Annual Report



2008

Central Bank of Seychelles

Celebrating 30 Years

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Letter of Transmittal

Central Bank of Seychelles
P.O. Box 701
Victoria

March 31, 2009

President J. A. Michel
State House
Victoria

Dear Mr. President,

I have the honour to submit the Fifth Annual Report of the Central Bank prepared in accordance with Section 47 (4) of the Central Bank of Seychelles Act, 2004, together with a copy of the Annual Accounts for 2008 certified by the Auditors.

Yours faithfully,

P. Laporte
Governor

Statement from the Governor

In 2008 the Central Bank of Seychelles celebrated its 30th Anniversary. At its inauguration in 1978 the Seychelles Monetary Authority (SMA) was an interim instrument that replaced the currency board which was in place at the time, though it acted as a typical central bank. The Seychelles Monetary Decree under which the SMA was established provided legal powers to the institution, allowing it "to act as manager of external reserves, banker to the government and banks, inspector of banks, and lender of last resort." On January 1, 1983, the SMA officially became the Central Bank of Seychelles (CBS) and was given the task of implementing monetary policy, in tandem with government's fiscal policy.

It was rather fitting that the 30th Anniversary of CBS coincided with the beginning of a major economic transformation that Seychelles was about to embark upon. As the world economy crumbled and domestic macroeconomic imbalances were stretched to the limit, Seychelles authorities responded with a historical economic reform programme that encompassed *inter alia* exchange rate, fiscal and monetary reforms. In terms of monetary policy, this required a major advancement in the way it is conducted, as the CBS moved toward the use of indirect or market-based instruments to achieve price stability as opposed to administrative ones that had been the practice before. The highlight of this transformation was the adoption of reserve money targeting in the context of the Bank's new monetary framework.

My appointment as Governor of the Central Bank of Seychelles in November 2008 came at a challenging time, and also coincided with the 30th Anniversary of the Bank. I took over an institution that had gone a long way and achieved a lot. However, there was a need to transform the institution itself, and not just its instruments. Under my leadership, the CBS has embarked on a series of initiatives to modernise the institution and bring its practices and standards in line with best international norms. Besides the new monetary framework, an 18-month action plan for banking supervision is being implemented, which will bring about a new approach to banking supervision, namely risk-based supervision. Internal audit and control systems are being strengthened, and by 2010 the CBS' accounting framework will be based on the International Financial Reporting System (IFRS). In the area of securities and financial markets, which the CBS regulates, important milestones were realized during 2008 with the enactment of several key regulations.

Going forward, the year 2009 will present significant challenges, not only for the Bank but Seychelles as a whole, as the country strives to overcome the challenges of the global downturn. The prevailing turmoil on the global financial markets will continue to disrupt FDI inflows and dampen the performance of the local tourism industry. The drop in real income is likely to weigh down on domestic demand and production, at least in the earlier part of the year, though the reforms would pave the way for a more sustainable growth once recovery is achieved. For its part the CBS will continue to develop new monetary instruments to support this recovery.

On this note, I would like to take this opportunity to thank the staff of the Central Bank for their support during 2008, and wish them success in the momentous task ahead.

CENTRAL BANK OF SEYCHELLES

Board of Directors

(as at 31st December 2008)

Pierre Laporte	-	Governor and Chairman
Jennifer Morel	-	Deputy Governor – Member
Francis Chang-Sam	-	Resigned as at 1st November, 2008
Errol Dias	-	Member
Jean Weeling-Lee	-	Member
Wilfred Jackson	-	Member

Secretary to the Board

Juliana Ah Thew-Rose

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Technical Note

Owing to rounding of figures, the sum of separate items may not always add up to the total shown. Abbreviations used in this Report are:

R	=	*Seychelles Rupee*
n.a	=	*Figure not available*
..	=	*Negligible*
-/0	=	*Nil*

SECTION ONE

Highlights of the Seychelles Economy

Overview

2008 was an eventful and challenging year for the Seychelles economy. In the midst of the international financial turmoil, the rise in world fuel and food prices, and the onset of the global economic recession, the Seychelles entered a most volatile phase in its economic history, marked by serious disruptions in key economic fundamentals caused in part by these occurrences and the impact of certain austerity measures implemented in the run-up to the formal acceptance of a Stand-by Arrangement with the IMF.

As early as in the first quarter of the year, economic stress became increasingly visible with the rise in international fuel and food prices threatening to destabilise fiscal and external fundamentals in a worrisome way. As these persisted, government found it necessary to undertake further policy reforms in order to relieve some pressures on its budget and the external accounts. This involved the withdrawal of subsidies to certain public sector entities and the implementation of flexible pricing policy for utility services, fuel at the pump and for essential goods so as to reflect the production or landed costs. However to lessen the inflationary impact on consumers, certain essential commodities were exempted from Goods and Services Tax (GST).

In support, the Central Bank of Seychelles (CBS) also undertook some important steps early in the year, reinforcing its existing monetary policy instruments, with the aim of maintaining both financial and monetary stability, in light of the emerging economic strains.

Notwithstanding the above mitigating measures, signs of imminent economic slowdown crystallised in the first half of 2008 as the global oil and food price shocks hit Seychelles hard. As a small open island economy with limited external reserves, the country suffered a significant worsening in its terms of trade, compounded further by a noticeable flattening in tourism performance toward the end of the year.

The consequences were strongly reflected in a major deterioration in the Balance of Payments (BOP) as an overwhelming share of foreign exchange was diverted to ensure the uninterrupted supply of energy products and staple commodities, leaving the productive sectors effectively starved off hard currency to import raw materials and spare parts. Moreover, the country's external debt service capacity virtually evaporated, leaving Seychelles with no option but to default on some large commercial debt obligations, including the coupon payment on the US$200 million international sovereign Eurobond issue in the second half of the year. Following these events, Standard and Poor's downgraded the country's rating from B^- to SD (selective default). With no future access to international commercial funding, and faced with growing economic imbalances internally, the authorities were impelled to call in the International Monetary Fund (IMF) with initial negotiations starting in mid-2008 to assist with the development of a comprehensive reform programme aimed at restoring external and internal economic imbalances.

Following extensive consultations, the government agreed to undertake a wholesale review of the country's prevailing macroeconomic policy framework which had for many years been anchored on a tourism and trade weighted exchange rate regime. This essentially meant transforming the country from a significantly administered economic setup to one that is predominantly market driven supported by a coherent set of fiscal, monetary and exchange rate policies. Thus, in November 2008, the Seychelles formally embarked on an IMF supported reform programme under a Stand-By Arrangement facility. The objective of the programme was to promote macroeconomic stability, debt sustainability and sustainable economic growth.

Under the framework of the agreement as embodied in the Memorandum of Economic and Financial Policies (MEFP), the major macroeconomic and structural reforms were:

- the liberalisation of the foreign exchange market so as to achieve full rupee convertibility, involving removal of all exchange restrictions and floatation of the rupee;
- a reform of the monetary policy framework to create a more market oriented financial system whilst preserving financial stability;
- a significant and sustained tightening of fiscal policy supported by a reduction in public employment and the replacement of indirect subsidies by a targeted social safety net (a tool to maintain social stability);
- a comprehensive debt restructuring strategy aimed at restoring public debt sustainability consistent with the government's ability to pay; and
- a reduction of the role of the state in the economy so as to boost private sector development through further privatisation, enhanced fiscal governance, and a review of the tax regime.

The bulk of the fiscal adjustment and other key measures envisaged under the economic reform programme were implemented in the fourth quarter of 2008 and the remainder is to be carried out in January 2009, as announced in the 2009 budget address. As part of the new fiscal management approach, government committed itself to reinforcing its fiscal revenue base, removing all tax exemptions, applying the GST to all-locally manufactured goods and initiating steps to strengthen its tax administration and public financial management. In addition, the authorities opted to withdraw all subsidies extended to parastatals such as STC, PUC and SPTC, thus resulting in an upsurge in domestic inflation as the prices of various products and services were adjusted to full cost-recovery levels. Moreover, the government took some important measures to contain its expenditures despite the inflationary pressures in order to meet its primary balance target as stipulated in the MEFP. In an attempt to put public debt on a sustainable path, the government initiated discussions with Paris Club as well as commercial creditors aimed at restructuring Seychelles' debt.

On the Monetary Policy front, interest rates were freed and the objective of price-stability was to be pursued through a combination of tight liquidity management and a stable exchange rate. Thus, in September of the year, the Bank introduced a new market-based policy instrument namely the Deposit Auction Arrangement as the conduit to exert control over reserve money. In the year to come additional monetary instruments will be introduced to further enhance the Bank's liquidity management capability and render the financial system more dynamic and efficient.

The adoption of a monetary targeting framework meant dropping the previous exchange rate nominal anchor and the establishment of a more market oriented financial system backed by a liberal exchange and payments system based on a floating regime.

The implementation of the floating exchange rate regime took place on November 1, with CBS subrogating its previous prescriptive role on the exchange rate to market forces. To complement and support the liberalisation of the foreign exchange market, the Foreign Earnings Regulations Act was repealed and significant amendments were made to the Exchange Control Act as well as the Central Bank Act to legalise the regime change.

The new exchange rate regime was intended to restore confidence in the local currency as legal tender, enhance external competitiveness and eliminate foreign exchange shortages. To support the domestic currency, a tight monetary policy had to be pursued, thus resulting in interest rates reaching historic highs, notably on government securities and on commercial loans.

The impact of the new economic reform programme coupled with global economic turbulence and price hikes translated in a marked slowdown in economic activity in 2008. Provisional estimates

indicate that real GDP may have declined by less than 1.0 per cent, mostly on account of a retrenchment in domestic demand as economic agents adjusted to the liberal - but initially unstable - market environment. During the year, both manufacturing and tourism related activities were down compared with 2007. However, construction activity remained quite buoyant, especially in respect of ongoing FDI-funded projects in tourism, such as the Ephelia Resort & Spa and the Four Seasons Petite Anse Resort.

After reaching a historic peak in 2007, the tourism industry lost momentum in the latter half of the year, a development driven by the economic downturn in the euro area, which constitutes the main market. Whilst up until the end of the third quarter, the number of visitor arrivals had outperformed last year's outcome, declining monthly growth rates were being registered, starting from 15 per cent in January to 1.4 per cent in September. Overall, the year ended with a fall of 1.4 per cent in visitor arrivals to 158,952.

Consumption was also down considerably during the year under review as real wages were adversely affected by rising prices especially following the fiscal measures taken by the government to contain budget pressures. After a promising start, both local and foreign direct investment (FDI) slowed somewhat, particularly in the last three months of the year. Domestic funded investments were worse hit by the economic turbulence, notably the depreciated rupee and the rise in the cost of borrowing, which collectively rendered many of the local capital projects unfeasible. Moreover, commercial banks' liquidity was generally tight throughout the year, and as a result banks were not able to meet the full demand for investment funds. Additionally, for the most part, access to foreign exchange by the private sector remained restricted as the bulk of hard currency went toward imports of food and energy products.

Rates of inflation reached record heights in 2008, principally in the aftermath of the currency floatation, the withdrawal of government subsidies to commercial parastatals, introduction of GST on additional goods and services, and the virtual abolition of price control. Prices of various goods and services more than doubled overnight as retailers and producers re-priced their products. The year ended with the year-on-year December inflation rate at the historic level of 63 per cent.

Liberalization of the economy created a huge incentive for foreign currency to flow into the official system as banks were able to match the exchange rates being offered in the parallel market. This allowed, among other things, for parastatals and the government to source their foreign currency needs through the banking system and relieve the pressure on central bank reserves. Coupled with CBS' ability to now purchase foreign currency from banks, the year ended with a significant growth in external reserves amounting to US$73 million (gross). Nevertheless, it should be noted that this

accumulation was still at the cost of accumulation of external arrears, mostly debt, which are now under discussion.

Monetary Developments

With the uncertainties in the global economy and the emerging stresses in domestic economic fundamentals, the Central Bank implemented a number of mitigating policy initiatives in 2008. This was done with technical assistance (TA), mostly from the IMF. In 2007, a TA mission assisted the CBS to establish a new monetary strategy. This framework is expected to be operational by June 2009. Under this new strategic policy framework the CBS targets reserve money as the intermediate target for the attainment of price stability.

In parallel to work on the new strategy, some supporting monetary measures were implemented. In June, the minimum reserve requirement was augmented from 5 per cent to 13 per cent and in September the definition of deposit liabilities was broadened to include the rupee equivalent of foreign currency deposits of residents. Furthermore, remuneration ceased to be calculated on excess cash reserves and interest of 0.25 per cent was applied only on minimum reserves as of September. The Local Assets Ratio (LAR) was reduced from 65 per cent to 50 per cent in June and was lowered even further to 45 per cent in September in anticipation of the floating of the currency. The rationale behind it was to assist banks in coping with the valuation effect of the depreciation of the rupee on their foreign exchange deposits liabilities.

With the signing of the MEFP the authorities signified their agreement to adopt a market-based approach to economic management and to solve the country's critical debt problem and external imbalances. Of most significance were the floatation of the rupee and the implementation of the reserve money targeting framework which required the development and deployment of several new money market instruments to assist with active liquidity management.

By the start of October, two of these instruments were in operation, namely the Deposit Auction Arrangement (DAA) and the weekly auction of 91-day t-bills. Both were instrumental in allowing the authorities to reach the set December target of R1,151 million for reserve money.

The DAA provided commercial banks with the avenue to invest excess reserves into short term deposits and earn competitive returns for durations of 7, 14 and 28 days. The 91-day Treasury bill tender issue, done on a weekly basis, was an important tool to mobilise domestic liquidity and engineer an upward shift in market interest rate so as to relieve demand pressure on the external accounts and thus help stabilise the rupee in the aftermath of the float. Moreover, by attracting funds directly from the public the instrument had the added effect of tightening banks' liquidity position and

hence their ability to support credit. At the end of the year, the 91-day t-bill rate stood at 26.30 per cent whereas the 7, 14 and 28 day (DAA) stood at 28.75, 12.50 and 11.75 per cent respectively.

Since 2005, the Central Bank has held a 20-year government bond in the amount of some R1.0 billion. With the signing of a Memorandum of Understanding between the Bank and government, agreement was reached for the restructuring of the bond into tranches of marketable securities. This will provide the Bank with additional instruments to enhance its capacity in liquidity management. The first R250 million tranche was converted into 91-day Treasury bills at a rate of 23.47 per cent plus a 0.5 per cent margin, in December.

Drafting of the operational manual for the Monetary Policy Framework was completed in December. This framework sets out clear guidelines and procedures for its proper usage whilst additionally mapping out future development undertakings. From a legal standpoint, adoption of the new policy framework necessitated numerous revisions or deletion of certain financial laws and regulations. Amongst these, was the repeal of the Foreign Earnings Regulation (Act); in the same context the Financial Institutions Act and the Central Bank Act will be amended in the first half of 2009. In addition to these legal changes the Central Bank abandoned its policy of fixing the minimum deposit rate - leaving it to the market - and also dismantled the foreign exchange pipeline scheme.

Fiscal Developments

Consistent with a market-approach to economic management is the need for a lean and efficient government operating primarily as facilitator/regulator rather than as operator in the economy. Under the MEFP, clear targets were set to downsize the public sector, withdraw subsidies to parastatals, eliminate sectoral fiscal concessions, modernise and streamline the tax structure and introduce best international practices on governance. Paradoxically, some of the above measures, notably reducing staffing levels, involved some heavy front-end redundancy payment costs, but these were considered necessary for efficiency gains.

Indeed, much of the benefits expected from the reform programme would be from fiscal sector reforms, which overall, are designed to redress the public debt problem whilst creating a sound, level and investor-friendly environment for businesses through eliminating structural barriers to economic growth.

The budget performance for the year captures in part the early impact of the reform programme. Although the primary balance was in surplus, the actual figure of R243 million fell short of the target of R704 million. Consequently, after interest costs, an overall deficit of R206 million was recorded against the surplus of R269 million anticipated. This outcome was due to the reclassification of a loan

extended by the Government to the state-owned public oil company (SEPEC) to secure fuel supply in the difficult period before the beginning of the reform program.

The floatation, and subsequent depreciation, of the rupee had major implications for government fiscal operations in 2008. One of its many effects was to induce an increase in domestic prices, thus triggering an overrun in fiscal expenditure and an upward (or nominal) review in salaries. On the other hand, the currency depreciation increased the rupee tax base for imports and thus contributed to record revenue collections of R3,263 million. However, the increased revenue buoyancy was not sufficient to allow revenues to cover expenditure, which overall increased to R3,469 million.

The year 2009 is slated to be a financially testing year as this would be the critical first year of the MEFP and will demonstrate the capability and resilience of the Nation to withstand and persevere with tough and ambitious economic reforms. The projected overall fiscal outcome is a deficit of R608 million, principally reflecting the high debt service interest costs arising from a highly inflationary environment and the depreciated rupee. Fiscal revenue for 2009 is estimated at R3.6 billion whilst the total expenditure is projected at R4.2 billion.

External Sector Development

In 2008, more so than in other areas, the BOP clearly reflected the depth of the combined impact of deepening global recession, energy and commodity price volatility, restrictive macroeconomic policies and ambitious market reforms on the Seychelles economy. For most of the year the economy functioned under severe hard currency rationing as the heavy costs of external debt service and high energy and commodity prices absorbed the predominant share of the country's external inflows, thus leaving few resources to support retail trade, agriculture, manufacturing and non-FDI construction activity. The floating of the currency in November and the softening of international oil prices in the latter half of the year significantly improved the accessibility to foreign exchange for the private sector. However, the main underlying cause of the perceived improvement in the foreign exchange situation arose as a consequence of a moratorium on bilateral and commercial debt service payments implemented as part of the due process of debt restructuring and reduction under the aegis of the Paris Club, thus temporarily relieving a heavy burden on the country.

In 2008, the current account closed the year in deficit, but unlike earlier years, the deficit amounted to a record (provisional) figure of R4,293 million, equivalent to 49 per cent of Gross Domestic Product (GDP). A large percentage of the deficit could be attributed to the net trade in goods, standing at a deficit of R5,192 million with imports rising to an estimated R8,835 million. The soaring price of oil meant that mineral fuel imports grew by 97 per cent relative to the 2007 figure whilst FDI-related imports increased to the equivalent of US$237 million.

Furthermore, reflecting the depreciation of the currency following the float, the fourth quarter saw a hike in c.i.f. value imports thus increasing the rupee value of imports further. The services sector, the main pillar of the economy, experienced a decline in its outcome relative to 2007. Nonetheless, service income (net) posted a surplus of R1,173 million. Conversely, the income account posted a deficit despite non-payments on the Eurobond (see above) whereas the transfers account surplus tripled in comparison to the 2007 figure.

The capital and financial account remained positive, an indication of foreign investment coming into the country. However, there was a reduction of R1,238 million over 2007, due to accumulation of arrears on commercial debt. The ensuing downgrade of Seychelles from a B^- to Selective Default on the Standard and Poor's credit rating had severe negative effect on the country's image.

Real Sector Development

Economic activity slowed during 2008. In the first half of the year the economy was seriously affected by chronic hard currency shortages and high imported commodity and energy prices, which contributed on the one hand to production disruptions, and on the other, a contraction in demand as real income declined. In the latter half of 2008 the recession in Europe - Seychelles' main tourism market - resulted in a drop in tourism-related activities. The year ended with a 1.4 per cent decline in the number of visitors which came to Seychelles compared to the year before. Nevertheless, due to the depreciation of the rupee tourism earnings increased from R1,901 million in 2007 to R2,438 million.

Construction activities remained buoyant in 2008 but well below expectations. Despite growing internal and external uncertainties, FDI in the country increased, thus boosting construction output. During 2008 FDI accounted for 36 per cent of GDP. However, construction on many of the approved projects such as the Emirates Resort (Cap Ternay) and the Qatari Diar Resort (Anse a La Mouche) failed to commence for various reasons, not least on account of the international credit crunch and tourism downturn, which is forcing investors to re-assess their strategic roadmap.

Elsewhere in the economy, notably in the manufacturing, fisheries and agricultural sectors, losses of output were registered. The plight of certain import-substituting entities was further aggravated by the adverse climatic conditions, introduction of GST on local manufactures and the hardening in domestic credit terms. Loss of consumer purchasing power also affected demand, most visibly in the beverages market.

The slowdown in economic activities began to impact adversely on the labour market towards the end of the year. This was compounded by redundancies implemented under the Voluntary Departure

Scheme of the government to streamline the public service. With demand in the economy at a low point, many private firms embraced rationalisation plans involving staff redundancies in order to survive the difficult economic phase. Nevertheless, the year 2008 ended with unemployment rate as low as 1.0 per cent compared to 1.9 per cent in December 2007 given that the impact of the redundancies will only be felt in the course of 2009.

Juxtaposed against the above complex web of events, was the general surge in inflationary tendencies which gained maximum momentum in the aftermath of the floatation of the rupee. The average rate of inflation for 2008 stood at 37 per cent, whilst the year-on-year rise in prices was 63 per cent in December 2008.

Outlook for 2009

Seychelles, like the rest of the global community, faces uncertain prospects in 2009. As 2008 closed, the international economic landscape remained very unstable with financial, stock and exchange markets in varying states of flux. Policymakers are yet to fully understand the depth of the economic crisis which in essence has no historical parallel and are therefore unsure of the impact of their coordinated and concerted policy responses, notably with regards to fiscal stimulus. Indeed, doubts persist on the capacity of sovereign governments to undertake further bailout packages to strengthen financial institutions and support strategic industries as in many developed countries given that these have been at the cost of mounting sovereign debt. Moreover with monetary policy at its most relaxed, evidenced by record low interest rates internationally, increasing resort to "quantitative easing" appears unavoidable, thus igniting risks of damaging inflationary tendencies during the upward phase of economic recovery.

For Seychelles, an early return to global economic recovery would significantly improve economic prospects, notably in terms of higher tourism activity, a strengthening of FDI and a more sympathetic climate for successful debt restructuring/reduction negotiations with the Paris Club. With the added proviso that energy and commodity prices remain reasonably in check, this would provide an enabling environment for a successful achievement of the economic reform process without the heavy costs of output losses.

Unfortunately, the consensus of cautious opinion is that 2009 will be a difficult year for Seychelles. The persisting turmoil in the international financial market is anticipated to affect the tempo of FDI inflows whilst the contraction in the world economy is projected to translate in a 15 per cent decline in tourism arrivals and an even deeper slide of 25 per cent in tourism earnings. This however, could change if the downturn is reversed faster than expected, and if early efforts by the local tourism trade to intensify marketing abroad pay dividends. With average domestic inflation expected to remain

high until at least November 2009, the prospects of interest rates returning to pre-November 2008 as early as this coming year remain low, which suggests therefore a subdued year for local investment activity. With real income dropping and the tourism industry in recession, demand conditions in the economy are likely to remain soft for another year, notably for manufactured and agricultural products, including beverages and meat products.

Nonetheless, the underlying weakness in demand and the continued tight domestic liquidity situation should help stabilise - and possibly - strengthen the value of the rupee against the world's major currencies. However this will depend much on the strength of foreign exchange inflows from sources other than tourism, which is anticipated to decline significantly in 2009. The first estimate for real GDP growth in 2009 is a decline of almost 10 per cent in real terms.

SECTION TWO

Financial Survey

2. Monetary Policy Development 2008

The year 2008 was an important and challenging one for overall liquidity management in the financial system as the government embraced fundamental market reforms to stabilise and restructure the economy in preparation for entering into a Stand-by Arrangement with the IMF.

In April, after careful analysis of developments on both the domestic and international markets, the Central Bank of Seychelles strengthened its monetary policy stance. Accordingly effective June 1, revisions were made to its main monetary policy instruments; notably a reduction in the local assets ratio, an upward revision in the minimum reserve requirement and an increase in the minimum deposit rate, with the overall objective of tightening liquidity in the financial system. In addition, a secondary market for treasury bonds was introduced so as to promote a more dynamic securities market and create an incipient platform for active money market operations.

Three months following these revisions, and in the lead up to the formal acceptance of the Memorandum of Economic and Financial Policies with the IMF, the country's macroeconomic policy framework underwent a major makeover. With the assistance of IMF through the Technical Assistance Program of January 2008 to June 2009 and the IMF Programme mission of September 5 – 18, 2008, the Central Bank abandoned its traditional prescriptive monetary policy framework anchored on a fixed exchange rate regime in favour of a market-based solution. This was necessary to promote consistency with the change in exchange rate regime to a floating system as advocated by the IMF to achieve unification of the official and parallel markets in hard currency, as a policy priority under the MEFP reform agenda.

In light of the new economic management approach, the Bank thoroughly revamped its internal structures and procedures and enhanced its technical capacity in order to cope with the new economic order. Hence, as recommended by the IMF consultants, the Bank moved away from its policy of exchange rate targeting to a framework centred around monetary targeting, with Reserve Money being

the operational target variable. Targets for such variable were set in the Technical Memorandum of Understanding of the Reform Programme. Under the new regime, price stability was designated the primary objective of monetary policy and this was to be achieved through the tight management of domestic liquidity which in the context of a small open island economy, implies in essence, a stable exchange rate coupled with the added requirement of low inflation in the country's trading partners.

The paradigm shift in policy execution places the burden of economic adjustment on "prices" and as such the Bank was obligated to engage in the liberalisation of the whole spectrum of financial prices and let market forces play their equilibrating role. Within the scope of the process, new market instruments, starting with the Deposit Auction Arrangement (DAA), were to be systematically phased in. As the financial system is transformed to a market setup, the Bank's responsibility would thus shift from administering financial prices to close monitoring of their developments on the market with intervention only permitted in order to minimise disruptive fluctuations in response to shocks or as necessary to attain the reserve money target.

Consequently, as of September 22, 2008 prior to the adoption of the floating exchange rate regime and in addition to further revisions made to existing monetary policy tools, (see details in section 2.1) CBS introduced the Deposit Auction Arrangement (DAA), allowing the Central Bank to directly influence domestic liquidity in line with the reserve money target. Moreover, the Bank in collaboration with the government began to conduct weekly auctions of 91-day Treasury bills. Through active use of these instruments, the Bank is now arguably in a position to modulate domestic liquidity with some degree of precision. To oversee the CBS market operations, the month of September also saw the creation of the Monetary Operations Committee.

Beginning October, as CBS committed itself to meet its end-December Reserve Money target, it suspended its secondary market and closed its short term credit window to the commercial banks. In pursuit of the same line, from November 2008 onwards, the Bank initiated foreign exchange auction sale to further reduce excess rupee liquidity in the system.

The opening impact of the new economic reforms was a significant depreciation of the domestic currency even in relation to the parallel market rate, an acceleration in the inflation rate and a major rise in interest rates on the DAA and treasury bill auctions. In consequence, the interest rate structure in the commercial banking sector shifted upwards but not to the extent and manner expected of an efficient market situation. On December 1st, the Central Bank withdrew its prescription on the minimum deposit rate since this had become redundant under the new monetary framework.

As the year drew to a close, the initial impact of the dramatic shift in macroeconomic stance to a liberal market regime on the real sector became a considerable source of concern. The considerable exchange rate overshooting and the unexpectedly high inflation pass-through caused some surprisingly serious disruptions to consumption and productive activities leading to immediate signs of economic contraction. Nonetheless, the underlying tightness of fiscal and monetary policies should in subsequent terms, stabilise the national currency and hence, provide the enabling platform for general economic recovery.

In the year 2009, the CBS will thus continue to work to achieve its monetary targets as set under the economic reform programme and introduce additional monetary policy instruments to further enhance liquidity management and render the financial system more dynamic and efficient. These would include credit auction arrangements; outright sales & purchases of government securities; repurchase agreements with government securities, standing facilities and an Inter-bank Market for foreign exchange.

2.1 Monetary Policy Instruments

Besides the introduction of new monetary policy instruments as mentioned above, CBS also made some revisions to its existing tools in the year, as detailed below.

2.1.1 Minimum Reserve Requirement

In its first Monetary Policy Review in April of the year, the Bank felt the need to raise the minimum reserve requirement seeing that banks were holding massive excess liquidity, at about 70 per cent of total reserves. To this end, in June 2008 the minimum reserve requirement was raised from 5.0 per cent to 13 per cent, in a bid to further tighten the amount of free cash in the system.

In the September reform, the ratio was kept at 13 per cent. However, effective September 15, the Bank revised the deposit base for the calculation of the minimum reserve requirements to include foreign currency deposits held by residents. Thus banks were required to hold 13 per cent of such deposits, in its corresponding rupee value, as reserves at the Central Bank. The justification for the inclusion of such deposits was to improve monetary control. Additionally, the minimum cash reserves of 13 per cent which were previously not attracting interest started to be remunerated at 0.25 per cent.

As for the remuneration on excess reserves which equalled the sum of the minimum deposit rate and a margin of 75 basis points, this rose from 4.25 per cent to 5.25 in June. The rise followed the upward revision made in the minimum deposit rate then, as mentioned below. However, as of September 22, under the Monetary Policy reform, excess reserves ceased to be remunerated. As an alternative, banks were encouraged to invest their excess cash in the DAA at more competitive returns.

2.1.2 Minimum Local Asset Ratio

In conjunction with the rise in minimum reserve requirement in June, the minimum local asset ratio (LAR) was revised downwards from 65 per cent to 50 per cent. Effective in the week of September 22, the ratio was further reduced to 45 per cent. This further reduction mainly followed the decision to remove excess reserves as part of the LAR definition. Eventually, LAR will be phased out completely but progressively replaced with a supervisory liquidity requirement for prudential purposes.

2.1.3 Minimum Deposit Rate

As briefly mentioned above, in the first Monetary Policy Review, Central Bank revised the minimum deposit rate upwards from 3.5 per cent to 4.5 per cent. This could be construed as a signalling event to the economy on the national need to curb current consumption and in turn relieve some pressures on the balance of payments.

However, with the introduction of new price-determined market instruments and the upward shift in the interest rate structure of banks, the CBS minimum deposit rate was automatically made redundant. Hence, the Board of the Central Bank of Seychelles decided to eliminate this instrument on December 1. In turn, this will further guarantee that the whole spectrum of interest rates in the system is essentially market determined. The minimum interest rate had been under the ambit of the CBS since 1988.

2.1.4 Deposit Auction Arrangement

As mentioned above, the Bank introduced a new monetary policy instrument, the Deposit Auction Arrangement (DAA) in September 2008, as part of its Monetary Policy Reform. The DAA is a liquidity management tool made available by the CBS to the commercial banks for better liquidity management by both parties. CBS uses the instrument to mop up excess liquidity in the system whilst the bank uses it so as to maximise interest earnings on any excess liquidity. The first DAA auction took place on September 22, 2008 and has been conducted on a weekly basis since then. (See section 6 on Operations and Administration of Central Bank)

2.2 Overview of the Monetary Sector in 2008

The performance of the monetary sector throughout the year 2008 was influenced by a series of monetary and fiscal policy measures. These were mainly the reform of the monetary framework, the amendments made to the monetary policy instruments, the liberalisation of the foreign exchange market as well as the move to a more liberal goods market.

The impact of all these developments on overall liquidity was initially expansionary in contrast to the contraction posted in 2007. This was apparent in both the broad measure of money supply M2(p) and the broadest money component M3, which includes foreign currency deposits of residents. Such

expansion was observed in most money components except for pipeline deposits. The contraction in the latter came following the liberalisation of the foreign exchange market which enabled the banks to meet some of the payment arrears.

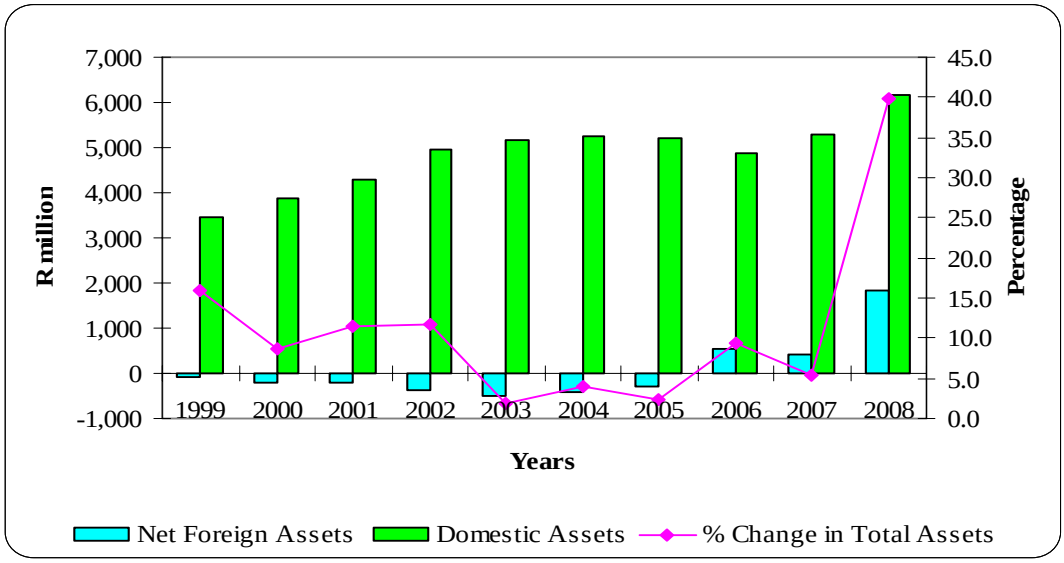
Nonetheless, the end of year growth in liquidity principally originated from the foreign side following an improvement in the net foreign assets position and a rise in foreign currency deposits, partly on account of revaluation gains associated with the rupee depreciation. Albeit to a lesser extent, a rise in domestic credit during the year also contributed to the expansion in liquidity in the system.

With the liberalisation of the determination of financial prices, interest rates had also increased by the end of the year in comparison to end 2007. Initially, banks were reluctant to take advantage of the market situation and bid in the treasury bill and DAA auctions in line with the interest benchmarks quoted in the MEFP document but with official encouragement, they subsequently upped their tender rates closer to the average annual inflationary trend.

2.3 Net Foreign and Domestic Assets

Net foreign assets (NFA) of the banking sector remained positive in 2008 and at end-December stood over fourfold relative to the corresponding 2007 position, rising from R432 million to R1,824 million. This reflected both a real increase in NFA in foreign exchange terms and the revaluation gains due to the weakening of the local currency. The loss in the value of the rupee inflated the rupee amount of the NFA by twice. Net foreign assets measured in US dollars rose from US$54 million to US$110 million by the end of the year. The rise in NFA which was evident throughout the year was most apparent in the last quarter.

Chart 2.1: Net Foreign Assets and Domestic Assets (1999 – 2008)



Source: Central Bank of Seychelles

By end 2008 the net external holdings of the Central Bank had tripled its 2007 position to stand at R1,050 million. For the first time ever, this figure would stand in billions of rupees. However, in dollar terms the improvement was by only 55 per cent (1.5 times more) to an estimated US$63 million. The prime sources for the accumulation of external reserves were the first IMF tranche of US$9.1 million as per the Stand-by Arrangement in November and purchases worth US$6.0 million from the commercial banks in need of rupees. As can be depicted from the movement in external reserves, the level of foreign exchange inflows outweighed the draw-downs in 2008.

On the commercial banks side, there was a similar pattern. The increase in NFA in the fourth quarter reflected a slump in foreign exchange demand rather than an increase in underlying inflows. Abstracting from certain exceptional purchases, the evidence in fact pointed to a decline in foreign exchange conversion in the economy, especially in the immediate aftermath of the float. The significant drop in demand was mostly on account of the exit of the government as an active participant in the market as the country suspended external debt service payments in the run-up to Paris Club debt restructuring negotiations. In addition, SEPEC's requirements for energy payments dropped sharply as the international oil price fell sharply under pressure from falling demand in the world economy. These developments offered the banks the opportunity to improve their net foreign assets position further from US$14 million to US$47 million. In parallel, banks were unshackled from previous regulations that tended to restrict their operations in the marketplace. As part of the liberalisation of the external sector, the 15 per cent surrender requirement on gross foreign exchange inflows in the banking system to the Central Bank was abolished following the repeal of the Foreign Earnings (Regulations) Act, 1996, foreign exchange restrictions on payments removed and the requirements to make certain payments by non-residents in foreign exchange eliminated. Moreover, late during the year, the Central Bank auctioned a total of US$2.0 million to the banks in order to help attain its reserve money target.

On the net domestic asset front, total credit continued to expand throughout the year, with an acceleration observed in the last three months. In comparison to R5,272 million posted at end-2007, the corresponding 2008 figure stood higher by 17 per cent at R6,150 million. The main driver of this expansion was the private sector with an additional credit usage of R1,026 million compared to the year before. To a lesser extent, claims on public entities also pushed NDA upwards. On the other hand, net claims on the government fell to R2,836 million in 2008 representing a reduction of R343 million.

2.4 Money Supply

In contrast to the contraction in liquidity observed in 2007, the year under review posted an expansion in the amount of money in the financial system. This was despite the measures taken by the Central Bank to mop up liquidity through new monetary policy instruments. The expansion was most evident

under M3, which reflected in large measure, the effect of revaluation gains of residents' foreign exchange deposits.

As measured by M3, the broadest money component, money supply increased by 12 per cent in 2008, compared to a drop of 2.4 per cent in the previous year. In rupee terms foreign currency deposits grew by 53 per cent or R339 million to R982 million whilst in dollar terms they actually fell from US$80 million to US$59 million a decline of 36 per cent. This rundown on foreign deposits lend credence to the proposition that residents opted to convert their available holdings of hard currency domestically rather than to bring in funds from overseas in the period following the float in view of the instability in the exchange rates.

Table 2.1

Monetary Survey;[1,3] 2004 - 2008

(R million)	2004	2005	2006	2007	2008
Net Foreign Assets [2]	**-414.5**	**-273.7**	**538.8**	**431.6**	**1824.3**
Central Bank	-306.2	-85.7	653.3	322.5	1049.8
Commercial Banks	-108.3	-188.0	-114.5	109.0	774.5
Domestic Assets	**5250.4**	**5223.0**	**4869.7**	**5272.5**	**6150.1**
Claims on private sector	1164.1	1247.3	1320.3	1752.6	2779.0
Claims on public entities	183.3	296.8	240.1	340.9	534.6
Claims on government (net)	3903.0	3678.8	3309.3	3179.0	2836.4
Money Supply, M3	**4268.5**	**4442.5**	**4659.7**	**4549.9**	**5104.8**
Money Supply, M2(p)	**4042.8**	**4196.2**	**4341.8**	**3906.4**	**4122.4**
Money Supply, M2	**3453.3**	**3697.9**	**3957.9**	**3814.4**	**4117.6**
Money Supply, M1	**1226.9**	**1397.0**	**1392.0**	**1602.0**	**1701.1**
Currency with public	295.8	325.7	392.8	407.8	430.4
Transferable deposits	931.1	1071.4	999.2	1194.2	1270.6
(of which public entities)	283.9	264.6	192.7	130.5	72.6
Quasi Money	**2226.5**	**2300.9**	**2565.9**	**2212.4**	**2416.5**
Fixed Term deposits	1420.9	1452.9	1613.3	1168.1	1335.5
(of which public entities)	152.2	152.8	312.5	330.7	340.0
Savings deposits	805.6	847.9	952.6	1044.3	1081.0
Pipeline deposits	**589.5**	**498.4**	**383.9**	**92.0**	**4.8**
Foreign Currency Deposits	**225.7**	**246.2**	**317.9**	**643.5**	**982.4**
Other items, net	**567.4**	**506.9**	**748.8**	**1154.2**	**2869.6**

Figures do not necessarily add up due to rounding off

Figures for previous years have changed given changes in definition of broad money

[1] End of period

[2] Excludes government balances

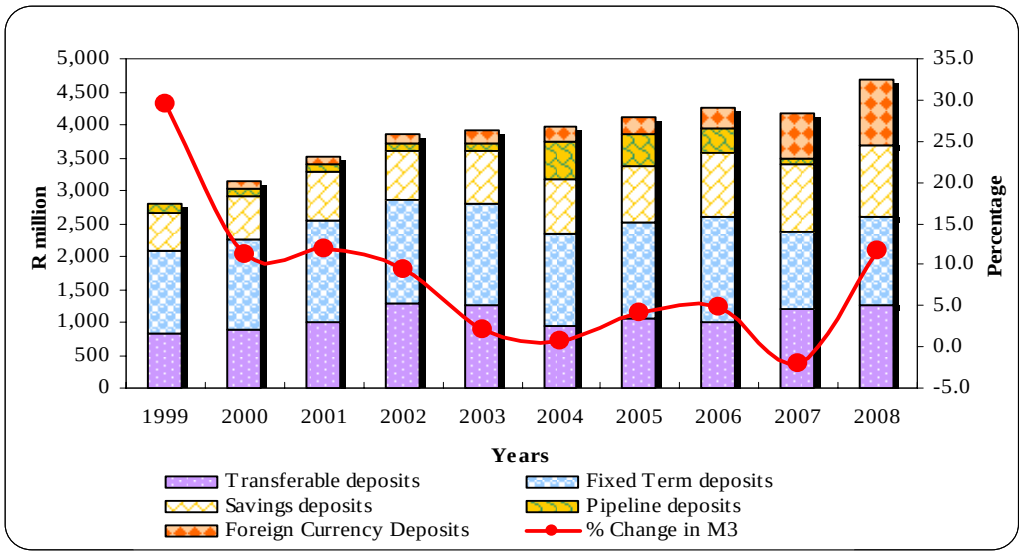
[3] Changes in 2007 figures are due to revisions

Source: Central Bank of Seychelles

When considering the broad money supply, namely M2(p), which excludes foreign currency deposits a slower expansion of 5.5 per cent was recorded. Yet, at R4,122 million M2(p) stood effectively below the 2006 level. The expansion in such monetary variable was principally spurred by the growth in the least liquid component of the money supply. Quasi money, which includes time and savings deposits, grew by R204 million (9.2 per cent) in 2008 to stand at R2,416 million.

Developments in quasi-money broadly mirrored those on the credit side but may have been affected by movements in interest rates. In December 2007, the CBS revised its minimum deposit rate to 3.5 per cent which was raised further to 4.5 per cent as of June 2008. Later in the year, following the liberalisation of the determination of financial prices, the banks increased their applicable rates on these deposits to between 8.0 – 13 per cent. In view of the higher rates being offered on such accounts, time deposits grew faster than savings deposits. Compared to 2007 fixed-term deposits increased by 14 per cent whilst savings deposits by 3.5 per cent. Part of these additional deposits could have come from the compensation and gratuity payments to former SMB staffs following privatisation of certain SMB activities in early 2008.

Chart 2.2: Money Supply (1999 – 2008)



Source: Central Bank of Seychelles

As for the most liquid component of money supply, namely M1, this grew by a smaller amount of R99 million or 6.2 per cent, driven mainly by the demand deposits which rose faster than the amount of currency with public. Currency with the public increased from R408 million in 2007 to R430 in 2008, possibly reflecting higher transaction balances on account of inflationary tendencies. Though at a slower pace than in the previous year, demand deposits continued to rise in 2008 and these were by R76 million (6.4 per cent).

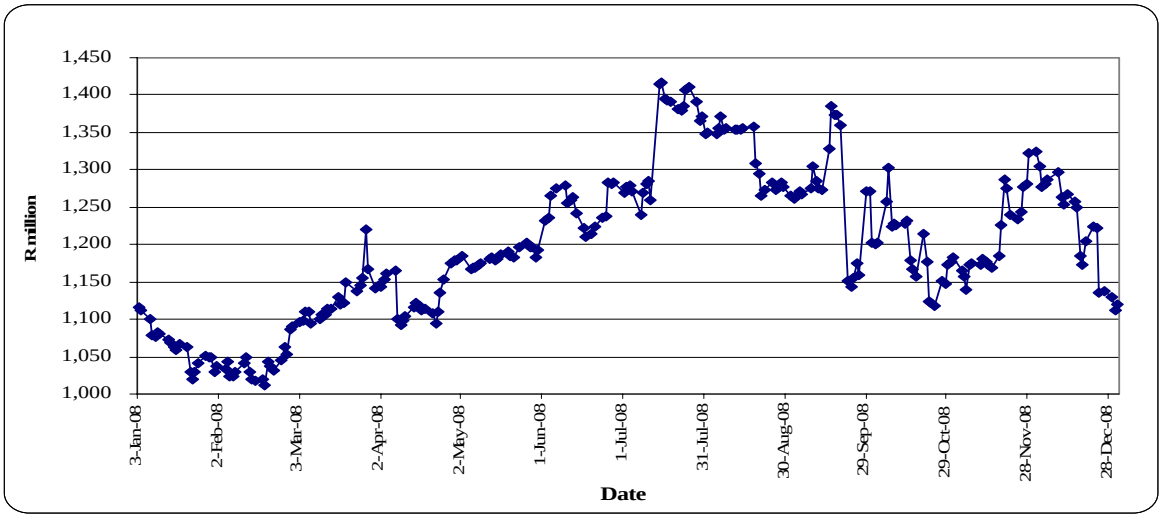
Over the year, pipeline deposits fell from R92 million to only R4.8 million. This reflected the impact of the foreign exchange liberalisation process as well as the decision by participants to withdraw funds from the scheme.

2.5 Reserve Money

As mentioned above, under the new monetary targeting framework, reserve money which comprises of currency in circulation and commercial banks deposits with the Central Bank, was chosen to be the operating target. This gave the Bank the responsibility of maintaining a ceiling on such monetary component and end-of-quarter targets were set under the reform programme. For end of December 2008, the limit was set at R1,151 million.

Therefore, in the last quarter of the year, CBS geared its effort towards influencing reserve money through market operations targeting banks' excess reserves by means of the deposit auction arrangement and the conduct of foreign exchange auctions. Moreover, in collaboration with the Ministry of Finance, the Central Bank promoted the participation of non-banks in the weekly Treasury bill auction, which helped to mop up additional liquidity in the financial system.

Chart 2.3: Movements in Reserve Money of the Central Bank



Source: Central Bank of Seychelles

As illustrated on the graph, throughout the months of October and November, reserve money mostly remained above its end-December target, except on five occasions. The highest level reached was R1,322 million on December 1 but from then on it gradually fell to hit below the target on December 24 and remained so in the last five working days of the year. By December 31, reserve money stood at R31 million below the ceiling, at R1,120 million**.**

2.6 Domestic Credit

2.6.1 Central Bank and Commercial Bank

Growth in domestic credit which was 4.6 per cent in 2007 accelerated to 22 per cent by the end of 2008 to stand at R6,760 million. This was purely caused by an increase in total credit extended by the commercial banks as opposed to Central Bank credit which remained somewhat stable.

By the end of the year, commercial banks' loan portfolio expanded by 27 per cent or R1,212 million. Like earlier intimated most of the additional loans went towards the private and parastatal sectors against the backdrop of strong inflationary pressures, especially in the closing quarter of the year. Commercial banks' claims on these sectors grew at 59 per cent (R1,026 million) and 57 per cent (R194 million), respectively.

Table 2.2
Credit; [1/2/3] 2004 - 2008

	2004	2005	2006	2007	2008
	(R million)				
Total Credit	**5492.6**	**5523.5**	**5302.7**	**5548.8**	**6760.2**
Commercial banks	**4092.1**	**4182.7**	**4191.7**	**4409.8**	**5621.5**
Claims on private sector	1162.1	1247.3	1320.3	1752.6	2779.0
Claims on parastal sector	183.3	296.8	240.1	340.9	534.6
Claims on government	2746.6	2638.5	2631.3	2316.3	2307.8
of which:					
Dev. fund stocks	(147.1)	(147.1)	(147.1)	(147.1)	(147.1)
Treasury bonds	(1079.4)	(1095.0)	(1342.4)	(1052.4)	(747.1)
Treasury bills	(1511.6)	(1302.2)	(1132.8)	(1092.6)	(1231.1)
Central Bank	**1400.6**	**1340.8**	**1111.1**	**1139.0**	**1138.7**
Claims on government	1400.6	1340.8	1111.1	1139.0	1138.7
of which:					
Advances	(1316.6)	(0.0)	(0.0)	(86.4)	(140.6)
Treasury bonds	(84.0)	(1340.8)	(1111.1)	(1052.6)	(747.1)
Treasury bills	(0.0)	(0.0)	(0.0)	(0.0)	(251.0)

Figures do not necessarily add up due to rounding off

[1] *End of period*

[2] *All figures for stocks, bonds and bills are at cost value*

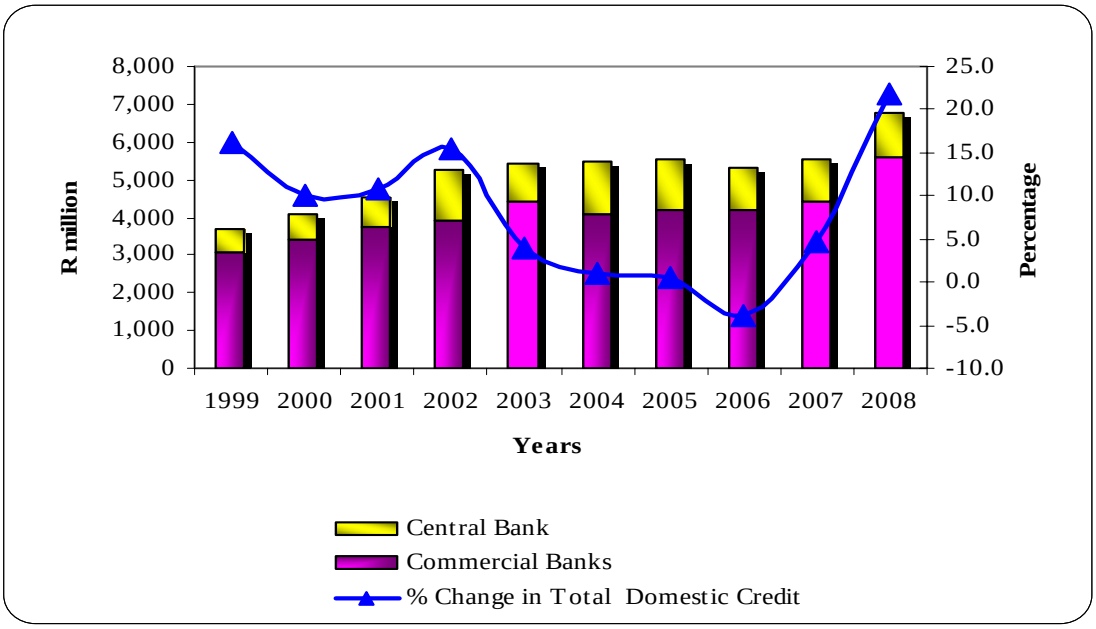
[3] *Changes in 2007 figures are due to revisions*

Source: Central Bank of Seychelles

Following these developments, the share of total credit extended by commercial banks to the private sector increased to 49 per cent by the end of 2008 compared to 40 per cent by end of the previous year. Similarly parastatal share rose from 7.7 per cent to 9.5 per cent. Apart from the higher amount of loans taken from the commercial banks in the year, the increase in the shares of these sectors was also

caused by reduced reliance by government on banking sector's financial resources. In 2008, government was able to cut back its loan balance from the commercial banks by R8.4 million compared to the preceding year.

Chart 2.4: Total Domestic Credit (1999 – 2008)



Source: Central Bank of Seychelles

In the case of the Central Bank on an end-of-year basis, government kept its outstanding amount of credit at an almost unchanged level compared to 2007. Yet, throughout the year and on an average basis, total CBS credit was 7.3 per cent higher than 2007. This was mainly on account of the government's use of the available short term advances facility which on average posted a fourfold increase in the year compared to 2007.

In spite of government's overall reduction in its loan balance with the banking sector, it remained the leading borrower in 2008. By the end of 2008, it held a ratio of 51.0 per cent. However, this represented a sharp decline from the share of 62 per cent posted by the end of 2007. The declining trend in government's share of total credit has been a phenomenon observed since 2003 when it stood at 80 per cent.

2.6.2 Sectoral Allocation of Credit to Private Sector and Parastatals

The non government sector debt at the commercial bank grew by 47 per cent or R981 million in 2008 to reach R3,074 million, mostly on account of valuation changes on foreign currency loans. Foreign denominated advances were higher in 2008 by R1,055 million compared to 2007. In dollar terms,

foreign currency loans increased from US$82 million to US$103 million. In contrast, loans in the local currency declined by R80 million. As a result, the share of total non-government credit of foreign currency denomination picked up 31 percentage points in 2008 to amount to 56 per cent as opposed to 35 per cent in 2007.

Table 2.3
Commercial Banks – Loans and Advances
To Non-Government Sector by Economic Sectors;[1] 2004-2008

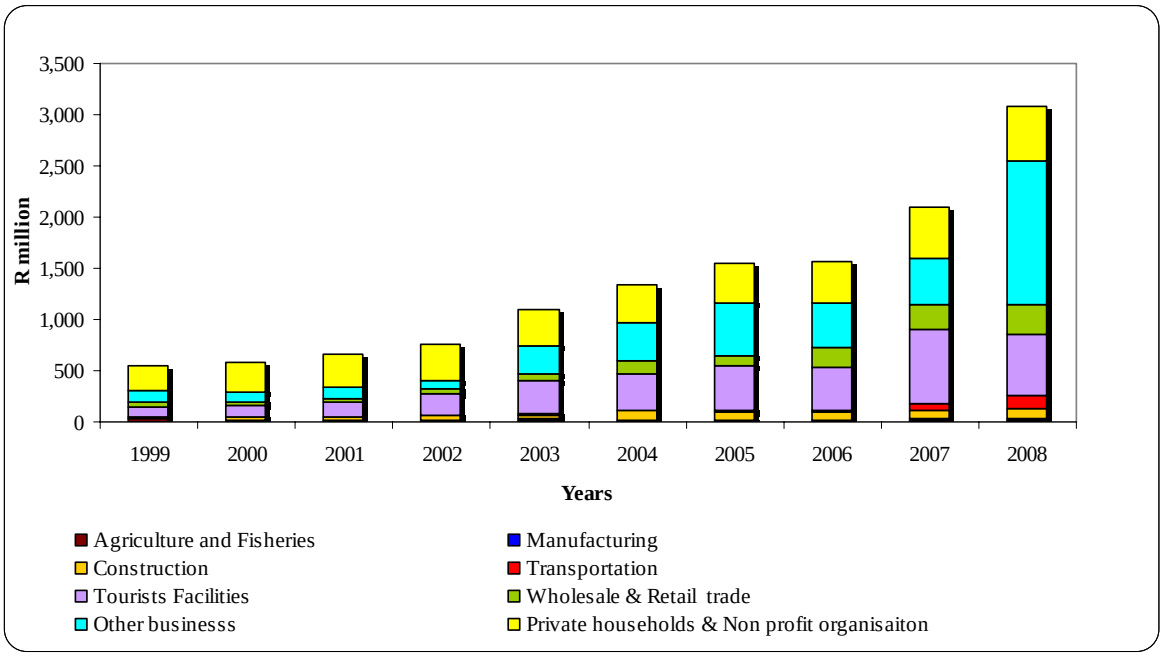
	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008
				(R million)				(per cent)		
Total Advances	**1345.4**	**1544.2**	**1561.8**	**2093.5**	**3074.7**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Of which:										
Foreign Currency Loan	121.9	222.1	338.0	652.1	1707.1	9.1	14.4	21.6	31.1	55.5
Agriculture & fisheries	11.6	10.4	12.8	14.8	11.1	0.9	0.7	0.8	0.7	0.4
Of which:										
Manufacturing	7.9	7.0	12.2	14.6	13.2	0.6	0.5	0.8	0.7	0.4
Construction	87.0	85.9	80.5	86.6	104.9	6.5	5.6	5.2	4.1	3.4
Transportation	6.6	5.1	9.1	53.7	124.0	0.5	0.3	0.6	2.6	4.0
Tourist facilities	361.5	438.1	424.0	739.0	601.6	26.9	28.4	27.1	35.3	19.6
Wholesale & Retail trade	124.4	104.3	183.5	241.2	290.0	9.2	6.8	11.7	11.5	9.4
Other businesses	366.1	511.0	437.4	451.8	1396.5	27.2	33.1	28.0	21.6	45.4
Private households & Non-profit organisations	380.4	382.4	402.3	491.8	533.3	28.3	24.8	25.8	23.5	17.3
Of which										
Mortgage loans	232.9	217.5	199.1	204.9	211.1	17.3	14.1	12.7	9.8	6.9

Figures do not necessarily add up due to rounding.
Changes in figures for 2007 are due to revisions
[1] *End-of-period data.*

Source: Central Bank of Seychelles

Further analysis showed that almost half of credit advanced by the commercial banks went towards the 'other business' category, representing 45 per cent of the total. In relation to 2007, this sector benefited from a significant increase in total amount of advances, from R452 million to R1,397 million. As may be implied from the figure, an overwhelming portion of these loans was in foreign, currency explaining the four-fold increase. Tourism which was the second main sector in terms of the amount of advances, with a share of 20 per cent, experienced a decline of 19 per cent in its loan portfolio at the commercial banks. As can be observed, developments in this important sector continued to be financed by FDI inflows.

Chart 2.5: Commercial Banks' Loans and Advances to Non-Government Sectors (1999 – 2008)



Source: Central Bank of Seychelles

Transport was another sector which experienced a sharp increase in its loan position at the commercial banks of some 131 per cent. To some extent, this may be explained by the increase in the value of imported vehicles especially following the sharp depreciation of the rupee. The other sectors which posted increases were construction at 21 percent, wholesale and retail trade at 20 per cent and private households and non-profit organisation at 8.4 per cent. In contrast, the outstanding level of advances for agriculture and fisheries as well as manufacturing, declined by 25 percent and 9.6 per cent respectively.

2.6.3 Development Bank's Credit[1]

The Development Bank of Seychelles (DBS) is the microfinance institution in the financial system, providing advances across economic sectors. DBS's loan portfolio contracted further in 2008 by R15 million or 5.2 per cent in comparison to 2007. However, such a decrease was at a slower pace considering the decline of R37 million or 11 per cent the year before.

[1] Development Bank of Seychelles (DBS) was established in 1977 under Decree No. 21 as a development financing institution with a specific mandate to assist in the economic development of Seychelles. DBS finances new, modernization and expansion projects in the fields of agriculture, fishery, industry, service and tourism as well as construction of commercial and residential complex. To qualify, the applicant must be a Seychellois citizen or a company incorporated in Seychelles with at least 51 per cent Seychellois ownership. Currently, DBS charges 9.5 per cent per annum on all loans and requires applicants to make a minimum personal contribution of 25 per cent of the total project cost. The Development Bank of Seychelles does not provide credit for working capital by itself.

Declines in the stock of outstanding loans at DBS were across the main economic sectors with the biggest drop being in the tourism sector at R6.4 million. However, in percentage terms, the fastest decrease was in the industry sector at 30 per cent followed by the fishing sector at 18 per cent. 'Other Services' sector which continued to account for the bulk of DBS' advances at 62 per cent observed a slight drop of R1.0 million in its loan balance.

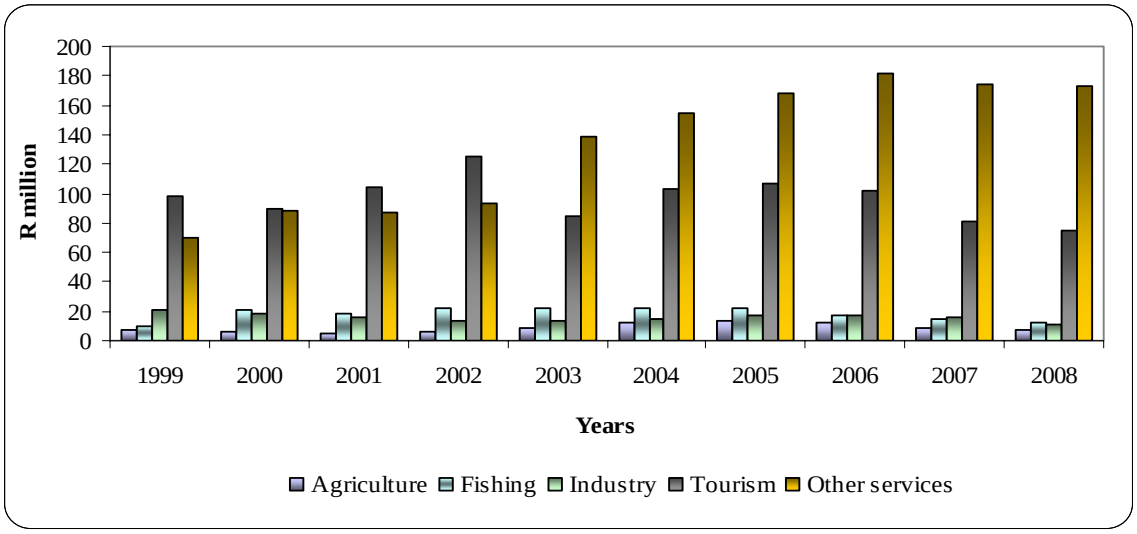
Table 2.4
Loans by Development Bank by Economic Sectors;[1] 2004-2008

	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008
	(R million)					(per cent)				
Total Advances	**307.5**	**327.1**	**330.8**	**293.9**	**278.7**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Agriculture	12.5	12.9	12.4	8.3	8.0	4.1	3.9	3.7	2.8	2.9
Fishing	22.1	22.4	17.5	15.0	12.3	7.2	6.8	5.3	5.1	4.4
Industry	14.9	17.5	17.6	15.8	11.0	4.8	5.4	5.3	5.4	4.0
Tourism	103.2	106.3	101.5	81.0	74.6	33.6	32.5	30.7	27.6	26.8
Other services	154.8	168.0	181.8	173.8	172.8	50.3	51.4	55.0	59.1	62.0

Figures do not necessarily add up due to rounding off.

[1] *End-of-period*
Source: Development Bank of Seychelles

Chart 2.6: Loans by Development Bank by Economic Sectors (1999 – 2008)



Source: Central Bank of Seychelles

2.7 Liquidity of the commercial banks

The overall liquidity position of the commercial banks had deteriorated by the end of 2008 mainly on account of the monetary policy initiatives taken under the economic reform programme.

However even earlier, in June, the liquidity operational envelope of the banks had tightened on account of a rise in the MRR from 5.0 per cent to 13 per cent. Even though banks were given two months to adjust to this new ratio, some of them had to take recourse to Central Bank's short term advances facility. Additionally, in September, the deposit liability for computing MRR was broadened to include foreign currency deposits for residents, thus further squeezing the liquidity of banks. In view of that, banks had additionally to keep the rupee equivalent of 13 per cent of foreign exchange deposits as reserves at the Central Bank. Such a move further interrupted banks' liquidity management and once again, in its capacity as lender of last resort, the Bank had to provide additional funds to the banking system, in the initial stage.

Table 2.5
CBS Advances to Commercial Banks; 2004-2008

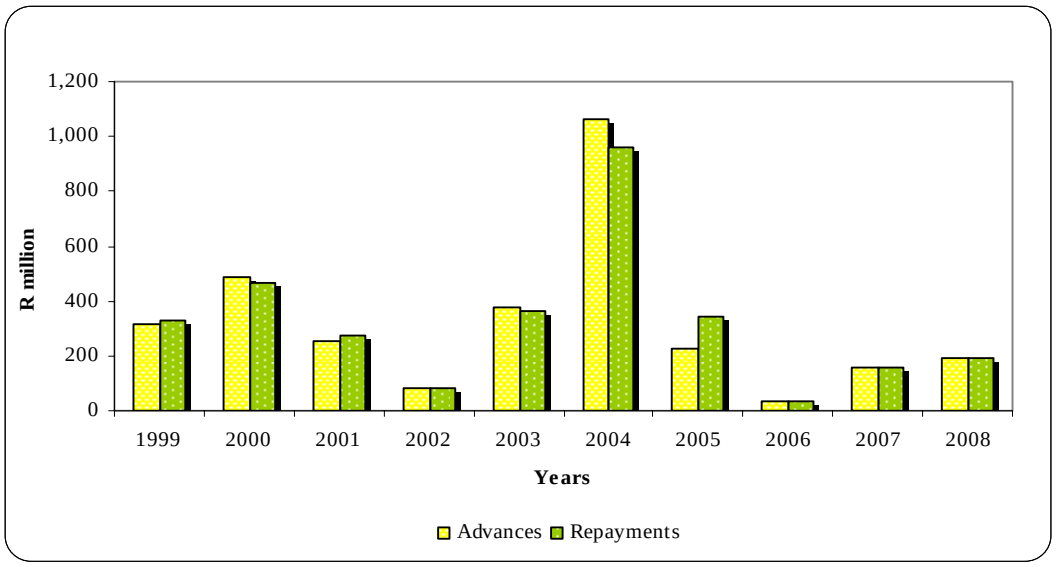
	2004	2005	2006	2007	2008
			(R million)		
Advances	1063.5	224.0	34.0	157.0	190.0
Repayments	962.5	344.0	34.0	157.0	190.0
Stock of credit[1]	120.0	0.0	0.0	0.0	0.0

[1] *End-of-period data.*
Source: Central Bank of Seychelles

The liquidity position of the commercial banks was aggravated by the considerable loss in the value of the local currency through the liberalisation of the foreign exchange market in November which made it difficult for them to meet the 13 per cent on foreign currency deposits. By then, the reserve requirement for the same amount of foreign currency liabilities in foreign currency terms had doubled in rupee terms. Consequently, the banks' domestic currency liquidity was squeezed to the extent that they reduced their level of participation in both the weekly 91-day Treasury bill and DAA auctions. To add to their liquidity predicament, Central Bank in an attempt to meet its reserve money target suspended its lender of last resort function to the commercial banks. As most banks were facing tight liquidity position, interbank lending became very limited and some banks were forced to sell foreign currencies so as to obtain some relief to their tight rupee cash flow. Commercial banks liquidity management in the last two months of the year was also made difficult by withdrawal of deposits linked with the participation of private and corporate entities in the weekly T-bills auctions as well as

the usual end-of-year festive season withdrawals. Over this period, banks lost R86 million of deposits and ended the year deficient on the minimum reserve requirement.

Chart 2.7: Central Bank Advances to Commercial Banks (1999 – 2008)



Source: Central Bank of Seychelles

Despite the fact that CBS closed its window on short term advances in the last 2 months of the year, as lender of last resort it extended R190 million to the commercial banks in total. This was a rise of R33 million with respect to 2007.

2.8 Interest rates

With the liberalisation of market interest rates and the establishment of new monetary management structures, a considerable rise in domestic interest rates was observed by the end of the year. This was consistent with government's financing requirement and in line with the strategy to tighten liquidity in the financial system, and thus reduce demand in the economy with the further objective of stabilising the exchange rate.

Such a development occurred mainly in the last three months of the year following the introduction of the weekly auctions of government 91-day T-bills and the DAA auction. Over this period, the upper end of market interest rates rose closer to the 12-month average inflation rate of 37 per cent. On an annual average basis, the rate on the 91-day T-bills for 2008 compared to 2007 rose from 3.98 per cent to 20.71 per cent, a development influenced by the move to tender such instrument on a weekly basis as of October. Following the same pattern, the return on the 365-day T-bills picked up 23.09 percentage points to stand at 27.98 per cent.

Table 2.6
Interest Rates;[1/ 5] 2004-2008

	2004	2005	2006	2007	2008
		(per cent)			
Volume-weighted average deposit rates:	2.80	2.97	2.78	3.50	9.68
Minimum Deposit Rate[2]	2.50	2.50	2.50	3.50	-
Fixed Term deposits rate					
<= 7 days	1.77	2.07	3.28	2.53	2.42
> 7 days <= 3 months	4.75	3.07	3.12	3.77	7.83
> 3 months <= 6 months	3.91	3.31	3.29	3.46	5.73
> 6 months <=12 months	3.12	3.02	3.23	3.32	7.47
> 12 months	3.01	3.01	3.48	2.72	5.84
Volume-weighted					
Average lending rate	9.81	9.90	10.52	11.26	16.19
91-day treasury bill rate[2]	2.59	2.93	3.79	3.98	20.71
91-day treasury bill rate[3]	3.83	4.24	4.12	4.89	27.98

[1] Average of quarterly data, compiled on an end-of-period basis, whereas that of the 91-day bill
[2] Minimum deposit rates was set by the Central and is no longer applicable since 1st December 2008 rate is the average of monthly data, compiled on an end-of-period basis.

[3] With effect from January 13, 2004, new 91-day bills were issued on tender

[4] With effect from December 20, 2004, new issues of 365-day bills were issued on tender

[5] Changes in figures for 2007 are due to revisions

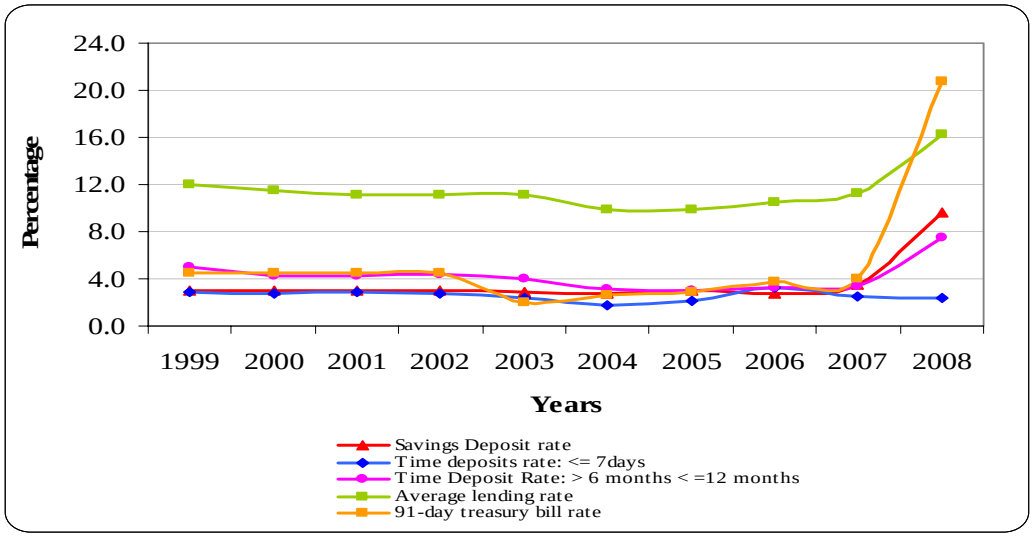
Consequently, as banks were getting a higher return on their investments in these instruments and to deter their most important customers (in terms of amount of deposits) from removing funds from their account, they decided to pass on some of the benefits to their customers and moved interest rates upwards towards the end of November and beginning December. As a result, the applicable savings rate in that period jumped from an average of 4.50 per cent to 9.75 per cent. Similarly rates on other deposits namely call and time deposits also rose to higher levels, adding between 3.50 and 7.65 percentage points to the previous rates. The average lending rate also picked up 7.25 percentage points to stand at 17.75 per cent.

Hence, as per the table below, based on annual averages, increases were posted in the applicable interest rates on most deposits with the exception of the fixed term deposit of less than seven days. The highest increase was on the savings account, which jumped 6.18 percentage points to 9.68 per cent. As for the other categories, namely the fixed term deposits, the highest rate recorded was on the 7 day – 3 month maturity which rose to 7.83 per cent, followed by the 6 – 12 months maturity which increased to 7.47 per cent. Yet, the rise in the interest rates was faster for the latter by 4.15 percentage points as opposed to 4.05 percentage points for the former, relative to 2007. The slowest rise in the

rates was posted for the 3 – 6 months maturity which only gained an additional 2.27 percentage points to stand at 5.73 per cent. On the lending side, the annual average cost of borrowing funds from the commercial banks, increased by 4.94 percentage points to 16.19 per cent.

In view of all these developments, the minimum deposit rate set by the Central Bank and which was raised to 4.5 per cent in June was removed as of December 1.

Chart 2.8: Interests Rates (1999 – 2008)



Source: Central Bank of Seychelles

SECTION THREE

Government Finance

3. Summary

The year 2008 was one of remarkable significance with regard to the fiscal policy of the Seychelles authorities. Under the Memorandum of Economic and Financial Programme (MEFP) signed by the authorities pertaining to the IMF Stand-By Arrangement fiscal policies represent one of the three key pillars of the country's new economic management strategy, the other two being monetary and structural policies.

One of the major fiscal measures was the removal of the bulk of government subsidies. Coupled with inflationary pressures in the aftermath of the currency depreciation, removal of these subsidies hit the more vulnerable segments of society particularly hard. To assist the most vulnerable individuals cope with the financial strain social safety nets have been put in place, notably an independent welfare agency that will provide means-tested assistance. For those parastatals providing goods and services, such as the STC, PUC, SEPEC and SPTC, controls were removed that allowed them to review their prices upward to cover their costs.

3.1 Policy Changes

The historical transition that the Seychelles economy underwent was deemed crucial to restore the country's underlying finances and eradicate the prevailing barriers to sustainable economic stability, development and growth. The transformation process involves sequentially restructuring public finances and creating a market environment which is transparent, level and investor-friendly, as necessary elements of a dynamic and modern economy.

The reforms envisaged under the MEFP are by design, fundamentally deep and target a major contraction of domestic consumption, particularly government expenditure to secure the necessary internal conditions consistent with a viable and sustainable external position. These adjustments are being accompanied by a debt reduction/restructuring program.

An ideal adjustment programme is one which tackles the economic weaknesses with the minimum social cost and involves no trade-off in terms of output or employment. In the case of Seychelles'

program this came against the backdrop of an unparalleled international financial crisis, volatile stock/currency markets and unstable commodity prices. Indeed, as the adjustment programme took shape, the economy was hit by unprecedented inflationary pressures arising from international hikes in food and fuel prices, coupled domestically with the sharp currency depreciation, removal of subsidies, and increases in taxes, fees, etc... The situation was further aggravated by an unexpectedly large contraction in domestic productive activity as the global economic slowdown led to a decline in tourism.

The formal engagement in the IMF-supported reform programme implied a redefinition of the role of the government from an active economic participant to one of regulator and facilitator. By extension, the private sector becomes *ipso facto* the engine of the economy, thus providing the justification for the privatisation of major commercial entities in which the government is a substantial shareholder.

The direct benefit of a downsized government is a corresponding fall in fiscal expenditure, which against an overall increase in the level of taxes, should provide the platform for redressing the state of government finances and rollback public debt. Under the new reform programme several targets were thus set in regards to both revenue and expenditure heads as were clearly laid down in the 2009 budget address.

One apparent paradox of the new macroeconomic framework is the initial jump in expenditure levels during the programme period arising from inflation adjustment of costs, higher interest payments and inter alia, the financial burden of a voluntary redundancy exercise. Thus for 2009, total planned expenditure stands at a record R4.4 billion. This includes a budgetary allocation of R100 million for persons meeting the minimum criteria for assistance. Reportedly, some 45 per cent are currently enjoying social assistance as they qualified for support from the new Welfare Agency. Conversely, the estimated revenue for the year 2009 was R3.5 billion indicating an increase of R281 million or 8.6 per cent on the 2008 revised budget.

Another key objective of the program is to restore debt sustainability from a combination of tight fiscal policies, donor budgetary support and a reduction/restructuring of existing debt stock. With total external debt amounting to US$763 million, of which US$236 million accounted for by arrears, debt reduction under the aegis of the Paris Club was deemed integral to the overall reform strategy and negotiations along this line are being vigorously pursued. The aim is to bring down total public debt to a level of at least 60 per cent of GDP. As part of the restructuring of the domestic debt profile, the government decided to convert the 20-year Restructuring Bond worth about R1.0 billion into marketable securities, of which the first tranche of R250 million was converted into 91-day Treasury

bills in December. As of January 2009, another R250 million of the outstanding will be 91-day Treasury Bills whilst the remaining will be in the form of 365-day Treasury Bills.

In the 2009 budget, a sum of R1.2 billion has been allocated for the payment of interests, reflecting for the most part the leap in domestic interest rates arising from the monetary squeeze imposed by the Central Bank in the financial system.

On structural reforms, the government removed direct or indirect subsidies extended to parastatals, but allowed parastatals to set their prices for basic goods and services. Going forward the authorities made the first moves toward a comprehensive review of the tax system and the strengthening of the tax administration in order to streamline tax collection, increase efficiency, eliminate loopholes and improve coverage, with a diagnostic mission from the IMF's fiscal affairs department. Streamlining of the tax regime and a more broad-based tax system would be considered in favour of special tax exemptions such as those embodied in the Tourism (incentives) Act and other similar legislations. Technical work on these issues is ongoing, with assistance from the Bretton Woods institutions.

The government implemented a Voluntary Departure Scheme in late 2008 that resulted in a reduction of 1,491 public servants. The aim of this exercise was to cut costs by streamlining the public service, and to make it more efficient. Whilst this carried some major initial budgetary costs, it was these ex-public sector employees which were expected to be absorbed by the private sector, and thus enable a replacement of expatriate workers presently employed in the private sector.

3.2 Outcome for 2008

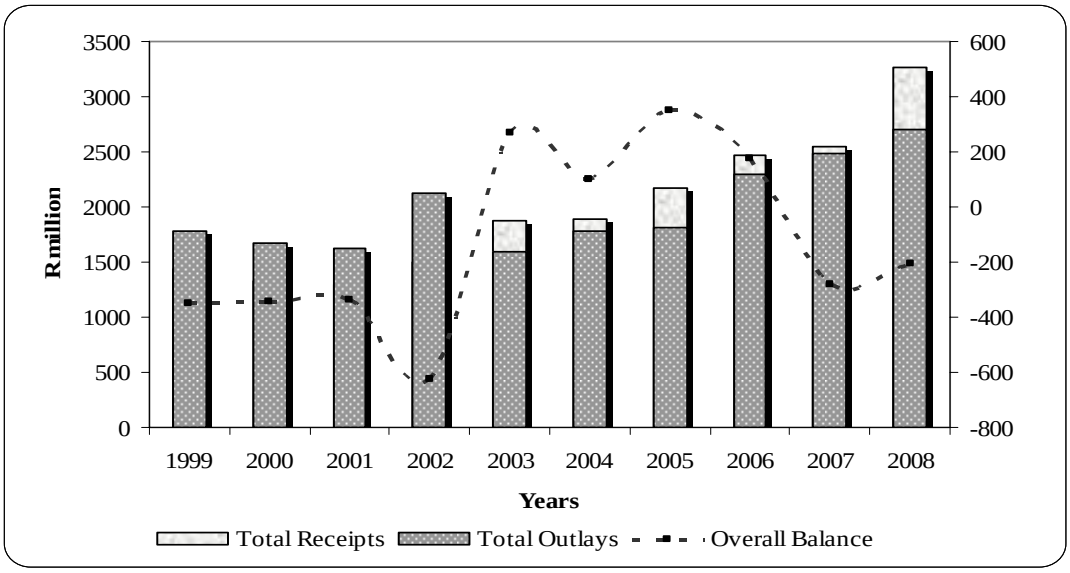
For 2008 the budget provided for a primary balance surplus of R704 million or 8.0 percent of GDP. One of the performance criteria (PC) under the program was the primary fiscal surplus. In a technical sense, this PC was not met because of a reclassification of a loan extended by the Government to the state-owned public oil company (SEPEC) to secure fuel supply in the difficult period before the program commenced. However, abstracting from the reclassification and higher than anticipated external grants (providing an unanticipated boost to the fiscal position), the primary surplus target for 2008 would have been met. Because of this reclassification instead of the target primary budget surplus of R704 million amounting to 8.0 per cent of GDP, an actual primary budget surplus of R243 million was recorded equivalent to 2.8 per cent of GDP. This led to an overall budget deficit of R206 million, equalling 2.4 per cent of GDP which was on account of the higher than anticipated total expenditure.

Table 3.1
Government Budget; 2006 – 2008
Summary

	2006 Budget	2006 Actual [1]	2007 Budget	2007 Actual [1]	2008 Budget	2008 Actual [1]
			(R million)			
Total Receipts	**1929**	**2476**	**2422**	**2549**	**2547**	**3263**
Current receipts	1924	2403	2362	2170	2532	2942
of which:						
Trades Tax	[199]	[225]	[260]	[265]	[360]	[410]
Transfers from SSF	[125]	[125]	[125]	[125]	[135]	[135]
Business/ income tax	[304]	[297]	[316]	[360]	[359]	[524]
Other Indirect Taxes	[673]	[723]	[883]	[884]	[1023]	[1058]
Grants	5	73	60	17	15	268
Total Outlays	**1751**	**2302**	**2095**	**2485**	**2278**	**2702**
Current outlays	1514	1901	1856	2172	1968	2247
Appropriation items	1357	1477	1479	1739	1513	1770
of which:						
Ministries/ departments	[836]	[952]	[933]	[1008]	[973]	[1074]
Social security contributions	[143]	[147]	[170]	[136]	[139]	[155]
Current outlays to parastatals	[62]	[124]	[121]	[239]	[68]	[79]
Charges	193	424	377	433	456	477
of which:						
Interest payments	[179]	[406]	[360]	[417]	[435]	[449]
Contingency Fund	0	0	0	0	0	0
Capital outlays	237	404	239	374	310	305
Net Lending	0	-3	0	-61	0	798
of which:						
Parastatals	[0]	[-3]	[0]	[-55]	[0]	[715]
Primary Balance[2]	**357**	**580**	**687**	**482**	**704**	**243**
Overall Balance	**178**	**174**	**327**	**65**	**269**	**-206**
Financing (net)	**-178**	**-174**	**-327**	**-65**	**-269**	**206**
Foreign loans (net)	-2	878	-27	725	26	206
Domestic loans (net)	-176	-522	-300	-328	-295	91
Cash movements	0	-531	0	-462	0	-92
Memorandum Items:						
Amortisation of loans	**1150**	**1373**	**1108**	**1281**	**1756**	**771**
of which:						
Foreign loans	50	453	144	366	225	320
Domestic loans	1100	919	964	914	1531	451

Figures do not necessarily add up due to rounding.
[1] These series are subject to audit and might be revised accordingly.
[2] The primary balance is obtained by excluding interest payments from the overall balance.
Source :Ministry of Finance

Chart 3.1: Government Finance Outcome (1999 – 2008)



Source: Ministry of Finance

After interest costs, the overall budgetary outcome was a deficit of R206 million against an expected budget surplus of R269 million and again exceeded the deficit of R139 million.

3.3 Revenue

In 2008, the buoyancy in the fiscal accounts was sustained, mostly in regard to trade-related taxes and tourism taxes. This though, was associated in part to valuation gains in rupee terms due to the depreciation of the local currency. In addition, business tax was unexpectedly high, reflecting strong economic activity during 2007 and the first three quarters of the year. Grant receipts similarly exceeded budget by over R250 million.

Overall, revenue totalled R3,263 million which was R716 million or 28 per cent higher than budgeted. Excluding grants of R268 million, current receipts amounted to R2,942 million, of which 'other indirect taxes' mainly GST accounted for the largest share at R1,058 million. Trades tax outperformed its target by R50 million, or 14 percent, to stand at R410 million whereas 'business tax' totalled R524 million, also well in excess of the R359 million expected. The annual 'transfers from social security' was in line with the budgeted R135 million.

In 2008, almost all of the components of current receipts, with the exception of "rents and royalties", "dividends and interest", and the item "miscellaneous" exceeded their targets. "Dividends and interest" fell short of target on account of the somewhat low remuneration of dividends from the parastatal sector, notably Seychelles Petroleum Company (SEPEC) and Nouvobanq (SIMBC). Both entities suffered from the impact of the devaluation of the rupee, albeit for different reasons. In the case of the former, higher oil prices seriously affected its cash flow situation whilst in the case of the

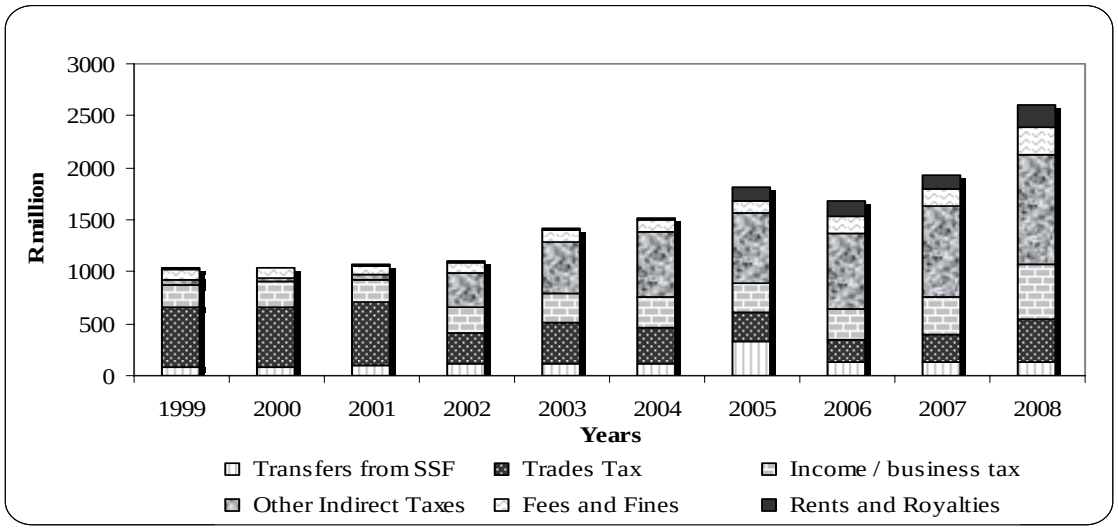
latter profits had to be retained to maintain compliance with prudential and monetary requirements on account of a quantum rise in deposit liabilities arising from the revaluation of foreign exchange deposits.

Table 3.2
Government Budget; 2006 – 2008
Revenue

	2006 Budget	2006 Actual [1]	2007 Budget	2007 Actual [1]	2008 Budget	2008 Actual [1]
				(R million)		
Total Receipts	**1929**	**2476**	**2422**	**2549**	**4034**	**4396**
Current Receipts	**1924**	**2403**	**2362**	**2170**	**2532**	**2942**
Transfers from SSF	125	125	125	125	135	135
Trades Tax	199	225	260	265	360	410
Income / business tax	304	297	316	361	359	524
Other Indirect Taxes	673	723	883	884	1023	1058
Of which GST on:						
Locally Manufactured Goods	219	217	222	251	270	216
Services	212	235	293	289	282	352
Imported Goods	170	170	265	259	324	313
Fees and Fines	116	166	143	111	133	272
Administration fees and charges	97	74	103	89	34	37
Rents and Royalties	96	144	256	132	256	204
Income - Public Services	9	9	9	10	10	11
Dividends and Interest	161	347	129	96	113	65
Reimbursements	33	40	40	45	31	45
Miscellaneous	111	253	66	10	8	7
Grants	5	73	60	29	15	321

Figures do not necessarily add up due to rounding
[1] *These series are subject to audit and might be revised accordingly.*
Source: Ministry of Finance

Chart 3.2: Major Revenue Flows in Current Receipts (1999 – 2008)



Source: Ministry of Finance

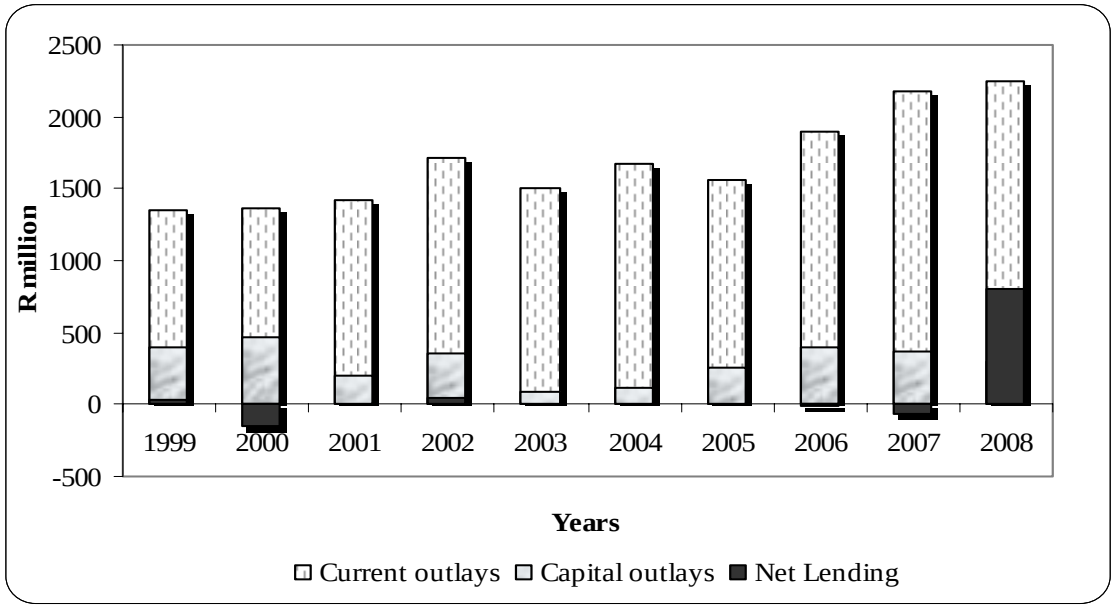
3.4 Expenditure

During the course of 2008 the government faced major challenges to maintain expenditure in check against the backdrop of strong domestic inflation and a harsh global economic environment. Thus, budgetary overruns were broad-based, affecting all expenditure heads, notably 'ministries/departments' which incurred outlays of R1,074 million as against R973 million budgeted. Current outlays to parastatals amounted to R79 million, exceeding the budgeted total by R11 million whilst interest payments reached R477 million compared with the target of R456 million.

As part of the IMF-supported reform programme, the government announced the elimination of various subsidies provided to the parastatals effective January 1, 2009. In anticipation of the new policy, parastatals such as Seychelles Public Transport Company (SPTC) raised the charges for bus fares whilst in the case of PUC, utility prices were increased during the year to reflect market prices, as government declined to continue with budgetary support.

Exchange rate movements directly affected many cost heads, including external debt service payments which rose in local currency terms. At the time of 2008 budget compilation, the gradual depreciation of the rupee in the lead-up to its floatation in November was not foreseen, thus contributing to some significant underestimation of most expense heads.

Chart 3.3: Government Expenditure by Main Heading (1999 – 2008)



Source: Ministry of Finance

Table 3.3
Government Budget; 2006 - 2008
Expenditure

	2006 Budget	2006 Actual [1]	2007 Budget	2007 Actual [1]	2008 Budget	2008 Actual [1]
			(R million)			
Total Budget Outlays	**1751**	**2302**	**2095**	**2485**	**2278**	**3469**
Total Current Outlays	**1514**	**1901**	**1856**	**2172**	**1968**	**2366**
Appropriation Items:	1357	1477	1479	1739	1513	1888
Ministries/Departments	835	952	933	1008	973	1074
Tourism & Transport	29	29	32	15	50	58
Education & Youth	181	197	185	190	196	210
Health	184	194	180	212	220	264
Defence	77	88	77	111	77	103
Internal Affairs	14	16	17	18	18	18
Pensions & Gratuities	33	31	35	27	37	33
Subventions	133	187	198	321	195	234
Regulatory bodies	66	57	71	75	118	144
Parastatals	62	124	121	239	68	79
Other bodies	6	6	6	7	8	12
Social Security Contributions	143	147	133	136	139	155
Pension Scheme Contributions	7	8	10	7	3	6
Land Acquisitions	0	11	5	3	5	7
Development Grants to Parastatals	0	0	34	43	55	33
Other appropriations	170	122	131	210	105	347
Charges	193	424	377	433	456	477
Public Debt Interest	179	406	360	422	435	449
Other charges	14	18	17	11	20	29
Capital Outlays	**237**	**404**	**239**	**374**	**310**	**305**
Development Grants to Parastatals	30	20	34	25	55	33
Land Acquisitions	7	11	5	7	5	7
Capital Projects	200	372	200	343	250	265
Net Lending	**0**	**-3**	**0**	**-62**	**0**	**798**
BTL Advances						
- Parastatals	0	0	0	(55)	0	(715)
- Other	0	(3)	0	(7)	0	(83)
Capital Subscriptions	0	0	0	0	0	0
Equity Participation	0	0	0	0	0	0

Source: Ministry of Finance

3.4.1 Current Outlays

Current expenditure totalled R2,366 million, R398 million or 20 per cent above target. Overspending was observed in the majority of components under the head "appropriation items" as well as under all components under the head "charges". More detailed analysis of the expenditure overrun in the

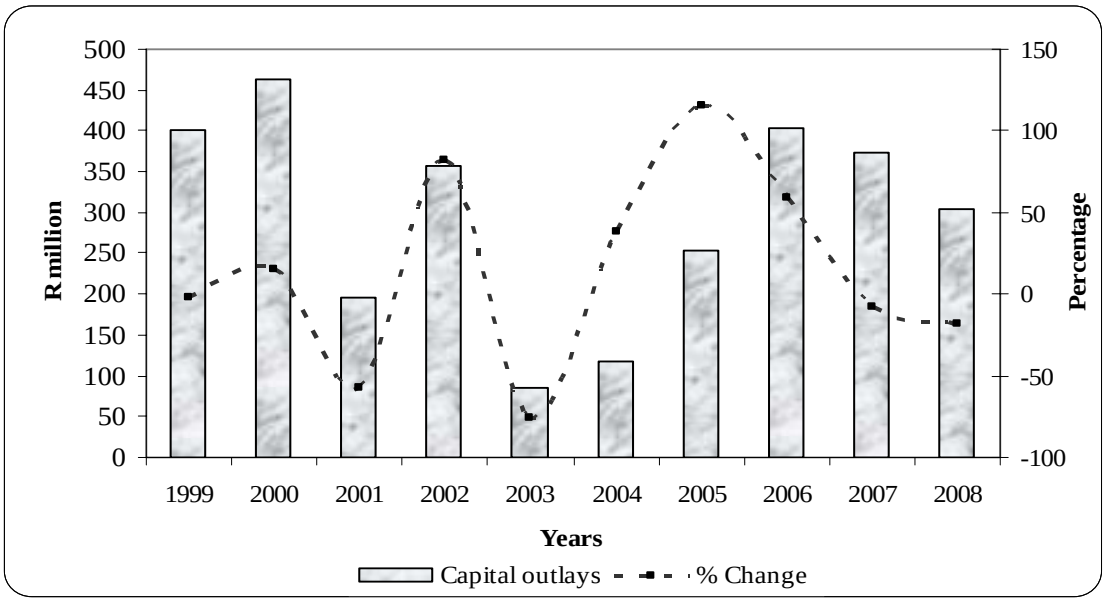
"appropriation items" points to spending slippages under heads such as "centralised payments", "special pension payments" and "current outlays on other bodies". The above mentioned components exceeded their respective budgetary allocations by 141 per cent to R223 million; 79 per cent to R2.6 million; and 50 per cent to R4.0 million. The expenditure overrun recorded for each component reflected the inflationary impact associated with the various economic changes occurring during the year. The rise in, "centralised payments" was partly accounted for by the impact of the Voluntary Departure Scheme announced in November.

3.4.2 Capital Outlays

Capital outlays for the year amounted to R305 million, below target by R5.0 million despite rising costs. Compared with 2007, such expenditure showed a decline of R69 million. However, under the heads "land acquisition" and "capital projects" overruns in their budgets were respectively recorded.

Nonetheless savings were recorded under other capital heads. The component termed "development grants" fell short of its target by R22 million, or 41 per cent. This was mostly as a result of a reduction of R23 million (51 percent) in the level of development grant earmarked for Public Utilities Corporation (PUC).

Chart 3.4: Government Capital Expenditure (1999 – 2008)



Source: Ministry of Finance

3.5 Public Sector Capital Project Expenditure

The year 2008 recorded capital expenditure summing up to R265 million which was not only below the proposed sum but also R78 million lower that in the preceding year. In the latter part of 2008,

government demonstrated much restraint in capital spending in order to remain within the target set in the MEFP.

3.5.1 Economic Sectors

A sum of R3.3 million was recorded under economic sectors as opposed to R4.4 million the preceding year (Table 3.4). Similar to the aforementioned year, this year saw the funding of only two economic sectors namely 'agriculture' and 'fisheries' where the latter received the largest share of the total.

3.5.2 Infrastructure and Utilities

The amount of funds allocated for infrastructure and utilities was significantly lower in comparison to the previous year. A figure of R13 million was recorded as opposed to R22 million in 2007. In contrast to the previous year, funds were only allocated for 'transport', 'water supply and sanitation' and 'land bank'. Additionally, no funds were provided for 'communications' and 'land reclamation' and this in turn ended the consecutive funding of such segments for several years. 'Transport' held the largest share of the total with a sum of R8.0 million.

3.5.3 Services

As has been the trend, services accounted for the bulk of financing on capital projects. Out of the total of R265 million, a sum of R249 million was allocated to services. This was nevertheless R68 million or 21 per cent lower than in 2007.

Analogous to the previous year, the sub-categories namely 'housing' and 'public sector management' required the most funds despite the fact that they were both lower than those of the abovementioned year. The sum of the two sub-categories equalled R186 million which made up approximately 75 per cent of the total financing on capital projects. In the previous year, the amount spent on the two sub-categories stood at R225 million, some R39 million more.

In regard to 'housing', most expenses were in respect of the continuation of the Ile Perseverance project which recorded a sum of R46 million, exceeding its budget level but remaining lower than last year's expenditure. Other housing projects absorbed a further R73 million in capital expenditure.

Several sub-categories recorded lower spending compared to the previous years such as 'education', 'social development', 'sports', information and media' and 'environment'. The one with the lowest amount in comparison to the previous year was 'social development' which recorded lower expenditure of R16 million. Additionally, some sub-categories received more funds that they did the year before notably 'health', 'culture' as well as 'internal affairs'.

Table 3.4
Public Sector Capital Expenditure; 2004-2008

	2004	2005	2006	2007	2008
Total	**114,083**	**223,002**	**372,121**	**343,499**	**265,329**
Economic Sectors	**5,450**	**1,869**	**4,054**	**4,382**	**3,256**
Agriculture	3,777	921	1,449	2,882	1,240
Fisheries	-	822	2,593	1,500	2,016
Tourism	1,664	127	12	1,500	-
Trade & Commerce	9	-	-	-	-
Infrastructure and Utilities	**26,121**	**20,411**	**43,420**	**22,185**	**12,870**
Transport	13,860	8,711	33,581	16,422	8,005
Electricity, Water supply & sanitation	275	4,572	313	315	209
Communications	122	1,035	3	10	-
Land Reclamation	6,880	-	-	-	-
Land Bank	4,984	6,093	9,523	5,439	4,656
Services	**82,512**	**200,722**	**324,647**	**316,932**	**249,203**
Education	17,424	22,824	1,662	1,518	956
Health	2,245	5,418	17,728	13,043	13,898
Housing	4,088	79,552	117,185	156,484	126,039
Social development	12,921	31,842	99,273	156,484	18,330
Culture	1,613	1,607	3,777	34,624	4,847
Youth & Sports	3,765	7,812	2,996	3,524	8,209
Information & media	-	30	34,623	11,388	7,673
Internal affairs	4,998	1,951	242	17,866	2,924
Public sector management	25,790	43,947	36,774	2,666	59,840
Environment	9,668	5,739	10,388	68,808	6,487

Source: Ministry of Finance

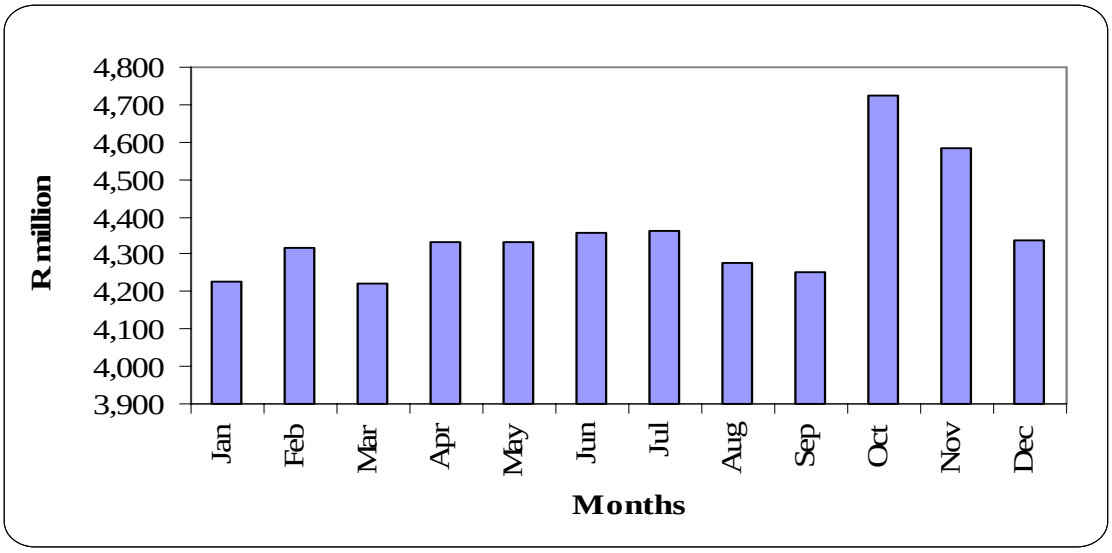
3.6 Net Lending

The principal underlying transactions under net lending is that any lending provided to public sector entities are for short-term purposes only and that they be repaid in full by the end of the year. The 2008 budget as approved by the national assembly made no allowance for net lending, however, by end-December 2008 the actual figure for net lending stood at R798 million. As mentioned earlier, the bulk of the sum lent out was a loan to SEPEC, which faced cash flow problems after the sharp rise in international prices. This loan is to be repaid in full during 2009.

3.7 Financing

This year's budget posted a deficit of R206 million, and this was covered by a combination of a net increase of R91 million in domestic debt, a drawdown of R92 million in cash balances, and R206 million of net external borrowings.

Chart 3.5: Stock of Domestic Debt (Jan – Dec 2008)



Source: Central Bank of Seychelles

As of December 2008, the total stock of domestic debt stood at R4.3 billion which is R38 million higher than that recorded in the year before.

SECTION FOUR

The External Sector

4. Overview

Developments in the international arena tested the resilience of the global economy to systemic shocks and the capability of governments to take compensating policy actions and avert an international depression of unparalleled depth. The sizeable financial support extended to financial markets stretched the fiscal capacity of major economies whilst the continuous softening in interest rates, meant monetary policy was at its most relaxed, leaving policymakers with no other option but to resort to "quantitative easing" to stimulate aggregate demand. As the year closed, economic prospects remained most uncertain and the threat of an L-shaped recession continued to persist.

Against the above backdrop, the underlying growth momentum of the Seychelles economy showed strong signs of a slowdown, triggered initially by soaring commodity and energy prices which began in 2007. The sharp rise in food and fuel prices significantly disrupted the domestic productive and consumption bases, whilst impacting adversely on the Balance of Payments (BOP). With an increasing share of the country's external earnings directed at basic import needs, the country's capacity to finance its external official debt obligations and clear commercial arrears was severely affected, notably towards the end of the year when both tourism earnings and FDI flows declined somewhat.

Provisional statistics showed an overall BOP deficit of R3,233 million for 2008. This represented a worsening of R3,500 million relative to the previous year when a surplus of R267 million was recorded. The BOP continued to be financed mostly from accumulated external arrears. With regards to the current account, a significant deterioration was observed under the "goods" and "income" sub-headings reflecting, to a certain extent, the effect of the depreciation of the Seychelles rupee.

In 2008, the soaring price of commodities and energy products tested the underlying financial viability of the Seychelles economy. The deterioration in the terms of trade arising from higher import prices were such that the country found it increasingly difficult to meet its commitments and ensure

sustainable economic development even on the presumption that the export and tourism sectors were to operate at maximum capacity. On a more encouraging note, SEPEC's decision to invest in its own fleet of tankers as part of its diversification strategy proved its worth during 2008. The increases in fuel prices on the international markets during the first half of the year meant high charter rates and thus a good performance for Seychelles' tankers. In March 2008, SEPEC took delivery of the fifth tanker, the *Seychelles Patriot*, which cost a total of US$37 million (R296 million). After almost six years of operational experience, the company felt that it had the capacity to take over the technical management of its fleet of tankers and in November 2008 took the necessary steps to create its own management company, Victoria Navigation, which is based in Cyprus. Previously, technical management of the tankers was undertaken by Columbia Ship Management Ltd, also based in Cyprus. In August 2008, SEPEC also bought 10 per cent shares (worth US$6 million) in Black Marlin Energy, the parent company of East African Exploration (EAX). Consequently, towards the end of last year, EAX signed a petroleum agreement with SEPEC for further oil exploration in Seychelles waters.

The strain on Seychelles' limited external reserves, exacerbated by deteriorating external conditions, plunged the country into a debt crisis towards the middle of the year. Seychelles has in the past borrowed extensively both domestically and internationally, to sustain its economic development and its relatively high standard of living. Moreover, in the recent past the bulk of these new borrowings have been commercial debt, often on stiff market repayment terms. This situation proved unsustainable and in July 2008, the country defaulted on one payment of a structured external promissory note commitment which, under the loan agreement, constituted a cause for accelerated repayment of the full principal. This had serious implications for Seychelles as the country's credit rating was immediately downgraded by Standard and Poor's from B^- to Selective Default (SD). This was followed by a further default on interest payable on a US$200 million international bond placed in 2006, which was due in October 2008.

These defaults inevitably starved Seychelles of the possibility of any further access to international financial support. In the second half of the year, the authorities embarked on a series of consultations with the IMF which resulted in agreement, in November, for a comprehensive reform programme. The programme was approved by the IMF's Executive Board on November 14 and is being supported by a 2-year US$ 26 million loan under the standby arrangement facility. The IMF's endorsement of Seychelles' programme also paved the way for formal negotiations with its creditors on rescheduling and/or part-cancellation of its external debt.

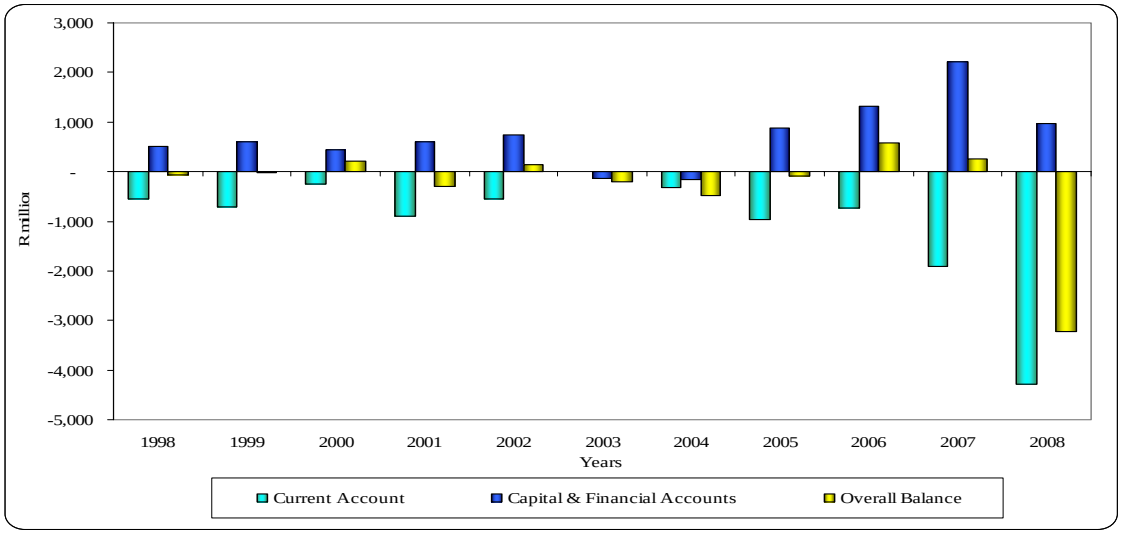
New exchange rate policy

One of the key elements of the IMF-supported reform programme was a fundamental change in the exchange rate regime. On November 3, 2008 the Seychelles rupee was floated and all foreign

exchange restrictions were removed. On the first day of business following the announcement of the changes, November 3, the value of the domestic currency dropped by almost 60 per cent against the dollar, 56 per cent to the euro and 58 per cent to the pound sterling. On that first trading day, the rupee stood on average at 14.2405 to the US dollar, 17.7976 to the euro and 22.8665 to the pound sterling. To enable the central bank to support the new exchange rate regime several measures were adopted, including legal amendments and new monetary policy instruments. The Financial Institutions Act, 2004 was amended and the Financial Institutions (Amendment) Act, 2008 came into effect. The amendment provides for the establishment of two classes of Bureau de Change with the aim of encouraging competition in the foreign exchange market. Operators with a Class B license are only allowed to purchase and sell foreign currencies while those holding Class A are also authorised to engage in wire transfer of foreign currencies.

Under the new exchange rate regime an inter-bank market for foreign exchange will become operational in early 2009. This would provide a platform for enhanced market development by enabling commercial banks to quote rates for spot transactions (i.e. buying and selling at the actual time) amongst themselves. A convention to be signed between commercial banks and the Central Bank will lay down the rules that would govern participation in the inter-bank market.

Chart 4.1: The overall balance, current account and capital & financial account of the BOP from 1998 – 2008



Sources: Central Bank of Seychelles, National Statistics Bureau

Another instrument available to the Central Bank is the Foreign Exchange Auction (FEA) facility which is aimed at assisting the banking sector in the price discovery process. The FEA is only available to commercial banks. The auction rate is defined as the weighted average rate of all the successful and awarded competitive bids. The Central Bank pre-announces the amount of foreign

currency it intends to auction. The first auction was held on November 20, 2008 for an amount of US$500,000. This temporary instrument will phase out once the inter-bank market is established.

Under the economic reform programme a number of targets were set with regard to the monetary and financial sectors, one of which is the accumulation of net international reserves, which was set at US$19 million at end of December 2008.

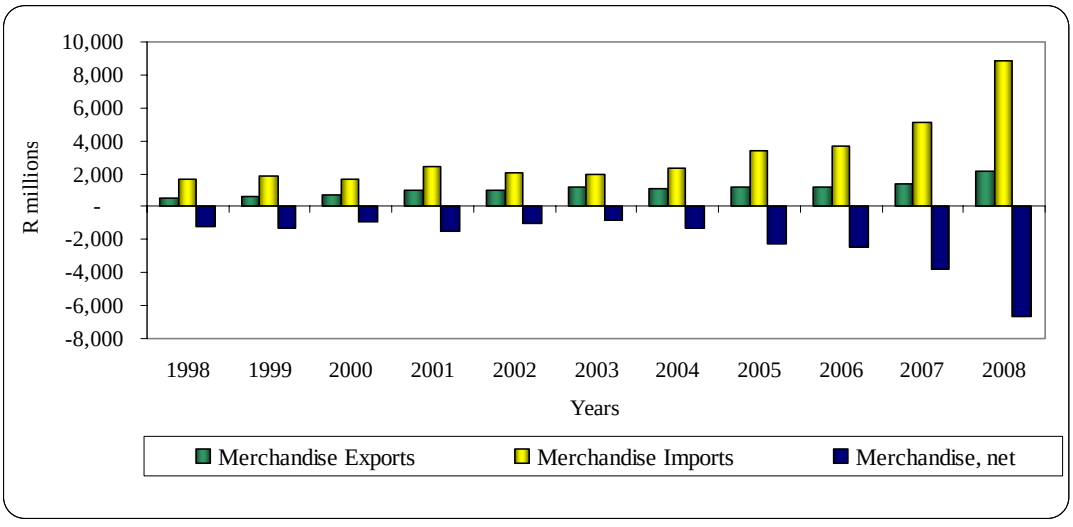
4.1 Current account

Seychelles' current account has traditionally been in deficit given that it relies heavily on imports. This is despite important exports in the form of tourism and canned tuna. In 2008, the country's current account showed a deficit of R4,292 million, worsening by R2,386 million. The deficit amounted to around 49 per cent of 2008 GDP.

4.1.1 Trade in goods

2008 was a difficult year all round. Soaring fuel and commodity prices on the international markets, the latter due largely to adverse economic and weather conditions affected most importing countries, both in terms of their import bills and regular supply of these commodities. Whereas oil exporting countries enjoyed a boom year supplying energy products at high prices, other countries faced major financial strain to fund such critical imports. Despite the high prices, certain food exporting countries found it necessary to impose export restrictions on commodities such as rice and wheat, in order to ensure that they had sufficient supply for their domestic markets.

Chart 4.2: Trade in Goods (1999 – 2008)



Sources: Central Bank of Seychelles, National Statistics Bureau

Table 4.1
Balance of Payments;[1/2] 2004-2008

	2004	2005	2006	2007	2008
	(R million)				
CURRENT ACCOUNT	**-330.0**	**-957.4**	**-739.8**	**-1906.5**	**-4292.1**
Goods,	**-853.5**	**-1646.2**	**-1602.2**	**-2827.7**	**-5191.9**
Credits (of which)	1656.0	1930.0	2319.2	2648.0	4653.4
Merchandise exports (f.o.b)	1097.3	1165.1	1215.5	1346.5	2187.7
Debits (of which)	2509.5	3576.2	3921.4	5475.7	9845.3
Merchandise imports (f.o.b)	2374.7	3434.6	3644.3	5091.8	8835.4
Services	**609.2**	**737.5**	**862.0**	**1182.2**	**1173.6**
Credits (of which)	1796.3	2028.2	2375.6	3225.9	4662.0
Tourism Earnings	938.3	1050.5	1251.7	1901.2	2437.8
Debits	1187.1	1290.7	1513.6	2043.7	3488.5
Income	**-185.3**	**-220.4**	**-242.2**	**-482.2**	**-1041.6**
Compensation of employees	-28.3	-31.8	-40.8	-67.2	-143.9
Credit	0.9	1.0	1.0	5.4	8.3
Debit	29.2	32.8	41.8	72.6	152.3
Investment income	-157.0	-188.6	-201.4	-415.0	-897.6
Credits	51.0	52.9	55.7	64.0	111.3
Debits	208.0	241.5	257.1	479.0	1008.9
Current transfers	**99.5**	**171.7**	**242.6**	**221.2**	**767.8**
General government	75.6	128.2	127.0	65.9	527.1
Credits	77.1	129.9	129.0	68.4	530.3
Fishing license fees	58.4	52.4	66.2	21.8	158.3
Other grants	10.2	77.5	62.8	46.6	372.5
Debits	1.5	1.7	2.0	2.5	3.7
Other sectors	23.9	43.6	115.6	155.3	240.6
Credits	38.4	65.5	169.4	227.9	346.2
Debits	14.4	22.0	53.8	72.5	105.5
CAPITAL AND FINANCIAL ACCOUNT	**-162.1**	**876.2**	**1312.1**	**2210.2**	**973.5**
CAPITAL ACCOUNT	**5.4**	**164.3**	**72.9**	**50.4**	**42.5**
FINANCIAL ACCOUNT	**-167.6**	**711.9**	**1239.2**	**2159.9**	**931.0**
Direct investment	**167.3**	**431.4**	**759.4**	**1520.5**	**3110.0**
Abroad	41.8	41.0	44.2	58.1	140.1
In Seychelles	209.1	472.3	803.6	1578.7	3250.1
Sale of Assets (Privatised enterprises)	0.0	1.9	5.0	0.0	0.0
Equity capital	176.0	410.5	705.1	1451.1	2989.8
Re-invested earnings	33.1	59.9	93.5	127.6	260.4
Portfolio investment	**5.9**	**5.6**	**1105.4**	**209.0**	**10.6**
Assets	-0.2	-0.2	-0.3	-0.2	-0.6
Liabilities	6.1	5.8	1105.7	209.3	11.1
Other investment	**-340.8**	**274.9**	**-625.6**	**430.3**	**-2189.6**
Assets	67.4	52.9	48.4	453.8	566.9
Liabilities	-273.4	327.8	-577.2	884.1	-1622.6
Net errors and omissions	**2.0**	**-2.9**	**10.7**	**-36.8**	**85.4**
OVERALL BALANCE	**-490.1**	**-84.1**	**583.0**	**267.0**	**-3233.2**
Financing of overall balance	**490.1**	**84.1**	**-583.0**	**-267.0**	**3233.2**
Reserve assets[3]	181.3	-120.9	-344.6	330.7	-884.6
Arrears	308.8	204.9	-238.4	-597.7	4117.8
Memorandum items:					
Current account (percentage of GDP)	*-6.9*	*-18.6*	*-12.9*	*-27.1*	*-48.1*
Trade Balance (f.o.b)(merchandise exports less	*-1277.4*	*-2269.5*	*-2428.8*	*-3745.2*	*-6647.7*
Stock of Reserves (Gross)(R million)	*187.8*	*308.7*	*653.3*	*322.5*	*1207.1*
Stock of Reserves (Gross) (Weeks of cif imports)	*3.5*	*5.5*	*11.0*	*3.9*	*8.4*
Exchange Rate (Rupee/US$; period average)	*5.5*	*5.5*		*6.7*	*9.4*

[1] *Contrary to the exchange record, this series is recorded on an accruals basis.*

[3] *(-) sign indicates increase in reserves.*
Source: Central Bank of Seychelles

The prevailing high international commodity prices combined with the float of the rupee in the fourth quarter of the year had a significant impact on the country's trade balance. From R2,828 million in 2007, the net value of the "goods account" deficit widened by R2,364 million (or 84 per cent) to stand at R5,192 million by the end of 2008. This was due mainly to the significant deterioration (78 per cent) of the "net merchandise trade balance" which showed a shortfall of R6,648 million in 2008 relative to R3,745 in 2007.

Although total exports increased by approximately R2,006 million from R2,648 million in 2007, the growth in the value of imported goods was R4,653 million higher than the previous year. This could be attributed principally to the high cost of imports and buoyant demand from most sectors of the economy for the most part of the year, particularly in the construction sector and tourism industry.

An increase was noted in the deficit recorded under "repairs on goods." This reflected extensive aircraft repair works undertaken during the year. Statistics showed a positive outcome under "goods procured in ports," indicating that goods sold to foreign ships and aircraft exceeded those purchased by Seychelles' vessels and aircraft overseas. The bulk of transactions in this category, amounting to R2,458 million, represented re-export of petroleum products and also earnings from the tankers' operations.

4.1.2 Merchandise exports

The country's narrow economic base has over the years resulted in limited production of export-oriented goods. As has been the case for the past several years, Seychelles' main exports came mostly from the fisheries sector. The total value (f.o.b.) of exports stood at R4,653 million, representing a growth of 76 per cent compared to the previous year. Once again, canned tuna represented the bulk of exports, bringing in approximately R2,039 million and accounted for 93 per cent of total export earnings.

In terms of "fish and fish products," canned tuna represented 98 per cent of the total 30,000 metric tonnes exported during the year under review. However, this represented a volume reduction of approximately 10 per cent. Other main exported items were fresh and frozen fish, and frozen prawns. Export revenue from "fish and fish products" amounted to R2.1 billion or an increase of 39 per cent relative to 2007. This was due mainly to an increase in the rupee unit price of the exported goods, as the catches were lower than during previous peak periods. Factors, such as the increase in operational costs due to the high fuel prices, possible stock stress and persisting adverse weather condition could have been the main reasons for the lower catches.

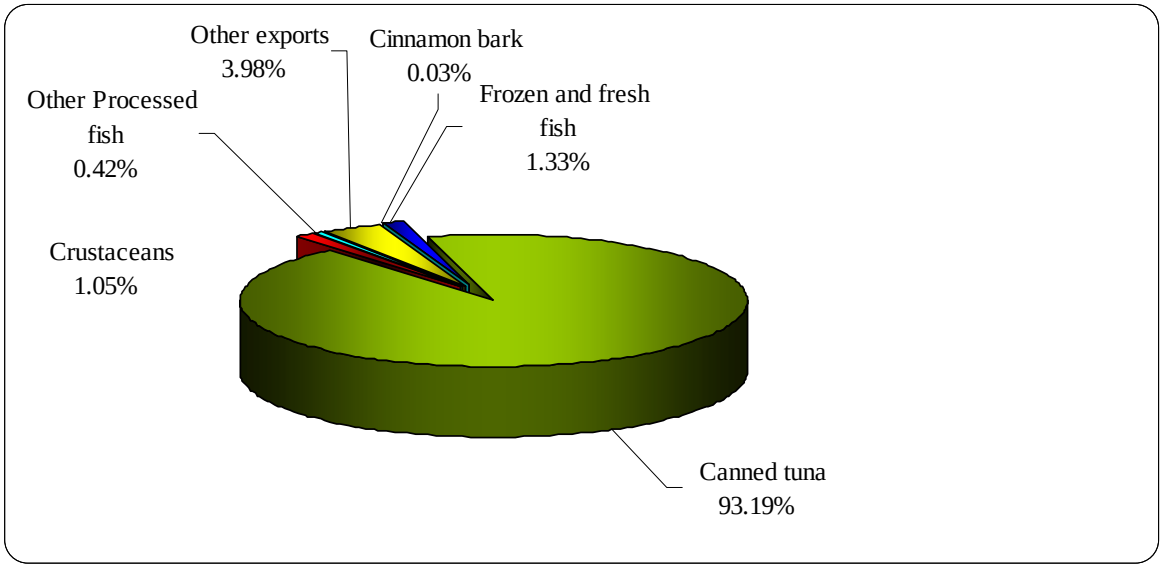
Export receipts from other traditional agricultural products such as cinnamon bark, were minimal.

Table 4.2
Domestic Exports; 2004-2008

	2004	2005	2006	2007	2008
	(R million)				
Total	**1097.3**	**1165.1**	**1215.5**	**1346.9**	**2187.7**
Cinnamon bark	0.5	0.5	0.8	0.5	0.7
Frozen and fresh fish	13.1	16.5	14.5	12.9	29.0
Canned tuna	923.2	969.6	1031.4	1231.2	2038.7
Other processed fish	8.3	10.2	3.1	6.5	9.3
Crustaceans	42.7	31.8	46.1	15.4	23.0
Other exports	109.4	136.4	119.7	80.4	87.1

Source: Central Bank of Seychelles

Chart 4.3: Exports 2008



Sources: Central Bank of Seychelles, National Statistics Bureau

4.1.3 Merchandise imports

The high fuel bills and commodity prices internationally, along with the depreciation of the rupee in November 2008, accounted for the significant increase in the rupee value of imports. Total debit for the year amounted to R9,845 million, an expansion of R4,370 million compared to 2007. The fuel bill for domestic consumption in 2008 stood at US$159 million, whilst the total cost of oil imports (including tanker operations) amounted to US$300 million.

The value (c.i.f.) of imported "mineral fuels" grew by approximately 97 per cent relative to the previous year and represented 31 per cent of total 2008 imports. The sub-category comprising of

"food, live animals and vegetable oil" grew by 84 per cent during that same period, amounting to 25 per cent of total imports.

Table 4.3
Imports (c.i.f.) – by HS[1] Sections; 2004-2008

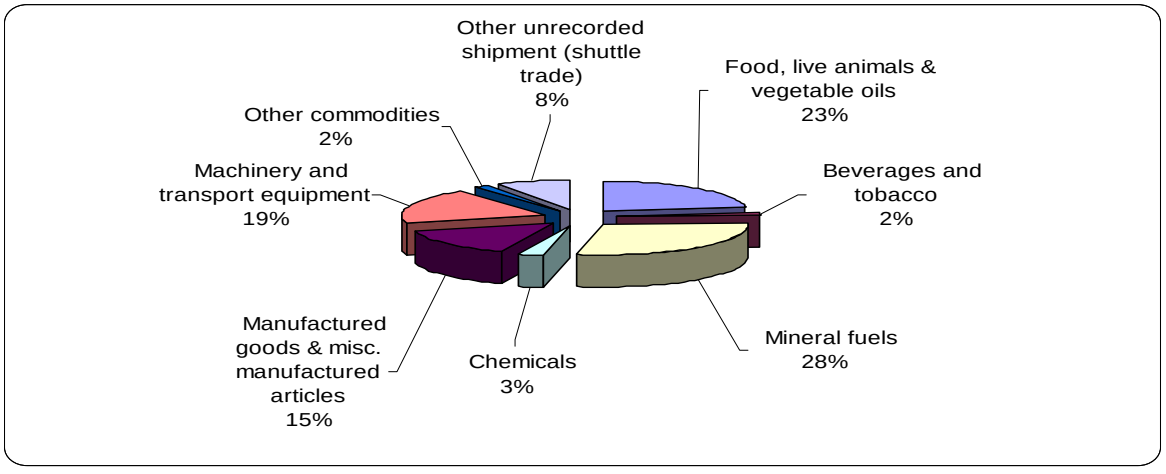
Description	2004	2005	2006	2007	2008
	(R million)				
Total imports	**2769.3**	**3846.0**	**4216.2**	**5779.6**	**10275.7**
Food. live animals & vegetable oil	740.3	808.8	1004.6	1227.1	2618.3
Beverages & tobacco	35.4	45.9	60.4	76.5	175.5
Mineral fuels	718.6	872.4	1113.8	1439.0	3182.8
Chemicals	198.5	238.4	191.8	253.2	352.5
Manufactured goods & Misc. manufactured articles	560.6	661.0	944.8	1166.2	1608.4
Machinery & transport equipment*	440.0	1045.2	814.5	1509.1	2163.6
Other commodities	38.4	174.4	86.3	108.5	174.6

[1] *Harmonised System*

Source: National Statistics Bureau & Central Bank of Seychelles.

Imports under "manufactured goods and miscellaneous manufactured articles" and "machineries and transport equipment" reflected the increase in the f.o.b. cost of these items on the international market amplified significantly by the depreciation of the rupee after the float in the fourth quarter.

Chart 4.4: Imports (f.o.b.) 2008



Sources: Central Bank of Seychelles, National Statistics Bureau

4.1.4 Goods procured in ports by carriers

Provisional statistics indicated that "goods procured in ports by carriers" showed a surplus of R1,632 million, an increase of R604 million relative to 2007. This was mainly attributed to the higher fuel prices as re-export of petroleum products accounted for R2,363 million or 96 per cent of gross

earnings in this category. The remaining was attributed to food and beverage sold to foreign ships and aircraft. On the debit side, most of the transactions related to fuel purchased by Air Seychelles abroad and petroleum products bought by the tanker, *Seychelles Pride*, on its charter operations. Food and beverages purchased by domestic aircraft and ships in overseas ports stood at around 4.7 per cent of gross debits.

Table 4.4
Goods procured in Ports; 2004-2008

	2004	2005	2006	2007	2008
	(R million)				
Goods procured in ports, net	**446.6**	**650.1**	**869.1**	**1028.3**	**1632.0**
Credits	**554.7**	**760.5**	**1098.8**	**1294.6**	**2457.9**
Petrol	531.0	736.2	1070.9	1265.2	2362.5
Food and beverages	8.5	9.5	11.1	12.4	43.1
Others	15.2	14.8	16.7	17.1	52.3
Debits	**108.1**	**110.5**	**229.7**	**266.4**	**825.9**
Petrol	94.4	96.7	217.7	252.8	786.7
Food and beverages	13.7	13.8	12.0	13.6	39.2

Source: National Statistics Bureau, Central Bank of Seychelles.

4.1.5 Repairs on goods

The deficit recorded under "repairs on goods" widened further to R176 million against R93 million in 2007. This reflected the much higher expenses incurred by domestic carriers and ships in respect of repairs carried out relative to the country's earnings from such services.

4.2 Services

The Seychelles economy relies heavily on income derived from the services industry. Tourism, which is the main economic pillar, contributed 26 per cent to GDP in 2008. Given that Seychelles is a net exporter of services, this component of the BOP is always positive. However, this sector is also vulnerable to exogenous factors that may directly affect the demand for tourism products. The economic and financial turmoil experienced by the most part of the world in 2008 has already began to impact on the domestic economy through the tourism industry. Moreover, with the crisis in international credit, inward flows of FDI are expected to be adversely affected during the course of 2009, unless the global financial situation improves.

Over the first three quarters of the year, activities in the tourism sector maintained more or less the same tempo as in previous years. Eventually, with the main tourism markets entering recession, visitor arrivals declined compared to 2007 as lower purchasing power forced customers to cut down on "unnecessary" expenses such as travel. For Seychelles this decline in arrivals impacts in a significant way on the industry's earnings.

In 2008, the service balance showed a surplus of R1,174 million. In comparison to 2007, this represented a fall of R8.7 million or 1 per cent given that receipts amounted to R4,662 million and payments grew at a faster pace to stand at R3,489 million. Tourism earnings accounted for 53 per cent of gross service inflows.

In terms of "transportation," the balance showed a surplus of R219 million. This included the performance of the three main components under that sub-heading, namely "passenger services," "freight" and "other transportation services."

The "passenger" account showed that receipts from tickets sold to foreigners travelling on the national carrier exceeded payments made by residents to foreign airlines. The net export of passenger services stood at R904 million, an increase of R516 million relative to the previous year.

On the other hand, a deficit of R787 million was recorded in the "freight" balance. The net balance deteriorated by approximately 70 per cent relative to 2007, when it registered a shortfall of R464 million. Due to the significant rise in the overall cost of c.i.f. imports partly on account of higher fuel prices, the debit side amounted to R1,106 million.

Similarly, a drop of 16 per cent was recorded under the net balance of "other transportation services," following a marked increase on the debit side which more than doubled the amount paid in 2007. This was partly attributed to the ground handling fees of domestic aircraft whilst abroad which rose from R60 million in 2007 to R155 million in 2008.

Another component of the services category, insurance, followed the import pattern. As this is closely related to the value of imports into the country, it is usually a negative balance. In 2008, the deficit in the net payment of insurance services widened further from R151 million in 2007 to R304 million. This represented a worsening of R153 million or almost 101 per cent. Import-related insurance payments stood at R253 million.

Table 4.5
Services;[1] 2004-2008

	2004	2005	2006	2007	2008
	(R million)				
SERVICES, NET	**661.5**	**737.5**	**862.0**	**1182.2**	**1173.6**
Transportation	**133.3**	**140.9**	**182.3**	**44.6**	**218.6**
Passenger	360.1	313.8	412.4	388.3	904.4
Credits	463.4	425.0	525.0	591.0	1182.5
Ticket sales to non-residents by Air Seychelles	463.4	425.0	524.5	591.0	1136.8
Others	0.0	0.0	0.0	0.0	13.8
Debits (tickets to foreign airlines by residents)	103.3	111.2	112.6	202.7	278.1
Freight	-305.3	-266.6	-358.2	-464.3	-787.8
Credits	36.2	138.4	167.6	189.3	317.9
Debits	341.5	405.0	525.8	653.6	1105.7
Other transportation services	78.5	93.8	129.7	120.7	101.9
Credits (of which)	150.6	170.7	195.8	240.2	355.7
Marine and port charges	34.6	39.3	40.7	42.4	50.6
Income from stevedoring	58.8	65.5	69.2	82.4	82.6
Agency service income	19.5	23.0	28.6	32.6	28.2
Airport (ground) handling fees	15.2	16.1	24.5	17.2	40.1
Aircraft landing fees	12.2	15.0	20.2	21.1	11.8
Others	10.4	11.8	12.7	44.5	142.4
Debits	72.1	76.9	66.1	119.5	253.8
Travel	**760.0**	**843.8**	**1059.0**	**1638.9**	**2093.9**
Credits (of which)	944.4	1056.5	1257.4	1907.8	2443.9
Tourism earnings[1]	938.3	1050.5	1251.7	1901.2	2437.8
Others	6.0	6.0	5.6	6.6	6.0
Debits (of which)	184.4	212.7	198.3	268.9	350.0
Foreign travel expenditure	109.0	120.9	109.7	167.8	192.6
Training of residents abroad	38.4	42.9	43.1	65.1	105.7
Health Services	22.3	32.7	33.8	36.0	51.7
Insurance, net	**-90.2**	**-91.6**	**-135.1**	**-151.3**	**-303.5**
Royalty debits	**-3.0**	**-3.0**	**-3.0**	**-3.6**	**-4.6**
Financial and Business Services	**-181.2**	**-183.2**	**-190.9**	**-215.9**	**-433.1**
Credits (of which)	93.8	97.8	106.5	127.8	172.1
Telecommunications	66.8	69.4	70.9	85.1	64.4
Debit	274.9	281.0	297.4	343.7	605.2
Construction Services	**-31.4**	**-70.6**	**-129.7**	**-264.3**	**-558.1**
Government Services	**73.9**	**101.1**	**71.3**	**133.8**	**160.4**
Credits (of which)	100.1	120.0	120.1	158.0	207.8
Foreign embassies in Seychelles	2.7	2.7	2.8	3.4	3.0
Licenses and other fees	96.5	116.4	116.4	153.7	204.4
Debits	26.2	18.9	48.8	24.2	47.4
Expenses by Seychelles embassies	3.3	3.4	2.6	3.2	8.4
Tourism promotion	12.7	11.0	6.0	7.6	11.8
Government others	10.2	4.6	40.2	13.4	27.2

[1] Tourism earnings include tourism income as per banks' records and an estimate of earnings not captured by the banking system.
Source: Central Bank of Seychelles

The "financial and business services" sub-heading is invariably in deficit, indicating that the country relies on imported services in this category. The shortfall deteriorated by an additional R217 million compared to the previous year, to stand at R433 million. With regard to other components of the services balance, for example, payments for the services of non-resident labour in the construction industry, these stood at approximately R558 million whilst net receipts for services offered by the government amounted to R160 million. The net payment recorded under "royalties" increased from R3.6 million in 2007 to R4.6 million during the year under review.

4.2.1 Income

The income account remained in deficit in 2008, due to deterioration in the two main components, namely "compensation of employees" and "investment income." A net outflow of R144 million was recorded under the first item, relative to R67 million in 2007. This represented an increase of R77 million in the amount paid for the services of foreign labour, reflecting the growing number of expatriates employed in various sectors of the economy and also the depreciation in the value of the domestic currency towards the end of the year.

"Investment income" showed a net outflow of R898 million in 2008 compared to R415 million the previous year. This was driven by the significant increase of R530 million in debits, whilst credits grew by R47 million. The bulk represented interest payable given the considerable size of the country's public debt portfolio.

4.2.2 Transfers

Seychelles received a substantial amount in current transfers during the year under review. The surplus of R767 million more than tripled that recorded in 2007 when it stood at R221 million. This outcome was mainly due to receipts under "general government" which equalled approximately R527 million. Credits under that sub-heading were mostly from overseas grants (R372 million) and fishing licence fees (R158 million).

"Other sectors" in that category also recorded net positive inflows of R241 million. The inward transfers (R346 million) reflected an estimate of fund transfers used to finance imports during most of 2008 (before the float of the rupee), on the basis of the discrepancy between payment allocation for imports by commercial banks and import statistics. On the debit side, the main item represented workers' remittances paid to foreigners working in Seychelles.

4.3 Capital and financial account

The capital and financial account captures financial and investment flows between the domestic economy and the rest of the world. In 2008, the balance under this heading stood at R973 million,

representing a fall of R1237 million or 56 per cent compared to 2007. This was attributed mainly to the accumulation of arrears in view of the default on repayment of commercial debt.

4.3.1 Capital account

In 2008, a total of R29 million was received as capital donations during the year in the form of a grant under the Renaissance Fund from the Republic of South Africa. In addition to that, other substantial bilateral grants were received from the People's Republic of China and the United Arab Emirates. Capital projects financed in the year amounted to R14 million, or R15 million less than in 2007. Overall, the capital account registered a surplus of R43 million, although this was R7.9 million (16 per cent) lower than the previous year.

4.3.2 Financial account

Provisional BOP statistics showed that similar to previous years, the financial account maintained its trend ending with a surplus of R980 million. However, it stood at R931 million (57 per cent) less than in 2007. Foreign direct investment into Seychelles was the main factor for this outcome, given that it more than doubled compared to the amount recorded in the previous year.

The component "direct investment" registered a net inward flow of R3,110 million. Residents invested approximately R140 million abroad in terms of equity capital and re-invested earnings, whilst investment into the domestic economy by non-residents amounted to R3,250 million.

FDI into Seychelles were mostly from investment in equity capital, which stood at R2,990 million, whilst re-invested earnings accounted for R260 million. In comparison to the previous year, equity capital grew by R1,539 million or 106 per cent and re-invested earnings by R133 million or 104 per cent.

Despite Seychelles defaulting on the repayment of the international US dollar bonds and the euro-denominated promissory notes, these still appear in the BOP as debt repayments which are recorded on an accrual basis; in this case non-payment was recorded as accumulation of arrears. The balance under "other investment" showed a deficit of R2,189 million compared to a surplus of R430 million in 2007. "Other investment" figures also include investment made by SEPEC in a small tanker, *Seychelles Paradise* worth 11 million euro, to serve the inter-island (Mahe – Praslin) route. In this connection, facilities for delivery of fuel are being installed on the Praslin jetty as the tanker is expected to be in operation by the end of October 2009.

4.4 External reserves

A significant improvement was recorded in the country's external reserves position at the end of December 2008. Compared to the previous year when it stood at R323 million (US$40 million), gross official reserves amounted to R1,207 million (US$73 million) at the end of 2008. This represented an increase of R885 million. In terms of imports, the gross official reserves were equivalent to 8.4 weeks of 2008 c.i.f. imports value. In 2007, this stood at 3.9 weeks.

Although the rupee value of the stock of reserves reflected in part, the devaluation of the domestic currency during the last quarter of the year, it should be noted that a significant amount was also accumulated in the context of the set target for Net International Reserves (NIR). The Memorandum of Economic and Financial Policies (MEFP), which was sent to the IMF in November 2008, set a net external reserves floor of US$19 million at the end of December 2008. In the event, the Central Bank accumulated almost US$42 million by year-end, due to a combination of receipts in terms of grants from bilateral partners, purchase from the domestic banking system and proceeds from the sale of government assets.

Table 4.6
External Reserves;[1] 2004-2008

	2004	2005	2006	2007	2008
	(R million)				
Gross official reserves	190.2	309.3	654.4	325.9	1215.1
Central Bank	187.8	308.7	653.3	322.5	1207.1
Central Bank's short-term Borrowings	494.0	394.4	0.0	0.0	157.4
Net official reserves	-303.8	-85.1	654.4	325.9	1057.8

[1] *End-of period data.*
Source: Central Bank of Seychelles

4.5 Exchange rates

For the most part of the year, the rupee continued to trade at the targeted R8 to the US dollar. The local currency reached an average of 8.6067 to the US dollar during the month of October from 7.9995 in January.

The change in exchange rate policy saw the rupee plunge on average to 14.2405 against the US dollar, 17.7976 to the euro and 22.8665 to the pound sterling on November 3, the first day of trading in the new regime. On average, the rupee stood at 16.1760 to the dollar, 20.3803 to the euro and 24.7365 to the pound sterling in November 2008.

By the end of December, the value of the local currency had dropped by approximately 87 per cent to the US dollar, 101 per cent to the euro and 64 per cent to the pound sterling relative to the end of October.

During the year, the average value of the rupee dropped significantly against all three major trading currencies. The rupee moved from 7.9995 to 16.7469 against the US dollar between January and December respectively, representing a depreciation of 109 per cent during that period. Relative to the euro, the rupee dropped 88 per cent on average from 11.7732 to 22.1742. Similarly, the domestic currency fell by 56 per cent against the pound sterling, from 15.7470 to 24.6009.

Table 4.7
Exchange Rates;[1] 2004-2008

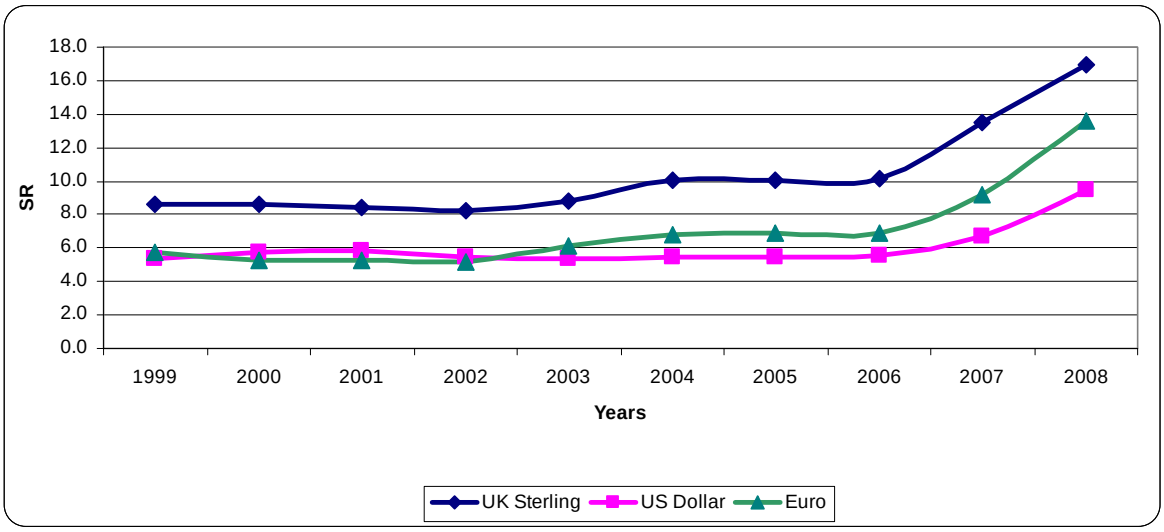
	2004	2005	2006	2007	2008
	(Seychelles Rupees per currency unit)				
Euro	6.8378	6.8483	6.9300	9.2363	13.5934
US dollar	5.5000	5.5000	5.5190	6.7102	9.4357
Pound sterling	10.0747	10.0118	10.1692	13.4515	16.9645
Japanese yen	0.0509	0.0501	0.0475	0.0572	0.0925
South African rand	0.8532	0.8661	0.8211	0.9552	1.1232
Singapore dollar	3.2539	3.3047	3.4748	4.4648	6.5990

[1] *Period averages.*
Source: Central Bank of Seychelles

On a yearly basis, the rupee averaged out at 9.4357 against the US dollar in 2008 compared to 6.7102 in 2007.

With the persisting shortages of hard currencies in the banking system during the most part of 2008, the parallel market remained active, offering foreign currencies at a significant premium above the official rates. The situation seemingly improved after the float of the rupee, resulting in a dwindling of parallel market operations. The competitiveness of the rates on offer within the official system - coupled with a deep contraction in demand by the private sector and in particular by the government - ensured that demand and supply were met as per market principles.

Chart 4.5: Exchange rate movements of the three main currencies (1998 – 2008)



Source: Central Bank of Seychelles

4.6 Offshore developments

Despite the uncertainty on the international financial market, the offshore sector continued to perform well during 2008. By the end of the year, the sector had not yet felt any adverse impact, although plans to set up a local stock exchange have been postponed to 2009, awaiting stabilisation in the global financial markets.

Approximately 13,751 new international business companies (IBC) were registered, bringing the total number of IBCs to 57,205. Businesses incorporated as Companies Special Licenses (CSL) also increased to stand at 153. However, there was a slight drop in operators in the international trade zone, with the number decreasing from 46 in 2007 to 41 by the end of 2008.

Based on earnings generated from services provided to the offshore sector, SIBA paid US$1.5 million (R25 million) to the government in terms of dividends for the year 2008.

SECTION FIVE

The Real Sector: Production, Labour and Prices

5. Overview – Domestic Income and Production

Although 2008 started on an upbeat note underpinned by strong investor confidence and buoyant consumer demand, economic activity declined significantly in the latter half of the year, resulting in a year of virtual slowdown. Provisional estimates of real Gross Domestic Product (GDP) at constant market prices showed that real output contracted by 0.9 per cent in 2008 compared to a growth of 9.7 per cent in 2007. In value terms, real GDP totalled R5,103.1 million compared to R5,121.1 million in the year 2007, while nominal GDP increased from R6,954.5 million to R8,755.7 million due to inflationary pressures experienced during the year.

During the past years, the government has promoted the Seychelles as a viable environment for investment. This has contributed to strong FDI activity, especially in the tourism sector, and the re-positioning of Seychelles as a world-class tourism destination. Unprecedented economic upheavals in the global economy, evidenced by the volatility in the equity, foreign exchange and energy markets, contrived to dampen investor interest somewhat but record investment activity was nonetheless observed locally. A total of 270 projects were approved by Seychelles Investment Bureau (SIB) of which a third were Foreign Direct Investments (FDI). FDI which amounted to 36 per cent of GDP rose from R1,521 million in 2007 to stand at R3,110 million by the end of the year. This figure captures the impact of ongoing tourism investments such as the Ephelia Resort & Spa, the Four Seasons Hotel, Raffles (Kingdom Hotels), the Shangri-La Resort and Eden island residences, as well as other smaller projects. Investment activity by local entrepreneurs remained high during the year but a downturn is expected in 2009 due to increases in interest rates following the central bank's policy of interest rate liberalization in November 2008.

Unlike in 2007, some easing in local supplies of critical building materials was evident for most of the year. This was predominantly due to the successful expansion of quarrying capacity by the existing operators and improved logistical planning by the project promoters. However, material procurements

internationally remained a challenge for most of the year with little softening in the high prices of steel, copper, cement and timber until towards the last quarter. Sporadic shortages of cement were reported as supplies hardened through traditional supply sources, resulting in many instances of construction disruptions.

As the effects of the international financial crisis was increasingly felt, a general slowdown in construction activity was observed, which also affected externally-funded projects. In certain cases, projects were put on hold whilst others saw their implementation timeframe expanded as promoters re-assessed their global investment strategy and financing options. In the case of local investors, the year ended on an uncertain note with many projects seriously affected by the high borrowing costs and poor economic visibility ahead.

The tourism sector, the country's principal source of the economic growth, lost much of its underlying momentum due to the recession in the euro zone which is Seychelles' main market. Against the target of another record year for arrivals, a 1.4 percent decline was recorded, with the slowdown crystallising in the latter half of 2008. The direct contribution of tourism to national output is estimated at 26 per cent, slightly above the previous year.

Through the IMF-supported reform programme the Seychelles authorities aim to transform the economic model of the country from one based on significant government involvement to a more liberal economic structure. This implies a gradual reduction in government's economic activities, thus releasing resources and creating more opportunities for the private sector. In 2008, the government privatised a number of its commercial operations, including most remaining units of the ex-Seychelles Marketing Board (SMB) and pledged to pursue this approach with more vigour into 2009 with the likely privatisation of other entities.

Within the same liberalisation framework, the government undertook to improve efficiency in the provision of various services. Furthermore, as a reflection of the new philosophy, private sector was accorded a leading role in the country's tourism marketing function within the restructuring process of the Seychelles Tourism Board (STB). The STB was trimmed down from 16 members to 7 members, with the majority of the members drawn from the private sector. This landmark event was well received by all industry stakeholders, placing heavy responsibility on the new board to produce tangible results at a time of increasing global economic uncertainties.

Table 5.1
Gross Domestic Product by Kind of Economic Activity; 2004 – 2008
at constant market prices

	2004	2005	2006	2007[1]	2008[2]
	(R million)				
GDP at 2006 constant market prices	**4831.2**	**5149.1.**	**5628.3**	**6171.8**	**6117.5**
Change		6.6%	9.3%	9.7%	-0.9%
Agriculture	92.8	95.2	95.9	94.1	92.3
Fishing	70.1	76.9	68.0	70.7	80.6
Manufacture of food	169.1	198.1	191.6	172.5	144.5
Manufacture of beverages and tobacco	126.1	132.0	153.1	161.4	126.6
Manufacture of concrete, rock products, glass etc	34.5	39.7	51.1	51.1	58.6
Manufacturing, other	113.7	124.7	114.9	142.2	134.1
Electricity, gas, steam and air conditioning supply	52.1	53.2	58.0	62.5	62.3
Water supply; sewerage, waste management and remediation activities	42.7	45.4	45.5	47.7	48.4
Construction	198.3	263.1	304.6	340.7	390.3
Wholesale and retail trade; repair of motor vehicles and motorcycles	332.9	328.6	356.5	412.0	350.5
Transportation and storage	476.1	516.3	565.3	593.8	672.6
Accommodation and food service activities	454.1	478.9	558.7	673.0	626.6
Information and communication	229.1	239.1	246.6	266.7	274.8
Financial and insurance activities	275.1	283.0	326.3	375.3	335.4
Real estate activities	70.3	80.7	103.7	142.3	172.3
Owner Occupied dwellings	424.1	453.4	474.5	496.5	517.4
Professional, scientific and technical activities	81.7	78.9	104.0	119.7	109.0
Administrative and support service activities	109.2	115.3	132.0	153.2	155.3
Public administration and defence; compulsory social security	453.2	451.6	518.4	529.2	537.3
Education	193.8	205.7	212.0	214.7	207.5
Human health and social work activities	140.1	144.6	149.3	153.4	147.3
Arts, entertainment and recreation	40.5	43.7	45.1	45.9	38.0
Other service activities	28.4	32.0	34.1	35.1	29.5
Allocation of FISIM to nominal sector	-170.5	-175.4	-202.2	-232.6	-207.9
Value Added at basic prices	4037.0	4304.6	4706.9	5121.1	5103.1
Other Taxes on Production	121.5	129.4	141.3	154.8	153.4
Taxes on Production and Imports	423.9	451.7	493.8	541.5	536.7
Goods and services Tax	324.3	344.3	374.9	451.5	420.5
Less subsidies	-76.0	-81.0	-88.5	-97.3	-96.2

[1] *Provisional Estimates*
[2] *Indicative Estimates*

Source: National Statistics Bureau

The high level of investment activity was once again reflected in quite buoyant merchandise imports during the year under review. In 2008, imports of R8,790 million (f.o.b.) were recorded compared to R5,092 million in 2007. Not all of this increase can however be attributed to FDI-related imports. The devaluation of the rupee during the last quarter of the year and the high prices of commodities on

the international market, particularly price of fuel and several food products contributed to this turnout.

Overall, 2008 was a challenging year for the retail trade - especially towards the end - after the value of the rupee dropped by up to 87 per cent against the US dollar, causing a major drop in households' demand. Nevertheless, the removal of all foreign exchange regulations in November, including the removal of the foreign exchange surrender requirement, was a bonus for retail traders since the combination of these events significantly improved their access to foreign exchange from the banking system.

As regards the fisheries sector, artisanal fishing activity was generally strong in 2008, even though it dropped somewhat toward the end of the year. . Late in the year, government reviewed its fuel subsidy scheme to fishermen that had been introduced in 1995. Government was of the view that this facility was being abused and represented an unlevel playing field relative to other activities.

In the case of industrial fisheries, during 2008 the government sought to enforce its rightful share of benefits from the sector. Hence, preparations for the next round of fisheries licence negotiations with the EU commenced with a view to maximising benefits to the country. Of the many issues that need to be addressed are new conditions for issuance of licences, notably the proposal that 'access for development' licences be granted preferably to companies that have invested in the country first, implying that fishing licences be considered as secondary access to the country's natural resources. Declaration of catches by licensed fishing vessels is also another contentious issue to be addressed.

Elsewhere in the economy, retail banking businesses appeared to have had a highly profitable year, benefiting largely from the floating of the rupee. It is estimated that around 25–30 per cent of 2008 profit is attributable to foreign exchange gains. Nevertheless, the banks remained exposed to a high degree of loan default risk although stress tests indicated that they had sufficient resilience to withstand considerable interest rate shocks to their balance sheets. Operationally however, the banking sector suffered a major liquidity squeeze with the tightening of monetary policy in support of the exchange rate, notably through the active implementation of reserve money targeting. Moreover, as a result of high interest rate offered on the government bills/bonds, banks faced a rundown on deposits as clients shifted their funds directly into these securities for higher returns. At the end of December 2008, in an attempt to promote competition in the foreign exchange market, the Central Bank licensed six bureaux de change of which four were class B (licensed to only sell and buy foreign exchange only in the form of notes, coins and travellers' cheques) and two class A (in addition to selling and buying foreign exchange, these engage in money transmission services).

Table 5.2
Gross Domestic Product by Kind of Economic Activity; 2004 – 2008
at current market prices

	2004	2005	2006	2007[1]	2008[2]
	(R million)				
GDP at current market prices	**4695.7**	**5043.2**	**5628.3**	**6877.0**	**8755.7**
Change		7.4%	11.6%	22.2%	26.3%
Agriculture	95.5	92.3	95.9	106.6	130.5
Fishing	61.8	60.4	68.0	66.4	78.1
Manufacture of food	132.8	159.4	191.6	270.6	308.6
Manufacture of beverages and tobacco	83.8	109.9	153.1	170.2	171.1
Manufacture of concrete, rock products, glass etc	27.3	41.4	51.1	51.2	72.9
Manufacturing, other	112.0	133.2	114.9	165.6	197.8
Electricity, gas, steam and air conditioning supply	67.1	34.0	58.0	36.3	28.5
Water supply; sewerage, waste management and remediation activities	32.4	41.8	45.5	53.8	64.8
Construction	229.9	311.0	304.6	360.6	499.3
Wholesale and retail trade; repair of motor vehicles and motorcycles	279.3	310.5	356.5	485.4	655.5
Transportation and storage	336.0	467.1	565.3	674.9	773.9
Accommodation and food service activities	447.0	464.9	558.7	1001.2	1501.0
Information and communication	204.6	224.7	246.6	230.7	272.9
Financial and insurance activities	278.7	271.0	326.3	414.9	448.6
Real estate activities	61.5	80.8	103.7	158.2	268.8
Owner Occupied dwellings	422.6	455.0	474.5	494.6	592.8
Professional, scientific and technical activities	58.5	53.1	104.0	124.3	149.5
Administrative and support service activities	89.7	110.7	132.0	190.7	260.3
Public administration and defence; compulsory social security	453.7	433.8	518.4	558.6	589.7
Education	197.9	210.1	212.0	231.7	257.5
Human health and social work activities	145.7	158.3	149.3	178.3	192.4
Arts, entertainment and recreation	38.9	44.0	45.1	47.2	60.7
Other service activities	26.1	30.5	34.1	36.4	36.6
Allocation of FISIM to nominal sector	-163.1	-174.7	-202.2	-280.6	-321.0
Value Added at basic prices	3719.6	4123.4	4706.9	5827.9	7290.6
Other Taxes on Production	154.6	123.0	141.3	208.6	254.5
Taxes on Production and Imports	537.9	507.6	493.8	587.3	713.4
Goods and services Tax	299.6	315.1	374.9	425.0	531.0
Less subsidies	-16.1	-26.0	-88.5	-171.8	-33.8

[1] *Provisional Estimates*
[2] *Indicative Estimates*

Source: National Statistics Bureau

5.1 Primary Sector

During the year, mixed performances were observed relating to the primary sector. Activities in agriculture and fisheries sector, which accounted for 2.4 per cent of GDP, were hindered by adverse weather conditions and constrained by shortages of imported inputs due to the limited availability of

foreign exchange. Moreover, the implementation of the new reform programme late during the year seriously escalated production costs such that the sector's competitiveness was adversely affected. This adverse outcome reflected the impact of the exchange rate depreciation compounded by the GST tax regime and the withdrawal of subsidies which together rendered many farming activities, especially meat and egg production, somewhat uneconomic. Retail prices of domestic meat products more than doubled resulting in a significant slump in local demand and a shift to cheaper imported substitutes. Within the limited scope at its disposal - having eliminated subsidies - government pledged to address the problems in a decisive way in order to maintain national food security.

For the coming year, the authorities have plans to review the Agricultural & Fisheries Incentive Act in an attempt to split the agriculture and fisheries sector, so that the legislation is in conformity with World Trade Organisation (WTO) rules on Non-Agricultural Market Access (NAMA).

5.1.1 Fisheries

On the whole, 2008 was not a good year for the fisheries sector. The exorbitant rise in fuel prices on the international market during the second quarter led to less fishing activities. This in turn contributed to a reduction in catch, thus raising unit operational costs and causing loss of revenue. Furthermore, the reduction in overall fish catch could have been due to stock stress in addition to other factors such as piracy in the Indian Ocean. According to the latest studies undertaken by the Seychelles Fishing Authority, the depredation rate in the region was about 21 per cent and this was regarded as one of the highest in the world.

Table 5.3
Estimates of Fish Landed

	2004	2005	2006	2007	2008[1]
	(Metric tonnes)				
Artisanal method	4,374	4,583	4,050	3,651	5,036
Semi-industrial (long line)	111	251	260	270	190
Industrial method					
- Caught	408,366	389,256	389,936	246,657	244,190
- Transshipped	300,937	338,271	371,087	212,000	210,000

[1] *Actual figures only for the first nine months added up with projections for the last quarter.*

Source: Seychelles Fishing Authority

As regards the artisanal sector, provisional figures showed an increase in total catch from 3,651 MT in 2007 to 5,036 MT by the end of 2008. Despite the rise in fish supply during the year, the Consumer Price Index (CPI) showed that fish prices in the economy were higher compared to the previous year, with an inflation rate of 10 per cent at end-December 2008. This rise was instigated largely by the

increases in fuel prices and, compounded after November by the removal of government subsidies and the devaluation of the rupee.

On the other hand, negative performances were observed for semi-industrial and industrial sector. Estimates for the whole of 2008 showed a drop of approximately 24 per cent in total catch by the semi-industrial sector relative to the previous year, and a 1.0 per cent decline in total catch from the industrial sector. A reduction of 4.0 per cent over the previous year was also noted in landing and transhipment of fish. It was projected that a total of 210,000 MT was handled in Port Victoria during the whole of 2008.

Despite intensified efforts by the authorities to encourage investment in the fisheries industry the level of FDI contribution to this sector was minimal in 2008. Uncertainties in the global financial environment appeared to discourage potential investors from investing in the sector. A similar picture emerges in the case of local entrepreneurs. According to the Development Bank of Seychelles and commercial banks, loans disbursed to the fisheries sector by the end of the year amounted to R12 million and R1.8 million down from R15 million and R2.4 million in 2007, respectively.

The Seychelles Fishing Authority embarked on several projects in 2008, including the Marine Science for Management (MASMA) project, which will run till the end of 2010. The aim of this project is to study the impact of Marine Protected Areas (MPA) on fish behaviour and how the behaviour of reef fish could be incorporated in the MPA. As for 2009, amid various projects, SFA will continue with its research projects especially the bait fishery as well as promote and facilitate sea-food value addition through secondary processing in the industry. Other projects planned include the setting up of a Development Fund, the rehabilitation of the damaged landing quay, the development of Zone 6 at Providence and a logistic base at Bel Ombre.

5.1.2 Aquaculture

Prawn farming, an aquaculture business designed to raise and produce freshwater prawns, remained the core of aquaculture in Seychelles during 2008. Following the previous year's declining trend, the production of prawns during the year dropped by 21 per cent from 368 tonnes in 2007 to 289 tonnes.

5.1.3 Agriculture

On a similar note, the year 2008 was not a profitable one for farmers. With the floating of the rupee and input prices rising, compounded by failing crops due to prolonged drought and floods and scarcity of cultivable land, farmers faced a difficult year. Soaring interest rates also impacted on investment undertakings, leading to lower output. Loans disbursed to this sector by DBS declined slightly from R8.3 million in 2007 to R8.0 million, whilst those disbursed by commercial banks decreased from

R12.3 million to R9.3 million. Furthermore, output and sales were affected by depressed demand as retail prices increased significantly following the removal of subsidies on animal feed, which resulted in consumers shifting from domestically produced goods to cheaper imports.

The beginning of June 2007 saw a major modification in the methodology for estimating agricultural production. This change was introduced by the Food and Agriculture Organisation (FAO), which proposed that data compilations should be on a June to June basis. Thus, for the period June 2007 to June 2008, total crop productions stood at 4,935 tonnes, of which 27 per cent came from the North of Mahe, 34 per cent and 30 per cent from Central and South regions respectively, whilst 9.4 per cent came from Praslin and La Digue.

As regards livestock production and importation during the period June 2007 - June 2008, 55 per cent of total pork consumed in the country was produced locally and 45 per cent was imported. Similarly, 60 per cent of chicken consumed was locally produced whereas 40 per cent was imported. In contrast to the above, 99 per cent of beef consumed was imported, whilst only 1.2 per cent was produced locally.

To address the national food security threats, the government and all national stakeholders launched the Food Security Strategy (FSS) 2008-2011 during the second quarter of 2008. This framework deals with five main issues, all of which aim at enhancing food security. These five points are: (i) 'agricultural land and its optimization'; (ii) 'procuring inputs and supplies'; (iii) 'infrastructure', (iv) 'policies and human development'; and (v) 'training'.

During the year the government was more proactive in ensuring that the population had adequate food supply. In April, the authorities identified new cultivated land and adopted policies for optimising under-utilised state land. As such, the tea plantations which spread over various locations were assessed for their effectiveness in agricultural production. Moreover, the government invested in many agricultural facilities, such as a new site catering for the pig generic centre which in due course will be displaced from Grand Anse Mahe.

In 2009, the farming community intends to introduction new products and acquire units concerned with agricultural inputs. By January 1, 2009, animal feed will be transferred to the farmers' cooperative. The hatchery and abattoir were also under consideration for a similar solution. Additionally, the Farmers' Association, is looking into the possibility of setting up an insurance scheme for farmers, locate distribution ports whereby inputs are distributed fairly, and network with local and regional agencies so as to make the most of available financial and technical resources.

5.2 Industries

On the whole, 2008 was also a challenging year for the secondary sector, notably so towards the end of the year. For the most part, activity in the sector was underpinned by construction, which continued to perform strongly. In comparison, the manufacturing sector experienced serious output losses.

5.2.1 Construction

During the first three quarters of the year under review, construction activity remained upbeat as a result of acceleration of ongoing tourism projects. This, however, contrived to place pressure on local quarry products as well as creating strong demand for imported construction materials. Relative to the previous year, production of blocks, plastering dust and concreting dust rose by 7.9 per cent, 54 per cent, and 24 per cent, respectively, whilst aggregates increased by 28 per cent and crusher waste by 56 per cent. The extent of the increases is not however representative of the rise in construction activity as reportedly companies were hoarding these materials as a hedge against future price increases for projects planned for 2009. Nevertheless, the impact of the macroeconomic and financial reform programme in November, compounded by the international financial crisis, has created uncertainties regarding the future of some of the major approved tourism developments. This applies to both local and FDI-driven projects. Investors raising money on the international financial markets are either still weighing the risks of proceeding ahead or simply finding it difficult to raise funds, whilst local businessmen are unable to commit because of the extremely high cost of borrowing.

Using banking indicators, further confirmation of the strong level of construction activity is obtained, notably for the first three quarters of 2008. In total, the commercial banks disbursed a sum of R105 million in loans to contractors by the end of the year compared to R87 million in 2007. However, following the liberalisation of interest rates, the cost of borrowing became exorbitant and clients were forced to cut back on borrowings, thus negatively impacting on the activity of building contractors.

As has been the case for quite a few years, construction companies have been employing a large number of expatriates. With FDI projects at a high level, and given a tight domestic labour market, the sector has become even more dependent on expatriates.

Overall the outlook for construction is mixed with strong downside risks due to the lack of visibility with regards to the implementation of planned projects. In addition, contractors face strong cost escalation in rupee terms in light of the impact of the currency float on construction material prices. Construction companies handling the big FDI projects are arguably better off in the sense that they are paid in foreign exchange and are thus significantly protected from price volatility arising from currency depreciation. Local funded projects, notably home building, are set to contract significantly as householders face considerable difficulties in raising finance due to high interest rates and tight

banking sector liquidity. In addition, the recent price escalation has rendered house building an unaffordable activity for most average families.

5.2.2 Manufacturing

Manufacturing is another sector that was adversely affected by developments on the international and national markets, as domestic demand tightened with the economic slowdown and under impact of the reform measures. As per the real GDP figures, output of this sector shrank by 12 per cent relative to 2007.

In 2008, the sector experienced some major shocks on its cost structure. Aside from the higher energy prices, operating conditions worsened with the depreciation of the national currency from November, leading to unexpectedly high spikes in the cost of inputs and pressure on wages.

The production of beverage products which is one of the main manufacturing activities failed to approach 2007 performance. According to statistics from NSB, the production of soft drinks and 'beer and stout' declined by 28 per cent and 19 per cent, respectively in 2008. On a similar note, juice production - mainly produced by STC (Agro division) - declined by 24 per cent. The leading company of this sector, Seychelles Breweries Limited (SBL), experienced a volume contraction of 16 per cent compared to the previous year. This was significantly driven by the price increases in their products following the loss in the value of the rupee, increases in input costs and the rise in fuel prices. Moreover, the imposition of GST on soft drinks and other negative cost developments in November forced another upward revision in the prices of their products, further impacting on consumer demand. Overall, SBL sees 2009 as a very challenging and difficult year and it is anticipated that volume sales will decline by 30 per cent.

The Indian Ocean Tuna Limited (IOT) reported a declining performance during the year given the low period for the industry. The cycle (between low and peak periods) which is based on weather patterns, provides an indication of the expected catch levels. Hence, this drop whilst significant relative to previous peak periods was however, in line with the company's business forecast. Compared to the previous year the production of canned tuna declined by 8.4 per cent to close at 28,907 tonnes. The company, however, did not really feel the impact of the currency depreciation as the company's earnings and expenses are predominantly in hard currency. Nevertheless, the price of tuna cans sold on the international markets fell significantly, resulting in a decline in IOT's export revenue from US$182 million in 2007 to US$160 million in 2008. In rupee terms earnings rose from R1,231 million in 2007 to R1,281 million due to the depreciation of the rupee against the US dollar. Production plans for 2009 are slated to be at the same level as that of 2008.

5.3 Services

The performance of the tertiary sector was encouraging at the start of 2008. However, due to the prevailing international crisis, the sector concluded the year on a negative note. The sub-sectors of the services industry are reviewed individually below.

5.3.1 Tourism

The tourism industry is the mainstay of the Seychelles economy. As mentioned above, the year under review began with optimism, backed by investor commitment to start works on many large luxury projects such as the Ephelia Resort & Spa (Port Launay), Emirates Resort (Cap Ternay) and the Qatari Diar resort (Anse a La Mouche). However, external factors, notably the global financial crisis, forced many investors to postpone their investments whilst the situation stabilises. Of the foregoing three resorts, the only one to start actual construction was the Ephelia project by the Corvina-Constance joint-venture.

Against the backdrop of looming economic recessions in Europe, which crystallised during the last quarter, tourism activity deteriorated. For 2008, tourism arrivals stood at 158,952 visitors compared to 161,273 visitors the same period of the previous year. In contrast to the 1.4 per cent decline in tourism arrivals, tourism earnings due to depreciation of the rupee, increased by 28 per cent to stand at R2,438 million by the end of December. In dollar terms, tourism earnings in 2008 stood at US $269 million relative to US $278 million in 2007.

Table 5.4
Tourism

	2004	2005	2006	2007	2008[1/2]
Visitors arrivals	120,765	128,654	140,627	161,273	158,952
Average length of stay (nights)	10.04	9.69	9.82	10.20	10.15
Tourism Foreign Exchange Earnings - R million	938	1,051	1,251	1,901	2,437
Average expenditure per diem - Rupees	773.5	842.9	906.2	1,155.8	1,510.5
Memorandum					
Hotel bed occupancy rate (%)	46	49	57	56	57

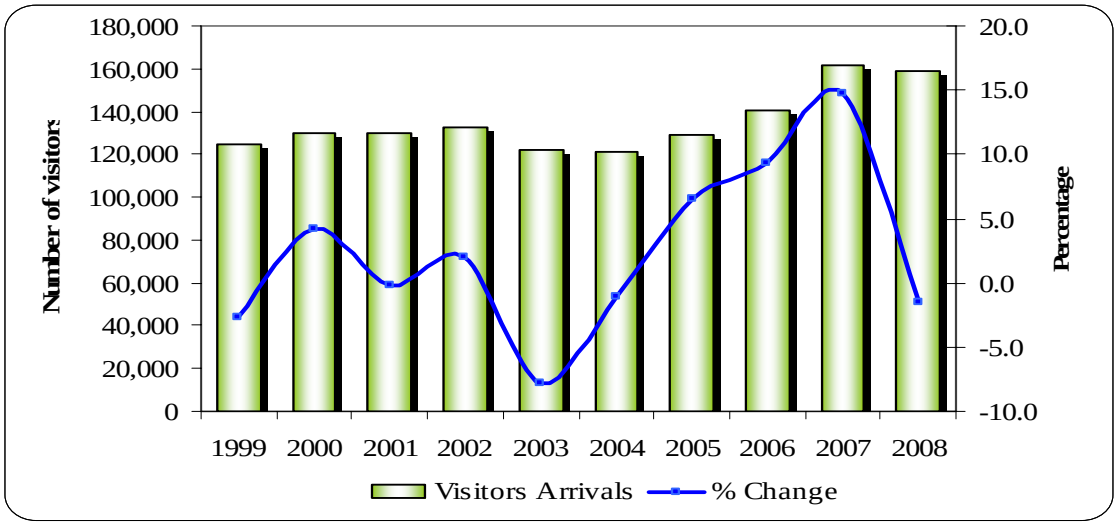
[1] *Hotel bed occupancy rate for 2008 is up to October*
[2] *Tourism Foreign Exchange Earnings for 2008 is CBS estimate*
Sources: National Statistics Bureau (except tourism foreign exchange earnings which are from Central Bank)

For several years, Europe accounted for the bulk of visitors to Seychelles with 78 per cent of total arrivals in 2008, followed by Africa with 12 per cent. Performance of the core markets was quite disappointing in the year ending 2008. Visitors from the UK declined by 19 per cent, those from Italy

fell by 6.8 per cent, whilst France posted a decline of 1.6 per cent. Notwithstanding the recession in Germany, visitors from that part of the world increased by 9.3 per cent.

To further promote tourism growth and maximise earnings, Seychelles Tourism Board and other industry stakeholders, organised a workshop at the Hilton Seychelles Northolme Resort and Spa in November, which focused on strategies to better exploit business potential in the Middle East region. This region is one of Seychelles' emerging markets, with year-on-year growth in visitors attaining 10 per cent. Growth was also observed in other emerging tourism markets such as Russia and South Africa. This occurred against the backdrop of Seychelles being named the best island destination throughout Africa and the Middle East by the widely read Travel and Leisure magazine for the third consecutive year.

Chart 5.1: Visitor Arrivals (1999 – 2008)



Source: National Statistics Bureau

In line with the adage *'fully booked airline seats=fully booked hotels'*, airline operators have a critical role to play vis-à-vis the country's economic development. The year under review witnessed the demise of XL Airways; as a consequence, the Boeing 767 200 'La-Belle Creole', which was on sub-lease to Air Seychelles by this failed operator, had to be grounded as part of usual liquidation procedures. The country's national carrier had a difficult 2008 catalogued by some costly equipment incidents and high fuel prices, compounded by an appreciating dollar. Considering that most of the airline's operating cost is dollar-denominated while its revenues mostly in Euros the company lost significantly on exchange rate movements in 2008. Despite the above difficulties, Air Seychelles was

able to pursue its expansion plan through the acquisition of a replacement aircraft for the regional network, a refitted Boeing B767-205EM aircraft named 'Amirantes', in the last quarter of 2008.

In terms of financial outcome, the national airline is bracing for a turbulent 2009. The downturn in projected load over the London-Seychelles sector has forced the company to drop its twice-weekly direct flights to London as of April 2009 in favour of an indirect route involving either a step-over in Zurich or Frankfurt. To increase aircraft utilisation and tap the promising CIS market, Air Seychelles in partnership with the Russian tour-operator Fourthtour, has begun a direct service to Moscow with somewhat mixed initial results. With the downturn in projected arrivals, the company will need to re-assess its route network and service frequency in order to maximise load factor and improve financial results. Despite the operational challenges, the airline aims to maintain its focus on safety and customer fulfilment in 2009. However, with the deterioration in the demand landscape, a dilution of yields over certain sectors is unavoidable and Air Seychelles could find itself having to lower some of its fares in 2009 to stimulate sales.

Likewise, Seychelles Tourism Board has been more hands-on in promoting Seychelles as the pre-eminent holiday destination in the region. These efforts have been rewarded by the continued arrival of many celebrities, dignitaries, high government officials, as well as high net-worth visitors to the country. To capitalise on this and offer high-quality services, Seychelles launched its first limousine company in December. Furthermore, 2008 saw the introduction of Seychelles SMART, an online distant programme which will be operative in 2009. The web site will give travel professionals the opportunity to learn more about the destination and its products and provide training/sales tools for the participants. To improve downstream linkages with other sectors, the Seychelles Tourism Board in tandem with the Seychelles Investment Bureau, introduced a new policy encouraging tourism operators to outsource certain services to other service providers on Mahe, Praslin and La Digue.

Despite the difficult outlook, a number of ongoing hotel projects are set to open their doors in 2009. These include Ephelia Resort and Spa Village, Four Seasons Hotel and Residential Villas at Petite Anse Baie Lazare, Desroches Residential Villas, Dhevatara Beach Resort at Grand Anse Praslin, as well as the Round Island Exclusive Resort and Spa on Round Island. These projects pre-dated the global financial capital squeeze of 2008.

In order to increase the Seychellois uptake of workers in the industry and absorb labour from the voluntary departure scheme introduced within the reform programme, the Seychelles Tourism Academy introduced certain modules with the aim of re-training former public sector employees so that they could be eligible for employment in the tourism industry. By the end of the year, a total of 102 participants had enrolled on the course. As regards to the Seychelles Tourism Academy normal

intake of students, the plan is to increase the cohort from 328 to 500 students during 2009. As guiding objective, the Academy is targeting the formation of 20 junior Seychellois managers working in various hotel establishments across the country within a decade.

Under current trends, it is anticipated that visitor arrivals will decline by 15 per cent in 2009 and earnings by 25 per cent. The deterioration is expected during the first half of 2009 but a gradual pick up later during the year could be cautiously anticipated, around the European summer holiday in July.

5.3.2 Telecommunication

Since the re-adjustment of the rupee in late 2007, certain costs were absorbed by the telecom companies, thus leaving tariff structures mostly unchanged. However, the demand for telecom services dampened in 2008 with the implementation of the reform programme and the decline in tourism arrivals during the last quarter. Nevertheless, international calls increased by 8.5 per cent, whilst on the other hand, local calls decreased by 34 per cent. However, mobile accounts increased by 10 per cent during the year, reflecting a healthy growth in handset ownership.

Telecom industries have greatly maximised customers' satisfactions and provided significantly improved services. The 3G and EDGE network systems facilitated the use of 'mobile broadband internet', 'video calling multimedia messaging', 'alo tunes' and various other applications. Frequent promotional vouchers and top-up services were also given, and in collaboration with commercial banks, new top-up systems were introduced directly from automatic teller machines (ATM).

5.4 Labour Market

The labour market entered a phase of unusual activity in 2008. This was in light of the redundancies implemented as part of the economic reform programme and growing prospects of private-sector redundancies as overall economic activity declined. However, in the construction industry, demand for labour remained strong and yet again, expatriates filled the bulk of vacancies due to lack of local interest or skills. As the year closed, even the hotel establishments, previously a growth sector began planning for redundancy as occupancy levels which stood at 57 per cent by the end of October 2008, dropped. In general, the policy has been to terminate or not renew expatriate employment such that Seychellois can be kept gainfully employed. As regards staff training and development, various training programmes were revised and transferred (or in process of being transferred) to other institutions namely the Ministry of Education and ALDEC, for more effective skill development nationally and to terminate employment schemes giving direct subsidies to potential employers.

Overall, at year's end, the unemployment rate showed another decline with a rise in the number of employees on record. Nevertheless, it is anticipated that the rate of unemployment will rise during

2009 as approximately 1,500 home carers are expected to be made redundant by March 2009. In addition, many public sector employees would have left employment under the voluntary departure scheme, which in combination with possible redundancies by various sectors of the economy, point to a rise in the unemployment rate in the coming year.

5.4.1 Employment

The year 2008 saw an encouraging increase in the number of the workers formally employed. By the end of the three quarters, the average number of employees in the country stood at 40,821 compared to 39,405 the same period of the previous year. Of this total, 59 per cent of employees were engaged in the private sector, 27 per cent in the public sector, whilst 14 per cent worked in the parastatal sector. Relative to the previous year, these represented an increase of 9.1 per cent in the private sector; and a fall of 1.2 per cent and 7.7 per cent in public sector and parastatal sector, respectively.

As part of the economic transformation process, the government restructured the public sector and in consequence 1,491 workers were made redundant under the voluntary departure scheme. Consequently, 'public administration' which accounted for the bulk of employees in the public sector declined by 1.1 per cent, employees from 'health and social work' fell by 0.5 per cent, whilst those from 'other community, social and personal services' declined by 6.5 per cent. As regard the private sector, the bulk of employees was in the tourism industry which actually rose by 5.1 per cent relative to the previous year, whilst employees in private education increased by 17 per cent. In view of the fact that the number of teachers from the public schools declined, this signified a shift of teachers from the public to private schools, possibly because of higher wages offered in the private sector.

Dependence on expatriate employment remained a feature of the national economy in 2008, especially for construction, tourism and highly skilled labour. An analysis of the figures during the first three quarters of the year revealed that in the public sector, expatriates accounted for 2.9 per cent of the workforce, with the highest number employed in 'education' followed by 'health and social work' with 150 and 97 employees, respectively. On the other hand, expatriates in the parastatal sector accounted for 5.3 per cent of the workforce, with the highest number being employed in the fishing industry.

Following the implementation of the voluntary departure scheme, a number of Seychellois showed interest in employment opportunities at IOT, the tuna cannery. By the beginning of 2009, it is expected that the company will employ approximately 150 local workers and there is a possibility that it will take on another 100 during the course of the year.

5.4.2 Unemployment

In spite of the closure of a major hotel and the voluntary departure scheme later during the year, the rate of unemployment declined by 0.9 percentage point to stand at 1.0 per cent by the end of December 2008 relative to December 2007. With a boost in Foreign Direct Investment (FDI) in the country, particularly in tourism industry, the number of jobseekers recorded by the unemployment bureau stood at 48 per cent lower than that recorded for the previous year. Notwithstanding the rise in FDI, the decline in the number of people searching for work as at the end of December 2008 was also due to the fact that the previous data set collected was overstated. Following an audit, it has been established that many of the registered unemployed were actually working but failed to hand in their job cards to the unemployment bureau. Accordingly, 2007 data have been reviewed downwards.

Table 5.5
Employment and Unemployment Rate; 2004 - 2008

	2004	2005	2006	2007	2008
	(end - of - year)				
Total Employment	**32,780**	**34,542**	**38,826**	**41,823**	**40,822**
Private Sector	16,944	18,595	20,017	22,008	24,204
Parastatals	5,545	5,931	6,036	6,167	5,673
Government	10,293	10,015	12,773	13,648	10,945
Unemployment Rate (%)	**3.5**	**3.6**	**2.6**	**1.9**	**1.0**

(1) Figures for employment for 2008 up to September, however unemployment rate data is for the whole year
Source: Employment Division - Ministry of Economic Planning and Employment

With investment activity strong for most of the year, job creation remained buoyant. However, due to mismatched skills, many vacancies were unfilled with the majority being in 'hotels and restaurants' as well as construction industries. As a clear evidence of this assertion, the number of vacancies stood at 7,108 by the end of December 2008, outweighing the number of jobseekers by 93 per cent.

5.4.3 Earnings

Average gross earnings for the first three quarters of 2008 in the private sector, public sector and parastatal stood at R4,128, R4,535 and R5,533, respectively. These earnings stood at 14 per cent, 8.3 per cent and 14 per cent higher than that of the corresponding period of the previous year. The highest average earning of R7,001 was in the private sector in the education industry, whilst the lowest was in agricultural and forestry industry in the private sector earning on average R2,650.

Seeking to sustain individuals' purchasing power, the government announced a rise in salary of R100-R300 during the third quarter and R450-R500 during the latter part of the year.

Overall, the increase in average earnings has trailed the underlying annual average inflation rate by a substantial 27 percent, which explains directly the observed contraction of consumer demand in the economy.

Table 5.6
Average Monthly Earnings; 2004 - 2008

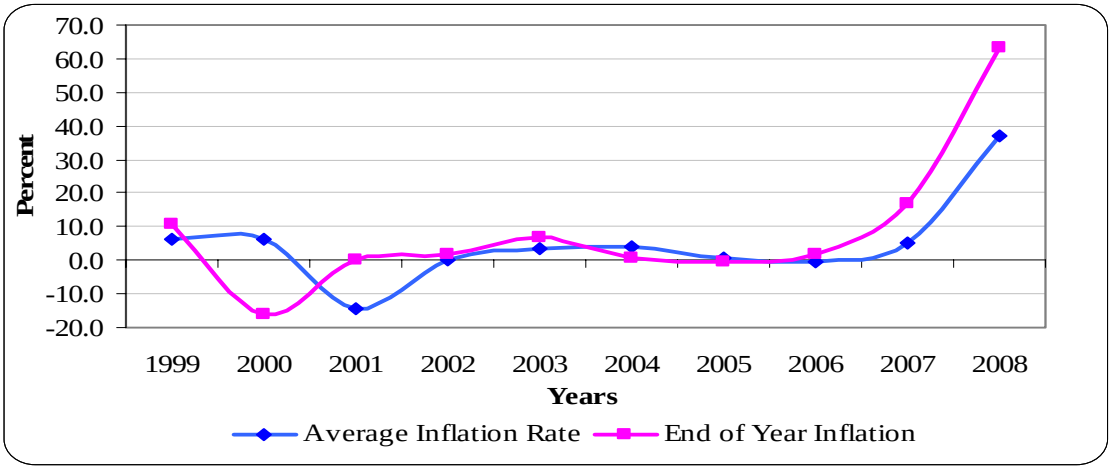
	2004	2005	2006	2007	2008[1]
	(Rupee - current prices)				
All Sectors	**3,708**	**3,750**	**3,817**	**4,015**	**4,399**
Private Sector	3,441	3,469	3,566	3,669	4,128
Parastatals	4,038	4,072	4,528	4,920	5,533
Government	3,971	4,081	3,891	4,216	4,535

[1] *Figures up to September 2008*
Sources: National Statistics Bureau

6. Prices

Inflationary tendencies were visibly strong and widespread in 2008, reflecting mostly the price pass-through impact of the currency re-alignment in late 2007 against the backdrop of international commodity price volatility. The situation worsened in the latter part of 2008 which witnessed the implementation of numerous policy changes, such as the floating of the rupee and the introduction of GST (in areas not covered previously at a time of growing economic and financial turmoil internationally). Although energy and commodity prices softened late during the year, the average rate of inflation for 2008 amounted to 37 per cent, standing 32 percentage points higher than that of the previous year. On a year-on-year comparison, prices in the economy increased by 63 per cent in December compared to the corresponding month of the previous year.

Chart 5.2: Price Movements (1999 – 2008)



Source: National Statistics Bureau

The main source of inflationary pressure was the impact of the sharp depreciation of the rupee following the November floatation, directly causing prices of most imported commodities to more than double and triggering upward price revisions over a wide spectrum of the economic base, from local agricultural produce to utilities. The price of 'food items' increased overall by 74 per cent, whilst 'housing, water, electricity and gas' rose by 90 per cent. Furthermore, with the removal of subsidy to 'public transportation', transport cost rose by 60 per cent over the year.

Table 5.7
Inflation Rates; 2004 - 2008

	Weights 2007	**2004**	**2005**	**2006**	**2007**	**2008**
(% change)						
Annual Average						
All Items	100	3.9	0.9	-0.4	5.3	37.0
Fish	3.3	-7.1	5.4	11.5	5.9	10.2
Other Food Items	25.5	1.9	0.6	2.8	8.7	41.8
Non-Food Items	71.1	5.0	0.8	-1.8	4.1	36.4
Year-on-Year						
All Items	100	-2.5	-0.7	2.3	16.7	63.3
Fish	3.3	-9.1	27.8	-3.5	19.4	11.4
Other Food Items	25.5	-4.3	-0.5	7.0	25.7	74.3
Non-Food Items	71.1	-1.7	-1.6	1.0	3.8	61.1

Source: National Statistics Bureau

The outlook ahead is that prices should stabilise since the observed surge is arguably tantamount to a price-level adjustment following the slide of the rupee from about R8/US$ to R17 by end-2008. However, full adjustment to the new exchange rate level will only be seen towards the end of 2009 and as such, the underlying inflationary trend remains upward in the absence of compensating developments, such as lower international prices, or a strengthening in the exchange rate.

SECTION SIX

Operations and Administration of the Central Bank[2]

6. Overview

The year 2009 witnessed a multitude of changes in the structure, operations and most importantly, policy stance of the Bank. Whereas in previous years, the Bank had maintained a gradual and cautious approach to policy conception and execution, 2008 oversaw extensive changes in the conduct of monetary policy, in line with a new direction in fiscal policy set by the government. This became most evident with the official adoption of the new macroeconomic policy framework launched in November under an IMF Stand-by Arrangement.

Under the new policy regime, monetary policy shifted to a more pro-active role to help address the external as well as internal factors which had hampered economic activity. With the change in policy going from a conventional pegged arrangement to the elimination of all exchange restrictions and a float of the Rupee[3], coupled with the systemic shock posed by the adoption of market-driven structures for the setting of rates of return on financial instruments, numerous figures and forecasts had to be adjusted to provide a more accurate view of the monetary sector of the economy as it adjusts to a different equilibrium time-path.

The "significant re-engineering" of the Bank was the follow-up to the findings/recommendations of assessments undertaken by a Technical Assistance Mission from the International Monetary Fund (IMF) in December 2007 and previous visits which focused on, amongst others, capacity building and restructuring. In conjunction with the IMF, a top to bottom management review was undertaken to analyse the role of the Bank as the monetary agent in the economy and to facilitate a smoother, more efficient system with a developed set of procedures enshrined in a market-oriented policy framework.

The important outcome of this exercise was a streamlining of the Bank's functional work processes into three distinct categories, namely policy formulation, regulations and operations. Of critical importance is the need to embrace policy formulation and monitoring within a coherent framework based on sound economic underpinnings with instruments and objectives clearly defined and in

[2] All the data presented in this section is actual.
[3] Highlighted in the approval of the Stand by Arrangement with the IMF.

harmony with the fiscal stance. To ensure compliance with the policy framework and meet prudential standards on liquidity, capital adequacy and exposure, the Bank issued new and/or updated regulations and guidelines in line with the objectives under the new economic framework. Finally, operations ensure that the procedures necessary to implement policies and guarantee that the outcome of any instrument is achieved are in place are effective and in conformity with international best practices. The three functions are closely intertwined and feed into each other, thus optimising dynamism and providing consistent information feedback such that deviations from policy are detected and corrective actions taken as the point of emergence.

These functional changes have necessitated the integration and consolidation of the various previous divisions of the Bank into more focused entities. For example, the Public Debt unit is now a subsidiary of the Banking Services Division, with the aim of emphasising that the unit is integral in the Bank's operations and core functions.

The Research and Statistics Division was for its part re-designated Monetary Analysis and Statistics Division with the main responsibilities of policy formulation, collection of statistics, monetary analysis and information assimilation and dissemination to relevant parties.

The Foreign Earnings Regulations Division, a division within the Bank that regulated and ensured compliance with foreign exchange surrender requirements became effectively redundant and was closed. This followed the repeal of the Foreign Earnings (Regulations) Act on October 31, which was created to address the legal obligation for residents and non-residents make payments for prescribed transactions in foreign currency. The repeal of the Act was an important component in the economic liberalisation roadmap as mapped out in the 2008-2009 Memorandum of Economic and Financial Policy (MEFP) between the IMF and the Seychelles authorities.

On the policy front, numerous changes were implemented with the adoption of the new monetary regime. The overall purpose of the policy was to tighten and in future to manage liquidity by targeting reserve money in the local market as well as liberalising key monetary instruments. In order to implement this, an enabling platform was needed and new monetary tools introduced.

Prior to fully implementing the policy, certain laws had to be amended or repealed to ensure the legality of the reforms as well as conform to the Articles of Agreement with the IMF, more precisely Article IV and Article VIII[4]. In the second half of the year, with relevance to the 2008-2009 MEFP, submitted by the government to the IMF, and in line with the new reform programme, certain statutory

[4] Article IV defines and outlines obligations regarding exchange arrangements involving anti-manipulation of exchange rates and matters relating to IMF surveillance. Article VIII outlines general obligations of members involving avoidance of discriminatory currency practices as well as the member's ability to impose restrictions on the making of payments and transfers for current international transactions.

amendments were promulgated to alter the Bank's functions and authority as were necessary in the context of the new monetary framework.

First, was the amendment to section 26 of the Central Bank of Seychelles Act, 2004 which defined the role of the Bank as the foreign exchange rate-setter. With the removal of all exchange restrictions, the Bank is now seen as an observer as opposed to a regulator on the exchange market and is thus in compliance with Article IV of the IMF agreement. The Foreign Earnings (Regulations) Act, which was concerned with the regulation of the inflow and outflow of foreign exchange in the country, with a percentage being surrendered to the Bank, was repealed thus ceasing and ending the Bank's direct role in the currency market and influence in current international transactions. This also required that the pipeline scheme, a "queue" instrument re-implemented, albeit refined, during the Macro Economic Reform Programme (MERP) be systematically dismantled.

The scheme, which involved backing foreign currency requests with their local currency equivalent, was used as a liquidity-mopping instrument and a tool for managing foreign currency outflows according to national priorities on a first-come first-served basis. In addition, statistical information derived from the scheme, such as the weighted average payment waiting time, was used to gauge the state of the parallel market as well as the tightness of monetary policy.

The culmination of the above developments was the drafting of a new monetary policy framework in December, which outlined the instruments, roles and procedures of future liquidity management tools. The framework also defined the role of the Bank and its interaction with the government and other commercial entities, which are overseen by the newly formed Monetary Operations Committee (MOC). Central to this framework was the conversion of the 20-year restructuring bond, a government security held by the Bank, into marketable securities in order to create an additional tool to control liquidity within the local market.

Furthermore, amendments and reviews were undertaken with regards to laws under which commercial banks are regulated. These included an on-going review of the Financial Institutions Act and the repeal of other redundant regulatory pieces of legislation.

Within the scope of the new policy framework, the Bank has adopted a more open approach to public relations and information dissemination. Key statistics that may affect individuals or any player in the economy, including exchange rates, fuel prices, and tender notices amongst others are now made public through visual or printed media. In this way, it is hoped that consumers and businesses will have the necessary accurate data set to optimise their economic behaviour within a market environment, thus minimising on costly decision errors. To further improve communication with the public, the Governor holds fortnightly meetings with the press, along with other key economic players

namely the Ministry of Finance, to address any queries that may arise with regards to economic policies.

With the reforms and its emphasis on free-market power and liquidity management, the underlying weaknesses of commercial banks in a competitive environment have been exposed, and in this connection, the training activities of the Seychelles Banking Institute (SBI), initially set up in 2007, are expected to have a significant impact on raising professionalism and building capacity in the financial sector. The SBI now functions with a small but efficient infrastructure dedicated to improving standards and consistency within the banking sector through the conduct of training workshops designed in partnership with local banks.

The courses, which are hosted at the Bank, vary in duration with the shortest being a day. Following these workshops, through liaisons with respective human resource representatives in the participating banks, the SBI ensures that a fair assessment of participants is undertaken and reported. Participating candidates are awarded with certificates with a further pecuniary reward system currently in discussion. The SBI hopes to build on this early foundation and conduct future workshops that will help unlock the full potential of human capital in the financial sector. In the short term, the institute is looking to improve its public relations level via a multitude of means, including IT tools and cyber media.

6.1 Monetary Policy Instruments

The Bank has found it necessary to enhance its capacity in institutional development, staff training and the formulation of policy framework to enhance its role within monetary sector. Following preliminary visits in 2007 of the IMF, a detailed action plan for each of the areas with deliverable dates was formulated lasting 18 months and beginning at the start of 2008.

The major outcome of this assessment was the finding of the need for a more comprehensive formulation of policy for the Bank to control liquidity within the economy with the correct instruments while targeting specified components of the money supply. Due to the fact that monetary authorities can only control money supply indirectly, reserve money - which is more directly controllable by the Bank - was chosen as the operating target for monetary management. Money supply is linked to reserve money through the money multiplier and the Bank aims to control money supply by influencing reserve money. In light of this, quarterly targets for reserve money have been set within the broader framework of the MEFP.

Currently, the Bank relies mostly on open market operations anchored through an auction mechanism to manage domestic liquidity. More precisely, liquidity targets are met through deposit and credit auctions, outright sales and purchases of government securities and repurchase agreements with government securities as underlying collateral. While some elements of the framework are as yet not

in operation, pending the resolution of a plethora of technical factors, a few of these liquidity management instruments are already operational and demonstrating effectiveness.

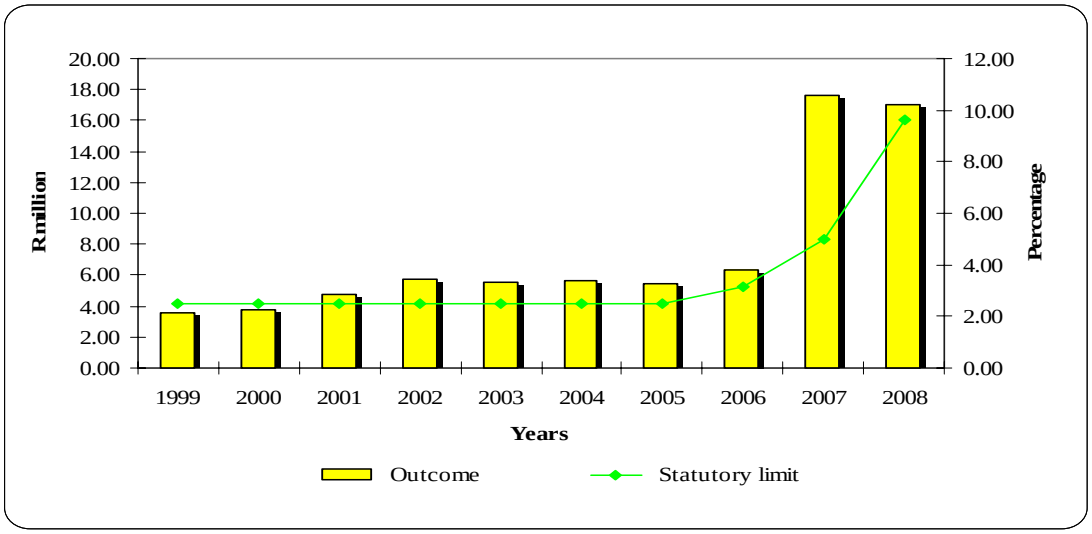
6.1.1 Minimum required capital and investment of capital funds

The minimum required capital is applicable to all financial institution whereas the investment of capital fund is applicable solely to banks. However, the repeal of The Minimum Capital Regulations (1986) in December will now see banks free to invest their capital funds in whatever instrument or opportunity they see fit.

6.1.2 Minimum reserve requirement and local asset ratio

Pursuant with the monetary policy objective of tightening liquidity, the Minimum Reserve Requirement was increased from 5 per cent to 13 per cent in June and in September the deposit liabilities base was redefined to include the rupee equivalent of foreign currency deposits of residents. Remuneration ceased to be calculated on excess reserves and interest of 0.25 per cent was applied only on minimum reserves as of September. In addition, the Local Asset Ratio was reduced from 65 per cent to 50 per cent in June. This was then changed to 45 per cent in September in anticipation of the floating of the currency, in order to allow banks to cope with a sudden rise in mandatory currency reserves arising from the revaluation effects of foreign exchange deposits on their balance sheet.

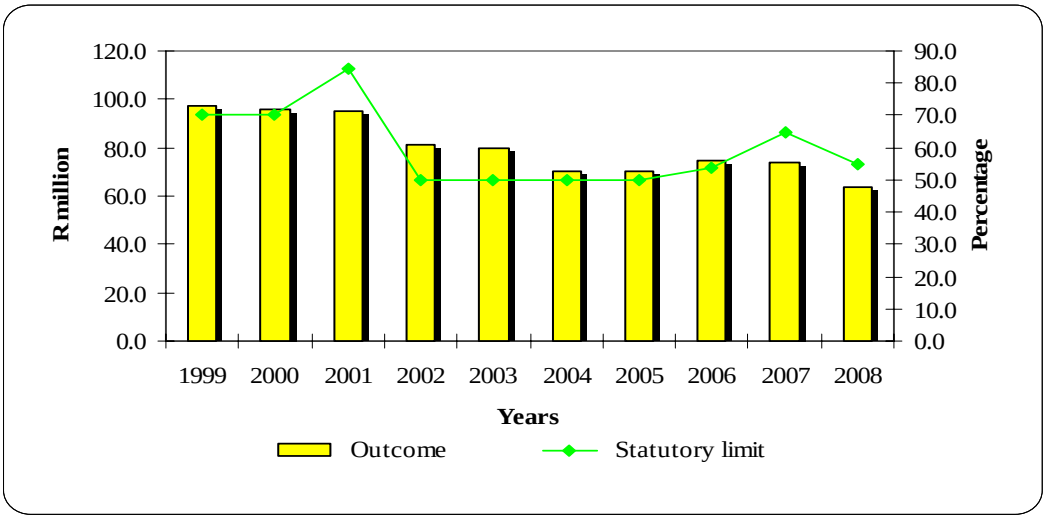
Chart 6.1 Minimum Reserve Requirements (1999 - 2008)



Source: Central Bank of Seychelles

While the local asset ratio may not be of future significant importance following the floating of the Rupee, the minimum reserve requirement remains an essential tool in managing liquidity. The Bank will continue to use the instrument as a liquidity management tool without making sudden changes in the rate pending the effectiveness, development and use of market oriented instruments.

Chart 6.2 Local Asset Ratio (1999 - 2008)



Source: Central Bank of Seychelles

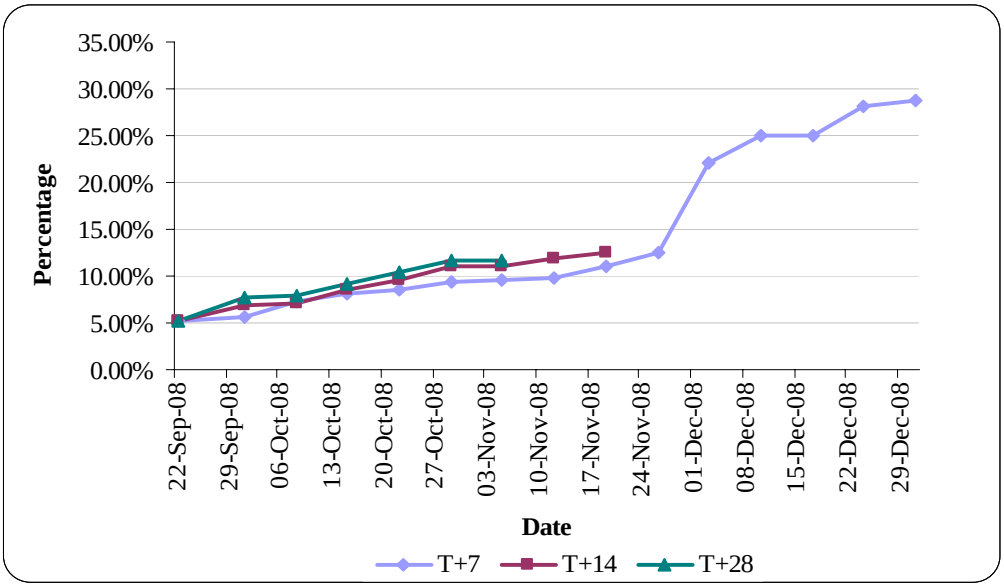
6.1.3 Deposit Auction Arrangement

The Deposit Auction Arrangement (DAA) is a liquidity management tool implemented as part of the new Monetary Policy, addressing the need to mop up excess liquidity within the monetary system. Commercial banks are provided with a convenient means for them to invest their excess reserves with the Bank and earn a competitive return over three specified short-term time span.

The instrument is also to be used as an analytical tool in determining the overall interest rates banks were willing to put on offer in the financial system, as well as provide the Bank with information on time-horizons banks were working with when it comes to freezing (albeit investing) their liquid assets, that is, excess reserves. The maturity times for the auction were 7, 14 and 28 days, with the auction taking place on a weekly basis.

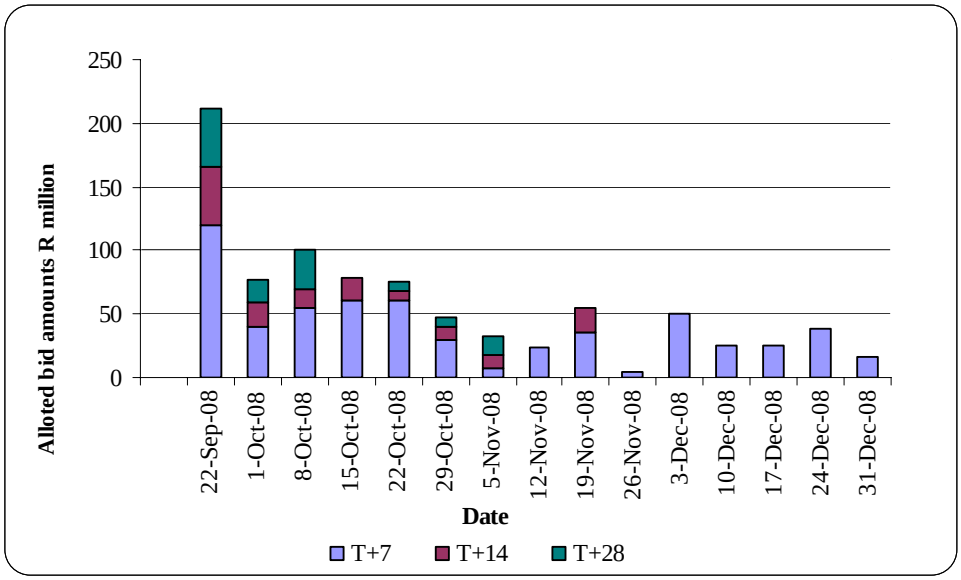
The DAA began operation in late September and following what the Bank saw as rates being offered as unreflective of current market conditions, the two first bids of December had the Bank establishing the DAA rates, thus the noticeable jump in rates. Despite the large deposits towards the beginning of the DAA, these gradually petered out due to a reduction of excess reserves faced by banks over the upcoming festive period. Banks were also unwilling to commit to a greater time span of greater than a week despite the appeal of a high rate of return further emphasizing the liquidity tightness faced by banks.

Chart 6.3 Deposit Auction Arrangement Rates (2008)[5]



Source: Central Bank of Seychelles

Chart 6.4 Deposit Auction Arrangement bids (2008)



Source: Central Bank of Seychelles

6.1.4 Foreign exchange operations

The Bank supported the implementation of the floating exchange rate regime in a number of ways. Operational guidelines were issued to specify the role of the Bank in the foreign exchange market

[5] The points at which the series end on the chart are indicative of the last bid in the year. For the 14-day maturity, the last bid was on November 19 and for the 28-day maturity, it was on the November 5. The Central Bank set the rates on December 3 and 10.

under the new regime with a general convention governing interbank trading with regard to the participants' reciprocal rights and obligations within the Seychelles Interbank Foreign Exchange Market. While the interbank market is still in development, the Bank auctioned foreign exchange on the interbank market, under the foreign exchange auction facility, purely as a means of gauging the commercial banks' responses to currency rates on offer and assisted the banking sector in the price discovery process. The rates as well as bid amounts provided an indication of the position of the commercial banks vis-à-vis their exchange reserve as well as an indication of the level of disparity between the spot and interbank rate that may come into existence once the interbank market is fully operational. The information gathered from the sale also provided an indication of the waning influence of the parallel market.

Table 6.1
Foreign Exchange Auction

		Bids		Accepted	
Auction Date	**CBS Offer in USD**	**Amount - USD**	**WA Exchange Rate R/$**	**Amount - USD**	**WA Exchange Rate R/$**
20-Nov-08	500,000	1,300,000	16.9496	500,000	17.5000
2-Dec-08	1,000,000	3,920,000	17.4034	1,000,000	18.0885
15-Dec-08	500,000	700,000	16.6786	500,000	16.8000

Source: Central Bank of Seychelles

6.2 Administration and Human Resources Division

The Administration and HR Division encompasses a wide range of services to the Bank. A particular focus in 2008 was to develop more support for enhancing team work, developing leadership skills, managing performance and fostering staff development. A one day Strategic Business Analysis workshop was held for managers and senior officers. Emphasis was also placed on enhancing the skills of managers through a series of Performance Management workshops which were organised for the Management team and the senior officers where necessary, coaching skills were also provided. Continuous efforts are being made by the Bank to improve the skills of the staff through learning and development opportunities.

2008 was a year of change for personnel and systems having undertaken some significant internal restructuring and staff movement. A total of 8 staff left the Bank under the voluntary departure scheme, 1 staff retired from the service, 10 staff resigned whilst 10 new appointees joined. In November 2008, a new Governor, Mr. Pierre Laporte commenced office following the resignation of the previous Governor, Mr. Francis Chang Leng. Mr. Laporte, who was previously an employee of the Central Bank worked for the IMF as an Economist for three years prior to his appointment as IMF's resident representative in Niger in 2005.

6.3 Banking Services Division

The Bank's primary operational role is being the banker to the government, the banking sector and other specified agencies, with the division being the executor of the role. The year oversaw the execution of all the required duties, with maximum efficiency and minimal wastage from the division. The division continues to strive in further improving its operational efficacy.

With that in mind, the year saw the restructuring of the Bank with Public Debt Division merging with the Banking Services Division. The reason behind this move was due to both divisions being involved in the practical execution of the banks' monetary policy. Together with the IMF, a Safeguard Assessment was conducted. This involved reviewing several key areas in the divisions' operations including the Internal and External Audit Mechanism, the legal structure and independence as well as the financial reporting framework. The current outcomes of this assessment were the appointment of PriceWaterhouseCoopers as the Banks' new External Auditors and the reactivation of the internal audit division in September with more improvements to follow.

Following on from the previous year, the Bank continued to improve the execution of its services via the means of electronic reporting. Key highlights included preparation of daily balance sheets and trial balance as well as the External Reserve Position report. Weekly reports are also provided on Treasury Bills and Bonds as well as liquidity data to the Monetary Analysis and Statistics Division for the latter's policy formulation function.

Further emphasising the commitment to better service, the National Payment System, aided by Technical Assistance from the IMF began its implementation. This is seen as a long term project and will be fully implemented in 4-5 years with the overall goal of reforming and modernizing the payment system of the country on an incremental, albeit non-linear basis.

6.3.1 Currency Issues

There was an increase of the currency in circulation in 2008 amounting to a rise of R27 million or 6.0 per cent relative to 2007. The rate of the rise or percentage change has however continued on a downward pattern seen since 2006, with the main constituent of the rise being an augmentation of the notes in circulation amounting to 5.9 per cent. Coins in circulation remained at a similar nominal quantity, but more specifically slightly higher than in 2007, standing at less than 6.7 per cent. Inflationary tendencies, parallel market activity and a rise in commodity prices with external trading partners were major issues seen throughout the year, thus creating the need for a greater quantity of currency to support transactions.

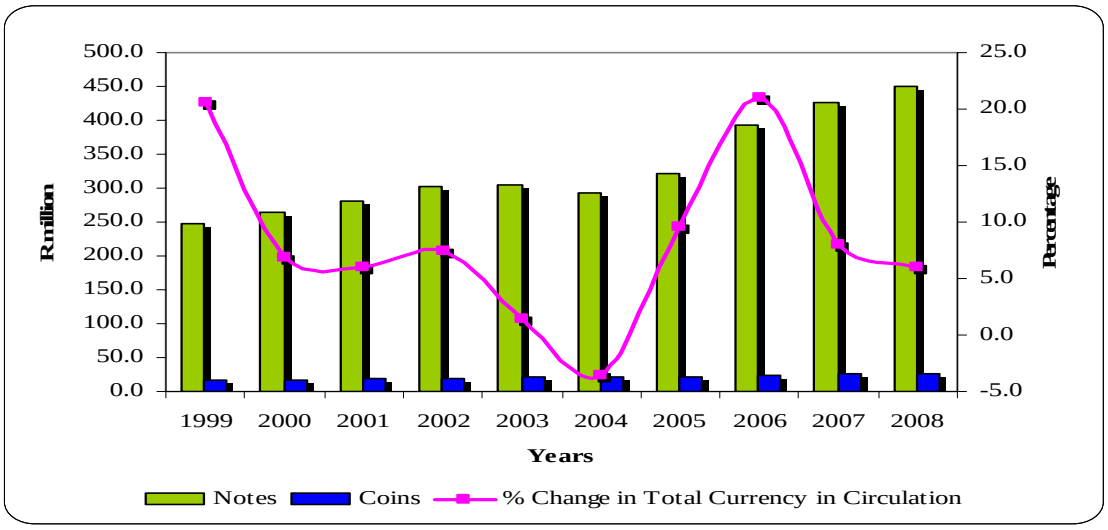
Table 6.2
Circulation of Notes and Coins[1]

	2004	2005	2006	2007	2008
Total (R million)	**314.6**	**344.8**	**417.2**	**450.6**	**477.6**
Notes	293.5	322.3	393.8	425.4	450.6
Coins	21.1	22.5	23.4	25.2	26.9
Share (%)					
Notes	93.3	93.5	94.4	94.4	94.3
Coins	6.7	6.5	5.6	5.6	5.7

[1]*End of period data*

Source: Central Bank of Seychelles

Chart 6.5 Notes and coins in circulation (1999 - 2008)



Source: Central Bank of Seychelles

6.4.2 Annual Balances

For 2008, the Bank posted a net operating profit of R95 million, a decline of R46 million, equivalent to 33 per cent relative to the previous year. The decline can primarily be attributed to the non-interest component which posted a fall of R38million or 36 per cent, primarily due to losses caused by changes in exchange rates, with net interest income posting a marginally higher profit. Net expenditure increased by R10 million which is equivalent to 38 per cent further contributing to the decline in net profit. Additional costs were spread across multiple expense streams coupled with new interest bearing instruments which the Bank currently offers as part of the new monetary policy.

6.4.3 External Reserves

As of December 31, the gross external reserves was valued at R1,207 million which amounted to an increase of R884 million or 274 per cent compared to 2007. The notable jump in external assets can

be attributed to both the floatation of the local currency and an actual increase in external reserve holdings. Comparing the year end figures of 2007 and 2008 showed that the rupee to dollar rate depreciated 105 per cent whereas the external reserves increased 79 per cent based on the derived daily exchange rates on the last day for the past two years under observation.

The key payment issue of the year was the loan payment arrears of the government but with the reform programme and IMF aid, a restructuring programme has been undertaken to resolve the situation with creditors. In 2008, the bulk of the external payments were deployed to cover medical/pharmaceutical bills, student stipends and energy needs. A key cause behind the current situation was the continual rise in oil prices seen for the first three quarters of the year in international markets; this consumed the bulk of the external reserves for the year, thus interrupting loan repayments to official creditors which reached an impasse by the second quarter of the year before being officially suspended as part of the Paris Club negotiations.

6.4.4 Accounts of Commercial Banks

With new instruments and regulations to address liquidity reserve money targeting, the year saw a significant movement in the commercial banks' deposit account. However, on an end-of-period basis, there was an increase of R67 million or 12 per cent relative to the previous calendar year. More indicative of the current policy would be the significant decline in the deposits of commercial banks when comparing on a mid and end of year basis, which has seen a reduction of R192 million or 23 per cent.

In order to tighten liquidity, the Bank raised the minimum reserve requirement to 13 per cent, effective June 1 2008. Notwithstanding this, the commercial banks had no major issues in posting excess reserves for much of the period. However, towards the end of the year, the revaluation of their accounts caused by the floating of the rupee coupled with the seasonal withdrawal of deposits during the festive season, had seen their cumulative excess reserve position dwindled to the point of reaching a negative value by the end of December.

The Clearing House remained active during the year, once again posting increases in volume of transactions and number of items by 11 per cent and 4.2 per cent respectively.

Table 6.3
Bankers' Clearing House Activities; 2004-2008

	2004	2005	2006	2007	2008
			(Total)		
Number of items cleared	586,068	587,552	596,638	629,724	658,603
Amount (R'000)	2,386,481	2,192,623	2,339,696	2,382,069	2,652,751
			(Daily average)		
Number of items cleared	2,326	2,341	2,416	2,519	2,624
Amount (R'000)	9,470	8,736	9,472	9,528	10,569

Source: Central Bank of Seychelles

6.4.5 Public Debt Division

The year has seen the division continue its' operations as the government's domestic debt management agent as well as the registrar for government securities. A key development of the year was the conversion of the 20-Year restructuring bond, with a signed Memorandum of Understanding with government, into new marketable securities. The division also continued to act as an advisor to the Ministry of Finance in regards to management of its domestic debt portfolio. Furthermore, it continued to handle existing government debt to ensure that all payout schedules are met and adhered to required rules.

6.5 CBS holdings of Government Security

As part of the monetary reforms, the CBS and government came to an agreement via the means of the signing of a Memorandum of Understanding (MOU) with regards to a major government debt instrument. The MOU would see the CBS use pre-existing government debt owed and convert the amount into marketable securities, thus providing the Bank with additional tools to influence domestic liquidity.

Under the agreement, the debt in question, the 20-year government restructuring bond would be converted in tranches with the first tranche of R250 million made into 91-day treasury bills in December. The conversions of the remaining also into treasury bills will be undertaken in the coming year. As and when necessary, the objective is to offload these new securities to the market in line with the underlying reserve money objective.

6.6 Treasury Bills[6]

The year saw a 27 per cent increase in the amount of treasury bills purchased amounting to R314 million, with the increase ending a pattern of three consecutive years of decline circulation on a year

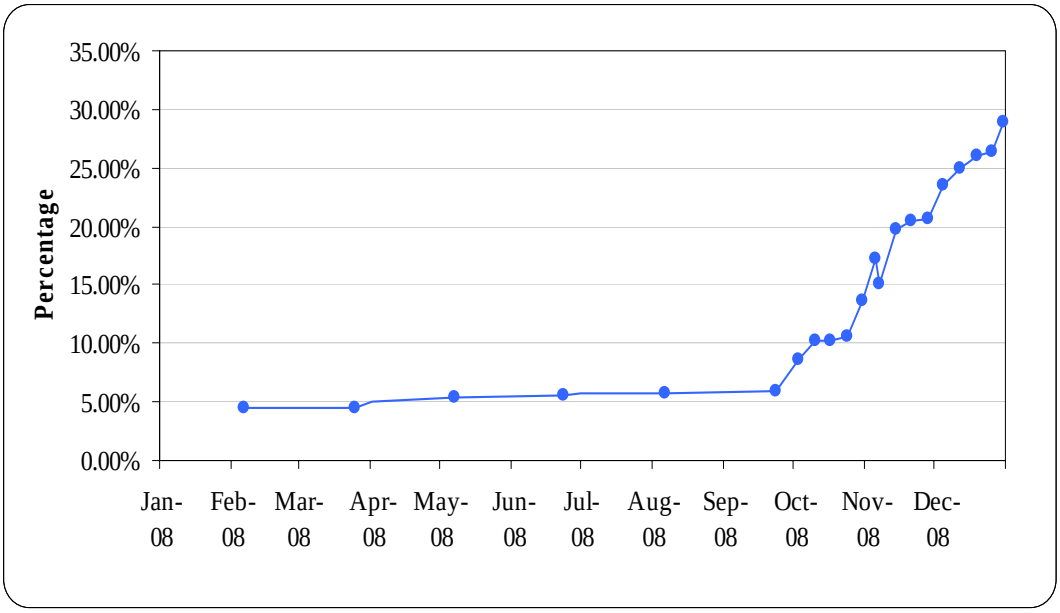
[6] Table non-inclusive of first tranche of R250 million of Treasury bills converted from the CBS 20-year restructuring bond.

end basis. This may be explained by the fact that in the last quarter of the year, unlike in the preceding years, the auction of the 91-day treasury bills was undertaken on a weekly basis, as part of the reform programme. It coincided well with the need for increased government funding in light of the inflationary tendencies that were seen to be developing towards the last quarter of 2009.

As has been the case over previous years, commercial banks remained the main participants in the primary auction with a R130 million or 12 per cent rise over a year ago. However, towards the end of 2008, the sharp rise in Treasury bill returns led to increased holdings by companies and individuals of 113 per cent or R60 million compared with the preceding year.

As monetary consolidation is achieved and inflationary tendencies subside, a softening in Treasury bill rates is expected on condition that inflation eases and the fiscal outcomes envisaged in the MEFP are met.

Chart 6.6 Tender Rates of 91-day T-Bills (2008)



Source: Central Bank of Seychelles

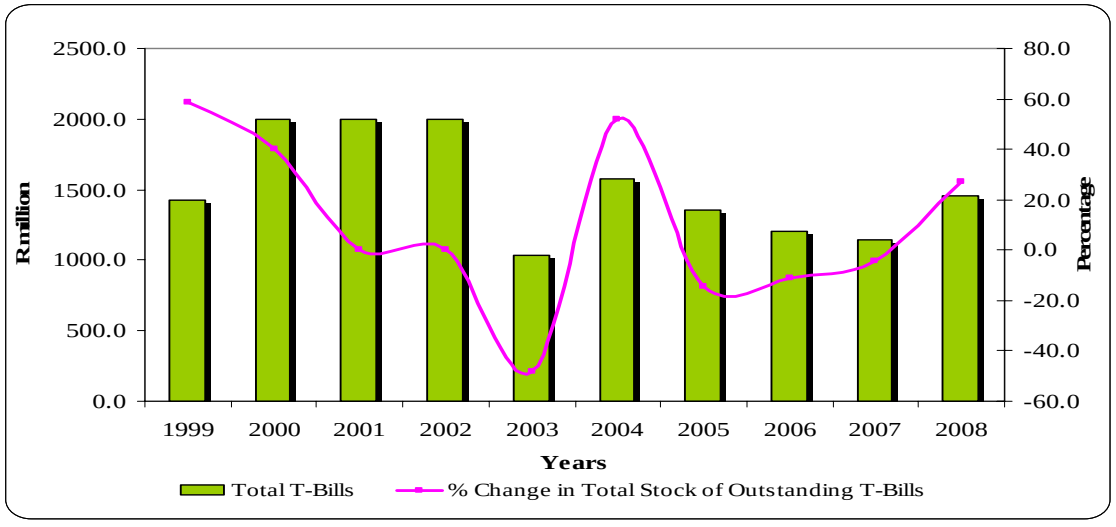
With the implementation of weekly tender bids for the treasury bills, the rates significantly increased compared to the first three quarters of the year. The increased frequency of the auction was a necessary measure so as to better manage liquidity conditions whilst meeting the financing needs of the budget. At the end of the year, the 91-day Treasury bill interest rate stood at 26.30 per cent.

Table 6.4
Treasury Bills;[1] 2004-2008[1/2/3]

	2004	2005	2006	2007	2008
	(R million)				
Stock outstanding [1/3]	**1564.7**	**1336.7**	**1,185.8**	**1,130.5**	**1,401.2**
91-day bills (tender issue)	1369.1	1144.88	1,089.7	1,035.2	1,323.1
365-day bills (tender issue)	192.6	191.9	96.1	95.3	78.1
Stock outstanding [2/3]	**1577.9**	**1353.2**	**1,200.0**	**1,145.0**	**1,458.8**
91-day bills (tender issue)	1377.9	1153.2	1,100.0	1,045.0	1,358.8
365-day bills (tender issue)	200.0	200.0	100.0	100.0	100.0
Commercial banks	1523.3	1315.7	1,143.0	1,102.7	1,233.0
Other financial institutions	0.0	0.0	0.0	0.0	25.5
Others	54.6	37.5	57.0	42.3	100.3

[1] *At cost value.*
[2] *At face value.*
[3] *End-of-period data.*
Note: With effect from January 2004 and December 2004, there were re-introductions of tender for 91-day and 365-day respectively.
Source: Central Bank of Seychelles

Chart 6.7 Total Stocks of Outstanding T-Bills (1999 - 2008)



Source: Central Bank of Seychelles

6.7 Treasury Bonds

The year saw the maturity of the 5.0 per cent 3-year bond, amounting to R490 million prior to the start of the year. As of the end of the year, R190 million is yet to be redeemed.

In December 2008, the government undertook a review of the coupon rates on existing bonds in light of the disparity with interest developments in the financial system. To help promote convergence, interest rates on the outstanding bonds were to be doubled effective January 2009 and would be further revised if returns do not still match future market conditions.

The year also saw a 273 per cent rise in subscription to the 6.0 per cent, 3 year bond bringing the total subscribed up to R87 million, with the issue frozen in September. With the restructuring of the 20-year bond into marketable securities, the Bank decided to close the primary market whilst an analysis of the secondary market is undertaken within the broader monetary policy framework.

Table 6.5
Treasury Bonds;[1] 2004-2008

Date Issued	**2004**	**2005**	**2006**	**2007**	**2008**
Stock outstanding	**1674.1**	**1765.6**	**2077.9**	**1826.2**	**1571.7**
4.0%, 3-yr	780.0	776.7	410.4	35.4	18.7
5.0%, 5-yr	500.0	490.9	490.9	490.9	189.7
7.5%, 7-yr	200.0	183.0	183.0	183.0	183.0
8.0%, 10-yr	194.1	291.5	293.6	293.6	293.6
8.25%, Esmeralda II	-	23.5	150.0	150.0	150.0
6.0%, 3-yr	-	-	500.0	500.0	500.0
10.0%, 3-yr	-	-	50.0	50.0	50.0
10.0%, 5-yr	-	-	-	100.0	100.0
6.0%, 3-yr	-	-	-	23.3	86.8
Commercial banks	1079.4	1094.5	1341.8	1052.4	841.0
Other financial institutions	8.6	94.7	402.8	405.2	352.9
Others	586.1	576.4	333.3	368.6	376.8

[1] *End-of-period data.*
Note: With effect from July 2003 there were new issues of bonds: 2.25%,1-yr; 4%, 3-yr;5%, 5-yr; 7%, 7-yr; and 8%, 10-yr.
With effect from June 2005 there was the issue of a new Esmeralda II bond yielding 8.25% compounded
With effect from July 2006 there were new issues of bonds; 6.0%, 3-yr; and 10.0%, 3-yr.
In May 2007 there was the issue of 10.0%, 5-yr bond.
In November 2007 there was the issue of 6.0%, 3-yr bond.
Source: Central Bank of Seychelles

6.8 Government Stocks

For the year, there was no change in the profile of government stocks, with no stock neither becoming due nor issued. Despite the change from a fixed to floating rate, the rates of returns have not been changed due to the fact that the function of the stocks, seen as a collateral-oriented instrument for the

Bank's dealings with commercial banks, will be up for review in consideration of their use as a prudential instrument.

Table 6.6
Government Stocks; [1/2]2004-2008

	2004	2005	2006	2007	2008
	(R million)				
Stock outstanding	**150.0**	**150.0**	**150.0**	**150.0**	**150.0**
8.00%, 2009	50.0	50.0	50.0	50.0	50.0
8.50%, 2005/07	30.0	30.0	30.0	-	-
8.50%, 2014	70.0	70.0	70.0	70.0	70.0
8.50%, 2017	-	-	-	30.0	30.0
Held by					
Commercial banks	147.1	147.1	147.1	147.1	147.1
Others	2.9	2.9	2.9	2.9	2.9

[1] *End-of-period data.*
[2] *At cost value.*
Source: Central Bank of Seychelles

6.9 Financial Intelligence Unit

The Financial Intelligence Unit (FIU), a unit housed within the Bank, was established on June 1, 2006.

Amongst the FIU's primary functions, is its upholding of the Anti Money Laundering Act 2006. This involves receiving, analysing and disseminating reports of transactions and notifying the relevant authorities if any fraudulent matter is suspected or discovered to be in contravention of the Act.

Over the year, it successfully completed 43 on-site examinations of Corporate Service Providers (CSPs). Also of paramount legislative importance is the Prevention of Terrorism Act 2004, where the FIU through the means of monitoring financial activities, can provide important information within the scope of its power to the authorities. To further improve its workings, the FIU has continued its' liaison with the Egmont Group through information exchanges with four new foreign institutions as well as requesting information from five similar foreign institutions.

On August 18, following the enactment of the amendment in the Anti-Money Laundering Act, the FIU was made an independent body free of Central Bank responsibility and with its own budget.

6.10 Financial Services Supervision Division

In 2008, the division continued with its endeavour to promote a sound financial structure through its methodical licensing process and on-site as well as off-site examinations of supervised institutions. In addition, the Division was actively involved in the revision of regulations.

In March 2008, BMI Offshore, a joint venture between Bank Muscat International and Nouvobanq was licensed. Together with the licensing of 6 new bureaux de change (4 Class B and 2 Class A), the portfolio of supervised institutions was brought to 16, consisting of 7 commercial banks of which 2 conduct offshore banking business, 8 bureaux de change and a micro-finance institution.

The proliferation in bureaux de change forms part of the reform programme supported by the IMF, in line with the Government's initiative to facilitate their establishment in order to bring competition in the foreign exchange market. To achieve this, the Financial Institutions Act, 2004 was amended and the Financial Institutions (bureau de change) Regulations, 2008 issued to provide for two classes of bureaux de change and allow for the abridgement of requirements to obtain a licence. Class B licence holders are only allowed to purchase and sell foreign currency while Class A ones are also authorised to engage in wire transfer of foreign currency.

In line with the 18-month action plan for technical assistance from the IMF, which was prepared based on the 25 Core Principles for Banking Supervision, a manual on licensing guidelines was drafted with the aim of ensuring that all licence applications are processed in an objective, fair, consistent and timely manner. In addition various regulations were drafted of which 2 (Liquidity Risk Management and Foreign Currency Exposure) were approved by the Central Bank's Board of Directors. These are scheduled to be published in the gazette in the first quarter of 2009 together with other regulations which are yet to be finalised. In addition, staff got the opportunity to interact with consultants on issues ranging from payments systems, monetary operations and financial institution stress testing.

Regulations on Complaints Handling were also issued in July as part of Central Bank's initiative to improve customer satisfaction with the services that banks and bureaux de change deliver. These institutions are expected to abide by the regulations which specify the rules, procedures and timeframes within which complaints need to be acknowledged, handled and reported.

The year under review saw the repeal of the Central Bank of Seychelles (Minimum Interest Rate) Regulations in December which had become redundant considering the adoption of a market-based approach to the determination of interest rates. The Minimum Capital Regulations 1986 was also repealed in the same month, allowing financial institutions the flexibility to decide where to invest their capital funds in line with international best practices. Further to that, discussions with commercial banks regarding the proposed second round revision to the Financial Institutions Act 2004, were initiated.

In line with its policy for continuous improvement, the division created a dedicated e-mail address for the submission of prudential returns. As such the electronic submission of returns replaced the need to

send hard copies and hence adopting a more modern and efficient way of work. That said, as customary, off-site monitoring of reporting institutions through the monitoring of the banks' statistical returns was carried out throughout the year. Subsequently, the relevant financial soundness indicators, which were revised during the year to include additional indicators of the health and financial soundness of financial institutions, were computed and analysed.

As regards to on-site supervision, Saymore, Seychelles Credit Union, Habib Bank and Barclays Bank Offshore were inspected. Reporting by exception was initiated in relation to the latter and will henceforth be the way forward.

In relation to ongoing training, members of staff were exposed to different courses which included Basel II, performance management, strategic business, mutual funds, soft skills, e-mail etiquette, Business French, international conference for banking supervisors as well as the chance to undertake a familiarisation visit in Bahrain as part of the process leading to the licensing of a new bank.

6.11 Securities and Financial Markets Division

The Securities and Financial Market (SFM) Division is governed by the Insurance, Mutual Fund and Securities Acts with the overall goal of providing sound financial services via the channels of implementing regulations, monitoring market developments and administration of licensed entities in accordance with the Acts. With the downturn in global financial markets, the division has not been able to achieve its ambitious yet fully tenable goals.

In regards to the core setup, several improvements have been made with more to follow with the overall objective of having the domestic financial markets seen as a sound investment vehicle for both local and international investors, thus broadening the scope of economic activity within the country.

6.11.1 Securities and Mutual Funds Section

A key development in the year and perhaps the future of the local financial markets was the enactment of the Mutual Funds Act, repealing the 1997 legislation. The year also saw a comprehensive review of both the securities and mutual funds acts with the aim to provide a more dynamic piece of legislation on which further guidelines and regulations could be created, modified or added.

With that in mind, several benchmarks were set including, among others, fit and proper guidelines, licensing and minimum competency. The end-result of these was the approved licensing of two Foreign Administrators through the means of exemption letters. While the goal is to have a fully developed local stock exchange, the current financial climate is not appealing to investors. The

division is however continuing its goal in securing the support of credible parties once global conditions stabilise by early 2009.

6.11.2 Insurance Section

The Insurance Act 2008, repealing the 1997 Act, became operational in April. The key change in the act was the shift in responsibility in regards to regulation from the Seychelles Insurance Authority to the SFM Division. As per the new legislative change, applications for licenses are starting afresh primarily from brokers and agents. The overall goal is to have a competitive market attracting international players seeking to invest into this segment of the financial market. This is line with the market liberalisation policy set forward by the government.

6.11.3 Compliance Section

The continuing development in human resources has seen the recruitment of various members to head their respective task force within the division. With the necessary procedures at near completion the importance of the compliance section was paramount to the overall running of the division. Prior to approval, and as defined by the relevant act, the compliance section works closely with the two other sections within the division, in ensuring that the necessary measure and checks are in place.

The foundation of success for the division lies with its standards and quality of its staff resources versus the highly competitive markets it is up against. Thus, from the start it has been the division's policy to gain maximum exposure, experiences and credibility from other markets and organizations to better the sector via a multitude of means and ensuring it has the appropriate human resources to carry out the necessary tasks.

The division had exchanges with its Mauritian counterpart with regards to the Financial Services Sector. This was followed by the visit of two senior officials from the Abu Dhabi Securities Exchange which will provide vital backing in setting up the local securities exchange.

Several international standards have been met including the IAIS and OGIS standards in the insurance sector and the IOSCO standard for securities. A direct rapport built with the Finance Intelligence Unit (FIU), will facilitate any Due Diligence checks.

The division has also sought extensive training from relevant international bodies and individuals starting with the Consultant of legal and financial training from the prestigious Gostick Hall (U.K.) in early January. This was followed mid-year by level 1 training on Mutual Funds, Hedge Funds and Securities. Several attachments were also undertaken with relevant bodies from Mauritius and Abu

Dhabi. Human resource development needs to be a continual process if the division is to accelerate the development of the markets which are still in the infancy stage in Seychelles.

6.12 Monetary Analysis and Statistics Division

In October of the year, the name of the division was changed from Research and Statistics to Monetary Analysis and Statistics following the decision of the Board to provide more focus on the Bank's monetary policy formulation function. To this end, the Division was mandated with the prime task of conducting frequent monetary and exchange rate policy reviews for better monitoring and design of policy prescriptions being implemented whilst allowing for prompt adjustment of policy instruments if the need arises.

Thus during the year, the Division received Technical Assistance from the IMF to enhance its capacity in monetary and foreign exchange operations and research. This was delivered through three 2-3 weeks visits of a monetary expert in combination with two visits of a foreign exchange operations expert. Consequently, besides the preparation of Quarterly Reviews and Annual Report as well as monthly economic reviews and weekly economic analysis, the Division also undertook a series of research work on monetary and exchange rate issues so as to address immediate policy concerns. Additionally, the Economic Analysis and Research Unit was actively involved in the formulation of both monetary and exchange rate policies as well as the implementation of new monetary policy instruments.

Consistent with the above, the Statistics Unit, with the assistance from the same monetary IMF consultant, designed a Liquidity Monitoring Framework to assist the Central Bank identify and assess the liquidity position in the banking system. This was to support the Bank in determining the most effective policy instruments for better liquidity management. The information that is produced is used by the Monetary Operations Committee in its decisions of policy actions.

Moreover, the Unit continued to improve its statistical database throughout the year. It re-designed several of its reporting forms to include additional information as well as add more clarity. The Unit also initiated electronic submission of these report forms mainly those from the commercial banks. As of October, the Division successfully implemented the electronic submission system thus allowing faster delivery of key monetary and finance statistics. Furthermore, as per the GDDS project and headed by the National Statistics Bureau (NSB), the Unit launched the National Summary Data Page (NSDP). This is a webpage uploaded on the NSB's website consisting of data from the three main agencies in the country; Central Bank of Seychelles, Ministry of Finance and NSB. In an attempt to allow for increased synergy between the Statistics Unit and the Economic Research and Analysis Unit, the former underwent some major restructuring during the year.

6.13 Internal Audit Division

In line with the new reforms at the Bank, the Internal Audit function was reactivated with an Internal Auditor being appointed. Due to its late activation in September, not much was done in terms of processed work but rather, emphasis was placed in structure and organization. An Audit Charter is currently being drafted and in due course will be presented to the Audit Committee prior to presentation before the Board. The Audit Charter will be done in conjunction with the Audit Committee.

6.14 Board of Directors

There were two changes in personnel on the Board of Directors with the appointments of a new Governor and a board member, where the latter is the new Attorney General who replaced Mr Chang-Sam following his resignation from the Board. For the year, there were 13 board meetings, five greater than the minimum statutory requirement.

6.15 Appreciation

The Board and management of the Central Bank wish to record their appreciation to all staff members of the Central Bank for their valuable contributions to the operations of the Bank in 2008. Despite the serious economic challenges, staff members have continued to discharge their responsibilities in a professional, ethical and exemplary manner as befitting a central monetary institution. Above all, they have done so with loyalty, sincerity, quiet efficiency. While the New Year will bring numerous challenges coupled with the beginning of a new era in economic management, the same if not more will be demanded of everyone. On this note, the Board of Directors look forward to another successful year ahead.

ANNEX I

OFFICE OF THE AUDITOR GENERAL
P.O. Box 49 - Victoria,
Mahe, Republic of Seychelles
Telephone: (248) 610360 Fax: (248) 610365
E-mail: auditgen@oag.sc

Please address all correspondence to the Auditor General

OPINION OF THE AUDITOR GENERAL ON THE ACCOUNTS OF THE CENTRAL BANK OF SEYCHELLES FOR THE YEAR ENDED 31 DECEMBER 2008

Scope

Pursuant to the power conferred on me by Section 47(3) of the Central Bank of Seychelles Act 2004, I have caused PricewaterhouseCoopers to audit on my behalf the financial statements of the Central Bank of Seychelles (the Bank) for the period ended 31st December 2008, as set out on pages 6 - 27 prepared on the basis of the accounting policies stated on pages 10 - 13.

The Board of the Bank is responsible for the preparation and fair presentation of these financial statements in accordance with Generally Accepted Accounting Practices and in compliance with the requirements of the provisions of the Central Bank of Seychelles Act 2004. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

The audit was conducted in accordance with the International Standards on Auditing. The audit procedures included examination, on a test basis, of evidence supporting the amounts and disclosures in the financial statements as well as an assessment of accounting policies and significant estimates.

The audit was planned and conducted so as to obtain all information and explanations considered necessary to provide the auditors with sufficient evidence to give a reasonable assurance that the financial statements are free of material misstatements. The overall adequacy of the presentation of information in the financial statements was also evaluated in forming my opinion.

The audit opinion has been formed on the above basis.

Opinion

In my opinion,

(a) proper accounting records have been kept by the Bank as far as it appears from the examination of those records; and

(b) the financial statements on pages 6 to 27 give a true and fair view of the financial position of the Bank at December 31, 2008, and of the financial performance and its cash flow for the year then ended in accordance with Generally Accepted Accounting Practices and comply with the Central Bank of Seychelles Act 2004.

Marc Benstrong
Auditor General

27 March 2009
Seychelles, Victoria

PRICEWATERHOUSECOOPERS

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AUDITOR'S REPORT TO THE AUDITOR GENERAL OF THE

CENTRAL BANK OF SEYCHELLES

Report on the Financial Statements

1. We have audited the financial statements of Central Bank of Seychelles (the "Bank") on pages 6 to 27 which comprise the balance sheet at 31 December 2008 and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' Responsibility for the financial statements

2. The directors are responsible for the preparation and fair presentation of these financial statements in accordance with the Bank's Accounting Policies and in compliance with the requirements of the provisions of the Central Bank of Seychelles Act 2004. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

3. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

5. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

"PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

PRICEWATERHOUSECOOPERS

AUDITOR'S REPORT TO THE AUDITOR GENERAL OF THE

CENTRAL BANK OF SEYCHELLES (CONTINUED)

Opinion

6. In our opinion, the financial statements on pages 6 to 27 have been prepared in all material respects, in accordance with the Bank's Accounting Policies, set out in Note 2 to the financial statements and comply with the Central Bank of Seychelles Act 2004.

Report on Other Legal and Regulatory Requirements

7. In our opinion, proper accounting records have been kept by the Bank as far as appears from our examination of those records.

Emphasis of matter

8. Without qualifying our opinion, we emphasise that the accounting policies used and disclosures made are not intended to, and do not, comply with all the requirements of International Financial Reporting Standards.

Other matters

9. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

10. The financial statements of the Bank as of 31 December 2007 were audited by other auditor whose report, dated 14 March 2008, expressed an unqualified opinion on those financial statements.

PricewaterhouseCoopers

27 March 2009

CENTRAL BANK OF SEYCHELLES

BALANCE SHEET AS AT 31 DECEMBER 2008

	Notes	2008	2007
		SCR	SCR
EQUITY AND LIABILITIES			
Capital and Reserves			
Capital	5	**1,000,000**	1,000,000
Reserves	6	**243,177,818**	151,641,042
Total capital and reserves		**244,177,818**	152,641,042
Liabilities			
Currency in circulation	7	**477,573,318**	450,609,571
Deposits			
Banks	8	**698,612,330**	662,443,749
Government	9	**115,061,490**	26,526,930
Others	10	**592,541,726**	22,026,263
Total Deposits		**1,406,215,546**	710,996,942
International Monetary Fund obligations	11	**168,033,660**	5,358,304
Other liabilities	12	**167,547,908**	191,036,475
		335,581,568	196,394,779
Total liabilities		**2,219,370,432**	1,358,001,292
Total liabilities and capital		**2,463,548,250**	1,510,642,334
ASSETS			
Cash and cash equivalents	13	**1,211,772,819**	322,507,904
Investments in Government Treasury Bills	14	**251,045,000**	-
Advances	15	**140,600,000**	86,400,000
Investments in Government Securities	16	**747,052,840**	1,052,583,173
Other assets	17	**12,864,309**	10,464,653
Long term deposit with financial institutions	18	**40,273,000**	-
Currency replacement cost		**6,437,465**	3,825,429
Property, plant and equipment	19	**53,502,817**	34,861,175
Total assets		**2,463,548,250**	1,510,642,334

These financial statements were approved and authorised for issue on March 27, 2009 **by the undersigned:**

P.A. Stravens
Head of Division – Banking Services

P.F. Laporte
Governor

The notes on pages 10 to 27 form an integral part of these financial statements.

CENTRAL BANK OF SEYCHELLES

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2008

	Notes	2008	2007
		SCR	SCR
INCOME			
Interest income	20	**85,637,169**	84,058,530
Interest expense	21	(**20,519,758**)	(21,209,215)
Net interest income		**65,117,411**	62,849,315
Other income	22	**68,646,537**	106,838,591
		133,763,948	169,687,906
EXPENDITURE			
Notes and coins- Currency expenses		(**20,375**)	(81,496)
Amortisation of currency cost		(**2,056,703**)	(956,357)
Other operating expenses		(**31,573,893**)	(25,268,138)
Financial and professional charges	23	(**4,424,586**)	(1,302,554)
		(**38,075,557**)	(27,608,545)
Net profit for the year	24	**95,688,391**	142,079,361

The notes on pages 10 to 27 form an integral part of these financial statements.

CENTRAL BANK OF SEYCHELLES

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2008

	Capital	General Reserve	Revaluation Reserve	Net Profit	Total
	SCR	SCR	SCR	SCR	SCR
At 01 January 2007	**1,000,000**	**20,000,000**	**68,043,028**	**-**	**89,043,028**
Exchange differences on translation of assets and liabilities	**-**	**-**	**96,508,275**	**-**	**96,508,275**
Net profit for the year	**-**	**-**	**-**	**142,079,361**	**142,079,361**
Transfer to Government Consolidated Fund	**-**	**-**	(**32,910,261**)	(**142,079,361**)	(**174,989,622**)
At 31 December 2007	**1,000,000**	**20,000,000**	**131,641,042**	**-**	**152,641,042**
Exchange differences on translation of assets and liabilities	**-**	**-**	**147,331,231**	**-**	**147,331,231**
Net profit for the year	**-**	**-**	**-**	**95,688,391**	**95,688,391**
Transfer to Government Consolidated Fund	**-**	**-**	(**55,794,455**)	(**95,688,391**)	(**151,482,846**)
At 31 December 2008	**1,000,000**	**20,000,000**	**223,177,818**	**-**	**244,177,818**

The notes on pages 10 to 27 form an integral part of these financial statements.

CENTRAL BANK OF SEYCHELLES

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008

	Notes	2008	2007
		SCR	SCR
Cash flows from operating activities			
Cash generated from/(used in) operations	27	**832,479,187**	(410,824,654)
Cash flows from investing activities			
Purchase of notes and coins		(**4,668,739**)	-
Acquisition of property, plant and equipment	19	(**20,753,082**)	(11,859,910)
Proceeds from disposal of property, plant and equipment		**758,469**	6,501
Proceeds from redemption of government securities		**55,530,333**	58,476,843
Net cash generated from investing activities		**30,866,981**	46,623,434
Cash flows from financing activities			
Increase in currency in circulation		**26,963,747**	33,396,845
Purchase of bonds		(**1,045,000**)	-
Net cash from financing activities		**25,918,747**	33,396,845
Increase/(decrease) in cash and cash equivalents		**889,264,915**	(330,804,375)
Cash and cash equivalents at start of the year		**322,507,904**	653,312,279
Cash and cash equivalents at end of year	13	**1,211,772,819**	322,507,904

The notes on pages 10 to 27 form an integral part of these financial statements.

CENTRAL BANK OF SEYCHELLES

NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2008

1 LEGAL INFORMATION

The Central Bank of Seychelles ("the Bank") is established by statute under section 3 of the Central Bank of Seychelles Act 2004 (the "CBS Act 2004") which states, "there is hereby established the Central Bank of Seychelles which shall be a body corporate with perpetual succession and a common seal."

The objectives of the Bank are:

- to regulate the issue, supply and availability of money and its international exchange;
- to promote price stability and the maintenance of both domestic and external value of the Seychelles currency;
- to advise the Government on banking, monetary and financial matters, and in particular on the monetary implications of proposed fiscal or credit policies or operations of the Government;
- to promote internal and external monetary stability;
- to promote a sound financial structure;
- to foster financial conditions conducive to the orderly and balanced economic development of Seychelles; and
- to perform such other functions as may be assigned to the Bank by any law.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted by the Bank are as follows:

(a) Basis of preparation

The financial statements have been prepared in accordance with the Bank's Accounting Policies and in conformity with the Central Bank of Seychelles Act 2004. They have been prepared under the historical cost convention as modified by the revaluation of certain assets and liabilities.

Where necessary, comparative figures have been amended to conform with change in presentation in the current year.

All changes made have had no impact on the Bank's profit for the year ended 31 December 2007 and 2006.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Foreign currency translation

Functional and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are presented in Seychelles Rupees ("SCR"), which is the Bank's functional and presentation currency.

Transactions and balances

Transactions denominated in foreign currencies are translated into SCR and recorded at the rates of exchange prevailing at the date of the transaction. Balances in foreign currencies are translated into SCR at the mid exchange rates ruling on the balance sheet date.

Net exchange differences arising on translation at the balance sheet date are recognised directly within the Revaluation Reserve Account as per section 28(1) of the CBS Act 2004. Until 31 October 2008, the exchange rate of the Seychelles rupee during the period was determined by the Board of Directors, in accordance with section 26 (1), of the CBS Act 2004, and having due regard to the obligations that Seychelles has assumed in accordance with the provisions of any international monetary agreement to which it is a party or to which it has adhered. Since 01 November 2008 the exchange rate of the Seychelles rupee is determined by the market.

The following rates of exchange were applied at 31 December 2008:

IMF Special Drawing Rights	XDR 1 = Rs 25.5448
United States Dollars	USD 1 = Rs 16.5732
British Pound Sterling	GBP 1 = Rs 23.6478
Swiss Francs	CHF 1 = Rs 15.3697
Euros	EUR 1 = Rs 22.8713

(d) Cash and Cash Equivalents

Cash and cash equivalents include all foreign currency balances held with international and local financial institutions. It also includes holdings of Special Drawing Rights with the International Monetary Fund ("IMF").

(e) Investments in Government Securities

Investments in Government Securities relate to Seychelles Government securities other than Treasury Bills and are stated on the following bases:

- Treasury Bonds - at nominal value
- Other securities - at nominal value

(f) Advances

Advances relate to advances made to commercial banks and the Government. Advances are stated at cost in the financial statements.

(g) Investments in Government Treasury Bills

Investments in treasury bills are stated at cost plus accrued discount.

(h) Deposits

Deposits held by the Bank, whether SCR or foreign deposits, earn no interest and are not allowed to be overdrawn. In the event of an overdraft on the Government general account and commercial bank's deposit accounts, the Bank will grant temporary short term advances and this will be charged at the applicable interest rates. Foreign currency deposit accounts are revalued to reflect the market exchange rate at the balance sheet date. Long term deposits carry interest and are stated at cost.

(i) Currency replacement cost

Currency note printing and coin minting costs incurred are deferred and are charged to the income statement. Useful lives are currently estimated to be 5 years but this is reviewed at least annually. The unamortised cost of purchased bank notes in issue is included in Currency replacement cost in the balance sheet.

When notes and coins are returned to the Bank by the commercial banks, Government entities and the general public they are removed from currency in circulation and, depending on their condition or legal tender status, they are either sent for destruction or held for re-issue.

(j) Property, plant and equipment

Property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial year in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

– Buildings $1^1/_2$% p.a.;
– Office furniture and equipment 10% - 20% p.a;
– Computer and office equipment 25% p.a.;
– Motor vehicles 20% p.a.

A full year's depreciation is charged in the year the assets are purchased and none in the year of sale.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Property, plant and equipment (Continued)

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement in Other income or in Operating expenses.

(k) Currency in Circulation

Currency in circulation represents money released to the public for circulation. This represents an unserviced liability of the Bank and is recorded at its face value.

(l) Balances with the International Monetary Fund

These include amounts due to/from the International Monetary Fund ("IMF") and are carried at cost in the financial statements.

(m) Interest income and expense

Interest income and interest expense are recognised on the dates of transactions.

(n) Fee and commission income

Commission on foreign exchange dealings are recognised on the dates of transactions.

3 FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks: market risk, currency risk, credit risk, liquidity risk and operational risk. A description of the significant risk factors is given below together with the risk management policies applicable.

(a) Market risk

Market risk refers to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices.

Market risk arises from open positions in interest rate and foreign currency products, all of which are exposed to general and specific market movements. The Bank's exposure to market risk is the result of both trading and asset/liability management activities. The market risk is managed by limiting transactions to mature markets.

(b) Currency risk

Currency risk refers to the risk that the fair value or future cash flows of financial instruments will fluctuate because of changes in foreign exchange rates.

The Bank operates internationally and takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows primarily with respect to the United States dollar, Euro and Great Britain Pound.

The Bank incurs currency exposure as a result of its management functions and does not hedge against currency risk. Exchange gains and losses arising from the revaluation of assets and liabilities denominated in foreign currencies are accounted in a revaluation reserve account in accordance with Section 28 of the CBS Act 2004.

(c) Credit risk

Credit risk refers to the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The Bank is not exposed to significant credit risk which is the risk that its counterparties will be unable to fulfill their contractual obligations.

The Bank manages its credit risks by adopting a practice of investing and holding demand deposits only with counterparts with good credit status such as other Central Banks and Banks for International Settlements.

3 FINANCIAL RISK MANAGEMENT (Continued)

(d) Liquidity risk

Liquidity risk refers to the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions. The Bank aims at maintaining flexibility in funding committed credit lines available. The Bank being an issuer of bank notes and coins and a creator of central bank money does not face significant liquidity risk in its domestic currency. Liquidity risk in foreign currencies is managed by investing in high quality liquid assets denominated in the appropriate currencies.

(e) Operational risk

Operational risk is the risk of financial loss and business instability arising from failures in internal controls, operational processes or other supporting systems. It is understood that such risks cannot be entirely eliminated and the cost of controls in minimising these risks may outweigh the potential benefits. As part of the implementation of the Bank's risk strategy, independent checks on risk issues are undertaken by the internal audit unit.

4 TRANSFER TO GOVERNMENT CONSOLIDATED FUND

Transfer to the Consolidated Fund has been carried out in accordance with Section 16(3) and Section 28(4) of the CBS Act 2004.

5 CAPITAL

	2008	2007
	SCR	SCR
Authorised	**10,000,000**	10,000,000
Paid up	**1,000,000**	1,000,000

The CBS Act 2004 requires that:

- the authorised share capital of the Bank shall be SCR 10 million and may be increased from time to time by such amount as may be proposed by the Board of directors in consultation with the President of the Seychelles.
- the initial paid-up capital of the Bank shall be SCR 1 million.

6 RESERVES

	2008	2007
	SCR	SCR
General Reserve (Note 6(a))	**20,000,000**	20,000,000
Revaluation Reserve (Note 6(b))	**223,177,818**	131,641,042
Total Reserves	**243,177,818**	151,641,042

(a) General Reserve

The General Reserve has been established and maintained in accordance with section 16(1) of the CBS Act 2004.

(b) Revaluation Reserve

Gains and losses arising from changes in the valuation of the Bank's assets and liabilities denominated in foreign currencies and other units of account as a result of alterations of parity of the Seychelles rupee have been credited or charged to this account in accordance with section 28 of the CBS Act 2004.

7 CURRENCY IN CIRCULATION

Notes and coins in circulation are shown at face value, net of the notes and coins held in the tills and vaults at the Bank. Coins sold for numismatic purposes, with a face value of approximately **SCR 16,151,157** at 31 December 2008 (2007 – SCR 16,151,157), have been excluded from currency in circulation since it is unlikely that such coins will be presented at any time for redemption.

CENTRAL BANK OF SEYCHELLES

NOTES TO THE FINANCIAL STATEMENTS –31 DECEMBER 2008 (CONTINUED)

	2008	2007
	SCR	SCR

7 CURRENCY IN CIRCULATION (Continued)

Notes issued		
Face value		
R 500	**187,842,000**	166,689,000
R 100	**220,887,000**	221,746,400
R 50	**25,153,550**	21,331,400
R 25	**7,940,275**	7,852,125
R 10	**8,838,080**	7,773,310
Total Notes issued	**450,660,905**	425,392,235
Coins Issued		
Face value		
R 5	**9,806,100**	9,130,220
R 1	**9,414,497**	8,848,964
25 cents	**5,043,700**	4,743,992
10 cents	**1,579,896**	1,494,896
5 cents	**1,050,398**	981,873
1 cent	**17,822**	17,391
Total Coins issued	**26,912,413**	25,217,336
Total Notes and Coins issued	**477,573,318**	450,609,571

8 BANKS DEPOSITS

Banks demand deposits	**637,534,144**	570,450,251
Deposit Auction Arrangement	**16,000,000**	-
Long Term Deposit from Financial Institutions	**40,273,000**	-
Pipeline Deposit Accounts (Repayable on Demand)	**4,805,186**	91,993,498
	698,612,330	662,443,749

8 BANKS DEPOSITS (Continued)

(a) Bank demand deposits

Commercial banks are required, as per regulations issued under the CBS Act 2004, to place deposits with the Bank. The level of these deposits is adjusted on the basis of the monetary policy stance as approved by the Board of Directors. As per the last revision, the minimum reserve requirement amounted to 13% of their customers' deposits (Rupee deposits held as demand, savings and time deposits and the equivalent in Seychelles Rupees of foreign currency deposits held by residents but exclude inter-bank and foreign currency deposits held by non-residents) and earn interest at 25 basis points.

(b) Deposit Auction Arrangement

The Deposit Auction Arrangement ("DAA") is a liquidity management tool made available by the Bank to the commercial banks for better liquidity management by both parties. The Bank uses the instrument to mop up excess liquidity in the system whilst the bank uses it as a convenient means for them to invest their excess reserves and earn a competitive return over three specified short-term time span (7 days, 14 days and 28 days).

This arrangement became operational in September 2008 and is held on a weekly basis. Under this scheme, commercial banks are called to state the amount of funds they would like to bid in any of these maturities at the desired interest rate. The Monetary Operation Committee of the Bank decides whether to accept or reject any bid as guided by the liquidity position in the financial system and depending on the sterilisation needs.

At the balance sheet date, the amount of SCR 16 million had a maturity period of 7 days.

(c) Long term deposit from Financial Institutions

This amount represents a three year fixed deposit made by a local financial institution with the Bank under a special arrangement and carries interest at the rate of 8% per annum payable monthly in USD.

(d) Pipeline Deposit Account (Repayable on demand)

Prior to October 2008, commercial banks were required to place the SCR equivalent of their foreign exchange request at the Bank. Following the liberalisation of the foreign exchange control in November 2008, there was no raison-d'etre for such a scheme. At the balance sheet date most commercial banks had withdrawn their deposit from the scheme.

9 GOVERNMENT DEPOSITS

	2008 SCR	2007 SCR
Government Rupee Deposits	**6,548,539**	7,628,862
Government Foreign Exchange Deposits (Project Accounts)	**108,428,832**	18,856,203
Government Deposits with IMF	**84,119**	41,865
	115,061,490	26,526,930

Government Foreign Exchange Deposits (Project Accounts)

These represent amounts deposited by the Government at the Bank and which have been earmarked for specific local projects to be undertaken by the Government. The deposits are denominated in foreign currencies and are non-interest bearing.

10 OTHER DEPOSITS

	2008 SCR	2007 SCR
Special Deposits	**115,261**	190,553
Central Bank of Seychelles Blocked Foreign Deposits	**100,350,421**	-
Abandoned Property Account	**7,281,608**	6,943,211
Liquidation Deposit	**439,893,106**	-
Others	**44,901,330**	14,892,499
	592,541,726	22,026,263

(a) Central Bank of Seychelles Blocked Foreign Deposits

These deposits are foreign exchange receipts denominated in the three main currencies for which the beneficiaries have not yet been identified and/or these funds have been deposited with the Bank for other purpose (not directly related to the Government or Central Bank) for which the relevant documents have not yet been formalised as at the balance sheet date.

(b) Abandoned Property Account

As per the Financial Institutions Act 2004, commercial banks are required to publish and report to the Bank, abandoned/dormant accounts of clients, where no transaction has been made for at least 10 years. In the 11th year, unclaimed funds are transferred to the Bank. The abandoned property account is non interest bearing and refundable to the clients on demand.

10 OTHER DEPOSITS (Continued)

(c) Liquidation deposit

Liquidation deposit represents funds deposited at the Bank by the liquidator following the disposal of a property in the Seychelles. The proceeds, denominated in foreign currency, were converted into SCR at the spot rate at the date of the transaction due to the foreign exchange restrictions prevailing at that date, and lodged with the Bank. The deposit is non interest bearing and the liability of the Bank is restricted to the SCR amount deposited at the date of the transaction.

11 INTERNATIONAL MONETARY FUND OBLIGATIONS

	2008	2007
	SCR	SCR
Purchases Outstanding - Stand-By Arrangement	**157,355,968**	-
Allocation of Special Drawing Rights (SDR)	**10,381,407**	5,145,345
IMF No. 1 Account	**285,100**	204,923
IMF No. 2 Account	**11,185**	8,036
	168,033,660	5,358,304

As a member of the IMF, Seychelles was assigned a quota of SDR 8,800,000 which determines the financial and organisational relation with the IMF.

Seychelles maintained the following balance sheet accounts with the IMF: IMF Purchases Outstanding Account; SDR Allocation Account; IMF No.1 Account and IMF No. 2 Account. Seychelles also hold an off balance sheet item called the IMF Securities Account. SDR Allocations are subject to charges while SDR holdings (No. 1 and No. 2 Accounts) earn interest on a quarterly basis.

The IMF Purchases Outstanding account was opened in November 2008 as a result of the IMF Reform Programme. In support of the IMF Reform Programme, the Government of Seychelles was granted a two-year Stand-by arrangement for an amount of SDR 17.6 million (200 percent of quota). 70% of the quota was paid up-front equivalent to SDR 6,160,000 (equivalent SCR 157,355,968) which is included under IMF Obligations on the Balance Sheet. The remaining amount will be disbursed equally starting from the second quarter of 2009 after each quarterly review.

12 OTHER LIABILITIES

	2008	2007
	SCR	SCR
Payable to Government Consolidated Fund		
Transfer from Income Statement	**95,688,391**	142,079,361
Transfer from Revaluation Reserve Account	**55,794,455**	32,910,261
	151,482,846	174,989,622
Others	**16,065,062**	16,046,853
	167,547,908	191,036,475

	2008	2007
	SCR	SCR

13 CASH AND CASH EQUIVALENTS

Balances held abroad and foreign currency notes	**1,211,702,366**	322,381,271
Holdings of Special Drawing Rights	**70,453**	126,633
	1,211,772,819	322,507,904

Included in cash and cash equivalents are pledged and encumbered assets amounting to SCR 208,933,825 and SCR 177,903,589 respectively. These represent earmarked funds set aside by the Bank for the purpose of developing projects or other pledges and contingent liabilities.

14 INVESTMENTS IN GOVERNMENT TREASURY BILLS

Government Treasury Bills	**251,045,000**	-

During the year ended 31 December 2008, SCR 250 million was converted into CBS securities from the 20 year government restructuring bond. The SCR 1 million represents CBS discounting of bills on behalf of government on the secondary market. The Bank facilitates the secondary market for buyers and sellers and holds the securities until their maturity or until there are new buyers and earns interest for the period of holding.

15 ADVANCES

	2008	2007
	SCR	SCR
Advances	**140,600,000**	86,400,000

Advances represent advances granted to the Government during the year. Interest on advances is calculated daily and is compounded on a monthly basis. The applicable rates of interest are as follows:

- Up to SCR 100 m – 4.5% p.a.;
- Above SCR 100 m – 7.5% p.a.

16 INVESTMENTS IN GOVERNMENT SECURITIES

	2008	2007
	SCR	SCR
20 Year Restructuring Bond	**747,052,840**	1,052,583,173

The investment relates to Seychelles Government Securities which has a maturity of 20 years and earns interest at the rate of 5% per annum.

17 OTHER ASSETS

	2008	2007
	SCR	SCR
Reserve tranche with IMF	**84,119**	41,692
Cheques held for clearing	**1,341,517**	3,448,724
Staff loan	**6,797,845**	5,948,001
Item due and unreceived	**4,044,413**	431,686
Others	**596,415**	594,550
	12,864,309	10,464,653

18 LONG TERM DEPOSIT WITH FINANCIAL INSTITUTIONS

	2008	2007
	SCR	SCR
Long term deposit with financial institution	**40,273,000**	-

The amount represents a three-year fixed deposit made by the Bank into a local financial institution. The deposit is denominated in SCR and earns interest at the rate of 5% p.a, payable monthly.

CENTRAL BANK OF SEYCHELLES

NOTES TO THE FINANCIAL STATEMENTS – 31 DECEMBER 2008 (CONTINUED)

19 PROPERTY, PLANT AND EQUIPMENT

	Land	Building	Office and furniture & Fittings	Computer and office equipment	Motor vehicles	Total
	SCR	SCR	SCR	SCR	SCR	SCR
COST						
At 01 January 2007	4,600,099	25,514,274	2,645,715	4,907,290	476,670	38,144,048
Additions	-	10,296,734	383,714	617,766	561,696	11,859,910
Disposal	-	-	(59,487)	(769,195)	-	(828,682)
At 31 December 2007	4,600,099	35,811,008	2,969,942	4,755,861	1,038,366	49,175,276
Additions	-	19,420,919	233,888	220,693	877,582	20,753,082
Disposals	-	(17,500)	(404,278)	(330,769)	(433,553)	(1,186,100)
At 31 December 2008	4,600,099	55,214,427	2,799,552	4,645,785	1,482,395	68,742,258
DEPRECIATION						
At 01 January 2007	-	7,273,630	2,128,310	4,210,839	119,645	13,732,424
Charge for the year	-	537,165	214,645	482,849	171,041	1,405,700
Disposals	-	-	(54,828)	(769,195)	-	(824,023)
At 31 December 2007	-	7,810,795	2,288,127	3,924,493	290,686	14,314,101
Charge for the year	-	828,216	203,713	386,680	208,263	1,626,872
Disposals	-	(6,141)	(283,886)	(279,958)	(131,547)	(701,532)
At 31 December 2008	-	8,632,870	2,207,954	4,031,215	367,402	15,239,441
NET BOOK VALUES						
At 31 December 2008	**4,600,099**	**46,581,557**	**591,598**	**614,570**	**1,114,993**	**53,502,817**
At 31 December 2007	**4,600,099**	**28,000,213**	**681,815**	**831,368**	**747,680**	**34,861,175**

	2008	2007
	SCR	SCR
20 INTEREST INCOME		
Interest on deposits with other banks	**11,923,619**	26,822,792
Interest on loans and advances to Government	**12,776,898**	2,569,603
Interest on local securities	**60,543,021**	54,456,560
Interest on other advances	**393,631**	209,575
	85,637,169	84,058,530
21 INTEREST EXPENSE		
Interest on deposits	**18,983,758**	20,998,764
Interest on loans	**1,536,000**	210,451
	20,519,758	21,209,215
22 OTHER INCOME		
Profit arising from dealing in foreign currencies	**21,116,985**	16,117,168
Gain on exchange	**45,514,378**	85,797,338
Other miscellaneous income	**2,015,174**	4,924,085
	68,646,537	106,838,591
23 FINANCIAL AND PROFESSIONAL CHARGES		
Consultancy fees	**4,190,186**	1,104,554
Legal fees	**76,000**	36,000
Directors fees and allowances	**158,400**	162,000
	4,424,586	1,302,554

24 NET PROFIT FOR THE YEAR

The following items have been charged/(credited) in arriving at net profit for the year:

	2008	2007
	SCR	SCR
Staff costs (Note 25)	**23,212,872**	20,193,895
Profit on disposal of property, plant and equipment	(**273,901**)	(1,841)
Fees paid to auditor:		
- Audit fees	**591,563**	211,497
- Other services	**94,650**	-
Depreciation of property, plant and equipment (Note 19)	**1,626,872**	1,405,700

25 STAFF COSTS

	2008	2007
	SCR	SCR
Salaries and allowances	**13,391,246**	10,414,199
Staff training	**1,246,300**	998,480
Other staff costs	**8,575,326**	8,781,216
	23,212,872	20,193,895

26 TAXATION

The Central Bank of Seychelles is exempted from taxation under Section 49 of the CBS Act 2004.

27 NOTES TO THE CASH FLOW STATEMENT

	2008	2007
	SCR	SCR
Cash flows from operating activities		
Net profit for the year	**95,688,391**	142,079,361
Adjustments for:		
Depreciation on property, plant and equipment	**1,626,872**	1,405,700
Amortisation of currency replacement cost	**2,056,703**	956,357
Profit on disposal of property, plant and equipment	(**273,901**)	(1,841)
Operating profit before working capital changes	**99,098,065**	144,439,577
Increase/(decrease) in deposits	**520,228,982**	(609,614,531)
Increase in International Monetary Fund obligations	**162,675,356**	1,617,743
Increase in other liabilities	**18,209**	869,277
Increase in placements with financial institution	(**40,273,000**)	-
Increase in advances	(**54,200,000**)	(86,400,000)
(Increase)/decrease in other assets	(**2,399,656**)	41,755,005
Exchange differences on revaluation of assets and liabilities	**147,331,231**	96,508,275
Net cash generated from/(used in) operations	**832,479,187**	(410,824,654)

28 CAPITAL COMMITMENTS

Capital expenditure approved by the Board and contracted for at year end but not yet incurred is as follows:

	2008	2007
	SCR	SCR
Property, plant and equipment	**2,261,200**	17,255,000

29 LOAN FROM THIRD PARTY

Pursuant to an agreement dated 01 May 2004, the Bank raised a loan of USD 3 million from a third party located in South Africa, for the benefit of the Government of the Republic of Seychelles. The contracting party was the Bank but it was in fact acting on behalf of the Government.

In December 2004, the Bank paid to the Government an amount of SCR 16.5 million representing the SCR equivalent of the loan of USD 3 million at the exchange rate prevailing on the date of receipt, in full settlement of the Bank's liability towards the Government in respect of the loan.

At the balance sheet date, there is no residual liability to the Bank in respect of the loan whether arising from fluctuations in exchange rates, interest or otherwise. The Government has also acknowledged the responsibility to settle the balance of the loan on its own without having any recourse to the Bank.

30 SUBSEQUENT EVENTS

Subsequent to the balance sheet date:

(i) the investment in government securities amounting to SCR 747,052,840 was fully converted into CBS Securities as follows: SCR 250,000,000 into 91-Day Treasury Bills and the balance of SCR 497,052,840 into 365-Day Treasury Bills; and

(ii) An amount of SCR 432.7 million of the Liquidation Deposit has been transferred to the Liquidator.

31 REGISTERED ADDRESS

The registered address of the Bank is Independence Avenue, Victoria, Mahé, Republic of Seychelles.

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INDEPENDENT AUDITOR'S REPORT TO THE DIRECTORS OF THE CENTRAL BANK OF SEYCHELLES ON THE STATEMENT OF RESERVE MONEY

1. We have audited the accompanying Statement of Reserve Money (the "Statement") of the Central Bank of Seychelles (the "Bank") as at 31 December 2008.

Directors' Responsibility

2. The Statement is the responsibility of management. It is also their responsibility to ensure that the information contained in the Statement is complete and has been accurately extracted from the Bank's Accounting records as at 31 December 2008 and that the Statement is prepared in accordance with the Technical Memorandum of Understanding dated 31 October 2008 between the International Monetary Fund ("IMF") and the Bank.

Auditor's Responsibility

3. Our responsibility is to express an opinion on the Statement based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Statement. Our audit also included assessing the consistency of accounting policies used with those used in the preparation of the statutory financial statements of the Bank.

Opinion

4. In our opinion, the amounts shown on the Statement are complete and has been accurately extracted from the Bank's Accounting records as at 31 December 2008 and have been prepared, in all material respects, in accordance with the program definitions and calculation methods set out in the Technical Memorandum of Understanding dated 31 October 2008 between the IMF and the Bank.

"PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

INDEPENDENT AUDITOR'S REPORT TO THE DIRECTORS OF THE CENTRAL BANK OF SEYCHELLES ON THE STATEMENT OF RESERVE MONEY (CONTINUED)

Emphasis of matter

5. Without qualifying our opinion, we draw attention to the fact that the information contained in this special purpose Statement is not intended to, and does not, give a true and fair view of the Bank's financial position at 31 December 2008 and the results of its operations for the period then ended in accordance with the Bank's Accounting policies.

Other matter

6. Our report is solely for your use in connection with the requirements of the IMF per the Technical Memorandum of Understanding dated 31 October 2008 between the IMF and the Bank. It is not to be used for any other purpose or to be distributed to any other parties except to the IMF. We will not accept any liability to any third party to whom our report is shown or into whose hands it may come.

PricewaterhouseCoopers

Mohammad Issa Taujoo
Licensed auditor

17 March 2009

CENTRAL BANK OF SEYCHELLES
P. O. Box 701 Victoria, Seychelles

Statement of Reserve Money as at December 31, 2008

	SR million
Reserve Money	**1,119.91**
Currency in Circulation	477.57
Other Depository Corporation's Reserves	642.34

We confirm to the best of our knowledge and belief, that total currency in circulation and all other depository corporation's reserves held by domestic Financial Institutions at the Central Bank of Seychelles have been included in the above statement.

Governor

Head of Division
Monetary Analysis & Statistics

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INDEPENDENT AUDITOR'S REPORT TO THE DIRECTORS OF THE CENTRAL BANK OF SEYCHELLES ON THE STATEMENT OF NET INTERNATIONAL RESERVES

1. We have audited the accompanying Statement of Net International Reserves (the "Statement") of the Central Bank of Seychelles (the "Bank") as at 31 December 2008.

Directors' Responsibility

2. The Statement is the responsibility of management. It is also their responsibility to ensure that the information contained in the Statement is complete and has been accurately extracted from the Bank's Accounting records as at 31 December 2008 and that the Statement is prepared in accordance with the Technical Memorandum of Understanding dated 31 October 2008 between the International Monetary Fund ("IMF") and the Bank.

Auditor's Responsibility

3. Our responsibility is to express an opinion on the Statement based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Statement. Our audit also included assessing the consistency of accounting policies used with those used in the preparation of the statutory financial statements of the Bank.

Opinion

4. In our opinion, the information shown on the Statement is complete and has been accurately extracted from the Bank's Accounting records as at 31 December 2008 and has been prepared, in all material respects, in accordance with the program definitions and calculation methods set out in the Technical Memorandum of Understanding dated 31 October 2008 between the IMF and the Bank.

"PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

INDEPENDENT AUDITOR'S REPORT TO THE DIRECTORS OF THE CENTRAL BANK OF SEYCHELLES ON THE STATEMENT OF NET INTERNATIONAL RESERVES (CONTINUED)

Emphases of matter

5. Without qualifying our opinion, we draw attention to the following:

   - We expressed a qualified opinion dated 18 March 2009 on the Statement, because we did not obtain confirmation directly from ABN AMRO Bank NV for an amount equivalent to USD 708,942. In the absence of that confirmation at the date we issued our opinion, we could not obtain sufficient appropriate evidence as to the completeness, accuracy and valuation on that amount. The confirmation reply was subsequently received on 19 March 2009. In the light of this evidence, we have been requested by directors to reissue our report on the Statement as at 31 December 2008. Accordingly, our report dated 18 March 2009 is withdrawn.

   - The rates used for translating foreign currency balances into US Dollars in the compilation of the Statement of Net International Reserves are those of 30 September 2008 as per Table 1 of the Memorandum of Economic and Financial Policies, which differ significantly from the market rates at 31 December 2008. Had the 31 December 2008 exchange rates been used, the balance of Net International Reserves as at that date would have been USD 40,370,177 instead of USD 41,540,148.

   - The information contained in this special purpose statement is not intended to, and does not, give a true and fair view of the Bank's financial position at 31 December 2008 and the results of its operations for the period then ended in accordance with the Bank's Accounting policies.

Other matters

6. Our report is solely for your use in connection with the requirements of the IMF per the Technical Memorandum of Understanding dated 31 October 2008 between the IMF and the Bank. It is not to be used for any other purpose or to be distributed to any other parties except to the IMF. We will not accept any liability to any third party to whom our report is shown or into whose hands it may come.

PricewaterhouseCoopers

Mohammad Issa Taujoo
Licensed auditor

19 March 2009

CENTRAL BANK OF SEYCHELLES
P. O. Box 701 Victoria, Seychelles

Statement of Net International Reserves as at December 31, 2008

			US Dollars
Net Foreign Assets of the CBS			***74,952,019.21***
Bank balances Held in Foreign Currencies			74,658,132.09
Cash in transit			293,887.12
Foreign Assets			***51,149,748.48***
Official Reserves (A)			51,149,748.48
Other Claims			-
Foreign Liabilities			***(9,609,600.00)***
Liabilities vis-à-vis Correspondents (Excluding IMF)			-
Liabilities to the IMF (Stand-by Arrangement) (B)	6,160,000	1.56	(9,609,600.00)
Other Liabilities			-
Net International Reserves (A-B)			***41,540,148.48***

Programme Accounting Exchange Rate used in the above computation are as follows:

US$/Euro	1.46
US$/UK pound	1.84
US$/SDR	1.56

We confirm to the best of our knowledge and belief, that all deposits and borrowings held with the Government and Financial Institutions overseas and in the Seychelles have been included in the above statement.

Governor

Head of Division - Banking Services

OFFICERS OF THE CENTRAL BANK OF SEYCHELLES

(as at December 31, 2008)

Mr. Pierre Laporte	-	Governor
Ms. Jennifer Morel	-	Deputy Governor

Governor's Office

IT Unit

Mr Darell Edmond	-	Systems Support Officer

Securities & Financial Markets Division

Mr. Conrad Benoiton	-	Director General
Mr. Nicolas Woodcock	-	Director - Insurance
Mrs Monica Charles	-	International Corporate Services Officer
Miss Emmalie Carosin	-	Securities Officer
Miss Shannon Jolicoeur	-	Legal Officer
Miss Danielle Robert	-	Funds Officer
Mr. Pedro Pierre	-	Compliance and Inspection Officer

Deputy Governor's Office

Miss Martine Faure	-	Legal Officer
Mr. Antoine Fernandes	-	Internal Auditor

Administration and Human Resources Division

Mrs Juliana AhThew-Rose	-	Head of Division
Mrs Levina Françoise	-	Senior Human Resources Officer
Mr. Jean-Claude d'Offay	-	Consultant

Banking Services Division

Mr. Patrick Stravens	-	Head of Division
Mr. Christophe Edmond	-	Director Banking and Currency Operations
Mr. Mike Tirant	-	Assistant Accountant
Mrs Jeannette Payet	-	Accounts Manager
Mr. Terry Adrienne	-	Payment System Officer
Mr. Francis Lebon	-	Public Debt Officer

OFFICERS OF THE CENTRAL BANK OF SEYCHELLES *(Cont'd)*

(as at December 31, 2008)

Financial Services Supervision Division

Vacant	-	Head of Division
Ms. Jenifer Sullivan	-	Director Financial Services Supervision
Mr. Francis Payet	-	Financial Services Analyst
Mr. Naadir Hassan	-	Financial Services Analyst
Mr. Jean-Paul Barbier	-	Assistant Financial Services Analyst
Miss Nathalie Houarau	-	Assistant Financial Services Analyst
Mr. James Jean	-	Assistant Financial Services Analyst
Miss Joan Lespoir	-	Assistant Financial Services Analyst

Monetary Analysis and Statistics Division

Miss Caroline Abel	-	Head of Division
Mr. Brian Commettant	-	Economist
Miss Moyra Alexis	-	Economist
Mrs Hilda Palconit		Economist
Miss Sharon Nolin	-	Economist
Miss Ingrid Sinon		Economist
Mr. Lenny Palit		Economist
Miss Gina Ally	-	Statistician
Miss Dorotha Michel	-	Statistician

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