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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/104-3

12:15 p.m., December 7, 2018

3. Seychelles—Second Review of the Policy Coordination Instrument and Request for Modification of Targets

Documents: EBS/18/108 and Correction 1

Staff: Sy, AFR; Sommer, SPR

Length: 29 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	A. Nainda (AE), Temporary
	F. Sylla (AF)
	J. Di Tata (AG)
N. Ray (AP)	
	P. Fachada (BR)
	X. Cai (CC), Temporary
	A. Arevalo Arroyo (CE), Temporary
L. Levonian (CO)	
	S. Benk (EC)
	F. Bellocq (FF), Temporary
	I. Fragin (GR), Temporary
	M. Roy (IN), Temporary
	P. Di Lorenzo (IT), Temporary
M. Kaizuka (JA)	
	S. Alavi (MD), Temporary
	W. Abdelati (MI), Temporary
	V. Rashkovan (NE)
	K. Virolainen (NO)
	Z. Smirnova (RU), Temporary
	R. Alkhareif (SA)
	U. Latu (ST)
	P. Trabinski (SZ)
	S. Vitvitsky (US), Temporary

G. Tsibouris, Acting Secretary
H. Malothra, Summing Up Officer
R. Smith Yee, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department: S. Dhungana, S. Issoufou, T. Konuki, D. Owen, A. Sy. Communications Department: G. Vilkas. Finance Department: N. Denewet, W. Wiranto. Legal Department: G. Rosenberg. Strategy, Policy, and Review Department: M. Sommer. Executive Director: S. Meyer (GR). Senior Advisors to Executive Directors: Z.Mohammed (BR), M. Tolici (NE). Advisors to Executive Directors: M. Bernatavicius (NO), S. David

(AP), T. Hemingway (UK), M. Kikiolo (AP), G. Kim (AP), N. Komura (JA), C. Moreno (AG), F. Rawah (SA), A. Urbanowska (SZ).

3. SEYCHELLES—SECOND REVIEW OF THE POLICY COORDINATION INSTRUMENT AND REQUEST FOR MODIFICATION OF TARGETS

Mr. Ray and Mr. Johnston submitted the following statement:

Seychelles began an extended program engagement with the Fund in 2008 after experiencing an acute balance of payments and public debt crisis. Since then, the authorities have restructured the country's debt, restored fiscal and monetary policy credibility, floated the exchange rate, strengthened public financial management, reformed the tax system and rebuilt reserves. Strong performance under three successive Fund-supported programs led to solid growth and a substantial improvement in the fiscal and external positions. Since 2015, Seychelles has been considered a high-income country by the World Bank. Still, as a small open country, dependent on tourism, Seychelles remains vulnerable to external shocks, and its debt is still high. In 2017, following the completion of its last EFF program, Seychelles became the first country to request the new Policy Coordination Instrument (PCI), which provides oversight and discipline around a reform agenda, without financing. The PCI for Seychelles has four key objectives: addressing medium-term fiscal sustainability; enhancing public investment efficiency and the quality of public services; minimizing the fiscal risk of SOEs; and modernizing the financial system and ensuring its stability. Program performance has been strong, notwithstanding some slight delays in the timelines for reform targets.

Seychelles' key fiscal target is to reduce public debt to below 50 percent of GDP by 2021, which requires a primary surplus each year of 2.5 percent of GDP. This has been achieved in 2018, with the authorities expecting a surplus of 3 percent. The 2019 Budget is also consistent with this requirement. It contains a number of new revenue initiatives, including a tax on sugar-sweetened drinks, an annual tax of 0.25 percent on foreign-owned residential properties, a 10 percent increase in tobacco excise, and a small fee on prescriptions for most working-age people. At the same time, nominal expenditure growth from 2018 to 2019 has been kept to 1.3 percent.

Large infrastructure projects previously announced by the President will be progressed over the medium term in a way consistent with the Government's debt objective, including through grants and PPPs. These projects include investments contributing to climate change mitigation and adaption, such as switching electricity generation from diesel to LNG and protecting water security by building a new dam at Grand Anse Mahé. Seychelles has a target of 5 percent renewable energy by 2020 and 15 percent by 2030 and is implementing a number of solar energy initiatives to help achieve these goals. The Climate Change Policy Assessment undertaken in 2017 found that projects associated with Seychelles' Nationally Determined Contribution could total 40 percent of GDP and stressed the need to mobilize private investment and concessional financing. Efforts to improve public investment management and minimize risks – including from PPPs – are therefore important and the authorities have asked the Fund to conduct a PIMA next year.

Seychelles has been innovative in its debt management. Earlier this year, the country agreed a debt-for-nature swap with a US-based conservation group – the first in the world aimed at protecting a marine area. It has also recently issued the world's first sovereign Blue Bond, raising US$15 million to support sustainable marine and fisheries projects through grants and loans. The bond is guaranteed by the World Bank, which is also assisting Seychelles in swapping US dollar obligations from a 2009 bond issue into euro obligations, as Seychelles' export earnings are chiefly in euros. On risk management more widely, the Government has for the first time published a fiscal risk statement as part of the 2019 Budget that covers macroeconomic shocks, revenue and spending risks, and risks arising from the ownership of public enterprises. The Government intends to raise the governance of all non-financial SOEs to international best practice through a new Code of Governance, and to report the cost of social obligations on SOEs – both are reform targets under the program.

The Central Bank of Seychelles (CBS) is transitioning to a new framework that uses interest rates to signal the monetary policy stance, rather than the quantity of reserves. The CBS has been working through a six-phase plan with guidance from the IMF and expects to have completed the core requirements of this in early 2019. It therefore makes sense to replace the current target for reserve money in the PCI with a monetary policy consultation clause. The CBS is not committing to an inflation target. Rather, the consultation clause would be based on an agreed quarterly inflation path. A deviation from this path of 2 percentage points would trigger a formal consultation with the Board as part of a program review, looking at the reasons for the deviation and whether remedial actions are needed. A deviation of 1.5 percentage points would be used as an early warning, triggering a consultation with IMF staff.

Seychelles remains concerned about risks to correspondent banking relationships, which arise, at least in part, from the country's small size, the presence of a significant offshore financial sector and AML/CFT risks. The authorities have been working to increase transparency, strengthen the

AML/CFT framework and ensure compliance with international standards, including on tax. For example, International Business Centres, which are incorporated in but do not do business in Seychelles, must now keep a register of beneficial owners. A mutual evaluation report by the FATF regional body ESAAMLG has recently been released and identifies a number of areas for improvement. New AML/CFT legislation will shortly be submitted to the National Assembly, drawing on the recommendations of the mutual evaluations, Seychelles' own risk assessment and Fund TA on correspondent banking pressures. This legislation will, among other things, establish a national committee to oversee AML/CFT enforcement, and an independent board to supervise the operations of the Financial Intelligence Unit, which will see an increase in resources. The authorities are also reviewing the offshore sector model with the intention of increasing transparency, in line with international best practice.

The Seychellois authorities continue to have a strong commitment to reform and to maintaining macroeconomic stability. They thank the Fund for its advice and support over ten years of economic transformation and thank the mission team for its work on this PCI review.

Mr. Fachada and Ms. Mohammed submitted the following statement:

We thank staff for the well-structured report and Mr. Ray and Mr. Johnston for their statement. We take note that the Seychelles authorities remain committed to safeguarding macroeconomic stability, and that program implementation under the Policy Coordination Instrument (PCI) is on track. Accordingly, we support the completion of the second review, as well as the modification of the end-December 2018 targets, and the proposed new end-June and end-December 2019 targets. We encourage the authorities to maintain their efforts to achieve these new targets and continue strengthening Seychelles policy framework.

The authorities' commitment to achieve the right balance between implementing revenue enhancing measures and keeping a tight rein on current expenditures is welcome. The measures proposed in the draft 2019 budget appears to be in line with the program's primary surplus target of 2 ½ percent of GDP, and the goal of bringing public debt to below 50 percent of GDP by 2021. Additionally, we welcome the assurances given by the authorities that the large infrastructure projects announced in March 2018 and investments aimed at enhancing resilience to climate change will be implemented within the parameters of the program.

The authorities must continue their efforts to reduce fiscal risks and create room to improve investment and boost growth prospects. Seychelles has come a long way in reducing its public debt ratio since the global financial crisis, and preserving these gains is critical. We agree with staff in highlighting the need to mitigating any risks of state-owned enterprises' obligations migrating to the government balance sheet. Efforts to strengthen public investment and public-private partnerships (PPPs) project management to address the infrastructure gap are also encouraged. We expect that concessional financing options for climate change related projects would provide Seychelles with favorable financing options to achieve its climate change mitigation and adaptation goals, as well as boost its growth prospects.

We support the replacement of the reserve money (RM) quantitative target (QT) with a monetary policy consultation clause (MPCC) to ensure a smooth transitioning to a more modern monetary policy framework. We expect that this new interest rate focused policy would be less difficult to operationalize by the Central Bank of Seychelles (CBS). We support staff's recommendation in encouraging the authorities to continue efforts to further strengthen their capacity for inflation forecasting and liquidity management, fine tune their communication policy, and develop the interbank market. Further, in the wake of fuel prices and utility adjustments, we join staff in recommending the CBS to be vigilant and prepared to continue tightening monetary policy at any signs of inflationary pressure.

We agree that the authorities should step up efforts to strengthen the AML/CFT framework and continue addressing the risks of further potential loss of corresponding banking relationships (CBRs). We commend the authorities in amending the AML/CFT framework and enhancing entity transparency in the offshore sector, in line with recommendations listed by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) and the Fund's Legal Department. We believe that tangible progress with these measures would assist in the alleviation of the pressures arising from CBRs withdrawals, and agree that further efforts to develop solutions at the regional/international level should continue. Progress made by the authorities to effectively implement the Base Erosion and Profit Shifting (BEPS) principles are reassuring.

Mr. Kaizuka and Mr. Komura submitted the following statement:

We thank staff for the comprehensive and well-written reports and Mr. Ray and Mr. Johnston for the informative statement. We welcome the favorable economic conditions in Seychelles. Specifically, economic growth is expected to remain robust at 3.5 percent during 2018-20, around its potential rate. The headline CPI inflation has been moderated, 3.3 percent in September, due to the appropriately tighter monetary policy.

Seychelles has left a strong track record in the Fund programs. Currently, Seychelles has been in the Policy Coordination Instrument (PCI) program as the first case of the instrument. It is welcoming that the PCI program is largely on track, meeting all quantitative targets (QTs) for end-June except for the reserve money target. We therefore support the completion of the second review of the PCI. Going forward, we expect that the authorities continue to take sound macroeconomic policies and conduct necessary reforms to achieve strong and sustainable growth under the PCI.

As we agree with the general thrust of the reports, we would like to offer the following comments for emphasis:

Fiscal Policy

We commend that the authorities remain committed to the primary surplus of 2.5 percent of GDP from 2019 onwards. Additional measures, especially streamlining and better targeting social welfare programs, would help to ensure a continuous achievement of this fiscal target while preserving resources for their priorities. The primary surplus is projected to be 2.5 percent in 2019 partly due to the permanent revenue measures in their 2019 budget. While the primary surplus is also expected to be 2.5 percent 2020 onwards now, the authorities need to take additional measures to make sure a continuous achievement of this fiscal target as well as to preserve resources for their priorities, including large infrastructure and climate change related projects. A key would be streamlining and better targeting social welfare programs. In this regard, we commend that the authorities are conducting a comprehensive study of social welfare programs. We look forward the authorities to completing this study timely and specifying reform measures to ensure an achievement of the fiscal target while supporting vulnerable groups efficiently.

The authorities need a careful implementation of the large projects. On the one hand, we recognize that Seychelles has certain financing needs. In particular, enhancing resilience to climate change is especially critical given its geological features. On the other hand, the authorities need continuous efforts on fiscal consolidation, in line with the welcoming authorities' commitment on the primary surplus of 2.5 percent of GDP. Taking these factors into consideration, the authorities should carefully manage the implementations for the large projects announced in the 2018 State of the Nation Address (SONA) whose total costs could reach around 30 percent of 2018 GDP. Specifically, the implementations should be within the fiscal target under the PCI. Also, the implementations need to be gradual, in line with the country's absorbing capacity. On these announced projects, we note that the President assures that the implementations would be through public-private partnerships (PPPs) and external grants. In this regard, the authorities need to strengthen an associated framework because usefulness of PPPs highly depends on such a framework, including risk managements. Thus, it is encouraging that the authorities consider several measures to reduce potential risks arising from PPPs. Against this backdrop, the authorities would benefit from establishing, with the help of the team, a detailed and realistic implementation plan for those SONA projects to steadily realize them without undermining macroeconomic stability. Staff's comments are welcome.

Financial Sector

We urge the authorities to accelerate their efforts to strengthen the AML/CFT framework. The recent FATF Mutual Evaluation Report (MER) indicates serious shortcomings. In this regard, we commend several progress in this area as the buff statement describes, while we have to mention that the Reform Target (RT) for the second review related to the AML/CFT framework has been delayed and the RT for the third review might be delayed as well. To reduce the risks of losing correspondence banking relationships (CBRs), the authorities need to take necessary actions in a timely manner.

Mr. Virolainen and Mr. Bernatavicius submitted the following statement:

We thank staff for the informative report and Mr. Ray and Mr. Johnston for the comprehensive buff statement. We welcome a strong PCI program implementation and a continued commitment to safeguard the macroeconomic stability. We support the completion of the second review under the PCI arrangement and urge the authorities to continue with the implementation of institutional and structural reforms, proceed with fiscal consolidation, further strengthen the AML/CFT framework, and enhance entity transparency in the offshore sector. We agree with staff that the authorities should strengthen efforts for a smooth transition to a new monetary policy framework and address CBR pressures.

We agree with staff, that the economic conditions continue to be favorable, but vulnerabilities to external shocks remain prominent. Strong performance under previous Fund-supported programs led to a substantial improvement in the fiscal position and restored economic growth. We welcome staff's assessment that the current program is largely on track and the fact that all the quantitative targets for end-June were met, except for reserve money target (RM). We support replacement of the RM with the monetary consultation clause and urge the authorities to strengthen efforts for a smooth transition to a new monetary policy framework. We take note, that two Reform Targets (RTs) for the second review are slightly delayed due to technical reasons.

We welcome strong commitments to proceed with fiscal consolidation. We also welcome the clarification provided by the authorities, that the new large infrastructure projects planned in the coming years will not compromise with agreed fiscal targets: reducing public debt below 50 percent of GDP by 2021 and a primary surplus target of 2,5 percent of GDP. We urge the authorities to continue with structural reforms to minimize contingent liabilities arising from SOEs and to seek better targeting of social welfare programs.

We welcome the recently introduced permanent revenue-enhancing measures in the 2019 budget. We call to explore the possibility of additional revenue measures to contain fiscal pressures arising from climate change. We also welcome the authorities' innovative approach to debt management, including a debt-for-nature swap and the world's first sovereign Blue Bond. Having in mind the 2017 Climate Change Policy Assessment for Seychelles, we wonder what role staff assigns to the assessment in helping to mobilize more private investment and concessional financing for climate-related projects?

We agree with staff that the authorities need to step up efforts to strengthen the AML/CFT framework to address CBR pressures. We welcome recent initiatives undertaken by the authorities and urge for their steadfast implementation.

Mr. Sun and Ms. Cai submitted the following statement:

We thank staff for the informative reports and Messrs. Ray and Johnston for the helpful buff statement. We commend the authorities' strong program implementation and commitment to pushing forward reforms. We support the completion of the second review under the PCI and the modification of targets.

On fiscal policy, we commend the authorities' efforts in improving the fiscal position through revenue mobilization as well as streamlining spending on social welfare. Increasing infrastructure investment would help address Seychelles' infrastructure gap. We take positive note that many projects would be implemented within the parameter of the program through PPP and external grants. The publication of the fiscal risk statement as part of the 2019 budget is welcome and we encourage technical assistance on fiscal management where necessary. Efforts to further improve the SOE's capacity to generate income, and more importantly, to enhance SOEs' governance in line with international best practices should continue. In this regard, we welcome the new Code of Governance.

On monetary and financial policies, the Central Bank of Seychelles' (CBS) recent transition from the use of quantity of reserve to the use of interest rates is an important step in modernizing the monetary policy framework. Given the current internal and external conditions, it seems to be appropriate to maintain the tight monetary policy stance until inflationary pressures abate. We take positive note of the authorities' work to enhance the country's legal framework for crisis management, bank resolution and financial safety net, where Fund's technical assistance has been provided. The issue of correspondence banking relationships should be resolved with efforts from all related parties. We commend the authorities for their concrete work to improve transparency and strengthen the AML/CFT framework by international standards, including on tax. We look forward to the approval of the new AML/CFT legislation by the National Assembly and encourage the authorities to continue efforts in this regard, following the recommendations in the FATF Mutual Evaluation Report.

On structural reforms, we welcome the CBS's efforts in designing a modernization plan to further develop the payments infrastructure, which will be helpful to increase financial services access. We encourage the authorities to further enhance the credit information system to allow for a better credit quality assessment.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Psalidopoulos and Mr. Di Lorenzo submitted the following statement:

We thank staff for their report and Messrs. Ray and Johnston for the well-written buff statement. We broadly share the thrust of the staff appraisal, commend the authorities for the strong program implementation, especially on the fiscal side, and support their request for the completion of the second review under the Policy Coordination Instrument, as well as the modification of the end – December 2018 targets. We would like to offer the following specific comments for emphasis.

Safeguarding macroeconomic stability requires keeping a prudent fiscal stance. The budget for 2019 set fiscal targets in line with the program; however, maintaining this level of primary surplus over time is necessary for a steady reduction in the debt ratio and in the associated financing needs. The introduction of a number of permanent revenue measures is a welcome step in this direction, while similar emphasis should be given to the protection of the most vulnerable groups from the increase in utility tariffs. In addition, continuous dialogue on the issue of possible - non discriminatory - revenue measures alternative to the property tax is of essence.

Moreover, large investment projects can present risks for debt sustainability and therefore deserve strong attention. The infrastructure and climate change related investments, on one hand, can significantly boost long-term growth and resilience to natural disasters; on the other hand, they create large commitments that will last for well beyond the end of the current program, exposing the debt trajectory to risks from contingent liabilities. While we welcome the assurances provided at the highest political level that the primary surplus agreed under the program won't be affected, we believe that legally binding caps to PPP-related payments and/or on the total value of the stock could also go a long way in containing such fiscal risks. Have staff discussed the introduction of similar ceilings being discussed with the authorities?

The new monetary policy framework is instrumental to better steer the communication and price dynamic. Since the institutional and financial setups appear adequate to provide an adequate support, we welcome the central bank decision to move to the policy rate as an operating target. Such a decision will contribute to improve the transparency of policy decisions and their predictability for market agents. In addition, a successful transition requires also that other conditions are in place, starting with the announcement of a policy rate. Can staff provide an update about the envisaged timing for a decision in this sense? In terms of monetary stance, the authorities should maintain, and transparently communicate, a tightening bias in view of possible upside risks to the inflation outlook. At the same time, adopting macroprudential measures and maintaining a flexible exchange rate will help to preserve price stability as the main objective of the monetary policy decisions.

Finally, we join staff's call in urging the authorities to fast track actions to strengthen the AML/CFT framework. Speeding up the approval of the legal amendments to address the sensible shortcoming recently identified in the mutual evaluation and curb risks of loss of CBRs should represent a primary policy goal. It is also imperative that the delayed implementation of a risk-based approach to financial supervision would be achieved by the new deadline. We welcome actions aimed to enforcing the BEPS principle and look forward to the authorities' new strategy for the offshore sector in line with international practice.

Mr. Tan and Ms. Latu submitted the following statement:

We thank staff for the comprehensive set of reports, and Mr. Ray and Mr. Johnston for their informative buff statement.

Seychelles' commitment to meet the Policy Coordination Instrument (PCI) targets and safeguard economic stability is commendable. While one of the Quantitative Targets was not met by a very close margin at the end of June 2018, we are pleased that the PCI has supported the authorities' fiscal and monetary policies, resulting in the higher foreign reserves and primary government budget surplus that were well above targets, as well as the declining trend in public debt level. Inflationary pressures were also well-contained as the authorities continued to make satisfactory progress towards the Reform Targets. In this regard, we support the completion of the second PCI review and the authorities' request for the modification of the end-December 2018 Quantitative Target, and the proposed new end-June and end-December 2019 Quantitative Targets.

Continued fiscal consolidation is encouraged to meet the medium-term target of reducing public debt to 50 percent of GDP by 2021. We welcome the authorities' continued efforts towards sustainable macroeconomic growth as reflected in the revenue-enhancing and expenditure-saving measures incorporated in the 2019 budget, which are in line with the PCI targets. We also acknowledge the authorities' initiatives to further reduce debt-related risks and their intended use of grants and concessional financing sources for public investments aimed at building climate change resilience. This would assist in creating additional fiscal space over the medium term especially given the country's vulnerability to external shocks. In the spirit of promoting inclusive growth, we agree with staff for the authorities to carefully consider the potential impact of the new saving measures on the vulnerable groups and to rigorously carry through the plans for enhancing inclusive growth.

We acknowledge the effectiveness of the authorities' prudent monetary policy in curbing inflation and their commitment to remain vigilant to any further signs of inflationary pressures. This is crucial due to the potential impact of the government's revenue enhancing measures and other developments such as the utility tariff adjustments. We are pleased with the progress in transitioning to the new interest rate-based monetary policy framework and we support continued work towards improving the authorities' capacity in inflation forecasting and liquidity management. This would support more effective monetary policy transmission and is particularly appropriate given the switch from the Quantitative Target to a Monetary Policy Consultation Clause under the PCI to better measure monetary policy effectiveness. We call on the authorities to continue to seek the Fund's expertise to support the implementation of the Action Plan and facilitate the transition to the new framework.

Structural reforms should be expedited to limit the potential risks from state-owned enterprises and improve the efficiency of public investments to complement the fiscal consolidation efforts. We welcome the authorities' progress on this front and support the continued close monitoring of the restructuring of Air Seychelles to minimize any further budgetary impact. We encourage the authorities to complete the proposed reforms to strengthen financial stability, with due consideration of the proposed financial inclusion initiatives, to ensure the financial sector remains viable while being supportive of broad-based economic growth. We also concur with staff to consider macroprudential measures to address any potential risk build-up in household credit.

We concur with staff that the authorities should expedite efforts to strengthen the AML/CFT framework by effectively implementing the Mutual Evaluation recommendations from the Eastern & Southern African Anti-Money Laundering Group. There will be significant long-term benefits in enhancing the authorities' ability to effectively mitigate money laundering and terrorist financing risks, considering the country's significant offshore sector, as well as in addressing the risks of further potential loss of correspondent banking relationships.

With the above remarks, we wish the authorities of Seychelles continued success in their reform efforts.

Mr. Rashkovan and Mr. Tolici submitted the following statement:

We thank staff for a comprehensive set of papers and Mr. Ray and Mr. Johnston for their informative buff statement. Over the last decade, Seychelles' sound macroeconomic policies and implementation of structural reforms, under successive Fund programs, have led to an important progress toward macroeconomic stability and public debt reduction. Nevertheless, risk stemming from external shocks and high public and external financing needs require further policy adjustments.

Given the commendable progress of the program, we support the completion of the second review under the PCI and the modification of targets. We also support the replacement of the Reserve Money (RM) quantitative target (QT) with a monetary policy consultation clause (MPCC) as the interest rate corridor around a policy rate will better signal the monetary policy stance, enhance the money market functioning and improve the liquidity management framework.

As we agree with the general thrust of the report, we have the following comments for emphasis:

Continued fiscal consolidation is key to ensure fiscal space needed for implementing 2018 State of the Nation Address (SONA) and climate change resilience projects while securing the debt reduction goal under the PCI. We welcome the authorities' commitment to secure the 2.5 percent of GDP primary surplus in the 2019 budget through expenditure saving and permanent revenue enhancing measures. From 2020 onward, additional measures are needed to continue the achievement of this fiscal target, as a significant proportion of 2018 and 2019 primary surplus has been related to one-off measures. While we agree with the Seychelles' priority investments in infrastructure and climate change resilience, we ask the authorities to remain prudent, and carefully balance the objectives of achieving medium-term public debt sustainability and implementing SONA agenda. Moreover, identifying concessional external sources to finance these projects is critical to remain within the fiscal targets and achieve the projected public debt reduction. Considering the sizable contingent liabilities of the SOE sector, the authorities must continue developing plans aimed at improving public financial management and public-sector efficiency.

We welcome the authorities' structural reform agenda aimed at enhancing inclusive growth and addressing income inequality. As the 2017 World Bank Systematic Country Diagnostic points out, inequality in the

Seychelles is significant and could be address by increasing the direct participation of Seychellois in “a skills-intensive, sophisticated economy”. We welcome the authorities’ efforts to better target social welfare programs starting in 2020 with the World Bank assistance. While supporting vulnerable groups more efficiently, the social welfare reform measures will contribute to the long term fiscal sustainability.

The authorities’ efforts toward bringing the AML/CFT framework in line with the international best practices must continue. We welcome the progress in addressing the deficiencies listed by the Eastern and Southern Africa Anti-Money Laundering Group MER and the Fund’s legal department TA report by amending the AML/CFT legal and institutional framework. Furthermore, we support authorities in their efforts to enhance transparency of the offshore financial sector and to implement a risk-based approach in bank supervision. In turn, these measures will alleviate the risk of further loss of corresponding banking relationships (CBRs).

Finally, we strongly support the central bank digitalization and Fintech agenda. We welcome the authorities’ plans to further develop e-payment/digital channels for financial services consumers. The implementation of an RTGS system and ACH will help digitization of government payment and enhance the use of e-payment facilities. We also commend the authorities for the planned adoption, in the first half of 2019, of the National Strategy for Fintech which will provide a coordinated approach regarding the Fintech adoption by the financial sector while considering the associated risks, including ones linked with AML/CFT.

Mr. Benk and Mr. Hagara submitted the following statement:

We thank staff for the report, and Messrs. Ray and Johnston for their informative buff statement. The Seychelles’ economic growth is projected to slow towards its potential on the back of tighter monetary policy and more moderate activity in the tourism sector. The program’s performance under the Policy Coordination Instrument (PCI) remains satisfactory with the end-June primary surplus, the quantitative targets on net international reserves met by a comfortable margin, and the reserve money target missed by a very small margin; however, the implementation of reform targets is slightly delayed. We can support the completion of the second review under the PCI and request for a modification of targets. We broadly agree with staff’s appraisal and provide the following comments for emphasis.

Continued fiscal prudence is warranted to achieve the program fiscal target and expedite debt reduction towards the authorities' debt goal. The primary surplus in 2018 is projected to outperform the program target of 2.5 percent of GDP. However, this is partly owing to temporary measures, and an additional fiscal consolidation effort is therefore needed, in line with the 2019 budget. We agree that the focus on revenue measures is appropriate given the infrastructure and climate resilience investment needs, while investment projects should be carefully prioritized and sequenced consistent with the country's absorptive capacity. In this vein, we welcome and support the authorities' request for a Public Investment Management Assessment during 2019.

Fiscal consolidation efforts should be accompanied by the strengthening of debt and public financial management frameworks. Given the large investment plans announced during the 2018 State of the Nation Address, which are partly financed by public-private partnerships, we strongly encourage the authorities to strengthen their assessment and monitoring of the related risks. As the role of state-owned enterprises (SOEs) in the economy remains significant, we welcome the progress with the structural reforms to reduce risks from SOEs. At the same time, the debt management strategy should continue to concentrate on the reduction of gross financing needs.

We encourage the authorities to expedite their efforts to bolster their AML/CFT framework. While the submission of the AML/CFT legal and institutional frameworks to the Cabinet was deferred to take into account the findings of the Eastern and Southern African Anti-Money Laundering Group's mutual evaluation report, the authorities should not allow any further delays, and address the identified serious shortcomings in the framework and ensure its thorough implementation. We believe that tangible progress on this front will alleviate risks of further withdrawals of correspondent banking relationships. We welcome that the authorities' AML/CFT efforts will be supported by the Fund's technical assistance.

While inflation declined recently, the authorities should remain vigilant for increases in inflationary pressures, including from the planned utility tariff adjustment. Given the authorities' ongoing efforts towards a new monetary policy framework, we agree with the replacement of the reserve money target with a monetary policy consultation clause to smooth the transition process.

Mr. Mouminah, Mr. Alkhareif and Mr. Rawah submitted the following statement:

We thank staff for the well-written report and Mr. Ray and Mr. Johnston for their helpful buff statement. We are in broad agreement with the staff's analysis and policy recommendations and would limit our remarks to a few issues.

We support the completion of the second review under the PCI and the associated decision. We commend the authorities for the satisfactory program implementation, resulting in higher than targeted primary fiscal balance and net international reserves. We appreciate the authorities' emphasis on safeguarding economic stability, but we would like to underscore the importance of further efforts to enhance the prospects for inclusive growth.

We welcome the authorities' commitment to pursue debt reduction over the medium term to reach below 50 percent of GDP by end-2021 and intention to streamline and better target social welfare programs. We also take note of the authorities' assurance that the large infrastructure projects announced in 2018 will be implemented in a manner consistent with the parameters of the program. Here, we would like to stress the importance of continuing efforts to improve the efficiency of public investments and reducing potential PPP-related risks. This is indeed important to safeguard fiscal sustainability and to improve growth prospects. We see merit in staff's view on creating further fiscal space in the medium-term, including through exploring further revenue mobilization measures, which would help sustain debt reduction, improve resilience, and support priority spending.

Finally, we join staff in urging the authorities to step up their efforts to strengthen the AML/CFT framework. This is important to preserve financial stability, especially amongst challenges stemming from CBR pressures as noted by staff. In this context, we welcome the authorities' continued efforts, including the work on amendments to the AML/CFT legal and institutional framework to address the recommendations listed in the mutual evaluation report and the Fund legal department's TA report.

With these remarks, we wish the authorities further success.

Mr. Meyer and Mr. Fragin submitted the following statement:

We thank staff for the well-written report and Mr. Ray and Mr. Johnston for their helpful buff statement.

Supported by prudent macroeconomic policies, economic conditions in Seychelles continue to be favorable while risks to the outlook are broadly balanced. Nevertheless, public debt levels remain around the high-risk benchmark, calling for further progress in reducing the stock of public debt. We broadly concur with the staff appraisal and would like to emphasize the following aspects:

In light of the largely satisfactory program performance, we support the completion of the second review. It is encouraging that the quantitative end-June targets for the primary surplus and net international reserves were met by a comfortable margin. At the same time, we note that progress on the structural front is rather limited at the current juncture. Both reform targets (RTs) for the second review have not been met and several RTs for future reviews have been postponed. Against this backdrop, we call on the authorities to avoid further delays in implementing the agreed reform measures, going forward.

We welcome the authorities' commitment to sustain a primary surplus of 2 ½ percent of GDP from 2019 onwards. Under the baseline scenario this would lead to a steady decline of the public debt-to-GDP ratio. In this context, we are encouraged to learn that higher revenues are underpinned by permanent measures and that the authorities are determined to keep current expenditure in check. As regards the large investment projects announced in the 2018 State of the Nation Address, staff rightly accentuates the need to implement these projects within the parameters of the program and in line with the state's absorptive capacity and to rely on concessional external financing to the largest extent possible. The authorities' emphasis on infrastructure build-up going forward – including through the use of PPPs – underscores the priority of buttressing administrative capacity and efficiency to minimize fiscal risks.

We agree with the authorities' request to switch to a monetary policy consultation clause and replace the current reserve money quantitative target. As highlighted by staff, this would better align program conditionality with the central bank's intention to move to an interest rate-based monetary policy framework. Regarding exchange rate policies, we echo staff's call to stick to a flexible exchange rate and maintain the current level of reserve coverage ratios which staff deems adequate.

Finally, we note that staff argues for removing the discriminatory features in the property tax to be introduced in 2019. We agree with staff that the property tax which discriminates between residents and nonresidents is a capital flow management measure (CFM) according to the Fund's institutional view. However, as measures classified as a CFM are not necessarily inconsistent with the institutional view, staff's recommendation to remove the above-mentioned feature would have benefitted from a thorough discussion and potentially a proposal of alternative measures that serve a similar purpose. Staff comments would be welcome. That being said, we do certainly share the view that CFMs, if used, should be transparent, targeted, temporary, preferably non-discriminatory, and should not substitute for warranted macroeconomic adjustment.

Mr. Geadah and Ms. Abdelati submitted the following statement:

We thank staff for the concise report and Mr. Ray and Mr. Johnston for their helpful statement. Economic growth prospects are favorable and headline CPI has moderated while debt is on a downward path. We take note of the Seychelles continued commitment to safeguarding macroeconomic stability and improving economic management. Program implementation under the PCI is on track and the fact that the First Review was completed on a LOT basis is also a sign of strong performance, notwithstanding the fact that there were some delays in the timeliness for some reform targets. We therefore support completion of the Second Review. Although considerable progress has been achieved under previous programs and this PCI, Seychelles remains vulnerable to external shocks and its debt is still high. We therefore support the continued focus on further improving medium-term fiscal sustainability, minimizing fiscal risks of SOEs, enhancing public investment efficiency, and modernizing the monetary framework.

We commend the authorities for ensuring fiscal developments are in line with their target of reducing public debt to below 50 percent of GDP by 2021 by delivering a primary surplus of at least 2.5 percent of GDP each year. The 2019 budget already includes sufficient revenue and spending measures to achieve this target. However, risks to achieving the target in future years will require articulating additional measures, including the better targeting of social welfare spending. Regarding the ongoing study of social welfare payments, we seek staff clarification of the likely savings from this, and whether the authorities are receiving technical assistance on how to mitigate the impact on the most vulnerable groups. We welcome ongoing efforts to publish a statement of fiscal risks together with the 2019 budget, and to adopt a new Code of Conduct for SOEs in line with international practice with a view to improve efficiency and limit contingent liabilities.

While reducing fiscal risks, the authorities need to address infrastructure gaps and finance climate change-related projects. In this regard, we welcome efforts to strengthen public investment efficiency, including through the upcoming PIMA, and strengthening the PPP framework as outlined in the MEFP. We congratulate the authorities for the innovative debt management initiatives. Is the debt-for-nature swap—and the Blue Bond—both the first in the world aimed at protecting a marine area and supporting sustainable fisheries—ones that can be more widely replicated by other countries?

We support the proposed transition toward using interest rates to signal the policy stance and the proposed shift from quantitative targets on Reserve Money to a monetary policy consultation. We support staff's recommendation for the Central Bank of Seychelles to further strengthen their capacity for inflation forecasting and liquidity management, develop an interbank market, and enhance their communications policy. We also join staff in calling for continued vigilance in monitoring inflationary pressures and standing ready to tighten monetary policy as needed.

We take note of the authorities continued efforts to address the implications of the withdrawal of correspondent bank relationships (CBRs). The small size of the country and the presence of a significant offshore financial sector have contributed to this challenge. In this regard, we take note of the areas identified for improvement in the recent FATF Mutual Evaluation Report (MER). We would like to hear staff's view on whether most of the recommendations will be addressed in the upcoming legislation to amend the AML/CFT framework and steps taken to enhance transparency in the off-shore sector.

With these comments, we wish the authorities continued success.

Mr. Trabinski and Ms. Urbanowska submitted the following statement:

We thank staff for the well-written report and Mr. Ray and Mr. Johnston for their informative buff statement.

We welcome Seychelles' progress in restoring macroeconomic stability and the authorities' consistent commitment to policy implementation since 2009. We support the completion of the second review under the PCI, as well as the modification of the quantitative and reform targets as reflected in Tables 1 and 2 of the program statement. Despite favorable economic conditions, Seychelles remain vulnerable to external shocks. Elevated external debt, high financing needs, and global banks' withdrawal of CBRs pose downside risks to the outlook.

Further fiscal consolidation measures are needed. Seychelles' public debt trajectory is projected to remain on a steady downward path. Although substantial progress has been made, public debt remains high and the country remains vulnerable to external shocks. The high financing needs are a key source of risk, as stressed by staff. We welcome the authorities' commitment to adhere to the fiscal targets, including the reduction of public debt below 50 percent of GDP by end-2021. Nevertheless, further efforts toward reducing the debt (including the new revenue initiatives) and extending the average maturity of domestic issuance are warranted. An enhanced debt management strategy would help reduce rollover risks over the medium term.

Seychelles' prudent monetary policy has helped contain inflationary pressures. The flexible exchange rate policy has served the country well, and the reserve buffers are adequate. We welcome the central bank's continued efforts to transition to an interest-based monetary policy framework and its readiness to tighten monetary policy, if needed.

The agreement between staff and the authorities on replacing the reserve money quantitative target (RM QT) with a monetary policy consultation clause (MPCC) certainly merits support. At the same time, further efforts to enhance CBS's capacity for inflation forecasting and liquidity management, improve its communication policy, and develop the interbank market will be crucial steps in the further reform process.

Structural reforms are needed to promote inclusive growth and reinforce resilience. We welcome the authorities' commitment to enhance the efficiency of public investments and mitigate potential risks arising from PPPs. In this regard, addressing the infrastructure gap, for instance, by improving the electricity network and undertaking solar energy projects (as stated in the buff) is a good step forward. Implementing further climate change related projects – in line with the 2017 CCPA recommendations – will not only increase the country's resilience, but it will also help mobilize private investment and concessional financing. In this context, we welcome the authorities' request to conduct a Public Investment Management Assessment (PIMA) next year.

Decisive efforts to strengthen the AML/CFT framework are needed. The recent FATF assessment has revealed serious shortcomings. Moreover, as staff highlight, the reform target related to the AML/CFT framework has been delayed. More broadly, we call on the authorities to strengthen the regulatory framework and further enhance the transparency of the offshore sector in line with international standards. This will also be critical to mitigate the risk of losing correspondent banking relationships.

Ms. Mannathoko, Ms. Nainda and Mr. Nakunyada submitted the following statement:

We thank staff for a well written report and Mr. Ray and Mr. Johnston for their helpful buff statement. We commend the Seychellois authorities for their continued track record and strong macroeconomic management. We broadly concur with staff's assessment and based on strong program implementation, we support the completion of this review of the policy coordination instrument along with the proposed decision.

We commend the authorities on their prudent debt management evidenced in the significant decline in the debt/GDP ratio over the past decade. In particular, we welcome the innovative debt management approach, attainment of the program primary surplus target, and on the permanent revenue enhancing measures. We note, however, that the declining trend for the debt/GDP ratio has flattened in recent years. Given the elevated financing needs at 30 percent of GDP, and indications in the DSA scenario analysis, that a persistent, loose fiscal policy stance would keep debt elevated going forward, we encourage the authorities to sustain fiscal discipline going forward, to bring the debt to GDP ratio below the 50 percent threshold. We further urge the authorities to closely monitor SOE debt and discourage expectations of its possible transfer to government in the future.

While the fiscal restraint needed for debt reduction is acknowledged, we do however seek clarification on the rest of the macroeconomic policy mix for growth going forward. Significantly lower growth is projected over the next four years; despite this, there does not appear to be any macroeconomic policy that supports general private sector expansion. Could staff clarify the rationale for pairing the already restrictive fiscal policy with a procyclical monetary policy stance, during a down-turn (proposal is to keep monetary policy tight despite a sharp decline in credit growth and low inflation at just 3.5 percent). This is especially the case as other policies also point to a pro-cyclical pattern entrenching lower growth. For example, the competitive benefits of the real depreciation seen in 2015, are being reversed with real appreciation evident in 2017 while the terms of trade are deteriorating. Could staff clarify the reasoning behind the restrictive monetary policy stance and indicate whether it is only intended as a short-term stance to weather the policy transition; or whether it is to be kept over the medium term? Could staff also comment on the implications for longer term growth beyond 2022?

On the program's monetary target, we note the conflicting signals introduced by the continued use of reserve money as a quantitative target when the authorities are now shifting away from targeting reserve money to targeting interest rates. Accordingly, in line with the guidance on review-based conditionality, we support the use of a monetary policy consultation clause instead of the reserve money target.

Augmented efforts are required to strengthen the AML/CFT framework to help maintain correspondent banking relationships and safeguard the financial sector. While we commend the authorities on reform progress achieved so far, we note longstanding pressures and underscore the need for concerted efforts to address deficiencies identified by the Financial Action Task Force regional body. We urge the authorities to leverage the Fund's convening powers in efforts to sustain regional and international dialogue aimed to develop appropriate policy responses required to halt the termination of CBRs. Furthermore, we underscore the need for stronger collaboration among the three key AML/CFT regulators to effectively combat money laundering, including the strengthening of cross-border supervisory cooperation. We are nevertheless, encouraged by the completion of new AML/CFT legislation due to be submitted to the National Assembly by year-end and look forward to its effective implementation.

We encourage the effective implementation of new measures cited by Messrs. Ray and Johnston, including the SOE code of governance due end-2018 and the intention to raise SOE governance standards to international best practice levels. That said, we would also like to commend the authorities for their efforts so far in reducing risks arising from SOEs, particularly Air Seychelles. We emphasize that the restructuring of expenditures should remain geared to creating the fiscal space needed to support government investment. We thus encourage the authorities to develop a more sustainable expenditure mix that will help to support the large financing needs of announced infrastructure projects aimed at providing energy and enhancing climate resilience. We also urge the authorities to prudently manage the risk of proposed investments and remain within program parameters We welcome progress made in improving the fishery industry and diversifying the tourism sector, as this should help ensure broader economic benefits; though we also note that the medium-term growth projections suggest the impact on growth may not be enough to boost growth significantly.

While appreciating the significant progress made by the authorities in program implementation, we wish the Seychellois authorities great success in implementing the remaining aspects of the policy coordination instrument.

Mr. Guerra and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for its comprehensive report. As stated in Mr. Ray and Mr. Johnston's buff statement, Seychelles began an extended program engagement with the IMF a decade ago. The authorities' strong commitment to the objectives of the successive Fund-Supported programs has been reflected in solid growth and the development of a stronger policy framework. Given that the program is largely on track, we support staff's recommendation for the completion of the second review under the Policy Coordination Instruments (PCI).

Going forward—although risks to the program are assessed as moderate given Seychelles' commitment to safeguarding macroeconomic stability—authorities still face a challenging policy agenda to secure resilient growth. External conditions have become more uncertain and authorities must continue to remain committed to strong program implementation while ensuring that the large infrastructure and climate change related projects will not derail the fiscal objectives under the PCI. In this regard, we take note of the result of the DSA framework that, although still pointing at a high-risk benchmark, public debt is projected to remain on a steadily downward path as fiscal consolidation takes place, as envisaged under the PCI. We concur with staff that extending the maturity of domestic debt would be desirable to reduce rollover risks. External debt remains also elevated at around 90 percent of GDP. In this regard, we would appreciate staff's comments on the credit risks related to external debt given the high sensitivity to a currency depreciation shock.

We fully support the proposal to replace the Reserve Money (RM) Quantitative Target (QT) with a new monetary policy-making framework to better align program conditionality to more closely follow the changes to the CBS policy making framework. The transition from RM to interest rates, as the operating target of monetary policy, must be made gradually taking into consideration the necessary time to develop the operational and communication frameworks. In this regard, we believe IMF TA could be instrumental to support the authorities' objectives.

We concur with staff regarding the urgency to step up efforts to strengthen the AML/CFT framework to reduce the risk of further potential loss of CBRs. We are glad that the authorities have committed to promptly amend the AML/CFT framework with international standards. Also, on the domestic front, instrumental to cope with these risks will be the coordination and cooperation among the different domestic regulators (CBS and other supervisory authorities including the financial intelligence unit). Finally, we note the call for addressing the issue of competition in the financial sector given the concentration of financial assets in three banks. Could staff comment on the main elements that could be expected to be included in a project to increase competition in the banking sector?

Mr. Di Tata and Ms. Moreno submitted the following statement:

We thank staff for the clear report and Mr. Ray and Mr. Johnston for their informative buff statement.

We commend the authorities for maintaining a strong performance under the Policy Coordination Instrument (PCI) program, notwithstanding slight delays in implementing some reform targets. Based on the above, we support the completion of the second review under the PCI. We also support the proposed replacement of the reserve money QT by a monetary policy consultation clause starting end-December 2018. As noted in the staff report, the risks faced by Seychelles are mostly of an external nature and refer mainly to the possibility of a reduction in tourist arrivals, international banks' potential withdrawal of CBRs, and higher international energy prices that could affect inflation and the external balance.

The PCI program emphasizes the importance of strengthening fiscal consolidation, reducing public debt, and building fiscal space to accommodate investment spending. Seychelles' key fiscal target is to reduce the public debt from the current level of about 65 percent of GDP to below 50 percent by 2021, which requires keeping a primary fiscal surplus of 2.5 percent of GDP every year. This target is expected to be exceeded in 2018, and the authorities remain committed to complying with a similar target from 2019 onwards. In this regard, we commend their efforts for introducing permanent revenue enhancing measures in the 2019 budget as well as for their intentions to contain the nominal growth of current spending. On a related matter, could staff comment on possible measures to mitigate the impact of the gradual increase in utility tariffs on the most vulnerable groups?

We encourage the authorities to adhere to their plans to implement the large projects announced in the 2018 SONA and the investments aimed at enhancing resilience to climate change in line with absorptive capacity and within the program fiscal targets, including by adopting additional revenue measures and using PPPs and external grants. The authorities' commitment to reduce the potential fiscal risks arising from PPPs and SOEs is also welcome. We agree with staff on the importance of closely monitoring the progress in Air Seychelles' restructuring and take corrective actions promptly, as needed. As part of a set of several initiatives, we take positive note that a new code of governance for the SOEs, in line with OECD guidelines, will be submitted to the cabinet by end 2018 as part of the third review reform targets.

As noted in the staff report, Seychelles' large gross financing needs constitute a major risk to debt sustainability. In this regard, we commend the authorities for the recent innovations in debt management described in the report and the buff statement and encourage them to continue with their efforts to lengthen the maturity of domestic debt.

We agree with staff on the need for the Central Bank of Seychelles (CBS) to closely monitor inflationary developments and stand ready to tighten monetary policy further, if needed. Macroprudential measures should also be considered to address potential risks related to household credit. Looking forward, we support the CBS' efforts for a smooth transition to a new monetary policy framework, putting more emphasis on the use of the interest corridor to guide the market on its policy stance, within the context of a flexible exchange rate policy with minimal intervention. Could staff comment on the authorities' intentions to eventually move to an inflation-targeting regime?

We agree with staff on the need to scale up efforts to address remaining shortcomings in the AML/CFT framework, in line with international standards and best practices, as well as with the recommendations of the MER and the Fund's Legal department. We also encourage the authorities to amend the relevant regulatory framework to address weaknesses in the legal framework for crisis management, bank resolution, and safety nets. This will also support the ongoing efforts to reduce the risk of a further loss of Corresponding Banking Relationships.

Enhancing inclusive growth requires addressing Seychelles infrastructure gap in a phased manner while improving the quality of public investments, increasing the electricity supply for businesses, upgrading the fishery industry and diversifying the tourism sector, and implementing an adequate financial inclusion strategy.

With these comments, we wish Seychelles and its people success in their future endeavors.

Mr. Gokarn and Mrs. Roy submitted the following statement:

We thank staff for an informative paper and Mr. Ray and Mr. Johnston for the insightful buff statement. We broadly agree with the staff appraisal. While Seychelles has a buoyant tourism and fishing sector and the authorities have restored macro-economic stability, lifted growth, reduced public debt and rebuilt international reserves, it also faces several risks. These risks include uncertain growth in major tourism markets, fiscal slippages, natural disasters, climate change risks and global banks' withdrawal of correspondent relationships.

Seychelles is availing of the Policy Coordination Instrument (PCI) to help support its continuing reform agenda which will help it to mitigate the risks mentioned above by strengthening medium-term fiscal sustainability, locking in price and external stability, buttressing financial stability, reducing fiscal risks, and enhancing inclusive growth. All quantitative targets (QTs) for end-June 2018 were met except for the reserve money (RM) target, which was missed by a very small margin. Implementation of the two Reform Targets (RTs) for the second review is slightly delayed due to technical reasons. Staff recommends replacement of the RM QT with a monetary policy consultation clause starting end-December 2018. The monetary policy consultation clause is considered more appropriate as simultaneously using RM and interest rates as operating targets sends conflicting signals to market participants. Also, the mechanics of meeting RM QTs are operationally onerous and are consuming the CBS's scarce human resources. The request is supported by strong domestic ownership. Therefore, we support the completion of the second review and the replacement of the RM QT with a monetary policy consultation clause.

The staff report states that tourism receipts increased by 8 percent year-on-year for the first eight months of 2018, with robust growth from the major European markets and the floor on NIR was exceeded by US$37 million thanks to the buoyant tourism receipts. Also, the authorities are making progress in diversifying the tourism sector. Though the tourism growth rate has decelerated from that of 2016-17 (16.7 percent), it continues to be positive over the projection period. But, the report also states that GDP growth is projected to moderate from 5.25 percent in 2017 to 3.50 percent during 2018–20, inter alia due to the moderation of tourism sector growth. Since tourism has continued to grow well in 2018 so far and will continue to grow, with the authorities making progress in diversifying the sector, what are the reasons behind the bearish prospects projected by the staff for this sector?

The CBS is set to transition toward a forward-looking interest rate-based monetary policy framework. The CBS has an implicit policy rate, the Deposit Auction Arrangement (DAA) rate, but has not yet announced it to the public. The recommended updates to the online portal aimed at facilitating a more efficient access to standing deposits and credit facilities have been completed. Are the deposit and credit facilities intended to be collateralized? What would be the spread between the DAA and the interest rate on credit from the central bank?

The staff report states that under the baseline, the primary budget surplus would lead to a steady decline of the public debt-to-GDP ratio from the current level of about 65 percent—near the high-risk benchmark—to below 50 percent by end-2021. Staff's debt sustainability analysis (DSA) indicates that gross public and external financing needs remain very high for the foreseeable future, and the large foreign currency-denominated debt remains a key source of risk. Standardized stress tests confirm that the country's external debt is particularly sensitive to currency depreciation shocks. What steps would protect the economy against the risk of a currency depreciation shock?

The authorities are confident that large projects would be implemented within the parameters of the program through the use of public-private partnerships (PPPs) and external grants. In the 2018 review and update of the Public Investment Management Assessment (PIMA), the study found that the management of PPPs had a low score in the planning stage reflecting the lack of a well-designed PPP framework to efficiently use PPPs in many countries. To ensure that PPPs are well-managed and do not expose the government to excessive risks, 72 percent of PIMAs recommended to integrate PPPs into the overall PIM framework, and improve the budgeting, accounting and reporting of PPP operations, including long-term commitments and contingent liabilities. The authorities have requested the Fund to conduct a PIMA during 2019. Would the staff be able to advise on a well-designed PPP framework for efficient use of PPPs in Seychelles in the PIMA recommendations?

We wish the authorities in Seychelles all success in their future endeavors.

Ms. Levonian and Mr. Feerick submitted the following statement:

We thank staff for their focused report and Messrs. Ray and Johnston for their helpful buff statement. Over the last decade, the Seychellois authorities have demonstrated strong commitment to the reform agenda, which is perhaps best exemplified by their undertaking of the PCI - the first Fund member to do so - to serve as an anchor for the ongoing reform momentum. We are pleased to note that this continues to be the case and the staff paper outlines the broad range of reforms that are currently in train, such as the new Code of Governance for SOEs.

Noting that the heatmap in the DSA shows areas of vulnerability, the authorities' fiscal strategy of maintaining a primary surplus of 2.5 percent over the medium term is appropriate to bring debt down to more sustainable levels. Relatedly, we welcome the inclusion of structural revenue measures in the 2019 draft budget to buttress the fiscal position. Of particular note is the innovative and proactive approach the Seychellois authorities have adopted regarding debt management, most notably the issuance of the world's first sovereign blue bond and the further work in lengthening maturities and swapping debt into more usable currencies. While all of the above is quite positive, it is clear and also acknowledged in the buff that, as a small open economy heavily dependent on one sector, the Seychelles remains vulnerable to external shocks and a continued focus on building resilience is warranted. Considering the above, we strongly support the passing of this review and the modification of targets. We would like to focus on one additional issue for emphasis.

Seychelles continues to be at high risk of further losses in correspondent banking relationships, and we agree with staff that the authorities should step up efforts in the AML/CFT space. We note that the recently published FATF Mutual Evaluation Report found serious shortcomings in the AML/CFT framework and, importantly, also contained a suite of recommendations on enhancing the effectiveness of the framework. Turning to the role of the Fund and building on some of the findings of the recent 2018 Review of Capacity Development - specifically the mutually reinforcing roles of training and technical assistance and the importance of identifying the capacity of institutions to absorb TA - we note that the Fund is providing technical assistance on the institutional framework. However, we wonder whether there is the capacity within the authorities to effectively implement this and what training could be delivered from the Fund or other providers to ensure this is the case.

Finally, while there are certainly idiosyncrasies as regards the Seychelles and the loss of correspondent banking relationships, there are also many other issues that are common to small and fragile states, such as those in our constituency. We urge the Fund to continue to be an international champion on this issue, which is certainly macro-critical for many of the membership countries.

Mr. de Villeroché, Ms. Riach, Mr. Bellocq, and Mr. Usmar submitted the following joint statement:

We thank staff for their comprehensive report and Mr. Ray and Mr. Johnston for the insightful buff statement.

The staff report underlines that the program implementation has been satisfactory and has helped the authorities in achieving economic stability. All but one Quantitative Targets (QTs) for end-June were met, with the QT on the reserve money target only missed by a small margin). We also note that Staff consider the two Reform Targets (RTs) to have been slightly delayed only for technical reasons. Against this background, we support the authorities' request for the completion of the second review under the PCI.

We largely agree with the staff appraisal and would like to highlight the following issues for staff's consideration.

On the fiscal side, we welcome the permanent revenue enhancing measures introduced in the 2019 budget. We note that a property tax has been reintroduced in the Budget and we welcome the planned phasing-out of fuel tax exemptions for the fishing and tourism industry. Regarding the risks to the budget, we note that Staff has been reassured by the authorities that the large public projects announced in the 2018 State of the Nation Address (associated with a cost of 30 percent of GDP over their lifespan) will be implemented under the program fiscal path thanks to the mobilization of Public-Private Partnerships and external grants. Against this background, we would be grateful if Staff could provide further details on the following: what is the past experience of the Seychelles authorities in setting up PPP schemes for significant projects? Does Staff have an estimate of potential contingent liabilities which could result from these operations? Where would the expected grants come from, given that Seychelles has a GDP per capita above $15000?

On expenditure, we note positively the authorities' willingness to streamline and better target social expenditure with the help of World Bank technical assistance. Regarding the utility tariff rebalancing, we agree with staff that the authorities should set up targeted measures to compensate the impact of tariff increase on the poorest.

The authorities' commitment to design their investment policy by taking into account climate change considerations is very much welcome, in line with the Seychelles' 2017 CCPA recommendations, helping increase resilience. We ask staff to provide the needed technical support to ensure that the funding of those investments is financially sustainable.

We are encouraged by the authorities' commitment to achieve the primary surplus target, which will be instrumental to bring public debt back on a sustainable path. As highlighted in the updated Debt Sustainability Assessment (DSA), the current authorities' commitment to prudent fiscal policy and the absence of major external shocks on the coming years will drive the public debt below 50 percent of GDP by end 2021. To ensure this baseline scenario, we also encourage the authorities to increase the maturity of domestic public debt and carefully manage the roll-over risks associated with these instruments.

We urge the authorities to increase their efforts to strengthen the AML-CFT framework and to address the risk of further loss of Correspondent Banking Relationships (CBRs). We are therefore pleased that the authorities are committed to promptly amending their AML-CFT framework in line with the recommendations listed by the ESAAMLG's MER report. We also encourage the authorities to continue implementing the OECD BEPS principles.

Mr. Palei and Ms. Smirnova submitted the following statement:

We thank staff for well-written report on Seychelles and Mr. Ray and Mr. Johnston for their informative BUFF statement. The economy demonstrates healthy economic growth close to potential rate, with tourism sector growing in response to the uptick in demand from the European countries. Inflationary pressures are under control. The PCI helps the authorities to implement their reform agenda aimed at making growth more sustainable in the long run. We note that the Seychelles was the first country to request the PCI, and we follow with interest the developments under the new instrument. We support the completion of the second review under the program. Given that program performance has been strong, and the authorities embarked on transition to a new monetary policy framework, the proposed modification of the associated program target is acceptable. We would like to provide the following comments.

During the year, the authorities maintained strong fiscal discipline, as evidenced by the fiscal surplus, which exceeded the expectations. We support the authorities' commitment to the primary surplus of 2.5 percent of GDP. The proposed revenue enhancing measures, including sugar tax introduction, reduction of fuel tax exemptions, and increase of excises, will allow to keep public debt under control, as well as create fiscal room for additional financing of infrastructure. We urge the authorities to develop more robust framework for social welfare programs, based on a more targeted approach in line with the World Bank's comprehensive study.

The Central Bank of Seychelles (CBS) appropriately tightened monetary policy and brought inflation down to about 3.3 percent from almost 5 percent in the beginning of the year. We commend the authorities' intention to keep monetary policy tight, given the planned utility tariff and public sector wage adjustments in 2019, as well as taking into account volatility on international fuel markets. The CBS continues transition to a new monetary policy framework, which aims at enhancing the role of interest rates as the main policy instrument and at building a better-functioning monetary transmission mechanism. We believe that the proposed replacement of the reserve money quantitative target with a monetary policy consultation clause (MPCC), based on CPI inflation, is an appropriate step in this transition. We also agree with staff's advice that the CBS should strengthen capacity for inflation forecasting. The CBS should further improve liquidity management, as well as develop interbank market infrastructure.

The AML/CFT framework on Seychelles is still missing important building blocks. We agree that know-your-customer (KYC) procedures and financial institutions' overall AML/CFT compliance should be strengthened. The current account deficit is around 18 percent of GDP, with tourism earnings around 30 percent of total exports. The resilience of the small open economy depends on well-functioning corresponding banking relationships (CBR), and the authorities cannot put them at risk. Given that adequate banking services are necessary for tourism, any damage to the CBR would lead to significant balance of payments pressures. We hope that the new national committee mentioned in the BUFF statement, will help to achieve progress in implementation of the FATF recommendations.

With this remarks, we wish the authorities success in their endeavors.

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We thank staff for the report and Messrs. Ray and Johnston for their buff statement. Seychelles' solid performance under the Policy Coordination Instrument (PCI) is a credit to good ownership by the authorities. We support the completion of the second review. We look forward to the authorities' continued strong performance under the PCI, though urge some caution on balancing public investment needs with debt sustainability and supporting the social safety net.

Long-term public investment needs will require a financing plan allowing for a continued decline in the debt-to-GDP ratio. In this context, we are glad to see that the large infrastructure projects planned in the coming years would be implemented within the envelope of the program's primary surplus target of 2.5 percent of GDP. At the same time, it will be challenging to meet the primary surplus target and maintain a downward debt trajectory while also continuing to balance public investment and social needs. Thus, it would be useful to have greater information on how the growing list of public (and PPP) projects are being financed and sequenced. On a related note, we welcome the authorities' request for a Public Investment Management Assessment and efforts to manage PPP risks, to help ensure that the benefits of such investments anticipated through cost-benefit analyses are indeed realized and associated risks are closely managed.

Regarding the shift from a reserve money quantitative target to a monetary policy consultation clause (MPCC), we understand that using two operating targets – reserve money and an interest rate corridor (re-introduced in 2017) – may be confusing to market participants. We are pleased to see progress – with Fund TA – toward the six-point plan of facilitating a transition from reserve money to interest rates as the operating target of monetary policy. We also concur with Fund staff that the authorities should adhere to a market-determined exchange rate. At the same time, we are somewhat confused on the practical implications of the MPCC, including future consultations with the Board and staff on the inflation tolerance bands. Staff comments would be welcome, including views on a communication strategy of rolling out the MPCC.

In paragraph 7, staff briefly mention the potential discriminatory features of a property tax to be introduced in 2019, with a corresponding footnote on the same page that references the tax as a capital flow measure (CFM) based on the Fund's Institutional View. Like Messrs. Meyer and

Fragin, we would have appreciated a more thorough discussion of this issue, including whether alternative measures are available to the authorities.

Finally, we urge the authorities to continue to make progress on effectively implementing international AML/CFT standards and taking steps to enhance transparency in the offshore sector.

Mr. Sylla and Ms. Nankunda submitted the following statement:

We thank staff for the well-written report and Mr. Ray and Mr. Johnston for their informative buff statement.

We commend the Seychellean authorities for their sound macroeconomic management and structural reforms which have led to significant progress towards macroeconomic stability under the Policy Coordination Instrument (PCI) program. Considering the strong program implementation, continued commitment to safeguarding macroeconomic stability and medium-term development strategy, we, therefore, support the authorities' request to complete the second review of the PCI program.

We welcome the authorities commitment to achieve a primary surplus of 2.5 percent in 2019 budget and subsequent years, which will help place the public below 50 percent of GDP by 2021. We commend the authorities for the efforts made in developing infrastructure while reducing public and external debt. The authorities' continued efforts to mobilize revenue and foster private investment are commendable. As current spending represents a large share of the budget and needs to be controlled, measures should be aimed at reducing the rising wage bill. While we agree on the need to target social welfare spending more appropriately, we encourage the authorities to ensure that this does not negatively impact the vulnerable segments of the Seychelles population and would appreciate staff 's comments on this matter.

Going forward, we welcome the authorities' continued commitment to ensuring medium-term fiscal and debt sustainability and their assurance that large infrastructure projects will be in line with fiscal targets. However, we concur with staff that additional fiscal measures will be necessary to address priority investment gaps and bolster country resilience to climate change.

We take positive note of the authorities for their prudent approach to monetary policy which has contained inflationary pressures and preserved reserves coverage at a comfortable level. The Central Bank of Seychelles' intention to keep a tight monetary policy stance is appropriate, given risks to the inflation outlook emanating from international fuel prices, utility tariff adjustments, and demand pressures from new higher income thresholds for personal income taxes. We welcome the authorities' progress in transitioning to an interest rate-based monetary policy framework. We agree that, with the introduction of the interest rate corridor, continued use of reserve money targeting would send confusing policy signals to markets. However, we also note that the necessary reforms to fully transition to an interest rate-based framework are still ongoing. In this respect, we welcome Staff's comments on the adequacy of the current monetary operations structure to support this new framework, including the preparedness for market interbank market players.

We also encourage the authorities to continue strengthening the AML/CFT framework in line with international standards while boosting financial integrity and minimizing the risks of Correspondence Bank Relations (CBR) withdrawals.

Finally, on structural reforms, we appreciate the authorities' intention to continue their reforms to reduce potential fiscal risks from SOEs. We welcome their intention to have new Code of Governance, and to report the cost of social obligations on SOEs to improve their governance, as indicated in Mr. Ray and Mr. Johnston's buff statement. Proper tax administrative measures, combined with an efficient public investment strategy should help improve the prospects for inclusive growth while building resilience to climate change. In this connection, financing strategy for the large projects announced in State of the Nation Address (SONA), as mentioned in staff appraisal, should also be helpful.

With this remark, we wish the Seychelles' authorities all the success in their future endeavors.

The Acting Chair (Mr. Zhang) made the following statement:

This is the second review of this Policy Coordination Instrument (PCI). The program implementation is strong, and the country has made considerable progress with regard to external vulnerabilities and fiscal sustainability since the crisis in 2008.

Seychelles is the first country to request the PCI from the Fund. As Directors' gray statements have reflected, Seychelles' program performance has been strong, and there are various innovations in financing strategies, particularly with regard to climate change. The country pays quite a bit of attention to the Anti-Money Laundering and Combating the Financing of

Terrorism (AML/CFT) legal framework and particularly the issues of de-risking, and correspondent banking relationships (CBRs) are on the radar screens.

At the end of the day, our concern is how we can make sure that inclusive growth and economic financial resilience could be further enhanced through the programs.

Mr. Kaizuka made the following statement:

Although I have issued a gray statement, I have something to say to congratulate the authorities and the staff.

I commend the authorities and the staff on the successful implementation of the PCI program to date and the fact that Seychelles is the first country to engage in the PCI. Also, the Climate Change Policy Assessment (CCPA) indicates that the country has strong ownership of its reform agenda and initiatives, and it has a solid basic governance structure. It also shows that the Fund has a good working relationship with the authorities, and their communication is working well, which should be appreciated.

I have only one specific comment on the large infrastructure project. We take positive note that the project is to be implemented within the envelope of the program's primary surplus target of 2.5 percent of GDP. We reiterate the importance of the gradual implementation of the project so that it would not undermine macroeconomic stability. The project could be appreciated to enhance ex ante the resilience of the country to natural disasters. At the same time, it is also important to ensure the good governance of the infrastructure project from a risk management perspective. In this regard, we welcome that the authorities have already requested the Fund to conduct a Public Investment Management Assessment (PIMA) in 2019. We hope the outcome of the PIMA could be shared with the Board when it becomes available.

With this, I wish the authorities every success in these endeavors.

Mr. Rashkovan made the following statement:

We thank the staff for a well-prepared set of papers, and Mr. Ray and Mr. Johnston for their informative buff statement. We also want to commend the authorities for their ownership of the reform agenda, which has resulted in their steady economic development.

We issued a gray statement, so I want to make a few points for emphasis.

We welcome the authorities' commitment to maintain a primary surplus of 2.5 percent of GDP from 2019 onward and implement their ambitious development agenda without sacrificing their fiscal consolidation. We consider that additional measures must be taken to further enhance revenue mobilization, and ask the authorities to carefully balance the objectives of achieving medium-term public debt sustainability and implementing climate change-related projects.

Like Mr. Mouminah and Mr. Trabinski, we highlight the need to improve financial management and strengthen the capacity to manage fiscal risks from public-private partnership (PPP) projects.

Like Mr. Meyer and Mr. Psalidopoulos, we consider that the proposed tax on foreign-owned property has a discriminatory nature—residents versus non-residents—and can be classified as a capital flow management measure (CFM). We ask the staff to continue discussions with the authorities and explore alternative measures.

We share Mr. Fachada's view that maintaining a tight monetary stance will keep inflationary pressures in check and support the move to an interest-based policy framework. The restrictive monetary policy has helped contain inflation, moderate private sector credit growth, and improve international reserves coverage. However, a potential increase in food prices, utility tariff adjustment, and the introduction of a VAT with a high-income threshold, would reverse the downward inflationary path, and the authorities must further tighten their monetary policy if inflationary pressures reappear.

We commend the authorities for limiting the exchange rate's intervention to only smooth out excess volatility, as the international reserve level is appropriate to adequately protect against external shocks, and the rupee is broadly in line with fundamentals.

Like other Directors, we welcome the progress on strengthening the AML/CFT framework and addressing the strategic deficiencies listed by the Eastern and Southern Africa Anti-Money Laundering Group and the Fund's Legal Department. We believe that enhancing the transparency of the offshore financial sector and implementing risk-based supervision will elevate the risk of further loss of correspondent banking relationships (CBRs).

Mr. Fragin made the following statement:

I thank the staff for the insightful report, and Mr. Ray and Mr. Johnston for their helpful buff statement. We commend the authorities for their prudent macroeconomic policies and support the completion of the review. We issued a gray statement and would like to make only a few remarks for emphasis.

We welcome the authorities' commitment to sustain a strong fiscal position. This will allow for a steady decline in the public debt-to-GDP ratio.

Regarding the large investment projects announced in the 2018 State of the Nation address, we agree with other Directors and the staff that implementing these projects within the parameters of the program will be critical. In this context, strengthening the administrative and monitoring capacity will be the key priority.

We also encourage the authorities to ensure a timely implementation of the agreed structural reform targets, aiming to reduce fiscal risks from state-owned enterprises (SOEs), as well as to bolster financial sector stability.

With this, we wish the authorities success in their endeavors.

The staff representative from the African Department (Mr. Sy), in response to questions and comments from Executive Directors, made the following statement:[1]

We thank the Directors for their useful comments. I will focus on policy questions, which we have grouped into four categories: one, questions on the monetary policy stance and regime; two, questions on the Seychelles' climate change adaptation and mitigation strategy, as well as on the financing of large infrastructure projects; three, questions on the upgrading of the AML/CFT legal framework; and four, a question on CFM issues.

Regarding the monetary policy stance and regime, we were asked to clarify the reasoning behind the restrictive monetary policy stance. Our response is that, although inflation and credit growth have both declined in recent months, the estimated output gap is still positive.

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

The staff expects inflationary pressures from second-round effects of the electricity tariff rebalancing and fuel price increases. As a result, the staff has supported the central bank in prudently maintaining a tight monetary policy stance for the remainder of this year. As the monetary policy stance is determined on a quarterly basis in Seychelles, depending on the impact of current macro developments on the inflation outlook, the staff supports the central bank's readiness to cautiously continue tightening if current conditions continue.

We had a question on an eventual move to an inflation targeting regime. The final target of monetary policy in Seychelles is price stability by law. In June 2017, the central bank developed an interest rate-based monetary policy framework. This framework would facilitate a move to an inflation targeting regime, should the authorities decide to do so. But we are at an early stage of implementation of the new regime. The central bank has not indicated to the staff its intentions to move to an inflation targeting regime, and we agree with this sequencing. Fund technical assistance (TA) is also supporting the central bank's efforts to implement the new regime.

Regarding the question on the communication of the monetary policy consultation clause, when it comes to communication with the general public, the central bank is working on its communication strategy and will announce its policy rate in January 2019.

Regarding communications with the Board, we will follow the guidance of the 2015 Fund policy paper on Conditionality in Evolving Monetary Policy Regimes.

The second type of questions were related to climate change adaptation and mitigation and the financing of large infrastructure projects. We received a question about whether the CCPA would help mobilize more private investment. The CCPA for Seychelles was jointly prepared with the World Bank, and it noted that innovative financing approaches may help to mobilize private investment and concessional financing for climate change adaptation and mitigation. Subsequently, the World Bank assisted Seychelles—including through the Global Environment Facility, for which the World Bank is a trustee—and raised financing through a Blue Bond. In a sense, the CCPA helped shape the agenda. Since it is also jointly conducted with the World Bank, it helped facilitate moving to an innovative financing choice.

There was a question on whether the debt-for-nature swap and also the Blue Bond can be more widely replicated by other countries. The country director of the World Bank has mentioned that this could be replicated for at least small states. Some other investors who took part in the Blue Bond placements have expressed their interest in a similar model.

In terms of the African Union, the African Union has appointed Seychelles' President as its "champion for the blue economy." Hopefully this experience will have a demonstration effect, at a minimum.

Regarding large infrastructure, there were questions about the large infrastructure projects in the State of the Nation address and also some concerns about fiscal risks. So far, we only have a list of announcements of large projects. We are continuing the discussions with the authorities as they are working on their project preparation, including with the help of the International Finance Corporation (IFC) when it comes to the largest project, which is about half of the total envelope. We are also working with them when it comes to prioritization. This is taking time, and we are advising a gradual implementation, in line with the absorptive capacity of the economy and the program's primary surplus and the GDP targets. The program also includes reform targets, to submit a report and cost-benefit analysis of large public investment projects, and also reform targets on fiscal risks, including contingent liabilities. Directors already mentioned that Seychelles will undergo a PIMA next year.

Regarding the AML/CFT framework. The authorities are committed to having an AML/CFT legal framework that is consistent with international standards and recommendations by the recently conducted evaluation by the Eastern and Southern Africa Anti-Money Laundering Group, the Financial Action Task Force (FATF)-style regional body. We are closely working with the authorities to review and ensure that most of the recommendations to amend the AML/CFT framework will be addressed and incorporated. We are also urging the authorities to demonstrate the effectiveness in implementing the framework and addressing money laundering and terrorism financing risks in the country.

Finally, in response to questions about the CFM, this is a longstanding issue that we have discussed with the Board, even during the program negotiations, and we are reiterating our advice in line with the Institutional View.

Mr. Ray made the following concluding statement:

I thank Directors for their comments. This year, Seychelles is celebrating 10 years of economic reform. I can report that they really are celebrating, including through a visit by the Managing Director shortly.

The authorities have shown consistently strong ownership of the reform program, and there is also public acceptance of the need for change and a marked absence of stigma when it comes to dealing with the Fund. In fact, I am told that if one goes to the local market and traders know one is from the Fund, one might get a discount. I do not think that happens in many of our members.

Seychelles has made great progress since 2008; but as many Directors have said, it remains vulnerable. It is one of the Fund's smallest members, both in size and in population, which is only 95,000.

The authorities need to maintain fiscal discipline, and they need to bring debt down. In Seychelles, there is a pervasive concern about the cost of living in terms of housing, interest rates, utility bills, and the price of food, almost all of which is imported. In many countries around the world, governments would respond to that by spending. It would be easy for the Seychelles government to do the same, but it is sticking to its fiscal targets quite admirably.

Seychelles also needs to address risks in its financial sector, and it wishes to modernize its monetary policy and make its public services more efficient and effective, including its SOEs. The PCI program is helping my authorities do this. The program provides oversight and external discipline, which is helpful, particularly in periods of political uncertainty, which the country has been going through.

The Seychelles does not envisage a need for financing, so the PCI is a good fit and a sign that the country is moving on from its previous programs. Seychelles' use of the PCI is a good demonstration for other countries that might consider such an instrument.

Program performance has been good. There have been some slight delays in achieving some of the reform targets, but these have been for understandable reasons.

Mr. Kaizuka's points on the major infrastructure projects and the risks around PPPs are important. As Mr. Sy has said, the authorities are aware of this. They are planning to implement these projects over the medium term, and they are looking for Fund assistance and guidance in going about it, including by managing the risks; hence, the request for a PIMA.

I thank the mission team, led by Mr. Sy, for their positive engagement with my authorities in the Seychelles, which I know is greatly welcomed and appreciated.

Lastly, I should touch on a point raised by a few Directors and by Mr. Rashkovan; that is the Seychelles' so-called CFM, their new tax on foreign-owned residential property. This is not something that my authorities want to dwell on, but Directors can take it as some gratuitous comments from this chair. The tax is simply a measure to raise a bit of revenue in order to meet the fiscal targets.

On basic tax design principles, it is a pretty good tax. It is efficient. It is vertically equitable, and it is simple. Indeed, it is better than most of the taxes that I have worked on over the past 30 years. It is not designed to restrict capital inflows, quite the reverse, and it is not there to forestall any economic adjustment, nor is it macro significant. Next year, it is expected to raise SCR 40 million out of a total tax take of SCR 7.5 billion. Therefore, this chair's view is that, by the principles of the Institutional View, it should not be considered a CFM, and therefore, should not be an issue for surveillance.

The following summing up was issued:

Executive Directors commended the authorities for the strong policy implementation under the Policy Coordination Instrument and welcomed their continued commitment to safeguarding macroeconomic stability. In light of the vulnerabilities, Directors agreed that sustained sound policy measures and reforms are important to enhance resilience and support inclusive growth.

Directors commended the authorities' fiscal consolidation efforts and encouraged continued action, including implementing savings measures, to achieve debt reduction goals, while protecting the most vulnerable. They welcomed that the 2019 budget includes permanent saving measures as well as efforts to streamline and better target the social welfare programs. Directors noted that the authorities' primary surplus target for 2019 onwards strikes a right balance between addressing the authorities' priority investment needs and preserving economic stability, anchored by a steady public debt reduction over the medium term.

Directors noted that the authorities intend to implement large infrastructure and climate change related projects within the fiscal targets envisaged under the program. However, they encouraged the authorities to take steps to create additional fiscal space over the medium term, beyond their debt reduction goal, for priority investment projects to boost infrastructure and resilience to climate change.

Directors supported the tight monetary policy stance and encouraged the central bank to remain vigilant to inflationary pressures and further tighten policy as needed. They recommended measures to enhance inflation forecasting and liquidity management, improve communication, and develop the interbank market. Directors also recommended maintaining a flexible exchange rate policy. They supported efforts to continue the transition to the new monetary policy framework.

Directors encouraged the authorities to step up efforts to address the risks of further potential loss of correspondent banking relationships. They called for action to amend the AML/CFT framework and its implementation in line with the international standards and best practices.

Directors noted potential fiscal risks stemming from state-owned enterprises and public private partnerships and encouraged the authorities to take measures to address these risks. They also called for continued implementation of structural reforms to enhance public investment efficiency and boost prospects for inclusive growth and resilience to climate change.

The Executive Board took the following decision:

Seychelles—Second Review of the Policy Coordination Instrument and Request for Modification of Targets

1. Pursuant to paragraph 7 of Decision No. 16230-(17/62), adopted July 14, 2017, and paragraph 1 of the Policy Coordination Instrument for Seychelles (“PCI”) [SM/17/120], the Fund has conducted a review to assess program implementation.

2. The Program Statement dated November 20, 2018 (the “November 2018 Program Statement”) and its attached Technical Memorandum of Understanding (the “November 2018 TMU”) shall be

attached to the PCI, and the Program Statement dated June 5, 2018, together with all of its attachments, shall be read as supplemented and modified by the November 2018 Program Statement and its attachment.

3. Accordingly, the standard continuous targets, the end-December 2018, the end-June 2019 and end-December 2019 quantitative targets and the reform targets under the PCI shall be as specified in Tables 1a and 1b and Table 2 attached to the November 2018 Program Statement and as further specified in the November 2018 TMU.

4. Paragraphs 4 and 5 of the PCI shall be renumbered as paragraphs 5 and 6, and a new para 4 shall be added to read as follows:

"4. Monetary Policy Consultation: A review under paragraph 3 of this Policy Coordination Instrument will not be completed unless Seychelles has consulted with the Fund as provided for in Table 1a of the November 2018 Program Statement and paragraph 6 of the November 2018 TMU"

5. The Fund completes the second review specified in paragraph 1 of the PCI on the condition that the information provided by Seychelles on its performance under the Quantitative Targets and Standard Continuous Targets related to this review is accurate.
(EBS/18/108, 11/26/18)

Decision No. 16451-(18/104), adopted
December 7, 2018

APPROVAL: April 14, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Growth Outlook

1. ***Since tourism has continued to grow well in 2018 so far and will continue to grow, with the authorities making progress in diversifying the sector, what are the reasons behind the bearish prospects projected by the staff?***

- In 2017, tourism receipts recorded exceptionally high growth compared with previous years' trend. Growth is expected to moderate, albeit remain strong in coming years, given the moratorium on new large hotel building, which will be in place until end-2020.

Fiscal Policy

2. ***Could staff comment on possible measures to mitigate the impact of the gradual increase in utility tariffs on the most vulnerable groups?***

- Cash transfers or near-cash transfers (voucher) targeted to the most vulnerable (poor) households would be the preferred approach. The on-going Household Budget Survey would help the authorities to enhance their capacity to identify which households are most vulnerable to the gradual increase in utility tariffs.

3. ***Regarding the ongoing study of social welfare payments, could the staff clarify what are the likely savings from this, and whether the authorities are receiving technical assistance on how to mitigate the impact on the most vulnerable groups?***

- Saving from this could be up to 0.5 percent of GDP, according to the preliminary estimates by the authorities. On-going TA from the World Bank on social welfare programs is done in a holistic manner, covering potential measures to mitigate the impact on the most vulnerable groups.

4. ***Standardized stress test confirm that the country's external debt is particularly sensitive to currency depreciation shocks. What steps would protect the economy against the risk of a currency depreciation shock?***

- Liability management exercise to swap current US dollar obligation into euros, to be implemented shortly, will reduce currency risks by better aligning the repayment currency with Seychelles' foreign exchange earnings (mostly in euros, Staff Report

¶11). Steadfast implementation of the envisaged fiscal consolidation would also help reduce vulnerability to depreciation shocks by reducing the external financing needs.

5. ***Would the staff be able to advise on a well-designed PPP framework for efficient use of PPPs in the PIMA recommendations?***

- Recommendations in the PIMA should advise on a PPP framework for Seychelles to help the country use PPPs in an efficient way.

Monetary Policy

6. ***The new monetary policy framework is instrumental to better steer the communication and price dynamic. Since the institutional and financial setups appear adequate to provide an adequate support, we welcome the central bank decision to move to the policy rate as an operating target… A successful transition requires also that other conditions are in place, starting with the announcement of a policy rate. Can the staff provide an update about the envisaged timing for a decision in this sense?***

- The Central Bank of Seychelles (CBS) plans to announce the policy rate in January 2019.

7. ***Are the deposit and credit facilities intended to be collateralized? What would be the spread between the DAA and the interest rate on credit from the central bank?***

- The standing credit facility is an overnight collateralized lending facility that provides funds to the eligible Other Deposits Corporations to cover end-of-day shortfalls that may arise. The standing deposit facility is an overnight deposit facility and allows ODCs to place excess funds for remuneration at their request. The standing credit facility is collateralized. Staff encouraged the CBS to aim at having a symmetrical interest rate corridor, implying a DAA rate as the mid-point of the corridor.

Financial Sector

8. ***What is the staff's view on whether most of the recommendations will be addressed in the upcoming legislation to amend the AML/CFT framework and steps taken to enhance transparency in the off-shore sector?***

- The authorities are committed to having an AML/CFT legal framework that is consistent with international standards and recommendations by the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG). Staff is closely working with the authorities to review and ensure that most of the recommendations to amend the AML/CFT framework will be addressed and incorporated. Staff also expects the authorities to take the necessary steps to enhance transparency in the off-shore sector (including the availability of the beneficial ownership information, especially with respect to international business companies).

- While these legislative measures aim to address legal and technical compliance with the international standards, the authorities will still have to demonstrate effectiveness in implementing the framework and addressing ML/FT risks in the country.

9. ***We note the call for addressing the issue of competition in the financial sector given the concentration of financial assets in three banks. Could the staff comment on the main elements that could be expected to be included in a project to increase competition in the banking sector?***

- The CBS is studying the determinants of the cost of credit in Seychelles, which could help design measures to increase competition.

- In addition, competition in the banking sector could be increased by improving financial literacy and the CBS is implementing measures to do so.

External Sector

10. ***External debt remains also elevated at around 90 percent of GDP. In this regard, could the staff comment on the credit risks related to external debt given the high sensitivity to a currency depreciation shock?***

- While external debt is high and is sensitive to a currency depreciation shock, credit risks are mitigated due to the composition and maturity profile of the debt. Seychelles' external debt is comprised mostly of public and tourism sector borrowing at favorable interest rates and long maturities. Public borrowing (about one third of external debt) is mostly from official sources at low interest rates and long maturities. Similarly, tourism sector borrowing (close to one third of external debt) is largely long-term FDI related, with the short-term component comprised of trade credit and other lines of credit.