

**FOR
INFORMATION**

FO/DIS/21/88

June 18, 2021

To: Members of the Executive Board
From: The Secretary
Subject: **Seychelles—Assessment Letter for the African Development Bank**

Board Action: Executive Directors' **information**

Publication: Yes*

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Seychelles—Assessment Letter for the African Development Bank

June 17, 2021

This assessment letter provides an update on the IMF's staff current assessment of Seychelles' recent economic developments, prospects and policies. The assessment has been requested by the African Development Bank.

Recent Economic Developments and the COVID-19 Impact

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

2. The pandemic severely disrupted economic activity. Tourism and its related sectors account for about two-thirds of Seychelles' GDP. As global travel came to a halt in 2020, tourism receipts plummeted, and an unprecedented economic contraction of 13 percent of GDP resulted, worsening the external and fiscal positions. The authorities responded with measures to protect the health of the population and mitigate the economic fallout on businesses and households.

3. Facing a deep recession and a slow recovery, the external position weakened significantly. The rupee depreciated by more than 35 percent against the US dollar in 2020. Tourism arrivals declined by about 60 percent. In spite of imports contracting sharply (25 percent) due to the depreciation of the exchange rate, border closures during the pandemic, and reduced demand, the current account deficit deteriorated to about 30 percent of GDP in 2020 (compared with the pre-pandemic projection of 17½ percent of GDP). However, financial support of the international community and a drawdown of private foreign currency deposits helped keep gross international reserves relatively stable.

4. The authorities made significant efforts to protect public health and the economy during the pandemic. They rolled out pandemic-related measures of nearly 7 percent of GDP, including wage support and subsidized loans to support the enterprises affected by the crisis. As a result, the primary deficit in 2020 was 16.3 percent of GDP. Public and publicly guaranteed debt increased from 62 percent of GDP in 2019 to 100 percent of GDP in 2020, reflecting the combined impact of a larger fiscal deficit, lower GDP, and a weaker exchange rate.

Outlook and Risks

5. Tourist arrivals have bounced back since April 2021, following the reopening of borders in late March. Seychelles was the first country to vaccinate more than 60 percent of its

population. Recent tourist arrivals reveal that new markets have emerged, with tourists from Russia, Israel, and UAE offsetting the absence of traditional clients from Europe. A recent flare-up of COVID cases led to domestic containment measures, such as school closures, but borders remain open and the number of cases appears to have peaked and is rapidly dropping.

6. Growth is expected to rebound in 2021–22, but uncertainty remains high. Barring a resurgence of the pandemic, the economy is projected to grow by 6.9 percent in 2021 and by 7.7 percent in 2022, underpinned by the more favorable global outlook, recovery of domestic activity, and a rebound in tourism, transportation, and related services. Growth should gradually converge to its potential in the medium term. Annual inflation will remain elevated in the coming months due to base effects but decline to about 3.9 percent by end-2022.

7. Market sentiment has improved following the reopening of borders. The rupee has appreciated by over 30 percent against the dollar since end-March, offsetting almost all the depreciation in 2020, helped by a rise in foreign currency deposits. The government was already able to issue 3, 5, and 7-year securities in February 2021 at lower interest rates than in 2020 and since the border reopening, these yields have decreased further. The demand for Treasury bills has also increased, with the one-year tenor Treasury bill yield falling by 20 basis points as of early June to 6.06 percent.

8. The outlook is positive but with significant downside risks. The outlook for tourism is bolstered by the recent recovery in tourist arrivals and in hotel and resort reservations for later this year. Vaccines are expected to be widely available in Seychelles' major markets (Europe, Middle East) by mid-summer 2021, while a faster-than-expected global recovery from the pandemic, driven by the United States and China, is expected to underpin global demand. Downside risks include prolonged impacts of the COVID-19 outbreak, including if vaccines prove less effective than expected, further disrupting domestic activity and tourism, as well as natural disasters.

Macroeconomic Policies

9. The pandemic-related fiscal expansion in 2020 will need to give way to a substantial consolidation. Consolidation measures could include: (a) optimizing the public sector wage bill; (b) limiting goods and services spending; (c) reviewing tax exemptions and (d) improving revenue collection, including by strengthening tax and customs administration. Social assistance also needs to be strengthened to improve targeting and adequacy.

10. At the time of the RFI request, debt was assessed to be “sustainable but with significant risk”. Since then, significant risks have materialized, with a sharp increase in the public debt ratio, substantial gross financing needs, albeit mitigated by an upward revision in the growth outlook, and uncovered financing gaps from 2021 onwards. As a result, debt remains sustainable with significant risk. Sustainability is predicated on a strong growth rebound, sizable fiscal adjustment, successful implementation of a debt management strategy aimed at reducing the cost of debt and lengthening its maturity, and the assumption that contingent liabilities do not materialize.

11. Inflation has been on the rise and the Central Bank of Seychelles (CBS) should remain vigilant. Second-round effects of the significant exchange rate depreciation in 2020, combined with one-off technical effects associated with a recalculation of the CPI basket, have contributed to inflationary pressure in recent months. However, the sharp currency appreciation in April is expected to partially reverse this effect with a lag and inflation should gradually return to about 3 percent over the medium term.

12. The banking sector appears in good financial health, but risks remain. Despite ample capital and liquidity buffers prior to the pandemic, the COVID crisis could pose challenges as asset quality may weaken with a lag. Banks entered the pandemic with high reported capital and profits, and a low level of NPLs, but the banking system remains exposed to risks from the COVID outbreak and future economic uncertainty. Once the moratoria and regulatory forbearance measures are withdrawn, recognition of the NPL levels and loan loss coverage ratios are likely to rise, creating pressure on asset quality, CAR, provisioning levels and profitability of the banking system. Given the likely impact of regulatory forbearance and economic recession on bank balance sheets, the CBS should remain vigilant toward any emerging risks to the financial sector, especially with respect to loan exposures with private households and the tourism sector. The CBS should therefore encourage and facilitate prudent restructuring of loans, proactively provide guidance on prudential treatment of moratoria and NPL management strategies, and develop detailed reporting templates for restructured and rescheduled loans and for monitoring the impact of COVID-19 measures on the asset quality of banks.

Relations with the Fund

13. Performance under Fund-supported programs was excellent under past programs. Reflecting the authorities' reform efforts, performance under Fund-supported programs (an SBA and two EFFs during 2009-mid 2017, followed by a PCI through end-2019) was strong and four reviews under the PCI were concluded on time. All December 2019 quantitative targets were met and structural reforms progressed as planned. To help address the urgent balance of payments need arising from the pandemic, the Executive Board approved emergency financing under the Rapid Financing Instrument (RFI) of SDR 22.9 million, equivalent to 100 percent of quota, in May 2020 (IMF Country Report No. 20/170).

14. The government has requested an IMF program. The difficult economic situation presents financing needs. Although the authorities have mobilized considerable bilateral support, further external financing is required to maintain financial sector stability, avoid adverse feedback loops on the economy, and prevent undue fiscal retrenchment. A greater reliance on concessional external financing, a planned fiscal consolidation, and lengthening domestic debt maturities will help Seychelles to reduce gross financing needs significantly over the medium term. Board approval of an IMF-supported economic reform program is expected to catalyze support from key development partners, including the World Bank, AfDB, and bilateral partners. Staff are planning a virtual mission in June to discuss program modalities.

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

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
	Act.	Act.	Act.	Act.	Prel.			Proj.			
(Annual percent change, unless otherwise indicated)											
National income and prices											
Nominal GDP (millions of Seychelles rupees)	18,989	20,858	21,540	22,192	20,021	23,585	26,219	28,889	31,235	33,781	36,464
Real GDP (millions of Seychelles rupees)	8,423	8,843	8,960	9,132	7,957	8,506	9,160	9,780	10,266	10,781	11,297
Real GDP	4.4	5.0	1.3	1.9	-12.9	6.9	7.7	6.8	5.0	5.0	4.8
CPI (annual average)	-1.0	2.9	3.7	1.8	1.2	10.0	3.7	3.2	3.0	3.0	3.0
CPI (end-of-period)	-0.2	3.5	3.4	1.7	3.8	8.6	3.9	3.5	3.2	3.0	3.0
GDP deflator average	-0.8	4.6	1.9	1.1	3.5	10.2	3.2	3.2	3.0	3.0	3.0
Money and credit											
Broad money	12.1	16.4	7.7	13.9	...	...	...	...	...	...	...
Reserve money (end-of-period)	14.5	18.9	4.5	22.7	...	...	...	...	...	...	...
Velocity (GDP/broad money)	1.4	1.3	1.3	1.1	...	...	...	...	...	...	...
Money multiplier (broad money/reserve money)	4.6	4.5	4.6	4.3	...	...	...	...	...	...	...
Credit to the private sector	10.3	17.8	11.5	22.3	20.2	10.3	17.4	18.6	17.0	17.0	16.7
(Percent of GDP, unless otherwise indicated)											
Savings-investment balance											
External savings	20.6	19.6	18.9	16.1	29.6	25.9	22.1	19.8	17.8	16.9	15.4
Gross national savings	9.6	9.2	7.8	10.3	-6.2	2.1	5.7	8.5	8.8	9.5	10.8
<i>Of which</i> : government savings	3.8	3.7	4.3	4.6	-13.8	-6.3	-1.8	1.8	2.7	4.3	5.3
private savings	5.8	5.5	3.5	5.7	7.6	8.4	7.6	6.7	6.1	5.2	5.5
Gross investment	30.2	28.9	26.7	26.4	23.4	28.0	27.9	28.4	26.7	26.5	26.5
<i>Of which</i> : public investment ¹	5.0	4.3	5.2	3.9	5.9	9.0	8.9	7.9	6.2	6.0	5.6
private investment	25.2	24.6	21.5	22.5	17.5	19.0	19.0	20.5	20.5	20.5	20.9
Private consumption	47.1	50.9	52.6	52.6	49.9	54.7	55.8	54.1	52.4	53.1	52.5
(Percent of GDP)											
Government budget											
Total revenue, excluding grants	36.7	35.0	37.1	37.6	35.7	30.7	32.4	33.6	35.4	36.0	36.5
Expenditure and net lending	38.2	36.4	38.8	37.7	57.1	48.5	44.6	40.5	39.0	37.6	36.7
Current expenditure	33.2	32.1	33.6	33.8	50.1	39.0	35.5	33.1	33.3	32.3	31.6
Capital expenditure ¹	5.0	4.3	5.2	3.9	5.9	9.0	8.9	7.9	6.2	6.0	5.6
Overall balance, including grants	-1.4	0.1	0.7	-0.9	-19.5	-13.7	-9.3	-4.8	-2.1	-0.2	1.0
Primary balance	3.4	3.1	3.0	2.8	-16.3	-9.7	-6.5	-2.3	1.3	2.8	3.2
Total government and government-guaranteed debt ²	72.8	65.7	62.3	61.8	99.6	87.7	89.1	86.4	82.2	76.5	69.5
Domestic (including debt issued for monetary purposes)	40.5	36.1	33.1	33.7	47.1	42.4	38.9	35.9	38.6	38.6	36.2
<i>of which</i> : Monetary debt	16.2	11.2	9.5	9.0	3.0	2.6	2.3	2.1	1.9	1.8	1.7
External	32.3	29.6	29.2	28.1	52.5	45.3	50.2	50.5	43.6	37.9	33.4
External sector											
Current account balance including official transfers (in percent of GDP)	-20.6	-19.6	-18.9	-16.1	-29.6	-25.9	-22.1	-19.8	-17.8	-16.9	-15.4
Total external debt outstanding (millions of U.S. dollars) ³	4,299	4,475	4,682	4,874	5,082	5,446	5,816	6,131	6,330	6,547	6,802
(percent of GDP)	301.5	292.8	303.7	308.5	446.7	346.4	331.4	314.0	296.1	279.5	262.9
Terms of trade (=deterioration)	-13.8	-2.9	-3.3	6.7	10.6	-3.6	-4.1	-0.4	0.9	0.9	0.0
Real effective exchange rate (average, percent change)	-0.1	-3.2	...	...	...	...	...	...	...	...	...
Gross official reserves (end of year, millions of U.S. dollars)	522.6	546	548	581	560	672	740	799	781	779	816
Months of imports, c.i.f.	3.7	3.5	3.7	5.2	4.5	4.6	4.4	4.3	3.9	3.6	3.8
In percent of Assessing Reserve Adequacy (ARA) metric	113.3	112.6	110.9	112.4	111.7	114.5	115.1	114.7	106.4	101.1	100.4
Exchange rate											
Seychelles rupees per US\$1 (end-of-period) ⁴	13.5	13.8	14.0	14.1	21.6	...	...	...	...	...	...
Seychelles rupees per US\$1 (period average) ⁴	13.3	13.6	14.0	14.0	17.6	...	...	...	...	...	...

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

¹ Includes onlending to the parastatals for investment purposes.² Includes debt issued by the Ministry of Finance for monetary purposes.³ Includes private external debt.⁴ As to 2020, exchange rate measured as of July 14, 2020.