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

Press Release:
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Seychelles](#)
June 7, 2012

May 22, 2012

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LETTER OF INTENT

May 22, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund

Dear Ms. Lagarde:

The attached Memorandum of Economic and Financial Policies (MEFP) describes Seychelles' performance through March 2012, and sets out our policy and reform priorities for the remainder of the Extended Arrangement with the Fund.

We request completion of the fifth review under our Extended Arrangement and the release of the eighth tranche of SDR 2.64 million (24 percent of quota). We have made significant progress in our reforms and the program remains on track. All quantitative performance criteria (PCs) at end-December 2011 and indicative targets for end-March 2012 were met with margins, and monetary and fiscal developments remain favorable.

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 2012.

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.

We request the modification of the performance criteria for end-June 2012. The increase of the NIR target reflects better-than-expected outcomes in December 2011 and March 2012, coupled with our intention to continue the path of moderate reserves accumulation. The reduction of the reserve money target signals our determination to tighten monetary policies to fend-off inflationary pressures. It is expected that the sixth and final review will be completed by end-September 2012. Financing assurance reviews will continue as long as public debt arrears to external private creditors remain outstanding.

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/

Pierre Laporte
Minister of Finance, Trade and Investment
Republic of Seychelles

/s/

Caroline Abel
Governor
Central Bank of Seychelles

Attachments: MEFP and TMU

ATTACHMENT 1

SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2011 AND 2012

I. INTRODUCTION

1. This document tracks progress after 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 23 December 2011 and details our policies for the remainder of 2012 to support completion of the fifth 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 accelerating measures in areas where progress has been less rapid (e.g. monitoring of public enterprises).

II. MACROECONOMIC PERFORMANCE IN 2011 AND OUTLOOK FOR 2012 AND BEYOND

3. **Macroeconomic outcomes for 2011 were in line with our projections** at the time of the fourth review (December 2011). Real GDP grew by 4.9 percent, inflation reached 5.5 percent, and the current account deficit was 22 percent of GDP at end-December. Tourism arrivals were 11 percent above the 2010 level, much better than expected given the economic turmoil in the Eurozone. Despite slightly shorter stays on average, the sector is estimated to have grown by approximately 7 percent in real terms.
4. **Growth is expected to slow markedly in 2012**, to less than 3 percent (down from 4 percent forecast in December). Tourism numbers have been buoyant (9 percent up year on year for first quarter) despite developments in the Eurozone and the cessation of Air Seychelles' direct flights to Europe. However, we forecast lower activity in non-tourism sectors as a result of the impact of higher import prices on domestic demand and the need to tighten monetary policy as described in the next paragraph.
5. **A weakened rupee continues to add to inflationary pressures.** The weakened Euro in relation to the greenback continues to negatively impact the terms of trade, and partly explains the sharp depreciation of the rupee versus the dollar in the past three months (from 12 SR/USD to 14 SR/USD). The remaining pass-through of international food, fuel and commodity prices temporarily puts further upwards pressure on inflation. Through tight monetary policy, we expect to limit inflation figures to less than seven percent by the end of the year.
6. **The external balance will remain stable.** The current account deficit is expected to stay at 22 percent of GDP in 2012 and further improve over the medium term, as FDI moderates following the completion of major projects. While the current account deficit remains large, it continues to be financed by non-debt incurring capital inflows including net FDI inflows of 18 percent of GDP in 2012. This will allow us to steadily reduce the external debt burden over the medium term. Our external debt restructuring is close to completion, with agreements with two non-Paris Club bilateral and one

commercial creditor—accounting for less than US\$9 million of claims—awaiting signatures. For one of the bilateral creditors one of two agreements has been signed and the other is in the final approval stage. The authorities of the second bilateral creditor have advised that agreements will be signed shortly. Representatives of the commercial creditor will visit Seychelles at end-May during which the agreement is expected to be signed.

7. **Despite large downside risks, there are grounds for optimism.** The improvement in communications which will follow the installation of Seychelles' first submarine cable later this year is expected to lead to growth and diversification of the economy. Traders and fishing operators (both domestic and foreign) have implemented practices to address piracy risks. We have also received assistance from a number of partner countries who are helping us combat the threat of piracy in the Indian Ocean. Increased tourism marketing in the Far East has begun to pay dividends, and increases in flight connectivity will support tourism activity over the medium-term. Moreover, our continued efforts to reduce public debt will boost investor confidence and maintain substantial inflows of foreign capital, mainly in the tourism industry.

III. PROGRAM IMPLEMENTATION

8. **We achieved—and in some cases comfortably exceeded—the quantitative targets of the program.** All quantitative performance criteria as of end-December 2011 were met (Table 1), and we are on track to achieve end-June targets.

9. **We exceeded our fiscal target by 1.1 percent of GDP.** Overall expenditure was within 0.4 percent of expectations, with some additional payments to the national airline being more than offset by deferred capital expenditure. Revenue was 1.1 percent of GDP higher than forecast, largely reflecting a one-off recovery of revenues worth approximately 0.7 percent of GDP.

10. **We tightened monetary policy to address inflationary risks.** Reduced excess liquidity has led to a marked increase in market interest rates (three month T-bill rates rose from 0.5 percent in the first quarter of the year to 5.0 percent in December). To ease the cost of sterilization treasury bills are now being issued for monetary policy purposes to help absorb part of liquidity, as needed.

11. **We have taken additional decisive steps to return the national airline to profitability.** Air Seychelles entered into a strategic partnership with Gulf carrier Etihad from 1 February. Etihad purchased 40 percent of the airline, providing: a much-needed capital injection of USD 20m; and provided a loan of USD 25m; code-sharing access to Etihad's global network; and valuable management expertise including a new CEO. As a condition of the deal, in early 2012 the Government made a capital injection (1 percent of GDP) and absorbed the airline's existing liabilities (2.2 percent of GDP) and restructuring costs (0.5 percent of GDP). In 2013, the government will contribute another capital injection (1 percent of GDP) and cover fees for the early termination of an airplane lease (0.3 percent of GDP). As a result of this restructuring, coupled with the new business plan, the company will return to profitability in 2014.

12. **We implemented another tariff adjustment, after some delays, and are now at virtually full pass-through as the next step in transitioning to an optimal electricity tariff.** Lower than expected profits of SEYPEC (the state-owned importer, distributor and re-exporter of petroleum products and oil tanker business) resulted in an unanticipated review of SEYPEC's cost and pricing

structure, including the price of fuel sold to the Public Utilities Company for electricity generation. The tariff adjustment scheduled for January was therefore delayed to 15th May, so that any potential changes in PUC's cost structure could be taken into account. The remaining steps to be taken to implement an optimal electricity tariff structure are described in paragraph 41. The cost of fuel at the pump was revised in mid-April, and cost of LPG was revised to full pass-through for commercial customers from 15th of May as a first step.

13. **Structural benchmarks were implemented according to schedule.** The credit information system was established, with information on prospective customers' non-performing loans being available to banks from end-March. Information on total loans outstanding is available since end-April. The Commercial Court was established in March 2012 and will commence hearings on new cases from June. In the interim, the Chief Justice will assume responsibility for the Commercial Court until a second judge is appointed later in 2012. The Cabinet approved a new mandate for the Development Bank of Seychelles in March, focusing on financing higher-risk small enterprises that commercial banks would normally be reluctant to finance.

IV. POLICIES FOR 2012 AND BEYOND

A. Fiscal Policy

14. We remain committed to achieving debt sustainability over the medium term, despite the additional pressures from Air Seychelles' restructuring. Sizeable budget surpluses will be delivered over the next five years to reduce public debt to 50 percent of GDP by 2018 (one of two over-arching goals of the program). This is despite slightly revising downwards the primary surplus target for 2012 to 4.5 percent of GDP from 4.7 percent at the time of the last review – mostly on account of increased spending on the national airline and a weaker rupee.

15. **The outlook for revenue has improved.** In view of the revised macroeconomic outlook, nominal tax collections are expected to be 0.6 percent of GDP higher than budgeted. This is further helped by gains in grant receipts of 0.3 percent of GDP on account of the weaker rupee. The introduction of the VAT in July 2012 is expected to be revenue neutral, and it will improve the efficiency of the tax system.

16. **Expenditure increases have been largely on account of external developments.** Aside from the increased transfers to Air Seychelles, the increases are on account of the weaker rupee (0.3% of GDP), increased spending on security, and increased foreign-financed capital expenditure.

17. **The government is enhancing the social safety net.** The 2012 budget of the Agency for Social Protection was increased 20% from 2011 to account for the projected impact of higher utility tariffs on the cost of the reference consumption basket. At the same time, eligibility requirements have been clarified, and beneficiaries are incentivized to return to employment as soon as possible.

B. Tax and Customs Reform

18. **The VAT implementation scheduled for 1 July 2012 remains on track.** Following extensive consultation with the private sector, a number of amendments were approved by Cabinet in May. These amendments broadly reflect the advice of the IMF FAD technical mission, and include measures such as:

- Exempting farmers and fishermen rather than zero-rating the two sectors.
- Local alcohol producers will be charged VAT at the applicable rate of 15 percent rather than being zero-rated as currently outlined in the legislation.
- SEYPEC—the domestic distributor of petroleum products—will be exempt rather than zero-rated.

The measures will facilitate the administration of the taxes and limit areas of potential losses.

19. **We are seeking advice from the South African Revenue Service (SARS) on transfer pricing in the tourism sector.** A memorandum of co-operation has been signed with SARS for the provision of technical assistance for capacity building to allow SRC staff to see evidence of this practice during audits. SARS will also provide capacity building in other areas.

20. **We are continuing with efforts to improve customs administration.** We are seeking additional technical assistance in the areas of staff integrity and post-clearance audit. A roadmap outlining SRC's actions in an effort to improve integrity within its administration will be presented to the Ministry of Finance, Trade and Investment in June 2012. This remains a priority following technical assistance from the World Customs Organization. A risk-management strategy was developed in parallel to the integrity framework, with Fund technical assistance, and has been implemented by the Revenue Commission.

C. Public Financial Management (PFM)

21. **Numerous reforms have been implemented in the past three years with tangible impacts on PFM performance.** Government has used the 2011 PEFA assessment (following the 2008 assessment) as a basis to prepare a 2012-14 PFM action plan that will be launched in June. The action plan includes the new Public Finance Management Act, introduction of a new chart of accounts; steps towards Program Based Budgeting and enhanced external scrutiny and audit.

22. **Submission to the National Assembly of the Public Finance Management Bill was an important milestone.** The expected approval of the bill by the National Assembly this June will bring our public finance legislation in line with international best practices. We plan to implement the 2013 budget based on the new legislation with AFRITAC-South providing capacity building. Amongst a number of reforms included in the Bill (see Paragraph 28 of the MEFP of 23 December 2011) is the oversight of the National Assembly on the budget for capital expenditure. The PFM Act is also formalizing the Government Audit Committee, which will oversee the implementation of recommendations of the Auditor General's annual reports. The Committee will consist of full-time dedicated employees and will be independent of the Ministry of Finance. The Charter of the Government Audit Committee will be submitted to the Cabinet of Ministers by end-June 2012.

23. We are progressing further key reforms to our accounting and budgeting systems (paragraphs 29-32 of the MEFP of 23 December 2011).

- ***Financial Instructions and Accounting Manual:*** We are incorporating the revised articles of the new Public Finance Act into the financial instructions and accounting manual to explain to the users the regulations and procedures. Training will start during the second half of the year.

- **Public Sector Investment Program:** A detailed manual has been finalized to help line Ministries prepare their investment plans in line with their medium term plans. Technical assistance is also being sought from the World Bank.
- **Chart of accounts:** We are developing the structure for the Chart of Accounts, benefitting from additional recommendations from a recent AFRITAC mission. The new chart of accounts will be reflected in the revised accounting instructions and manual, in line with the new PFM Act. We are also taking appropriate measures to facilitate the migration between the old and the new Chart of Accounts. It will be first deployed in the preparation of the 2013 budget.
- **Program based budgeting (PBB):** Progress is being made on the move to PBB. The Government is developing a policy paper for Cabinet, Parliament and other public servants on program based budgeting and its implications for the public finance of Seychelles. The Government is seeking technical assistance from the World Bank to develop a guideline on Program Based Budgeting and an implementation strategy.

24. **Our reforms to the social security system are well advanced.** The Agency for Social Protection, created in January, is now the only institution administering social benefits, following the incorporation of statutory benefits previously administered by the Social Security Fund (see Paragraph 33 of the MEFP of 23 December 2011). The Social Security Fund Board of Trustees, which oversees the management of the assets of the former institution (totaling approximately 2.6 percent of GDP), has presented a strategic investment plan to Government. The income generated by these assets will be used (but not necessarily earmarked) to improve the social protection of all Seychellois. The 2012 returns will be transferred to the government budget.

D. Monetary and Exchange Rate Policies

25. **CBS is tightening monetary policy to reverse the current upward inflation trend.** If needed, the CBS will tighten further to contain any additional second round effects of the domestic currency depreciation and increases in fuel prices and energy tariffs. CBS is determined to maintain single-digit inflation throughout the year, aiming to end the year below 7 percent. The Central Bank will continue to use reserve money targeting as its policy framework.

26. **Government has begun issuing treasury bills to help CBS' liquidity management efforts.** This arrangement will be formalized and enhanced by a Memorandum of Understanding between the Central Bank and the MOF, which spells out the modalities of issuance of T-bills for monetary purposes, will be signed by end-June 2012. Proceeds from issuance of these T-bills will be deposited in a blocked account at the CBS and government is to bear the interest cost.

27. **We remain committed to a floating exchange rate regime to allow the rupee to adjust to domestic and global developments.** CBS will intervene in the foreign exchange market only to smooth out excessive volatility and ensure orderly market conditions.

28. **CBS will continue to build up international reserves, which will provide Seychelles with an adequate buffer against external shocks.** To achieve this objective, in the coming months CBS will purchase foreign currency for reserves accumulation purposes on the domestic interbank market.

This new approach will assist in the deepening of the domestic foreign currency market and will allow for a more efficient allocation of foreign exchange around the financial system.

29. **The CBS continues to strengthen its reserve management practices.** The bulk of its reserves are placed with the Bank for International Settlements which provides reserve management services and training for CBS staff. The CBS is also planning to diversify its portfolio in other avenues. Discussions between the CBS and the World Bank to begin using its Reserve Advisory Management Program (RAMP) have progressed well. However, uncertainties and volatilities in the international financial markets have delayed CBS' use of the program.

E. Financial Sector Reforms

30. **CBS remains committed to improving competition and transparency in the banking sector.** The Financial Institutions Act 2004 (FIA) was amended in December 2011 to, *inter alia* introduce a single licensing regime for banks. This is expected to promote competition in the banking sector by allowing offshore banks to operate in the domestic market therefore offering the public more choice. Moreover, the amendments allow the CBS to intervene where bank fees and charges are deemed detrimental to competition such as penalties for early loan repayments. In addition, the financial literacy program is ongoing.

31. **To enhance financial deepening the legislative framework for hire purchase and leasing will be introduced shortly.** The Hire Purchase and Credit Sales Bill was submitted to Cabinet in May 2012 whilst that for Leasing is scheduled for end-2012. This initiative is expected to provide households and small businesses with greater access to credit.

32. **The CBS will implement new initiatives to strengthen supervision of the financial sector.** We will require financial institutions that provide credit to submit periodically business plans to the CBS, which will enhance our forward looking approach to supervision. This initiative will allow CBS to develop a CAELS¹ rating system based on projected financials. The first submission is expected by June 2012 and henceforth will be done by end of first quarter of each year. As to onsite supervision, a full cycle of examination has been concluded. Further examinations will be conducted on an ongoing basis, based on institutions' ratings.

33. **Implementation of the Statistical and Supervisory Application (SSA) project will assist in improving supervision.** The SSA which is expected to go live by July 2012 will increase efficiency by further automating the process for offsite supervision through online submission of returns and embedded analytical tools. In this regard, the SSA will eliminate most of the manual processes of validating data.

34. **The CBS continues to develop the insurance regulatory framework.** The technical assistance by FIRST Initiative which began in 2011 is expected to lead to the implementation of a risk-based solvency regime which is in line with international best practice. The proposed regulatory framework is expected to be introduced by end-December 2012, following further discussions with the industry.

¹ CAELS stands for Capital, Asset quality, Earnings, Liquidity, Sensitivity to market risk.

35. **Seychelles has taken major steps in its endeavor to fight money laundering, financing of terrorism and to improve international tax co-operation.** We recently made amendments to the Anti-Money Laundering (AML) Act, to enhance the independence of our Financial Intelligence Unit (FIU) and establish a time-frame for its freezing of suspected assets. FIU is in the process of recruiting more staff to increase efficiency and speed up the resolution of cases. We have also made important strides in strengthening our legislative framework that govern offshore activities. Following on recommendations of the last peer review report of the OECD forum for fiscal transparency and exchange of information for tax purposes, amendments were made to the legislation governing offshore financial sector activities such as trusts and funds, as well as their taxation. These amendments should also facilitate international coordination, including through Seychelles' entry into the Egmont group.

36. **The financial service sector will be boosted with the launching of the stock exchange in the second half of 2012.** A license for the exchange was granted earlier this year following a rigorous application and vetting by a national committee which consisted of representatives of key financial-related institutions both public and private. Initially the exchange will handle local listings including shares of both private and public companies. Thereafter it will operate a dual listing system.

F. CBS Operations and Governance

37. **The central bank continues to improve its internal audit processes,** through the Quality Assurance and Improvement Program (QAIP). It continuously carries out internal assessment reviews to ensure that the function adds value to the organization. This is enhanced through the Teammate software that allows coaching notes to be conveyed through the system and records of such notes to be kept. The QAIP Policy and Procedures will be finalized and approved by the Board in Q2 2012. Furthermore, CBS developed an Internal Audit Quality Assessment Framework, a tool for evaluating the quality of internal audit and for conducting internal and external Quality Assurance Reviews (QAR) in compliance with IIA standards. The external QAR of the QAIP will be conducted in December 2013.

38. **Work on a modern payment system is progressing.** Following successful implementation of its CORE Banking System, the Electronic Clearing House project is now underway and is scheduled to go live in Q3 2012. The Electronic Funds Transfer project has also been initiated and is expected to go live in Q2 2013. This will be followed by the implementation of a local rupee switching system and the Real Time Gross Settlement system.

Text Table: Matrix of Actions in the Financial Sector Area

Action	Deadline
Issuance of regulations for operation of Credit Information System	March 2012
Implementation of the Credit Information System	March 2012
Submit Hire Purchase and Credit Sales Bill to Cabinet	May 2012
Implementation of Statistical and Supervisory Application	July 2012
Implementation of the Quality Assurance and Improvement Program for CBS' Internal Audit Division	September 2012
Implementation of Electronic Clearing House system	September 2012
Submit Leasing Bill to Cabinet	December 2012
Finalization of risk-based solvency regime	December 2012
Implementation of Electronic Funds Transfer	June 2013
Implementation of ATM/POS Switch	September 2013
External review of the Quality Assurance and Improvement Program	December 2013

G. Private Sector Development and Reform of Public Enterprises

39. **We will intensify our efforts to improve the business environment for private sector development.** A technical working group has been working with the World Bank on specific proposals in the areas set out in paragraph 49 of the MEFP of December 2011. The technical working group submitted a report to our High Level Committee on Doing Business in May 2012. We have already begun implementing the recommendations of the report including: (i) appointment of a new Registrar General and reorganization of the Registrar; (ii) introduction of a flat fee for company registration (iii) revised application forms and include standardized requirements; and (iv) development of an on-line application, linked to all relevant agencies, for construction permits. A series of additional actions are planned between now and end-2012.

40. **We will strengthen the framework for the monitoring of public enterprises to minimize the risks of** negative spillovers from these entities to the budget and real economy. This will include amendments to the Public Enterprise Monitoring Law, to strengthen monitoring and the analytical capability of the MoF. Amongst the new legal requirements, the entities will be required to submit a statement of operations and financial performance to the Finance and Public Accounts Committee of the National Assembly each quarter, and existing arrangements allowing the MoF to seek monthly reports on financial performance and debt will be more rigorously utilized. Whilst the monitoring will

cover all public entities, particular focus will be placed on the seven largest public entities. Efforts to strengthen government oversight of public enterprises have been enhanced with the establishment in May 2012 of a public projects review committee. The committee will review all potential public projects of a magnitude greater than SR 25 million and assess their macroeconomic and fiscal risks.

41. **We will use the launch of the Seychelles Stock Exchange in the third quarter of 2012 to advance our privatization program.** To begin with, we will sell our minority shares in cargo handling and stevedoring (Land Marine), ship repair (Naval Services) and insurance (Sacos Insurance Company Limited). We will also complete the sale of 40 percent of the Seychelles Commercial Bank (previously Seychelles Savings Bank). Preparations for these privatizations are underway; we are in the process of selecting consultants to carry out the evaluations of the companies. As previously pledged, we will take additional measures such as regulatory changes to ensure that no private monopolies emerge as a result of these sales.

42. **Government will continue to take necessary steps to maintain the financial viability of the Public Utilities Corporation.** Tariff increases in November 2011 and May 2012 will ensure that the company ends the year with a positive cash balance. However, the company remains exposed to fluctuations in international prices of refined petroleum products and the SR/USD exchange rate. The Government has commissioned a study on the optimal tariff structure, which will be completed by end-June. Government will adopt a revised tariff structure based on the report's recommendations by end-September. The objectives of the new tariff regime will be to: (a) limit cross-subsidization across products and customer segments; (b) to reduce the public utility company's need for budget financing; and (c) enable tariffs to be adjusted regularly as needed in respond to changes in input costs. Additionally, work continues on a new Energy Act to modernize the legal framework for the production of energy, which will improve energy efficiency over the longer run by introducing energy standards and promoting renewable energy sources. In this regard, the commissioning of a wind farm in late 2012 (financed by a UAE grant) will reduce oil imports. In the area of water supply, following the adoption of the PUC's Water Master Plan last year, the authorities have signed a financing agreement with the European Investment Bank for Euro 26m worth of projects in the water sector.

43. **We have reformed the Development Bank of Seychelles (DBS).** DBS was incorporated as a company under the Companies Act in April 2012 and given a new, clearly defined mandate. To fulfill this new mandate of focusing on small and medium enterprises, DBS will limit the size of individual loans to SR 2m. In addition, it will take measures to strengthen its governance and internal control system. Moreover, it will introduce a risk-based lending and pricing framework. To complement the role of the DBS a new financing agency is being set up to facilitate micro businesses' access to credit and help them build book-keeping and marketing skills.

44. **We have begun to implement our new policy on housing finance.** Following Cabinet's adoption of a strategic plan for housing finance in December 2011 a committee was set up in May to ensure the effective implementation of the plan. As a first step the HFC will be split before end June 2012 into two separate entities: one for lending, and the other for the management of government properties. We aim to have the necessary legal arrangements and human capacity in place to implement the new mandate of HFC by October 2012. Moreover, we have begun preparations for the adoption of the smart subsidy scheme with the assistance of the World Bank's FIRST Initiative. The program will target low-income households by subsidizing mortgage-loans, including those from

commercial banks, while at the same time maintaining the envelope for social housing expenditure unchanged as a share of GDP.

45. **The financial position of SEYPEC has been weakened by losses on its tanker operations amidst a downturn in tanker activities worldwide.** The losses on our tanker operations since 2008 have been supported through cross-subsidies from other more profitable operations of the company, notably bunkering. SEYPEC is taking measures to ease the pressure on its finances, including negotiating with its creditors a rescheduling of the loans for the tankers.

H. Petroleum issues

46. **We started preparations for potential oil discoveries.** Drilling on two fields that have been already surveyed is planned for late 2013, and additional blocks are being considered for auctioning. A high-level oil coordination unit, representing key stakeholders including the civil society, was established in May 2012. The committee will guide the authorities and ensure transparency in the process. We have sought technical assistance and training from the IMF, World Bank, the Commonwealth, the US and Australian governments on the full range of aspects: institutional framework, oil taxation, oil revenue and wealth management, budgetary implications and environmental issues. The operations of SEYPEC have been split in two. SEYPEC will focus on oil trading and tanker management, whereas the newly established PetroSeychelles will be responsible for exploitation.

I. Statistics

47. As part of our objective 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 has completed the compilation of a partial International Investment Position (IIP) statement, covering the public sector and commercial banks. We are also improving 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.

48. **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. We plan to introduce a producer price index and the production index when we launch the quarterly GDP data. Preparation will begin shortly to collect relevant data for the compilation of these indices.

49. **The National Bureau of Statistics is currently preparing for the launching in 2012 of a household budget survey.** The results of the survey will be used to revise the CPI basket composition. The household budget survey questionnaire was finalized in February with the assistance of the World Bank. Additional field workers and supervisors have been recruited and trained in April, ahead of the pilot survey in May and survey launch in July. We are also engaged in the Harmonized Consumer Price Index project of the COMESA and in an International Comparison Program coordinated by the African Development Bank.

V. PROGRAM MONITORING

50. The last semi-annual review will be based on a set of quantitative performance criteria as shown in Table 1 and structural benchmarks as shown in Table 2. The attached revised Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria, indicative targets, and adjusters under the program.

51. 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 1. Quantitative Performance Criteria Under the Extended Arrangement, 2011–12
(Millions of Seychelles rupees; end-of-period)

	2011			2012								
	December		Actual	March			June		September		December	
	Performance Criteria	Adjusted		Indicative Target	Adjusted	Prel.	Prog.	Revised Performance Criteria	Prog.	Revised Indicative Target	Prog.	Revised Indicative Target
Performance criteria												
Net international reserves of the CBS, millions of U.S. dollars (floor) ¹	199	204	218	202	206	216	204	220	204	217	213	226
Reserve money (ceiling)	1,765	...	1,699	1,810	...	1,750	1,840	1,800	1,869	1,800	1,910	1,850
Primary balance of the consolidated government (cumulative floor) ²	536	...	709	179	...	227	309	309	512	431	637	610
Contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) ²	47	...	46	30	...	0	30	30	40	40	40	40
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	0.0
Accumulation of external payments arrears by the public sector (ceiling) ³	0.0	...	0.0	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Accumulation of domestic payment arrears by the government (ceiling)	0.0	...	0.0	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Net external non-project financing (millions of U.S. dollars; cumulative) ^{2,4}	1.6	...	6.8	-4.1	...	-0.7	-5.5	-3.7	-9.9	-7.5	-0.6	1.0
Program financing support	0.0	...	3.2	0.0	...	0.0	0.0	0.0	0.0	0.0	11.8	11.7
Cash payments on foreign debt service	4.8	...	14.3	4.9	...	1.5	8.7	6.8	15.7	13.5	24.3	23.2
External budget grants	6.4	...	17.8	0.8	...	0.8	3.2	3.2	5.9	6.0	11.9	12.5
Program accounting exchange rates												
SR/US\$ (end-of-quarter)	12.15	...	12.15	12.41	...	12.41	12.41	14.04	12.41	14.04	12.41	14.04
US\$/Euro (end-of-quarter)	1.34	...	1.34	1.35	...	1.35	1.35	1.33	1.35	1.33	1.35	1.33
US\$/UK pound (end-of-quarter)	1.56	...	1.56	1.56	...	1.56	1.56	1.60	1.56	1.60	1.56	1.60
US\$/AUD (end-of-quarter)	0.97	...	0.97	0.97	...	0.97	0.97	1.04	0.97	1.04	0.97	1.04
US\$/SDR (end-of-quarter)	1.49	...	1.49	1.56	...	1.56	1.56	1.55	1.56	1.55	1.56	1.55

Sources: Seychelles authorities and IMF staff estimates and projections.

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

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

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

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

Table 2. Structural Benchmarks, 2011–12

Measure	Target Date	Macroeconomic Rationale	Status
Cabinet approval of the amendments to Financial Institutions Act as described in 3 rd 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 rd 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 rd 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 rd 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 rd 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 rd Review MEFP, ¶22)	End-September 2011	To strengthen public finance management.	Met.
Reinstate the electricity tariff adjustment for fuel price variation (3 rd Review MEFP, ¶56)	End-September 2011	To reduce losses of the public utility company.	Electricity tariffs increased in multiple steps August through May 2012.
Introduction of the credit information system (4 th Review MEFP, ¶46)	End-March 2012		Met.
Creation of the commercial court (4 th Review MEFP, ¶47)	End-March 2012		Met.
Cabinet approval of new DBS mandates (4 th Review MEFP, ¶54)	End-March 2012	To redefine its mandate to finance small and medium enterprises	Met.
Commission and complete a study on optimal tariffs for utilities (4 th Review 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 (4 th Review MEFP, ¶26)	July 2012	To modernize the tax system and remove tax distortions	
Cabinet approval of the Public Sector Investment Program to be used for the 2013 budget planning. (4 th Review 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 (4 th Review MEFP, ¶51)	End-September 2012	To ensure long-term financial sustainability of utilities	
Implementation of Electronic Clearing House system (MEFP, ¶38)	End-September 2012	To improve transmission of monetary policy and reduce cost of financial transactions.	

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 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 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.

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' internal audit division in accordance with International Standards on Auditing, to ensure conformity with the program definition and calculation methods. Reports will be submitted to the IMF no later than two months after each test date.

Adjusters

5. The floor on the CBS's NIR will be adjusted upward (downward) by the amount by which the external non-project loans and cash grants 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), 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' internal audit division in accordance with International Standards on Auditing, to ensure conformity with the program definition. Reports will be submitted to the IMF no later than two months after each test date.

C. 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.

D. Public External Debt (Ceiling)

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

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.

E. External Arrears of the Public Sector

10. 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. Domestic Arrears of Government

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

service payment on domestic debt of the government or guaranteed by the government that has not been made within the contractually agreed period.

II. DATA AND INFORMATION

11. 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.