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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

August 2018

2018 ARTICLE IV CONSULTATION, FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY, REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA, AND FINANCING ASSURANCES REVIEW

In the context of the Article IV Consultation and the Fifth Review Under the Extended Credit Facility Arrangement, Request for Waivers for Nonobservance of Performance Criteria, and Financing Assurances Review, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 23, 2018, following discussions that ended on June 12, 2018, with the officials of the Democratic Republic of São Tomé and Príncipe on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on July 9, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for Democratic Republic of São Tomé and Príncipe.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 18/303
FOR IMMEDIATE RELEASE
July 23, 2018

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes the Fifth Review under the Extended Credit Facility Arrangement, Approves US$0.9 Million Disbursement, and Concludes the 2018 Article IV Consultation with the Democratic Republic of São Tomé and Príncipe

The Executive Board of the International Monetary Fund (IMF) today completed the fifth review of the arrangement under the Extended Credit Facility (ECF) for São Tomé and Príncipe. The Board's decision enables the immediate disbursement of SDR 634,285 (about US$0.9 million), bringing total disbursements under the arrangement to roughly SDR 3.81 million (about US$5.3 million).

The ECF arrangement for São Tomé and Príncipe in the amount of SDR 4.44 million (about US$6.2 million or 60 percent of the country's quota at the time of approval) was approved on July 13, 2015 (see Press Release No. 15/336) to support the government's economic reform program for stronger and more inclusive growth.

The Executive Board today also concluded the 2018 Article IV consultation with São Tomé and Príncipe. A press release will be issued separately.

Following the Executive Board's decision, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair issued the following statement:

"São Tomé and Príncipe's economy continued to grow steadily in 2017 and the medium-term outlook is favorable. However, continued structural reforms and prudent fiscal policy are key to maintaining macroeconomic stability and boosting growth to reduce poverty and generate employment.

"The authorities have taken some encouraging steps to correct past policy slippages. The collection of past tax arrears from large taxpayers will not only help safeguard the fiscal targets but also strengthen the integrity of the tax collection system. Additional efforts are needed to address revenue shortfalls, while expenditure control measures should be enforced to prevent the recurrence of domestic arrears. The ratification of the VAT law by the Parliament as soon as possible will be essential to prepare the ground for the introduction of the VAT in 2019, which together with a closer monitoring of large taxpayers, will help revenue mobilization. Further fiscal consolidation and borrowing only on concessional terms and at a measured pace will be key to reducing the debt burden overtime.

“The authorities have made progress on other structural reforms—notably, the approval of the public-private partnership law and adopting a Tourism Development Strategy to promote inclusive growth. Implementing measures to contain financial losses at the state-owned electricity and water supply company (EMAE) will minimize contingent fiscal liabilities and reduce dependence on oil imports, which along with continued fiscal consolidation, will help rebuild reserves buffers.”

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 18/314
FOR IMMEDIATE RELEASE
July 27, 2018

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2018 Article IV Consultation with the Democratic Republic of São Tomé and Príncipe

On July 23, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Democratic Republic of São Tomé and Príncipe.

GDP growth in 2017 is estimated at about 4 percent, similar to the previous two years. Meanwhile, inflation spiked to 7.7 percent at end 2017, caused by unfavorable weather conditions and an increase in import taxes on selective goods. Fiscal consolidation continued albeit at a slower pace than expected, partly because the authorities increased health and education spending to address urgent needs, including a virus outbreak. Tax revenues continued to fall below expectations, and the authorities partially offset the shortfall by restraining spending. The current account deficit widened, mainly driven by imports financed by foreign investment related to deep-sea oil exploration. While banks were adequately capitalized and provisioned, elevated non-performing loans have constrained bank lending growth, which remained sluggish at 2.5 percent.

The macroeconomic outlook is positive. Growth is expected to remain at 4 percent in 2018 and to accelerate to 5 percent in the medium term as new externally-financed projects—including an airport expansion, road construction and restoration, and the rehabilitation of the electricity system—get underway. Inflation is expected to moderate to 6 percent in 2018. This outlook is contingent on continued fiscal discipline and structural reforms to boost tax revenue, reduce fiscal risks from state-owned utility company EMAE, and reduce the debt burden over time. Risks include fiscal slippages ahead of this year's legislative election, delayed bank resolution and continued high NPLs, which could further stall credit expansion and, hence, growth. In addition, delays in donor disbursements could undermine growth prospects. On the upside, faster implementation of large externally-financed projects could spur growth.

The authorities remain committed to the economic reform program supported by the ECF-supported arrangement to restore fiscal sustainability and foster private sector-led and inclusive growth. In particular, they are committed to improve revenue collection, especially from large taxpayers, and introduce a VAT in 2019. They will also improve the monitoring of disbursement

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

of foreign financed projects. To balance the need for investment while reducing the debt burden, the authorities will borrow only at concessional terms and at a measured pace. They will also continue to implement the strategy to reduce the stock of nonperforming loans and safeguard financial stability.

Executive Board Assessment[2]

Executive Directors welcomed progress on fiscal consolidation and structural reforms, which has contributed to strengthening macroeconomic stability and the favorable medium-term outlook. Directors noted, however, that program performance has been uneven and downside risks remain. They underscored that continued commitment to structural reforms and prudent fiscal policy is key to maintaining macroeconomic stability and boosting growth to reduce poverty and generate employment for a young population.

Directors welcomed the authorities' resolve to continue fiscal consolidation to improve the fiscal position and reduce public debt. They underscored the need for steadfast implementation of revenue-enhancing measures to address tax revenue underperformance, including the collection of tax arrears and the introduction of the VAT next year. Directors welcomed the authorities' commitment to eschew non-concessional loans and limit external concessional borrowing. They encouraged the authorities to strengthen debt management capacity through implementing recommendations under the Debt Management Performance Assessment and finalizing the medium-term debt management strategy.

Directors emphasized the importance of reforming state-owned enterprises, particularly the electricity and water supply company (EMAE). They noted that improving the commercial viability of EMAE will not only reduce fiscal risks, but also strengthen the external position by reducing oil imports, and support growth by improving electricity provision. It will also help boost reserve accumulation, and support the removal of exchange restrictions over the medium term.

Directors welcomed the progress made in strengthening banking supervision. They encouraged the authorities to continue to implement the strategy to reduce the stock of nonperforming loans, including through concerted efforts to reform the legal system to assist loan recovery. The remaining recommendations of the safeguards assessment should be implemented without delay.

Directors highlighted the importance of structural reforms to promote inclusive growth. In this context, they welcomed the recent adoption of the tourism development strategy. Directors encouraged the authorities to focus on high-return infrastructure projects to support tourism and other key sectors of the economy.

It is expected that the next Article IV consultation with the Democratic Republic of São Tomé and Príncipe will be held in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2015–20
(Annual change in percent, unless otherwise indicated)

	2015	2016	2017		2018		2019		2020
			EBS/17/119		EBS/17/119		EBS/17/119		
	Actual	Actual	4th Rev	Prel.	4th Rev	Proj.	4th Rev	Proj.	Proj.
National income and prices									
GDP at constant prices	3.8	4.2	4.0	3.9	5.0	4.0	5.5	4.5	5.0
GDP deflator	4.2	8.1	2.7	4.7	3.5	3.9	4.0	6.2	5.0
Consumer prices									
End of period	4.0	5.1	6.0	7.7	5.0	6.0	4.5	5.0	4.0
Period average	5.3	5.4	5.6	5.7	5.5	6.8	4.7	5.5	4.5
External trade									
Exports of goods and nonfactor services	1.7	7.4	2.7	9.6	7.6	5.4	7.3	10.1	8.5
Imports of goods and nonfactor services	-18.2	-0.2	8.4	2.9	5.6	13.1	6.5	13.8	5.4
Exchange rate (new dobras per US$; end of period) [1]	22	23	...	21	...	...	...	...	...
Real effective exchange rate (period average, depreciation = -)	1.8	5.6	...	-0.6	...	...	...	...	...
Money and credit									
Base money	37.5	5.0	1.5	-9.6	5.1	9.3	3.5	5.3	5.0
Broad money (M3)	13.1	-4.8	-0.2	-0.4	8.7	12.6	9.7	10.9	10.3
Credit to the economy	5.4	6.6	3.4	2.5	5.8	5.8	9.2	10.2	9.7
Velocity (GDP to broad money; end of period)	2.5	2.9	3.1	3.2	3.1	3.1	3.1	3.1	3.1
Central bank reference interest rate (percent)	10.0	10.0	...	9.0	...	...	...	...	...
Average bank lending rate (percent)	23.3	19.6	...	19.6	...	...	...	...	...
Average bank deposit rate (percent)	6.9	4.1	...	4.2	...	...	...	...	...
Government finance (in percent of GDP)									
Total revenue, grants, and oil signature bonuses	28.2	27.6	24.6	23.8	28.3	27.5	28.2	25.7	26.0
Of which: tax revenue	14.4	12.1	13.0	12.1	13.4	11.8	13.7	12.5	12.9
Nontax revenue	1.5	2.3	1.5	1.6	1.6	2.9	1.6	1.0	1.0
Grants	11.5	13.2	10.1	10.1	13.3	12.8	12.9	12.2	12.2
Total expenditure and net lending	34.5	31.8	29.5	26.4	30.8	27.3	31.1	29.2	28.9
Personnel costs	8.9	8.7	8.5	8.0	8.3	7.7	8.2	7.8	7.9
Interest due	0.8	0.4	0.7	0.5	0.5	0.6	0.7	0.6	0.4

Nonwage noninterest current expenditure	8.6	7.8	7.0	6.6	6.8	5.9	6.8	5.7	5.7
Treasury funded capital expenditures	0.7	0.6	0.3	0.7	0.3	0.1	0.6	0.3	0.4
Donor funded capital expenditures	14.9	13.9	12.8	10.5	14.6	12.8	14.3	14.6	14.1
HIPC Initiative-related capital expenditure	0.6	0.2	0.2	0.2	0.2	0.2	0.7	0.2	0.4
Domestic primary balance [2]	-3.0	-4.0	-1.8	-2.3	-1.0	-1.3	-1.0	-1.2	-1.2
Overall balance (commitment basis)	-6.3	-4.2	-4.9	-2.6	-2.4	0.3	-2.7	-3.5	-2.9
External sector									
Current account balance (percent of GDP)									
Including official transfers	-13.0	-6.5	-12.2	-8.2	-7.2	-6.8	-7.0	-9.8	-8.6
Excluding official transfers	-25.7	-20.2	-22.3	-18.8	-20.5	-20.0	-19.9	-22.0	-20.8
PV of external debt (percent of GDP)	39.7	31.5	30.5	28.4	31.2	26.9	30.7	26.9	26.8
External debt service (percent of exports) [3]	3.8	3.3	4.7	3.1	4.7	4.6	5.5	5.3	5.0
Export of goods and non-factor services (US$ millions)	89.9	96.5	99.2	105.8	106.7	111.5	114.5	122.8	133.2
Gross international reserves [4]									
Millions of U.S. dollars	61.9	55.9	58.7	51.3	64.4	58.2	67.1	62.2	64.8
Months of imports of goods and nonfactor services [5]	5.3	5.1	4.0	4.2	4.2	4.4	4.1	4.5	4.6
National Oil Account (US$ millions)	10.3	11.5	11.7	11.3	10.6	11.4	9.0	11.4	9.1
Memorandum Item									
Gross Domestic Product									
Millions of new dobra	6,970	7,846	8,300	8,535	9,019	9,222	9,891	10,231	11,285
Millions of U.S. dollars	315.5	354.2	375.0	392.5	417.7	466.1	459.8	523.1	583.8
Per capita (in U.S. dollars)	1,556	1,706	1,764	1,847	1,921	2,143	2,068	2,353	2,570
Unemployment rate (percent)	13.0	12.6	…	12.2	…	11.7	…	11.3	10.8

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.

[1] Central Bank (BCSTP) mid-point rate.

[2] Excludes oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.

[3] Percent of exports of goods and nonfactor services.

[4] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements, for new licensing, and for meeting capital requirements.

[5] Imports of goods and nonfactor services, excluding imports of investment goods and technical assistance.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

July 9, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION, FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY, REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA, AND FINANCING ASSURANCES REVIEW

KEY ISSUES

Context: Progress has been made in fiscal consolidation and structural reform in the past year. Nevertheless, the country still faces a high debt level, has a low ratio of tax revenue to GDP, and relies heavily on external support. While the economy grew steadily at about 4 percent in the past three years, accelerating growth through consolidating macroeconomic stability and continued structural reforms will be essential for poverty reduction in a country with a young population.

Program review: Performance was mixed under extenuating circumstances. Three out of five end-2017 performance criteria (PCs) were missed. The PC on the domestic primary deficit (DPD) was missed by ½ percent of GDP, mirrored by the PC on net credit to the government, though the DPD was still reduced by 1¾ percent of GDP relative to 2016. Meanwhile, net international reserves fell below the target mainly because of lower-than-expected external support. The continuous PC prohibiting the introduction or intensification of exchange restrictions was inadvertently missed. Structural reforms were broadly on track. Staff recommends completion of the fifth review and modification of indicative targets and structural benchmarks through the rest of 2018, and supports the authorities' request for waivers for nonobservance of PCs based on prior actions and corrective measures.

Recommendations: In 2018, enhance tax arrears collection and restrain spending to available resources to safeguard the fiscal targets and avoid new domestic arrears. Step up the preparation for the transition to a VAT in 2019 to increase revenue mobilization. Continue to reform EMAE (a state-owned electricity company) to contain its losses and the associated fiscal risks. Expedite structural reforms and project implementation to unlock growth potential and to avoid delays in inflows of external support. Continue to implement the strategy for reducing non-performing loans and strengthen risk-based supervision. Over the medium term, reduce the debt level by continuing fiscal consolidation and borrowing only at concessional terms and at a measured pace. Implement the tourism development strategy to promote poverty-reducing growth.

Outlook and risks: GDP growth is expected to stay at 4 percent in 2018 and to rise to 5 percent in the medium term. Main risks include spending pressure ahead of the legislative elections in October. On the upside, earlier implementation of large infrastructure projects could accelerate growth.

Approved By
David Owen (AFR) and Kevin Fletcher (SPR)

Discussions were held in São Tomé during March 28 to April 12 and June 6-12, 2018. The initial staff team included Xiangming Li (head), Marlon E. Francisco, Jehann Jack, Gabriel Srour, Torsten Wezel, and Yunhui Zhao (all AFR). Luiza Antoun de Almeida (EUR) provided extensive support for the mission preparation, María Inés Canales Munoz (AFR) provided administrative support, and Yun Liu (AFR) provided research support (all from headquarters). Kelvio Carvalho da Silveira (OED) joined the mission. The mission met with Prime Minister Patrice Trovoada, Minister of Finance Américo Ramos, Minister of Justice Ilza Vaz, Minister of Agriculture Teodorico Campos, the Governor of the Central Bank Hélio Almeida, other senior government officials, and representatives of the private sector and development partners. The follow-up staff team comprised Ms. Li (head) and Mr. Srour (both AFR) and Djaima Costa (STA); it was joined by Audrey Yiadom and Gabriela Rosenberg (both LEG) and Svetlana Popova (MCM), working on Article VIII related issues. The follow-up mission was assisted by Ms. Jack and Mr. Zhao (both AFR) from headquarters.

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CONTEXT: REFORM TO ACCELERATE GROWTH

1. **São Tomé and Príncipe is a fragile, small, remote island-state constrained by limited resources and capacity.** The economy is based mainly on subsistence agriculture and fisheries and relies heavily on foreign grants, which exceeded 10 percent of GDP in recent years. It exports mainly cocoa and has a nascent tourism industry, while it imports a wide range of goods including not only manufacturing products but also food products such as rice, wheat, and many vegetables. High hopes for commercial oil production receded in 2013 due to prohibitive extraction costs from the deep sea,[1] leaving a legacy of high public debt and a vulnerable banking sector. Meanwhile, weak revenues limit social development programs and contribute to the accumulation of government arrears to suppliers. In addition, poor governance in the past created loss-making state-owned enterprises (SOEs) and system-wide cross-arrears, hindering the functioning of the economy. The country's low capacity and relatively weak institutions impeded reform efforts, underscoring the need for continued support in capacity development.

2. **Good progress has been made towards strengthening macroeconomic stability; however, sustained reforms will be essential to unleash the full growth potential.** Progress in implementing the 2016 Article IV recommendations has been uneven (Box 1). Some commendable progress has been made, particularly in supporting traditional sectors, lowering the debt level, and reducing the fiscal deficit following slippages in the run-up to presidential elections in 2016. However, continued efforts in revenue mobilization, building reserves buffer, and structural reforms are essential. Over the last three years, GDP grew by 4 percent annually, and inflation averaged only 5.5 percent. Nevertheless, growth has been too slow to meaningfully reduce poverty. With 40 percent of the population under the age of 14, faster growth is needed to absorb the large number of youth entering the labor force each year. In addition, the country's per capita income and other social indicators lag significantly behind other small island-states in Africa (Selected Issues Paper (SIP) Chapter 1). The government's debt level remains elevated and is classified as in debt distress as the ongoing negotiations of rescheduling arrears have been delayed pending creditors' responses. However, the outlook has improved and the debt is sustainable in the medium term.

3. **Recognizing the challenges of pursuing sustained reforms, the authorities have committed to continue to build capacity.** They stress the need for hands-on technical assistance (TA), particularly by long-term resident experts as highlighted in the medium-term capacity development strategy (Annex I). In line with reform agendas, TA priorities include revenue administration (notably implementing VAT), public financial management (PFM) to improve budget preparation and execution, and banking regulation and supervision. Given the wide scope of reforms envisaged in a fragile environment, sustained support from bilateral and multilateral development partners is also essential to develop capacity in the country.

[1] There are still oil exploration activities outside the Joint Development Zone but no confirmation of commercial quantities yet.

Box 1. Main Recommendations of the 2016 Article IV Consultation and Their Current Status

Recommendation	Status
Fiscal	
Anchor medium-term fiscal policy on bringing debt to a downward trajectory toward a moderate risk of debt distress.	Partially achieved. Central government debt has declined by 8 percent of GDP and the debt outlook has improved. However, some external arrears have not yet been resolved.
Reduce the domestic primary deficit (DPD) through boosting tax revenues and containing discretionary expenditure.	Partially achieved. The DPD has declined through prudent expenditure. However, tax revenue continues to underperform and remains practically unchanged relative to GDP.
Monetary	
Further refine the liquidity forecasting and management tools to address liquidity overhang and enhance monetary management.	Ongoing. The BCSTP, in coordination with the Treasury, has made improvements in liquidity forecasting. Recent amendments to the regulations allow the government to issue T-Bills, for which the maturity can bridge years.
Financial	
Enhance the role of macro-financial linkages through implementing necessary measures to tackle both the large stock and the rapid growth of non-performing loans (NPLs).	Ongoing. The NPL reduction strategy is currently being implemented by the BCSTP through encouraging more concerted efforts to step up recoveries and write-offs by banks, enforcing collateral guidelines, and strictly overseeing banks' credit risk management frameworks and lending policies.
Strengthen financial sector stability by enforcing capital requirements and conducting regular asset quality reviews to identify problem banks that would require swift corrective measures.	Ongoing. Previously-undercapitalized banks have either raised their capital or been forced to exit the market. The BCSTP has done internal asset quality reviews and an external exercise (funded by the World Bank) is being negotiated.
Further develop the Treasury Bills market, while ensuring its consistency with the fiscal sector.	Ongoing. Plans are underway to allow for longer-term instruments (for which legislation is already drafted), and a secondary market over time.
Promote financial inclusion and literacy.	Ongoing. The coverage and usefulness of the credit registry system have continued to improve. Ongoing judicial reforms have paved the way for out-of-court settlements, and led to a reduction in court fees. Financial system operators have been facilitating financial literacy initiatives, spearheaded by the BCSTP.
External and Structural	
While the international reserves coverage was just at the recommended benchmark level, it may be desirable to build an additional buffer.	Not yet achieved, with significant challenges ahead. The lower external inflows and uptick in imports caused gross international reserves to decline by $4.6 million between end-2016 and end-2017.
Address the moderately over-valued real effective exchange rate (REER) and the low level of competitiveness through further diversifying the economy and targeted actions to improve the business environment. Focus on high value-added tourism activities, broader diversification of source markets, and more open, competitive air transport connections.	Ongoing. A tourism development strategy (as a key component of export diversification) was launched in January 2018. A grant-financed airport expansion and road rehabilitation are likely to begin in late 2018 or early 2019. The government is also pursuing strategies to address the unreliable supply and high cost of electricity, including the development of cheaper energy sources.
Support the traditional sectors (agriculture and fisheries) to boost job creation and reduce poverty.	Ongoing. São Tomé and Príncipe has been working closely with China and other development partners on sustainable and resilient agriculture and fisheries, including building greenhouses and improving farming and husbandry practices. In collaboration with development partners, the government also encourages the formation of farming and fishing cooperatives to benefit from economies of scale. It is also granting land rights to farmers to facilitate access to credit.

Source: IMF staff assessment.

RECENT ECONOMIC DEVELOPMENTS

4. Economic activity decelerated slightly in 2017, largely due to lower external support. Real GDP growth slowed from 4.2 percent in 2016 to 3.9 percent in 2017, amid fiscal tightening, delays in foreign-financed projects, and slowing construction activity. Tourism remained robust, as more frequent flights, simplified entry requirements, and increased publicity continue to draw tourists. Meanwhile, bumper cocoa production—the main cash crop—was tempered by lower international prices. Annual inflation, however, spiked to 7.7 percent at end-2017, driven by increased import taxes on selected goods and a temporary shortage of locally produced foods caused by unfavorable weather conditions. Inflation showed signs of deceleration, with annualized seasonally-adjusted monthly inflation decelerating from 11 percent in December 2017 to 0 percent by April 2018. Agricultural programs implemented recently have increased the local supply of vegetables and fish, making the production less vulnerable to excessive rain. The current account deficit was projected to have widened to 8.2 percent of GDP, mainly driven by a substantial increase in imports of oil-related investment goods (up by 67.3 percent), which was largely financed by oil-related FDI.

5. A decline in external inflows and spillovers of foreign exchange pressures from neighboring countries increased foreign exchange shortages, and the authorities responded by tightening foreign exchange regulations. Net official transfers fell from 13.7 percent of GDP in 2016 to 10.6 percent of GDP in 2017. Authorities noted that there was evidence that foreign exchange has been increasingly flowing out of the country to satisfy demand from neighboring oil exporters under stress. They explained that this took place through external trade contracts that did not result in actual imports of goods to the country. Gross international reserves (GIR), marked to market, fell by about US$4.6 million to US$51 million (or 4.2 months of import cover) mainly due to lower external inflows. Net international reserves (NIR), a program target, declined by US$6.1 million to $44 million. At end-March 2018, NIR rose by $2 million to $46 million. While the reserves level missed the unadjusted indicative target of $52 million, the accumulation exceeded the projection of $1 million. In response to the increasing shortage and to prevent further depletion of international reserves and safeguard the exchange rate peg, the authorities intensified an existing exchange restriction that predated the current program, through the implementation of a new regulation (NAP 05/2017) on March 1, 2017 (MEFP ¶37-39). This tightening inadvertently breached the continuous performance criterion that prohibits the intensification of existing exchange restrictions.

6. A combination of revenue and expenditure measures was implemented in 2017 to reduce the DPD (Text Table 1). Tax measures implemented in 2017 included a new consumption tax on imported alcoholic beverages, a hike in duty on selected imported commodities starting in July, particularly on alcoholic beverages, and the collection of tax arrears from large taxpayers. While these measures offset the loss of revenues from a correction of the income tax return formula, the revenue outturn was 0.9 percent of GDP lower than anticipated. Imports of goods affected by the hike in duty plummeted, and some large taxpayers failed to honor the agreements with the government on tax arrears clearance. The authorities offset the revenue shortfall by under-executing the budget on transfers and personnel costs, while they spent about ½ percent of GDP more than anticipated on capital and current expenditure in health and education, partly due to a virus outbreak that led to a public health emergency. Accordingly, total discretionary expenditure was cut by almost 2 percent of GDP relative to 2016, and the DPD exceeded the target by ½ percent of GDP.

7. Preliminary fiscal data for the first quarter in 2018 are broadly in line with last year's outturns. The continued revenue underperformance from the hike in import duties in 2017 was exacerbated by delayed tax payments from large firms (notably ½ percent of GDP in import taxes due by ENCO as of May). This was partially offset by higher oil import tax revenue, reflecting higher international oil prices, and budget under-execution. As a result, the end-March fiscal indicative targets for the DPD, tax revenue and new domestic arrears were missed by about 0.3, 0.5 and 0.07 percent of GDP, respectively. However, the indicative target on the change in net bank credit to the central government was met.

Text Table 1. Fiscal Performance 2017
(in percent of GDP)

	2016	2017	
	Actual	4th rev.	Prel.
Total domestic revenue	14.4	14.5	13.8
Total domestic revenue (ex oil)	13.5	14.2	13.2
Tax revenue	12.1	13.0	12.1
Import taxes	4.7	4.9	4.6
Consumption taxes	1.2	1.7	1.6
Profit taxes	1.3	1.9	1.7
Personal income taxes	3.4	3.0	2.9
Other taxes	1.5	1.4	1.4
Nontax revenue	2.3	1.5	1.6
Of which: oil revenue	0.9	0.4	0.6
Total domestic expenditure	17.9	16.7	15.9
Primary domestic expenditure	17.5	16.0	15.4
Current expenditure	17.0	16.2	15.1
Personnel costs	8.7	8.5	8.0
Goods and services	3.2	2.7	3.0
Interest payments	0.4	0.7	0.5
Transfers	3.6	3.4	2.7
Other expenditures	1.1	0.9	0.9
Treasury-funded capital expend.	0.6	0.3	0.7
HIPC-related capital expenditure	0.2	0.2	0.2
Domestic Primary Balance	-4.0	-1.8	-2.3

Sources: Ministry of Finance and IMF staff estimates.

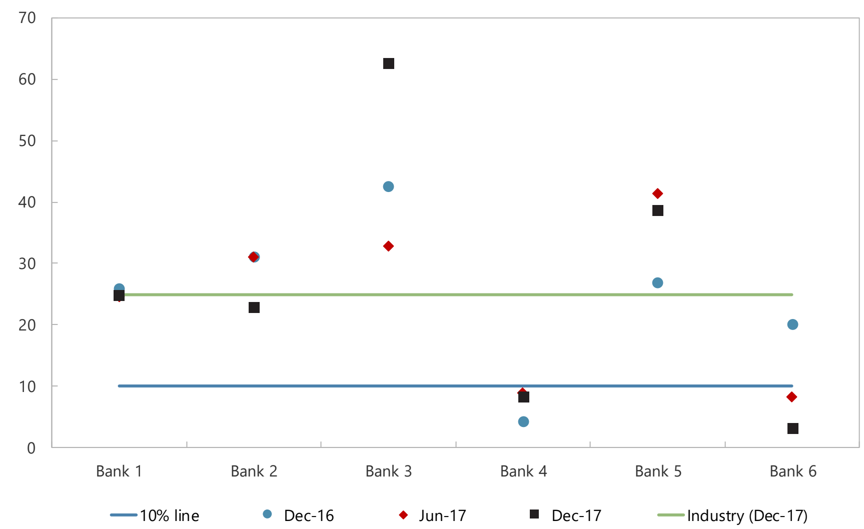
8. Public and publicly guaranteed (PPG) debt has declined. External debt decreased from 52.5 percent of GDP in 2016 to 45.7 percent of GDP in 2017, reflecting economic growth, a strengthened euro-dollar exchange rate, and little new borrowing (0.5 percent of GDP).[2] The government accumulated a small amount of domestic arrears to suppliers (0.1 percent of GDP) and failed to clear previous arrears as programmed (0.1 percent of GDP), partly because the EU budget support grant was reduced by €1 million (0.3 percent of GDP) in 2017 due to slow progress in PFM reform. Meanwhile, the higher oil price at the pump, relative to import prices, generated gains that were used to pay down debt to ENCO, bringing total debt down from 67.6 percent of GDP in 2016 to 64.4 percent of GDP in 2017.

9. Financial soundness indicators (FSIs) improved somewhat but continued to show signs of vulnerability (Table 5). Starting in August 2016 with the exit of Banco Equador, all banks have regulatory capital to risk-weighted assets greater or equal to 10 percent. The overall NPL ratio fell by 2.2 percentage points to 24.9 percent at end-2017 from end-2016. The system-wide capital adequacy ratio improved to 33.6 percent of risk-weighted assets as banks shifted resources into government paper. In addition, provisioning coverage of NPLs is quite high, in excess of 80 percent of NPLs. Sensitivity analyses suggest that the system-wide capital is ample, and the capital adequacy ratio will become insufficient only if the NPL ratio increased by another 22 percentage points (to 47

[2] The debt figures mentioned exclude pre-HIPC arrears and disputed debt.

percent). However, pockets of vulnerability persist and require vigilance. System wide, the default rate among new and restructured loans issued since end-2016 doubled to 6.7 percent. FSIs were broadly unchanged in the first quarter of 2018. The smallest bank (Banco Privado) was intervened and put up for sale by the BCSTP in February 2018 after the bank incurred large loan losses and became undercapitalized. BCSTP decided in mid-June to close the bank outright, transferring its portfolio to other banking institutions in the country. Sensitivity analyses of individual banks show that one bank could have insufficient capital should its NPLs increase by 5½ percentage points. In addition, most banks are still loss-making due to high operational cost, including of energy. Meanwhile, the liquidation of Banco Equador is still pending court approval of required procedures although the liquidator assumed his position in October 2017.

Text Figure 1. São Tomé and Príncipe: Non-Performing Loans Ratios by Bank
(percent, 2016-17)



Sources: BCSTP; and IMF staff calculations.

10. The central bank successfully redenominated the local currency on January 1, 2018. After removing three zeros, the currency is now valued at 24.50 new dobras per euro, maintaining a peg implemented in 2010. Anecdotal information and data suggest that the redenomination went smoothly with negligible impact on inflation.

11. Credit growth decelerated. The growth of credit to the economy slowed to 2.5 percent in 2017 compared with 6.6 percent in 2016. Banks shrank credit in some segments, notably the trading sector, reflecting slow economic activity and continued risk aversion. At the same time, banks invested some excess liquidity in Treasury Bills, the issuances of which were over-subscribed. Consequently, the average liquidity ratio declined from 58 to 50 percent but remains high overall. Meanwhile, a new facility for small and medium-sized enterprises (SMEs)—funded by the International Finance Corporation—at a large bank has been slow to generate credit.

PROGRAM PERFORMANCE

12. Program performance at end-2017 was uneven (MEFP Table 1). The performance criteria (PCs) on the DPD and net bank financing of the central government (NCG) were missed by ½ percent of GDP, due to the substantial shortfall in revenue and higher spending in health and education. The authorities noted that they spent more on health and education in anticipation of external budget support that failed to materialize and to address a virus outbreak of "necrotizing cellulite." Nonetheless, the reduction in the DPD in 2017 was still a substantial 1.7 percent of GDP. The PC on net international reserves (NIR) was missed partly because of a one-off large shortfall of external financing, particularly from international financial institutions, which was only partly accommodated by program adjusters. Two other PCs on external arrears and external borrowing were met. The continuous PC that prohibits the introduction or intensification of exchange restrictions was inadvertently breached (¶13). Fiscal indicative targets (IT) on tax revenue and new domestic arrears were missed by about 0.5 and 0.07 percent of GDP, respectively, while the pro-poor spending target was met. Corrective measures to address tax revenue under-performance have been introduced (¶19-21 and MEFP ¶20-22).

13. The BCSTP adopted a foreign exchange regulation (NAP 05/2017), effective March 1, 2017, which further tightened an existing foreign exchange restriction. This exchange restriction predates the ECF arrangement. During the staff visit in June 2018, market participants—both banks and importers—reported long-standing difficulties to meet foreign currency demand, which were further intensified with the adoption of the March 2017 regulation. Staff also received a copy of the regulation and determined that it intensified the limitations on access to foreign exchange. As such, the continuous PC against the intensification of exchange restrictions had not been observed at the time of the completion of the third and fourth reviews under the ECF arrangement last December. However, this is not a case of misreporting, since the authorities informed Fund staff when discussing the third review that they had tightened the foreign exchange regulation. Staff should have followed up to obtain a copy of the regulation to enable an assessment about its consistency with the PC.

14. The government has made progress in implementing structural reforms (MEFP Table 2). A draft Public-Private Partnership (PPP) law was submitted to the National Assembly on October 30, 2017, and has been approved, and measures to contain financial losses at EMAE in the near term have been implemented (MEFP ¶22), meeting end-December 2017 structural benchmarks. Furthermore, some end-June 2018 structural benchmarks have been met (MEFP Table 4)—a VAT law was submitted to parliament on May 24, and a Tourism Development Strategy (the core of the National Export Diversification Strategy) was launched in January 2018. The end-June benchmark to adopt a financial management plan and least cost energy-production plan for EMAE and the end-June benchmark to complete an independent detailed asset quality review of banks were delayed because of longer-than-expected procurement processes (¶33, ¶42, MEFP ¶15, and MEFP ¶29).

ECONOMIC OUTLOOK AND RISKS

15. The economic outlook remains positive on balance. The economy is forecast to grow by 4 percent in 2018 and to accelerate to 5 percent in the medium term as new externally-financed projects—including an airport expansion, road construction and restoration, and the rehabilitation of the electricity system—get underway. Faster growth, accompanied by appropriate structural reforms, will lay the foundation for increasing employment and reducing poverty. Inflation is expected to moderate to 6 percent in 2018 as the one-off supply and tax effects in 2017 subside, and to fall below 5 percent in the medium term.

16. The outlook is fraught with risks (Box 2). The downside risks include pre-election pressures that could delay structural reforms, impede revenue mobilization, particularly tax arrears collection from large taxpayers, and raise extra-budgetary spending. These potential slippages could undermine hard-won fiscal consolidation and discipline. In addition, delayed reforms of EMAE would lead to continued large losses and increased fiscal burden. Meanwhile, prolonged bank resolution and continued high NPLs could further stall credit expansion, particularly to small enterprises, and hinder growth. Externally, delays in donor disbursements would undermine growth prospects and affect reserves accumulation, and weak growth in key advanced economies, particularly Portugal, could dampen the country's exports, especially its tourism industry. On the upside, faster implementation of large externally-financed projects could spur growth. In addition, lower international energy prices could reduce imports.

17. The country is classified as being in debt distress because of the existence of long-standing external arrears, although the updated Debt Sustainability Analysis (DSA) shows that the outlook has improved and the debt is sustainable in the medium term. The government has sought debt rescheduling agreements on external arrears with Angola, Brazil, and Equatorial Guinea. An agreement with the Brazilian government was reached, but is pending the ratification by the Brazilian Senate. The government is still waiting for responses from the other two countries to continue negotiations, as well as from Nigeria on discussing the disputed loan. Meanwhile, as noted previously, external and PPG debt declined in 2017, a trend expected to continue. Under the baseline scenario, the present value (PV) of PPG external debt-to-GDP ratio now stays below the threshold for high risk of debt distress during the entire projection period. Nevertheless, the ratios of the PV of PPG external debt to exports and to revenue still exceed their respective thresholds under the baseline scenario, though they both decline over time to be below the thresholds. The DSA underscores the importance of continuing fiscal consolidation, eschewing non-concessional loans, limiting external concessional borrowing, and expanding the export base. Provided that such policies are followed as envisaged under the program and the economy and export base continue to grow steadily, staff assesses that debt is sustainable in the medium term, with all indicators eventually falling below their thresholds in the baseline scenario.

Box 2. São Tomé and Príncipe: Risk Assessment Matrix 2018[1]

Source of Risks	Relative Likelihood	Time Horizon	Potential Impact	Policy Response
Domestic risks				
Limited implementation capacity	High	Short to Medium Term	High. It could affect tax collection and spending controls, as well as slow structural reforms and associated external financing.	Prior action for arrears collection and appointment of the Treasury to coordinate externally financed projects to avoid delay.
Political risk associated with the upcoming legislative elections in October 2018	Medium	Short Term	High. Pressure for spending could heighten ahead of the elections.	Concrete measures are identified for meeting 2018 fiscal targets.
Continued weakness in banking sector	Medium	Short to Medium Term	Low. Continued high NPLs could further stall already anemic credit growth.	Stay vigilant and strengthen risk-based supervision. Reform the legal system to reduce credit risk. Advance the AQR.
External risks				
Delays in donor disbursements	Medium	Short to Medium Term	High. The country heavily depends on external support, and delayed disbursements would undermine growth and international reserves accumulation.	Appointment of the Treasury to coordinate externally financed projects to avoid delay.
Tighter global financial conditions	High	Short to Medium Term	Low. It could lead to less availability of concessional lending and higher interest payments for new loans.	Mobilize fiscal revenues and continue fiscal consolidation to reduce the external financing needs. Diversify the financing sources.
Weaker-than-expected global growth:				Implement the tourism development strategy and improve agricultural productivity.
• **Structurally weak growth in key advanced economies**	High	Medium Term	Medium. Weakness in external demand could dampen the country's exports, especially its tourism industry, leading to lower real GDP growth and slower reserves accumulation.	
• **Significant U.S. slowdown and its spillovers**	Medium	Medium Term	Low. The economic linkages between São Tomé and Príncipe and the U.S. are weak, hence the potential impact would be low.	
• **Significant China slowdown and its spillovers**	Low/ Medium	Short to Medium Term	Low. China's support, all in grants so far, is unlikely to be affected given that the amount involved is very low and the diplomatic relationship between China and São Tomé and Príncipe was recently renewed.	
Lower energy prices, driven by weakening OPEC/Russia cartel cohesion and/or recovery of oil production in the African continent.	Low	Short to Medium Term	Medium. As São Tomé and Príncipe is an oil-importing country, this constitutes an upside risk of import costs.	Make use of the opportunity to accumulate reserves and build buffers to prepare for oil price increase in the future. Improve the efficiency of electricity generation to reduce oil imports.

Source: IMF staff assessment.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Authorities' Views

18. The authorities broadly agreed with staff's assessment of the medium-term outlook and associated risks, but have a more optimistic view on near-term growth prospects. They expected GDP growth to accelerate in 2018, on account of planned infrastructure projects. They concurred that without policy actions, public debt dynamics and fiscal liabilities from large losses of EMAE are unsustainable. They reiterated their commitment to the program, notwithstanding the elections, and intention to press ahead with the structural reform agenda, including adopting a VAT and implementing various sectoral development plans. They pointed out that the delays in implementing reforms also reflected lengthy procedures of their development partners. In addition, they have actively sought debt rescheduling agreements with Angola, Brazil, and Equatorial Guinea, through correspondence and high-level meetings.

POLICY DISCUSSIONS

Policy discussions focused on immediate measures to offset the revenue shortfall to achieve the fiscal targets for 2018; the transition to a VAT regime in 2019; reforms of EMAE; boosting international reserves to protect the peg; safeguarding financial sector stability in the face of persistently high NPLs; and promoting private sector led growth, particularly tourism.

A. Address Revenue Shortfall and Contingent Liabilities, and Reduce Debt Burden over the Medium Term

19. The government has taken revenue measures to partially offset a revenue shortfall in the near term (MEFP ¶20-22). Under unchanged policies, the drop of imports due to the hike in duty on imports in 2017, weak tax performance in the first quarter of 2018 and lower collection of tax arrears, and the cancellation in January 2018 of the earlier decision to suspend the deductible of the personal income tax (PIT) in the tax law would cause a revenue shortfall in 2018 of about 1.8 percent of GDP relative to the previous review. To offset the revenue shortfall, and as a prior action for the fifth review, the government will collect close to ½ percent of GDP in tax arrears plus applicable penalties owed by the local beer producer Rosema and other firms, largely consisting of consumption tax on sales and PIT on their employees that the firms collected on behalf of the state (MEFP ¶21). The government will also endeavor to collect tax arrears from other large taxpayers, including the airport authority ENASA (SIP Chapter 3).

Text Table 2. Impact of Fiscal Measures
(in percent of GDP)

Measures	2018
Total revenue gains	0.5
Collection of tax arrears	0.5
Total domestic expenditure cuts	1.1
of which: Cuts in goods and services	0.4
Cuts in transfers adopted in 2017	0.5
Cuts in capex	0.2
Total savings	1.6

Sources: Ministry of Finance and IMF staff estimates.

20. Preliminary data suggest that the government is on track to meet the end-June fiscal targets (Text Table 3). The government has committed as a prior action to collect current taxes of about 0.7 percent of GDP before end-June from some large taxpayers that fell behind their payments in the second quarter of 2018 (MEFP ¶20). Preliminary fiscal data indicate a DPD of about 1.4 percent of GDP at end-May. The combined gains from collecting tax arrears and late payments of close to 1.1 percent of GDP should then bring the DPD below the end-June's target of 95 million new dobras (1 percent of GDP), given the expected budget execution for the month of June. In addition, the government will monitor monthly the top ten large taxpayers' payments against their projected taxes due (new end-November 2018 structural benchmark).

Text Table 3. Fiscal Performance 2018:H1
(percent of GDP)

	Jan-May Actual	Jan-Jun Proj.
Total domestic revenue (excl. Oil)	4.3	6.3
Tax revenue	4.1	6.0
Import taxes	1.5	1.8
Other taxes	2.6	3.1
Collection of tax arrears and	…	1.1
Nontax revenue (excl. oil)	0.3	0.3
Total primary expenditure	5.7	6.9
Current primary expenditure	5.6	6.7
Personnel costs	2.9	3.4
Goods and services	1.1	1.4
Transfers	1.3	1.6
Other expenditures	0.3	0.3
Domestic Capital expenditure	0.1	0.1
HIPC-related social expenditure	0.1	0.1
Domestic Primary Balance	-1.4	-0.6
in million new dobras		
Tax revenue	375	551
Program target		535
Domestic Primary Balance	-126	-53
Program target		-95

Sources: Ministry of Finance and IMF staff estimates.

21. Spending measures will complement the revenue measures to continue fiscal consolidation in 2018. The end-December 2018 DPD target is set at 1.3 percent of GDP, slightly higher than the 1 percent targeted in the fourth review to allow for measured adjustment, but still below the 1.8 percent of GDP target for last year. The government intends to generate savings of about 1.1 percent of GDP in primary domestic expenditures largely through maintaining the cuts in transfers and personnel costs introduced in 2017 and reducing consumption of electricity, water, and fuel by public agencies (MEFP ¶22). As previously programmed, the nominal public wage bill will grow below the rate of GDP growth by keeping wages largely unchanged to free resources for new hiring for priority needs in education, health, and security services. Domestically-financed capital expenditure will be slightly reduced from 2017 in light of the higher spending last year and expected higher externally-financed spending this year. In view of the uncertainty of revenue, as a precautionary measure to ensure the DPD target is met, the government will hold back expenditure to match available resources. The Minister of Finance has issued a resolution to limit budgetary expenditure in line with the program, meeting a prior action for the completion of the review.

22. The government also remains committed to bring the arrears clearance plan back on track (MEFP ¶23). The government has agreed to prioritize arrears clearance if additional resources, including additional budget support or revenue, materialize. Given expected disbursement of budget grants equivalent to 2.1 percent of GDP, the government would allocate the equivalent of 0.7 percent of GDP in non-project grants to pay down debt. In addition, effective from 2019, a surcharge will be applied to the price of oil products in place of the current differential between domestic and import prices to pay the debt to ENCO.

23. Over the medium term, fiscal policy will continue to be aimed at reducing debt to a more sustainable level and reducing aid dependency. The DPD would be maintained close to 1 percent of GDP to reduce aid dependency while safeguarding social spending. To this end, policy will continue to rely on expenditure rationalization in the near term while efforts are being stepped up for the transition to the VAT regime and the necessary realignment of regulations (see ¶25). New external borrowing would eschew non-concessional loans (including for large infrastructural projects).[3] To balance the needs to reduce the debt burden and meet large investment needs, concessional borrowing will be kept below 4 percent of GDP per year. This will keep debt relative to GDP and revenue below debt distress thresholds and bring debt relative to exports gradually below the distress threshold.

24. Reducing fiscal risk posed by the state-owned enterprises (SOEs), particularly the utility company, EMAE, remains a priority. EMAE's arrears to ENCO increased by US$16.6 million (4¼ percent of GDP) in 2017 to reach US$77 million, despite immediate measures to contain operational costs and collect unpaid bills. EMAE is likely to remain loss-making until medium-term investment projects supported by development partners decrease operational costs. Several reform projects, notably rehabilitation of the energy grid and installation of meters, the Financial Management Improvement Plan (FMIP) and the Least Cost Development Plan (LCDP) are advancing. Two other financially-fragile SOEs—the port and airport operators—have agreed on plans with the government to gradually clear their large tax arrears. However, timely implementation will hinge critically on the SOEs' success in containing costs, including reducing staff costs, and collecting dues. In this connection, the ongoing pre-audit of all SOEs by an international firm (supported by the World Bank) is an important step. Restoring the cost recovery of these SOEs will also be essential to disentangle the web of domestic arrears, the total gross value of which reached about 60 percent of GDP (in unconsolidated terms), of which 14 percent of GDP is owed by the government and 3 percent of GDP is owed to the government.

25. The recent revenue underperformance underscores the need for revenue mobilization. Tax revenues have so far relied heavily on customs and, as a consequence, have been vulnerable to volatility of imports (including in international oil prices) and low tax compliance. Preparations are ongoing to introduce a VAT regime in early 2019, which is expected to gain 2.1 percent of GDP in revenue over the medium term (Box 3, MEFP ¶25). These preparations include alignment of tax regulations on VAT and other taxes, including the recent hikes in import duty. In line with the recommendations of IMF TA on tax administration, the government is also working to implement a more systematic inspection of large taxpayers and a wider computer-based surveillance of taxpayers. In this connection, the authorities will start to monitor large taxpayers' tax payment against the estimated tax due, while work continues to establish a dedicated large taxpayers' unit

[3] Including the airport expansion, which will be financed by grants only as indicated by the authorities. The mission has been advising the authorities to use means that are non-debt creating and do not require public guarantees for a deep-water port for fisheries, the plan for which is yet to be fully developed.

(MEFP ¶25). Also in line with IMF TA, the authorities plan to strengthen revenue forecasts and budget control to avoid arrears accumulation, improve project coordination and management, and strengthen financial programming consistency in budget preparation. In particular, controls of spending on energy and telecommunications have been devised in coordination with the suppliers. The government is committed to effectively apply the automatic fuel price adjustment mechanism, and has accordingly raised prices in June to reflect the recent international oil price increases.

26. The government is implementing some of the main recommendations of the Debt Management Performance Assessment (DeMPA). In particular, the authorities are developing the medium-term debt management strategy, establishing a debt database, and training officials on debt management, including T-Bill issuance (MEFP ¶42).

Authorities' Views

27. The authorities agreed with staff's assessments and measures proposed. They noted that they have begun procedures to collect tax arrears owed by Rosema and expected to collect all the arrears by end-June 2018. In addition, they are discussing with Ghana's government to help recuperate fees owed to ENASA and hence to the Treasury. They also committed to contain discretionary spending and to use any additional resources available to clear the arrears by the state. They further noted that while preparations for the adoption of the VAT have taken longer than expected, this partly reflects their caution to ensure a smooth transition and to avoid the difficulties that other countries faced at the beginning, such as a large backlog in VAT refunds. They pointed out that some of the delays in reforms, including regarding EMAE, stemmed from delays in technical and financial assistance provided by development partners. In addition, they broadly agreed with staff's recommendation to identify further short-term measures to improve SOEs' operational performance, notably in reducing staff costs and accelerating arrears collection.

B. Boost International Reserves Buffers

28. Monetary policy will continue to be anchored by the peg to the euro. As a small-island economy that depends extensively on imports, the pegged exchange rate (introduced in 2010) has served the country well. Inflation rates have been reduced from pre-peg double digits to around 6 percent.[4] As banks continue to hold large excess reserves and the interbank market remains dormant, monetary transmission is muted; this is illustrated by the lending rate's limited response to the reduction of the BCSTP reference rate in June 2017. Given the limited effectiveness of current tools, efforts are being made to strengthen the toolkit (MEFP ¶33). In the meantime, sound fiscal policies and structural reforms to boost exports, reduce energy imports, and improve

[4] An analysis of the quarterly data shows that the introduction of the peg in January 2010 lowered both food and nonfood inflation (SIP Chapter 2). It also shows that domestically financed fiscal spending, which is reflected in the growth of M2, is associated with higher inflation. From the supply side, food inflation follows the international food price index and rises with higher rainfall, which damages crops and negatively affects fishing. In addition, nonfood inflation is positively correlated with the growth of tourist arrivals, reflecting infrastructure bottlenecks.

implementation of externally funded projects are the most important tools for supporting reserves and the peg.

29. The External Balance Assessment (EBA) suggests that the external position of São Tomé and Príncipe is moderately weaker than indicated by fundamentals and desirable policies, implying a moderately overvalued real effective exchange rate (REER) (Annex II). The external imbalance underscores the need for structural reforms to strengthen competitiveness, diversify the economy, reduce the reliance on oil imports via electricity sector reforms, and improve the efficiency of implementing externally funded projects to avoid disbursement delays. To this end, the Treasury will publish quarterly reports on the progress of externally financed projects. It will also revise the projected external disbursements in cooperation with the central bank, including both project and budgetary grants and loans (MEFP ¶32), which will increase aid transparency and facilitate macroeconomic management. In addition, continued fiscal consolidation will help build a higher reserves buffer in the near term.

30. Efforts have been made to upgrade the infrastructure for monetary management, including the securities' market. The BCSTP drafted revised regulations to introduce a secondary market and longer-term instruments. The central bank also took welcomed steps to increase transparency and promote interbank activity by enforcing publication of banks' financial statements.

Authorities' Views

31. The authorities agreed that the peg serves the country well and recognized the need to address the existing external sector imbalances. The central bank is committed to continue to monitor changes to inflation and to tighten monetary policy if necessary. They concurred that diversifying the economy and reducing its dependence on imports for basic needs would strengthen competitiveness and the external balance position. In particular, to diminish dependence on oil imports and the accompanying demand for foreign exchange reserves, the government is developing the country's hydro capacity and exploring the options of solar and natural gas power plants.

C. Safeguard Financial Stability

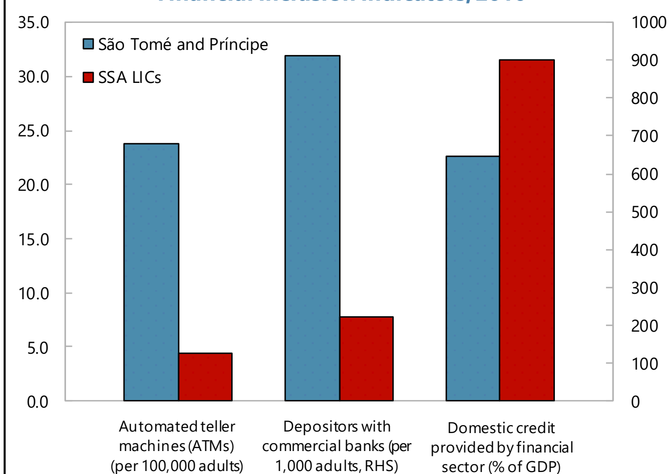
32. NPL resolution is moving ahead, albeit at a slow pace. Stringent bank supervision by the BCSTP has strengthened asset classifications. The BCSTP agreed with the mission's recommendation to introduce a requirement for banks to write off a loan when it is past-due for a certain period, given the slim chance of recovering through the judicial system. Meanwhile, the authorities are looking for start-up funding for the new arbitration centers to start operation and facilitate out-of-court settlement.

33. The asset quality review (AQR) of the banking system is unexpectedly delayed. The AQR is being supported by the World Bank. The international selection process for the consultants, which had started in October 2017, took longer than expected to conclude, as did the negotiations on the price and scope of the project with the selected consultant. An inception report is expected by end-September 2018, a draft report by end-October 2018, and the final AQR results by mid-2019. The BCSTP will liaise with the banks to facilitate a swift evaluation process and intends to leverage the AQR findings for the planned overhaul of its prudential regulation.

34. Financial sector infrastructure and regulation are being upgraded. To mitigate the high risk in private sector credit, the BCSTP recently upgraded its credit registry (MEFP ¶9). An upgrade to the payment systems infrastructure is also underway with World Bank and AfDB support. The World Bank is also assisting the authorities to develop a resolutions manual. International accounting standards (IFRS) are being implemented over a three-year period. Macroprudential policy is in its infancy, though the credit registry offers a proxy for borrowers' debt-to-income ratio that could be used to this end. Lastly, there has been an implementation delay for some of the recommendations of the last safeguards assessment (¶48 and MEFP ¶30).

35. Financial inclusion indicators compare favorably with those of regional peers, but the development has stagnated. The numbers of ATMs and depositors per adult are the highest among SSA LICs, whereas domestic credit relative to GDP is below average (Text Figure 2). However, these ratios have not improved in recent years. Banks face a disincentive to installing new ATMs since, by regulation, they are not permitted to charge clients for ATM usage. Access to finance by SMEs is hindered by rampant credit risk, shortage of eligible collateral, and a high degree of informality, although some banks help clients become creditworthy (e.g. forming cooperatives, promoting young entrepreneurs).

Text Figure 2. São Tomé and Príncipe: Selected Financial Inclusion Indicators, 2016



Sources: World Development Indicators, World Bank; and IMF staff calculations.

Authorities' Views

36. BCSTP staff pointed to a recent survey that would inform the financial inclusion strategy going forward. Moreover, the BCSTP has drafted a microfinance law and a payment systems law that address the legal void in microfinance lending and mobile banking, respectively. It is also promoting financial literacy via the media. The BCSTP, however, felt that the objective of higher bankarization superseded the need for banks to recover ATM operation cost, even if only partially, as suggested by the mission.

D. Accelerate Growth-Enhancing Projects and Structural Reforms

37. Structural impediments are limiting growth and keeping poverty and unemployment high, particularly among women and the youth. Long-run growth has been relatively stable, averaging 4 percent; however, poverty and unemployment statistics are persistently high and disproportionately affect the female and young population groups. Labor statistics show that the unemployment rate inched down from 13.9 percent in 2008 to 13.0 percent in 2015 and remains close to that level; in the latter year, of the unemployed, around 60 percent were women and almost 85 percent were below 35 years of age. Poverty and unemployment, particularly among the youth, can not only perpetuate generational cycles of poverty, but also break down social cohesion and lead to higher crime rates, undermining economic growth potential and social stability. Tourism and agriculture are expected to be the main growth drivers (Box 4). Structural reforms to facilitate growth in these sectors are therefore essential. In this connection, ongoing judicial reforms in areas such as enforcing contracts, registering property, and resolving insolvency, will improve the business environment.

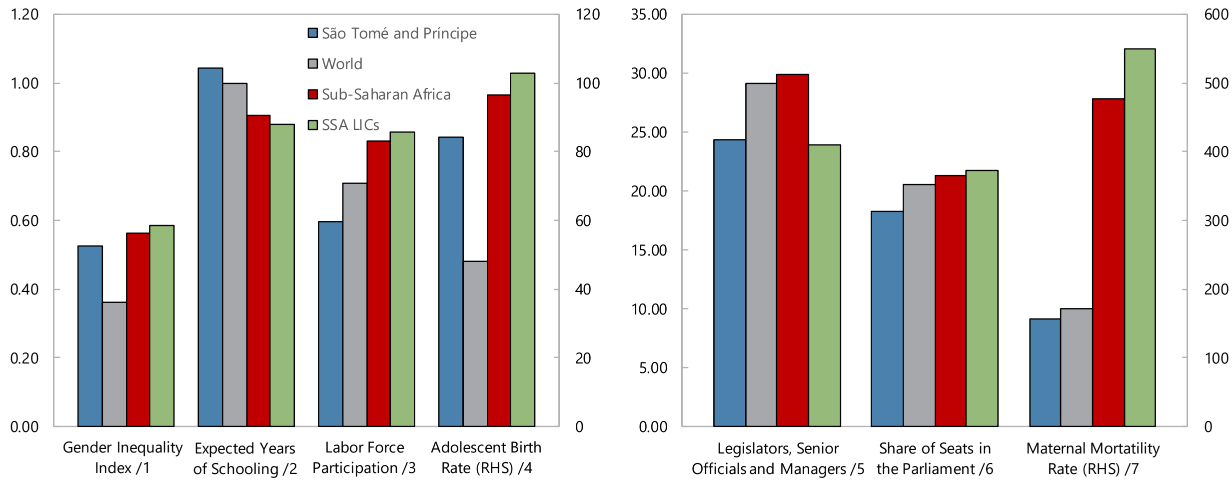
38. Besides support for infrastructural projects, the authorities have received assistance from development partners to design key sector strategies. A tourism development strategy, developed with World Bank support, has been adopted; and a private sector strategy (2015–24), prepared with the help of AfDB, is being implemented. The authorities also prepared a National Development Plan (NDP 2017-2021) to operationalize their long-term development agenda over the medium term.

39. São Tomé and Príncipe, as a dual-island state, is vulnerable to climatic changes. Recent events—episodes of coastal erosion and weather-related price shocks—have exposed the country's vulnerability and underlined the need to strengthen resilience to adverse climate change. Initiatives for mitigating the impact of climate change are underway. On environmental issues, the government has been working with NGOs to implement the national sanitation plan and promote sustainable biodiversity (with the latter focusing on Príncipe Island), among other initiatives. Challenges include limited capacity; not-well-organized associations and cooperatives; and low environmental awareness among residents.

40. Levels of female education and reproductive health exceed those seen in the sub-Saharan Africa (SSA) region; however, women's participation in the formal economy and representation in the government fall below the regional average. As Text Figure 3 shows, São Tomé and Príncipe fares better than SSA in the Gender Inequality Index, expected years of schooling ratio (EYS), maternal mortality rate (MMR), and adolescent birth rate. The country's EYS and MMR are also better than the world average. Nevertheless, the share of female legislators, senior officials and managers, and the share of female seats in the parliament are lower than the SSA averages by 5.4 and 3.1 percentage points, respectively. Even though the legal system guarantees equal rights for both genders, women still have a low participation rate in the formal labor market. Entrenched social norms and domestic violence[5] against women create gender gaps in both opportunities and outcomes, particularly in rural areas.

[5] Although no data on domestic violence seem to be available, interviews with authorities indicate that this is a key area for improvement.

Text Figure 3. São Tomé and Príncipe: Selected Gender Inequality Measures, 2015



Sources: UNDP, Human Development Reports; and IMF staff calculations.
Note: Data may not be available for all countries. Latest available data was used to construct this presentation.
1/ Gender Inequality Index (GII) is an index developed by the UNDP. It measures gender inequalities in three aspects: reproductive health, female empowerment, and economic status.
2/ Ratio between the expected years of schooling for females, and the expected years of schooling for males.
3/ Ratio between the labor force participation rate females, and the labor force participation rate for males.
4/ Births per 1,000 women ages 15-19.
5/ Percent of total legislators, senior officials and managers who are female.
6/ Percent of total seats occupied by women in the country parliament.
7/ Measured in deaths per 100,000 live births.

Authorities' Views

41. **The authorities agreed that structural reforms are key to achieve strong and sustained growth.** In particular, registering property, granting farmers land rights, and establishing accurate information about property records would help reduce credit risk. They pointed out that recent reforms to rationalize court fees and strengthen insolvency legislation should reduce legal costs and help make justice available to all. Meanwhile, private sector representatives pointed to inefficiencies in the judicial system that create delays and add to the costs of doing business. Regarding gender issues, the authorities underscored the progressive laws that give women equal rights and noted that they are working with development partners, such as the EU and UN, to promote gender equality.

PROGRAM ISSUES, SAFEGUARDS, AND RISKS

42. **Staff proposes to adjust program indicative targets for 2018 in line with the policy discussions** (MEFP Table 3). The DPD target for end-September is revised up in line with an upward revision also in the end-December target from 1 to 1.3 percent of GDP (¶21). The NIR targets for end-December are revised down by US$4 million, following the US$7 million shortfall relative to the unadjusted target at end-2017, to allow a measured rebuilding of reserves. These targets are consistent with rebuilding NIR closer to the end-2016 level and the associated GIR reserves cover to 4.6 months of imports by end-2018, above the optimal GIR of 3.8 months of imports as indicated by

the IMF low-income country reserve metric. Given the delays in contracting an auditing firm, staff proposes to change the benchmark of completing the AQR to requiring the external consultant to prepare an inception report by end-September 2018. Similarly, the adoption of the financial management plan and least cost energy-production plan for EMAE is proposed for rephasing to end-September 2018.

43. **Completing the fifth review is conditional on the authorities' implementation of three prior actions** (MEFP Table 4). These are collecting tax arrears from Rosema, collecting tax liabilities accumulated in 2018 from large taxpayers, and issuing a resolution to limit budgetary expenditure in line with the program.

44. **The authorities are requesting waivers for the nonobservance of three periodic PCs—DPD, NCG, and NIR—and one continuous PC that prohibits the imposition or intensification of exchange restrictions.** In the case of the DPD and NCG, the requests are based on corrective measures to ensure continued fiscal consolidation (¶19-21). In the case of the end-2017 NIR target, which partly reflected a one-off large shortfall of external support, the request is based on corrective measures to bolster the balance of payments, including fiscal consolidation based on the measures noted above, continued electricity sector reform to reduce oil import demand, and appointment of the Treasury to coordinate externally financed projects to avoid disbursement delays. The authorities have also committed to eliminate foreign exchange restrictions over time once balance of payment pressures have eased.

45. **The authorities are also requesting approval of the retention of the measures that give rise to exchange restrictions and a multiple currency practice subject to Fund jurisdiction under Article VIII, Sections 2(a) and 3, respectively**. These exchange measures include: (i) an exchange restriction arising under Articles 3(g) and 18 of the Investment Code of 2016 due to limitations on the transferability of net income from investments; and (ii) an exchange restriction arising from limitations on the availability of foreign exchange for payments of current international transactions, due to the rationing of foreign exchange by BCSTP. The latter exchange restriction also gives rise to a multiple currency practice as it has resulted in the channeling of transactions to the parallel market where the exchange rate is at a spread of more than 2 percent from the exchange rate in the formal market. The authorities have requested approval of these measures for a period of twelve months because they are temporary, non-discriminatory and needed for balance of payments reasons.

46. **The program is subject to downside risks**. In particular, pressure on spending could heighten ahead of the legislative elections in October 2018. In addition, weak capacity could constrain program implementation, which, in turn, could delay external financing.

47. **The country's capacity to repay the Fund is adequate** (Table 8). Requisite financing assurances exist and the program is fully financed. External repayments under the ECF-supported program will remain below 0.3 percent of exports of goods and services during the program period, and peak at 0.8 percent of exports of goods and services in 2024. However, because of São Tomé

and Príncipe's imposition of exchange controls, there are non-sovereign external payment arrears and a financing assurances review must be completed by the Executive Board.

48. A number of key recommendations from the previous safeguards assessment remain outstanding. Strengthening the BCSTP law was put on hold, pending alignment with the financial institutions law, and enactment is now expected during 2018. The BCSTP entered into an agreement with the Central Bank of Brazil for technical assistance on IFRS implementation and scoping work has begun. While the Audit Board Regulations were revised in line with Fund advice, the Audit Board has not significantly changed its modalities on oversight of audit mechanisms and controls, pending change in the composition as envisaged in the amendments to the BCSTP law. Furthermore, the BCSTP has not made much progress in strengthening internal audit.

OTHER SURVEILLANCE ISSUES

49. Further efforts are needed to improve the economic data, although they are broadly adequate for surveillance. Data provision and development are constrained by a lack of capacity. While the authorities have published the rebased (2008 base year) national account series (in satisfaction of an end-2015 structural benchmark), this is already outdated and needs a new update. The authorities plan to enhance leading indicators of economic activities, including data on tourism activity, while continue to strengthen other critical macroeconomic statistics. The authorities should leverage VAT implementation to develop foundational data for national account statistics. VAT data are a key source for compiling contemporary estimates of GDP (i.e., quarterly data) and implementation plans should provide for data collection for statistical purposes, which would support GDP compilation.

50. São Tomé and Príncipe continues to avail itself of the transitional arrangements under Article XIV, but does not maintain restrictions under Article XIV. However, it maintains two exchange restrictions subject to Fund approval under Article VIII (¶45). The authorities are committed to removing the existing exchange restrictions over time and continue to make efforts to facilitate the private sector to settle arrears to external private creditors, stemming from the past imposition of exchange controls. The country's exchange rate arrangement is, since 2010, a de facto fixed peg to the euro.

STAFF APPRAISAL

51. Macroeconomic stability has been strengthened, but more efforts are needed. While the economy grew steadily at 4 percent in recent years, acceleration is needed to reduce poverty in light of the young population. The spike in inflation in 2017 appears to have begun to wane as one-off effects subside. Fiscal consolidation and expected foreign inflows should buttress international reserves. However, vigilance is needed to safeguard the exchange rate peg.

52. Staff commends the authorities' resolve to continue fiscal consolidation to improve the fiscal position and reduce public debt. The continued underperformance of tax revenue calls for steadfast implementation of identified revenue-enhancing measures, including the collection of tax arrears from large private companies and SOEs in the near term. Preparation for the adoption of VAT next year should be accelerated, particularly harmonization of the VAT with the rest of the tax system. The cuts in discretionary expenditure are appropriate. In addition, the commitment to prioritize arrears clearance if additional resources materialize and the planned introduction of the oil surcharge to help pay down the debt from past oil subsidies are welcome.

53. Continued reliance on grants and concessional loans for external financing while strengthening debt management capacity is at the core of the debt reduction strategy. Staff welcomes the authorities' decision to eschew non-concessional loans, including for large infrastructural projects, and to limit external concessional borrowing to less than 4 percent of GDP per year. Work should continue to implement recommendations under the DeMPA and finalize the medium-term debt management strategy. Continued efforts are needed to resolve external arrears and disputed debt with creditors.

54. Reforming the utility company, EMAE, is a priority. The high cost of energy is hindering growth and the prolonged delays in reforming the energy sector pose a serious fiscal risk. The authorities are encouraged to work with development partners to accelerate the implementation of reforms and increase the cost effectiveness of electricity generation, which will also help reduce oil imports and the external imbalance. In this context, the pre-audit of all SOEs, including EMAE, by an international firm with the support of the World Bank will help to improve the commercial viability of SOEs and reduce fiscal risk.

55. Strengthened banking supervision is welcome, though vigilance continues to be essential. It is commendable that the authorities have strengthened asset classifications and upgraded laws and financial sector infrastructure, including the microfinance law and the credit registry. The long-delayed AQR should enable further strengthening of prudential regulation. Nevertheless, concerted efforts to reform the legal system to assist loan recovery will be crucial for lowering the NPL ratio and for the banking sector to support economic growth. While the authorities have made good progress towards the establishment of arbitration centers to facilitate out-of-court settlements, more efforts are needed to make them operational. The recommendations of the last safeguards assessment should be implemented without further delay.

56. The external position, which is assessed to be moderately weaker than warranted by fundamentals and desirable policies, and loss of foreign reserves last year call for vigilance. The central bank's commitment to develop the monetary policy tools available to support reserves accumulation is welcome. In the meantime, continued fiscal consolidation and structural reforms will be essential to strengthen the external position and improve competitiveness. In particular, improvement of the electricity system to reduce oil imports will help reduce the current account deficit. In addition, better implementation of externally funded projects to facilitate timely disbursements will also buttress reserves accumulation.

57. Structural reforms will be essential for promoting inclusive growth and reducing poverty. The recently adopted tourism development strategy could provide good foundations for promoting this key sector and for opening opportunities to a young population. More efforts are needed to speed up implementation of infrastructure projects, including road rehabilitation, airport expansion, and water and sanitation, to support tourism as well as the other key sectors such as agriculture and fisheries.

58. Staff recommends the completion of the fifth review under the ECF arrangement. The authorities have taken corrective measures to keep the program on track following the slippages last year, and economic policies for 2018 are consistent with the program's objectives. Staff also recommends waivers for the nonobservance of the PCs on the floor on the domestic primary balance, the ceiling on changes in net bank credit to the central government, the floor on net international reserves, and the continuous PC on not introducing or intensifying exchange restrictions based on corrective measures committed by the authorities (¶19-21 and ¶28-30) and because the program can still be successfully implemented despite these slippages. Staff also supports the establishment and modification of indicative targets and structural benchmarks for end-September through end-December 2018, as well as the completion of the financing assurances review. Staff also supports the sixth disbursement in the amount of SDR 634,285.

59. Staff recommends that the next Article IV Consultation for São Tomé and Príncipe be held on the 24-month cycle.

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2015–20

(Annual change in percent, unless otherwise indicated)

	2015	2016	2017		2018		2019		2020
			EBS/17/119		EBS/17/119		EBS/17/119		
	Actual	Actual	4th Rev	Prel.	4th Rev	Proj.	4th Rev	Proj.	Proj.
National income and prices									
GDP at constant prices	3.8	4.2	4.0	3.9	5.0	4.0	5.5	4.5	5.0
GDP deflator	4.2	8.1	2.7	4.7	3.5	3.9	4.0	6.2	5.0
Consumer prices									
End of period	4.0	5.1	6.0	7.7	5.0	6.0	4.5	5.0	4.0
Period average	5.3	5.4	5.6	5.7	5.5	6.8	4.7	5.5	4.5
External trade									
Exports of goods and nonfactor services	1.7	7.4	2.7	9.6	7.6	5.4	7.3	10.1	8.5
Imports of goods and nonfactor services	-18.2	-0.2	8.4	2.9	5.6	13.1	6.5	13.8	5.4
Exchange rate (new dobras per US$; end of period) [1]	22	23	...	21	...	...	...	...	...
Real effective exchange rate (period average, depreciat	1.8	5.6	...	-0.6	...	...	...	...	...
Money and credit									
Base money	37.5	5.0	1.5	-9.6	5.1	9.3	3.5	5.3	5.0
Broad money (M3)	13.1	-4.8	-0.2	-0.4	8.7	12.6	9.7	10.9	10.3
Credit to the economy	5.4	6.6	3.4	2.5	5.8	5.8	9.2	10.2	9.7
Velocity (GDP to broad money; end of period)	2.5	2.9	3.1	3.2	3.1	3.1	3.1	3.1	3.1
Central bank reference interest rate (percent)	10.0	10.0	...	9.0	...	...	...	...	...
Average bank lending rate (percent)	23.3	19.6	...	19.6	...	...	...	...	...
Average bank deposit rate (percent)	6.9	4.1	...	4.2	...	...	...	...	...
Government finance (in percent of GDP)									
Total revenue, grants, and oil signature bonuses	28.2	27.6	24.6	23.8	28.3	27.5	28.2	25.7	26.0
Of which: tax revenue	14.4	12.1	13.0	12.1	13.4	11.8	13.7	12.5	12.9
Nontax revenue	1.5	2.3	1.5	1.6	1.6	2.9	1.6	1.0	1.0
Grants	11.5	13.2	10.1	10.1	13.3	12.8	12.9	12.2	12.2
Total expenditure and net lending	34.5	31.8	29.5	26.4	30.8	27.3	31.1	29.2	28.9
Personnel costs	8.9	8.7	8.5	8.0	8.3	7.7	8.2	7.8	7.9
Interest due	0.8	0.4	0.7	0.5	0.5	0.6	0.7	0.6	0.4
Nonwage noninterest current expenditure	8.6	7.8	7.0	6.6	6.8	5.9	6.8	5.7	5.7
Treasury funded capital expenditures	0.7	0.6	0.3	0.7	0.3	0.1	0.6	0.3	0.4
Donor funded capital expenditures	14.9	13.9	12.8	10.5	14.6	12.8	14.3	14.6	14.1
HIPC Initiative-related capital expenditure	0.6	0.2	0.2	0.2	0.2	0.2	0.7	0.2	0.4
Domestic primary balance [2]	-3.0	-4.0	-1.8	-2.3	-1.0	-1.3	-1.0	-1.2	-1.2
Overall balance (commitment basis)	-6.3	-4.2	-4.9	-2.6	-2.4	0.3	-2.7	-3.5	-2.9
External sector									
Current account balance (percent of GDP)									
Including official transfers	-13.0	-6.5	-12.2	-8.2	-7.2	-6.8	-7.0	-9.8	-8.6
Excluding official transfers	-25.7	-20.2	-22.3	-18.8	-20.5	-20.0	-19.9	-22.0	-20.8
PV of external debt (percent of GDP)	39.7	31.5	30.5	28.4	31.2	26.9	30.7	26.9	26.8
External debt service (percent of exports) [3]	3.8	3.3	4.7	3.1	4.7	4.6	5.5	5.3	5.0
Export of goods and non-factor services (US$ millions)	89.9	96.5	99.2	105.8	106.7	111.5	114.5	122.8	133.2
Gross international reserves [4]									
Millions of U.S. dollars	61.9	55.9	58.7	51.3	64.4	58.2	67.1	62.2	64.8
Months of imports of goods and nonfactor services [5]	5.3	5.1	4.0	4.2	4.2	4.4	4.1	4.5	4.6
National Oil Account (US$ millions)	10.3	11.5	11.7	11.3	10.6	11.4	9.0	11.4	9.1
Memorandum Item									
Gross Domestic Product									
Millions of new dobra	6,970	7,846	8,300	8,535	9,019	9,222	9,891	10,231	11,285
Millions of U.S. dollars	315.5	354.2	375.0	392.5	417.7	466.1	459.8	523.1	583.8
Per capita (in U.S. dollars)	1,556	1,706	1,764	1,847	1,921	2,143	2,068	2,353	2,570
Unemployment rate (percent)	13.0	12.6	...	12.2	...	11.7	...	11.3	10.8

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.

[1] Central Bank (BCSTP) mid-point rate.

[2] Excludes oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.

[3] Percent of exports of goods and nonfactor services.

[4] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements, for new licensing, and for meeting capital requirements.

[5] Imports of goods and nonfactor services, excluding imports of investment goods and technical assistance.

Table 2a. São Tomé and Príncipe: Financial Operations of the Central Government, 2015–20
(Millions of new dobra)

	2015	2016	2017		2018		2019		2020
			EBS/17/119		EBS/17/119		EBS/17/119		
	Actual	Actual	4th Rev	Prel.	4th Rev	Proj.	4th Rev	Proj.	Proj.
Total revenue and grants [5]	1965	2168	2042	2034	2556	2537	2788	2625	2931
Total revenue	1108	1130	1206	1174	1359	1353	1514	1373	1559
Tax revenue	1006	949	1077	1036	1213	1084	1354	1274	1450
of which: import taxes	455	371	409	388	466	451	520	486	536
oil surcharge						0		40	45
Other taxes	550	578	668	647	747	633	834	788	914
Nontax revenue	102	181	128	138	146	269	160	98	109
of which: oil revenue	0	74	29	51	35	198	38	20	22
Grants	804	1038	836	860	1197	1184	1274	1252	1372
Project grants	610	891	641	594	933	908	1023	1008	1112
Nonproject grants [4]	61	81	113	198	181	192	156	171	189
HIPC Initiative-related grants	133	65	82	67	83	83	95	73	72
Total expenditure	2405	2494	2451	2253	2774	2508	3081	2987	3262
Of which: domestic primary expenditure	1315	1370	1329	1316	1416	1279	1605	1440	1625
Current expenditure	1274	1334	1343	1287	1411	1303	1550	1446	1591
Personnel costs	623	684	702	681	749	706	807	802	895
Interest due	54	34	59	43	44	50	66	57	49
Goods and services	239	249	226	253	246	205	269	237	256
Transfers	248	282	280	234	295	278	324	282	316
Other current expenditure	110	84	76	76	77	64	84	68	74
Capital expenditure	1087	1141	1090	952	1341	1191	1465	1520	1628
Financed by the Treasury	51	50	27	58	28	12	56	30	40
Financed by privatization proceeds	…	0	0	0	0	0	0	0	0
Financed by external sources	1036	1090	1063	894	1314	1179	1410	1490	1588
HIPC Initiative-related capital expenditure	44	19	19	15	21	14	66	21	43
Domestic primary balance [1]	-207	-314	-152	-193	-92	-124	-100	-127	-133
Overall fiscal balance (commitment basis)	-440	-326	-410	-219	-218	29	-263	-363	-331
Net change in arrears, float, and stat. discrepancies (reduction = -) [4]	-85	296	-12	6	-36	-66	-86	-86	-86
Overall fiscal balance (cash basis)	-524	-30	-422	-213	-254	-37	-349	-449	-417
Financing	524	30	422	213	254	37	294	449	417
Net external	576	62	298	103	200	123	299	309	326
Disbursements [2]	742	143	422	160	381	200	387	482	477
Program financing (loans) [3]	20	32	0	37	0	37	0	0	0
Scheduled amortization	-187	-112	-124	-94	-181	-114	-88	-174	-151
Net domestic	-51	-32	123	110	54	-86	-4	140	91
Net bank credit to the government	-51	-32	123	110	54	-86	-4	140	91
Banking system credit (net, excluding National Oil Account)	-42	-5	93	101	58	66	-49	115	70
National Oil Account	-10	-27	30	9	-4	-152	44	24	22
Nonbank financing	0	0	0	0	0	0	0	0	0
Of which: Privatization	0	0	0	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	-54	0	0
Memorandum items:									
National Oil Account balance (US$ million, excl. transfers to budget)	10.3	11.5	11.7	11.3	10.6	11.4	9.0	11.4	9.1

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.
[1] Excludes oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlays.
[2] Includes loan from Angola in 2016 and 2017.
[3] Includes use of IMF program support.
[4] The central bank shows receipt of $5 mln in budget support from the World Bank at the very end of 2016, whereas the treasury accounts for them in 2017 when they received them.
[5] Revenue is measured on a cash basis.

Table 2b. São Tomé and Príncipe: Financial Operations of the Central Government, 2015–20
(In percent of GDP)

	2015	2016	2017		2018		2019		2020
			EBS/17/119		EBS/17/119		EBS/17/119		
	Actual	Actual	4th Rev	Prel.	4th Rev	Proj.	4th Rev	Proj.	Proj.
Total revenue and grants [5]	**28.2**	**27.6**	**24.6**	**23.8**	**28.3**	**27.5**	**28.2**	**25.7**	**26.0**
Total revenue	15.9	14.4	14.5	13.8	15.1	14.7	15.3	13.4	13.8
Tax revenue	14.4	12.1	13.0	12.1	13.4	11.8	13.7	12.5	12.9
of which: import taxes	6.5	4.7	4.9	4.6	5.2	4.9	5.3	4.8	4.7
oil surcharge						0.0		0.4	0.4
Other taxes	7.9	7.4	8.1	7.6	8.3	6.9	8.4	7.7	8.1
Nontax revenue	1.5	2.3	1.5	1.6	1.6	2.9	1.6	1.0	1.0
of which: oil revenue	0.0	0.9	0.4	0.6	0.4	2.1	0.4	0.2	0.2
Grants	11.5	13.2	10.1	10.1	13.3	12.8	12.9	12.2	12.2
Project grants	8.8	11.4	7.7	7.0	10.3	9.9	10.3	9.9	9.9
Nonproject grants [4]	0.9	1.0	1.4	2.3	2.0	2.1	1.6	1.7	1.7
HIPC Initiative-related grants	1.9	0.8	1.0	0.8	0.9	0.9	1.0	0.7	0.6
Total expenditure	**34.5**	**31.8**	**29.5**	**26.4**	**30.8**	**27.2**	**31.1**	**29.2**	**28.9**
Of which: Domestic primary expenditure	18.9	17.5	16.0	15.4	15.7	13.9	16.2	14.1	14.4
Current expenditure	18.3	17.0	16.2	15.1	15.6	14.1	15.7	14.1	14.1
Personnel costs	8.9	8.7	8.5	8.0	8.3	7.7	8.2	7.8	7.9
Interest due	0.8	0.4	0.7	0.5	0.5	0.6	0.7	0.6	0.4
Goods and services	3.4	3.2	2.7	3.0	2.7	2.2	2.7	2.3	2.3
Transfers	3.6	3.6	3.4	2.7	3.3	3.0	3.3	2.8	2.8
Other current expenditure	1.6	1.1	0.9	0.9	0.9	0.7	0.9	0.7	0.7
Capital expenditure	15.6	14.5	13.1	11.2	14.9	12.9	14.8	14.9	14.4
Financed by the Treasury	0.7	0.6	0.3	0.7	0.3	0.1	0.6	0.3	0.4
Financed by external sources	14.9	13.9	12.8	10.5	14.6	12.8	14.3	14.6	14.1
HIPC Initiative-related capital expenditure	0.6	0.2	0.2	0.2	0.2	0.2	0.7	0.2	0.4
Domestic primary balance [1]	-3.0	-4.0	-1.8	-2.3	-1.0	-1.3	-1.0	-1.2	-1.2
Overall fiscal balance (commitment basis)	-6.3	-4.2	-4.9	-2.6	-2.4	0.3	-2.7	-3.5	-2.9
Net change in arrears, float, and stat. discrepancies (reduction = -) [4]	-1.2	3.8	-0.1	0.1	-0.4	-0.7	-0.9	-0.8	-0.8
Overall fiscal balance (cash basis)	**-7.5**	**-0.4**	**-5.1**	**-2.5**	**-2.8**	**-0.4**	**-3.5**	**-4.4**	**-3.7**
Financing	**7.5**	**0.4**	**5.1**	**2.5**	**2.8**	**0.4**	**3.0**	**4.4**	**3.7**
Net external	8.3	0.8	3.6	1.2	2.2	1.3	3.0	3.0	2.9
Disbursements[2]	10.7	1.8	5.1	1.9	4.2	2.2	3.9	4.7	4.2
Program financing (loans)	0.3	0.4	0.0	0.4	0.0	0.4	0.0	0.0	0.0
Scheduled amortization	-2.7	-1.4	-1.5	-1.1	-2.0	-1.2	-0.9	-1.7	-1.3
Net domestic	-0.7	-0.4	1.5	1.3	0.6	-0.9	0.0	1.4	0.8
Net bank credit to the government	-0.7	-0.4	1.5	1.3	0.6	-0.9	0.0	1.4	0.8
Banking system credit (net, excluding National Oil Account) [3]	-0.6	-0.1	1.1	1.2	0.6	0.7	-0.5	1.1	0.6
National Oil Account	-0.1	-0.3	0.4	0.1	0.0	-1.7	0.4	0.2	0.2
Nonbank financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	-0.6	0.0	0.0
Memorandum items:									
National Oil Account balance (US$ million, excl. transfers to budget)	10.3	11.5	11.7	11.3	10.6	11.4	9.0	11.4	9.1
Nominal GDP (Millions of new dobra)	6,970	7,846	8,300	8,535	9,019	9,222	9,891	10,231	11,285

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.

[1] Excludes oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlays.

[2] Includes loan from Angola in 2016 and 2017.

[3] Includes use of IMF program support.

[4] The central bank shows receipt of $5 mln in budget support from the World Bank at the very end of 2016, whereas the treasury accounts for them in 2017 when they received them.

[5] Revenue is measured on a cash basis.

Table 3. São Tomé and Príncipe: Summary Accounts of the Central Bank, 2015–20
(Millions of new dobra)

	2015	2016	2017		2018		2019		2020
			EBS/17/119		EBS/17/119		EBS/17/119		
	Actual	Actual	4th Rev	Prel.	4th Rev	Proj.	4th Rev	Proj.	Proj.
Net foreign assets	**1,903**	**1,775**	**1,717**	**1,474**	**1,709**	**1,590**	**1,740**	**1,636**	**1,651**
Claims on nonresidents	2,243	2,144	2,072	1,840	2,092	1,958	2,115	1,993	2,006
Official foreign reserves	1,864	1,752	1,724	1,442	1,744	1,588	1,766	1,625	1,633
Other foreign assets	379	392	348	398	348	370	349	368	373
Liabilities to nonresidents	-341	-368	-355	-366	-383	-368	-375	-357	-355
Short-term liabilities to nonresidents	-120	-144	-156	-158	-185	-175	-176	-165	-161
Other foreign liabilities	-221	-224	-199	-208	-199	-193	-199	-192	-195
Net domestic assets	**-341**	**-135**	**-52**	**9**	**41**	**31**	**70**	**71**	**140**
Net domestic credit	130	259	251	172	251	93	252	239	335
Claims on other depository corporations	128	198	198	195	198	195	198	195	195
Net claims on central government	-113	-69	-83	-157	-89	-244	-93	-104	-12
Claims on central government	266	446	323	260	481	371	374	511	603
Of which: use of SDRs/PRGF	*196*	*180*	*114*	*211*	*48*	*83*	*48*	*82*	*83*
Liabilities to central government	-380	-515	-406	-417	-569	-615	-466	-615	-615
Ordinary deposits of central government	-11	-33	-8	-41	-194	-262	-125	-262	-262
Counterpart funds	-120	-82	-82	-60	-82	-60	-82	-60	-60
Foreign currency deposits	-249	-400	-316	-316	-294	-293	-260	-293	-293
Of which: National oil account	*-230*	*-271*	*-252*	*-232*	*-229*	*-224*	*-192*	*-221*	*-176*
Claims on other sectors	115	131	136	135	142	142	147	148	153
Other items (net)	-470	-394	-303	-163	-210	-62	-182	-168	-195
Base money	**1,562**	**1,640**	**1,665**	**1,484**	**1,750**	**1,621**	**1,811**	**1,707**	**1,791**
Currency issued	315	309	302	324	300	354	310	373	391
Bank reserves	1,247	1,332	1,364	1,160	1,450	1,267	1,501	1,334	1,400
Of which: domestic currency	980	1,183	1,203	1,013	1,281	1,107	1,326	1,165	1,223
Of which: foreign currency	266	149	161	147	169	160	175	169	177
Memorandum items:									
Gross international reserves (US$ millions) [1]	61.9	55.9	58.7	51.3	64.4	58.2	67.1	62.2	64.8
Months of imports of goods and nonfactor services [2]	5.3	5.1	4.0	4.2	4.2	4.4	4.1	4.5	4.6
Net international reserves (US$ millions) [3]	56.5	49.7	51.5	43.6	55.8	49.3	58.9	53.7	56.5
Months of imports of goods and nonfactor services [2]	4.8	4.5	3.5	3.6	3.6	3.7	3.6	3.9	4.0
National Oil Account (US$ millions)	10.3	11.5	11.7	11.3	10.6	11.4	9.0	11.4	9.1
Commercial banks reserves in foreign currency (US$ millions)	11.9	6.3	7.5	7.2	7.9	8.2	8.1	8.7	9.2
Guaranteed deposits (US$ millions)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Base money (annual percent change)	37.5	5.0	1.5	-9.6	5.1	9.3	3.5	5.3	5.0

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.

[1] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements, for new licensing, and for meeting capital requirements.

[2] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

[3] Net international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements, for new licensing, and for meeting capital requirements.

Table 4. São Tomé and Príncipe: Monetary Survey, 2015–20
(Millions of new dobra)

	2015	2016	2017		2018		2019		2020
			EBS/17/119		EBS/17/119		EBS/17/119		
	Actual	Actual	4th Rev	Proj.	4th Rev	Proj.	4th Rev	Proj.	Proj.
Net foreign assets	**2,527**	**2,105**	**2,001**	**1,582**	**2,012**	**1,709**	**2,062**	**1,754**	**1,742**
Net foreign assets of the BCSTP	1,903	1,775	1,717	1,474	1,709	1,590	1,740	1,636	1,651
Net foreign assets of other depository corporations	624	330	283	108	303	119	322	118	91
Net domestic assets	**301**	**586**	**686**	**1,099**	**908**	**1,310**	**1,139**	**1,595**	**1,952**
Net domestic credit	1,680	1,779	1,915	1,972	2,096	2,011	2,305	2,386	2,721
Net claims on central government	-303	-336	-272	-196	-218	-283	-222	-143	-51
Claims on central government	275	483	430	687	648	798	541	938	1,030
Liabilities to central government	-578	-819	-703	-883	-866	-1,081	-763	-1,081	-1,081
Budgetary deposits	-11	-33	-8	-41	-194	-262	-125	-262	-262
Counterpart funds	-120	-82	-82	-60	-82	-60	-82	-60	-60
Foreign currency deposits	-448	-704	-613	-782	-591	-759	-557	-759	-759
Of which: National Oil Account	-230	-271	-252	-232	-229	-224	-192	-221	-176
Claims on other sectors	1,984	2,115	2,187	2,168	2,314	2,293	2,527	2,528	2,773
Of which: claims in foreign currency	609	515	533	442	564	468	618	518	570
(Millions of $US)	27	22	25	22	26	24	29	27	30
Other items (net)	-1,379	-1,193	-1,229	-873	-1,189	-700	-1,166	-790	-770
Broad money (M3)	**2,828**	**2,691**	**2,687**	**2,681**	**2,919**	**3,019**	**3,202**	**3,349**	**3,694**
Local currency liabilities included in broad money (M2)	1,894	1,898	1,900	1,966	2,065	2,213	2,264	2,455	2,708
Money (M1)	1,431	1,522	1,435	1,578	1,560	1,777	1,711	1,971	2,174
Currency outside depository corporations	247	259	227	295	239	323	219	309	341
Transferable deposits in dobra	1,184	1,264	1,208	1,283	1,321	1,454	1,491	1,662	1,833
Other deposits in dobra	463	375	465	388	505	436	554	484	534
Foreign currency deposits	934	794	787	716	855	806	937	894	986
Memorandum items:									
Velocity (ratio of GDP to M3; end of period)	2.5	2.9	3.1	3.2	3.1	3.1	3.1	3.1	3.1
Money multiplier (M3/M0)	1.8	1.6	1.6	1.8	1.7	1.9	1.8	2.0	2.1
Base money (12-month growth rate)	37.5	5.0	1.5	-9.6	5.1	9.3	3.5	5.3	5.0
Claims on other resident sectors (12-month growth rate)	5.4	6.6	3.4	2.5	5.8	5.8	9.2	10.2	9.7
M3 (12-month growth rate)	13.1	-4.8	-0.2	-0.4	8.7	12.6	9.7	10.9	10.3
Eurorization ratio	35.9	32.3	29.8	27.1	30.2	28.5	30.3	28.9	29.5

Table 5. São Tomé and Príncipe: Financial Soundness Indicators, December 2012 – March 2018[1]

(Percent)

	2012 Dec.	2013 Dec.	2014 Dec.	2015 Dec.	2016 Dec.	2017 Dec.	2018 Mar.
Capital Adequacy							
Regulatory capital to risk-weighted assets	20.3	22.7	22.6	24.1	27.8	33.6	34.9
Percentage of banks (out of total number) with regulatory capital to risk-weighted assets							
... greater or equal to 10 percent	87.5	75.0	75.0	85.7	100.0	100.0	100.0
... between 6 and 10 percent	0.0	12.5	0.0	0.0	0.0	0.0	0.0
... below 6 percent minimum	12.5	12.5	25.0	14.3	0.0	0.0	0.0
Capital (net worth) to assets	22.7	18.4	20.3	15.5	22.5	24.0	23.8
Deposits with banks below 6 percent capital to assets							
... (in millions of dobras)	83.2	59.0	325.1	455.3	0.0	0.0	0.0
... (percent of deposits)	4.6	2.9	13.7	17.5	0.0	0.0	0.0
... (percent of GDP)	1.7	1.1	5.1	6.5	0.0	0.0	0.0
Asset quality							
Foreign exchange loans to total loans	57.9	53.9	46.5	42.1	27.5	17.2	16.5
Past-due loans to gross loans	66.7	30.4	36.2	35.0	30.7	27.6	28.3
Nonperforming loans/credit (IFRS definition)	15.4	16.9	19.1	29.8	27.0	24.9	25.4
Watch-listed loans	51.3	13.6	17.2	5.2	3.7	2.8	2.9
Provision as percent of past-due loans	15.4	56.3	45.1	68.7	71.2	80.0	80.8
Earnings and profitability							
Return on assets	-0.8	-2.1	-3.2	-5.2	0.0	-0.6	0.4
Return on equity	-3.3	-9.3	-15.9	-27.1	0.2	-3.0	1.8
Expense (w/ amortization & provisions)/income	117.8	471.1	164.5	215.9	108.6	112.8	92.0
Liquidity							
Liquid assets/total assets	37.8	40.8	45.8	52.0	54.0	49.7	50.8
Liquid assets/short term liabilities	61.5	39.6	72.7	72.5	84.6	69.1	68.2
Loan/total liabilities	64.7	56.3	47.3	47.1	47.0	53.1	50.2
Foreign exchange liabilities/total liabilities	30.8	27.0	28.1	30.0	26.6	28.6	27.8
Loan/deposits	101.7	85.8	69.6	63.5	63.5	59.7	57.3
Sensitivity to market risk							
Foreign exchange liabilities to shareholders funds	105.0	119.3	110.3	162.8	91.5	90.5	88.7

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates.

Note: Beginning June 2013, data are based on improved methodology and not strictly comparable with earlier data.

[1] Excluding Banco Equador (from the time that its banking licence was withdrawn in August 2016).

Table 6a. São Tomé and Príncipe: Balance of Payments, 2015–20

(Millions of U.S. dollars)

	2015	2016	2017		2018		2019		2020
			EBS/17/119		EBS/17/119		EBS/17/119		
	Actual	Actual	4th Rev	Prel.	4th Rev	Proj.	4th Rev	Proj.	Proj.
Trade balance	**-107.6**	**-105.5**	**-115.1**	**-112.1**	**-127.1**	**-141.3**	**-136.0**	**-164.3**	**-176.4**
Exports, f.o.b.	11.3	13.6	11.6	15.6	13.3	14.0	14.9	15.5	15.7
Cocoa	7.9	8.6	6.4	8.6	8.3	11.3	9.0	12.2	13.0
Re-export	2.2	3.2	3.7	4.7	3.5	5.1	4.3	6.2	6.1
Imports, f.o.b.	-118.9	-119.1	-126.7	-127.7	-140.4	-155.3	-151.0	-179.8	-192.1
Food	-34.3	-36.1	-38.9	-35.1	-40.6	-38.4	-42.5	-40.6	-41.9
Petroleum products	-31.3	-21.7	-29.1	-27.6	-30.5	-39.2	-33.4	-41.2	-40.7
Non-oil investment goods	-27.9	-31.2	-28.0	-36.8	-36.9	-42.4	-39.4	-54.4	-59.4
Oil sector related investment goods	-15.9	-12.7	0.0	-21.3	0.0	-25.9	0.0	-31.6	-34.8
Other	-9.6	-17.4	-30.6	-6.9	-32.4	-9.4	-35.7	-12.0	-15.2
Services and income (net)	**8.5**	**15.3**	**14.5**	**20.3**	**22.9**	**29.1**	**25.8**	**29.4**	**34.0**
Exports of nonfactor services	78.6	82.9	87.6	90.2	93.4	97.4	99.5	107.3	117.6
Of which : travel and tourism	62.2	69.2	73.7	75.3	78.7	81.4	84.0	90.3	99.6
Imports of nonfactor services	-69.1	-68.5	-75.3	-65.5	-72.8	-63.1	-76.1	-68.6	-69.9
Factor services (net)	-1.0	1.0	2.2	-4.4	2.3	-5.2	2.4	-9.3	-13.7
Of which: oil related	0.0	0.0	0.2	-1.1	0.1	0.1	0.1	0.1	0.1
Private transfers (net)	**18.1**	**18.6**	**17.0**	**18.1**	**18.5**	**19.1**	**18.8**	**19.7**	**21.0**
Official transfers (net)	**40.0**	**48.5**	**37.8**	**41.6**	**55.4**	**61.3**	**59.2**	**64.0**	**71.0**
Of which : project grants	27.6	40.2	29.0	27.3	43.2	45.9	47.5	51.5	57.5
HIPC Initiative-related grants	6.0	2.9	3.7	3.1	3.8	4.2	4.4	3.7	3.7
Current account balance									
Including official transfers	-41.0	-23.0	-45.8	-32.1	-30.3	-31.7	-32.2	-51.2	-50.4
Excluding official transfers	-81.0	-71.5	-83.6	-73.7	-85.7	-93.0	-91.5	-115.2	-121.4
Capital and financial account balance	**57.2**	**-13.4**	**44.7**	**31.9**	**33.1**	**36.9**	**28.8**	**56.0**	**51.9**
Financial account	57.2	-13.4	44.7	31.9	33.1	36.9	28.8	56.0	51.9
Foreign Direct Investment	25.8	20.7	42.9	41.4	11.2	50.0	12.4	59.9	66.3
Oil signature bonuses	2.4	3.3	0.0	2.3	0.0	10.0	0.0	1.0	1.1
Petroleum related investment	24.2	19.3	43.6	32.3	0.0	39.3	0.0	47.8	52.7
Portfolio Investment (net)	0.3	0.6	0.0	0.6	0.0	0.0	0.0	0.0	0.0
Other investment (net)	31.1	-34.8	1.8	-10.1	21.9	-13.1	16.4	-3.9	-14.3
Assets	9.5	-19.5	0.0	2.2	0.0	-9.5	0.0	-9.7	-9.9
Public sector (net)	26.0	3.3	15.2	0.4	13.7	3.5	13.9	17.5	17.1
Project loans	33.6	6.4	19.1	7.3	17.6	10.1	17.6	24.7	24.7
Program loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-7.5	-4.1	-2.4	-4.2	-2.6	-6.0	-4.1	-7.5	-7.8
Of which : HIPC Initiative-related grants	-6.1	-2.9	...	-2.5	...	-3.3	...	-3.3	-3.3
Other investment	-0.1	1.0	-1.6	-2.8	-1.4	-0.6	0.3	0.3	0.3
Of which : transfers to JDA	-0.2	-0.4	-0.2	-0.2	-0.4	-0.5	-0.4	-0.5	-0.5
Private sector (net)	-4.3	-18.6	-13.4	-12.8	8.2	-7.1	2.5	-11.6	-21.6
Commercial banks	9.7	13.8	-0.9	8.8	1.4	-0.8	1.0	0.0	1.3
Short-term private capital	-14.0	-32.3	-12.4	-21.6	6.8	-6.3	1.5	-11.6	-22.9
Errors and omissions	**-3.8**	**31.9**	**0.0**	**-9.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**18.5**	**-4.6**	**-1.1**	**-9.6**	**2.8**	**4.4**	**-3.4**	**4.8**	**1.6**
Financing	-18.5	4.6	1.1	9.6	-2.8	-4.4	-1.9	-4.8	-1.6
Change in official reserves, excl. NOA (increase= -)	-18.2	5.0	1.0	6.6	-5.1	-5.7	-4.3	-4.5	-3.5
Use of Fund resources (net)	0.0	0.9	1.6	2.8	1.4	1.4	-0.3	-0.3	-0.3
Purchases	0.9	1.8	1.8	2.8	1.8	1.8	0.0	0.0	0.0
Repurchases (incl. MDRI repayment)	-0.9	-0.9	-0.2	0.0	-0.4	-0.4	-0.3	-0.3	-0.3
National Oil Account (increase = -)	-0.4	-1.3	-1.4	0.2	0.9	-0.1	2.7	0.0	2.2
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	-5.3	0.0	0.0
Memorandum items:									
Current account balance (percent of GDP)									
Before official transfers	-25.7	-20.2	-22.3	-18.8	-20.5	-20.0	-19.9	-22.0	-20.8
After official transfers	-13.0	-6.5	-12.2	-8.2	-7.2	-6.8	-7.0	-9.8	-8.6
Debt service ratio (percent of exports) [1]	3.8	3.3	4.5	3.1	4.5	4.6	5.5	5.3	5.0
Gross international reserves [2]									
Millions of U.S. dollars	61.9	55.9	58.7	51.3	64.4	58.2	67.1	62.2	64.8
Months of imports of goods and nonfactor services [3]	5.3	5.1	4.0	4.2	4.2	4.4	4.1	4.5	4.6

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.

[1] Percent of exports of goods and nonfactor services.

[2] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements, for new licensing, and for meeting capital requirements.

[3] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

Table 6b. São Tomé and Príncipe: Balance of Payments, 2015–20

(In percent of GDP)

	2015	2016	2017		2018		2019		2020
			EBS/17/119		EBS/17/119		EBS/17/119		
	Actual	Actual	4th Rev	Prel.	4th Rev	Proj.	4th Rev	Proj.	Proj.
Trade balance	**-34.1**	**-29.8**	**-30.7**	**-28.6**	**-30.4**	**-30.3**	**-29.6**	**-31.4**	**-30.2**
Exports, f.o.b.	3.6	3.9	3.1	4.0	3.2	3.0	3.2	3.0	2.7
Cocoa	2.5	2.4	1.7	2.2	2.0	2.4	1.9	2.3	2.2
Re-export	0.7	0.9	1.0	1.2	0.8	1.1	0.9	1.2	1.0
Imports, f.o.b.	-37.7	-33.6	-33.8	-32.5	-33.6	-33.3	-32.8	-34.4	-32.9
Food	-10.9	-10.2	-10.4	-8.9	-9.7	-8.2	-9.2	-7.8	-7.2
Petroleum products	-9.9	-6.1	-7.8	-7.0	-7.3	-8.4	-7.3	-7.9	-7.0
Non-oil investment goods	-8.8	-8.8	-7.5	-9.4	-8.8	-9.1	-8.6	-10.4	-10.2
Oil sector related investment goods	-5.1	-3.6	0.0	-5.4	0.0	-5.6	0.0	-6.0	-6.0
Other	-3.0	-4.9	0.0	-1.7	0.0	-2.0	0.0	-2.3	-2.6
Services and income (net)	**2.7**	**4.3**	**3.9**	**5.2**	**5.5**	**6.2**	**5.6**	**5.6**	**5.8**
Exports of nonfactor services	24.9	23.4	23.4	23.0	22.3	20.9	21.6	20.5	20.1
Of which : travel and tourism	19.7	19.5	19.7	19.2	18.8	17.5	18.3	17.3	17.1
Imports of nonfactor services	-21.9	-19.3	-20.1	-16.7	-17.4	-13.5	-16.5	-13.1	-12.0
Factor services (net)	-0.3	0.3	0.6	-1.1	0.5	-1.1	0.5	-1.8	-2.3
Of which: oil related	0.0	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Private transfers (net)	**5.8**	**5.3**	**4.5**	**4.6**	**4.4**	**4.1**	**4.1**	**3.8**	**3.6**
Official transfers (net)	**12.7**	**13.7**	**10.1**	**10.6**	**13.3**	**13.2**	**12.9**	**12.2**	**12.2**
Of which : project grants	8.8	11.4	7.7	7.0	10.3	9.9	10.3	9.9	9.9
HIPC Initiative-related grants	1.9	0.8	1.0	0.8	0.9	0.9	1.0	0.7	0.6
Current account balance									
Including official transfers	-13.0	-6.5	-12.2	-8.2	-7.2	-6.8	-7.0	-9.8	-8.6
Excluding official transfers	-25.7	-20.2	-22.3	-18.8	-20.5	-20.0	-19.9	-22.0	-20.8
Capital and financial account balance	**18.1**	**-3.8**	**11.9**	**8.1**	**7.9**	**7.9**	**6.3**	**10.7**	**8.9**
Financial account	18.1	-3.8	11.9	8.1	7.9	7.9	6.3	10.7	8.9
Foreign Direct Investment	8.2	5.8	11.4	10.6	2.7	10.7	2.7	11.4	11.4
Oil signature bonuses	0.8	0.9	0.0	0.6	0.0	2.1	0.0	0.2	0.2
Petroleum related investment	7.7	5.4	11.6	8.2	0.0	8.4	0.0	9.1	9.0
Portfolio Investment (net)	0.1	0.2	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Other investment (net)	9.9	-9.8	0.5	-2.6	5.2	-2.8	3.6	-0.7	-2.5
Assets	3.0	-5.5	0.0	0.6	0.0	-2.0	0.0	-1.9	-1.7
Public sector (net)	8.2	0.9	4.0	0.1	3.3	0.8	3.0	3.3	2.9
Project loans	10.7	1.8	5.1	1.9	4.2	2.2	3.8	4.7	4.2
Program loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-2.4	-1.1	-0.6	-1.1	-0.6	-1.3	-0.9	-1.4	-1.3
Of which : HIPC Initiative-related grants	-1.9	-0.8	-0.6	-0.6	-0.6	-0.7	-0.9	-0.6	-0.6
Other investment	0.0	0.3	-0.4	-0.7	-0.3	-0.1	0.1	0.1	0.0
Of which : transfers to JDA	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Private sector (net)	-1.4	-5.2	-3.6	-3.3	2.0	-1.5	0.5	-2.2	-3.7
Commercial banks	3.1	3.9	-0.3	2.2	0.3	-0.2	0.2	0.0	0.2
Short-term private capital	-4.4	-9.1	-3.3	-5.5	1.6	-1.4	0.3	-2.2	-3.9
Errors and omissions	**-1.2**	**9.0**	**0.0**	**-2.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**5.9**	**-1.3**	**-0.3**	**-2.5**	**0.7**	**0.9**	**-0.8**	**0.9**	**0.3**
Financing	-5.9	1.3	0.3	2.5	-0.7	-0.9	-0.4	-0.9	-0.3
Change in official reserves, excl. NOA (increase= -)	-5.8	1.4	0.3	1.7	-1.2	-1.2	-0.9	-0.9	-0.6
Use of Fund resources (net)	0.0	0.3	0.4	0.7	0.3	0.3	-0.1	-0.1	0.0
Purchases	0.3	0.5	0.5	0.7	0.4	0.4	0.0	0.0	0.0
Repurchases (incl. MDRI repayment)	-0.3	-0.3	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	0.0
National Oil Account (increase = -)	-0.1	-0.4	-0.4	0.1	0.2	0.0	0.6	0.0	0.4
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	-1.2	0.0	0.0
Memorandum items:									
Debt service ratio (percent of exports) [1]	3.8	3.3	4.5	3.1	4.5	4.6	5.5	5.3	5.0
Gross international reserves [2]									
Millions of U.S. dollars	61.9	55.9	58.7	51.3	64.4	58.2	67.1	62.2	64.8
Months of imports of goods and nonfactor services [3]	5.3	5.1	4.0	4.2	4.2	4.4	4.1	4.5	4.6

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.

[1] Percent of exports of goods and nonfactor services.

[2] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements, for new licensing, and for meeting capital requirements.

[3] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

Table 7. São Tomé and Príncipe: External Financing Requirements and Sources, 2015–20

(Millions of U.S. dollars)

	2015	2016	2017		2018		2019		2020
			EBS/17/119		EBS/17/119		EBS/17/119		
	Actual	Actual	4th Rev	Prel.	4th Rev	Proj.	4th Rev	Proj.	Proj.
Gross financing requirements	**-107.7**	**-70.6**	**-87.9**	**-74.1**	**-95.3**	**-105.7**	**-98.8**	**-127.2**	**-132.7**
Current account, excluding official transfers	-81.0	-71.5	-83.6	-73.7	-85.7	-93.0	-91.5	-115.2	-121.4
Exports, f.o.b.	11.3	13.6	11.6	15.6	13.3	14.0	14.9	15.5	15.7
Imports, f.o.b.	-118.9	-119.1	-126.7	-127.7	-140.4	-155.3	-151.0	-179.8	-192.1
Services and income (net)	8.5	15.3	14.5	20.3	22.9	29.1	25.8	29.4	34.0
Private transfers	18.1	18.6	17.0	18.1	18.5	19.1	18.8	19.7	21.0
Financial account	-8.5	-4.0	-4.1	-7.0	-4.3	-7.0	-4.1	-7.5	-7.8
Scheduled amortization	-7.5	-4.1	-2.4	-4.2	-2.6	-6.0	-4.1	-7.5	-7.8
IMF repayments	-0.9	-0.9	-0.2	0.0	-0.4	-0.4	-0.3	-0.3	-0.3
Other public sector flows (net)	-0.1	1.0	-1.6	-2.8	-1.4	-0.6	0.3	0.3	0.3
Change in external reserves (-ve = increase)	-18.2	5.0	-0.3	6.6	-5.2	-5.7	-3.2	-4.5	-3.5
Available funding	**101.6**	**70.6**	**87.9**	**74.1**	**95.3**	**106.5**	**98.8**	**127.2**	**132.7**
National Oil Fund (net)	2.0	2.1	-0.2	2.6	1.1	9.9	1.7	1.0	3.4
Oil signature bonuses	2.4	3.3	0.0	2.3	0.0	10.0	0.0	1.0	1.1
Saving (-ve = accumulation of oil reserve fund)	-0.4	-1.3	-0.2	0.2	0.9	-0.1	1.7	0.0	2.2
Expected disbursements	73.6	54.9	56.8	49.0	73.1	71.4	76.9	88.7	95.7
Multilateral HIPC interim assistance	6.0	2.9	3.7	3.1	3.8	4.2	4.4	3.7	3.7
Grants	34.0	45.6	34.0	38.6	51.6	57.1	54.8	60.3	67.3
Concessional loans	33.6	6.4	19.1	7.3	17.6	10.1	17.6	24.7	24.7
Project loans	33.6	6.4	19.1	7.3	17.6	10.1	17.6	24.7	24.7
Program loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector (net)	25.0	11.8	29.5	19.8	19.4	23.3	14.9	37.5	33.7
IMF	0.9	1.8	1.8	2.8	1.8	1.8	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	5.3	0.0	0.0
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.

Table 8. São Tomé and Príncipe: Indicators of Capacity to Repay the Fund, 2018–32
(as of June 19, 2018)

		Projections													
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Fund obligations based on existing credit (millions of SDRs)															
Principal	0.19	0.33	0.26	0.41	0.60	0.75	0.63	0.63	0.44	0.25	0.00	0.00	0.00	0.00	0.00
Charges and interest	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.98	0.00
Fund obligations based on existing and prospective credit (millions of SDRs)															
Principal	0.19	0.33	0.26	0.41	0.60	0.75	0.89	0.89	0.70	0.51	0.25	0.00	0.00	0.00	0.00
Charges and interest	0.03	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
Total obligations based on existing and prospective credit															
Millions of SDRs	0.22	0.40	0.33	0.48	0.67	0.82	0.96	0.96	0.77	0.58	0.32	0.07	0.07	0.07	0.07
Millions of U.S. dollars	0.32	0.57	0.48	0.69	0.97	1.19	1.40	1.40	1.12	0.84	0.47	0.10	0.10	0.10	0.10
Percent of exports of goods and services	0.28	0.47	0.36	0.49	0.64	0.73	0.81	0.77	0.58	0.42	0.22	0.04	0.04	0.04	0.04
Percent of debt service [1]	6.21	8.79	7.06	10.16	13.42	15.65	12.48	12.97	10.72	8.24	4.67	1.03	0.99	1.00	1.01
Percent of quota	1.49	2.70	2.23	3.24	4.53	5.54	6.49	6.49	5.20	3.92	2.16	0.47	0.47	0.47	0.47
Percent of gross international reserves [2]	0.54	0.92	0.73	1.03	1.38	1.62	1.80	1.73	1.34	0.97	0.52	0.11	0.11	0.11	0.10
Outstanding Fund credit															
Millions of SDRs	5.6	5.3	5.0	4.6	4.0	3.2	2.4	1.5	0.8	0.3	0.0	0.0	0.0	0.0	0.0
Millions of U.S. dollars	8.0	7.5	7.2	6.6	5.8	4.7	3.4	2.1	1.1	0.4	0.0	0.0	0.0	0.0	0.0
Percent of exports of goods and services	7.2	6.1	5.4	4.7	3.8	2.9	2.0	1.2	0.6	0.2	0.0	0.0	0.0	0.0	0.0
Percent of debt service [1]	157.8	115.3	107.0	96.9	79.7	61.7	30.6	19.7	10.6	3.6	0.0	0.0	0.0	0.0	0.0
Percent of quota	37.8	35.5	33.8	30.9	26.9	21.8	15.9	9.9	5.1	1.7	0.0	0.0	0.0	0.0	0.0
Percent of gross international reserves [2]	13.8	12.1	11.1	9.8	8.2	6.4	4.4	2.6	1.3	0.4	0.0	0.0	0.0	0.0	0.0
Memorandum items:															
Exports of goods and services (millions of U.S. dollars)	111.5	122.8	133.2	141.8	152.8	163.0	172.2	181.9	192.1	202.9	214.3	226.4	239.1	252.6	266.8
Debt service (millions of U.S. dollars)	5.1	6.5	6.7	6.8	7.2	7.6	11.2	10.8	10.5	10.2	10.0	9.9	10.3	10.2	10.1
Quota (millions of SDRs)	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8
Gross international reserves [2]	58.2	62.2	64.8	67.4	70.2	73.7	77.8	80.9	83.9	86.6	89.3	92.0	94.4	96.8	99.1
GDP (millions of U.S. dollars)	466	523	584	640	692	742	795	852	913	979	1050	1125	1206	1293	1386

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.

[1] After HIPC and MDRI debt relief. Including IMF repurchases and repayments in total debt service.

[2] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements, for new licensing, and for meeting capital requirements.

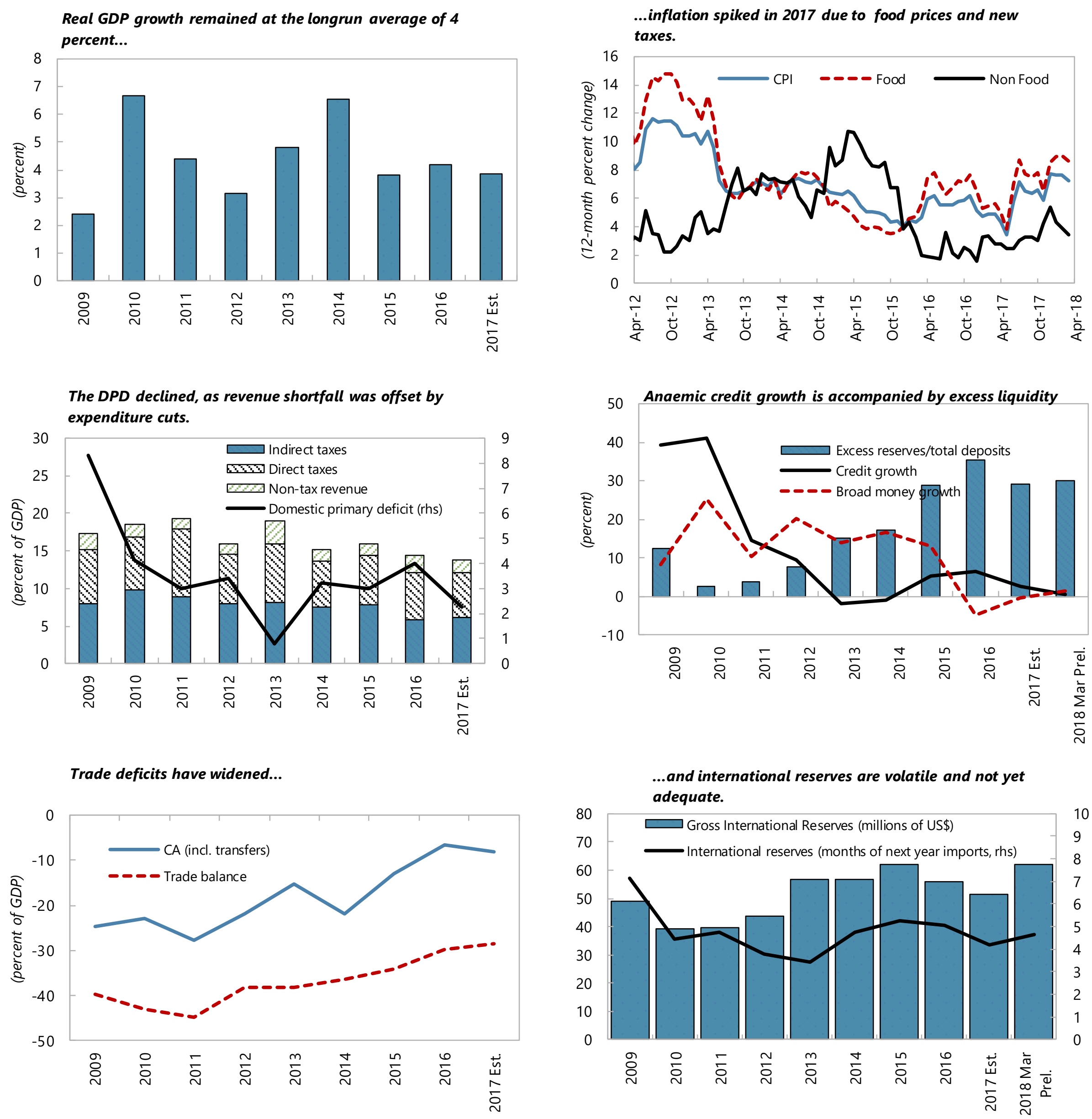
Table 9. São Tomé and Príncipe: Schedule of Disbursements Under an Extended ECF Arrangement, 2015–18

Date[1]	Disbursement conditions	SDR Amount	Percent of Quota
07/13/15	Board approval of arrangement.	634,285	4.29
06/10/16	Observance of continuous and end-December 2015 PCs and completion of the first review.	634,285	4.29
12/09/16	Observance of continuous and end-June 2016 PCs and completion of the second review.	634,285	4.29
12/11/17	Observance of continuous and end-December 2016 PCs and completion of the third review.	634,285	4.29
12/11/17	Observance of continuous and end-June 2017 PCs and completion of the fourth review.	634,285	4.29
04/15/18	Observance of continuous and end-December 2017 PCs and completion of the fifth review	634,285	4.29
10/15/18	Observance of continuous and end-June 2018 PCs and completion of the sixth review.	634,290	4.29
	Total	4,440,000	30

Source: International Monetary Fund.

[1] Board date, in the case of completed reviews.

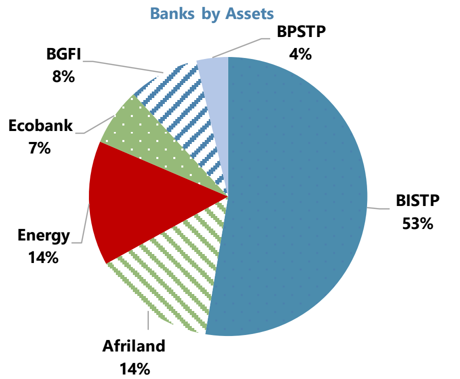
Figure 1. São Tomé and Príncipe: Recent Macroeconomic Developments, 2009-18



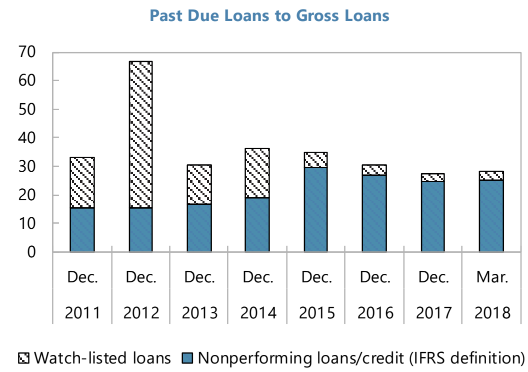
Sources: São Tomé and Príncipe authorities; and IMF staff estimates.

Figure 2. São Tomé and Príncipe: Financial Sector Developments, 2011-18[1]

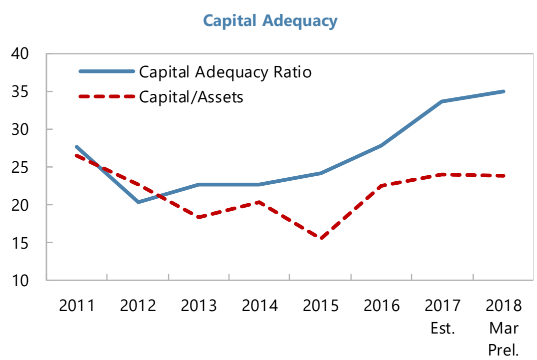
The largest bank has over half of total assets in a highly-concentrated banking system...



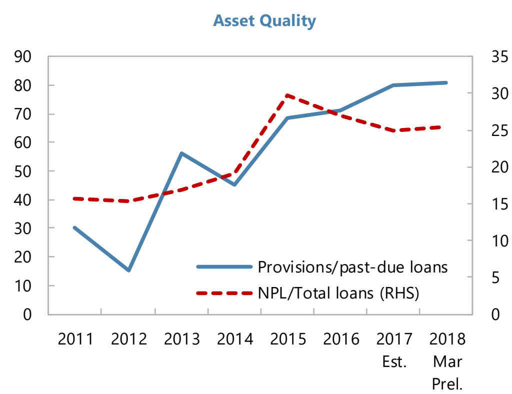
Past due loans have inched downwards...



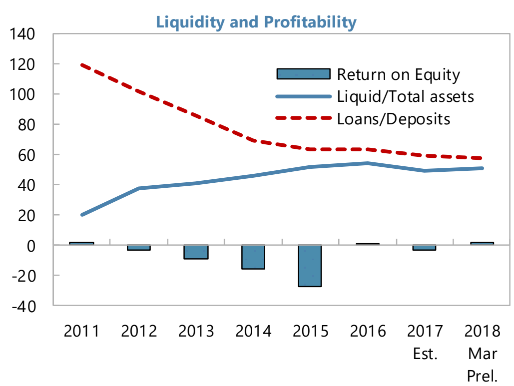
Capital adequacy continued to improve, well above regulatory requirements.



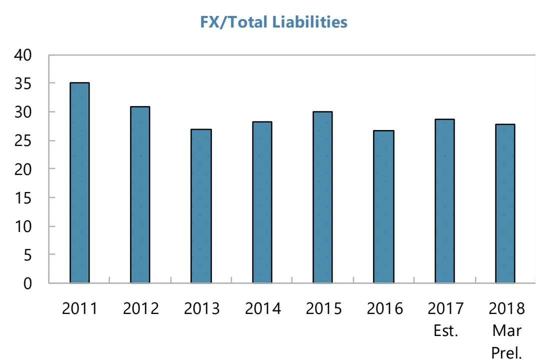
While the system-wide NPL ratio has fallen, provisioning has increased.



After posting a marginal profit in 2016, the banking system reported an average net loss in 2017.



Foreign currency liabilities increased.



Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.
[1] Includes BPSTP, which was intervened by the central bank on February 12, 2018.

Box 3. Introduction of the VAT

Tax revenue in São Tomé and Príncipe relies heavily on import duties, and at about 13 percent of GDP it is insufficient to meet the country's growth and development goals. Until 2016, when the Decree Law 13-2016 introduced taxation of imported liquor, alcoholic beverages and tobacco products, the consumption tax was levied solely on locally produced beer and the provision of services. All other imported goods, which make up the vast majority of goods consumed in the country, are still only taxable under import duties.

In 2016, an IMF technical assistance mission recommended the adoption of a consumption-type VAT under the destination principle, charged by the invoice-credit method, to replace the consumption tax and, partially, the real estate transfer tax (SISA) and the stamp duty. To avoid cascading and enhance production efficiency, refunds would be provided immediately for exporters and after 4 months of carrying forward for other taxpayers. It was also recommended to adopt a VAT threshold of US$24,000 of annual turnover. Taxpayers below the threshold would pay a 7 percent presumptive tax based on gross income, except for micro-enterprises (with annual turnover below US$2,400) that would pay a fixed annual or semi-annual tax. It is estimated that the VAT system would raise tax revenues by 2.1 percent of GDP over the medium term, assuming a single positive VAT rate of 15 percent, with additional revenue supplemented by excises taxes on alcoholic beverages, tobacco, oil products, and motor vehicles. In order to mitigate the price increase that will occur upon the introduction of VAT as well as its effect on low-income households, the IMF mission proposed to review the import tariff structure on products such as food, raw materials and capital goods and/or exempt from VAT a limited list of basic food items (vegetables, plants, roots, consumables and fish), which have large weights in the price index and in the budget of low-income households.

The successful introduction of the tax requires a combination of policy, legal and administration reforms. To help implementation, the IMF began providing technical assistance under the Revenue Mobilization Trust Fund in August 2017 focused on (i) completing the appropriate VAT legislation (including other related regulations), (ii) monitoring the development of the new IT system (supported by the AfDB), (iii) recruiting and training 25 new officials for administration of the new tax (supported partially by the World Bank), (iv) enhancing physical infrastructure and logistics, (v) implementing a new organizational structure, and (vi) defining education and communication strategies. The project has been assisting the authorities to complete all VAT preconditions with the help of a peripatetic resident expert and it will continue monitoring the completion of other VAT-related milestones in a timely manner. Additional structural changes in the Tax Directorate—especially related to paper-based and bureaucratic processes and lack of compliance risk management practices—are needed in the medium term to properly manage the VAT in the coming years.

Box 4. Economic Diversification in São Tomé and Príncipe

São Tomé and Príncipe, one of the world's smallest economies, is striving to diversify its economy for sustainable growth and poverty reduction. With a population of roughly 206,000 and a GDP of about US$393 million, per capita income is estimated at US$1,847 in 2017, below the average of other small-island developing economies. It is a young country with more than 60 percent of the population under 25 years. While the country has made commendable progress toward greater macroeconomic stability over the last decade, with GDP growth averaging at 4 percent per year since 2000, to achieve substantial poverty reduction and ensure sustained growth, economic diversification is imperative.

Constrained by its insularity, fragility and limited resources, São Tomé and Príncipe has a largely mono-culture economy. Among the productive sectors, the agriculture sector contributes more than 15 percent to total GDP, ranking as the second largest sector, and is a key employer. However, the sectoral share of output shows distributive trade's dominance in the economy (contributing roughly a quarter to real GDP), reflecting the island economy's reliance on foreign aid and trade (imports). Its export base is undiversified and consists of cocoa and a nascent tourism industry that is yet to be fully tapped. The European Union has been the dominant market for some time and there is opportunity to diversify both its export target markets for products and services.

The government has identified agriculture (including fisheries), tourism, and transportation as the key drivers of the structural transformation and economic diversification process. Leveraging the country's competitive advantages—political stability, fertile land, long coastline, and various tourism resources—the government hopes to create stronger pillars for inclusive and sustainable growth and development. A recently-launched tourism development strategy, published in January 2018 and developed in partnership with the World Bank, aims to transform the tourism sector by 2025. It markets São Tomé and Príncipe as being a comprehensive destination (focusing on other areas beyond beach tourism), and targets high-end tourists from more diversified sources than the current ones. If well implemented, it would transform the tourism sector into one of the main sectors of income and employment in the country. Given its trade dependence, investments in infrastructure are being pursued to reduce the transportation cost for its agricultural, trade, and tourism sectors. In the long run, the government expects that the country's political stability and geographic location will propel it into a travel and transshipment hub in the sub-region.

To realize its development strategy, some business-friendly reforms are being introduced to generate long-run economic payback. Recent reform initiatives, such as an e-Visa system and single windows for business registration and foreign trade, have already led to increased tourist arrivals and better doing business indicators. However, the country's low capacity and relatively weak institutions (with a CPIA score of 3.05, lower than the sub-Saharan Africa average) continue to undermine its reform effort. Reforms in ICT and the legal system, among others, can feasibly improve labor productivity and enable a more diversified economy with vibrant private sector participation.

Annex I. Capacity Development Strategy 2018-20

Summary

A. Main Macro Challenges

1. **São Tomé and Príncipe's policy imperatives focus on ensuring fiscal and debt sustainability, strengthening the financial sector, and improving macroeconomic statistics**. The main sources of short-term risks to the macroeconomic outlook are weakness in revenue administration and public expenditure control including accumulation of arrears at SOEs, high risk of debt distress, and high levels of non-performing loans in the banking sector.

B. Past TA Assessment

2. **CD activities in recent years reflected actual demand from the authorities and were fully in line with the reform priorities identified in the context of Article IV consultations and program reviews**. The IMF has provided São Tomé and Príncipe with substantial technical assistance (TA) focused on: revenue administration and tax policy; PFM reform; banking resolution; and macroeconomic statistics.

Key achievements include:

- Implementation of an automatic fuel price adjustment mechanism
- Measures to strengthen PFM
- Drafting of a VAT law and preparation towards the introduction of the VAT
- Approval of a banking resolution law
- Adoption of risk-based supervision
- Introduction of an interbank market

3. **However, limited human capacity has slowed implementation of reforms**. The TA activities that were most effective are those that were accompanied by hands-on support and close follow-ups.

C. Main TA priorities

4. The **top priority reforms** going forward are:

- Maintain fiscal and debt sustainability and reduce the risk of debt distress through fiscal consolidation and improved public financial management, including at SOEs.
- Enhance revenue mobilization, notably by introducing a VAT regime, to create fiscal space for social and capital spending.
- Strengthen financial stability and intermediation by reducing NPLs, enhancing banking regulation and supervision, and improving the bank resolution framework.
- Improve quality and timeliness of economic statistics.

5. **Accordingly, the capacity development (CD) strategy** for São Tomé and Príncipe focuses on the following areas in order of priority for the next 3 years and the main objectives sought.

Priorities	**Objectives**
Tax Policy and Revenue Administration	Transition to VAT regime Strengthen the operational capacity of the tax administration Implement a medium-term modernization process of the tax administration
Public Financial Management	Improve budget preparation and forecasting Improve budget execution and control of arrears Strengthen capital spending framework Introduce MTEF
Financial Sector Regulation and Supervision	Implement NPL reduction strategy Enhance credit and liquidity risk assessment
Expenditure Policy	Rationalize current expenditure and improve public spending efficiency Create fiscal space

Priorities	**Objectives**
Compilation of Statistics	Improve macroeconomic data (specifically, Improve GDP and CPI series Improve quarterly BOP and IIP statistics Improve monetary and government finance statistics)
Financial Crisis Management	Improve resolution frameworks Support ongoing bank liquidation
Debt Management	Improve debt and cash flow management Foster interbank market development
Financial & Fiscal Law Reform	Strengthen financial sector legal and regulatory framework
Systemic Risk Analysis	Implement stress testing

D. Authorities' Views

6. Experience shows that Technical Assistance (TA) provided by long-term experts has been more effective because it not only produces the diagnosis of the problems but also supports the implementation of the actions. In other words, long-term experts can facilitate the full cycle of TA from diagnosis to implementation of recommendations.

7. The effectiveness of TA could be improved through mobilization of Portuguese speaking experts to facilitate interaction, because they are more likely to perceive the core of the problem and are better positioned to enhance the capabilities of local technicians.

8. In particular, TAs that include on-the-job training have also been shown to be quite effective in the context of Banking Supervision and Statistics.

Annex II. External Sector Assessment

Staff's bottom-line assessment is that São Tomé and Príncipe's external position in 2017 was moderately weaker than warranted by fundamentals and desirable policy settings, suggesting a moderate overvaluation of the real effective exchange rate. The level of gross international reserves is assessed to be adequate based on standard benchmark metrics. Although immediate risks to the external position seem manageable, medium-term vulnerabilities remain significant given the country's narrow export base and large reliance on volatile external financing. As the peg to the euro has served the country well by decreasing the inflation rate, external imbalances should be addressed through structural reforms that aim to increase competitiveness and diversify the economy, as well as continued efforts to ensure a sound fiscal position.

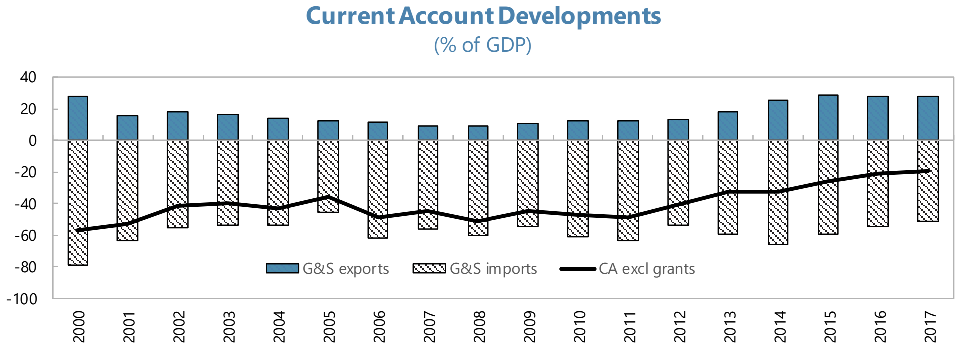
A. Evolution of the Balance of Payments

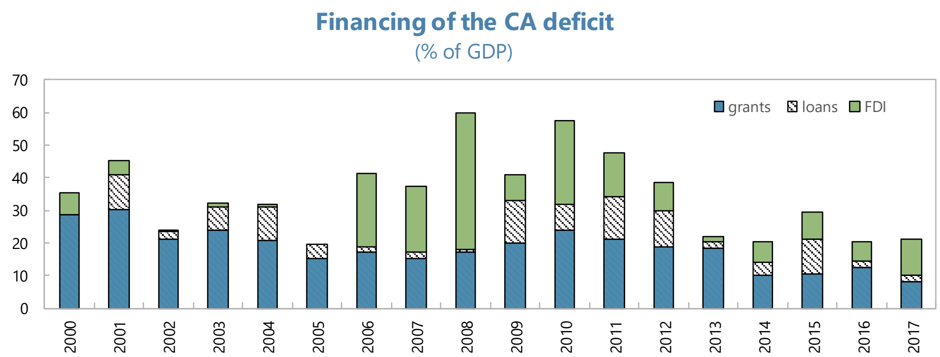
1. The current account (CA) deficit has decreased considerably since 2015. While the average CA deficit (excluding grants) was 44 percent of GDP between 2000 and 2014, it declined to 22 percent of GDP between 2015 and 2017. The decline partly reflects a considerable increase in tourism receipts since 2014 when the frequency of flights from Europe to São Tomé and Príncipe was increased. In addition, lower oil prices since 2015 have contributed to a contraction of imports. The CA deficit is expected to stay around the current level over the medium term, as further expansion of the tourism sector offsets rising investment-related imports.

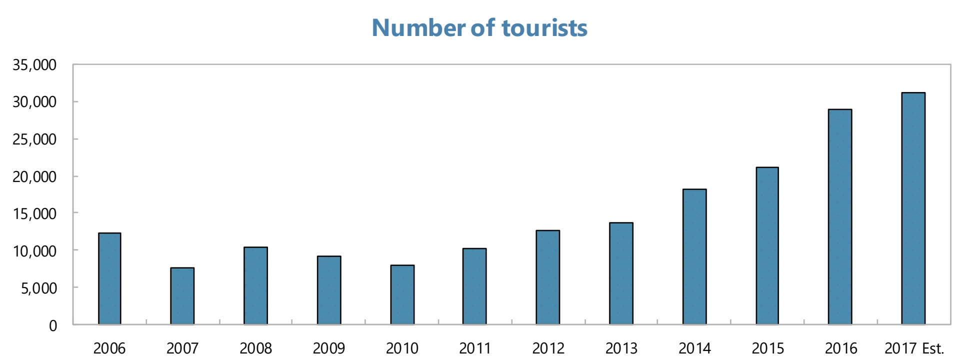
2. Receipts from tourism have increased from 5 percent of GDP in 2006 to 19 percent of GDP in 2017, leading to an improvement of the CA balance. Tourism revenue (19 percent of GDP) is significantly more important to the external balance than cocoa exports (2 percent of GDP). Data from the tourism authority shows that approximately half of the number of tourists come from Portugal. Cocoa exports go mostly to Europe (74 percent), mainly to the Netherlands (24 percent) and France (22 percent). Around half of São Tomé and Príncipe's goods imports come from Portugal and another 20 percent from Angola (Annex Figure 1).

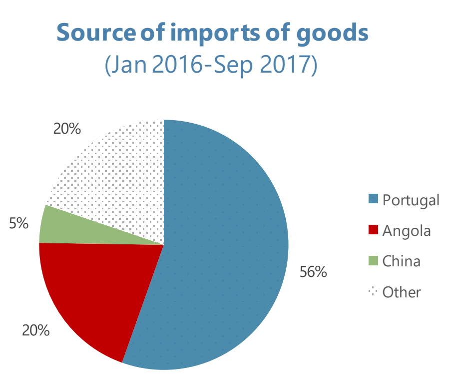
3. The largest share of the CA deficit is financed by grants, followed by FDI and then loans. Grants to São Tomé and Príncipe amounted to 10½ percent of GDP in 2015-17, down from 20 percent on average between 2000 and 2014. Meanwhile, FDI accounted for on average 8½ percent of GDP and loan disbursements for 5 percent of GDP during 2015-17. Most FDIs are related to the oil sector. The availability of these three types of financing has proven to be volatile in the recent past, which leaves São Tomé and Príncipe vulnerable.

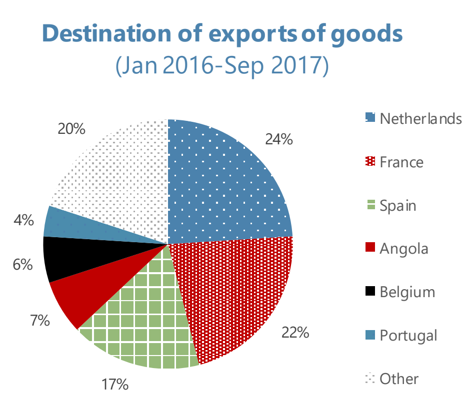
Annex Figure 1. São Tomé and Príncipe's balance of payments









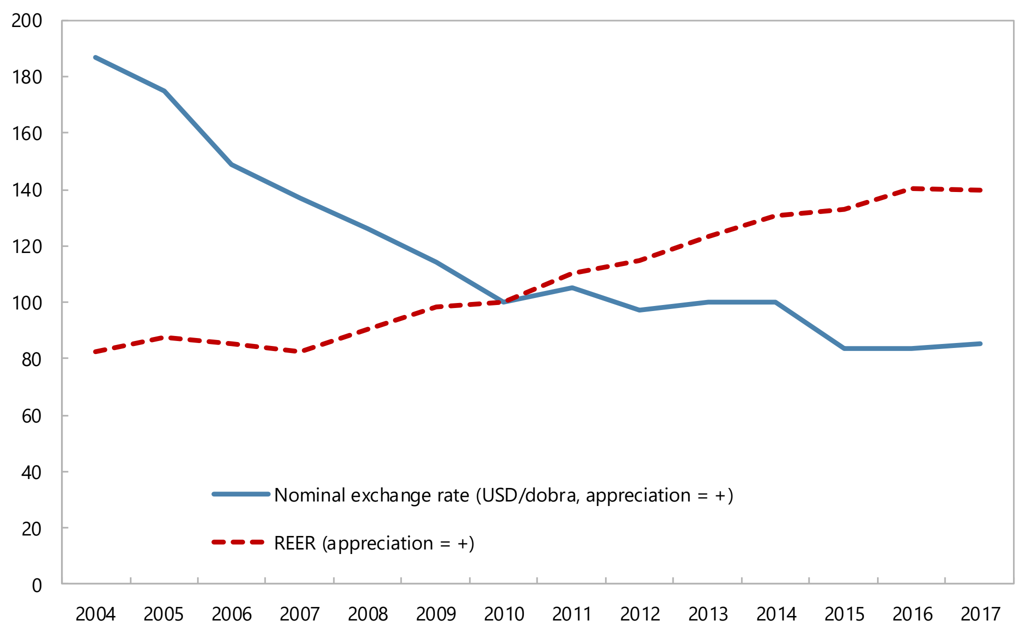


Sources: São Tomé and Príncipe authorities' data; and IMF staff estimates.

B. Exchange Rate and Current Account Assessment

Annex Figure 2. São Tomé and Príncipe: Exchange Rate Developments

(2010=100)



Sources: São Tomé and Príncipe authorities' data; and IMF staff estimates.

4. São Tomé and Príncipe's real effective exchange rate (REER) has appreciated considerably since the introduction of the peg to the euro in January 2010 (Annex Figure 2). The REER has appreciated by 40 percent between 2010 and 2017, as the gradual disinflation process has been too slow to close the inflation differential with trading partners. Specifically, average inflation in the euro area was 1.2 percent in 2010-17 compared to 8 percent in São Tomé and Príncipe. In other words, prices in the euro area have increased by 9 percent since 2010, compared to 71 percent in São Tomé and Príncipe.

5. Nonetheless, the peg has helped São Tomé and Príncipe to halve the average inflation rate from 16 percent during 2000-09 to 8 percent during 2010-17. Since 2015, annual average inflation has been around 5½ percent. Price inflation in the tourism sector has been even lower, limiting somewhat the effect of the REER appreciation on export competitiveness. As a small open economy, the peg has served the country well overall. However, the peg needs to be supported by strong macro policies (continued efforts to ensure a sound fiscal position and structural reforms) to avoid external imbalances.

6. **The EBA-lite models yield a range of assessments of the external position in 2017 (Annex Table 1)**. However, the results should be interpreted with caution given the inherent difficulties in benchmarking external stability for a fragile and small country with significant data limitations, such as São Tomé and Príncipe.

Annex Table 1. São Tomé and Príncipe: Real Effective Exchange Rate Assessment 2017
(Percent of GDP, unless otherwise indicated)

EBA lite current account model		**EBA lite Index REER model**	
CA actual (A)	-8.2	Fitted LN(REER) (N)	4.66
Cyclical contributions (from model) (B)	0.2	Policy gap (O)[1]	0.00
Cyclically-adjusted CA (C=A-B)	-8.4		
CA norm (F=M-J)	-8.3	LN(REER) norm (P=N-O)	4.66
Cyclically-adjusted CA norm (H=F-B)	-8.4	LN(REER) actual (Q)	4.94
CA gap (I=C-H)	**0.1**	**REER gap, in percent (R=Q-P)[2]**	**27.5**
o/w policy gap (J)[1]	1.0		
REER gap, in percent[2]	**-0.4**		
CA fitted (M)	-7.2		
Residual	-1.0		

	Stabilizing IIP at:		
	Scenario 1:	Scenario 2:	Scenario 3:
External sustainability approach	-135.1 of GDP	-66.0 percent of GDP[4]	-66.0 percent of GDP in 2037[4]
CA norm (S)	-12.0	-6.6	-5.6
Underlying CA (T)[3]	-8.6	-8.6	-8.6
CA gap (U=T-S)	**3.3**	**-2.1**	**-3.0**
REER gap, in percent[1]	**-16.6**	**10.4**	**15.2**
Memorandum item:			
Trade elasticity (K)	-0.20		

Sources: São Tomé and Príncipe authorities' data and IMF staff estimates
[1] Deviations of São Tomé and Príncipe's actual policies from its optimal level and also the average policy misalignment relative to the rest of the world.
[2] " + " overvaluation, " - " undervaluation. Change in the REER (in percentage) needed to close gap.
[3] Using 2022 projected current account as the medium-term reference period.
[4] Average IIP position of fragile small states in 2016.

- **The EBA-lite CA model suggests that the external position is broadly consistent with fundamentals and desirable policies.** The model estimates a cyclically-adjusted CA norm of -8.4 percent of GDP. This is essentially equal to the actual cyclically-adjusted CA balance in 2017, implying a CA gap of only 0.1 percent of GDP, and consequently, a slight undervaluation of the REER of about 0.4 percent (assuming an elasticity of the CA to the REER of -0.2). The policy gap (or the sum of deviations of São Tomé and Príncipe's actual fiscal balance, change in reserves, and private sector credit from their optimal levels and the world's averages of the same policy variables from their optimal levels) of 1.0 percent of GDP mainly reflects deviations from the world's policy variables and their optimal levels, which more than offsets a modest negative fiscal policy gap for São Tomé and Príncipe due to fiscal policy in 2017 being moderately looser than desirable medium-term levels. The resulting negative residual (i.e., the difference between the CA gap and policy gap) may reflect unmeasured structural policy gaps.

- **The EBA-lite REER Index model estimates a substantially stronger REER overvaluation than warranted by fundamentals and desirable policies (27.5 percent).** However, the REER Index model can be inaccurate for countries with limited data. As such, the result should be interpreted with caution.

- **The EBA-lite external sustainability (ES) approach estimates an overvalued REER if the target net International Investment Position (IIP) is benchmarked to the average of other fragile states.** In all three scenarios, an underlying (medium-term) current account of -8.6 percent and an elasticity of the CA to REER of -0.2 are used. Targeting the net IIP to -66.0 percent of GDP, a level consistent with the 2016 average for fragile countries, results in an overvalued REER of 10.4 percent if the net IIP is stabilized over time (Scenario 2), or an overvaluation of 15.2 percent if the net IIP is stabilized by 2036 (Scenario 3).[1]

C. Reserve Adequacy Assessment

7. São Tomé and Príncipe needs to build strong international reserve buffers given the persistence and magnitude of shocks it faces as a small and fragile LIC with a pegged exchange rate regime. São Tomé and Príncipe's 2017 level of gross international reserves (GIR) was adequate, slightly above the benchmark level. GIR corresponded to 4.2 months of prospective imports and 39 percent of the broad money measure at the end of 2017 (Annex Table 2). These values are above the standard metrics of 3 months of imports and 20 percent of broad money coverage. The IMF LIC reserve metric, also known as the ARA metric for credit-constrained countries, suggests that the optimal reserves metric for São Tomé and Príncipe is of 3.8 months of imports. This metric balances the benefits of holding reserves against the opportunity costs. It considers country specificities, such as being a small state and having a fixed exchange rate peg. Furthermore, São Tomé and Príncipe has access to extra reserve buffers in the form of exceptional access to a USD 12 million deposit at the National Oil Account (NOA) and a EUR 25 million contingent credit line from Portugal in case reserves fall below 3 months of imports.

Annex Table 2. São Tomé and Príncipe: Gross International Reserves Coverage Metrics

	2010	2011	2012	2013	2014	2015	2016	2017
GIR (months of prospective imports)	4.5	4.8	3.8	3.4	4.8	5.3	5.1	4.2
GIR (% of broad money)	52	48	43	47	46	49	49	39
GIR (% of debt service)	2,429	1,686	1,816	1,220	1,716	1,789	1,751	1,582
GIR (% of PPG ext. debt)	51	39	34	41	34	32	25	23
GIR (USD m)	39	40	44	57	57	62	56	51
GDP (USD m)	197	233	253	303	349	316	354	393

Sources: São Tomé and Príncipe authorities; and IMF staff calculations.

[1] Targeting a net IIP at its current level translates into a current account norm of -12.0 percent of GDP, which in turn implies an undervaluation of 16.6 percent (Scenario 1). However, staff assess that such a current account level is not desirable, so the result for Scenario 1 should be substantially underweighted.

D. Non-price Competitiveness Assessment

8. São Tomé and Príncipe should continue to improve its competitiveness according to the 2018 World Bank's *Doing Business* survey. Compared to SSA countries, São Tomé and Príncipe outperforms in the categories "protecting minority investors," "getting electricity," and "trade across borders," and underperforms in the categories "resolving solvency," "enforcing contracts," and "getting credit" (Annex Figure 3). Compared to the previous assessment, São Tomé and Príncipe improved in the category "starting a business" by eliminating the minimum capital requirement for business entities with no need to obtain commercial license, and in "trade across borders" by reducing the time required for border compliance after the implementation of an electronic trade single-window. On the other hand, São Tomé and Príncipe worsened its position in the category "enforcing contracts" due to a longer process period. It takes 1,185 days to enforce a contract in São Tomé and Príncipe while the SSA average is 657 days. The planned reform of the judicial sector aims to improve this situation.

E. Conclusion

9. Overall, staff's assessment is that São Tomé and Príncipe's external position in 2017 was moderately weaker than warranted by fundamentals and desirable policy setings. Specifically, staff assesses the CA gap to be between -1 and -2 percent of GDP. Consistent with this, staff estimates the REER to be overvalued by 5 to 10 percent. This range is obtained mainly by taking into account the results of both the CA model and the ES approach and allowing for some uncertainty. Specifically, using the CA model and Scenario 2 of the ES approach, the overvaluation would be around 5 percent; using the CA model and the Scenario 3 of the ES approach, it would be around 7½ percent.

10. Strong policies will help strengthen the external position. The peg has served this small open economy well by promoting disinflation and reducing exchange rate volatility. However, to support the peg and strengthen the external position, it will be important to continue efforts to ensure a sound fiscal position and advance structural reforms. For the latter, key reforms include the envisaged diversification strategy and reform of the electricity company, which should lead to higher exports and lower oil imports, respectively, thereby helping external rebalancing.

Annex Figure 3. São Tomé and Príncipe: Doing Business Indicators

(0=worst, 100=best)

Sources: World Bank Doing Business survey and IMF staff estimates.

Appendix I. Letter of Intent

São Tomé, July 9, 2018

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington, D.C. 20431
USA

Dear Ms. Lagarde:

The government of the Democratic Republic of São Tomé and Príncipe requests the IMF Executive Board to complete the fifth review of the Extended Credit Facility (ECF) arrangement and to approve the disbursement of the sixth tranche of the loan based on partial implementation of end-December 2017 performance criteria (PC) and satisfactory implementation of the prior actions.

As documented in the attached Memorandum of Economic and Financial Policies (MEFP), economic conditions remained challenging in 2017 and program performance was uneven under an unfavorable external environment. Both reduced and delayed financial support from our partners led to less dynamism in the economy, presenting a difficult challenge for striking the right balance between adjustment and growth and for achieving the program targets. Therefore, we would like to request the IMF Executive Board to approve waivers for the nonobservance of the program targets in 2017, including the domestic primary balance and bank financing of the central government (both missed by ½ percent of GDP), as well as net international reserves and the continuous PC on not introducing or intensifying any exchange restrictions. Additionally, as a sign of our commitment to the program, we have completed the prior actions for the fifth review.

The MEFP updates the government's policies and objectives for 2018 and beyond, which are anchored by our development strategies as outlined in the National Development Plan (NDP) 2017-2021 and the Vision 2030: Transformation Agenda. Specifically, the MEFP lays out policies for strengthening program implementation to meet program objectives for the remainder of the current arrangement and continue to safeguard macroeconomic stability and promote growth. We will implement fiscal measures to mobilize domestic revenue (including preparing the groundwork for the implementation of a value-added tax (VAT) in 2019), collect tax arrears owed to the government, keep the arrears clearance strategy on track, and reduce the public debt burden. We will also expedite the reform of a state-owned utility company (EMAE) to cut losses and contain fiscal risks.

The Central Bank of São Tomé and Príncipe (BCSTP) also remains committed to safeguarding financial sector stability and supporting sustainable credit growth. Our focus will be to deal proactively with problem banks and move ahead with the implementation of several key monetary reforms and strategic plans, such as the Non-Performing Loans (NPL) Reduction Strategy and the Financial Sector Development Implementation Plan (FSDIP).

Our country continues to face tremendous challenges and the support of the IMF is necessary to address our development issues. The government believes that measures and policies described in the July 2015 MEFP and its subsequent supplements, together with the attached supplementary MEFP, provide an adequate basis for attaining our economic policy objectives. However, we stand ready to take any additional measures, if necessary, including addressing any revenue shortfall. We will consult with the IMF, in advance, on the adoption of these measures and on any revisions to the policies contained in this supplementary MEFP, in accordance with the Fund policies on such consultation. We will hold timely discussions with the IMF staff on the terms of large external borrowing to ensure that such borrowing meets the concessionality requirement under the program, does not jeopardize debt sustainability, and is in line with the Fund's debt limit policy.

The government will also provide the IMF staff with all the relevant information required to complete program reviews and monitor performance on a timely manner as outlined in the TMU. During the remaining program period, the government will not introduce or intensify any exchange restrictions and multiple currency practices, or import restrictions for balance of payments purposes, nor conclude any bilateral payment agreements in violation of Article VIII of the Fund's Articles of Agreement.

The government agrees to make public this Letter of Intent, along with the attached supplementary MEFP and TMU, and the entire IMF staff report on the 2018 Article IV consultation and the fifth ECF review. We hereby authorize their publication and posting on the IMF website, once the IMF Executive Board approves the completion of the 2018 Article IV consultation and the fifth review under the three-year ECF arrangement.

Sincerely yours,

/s/
Mr. Américo d'Oliveira Ramos,
Minister of Finance, Commerce and the Blue Economy

/s/
Mr. Hélio Silva Almeida,
Governor of the Central Bank of São Tomé and Príncipe

Attachments:
/1 Memorandum of Economic and Financial Policies.
/2 Technical Memorandum of Understanding.

Attachment I. Supplementary Memorandum of Economic and Financial Policies for 2018

INTRODUCTION

1. The Executive Board of the International Monetary Fund approved on July 13, 2015 a three-year arrangement under the Extended Credit Facility (ECF) in support of São Tomé and Príncipe's economic reform program to promote sustainable growth and reduce poverty. The program aims to lay the foundation for stronger, more inclusive growth, and to catalyze financial support from bilateral and multilateral partners. Key aspects of the program include actions to strengthen public finances, reduce balance-of-payments vulnerabilities, and clear large domestic arrears.

2. This supplementary Memorandum of Economic and Financial Policies (MEFP) reviews recent economic developments and performance under the ECF-supported program and updates the supplementary MEFP for the combined third and fourth review approved by the IMF Executive Board on December 11, 2017. It provides an assessment of recent macroeconomic developments, implementation of the ECF-supported program, the economic outlook and risks, and macroeconomic policies for 2018 and beyond.

RECENT ECONOMIC DEVELOPMENTS

3. Economic activity in 2017 decelerated somewhat, as the public spending impetus was constrained by reduced external inflows. Real GDP growth slowed to 3.9 percent in 2017 from 4.2 percent in 2016. Wholesale and retail trade sectors grew, while indications are that tourist receipts also increased. Increased activity in the agricultural sector (mostly for cocoa), however, is moderated by lower international prices, and construction activity is estimated to have fallen, evidenced by a reduction in the imports of construction material.

4. Inflation increased, mainly driven by higher prices for locally-produced food, despite economic slack and fiscal consolidation. Unseasonal rain impeded fishing and damaged vegetable crops, leading to an acceleration of year-on-year inflation from a low of 3.5 percent during May 2017 to 7.7 percent at end-2017. One-off factors, such as the introduction of new import taxes and charges, also contributed to this development. However, seasonally-adjusted monthly inflation shows that inflation decelerated during the first four months of 2018. The January 2018 dobra redenomination did not come with any price gouging effects.

5. Given strong headwinds, the fiscal deficit targets for 2017 were missed. New tax measures, including a higher tax on imported alcoholic beverages, higher duties on selected imported commodities, and collection of tax arrears from large enterprises, raised revenue by less than 0.1 percent of GDP in 2017. The higher taxes on alcoholic beverages also reduced consumption, promoting good health among the population. However, the reduced imports, along with cash flow problems and operational difficulties among some of the firms, lowered the yields from import taxes and arrears collection, leading to a shortfall of about 0.9 percent of GDP than expected. While the revenue shortfall was largely offset by under-executing the budget on transfers and personnel costs, it was necessary to increase investment in health and education by about ½ percent of GDP more than anticipated, partly to address a virus outbreak of "necrotizing cellulite". As a result, the domestic primary deficit (DPD) exceeded the program target of 1.8 percent of GDP by ½ percent of GDP, which was mirrored by a similar miss of the target on the change in net bank credit to the central government.

6. **Preliminary data suggest broadly similar trends in the first quarter of 2018**. The hike in import duties and delayed tax payments from large firms (notably ½ percent of GDP in import taxes due by ENCO as of May) continued to dampen tax revenue. This was mitigated by higher oil import tax revenue from higher international oil prices and budget under-execution. As a result, the end-March DPD indicative target was missed by 0.3 percent of GDP. However, the indicative target on the change in net bank financing of the central government was met.

7. **While accelerating the debt payment to ENCO, the government fell behind in arrears clearance with other domestic suppliers.** It accumulated a small amount of domestic arrears (6 million new dobras) and was unable to clear arrears as assumed in the revised budget (36 million new dobras), partly because budget support from the World Bank did not materialize and that from the EU was reduced by €1 million due to slow progress in public financial management (PFM) reform. In addition, the EU disbursement was used for investment projects that are needed to meet the requirements associated with the grant. Nonetheless, total public and publicly guaranteed debt fell from 67.6 percent of GDP in 2016 to 56.6 percent of GDP in 2017 on account of an appreciation of the euro-dollar exchange rate, accelerated debt payment to ENCO from gains through the higher domestic relative to import prices of oil, low external disbursements, and nominal GDP growth.

8. **Credit growth stalled in 2017 amid banks' efforts to de-risk their portfolios to become profitable.** While lending to the economy was stagnant, banks increased their holdings of Treasury Bills (T-bills), reducing excess liquidity at the BCSTP and deposits abroad. The T-bill stock held by banks now accounts for 9 percent of total assets, up from 2 percent in 2016. After breaking even on average in 2016, banks' return on assets (ROA) turned negative (-0.7 percent) again, with two-thirds of the banks posting losses as in 2016. As net interest income is flat, banks resolved to increase their fee income by 20 percent in 2017. This notwithstanding, banks' operating costs remain relatively high, with the cost-to-income ratio (before loan loss provisioning) at 75 percent.

9. **The NPLs remained high while provisions improved further.** Write-offs and loan recoveries—including out of court settlement—improved the NPL ratio by 2 percentage points to 25 percent, offsetting a spike in the default rate to 6.7 percent among loans contracted or restructured since end-2016. The rebound in this default rate may be temporary but vigilance is still required to ensure that NPLs stay on a declining path. At the same time, provisions coverage of NPLs rose to 88 percent, pointing to more stringent classification of NPLs. The still-elevated NPL ratio is also owed to banks' slow write-off practices, despite the slim chance of recovering collateral because of the bottleneck at the judicial system. To mitigate the high credit risk, the BCSTP has recently upgraded

its credit registry (CRC) along several dimensions, providing a wealth of real-time borrower information for banks to make well-informed lending decisions.

10. In line with banks' portfolio shift, liquidity indicators in the banking system fell somewhat while capitalization increased and monetary aggregates contracted slightly. The liquidity ratio (liquid assets to total assets) dropped from 54 to 50 percent, while the average capital adequacy ratio increased from 28 to 33 percent, as the decrease in risk-weighted assets more than offset negative profits that have been weighing on banks. One bank with a capital shortage injected additional capital in accordance with current regulations. Broad money (M3) fell marginally (0.4 percent) in 2017, reflecting lower net foreign assets from reduced external inflows.

11. The BCSTP intervened in a small bank in early 2018, while the liquidation of Banco Equador is waiting for court approval of the relevant procedures. Banco Privado (BPSTP)—the smallest bank in the system—was intervened on the grounds of several governance problems that led to sharply-higher NPLs, consecutive losses, and inadequate equity with own funds below the statutory minimum. After carefully considering various resolution options, the central bank announced in mid-June its decision to close the bank and transfer its portfolio to other financial institutions. Regarding Banco Equador, the liquidation process will be advanced as soon as the court approves the relevant procedures.

12. The current account worsened in 2017 after an improvement in 2016, mainly due to a contraction in grants and an increase in oil and investment imports. Imports of goods and non-factor services increased by almost 3 percent in 2017, after remaining broadly constant in 2016. Capital goods imports were up by 18 percent, and increased volume and rising international prices led to a 27 percent expansion in the value of oil imports. These factors more than offset the growth in exports of goods and non-factor services of 9.6 percent, given its low base. Tourist receipts are estimated to have grown by 8.8 percent while lower international prices offset the rising cocoa production. The lower external inflows and uptick in imports caused the gross international reserves at the market value to decline by $4.6 million to $51 million (4.2 months of imports).

PROGRAM PERFORMANCE

13. Program performance at end-2017 was uneven (Table 1). Three out of five performance criteria (PCs) are missed. The PC on the domestic primary balance and net bank financing of the central government (NCG) were missed by ½ percent of GDP. The PC on NIR was missed mainly because of lower external support, which was only partly accommodated by program adjusters. Two other PCs on external payment arrears and borrowing on non-concessional terms were met. The continuous PC which prohibits introducing or intensifying exchange restrictions was inadvertently missed. Fiscal indicative targets (IT) on tax revenue and new domestic arrears were missed, marginally for the latter. The pro-poor spending target was met.

14. The end-2017 structural reform agenda progressed according to plans (Table 2). A draft Public-Private Partnership (PPP) law was submitted to the National Assembly in October 2017 and promulgated in March 2018, and immediate measures to contain the financial losses of EMAE mostly through improving collection have been implemented.

15. Progress was also made on preparing for the end-June 2018 structural benchmarks (Table 4). A VAT law, drafted with the support of the IMF, was submitted to parliament on May 24, meeting an end-June structural benchmark. The strategy for tourism development was launched in January 2018 with the support of the World Bank. In light of the crucial role of tourism in the country's export diversification, this document forms the core of the planned export diversification strategy. On the other hand, the further delays in both the adoption of the financial management plan and least cost energy-production plan for EMAE and the commencement of an asset quality review (AQR) were attributable to needed steps for procurement. We wish to propose that the associated benchmark on the AQR be revised to require the delivery of an inception report from the external consultant in lieu of the completion of the AQR and that both benchmarks be rephased to end-September 2018.

16. In addition, we have also implemented other structural reforms. To prepare for VAT implementation, a law was promulgated to require companies to issue fiscal invoices. With the World Bank's support, a draft law on microfinance was submitted to parliament to address the legal and regulatory void for providers of microfinance, and a new National Payment Systems Law was submitted to parliament for regulation of modern payment methods, including agent banking, mobile money, and electronic payments.

ECONOMIC OUTLOOK AND RISKS

17. Economic growth is expected to remain stable in 2018 and accelerate gradually in the medium term. Real GDP growth is expected to stay at around 4 percent in 2018 and average around 5 percent in the medium term, supported by externally-financed projects in the construction, agriculture, and tourism sectors. Key infrastructure projects—such as a grant financed airport expansion and road rehabilitation, part of the latter started in early 2018. These projects will not only increase construction activity, but also lay the foundation for growth in the tourism and agro-processing industries. Faster growth, accompanied by appropriate structural reforms, will support plans for job creation and poverty reduction. Annual inflation is expected to recede to only 6 percent in 2018 as forecasts for rising oil prices could slow down its deceleration. Medium-term inflation is likely to average below 5 percent.

18. The economy also faces downside risks. The upcoming legislative elections in October 2018 could disrupt policy implementation as pressures to overspend heighten in the run-up to the elections; they may also hold back investment if investors take a wait-and-see approach. Furthermore, there are other uncertainties, concerning external financing, and infrastructure and service constraints that may restrict necessary investments and tourism growth. Limited implementation capacity also challenges the implementation of structural reforms and associated external financing. Continued high NPLs could further stall private sector lending and impede economic growth. On the upside, heightened interest from oil prospectors in acquiring exploration rights from the country is likely to boost external inflows through signing bonus, exploration activities, and social projects as components of the contracts.

POLICY OBJECTIVES FOR 2018

The main priorities for 2018 will be to consolidate macroeconomic stability, strengthen the financial sector, advance monetary reforms, and remove structural bottlenecks to higher, sustained, and inclusive growth.

A. Fiscal Policy

19. The government has reduced the deficit in 2017 and is committed to meet its fiscal targets in 2018. As noted above, the higher duty on selected products that took effect in July 2017 substantially reduced the import volume of these items. The government recognizes that this effect will also dampen revenues by about 1.4 percent of GDP this year relative to the initial budget. To avoid an unfair burden on families, the government has also rescinded its initial decision to suspend the deductible of the PIT in the tax law, lowering revenue by an additional 0.2 percent of GDP. The preliminary fiscal data for the first quarter of 2018 broadly confirmed this assessment. In addition, tax performance was also weakened by delayed tax payments from large firms.

20. The government will forcefully collect taxes due from large taxpayers. In particular, as a prior action, it will collect tax liabilities accumulated in 2018, amounting to over 60 million new dobras, from large taxpayers such as ENAPORT, BCSTP, INAC, and ENCO. To facilitate this ongoing assessment, we will put in place a system to closely monitor tax collections from large taxpayers, and will share with the IMF staff two weeks after each month monitoring tables of tax payments by top ten taxpayers against their projected taxes due during June-October 2018 *(newly proposed end-November 2018 structural benchmark),* and are prepared to launch administrative and legal procedures, including penalties, promptly if large taxpayers fail to comply.

21. The government has also identified revenue measures to offset the projected lower tax revenues (Table below). Taxpayers owe over 300 million new dobras in tax arrears to the state. As a first step, the state will target companies with large tax arrears such as Rosema (a beer maker) and ENASA (the airport authority). Rosema owes the state about 42 million new dobras, mostly in revenues it collected on behalf of the state for consumption tax on sales and income tax on its employees' salaries. ENASA owes 62 million new dobras mostly in legacy arrears prior to 2014. These tax arrears have not only deprived the state much needed revenue for social programs, such as education and health, but have also damaged the credibility of our tax system. For these reasons, the government has initiated fiscal and legal procedures to collect tax arrears owed by Rosema plus applicable penalties and has already collected 12 million new dobras. As a prior action for the completion of the fifth review (Table 4), the government will collect an additional 29 million new dobras of tax arrears from Rosema and 9 million new dobras from other large tax payers. The government has already reached agreements with other large taxpayers, including ENAPORT and ENASA, to collect tax arrears, and will take prompt legal actions if necessary to enforce these agreements. At the same time, it will help ENASA recover payment arrears from its clients for airport services and airport tax withheld amounting to about 38 million new dobras, including from an SOE in Ghana and various airlines. In return, ENASA's arrears clearance will be accelerated by the amount recovered which is expected to be at least 10 million new dobras. The government will pursue similar plans to collect tax arrears from other large taxpayers. It is committed to keep the arrears collection plan on track, which is essential for completing the program review, catalyzing the financing of projects and reform programs supported by other development partners.

22. The revenue measures will be complemented with spending restraint. The cuts in transfers and personnel costs that were introduced in 2017 will be maintained, and strict limits will be applied with the help of EMAE on the consumption of electricity and water as well as on fuel by public agencies, while domestically-financed capital expenditure will be reduced in light of expected higher externally-financed spending. Furthermore, in view of the uncertainty of revenue, the government will hold back expenditure to match available resources and meet the DPD target.

Impact of New Fiscal Measures
(Millions of new dobras)

Total revenue gain	43
Collection of tax arrears	43
Total domestic expenditure cuts	130
Of which: Cuts in transfers and personnel costs	79
Savings on goods and services	36
Cuts in capex	15
Total savings	173

23. Fiscal consolidation will continue in 2018 and over the medium term. Consistent with the budget law, the Minister of Finance has issued a resolution to limit budgetary expenditure in line with the program, meeting another prior action for the fifth review. Specifically:

- The DPD target is set at 1.3 percent of GDP for end-September and end-December. This assumes budget support grants in 2018 of $6 million from the World Bank and €3 million from the EU, and no privatization proceeds. As previously programmed, the nominal public wage bill will grow below GDP growth through keeping wages largely unchanged to free resources for new hiring for priority needs in the education, health, and security services, costing about 0.2 percent of GDP, while at the same time seeking savings through rationalization and higher efficiency in these sectors.

- The government is also committed to make up for delayed domestic arrears payments to suppliers to bring the arrears clearance plan back on track by 2020. To this end, a portion of budget grants and domestic borrowing (65 million new dobras) will be used to pay down arrears. In addition, a surcharge will be introduced in 2019 over the price of oil products to pay the debt to ENCO even after the differential between the current domestic and import prices fades. The surcharge will be set to raise about $2.7 to 3 million per year. The government will also prioritize arrears clearance if additional resources, including tax revenue, budget grants, delayed planned investment using budget support or privatization proceeds materialize. In addition, the Treasury has begun to prepare monthly liquidity projection to guide liquidity management and the issuance of T-bills.

Domestic Payables/Arrears 2016-18, Stocks

	2016 Actual	2017 Actual	2018 Plan
Treasury to EMAE (STD m)	55.1	54.2	0.0
Treasury to CST (STD m)	98.6	119.6	107.5
Treasury to other suppliers (STD m)	288.9	276.5	263.5
Treasury to ENCO (USD m)	43.9	38.5	35.5
EMAE to ENCO (USD m)	60.4	77.0	…

24. Reducing fiscal risks posed by the state-owned enterprises (SOEs), particularly the utility company, EMAE, remains high on the government's agenda. EMAE's arrears to ENCO increased by $16.6 million (4¼ percent of GDP) in 2017 to reach $77 million, like last year, despite immediate measures taken. To contain costs, retired staff are not replaced; customers missing three payments are disconnected; arrears payment plans are being developed with large debtors; a communication campaign was launched to change the non-payment culture; and customer services were improved, including shortened installation time and ease of bill payment. At the same time, we are advancing several medium-term efficiency-enhancing reform projects, notably the Financial Management Improvement Plan (FMIP) and the Least Cost Development Plan (LCDP), supported by our development partners. Other important steps encompass the pre-audit of all SOEs by an international firm under the auspices of the World Bank, and preparations for rehabilitation of the energy grid and large-scale installation of meters.

25. Ongoing work to introduce the VAT in 2019 will be accelerated. Focus will be placed on the finalization of the VAT law and its approval by Parliament, and: (i) hiring and training of 25 new employees; (ii) drafting regulations for the implementation of VAT, including the harmonization of other laws with the new VAT Law; (iii) providing adequate space, including furniture and computers to all staff by June 2018; (iv) adopting a clear organizational structure along functional lines and/or taxpayer segments for the tax administration by June 2018; (v) adopting a modern computer information system with key functionalities, such as automatic notification of taxpayers in default, extraction of statistical data, surveillance, and oversight support by July 2018; and (vi) implementing a customer services area and continued taxpayers education. To improve domestic revenue mobilization in the medium term, and in line with the recommendations of IMF TA on tax administration, the government will implement a more systematic inspection of large taxpayers and a wider surveillance coverage of taxpayers through a computer-based selection process, and improved risk management.

26. The government will continue to strengthen public financial management. The government, with the support of African Development Bank (AfDB), is further improving the electronic information management system (SAFEe), and has extended access to the general inspection finance entity and to the Court of Public Accounts. In this context, it has already submitted the state's accounts for 2015 and will accelerate the submission of those for 2016 to the Court of Auditors by July 2018. The government will also move to a centralized framework for monitoring and evaluating projects to ensure value for money. This will be done through the prioritization of capital projects and the adoption of public investment management assessment framework, and medium-term fiscal and expenditure frameworks. Additional TA will be needed in this regard. The government will implement the recommendations of a recent IMF TA mission on public financial management, including strengthening revenue forecasting and ensuring the coherence of the financial programming and macroeconomic framework in budget preparation and management, and limit the accumulation of arrears.

27. In addition to the VAT mentioned above, structural reforms will be accelerated to strengthen the fiscal position. The government is committed to effectively apply the automatic fuel price adjustment mechanism as international oil prices increase. The government has taken steps to control spending and rein in arrears. In particular, instructions have been sent to EMAE to control unbudgeted spending on electricity and water following recommendations by a working group that assessed the appropriate limits for different government units.

B. Financial Sector Policy

28. The BCSTP will continue to reduce banking sector vulnerabilities through frequent monitoring and enhanced supervision. In line with the NPL reduction strategy, the BCSTP is addressing the elevated level of NPLs through encouraging more concerted efforts to step up recoveries and write-offs by banks, enforcing collateral guidelines, and strictly overseeing banks' credit risk management frameworks and lending policies. To safeguard depositor interests and minimize fiscal cost, the central bank will continue to monitor the resolution of Banco Equador and spearhead the transfer of BPSTP's bank book to viable commercial banks.

29. Preparations for the AQR of the banking system with the support of the World Bank (structural benchmark, end-June 2018) are advancing though delayed. The external consultant is expected to sign the contract in July 2018 after a lengthy procurement process and contract negotiation period, and is required to prepare an inception report by end-September 2018 *(revised structural benchmark)* and a draft report by end-October 2018. The central bank has already communicated the plans and expectations to banks, and reviewed credit files to ensure that all documentation is in order to facilitate the work of the consultant. The BCSTP intends to leverage the AQR findings—the full report is expected by mid-2019—to update its loan classification system and the set of prudential regulations more broadly, with support from the Central Africa Regional Technical Assistance Center (AFC).

30. There has been an implementation delay for some of the recommendations of the last safeguards assessment. To ensure consistency, the revision to the Central Bank (Organic) law has been put on hold after some work was carried out in 2016 while the financial institutions law is being revised to align it with the proposed changes to the organic law regarding areas of oversight and resolution. The government hopes to have both laws approved by end-2018. The BCSTP Audit Board Regulations were revised in line with advice from the IMF Finance Department and approved in March 2017. However, staffing and physical space constraints have led to difficulties in adding staff to the Internal Audit Department. The completion of a new central bank headquarters, expected by end-2018, will allow for the eventual recruitment of more staff. An international auditing company, BDO, has already done field work on a central bank audit and submitted its draft report. BCSTP signed a cooperation agreement with the Central Bank of Brazil in November 2017 to support IFRS implementation over a three-year period. Banks will provision according to their calculations of expected loss, which may be higher than what the BCSTP requires as per its provisioning table. However, the CRC tool will help to validate whether the rates are in line with default history. A Brazilian team visited São Tomé in April 2018 on a scoping mission to begin working on the different modules of IFRS implementation. Another technical assistance mission from the Central Bank of Brazil in May supported the modernization of the CRC in collaboration with the World Bank.

31. The central bank is also working on other medium-term financial sector reform initiatives, such as developing a movable collateral registry (with support from the World Bank in line with our Financial Sector Development Implementation Plan (FSDIP)) and a corporate balance sheet repository (under a cooperation agreement with the Bank of Portugal and with financial support from the World Bank). An upgrade to the payment systems infrastructure is also underway with World Bank and AfDB support. BCSTP benefitted from AFC TA in May 2018 to modernize the prudential regulations on internal control (11/2007) and align it with the recently-issued regulation on corporate governance (17/2017).

C. Monetary Policy

32. The government will implement a set of measures to rebuild the reserves buffer. Continued fiscal consolidation will help control inflation and build a higher reserves buffer. The central bank, in an environment in which policy transmission depends on various structural factors of the national financial system (including the high credit risk index and bottlenecks in enforcing guarantees), will continue to monitor changes to inflation and develop the monetary policy tools available to support reserves accumulation. In addition, the Ministry of Finance will require the Treasury to act as project coordinator, working with various ministries, departments and external agencies to improve the implementation rate of externally-funded projects to avoid disbursement delays. The Treasury will publish quarterly reports on the progress of externally financed projects and revise the projected external disbursements in cooperation with the central bank, including both project and budgetary grants and loans. Among medium-term initiatives, ongoing plans to diversify the economy (centered around tourism, agriculture and fisheries) and efforts to reduce reliance on oil imports via electricity sector reform will both generate and save reserves. The future sale of exploration rights within the administrative areas will also generate needed foreign exchange for the country through attendant social programs, even though the associated signing bonuses are not considered for the calculation of the program target on reserves. The recent sale of two exploration blocks will add US$10 million oil signature bonus to the National Oil Account.

33. The government is making good efforts to develop monetary instruments. Recent amendments to the regulations (16/2017) allow the government to issue Treasury Bills, for which the maturity can bridge years. Based on this legislative amendment, the government successfully issued new bills in the second half of 2017 to manage the non-disbursement of World Bank funds as well as the shortfall and delay in EU assistance. Plans are also underway to further develop the securities market to allow for longer-term instruments, for which legislation is already drafted, and a secondary market overtime.

34. Interest in the domestic debt market remains strong, supporting the government's effort to issue securities as part of its cash management strategy. Each of the three issuances in 2017 were oversubscribed by an average of 60 percent; however, commercial banks continue to submit bids only at the ceiling of the variable rate, so allocations are done on a proportional basis.

35. The BCSTP, in coordination with the Treasury, has made some improvement in liquidity forecasting. Furthermore, thanks to better coordination and information sharing with economic agents—namely, commercial banks, the Treasury, as well as departments within the central bank, liquidity forecasting is more reliable. The BCSTP Markets Department now generally receives better and timely information. The main problem in the past with liquidity management was due to asymmetric information and reporting delays. Reporting today is more reliable, which helps to minimize forecasting errors that still occur, partially due to one-off unexpected operations.

36. The central bank successfully redenominated the domestic currency, effective January 1, 2018. The BCSTP kept the exchange peg unchanged and eliminated three zeros from the dobra and issued new notes and coins for use. The new bills include innovative features that secure against counterfeiting and the redenominated exchange rate is 24.50 new dobras for 1 euro. In large part due to the rollout of an extensive awareness campaign, involving all sectors, the public at large has welcomed the monetary reform plan and the risk of a negative impact on inflation did not materialize as post-redenomination inflation is in line with year-on-year figures.

D. External Sector Policies

Exchange Restrictions

37. As a microstate and a fragile economy, São Tomé and Príncipe faces wide fluctuations in foreign inflows and has experienced frequent foreign exchange shortages, which intensified in recent years from the delayed external support and the impact of lower oil

prices on our neighbors. With a population of less than 200,000 and an economy based mainly on subsistence agriculture and fisheries, the country relies heavily on imports for basic needs, requiring a large amount of foreign currency. Relative to these needs, sources of foreign currency (mainly official transfers and tourism receipts) are limited and volatile. For example, net official transfers fell from 13.7 percent of GDP in 2016 to 10.6 percent of GDP in 2017. The lower oil prices since 2014 put the economies and the foreign exchange markets of neighboring oil exporters under stress. In response, residents of those countries obtained foreign currency from São Tomé and Príncipe, including through external trade contracts that did not result in actual imports of goods to the country. There has been an intensification of such transactions since 2016. Because of the FX shortage and volatility, international reserves have been managed carefully.

38. Against this backdrop, a foreign exchange regulation (NAP 05/2017) was introduced on March 1, 2017 to ensure that import transactions of a bona fide nature are covered by the central bank while avoiding pressure on international reserves. The new regulation intensified an existing exchange restriction by limiting further the BCSTP's foreign exchange coverage to payments of imported goods that have already been delivered and excluding from such coverage payments for imports of services, invisible transactions, advance payments for goods, and import payments for goods based on invoices dated later than 6 months from the date of the foreign exchange coverage request. It also makes clear that foreign exchange from the BCSTP would not be provided for the banks' own proprietary current international transactions. While these measures were needed to meet the balance of payment needs, they also caused private external payment arrears for current international transactions.

39. The authorities are committed to eventually remove the exchange measures that limit the availability of foreign exchange for payments and transfer for current international transactions, and has been taking steps to improve its balance of payments to support such removal over time. In particular, the authorities are (i) implementing structural reforms to promote private-sector led growth, particularly in tourism and agro-business, to foster exports, (ii) reducing energy imports by revamping the electricity sector with World Bank and European Investment Bank support, and (iii) pursuing fiscal consolidation to address domestic demand. These measures are expected to improve the balance of payments over the medium term. This strengthening of the balance of payments should eventually allow an easing of exchange restrictions.

External Debt

40. Given the prolonged negotiations on rescheduling external arrears, the country is classified as being in debt distress, although the Debt Sustainability Analysis (DSA) shows that the outlook has improved. Under the baseline scenario, the ratio of the present value of public and publicly-guaranteed external debt to GDP no longer exceeds its threshold compared with the previous DSA, and the ratios to exports and to revenue still exceed their respective thresholds early in the projection period but decline over time with prudent policies. The government will continue its fiscal consolidation program and work to diversify the economy and expand the export base. In addition, the government will limit concessional borrowing to about 4 percent of GDP in the medium term and eschew non-concessional loans to help reduce the high risk of debt distress to ensure debt sustainability.

41. Despite the government's best efforts, the outstanding arrears with external creditors are yet to be resolved. The government has actively sought debt rescheduling agreements with Angola, Brazil, and Equatorial Guinea, through correspondence and high-level meetings. An agreement with the Brazilian government was reached, pending the ratification by the Brazilian Senate. The government is still waiting for responses from the other two countries on scheduling negotiation sessions, as well as from Nigeria on discussing the disputed loan.

42. The government is implementing measures to strengthen debt management, improve the management of its current loans portfolio, and manage the acquisition of new loans. The government is in the process of implementing some of the main recommendations of the Debt Management Performance Assessment (DeMPA), which was completed with the support of the World Bank in November 2016. In particular, a draft medium-term debt management strategy has been prepared and is being discussed within the government. With the help of the World Bank, a debt database is being established, which is critical for improving debt service projections, conducting risk analyses, and reporting more detailed information on the debt stock. Training of officials on debt management, including T-Bill issuance, is planned to start in 2018 with the help of the World Bank and the AfDB. The government will develop and publish an annual schedule of T-Bill issuance that aligns with cash flow forecasts and borrowing plans.

Borrowing Plan 2018–20
(Millions of U.S. dollars)

New public debt contracted or guaranteed	2018 Volume 1/	2018 Present value 1/
Sources of debt financing	17.9	11.6
Concessional debt of which 2/	17.9	11.6
Non-concessional debt of which 2/	0.0	0.0
Semi-concessional debt 3/	0.0	0.0
Commercial terms 4/	0.0	0.0
Uses of debt financing	17.9	11.6
Memorandum items		
Indicative projections		
2019	19.9	12.9
2020	21.8	14.2

1/ Contracting and guaranteeing of new debt. The present value of debt is calculated using the terms of individual loans and applying the 5 percent program discount rate.
2/ Debt with a grant element that exceeds a minimum threshold of 35 percent.
3/ Debt with a positive grant element below the minimum grant element.
4/ Debt without a positive grant element. For commercial debt, the present value would be defined as the nominal/face value.

43. The government has secured a grant from China to complement a Kuwaiti loan in financing the Dr. Ayres Menezes Hospital. The financing package will have a grant element of well above the 35 percent threshold required under the program, although the Kuwaiti loan itself has a grant element of 34 percent. This project will bring significant benefits to our people by improving health services.

E. The Implementation of Other Structural Reforms

Development Planning

44. São Tomé and Príncipe has made considerable progress in promoting inclusive growth and tackling environmental issues, although significant challenges remain. The government passed the National Development Plan (NDP) for 2017-2021, in which some of the development priorities include quality education and a functioning judicial system accessible to all. On gender equality, the legal system provides equal rights to men and women; however, in practice, there is room for improvement in some social norms and outcomes. For example, the estimated gross national income per capita for women was less than half of that for men in 2015. On environmental issues, the government (particularly the Ministry of Agriculture) has been working with NGOs to implement the national sanitation plan and promote sustainable biodiversity (with the latter focusing on Príncipe), among other initiatives. Challenges include limited capacity in sectoral ministries; not-well-organized associations and cooperatives; and low environmental awareness among local residents.

Business Climate

45. The government is committed to create a conducive environment for private sector development. To this end, our structural reforms agenda prioritizes export diversification and cost competitiveness to support growth and external stability. The government adopted a tourism development strategy as a core element of an export diversification strategy (*end-June 2018 structural benchmark*). In addition, the government will pursue strategies to address the unreliable supply and high cost of electricity, including the development of cheaper energy sources. As discussed previously, the government will follow through on plans to reform the state electricity company (EMAE), eliminate cross-subsidies, and move to full cost recovery of electricity tariffs. The authorities are also committed to revise the Investment Code (12/2016) and its regulations on foreign exchange cover (05/2017) to remove the remaining exchange restrictions and multiple currency practice over time, while addressing balance of payment needs through implementing the policies under the program.

Capacity Development

46. Capacity development remains key and continued IMF support will be needed. The priority areas for capacity development include domestic revenue mobilization, public financial management, public investment management, public debt management, and financial sector regulation and supervision. However, weak domestic capacity has slowed the implementation of TA recommendations and delayed external project-related disbursements, requiring more hands-on support from our partners. The government will continue working with the IMF and other development partners to achieve its capacity development goals. The government will particularly welcome increased hands-on follow-up support on the implementation of TA recommendations to improve the impact of TA.

F. Statistics

47. Efforts to address data shortcomings in economic statistics for surveillance will continue. Having received TA from the IMF to improve balance of payments statistics and extend the coverage of the international investment position, the BCSTP is working on implementing the recommended actions to ensure better quality and broader coverage. Following the rebasing of the national accounts to 2008 and a new CPI, using a broader basket of goods and services and 2014 as the base year, and reweighting the sub-indices, the national statistics institute (INE) is planning to publish the analytical back series. It also expects to improve the real-sector statistics by developing data on the components of GDP on the demand side and quarterly GDP, including leading indicators of economic activity.

PROGRAM MONITORING

48. The performance criteria (PCs), indicative targets (ITs), prior actions, and structural benchmarks for end-June 2018 are presented in Tables 3 and 4. The definitions of quantitative PCs and ITs are provided in the attached TMU, which also defines the scope and frequency of data reporting for program monitoring purposes. The sixth review is expected to be completed on or after October 15, 2018.

Table 1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2017, Preliminary

(Millions of new dobra, cumulative from beginning of year, unless otherwise specified)

	2017					
	September		December			
	Indicative Target 4th Review	Preliminary	Performance Criteria [1] 4th Review	Performance Criteria [1] w/adjustments	Preliminary	Status
Performance Criteria:						
Floor on domestic primary balance (as defined in the TMU) [2]	-173	-145	-152	…	-192	Not met
Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	0	142	66	184	229	Not met
Floor on net international reserves of the central bank (US$ millions) [2, 4]	50	46	51	48	44	Not met
Ceiling on the accumulation of central government's new external payment arrears (US$ millions) [5, 6, 7, 8]	0	0	0	…	0	Met
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the central government or the BCSTP (US$ millions) [5, 6, 7, 8, 9]	0	0	0	…	0	Met
Indicative Targets:						
Ceiling on change of central government's new domestic arrears	0	41	0	…	6	Not met
Floor on pro-poor expenditures	417	395	501	…	551	Met
Floor on tax revenue	817	738	1,066	…	1,036	Not met
Memorandum items:						
Ceiling on dobra base money (stock) [10]	1,290	1,388	1,504		1,337	
New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the BCSTP (US$ millions) [5, 7, 8, 11]	22		22		2	
Transfer from NOA to the budget (US$ millions)	2.3		2.3		2.3	
Net external debt service payments [12]	57.7		55.0		68.3	
Official external program support [12]	8		147		37.1	
Budget support grants	…		110		0.0	
Treasury-funded capital expenditure	25		27		23	

Sources: São Tomé and Príncipe authorities; and IMF staff estimates and projections.

[1] Performance at the December 2017 test date is assessed on the fifth review.

[2] The floor will be adjusted upward or downward according to definitions in the TMU.

[3] The ceiling will be adjusted downward or upward according to definitions in the TMU.

[4] Excluding the National Oil Account (NOA) at the Central Bank.

[5] The term "central government" is defined as in ¶ 5 of the TMU, which excludes the operations of state-owned enterprises.

[6] This criterion will be assessed as a continuous performance criterion.

[7] The term "external" is defined on the basis of the residency of the creditor per paragraph 5 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014).

[8] This performance criterion or memorandum item applies not only to debt as defined in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014), but also to commitments contracted or guaranteed for which value has not been received. For further details on the definition of debt and external arrears refer to the TMU, ¶¶ 6 and 13.

[9] Only applies to debt with a grant element of less than 35 percent. For further details refer to the TMU, ¶ 17.

[10] Changed to a memorandum item.

[11] Only applies to debt with a grant element of at least 35 percent.

[12] As defined in the TMU, valued at the program exchange rate, excludes HIPC-related amortization.

Table 2. São Tomé and Príncipe: Structural Benchmarks Under ECF Program, December 2017

Policy Objectives and Measures	Timing	Macro Rationale	TA involved	Status
Strengthening Public Finances				
Adopt a 2018 budget that is consistent with the program parameters *(prior action for the 3rd and 4th reviews).*	End-November 2017	To demonstrate commitment to fiscal consolidation	No TA involved	Met.
Adopt measures to contain EMAE's loss in the near term.	End-December 2017	To contain fiscal risk	No TA involved	Met.
Submit the draft public private partnership (PPP) law to the National Assembly.	End-December 2017	To enhance capacity for efficient public investment decision-making	No TA involved	Met.

Table 3. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2018, Preliminary

(Millions of new dobra, cumulative from beginning of year, unless otherwise specified)

	2018					
	March		June	September	December	
	Indicative Target		Performance Criteria [1]	Indicative Target	Indicative Target	
	4th review	Prel.	4th review	Proposed	4th review	Revised
Performance Criteria:						
Floor on domestic primary balance (as defined in the TMU) [2]	-48	-78	-90	-122	-97	-124
Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	50	8	75	70	65	70
Floor on net international reserves of the central bank (US$ millions) [2, 4]	52	46	52	49	54	50
Ceiling on the accumulation of central government's new external payment arrears (US$ millions) [5, 6, 7, 8]	0	0	0	0	0	0
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the central government or the BCSTP (US$ millions) [5, 6, 7, 8, 9]	0	0	0	0	0	0
Indicative Targets:						
Ceiling on change of central government's new domestic arrears	0	15	0	0	0	0
Floor on pro-poor expenditures	188	n.a.	289	413	551	551
Floor on tax revenue	238	193	535	745	1,211	1,084
Memorandum items:						
Ceiling on dobra base money (stock) [10]	1,553	1,336	1,578	1,574	1,574	1,499
New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the BCSTP (US$ millions) [5, 7, 8, 11]	17	n.a.	17	17	17	17
Transfer from NOA to the budget (US$ millions)	1.5	0.0	1.5	2.2	1.5	2.2
Net external debt service payments [12]	34	n.a.	68	59	136	79
Official external program support [12]	45	0	85	120	218	179
Budget support grants [13]	45	0	66	101	181	142
Treasury-funded capital expenditure	6	3	13	10	28	12

Sources: São Tomé and Príncipe authorities; and IMF staff estimates and projections.

[1] Performance at the June 2018 test date is assessed on the sixth review.

[2] The floor will be adjusted upward or downward according to definitions in the TMU.

[3] The ceiling will be adjusted downward or upward according to definitions in the TMU.

[4] Excluding the National Oil Account (NOA) at the Central Bank.

[5] The term "central government" is defined as in ¶ 5 of the TMU, which excludes the operations of state-owned enterprises.

[6] This criterion will be assessed as a continuous performance criterion.

[7] The term "external" is defined on the basis of the residency of the creditor per paragraph 5 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014).

[8] This performance criterion or memorandum item applies not only to debt as defined in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014), but also to commitments contracted or guaranteed for which value has not been received. For further details on the definition of debt and external arrears refer to the TMU, ¶¶ 6 and 13.

[9] Only applies to debt with a grant element of less than 35 percent. For further details refer to the TMU, ¶ 17.

[10] Changed to a memorandum item.

[11] Only applies to debt with a grant element of at least 35 percent.

[12] As defined in the TMU, valued at the program exchange rate, excludes HIPC-related amortization.

[13] The expected WB budget support in 2018 is $6 million of which $1 million will be treated as project grants and excluded from the DPD if it is spent on facilities for the tax administration.

Table 4. São Tomé and Príncipe: Structural Benchmarks Under ECF Program, 2018

Policy Objectives and Measures	Timing	Macro Rationale	TA involved	Status
Prior actions				
Issue a resolution to incorporate expenditure measures in the 2018 budget in line with the program.	End-May 2018	To demonstrate commitment to fiscal consolidation	No TA involved	Met.
Collect tax arrears owed by Rosema and other large taxpayers (38 million new dobras).	End-June 2018	To mobilize domestic revenue	No TA involved	Met.
Collect tax liabilities accumulated in 2018 from large taxpayers (60 million new dobras).	End-June 2018	To mobilize domestic revenue	No TA involved	Met.
Strengthening Public Finances				
Submit to the National Assembly a new VAT law.	End-June 2018	To support the introduction of VAT	FAD/LEG	Met.
Adopt financial management plan and least cost energy-production plan for EMAE *(proposed to be rephased to end-September 2018 as shown below).*	End-June 2018	To contain fiscal risk	With World Bank support	Not met.
Adopt financial management plan and least cost energy-production plan for EMAE *(newly rephased).*	End-September 2018	To contain fiscal risk	With World Bank support	-
Submit monthly monitoring table of tax payments by top 10 taxpayers during June-October 2018 *(newly proposed).*	End-November 2018	To mobilize domestic revenue	No TA involved	-
Enhancing Monetary Policy and Financial Stability				
Complete an independent detailed asset quality review of banks *(proposed to be rephased and replaced by "require the external consultant to complete an inception report" as shown below).*	End-June 2018	To support financial sector stability and growth	With World Bank support	Not met.
Require the external consultant to complete an inception report for asset quality review of banks *(newly proposed).*	End-September 2018	To support financial sector stability and growth	With World Bank support	-
Facilitating Business Activities				
Develop and submit to the National Assembly a National Export Diversification Strategy document.	End-June 2018	To promote economic diversification and employment opportunities	With World Bank support	Met.

Attachment II. Technical Memorandum of Understanding, July 2018

1. **This Technical Memorandum of Understanding (TMU) contains definitions and adjuster mechanisms that clarify the measurement of quantitative performance criteria and indicative targets in Table 3**, which are attached to the Memorandum of Economic and Financial Policies for 2018. Unless otherwise specified, all quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from the beginning of each calendar year.

2. **The program exchange rate** for the purposes of this TMU[1] will be 20.299 new dobras per U.S. dollar, 24.5 new dobras per euro, and 29.236 new dobras per SDR for 2018.

PROVISION OF DATA TO THE FUND

3. **Data with respect to all variables subject to performance criteria and indicative targets will be provided to Fund staff on the frequency described below** (paragraph 24) with a lag of no more than four weeks for data on net international reserves of the Central Bank of São Tomé and Príncipe (BCSTP) and six weeks for other data. The authorities will transmit promptly to Fund staff any data revisions. For variables that are relevant for assessing performance against program objectives but are not specifically defined in this memorandum, the authorities will consult with Fund staff as needed on the appropriate way of measuring and reporting. Performance criteria included in the program are defined below, specifically (i) the floor on domestic primary balance; (ii) the ceiling on changes in net bank financing of the central government; (iii) the floor on net international reserves of the central bank; (iv) the ceiling on central government's outstanding external payments arrears; and (v) the ceiling on the contracting or guaranteeing of new non-concessional external debt by the central government or the BCSTP.

DEFINITIONS

4. **For the purposes of this TMU**, **external** and **domestic** shall be defined on a residency basis.

5. **Central government is defined for the purposes of this TMU** to comprise all governmental departments, offices, establishments, and other bodies that are agencies or instruments of the central authority of São Tomé and Príncipe. The central government does not include the operations of state-owned enterprises.

6. **Debt is defined as in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014).** "Debt will be understood to mean a current, i.e., not contingent, liability, created under a contractual agreement through the provision of value in the form of assets (including currency) or services, and

[1] Data refer to the mid-point exchange rates published on the BCSTP's webpage for the last day of 2014.

which requires the obligor to make one or more payments in the form of assets (including currency) or services at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract."

7. Government domestic revenue (excluding oil revenue) comprises all tax and non-tax revenue of the government (in domestic and foreign currencies), excluding: (1) foreign grants, (2) the receipts from the local sale of in-kind grants (e.g., crude oil received from Nigeria, food aid, etc.), and (3) any gross inflows to the government on account of oil signature bonus receipts and accrued interest on the National Oil Account (NOA). Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and the Directorate of Treasury in the Ministry of Finance, Commerce and the Blue Economy (MOF).

8. Domestic primary expenditure comprises all government spending assessed on a commitment basis (*base compromisso*), excluding (1) capital expenditure financed with external concessional loans and project grants and (2) scheduled interest payments. Reporting of government domestic expenditure will be based on the state budget execution prepared every month by the Directorate of Budget and the Directorate of Treasury in the MOF. The portion of EU budget support grants that is used to finance capital expenditures in the areas linked to the conditionality of the grants, specifically on improving water supply and sanitation, is treated as project grants. The World Bank disbursement of up to $1 million spent on facilities for the tax administration is treated as project grant for September and December 2018 indicative targets.

Official External Program Support

	2017	2018 H1	2018	Currency Unit
Projected budgetary support grants				
World Bank	0.0	3.0	6.0	million US dollars
European Union	4.5	1.5	3.3	million euros
IMF ECF program	1.3	0.6	1.3	million SDR

PERFORMANCE CRITERIA

9. Performance criterion on the floor on domestic primary balance. This performance criterion refers to the difference between government domestic revenue (excluding oil revenue) and domestic primary expenditure. For reference, this balance for end 2016 was -314 million new dobras, broken down as follows:

Domestic Primary Balance (2016, millions of new dobras)		
I	Total revenue (=1+2)	1130
I.A	***of Which: Government Domestic Revenue (=I-2.1)***	***1056***
1	Tax revenue	949
2	Nontax revenue	181
2.1	*of which: oil revenue*	74
II	Total Domestic expenditure (=4+5+6)	1403
II.A	***Of which: Domestic primary expenditure (=I-4.2)***	***1370***
4	Current expenditure	1334
4.1	Personnel costs	684
4.2	Interest due	34
4.3	Goods and services	249
4.4	Transfers	282
4.5	Other current expenditure	84
5	Domestic capital expenditure	50
5.1	Financed by the Treasury	50
5.2	Financed by privatization proceeds	0
6	HIPC Initiative-related social expenditure	19
III	**Domestic primary balance (= I.A - II.A)**	**-314**

10. Performance criterion on the ceiling on changes in net bank financing of the central government (NCG). This performance criterion refers to the increase (decrease) of net bank financing of the central government, which equals the stock of all outstanding claims on the central government held by the BCSTP and by other depository corporations (ODCs), less the stock of all deposits held by the central government with the BCSTP and with ODCs. The balance of the National Oil Account (NOA), deposits from project grants and loans, contingent liabilities, and social security operations are not included in NCG. All foreign exchange-denominated accounts will be converted to new dobras at the program exchange rate. The relevant data are reported monthly by the BCSTP to the IMF staff. For reference, at end-2016, outstanding net bank financing of the central government (excluding NOA) was 224 million new dobras, as follows:

Net Banking Financing (millions of new dobras)			
		2015	2016
I	***Net credit to government by the BCSTP (=I.1-I.2)***	…	***221***
I.1	BCSTP credit, including use of IMF resources:	…	446
I.2	Government deposits with the BCSTP (excluding NOA)	…	225
	Treasury dobra-denominated accounts	…	14
	Treasury foreign currency-denominated accounts	…	129
	Counterpart deposits	…	82
II	***Net credit to government by ODCs***	…	***4***
II.1	ODC's credit to the government	…	4
II.2	Government deposits with ODCs (including counterpart funds)	…	0
III	***Net bank financing of the government (excluding NOA) (=I-II)***	***117***	***224***
IV	**Changes during 2016 in net bank financing of the central government (NCG)**		**107**

11. Performance criterion on the floor on net international reserves (NIR) of the BCSTP. The NIR of the BCSTP are defined for program-monitoring purposes as short-term (i.e., original maturities of one year or less), tradable foreign assets of the BCSTP minus short-term external liabilities, including liabilities to the IMF. All short-term foreign assets that are not fully convertible external assets nor readily available to and controlled by the BCSTP (i.e., they are pledged or otherwise encumbered external assets, including but not limited to the HIPC umbrella SDR account and assets used as collateral or guarantees for third-party liabilities) will be excluded from the definition of NIR. Securities whose market value on the last day of the year differs by over 20 percent from their original nominal issue price will be assessed at their market value as reported by the BCSTP's Markets Department. The balance of (1) NOA at the BCSTP, (2) banks' deposits related to capital or licensing requirements, and (3) banks' reserves denominated in foreign currency are excluded from the program definition of NIR. All values are to be converted to U.S. dollars at the actual mid-point market exchange rates prevailing at the test date. For reference, at end 2016 NIR was 1,188 million new dobras (or $50.7 million, using the exchange rate of 23.438 new dobras per U.S. dollar), calculated as follows:

International Reserves
(End-2016, millions of new dobras)

I	***Gross international reserves***	***1481***
	Cash	16
	Demand deposits	407
	Term deposits (incl. banks' deposits in foreign currency)	188
	Securities other than shares	840
	Portuguese Treasury Bond I	234
	Portuguese Treasury Bond II	248
	Rede Ferroviaria Nacional bonds	126
	US Treasury Bill I	116
	US Treasury Bill II	117
	Accrued interest on securities	15
	Reserve position in the Fund	0
	SDR holdings	15
II	***Foreign exchange liability***	***293***
	Short-term bilateral liabilities	23
	Liabilities to the IMF	121
	Banks' reserves denominated in foreign currency	149
	Banks' guaranteed deposits denominated in foreign currency	0
III	**Net international reserves (NIR) (=I - II)**	**1188**
IV	***Net other foreign assets***	***169***
	Other foreign assets	392
	Medium and long-term liabilities (including SDR allocation)	223
IV	***Net foreign assets (III+IV)***	***1357***
	Memorandum item: National Oil Account (NOA)	271

12. Performance criterion on the ceiling on the contracting or guaranteeing of new nonconcessional external debt by the central government or the BCSTP. This is a continuous performance criterion that refers to the contracting or guaranteeing of new external debt of any maturity (including overdraft positions but excluding normal import and supplier credits) by the government and/or the BCSTP. Debt is considered nonconcessional if it includes a grant element less than 35 percent. The grant element is the difference between the nominal value of the loan and its net present value, expressed as a percentage of the nominal value. The net present value of the debt at the date on which it is contracted is calculated by discounting the stream of debt service payments at the time of the contracting. The discount rate used for this purpose is 5 percent. A loan comes into effect on the signature date of the contract, unless it is specified in the contract that it becomes effective upon ratification by the parliament. For the program monitoring purpose, a loan contract is treated to be in effect on the date of the first disbursement if that is earlier than the date of signature or ratification of the contract. With respect to the precautionary line of credit from Portugal to support the pegging of the new dobra to the euro, unpaid balances outstanding during the first three quarters of a given calendar year will be excluded from this ceiling. However, outstanding balances at the end of a given calendar year will be included in the assessment of compliance with this performance criterion. This performance criterion does not apply to IMF facilities. Debt being rescheduled or restructured is excluded from this ceiling. Medium- and long-term debt will be reported by the Debt Management Department of the MOF (as appropriate), measured in U.S. dollars at the prevailing exchange rates published by the BCSTP. The government should consult with IMF staff before contracting or guaranteeing new medium– or long–term debt obligations.

13. Performance criterion on the ceiling on the accumulation of central government's new external payment arrears. This is a continuous performance criterion. New central government external payment arrears consist of external debt service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreement, subject to any applicable grace period. This performance criterion does not apply to arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or for which the government is actively seeking a rescheduling agreement.

INDICATIVE TARGETS

14. Ceiling on change of central government's new domestic arrears is set on the difference between expenditure on a commitment basis and cash payments (amounts past due after 40 days and unpaid).

15. Within domestic primary expenditure, the floor on pro-poor expenditure refers to the floor on government outlays recorded in the budget that have a direct effect on reducing poverty, as agreed with the IMF and World Bank staffs. These expenditures, which include both current and capital outlays, are defined as follows:

a. **Pro-poor current spending:** These cover the following functional classifications and expenditure categories (by budget code) as described in the matrix below:

Pro-Poor Current Spending

Code	Economic classification of current expenditure	Education	Health	Social Security and Assistance	Housing and Community Services	Culture and Sport	Fuel and Energy	Agriculture and Fisheries
310000	Personnel Expenses	x	x					
331210	Specialty Durable Goods	x	x					
331290	Other Durable Goods	x	x					
331120	Fuels and Lubricants[1]	x	x					
331130	Foodstuffs, Food[1] and Accommodation	x	x					
331140	Specialized Current Consumable Materials (Specific to Each Sector)	x	x					
331190	Other Consumer Non Durable Goods	x	x					
332110	Water and Energy Services	x	x					
332120	Communication Services	x	x					
332130	Health services	x	x					
332220	Maintenance and Conservation Services	x	x					
353900	Other Miscellaneous Current Expenses	x	x	x				
352200	Transfers to non-profit institutions (private)		x	x				
352310	Retirement Pension and Veterans		x	x				
352320	Family Benefit		x	x				
352330	Scholarships	x						
352390	Other Current Transfers to Families		x	x				
353100	Unemployment Fund		x	x				
Code	**Economic classification of capital expenditure**							
411110	Feasibility Study and Technical Assistance	x	x	x	x	x	x	x
411120	Procurement and Construction of Real Estate	x	x	x	x	x	x	x
411200	Rehabilitation Works and Facilities	x	x	x	x	x	x	x
411300	Means and Equipments of Transportation	x	x	x	x	x	x	x
411400	Machinery and Equipment	x	x	x	x	x	x	x
411900	Other Fixed Capital Goods	x	x	x	x	x	x	x
412000	Stocks	x	x	x	x	x	x	x

Source: Diário da Republica de São Tome e Príncipe No. 21 - May 7, 2008, pages 12-13.

[1] Expenditures on fuels and lubricants (*combustíveis e lubrificantes*) that are affected for administrative purposes are excluded. Likewise, food (*alimentação*) and clothing and shoes (*roupas e calçados*) supplied to administrative staff are excluded.

b. **Pro-poor treasury-funded capital spending:** This covers projects that are deemed to have a direct impact on alleviating poverty in the following sectors: education, health, social safety nets, agriculture and fisheries, rural development, youth and sports, provision of potable water, and electrification.

16. Floor on tax revenue is set on tax revenue that includes direct and indirect taxes as well as recovery of tax arrears and additional collection efforts.

MEMORANDUM ITEMS

17. New concessional external debt contracted or guaranteed by the central government or the BCSTP measures such debt with a grant element of at least 35 percent.

18. Net external debt service payments by the central government are defined as debt service due less the accumulation of any new external payment arrears, as defined under the performance criterion on the ceiling on central government's outstanding external payment arrears.

19. Official external program support is defined as budget support grants and loans, including disbursements from the IMF under the ECF arrangement and in-kind aid when the products are sold by the government and the receipts are earmarked for a budgeted spending item, and other exceptional financing provided by foreign official entities and incorporated into the budget.

20. Treasury-funded capital expenditure is classified as part of domestic primary expenditure and covers public investment projects that are not directly financed by project grants and concessional loans or that have to be partially co-financed with government resources. It includes spending on new construction, rehabilitation, and maintenance. Expenditure on wages and salaries and the purchase of goods and services related to the projects will not be classified as capital expenditure.

21. Ceiling on base money is set on the sum of currency issued—which consists of currency outside depository corporations and cash in vaults—and banks reserves denominated in new dobras. Bank reserves refer to reserves of commercial banks (in new dobras) held with the central bank and include reserves in excess of the reserve requirements.

USE OF ADJUSTERS

22. The performance criterion on the domestic primary balance will have one adjuster. The floor on the domestic primary balance will be adjusted downward if the government receives more than projected budget support grants (excluding any portion of the additional EU grant used to finance capital expenditure on water and sanitation, which will be included in project grant financed capital expenditure) and privatization receipts in 2017 and 2018; this adjuster will be capped at 77.7 million dobras (about 1 percent of 2016 GDP) for 2017 and 38.8 million new dobras for the first semester of 2018.[1] For program purpose, the projected privatization proceeds are 0 in 2017 and 2018. For end 2018, if the collection of tax arrears from Rosema does not materialize, the floor on the domestic primary balance will be adjusted downward (in absolute value) by the market value of Rosema's assets that the government seizes.

23. The performance criteria on net bank financing of the central government and net international reserves of the central bank will be subject to the following adjusters based on deviations calculated cumulatively from end-December 2016 or end-December 2017, as appropriate (MEFP Attachment I, Table 3):

- ***Adjusters on ceilings on changes in net bank financing of the central government (NCG)***: Quarterly differences between actual and projected receipts of budget transfers from the NOA, budgetary support grant, net external debt service payments, and domestic arrears will be converted to new dobras at the program exchange rate and aggregated from end-December 2016 or end-December 2017, as appropriate, to the test date. The ceilings will be adjusted:
    - (i) downward (upward) by cumulative deviations downward (upward) of actual from projected net external debt service payments (exclude HPIC),
    - (ii) downward (upward) by deviation upward (downward) in budget transfers from the NOA,
    - (iii) downward by deviation upward of budgetary support grants in excess of 77.7 million new dobras and upward for the full deviation downward of budgetary support grants.
    - (iv) downward by deviation upward of domestic arrears.

The combined application of all adjusters at any test date is capped at the equivalent of US$3 million at the program exchange rate.

- ***Adjusters for the floor on net international reserves (NIR) of the BCSTP***: Quarterly differences between actual and projected receipts of budget transfers from the NOA, official external program support, net external debt service payments, and domestic arrears in new dobras, will be converted to U.S. dollars at the program exchange rate and aggregated from end-December 2016 or end-December 2017, as appropriate, to the test date. The floor will be adjusted upward (downward):
    - (i) by the cumulative deviation downward (upward) of actual from projected net external debt service payments of the central government;

[1] Grants and related expenditures to cover the cost of the elections will be excluded from the measurements of the domestic primary deficit.

- (ii) by deviations upward (downward) for budget transfers from the NOA, and
- (iii) by deviations upward (downward) of official external program support. Budget support loans in 2017 and 2018 are projected to be 0.

The combined application of all adjusters at any test date is capped at the equivalent of US$3 million at the program exchange rate.

DATA REPORTING

24. The following information will be provided to the IMF staff for the purpose of monitoring the program.

1) **Fiscal Data:** The Directorate of Treasury and Directorate of Budget at the MOF will provide the following information to IMF staff, within six weeks after the end of each month or quarter, except for the public investment program (PIP), which will be provided three months after each quarter:

   - Monthly data on central government operations for revenues, expenditure, and financing, including detailed description of net earmarked resources (*recursos consignados*), on commitment (*compromisso*) and cash payments (*caixa*);
   - Monthly data on net credit to the government by the BCSTP, recorded account by account in a format fully compatible with the monetary accounts of the BCSTP;
   - Monthly detailed data on tax and nontax revenues;
   - Monthly detailed data on domestically financed capital expenditure on commitment (*compromisso*) and cash payments (*caixa*);
   - Monthly data on domestic arrears by type and by creditor;
   - Quarterly data on implicit arrears to ENCO on account of fuel retail prices eventually not covering import costs, distribution margins and applicable taxes;
   - Quarterly data on EMAE's arrears to ENCO;
   - Monthly data on official external program support (non-project);
   - Quarterly data on the execution of the public investment program (PIP) by project and sources of financing;
   - Quarterly data on the execution of Treasury-funded capital expenditure by project type, amount, timetable of execution, and progress of execution;
   - Quarterly data on project grant and loan disbursement (HIPC and non-HIPC);

- Quarterly data on bilateral HIPC debt relief;
- Quarterly information on the latest outstanding petroleum price structures and submission of new pricing structures (within a week of becoming available).
- Quarterly pro-poor expenditure.

2) **Monetary Data:** The BCSTP will provide the IMF staff, within three weeks from the end of each month, the monetary accounts of the BCSTP. Other monetary data will be provided within six weeks after the end of each month for monthly data, within two months after the end of each quarter for quarterly data, and within two months after the end of the year for annual data. The BCSTP will provide the following information to IMF staff:

- Daily data on exchange rates, to be posted on the central bank's web site;
- Daily data on interest rates, to be posted on the central bank's web site;
- Daily liquidity management table, including base money (in new dobras) and currency in circulation, to be posted on the central bank's web site;
- Daily net international reserve position, to be posted on the central bank's web site;
- Monthly balance sheet data of BCSTP (in IMF report form 1SR, with requested memorandum items);
- Monthly consolidated balance sheet data of other depository corporations (in IMF report form 2SR);
- Monthly consolidated depository corporations survey (in IMF survey 3SG);
- Monthly central bank foreign exchange balance (*Orçamento cambial*);
- Quarterly table on bank prudential ratios and financial soundness indicators;
- Quarterly data on the BCSTP's financial position (profit and loss statement, deficit, budget execution, etc.).

3) **External Debt Data:** The Directorate of Treasury at the MOF will provide the IMF staff, within two months after the end of each month the following information:

- Monthly data on amortization and interest on external debt by creditor; paid, scheduled, in arrears, and subject to debt relief or rescheduled;
- Quarterly data on disbursements for foreign-financed projects and program support loans;

- Annual data on future borrowing plans.

4) **National Accounts and Trade Statistics:** The following data will be provided to the IMF staff:

- Monthly consumer price index data, provided by the National Institute of Statistics within one month after the end of each month;

- Monthly data on imports (value of imports, import taxes collected, and arrears) and commodity export values, provided by the Customs Directorate at the MOF, within two months after the end of each month;

- Monthly data on petroleum shipments and consumption (volumes and c.i.f. prices, by product), provided by the Customs Directorate.

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

July 9, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION, FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY, REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA AND FINANCING ASSURANCES REVIEW—INFORMATIONAL ANNEX

Prepared By	The African Department (in consultation with other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of May 31, 2018)

Membership Status

Joined: September 30, 1977; Article XIV

General Resources Account:	**SDR Million**	**% Quota**
Quota	14.80	100.00
Fund holdings of currency	14.80	100.02
Reserve tranche position	0.00	0.00

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	7.10	100.00
Holdings	0.14	1.94

Outstanding Purchases and Loans:	**SDR Million**	**% Quota**
ECF Arrangements	4.51	30.46

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ECF	07/13/2015	12/31/2018	4.44	3.17
ECF	07/20/2012	07/13/2015	2.59	1.11
ECF[1]	03/02/2009	03/01/2012	2.59	0.74

1/ Formerly PRGF.

Projected Payments to Fund[1]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2018	2019	2020	2021	2022
Principal	0.19	0.33	0.26	0.41	0.60
Charges/Interest	0.03	0.07	0.07	0.07	0.07
Total	0.22	0.40	0.32	0.48	0.67

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative:

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	December 2000
Assistance committed	
by all creditors (US$ million)[1]	124.30
Of which: IMF assistance (US$ million)	1.24
(SDR equivalent in millions)	0.82
Completion point date	March 2007
Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	0.82
Interim assistance	…
Completion point balance	0.82
Additional disbursement of interest income[2]	0.04
Total disbursements	0.87

1/ Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts cannot be added.

2/ Under the enhanced framework, an additional disbursement is made corresponding to interest income earned on the amount of HIPC assistance committed but not disbursed.

Implementation of Multilateral Debt Relief Initiative (MDRI):

MDRI-eligible debt (SDR Million)[1]	1.43
Financed by: MDRI Trust	1.05
Remaining HIPC resources	0.38

Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGT**	**Total**
December 2007	N/A	0.38	0.38
March 2007	N/A	1.05	1.05

1/ The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Safeguards Assessments:

Safeguards assessments were conducted in 2009, 2013, and 2015. Severe capacity constraints have contributed to a weak safeguards framework at the BCSTP. External audits conducted by a reputable audit firm have served as a critical safeguard. Key areas in need of strengthening are financial reporting practices, independent oversight on audit and control mechanisms, and the BCSTP's legal framework. While the BCSTP has drafted and approved a new Audit Board Charter, implementation has been slow and independent oversight is still lacking. The drafting of legal reforms is still ongoing and institutional development will be needed to strengthen capacity, especially in the areas of internal audit and financial reporting.

Exchange Arrangements:

The de jure and de facto exchange rate arrangement is a conventional peg against the euro. São Tomé and Príncipe has pegged the dobra to the euro since January 2010, initially at a rate of dobra 24,500 per euro; however, it redenominated the currency by removing three zeros in January 2018. The organic law of the BCSTP authorizes it to make decisions regarding exchange rate policy. The commission on foreign exchange sales by banks cannot be higher than 2 percent for the euro, while the spread for other currencies cannot exceed 4 percent. Purchases of euro by banks must be done at the rate published by the BCSTP and no commissions are allowed. The BCSTP finances current international transactions at the official exchange rate and only after verification of the documentation establishing the bona fide nature of the bank's request. Access to foreign exchange is limited to banks having a net open position in the transaction currency of less than 12 percent of qualified capital, a net open position in total foreign currency less than 25 percent of qualified capital, and which are in compliance with the solvency and liquidity ratios set by the central bank, as well as minimum capital requirement. Banks are allowed to have a direct access to the central bank's facilities regardless of the above conditions if the foreign exchange is to be used for importation of goods in periods of crisis or for the importation of fuel. The central bank charges 1.5 percent commission on sales of euro and a 0.5 percent commission on purchases of euro. The buying rate is mainly indicative because the BCSTP rarely makes purchases.

São Tomé and Príncipe continues to avail itself of the transitional arrangements under Article XIV, but it does not maintain restrictions under Article XIV. However, it maintains one previously identified and one newly identified restriction subject to Fund approval under Article VIII. The previously identified exchange restriction regarding limitations on the transferability of net income from investment arises from Article 3(g) and Article 18 of the Investment Code (Law No. 19/2016). The restriction results from the requirement that taxes and other obligations to the government have to be paid/fulfilled as a condition for transfer, to the extent the requirement includes the payment of taxes and the fulfillment of obligations unrelated to the net income to be transferred. In the context of the 2018 Article IV Consultation, staff found that São Tomé and Príncipe maintains an additional exchange restriction that is subject to Fund approval under Article VIII. This exchange restriction arises from limitations on the availability of foreign exchange through rationing of foreign exchange by BCSTP. This exchange restriction also gives rise to a multiple currency practice as the rationing has channeled bona fide current transactions to the parallel market where the exchange rate is at a spread of more than 2 percent from the exchange rate in the formal market.

Article IV Consultation:

São Tomé and Príncipe is currently under a 24-month consultation cycle. The Executive Board concluded the last Article IV consultation on June 10, 2016.

Financial Sector Assessment Program (FSAP), Reports on Observance of Standards and Codes (ROSCs), and Offshore Financial Center (OFC) Assessments:

None.

Resident Representative:

The Fund has not had a Resident Representative office in São Tomé and Príncipe since October 2006.

Technical Assistance 2013–18:

Date of Delivery	Department/Purpose
June 2018	FAD mission on preparation for VAT
May 2018	AFRITAC training workshop on debt management
May 2018	AFRITAC mission on banking reg. and supervision
April 2018	AFRITAC mission on GFS
February 2018	AFRITAC mission on customs administration
February 2018	STA mission on BoP statistics
January-April 2018	FAD Peripatetic expert on preparation for VAT
January 2018	STA mission on price statistics
January 2018	AFRITAC mission on national accounts statistics
January 2018	AFRITAC mission on customs administration
December 2017	AFRITAC mission on banking reg. and supervision
December 2017	AFRITAC mission on public debt management
November 2017	MCM mission on bank resolution and liquidation
November 2017	LEG follow-up mission on VAT tax law
August 2017	AFRITAC mission on government finance statistics
July 2017	FAD mission on budget execution and control
March 2017	FAD mission on revenue administration
March 2017	FAD mission on arrears management
March 2017	STA mission on national accounts statistics
February 2017	MCM mission on banking supervision and regulation
November 2016	MCM mission on bank resolution and liquidation
August 2016	MCM mission on banking supervision and regulation

Date of Delivery	Department/Purpose
August 2016	FAD/LEG mission on tax policy
April 2016	FAD mission on arrears management
March 2016	MCM mission on banking supervision
November 2015	STA mission on national accounts statistics
November 2015	FAD mission on automatic fuel pricing mechanism
September/October 2015	FIN mission on safeguards assessment
September 2015	MCM mission on banking supervision
July 2015	FAD mission on tax administration
June 2015	STA mission on balance of payments and IIP
April 2015	FAD mission on medium-term fiscal framework
March 2015	FAD mission on tax administration
March 2015	MCM mission on banking supervision
November 2014	MCM mission on banking supervision
September 2014	STA mission on national accounts statistics
September 2014	MCM mission on liquidity management
April 2014	STA mission on balance of payments and IIP
April 2014	MCM mission on liquidity management
March 2014	MCM mission on banking supervision
February 2014	FAD mission on public accounting
December 2013	FAD short-term expert visit on public accounting
November 2013	MCM mission on banking supervision
August 2013	FAD mission on revenue administration
August 2013	MCM mission on banking supervision
June 2013	FAD mission on public accounting
March 2013	MCM mission on banking supervision
January 2013	MCM mission on liquidity management
January 2013	FAD mission on public accounting

RELATIONS WITH THE WORLD BANK GROUP

Joint Managerial Action Plan (JMAP) for São Tomé and Príncipe

(As of May 11, 2018)

The IMF and World Bank São Tomé and Príncipe teams held regular meetings to discuss their respective work programs and macro critical structural reforms for São Tomé and Príncipe. The two institutions' teams met in the context of the supervision for the current ECF-supported program that discusses policies and financing during the prospective program period 2015–18.

The World Bank's work program is guided by a Country Partnership Framework (CPF) for the fiscal years 2014 to 2018, approved in FY14, that focuses on supporting growth and job creation through two broad themes: macroeconomic stability and national competitiveness, and reducing vulnerability and strengthening human capacity. Gender, partnership, and capacity building are elements that cut across all the proposed engagements. A two-year extension of the current CPF is being sought to incorporate the results of the Performance and Learning Review. A new household survey and a Country Economic Memorandum will be available in FY 19, which will inform the Systematic Country Diagnosis (SCD) and the new CPF. A Debt Management and Performance Assessment (DeMPA) report was completed in November 2016.

The IMF's work program included the Executive Board's consideration of the second review under the ECF-supported program in December 2016, a staff visit in July 2017, and a review mission in September 2017 to supervise the ECF-supported program, and assistance with capacity development in the areas of public financial management, revenue administration, and banking supervision.

The Bank and the Fund are providing complementary support to help São Tomé and Príncipe strengthen public financial management and make progress towards debt sustainability. Regarding the latter, the teams prepared a Joint IMF-World Bank Debt Sustainability Analysis (DSA) update in 2017 to accompany the ECF-supported program review to the Board in December 2017.

Work Program for Period 2018–19			
Title	*Products*	*Provisional timing of missions*	*Expected delivery date*
A. Mutual information on relevant work programs			
World Bank work program in the next 12 months	• STP Power Sector Recovery Project • 2nd Development Policy Operation • 3rd Development Policy Operation • Payment system & financial inclusion • Bank resolution • Transport Sector Development Project • Quality Education for All • Institutional Capacity Project • Social Protection and Skills Development	Sep 2018 Jun 2018 Jun 2018 Aug 2018 Jul 2018 Jul 2018 Sep 2018 Nov 2017 Nov 2018	Approved Approved FY2019 FY2019 FY2019 FY2019 Approved Approved FY2019
IMF work program in the next 12 months	• ECF sixth review • Technical Assistance from (1) FAD/LEG/AFRITAC: ○ Tax policy (VAT) ○ Revenue administration ○ PFM (2) MCM: ○ Bank resolution ○ Banking supervision	Oct-Nov 2018 FY2019 FY2019 FY2019 FY2019 FY2019	FY2019 FY2019 FY2019 FY2019 FY2019 FY2019
B. Requests for work program inputs			
Fund request to Bank	• Information on Bank budget support operations and disbursement schedule • Support on the Asset Quality Review (AQR)	To support the fiscal program	Ongoing Ongoing
Bank request to Fund	• Collaboration on providing full set of macroeconomic framework and tables		Ongoing

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of May 18, 2018)

The Bank Group commenced lending operations in São Tomé and Príncipe in 1978. To date, the Bank approved loans and grants, amounting to a cumulative commitment of about UA 135 million (US$191 million).

As of May 2018, the Bank's active portfolio in São Tomé and Príncipe (STP) consisted of six operations, amounting to roughly UA 25 million (US$35 million). These are: Infrastructure Rehabilitation for Food Security (PRIASA II); the Public Finance Management Project (PAGEF); the National Planning Scheme study; and the Payment System (Table 1). The portfolio is relatively young. The average age of the portfolio is 3.4 years and the cumulative disbursement rate is 34 percent after the closure of two projects (i.e., PRIASA I with a disbursement rate of 100 percent, National Program for Drinking Water Supply and Rural Sanitation with 85 percent disbursement rate, and Trade Facilitation with 86 percent disbursement rate). In terms of sectoral distribution, the agriculture and fisheries sector dominates the portfolio with 57 percent, followed by the multi-sector operations with 37 percent and finance with 6 percent. There is no ongoing private sector or multinational projects. The portfolio is largely funded by African Development Fund loan (82 percent), followed by the Global Environmental Fund (GEF) (10 percent), the Transition Support Facility (TSF) (8 percent), and the African Trade Facilitation Fund (1.5 percent). The Bank also conducted analytical work focused in the areas of energy, agriculture, public financial management, and the private sector development strategy 2015–24.

The AfDB current involvement in STP is guided by the Country Strategy Paper (CSP) 2012–16, approved in July 2012. The strategy was focused on two pillars: Pillar I– Strengthening Governance; and Pillar II–Promotion of Agriculture Infrastructure. The CSP's main objective was to prepare the authorities for the forthcoming oil production era and the associated challenges and risks to the country's socio-economic development, as well as to help the government address the issue of food security. In addition, the Bank has finalized its new CSP 2018-2022 for the country scheduled for Board approval on June 6, 2018. The objective of the CSP is to support STP's economic transformation, expand its production base, with a focus on the key High 5 priority area of agriculture, and improve the quality of life of the population. Bank support will focus on putting in place an enabling environment for agri-business and value chains development through investments in agriculture-supporting infrastructure and in key complementary sectors of energy and water infrastructure. Support will also focus on capacity building of key public-sector institutions for the formulation and effective implementation of macroeconomic and public financial management reforms, with a view towards improving the prioritization, allocation and use of public resources. In this context, two pillars were identified: Pillar I – supporting agriculture value chains development, and Pillar II – improving the quality of life of the population through strengthened economic and financial management. Both pillars are consistent with the authorities' priorities as well as with the AfDB's priorities outlined in the 2013–22 strategy, and the High 5 agenda.

As part of its strategy and knowledge products, the AfDB also envisages to undertake the following economic and sector work: (i) governance profile (an update); (ii) agriculture statistics strategy; (iii) study on the constraints and potentials of blue economy; and (iv) preparation of a gender strategy 2019-2023. These studies will inform the preparation of future projects and provide support to the government's policy reform efforts. Meanwhile, the fragility assessment, and the national strategy for youth employment and human capital studies have already been completed.

STP reached the Highly-Indebted Poor Countries (HIPC) decision and completion points in 2000 and 2007, respectively. As a result, in March 2007, the country achieved the completion point and benefited from debt relief under HIPC and Multilateral Debt Relief Initiative (MDRI), amounting to US$327 million. About 73 percent of the debt relief was made by multilateral institutions—of which, 40 percent from the African Development Bank, 29 percent from the World Bank, and 27 percent from bilateral partners (11 percent from Paris Club countries and 16 percent from non-Paris Club countries)[1]. The country's outstanding debt to the AfDB is projected to reach US$0.11 million by the end of 2017.

Table 1. AfDB Ongoing Projects (Millions of UA)

Description	Approval Date	Completion Date	Net commitments (UA million)	Disbursement Rate (%)	Window
Food Security Support Project (PRIASA II)	10/06/2015	31/12/2020	11.50	23	ADF loan
			2.48	0	GEF
National Planning Scheme (PNAT)	25/01/2016	31/12/2018	2.00	34	ADF loan
Total Agriculture			**15.98**	**19**	
Economic and Financial Management Project (PAGEF)	14/01/2013	29/06/2018	5.00	63	ADF grant
			2.00	90	TSF grant
Total Multisector			**7.00**	**71**	
Payment System Infrastructure and Financial Inclusion (SPAUT)	03/02/2017	31/12/2021	1.50	3.2	ADF loan
Total Finance Sector			**1.50**	**3.2**	
Total Portfolio			**24.48**	**34**	

[1] Data from the Government.

STATISTICAL ISSUES

(As of June 28, 2018)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings but is broadly adequate for surveillance. Serious financial, human, and technological resource constraints have delayed efforts to strengthen the statistical system. Key shortcomings are in the national accounts and fiscal sector.
National Accounts: The authorities compile and publish an annual GDP time series, using an outdated base year (2008) and inadequate source data. The GDP time series contains several shortcomings, including an intermediate consumption ratio assumed to be fixed over time at current prices, and estimates of GDP using the expenditure approach that estimates household final consumption expenditure as the residual. The authorities expect to issue a revised time series by the end of 2018, which addresses these issues, and continue to work on improvements to source data. The latest estimate of GDP is for calendar year 2016. Quarterly estimates of GDP are not compiled.
Consumer Price Statistics: The INE began to disseminate a new CPI (base: 2014 = 100) from January 2016. With the assistance of AFRISTAT, the product mix was changed and the weights were updated, using the results of a household expenditure survey conducted in 2010. Due to financial constraints, the new CPI only covers the capital city. A technical assistance mission in FY2018 reviewed the re-referenced index, performed diagnostics on the entire series, linked the pre- and post-rebased series to produce an analytical series for the IMF database and statistical purposes, and considered INE's plans for further updates to the CPI upon completion of the new HES that is underway with World Bank support.
Government Finance Statistics: Detailed revenue and expenditure data are compiled and reported to AFR. The main areas that need to be strengthened are: (i) monitoring of expenditures on projects financed by donors; and (ii) financing operations. All project loans (financed by donors) are programmed in the budget, but some are executed independently. The government has requested development partners to help in recording all external financing in the budget. The recording of financing operations and stocks is expected to improve since the debt data management capacity is expected to be strengthened. The 2010–14 government accounts have been finalized and presented to the Court of Audit. The authorities are working on the 2015 and 2016 government accounts. STP joined the AFRITAC Central project in 2017 with plans to develop GFS. Two TA missions have taken place and another two are planned for the forthcoming months. The first missions: i) identified the priorities in terms of the GFS compilation and suggested to the authorities a migration path towards the full adoption of the *Government Finance Statistics Manual 2014 (GFSM 2014)* principles; and ii) have assisted the Ministry of Finance to compile GFS for the budgetary central government for one fiscal year in accordance with the GFSM 2014. Once the data are finalized and validated, the authorities will transmit them to STA.

Monetary and Financial Statistics: STA missions provided technical assistance on monetary statistics in December 2004, April/May 2006, June 2007 and September 2010. As a result, the accuracy and timeliness of the monetary data reported in the standardized report forms (SRF) for the central bank and the other depository corporations' data improved significantly. The BCSTP has resumed reporting monthly data to STA for the central bank and other depository corporations (ODCs) on a regular basis.

The BCSTP monthly trial balance sheet is broadly adequate to compile monetary statistics in line with the *Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG).*

A new plan of accounts for ODCs was introduced in January 2010. The September 2010 mission reviewed the new plan of accounts for the financial system, and found it adequate for a proper classification, sectorization, and valuation of financial instruments, and in line with the methodology of the *MFSMCG*. However, the mission detected serious shortcomings in the information reported by some banks and an inconsistent approach in the way banks report to the BCSTP. Following the mission's recommendations, the BCSTP worked towards eliminating those problems. The central bank has begun to collect data from insurance companies that opened in the past few years. The asset sizes of insurance companies remain small enough not to warrant inclusion in monetary statistics at this time.

The central bank produces a quarterly FSI table. MCM TA missions on banking supervision have helped expand the coverage of the table and improved the data quality. The additional information compiled could permit the beginning of stress testing exercises in the near future. STA contacted the BCSTP several times to receive FSI data on a regular basis according to the methodology of the *FSI Compilation Guide* for their posting on the IMF's website, but the BCSTP did not respond.

External Sector Statistics: The BCSTP compiles quarterly balance of payments (BOP) and international investment position (IIP) statistics consistent with the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)*. The BOP and IIP series have been converted to the BPM6 presentation starting 1997-Q1 and 2013-Q4 respectively. Data submission to STA is regular, although still with more than two-quarters lag, if compared with best dissemination practices.

The BCSTP conducts quarterly surveys to collect BOP and IIP data from the private nonfinancial sector and from the oil and gas sector. However, the response rates are low and the net errors and omissions figures are still very large. In this regard, the BCSTP is evaluating the collection of data through different methods until the survey response rate is deemed adequate.

There is room to improve the compilation of external sector statistics, particularly to improve timeliness and to lower large net errors and omissions. The BCSTP has worked to improve the compilation of financial transactions and IIP statistics. However, further work is needed to expand the coverage, improve reliability, and ensure consistency between IIP and BOP data.

The February 2018 technical assistance mission found that the BCSTP should overcome challenges related to the low response rate of External Sector Statistics (ESS) surveys, limited granularity and coverage of the goods account, and constrained staff resources. Direct access by compilers to oil trade data is key to achieve better quality in ESS and lower the amount of errors and omissions in the BOP. Currently, lack of good quality oil trade statistics could explain two thirds of net errors and omissions in the BOP.
II. Data Standards and Quality
São Tomé and Príncipe is a participant in the Fund's enhanced General Data Dissemination System (eGDDS), but has not yet implemented the National Summary Data Page.

Democratic Republic of São Tomé and Príncipe: Table of Common Indicators Required for Surveillance

(As of June 28, 2018)

	Date of Last Actual Observation	Date Received	Frequency of Data[6]	Frequency of Reporting	Frequency of Publication
Exchange rates	June 2018	June 2018	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	June 2018	June 2018	D	D	D
International investment position	Mar 2018	Apr 2018	Q	Q	Q
Reserve/base money	June 2018	June 2018	D	D	D
Broad money	Apr 2018	Jun 2018	M	M	M
Central bank balance sheet	Apr 2018	Jun 2018	M	M	M
Consolidated balance sheet of the banking system	Apr 2018	Jun 2018	M	M	M
Interest rates[2]	Jun 2017	Sep 2017	I	I	I
Consumer Price Index	Apr 2018	May 2018	M	M	M
Revenue, expenditure, balance and composition of financing[3] – general government[4]	May 2018	Jun 2018	M	M	M
Revenue, expenditure, balance and composition of financing[3] – central government	May 2018	Jun 2018	M	M	M
Stocks of central government and central government-guaranteed debt[5]	Dec 2017	Mar 2018	M	Q	Q
External current account balance	QI 2018	Jun 2018	Q	Q	Q
Exports and imports of goods	May 2018	Jun 2018	M	M	M
GDP/GNP[6]	2017	Mar 2018	A	A	A
Gross external debt	Dec 2017	Mar 2018	M	Q	Q

[1] Includes reserve asset pledged or otherwise encumbered as well as net derivative positions.

[2] Central bank's reference rate.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); not available (NA).

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

July 9, 2018

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION, FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY, REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA AND FINANCING ASSURANCES REVIEW—DEBT SUSTAINABILITY ANALYSIS[1]

Approved By
David Owen and Kevin Fletcher (IMF) and Paloma Anos-Casero (IDA)

Prepared by International Monetary Fund and International Development Association staffs in collaboration with the authorities of São Tomé and Príncipe.

São Tomé and Príncipe is classified as being in debt distress according to this joint World Bank-IMF low-income country debt sustainability analysis (DSA). *This assessment has changed from the previous DSA completed in December 2017 (high risk of external debt distress) due to the prolonged negotiations on rescheduling external arrears. Nonetheless, São Tomé and Príncipe's debt ratios have improved since the previous DSA. Specifically, the ratio of the present value of public and publicly-guaranteed (PPG) external debt to GDP no longer exceeds its threshold under the baseline scenario, due to lower-than-expected loan disbursements in 2017, an appreciation of the euro vis-à-vis the U.S. dollar, and higher-than-expected GDP deflator growth. As in the previous DSA, the debt service ratios stay below their respective thresholds under almost all scenarios. Nevertheless, the ratios of the present value of debt to exports and to revenue still exceed their respective thresholds under the baseline scenario early in the projection period, though they decline over time. This DSA underscores the importance of lowering all PPG external debt indicators below their thresholds by continuing fiscal consolidation, eschewing non-concessional loans, promoting growth, and expanding the export base.*

[1] The DSA update was prepared by IMF and World Bank staffs in collaboration with the authorities of São Tomé and Príncipe. The analysis updates the previous Joint DSA dated December 11, 2017 (IMF Country Report No. 17/382). The DSA follows the IMF and World Bank Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries (November 5, 2013). The DSA uses the unified discount rate of 5 percent set out in Decision No. 15462 (October 11, 2013). For the purpose of defining debt burden thresholds under the Debt Sustainability Framework (DSF), São Tomé and Príncipe is classified as a weak policy performer. São Tomé and Príncipe's average rating on the World Bank's Country Policy and Institutional Assessment (CPIA) for the period 2014-16 is 3.07. The corresponding indicative thresholds are: 30 percent for the NPV of debt-to-GDP ratio; 100 percent for the net present value (NPV) of debt-to-exports ratio; 200 percent for NPV of debt-to-revenue ratio; 15 percent for the debt service-to-exports ratio; and 18 percent for the debt service-to-revenue ratio.

BACKGROUND

1. **This debt sustainability analysis (DSA) updates the DSA for São Tomé and Príncipe that was completed on December 11, 2017 (IMF Country Report No. 17/382).** That DSA concluded that São Tomé and Príncipe stood at high risk of debt distress.

2. **Total public and publicly guaranteed (PPG) external debt decreased from 52.5 percent of GDP in 2016 to 45.7 percent of GDP in 2017** (Text Table 1).[2] PPG external debt at end-2017 was also lower than the previous projection of 49.9 percent of GDP. This decline was mainly driven by lower-than-expected disbursements due to absorption constraints (Text Table 2), an appreciation of the euro vis-à-vis the U.S. dollar, and higher-than-expected GDP deflator growth. Meanwhile, preliminary data indicate that the stock of domestic debt also decreased, bringing total PPG debt from 67.6 percent of GDP in 2016 to 64.4 percent of GDP in 2017, mainly due to the positive price differential between imported and pump oil prices, which was used to reduce the debt owed to the oil importing company, ENCO. Domestic debt includes domestic arrears and government securities issued in the domestic market (around 4.2 percent of GDP).

Text Table 1. São Tomé and Príncipe: Public Debt Stock

(As of end 2017)	Million USD	Share of GDP (%)
Total PPG debt	**267.6**	**64.4%**
Total PPG external debt	**189.8**	**45.7%**
Multilateral Creditors	**45.3**	**10.9%**
IDA	11.9	**2.9%**
BADEA	12.0	**2.9%**
FIDA	5.8	**1.4%**
AfDB	6.9	**1.7%**
IMF	6.7	**1.6%**
OPEC	2.0	**0.5%**
Bilateral Creditors	**131.9**	**31.7%**
Portugal	59.6	**14.3%**
Angola	55.6	**13.4%**
China[1]	10.0	**2.4%**
Brazil[1]	4.3	**1.0%**
Equatorial Guinea	1.7	**0.4%**
Belgium	0.8	**0.2%**
External suppliers' debt	**12.5**	**3.0%**
Domestic debt[2]	**77.8**	**18.7%**
Domestic arrears	**60.3**	**14.5%**
ENCO (oil importing company)	38.5	**9.3%**
CST (telecom)	5.8	**1.4%**
EMAE (water and electricity)	2.6	**0.6%**
Other suppliers	13.4	**3.2%**
Domestic debt (other)	**17.5**	**4.2%**
Memorandum items:		**0.0%**
Pre-HIPC legacy arrears	**54.9**	**13.2%**
Italy[1]	24.3	**5.8%**
Angola	30.6	**7.4%**
Arrears from EMAE to ENCO[2]	**66.6**	**16.0%**

Sources: Country authorities and IMF staff estimates

[1] Commercial debt guaranteed by the government.

[2] Preliminary data

3. **Looking forward, the 2018 budget foresees \$11.0 million (2.4 percent of GDP) in loan disbursements** (Text Table 2). A large share of this is expected to come from the AfDB. Already contracted debt that was not disbursed in 2017 and is not expected to be disbursed in 2018 is projected to be disbursed in 2019-21.

4. **In terms of coverage, the DSA includes only debt contracted or guaranteed by the central government**. State-owned enterprises (SOEs) do not have external debt.

5. **São Tomé and Príncipe continues to have post-HIPC arrears with bilateral creditors.** These arrears are to Angola (US\$4.8 million), Brazil (US\$4.3

[2] These debt numbers exclude pre-HIPC initiative arrears equal to 14.0 percent of GDP (on the assumption of debt forgiveness) and a disputed loan from Nigeria equal to 7.6 percent of GDP.

million), and Equatorial Guinea (US$1.7 million). In total, they equal 2.8 percent of GDP. In addition, a loan from Nigeria equal to 7.6 percent of GDP is excluded from the debt stock, as it is under dispute according to information provided by the São Tomé and Príncipe authorities. Text Table 3 provides more details on the arrears and disputed debt.

Text Table 2. Loan Disbursements
(millions of USD)

	2016	Proj. 2017[1]	2017	Proj. 2018	Proj. 2019-21
Kuwait	0.0	1.7	0.0	1.7	14.7
EIB	0.0	0.0	0.0	0.0	12.7
AfDB	0.9	7.6	2.2	4.5	13.4
Portugal	2.7	2.2	0.0	0.0	6.8
BADEA	1.4	1.2	0.3	1.2	6.0
IMF	1.8	1.8	1.8	1.8	0.0
Angola	4.5	4.5	4.5	0.0	0.0
IFAD	0.0	1.9	0.0	1.8	0.0
Sum	**11.3**	**20.9**	**8.8**	**11.0**	**53.6**
Percent of GDP	**3.2**	**5.3**	**1.9**	**2.4**	**3.1**

[1]Projection in the December 2017 DSA.

Text Table 3. Arrears and Disputed Debt
(As of end-December 2017)

Type	**Description**	**DSA Treatment**
Pre-HIPC legacy arrears (14.0 percent of GDP)	São Tomé and Príncipe has pre-HIPC legacy arrears to Angola ($30.6 million) and Italy ($24.3 million), in total $54.9 million. São Tomé and Príncipe is making best efforts to reach an agreement consistent with the representative Paris Club agreement. In 2017 São Tomé and Príncipe was able to secure relief from pre-HIPC legacy arrears to China of $18.4 million.	Not included in the DSA.
Post-HIPC bilateral arrears (2.8 percent of GDP)	São Tomé and Príncipe has post-HIPC arrears to Angola ($4.8 million), Brazil ($4.3 million), and Equatorial Guinea ($1.7 million), in total $10.8 million. The government has actively sought debt rescheduling agreements with Angola and Equatorial Guinea through correspondence and high-level meetings. However, responses are pending from these two countries on continuing the negotiations. These arrears are the result of weak debt management, and staff assesses that São Tomé and Príncipe has the capacity to repay them over time.	Included in the DSA.

Text Table 3. Arrears and Disputed Debt (concluded)

(As of end-December 2017)

Type	Description	DSA Treatment
Domestic arrears (14.5 percent of GDP)	São Tomé and Príncipe has domestic arrears to the oil-company ENCO ($38.5 million), the telecom company CST ($5.8 million), and the water and electricity company EMAE ($2.6 million). There are also arrears to other suppliers amounting to $13.4 million. In total, the domestic arrears amount to $60.3 million. The government has a domestic arrears clearance plan.	Included in the DSA.
Disputed debt (7.6 percent of GDP)	A loan from Nigeria in the amount of $30 million was excluded from the debt stock as there is no signed contract with repayment conditions between the two countries. Nonetheless, the authorities acknowledged the receipt of the funds, which were spent as evidenced by budget documents. This loan was extended as advances on oil revenues in the context of the joint development zone between these two countries, but this project has stalled. According to São Tomé and Príncipe authorities, this loan is under dispute since it should only be repaid in case revenues from oil are materialized. The authorities are still waiting for responses from Nigeria on discussing the disputed loan.	Not included in the DSA.

6. **São Tomé and Príncipe continues to engage actively in rescheduling negotiations with these creditors.** An agreement with the Brazilian government was reached, pending ratification by the Brazilian Senate. The government has actively sought debt rescheduling agreements with Angola and Equatorial Guinea through correspondence and high-level meetings. However, responses are pending from these two countries on continuing the negotiations. Similarly, Nigeria is yet to respond to the authorities' request for discussing the disputed loan.

MACROECONOMIC ASSUMPTIONS

7. **The macroeconomic assumptions have changed modestly from the previous DSA**. The current DSA assumes lower long-run real GDP growth (4.9 percent instead of 5.4) due to uncertainty about the implementation of large projects. At the same time, the GDP deflator has been raised in line with recently released deflator series by the authorities. In addition, FDI and the current account deficit[3] have been raised in line with the recently heightened interest in oil exploration (Text Table 4),

[3] Higher FDI inflows will lead to more imports of investment goods, and thus a higher current account deficit.

as evidenced by the large oil signature bonus and the announcement of tenders on new exploration blocks.

Text Table 4. Macroeconomic Assumptions

	Historical			Forecasts	
	2017 DSA[1]	2018 DSA[1]	Last 4 years	2017 DSA[1]	2018 DSA
	2007-16	2008-17	2014-17	2017-37	2018-38
Real GDP growth (percent)	4.3	4.8	4.6	5.4	4.9
Inflation (percent average)	13.2	11.9	5.8	3.4	3.4
GDP deflator (percent)	5.6	5.8	2.4	2.2	2.9
Domestic primary balance (percent of GDP)	-4.5	-3.9	-3.1	-1.3	-1.0
Primary balance (percent of GDP)	-9.3	-8.7	-5.5	-2.4	-1.6
Grants (percent of GDP)	17.3	16.7	11.8	7.6	7.4
New borrowing (percent of GDP)	7.6	7.5	5.5	2.3	2.3
FDI (percent of GDP)	15.7	13.0	7.8	3.8	11.9
USD export growth (percent)	21.9	24.6	24.3	6.6	6.2
USD import growth (percent)	9.6	10.3	3.3	5.5	6.3
Current account balance, excluding grants (percent of GDP)	-38.7	-36.3	-24.2	-13.2	-17.1
Current account balance, including grants (percent of GDP)	-21.4	-19.6	-12.4	-5.6	-9.7

[1] IMF Country Report No. 17/382

EXTERNAL DEBT SUSTAINABILITY

8. Under the baseline scenario, the present value (PV) of debt to exports and the PV of debt to revenue both breach their indicative thresholds, but debt *service* ratios remain below their thresholds under almost all scenarios (Figure 1).[4] These breaches also occurred in the previous DSA. However, the PV of PPG debt to GDP no longer breaches its threshold. This improvement from the previous DSA is driven by lower-than-expected disbursements in 2017, an appreciation of the euro vis-à-vis the U.S. dollar, and higher-than-expected GDP deflator growth. Like in the previous DSA, the debt service ratios continue to stay below their thresholds under all scenarios, except the debt-service-to-exports ratio under the historical scenario. All indicators improve over time under the baseline and the most extreme scenarios as a result of economic growth, fiscal consolidation, slower debt accumulation, expansion of the export base, and constrained imports.

[4] São Tomé and Príncipe's quality of policies and institutions, as measured by the average World Bank's Country Policy and Institutional Assessment (CPIA) for the period 2014-16, is 3.07 (weak performer). The corresponding indicative thresholds are: 30 percent for the net present value (NPV) of debt-to-GDP ratio; 100 percent for the NPV of debt-to-export ratio; 200 percent for NPV of debt-to-revenue ratio; 15 percent for the debt service-to-exports ratio; and 18 percent for the debt service-to-revenue ratio.

9. Under stress tests with the most extreme shock, all external debt *stock* indicators breach their respective thresholds early in the projection period, albeit with a declining trend (Figure 1, solid black lines). As in the previous DSA, export-based indicators are most sensitive to exports shocks, while the remaining indicators are most sensitive to a one-time 30-percent depreciation shock. This highlights the need to diversify the export base and maintain the credibility of the exchange rate peg.

PUBLIC DEBT SUSTAINABILITY

10. Unlike the previous DSA, the PV of total public debt to GDP ratio no longer breaches the benchmark under the baseline and fixed primary balance scenarios (Figure 2). The baseline scenario has improved for the reasons discussed above. The fixed primary balance scenario has also improved because a primary surplus of 0.6 percent of GDP is expected for 2018, in contrast with the primary deficit in 2017 of 1.0 percent of GDP, on account of a signing bonus for oil exploration. As is the case in the previous DSA, public debt dynamics appear unsustainable under the historical scenario, underscoring the importance of continued fiscal consolidation and fostering private-sector led growth through structural reforms. The PV of debt to revenue ratio is most sensitive to a deterioration of one standard deviation in the historical primary deficit. The other two indicators are most sensitive to a one-time 30-percent depreciation.

DEBT DISTRESS QUALIFICATION AND CONCLUSIONS

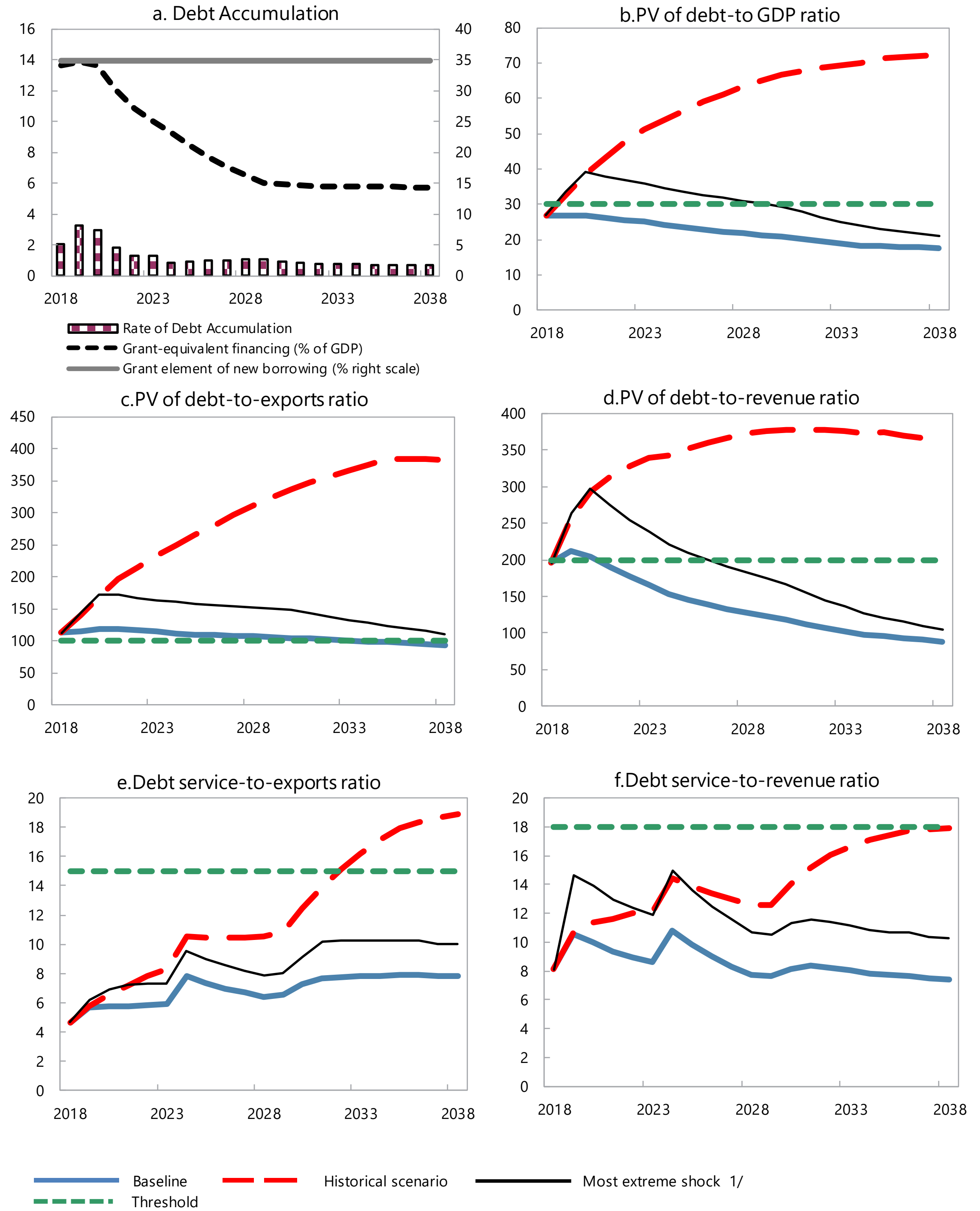
11. São Tomé and Príncipe's classification has been updated to stand in debt distress. This change was not made at the time of the previous DSA because the regularization of São Tomé and Príncipe's post-HIPC sovereign arrears (to Angola, Brazil, and Equatorial Guinea, totaling around 2.8 percent of GDP) was considered imminent. As these arrears are still not regularized, staff now views the appropriate classification as being in debt distress. São Tomé and Príncipe continues to actively seek rescheduling agreements.

12. Absent these arrears, São Tomé and Príncipe would be classified at high risk of debt distress. This reflects the threshold breaches under the baseline scenario. Two other aggravating factors are that (i) a large part of the government's domestic arrears, namely those to ENCO, are denominated in U.S. dollars and ENCO is majority foreign-owned and (ii) there are considerable contingent liabilities stemming from the state-owned electricity enterprise EMAE, which are not considered in this DSA, as it focuses only on the central government. However, the World Bank is providing technical assistance to São Tomé and Príncipe to improve its debt and SOE management, which should help reduce the incidence of external and domestic arrears. Fiscal consolidation, prudence in contracting new debt, and continued diversification of the economy and export base are needed to improve debt indicators over the medium term.

13. These findings underscore the importance of maintaining strong policies in order to reduce debt-related risks. Such policies include continuing fiscal consolidation, eschewing non-concessional loans, promoting growth, and expanding the export base.

14. Authorities' views: In response to the staff's presentation of this analysis in March-April 2018, the authorities broadly agreed with the assessment. They understood that the main reason for being classified as being in debt distress is the existence of long-standing external arrears. Moreover, they reiterated their commitment to borrow at a measured pace, to strive for debt sustainability, and to actively seek restructuring of the current arrears.

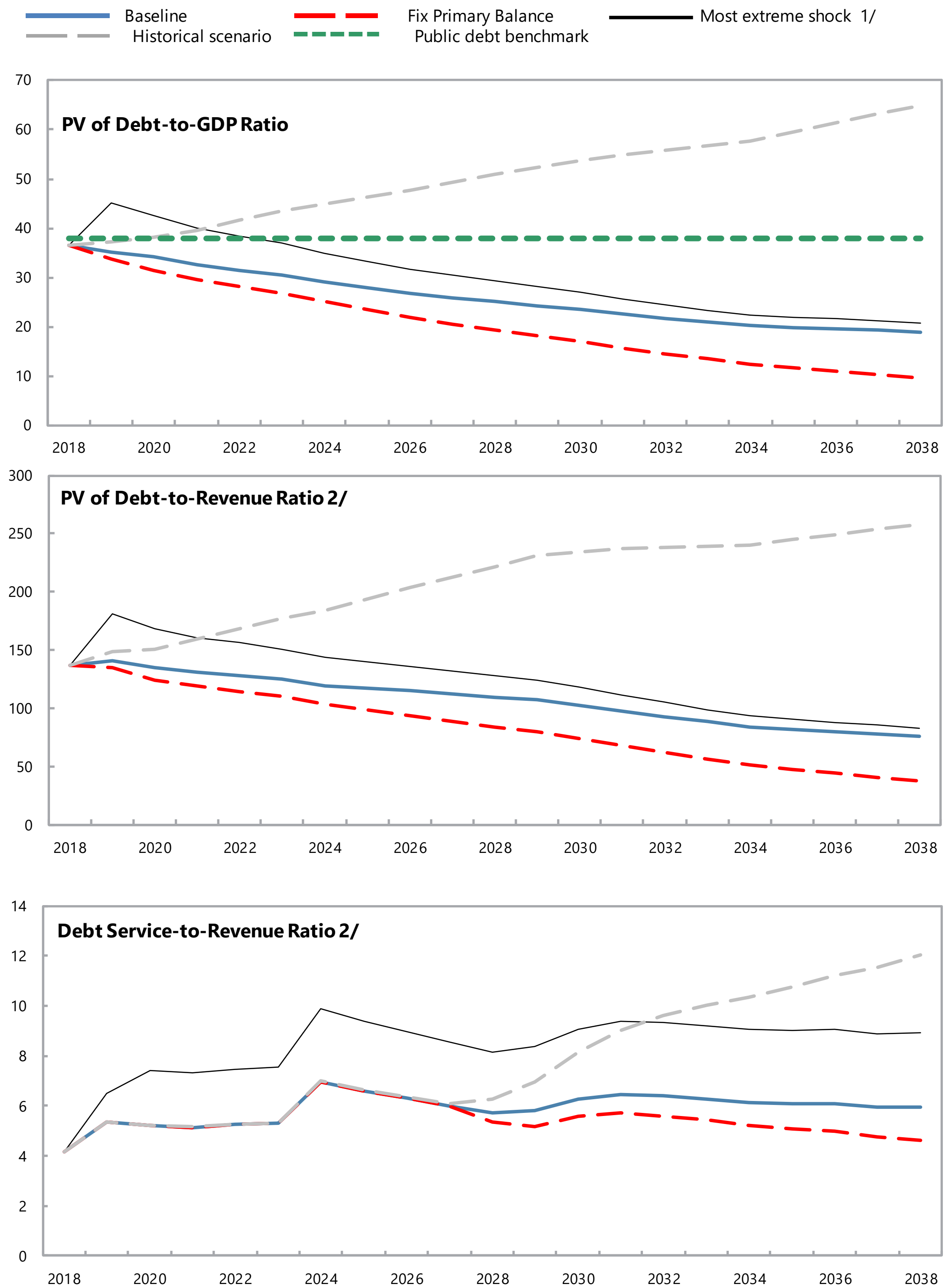
Figure 1. São Tomé and Príncipe: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2018–38



Sources: São Tomé and Príncipe's authorities, and IMF staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2028. The most extreme shocks are a one-time 30-percent nominal depreciation in Figures a, b, d, and f; and a one standard deviation decrease in the historical export value growth in the case of c and e.

Figure 2. São Tomé and Príncipe: Indicators of Public Debt Under Alternative Scenarios, 2018–38



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2028.
2/ Revenues are defined inclusive of grants.

Table 1. São Tomé and Príncipe: External Debt Sustainability Framework, Baseline Scenario, 2015–38

(Percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2015	2016	2017			2018	2019	2020	2021	2022	2023	2018-2023 Average	2028	2038	2024-2038 Average
External debt (nominal) 1/	**62.8**	**52.5**	**45.7**			**42.1**	**41.4**	**40.5**	**38.8**	**37.4**	**36.1**		**29.9**	**24.1**	
of which: public and publicly guaranteed (PPG)	62.8	52.5	45.7			42.1	41.4	40.5	38.8	37.4	36.1		29.9	24.1	
Change in external debt	11.5	-10.3	-6.8			-3.5	-0.8	-0.8	-1.7	-1.4	-1.3		-0.9	-0.2	
Identified net debt-creating flows	10.3	-6.2	-7.5			-5.5	-3.3	-4.6	-5.1	-4.5	-4.6		-3.3	-3.3	
Non-interest current account deficit	**12.7**	**6.2**	**7.8**	**19.3**	**8.8**	**6.4**	**9.3**	**8.1**	**7.5**	**8.1**	**8.1**		**9.5**	**10.9**	9.8
Deficit in balance of goods and services	31.1	25.7	22.3			22.9	24.0	22.0	19.8	19.0	18.1		16.0	16.3	
Exports	28.5	27.3	26.9			23.9	23.5	22.8	22.1	22.1	22.0		20.4	19.0	
Imports	59.6	53.0	49.2			46.9	47.5	44.9	42.0	41.0	40.1		36.4	35.3	
Net current transfers (negative = inflow)	-18.4	-18.9	-15.2	-20.2	3.7	-17.3	-16.0	-15.8	-14.7	-13.7	-12.9		-9.6	-9.4	-9.7
of which: official	-12.7	-13.7	-10.6			-13.2	-12.2	-12.2	-11.1	-10.2	-9.3		-5.9	-5.0	
Other current account flows (negative = net inflow)	0.0	-0.5	0.8			0.7	1.3	1.9	2.4	2.9	2.9		3.2	4.0	
Net FDI (negative = inflow)	**-8.2**	**-5.8**	**-10.6**	**-13.0**	**12.0**	**-10.7**	**-11.4**	**-11.4**	**-11.3**	**-11.3**	**-11.4**		**-11.8**	**-13.5**	-12.2
Endogenous debt dynamics 2/	**5.8**	**-6.6**	**-4.8**			**-1.1**	**-1.2**	**-1.4**	**-1.4**	**-1.3**	**-1.3**		**-1.0**	**-0.7**	
Contribution from nominal interest rate	0.3	0.3	0.4			0.4	0.4	0.5	0.5	0.5	0.5		0.5	0.5	
Contribution from real GDP growth	-2.2	-2.3	-1.8			-1.5	-1.7	-1.9	-1.8	-1.8	-1.7		-1.4	-1.2	
Contribution from price and exchange rate changes	7.6	-4.5	-3.3			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**1.2**	**-4.1**	**0.7**			**2.0**	**2.6**	**3.8**	**3.4**	**3.2**	**3.3**		**2.4**	**3.2**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	28.4			26.9	26.9	26.8	26.1	25.6	25.1		21.7	17.6	
In percent of exports	...	...	105.6			112.6	114.7	117.5	117.9	115.9	114.1		106.5	93.1	
PV of PPG external debt	**...**	**...**	**28.4**			**26.9**	**26.9**	**26.8**	**26.1**	**25.6**	**25.1**		**21.7**	**17.6**	
In percent of exports	**...**	**...**	**105.6**			**112.6**	**114.7**	**117.5**	**117.9**	**115.9**	**114.1**		**106.5**	**93.1**	
In percent of government revenues	**...**	**...**	**219.3**			**195.5**	**211.9**	**203.5**	**189.5**	**177.1**	**166.4**		**127.9**	**88.1**	
Debt service-to-exports ratio (in percent)	**3.8**	**3.3**	**3.1**			**4.7**	**5.7**	**5.8**	**5.8**	**5.8**	**5.9**		**6.4**	**7.8**	
PPG debt service-to-exports ratio (in percent)	**3.8**	**3.3**	**3.1**			**4.7**	**5.7**	**5.8**	**5.8**	**5.8**	**5.9**		**6.4**	**7.8**	
PPG debt service-to-revenue ratio (in percent)	**7.8**	**6.6**	**6.4**			**8.1**	**10.5**	**10.0**	**9.3**	**8.9**	**8.6**		**7.7**	**7.4**	
Total gross financing need (Millions of U.S. dollars)	17.7	4.6	-7.4			-15.1	-4.0	-11.0	-16.0	-13.5	-15.0		-10.9	-22.4	
Non-interest current account deficit that stabilizes debt ratio	1.2	16.6	14.6			9.9	10.1	9.0	9.2	9.5	9.4		10.4	11.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	3.8	4.2	3.9	4.8	1.8	4.0	4.5	5.0	5.0	5.0	5.0	4.8	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	-12.9	7.8	6.7	5.8	9.5	14.2	7.4	6.3	4.5	2.9	2.1	6.2	2.1	0.0	1.6
Effective interest rate (percent) 5/	0.6	0.5	0.8	0.8	0.2	1.1	1.2	1.3	1.3	1.4	1.4	1.3	1.6	2.0	1.7
Growth of exports of G&S (US dollar terms, in percent)	1.7	7.4	9.6	24.6	23.4	5.4	10.1	8.5	6.4	7.7	6.7	7.5	5.6	5.6	5.6
Growth of imports of G&S (US dollar terms, in percent)	-18.2	-0.2	2.9	10.3	19.1	13.1	13.8	5.4	2.6	5.6	4.7	7.5	5.4	6.0	5.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9
Government revenues (excluding grants, in percent of GDP)	14.0	13.6	13.0			13.8	12.7	13.2	13.8	14.5	15.1		17.0	20.0	17.9
Aid flows (in Millions of US dollars) 7/	71.0	56.9	50.6			70.9	88.7	95.7	88.2	84.1	84.0		82.7	137.3	
of which: Grants	36.4	46.9	39.5			59.8	64.0	71.0	71.2	70.3	69.2		61.7	98.2	
of which: Concessional loans	34.5	10.1	11.1			11.1	24.7	24.7	17.0	13.8	14.8		21.0	39.1	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			13.7	13.9	13.6	12.0	10.9	10.0		6.6	5.7	6.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			89.8	81.9	83.2	87.4	89.3	88.5		83.5	81.5	83.0
Memorandum items:															
Nominal GDP (Millions of US dollars)	315.5	354.2	392.5			466.1	523.1	583.8	640.5	691.7	741.5		1049.6	1956.3	
Nominal dollar GDP growth	-9.6	12.3	10.8			18.7	12.2	11.6	9.7	8.0	7.2	11.2	7.2	5.0	6.7
PV of PPG external debt (in Millions of US dollars)			118.3			126.3	141.7	157.1	167.9	176.3	185.2		227.3	340.1	
(PVt-PVt-1)/GDPt-1 (in percent)						2.1	3.3	3.0	1.8	1.3	1.3	2.1	1.1	0.7	0.9
Gross workers' remittances (Millions of US dollars)	18.1	18.6	18.1			19.1	19.7	21.0	22.9	24.7	26.7		39.5	86.5	
PV of PPG external debt (in percent of GDP + remittances)	...	...	27.2			25.9	25.9	25.9	25.2	24.7	24.2		21.0	16.9	
PV of PPG external debt (in percent of exports + remittances)	...	...	90.2			96.1	98.8	101.5	101.6	99.8	98.0		89.9	75.5	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.6			4.0	4.9	5.0	5.0	5.0	5.1		5.4	6.3	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2a. São Tomé and Príncipe: Sensitivity Analysis of Key Indicators of Public and Publicly Guaranteed External Debt, 2018-38

(Percent)

	Projections							
	2018	2019	2020	2021	2022	2023	**2028**	2038
PV of debt-to GDP ratio								
Baseline	27	27	27	26	26	25	**22**	18
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	27	33	39	43	48	51	**63**	72
A2. New public sector loans on less favorable terms in 2018-2038 2	27	28	29	29	28	28	**27**	26
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	27	27	28	27	26	26	**22**	18
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	27	28	30	29	29	28	**24**	18
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	27	30	33	32	31	31	**27**	21
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	27	34	39	38	37	36	**31**	21
B5. Combination of B1-B4 using one-half standard deviation shocks	27	31	35	34	33	32	**28**	21
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	27	38	37	36	35	35	**30**	24
PV of debt-to-exports ratio								
Baseline	113	115	118	118	116	114	**107**	93
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	113	139	169	196	215	232	**310**	382
A2. New public sector loans on less favorable terms in 2018-2038 2	113	120	127	130	129	129	**132**	137
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	113	115	118	118	115	114	**106**	92
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	113	131	155	155	151	148	**138**	113
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	113	115	118	118	115	114	**106**	92
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	113	143	172	171	166	163	**152**	111
B5. Combination of B1-B4 using one-half standard deviation shocks	113	121	127	127	124	122	**114**	92
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	113	115	118	118	115	114	**106**	92
PV of debt-to-revenue ratio								
Baseline	196	212	204	189	177	166	**128**	88
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	196	257	293	315	329	339	**372**	362
A2. New public sector loans on less favorable terms in 2018-2038 2	196	222	220	209	197	188	**158**	130
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	196	216	211	197	182	171	**132**	90
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	196	223	229	213	197	185	**142**	92
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	196	238	251	234	217	204	**157**	107
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	196	264	298	275	254	238	**183**	105
B5. Combination of B1-B4 using one-half standard deviation shocks	196	245	267	247	229	215	**165**	105
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	196	296	283	264	245	230	**177**	120

Table 2b. São Tomé and Príncipe: Sensitivity Analysis of Key Indicators of Public and Publicly Guaranteed External Debt, 2018–38 (concluded)

(Percent)

	Projections							
	2018	2019	2020	2021	2022	2023	**2028**	2038
Debt service-to-exports ratio								
Baseline	5	6	6	6	6	6	**6**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	5	6	7	7	8	8	**10**	19
A2. New public sector loans on less favorable terms in 2018-2038 2	5	6	6	6	6	7	**8**	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	5	6	6	6	6	6	**6**	8
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	5	6	7	7	7	7	**8**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	5	6	6	6	6	6	**6**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	5	6	7	7	7	7	**8**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	5	6	6	6	6	6	**6**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	5	6	6	6	6	6	**6**	8
Debt service-to-revenue ratio								
Baseline	8	11	10	9	9	9	**8**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	8	11	11	12	12	12	**13**	18
A2. New public sector loans on less favorable terms in 2018-2038 2	8	11	10	10	10	10	**10**	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	8	11	10	10	9	9	**8**	8
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	8	11	10	10	10	9	**8**	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	8	12	12	11	11	11	**9**	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	8	11	11	12	11	11	**9**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	8	11	12	11	11	10	**9**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	8	15	14	13	12	12	**11**	10
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	35	35	35	35	35	35	**35**	35

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. São Tomé and Príncipe: Public Sector Debt Sustainability Framework, Baseline Scenario, 2015–2038

(Percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2015	2016	2017	Average 5/	Standard Deviation 5/	2018	2019	2020	2021	2022	2023	2018-23 Average	2028	2038	2024-38 Average
Public sector debt 1/	62.8	67.6	56.7			51.7	49.7	47.9	45.3	43.4	41.5		33.3	25.4	
of which: foreign-currency denominated	62.8	52.5	45.7			42.1	41.4	40.5	38.8	37.4	36.1		29.9	24.1	
Change in public sector debt	11.5	4.8	-10.9			-5.0	-2.0	-1.8	-2.5	-2.0	-1.8		-1.2	-0.3	
Identified debt-creating flows	10.5	0.5	-8.1			-5.4	-1.3	-1.4	-2.4	-1.5	-1.3		-0.2	0.8	
Primary deficit	8.7	4.7	3.0	8.7	6.3	0.2	3.8	3.1	1.3	1.1	1.1	1.8	1.7	1.6	1.6
Revenue and grants	25.5	26.8	23.0			26.6	24.9	25.3	24.9	24.6	24.4		22.9	25.0	
of which: grants	11.5	13.2	10.1			12.8	12.2	12.2	11.1	10.2	9.3		5.9	5.0	
Primary (noninterest) expenditure	34.2	31.5	26.1			26.8	28.7	28.4	26.2	25.7	25.5		24.5	26.6	
Automatic debt dynamics	1.8	-4.2	-11.1			-5.6	-5.1	-4.5	-3.7	-2.6	-2.5		-1.9	-0.8	
Contribution from interest rate/growth differential	-2.1	-3.0	-3.7			-3.1	-3.1	-3.0	-2.7	-2.5	-2.4		-1.8	-1.2	
of which: contribution from average real interest rate	-0.2	-0.5	-1.2			-0.9	-0.9	-0.6	-0.5	-0.4	-0.3		-0.2	0.0	
of which: contribution from real GDP growth	-1.9	-2.5	-2.5			-2.2	-2.2	-2.4	-2.3	-2.2	-2.1		-1.6	-1.2	
Contribution from real exchange rate depreciation	3.9	-1.2	-7.4			-2.5	-1.9	-1.5	-0.9	0.0	-0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	1.0	4.2	-2.8			0.5	-0.7	-0.4	-0.1	-0.5	-0.5		-1.0	-1.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	39.5			36.5	35.3	34.1	32.6	31.5	30.5		25.1	18.9	
of which: foreign-currency denominated	...	...	28.4			26.9	26.9	26.8	26.1	25.6	25.1		21.7	17.6	
of which: external	...	...	28.4			26.9	26.9	26.8	26.1	25.6	25.1		21.7	17.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	9.8	5.6	3.8			1.3	5.1	4.4	2.5	2.4	2.4		3.0	3.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	171.3			137.1	141.3	134.7	131.0	128.1	124.9		109.6	75.6	
PV of public sector debt-to-revenue ratio (in percent)	…	…	304.3			265.0	277.5	259.1	236.7	218.1	202.2		147.5	94.6	
of which: external 3/	…	…	219.3			195.5	211.9	203.5	189.5	177.1	166.4		127.9	88.1	
Debt service-to-revenue and grants ratio (in percent) 4/	4.3	3.4	3.6			4.2	5.4	5.2	5.1	5.2	5.3		5.7	5.9	
Debt service-to-revenue ratio (in percent) 4/	7.8	6.6	6.4			8.1	10.5	10.0	9.3	8.9	8.6		7.7	7.4	
Primary deficit that stabilizes the debt-to-GDP ratio	-2.8	0.0	13.9			5.1	5.8	4.9	3.8	3.1	3.0		2.9	1.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	3.8	4.2	3.9	4.8	1.8	4.0	4.5	5.0	5.0	5.0	5.0	4.8	5.0	5.0	5.0
Average nominal interest rate on forex debt (in percent)	0.6	0.5	0.8	0.8	0.2	1.1	1.2	1.3	1.3	1.4	1.4	1.3	1.6	2.0	1.7
Average real interest rate on domestic debt (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Real exchange rate depreciation (in percent, + indicates depreciation)	8.0	-2.0	-14.9	-4.4	9.2	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.2	8.1	4.7	10.8	7.5	3.9	6.2	5.0	3.7	2.9	3.0	4.1	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	18.0	-4.0	-14.1	0.0	7.7	6.8	12.3	3.8	-3.4	3.2	4.3	4.5	4.3	6.1	5.3
Grant element of new external borrowing (in percent)	...	...	...	...	...	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	34.9	...

Sources: Country authorities; and staff estimates and projections.

1/ Public debt consists of central government debt. Gross debt is considered.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. São Tomé and Príncipe: Sensitivity Analysis of Key Indicators of Public Debt, 2018–38

	Projections							
	2018	2019	2020	2021	2022	2023	2028	2038
PV of Debt-to-GDP Ratio								
Baseline	36	35	34	33	32	30	25	19
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	36	37	38	40	42	43	51	65
A2. Primary balance is unchanged from 2018	36	34	32	30	28	27	19	9
A3. Permanently lower GDP growth 1/	36	35	34	33	32	31	27	26
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	36	36	36	34	33	32	28	23
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	36	40	43	41	40	39	32	23
B3. Combination of B1-B2 using one half standard deviation shocks	36	39	41	40	38	37	32	24
B4. One-time 30 percent real depreciation in 2019	36	45	43	40	38	37	29	21
B5. 10 percent of GDP increase in other debt-creating flows in 2019	36	39	38	36	35	34	28	21
PV of Debt-to-Revenue Ratio 2/								
Baseline	137	141	135	131	128	125	110	76
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	137	149	151	159	169	178	222	258
A2. Primary balance is unchanged from 2018	137	135	124	119	115	110	84	38
A3. Permanently lower GDP growth 1/	137	142	135	132	130	128	118	101
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	137	143	138	135	133	131	120	92
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	137	160	171	166	163	159	142	93
B3. Combination of B1-B2 using one half standard deviation shocks	137	155	162	158	155	152	138	96
B4. One-time 30 percent real depreciation in 2019	137	181	168	161	156	151	128	83
B5. 10 percent of GDP increase in other debt-creating flows in 2019	137	158	150	146	143	139	123	83
Debt Service-to-Revenue Ratio 2/								
Baseline	4	5	5	5	5	5	6	6
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	4	5	5	5	5	5	6	12
A2. Primary balance is unchanged from 2018	4	5	5	5	5	5	5	5
A3. Permanently lower GDP growth 1/	4	5	5	5	5	5	6	7
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	4	5	5	5	5	5	6	7
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	4	5	5	5	5	5	7	7
B3. Combination of B1-B2 using one half standard deviation shocks	4	5	5	5	5	5	7	7
B4. One-time 30 percent real depreciation in 2019	4	6	7	7	7	8	8	9
B5. 10 percent of GDP increase in other debt-creating flows in 2019	4	5	5	5	5	5	7	6

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Statement by Mr. Daouda Sembene, Executive Director, and Mr. Kelvio Carvalho da Silveira, Advisor, on Democratic Republic of São Tomé and Príncipe

July 23, 2018

On behalf of the Sao Tomean authorities, we would like to express our appreciation to Management and staff for the constructive engagement and policy dialogue during the 2018 Article IV consultation and fifth review under the Extended Credit Facility (ECF). The authorities also welcome Fund's invaluable technical assistance provided over the years. The report provides a candid assessment of the macroeconomic situation, including progress achieved to date as well as challenges and policy priorities for 2018 and beyond.

Noticeable progress has been made in advancing fiscal consolidation and addressing some structural bottlenecks. Still, significant challenges related to the country's state of fragility complicates the achievement of the authorities' targeted development outcomes. These include limited institutional capacity, vulnerability to climate change, and high dependency on external assistance. Nevertheless, the authorities remain committed to addressing these vulnerabilities, notably by pursuing their reform efforts in the context of the ECF-supported program and strengthening capacities with the support of the Fund and other partners.

Performance under the ECF Program

Implementation of the ECF arrangement has recently proceeded in a challenging context. As a result, two out of five performance criteria (PCs) were met, while others related to the Domestic Primary Deficit (DPD) and net bank financing of the central government were missed owing to revenue underperformance, combined with unrealized external budget support and critical spending to address a public health concern. In addition, the PC on net international reserves was unmet due to lower-than-expected external financing. On the structural front, all end-December 2017 and most end-June 2018 benchmarks were met.

The introduction of a central bank's foreign exchange regulation in March 2017 was assessed by staff to have inadvertently led to the breach of the continuous PC against the introduction or intensification of exchange restrictions. This move was deemed critical for the successful implementation of the authorities' capital account management strategy. Moving forward, the authorities intend to take steps in due course to roll back measures that contribute to exchange restrictions and multiple currency practice, while taking into account the need to maintain external stability.

Recent Economic Development and Outlook

Fiscal tightening and reduced external inflows contributed to holding back economic activity in 2017, with real GDP growth decreasing to 3.9 percent from 4.2 percent in 2016. Cocoa, tourism and construction sectors continue to be the main drivers of the economy. Inflation continued to increase, reaching 7.7 percent at end-2017. The current account deficit worsened due to stronger imports of capital goods and oil products.

Regarding the outlook, staff expects real GDP growth to pick up modestly from about 4 percent in 2018 to around 5 percent in medium term, as key infrastructure projects start to materialize. Inflation is expected to decline this year and remain below 5 percent in the medium term. The authorities concur with staff that the macroeconomic outlook for 2018 and beyond remains positive, but believe the infrastructure projects could lead to a more buoyant near-term prospect. Staff highlights a number of risks to the outlook that could stem from the upcoming elections, delays in donor disbursement, and limited implementation due to capacity constraints. Notwithstanding these uncertainties, the authorities have restated their commitment to steadfastly implement the reform agenda envisaged under the program, as reflected by the implementation of politically difficult prior actions during election year.

Policy Priorities for 2018 and Beyond

Addressing Revenue Shortfall and Contingent Liabilities, and Reduce Debt Burden over the Medium Term

Although revenue outturn was lower than expected, fiscal consolidation efforts have helped to reduce the DPD in 2017. To meet the 2018 fiscal targets and offset the revenue shortfall, the authorities took steps to collect tax arrears owed by large taxpayers. In this respect, fiscal and legal procedures were initiated against the beer manufacturer, Rosema, to resolve tax arrears comprising mainly consumption and personal income taxes that it collected on behalf of the government. As a result of these efforts, staff preliminary assessment suggests that Sao Tome and Principe's end-June 2018 fiscal performance under the ECF arrangement was satisfactory.

Fiscal reforms will be undertaken to support revenue mobilization efforts. In particular, preparatory work will continue for the introduction of the VAT in 2019, with a view to ensuring a smooth transition. Emphasis will be placed notably on facilitating the approval of the VAT Law by the Parliament, harmonizing other tax laws with the VAT Law, securing appropriate space and equipment, and hiring and training personnel. In line with Fund TA recommendation, a computer-based monitoring system will be implemented for large taxpayers to help boost domestic revenue mobilization. Furthermore, implementation of the automatic price adjustment mechanism led to a rise in domestic pump prices in June 2018 in line with recent international oil price increases.

On the spending front, the focus is put on maintaining fiscal discipline in line with program objectives. This includes streamlining transfers and personnel costs, capping utility consumption of public agencies (including EMAE), containing domestically-financed capital expenditure and freezing real wage growth. If additional resources are available, the authorities are also committed to continuing prioritizing the clearance of arrears to suppliers.

Fiscal risks posed by the public utility company EMAE is still a source of concern for the government. The ongoing reform process should help revamp EMAE's operational efficiency even though it is expected to continue making losses in the medium-term. At the same time, the authorities also expressed concerns over delays in the provision of technical and financial assistance by development partners which have contributed to slowing down some aspects of reform implementation. Going forward, the authorities agree with staff that additional short-term measures to contain costs in SOEs are critical for improving their operational efficiency, and ultimately address the complex web of domestic cross arrears.

The 2018 Debt Sustainability Analysis (DSA) shows that debt ratios have improved but staff highlights the importance of advancing negotiations with external creditors on resolving external arrears. In this connection, the authorities managed to reach an agreement with Brazil which awaiting legislative approval from Brazilian lawmakers, as noted in the staff report. The authorities reiterated their attachment to prudent debt management, as reflected in their intention to limit concessional borrowing. Steps were also taken by the authorities to implement recommendations of the Debt Management Performance Assessment (DeMPA). In this respect, a draft medium-term debt management strategy was prepared; a detailed debt database is being established with the support of the World Bank; and training activities for officials on debt management are being conducted. This work will also be complemented by the dissemination of an annual schedule of T-Bills issuance, aligned with cash flow forecasts and borrowing plans. Going forward, they will continue to make efforts to reach agreement with external creditors on arrears and strengthen their debt management capacity.

Boosting International Reserve Buffers

The authorities take note of staff's assessment that the country's external position is moderately weaker than indicated by fundamentals and desirable policies, and strong reserve buffers are necessary against shocks. To boost reserve buffers, the central bank has started taking steps to strengthen monetary policy tools by amending the regulatory framework to allow the issuance of Treasury Bills and support the development of the securities market. In the medium-term, continued efforts will be consented to advance structural measures aimed at reducing oil dependence by exploring sources of renewal energy, boosting exports, and improving the implementation of externally funded projects. The authorities will also stand ready to conduct joint efforts with the country's partners to improve the predictability of external assistance.

Safeguarding Financial Stability

The central bank continues to make progress in strengthening banking supervision. In line with staff's recommendation to address the high level of NPLs, a requirement to improve write-offs and recoveries for banks was introduced. Collateral guidelines were enforced while the oversight of the credit risk management framework was improved. In addition, financial sector infrastructure and regulation are being revamped with the support of development partners. This entails notably upgrading the credit registry, infrastructure and laws on payment system, and the microfinance legal framework. Looking ahead, the authorities will continue to implement their financial sector reform agenda while making efforts to accelerate the recommendations of the last safeguards assessment.

Staff's correctly report that preparations for the asset quality review (AQR) of the banking system is advancing—albeit at a slow pace. The authorities noted that factors behind the delays in the procurement process were beyond their control. Going forward, the central bank will continue to liaise with local banks in order to smoothen the process. The full AQR report is expected by mid-2019 and the findings will be used by the central bank to update its loan classification system and strengthen prudential regulations.

Accelerate Growth-Enhancing Projects and Structural Reforms

The authorities acknowledge that continued structural reform efforts are critical to promote sustainable long-term growth, improve competitiveness, strengthen resilience to shocks and address impediments to job creation and investments. They developed the National Development Plan (NDP) for 2017-2021 which highlights the country's development priorities, and focuses on inclusive growth, poverty alleviation and climate change resilience. Most recently, the tourism development strategy focused on export diversification was adopted. In line with staff's recommendation, efforts will be geared at working closely with development partners to accelerate key infrastructure projects, such as the airport expansion, energy grid rehabilitation, and coastal requalification. At the same time, the authorities also envisage some reform measures to address inefficiencies in the judicial system, which should help reduce legal process delays and costs.

Capacity development from partners has been instrumental in helping the country advance their reform agenda. We call on the Fund to take good note of the authorities' strong preference for the assignment of resident and Portuguese-speaking experts in the context of Fund's capacity building initiatives conducted by the Fund for the benefit of their country.

Conclusion

Against a challenging backdrop, the Sao Tomean authorities reiterate their strong commitment to the implementation of their ECF-supported program. Continued engagement and timely delivery of technical and financial assistance from development partners will be critical to safeguarding macroeconomic stability and making headways toward inclusive growth and poverty reduction. In particular, Fund's continued support and catalytic role will be key in achieving these objectives. We would therefore appreciate Directors' support for the completion of the fifth ECF Review as well as the authorities' requests for the approval of waivers for the nonobservance of program targets and the continuous PC related to exchange restrictions.