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Republic of Seychells: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

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REPUBLIC OF SEYCHELLES: LETTER OF INTENT

March 13, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund

Dear Mr. Strauss-Kahn:

- 1. The attached updated Memorandum of Economic and Financial Policies for 2009 (MEFP) describes Seychelles' performance through end-2008 as well as our policies for 2009.** We are continuing to implement our reform program with determination and the reform effort is beginning to yield results. We request completion of the first review under the Stand-by arrangement and the release of the second tranche of SDR 0.88 million (10 percent of quota).
- 2. All the quantitative performance criteria at end-December 2008 were met except for the primary fiscal surplus and the temporary accumulation of external arrears, for which we request waivers.** The three structural benchmarks for end-December were all observed. We are making progress towards meeting the structural performance criterion for end-June on the tax audit of the 20 largest firms. We are also moving ahead with our strategy for external debt restructuring.
- 3. We believe that the economic and financial policies set forth in the MEFP are sufficient to ensure that the objectives of the 2009 program will be met.** If needed, 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. The quarterly quantitative performance criteria and indicative targets for 2009 are shown in Table 1, and the structural benchmarks and performance criteria are shown in Table 2. We are also committed to continue our strong efforts to quickly address the areas of concern identified in the IMF's safeguards assessment of the Central Bank of Seychelles (CBS).
- 4. We are elaborating a comprehensive medium-term reform strategy, in support of which we intend to request a 3-year arrangement under the Extended Fund Facility at the time of the 2010 budget.** As noted in my letter of October 31, 2008, we believe our reform strategy will require sustained effort over the medium term with the support of our international partners. We are actively working with IMF, World Bank and African Development Bank staff to elaborate a comprehensive structural reform program to be put in place in the second half of 2009.

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

Sincerely yours,

/s/

James Alix Michel
President
Republic of Seychelles

Attachments: MEFP and TMU

ATTACHMENT I

REPUBLIC OF SEYCHELLES: MEMORANDUM OF ECONOMIC
AND FINANCIAL POLICIES FOR 2009

I. INTRODUCTION

1. **Seychelles embarked on a comprehensive reform program in late 2008 aimed at addressing large fiscal and external deficits and economic inefficiencies that led to persistent macroeconomic imbalances and an unsustainable public debt burden.** The foreign exchange regime was liberalized and the rupee was floated, supported by a further significant tightening of fiscal and monetary policies. Interest rates were freed and are now driven by market forces. We have initiated a comprehensive debt restructuring strategy aimed restoring public debt sustainability and closing external financing gaps. We have implemented our reform program with determination and early results are satisfactory. However, much remains to be done to stabilize the economy and put it on a higher growth path.
2. **This memorandum reviews macroeconomic and financial performance at end December 2008, describes our policies for the remainder of 2009 and outlines some preliminary policies for 2010 under our two year Stand-by Arrangement (SBA) with the IMF approved on November 14, 2008.**

II. PERFORMANCE UNDER THE PROGRAM AT END DECEMBER 2008

3. **Growth in 2008 slowed considerably due to the economic crisis in Seychelles and increasingly on account of the impact of the deteriorating global environment.** Real GDP growth is estimated at zero percent in 2008, down from 3.1 percent expected at the time the program was put in place. While construction grew strongly, manufacturing activity declined and tourism earnings began to fall sharply in the fourth quarter (for an annual decline of 2.7 percent). Unemployment remained in the low single digits but inflation, which had eased to an annual rate of 32.2 percent in October, jumped in November (by 24 percent) to end the year at 63.3 percent. The increase in November was primarily a one-off price level adjustment to the float of the rupee, increases in the goods and services tax (GST) and administered prices on several products, and removal of indirect subsidies.
4. **The quantitative performance criteria for end-December were comfortably met, with the exception of the primary fiscal surplus target and the temporary accumulation of external arrears, for reasons explained in ¶13 below (Table 1).** The three structural benchmarks for end-December were met (Table 2).
 - The National Assembly approved a new Public Procurement Act, drafted with the support of the COMESA secretariat and the World Bank.

- A memorandum of understanding between the Ministry of Finance and the CBS that formalizes the operational terms under which the CBS acts as agent for the government was also approved, as recommended by the IMF safeguards assessment.
- A Public Debt Law was approved by the National Assembly in late-December, as an important first step in strengthening the transparency and management of public debt.
- We have hired several expatriate tax inspectors and auditors in early 2009, primarily to conduct audits of the 20 largest firms (structural for June 2009), and expect to meet the target.

5. **Following the float of the rupee in early November the exchange rate depreciated by about 50 percent against the U.S. dollar, and has since stabilized.** The initial depreciation was somewhat greater than expected, but despite transition issues in the exchange market and delays in implementing some supporting measures, the market mechanism is functioning adequately. The parallel exchange market has disappeared. The licensing of foreign exchange bureaus began in December but many took longer than anticipated to become operational. Regulations on net open positions in foreign exchange were approved in late December and came into effect in mid-February.

6. **Monetary policy has been tightened in line with the program objectives.** The weekly bank deposit facility at the central bank (CBS) and the 91-day treasury bill auction (which was opened to the nonbank public) have worked well and are helping to contain domestic liquidity and support the rupee. Following the removal of controls, interest rates have risen strongly—T-bill rates rose to over 29 percent in late December and, importantly, retail deposit and loan rates have also begun to rise. Recent indications are that T-bill rates have peaked, with slight declines recorded in early 2009. Domestic sterilization efforts, including significant T-bill sales to the nonbank public, were key in meeting the reserve money target. In late November, the CBS appointed a new external auditor, PricewaterhouseCoopers, on a five-year contract and began addressing areas of concern identified in the IMF safeguards assessment.

7. **The 2008 fiscal performance was somewhat better than anticipated, abstracting from the reclassification of an on lending operation with the national oil company (SEYPEC), as described below.** External grants exceeding program expectations, a large proportion of which were applied to the clearance of domestic arrears.¹ Despite inflationary pressures, primary spending was kept close to the program target (again, abstracting from the SEYPEC operation), including due to public sector wage restraint. A public sector wage increase—accorded in November to compensate for the higher cost of living resulting from the float of the rupee—averaged 12 percent. Tax revenues were the target for the year as a whole, but softened towards the end of the fourth quarter. We implemented all the fiscal measures described in paragraphs 19-20 of our MEFP of October 31, 2008.

¹ Grants received totaled US\$19.9 million (US\$15 million from Abu Dhabi; US\$1.5 million from China; and US\$3.4 million from South Africa), of which US\$7.4 million was used to clear domestic arrears.

8. **The 2009 budget was passed in line with program understandings.** Discretionary tax exemptions were eliminated, some taxes were raised, new taxes introduced, and fees, rents, and licenses were adjusted for inflation through September. Expenditure measures included the replacement of universal subsidies on fuel and other goods with a targeted social safety net and a substantial reduction the public sector workforce, primarily through a voluntary departure scheme. The downsizing of the civil service, initiated in November 2008, was greater than targeted at some 3,300 staff (17 percent of government employees).

9. **We have also made progress with fiscal structural reforms.** We established a public enterprise monitoring unit in the Ministry of Finance to reinforce parastatal monitoring, reporting, and better assess quasi-fiscal risks. We have introduced a full cost recovery policy in the provision of public utilities, supported by more frequent adjustments of administered prices. The privatization and liquidation of former units of the Seychelles Marketing Board (Agro Industries–sold; Animal feed–sold; and Coetivy Prawns-liquidated) progressed, although the privatization of Seychelles Savings Bank has been delayed until the first half of 2009.

10. **The quantitative performance criterion on the primary fiscal balance for 2008 was breached due to the reclassification of financing extended to SEYPEC prior to the commencement of our program.** Following the substantial increase in international oil prices and devaluation of the rupee in 2007 and early 2008, the cost to SEYPEC of administering the Government’s legislated subsidy on fuel products increased substantially, exceeding SEYPEC’s capacity to fund the subsidy internally. To secure domestic fuel supply in the difficult period from April to October 2008, the Government provided a short-term financing facility to SEYPEC of SR677 million (8.5 percent of GDP), on commercial terms. The loan was initially recorded as a financing item and not captured in the program fiscal data. The appropriate classification under GFS is in on lending, as it reflected the cost of administering the Government’s legislated fuel subsidies. Repayment of the loan commenced in January 2009 and will be fully repaid over period of about 18 months. The universal subsidies on fuel were eliminated in November 2008. The revised primary balance profile highlights the cost of the indirect subsidies and the significant fiscal tightening now underway. Moreover, in the absence of the reclassification, and abstracting from higher than anticipated external grants, we would have exceeded the program primary surplus target.

11. **The external current account deficit rose to 32 percent of GDP in 2008, primarily due to the impact of high petroleum and food prices and buoyant FDI-related imports.** The growth rate of tourism earnings began to decline in mid year and turned negative in the fourth quarter, reflecting the global slowdown. The CBS was able to secure the unblocking of a major foreign exchange asset in November, which helped it meet the NIR target. Gross official reserves rose to US\$50.9 million (0.7 months of imports), well above the program target adjusted for higher financial support. Public external debt rose to 91.4 percent of GDP in 2008, of which 40.6 percent of GDP was in arrears.

12. **We made progress with the public external debt restructuring strategy.** In November, together with our financial advisors, we conducted a road show, meeting with holders of almost 80 percent of the outstanding securities. On the bilateral side, Paris Club creditors have agreed to treat Seychelles external debts under the Evian approach, and we expect formal negotiations to commence in the Spring 2009. Discussions have also taken place with some non-Paris Club external creditors.

13. **There was a temporary accumulation of arrears to multilateral creditors in late 2008 and early 2009, breaching a continuous performance criterion.** Repayments to the European Investment Bank (EIB) due in early and mid-December were made in late-December, and repayments to BADEA due in early-January were made in late-January. Following these repayments, there are now no outstanding arrears to multilateral creditors. We have also taken comprehensive measures to eliminate the risk of a recurrence, including: centralizing management of repayments to multilateral creditors within the Ministry of Finance; commissioning the assistance of the COMESA Secretariat to strengthen our debt management information technology systems; and bolstering staffing resources in Ministry of Finance's debt management section. We have also requested technical assistance from the IMF's Monetary and Capital Markets (MCM) department to help further strengthen our debt management capacity.

III. MACROECONOMIC AND FINANCIAL PROGRAM FOR 2009–10

14. **The objectives of our reform program for 2009 are to consolidate and extend the reforms of late 2008, sustaining our tighter fiscal and monetary policies to stabilize the economy and lay the foundations of a recovery in 2010.** Since the program was put in place in November, the global economic environment has deteriorated sharply, with implications for our program. The outlook is for a deeper decline in GDP and a less favorable fiscal and external performance in 2009. A progressive recovery is projected in 2010 and beyond under the impulse of rising foreign investment in tourism following the lifting of exchange restrictions and other bottlenecks, which hampered investment and growth. We will also pursue our a comprehensive debt restructuring strategy aimed at placing public debt on a sustainable path.

15. **Preliminary projections suggest a contraction of real GDP for 2009 of about 9.6 percent (revised from a forecast contraction of 0.5 percent at the time our program was put in place), with a gradual recovery expected from 2010.** Tourism earnings are expected to drop significantly (by 25 percent), although the balance of payments effect will be offset to a large extent by reduced import volumes and much lower food and fuel prices. Inflation, following a large one-time adjustment in prices in November 2008, is expected to decline steadily in 2009 due to weaker international prices, slower domestic demand, and tight monetary policy. We will be vigilant in guarding against any entrenchment in high inflation expectations, including through continued adherence to public sector wage restraint.

16. **The current account balance is projected to improve in 2009, to a deficit of about 29 percent of GDP, and to decline further through the medium term.** Merchandise imports are expected to decline sharply (by about 37 percent in US dollar terms) in 2009 under the impact of the devaluation and a decline in FDI and tourism-related imports, before a gradual recovery broadly compatible with GDP growth in 2010 and beyond. The growth of goods exports is expected to be moderate at about 4 percent in 2009. Over the medium-term, services exports, largely tourism, are expected to grow strongly under the impulse of a recovery in direct foreign investment on improved competitiveness, and a more conducive business environment.

A. Fiscal Policy

17. **We will maintain a tight fiscal stance in 2009.** We are taking measures to further strengthen revenue collection, control public expenditure, and raise the efficiency and transparency of public finance. Primary fiscal surpluses of 6.2 percent of GDP on average are targeted in 2009-10, excluding the impact of the repayment of the SEYPEC financing facility of 2008. This will be achieved through expenditure restraint, the full year effect of eliminating indirect product subsidies in late 2008 and a reduction of the government wage bill in real terms (from about 8.7 percent of GDP in 2008 to 6.9 percent of GDP in 2010) as part of our plan to reduce the size of the public sector. A revenue shortfall of 3.5 percent of GDP (largely on trade taxes and GST) from the drop in tourism earnings has been partly compensated for by higher negotiated receipts from the fishing sector (2.8 percent of GDP). At this stage we do not foresee the use of the fiscal recapitalization contingency for public financial institutions provided for under our program in the short-term, but will keep the situation under close supervision.

18. **In the coming months will work with the IMF, World Bank and African Development Bank on a medium-term economic strategy** that will include fundamental reform of our tax system, strengthened tax administration and public financial management, and further privatization of public enterprises.

Fiscal structural reforms

19. **We will continue to strengthen the public financial management framework and the budgetary process in order to facilitate fiscal consolidation.** We will strengthen the budget formulation and execution process to ensure that resources can be allocated and used efficiently and that established spending limits are respected. We will reinforce financial control within major spending ministries and bolster the Ministry of Finance's expenditure oversight and tracking functions. This will include adoption of a Treasury Single Account to consolidate and optimize the use of government cash balances. We will implement rationalization measures recommended in the World Bank's Public Expenditure Review (PER), initially focusing on the health and education sectors. We have also established a public enterprise monitoring unit in the Ministry of Finance to effectively monitor and control quasi-fiscal risks. Beginning with the 2010 Budget, we will present a complete

budget package to parliament, including financing and debt, for approval in replacement of our current appropriations bill.

20. **We are preparing a fundamental reform of the tax system with technical support from the IMF.** The current system has many differentiated rates of tax, high overall tax rates for businesses, and a significant number of exemptions, particularly for the tourism and fishing sectors. Our objective is to have a simple, fair, and equitable system, featuring low, harmonized rates and a broader tax base, which will reduce incentives for evasion. An IMF tax policy mission in February and recommended a plan of action over the medium term, which we intend to launch in mid-2009.

Revenue Measures

Action	Timing
Introduce GST on casinos	March
Remove the GST on animal feed	March
Launch a tax reform strategy following further discussions with IMF staff	May
Complete tax audits of the 20 largest enterprises	June

21. **Strengthening public debt management forms an integral part of our adjustment strategy.** As stipulated by the new Public debt Act, we will formulate a medium-term public debt strategy, aimed at achieving an optimal trade-off between cost and risk of public debt and consistent with long-run debt sustainability. We will increase the transparency and reporting of public debt and strengthen the Ministry of Finance's debt management functions. We also plan to strengthen the rules governing provision of government guarantees and start charging guarantee fees. We will take all the necessary measures to not accumulate new arrears to external or domestic creditors. We have also taken initial steps to improve monitoring of contingent liabilities that may arise within the public sector. We have requested technical assistance from MCM in these areas.

22. **A high-level government task force, headed by the Minister of Finance, is laying the groundwork for major public service reform.** The task force conducted a comprehensive review of the range of functions performed by government employees, with a view to eliminating duplication and to outsourcing services that can be provided more efficiently by the private sector. The review identified scope within most government departments for outsourcing ancillary services (e.g., cleaning, maintenance, security and some administrative functions) to the private sector and steps in this direction have commenced.

23. **In recognition of the need for Government to better manage the process of according fiscal concessions to investment proposals in line with the Government's long term fiscal policy,** to ensure appropriate management of such concessions and enhance the revenue analysis capacity of the Government, the Ministry of Finance will set up a Financial Analysis Branch, involving specialist accountants, internal auditors and graduating economists within the next 12 months. One of the functions of the Financial Analysis Branch will be the assessment of investment proposals of above SR 10 million.

24. **We are actively pursuing the further privatization and reform of public enterprises, with a view to reducing the role of the state and encouraging private sector activity.** We will work closely with the World Bank and African Development Bank on designing a strategy for further privatization and public enterprise reform, and are seeking the support of IFC. Going forward the government and state enterprises will avoid retaining minority stakes in the firms we privatize, and in the context of the government's current financial constraints, acquiring new positions without the approval of the Minister of Finance.

Expenditure measures

Action	Timing
Appoint a qualified financial controller to the Ministry of Health to strengthen expenditure control	March
Commence work towards implementation of a treasury single account	March
Close three remaining debt service escrow accounts at CBS	March
Finalize annual report on the public debt	March
Gather comprehensive data on parastatal debt and finances	March
Hire additional qualified staff and equip the public enterprise monitoring unit	June
Seek to revive IFC support and participation in privatization of Nouvobanq	June
Adopt a treasury single account	September
Complete external audits of the 2008 accounts of seven major public enterprises (PUC, STC, SEYPEC, SCAA, IDC, Air Seychelles and Nouvobanq) in accordance with international audit standards and undertaken by a firm acceptable to the Minister of Finance	September
Prepare a debt strategy to be submitted with the 2010 budget	September
Prepare a strategic plan for each major public enterprise	September
Centralize public debt management in the Ministry of Finance and bolster debt management systems and capacity	2009
Set up a Financial Analysis Branch at Ministry of Finance to assess investment proposals.	2009

B. Public Debt Restructuring Strategy

25. **The success of our adjustment and reform program requires external financial support, including a restructuring of our external debt.** We are committed to sustaining a strong fiscal effort over the medium term complemented by a comprehensive debt restructuring, consistent with our payments capacity and the Fund's lending into arrears policy, with particular focus on information transparency, inter-creditor equity, and dialogue with all creditor groups. Immediate and sizable cash flow relief in the short- to medium-term, sustained reduction of our debt service burden, and significant balance of payments support from our international partners, will be necessary. With regard to domestic debt, we will need to assure the stability of our banking system which has a large portion of its assets in government debt.

C. Monetary, Exchange Rate, and Financial Sector Policies

26. **We are committed to maintaining a tight monetary policy stance in 2009 to reestablish price stability, restore confidence in the rupee, and stabilize the economy.** Our new market-based monetary policy framework has yielded encouraging results, with real interest rates rising from highly negative to positive levels and early signs that inflation is slowing after the one-off price level adjustment in November 2008. The external position has been reinforced by the float of the rupee, supporting an increase in international reserves. The coordination of monetary and fiscal policy is also improving, with our 2009 Budget and prudent fiscal targets established under the program supporting the CBS's monetary policy objectives.
27. **We are taking measures to strengthen the operation of monetary policy, improve the efficiency of the financial sector and address areas identified by the IMF safeguards assessment.** The CBS and Ministry of Finance are working together on improving cash flow forecasting, supporting the CBS's liquidity management functions. With IMF technical assistance, we are determined to reinforce the stability, accountability, and transparency of the financial system through the introduction of modernized regulations, conservative financial norms and a Financial Institutions Act that accords with international best practice. We will also continue our efforts to improve governance and internal operations at CBS, including by addressing risk areas identified in the IMF safeguards assessment.
28. **The CBS is materially undercapitalized and profit distribution will be constrained over the next 3-5 years so that capital can be built up to adequate levels (10 percent of monetary liabilities).** The 2008 profit distribution will be limited to 70 percent of operational profit, excluding unrealized and revaluation gains. In anticipation of the CBS's new capital provisions proposed under the amended CBS act, the CBS and the Ministry of Finance have formally agreed to retain the CBS unrealized and revaluation gains in an escrow account for reapplication to the CBS capital structure following passage of the amended CBS act, expected in April.
29. **The CBS will continue to work with the IMF's technical experts to build capacity on policy monitoring and implementation.** We have benefited from IMF technical assistance on monetary and foreign exchange operations, banking supervision, payment systems, and central bank internal audit control. We welcome visits from the IMF's MCM experts to: assist in the establishment of an automated interbank market in foreign exchange; strengthen reserve money targeting; reinforce and modernize banking supervision; improve CBS capacity in central bank accounting, audit and external reserves management; and modernize our payment systems.

Monetary measures

Action	Timing
Introduce remuneration on statutory commercial bank reserves above a certain threshold at an interest rate that reflects the financial cost to commercial banks	March
Increase required reserves maintenance period to two weeks	June
Reduce the local asset ratio with the aim of phasing it out over the program period as conditions permit, in consultation with IMF staff	2009
Improve liquidity forecasting and strengthen monetary targeting	September

Governance and safeguards measures

30. **We are committed to continued rapid implementation of measures to improve CBS governance, financial and accounting systems, and internal audit and control procedures, as identified in the IMF safeguards report.** We are working closely with MCM to address all of these recommendations over the next two years.

Action	Timing
Full disclosure in 2008 Annual CBS report of all off balance sheet items, including pledged assets and earmarked or blocked funds	March
Submit to Parliament a revised CBS Act, inter alia to strengthen governance and operations.	April
Publish external audit letter and accounts on CBS website	April
Begin transition to IFRS accounting standards at CBS by 2010 financial year	2009
Upgrade CBS' IT system, particularly to introduce an integrated accounting framework	2009

Exchange rate regime

31. **The liberalization of the exchange regime has lifted severe constraints on the development of the economy and we are committed to maintaining a market float of the rupee.** Central Bank interventions in the foreign exchange rate market will be limited to smoothing excessive volatility and ensuring orderly market conditions, subject to the achievement of our reserve money and external reserves targets. We will continue, with IMF technical support, to introduce measures to strengthen nascent foreign exchange institutions and promote efficiency and transparency in the market.

Action	Timing
With technical assistance from the IMF, establish a platform at the CBS for interbank foreign exchange trading/fixing	April
Prepare and submit to the National Assembly a modernized, simplified and transparent foreign exchange act.	June
Reduce to 30 per cent of capital net open positions on foreign exchange	June
Establish a Foreign Reserves Management Committee within the CBS, and	September

adopt investment guidelines	
Establish stronger controls over day-to-day foreign exchange operations by separating key responsibilities and reporting lines	September
Introduce an augmented real-time gross settlement foreign exchange system	2010

Financial sector development and stability

32. **The CBS is committed to improving the efficiency and operations of the financial market.** Outdated financial regulations underpinning the current system of administrative monetary policy instruments will be streamlined and gradually phased out. We will continue to closely monitor the operations and capitalization of the financial sector, in particular of state-owned financial institutions. A reassessment of the strategic role of public nonbank financial institutions will also be undertaken, and we are seeking technical assistance to create a specialized oversight function at the Ministry of Finance to advise on options available to the government.

Financial sector reforms

Action	Timing
Presentation to the National Assembly of a modernized and strengthened Financial Institutions Act with IMF technical support	June
Further strengthen financial sector supervision through implementation of the action plan developed in consultation with IMF technical experts in December 2007, including:	2009
<ul style="list-style-type: none"> • Introduction of new liquidity risk management regulations 	March
<ul style="list-style-type: none"> • Introduce new bank and <i>bureau de change</i> licensing regulations and update documentation requirements for banks 	March
<ul style="list-style-type: none"> • Update credit classification and provisioning regulations 	April
<ul style="list-style-type: none"> • Update and strengthen commercial bank capitalization norms 	April
<ul style="list-style-type: none"> • Issue regulations to banks on minimum requirements for appointing external auditors, which will replace existing circular 	June
<ul style="list-style-type: none"> • Update credit concentration regulations and connected lending regulations in parallel with amendments to the Financial Institutions Act 	June
<ul style="list-style-type: none"> • Introduce new regulations on the acquisition of substantial interests 	June

D. Statistical Issues

33. **Notwithstanding significant improvements, we recognize that there remain deficiencies in key macroeconomic data** – especially GDP estimates, and external sector statistics, which limit their usefulness for surveillance, economic analysis, and policy formulation. The government will strive to further improve the quality, periodicity, and timeliness of macroeconomic statistics. The government has requested technical assistance in these areas from the IMF Statistics Department. We will also strive to fully implement the

GFS classification system in order to present our fiscal accounts in the IMF format for easier budget monitoring and reporting.

E. Program Financing

34. **For 2009, the external nonproject financing requirement is expected to be covered by** disbursements from the IMF under the SBA (30 percent of quota; SDR 2.64 million; US\$3.85 million), from the joint World Bank and African Development Bank Development Policy Loan (US\$19 million) and from external debt relief (US\$89million).

IV. PROGRAM MONITORING

35. **The SBA will continue to be monitored by quarterly program and financing assurances reviews.** The quarterly quantitative performance criteria for 2009 are shown in Table 1. The structural benchmarks and performance criterion for 2009 are shown in Table 2. The non zero ceilings on the contracting or guaranteeing of external debt are to allow for budgeted public project finance and program support from multilateral institutions exclusively.

36. **The completion of the first and second reviews under the program are based on meeting the quantitative performance criteria (QPCs) at end-December 2008 and end-March 2009, respectively.** The second review will also focus on strengthening governance and operations at the CBS, progress reinforcing public financial management, progress on normalizing relations with external creditors, upgraded bank capitalization and credit quality norms, and progress on a tax policy reform strategy. The third, fourth, and fifth program reviews under the SBA are based on meeting the QPCs at end June, end September and end December 2009 and are scheduled to be completed by end September, end December and end March 2010, respectively. Financing assurance reviews will coincide with the program reviews.

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

Table 1. Seychelles: Quantitative Performance Criteria Under the Stand-By Arrangement, June 2008–December 2009
(Millions of Seychelles rupees; end-of-period)

	2008						2009							
	June	September		December		March	June		September		December			
	Actual	Estimates	Actual	Country Report No. 08/365	Adjusted	Actual	Country Report No. 08/365	Country Report No. 08/365	Rev. Prog.	Country Report No. 08/365	Rev. Prog.	Country Report No. 08/365	Rev. Prog.	
Performance criteria														
Net international reserves of the CBS, millions of U.S. dollars (floor) ¹	14.0	14.0	14.0	19.0	26.0	41.2	20.0	18.0	51.9	57.0	60.5	80.0	77.2	
Reserve money (ceiling)	1,282.3	1,271.0	1,271.1	1,151.0	...	1,119.9	1,146.0	1,261.0	1,265.9	1,393.0	1,310.6	1,386.0	1,350.8	
Primary balance of the consolidated government (cumulative floor) ^{2,3,4}	-2.3	420.0	184.2	560.0	...	335.7	73.0	88.0	386.9	299.0	641.6	622.0	945.6	
The contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) ²				15		10.3	10.0	10.0	10.0	30.0	30.0	35.0	35.0	
The contracting or guaranteeing of new short-term external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) ²				0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
The accumulation of external payments arrears by the public sector (ceiling) ⁵				0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
The accumulation of domestic payment arrears by the public sector (ceiling)				0.0		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Memorandum items:														
External non project financing (millions of U.S. dollars; cumulative) ²				-0.4	6.6	6.6	-10.0	-23.0	-16.1	-11.0	-4.0	-19.0	-8.2	
Program financing support ²				1.6	19.9	19.9	0.0	0.0	0.0	15.0	19.0	15.0	19.0	
Cash payments on foreign debt service ²				2.0	13.3	13.3	10.0	23.0	16.7	26.0	23.9	34.0	28.4	
External budget grants ²									0.6		0.9		1.2	
Program accounting exchange rates														
SR/US\$ (end-of-quarter)	8.00	8.00	8.26	14.00		16.57	14.00	14.00	16.00	14.00	16.00	14.00	16.00	
US\$/Euro (end-of-quarter)	1.58	1.46	1.28	1.46		1.39	1.46	1.46		1.46		1.46	1.46	
US\$/UK pound (end-of-quarter)	1.99	1.84	1.78	1.84		1.44	1.84	1.84		1.84		1.84	1.84	
US\$/SDR (end-of-quarter)	1.63	1.56	1.56	1.56		1.54	1.56	1.56		1.56		1.56	1.56	
Reserve requirement (percent of deposits)	13	13	13	13		13	13	13		13		13	13	
Local asset ratio (percent of deposits)	50	45	45	45		45	45	45		45		45	45	

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

¹ The floor will be adjusted downwards (upwards) for any shortfall (excess) in external nonproject financial support from that assumed in the program.

² Cumulative flows from the beginning of the calendar year.

³ The floor will be adjusted upwards for any unused amounts of the contingency in the budget for the recapitalization of the banking sector assumed in the program. Amounts of the contingency in excess of programmed amounts need to be funded within the program limits.

⁴ The floor on the primary fiscal surplus will be adjusted upwards (downwards) by any excess (shortfall) of external budget grants from that assumed in the program.

⁵ The non-accumulation of new external payment arrears constitutes a continuous performance criterion. Excludes arrears for which a rescheduling agreement is sought. Some external arrears were accumulated in December 2008, but cleared before end-December.

Table 2. Seychelles: Structural Benchmarks and Performance Criterion, 2008–09

Measure	Target date	Status
Structural performance criterion		
<ul style="list-style-type: none"> Complete tax audits by Seychelles Revenue Commission of the 20 largest companies 	End-June 2009	Work in progress
Structural benchmarks		
<ul style="list-style-type: none"> Submit to Parliament a Public Debt Law, defining a legal framework for public debt management, and specifying the roles and responsibilities of the bodies engaged in contracting and managing public debt. 	End-December 2008	Met. Law approved by the National Assembly.
<ul style="list-style-type: none"> Parliamentary approval of a Public Procurement Act. 	End-December 2008	Met.
<ul style="list-style-type: none"> Approve a memorandum of understanding, under Article 34 of the CBS act, formalizing the operational terms and conditions under which the CBS acts as agent for the government. 	End-December 2008	Met.
<ul style="list-style-type: none"> Submit to the National Assembly a revision of the CBS act to strengthen governance and operations (MEFP, ¶ 30). 	End-April 2009	
<ul style="list-style-type: none"> Promulgate updated credit classification and provisioning regulations and strengthened commercial bank capitalization norms. (MEFP, ¶ 32). 	End-April 2009	
<ul style="list-style-type: none"> Adopt a tax policy reform strategy with FAD TA (MEFP, ¶ 20). 	End-June 2009	
<ul style="list-style-type: none"> Adopt a modernized and strengthened financial institutions act, with IMF T/A support. (MEFP, ¶ 32). 	End-June 2009	
<ul style="list-style-type: none"> Introduce a treasury single account (MEFP, ¶ 19). 	End-September 2009	
<ul style="list-style-type: none"> Establish a foreign reserves management committee and adopt investment guidelines (MEFP, ¶ 31). 	End-September 2009	

ATTACHMENT II**REPUBLIC OF SEYCHELLES: TECHNICAL MEMORANDUM OF UNDERSTANDING**

1. This technical memorandum of understanding presents the definitions of variables included in the quantitative performance criteria and indicative targets set out in the memorandum of economic and financial policies (MEFP), the key assumptions, and the reporting requirements of the Government and the Central Bank of Seychelles (CBS) needed to adequately monitor economic and financial developments. The quantitative performance criteria and indicative targets, and the structural performance criterion and benchmarks for 2008-09 are listed in Tables 1 and 2 of the MEFP, respectively.

I. QUANTITATIVE PERFORMANCE CRITERIA**A. Net International Reserves of the CBS (Floor)****Definition**

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

Calculation method

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

Monitoring and reporting

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

Adjusters

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

B. Reserve Money (Ceiling)

Definition

6. Reserve money is equivalent to currency issued and deposits held by financial institutions at the central bank (bank reserves). Evaluation of performance of reserve money with respect to the program ceiling will take account of any changes in regulations affecting the level of banks' required reserves.

Monitoring and reporting

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

Adjusters

8. The reserve money target would be lowered (raised) for any reduction (increase) in the reserve requirements from those assumed in the program. A change in the reserve requirement coefficient will change the reserve money (RM) ceilings according to the following formula:

$$\Delta RM = \Delta r_D * DD_0 + \Delta r_F * DF_0,$$

where: DD_0 denotes the level of domestic currency deposits and DF_0 denotes the level of foreign currency deposits to which the reserve requirements for domestic currency and foreign currency deposits, respectively, apply during the period immediately preceding the date when the new reserve regulation becomes effective; Δr_D and Δr_F denote the change in the reserve requirement coefficient for domestic currency and foreign currency deposits, respectively.

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

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

Adjusters

10. The floor on the primary surplus of the consolidated government will be adjusted upwards by the cumulative amount of the contingency for recapitalizing the state-controlled financial institutions which is not used for that purpose. Any amounts spent for the recapitalizing of the state-controlled financial institutions in excess of programmed contingency will need to be funded within the program limit on the primary balance.

11. The floor on the primary surplus of the consolidated government will be adjusted upward (downward) by the amount by which external budget grants exceeds (falls short of) the amounts assumed in the program (MEFP Table 1).

D. Public External Debt (Ceiling)

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

- A zero subceiling on short-term external debt applies continuously to the contracting or guaranteeing of short-term external debt by the public sector, with an original maturity of up to and including one year.

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

(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 some time 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 title to the property. The debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

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

E. External Arrears of the Public Sector

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

F. Budget Expenditure Arrears

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

II. DATA AND INFORMATION

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

The CBS will report

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

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

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

- The monetary survey in the standardized report form format.
- The foreign exchange cash flow, actual and updated.
- Financial soundness indicators.

- Stock of government securities in circulation by holder (banks and nonbanks) and by original maturity and the debt service profile report.

The Ministry of Finance will report

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

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

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.