

COUNTRY REVIEW

Seychelles



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COUNTRY PROFILE

Capital city:	Victoria (on Mahé)
GDP:	USD740mn (2009)
Population:	0.1mn (2009)
GDP per capita:	USD7,400 (2009)
Currency:	Rupee (SCR)
Form of state:	Republic
Head of government:	President James Alix Michel
Next elections:	Presidential by August 2011, legislative by May 2012

The Seychelles People's Progressive Front (SPPF) became the sole legal party in 1979, when decision-making became increasingly centralised and concentrated in the hands of President France Albert René and his closest aides. Over the next two decades, René assumed almost supreme control over all key ministries and became **increasingly autocratic**, although his style was relatively benign, rather than aggressive. Following signs of public dissent and an alleged coup attempt, **one-party rule was abandoned formally in 1992, with the official registration of rival political parties.** A third constitution was approved by referendum in June 1993, providing for a National Assembly of 25 directly-elected members and nine allocated on a proportional basis. Although René's narrow victory in the 2001 presidential election gave him another five years in power, in April 2004 he stood down in favour of his nominated successor, **James Michel. The latter won a five-year term in end-July 2006 presidential elections**, albeit by a narrow (54% to 46%) margin, and therefore had a stronger personal mandate to govern. Economic liberalisation is now promoted by the ruling People's Party (the SPPF changed its name in July 2009) and relations with the IMF have improved. One strong tenet of policy under the SPPF had been a determination to avoid devaluation, despite the recommendations of the IMF, among others, and Michel has continued with this agenda but has overseen a period of currency re-alignment through strong depreciation.

International relations have improved in the last few years as the government has adopted a revised strategy of co-operation with the donor community, including the IMF, the World Bank and the EU. Donors are keen to see further structural reform. Seychelles' strategic location between Africa and South Asia and with relatively easy flight paths to the Middle East has ensured close military ties with the US.

Seychelles has **one of the highest standards of living in Africa**, based on a low population and buoyant tourism sector. However, under René's lengthy stewardship, economic problems mounted and the sustainability of the country's favoured status came under threat from macro-economic imbalances and structural deficiencies. In particular, the state's dominant role in the economy (employing over 50% of the labour force in 2002) led to large fiscal deficits and foreign debt servicing crowded out development of the domestic economy. **Shortages of FX in the 1990s resulted in creation of a pipeline for payments, which has had a lasting legacy on the country's credit standing. Arrears still exist, although exchange controls have now been lifted.**

The group of islands occupies little land area and the country is almost totally reliant on imported goods. The Indian Ocean tsunami of December 2004 had a negative impact on the fishing and tourism sectors but aid flows and offers of temporary suspension of debt repayments acted to fill fiscal and external sector shortfalls and the resulting reconstruction work generated positive growth (real GDP of 5.3% in 2006 and in 2007, following contraction of 1.5% in 2005). Tourism and tuna fishing recovered from the post-tsunami period relatively quickly. **In 2009, GDP contracted by around 7%**, reflecting recession in key trading markets and, in particular, a reduction in tourism spending. **A rebound to around 4-5% GDP growth is forecast for this year and in 2011.**

The rupee, which had been nominally pegged to the Seychelles Trade and Tourism Weighted Basket, with 38% and 26% weightings towards the euro and dollar, respectively, is now a floating currency. Rupee overvaluation was the main reason for relatively poor relations with the IMF until the end of 2008. **The local authorities did not allow any weakening of the currency until 2007 and then instigated a gradual depreciation, rather than a large one-off devaluation.** The government's change in policy stance on the exchange rate followed years of foreign-exchange shortages and mounting debt. The rupee then fell more steeply, from an average SCR5.5:USD1 in 2005 and 2006 to SCR13.6 in 2009, although a moderate strengthening has been evident in 2010, suggesting that the

currency may have found some ST stability. However, further moderate depreciation can be expected as the authorities will want to ensure that the rupee maintains trade competitiveness.

Inflation surged from 12% yr/yr in Q4 2007 to average 37% in 2008 and almost 32% in 2009, reflecting rupee depreciation, high world oil prices (**fuels account for around 24% of import costs**), liberalisation of domestic fuel prices and increases in electricity tariffs. However, by end 2009 and into early 2010, deflation set in, suggesting that high price increases resulting from currency depreciation had worked through the economy. We forecast average inflation rates of around 5% in 2010 and 2011.

Largely reflecting its small size and its location, together with a narrow export base and dependence on sources of imported energy, the economy registers **large current account deficits**. In 2008, the deficit reached 49% of GDP, although it narrowed to around 25% in 2009. **Despite investments in the tuna canning sector and port facilities, growth in exports is not likely to keep pace with import growth** (driven by goods related to construction within the tourism sector and by high food costs) so that the trade and current account balances will remain large negatives. We forecast that the **current account deficit will be equivalent to 25-35% of GDP in 2010 and 2011**. Such deficits are unsustainable without further corrective measures and assistance from the international donor community, so the economy will remain fragile.

FX reserves declined from USD113mn at end-2006 to USD41mn at end-2007 and only USD64mn by the end of 2008. However, there has been a reversal in economic policy since then, with adoption of IMF-supported reforms, and this has enabled accumulation of reserves, with USD191mn recorded by end-2009 and latest data (March 2010) indicating further augmentation to around USD205mn, thereby providing **import cover of around ten weeks, compared with around two at the height of the debt crisis in 2008**. Perhaps the most significant aspect of recent economic policy is the re-adoption of full relations with the IMF. A recent report by the Fund suggested that Seychelles had met all the conditions associated with its programme, with exemplary implementation of policy changes. As a result, in December 2009, the **IMF converted a two-year Stand-By Arrangement into a three-year Extended Fund Facility (EFF)**. As part of the financial assistance under the EFF, Seychelles has indicated a willingness to accelerate its structural reforms to include an overhaul of the tax system, rationalisation of parastatal enterprises, strengthening the financial sector and further deregulation. Moreover, endorsement from the IMF brings on board the wider international donor community, including the World Bank, and is likely to lead to rescheduling and restructuring of the country's large **external debt, which is estimated at around 100% of GDP**. As a further sign of progress in relation to resolving the foreign debt overhang—a 45% write-off was agreed by the Paris Club of bilateral creditors in April 2009—in January 2010, commercial creditors approved a scheme whereby a restructuring will reduce the outstanding amount by 50%, with repayments taking place between 2016 and 2026.

The **structural business environment is weak**. According to the World Bank's Doing Business Survey 2010, Seychelles ranks 111 out of 183 countries measured in terms of the ease of doing business. Enforcing contracts in Seychelles equates to the regional average in terms of number of procedures and is worse in the time taken to resolve a payment dispute, although the cost of legal action is much lower. The Survey does not provide information on the effectiveness of insolvency legislation. Moreover, Seychelles ranks 156 out of 180 economies in the Heritage Foundation's 2010 Index of Economic Freedom (IEF)—a proxy for the level of openness of an economy—and grades it below Central African Republic, Angola and Lesotho. Seychelles is ranked 54 out of 180 countries ranked by Transparency International's Corruption Perception Index 2009, below Poland, Czech Republic and Lithuania but above South Africa, Latvia and Malaysia.

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