods and services in 2020, in an amount of US$ 560 million, which is

US$ 21 million below the level at end-2019. GIR are projected to maintain import coverage in the range of 3-4 months over the medium term.

15. Assessment. Seychelles' international reserve holdings is assessed against the standard reserve adequacy benchmark. Per the standard metric, staff estimates that international reserves at end-2020 were within the advisable range of international reserves. The level of international reserves at the end of 2020 stood at about 112 percent of the ARA metric.

Seychelles: Other Indicators of External Competitiveness



Source: World Bank, WEO, Country Authorities, Staff Calculations

Annex IV. Seychelles: Inflation and Exchange Rate Pass-through[4]

What is the foreign exchange (FX) pass-through in Seychelles? Seychellois rupees depreciated sharply in 2020 due to the country's lockdown and the global travel ban amid the COVID-19 pandemic. As a result, the real effective exchange rate depreciated by 37.6 percent year-on-year in 2020. Yet, inflation was subdued, with an average rate of 1.2 percent in 2020. More recently, following the reopening of the border, the currency appreciated by 26 percent between March and June 2021 while the inflation rate accelerated to 11.4 percent during the first five months of 2021. Is this coming from second-round effects stemming from the significant exchange rate depreciation in 2020?

This exercise is conducted to explore the pass-through from the exchange rate to inflation in Seychelles. An ARDL model that exploits monthly data on the average foreign exchange rate and the CPI index during 2007–21 suggests that the pass-through from the FX to inflation is low in the short run and moderate in the long run. A 10 percent FX depreciation will cause a 0.4 percent increase in prices within two months and an overall 6.5 percent increase in the long run (or 5.2 percent increase in one year).

1. Data. The data comprise the monthly CPI index (CPI) and the SCR/USD FX rate (E) from Jan. 2007 to May 2021. CPI series are taken from National Bureau of Statistics Seychelles (NBS) and FX rates are from Central Bank of Seychelles (CBS).

2. Dummy Variable. Dummy variable dcpi is introduced to control the structural change in the CPI basket weight revisions in 2015 and 2021.

3. Unit Root Test. Figure 1 shows that the two series are highly correlated (the contemporaneous correlation ρ equals 0.9036 and the lead and lag cross correlations remain very high for up to 6 months). The series are stationary at the 5 percent level, as shown in Table 1.

4. Empirical Methodology. The FX rate pass-through is estimated using the following ARDL specification:

Estimation Equation:

LOG_CPI = C(1)*LOG_CPI(-1) + C(2)*LOG_E + C(3)*LOG_E(-1) + C(4)*DCPI + C

[4] Prepared by Shijia (Kia) Luo.

Substituted Coefficients based on ARDL results in table 2:

LOG_CPI = 0.953910626835*LOG_CPI(-1) + 0.236666566568*LOG_E - 0.207023201729*LOG_E(-1) + 0.0254129487309*DCPI + 0.13782291384

The short-term pass-through elasticity is

$$\frac{\partial \mathrm{LOG}_{\mathrm{CPI}}}{\partial \mathrm{LOG}_{\mathrm{E}}} = -0.207023 \times 0.953911 + 0.23667 = 0.039$$

Therefore, a 10 percent FX depreciation would lead to a 0.4 percent increase in CPI inflation within two months.

In turn, the long-term interaction coefficient is given by:

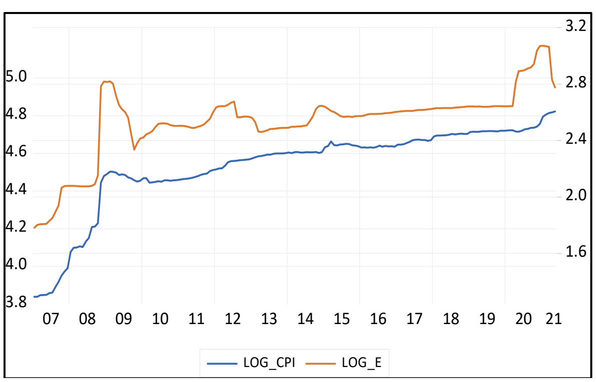
$$\frac{\partial \mathrm{LOG\_CPI}}{\partial \mathrm{LOG\_E}} = \frac{C(2) + C(3)}{1 - C(1)} = \frac{0.23667 - 0.207023}{1 - 0.953911} = 0.643$$

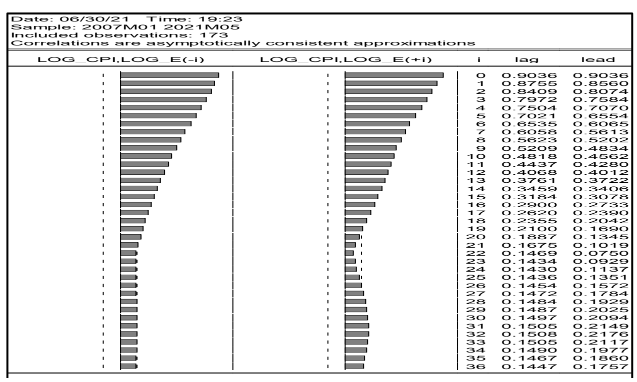
A 10 percent FX depreciation would lead to a 6.4 percent increase in CPI inflation in the long run. The Error Correction representation indicates that the (logs of the) CPI and the FX rate have a stable cointegrating relationship and corroborate the previous result.

Cointegrating Equation with substituted Coefficients based on ECM regression results in table 2:

D(LOG_CPI) = -0.046089373165*(LOG_CPI(-1) - (0.64317136*LOG_E(-1) + 2.99034038))

Figure 1. Seychelles: Relationship between CPI and the FX Rate (in logs)




Date: 06/30/21 Time: 19:23
Sample: 2007M01 2021M05
Included observations: 173
Correlations are asymptotically consistent approximations

LOG_CPI,LOG_E(-i)	LOG_CPI,LOG_E(+i)	i	lag	lead
		0	0.9036	0.9036
		1	0.8755	0.8560
		2	0.8409	0.8074
		3	0.7972	0.7584
		4	0.7504	0.7070
		5	0.7021	0.6554
		6	0.6535	0.6065
		7	0.6058	0.5613
		8	0.5623	0.5202
		9	0.5209	0.4834
		10	0.4818	0.4562
		11	0.4437	0.4280
		12	0.4068	0.4012
		13	0.3761	0.3722
		14	0.3459	0.3406
		15	0.3184	0.3078
		16	0.2900	0.2733
		17	0.2620	0.2390
		18	0.2355	0.2042
		19	0.2100	0.1690
		20	0.1887	0.1345
		21	0.1675	0.1019
		22	0.1469	0.0750
		23	0.1434	0.0929
		24	0.1430	0.1137
		25	0.1436	0.1351
		26	0.1454	0.1572
		27	0.1472	0.1784
		28	0.1484	0.1929
		29	0.1487	0.2025
		30	0.1497	0.2094
		31	0.1505	0.2149
		32	0.1508	0.2176
		33	0.1505	0.2117
		34	0.1490	0.1977
		35	0.1467	0.1860
		36	0.1447	0.1757

Sources: NBS, CBS, and IMF staff calculations.

Table 1. Seychelles: Augmented Dickey-Fuller Unit Root Test on LOG_E and LOG_CPI

Null Hypothesis: LOG_CPI has a unit root
Exogenous: Constant
Lag Length: 1 (Automatic - based on SIC, maxlag=13)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-3.734330	0.0044
Test critical values:	1% level	-3.468749	
	5% level	-2.878311	
	10% level	-2.575791	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(LOG_CPI)
Method: Least Squares
Date: 06/30/21 Time: 18:06
Sample (adjusted): 2007M03 2021M05
Included observations: 171 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG_CPI(-1)	-0.024576	0.006581	-3.734330	0.0003
D(LOG_CPI(-1))	0.189242	0.073598	2.571285	0.0110
C	0.116109	0.029970	3.874197	0.0002

R-squared	0.134521	Mean dependent var	0.005763
Adjusted R-squared	0.124218	S.D. dependent var	0.019830
S.E. of regression	0.018557	Akaike info criterion	-5.118509
Sum squared resid	0.057855	Schwarz criterion	-5.063392
Log likelihood	440.6325	Hannan-Quinn criter.	-5.096145
F-statistic	13.05607	Durbin-Watson stat	2.011387
Prob(F-statistic)	0.000005		

Null Hypothesis: LOG_E has a unit root
Exogenous: Constant
Lag Length: 1 (Automatic - based on SIC, maxlag=13)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-3.091013	0.0291
Test critical values:	1% level	-3.468749	
	5% level	-2.878311	
	10% level	-2.575791	

*MacKinnon (1996) one-sided p-values.

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(LOG_E)
Method: Least Squares
Date: 06/30/21 Time: 18:07
Sample (adjusted): 2007M03 2021M05
Included observations: 171 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG_E(-1)	-0.054977	0.017786	-3.091013	0.0023
D(LOG_E(-1))	0.234026	0.073309	3.192307	0.0017
C	0.143654	0.045297	3.171389	0.0018

R-squared	0.102914	Mean dependent var	0.005687
Adjusted R-squared	0.092234	S.D. dependent var	0.059282
S.E. of regression	0.056482	Akaike info criterion	-2.892399
Sum squared resid	0.535957	Schwarz criterion	-2.837282
Log likelihood	250.3001	Hannan-Quinn criter.	-2.870035
F-statistic	9.636511	Durbin-Watson stat	2.007306
Prob(F-statistic)	0.000109		

Sources: NBS, CBS, and IMF staff calculations.

Table 2. Seychelles: ARDL and ECM regression results

Dependent Variable: LOG_CPI
Method: ARDL
Date: 06/30/21 Time: 19:32
Sample (adjusted): 2007M02 2021M05
Included observations: 172 after adjustments
Dependent lags: 1 (Fixed)
Dynamic regressors (1 lag, fixed): LOG_E
Fixed regressors: DCPI C

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
LOG_CPI(-1)	0.953911	0.010065	94.77087	0.0000
LOG_E	0.236667	0.016897	14.00639	0.0000
LOG_E(-1)	-0.207023	0.017996	-11.50374	0.0000
DCPI	0.025413	0.009221	2.756126	0.0065
C	0.137823	0.026379	5.224635	0.0000

R-squared	0.996803	Mean dependent var	4.535840
Adjusted R-squared	0.996727	S.D. dependent var	0.222260
S.E. of regression	0.012716	Akaike info criterion	-5.863279
Sum squared resid	0.027003	Schwarz criterion	-5.771782
Log likelihood	509.2420	Hannan-Quinn criter.	-5.826156
F-statistic	13018.73	Durbin-Watson stat	1.538964
Prob(F-statistic)	0.000000		

*Note: p-values and any subsequent tests do not account for model selection.

ARDL Error Correction Regression
Dependent Variable: D(LOG_CPI)
Selected Model: ARDL(1, 1)
Case 2: Restricted Constant and No Trend
Date: 06/30/21 Time: 21:40
Sample: 2007M01 2021M05
Included observations: 172

ECM Regression
Case 2: Restricted Constant and No Trend

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LOG_E)	0.236667	0.016339	14.48519	0.0000
DCPI	0.025413	0.008997	2.824514	0.0053
CointEq(-1)*	-0.046089	0.007016	-6.569510	0.0000

R-squared	0.596234	Mean dependent var	0.005731
Adjusted R-squared	0.591456	S.D. dependent var	0.019776
S.E. of regression	0.012640	Akaike info criterion	-5.886534
Sum squared resid	0.027003	Schwarz criterion	-5.831636
Log likelihood	509.2420	Hannan-Quinn criter.	-5.864261
Durbin-Watson stat	1.538964		

* p-value incompatible with t-Bounds distribution.

F-Bounds Test — Null Hypothesis: No levels relationship

Test Statistic	Value	Signif.	I(0)	I(1)
F-statistic	14.21591	10%	3.02	3.51
k	1	5%	3.62	4.16
		2.5%	4.18	4.79
		1%	4.94	5.58

Sources: NBS, CBS, and IMF staff calculations.

5. Implication of the Long-term Pass-through Elasticity. Given C(1) is the correlation between CPI and its lag 1 in log terms, the long-term convergence can be expressed as

$$\frac{\mathrm{LOG\_CPI} - \mathrm{LOG\_CPI}(-\mathrm{n})}{\mathrm{LOG\_CPI}} = \frac{1 - C(1)^n}{C(1)^n},$$

where $\mathrm{LOG\_CPI}$ (-n) is the lag n term of $\mathrm{LOG\_CPI}$.

If $\frac{1-C(1)^n}{C(1)^n} = 0.5$, then n$\approx 8\, months$; If $\frac{1-C(1)^n}{C(1)^n} = 0.8$, then n$\approx 12\, months$

Therefore, 50 percent of the long-term convergence will take around 8 months and 80 percent of the adjustment will take about 12 months.

Thirty-two Months Extended Arrangement Under the Extended Fund Facility

Attached hereto is a letter dated July 20, 2021 (the "Letter") with its annexed Memorandum of Economic and Financial Policies (the "MEFP") and Technical Memorandum of Understanding (the "TMU") from the Minister of Finance, Economic Planning and Trade and the Governor of the Central Bank of Seychelles, requesting an extended arrangement and setting forth:

a) the objectives and policies that the authorities of Seychelles intend to pursue for the period of this extended arrangement;

b) the policies and measures that the authorities of Seychelles intend to pursue during the first year of this extended arrangement; and

c) the understandings of Seychelles with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Seychelles will pursue for the remaining period of this extended arrangement.

To support these objectives and policies, the International Monetary Fund grants this extended arrangement in accordance with the following provisions:

1. For a period of thirty-two months from the date of approval of this extended arrangement, Seychelles will have the right to make purchases from the Fund in an amount equivalent to SDR 74 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this extended arrangement shall not, without the consent of the Fund, exceedthe equivalent of SDR 24 million until December 1, 2021, SDR 48 million until June 1, 2022, the equivalent of SDR 54.5 million until December 1, 2022, the equivalent of SDR 61 million until June 1, 2023, and the equivalent of SDR 67.5 million until December 1, 2023.

   (b) Until the end of the second year of this arrangement, purchases shall not, without the consentof the Fund, exceed the equivalent of SDR 67.5 million.

3. Seychelles will not make purchases under this extended arrangement:

(a) 105), as amended, during any period in which the data at the end of the preceding period indicate that:

(i) the net domestic financing of the government

(ii) the primary balance of the consolidated government

(iii) the total revenue; or

(iv) the net international reserves of the Central Bank of Seychelles,

as set out in Table 1 of the MEFP, and as further specified in the TMU, is not observed; or

(b) if at any time during the period of the extended arrangement:

(i) the ceiling on the accumulation of new external payment arrears; or

(ii) the ceiling on the accumulation of new domestic payment arrears.

as set out in Table 1 of the MEFP, and as further specified in the TMU, is not observed, or

(c) after November 30, 2021, May 31, 2022, November 30, 2022, May 31, 2023, and November 30, 2023 until the respective reviews contemplated in paragraph 76 of the attached MEFP are completed, or

(d) if at any time during the period of the extended arrangement, Seychelles

i. imposes or intensifies restrictions on the making of payments and transfers for currentinternational transactions, or

ii. introduces or modifies multiple currency practices, or

iii. concludes bilateral payments agreements which are inconsistent with Article VIII, or

iv. imposes or intensifies import restrictions for balance of payments reasons; or

When Seychelles is prevented from purchasing under this extended arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Seychelles and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Seychelles will not make purchases under this extended arrangement during any period in which Seychelles: (i) has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action, or (ii) is failing to meet a repayment obligation to the PRG Trust established by Decision No. 8759-(87/176) PRGT, as amended, or a repayment expectation to that Trust pursuant to the provisions of Appendix I to the PRG Trust Instrument.

5. Seychelles' right to engage in the transactions covered by this extended arrangement can

be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Seychelles. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this extended arrangement will be resumed only after consultation has taken place between the Fund and Seychelles and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this extended arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Seychelles, the Fund agrees to provide SDRs at the time of the purchase.

7. Seychelles shall pay a charge for this extended arrangement in accordance with the decisions of the Fund.

8. (a) Seychelles shall repurchase the amount of its currency that results from a purchase under this extended arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Seychelles' balance of payments and reserve position improves.
(b) Any reductions in Seychelles' currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

9. During the period of the extended arrangement, Seychelles shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Seychellesor of representatives of Seychelles to the Fund. Seychelles shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Seychelles in achieving the objectives and policies set forth in the attached Letter and annexed MEFP.

10. In accordance with the penultimate paragraph of the attached Letter, Seychelles will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because the

Managing Director considers that consultation on the program is desirable. In addition, after the period of the extended arrangement and while Seychelles has outstanding purchases under this extended arrangement, the government will consult with the Fund from time to time, at the initiative of the government or at the request of the Managing Director, concerning Seychelles' balance of payments policies.

Appendix I. Letter of Intent

Victoria

July 20, 2021

Ms. Kristalina Georgieva,

Managing Director,

International Monetary Fund

700 19th St, NW

Washington, DC 20431

USA

Dear Madam Managing Director:

The ongoing global pandemic has affected Seychelles greatly, with a significant impact on its main source of revenue and requires that we demonstrate our resilience as a nation and take into account the economic reality that we are facing today.

With the economy, largely dependent on tourism the government had to respond with measures to sustain livelihoods and this came at a large fiscal cost, while tax revenue plummeted.

As a result, the government debt surged, further exacerbated by a strong depreciation of the exchange rate in the last months of 2020. The Government launched its vaccination campaign in January, which has been largely successful. Whilst we have not been able to fully suppress the spread of COVID-19, we took the bold decision to reopen our economy and lift the containment measures. In March 2021 the international airport was reopened and we started to welcome back tourists to our shores. Tourist arrivals in the April- June period were encouraging, though only 40 percent of the 2019 level. The appreciation of the exchange rate in April contributed to containing inflationary pressures and lowered the government debt -GDP ratio by about 12 percent of GDP.

In the pursuit of recovery, our overall aim is to restore growth, reduce the fiscal deficit in order to place the public debt on a sustainable path in relation to GDP. At the same time, we are committed to accelerate the diversification of the economy and to strengthen measures aimed at containing carbon emissions, thus contributing to the global efforts against climate change.

Our economic program has a number of objectives: (1) Contain the fiscal deficit with revenue and expenditure measures so as to attain a significant primary surplus by 2024 and assure debt sustainability; (2) improve the structure of government debt lengthening maturities, thus reducing rollover risk; (3) Improve the efficiency of government spending, reform the public service, and rationalize the tax structure, with the elimination of exemption and special treatments for certain sectors. (4) restructure the airline company now under full government control; (5) strengthen financial stability and enhancing compliance with international financial standards.

To support these objectives, we wish to request a 32-month arrangement under the Extended Fund Facility (EFF) in the amount of SDR 74 million, corresponding to 323 percent of Seychelles' quota at the Fund. Along with support from other development partners and other financing sources the proposed arrangement will provide much needed relief to our fiscal and external financing gaps and allow a reduction of recourse to domestic financing.

Program implementation will be monitored through quantitative performance criteria, indicative targets, and structural benchmarks as set out in Tables 1-2 of the MEFP and described further in the TMU. It also includes a series of structural benchmarks covering reform actions that will enhance economic performance.

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. We stand ready to take any further measures that may prove necessary to meet our objectives. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations. We will supply the Fund with timely and accurate data that are needed for program monitoring.

We authorize the publication of this letter of intent, the attached MEFP, the technical memorandum of understanding, and the forthcoming staff report for the request of the EFF arrangement.

Sincerely yours,

/s/

Naadir Hassan,

Minister of Finance, Economic Planning and Trade

/s/

Caroline Abel

Governor Central Bank of Seychelles

Attachment I. Memorandum of Economic and Financial Policies for 2021-23

Background and Recent Economic Developments

1. Seychelles has achieved a strong and balanced economic performance since 2010, with average annual real GDP growth of 4.3 percent, led by a buoyant tourist sector, and sound fiscal policies that led to a reduction of government debt from 82 percent of GDP in 2010 to 62 percent in 2019. The balance of payments recorded overall surpluses, with strong increases in foreign direct investment in tourism facilities and other sectors, and gross official reserves that rose steadily to 5.2 months of imports cover at end-2019 from 2.2 months at end-2009.

2. Following this good performance, the global pandemic took a severe toll on the Seychelles economy in 2020, with real GDP estimated to have dropped by 12.9 percent. A large fiscal deficit was recorded in 2020, as the government sustained livelihood support measures for job retention. On the production side, the sharp decline in accommodation services was accompanied by a fall in manufacturing, transportation, and trade, which are all strongly linked to tourism activity. The fishing and agriculture sectors recorded positive growth, and so did information and communication services

3. In 2020, consumer price inflation rose by 3.8 percent compared to an increase of 1.7 percent in 2019, reflecting the strong depreciation of the exchange rate, by 26 percent against the USD on an annual average and by 53 percent on end-of-year basis. In 2021 thus far, inflation has been higher than in 2020, a result which, in addition to the weaker currency, reflects improved coverage and revision of the Consumer Price Index (CPI) basket as of January 2021 to incorporate the outcome of the most recent household budget survey. In May 2021, year-on-year inflation stood at 11.4 percent; the 12-month average rate was at 5.0 percent.

4. Monetary policy has been accommodative since the second quarter of 2020. The Monetary Policy Rate (MPR), which stood at 5.0 percent in Q1, was reduced by 1 percentage point in Q2 and a further 1 percentage point in Q3 in order to support the domestic economy facing unprecedented challenges caused by COVID-19. The accompanying Standing Deposit Facility (SDF) and Standing Credit Facility (SCF) rates, which act as a floor and ceiling, were lowered to 1.0 percent and 6.0 percent, respectively, as of Q3 2020 and these rates were maintained during the first half of 2021.

5. The CBS realigned the interest rate structure in the third quarter of 2021, when the MPR was reduced to 2.0 percent while the applicable rate on the SCF was lowered to 3.5 percent from 6.0 percent, and the rate on the SDF to 0.5 percent from 1.0 percent. Consequently, the width of the official interest rate corridor narrowed from 5.0 to 3.0 percentage points. In addition, effective July 14, 2021, the Minimum Reserve Requirement (MRR) applicable on rupee deposits was lowered from 13 percent to 10 percent as part of the liquidity backstops for financial institutions (FIs) to mitigate some of the financial stability risks resulting from the government's decision to implement a Liability Management Operation (LMO) to address public debt sustainability and to ensure utmost participation by FIs.

6. The sharp decline in economic activity and tourism in 2020 and the need to support workers with an income maintenance scheme contributed to a strong deterioration in public finances. In March 2020, the authorities introduced a job retention financial assistance scheme, under which companies impacted by the pandemic could request the government to pay the salaries of employees that were not furloughed. The scheme initially intended for the period April- June 2020, was extended to the end of the year, at a cost of SCR 1. 2 billion for the year, or 6 percent of GDP. The scheme was scaled down effective January 1, 2021, with the tourism sector receiving 100 percent of assistance in January and 50 percent of assistance in February and March, at which time the scheme is terminated; for the other sectors the scheme was terminated at end -January 2021. To strengthen our defenses against the pandemic, the government approved in March 2020 an additional amount of SCR 110 million (0.5 percent of GDP) for health-related contingency spending and about SCR 50 million for social protection spending for vulnerable groups.

7. The central bank and the banking system took various actions from March 2020 to support the business community. The central bank reduced its policy rate and increased liquidity provisioning to the banking system. The banking system supported the business sector with a moratorium of loan repayments for up to a 6-month period starting in March 2020, while for individual borrowers the moratorium was for up to 3 months. Banks are currently discussing with clients the extension of the moratorium and the restructuring of loans on a case by case basis.

8. The central bank established in March 2020 a long-term lending instrument for banks to provide support to businesses. Accordingly, two funds, one available to support small businesses, with 500 million SCR to on-lend at an interest rate of 1.5 percent, and a second fund for larger businesses, with 750 million SCR to on-lend at an interest rate of 4.5 percent were set up. At the point of establishment, the banks had until December 2020 to request for advances from the CBS, but after conducting an assessment of the economic situation, the deadline was extended to December 2021. In terms of support to businesses under the schemes, initially they were to cover a period of 6 months of expenses, but this period has been revised to 12 months, following an internal assessments and consultation with the private sector. These two funds were drawn down only for modest amounts, with an 18.95 percent drawdown for the first and 30.42 percent for the second as at June 8, 2021.

9. Banks' financial performance has likely been impacted by the COVID 19 shock. Banks remain highly liquid on account of stable deposit levels and a reduced demand for credit. There is a slight increase in the nonperforming loan (NPL) ratio from 3.3 percent at end-December 2020 to 5.1 percent as of May 2021. Compared to the previous year, reported capital adequacy ratios are increasing from January to April 2021, primarily due to a reduction in risk adjusted assets, following an appreciation of the domestic currency in April 2021. By the end of May 2021, the banking sector's capital adequacy ratio stood at 19.9 percent, well above the prudential limit of 12 percent. Nonetheless, given the economic fallout of Covid-19, we are monitoring the system closely to ensure NPLs are appropriately measured and that provisioning and capital remain adequate for all banks.

10. **With a fall in tax revenues in 2020, reflecting lower tourism-related activity, and much higher expenditure due to the financial assistance for job retention, the overall government balance shifted to a deficit of 19.5 percent of GDP in 2020**, compared with a deficit of 0.9 percent in 2019. Tax and nontax revenue fell by 2.2 percent of GDP, to 33.8 percent, with strong declines in VAT receipts (1 percent of GDP), business taxes (0.2 percent of GDP), and stamp duties which were very high in 2019 because of an exceptional corporate sale transaction. Current expenditure rose from 33.8 percent of GDP in 2019 to 50.1 percent in 2020, reflecting the job retention financial assistance scheme, higher expenditure for goods and services (7.8 percent increase), mainly to cover higher costs of imported drugs and treatment abroad due to the depreciation of the rupee (additional COVID related cost amounted to 0.6 percent of GDP), and wages and salaries (18 percent increase), mainly in the education, defense and police sectors. Transfers to public enterprise rose by 1.5 percent of GDP, because of support to Air Seychelles to pay salaries. There was also a significant increase in capital expenditure, attributable to ongoing land development and housing projects, and construction of new and improved health centers.

11. **The deficit was financed both domestically and externally.** Domestic financing included the issuance of long-term bonds in June (1,500 million SR of Solidarity bonds at 3, 5, and 7- years maturities, equivalent to 7 percent of GDP), and an increase in the stock of Treasury bills (600 million SCR, or 3 percent of GDP). External financing included support from the IMF under the Rapid Financing Instrument (equivalent to 2.8 percent of GDP) and the World Bank and African Development Bank (3 percent of GDP), in addition to project loans. External government debt rose sharply in local currency, because of the depreciation of the exchange rate. At end-year government debt, including guaranteed debt, reached 100.8 percent of GDP, up from 61.8 percent at end 2019, with domestic debt at 47 percent of GDP, up from 33.7 percent.

12. **The current account balance registered a strong deterioration in 2020**, from a deficit of 16.4 percent of GDP in 2019 to a deficit of 27.4 percent in 2020, mainly reflecting the decline of tourism earnings by 63 percent. The deterioration of the service balance was partly offset by lower imports. The financial account improvement offset most of the current account deterioration, as the government obtained loans from the IMF, the World Bank, and the African Development Bank, and as commercial banks repatriated balances from abroad[1]. The loss of gross international reserves of the central bank was limited to US$21 million, out of a total stock of US$580 million at end-2019, which thus fell to US$ 559 million by end-2020.

13. **At end of January 2021 the government presented to the National Assembly a 2021 budget designed to bring down the overall deficit to 15.3 percent of GDP**. Total tax and non-tax revenue was projected prudently at 31.6 percent of GDP, a 2.3 percentage point decline from 2020, with business tax revenue expected to fall by 1 percent of GDP, VAT revenue by 0.5 percent of GDP, based on conservative tourist arrival projections, and income tax by 0.7 percent. To assist businesses,

[1] These placements are made mainly for the management of the structural liquidity and interest rate risk mismatches in the banking book, and for investment, settlement and nostro account purposes, and movements in these placements depend mainly on the asset-liability management decisions of banks.

the corporate responsibility tax (equal to 0.5 percent of turnover) has been eliminated, with a revenue loss of 0.4 percentage points of GDP. Subsequently to the initial budget presentation, revenue forecasts were revised upwards by 0.3 percent of GDP, to 31.9 percent of GDP, mainly on account of the VAT reflecting a higher forecast of tourism arrivals. The receipts of grants, linked to capital projects, are forecast to increase sharply, from 1.9 percent of GDP in 2020 to 4.1 percent in 2021 (from the equivalent of US$ 15 million to US$ 52 million), reflecting faster project execution. On the expenditure side, the wage bill will be held stable with promotion and hiring in the public sector being frozen, and transfers to the private sector cut sharply with the termination of the job retention scheme. Goods and services outlays will increase by only 2 percent, reflecting higher import costs. Capital expenditure will be strictly prioritized, but outlays on foreign financed projects would still increase as a share of GDP. The budget measures, discussed in the next section, include streamlining of government agencies, rationalizing the social protection system, making additional progress in procurement reforms, and stimulating the development of renewable energy.

14. The government is addressing the issue of Air Seychelles. Etihad has relinquished its 40 percent shareholding to the government in March 2021, and the government has taken over US$11.4 million of the unsecured debt to be repaid until 2024. However, the Air Seychelles box bond of US$ 71.5 million is still under negotiation with the bondholders. We will get Cabinet approval of (1) least cost structure for Air Seychelles, as part of the 2022 budget process; and (2) long-term strategy that lays out long-term options for Air Seychelles, in consultation with IMF/WB staff (structural benchmark for end-September 2021).

Macroeconomic Outlook

15. Our baseline outlook for 2021, which is based on the developments in the first 6 months of the year, foresees a growth rate of close to 7 percent, assuming a continuation of the favorable trends of tourist arrivals observed in April-June. Output will also be supported by a continuation of the good performance of the fishing sector and tuna canned manufacturing recorded in 2020, and of the telecommunication and other services sectors. Real GDP growth is expected at 5.9 percent on average in 2023 and 2024, with continued growth in tourism.

16. With the exchange rate having stabilized after the depreciation at end-2020, we expect that the recent pick up of inflation will abate and that consumer price inflation will decline from 10 percent projected at end-2021 to 3.7 percent at end-2022. Despite a gradual revival of tourist activity, the current account deficit is projected to remain broadly stable at 25.7 percent of GDP in 2021, but a pickup in foreign direct investment linked to tourism will improve the overall balance**.**

17. The key aim of the program is to reduce the fiscal deficit and bring down the ratio of government debt-to- GDP to below 70 percent of GDP by 2026, while also reducing roll-over risk by extending the maturity of the government debt stock, three-fourths of which presently consists of treasury bills with maturities less than one year.

Program Policies

Real Sector Reforms (Diversification, Digitization, Climate Change Adaptation)

18. The government aims at improving the prospects for sustainable and inclusive medium-term growth, which will rely on actions to diversify tourism services, and to enhance the capacity of the fishery sector where large potential exists through diversification of the production chains and intervention of new operators, along the line envisaged in the World Bank supported SWIOFISH 3 project.

19. In the tourism sector the authorities have updated the Tourism Master Plan, which identifies actions to tackle structural bottlenecks on an island-by-island basis, and aims at widening the offer of services with the balanced objectives of economic empowerment, environmental preservation, and socio- cultural integration. Positive results were achieved in reaching previously untapped markets and better promoting local content, but additional actions will continue to be undertaken to attract skilled local labor, increase the supply of local agricultural products to the sector, and support small businesses, based on the recent Tourism Value Chain Analysis.

20. In the fishery sector significant progress is being achieved to diversify the value chain, with the completion expected in mid- 2021 of the cold storage facilities in the new industrial zone in Iles du Port, and the expected entry into operation of new fish processing units with medium size factories, which will expand export and local employment.

21. The Government remains committed to accelerate the drive for energy transition. Renewables will be at the heart of economic recovery strategies to advance economic, social and climate priorities for a Sustainable Post-COVID Recovery, so as to meet the set target of renewable energy (RE) providing 15 percent of Seychelles' energy consumption by 2030 with reinforcement of the grid through investments in distribution networks and energy storage systems, as well as an increase in the number of households and public infrastructures utilizing alternate or RE sources.

22. With its updated Nationally Determined Contribution (NDC) submission, Government is re-iterating and improving upon its conditional commitments towards increasing the reduction of greenhouse gas emissions. Emissions will be reduced by 293,8 $ktCO_{2e}$ by 2030 instead of by 188 $ktCO_{2e}$, stated in NDC 2015. This will concomitantly increase its mitigation contribution and improve its adaptation strategies to effectively respond to climate change in the context of sustainable development, with a particular emphasis on Seychelles' Blue Economy, supported and enabled by technology, financing and capacity building.

23. The Energy policy is currently being reviewed. A new policy document will be presented to the Government for approval in July 2021. The target is 15.5 percent energy efficiency and 15 percent renewables by 2030. These targets are very ambitious for a Small Islands Developing State, and Seychelles is currently producing 5 percent RE and will need to scale up 10 percent in 10 years taking into account economic growth. The foreseen RE technologies to be used will be solar photovoltaic and wind energy for electricity production. Greenhouse gas reduction on target of 124 kt CO_{2e} is foreseen by 2030.

24. The Covid-19 pandemic has shown us how vulnerable we are as an island state and underscores the need for economic diversification. Our country is one of the small island states that has been most affected. This is because the pandemic has impacted our most important source of revenue, our tourism industry. At this point, it is important to note that tourism will remain the main pillar of our economy. We must thus ensure that our recovery strategy is one that will help us become more resilient in the face of external shocks.

25. It is for this reason that we will explore different options to transform our economy. In the tourism sector, we will intensify our efforts to put more on offer than just our natural beauty, and we must also be able to offer a cultural experience that will give our visitors a uniquely Seychellois experience.

26. In the agricultural and fisheries sectors, we will encourage the development of more products with added value that can also bring about more exportation opportunities for our local enterprises. It is just as important to encourage a culture of entrepreneurship in our population, to facilitate this economic transformation.

27. The Ministry of Investment, Entrepreneurship and Industry will place emphasis on facilitating business start-ups and will work toward improving the business climate. Priority will be given to the online registration of businesses. Secondly, we will put a lot of effort into helping small and medium enterprises to expand. We shall encourage local production to reduce dependence on imports where possible. This ministry will create a framework to support research and development activities, and the proper protection of intellectual property, with the aim of increasing our capacity for exporting in the region and internationally. This is important for expanding our economic and social development base.

28. We will put in place the policies and structure that will enable us to develop the digital economy. Recognising that the path to economic growth will involve economic diversification and increasing productivity, through technological improvements and digital innovation, the. World Bank has assisted us with a digital economy assessment providing the authorities with a snapshot of the state of the digital economy and recommendations on priority areas for development. The key actions to be undertaken going forward are:

- Maximising the impact of investments made in digital infrastructure
- Boosting digital skills by creating a workforce ready to harness new digital tools, platforms and services and leveraging opportunities
- Expansion of digital platforms and services so as to optimize the productivity of a small workforce and cultivate efficiency through the creation of economies of scale and network effects**.**

- Development of digital financial services to support both further growth and diversification by strengthening the existing financial sector as a key pillar of the economy as well as encouraging the expansion of other businesses through greater access to new financial services.
- Developing digital entrepreneurship and creating an enabling environment for a digital marketplace.

29. Priority climate change adaptation investments have been identified in the areas of critical infrastructure, tourism and coastal management, food security, biodiversity, water security, and the blue economy. Furthermore, there are planned projects under the umbrella of disaster risk reduction management, such as establishing early warning systems and improving coastal resilience that are worth considering. The Government of Seychelles (GOS) plans to mainstream climate adaptation in Seychelles' recovery post-pandemic plan. Also, a careful cost-benefit analysis of climate change related projects is being undertaken as the government prioritizes its spending. Seychelles is recognized -- and receives the support of other countries and international organizations -- for its programme of adaptation to climate change and the management of the challenges associated with it. Severe erosion, waves crashing on coastal roads, and inundations during both annual rainy seasons has shown us that our environment, our economic resources, and even our social life, remain vulnerable, and that we need to seriously address these problems.

30. Government continues its preparation for an implementation of the African Continental Free Trade Area (AfCFTA) including close consultations with the private sector on the services industry. The National Assembly approved the ratification of the AfCFTA on June 25, 2021. This was preceded by consultation meetings with key business players through the establishment of a national committee since Seychelles signed the agreement in March 2018.

Fiscal Policies

31. The keystone of our reform program is a large, upfront fiscal adjustment leading to the attainment of sustainable fiscal surpluses over the medium term. Such a turnaround in fiscal policy is necessary to reduce public debt sustainability risks. Despite the sharp recovery in the exchange rate in April 2021, resulting in a reduction in public debt by 14 percentage points of GDP in local currency terms, significant risks to debt sustainability continue to exist. Overall, a policy of fiscal consolidation, economic recovery and prudent debt management is expected to reduce public and publicly guaranteed debt from 100 percent of GDP in 2020 to 64 percent in 2026.

32. In this context, our fiscal policy aims to achieve a primary surplus of 2.8 percent of GDP by 2024 (similar to that in 2019) and 3.2 percent by 2026. These outcomes compare with a deficit of 16.3 percent of GDP in 2020. This adjustment will be achieved by (1) assessing the current VAT structure including the exemption list, amending the business tax laws to streamline exemptions supported by IMF technical assistance, and other revenue measures to generate savings of about 3.6 percent of GDP over the medium term (2022-26); (2) rationalizing the wage bill as well as goods and services expenses; (3) containing transfers, including through reviewing the programs to make them better targeted and financially sustainable, and; (4) undertaking a comprehensive review of the procurement environment in Seychelles to inform comprehensive procurement reforms. Such measures would allow us to achieve the target of 5.2 percent of GDP in structural fiscal adjustment over the course of the program. In addition, we will get Cabinet approval of legislative amendments to streamline VAT exemptions, in consultation with IMF staff (structural benchmark for end-September 2022).

33. The 2021 budget assumes a recovery in growth, withdrawal of the COVID-19 fiscal support package, and smaller transfers to SOEs, including Air Seychelles. On the expenditure side, most of the envisaged savings would come from the reduction of current expenditures. COVID 19-related expenditures represented a significant part of transfers in 2020. Their reduction has already started in 2021, which will help to reach the fiscal consolidation targets. Transfers would halve from 18 percent of GDP in 2020 to around 9 percent in 2021, compared with pre-pandemic levels of 7.3 percent of GDP. Public debt burden indicators hit their highest levels in 2020, but have since improved due, in large part, to the recent currency appreciation

Revenue Measures

34. We are convinced that eliminating the numerous tax exemptions and scaling down the concessional business tax regime would significantly improve revenue performance, efficiency, and equity of the tax system. Specifically, the Eighth Schedule to the Business Tax Act offers generous tax incentives to many businesses—reduced rates of business tax, tax credits, and special deductions. The rates of business tax for firms subject to this schedule are 0 percent on the first SCR 250,000 of profits and 15 percent on the balance. We will harmonize the business tax rate to ensure consistency in all sectors. The Business Tax Act currently allows an accelerated depreciation rate on capital investment other than buildings that sums up to 145 percent in five years, to tourism related businesses as well as agriculture and fisheries, compared to other sectors. The Business Tax Act will be revised to reduce the allowed depreciation to a maximum of 100 percent. The objective of the reform is to:

- Revise and better target tax incentives, including the business tax exemption under the International Trade Zone regime and the generous tax depreciation allowances granted to businesses in specific sectors
- Prevent the erosion of the corporate tax base through international profit shifting
- Introduce a unified business tax rate schedule across sectors that taxes profits below SCR 1 million at 15 percent and profits above that level at 25 percent, except for the tax rate for the high-end sectors that will still remain at 33 percent.

A critical review of these provisions can raise revenue substantially without materially impacting private investment. We will get cabinet approval of revisions to business tax laws to streamline exemptions, in consultation with IMF staff (structural benchmark for end-November 2021). We are also aiming to work on tax arrears as a priority. The arrears collection plan is expected to generate savings amounted to 0.7 percent of over the medium-term. We will also get cabinet approval of all the necessary legislation to ensure Seychelles is fully compliant to be removed from the EU list of non-corporative jurisdictions (structural benchmark for end-September 2021).

35. Our priorities over the medium term will be to modernize the Seychelles Revenue Commission (SRC), with emphasis this year being laid on improving compliance, while moving towards e-service. The main components of this actions plan are:

- **Upgrade the ASYCUDA system,** with the aim to moving to online service and reduce paper transactions. This initiative will allow for declarations associated with imports and exports to be made electronically, reducing the cost and time it takes to discharge merchandise at the ports and airport, including exportation costs for our local businesses. A cargo tracking system will also be introduced to enable the identification of risks associated with specific cargo from their points of origin, which will facilitate the offloading of the merchandise when it arrives in Seychelles. We will complete the customs automation project, in consultation with IMF staff (structural benchmark for end-September 2023).

- **Increase the number of services that can be offered online** such as business registrations, and the submission of returns and other forms that International Business Companies (IBCs) are obliged to submit.

- **Change the way SRC manages tax returns, with the aim to improving tax collection and ensuring that businesses honour their obligations.** Government will improve self-assessment by rigorously educating taxpayers and making it easy for them to file and pay on-time, following-up on late-filers and payers, and taking measures to enforce filing and payment compliance.

- **Utilize information received from financial institutions that report to Seychelles, under the 'Global Forum's Automatic Exchange of Information'**, Enhance sourcing and utilization of third-party information to identify risk of non-compliance; including use of information received from financial institutions that report to Seychelles, under the 'Global Forum's Automatic Exchange of Information', since 2017. No system is currently in place to manage this information. SRC has completed the process of selecting a service provider for installing a new system which will enable using this information to audit and identify businesses that make financial deposits abroad, but that do not submit tax returns on these revenues to the authorities in Seychelles. SRC also needs to strengthen capacity for managing international taxation risk. Increase the functionalities of the current Client Management System (CMS), utilized by the SRC to close significant gaps, which hinder a modern tax management system. Gaps include the fact that the system is not in web-form and has not been upgraded with the latest IT language. Several procedures in the system are not fully integrated and are implemented as manual steps, the system is not integrated with E-Services, and does not include key functions like case management, debt management, business intelligence, and data warehousing. Financing is provided by the EU under an agreement signed in April 2019. The Cabinet of Ministers has approved for a new taxation management system to be developed from the core source codes of the current Client Management System with the aim to complete the project in 2023.

- **UNDP will finance an expert through Tax Inspectors Without Borders to assist SRC.** The expert will provide practical real time support to execute actual audits, with specific attention to preventing cross border tax avoidance, developing risk assessment, obtaining information from third parties, identifying transfer pricing transactions, and applying treaty provisions.

Expenditure Measures

36. The GOS has introduced further expenditure-saving measures in the 2021 budget. New recruitments are expected to be limited to key positions in certain ministries and departments (savings of SCR 38.3 million). There will be no salary increase for public service employees (savings of SCR 7.9 million), no increase in the long service allowance (savings of SCR 8.5 million), and no new scheme of service (SCR 22.1 million). Such measures are expected to be maintained in the medium term. Also, the GOS is reviewing services currently being outsourced to identify areas of savings. Negotiations with landlords are ongoing to achieve a reduction of 25 percent on rental and office accommodation costs. Finally, more emphasis is being given to virtual meetings to reduce the cost of travel.

37. The GOS is committed to adopt a Medium-Term Fiscal or Budget Framework to bolster the credibility of our planned post-program fiscal targets. We had an initial discussion with the IMF team and an AFRITAC SOUTH (AFS) expert. We agreed to further discuss with the AFRITAC SOUTH expert about the scope and timing of a mission that would help identifying the areas that need development. The following step would consist of defining the contours of the implementation of a multi-year budget.

38. The Government has requested World Bank budget support of US$ 30 million which will take the form of a "Program for Results" (PforR), targeting reforms across the social protection system in Seychelles. The aim is to reform the social protection system to ensure its sustainability, as well as to enable working-age beneficiaries to be economically included by participating in the labor force. The Program covers the five largest cash transfer programs managed by the Agency for Social Protection (ASP): Retirement Pension (RP), Homecare Program (HCP), Invalidity Benefit (IB), Disability Benefit (DB), and Social Welfare Assistance (SWA).

39. The Program development objectives are to improve the efficiency and effectiveness of social protection programs in the Seychelles. On the **efficiency** side, the program seeks to:

- improve the fiscal sustainability of the RP benefits, by increasing the retirement age to 65, adopting additional measures, as well as launching public information campaigns about the new measures.
- make state-provided home care available to those deemed to have the greatest physical and financial need, with physical needs measured according to internationally recognized standards, and financial need measured according to a single unified standard across programs.
- provide invalidity and disability benefits to those with physical needs as defined by internationally recognized standards; and

- provide social welfare assistance to those with socioeconomic needs.

On the **effectiveness** side, the program seeks to:

- provide access to services to social protection beneficiaries by establishing an Inter-ministerial Committee for Social Protection that will enable cross-sectoral coordination and establishing a social registry to enable referrals from the Agency for Social Protection to other ministries, departments, and agencies and vice-versa;
- increase the quality of home care services provided under the state-financed home care program by increasing the training provided to caregivers; and
- allocate adequate budgets to social protection programs to cover emergency responses.

Increase Efficiency of Public Spending

40. The GOS will seek to improve the efficiency of government spending. A July 2019 FAD-AFS mission recommended a comprehensive review of the legal framework for public procurement in Seychelles that would consider structural, legal, and operational factors of Seychelles' procurement system. It suggested the World Bank could take the lead on this reform. A Public Investment Management Assessment (PIMA) planned for FY22 will help identify opportunities to increase the efficiency of public investment including the scope for the procurement system to support PPPs. The GOS is committed to implement the RFI commitments to transparency of COVID emergency-related spending, specifically the conduct of an audit and publication of information of awarded companies. An independent audit of emergency spending and related procurement is ongoing; its results will be made public in September 2021.

41. The last Public Expenditure and Financial Accountability (PEFA) Framework assessment was done in 2017. The Government will complete a streamlined PEFA assessment (by December 2023), which will focus on taking stock on the implementation of previous recommendation**.** In addition, the Government will work with the Fund for its first Public Investment Management Framework assessment before the end of September 2022. AFS fielded a remote technical assistance (TA) mission to Seychelles in early 2021, on developing a strategy to improve PFM capacity through integrated financial management information systems (IFMIS). On the basis of the mission's conclusions, it was decided that a new IFMIS platform should be installed, which should strengthen capacities to manage PFM business processes and also link up with the emerging national payments platform prepared by the central bank. A budget for the new IFMIS will be included in the 2022 budget.

Results-Based Management

42. After the strong fiscal and public sector reforms in the wake of the 2008/2009 crisis, the second generation of reforms in 2013 began with the adoption of a Results-Based Management (RBM) approach, which lays the foundation for performance reforms. The aim is to strengthen the results-focus across government to enhance public sector efficiency, effectiveness, transparency, and accountability with the ultimate objectives to enhance growth, economic diversification, and social inclusion across sectors.

43. The RBM concept has four pillars across the public sector policy cycle: planning, budgeting, performance monitoring and evaluation, and performance management functions. These are:

- Strategic planning (SP), led by the Economic Planning Department
- Program-Performance Based Budgeting (PPBB), led by the Finance Department
- Performance Monitoring & Evaluation (PM&E), led by the Department of Public Administration (DPA)
- Performance Management System (PMS), led by DPA

The Government will have a whole rollout of RBM, with preparatory work beginning immediately and ready for the 2023 budget process.

Minimizing Risks of SOEs

44. The reform of state-owned enterprises will be key in rationalizing public spending and restoring public debt sustainability. Following government's adoption of the 'Good Governance Code' and policies that are linked to public enterprises, the GOS will place more emphasis on the governance of those enterprises. The Public Enterprise Monitoring Commission (PEMC) will become the only authority to oversee public enterprises. In collaboration with the ministries concerned, and their boards, the PEMC will establish targets for these enterprises to ensure that they generate revenue for the government and for the people of Seychelles. This authority will also ensure appropriate oversight of public enterprises and that they are accountable to Government. The decisions taken by public enterprises must be aligned with national plans, and their boards will be responsible for implementing the government's vision. PEMC will be given every support and the necessary authority to ensure that the government's mandate is implemented. We are aiming to submit, by end-November 2021, the amendments on the Public Enterprise Monitoring Committee (PEMC) Act to the Cabinet to strengthen the enforcement power of PEMC (structural benchmark for end-November 2021).

45. Air Seychelles poses significant risks to debt sustainability. The GOS is actively searching for a viable solution that would limit the cost to the government budget. The GOS has worked with the World Bank and identified that the least costly scenario would be the liquidation of Air Seychelles. Discussions between the authorities and bondholders are taking place. The government lawyers are assessing the legal implications of unwinding the company and ways to protect employees and maintain ground handling operations.

Public Debt Management Strategy

46. In addition to fiscal consolidation measures, a change in debt management strategy is being worked out to restore debt sustainability and mitigate the attendant risks. A multi-pronged strategy will be adopted to reduce the significant refinancing risks emanating from the high stock of Treasury Bills (T-Bills) by extending maturity of the debt portfolio. Substitution with concessional external loans and a "one-off" market-based liability management operation in the domestic market is expected to reduce the share of T-Bills in the government debt portfolio. A combination of these strategies is expected to reduce the gross financing needs from 50 percent of GDP in 2020 to 12.6 percent by 2026. The reduction in the stock of T-Bills will not affect the adequacy of the overall availability of T-Bills required for meeting banking sector liquidity needs and monetary policy operations. Efforts are also being made to assess options to refinance other debt by extending the maturity and to possibly reduce interest costs. A medium-term debt management strategy (MTDS; structural benchmark for end-March 2022) will be published with technical support from the IMF to guide future borrowing decisions that would adequately consider cost-risk tradeoffs. Further, implementation of the MTDS will be supported by publishing an Annual Borrowing Plan (structural benchmark for end-March 2022) along with an auction calendar to help market participants plan their liquidity management and reduce uncertainty. The Ministry of Finance will publish quarterly reports on debt management operations and outstanding debt position as published in the debt bulletin on its website (structural benchmark for end-September 2021).

47. In order to reduce the significant refinancing risks, we have successfully executed a LMO that switched SCR 1.2 bn of T-bills into bonds with 3, 5 and 7-year tenors, resulting in an average maturity of 4.8 years. The 3, 5 and 7-year bonds allocated in the auction amounted to 38 percent, 33 percent and 29 percent, respectively, for the three tenors. The LMO as resulted in a significant drop in the GFN going forward. The weighted average yields on the LMO for the bonds are lower by 125-150 bps compared to the previously issued rates and would help to lower the borrowing costs through longer-term maturities.

48. A concerted effort will be made to adopt a regular and predictable issuance of bonds through the auction mechanism. The recent drop in longer-term yields and a recovery in investor confidence on government securities pave the way for regular issuance of bonds in the future. A switch to bond issuance will need to be supported by improving their liquidity through repo operations and initiating trading reforms in government securities.

49. In addition, Government will continue to maintain the treasury single account system that was introduced as part of the 2009 PFM reform to enable better management of cash flow of Government and debt issuance. We will get Ministerial Approval of a Circular to reduce the deviation between the forecast and the outcome in the monthly cashflow plan consistent with the 2022 budget, in consultation with IMF staff (structural benchmark for end-June 2022).

Monetary and Exchange Rate Policy

50. Monetary policy has been accommodative since the second quarter of 2020, a stance that is expected to be maintained in the short-term. Under the existing framework, the MPR, which lies at the midpoint of the interest rate corridor, remains the key policy signal. The monetary policy stance is part of a set of broader measures being implemented by the Central Bank to address the challenges of the pandemic and to minimize economic loss.

51. As of the third quarter of 2021, the interest rate corridor was shifted downwards such that the interest rate structure in the economy is aligned with prevailing macroeconomic fundamentals. The resulted reduction in the cost of credit in the short to medium term should boost economic activity and therefore support the recovery.

52. The Bank remains committed to a floating exchange rate and will only intervene to facilitate an orderly functioning of the market. As the automatic stabilizer, during 2020, the exchange rate adjusted to reflect the significant drop in supply of foreign exchange, primarily brought about by the contraction in tourism activities. In order to support the market and ensure the country continued to meet its external obligations, the Central Bank provided foreign exchange assistance in 2020. Hence, international reserves were used to assist the market through: (i) Foreign Exchange Auctions (FEAs), and (ii) direct sales to the Seychelles Petroleum Company (SEYPEC) for the purchase of fuel and the Seychelles Trading Company (STC) for importation of essential goods[2].

53. Since the start of 2021, supply of foreign exchange has been stronger than demand, which resulted in an appreciation of the local currency. Nonetheless, contrary to expectation under a free-floating exchange rate regime, market-clearing adjustment was delayed. To address such market failure and consistent with its role to ensure orderly functioning of the foreign exchange market, the Central Bank conducted FEAs to remove this excess supply. Subsequently, some adjustments were observed in the exchange rate in line with the prevailing level of demand and supply. However, in May 2021, the Bank sold USD 4.0 million to commercial banks to address some delays in meeting demand after which the foreign exchange market has been functioning in an orderly manner.

54. We are committed to effectively monitor the foreign exchange positions of banks. We will continue to allow the market to determine the exchange rate, with interventions only to limit disorderly market conditions and to build external buffers. The CBS will enhance its monitoring of fore ign exchange exposures of banks with a particular focus on the change in the repayment capacity of borrowers against exchange rate fluctuations.

55. In view of the global pandemic, Gross International Reserves (GIR) fell in 2020, the first contraction in four years. A further decline is expected in 2021 mainly due to anticipated lower receipts, along with a decrease in income from investments due to lower interest rates on the international market. If required, international reserves will be used to support the market whilst ensuring such action does not compromise the floating exchange rate regime.

56. The Advisory and Asset Management agreement signed in January 2019 between the IBRD and CBS remains operational. As part of the engagement, US$100 million worth of assets is being managed by the Reserves Advisory and Management Partnership (RAMP). The agreement, moreover, provides for capacity building of the CBS staff in areas of reserves management.

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[2] Prevailing market exchange rates were used at the time of the transactions.

57. The CBS is determined to continue its long-lasting work on the continuous improvement of its international reserves' management framework. For the year 2021, major milestones are expected in risk management within the international reserves functions—being the implementation of role specific operational and credit risk management frameworks. Moreover, the usual reviews of the strategic policy ¶meters are expected with enhanced frequency to ensure relevance with the dynamic economic fundamentals both locally and internationally. Additionally, with its early adoption of the IMF Central Bank Transparency Code, the CBS intends to further enhance the disclosure of information on the management of the international reserves.

Efforts to Improve External Statistics

58. The CBS has continued with implementation of its plans to improve external sector statistics, particularly the estimate of tourism receipts and the offshore sector. The Bank is of the view that the current estimates of current inflows do not fully capture the total value of the country's foreign exchange receipts and therefore result in over-estimation of the current account deficit. Given the shock in the data series experienced in 2020, the plan to incorporate the new estimates in the compiled BOP statistics has been delayed. TA from the IMF Statistics Department is expected to help better compile external sector statistics by identifying offshore data, which remains a major challenge.

Modernizing the Financial System and Ensuring Financial Stability

59. As part of the Financial Sector Development Plan, efforts have been focused on modernizing the financial system and enhancing the regulatory and supervisory framework with the aim of deepening the financial sector, including to support inclusive and sustainable growth, whilst preserving financial stability. Upon the onset of the Covid-19 pandemic, Seychelles authorities have responded from a monetary, prudential, and fiscal standpoint to deal with the risks emanating from the current crisis, including reprioritization of projects.

60. We remain committed to ensuring a stable and well-capitalized banking system that can support the recovery by effectively monitoring and supervising the health of the financial system. To ensure effectiveness of the supervisory process, we stand ready to take relevant and timely enforcement actions where necessary. If any bank becomes undercapitalized, the CBS will use the set of relevant early intervention measures, including further suspension of dividend payments. Within our usual regulatory framework, viable but undercapitalized banks would be required to submit capital plans while nonviable financial institutions would be resolved using the appropriate resolution tools. Borrower support measures should be gradually unwound, and the remaining ones will be targeted and time bound. We will ensure that banks' loan classification correctly reflects the asset quality of the banking system and regulatory forbearance measures will be withdrawn.

61. We are committed to making our supervisory framework more risk-sensitive, objective, forward-looking and continuous. For that purpose, we had initiated a project in 2018 for the adoption of a risk-based supervision (RBS) framework, which integrates Basel II Pillar 2 requirements. During 2020, we successfully completed the second phase of the project which entailed the design and development of the risk-based supervisory framework and associated data models, guidelines/circulars, manuals, and policies, as well as capacity building for supervisors and supervised entities. The initial roll out of the RBS framework has started in 2021 and is covering the first supervisory cycle

62. Throughout 2020, work remained ongoing to finalize a policy paper for adoption of Basel II Pillar 1. The paper was endorsed by the Cabinet of Ministers in late 2020 and is now with the Attorney General's Office for drafting. As regards to Basel II Pillar 3, the CBS anticipates finalizing its set of disclosure guidelines by May 2022. Furthermore, the policy paper for the amendment in the Financial Institutions Capital Adequacy Regulation, 2010 to adopt the Basel III capital definition will be approved by the Cabinet by May 2022, with the assistance of technical advisors (structural benchmark for end-May 2022).

63. In order to boost financial sector resilience, we will enhance the monitoring of the banking system by developing templates for restructured and rescheduled loans and for monitoring the impact of COVID-19 measures. We will closely monitor and asses the deterioration in the asset quality of banks resulting from the COVID-19 pandemic and take early intervention measures where necessary. To preserve the stability of the financial system while supporting growth, banks will be encouraged to engage in restructuring of loans for firms that are viable but have temporary liquidity shortages. We will monitor the relevant reclassification of loans and proactively provide guidance on prudential treatment of moratoria and NPL management strategies.

64. The CBS focuses on strengthening the legal basis of the Financial Stability Committee (FSC). Following the establishment of the FSC in March 2016, work remains ongoing in ensuring that the legal basis of the FSC and its mandate are strengthened. In that regard, the CBS prepared a draft policy paper outlining various policy considerations for the drafting of a financial stability bill in April 2021. The CBS is hiring a consultant to review it. It is anticipated that a consultant will be on boarded by September 2021 and the policy paper for the draft Financial Stability Bill to empower the relevant authorities to use macroprudential tools and provide the legal basis for the Financial Stability Committee will be approved by the Cabinet by end November 2021 (structural benchmark for end-November 2021). We are targeting to finalize the draft financial stability bill by May 2022.

65. The CBS remains committed to having a robust crisis management and resolution framework; we will take the necessary steps to enhance our macroprudential toolkit as well as the crisis management and bank resolution framework. A policy paper supporting the drafting of an effective resolution framework, aligned with the BCBS recommendations and FSB Key Attributes of Effective Resolution Regimes, was presented to the Cabinet of Ministers and endorsed in December 2018. However, due to capacity constraints on the legislative drafting, the policy paper has not yet been turned into a draft bill. The policy paper is currently being reviewed in view of recent developments, necessitating changes to further enhance the powers of resolution authorities in respect of co-ordination and co-operation mechanisms, as well as instruments to deal with evolving types of crises, such as the recent pandemic whereby aspects of business continuity and operational resilience have received due attention. By end June 2022, we will submit a Policy Paper to the Cabinet of the draft bill on crisis management and bank resolution framework (Bank Resolution Bill) in alignment with international best practices and tailored to the financial system of Seychelles (structural benchmark for end-June 2022). The draft Bank Resolution Bill will be approved by the Cabinet by end June 2023 (structural benchmark for end-June 2023).

66. The CBS pursues its effort in ensuring that its legislative framework for the National Payment System remains aligned with international standards and best practices. A review of the National Payment System Act, 2014, along with supporting regulations, is being undertaken to ensure that deficiencies identified while administering the Act are addressed and its regulatory framework is aligned with international standards and best practices. Policy proposals for amendments to the legal framework are anticipated to be finalized in March 2022. In addition, the CBS is in the process of finalizing its oversight framework and, with the technical assistance received from AFS in May-June 2021, this work is expected to be completed by December 2021.

67. The CBS aims to further develop the National Payment System by establishing a conducive environment whereby payments are convenient, affordable, reliable, efficient, and safe. The modernization of the national payment system is in line with an action plan approved in 2020 by the Cabinet of Ministers whereby initiatives include the establishment of a payments system body to manage the payments infrastructure through a public-private partnership to be finalized in 2023, as well as the implementation of a new core banking system within the CBS to be finalized in 2023.

68. The CBS pursues its efforts to enhance the adoption of innovative financial services, in line with the government's digital economy agenda. The Central Bank and the Ministry responsible for Finance have sought technical assistance from the World Bank to undertake a digital economy assessment and formulate a national fintech strategy, that would set the necessary pillars for the use of financial technologies which embrace innovation and competition, and lower transaction costs. The fintech strategy is to be finalized in 2021.

69. The competent authorities are intensifying efforts to put in place the necessary framework and mechanisms to empower consumers, promote digital financial literacy and enhance financial consumer protection. Given the digital economy agenda and the specificities associated with digital financial services, a comprehensive digital financial literacy roadmap has been formulated. In addition, the Financial Consumer Protection legislation and its supporting regulations is expected to be enacted by the end of 2021.

70. The Central Bank remains committed to implementing an enhanced credit information system and the supporting legal framework to extend the coverage of credit information. The enhanced credit information system will be critical for economic recovery, supporting the allocation of credits to sectors, including MSMEs promoting financial stability and economic growth. With the assistance from the World Bank, it is anticipated that the project will be completed by the end of 2022.

71. Having a robust AML-CFT regulatory and supervisory framework remains high on the agenda. In August 2020, the new AML/CFT Act and Regulations came into force. These have been formulated to cater to deficiencies identified by the Mutual Evaluation undertaken by ESAAMLG and the weaknesses identified through the National Risk Assessment which was finalized in 2018. One of the major changes to the Act was the allocation of the supervisory aspect of ML and TF, to three supervisory authorities; FIU, FSA and CBS, in order to ensure effectiveness in the supervision of the entities regulated by the respective supervisory authorities. A tripartite Memorandum of Understanding was signed between the aforementioned authorities in 2020 to further foster collaboration in the discharge of their regulatory and supervisory functions vis-à-vis the new AML/CFT legislation.

72. In line with the new mandate assigned by the Anti-Money Laundering Act of 2020 (AMLA 2020), a section within the Financial Surveillance Division of the CBS was set up to take on the responsibility for AML/CFT supervision for institutions under the Bank's purview. The section caters for onsite, offsite and policy work pertaining to supervision from an AML/CFT perspective and continues to assist with the national AML/CFT strategy, which was approved in August 2020, as part of its membership in the National Technical AML/CFT Committee. In conjunction with the World Bank, a risk-based supervision framework which includes a risk matrix that allows for identification of high risks institutions, sectoral supervisory strategies, and the supervision manual are also being developed. Moreover, the supervisors are finalizing a Institutional Risk Assessment template which would feed into its risk profile. This will allow for allocation of resources on a risk basis to institutions which have the most risks of being used for ML/TF. To note, several amendments have been made to the AML/CFT Act and Regulations, in addition to the Mutual Legal Assistance Act, Extradition Act, Prevention of Terrorism Act, and other undertakings to better meet the requirements of the FAFT Recommendations and enhance the regulatory regime of Seychelles. We are currently working on the three outstanding recommendations that Seychelles needs to address to fully comply with the FATF Recommendations, namely:

- Review of the Registration of Association Act.,
- Review of the licensing structure of the Designated Non-Financial Businesses and Professions, and introducing a licensing secretary regime for the domestic companies,
- A new framework for Virtual Asset Service Providers; and
- A new Asset Management Regime in support of asset recovery efforts.

73. In August 2020, the new Beneficial Ownership Act and Regulations came into force. The Act provides for identification and verification of beneficial ownership of legal persons and legal arrangements, in addition to the requirements to establish and maintain an up to date register of beneficial owners by resident agents, and a centralized database to be kept by FIU. The centralized database will become operational in July 2021. We will ensure that the beneficial ownership database is fully operational by October 2021 for international financial entities and by December 2021 for domestic entities. The Beneficial Ownership Act and Regulations are also being amended in 2021 to address deficiencies and concerns in relation to certain provisions in the legislation.

Safeguards at the CBS

74. The CBS is committed to implement the recommendations of the June 2021 update safeguards assessment. It has implemented most of the recommendations of the voluntary safeguards assessment that was completed in February 2018. With the exception of the proposed amendments to the CBS Act (see below), all other recommendations from the 2018 safeguards report have been implemented. In September 2020, the Audit and Risk Committee (ARC) Charter was reviewed, and the revisions approved included a greater focus on operational and strategic risks. The Charter also sets out the role of the ARC with regards to the compliance function which was set up in April 2019. While steps have been taken to improve the internal audit function, including strengthening capacity in core central banking operations, continuing to implement the external quality assessment's recommendations, and appointing a Head of Internal Audit Division in February 2021, further efforts and enhanced oversight by the ARV are needed to ensure adequate capacity and internal audit coverage.

75. The CBS underwent a recent safeguards assessment and the report was finalized in June 2021. Accordingly, the CBS plans, in consultation with the IMF, to submit amendments to the CBS Act to the Cabinet in October 2021 which would strengthen governance and oversight, enhance institutional and personal autonomy, and safeguard financial autonomy. Moreover, the CBS will strengthen the oversight structure of the risk management and internal audit functions.

76. Program Monitoring. Program implementation will be monitored through semi-annual reviews, quantitative performance criteria and indicative targets, continuous performance criteria, and structural benchmarks. The first review is set for December 2021 based on end-July 2021 quantitative targets and the second review is set for June 2022 based on end-December 2021 quantitative targets. The quantitative targets and structural benchmarks are set out in Tables 1 and 2 of the MEFP respectively.

Table 1. Seychelles: Proposed Quantitative Program Targets, 2021-2022 [1]
(In millions of Seychelles Rupees)

	July 31, 2021			September 30, 2021			December 31, 2021			March 31 2022			June 30, 2022			September 30, 2022		
	Performance Criteria			IT			Performance Criteria			IT			IT			IT		
	Prog.	Actual	Status	Prog.	Actual	Status	Prog.	Actual	Status	Prog.	Actual	Status	Prog.	Actual	Status	Prog.	Actual	Status
A. Quantitative performance criteria[2]																		
Net domestic financing of the government (ceiling)[3]	2034.0			-109.0			-555.0			25.0			-50.0			-200.0		
Primary balance of the consolidated government (floor)	-1726.0			-2026.0			-2289.0			-700.0			-1000.0			-1100.0		
Total revenue (floor)[4]	2217.4			3626.0			7252.0			1735.5			3470.9			5206.4		
Net international reserves of the CBS, millions of US dolloars (floor)	359.0			374.0			394.0			407.0			410.0			420.0		
B. Continuous quantitative performance criteria (ceilings)																		
Accumulation of new external payments arrears	0.0			0.0			0.0			0.0			0.0			0.0		
Accumulation of new domestic payments arrears	0.0			0.0			0.0			0.0			0.0			0.0		
C. IT																		
Net change in CG guaranteed domestic and external debt	502.0			604.0			753.0			990.0			1600.0			2036.0		
Priority social expenditure (floor)[2]	475.2			712.8			1425.5			287.0			574.1			861.1		

Sources: Seychelles authorities; IMF staff estimates and projections.

[1] The terms in this table are defined in the Technical Memorandum of Understanding (TMU).

[2] The performance criteria are cumulative from the beginning of the calendar year.

[3] If the amount of disbursed external budgetary assistance net of external debt service obligations falls short of the program forecast, the ceiling on net domestic financing will be adjusted pro-tanto. If the amount of disbursed external budgetary assistance net of external debt service obligations exceeds the program forecast, the ceiling will be adjusted downward by the excess disbursement unless it is used to reduce domestic payment arrears. The NDF refers to the central government.

[4] If growth fall short of targets the revenues floor will be adjusted accordingly.

Table 2. Seychelles: Structural Benchmarks Under the EFF, 2021–2023

Actions	Timing	Objective
Fiscal and Public Financial Management Policy		
Cabinet approval of all the necessary legislation to ensure Seychelles is fully compliant to be removed from the EU list of non-corporative jurisdictions.	End-September 2021	Ensure Seychelles is fully compliant with EU and OECD international tax framework.
Ministerial Approval of Circular to reduce the deviation between the forecast and the outcome in the monthly cashflow plan consistent with the 2022 budget, in consultation with IMF staff.	End-June 2022	Strengthen Treasury cash management.
Cabinet approval of legislative amendments to streamline VAT exemptions, in consultation with IMF staff.	End-September 2022	Strengthen revenue mobilization.
Cabinet approval of revisions to business tax laws to streamline exemptions, in consultation with IMF staff.	End-November 2021	Strengthen revenue mobilization.
Completing the customs automation project, in consultation with IMF staff.	End-September 2023	Strengthen revenue mobilization.
Debt Management		
Publish a new domestic debt management strategy document.	End-March 2022	Mitigate foreign currency and rollover risks, optimize issuance decisions, and strengthen benchmark pricing through extension of the yield curve. The debt management strategy will guide future borrowing decisions based on cost-risk trade-offs related to the debt portfolio.
Publish an Annual Borrowing Plan along with an auction calendar to help market participants plan their liquidity management and reduce uncertainty.	End-March 2022	Implement the debt management strategy.
The Ministry of Finance will publish quarterly reports on debt management operations and outstanding debt position as published in the debt bulletin on its website.	End-September 2021 and quarterly thereafter	Enhance debt management and transparency.

Table 2: Seychelles Structural Benchmarks Under the EFF, 2021–2023 (concluded)		
State-Owned Enterprises (SOEs)		
Cabinet approval of (1) least cost structure for Air Seychelles, as part of the 2022 budget process; and (2) long-term strategy that lays out long-term options for Air Seychelles, in consultation with IMF/WB staff.	End-September 2021	Minimize the fiscal impact on the 2022 budget.
Cabinet approval of Amendments on the Public Enterprise Monitoring Committee (PEMC) Act to strengthen the enforcement power of the PEMC, in consultation with IMF staff.	End-November 2021	Reduce contingent fiscal risks.
Financial Sector Stability		
Cabinet approval for policy paper for the draft Financial Stability Bill for empowering the relevant authorities to use macroprudential tools and providing the legal basis for the Financial Stability Committee.	End-November 2021	Enhance financial stability powers with the aim of safeguarding the stability of the financial system
Cabinet approval of the policy paper for the amendment in the Financial Institutions Capital Adequacy Regulations, 2010 for the CBS to adopt the Basel III Capital Definition	End-May 2022	Buttress banking sector soundness and financial sector stability
Submit policy paper for the draft Bank Resolution Bill to the Cabinet	End-June 2022	Address shortcomings from previously approved cabinet policy paper for bank resolution and to align with ongoing revisions to the Financial Institutions Act, 2004 as amended and Insolvency Law, as well as cater recent developments stemming from the current crisis. Includes identification of consequential amendments in subsidiary legislations, with the objective of providing the regulators the necessary powers to effectively resolve troubled financial institutions.
Cabinet approval for draft Bank Resolution Bill in alignment with international best practice	End-June 2023	Address shortcomings from previously approved cabinet policy paper for bank resolution and to align with ongoing revisions to the Financial Institutions Act, 2004 as amended and Insolvency Law, as well as cater recent developments stemming from the current crisis. Includes identification of consequential amendments in subsidiary legislations, with the objective of providing the regulators the necessary powers to effectively resolve troubled financial institutions.

Attachment II. Technical Memorandum of Understanding

This Technical Memorandum of Understanding (TMU) defines the performance criteria, quantitative benchmarks, and structural benchmarks of the Republic of Seychelles' economic and financial program supported by the Extended Fund Facility (EFF). It also specifies the frequency and deadlines for data reporting to the staff of the International Monetary Fund (IMF) for program monitoring purposes.

I. DEFINITIONS

a) Unless otherwise indicated, "government" is understood to mean the central government of the Republic of Seychelles and does not include any political subdivisions (such as local governments), the central bank, or any other public or government-owned entity with autonomous legal personality not included in the government's budget.

b) Consolidated government debt is understood to mean central government debt plus public guarantees.

c) "External debt" is defined as debt denominated in any currency other than the Seychellois rupee (SCR). The performance criterion or indicative target will include all forms of debt. The definition of "debt" is set out in paragraph 8 (a) of the Guidelines on Public Debt Limits in Fund-Supported Programs attached to the Executive Board Decision No. 16919-(20/103), adopted October 28, 2020. For the purpose of these guidelines, the term "debt" will be understood to mean a current, i.e., not 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 point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

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

ii. suppliers' credits, i.e., 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

iii. leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, 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.

(2) 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.

II. QUANTITATIVE PERFORMANCE CRITERIA

A. Ceiling on Net Domestic Financing of the Government

1. Net domestic financing (NDF) of the government is defined as the sum of: (i) net bank credit to the government, defined below; and (ii) net nonbank financing of the government, including the proceeds of the sale of government assets, which includes proceeds from the divestiture of shares of public enterprises, that is privatizations, Treasury bills, and other securitized obligations issued by the government and listed in rupees in the domestic financial market, and any Central Bank of Seychelles (CBS) credit to the government, including any drawings on the rupees counterpart of the Special Drawing Rights (SDR) allocation.

2. The data deemed valid within the framework of the program will be the amounts for net bank credit to the government and for the net amount of Treasury bills and bonds issued in rupees on the domestic financial market, calculated by the CBS, and the amounts for nonbank financing calculated by the Treasury of Seychelles.

3. Gross external budgetary assistance is defined as grants, loans, and non-earmarked debt relief operations (excluding project-related loans and grants, use of IMF resources, and debt relief under the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDRI) Initiatives. Net external budgetary assistance is defined as the difference between gross external budgetary assistance and the sum of total debt service obligations on all public external debt (defined as the sum of interest payments and amortizations on all external loans, including interest payments and other charges to the IMF and on project-related loans, but excluding repayment obligations to the IMF), and all payments of external arrears.

4. Adjustors: Net domestic financing of the government will be adjusted downward (upward) if net external budgetary assistance exceeds (falls short of) the program projections.

5. For the purpose of monitoring, data will be provided to the Fund by the authorities on a monthly basis with a lag of no more than four weeks from the end-of-period.

B. Floor on the Primary Balance

6. The primary balance is defined as total revenues and grants minus primary expenditure and covers non-interest government activities as specified in the budget. The primary balance will be measured as cumulative over the fiscal year and it will be monitored from above the line.

- Revenues are recorded when the funds are transferred to a government revenue account. Tax revenues are recorded as net of tax refunds. Revenues will also include grants. Capital revenues will not include any revenues from non-financial asset sales proceeding from divestment operations.

- Central government primary expenditure is recorded on a cash basis and includes recurrent expenditures and capital spending. Primary expenditure also includes transfers to State-Owned Enterprises (SOEs). All primary expenditures directly settled with bonds or any other form of non-cash liability will be treated as one-off adjustments and recorded as spending above-the-line, financed with debt issuance, and will therefore affect the primary balance.

7. Adjustors: The primary balance target will be adjusted upward (downward) by the surplus (shortfall) in disbursements of grants relative to the baseline projection.

8. For the purpose of monitoring, data will be provided to the Fund by the authorities monthly with a lag of no more than four weeks from the end-of-period.

C. Floor on Total Revenue

9. Total government revenue includes tax and nontax revenue, as shown in the fiscal table, but excludes external grants, revenue of autonomous agencies, and privatization receipts.

10. The government revenue floor will be adjusted downward by the amount equivalent to the shortfall in gross domestic product compared to the program projections.

11. For the purpose of monitoring, data will be provided to the Fund by the authorities on a monthly basis with a lag of no more than four weeks from the end-of-period.

D. Floor on Net International Reserves

12. Net International Reserves (NIR) of the CBS are defined as the difference between reserve assets and reserve liabilities with a maturity of less than one year.

13. Reserve assets are defined as readily available claims on nonresidents denominated in foreign convertible currencies. They include the CBS's holdings of monetary gold, SDRs, foreign currency cash, foreign currency securities, deposits abroad, and the country's reserve position at the Fund. Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered, claims on residents, claims in foreign exchange arising from derivatives in foreign currencies vis-a-vis domestic currency (such as futures, forwards, swaps, options et cetera), precious metals other than gold, assets in nonconvertible currencies, and illiquid assets.

14. Reserve liabilities are: (1) all foreign exchange liabilities to residents and nonresidents with maturity of less than one year, including commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, options, et cetera); and (2) all liabilities outstanding to the IMF (only the total outstanding use of Fund Credit and loans is included in reserve liabilities).

15. Adjustors: 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. The floor will also be adjusted upwards (downwards) by the amount that external debt service payments fall short of (exceed) the amounts assumed in the program. The floors will also be adjusted upwards by the amount of the new SDR allocation to Seychelles if the IMF makes a new allocation of SDRs to its membership.

16. For the purpose of monitoring, the data will be reported by the CBS on a daily basis, with a lag of no more than one week from the end-of-period.

E. Non-Accumulation of New Domestic and External Arrears (continuous)

17. Domestic payments arrears are defined as domestic payments due but not paid by the government after a 90-day grace period, unless the payment arrangements specify a longer payment period. The Ministry of Finance records and updates the data on the accumulation and reduction of domestic payments arrears.

18. The government undertakes not to accumulate any new domestic payments arrears. The non-accumulation of new domestic payments arrears will be continuously monitored throughout the program. The accumulation of any new domestic payments arrears will be reported immediately by the government to Fund staff.

19. The government undertakes not to accumulate any new external public payments arrears, with the exception of arrears related to debt that is the subject of rescheduling. External public payments arrears are defined as payments due but not paid by the government as of the due date specified in the contract, taking into account any applicable grace periods, including contractual and late interest, on the external debt of the government or external debt guaranteed by the government. The performance criterion on the non-accumulation of new external public payments arrears will be continuously monitored throughout the program. The accumulation of any new external payments arrears will be reported immediately by the government to Fund staff.

20. Standard continuous performance criteria include: 1) prohibition on the imposition or intensification of restrictions on making of payments and transfers for current international transactions; 2) prohibition on the introduction or modification of multiple currency practices; 3) prohibition on the conclusion of bilateral payments agreements that is inconsistent with Article VIII;

and 4) prohibition on the imposition or intensification of import restrictions for balance of payments reasons.

III. INDICATVE TARGETS

A. Net Change in Consolidated Government Guaranteed Domestic and External Debt

21. The government guaranteed domestic and external debt is defined as the public debt and includes the central government debt plus domestic and external guarantees provided by the government.

B. Floor on Government Social Spending

22. The indicative floor on social spending will apply to the expenditures incurred by the government on the following plans and programs that are intended to have a positive impact on education, health, social protection, housing and community services and recreational activities:

- Social Programs of Government Benefits and approved programs of ASP (Invalidity benefits, disability benefits, post-secondary students bursary, sickness benefits, maternity benefits, orphans benefits, injury benefits, semi-orphan benefits, apprenticeship scheme, home careers schemes, vulnerable home repair scheme, SPTC travel concessions, inter island transport etc.)

IV. PROGRAM REPORTING REQUIREMENTS

24. Performance under the program will be monitored from data supplied to the IMF by the authorities. The authorities will transmit promptly to IMF staff any data revisions as well as other information necessary to monitor the arrangement under the EFF.

V. DATA AND INFORMATION

25. 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.

26. 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.

July 26, 2021

Statement by Mr. Huh,
Executive Director for Seychelles
Mr. Khurelbaatar, advisor for Seychelles,
Executive Board Meeting
July 29, 2021

On behalf of our Seychellois authorities, we thank management and the Executive Board for their continued support of the Seychelles, especially during these challenging times. We also would like to thank Ms. Yontcheva and her team for their dedication and hard work and for concluding this critical program, despite difficulties and challenges related to conducting the negotiation.

Following the global financial crisis, the Seychelles experienced a similar crisis when debt rose to 175 percent of GDP, largely as a result of imprudent macroeconomic policies. Since then, the Seychelles has demonstrated a strong track record and made significant progress in strengthening economic stability and sustainability under several IMF programs. As a result, macroeconomic vulnerabilities were significantly reduced, and the authorities were able to decrease the level of debt to 60 percent of GDP by 2019, while also building buffers. However, the external shock from the pandemic was beyond comprehension for a small, open economy, heavily reliant on the outside world. Consequently the economy contracted rapidly with large external and fiscal deficits. Gross financing needs rose rapidly, and domestic financing options reached their limits and without the ability to tap into external resources. Against this backdrop, the authorities requested a program in November 2020 to assist them with the balance of payments needs arising from the unprecedented shock from the pandemic.

Recent developments, COVID-19, Outlook

The first case of COVID-19 was registered in Seychelles in March 2020. Since then, the authorities took swift measures to mitigate the negative impacts of the pandemic and support vulnerable households and firms. Once vaccines were available, the authorities took proactive actions and the majority of the population was vaccinated by March 2021 allowing for borders to reopen to foreign visitors. Since the opening of the borders, the number of tourists' arrivals has exceeded expectations and the authorities are hopeful for a V-shaped recovery driven strongly by tourism. The bounce-back is thanks to the opening of new tourist markets, positive progress on global vaccinations allowing for the resumption of international travel, as well as the continued arrival of tourists from traditional markets which are all expected to support the tourism industry. The growth is projected to reach 6.9 percent this year and around 6 percent over the medium term.

The program

The program envisages a broad range of structural reforms, focusing on ensuring debt sustainability while building the basis for long-term inclusive growth. The highest priorities for the program are to ensure macroeconomic stabilization and to reduce short-term financing needs. After the staff level agreement was reached in July, the authorities utilized the favorable market situation and successfully executed the liability management operation, which lengthened the maturity of the government debt by 4.8 years and reduced the interest by 125-150 basis points. The successful liability management operation safeguarded debt sustainability and reduced the pressure for short-term financing needs. Going forward, frontloading of program financing is essential to ensure and smooth out financing needs throughout the program period. In addition, the program will facilitate additional financing from World Bank, AfDB, and other bilateral partners, which will support the country's gross financing and developmental needs.

Fiscal Policy

The authorities plan an ambitious fiscal consolidation under the program and a total adjustment of 15.8 percent of GDP is planned for 2020-2023. The fiscal consolidation will be done through rationalizing and reducing fiscal expenditure, particularly from unwinding COVID-19 support measures, enhancing revenue mobilization, and effectively reducing financing costs. The fiscal adjustment efforts are well underway thanks to a more positive economic outlook, and the authorities have been able to start unwinding the pandemic support measures. Given the risks to the outlook, especially from the spread of new variants of COVID-19, travel restrictions, and uncertainties regarding global growth, the authorities are reprioritizing budget spending towards health and social expenditures and stand ready to further reduce budget expenditures in the event that downside risks materialize. Accordingly, the authorities are preparing the supplementary budget as per the Public Financial Management Act in line with the program parameters reducing the budget deficit to 9.8 percent of GDP.

The authorities are planning to undertake deep budgetary reforms to enhance public financial management capabilities under the program. On the revenue side, several reforms are planned to enhance revenue collection and to strengthen revenue administration, including limiting tax exemptions, and implementing measures to prevent the erosion of the corporate tax base through international profit shifting. On the expenditure side, reforms to freeze salary increases for public servants, strengthen public procurement, better target and increase the efficiency of the social protection system, and enhance the competency of public institutions are planned. In addition, the authorities are committed to resolving contingent liability issues arising from Air Seychelles' operation and exploring possible solutions with support from the IMF and WB.

Monetary and Financial Sector policies

The authorities will maintain an accommodative monetary stance as appropriate, considering the weakening credit growth and subdued economic activities. The Central Bank of Seychelles will stand ready to intervene if inflationary pressures persist. The level of foreign reserves decreased for the first time over the last four years in 2020, but the reserve levels have since stabilized with the opening of international borders. The authorities will closely monitor the foreign exchange positions of banks and intervene only in the case of disorderly market moves. Moreover, the Central Bank of Seychelles is committed to a floating exchange rate mechanism and allowing the market to determine the exchange rate. The Central Bank of Seychelles implemented all the recommendations of safeguards assessment completed in 2018 and have committed to undertake necessary actions arising from the recent safeguard assessment from June 2021.

The banking sector entered the pandemic with high profitability, robust liquidity, and low levels of NPLs. The economic crisis impacted the banks, and the economic slowdown and unwinding of supporting measures may negatively impact the banks' liquidity positions. Nonetheless, the banks continue to be well-capitalized, and NPLs have only risen slightly, and the central bank has tightened its supervision efforts since the pandemic and is closely monitoring banking sector developments and stands ready to take appropriate actions.

Structural policies

Under the program, the authorities aim to strengthen the economy, alleviate macroeconomic vulnerabilities, and improve governance and competitiveness. Strengthening government institutions, improving the business environment, financial inclusion, development of fintech, and consumer protection, among others, are priority areas for reforms for the authorities. Furthermore, diversifying the economy, further developing the fisheries industry, and enhancing tourism infrastructure to increase the revenue per incoming tourists is vital for creating jobs, supporting SMEs, and improving the economy's resilience. Climate change is one of the areas where the Seychelles is particularly vulnerable. Thus, the authorities are planning to undertake reforms to increase its resilience to climate issues.