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Seventh Review
Under the Extended
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Approves US\\$5.0
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May 8, 2013

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Seychelles: Letter of Intent and Technical Memorandum of Understanding

April 19, 2013

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.

SUPPLEMENTAL LETTER OF INTENT

April 19, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund

Dear Managing Director Lagarde:

We are writing to request completion of the seventh and penultimate review under our Extended Arrangement, and the availability for purchase of the tenth tranche of SDR 3.30 million (30.3 percent of quota).

We met all end-December quantitative performance criteria under the program, and economic performance during 2012 was highly satisfactory, with most key indicators exceeding expectations. Real GDP growth is estimated to have been slightly higher than projection at 2.9 percent (projection was 2.7 percent). We also exceeded our end-of-year targets with regard to the primary fiscal surplus and net international reserves. Early indicators of economic activity in 2013 are highly encouraging, with the tourism sector – our mainstay – performing strongly, as indicated by a 19 percent growth in visitor arrivals for the first ten weeks of the year compared to the same period last year. This puts us in a good position to exceed the projected real growth target of 3.3 percent for 2013.

We remain strongly committed to maintain fiscal discipline that is vital for attaining long-term debt sustainability. Nevertheless we are cognizant of some downside risks due, among other things, to the tropical cyclone that affected Seychelles in late January, as well as revised bases for tax collections following introduction of the VAT and a number of other taxes. As a result of the heavy rains, Government established a special Fund for donations from the international community. However, the fundraising is not expected to cover the total costs for damage and losses (estimated at \$8 million by the World Bank), and it is anticipated that a certain level of expenditure will need to be incurred by the Budget. Moreover, the tax performance for the last two months of 2012 was less favorable than forecast at the time of preparing the 2013 budget, and consequently the base for the 2013 projections was revised downwards. Combined with a strong rupee this could negatively impact revenues. We are nevertheless committed to achieving a primary surplus in excess of 5 percent of GDP for the year.

We also remain strongly committed to our structural reform agenda. One of the key reforms under the program supported by the Extended Fund Facility—introduction of a Value Added Tax—was implemented on January 1, 2013. Besides a few teething problems the transition has been satisfactory. In terms of Public Finance Management, the reforms are on track and the Ministry of

Finance is on schedule for the introduction of new accounting manuals and procedures towards the middle of this year. In March, the Cabinet approved a policy for indexation of utility tariffs, as well as a roadmap for the re-balancing of tariffs to ensure the sustainability of the state-owned utility company. Implementation of this rebalancing exercise will begin on July 1 this year.

We have raised our net international reserves target because of the good performance of the export sector underpinned by strong inflows from tourism, and request modification of the end-June 2013 performance criterion. The Central Bank will accumulate reserves by opportunistically buying foreign currency such that the Bank's presence in the market does not influence the exchange rate level. Our target remains for gross official reserves to reach at least three months import cover by end-2013.

We will continue to implement monetary policy under the reserve money targeting framework. However, we intend to broaden our range of indicators for macroeconomic conditions in the short term so as to improve the transmission mechanism and make the monetary policy framework more flexible.

In line with the commitments made in the memorandum of economic and financial policies (MEFP) of November last year, we are confident of maintaining our course to achieve the objectives of the program. Nonetheless, 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 and this letter, in accordance with the Fund's policies on such consultations.

The eighth and final review under the EFF Arrangement based on performance criteria for end-June 2013 is expected to be completed on or after September 30, 2013.

In line with our commitment to transparency, we request that the IMF publish this letter, the attached technical memorandum of understanding (TMU), and the staff report for the seventh review and Article IV consultation. 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

Attachment 1—Table 1. Quantitative Performance Criteria Under the Extended Arrangement, 2012–13
(millions of Seychelles rupees; end-of-period)

	2012				2013			
	Performance Criteria	December			March	June	September	December
		Adjusted	Actual (prog rate)	Actual (market rate)	Indicative Target	Performance Criteria	Indicative Target	Indicative Target
Performance criteria								
Net international reserves of the CBS, millions of U.S. dollars (floor) ¹	223	224	234	235	227	236	234	241
Reserve money (ceiling)	1,920	...	1,816	...	1,950	1,980	2,010	2,040
Primary balance of the consolidated government (cumulative floor) ²	837	...	877	...	136	412	684	785
Contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) ²	40	...	36	...	25	40	55	55
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
Accumulation of external payments arrears by the public sector (ceiling) ³	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
Memorandum items:								
Net external non-project financing (millions of U.S. dollars; cumulative) ^{2,4}	-13.1	...	-12.3	...	-2.0	-15.3	-17.4	-12.2
External budget loans	7.0	...	7.0	...	0.0	0.0	0.0	17.0
Cash payments on foreign debt service	25.1	...	23.6	...	2.0	15.3	17.4	32.1
External budget grants	5.0	...	4.2	...	0.0	0.0	0.0	2.9
Program accounting exchange rates								
SR/US\$ (end-of-quarter)	13.02	...	13.02	13.00	13.02	12.80	12.80	12.80
US\$/Euro (end-of-quarter)	1.29	...	1.29	1.32	1.29	1.36	1.36	1.36
US\$/UK pound (end-of-quarter)	1.62	...	1.62	1.62	1.62	1.59	1.59	1.59
US\$/AUD (end-of-quarter)	1.04	...	1.04	1.04	1.04	1.04	1.04	1.04
US\$/SDR (end-of-quarter)	1.54	...	1.54	1.54	1.54	1.54	1.54	1.54

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.

Attachment 2—Table 2. Structural Benchmarks, June 2012–13

Measure	Target Date	Macroeconomic Rationale	Status
Commission and complete a study on optimal tariffs for utilities (4 th Review MEFP, ¶151).	End-June 2012	To ensure cost recovery and long-term sustainability of utilities.	Met. Final version received October 2012.
Cabinet approval of the Public Sector Investment Program to be used for the 2013 budget planning (4 th Review MEFP, ¶128).	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.	Met.
Implementation of Electronic Clearing House system (5 th Review MEFP, ¶138).	End-September 2012	To improve transmission of monetary policy and reduce cost of financial transactions.	Met.
Introduce VAT.	January 1, 2013	To modernize the tax system and remove tax distortions.	Met.
Cabinet approval of the action plan to rebalance utility tariffs.	End-March 2013	To ensure cost recovery and long-term sustainability of utilities.	Met.
Cabinet approval of Financial Instructions and Accounting Manuals in line with new PFM Act and IPSAS standards (6 th Review MEFP, ¶127).	End-June 2013	To improve efficiency of public finance management.	
Approval of Leasing Bill by National Assembly (6 th Review MEFP, ¶135)..	End-June 2013	To improve access to credit.	
Implement the first step of the utilities tariffs rebalancing (6 th Review MEFP, ¶111).	July 1, 2013	To ensure long-term financial sustainability of utilities.	

Attachment 3: 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 supplemental letter of intent (LOI), 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 2013 are listed in Tables 1 and 2 attached to the LOI, 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 non-project cash grants exceeds (falls short of) the amounts assumed in the program (LOI 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.

10. For the purposes of this performance criterion, the definition of debt is set out in Point 9 of the "Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements," attached to Executive Board Decision No.6230-(79/140), as amended. 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 sometime 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. Failure to make payment on an obligation that is not considered debt under this definition (e.g. payment on delivery) will not give rise to debt.

E. 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, subject to any applicable grace 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

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.

II. 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

14. 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.