

## International Monetary Fund

[Seychelles](#) and the  
IMF

**Seychelles:** Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

**Press Release:**  
[IMF Completes the Fourth Review and Financing Assurances Review under the Extended Arrangement for Seychelles](#)  
January 12, 2012

December 23, 2011

The following item is a Letter of Intent of the government of Seychelles, which describes the policies that Seychelles intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Seychelles, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

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## LETTER OF INTENT

December 23, 2011

Ms. Christine Lagarde  
Managing Director  
International Monetary Fund

Dear Ms. Lagarde:

1. The attached Memorandum of Economic and Financial Policies (MEFP) describes Seychelles' performance through September 2011, and sets out our policy and reform priorities for the remainder of the Extended Arrangement with the Fund.
2. **We request completion of the fourth review under our Extended Arrangement and the release of the seventh tranche of SDR 3.08 million (28 percent of quota).** We have made significant progress in our reforms and the program remains on track. All quantitative performance criteria (PCs) at end-June 2011 and indicative targets for end-September were met with margins, and monetary and fiscal developments remain favorable. Two structural benchmarks for this review have not been implemented owing to capacity constraints. The end-June 2011 benchmark related to the optimal tariff study has been postponed because of administrative hurdles in securing donor financing and finding a qualified expert. These difficulties have been resolved now and we plan to complete the tariff study by July 2012 with the view to implementing a new tariff structure by end-September 2012. Pending this measure, instead of reinstating the electricity tariff adjustment to fuel prices (end-September structural benchmark), we raised electricity tariffs significantly to fully cover the cost and ensure financial viability of public utilities.
3. **The Extended Arrangement continues to support our comprehensive medium-term structural reform strategy** aimed at consolidating macroeconomic stability, improving debt sustainability, and promoting private sector-led growth; and to guide our macroeconomic policies in the remainder of 2011 and in 2012.
4. **We believe that the economic and financial policies set forth in the MEFP are sufficient to ensure that the objectives of the program will continue to 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.
5. **We request a waiver of applicability for all end-December 2011 and relevant performance criteria.** The relevant information is not yet available, but we believe that these criteria will be observed.
6. **We also request the establishment of the performance criteria for end-June 2012.** It is expected that the fifth review under the arrangement will be completed by end-March

2012 and that the sixth and the final review be completed by end-September 2012. Financing assurance reviews will continue as long as public debt arrears to external private creditors remain outstanding.

7. **In line with our commitment to transparency, we request that 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/  
Danny Faure  
Vice President and Minister of Finance  
Republic of Seychelles

/s/  
Pierre Laporte  
Governor  
Central Bank of Seychelles

Attachments: MEFP and TMU

## ATTACHMENT 1

### SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2011 AND 2012

#### A. Introduction

1. This document tracks progress after almost two years of macroeconomic and financial structural reforms under the three-year program supported by an Extended Arrangement under the Extended Fund Facility (EFF). It updates the MEFP of May the 18<sup>th</sup>, 2011 and details our policies for the remainder of 2011 and 2012 to support completion of the fourth review.

2. This MEFP aims at cementing gains in areas where progress has been swift and tangible (notably, public financial management and taxation reform), whilst forcing through some measures in areas where progress has been less rapid (e.g. public enterprises posing threat to budget).

#### B. Macroeconomic Performance and Outlook for the Remainder of 2011

3. **Macroeconomic outcomes to date in 2011 have turned out to be more favorable than expected despite a marked slowdown in growth in Western Europe (our primary tourism market).** Real GDP growth in 2011 is now projected at 5 percent, up from 4 percent projected at the time of the third review (June 2011), bolstered by buoyant tourism and canned tuna sectors.

4. **The increase in world commodity prices and costs associated with protecting imports from piracy threats continue to pass-through to higher consumer prices, but there is little evidence of impending inflationary pressures coming from second-round effects.** CPI inflation has increased from close to zero at end-December 2010 (year-on-year) to 3.3 percent as of end-September, largely due to higher fuel and electricity prices and is expected to peak at 5.4 percent at the end of the year. The nominal effective exchange rate has been roughly stable, with the depreciation of the rupee against the dollar largely offset by its appreciation against the euro. However, exchange rate movements between the euro and the dollar have negatively impacted our terms of trade. We have nonetheless continued to rebuild our gross international reserves, which now reached 2.4 months of prospective imports of goods and services.

5. **The current account deficit continues to be financed by sizeable net FDI inflows and capital grants.** Major revisions to balance of payments data were recently released, based on our first comprehensive survey implemented for 2010 with technical assistance provided by the IMF Statistics Department. The revised figures indicate that the current account deficit is smaller than previously reported, largely due to upward revisions to our exports of services. Despite these revisions, the current account deficit remains large, projected at around 22 percent of GDP in 2011, but is largely financed by non-debt incurring capital inflows, with net FDI inflows projected at 20 percent of GDP in 2011, enabling us to maintain the external debt burden on a clear downward profile over the medium term.

### C. Program Implementation in 2011

6. **We achieved the quantitative targets of the program.** All quantitative performance criteria as of end-June and all indicative targets as of end- September 2011 were met (Table 2), and end-December targets appear achievable.

7. **Our fiscal policy stance in 2011 is expected to be slightly above our objective set at the last review, with revenue and expenditure larger than projected.** The surplus in the primary balance should be around 4.7 percent of the GDP projected at the beginning of the year.<sup>1</sup> Based on tax revenue collection through end-September, we project to exceed our government revenue objective in 2011 by about 2 percent of GDP (somewhat less than last year). As of end-September, revenue over performance is mostly attributable to the strong economy and imports, as well as successful efforts to collect business tax arrears. We have maintained an extensive capital budget for 2011 to ensure significant improvement in national public infrastructure. This has been spent primarily on the utility company, which amongst its many projects included the purchase and installation of water desalination plants to cope with the longer dry periods. Additionally, the completion of over 300 housing units on Perseverance Island will help ease the shortage of housing on the market. Through two supplementary budget laws in June and in October, we made parallel appropriations, mainly for unexpected expenditures to cover the temporary stabilization of a few sensible prices (0.4 percent of GDP), emergency support for our national airline (1 percent of GDP), an early parliamentary election (0.2 percent of GDP), as well as unforeseen costs for the organization of the Indian Ocean Island Games. In line with recent years' practice, we are projecting to save about 0.2 percent of GDP of the extra revenue to accelerate our debt reduction.

8. **We have tightened monetary policy since the beginning of 2011 to absorb the excess liquidity in the banking system and to prevent a second-round of domestic inflation.** Monetary aggregates have been kept under control through hikes in reserve requirements and sterilization operations that had led to a marked rise in market rates (three month T-bill rates have risen from 0.5 percent in the first quarter of the year to 5 percent since June). Private sector credit growth over the twelve months ending in September has nonetheless reached 16 percent. In view of the remaining domestic price increase needed to complete the pass-through of international prices, we plan to maintain the monetary policy stance through the end of the year.

9. **We are implementing our structural reform program, although with some delays.** Two elections and unexpected events such as a severe draught slowed down actions that had been scheduled as structural benchmarks for end-June and end-September 2011 (Table 3). However, we have been catching up in the recent weeks. The completion of a tariff study for the public utility company is pending due to unexpected difficulties to recruit a consultant. The consultant is being recruited with the assistance of the World Bank and the study should be available by end-June 2012, in time to prepare for a comprehensive electricity and water tariff reform by end-September 2012. Although we have not formally reinstated the electricity tariff adjustment for fuel price variation at end-September 2011 as envisaged, we have adjusted twice this tariff in August and November 2011, and stand ready to adjust it further as needed, pending this comprehensive tariff reform.

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<sup>1</sup> Significant revisions in nominal GDP for the 2008–10 period have led to a 4 percent increase in nominal GDP projection. As a result, the primary balance expressed in percentage points of the revised GDP is 4.5 percent.

10. **Despite the adoption of several measures, the restructuring of Air Seychelles is experiencing further difficulties.** We have appointed a new CEO, a professional aviation manager, with a mandate to promptly bring the company back to profitability, stopped flights to four loss-making destinations, retired four planes, including two old planes that had excessive operational and maintenance costs and renegotiated slightly more favourable terms for a code-sharing agreement. Despite these measures, the company's losses have not been reduced in part due to the loss of a contract for profitable charter activity. This and adverse short-term prospects with the beginning of two international carriers' activity in Seychelles from November 2011 forces the company to further downsize its activity (see ¶16).

#### **D. Macroeconomic Outlook for 2012 and Beyond**

11. **With tourism earnings continuing to exhibit resilience in the wake of growing uncertainty surrounding growth prospects in Europe, growth is expected to decline modestly to 4 percent in 2012, with the balance of risks tilted to the downside.** Our aggressive global pricing and marketing strategy (selling a more affordable Seychelles to diversified tourist populations, including in rapidly growing emerging market economies), combined with our open sky policy that continues attracting more carriers should offset the fragility of the world recovery, and in particular the slowing down in the Eurozone.

12. **Despite large downside risks, there are grounds for optimism over the medium term.** The vast improvement in communications which will follow the installation of Seychelles' first submarine cable is expected to lead to growth and diversification of the economy. Traders and fishing operators (both domestic and foreign) have incorporated practices to address piracy risks, and activity in these sectors is picking up to pre-2008 levels. We have also received assistance from a number of partner countries who are helping us combat the threat of piracy in the Indian Ocean. The large increase in flights and construction of new hotels will be a source of continued growth in tourism activity in the country. The external current account deficit is projected to contract in the medium term. At the same time, good progress in the planned reduction of the public debt is expected to boost investor confidence and maintain substantial inflows of foreign capital, mainly in the tourism industry.

#### **E. Policies for 2012 and Beyond**

##### *Fiscal Policy*

13. **We are committed to maintain a sustainable fiscal policy, in line with our strategy to bring public debt below 50 percent of GDP by 2018.** Assuming the continuation of a strong revenue performance and a smaller volume of one-off expenditures in 2012, we plan to increase the primary surplus target for 2012 to 4.7 percent of the revised GDP against 4.5 percent in 2011 with a view to accelerate our debt retirement obligations.

14. **Revenue collection in 2012 is projected to slightly decrease in percentage of GDP in 2012 with the expected reduction in business tax arrears.** Positive factors include the impact of the increase in the GST rate for the tourism sector from 12 to 15 percent in November 2011 and the strengthening of tax and customs administrations. The introduction of a single-rate value added tax (VAT) in July 2012 will crown the major tax reforms that started under the first Fund-supported program in 2008. It is expected to be revenue-neutral in the medium term; the two-month delay in processing VAT refunds will improve slightly our tax collections in 2012. Over the medium term, we plan to stabilize the revenue-to-GDP ratio at around 35 percent.

15. **Most current expenditures will be tightly contained in 2012 to maintain a high level of capital expenditures.** The wage bill is projected to decline slightly in percentage of GDP. The nominal increase will reflect the hiring of qualified staff in areas where the administration suffers from bottlenecks (attorney general office, revenue commission, social welfare administration, statistics), mid-year changes in our pay scale (scheme of services) to retain our most skilled civil servants, as well as modest wage increases, targeting mainly the lower end of the pay scale. Given the recent and forthcoming price adjustments in the basket of goods defining minimum living standards, targeted social transfers through the Social Welfare Agency will also increase in 2012. However, the additional cost of this targeted support (0.2 percent of GDP) will be far lower than the cost of the Stabilization Fund in 2011, now discontinued. Purchases of goods and services incorporate allocations for the proper functioning of new facilities that were granted to Seychelles in 2011, in particular two health centres. Capital expenditures will focus on infrastructure to cope with the expansion of our tourism capacity and on priority social needs.

16. **Air Seychelles is implementing further drastic steps to streamline its loss-making activities, limit the need for budget assistance in 2012, and break-even by 2013.** The company will cut losses by eliminating its loss-making long-haul flights and focus its operations on local and regional destinations, starting April 2012. We are budgeting the equivalent of 1.2 percent of GDP to help the company cover its debt servicing costs for loans taken in 2010 and 2011, as well as operational losses and one-off downsizing costs (penalties for early lease cessation) during the first part of the year.

17. **In line with the new PFM legislation adopted by the Cabinet, we have included a contingency appropriation in the 2012 budget which we will only activate in the case of unforeseen expenses.** This appropriation replaces the contingency fund and the stabilization fund. This will in particular cover the budget risks associated with piracy, natural disasters, and further sharp increases in international food and fuel prices. It has been set at SR 75 million, about 1.5 percent of the total budget appropriations for 2012 and 0.6 percent of GDP. In the event that there are no unforeseen expenses in the first half of the year, and revenue remains on track through end-June we plan to release progressively this reserve for capital investment projects, starting in July 2012.

### *Tax and Customs Reform*

18. **We will pursue efforts to modernize the Seychelles Revenue Commission, notably in the customs administration area.** With the technical assistance of the IMF and the EU, we are also preparing for the effective launching of the VAT.

19. **The enacting of the new Customs Management Act provides a strong opportunity to improve the efficiency and governance of the SRC's Customs Department.** The Bill was initially submitted to the National Assembly in December 2010, and the latter requested that the Bill be completely reviewed. This was carried out by a special Committee, and the revised Bill was approved by the newly elected Assembly in December 2011. The Act will become operational in June 2012, giving sufficient time for the development of supporting regulations, staff training, outreach for importers, agents and the general public.

20. **Customs collection and fight against fraud will be improved by the introduction of a single tax identification number (TIN) by October 2011.** The SRC will be repealing

the Seychelles Business Number Act, which refers to the Business Number by October 2011 and amending the Revenue Administration Act and Seychelles Revenue Commission Act accordingly.

21. **The Customs' automated data system will be linked with the domestic tax system by December 2011 to facilitate information exchange.** Combined with the introduction of the TIN, this should facilitate analysis, auditing and tracking of entities to facilitate revenue administration. Customs will upgrade to ASYCUDA World in 2012 with support provided by COMESA. The work is being carried out by the Customs reform team appointed in April 2011 in conjunction with the Government's Department of ICT.

22. **Risk Management and Post Clearance Audit (PCA) in Customs have been earmarked as two key priorities under the Customs modernization program.** In July 2011, the PCA unit was formerly established in Customs. Building capacity of the unit is ongoing with assistance from regional customs administrations. Technical assistance on developing a risk management strategy for Customs was also provided by the IMF Africa Regional Technical Assistance Centre (AFRITAC) South, in October, 2011.

23. **Current Standard Operating Procedures (SOPs) for Customs will be updated in line with the Customs Management Act and regulations which reflect current international best practices as prescribed by the WCO Revised Kyoto Convention.** Priorities have been identified for the development and review of SOP's in Warehouse Management, Export Procedure and Temporary Importation. The development of these SOP's will facilitate the transition to VAT.

24. **Effort continues to promote integrity within SRC.** We will receive technical assistance from WCO in January 2012 to assist with the development and implementation of an integrity/ethics framework for SRC by 2013.

25. **SRC continues to focus on improving revenues through audits of top taxpayers, including those in the tourism sector.** SRC has recently completed a review of potential sources of transfer pricing and is in the process of enhancing its capacity to ensure full compliance under its competitive tax regime. Government will in parallel be undertaking a review of guidance on revenue booking practices and expense deduction within the hotel industry.

26. **A smooth launching of the VAT on July 1, 2012 to replace the existing Goods and Services Tax is our main objective for this year.** In this regard, our preparation is on schedule. We have published the applicable rate (15 percent) and the threshold for mandatory registration for the Value Added Tax. These rates, based on projections done by the Ministry of Finance, are consistent with the advice of the IMF VAT mission in February 2011 and revenue neutrality. A resident IMF expert, whose funding for 18 months is covered by an EU grant, is assisting the SRC in developing skills, procedures, and manuals necessary to secure a successful transition. The work includes:

- a. On-going meetings with the public and private entities to increase awareness of the VAT Act and its repercussions.
- b. Employing new staff to facilitate the implementation of VAT (8 so far), and recruitment will continue in 2012.

- c. Amending the Revenue Administration Act to ensure consistency of definitions of business size with the VAT Act.

***Public Financial Management (PFM)***

27. **We are committed to further improvements in the management of public finances in 2012, notably in the area of budget preparation, accounting procedures, and budget executions.** The revised action plan addresses inherent weaknesses and focuses on the sustainability of reforms made to date, drawing from a recent Public Expenditure and Financial Accountability (PEFA) assessment and the report of the recent IMF Fiscal Affairs Department mission.

28. **Our Cabinet has approved a new Public Finance Bill which incorporates recently improved practices into legal requirements and introduces additional strengthening of budget processes.** When the law is approved by the National Assembly and becomes effective (at the time of the 2013 budget presentation), improved information requirements and procedures such as a mid-year execution report and technical justifications underlying budget preparations will become legal requirements. In addition, capital expenditures will be integrated in the budget law and subject to parliamentary approval. In particular, the new Bill requires the integration of the development fund— used to fund capital projects of some public entities involved with public infrastructure—into the Budget document.

29. **We will revise our Financial Instructions and Accounting Manual by September 2012.** The manual will be revised for coherence with the newly approved Public Finance Bill as well as the International Public Sector Accounting Standards (IPSAS). Staff in all the ministries and departments will undergo training in 2012 to facilitate the successful transition to the requirements of the new manual. Capacity building for the implementation of IPSAS shall commence in the first quarter of 2012. The centralized procurement management system will be upgraded to facilitate the eventual transition to accrual-based IPSAS.

30. **We will introduce a Public Sector Investment Program (PSIP) with the 2013 budget.** The framework for the PSIP – which maps capital expenditure projects over five years—will be submitted to Cabinet by September 2012. The PSIP will help plan the borrowing requirements for financing investment whilst keeping the public debt at sustainable levels. The introduction of these standards will enhance the credibility and comparability of our published accounts. The PSIP will be the basis for the National Development Plan.

31. **The new Chart of Accounts—called to facilitate the analysis of expenditure and budget preparation—is now scheduled to be introduced next year, for the preparation of the 2013 budget.** The time required to migrate all ministries and departments between Charts was underestimated, (MoF will be providing extensive training to accounting staff of other ministries and departments) thereby preventing implementation before Budget 2012.

32. **Program-based budgeting remains a target for the medium term,** and the new Chart of Accounts is designed to incorporate it. The two biggest ministries (Health and Education) shall start migrating towards this type of budgeting in the second half of 2012. The rest of Government will be phased in gradually, with Budget 2015 being the target for the first fully program-based Budget.

33. **As part of a strategic plan adopted by the Cabinet, we have passed necessary legislation establishing a new entity, named Agency for Social Protection, which is the first step** to ensure that synergies are obtained, and will make it easier to monitor and control statutory and means-tested benefits since all will be administered by this new Agency. SSF assets were frozen when the SSF contributions were replaced in July 2011 by a personal income tax and the budget took over the payment of the fund's benefits. The remaining assets will be transferred to a new Fund to be managed by a Board of Trustees as per approved investment policies and guidelines. The income generated by these assets will be used to improve the social protection of all Seychellois. Legislative amendments will be made to the Social Security Act 2010 and Social Security (Board of Trustees) Regulations 2011 in order to eliminate conflicting and discretionary provisions, ensure transparency in the management of the Fund and refine the mandate of the new SSF. The Board of Trustees (BoT) has been appointed to oversee the management of these assets. Amendments to the regulations governing the BoT will also provide it with the mandate to submit proposals to the government on the investment strategy and on the use of the income (in conformity with the objectives established by the law), and to manage the use of the income generated by the Fund.

34. **We will increase mandatory contributions to the Seychelles Pension Fund (SPF) to ensure progress toward the Fund's long-term sustainability.** The SPF is largely underfunded according to the 2008 actuarial audit. A new audit released in November 2011 provides updated guidance on the further measures that may be necessary over the medium term elements to ensure that the SPF is fully funded. As a first step, both employer and employee contribution rates will be raised from 1 percent to 1.5 percent.

#### *Monetary and Exchange Rate Policies*

35. **The Central Bank will continue to maintain reserve money targeting as its monetary policy framework.** By relying primarily on a wide range of market-based instruments at its disposal, the CBS will ensure that it maintains a monetary policy stance that is consistent with its price stability objective. Broad money is projected to grow slightly less than nominal GDP to contain inflation. With net claims on the government expected to decline on account of large fiscal surpluses, the crowding-in effect should allow for a healthy private credit growth.

36. **The issuance of Treasury bills for monetary policy purposes will facilitate the CBS's liquidity management efforts.** A draft memorandum of understanding between the central bank and the Treasury is being prepared to spell out the modalities. It provides for Government to park the proceeds of the T-bill issuance in a blocked account at the central bank, and to bear the interest cost on the issued T-bills.

37. **We will maintain the floating exchange rate regime to allow the rupee to adjust to global developments as well as domestic market conditions.** The CBS remains firmly committed to only intervene in the foreign exchange market to smooth out excessive volatility and to ensure orderly market conditions. In line with program objectives, the CBS will continue to aim at building up international reserves to reach the equivalent of three months of prospective import coverage. This should provide Seychelles with adequate buffer against external shocks given the country's openness and dependency on the world economy.

38. **The CBS will continue to strengthen its reserve management practices.** It continues to place the bulk of its reserves with the Bank for International Settlements (BIS). Besides its reserve management services the BIS program also provides training for CBS staff. The CBS had initiated discussions with the World Bank to begin using its Reserve Asset Management Program (RAMP).

39. **Progress has been made in promoting competition and enhancing transparency in the banking sector.** The financial literacy campaign is on the right track. CBS has issued guidelines in October 2011 on disclosure requirements of banks' terms and conditions, which inter alia, deal with the minimum information that banks need to disclose to their clients on loans, dormant accounts and bank statements. In relation to the financial literacy program, articles have been published in the local newspapers to educate the public on issues pertinent to central as well as commercial banking, various presentations have been delivered to target audience and a CBS' open day was organized.

40. **The CBS remains committed to ensuring effectiveness in the supervision of the financial sector.** The amendments to the Financial Institutions Act, 2004 that were approved by Cabinet in June 2011 and are scheduled to be put before the National Assembly by end-2011, further strengthen the supervisory framework. Data collected offsite from supervised institutions will be more systematically validated, analyzed and maintained through the use of a statistical and supervisory application. Onsite inspections remain a strong supervisory approach that CBS continues to adopt; from the second half of 2009 to the first quarter of 2012 a full cycle of onsite examinations of all banks and quasi-bank institutions is expected to have been completed.

41. **The CBS continues to work toward strengthening the insurance regulatory framework.** The technical assistance financed by the FIRST Initiative has started this year and is expected to address limitations in the legal framework and supervisory approaches. The report from the first TA mission is being reviewed by CBS staff.

42. **Seychelles remains committed to fight money laundering and financing of terrorism.** We recently made some amendments to the Anti-Money Laundering Act, to enhance the independence of our Financial Intelligence Unit (FIU) and establish a time-frame for its freezing of suspected assets. These amendments should facilitate international coordination, including through Seychelles' entry into the Egmont group.

#### *CBS Operations and Governance and Financial Sector Reforms*

43. **The central bank's Internal Audit Division (IAD) adopted the Institute of Internal Auditors' (IIA) framework in January 2011.** The standards require that IAD has in place a Quality Assurance and Improvement Program (QAIP) to ensure that the function adds value to the organization. Whilst internal assessment reviews are carried out on a periodic basis, an external Quality Assessment Review (QAR) of the QAIP has to be performed at least once every three years to ensure its effectiveness. In line with the standards, an external assessment of the QAIP will be conducted in December 2013.

44. **The National Payment System project is being implemented in accordance to our reform and modernization strategy.** The CORE Banking System provides the platform for future payment system integration such as the introduction of the Electronic Clearing House and Electronic Funds Transfer which is scheduled to go live during the fourth quarter of 2012 and second quarter of 2013, respectively. This will be followed with the implementation of a

local rupee switching system and the Real Time Gross Settlement system. With the implementation of the above projects, the customers will greatly benefit from a more secure and efficient payment system infrastructure. Since the implementation of the CORE Banking System in December 2010, the new system has changed the way CBS provides banking services to Government and commercial banks. This has brought additional benefits to the market by providing commercial banks and the Government more efficient payment, clearing and settlement facilities. In addition, the system has greatly improved the internal control processes of the central bank's operations.

45. **The CBS has adopted the International Financial Reporting Standard (IFRS) from the financial year 2009. This has allowed for a better reflection of the operations of the Central Bank in its Audited Financial Statements.** The internal control system of Banking Services operations has further improved with more segregation of duties by separating the front, middle and back office functions, for which only the back office functions remain with the Banking Services Division. The front and middle office functions are now under the domain of the Financial Markets Division.

46. **The CBS will launch a Credit Information System (CIS) in early 2012.** The CIS will promote a competitive financial system and a more efficient risk-pricing mechanism for products offered by financial institutions, and will serve as an incentive for clients to maintain good financial relationships with such institutions. It will initially be housed within the central bank, with the view of extending it to a full fledged privately run credit information bureau in the future. A first draft of the regulations governing the activities of the different participants of the CIS has been prepared, and the setting up of the IT platform is under way.

47. **The CBS has begun discussions with the Judiciary to put in place a commercial court that will be tasked with handling financial disputes.** The establishment of the court is expected to reduce the significant backlog of commercial cases due to capacity constraints. Long delays in the resolution of financial disputes is one major weakness in Seychelles' business environment and the proposed commercial court, along with the CIS, would thus complement the Government's efforts in improving the overall business climate.

48. **We have made major strides toward the establishment of a Seychelles stock exchange.** In July 2011 we launched an international tender for the exchange. A national committee has since been established to consider the applications. A decision on the award of the license for the exchange will be made before end 2011 such that the exchange could be operational in 2012.

**Table 1: Matrix of Actions in the Financial Sector Area**

<b>Action</b>	<b>Deadline</b>
Issuance of regulations for operation of Credit Information System	December 2011
Implementation of the Credit Information System	February 2012
Implementation of Statistical and Supervisory Application	September 2012
Implementation of the Quality Assurance and Improvement Program for CBS' Internal Audit Division	September 2012
Implementation of Electronic Clearing House system	October 2012
Review of the Insurance Regulatory framework	December 2012
External review of the Quality Assurance and Improvement Program	December 2013
Implementation of Electronic Funds Transfer	June 2013

***Reform of Public Enterprises and Private Sector Development***

49. **We will continue to make progress on laying the foundations for a sustainable private sector-led growth.** To this end, we will continue to reduce and redefine the role of the state in the economy, and reform and downsize the public sector. In coordination with the World Bank, we have begun a comprehensive review of the obstacles to starting and operating a business in the country. In early 2012 we will begin to implement several measures aimed to:

- speed up procedures to start up and closing businesses by reducing the number of procedures, time and cost to register a company;
- make the process of obtaining a construction permit faster and cheaper;
- speed up procedures for registering a business by allowing for more efficient and less costly transfer and registration of property titles;
- improve access to credit by allowing more flexibility in the use of collateral to secure loans
- enhance efficiency in paying taxes by reducing administrative burdens on companies to comply with tax requirements;
- enhance trading across borders by reducing the number of documents and time to trade; and
- strengthen procedures for the enforcement of contracts by streamlining the time, costs and procedures involved in enforcing a contract:

50. **Cabinet has approved a strategic plan for privatizations, starting with companies in which the state retains minority shares.** In 2012, we plan to sell our shares in cargo handling and stevedoring (Land Marine), ship repair (Naval Services), and insurance (Sacos Insurance Company Limited). When necessary, prior to the privatization of some of these

enterprises, we will take additional measures, including regulatory changes to prevent the emergence of private monopolies.

51. **Public Utilities Corporation (PUC).** Efforts to restore financial viability to PUC will continue. The electricity tariff was increased by 5 percent in August, and a further 24 percent is being implemented in two steps in November 2011 and January 2012. This increase will allow PUC to overcome losses incurred due to current fuel price increases. PUC stands ready to revise tariffs further if fuel prices rise above those prevailing to PUC in Oct 2011. PUC will prepare for the introduction of a new tariff structure by end-September 2012, based on the tariff study due to start early in 2012 by externally funded experts. The energy commission is preparing a new Energy Act to modernise the legal framework surrounding the production of energy. New features expected under the framework will allow for competition in the production of energy whilst providing for consumer protection. The new act will support energy efficiency as well as standards and will promote the application of renewable energy systems. These measures could lead in the long run to lower capital grants to finance infrastructure. PUC has adopted, with the help of multilateral and bilateral partners a Water Master Plan which will guide the investment decisions over the next four years and will benefit from external, concessional financing.

52. **Government has successfully sold over 23 percent of its shares in the Seychelles Savings Bank.** We offered SSB account holders the opportunity to buy 40 percent of shares. Following the first round, approximately 60 percent of the shares on offer were bought. We are now working on the modalities to sell the remaining shares (i.e. just under 17 percent of SSB) in Phase II.

53. **Efforts to sell government's stake in Nouvobanq have been put on hold due to the weak appetite for banking assets globally.** Strong progress continues to be made in ensuring that Nouvobanq is a sound, profitable, and independently run bank providing finance to the private sector. However, market conditions for privatization are presently unfavorable.

54. **Development Bank of Seychelles (DBS).** DBS continues to play an important role in the financing of the private sector, disbursing more than SR 120 million through the third quarter of 2011. Since the last review, DBS has achieved a positive lending margin after expenses by raising its lending rate and issuing medium-term, government-guaranteed, rupee bonds that match the average life of its loans. Over the same period, the government and DBS have begun preparations on a new mandate for DBS, which will be submitted to Cabinet by December 2011. DBS will be re-structured with a clearly defined mandate described within its memorandum and articles of association. The objectives will be to ensure that DBS is financially viable whilst targeting the financing of higher-risk small enterprises that commercial banks would normally be reluctant to finance, such as those in a start up phase. Other key features of the DBS reform will involve strengthening its governance and independence, introducing risk-based pricing framework, and imposing appropriate limits on the size of the loans. Pending the introduction of this new mandate and the risk-based lending and pricing framework, the bank will review the backlog of applications approved already with a view of identifying those that fit DBS's new mandate. In addition, the bank will promptly address the CBS's recent on-site examination report.

55. **We have reviewed the housing policy of government to increase the role of the private sector in the housing market,** in line with our Cabinet-endorsed strategic plan for

house financing that has been just finalized. The Government plans to reduce the budgetary cost of addressing the significant pent-up demand for housing and limited commercial bank financing for lower income applicants. In the short term, given the high construction and financing costs relative to the average household income, government institutions, in particular the House Financing Cooperation (HFC), will have to continue to play a direct role in the provision of low-cost housing and mortgages. However, over the longer term our objective is to limit state interventions to the construction of social housing for the most vulnerable households. For others, we will introduce the system of “smart subsidies” the goal of which is to combine budget subsidies with the provision of housing finance loans at market rates from commercial banks and other lenders. This approach will reduce the budget cost of loan programs presently administered by the HFC, and promote affordable real estate financing for lower income groups on commercial basis. We will work with commercial banks on possible ways to increase their provision of housing finance, exploring in particular the creation of a special housing loan scheme through which government subsidies for lower income groups could be channeled. Meanwhile, we will tighten the eligibility criteria for HFC loans. We have started modernizing HFC, and will modify its mandate to ensure a clean institutional and accounting separation between its property management functions (leasing and sale of government-built houses) and its mortgage lending activities. The recent on-site supervisory examination by the CBS has revealed a number of deficiencies in governance, operations and accounting of HFC, which we plan to address promptly. We will also strengthen HFC’s governance and operations to make it a financially viable institution.

### *Trade Policies*

56. **Seychelles will continue to work towards WTO accession with a view to achieving membership by 2014.** Our import tariff regime is already highly liberal, with more than 94 percent of all tariff lines set at zero. Seychelles maintains also its commitment towards regional integration, with particular emphasis on joining the SADC Free Trade Area by the end of 2012. Our active trade policy has an overall objective of increasing potential import and export markets and encouraging investment (regionally and globally).

### *External Public Debt and Financing*

57. **Our external debt restructuring is close to completion. We signed final agreements with two bilateral creditors** and one commercial creditor since the beginning this year. Agreements on the restructuring of the remaining debts in arrears (one export credit extended by India, and another involving South Africa and a private partner) await signatures. These three claims account for less than US\$9 million.

58. **To ensure progress toward our objective to reduce external debt, we intend to limit our contracting or guaranteeing of new external loans to the equivalent of US\$40 million in 2012.** These loans will be mainly used to finance infrastructure projects. Our annual debt strategy update will be presented to the National Assembly together with the 2012 budget.

59. **We will strengthen the government control of public entities’ investment projects.** Starting in 2012, a committee, chaired by the Minister for Finance, will review all public projects of a magnitude greater than SR 25 million and assess their macro-economic impact and their risks to the budget, including for those that do not necessarily need a

government loan or a sovereign guarantee. This assessment will inform Cabinet decision on these projects.

### *Petroleum Exploration*

60. **We have begun institutional preparations in case oil exploration planned for next year discovers commercially viable oil deposits.** Initial seismic tests indicate the potential presence of oil in Seychelles' economic zone. Test drilling is expected to begin in late-2012 and, if successful, oil could flow as early as 2014. To coordinate all aspects of oil exploration and oil wealth management, we have established a high-level oil coordination unit, which will bring together all parties involved (the Ministry for Energy, the Finance Ministry, the Central Bank, and SEYPEC, our public enterprise that imports and distributes petroleum products in the country). The unit would be responsible for formulating legislation, oil wealth management principles, and for interacting with international oil companies. The government and SEYPEC are receiving technical assistance on oil-related issues from a number of bilateral and multilateral donors, and IMF is scheduling a mission to assist with the management of any potential oil revenues.

### *Statistics*

61. **As part of our strategy to achieve compliance with the IMF's Special Data Dissemination Standard (SDDS), we are improving external statistics,** based on the recommendations of the IMF and other external advisors. The Central Bank plans to complete by end-2011 the compilation of a partial International Investment Position (IIP) statement, covering the public sector and commercial banks. Efforts are also being made to improve coverage of the private sector's external operations. To achieve this objective, the Central Bank Act has been amended to allow the Bank to collect information from all companies.

62. **We also plan to produce more frequent national account data.** We expect to publish quarterly GDP within one quarter (another SDDS requirement) by September 2013. We are exploring the use of the forthcoming VAT returns to this end.

63. **We are currently undertaking a labour force survey and preparing for the launching in 2012 of a household budget survey.** We are also engaged in the Harmonised Consumer Price Index project of the COMESA and in an International Comparison Program coordinated by the African Development Bank.

64. **Additional budget resources have been granted to the National Statistics Bureau in 2012 for human capital and institutional capacity building.** A training program will also be put in place for the new recruits such that the statistical knowledge can be imparted.

### **F. Program Monitoring**

65. **The program will continue to be monitored through semi-annual reviews, with semi-annual quantitative performance criteria and disbursements, in line with the MEFP of May 16, 2010.** The quantitative performance criteria for 2011 are shown in Table 2. The structural benchmarks are shown in Table 3. The attached revised Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria, indicative targets, and adjusters under the program.

66. Seychelles will avoid introducing new exchange restrictions, multiple currency practices, or bilateral payment 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 2. Quantitative Performance Criteria Under the Extended Arrangement, 2011-12**  
(Millions of Seychelles rupees; end-of-period)

	2011						2012				
	June		September			December	March	June	September	December	
	Performance Criteria	Adjusted	Actual	Indicative Target	Adjusted	Prel.	Performance Criteria	Indicative Target	Performance Criteria	Indicative Target	Indicative Target
<b>Performance criteria</b>											
Net international reserves of the CBS, millions of U.S. dollars (floor) <sup>1</sup>	204	204	219	203	197	205	199	202	204	204	213
Reserve money (ceiling)	1,755	...	1,728	1,757	...	1,727	1,765	1,810	1,840	1,869	1,910
Primary balance of the consolidated government (cumulative floor) <sup>2</sup>	240	...	643	462	...	578	536	179	314	516	642
Contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) <sup>2</sup>	33	...	0	46	...	14	47	30	30	40	40
Contracting or guaranteeing of new short-term external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) <sup>4</sup>	0.0	...	0.0	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
Accumulation of external payments arrears by the public sector (ceiling) <sup>3</sup>	0.0	...	0.0	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
Accumulation of domestic payment arrears by the government (ceiling)	0.0	...	0.0	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
<b>Memorandum items:</b>											
Net external non-project financing (millions of U.S. dollars; cumulative) <sup>2, 4</sup>	-0.6	...	-1.1	6.8	...	1.0	1.6	-4.1	-5.5	-9.9	-0.6
<b>Program accounting exchange rates</b>											
SR/US\$ (end-of-quarter)	12.15	...	...	12.15	...	...	12.15	12.41	12.41	12.41	12.41
US\$/Euro (end-of-quarter)	1.34	...	...	1.34	...	...	1.34	1.35	1.35	1.35	1.35
US\$/UK pound (end-of-quarter)	1.56	...	...	1.56	...	...	1.56	1.56	1.56	1.56	1.56
US\$/SDR (end-of-quarter)	1.49	...	...	1.49	...	...	1.49	1.56	1.56	1.56	1.56
US\$/AUD (end-of-quarter)	...	...	...	...	...	...	0.97	0.97	0.97	0.97	0.97

Sources: Seychelles authorities and IMF staff estimates and projections.

<sup>1</sup> The NIR floor is adjusted as defined in the TMU.

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

<sup>3</sup> The nonaccumulation of new external payment arrears constitutes a continuous performance criterion. Excludes arrears for which a rescheduling agreement is sought.

<sup>4</sup> Includes external non-project loans and cash grants net of external debt service payments.

**Table 3. Structural Benchmarks, 2011–12**

<b>Measure</b>	<b>Target Date</b>	<b>Macroeconomic Rationale</b>	<b>Status</b>
Cabinet approval of the amendments to Financial Institutions Act as described in 3 <sup>rd</sup> Review MEFP, ¶41	End-April 2011	To strengthen competition in the banking sector and improve risk management.	Not met. Implemented in June due to a backlog of reviews in the Attorney General's office.
Adopt an action plan for house financing policy that limits the role of the public sector (3 <sup>rd</sup> Review MEFP, ¶61)	End-June 2011	To reduce fiscal risks, strengthen competition, and promote development of the banking system.	Not met. Implemented in December 2011
Launch a strategic plan for the reform of the social security system (3 <sup>rd</sup> Review MEFP, ¶27)	End-June 2011	To establish well-targeted and sustainable social security system.	Not met. Implemented in December 2011
Cabinet approval of VAT regulations, including rates, exemptions, and thresholds (3 <sup>rd</sup> Review MEFP, ¶23)	End-June 2011	To modernize the tax system and remove tax distortions.	Met.
Develop a privatization plan for nonstrategic public enterprises, which do not serve public policy goals (3 <sup>rd</sup> Review MEFP, ¶50)	End-September 2011	To reduce the role of the state in the economy, improve corporate governance and minimize fiscal risks.	Met.
Cabinet approval of a new Public Finance Bill extending the National Assembly's oversight on capital expenditure budget (3 <sup>rd</sup> Review MEFP, ¶22)	End-September 2011	To strengthen public finance management.	Met
Reinstate the electricity tariff adjustment for fuel price variation (3 <sup>rd</sup> Review MEFP, ¶56)	End-September 2011	To reduce losses of the public utility company.	Not met. Electricity tariffs were increased by 5% in August, and 24% effective January 2012
Introduction of the credit information system (MEFP, ¶46)	End-March 2012		
Creation of the commercial court (MEFP, ¶47)	End-March 2012		
Cabinet approval of new DBS mandates (MEFP, ¶54)	End-March 2012	To redefine its mandate to finance small and medium enterprises	
Commission and complete a study on optimal tariffs for utilities (MEFP, ¶51)	End-June 2012	To ensure cost recovery and long-term sustainability of utilities.	Rescheduled from end-July 2011 due to administrative hurdles in securing donor financing, and difficulties in finding a qualified expert.
Introduce VAT (MEFP, ¶26)	July 2012	To modernize the tax system and remove tax distortions	
Cabinet approval of the Public Sector Investment Programme to be used for the 2013 budget planning. (MEFP, ¶28)	End-September 2012	To improve efficiency of public finance management and planning in capital investments by costing capital projects over the entirety of their implementation phase	
Based on the results of optimal tariff study, implement reform of utilities tariffs (MEFP, ¶51)	End-September 2012	To ensure long-term financial sustainability of utilities	

**ATTACHMENT 2****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 benchmarks for 2011-2012 are listed in Tables 2 and 3 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 assets, free of any pledges or encumbrances and excluding project balances and blocked or escrow accounts, and bank reserves in foreign currency maintained for the purpose of meeting the reserve requirements), controlled by the CBS, and held for the purpose of intervening in foreign exchange markets. They include holdings of SDRs, holdings of foreign exchange, demand and short-term deposits at foreign banks abroad, fixed-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade securities. Reserve liabilities of the CBS comprise liabilities to nonresidents contracted by the CBS, any net off-balance-sheet position of the CBS (futures, forwards, swaps, or options) with either residents or nonresidents, including those to the IMF.

**Calculation method**

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

**II. 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 will 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 external non-project loans and cash grants exceeds (falls short of) the amounts assumed in the program (MEFP Table 2). 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.

### **A. Reserve Money (Ceiling)**

#### **Definition**

6. Reserve money is equivalent to currency issued and deposits held by financial institutions at the central bank (bank reserves), including those denominated in foreign currencies. Evaluation of performance of reserve money with respect to the program ceiling will be done at the program accounting exchange rate.

#### **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 will be submitted to the CBS, with a copy to the IMF, no later than two months after each test date.

### **B. Primary Balance of the Consolidated Government (Cumulative Floor)**

8. 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.

### **C. Public External Debt (Ceiling)**

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

10. For the purposes of this performance criterion, the definition of debt is set out in Executive Board Decision No.6230-(79/140), Point 9, as revised on August 31, 2009 (Decision No. 14416-(09/91)). Debt is understood to mean a current, non contingent liability,

created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future points in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. The ceiling on contracting official and officially guaranteed external debt includes all form of debt, including:

- a. loans, that is , advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);
- b. suppliers credits, that is., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and,
- c. leases, that is., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the 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.
- d. arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt.

#### **D. External Arrears of the Public Sector**

11. The nonaccumulation of arrears to external creditors will be a continuous performance criterion under the program. External payments arrears for program monitoring purposes are defined as the amount of external debt service due and not paid within the contractually agreed period, 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.

#### **E. Domestic Arrears of Government**

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

denomination of the debt; and (3) debt service payment on domestic debt of the government or guaranteed by the government that has not been made within the contractually agreed period.

### **III. Data and Information**

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

#### **The CBS will report**

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

- Reserve money.
- 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.
  - The detailed revenues and expenditures of the central government and social security fund.
  - Accounts of the public nonbank financial institutions.
  - Import and export data from the customs department.
  - Public debt report.
  - Statements of Stabilization Fund operations
  - Consolidated creditors schedule on domestic expenditure arrears of the government.
- **Quarterly** (within a month from the end of the quarter):
  - Financial statements of Air Seychelles

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.