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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

December 30, 2013

2013 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—STAFF REPORT; INFORMATIONAL ANNEX; DEBT SUSTAINABILITY ANALYSIS; PRESS RELEASE ON THE EXECUTIVE BOARD DISCUSSION; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SÃO TOMÉ AND PRÍNCIPE

In the context of the 2013 Article IV Consultation and Second Review Under the Extended Credit Facility Arrangement, the following documents have been released and are included in this package:

- The **Staff Report** for the 2013 2013 Article IV Consultation and Second Review Under the Extended Credit Facility Arrangement prepared by a staff team of the IMF, following discussions that ended on September 26, 2013 with the officials of São Tomé and Príncipe on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 2, 2013.
- An **Informational Annex** prepared by the IMF in consultation with the World Bank.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- **Press Releases** including a statement by the Chair of the Executive Board, and summarizing the views of the Executive Board as expressed during its December 16, 2013 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- A **Statement by the Executive Director** for São Tomé and Príncipe.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of São Tomé and Príncipe *
Memorandum of Economic and Financial Policies by the authorities of São Tomé and Príncipe *
Technical Memorandum of Understanding*
Joint Staff Assessment Note
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

December 2, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT

EXECUTIVE SUMMARY

Context. The coalition government that came into office on December 12, 2012, remains fully committed to the pursuit of sound policies that are helping to consolidate macroeconomic stability, despite a challenging external environment and more uncertain oil prospects.

Program performance. Overall, program performance has been satisfactory. All continuous and end-June 2013 quantitative performance criteria were met, and one of two end-June 2013 structural benchmarks was met while the other one will be met with a delay. However, more time will be needed to devise a plan to clear cross-arrears (the end-September 2013 structural benchmark was missed). The quantitative indicative target on pro-poor spending was met, but the other two indicative targets were not.

Macroeconomic and key structural policies. The authorities' macroeconomic policy framework for 2014 and beyond reaffirms their commitment to fiscal prudence in support of the exchange rate peg to the euro and debt sustainability, and to the pursuit of sound financial policies. The authorities are committed to a 2014 domestic primary deficit target of 3.0 percent of GDP, in line with projected non-debt-creating financing, and to a further tightening of the fiscal stance by 2017, given more uncertain oil prospects. To meet the fiscal targets and create additional space for priority infrastructure and pro-poor spending, the authorities will strengthen revenue collections, including by modernizing the tax and customs administrations and broadening the tax base, and will contain non-priority spending. The central bank has increased its vigilance over the financial sector through off- and on-site inspections of commercial banks, and is reinforcing compliance with regulatory and prudential requirements. It will work with commercial banks to enhance the banking system's efficiency, profitability, and resilience. The authorities are striving to strengthen external competitiveness and reduce external vulnerabilities through improvements in the business climate and various productivity-enhancing measures.

Approved By
David Owen (AFR) and Dhaneshwar Ghura (SPR)

Discussions were held in São Tomé during September 13-26, 2013, and in Washington during October 10–12, 2013. The team comprised Messrs. Ricardo Velloso (head), Rodgers Chawani, and Justin Matz, and Mrs. Ruby Randall (all AFR). Mr. David Owen (AFR) participated in the first week of the mission, and Mr. Thierry Nguema Affane (OED) accompanied the mission and attended all policy discussions. The team met with Prime Minister Gabriel Costa, Central Bank Governor Maria do Carmo Silveira, Finance Minister Hélio Almeida, Public Works Minister Osvaldo Abreu, Health Minister Leonel Pontes, Agriculture Minister António Dias, and their respective senior staffs. The team also met with representatives of the National Assembly, labor unions, financial and nonfinancial private sector, and São Tomé and Príncipe's development partners.

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CONTEXT

The authorities remain fully committed to the pursuit of sound policies that are helping to consolidate macroeconomic stability despite a challenging external environment and more uncertain oil prospects.

1. **The new government that came into office in late 2012 remains committed to fiscal discipline**. The previous minority government was censured by the National Assembly on November 26, 2012, and formally dismissed by President Pinto da Costa on December 4, 2012. A coalition, majority government consisting of the other three parties with representation in the National Assembly was formed under the leadership of Prime Minister Gabriel Costa and sworn in by the President on December 12, 2012. Since taking office, the new government has demonstrated its commitment to resisting spending pressures that in past election cycles derailed fiscal rectitude (local and parliamentary elections are expected to be held by August 2014).

2. **The government is committed to implementing the National Poverty Reduction Strategy Paper II and to the consolidation of macroeconomic and financial stability** (Box 1). These policies aim to reduce poverty through wealth creation, and promote economic development through fiscal prudence, financial stability, and the creation of an enabling environment for private investment and inclusive growth. Fiscal policy continues to support macroeconomic stability and ongoing efforts to mitigate debt sustainability risks, by ensuring that the domestic primary deficit is in line with available non-debt-creating financing while mobilizing additional domestic revenue for priority infrastructure and pro-poor spending. Given the critical role of good liquidity management and effective banking supervision in maintaining financial stability, the central bank will continue to improve its liquidity forecasting capabilities, and it will continue to implement diligently its planned on-site inspections of commercial banks.

3. **The recent decision by the French oil company Total to withdraw from Block 1 of the Joint Development Zone (JDZ) with Nigeria is akin to a significant external shock, calling for a strengthening of macroeconomic and financial policies given more uncertain oil prospects** (Box 2). Oil production was projected to start in Block 1 of the JDZ in 2015. While the authorities remain optimistic about the country's longer-term prospects for oil production, citing the interest of several medium-size oil companies to take over from Total, they also recognize the need to strengthen macroeconomic and financial policies. In particular, increased uncertainty around the timing and volume of oil production suggests the need to gradually tighten fiscal policy and reduce the size the banking system—with a view to increasing the system's efficiency, profitability, and

resilience—and to promote even more forcefully the development of non-oil priority sectors, such as tourism, agriculture and fisheries.

4. **Implementation of the main recommendations of the last Article IV consultation discussions has been relatively good** (Box 3). Executive Directors emphasized the need to maintain fiscal prudence and stabilize the domestic primary deficit in line with available non-debt creating flows, while enhancing tax revenues through a reduction of tax exemptions. They also recommended the adoption of reforms designed to eliminate cross-arrears.[1] In addition, noting São Tomé and Príncipe's high risk of debt distress, Executive Directors advised the authorities to increase their reliance on grants and highly concessional finance. These recommendations have either been adopted or are being addressed within the context of the ECF supported arrangement, although tangible progress toward the elimination of cross-arrears remains elusive.

RECENT ECONOMIC DEVELOPMENTS AND PROSPECTS

Adherence to a prudent fiscal policy stance in the context of the fixed exchange rate regime has helped to foster macroeconomic stability despite the country's vulnerability to shocks.

5. **After experiencing significant real economic growth volatility and high inflation through 2009, growth has become more stable since and inflation reached single digits recently** (Table 1, and Figure 1). However, real economic growth slowed to 4 percent in 2012, reflecting a scaling back of project financing and foreign direct investment as many of São Tomé and Príncipe's key partners were hard hit by the global economic slowdown. Growth is projected to remain unchanged at 4 percent in 2013 in light of lingering uncertainties stemming from the challenging external environment and continued weak external financing prospects. Despite São Tomé and Príncipe's vulnerability to supply shocks, inflation has continued to recede following the adoption of the peg to the euro in January 2010 and maintenance of fiscal discipline since then (see below). Although annual inflation reached 10½ percent at end-2012, following unseasonably heavy rains, which disrupted the supply of perishables, inflationary pressures abated by early 2013 and annual inflation reached 6½ percent in August 2013 (its lowest level in two decades).

6. **The fiscal stance has been prudent in recent years** (Tables 2 and 3, and Figure 2). After an initial slippage in 2009, the domestic primary balance has improved steadily thereafter, reflecting efforts to increase tax revenues and contain domestically-financed capital expenditures and goods

[1] Domestic arrears between: the Treasury and EMAE, the state-owned water and electricity company; EMAE and ENCO, the fuel importer; and between ENCO and the Treasury (fuel tax arrears).

and services outlays. However, the authorities have had difficulty sustaining the tax effort, which dipped from 16½ percent of GDP in 2010–11 to just 14 percent of GDP in 2012. Although this pro-cyclical outcome reflected the influence of the weakening economy on customs duties and consumption and profit taxes, revenue mobilization was also adversely affected by a still narrow tax base and the persistence of cross-arrears, which include fuel tax arrears.

7. **Fiscal performance through end-June 2013 was satisfactory, but cross-arrears flared up again**. The authorities offset the underperformance of tax revenues (due to the weakening economy and accumulation of fuel tax arrears) and a higher wage bill—related to the adoption of a new career ladder in the national security sector and overtime payments for teachers that were not foreseen in the budget—with higher nontax revenues and lower discretionary spending. In particular, transfers from parastatal and fishing royalties were front-loaded, and license fees related to the sale of the government's stake in STP Cabo to an Angolan telecommunications company boosted nontax revenues, while there was under-execution of transfer payments and domestically-financed capital expenditure, as well as lower goods and services outlays.

8. **Following the adoption of the fixed exchange rate regime, monetary aggregate growth has been consistent with maintaining the credibility of the peg** (Tables 4 and 5, and Figure 3). Broad money growth accelerated in 2012, reflecting a larger than projected accumulation of foreign assets, but it has since abated. Year-on-year growth in broad money slowed from an average of 18¾ percent during the second half of 2012 to 16½ percent during the first half of 2013, and it is now broadly in line with nominal GDP growth. This also reflects the tailing off of private sector credit growth as household debt levels reached record highs, and the dearth of suitable bankable investment opportunities despite some banks' holdings of excess reserves with the central bank above the statutory requirement.

9. **The financial soundness of the banking system was adversely impacted by rapid credit expansion until 2011 in the context of poor risk management and lending practices** (Table 6, and Figure 3). The data reveal low overall profitability, a high and rising share of nonperforming loans, and a rapidly declining trend in banks' capital-to-risk-weighted-asset ratios. On the positive side, dollarization in the banking system continues to decline, reflecting measures to foster the use of the local currency, as well as the public's increased confidence in the peg as inflation converges to international levels. In April 2013, the central bank took over the operations of Island Bank, after this small commercial bank (with only 5 percent of the system's deposits) failed to comply with supervisory requirements and did not submit a remedial action plan.

10. **The external current account deficit continues to decline and central bank's international reserves to improve** (Tables 7, 8, and 9, and Figure 4). Weaker economic activity has led to reduced imports of goods and services and an improved external current account balance. After falling below three months of imports in mid-2012, the central bank has since accumulated international reserves considerably. International reserves, which have been boosted by privatization receipts from the sale of STP Cabo and grants from the World Bank and Timor-Leste, stood at around 5½ months of imports at end-September 2013.

11. **São Tomé and Príncipe's economic outlook will depend on strengthening the economy's resilience in the wake of diminished near-term oil prospects** (Box 4). Fiscal and external debt sustainability indicators are expected to improve more slowly following Total's unexpected announced withdrawal from Block 1 of the JDZ. The authorities will have to continue relying on grants and highly concessional financing for many years to come, and more difficult budget financing prospects will necessitate a tighter fiscal policy stance. Commercial banks will also have to adapt to the new reality, and the ones that have entered the market lured mainly by the prospects of oil will have to change their market strategy and strengthen their balance sheets, including by further recapitalization. There is also a need to restructure and strengthen the banking system through mergers and/or closure of distressed and weak banks. Finally, the authorities will have to promote even more forcefully the development of non-oil priority sectors, such as tourism, agriculture, and fisheries, including by further improving the business climate and upgrading the country's infrastructure with private sector support.

12. **The outlook for 2014 continues to be affected by difficult global conditions**. Real GDP growth has been revised downward, from 5½ to 5 percent, reflecting lingering uncertainties in the world economy, weak external financing prospects for investment projects, and the changed oil outlook.[2] Inflation is projected to reach 6 percent by end-2014, as inflation expectations continue to be anchored by a prudent fiscal policy stance and the peg of the dobra to the euro. The external current account deficit is expected to narrow further, with weaker than previously projected economic activity leading to lower import growth; and the central bank's international reserves are expected to remain comfortably above 3½ months of imports (the program's new floor).

13. **Nevertheless, risks to the outlook are manageable**. Downside risks include significant spending overruns in the run-up to next year's local and parliamentary elections, which in past election cycles derailed fiscal rectitude. The authorities, however, are fully committed to resisting

[2] The projected start of oil production under the alternative oil scenario described in the DSA has been pushed back to 2019.

spending pressures. The outlook could also be adversely affected by the materialization of supply shocks (leading to higher inflation and lower growth), spillovers from a further deterioration in financial conditions in Europe (resulting in delays in project execution due to financing shortfalls), and delays in restructuring São Tomé and Príncipe's banking sector (leading to continued low profitability in the sector and stagnant credit). Upside risks include the possibility of stronger growth in Europe, lower-than-projected inflation for 2013, and oil production.

PERFORMANCE UNDER THE ECF-SUPPORTED PROGRAM

Overall, program implementation through end-June 2013 was satisfactory, but implementation challenges delayed some structural reforms.

14. **Program performance through end-June 2013 was satisfactory** (MEFP, Table 1). All continuous and quantitative performance criteria (PCs) were met, but two out of three indicative targets (ITs) were missed. The authorities met, with wide margins, the PCs on domestic primary balance and central bank's net international reserves. However, the larger-than-programmed increase in net international reserves contributed to a narrow miss of the IT on base money.[3] The IT on central government domestic arrears was missed mainly due to the resurgence of the cross-arrears problem, but the IT on pro-poor spending was met despite difficult financing conditions.

15. **Structural reforms have progressed, albeit at an uneven pace** (MEFP, Table 2). One of two end-June 2013 structural benchmarks was met and progress has been steadfast toward implementation of three end-December 2013 structural benchmarks, pertaining to improvements in both tax and customs administration and enhancements to the consumer price index. Completion of the on-site inspection of the country's largest commercial bank was done before the end-June 2013 target date, despite staffing constraints due to the central bank's administrative takeover of Island Bank. The 2010 government accounts were finalized and presented to the Court of Audit in June 2013 (the first time in over two decades that government accounts have been prepared and submitted). The authorities are working on the 2011 and 2012 government accounts, but preparing the latter using the accounting feature of SAFE-e will take longer than expected given delays in the

[3] It has been very difficult to forecast base money in São Tomé and Príncipe due to the large size of foreign exchange flows relative to the economy and the limited sterilization options available to the central bank. However, the wild swings of base money growth (Figure 3, left-middle graph) seem to have had limited impact on inflation since the adoption of the peg to the euro in early 2010.

provision of technical assistance and training in this area. The formulation of a plan to clear cross-arrears between ENCO, EMAE, and the Treasury and to avoid their recurrence is still pending. A critical element of this strategy is to improve EMAE's cash flow. The authorities have recently asked the World Bank and the IFC to provide options to address this issue, which may include contracting out the management of EMAE to a reputable international operator.

POLICIES IN THE NEAR- AND MEDIUM-TERM

Discussions centered on the need to maintain fiscal prudence in the run-up to the 2014 local and parliamentary elections, and to formulate an appropriate policy response to more uncertain oil prospects. There was agreement that fiscal rectitude should be maintained and the fiscal policy stance tightened gradually over the medium term given the high risk of debt distress and more limited availability of non-debt-creating financing in the absence of oil. The authorities stressed that efforts to strengthen monetary liquidity management and supervisory and regulatory oversight over the financial sector would be stepped up, and that the central bank would work with commercial banks to increase the system's efficiency, profitability, and resilience.

A. Strengthening Public Finances

16. **The authorities are on track to achieving the 2013 domestic primary deficit target of 3.1 percent of GDP**. The domestic primary deficit target remains unchanged despite higher projected personnel costs (an increase of about Db37 billion, or ⅔ percent of GDP, over the budgeted amount), due to the cost of the introduction of new job ladders in the health, education, and security sectors and a 10 percent increase in teachers' wages (effective August 2013). Revenue collections will be higher-than-programmed because of higher nontax revenue stemming from license fees associated with the sale of the government's stake in STP Cabo, while the tax-to-GDP ratio will be unchanged (from 2012 levels) as ongoing efforts to strengthen the tax and customs administrations and broaden the tax base are expected to offset the adverse effects on tax collections of weaker economic growth. Finally, non-interest recurrent spending is projected to remain in line with earlier projections, despite higher personnel costs as mentioned above, due to non-wage recurrent and domestically-financed capital expenditure reprioritization and restraint.

17. **The fiscal program for 2013 remains fully funded.** Additional external inflows more than offset a delay in scholarship grants from Nigeria, which are now expected in 2014. Unanticipated inflows in 2013 included: increased budget support from the World Bank (an additional US$1.3 million); budget support from Timor-Leste (US$7 million); and proceeds from the sale of the government's stake in STP Cabo (US$6.4 million). These additional inflows have funded a pickup in

project execution relative to the first half of year, and will be used to clear Treasury's arrears to EMAE by end-2013 (structural benchmark).

18. **The 2014 budget will maintain fiscal rectitude during an election year**. The budget will target a domestic primary deficit of 3.0 percent of GDP, which is fully consistent with available non-debt creating financing from the World Bank, Nigeria, and transfers from the National Oil Account (NOA). Gains from the widening of the tax base and improved taxpayer segmentation (designed to enhance compliance among large taxpayers) are projected to result in a modest increase in the tax effort. On the spending side, the authorities are fully committed to containing the growth of the public sector wage bill in line with projected average inflation. The elimination (in 2013) and non-accumulation (in 2014 and beyond) of Treasury's arrears to EMAE is expected to serve as a catalyst for the reduction of EMAE's arrears to ENCO and facilitate the elimination of ENCO's fuel tax arrears.

19. **Looking ahead, fiscal consolidation will be implemented gradually to limit its contractionary impact**. A cumulative adjustment of the domestic primary deficit of 1.0 percent of GDP will be phased in over three years, starting in the year after local and parliamentary elections. This will enable the authorities to weather the initial negative impact of Total's decision and undertake the fiscal adjustment once the recovery is firmly underway. Given the relatively low level of recurrent and domestically-financed capital expenditure, there is limited scope for further expenditure containment. Thus, notwithstanding ongoing efforts at strengthening expenditure prioritization and public financial management, the needed fiscal adjustment will be more heavily weighted toward revenue enhancement, comprising a mix of customs and tax administrative reforms and, as needed, tax policy measures.

20. **While the authorities reiterated their commitment to fiscal prudence, they had some reservations about the medium-term revenue projections**. The authorities expressed concern about the revenue projections which, they noted, depended to some extent on the resolution of the arrears issue between EMAE and ENCO. Staff stressed that the revenue projections were indeed consistent with a regularization of fuel tax payments by ENCO. In addition, staff noted that revenue projections were in line with São Tomé and Príncipe's past revenue performance and expected improvements in the tax and customs administrations due to extensive technical assistance provided by the Fund and others.

Structural reforms to strengthen public finances

21. **Specific achievements in 2013 in the fiscal reform area included the following**:

- Creation of a macro-fiscal unit, with representatives from the Ministry of Planning and Finance, Central Bank, and National Institute of Statistics (INE), which has begun the preliminary work toward implementing a medium-term fiscal framework (MTFF).

- Steps to make the government's financial administration system (SAFE-e) fully operational, including the activation of the system's accounting module.

22. **Reforms that are ongoing or currently slated for 2014 include**:

- Adopting a comprehensive solution to the problem of cross-arrears. The plan to eliminate cross-arrears between the Treasury, EMAE and ENCO and to avoid their recurrence is now expected to be finalized by end-March 2014 (structural benchmark) and the elimination of Treasury's arrears to EMAE by end-December 2013 (structural benchmark). In addition, quarterly ITs have been introduced to monitor during 2014 the non-accumulation of Treasury's arrears to EMAE.

- Expanding the tax base by launching the "Operation Taxpayer Inclusion" project and adopting and executing quarterly metrics for the number of newly registered taxpayers. The project is designed to register on a cumulative basis 500 and 800 new taxpayers, respectively, by end-June 2014 and end-December 2014 (structural benchmarks), and ultimately targets registration of an additional 3,000 taxpayers by the project's end.

- Enhancing taxpayer management within the Tax Directorate by increasing security of the Taxpayer Registry, and by creating a dedicated large taxpayer unit and of a single taxpayer computerized file system (structural benchmark, December 2013).

- Progressing toward completion of the second phase of ASYCUDA World through activation of all the functionalities and the establishment of a fully computerized procedure (structural benchmark, December 2013).

- Preparing the general government accounts for 2012 and presenting them to the National Assembly and Court of Audit by end-December 2013 (structural benchmark).

- Combating tax fraud and evasion by improving the selection of taxpayers for audit through risk analysis, expanding tax coverage throughout the country, and strengthening the National Tax Court, by allowing it to perform its duties with own resources.

- Increasing taxpayer voluntary compliance by improving the quality of services provided to taxpayers, simplifying and harmonizing tax procedures, extending tax services to the more remote areas of the country, and conducting visits to newly created firms.
- Providing the tax and customs administrations with the necessary resources, including additional staff and equipment, to implement the reforms mentioned above.

B. Financial Sector Diagnostic

While the banking system is generally seen as stable and dollarization is on the decline, discussions centered on possible ways to improve its performance and resilience.

23. **There is room to improve the banking system's performance and resilience**. The staff analysis presented in Appendix 2 reveals a higher prevalence of banks in São Tomé and Príncipe relative to peer small island states, suggesting that the country is relatively over-banked. Moreover, although the banking system's average capital adequacy ratio appears adequate, this indicator has been trending downward and it masks underlying weaknesses in some cases. Asset quality has also deteriorated, reflecting unsound lending practices and poor risk management during the credit boom that ended in 2011. In addition, with subdued economic activity and rising nonperforming loans, profitability indicators have declined and are likely to remain under pressure for the foreseeable future, in the absence of corrective action. The slowing in private sector credit growth together with largely inoperative money and interbank markets has contributed to a buildup of excess liquidity, which may undermine the central bank's efforts to properly manage liquidity. On the positive side, staff recognized the success in reducing dollarization in the banking system, including through a combination of market and prudential forces, and commended the authorities' efforts in this regard.

24. **In view of the above findings, staff made the following recommendations to the authorities**:

- Stepping up efforts to strengthen supervision and enforce prudential requirements throughout the banking system, including the strict enforcement of the minimum capital-to-risk-weighted asset ratio of 12 percent.
- Considering ways to foster the merger of some small banks to increase the banking system's efficiency and profitability, and promote financial stability further.

- Enforcing the legal requirement that all commercial banks publish their financial accounts to enhance transparency and facilitate assessments of counterparty risks.

- Encouraging banks to revisit their business plans and investment strategies in light of more uncertain oil prospects, and to adjust their balance sheets accordingly.

25. **The authorities were appreciative of the staff analysis and agreed that there was a need to improve the overall health of the banking sector**. However, they attributed greater weight to the need to address the underlying causes of the high fixed costs of the banking system, including costly electricity and telecommunications. They also noted that the cumbersome and costly judicial process was affecting bank profitability, and that delays in court adjudication affected the enforcement of creditor claims. The authorities, therefore, stressed the need to improve São Tomé and Príncipe's infrastructure and strengthen its legislative and judicial frameworks. While a solution to these long-standing challenges is clearly needed, staff noted that this could take time and was not under the direct control of the central bank, and stressed that restructuring the banking system was a more immediate solution to improve financial stability.

26. **The authorities reiterated their commitment to taking prompt corrective action to resolve outstanding issues pertaining to distressed banks**. They indicated their intention to appoint a provisional administrator for Island Bank, and informed staff that they were vetting offers from potential investors interested in Island Bank. The authorities added that addressing the needs of distressed banks would not have any fiscal implications, and indicated that the central bank is prepared to liquidate Island Bank if no firm investor commitments are received in due course.

27. **The authorities stated a clear preference for allowing more time for banks to adjust to diminished oil prospects**. While agreeing that the high share of nonperforming loans is a drag on banks' balance sheets, the authorities expressed concern that forcing banks to move too fast with portfolio cleaning would only amplify their losses given the weak economy and dearth of investment alternatives. In this context, they noted that the newly-created Bankers' Association would facilitate discussions on the way forward amongst industry participants and policy makers. This forum has now tabled for discussion the deteriorating bank asset quality and other related issues, and it could also serve as a useful forum for discussing needed legislative and judicial reforms that are needed to reduce costs in the banking sector.

C. Enhancing Liquidity Management, Financial Stability and Safeguards

28. **The central bank continues to develop its monetary liquidity management framework and supervisory capabilities**. It has now successfully extended the liquidity forecasting horizon to one month and is adopting a systematic approach to analyze forecasting errors as a precursor to the introduction in due course of money market instruments. In a bid to address capacity constraints, the central bank has recently recruited three additional staff to the Banking Supervision Department, but staffing levels remain below optimum. A program of on-site inspections is currently in progress, and all commercial banks are now expected to be inspected by end-June 2014, after the inspection of the two remaining banks that have not yet been subject to inspection (structural benchmark). In addition, the central bank will conduct by end-2013 a second on-site inspection of one bank that was previously inspected.

29. **Other specific achievements in 2013 included**:

- Completing the on-site inspection of the largest commercial bank in the first half of the year.
- Supporting the exchange rate peg by maintaining net international reserves at the central bank above the equivalent of three months of imports, and investing additional international reserves in high quality and liquid financial assets.
- Expanding the role of the Internal Audit Department to track more systematically the implementation of external auditors' recommendations and monitor the main risks to the central bank's balance sheet.
- Taking over the operations of Island Bank, following the bank's failure to comply with supervisory requirements and to submit a remedial action plan.

30. **Reforms planned for the next year strengthen the economy's resilience to shocks, bolster the central bank's independence and supervisory practices, and promote financial literacy and transparency include**:

- Increasing the program's floor on net international reserves from 3 to 3½ months of imports to boost confidence in the wake of reduced oil prospects in the near term.
- Reinforcing compliance with solvency and other regulatory standards by requiring that all commercial banks that operate in São Tomé and Príncipe have a capital-to-risk-weighted-

asset ratio of at least 12 percent by end-March 2014 (structural benchmark), and strictly enforcing other banking regulations, such as reserve requirements and dissemination of data to the credit registry, with application of penalties to non-compliant institutions.

- Conducting on-site inspections of the two remaining commercial banks that have not yet been subject to inspection by end-June 2014 (structural benchmark), and increasing the frequency of on-site inspections thereafter, as well as improved analysis of the commercial banks' quarterly reports, made possible in part through the hiring of additional bank supervisors.

- Enhancing commercial bank transparency by ensuring that all commercial banks publish their financial results for 2012 by end-March 2014. Commercial banks should aim to publish their 2013 accounts by end-September 2014, or face penalties for non-compliance (structural benchmark).

- Developing and beginning to implement a work program to introduce a new chart-of-accounts and reporting at the central bank in line with International Financial Reporting Standards (IFRS), with technical assistance from the Central Bank of Brazil.

- Preparing by end-September 2014 a revised draft of the Central Bank Law that strengthens the autonomy of the central bank in line with international standards, including in the resolution of problem banks (structural benchmark).[4]

- Improving external communications policies to enhance financial literacy and boost confidence in the financial system, including regular publication of reports and economic bulletins, strengthening the capacity of the Office of Consumer Affairs, and promoting financial literacy.

- Encouraging the use of modern technology, including credit and debit cards, point-of-sale terminals, ATMs, and secure mobile-banking, with the objective of expanding the operations of the electronic payments system to the whole country.

[4] Further changes to the legal framework, including to the Financial Institutions Law, may also be required.

D. External Balance Assessment

Staff analysis found no conclusive evidence of a real exchange rate misalignment, but pointed to the need to continue reducing external vulnerabilities given the country's narrow export base and more uncertain oil prospects.

31. **São Tomé and Príncipe's external position is vulnerable owing to a number of factors, including the country's narrow export base** (Appendix II). The external current account is projected to remain in deficit over the long term, reflecting both the narrow export base and a heavy import dependency on food, fuel, and project-related investment goods. Given São Tomé and Príncipe's high risk of debt distress and structural international trade deficit, achieving external sustainability will require continued reliance on FDI, grants, and highly concessional loans.

32. **Staff analysis showed no conclusive evidence of a real exchange rate misalignment over the medium term**. In particular, the exchange rate assessment exercise, based on the IMF's Consultative Group on Exchange Rate (CGER) methodologies, showed that the exchange rate is overvalued in the short-run but broadly in line with medium-term fundamentals. In the short run, both the macroeconomic balance (MB) and external sustainability (ES) approaches suggested overvaluation (6 and 10 percent, respectively). The models demonstrated that the real exchange rate is generally in line with fundamentals over the medium term (undervaluation of 2½ percent (MB) and overvaluation of 1 percent (ES)). The equilibrium real exchange rate approach, which is subject to large uncertainties surrounding the estimates due to data limitations, showed that the dobra is significantly overvalued in the short run (about 34 percent) and medium-term (about 37 percent).[5] The potential adverse impact of the real appreciation of the currency since the adoption of the fixed exchange rate regime, due the inflation differential between São Tomé and Príncipe and its trading partners, is mitigated in part by other extenuating factors. On the one hand, the gradual disinflation process currently underway can be expected to continue if fiscal prudence is sustained—thereby significantly reducing the scope of the problem.[6] In addition, the authorities' commitment to social investment spending and utilization of aid inflows for productivity-enhancing capital investment

[5] The equilibrium real exchange rate (ERER) approach is a reduced form regression model, unlike the two other approaches which use behavioral based regression models. It does not perform well when there are data limitations and short historical time series, as in the case of São Tomé and Príncipe.

[6] Hamann and Prati (IMF, WP/02/228) examine the disinflation experience of a panel of countries and concluded that exchange rate stabilizations were more likely to be successful than money-based stabilizations in the context of durable and sufficient policy adjustment.

should help to boost São Tomé and Príncipe's underlying growth potential and strengthen its fundamentals.

33. **Staff assess that the risk of capital reversals is low since the bulk of capital flows are in the form of equity and public sector borrowing**. The authorities have also been taking steps to reduce their external vulnerabilities, including by building up international reserves, but will need to accelerate structural reforms given the increased uncertainties surrounding oil production. In this regard, staff advised the central bank to maintain a comfortable international reserves position, and recommended a continuation of ongoing efforts to further diversify and expand the export base by targeting reforms that improve the country's competitiveness and business climate.

34. **Staff assessed that the central bank's international reserves have reached levels that are broadly in line with peer countries and considered adequate to withstand external shocks**. At about 5½ months of imports, international reserves at the central bank are in line with the recommended five to six months of imports for low-income commodity exporters with a fixed exchange rate.[7] They are also significantly higher than traditional measures of adequacy, such as three months of imports, 20 percent of M2, and the so-called IMF metric (30 percent of short-term external debt, 15 percent of official foreign liabilities, 10 percent of M2, and 10 percent of exports). In addition, the authorities have access to US$ 7.2 million in NOA deposits and €25 million from a contingent credit line with Portugal.[8]

35. **The authorities underscored their commitment to external sustainability, but cautioned that unlocking the country's growth potential would necessitate additional capital investment**. They added that it would take time to reduce the current account deficit given the country's infrastructure needs and structural trade deficit. While recognizing the vulnerabilities caused by high debt levels, the authorities noted that a low risk of capital reversals was a mitigating factor, lowering the risks of external borrowing for infrastructure development. At the same time, they stressed that identifying additional sources of capital was critical to enable the country to reach its full growth potential. They added that both the disinflation process and international reserve

[7] Dabla-Norris, Era, and others, "Optimal Precautionary Reserves for Low-Income Countries: A Cost-Benefit Analysis," IMF Working Paper 11/249, Figure 7.

[8] In support of the exchange rate peg to the Euro, the authorities have an agreement with Portugal according to which Portugal stands ready to provide support in the form of a credit line of up to €25 million, adding another 3½ months of imports cushion to international reserves.

accumulation were encouraging signs and that the economic recovery was well underway, which would enhance São Tomé and Príncipe's external position. While they valued the staff analysis, the authorities argued that the analysis could be further strengthened with better data and identified the development of an international investment position (IIP) dataset as a top priority.

36. **The authorities remain fully committed to the fixed exchange rate regime and the current level of the peg, which is seen as an effective nominal anchor for inflation**. Thus, in view of the pressing need to diversify and grow the economy's productive and export base, staff stressed that an added premium was placed on achieving external competitiveness through continued tight demand management and structural reforms designed to raise productivity and boost private investment. In addition staff identified factor price flexibility and improvements in the business climate as critical elements of this strategy (see below).

37. **São Tomé and Príncipe continues to maintain one foreign exchange restriction**. It avails itself of the transitional arrangements under Article XIV, but does not maintain restrictions under Article XIV. However, it maintains one measure subject to Fund approval under Article VIII—namely, an exchange restriction arising from Article 3(i) and Article 10.1(b) of the Investment Code (Law No. 7/2008) regarding limitations on the transferability of net income. As the authorities have not provided a specific timetable for the removal of the existing restriction, staff do not recommend its approval by the Executive Board.

E. Improving the Business Climate and International Competitiveness

38. **Fostering private sector led economic growth and diversification will require an improved business climate**. São Tomé and Príncipe has recently made progress in improving its business environment, but more needs to be done to diversify production and put the economy on a sustainable growth path. Although São Tomé and Príncipe was ranked as one of the top reformers in 2011 in the World Bank's 2012 *Doing Business Survey*,[9] this effort was not sustained. In the recently released 2014 Survey, São Tomé and Príncipe's ranking slipped a few positions. Its ranking is also lower than comparator small states and well below the average for sub-Saharan Africa. Moreover, the 2014 survey shows a decline in eight out of 10 indicators, with only modest improvements pertaining to the ease of getting electricity and enforcing contracts.

[9] While the *Doing Business Survey* generally provides an indication of progress and areas in need of improvement its results, including for São Tomé and Príncipe, should be interpreted with caution given, inter alia, limited coverage of businesses constraints and small number of informants.

39. **The authorities agreed that there was a pressing need for additional structural reforms to boost private investment and raise productivity through an improved business climate**. Improvements to physical infrastructure and key legislative and administrative reforms are needed with respect to: enhanced trade facilitation; strengthening property and investor rights, access to credit, simplification of the payment of taxes, and improved access to construction licenses; as well as improved transportation networks and utility services.

40. **Some of the concerns raised in the *Doing Business Survey* will be addressed by the planned one-stop shop within the customs administration**. Preparatory arrangements are now underway for the launching the new trade-related one-stop-shop by early-2015. Once in place, the new facility will reduce trade-related transaction costs and enhance São Tomé and Príncipe's external competitiveness. It will also have a positive effect on revenue collection, by permitting the single and simultaneous payment of customs duties and other fees and taxes due to all institutions involved in the clearance of goods. According to the authorities, key milestones include: establishing by end-June 2014 the connectivity of the Customs and Tax Directorate (structural benchmark); and the elimination by end-December 2014 of hard-copy documents and introduction of electronic signing and approval of documents (structural benchmark). This facility will also compliment the one-stop shop for investors established in 2011, which was designed to centralize the administrative requirements for establishing a business in São Tomé and Príncipe and reduce investor costs.

F. Strengthening the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Framework

41. **The authorities have taken steps to address the deficiencies of São Tomé and Príncipe's AML/CFT framework**. With technical assistance from the IMF's Legal Department, they drafted amendments to the AML/CFT Law and submitted the draft law to the National Assembly in May 2013. The law was approved unanimously by the National Assembly, and President Pinto da Costa has signed it. Passage of this law has facilitated the recent removal of São Tomé and Príncipe from the Financial Action Task Force (FATF)'s list of high risk and non-cooperative jurisdictions. The FATF noted, however, that Sao Tomé and Principe's AML/CFT regime still exhibited a number of strategic deficiencies and has encouraged the authorities to work with the Inter-Governmental Group Against Money Laundering in West Africa (GIABA) to address these issues, including by strengthening the operations and core functions of the financial intelligence unit (FIU) through improved resources, including staffing, equipment and training.

STRENGTHENING THE STATISTICAL SYSTEM

42. **The authorities continue to strengthen the statistical system**. In addition to the several improvements listed above, INE is taking steps to improve the outdated consumer price index (CPI). The household survey completed in 2011 is providing the basis for reweighting the CPI components and introducing new goods and services to its basket (both were updated last about twenty years ago). The introduction of the new CPI by end-December 2013 (structural benchmark) is expected to greatly improve the measurement of inflation (Informational Annex).

PROGRAM MONITORING AND SAFEGUARDS

43. **Program monitoring**. Staff and the authorities have reached agreement regarding PCs for 2014, and the PCs, ITs, and structural benchmarks for the second half of 2013 and for 2014 are presented in Tables 1–4 of Memorandum of Economic and Financial Policies (MEFP, Attachment I). The definitions of quantitative PCs and ITs are provided in the Technical Memorandum of Understanding (TMU, Attachment II). The third review is expected to be completed by April 2014, the fourth review by October 2014, and the fifth review by April 2015.

44. **Safeguards**. The commitment of the authorities to strengthen the central bank's governance structure and to mitigate the risks identified by the recent IMF safeguards assessment is welcome.[10] Important milestones in this direction will include: (i) establishing independent oversight on audit and control functions; (ii) transitioning to International Financial Reporting Standards; (iii) implementing external auditors' recommendations; and (iv) monitoring the main risks to the central bank's balance sheet.

STAFF APPRAISAL

The authorities are encouraged to continue pursuing sound policies and consolidating recent macroeconomic gains despite a challenging external environment. This is particularly important given a more uncertain outlook for oil production, which will also necessitate a gradual fiscal adjustment over the medium term and continued heavy reliance on grant and highly concessional financing to mitigate São Tomé and Príncipe's high risk of debt distress. In addition, the authorities should work with commercial banks to reduce the size of the banking system and increase the system's efficiency,

[10] For more details on the safeguards assessment mission's main findings and recommendations, see Informational Annex.

profitability, and resilience. Fostering private sector led economic growth and diversification will require further improvements to the business climate.

45. **Fiscal discipline needs to be maintained in the run-up to the 2014 local and parliamentary elections, and gradual fiscal consolidation undertaken to help mitigate São Tomé and Príncipe's high risk of debt distress**. Given the poor track record during electoral cycles, the authorities should ensure that spending pressures are resisted, the 2013 budget is executed as planned, and the forthcoming 2014 budget is realistic and in line with the ECF supported program objectives. A gradual fiscal adjustment of 1.0 percent of GDP will be needed over the medium term. Staff are of the view that this adjustment should be more heavily weighted toward revenue enhancement and comprised of a mix of customs and tax administrative reforms and, if needed, tax policy measures, to safeguard priority infrastructure and pro-poor spending.

46. **A comprehensive and credible solution to the long-standing cross-arrears problem is needed to improve fiscal transparency and achieve lasting fiscal sustainability**. This problem has proven persistent and intractable, but needs to be addressed. With assistance from the IFC and the World Bank, the authorities should be encouraged to draw up an actionable and viable plan for improving EMAE's cash flow, which would then form the basis for devising a strategy to pay down over time their arrears to ENCO and prevent a recurrence of this problem in the future.

47. **Revenue mobilization efforts designed to increase tax compliance and broaden the tax base should be diligently executed**. In this regard, staff strongly support the decision to launch the Taxpayer Inclusion Project, designed to register an additional 3,000 tax payers, as well as the effective implementation of dedicated Large and Medium Taxpayers' Units. Staff also support ongoing reforms to establish the one-stop shop within the customs administration that will help to enhance revenue collections by permitting the single and simultaneous payment of customs duties and other fees and taxes due to all institutions involved in the clearance of goods. In addition, completion of the second phase of ASYCUDA WORLD will enable the computerization of customs clearance and greatly reduce the risks of under-invoicing.

48. **Staff support the authorities' view that the fixed exchange rate regime has served São Tomé and Príncipe well in the context of fiscal rectitude and an adequate level of international reserves**. However, further efforts are needed to make the economy more efficient and boost competitiveness and exports, including through improvements to the country's physical infrastructure and the implementation of regulatory and legislative reforms. In this regard, staff agree that the completion of the one-stop-shop within the in customs administration will further enhance external competitiveness by reducing business costs. However, other complementary

reforms are needed, including: the elimination of regulatory and other price distortions, including by moving toward cost recovery electricity tariffs within the context of structural reforms to EMAE to strengthen its operational capacity; factor price flexibility; trade facilitation; strengthening property and investor rights; improving access to credit; simplification of tax payments; and improved access to construction licenses.

49. **The recent improvements in the central bank's supervisory capabilities are welcome, but further work is needed to strengthen financial stability**. The central bank has increased its vigilance over the financial sector through off- and on-site inspections of commercial banks. It should also reinforce compliance with regulatory and prudential requirements, including by ensuring that all commercial banks in operation in São Tomé and Príncipe maintain a minimum capital-to-risk-weighted-asset ratio of 12 percent. The central bank should work with commercial banks to reduce the size of the banking system and increase the system's efficiency, profitability, and resilience. In this regard, staff underscore the importance of adopting a crisis management and bank resolution framework and developing restructuring solutions for banks that are unlikely to restore profitability over the medium term. In addition, the central bank should continue to promote financial literacy and transparency, which will enhance financial inclusion and boost confidence in the financial system.

50. **Staff commend the authorities for the expeditious and unanimous approval of a modern AML/CFT Law.** The approval of this law has facilitated the removal of São Tomé and Príncipe from the Financial Action Task Force's list of high risk and non-cooperative jurisdictions, and it sends an important positive signal to the investment and donor communities. Apart from the passage of the legislation, the authorities are encouraged to take concrete steps to improve the general effectiveness of the AML/CFT framework, including measures to strengthen the operations of the Financial Intelligence Unit (FIU), with emphasis on additional staffing and equipment and better training.

51. **In light of the good performance so far and the authorities' commitment to strong policies, staff support the authorities' request for the completion of the second review under the ECF arrangement and the third disbursement in the amount of SDR 370,000**.

52. **It is proposed that the next Article IV Consultation with Sao Tome and Principe takes place within 24 months, in accordance with the *Decision on Article IV Consultation Cycles* (Decision No. 14747-(10/96), as amended).**

Box 1. PRSP-II

As conveyed to their respective Executive Boards in the Joint Staff Advisory note (EBD/13/16 of March 26, 2013), the staffs of the IMF and the World Bank "overall regard the PRSP-II as an adequate foundation for achieving the government's medium-term growth and poverty-reduction objectives." Nine months since this assessment was made, staff would reiterate this while calling attention to the following developments:

- **The enhanced focus under PRSP-II has allowed the authorities to concentrate on fewer objectives and use better poverty indicators**. The authorities have sought to build on the accomplishments under PRSP-I, by making the participatory process more inclusive, using a more precise measure of poverty (daily caloric intake), and reducing the strategic poverty-reduction axes to four. As confirmed by the authorities, this has allowed them better monitoring and response capacity, which were areas for action flagged by staffs in the JSAN.

- **The use in the PRSP-II's macroeconomic framework of two scenarios (oil and non-oil) has proven to be farsighted** given recent developments implying that oil production will not start in 2015 as hoped for under the baseline oil scenario. Although the more ambitious medium-term poverty reduction objectives under the PRSP-II will be adversely affected, the PRSP-II strategy will remain valid under the alternative (non-oil) scenario that assumes no such revenues during the PRSP-II implementation period.

- **Costing of poverty reduction programs remains an issue, and it has been aggravated by increasing unpredictability of external support and export revenues**. Staffs flagged in the JSAN that while PRSP priorities were appropriately identified, their costing and funding were not. This remains a concern in view of the delays in disbursement in donor assistance during 2013 and the more uncertain outlook for oil.

Box 2. Oil Production Prospects

The French oil company Total's announcement that it would no longer seek to explore for oil in Block 1 of the Joint Development Zone (JDZ) with Nigeria was a startling development. TOTAL had been the last major oil company prospecting in the JDZ following the departure of other major players (Exxon, Chevron and Sinopec) in 2007-12, who, like TOTAL, had been disappointed with the results of their exploration drillings that indicated hydrocarbon reserves were too small and costly to extract to warrant further investment.

São Tomé and Príncipe once again has its prospects for oil wealth delayed into the future. Oil exploration in São Tomé and Príncipe started in 1997 and optimistic assessments at the time indicated production could start as early as 2002. Oil companies paid sizable "signing bonuses" to start exploration. Agreement with Nigeria on the creation of the JDZ was reached in 2001, and a modern oil revenue management law was enacted in 2004. However, since then, the exploratory oil drillings yielded unsatisfactory results. TOTAL's withdrawal has diminished oil prospects for the foreseeable future.

Prospects for oil exploration in São Tomé and Príncipe are now likely left to medium-size companies with reduced deep-sea offshore drilling capabilities. However, the Joint Development Authority (JDA), which was created to manage oil exploration in the JDZ, has expressed confidence that the exploration block abandoned by TOTAL and other major oil companies will be picked up by medium-size companies which, according to the JDA, could be profitable at smaller extraction volumes.

Box 3. Main Recommendations of the 2011 Article IV Consultation and their Current Status

Advice	**Status**
Finance the domestic primary deficit with available non-debt-creating resources	Largely achieved. The domestic primary deficit averaged 3.4 percent over 2010-12 consistent with non-debt creating flows, and is projected to remain on a downward trajectory over the medium term.
Raise domestic revenues by reducing customs duty exemptions and adopting an automatic price adjustment mechanism for fuels.	Partially achieved. The tax-to-GDP ratio increased from 14.5 percent in 2009 to 16.6 percent and stabilized during 2010-11 before declining again to 14.0 percent in 2012. This decline was due both to the weakening economy and accumulation of fuel tax arrears by ENCO. Efforts to further enhance tax and customs administration are ongoing. However, there has been no progress on the automatic price adjustment for fuels.
Eliminate cross-arrears by realistic budgeting for government's utility bills, constraining regional and local government expenditures, achieving commercial viability of EMAE.	Largely unachieved. Cross-arrears were significant reduced in early 2013, but flared up again in subsequent months. The formulation of a plan to clear cross-arrears between ENCO, EMAE, and the Treasury and to avoid their reoccurrence is still pending. A critical element of this strategy is to improve EMAE's cash flow, and the authorities have recently asked the World Bank and the IFC to provide options to address this particular issue, which may include contracting out the management of EMAE to a reputable international operator.
Ensure sound management of future oil revenues	Largely achieved. The authorities have established an effective Oil Resource Management Law. Annual transfers from the National Oil Account (NOA) to the budget have been in accordance with the law.
Adopt a prudent external borrowing policy reliant on grants and highly concessional borrowing.	Ongoing. While the ECF supported program adopts this prudent external borrowing strategy as the country's de facto policy, the design, approval, and implementation of a formal medium-term debt strategy is ongoing with TA from the World Bank.
Manage financial risks through enhanced regulatory oversight and intervention	Ongoing. The banking system is still characterized by low overall profitability, a high and rising share of nonperforming loans, and a rapidly declining trend in banks' capital-to-risk-weighted-asset ratios. However, the Central Bank is now more vigilant, with an active program of on- and off-site inspections, higher capital requirements, and resolution of distressed banks. Dollarization in the banking system continues to decline, reflecting Central Bank policies that foster the use of the Dobra, and increased confidence in the Dobra as inflation converges to international levels.
Strengthen the AML/CFT framework	Achieved. With LEG TA, the authorities drafted amendments to the AML/CFT law which have now been submitted and approved. Passage of this law has facilitated the recent removal of São Tomé and Príncipe from the Financial Action Task Force's list of high risk and non-cooperative jurisdictions.

Box 4. Risk Assessment Matrix for São Tomé and Príncipe

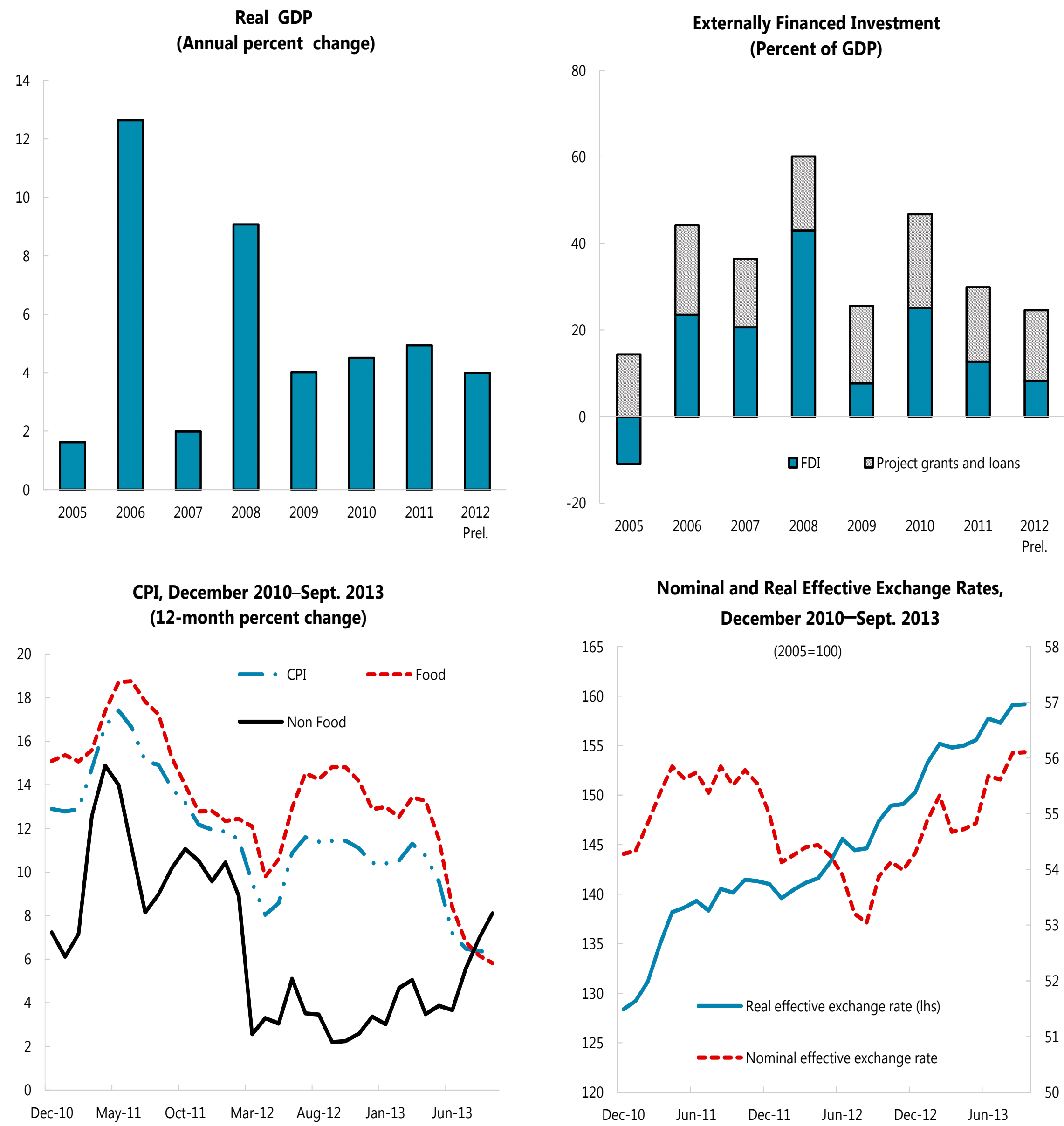
Source of threat	**Likelihood**	**Severity**	**Impact**	**Policy response**
		Short-term risks		
Early start to the political cycle and related additional spending	Medium	High	Significant election related spending would derail hard-won fiscal rectitude and lead to additional borrowing needs, which may be difficult to identify and lead to international reserve losses. There could be a loss of fiscal space for priority infrastructure and pro-poor spending.	Maintain fiscal prudence by ensuring that spending plans for 2013 proceed as budgeted, and by approving a 2014 budget that is in line with the ECF supported program.
Financial stress in the Euro area re-emerges	Medium	Medium	Given that much of the country's project financing (official grants and FDI) are sourced from Europe, this could lead to a further deceleration of public and private investments and depress economic growth.	Further accelerate reforms to the business environment to boost growth, create jobs, and expand nontraditional exports. There is no room for fiscal stimulus (tight financing constraints) nor monetary stimulus (fixed exchange rate regime).
Global oil shock triggered by geopolitical events	Low	Medium	Higher oil prices would worsen the (already large) external current account deficit. If full pass through was allowed, the impact on inflation would be important. If not, direct and contingent government liabilities would increase.	Allow full pass-through of higher international fuel prices, while seeking to minimize the impact on the poor and trying to contain second round effects on inflation by tightening monetary conditions.

Box 4. Risk Assessment Matrix for São Tomé and Príncipe (concluded)

		Medium-term risks		
Continued weakness in banking intermediation	Medium	Medium	Continued high levels of nonperforming loans and low profitability of banks would prevent a bottoming out of the credit cycle and adversely affect economic growth.	Require all banks to have a capital-to-risk-weighted-asset ratio of 12 percent to absorb credit losses and strictly enforce other banking regulations. Prepare restructuring solutions for banks that are unlikely to restore profitability.
Protracted period of slower European Growth	High	Medium	Given that much of the country's project financing (official grants and FDI) are sourced from Europe, this could lead to a further deceleration of public and private investments and depress economic growth.	Further accelerate reforms to the business environment to boost growth, create jobs, and expand nontraditional exports. There is no room for fiscal stimulus (tight financing constraints) nor monetary stimulus (fixed exchange rate regime).

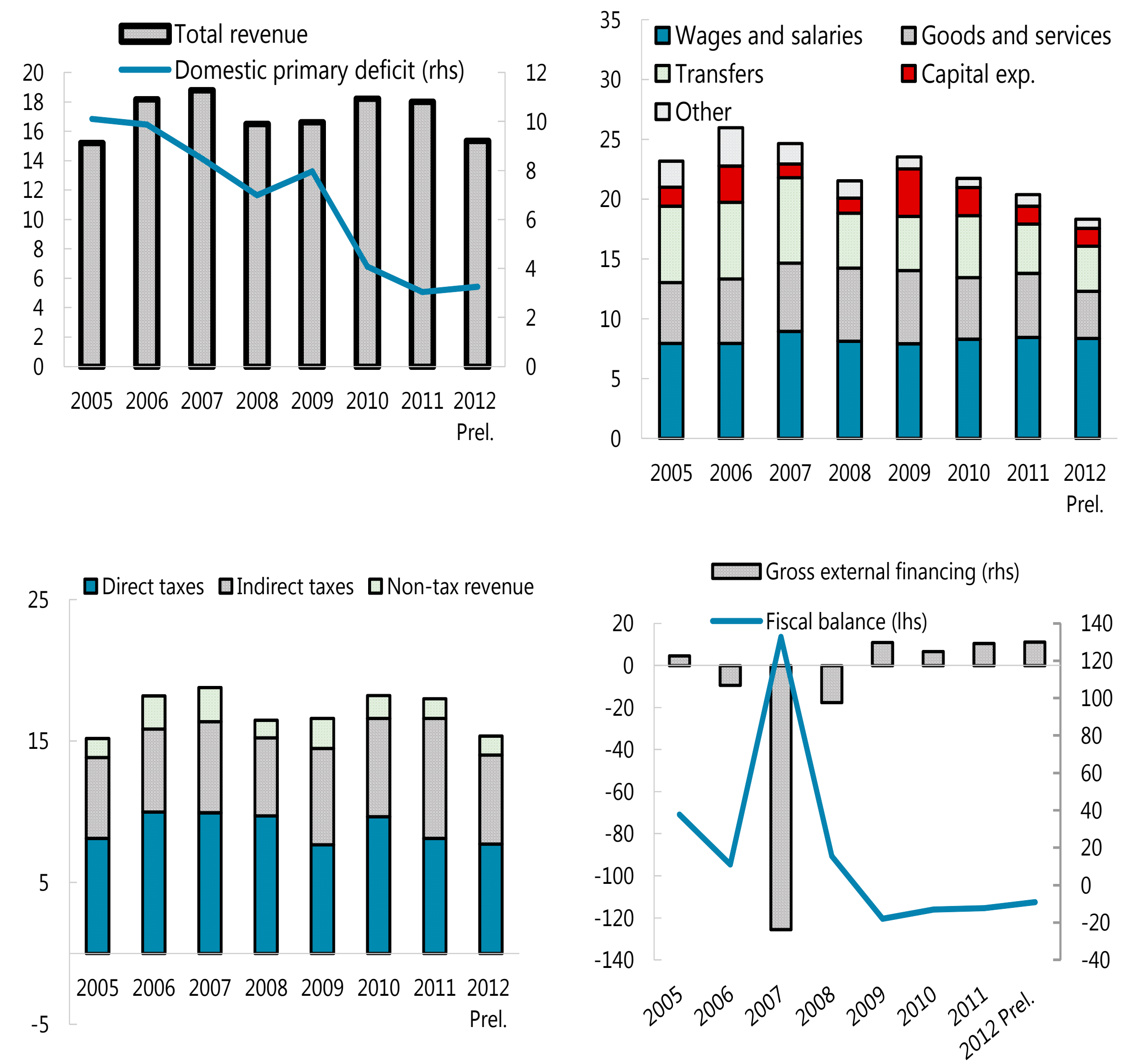
Note: The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.

Figure 1. São Tomé and Príncipe: Recent Macroeconomic Developments



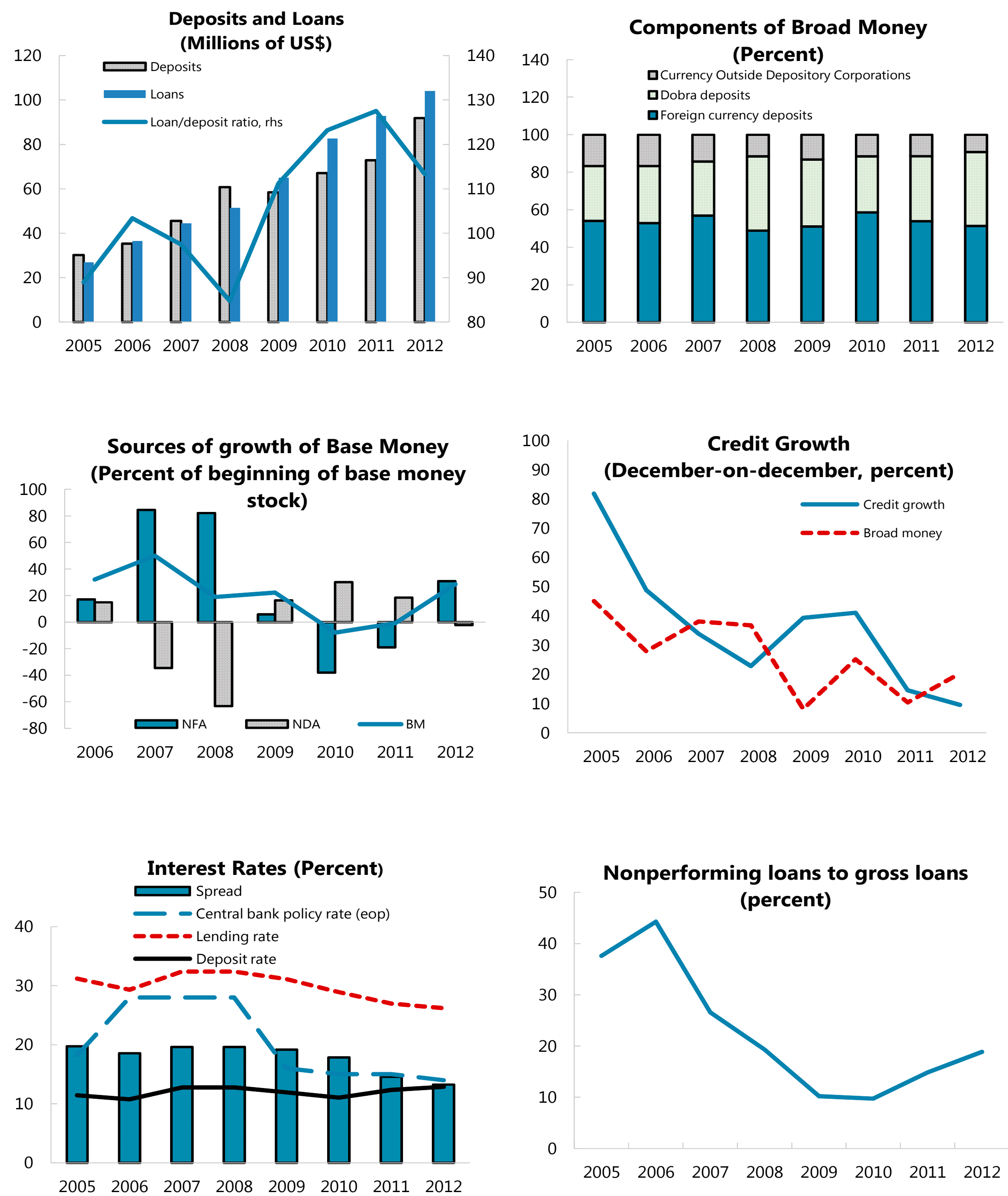
Sources: Data provided by the authorities and IMF staff estimates.

Figure 2. São Tomé and Príncipe: Fiscal Indicators 2005–12
(Percent of GDP)



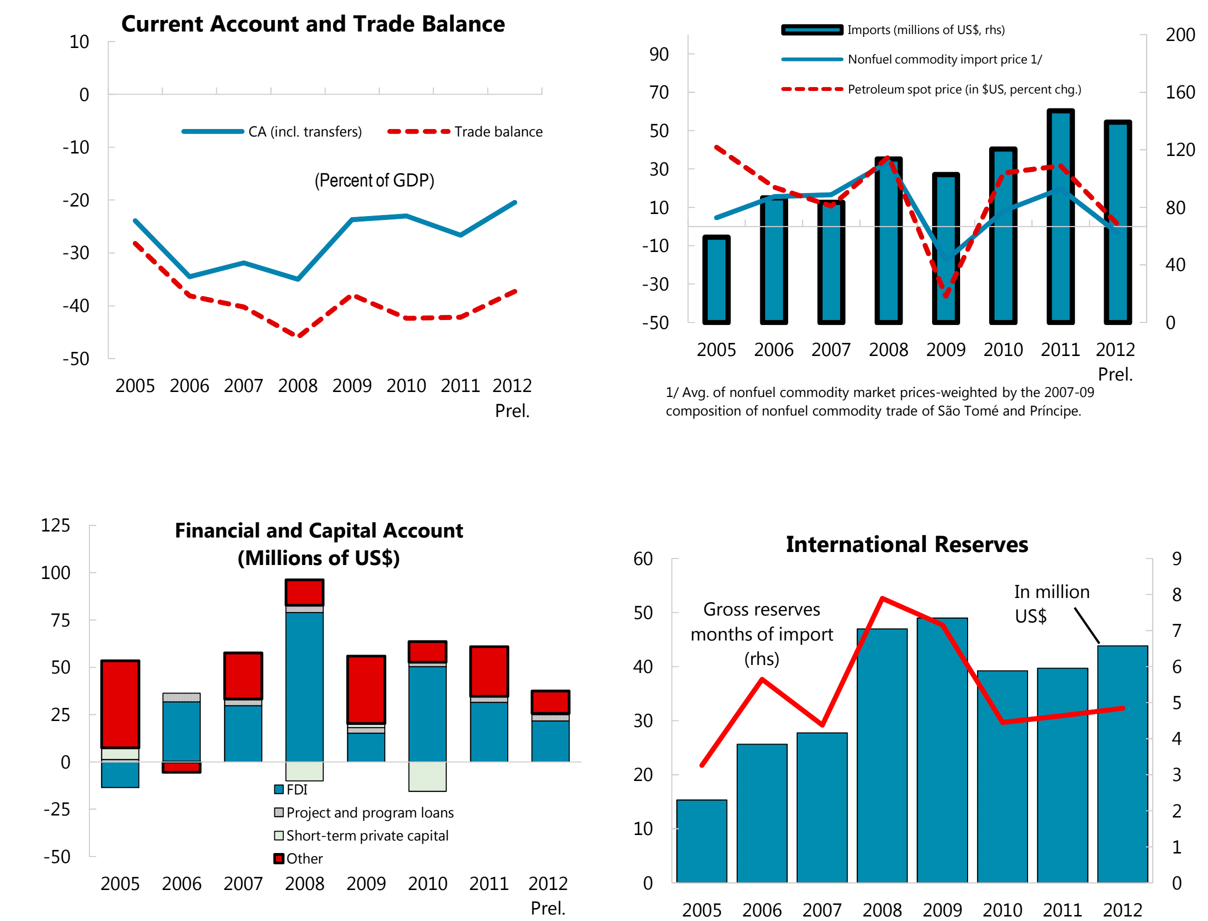
Sources: Data provided by the authorities and IMF staff estimates.

Figure 3. São Tomé and Príncipe: Money and Credit Developments, 2005–12



Sources: Data provided by the authorities and IMF staff estimates.

Figure 4. São Tomé and Príncipe: External Sector 2005–12



Sources: Data provided by the authorities and IMF staff estimates.

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2010–18

(Annual change in percent, unless otherwise indicated)

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Actual			First ECF Review	Revised Program	First ECF Review	Revised Program	Projections			
National income and prices											
GDP at constant prices	4.5	4.9	4.0	4.5	4.0	5.5	5.0	5.5	5.5	6.0	6.0
Consumer prices											
End of period	12.9	11.9	10.4	8.0	8.0	6.0	6.0	4.0	3.0	3.0	3.0
Period average	13.3	14.3	10.6	9.0	8.3	7.1	7.1	5.0	3.5	3.0	3.0
External trade											
Exports of goods and nonfactor services	24.0	20.7	16.1	10.6	0.3	15.3	7.0	10.2	6.7	8.6	7.4
Imports of goods and nonfactor services	17.3	22.0	-5.4	10.5	5.4	3.7	9.1	7.5	5.6	6.4	6.3
Exchange rate (dobras per US$; end of period) [1]	18,651	19,008	18,585	...	...	...	...	...	...	...	...
Real effective exchange rate (depreciation = -)	-2.8	11.7	5.0	...	...	...	...	...	...	...	...
Money and credit											
Base money	-7.9	-0.7	28.6	11.8	42.9	26.8	10.0	9.0	5.5	7.0	5.2
Broad money (M3)	25.1	10.4	20.3	14.7	11.5	25.9	13.1	9.5	9.2	9.6	10.2
Credit to the economy	41.1	14.5	9.6	9.4	9.4	10.4	9.9	10.2	11.1	11.1	10.7
Velocity (GDP to broad money; end of period)	2.6	2.8	2.7	2.7	2.7	2.5	2.8	2.7	2.7	2.6	2.6
Central bank reference interest rate (percent)	15.0	15.0	14.0	...	...	...	...	...	...	...	...
Bank lending rate (percent)	28.9	27.0	26.2	...	...	...	...	...	...	...	...
Bank deposit rate (percent)	11.0	12.4	12.9	...	...	...	...	...	...	...	...
Government finance (figures in percent of GDP)											
Total revenue, grants, and oil signature bonuses [2]	38.1	37.1	33.6	38.4	31.7	31.3	31.9	32.7	33.4	34.2	34.7
Of which: tax revenue	16.6	16.6	14.0	15.2	15.2	15.7	15.3	15.6	15.8	16.1	16.1
Nontax revenue	1.6	1.4	1.3	1.3	1.7	1.3	1.3	1.3	1.3	1.3	1.3
Grants	19.9	18.3	17.5	20.6	13.2	14.3	15.3	15.8	16.3	16.8	17.3
Oil signature bonuses	0.0	0.8	0.8	1.3	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	49.1	49.0	44.3	45.7	39.0	39.9	38.9	38.6	38.5	38.4	38.4
Personnel costs	8.3	8.4	8.4	7.8	8.5	7.8	8.2	8.1	8.1	8.1	8.1
Interest due	0.4	0.5	0.6	0.4	0.4	0.5	0.6	0.6	0.5	0.5	0.4
Nonwage noninterest current expenditure	11.1	10.5	8.5	9.6	9.4	9.6	9.2	9.2	9.0	9.0	9.0
Treasury funded capital expenditures	2.3	1.5	1.5	1.7	1.7	2.2	1.7	1.7	1.7	1.7	1.7
Donor funded capital expenditures	26.3	27.5	25.1	25.7	18.6	19.3	18.6	18.6	18.6	18.6	18.6
HIPC Initiative-related social expenditure	0.6	0.7	0.3	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.5
Domestic primary balance [3]	-4.1	-3.0	-3.3	-3.1	-3.1	-3.0	-3.0	-2.6	-2.3	-2.0	-2.0
Overall balance (commitment basis)	-11.0	-12.0	-10.8	-7.2	-7.3	-8.6	-7.0	-6.0	-5.1	-4.2	-3.7
External sector											
Current account balance (percent of GDP)											
Including official transfers	-23.0	-26.6	-20.5	-16.6	-20.2	-18.5	-15.9	-14.5	-13.0	-11.6	-10.5
Excluding official transfers	-46.5	-46.5	-38.9	-37.7	-34.1	-33.3	-32.0	-31.0	-30.1	-29.3	-28.8
PV of external debt (percent of GDP)	33.7	33.6	35.7	32.5	32.7	30.9	30.4	28.0	26.0	23.8	22.1
External debt service (percent of exports) [4]	6.6	8.0	7.1	12.7	15.5	12.4	15.0	13.6	12.2	10.7	9.8
Export of goods and non-factor services (US$ millions)	24.3	29.3	34.1	32.7	34.2	37.7	36.6	40.3	43.0	46.7	50.2
Gross international reserves [5, 6, 7]											
Millions of U.S. dollars	39.3	39.7	43.8	37.3	53.4	37.1	59.0	65.2	70.3	75.8	80.5
Months of imports of goods and nonfactor services [8]	4.5	4.6	4.8	4.0	5.5	4.1	5.7	6.0	6.1	6.2	6.2
National Oil Account (US$ millions)	7.8	8.3	9.0	11.5	12.2	9.2	9.9	8.0	6.5	5.3	4.3
Memorandum Item											
GDP											
Billions of dobras	3,719	4,376	5,021	5,780	5,732	6,569	6,524	7,064	7,589	8,180	8,848
Millions of U.S. dollars	201.0	248.3	263.3	312.2	310.2	353.6	359.1	393.9	428.0	465.9	504.1

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

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

[2] Includes HIPC and MDRI debt relief.

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

[4] In percent of exports of goods and nonfactor services. Includes HIPC and MDRI debt relief.

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

[6] For 2008 and 2009, includes the proceeds from the privatization of the government's share in the National Fuel Company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the BCSTP to boost reserves.

[7] For 2009, includes new allocation of SDR 6.5 million.

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

Table 2. São Tomé and Príncipe: Financial Operations of the Central Government, 2010–18

(Billions of dobra)

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Actual			First ECF Review	Revised Program	First ECF Review	Revised Program	Projections			
Total revenue and grants	1417	1622	1685	2222	1819	2058	2079	2308	2535	2799	3071
Total revenue	677	787	771	954	970	1118	1081	1192	1296	1421	1538
Tax revenue	617	726	704	878	871	1030	998	1102	1200	1317	1425
Nontax revenue	60	61	67	77	100	87	83	90	97	104	113
Grants	739	799	876	1190	757	941	998	1116	1239	1377	1533
Project grants	686	674	730	964	475	702	705	848	964	1104	1239
Nonproject grants	25	83	119	193	240	190	246	218	222	215	233
HIPC Initiative-related grants	28	43	28	32	42	49	46	49	53	57	62
Oil signature bonuses	0	35	38	78	91	0	0	0	0	0	0
Total expenditure	1824	2145	2225	2639	2238	2620	2535	2730	2921	3145	3398
Domestic primary expenditure	829	920	934	1133	1149	1318	1280	1377	1471	1586	1715
Current expenditure	737	851	875	1030	1046	1176	1178	1261	1342	1443	1557
Of which: personnel costs	309	369	419	449	486	510	535	575	618	666	720
Interest due	16	24	30	24	21	32	40	39	38	37	37
Goods and services	191	234	198	236	230	268	262	277	289	311	337
Transfers	192	181	190	287	275	327	300	326	350	377	408
Other current expenditure	28	43	39	34	34	39	41	44	48	51	55
Capital expenditure	1066	1266	1336	1581	1164	1416	1326	1434	1541	1661	1796
Of which: financed by the Treasury	87	65	74	99	96	146	111	120	129	139	150
Financed by external sources	979	1201	1262	1483	1068	1271	1215	1314	1412	1522	1646
HIPC Initiative-related social expenditure	21	29	14	28	28	28	31	35	38	41	44
Primary Balance	-391	-500	-511	-394	-397	-530	-416	-383	-424	-384	-364
Overall fiscal balance (commitment basis)	-408	-524	-540	-417	-419	-562	-456	-422	-386	-346	-327
Net change in arrears, float, and stat. discrepancies (reduction = -)	-75	-15	87	0	-87	0	0	0	0	0	0
External arrears	0	0	0	0	0	0	0	0	0	0	0
Domestic arrears	0	65	33	0	-87	0	0	0	0	0	0
Float and statistical discrepancies	-75	-80	54	0	0	0	0	0	0	0	0
Overall fiscal balance (cash basis)	-483	-539	-453	-417	-506	-562	-456	-422	-386	-346	-327
Financing	483	539	453	418	506	562	456	422	386	346	327
Net external	246	461	558	461	564	519	411	410	394	364	353
Disbursements (projects)	293	528	532	518	592	569	511	466	448	417	407
Program financing (loans)	1	1	75	0	60	0	0	0	0	0	0
Net short-term loans	0	0	0	0	0	0	0	0	0	0	0
Scheduled amortization	-48	-68	-49	-57	-89	-50	-99	-56	-54	-54	-54
Change in arrears (principal)	0	0	0	0	0	0	0	0	0	0	0
Bilateral rescheduling	0	0	0	0	0	0	0	0	0	0	0
HIPC flow savings	0	0	0	0	0	0	0	0	0	0	0
Net domestic	236	78	-104	-43	-58	43	45	12	-8	-17	-26
Net bank credit to the government	236	78	-104	-43	-58	43	45	12	-8	-17	-26
Banking system credit (excluding National Oil Account)	201	51	-66	0	0	0	0	-23	-36	-40	-44
Of which: Privatisation account [1]	13	0	0	0	0	0	0	0	0	0	0
National Oil Account	35	27	-38	-43	-58	43	45	35	28	23	19
Nonbank financing	0	0	0	0	0	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:											
Domestic primary balance [2]	-152	-133	-163	-178	-178	-200	-198	-185	-175	-164	-177
MDRI debt relief (flow in US$ million)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatisation account balance (US$ million)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Oil Account balance (US$ million, excl. transfers to budget)	7.8	8.3	9.0	11.5	12.2	9.2	9.9	8.0	6.5	5.3	4.3

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

[1] For 2008, includes the proceeds from the privatization of the government's share in the National Fuel Company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the BCSTP to boost reserves.

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

Table 3. São Tomé and Príncipe: Financial Operations of the Central Government, 2010–18

(Percent of GDP)

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Actual			First ECF Review	Revised Program	First ECF Review	Revised Program	Projections			
Total revenue and grants	**38.1**	**37.1**	**33.6**	**38.4**	**31.7**	**31.3**	**31.9**	**32.7**	**33.4**	**34.2**	**34.7**
Total revenue	18.2	18.0	15.3	16.5	16.9	17.0	16.6	16.9	17.1	17.4	17.4
Tax revenue	16.6	16.6	14.0	15.2	15.2	15.7	15.3	15.6	15.8	16.1	16.1
Nontax revenue	1.6	1.4	1.3	1.3	1.7	1.3	1.3	1.3	1.3	1.3	1.3
Grants	19.9	18.3	17.5	20.6	13.2	14.3	15.3	15.8	16.3	16.8	17.3
Project grants	18.5	15.4	14.5	16.7	8.3	10.7	10.8	12.0	12.7	13.5	14.0
Nonproject grants	0.7	1.9	2.4	3.3	4.2	2.9	3.8	3.1	2.9	2.6	2.6
HIPC Initiative-related grants	0.7	1.0	0.5	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Oil signature bonuses	0.0	0.8	0.8	1.3	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	**49.1**	**49.0**	**44.3**	**45.7**	**39.0**	**39.9**	**38.9**	**38.6**	**38.5**	**38.4**	**38.4**
Domestic primary expenditure	22.3	21.0	18.6	19.6	20.0	20.1	19.6	19.5	19.4	19.4	19.4
Current expenditure	19.8	19.4	17.4	17.8	18.3	17.9	18.1	17.8	17.7	17.6	17.6
Of which: personnel costs	8.3	8.4	8.4	7.8	8.5	7.8	8.2	8.1	8.1	8.1	8.1
Interest due	0.4	0.5	0.6	0.4	0.4	0.5	0.6	0.6	0.5	0.5	0.4
Goods and services	5.1	5.3	3.9	4.1	4.0	4.1	4.0	3.9	3.8	3.8	3.8
Transfers	5.2	4.1	3.8	5.0	4.8	5.0	4.6	4.6	4.6	4.6	4.6
Other current expenditure	0.8	1.0	0.8	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Capital expenditure	28.7	28.9	26.6	27.4	20.3	21.6	20.3	20.3	20.3	20.3	20.3
Of which: financed by the Treasury	2.3	1.5	1.5	1.7	1.7	2.2	1.7	1.7	1.7	1.7	1.7
Financed by external sources	26.3	27.5	25.1	25.7	18.6	19.3	18.6	18.6	18.6	18.6	18.6
HIPC Initiative-related social expenditure	0.6	0.7	0.3	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.5
Primary Balance	-10.5	-11.4	-10.2	-6.8	-6.9	-8.1	-6.4	-5.4	-5.6	-4.7	-4.1
Overall fiscal balance (commitment basis)	-11.0	-12.0	-10.8	-7.2	-7.3	-8.6	-7.0	-6.0	-5.1	-4.2	-3.7
Net change in arrears, float, and stat. discrepancies (reduction = -)	-2.0	-0.3	1.7	0.0	-1.5	0.0	0.0	0.0	0.0	0.0	0.0
External arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic arrears	0.0	1.5	0.7	0.0	-1.5	0.0	0.0	0.0	0.0	0.0	0.0
Float and statistical discrepancies	-2.0	-1.8	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall fiscal balance (cash basis)	**-13.0**	**-12.3**	**-9.0**	**-7.2**	**-8.8**	**-8.6**	**-7.0**	**-6.0**	**-5.1**	**-4.2**	**-3.7**
Financing	**13.0**	**12.3**	**9.0**	**7.2**	**8.8**	**8.6**	**7.0**	**6.0**	**5.1**	**4.2**	**3.7**
Net external	6.6	10.5	11.1	8.0	9.8	7.9	6.3	5.8	5.2	4.4	4.0
Disbursements (projects)	7.9	12.1	10.6	9.0	10.3	8.7	7.8	6.6	5.9	5.1	4.6
Program financing (loans)	0.0	0.0	1.5	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Net short-term loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Scheduled amortization	-1.3	-1.6	-1.0	-1.0	-1.5	-0.8	-1.5	-0.8	-0.7	-0.7	-0.6
Change in arrears (principal)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral rescheduling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
HIPC flow savings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic	6.4	1.8	-2.1	-0.8	-1.0	0.6	0.7	0.2	-0.1	-0.2	-0.3
Net bank credit to the government	6.4	1.8	-2.1	-0.8	-1.0	0.6	0.7	0.2	-0.1	-0.2	-0.3
Banking system credit (excluding National Oil Account)	5.4	1.2	-1.3	0.0	0.0	0.0	0.0	-0.3	-0.5	-0.5	-0.5
Of which: Privatisation account [1]	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Oil Account	0.9	0.6	-0.8	-0.8	-1.0	0.6	0.7	0.5	0.4	0.3	0.2
Nonbank financing	0.0	0.0	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	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Domestic primary balance [2]	-4.1	-3.0	-3.3	-3.1	-3.1	-3.0	-3.0	-2.6	-2.3	-2.0	-2.0
MDRI debt relief (flow in US$ million)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatisation account balance (US$ million)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Oil Account balance (US$ million, excl. transfers to budget)	7.8	8.3	9.0	11.5	12.2	9.2	9.9	8.0	6.5	5.3	4.3
Nominal GDP (Billions of dobras)	3,719	4,376	5,021	5,780	5,732	6,569	6,524	7,064	7,589	8,180	8,848

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

[1] For 2008, includes the proceeds from the privatization of the government's share in the National Fuel Company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the BCSTP to boost reserves.

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

Table 4. São Tomé and Príncipe: Summary Accounts of the Central Bank, 2010–18

(Billions of dobra)

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Actual			First ECF Review	Revised Program	First ECF Review	Revised Program	Projections			
Net foreign assets	**998**	**891**	**1,062**	**975**	**1,297**	**969**	**1,347**	**1,436**	**1,511**	**1,597**	**1,681**
Claims on nonresidents	1,311	1,385	1,385	1,318	1,636	1,314	1,682	1,760	1,816	1,887	1,961
Official foreign reserves [1]	1,052	1,148	1,136	1,066	1,396	1,058	1,450	1,532	1,589	1,663	1,735
Other foreign assets	259	237	249	252	239	256	232	229	226	224	226
Liabilities to nonresidents	-313	-494	-324	-343	-339	-345	-335	-324	-305	-290	-279
Short-term liabilities to nonresidents	-110	-287	-121	-141	-140	-142	-138	-129	-112	-99	-87
Other foreign liabilities [1]	-203	-207	-203	-202	-200	-203	-197	-194	-192	-191	-192
Net domestic assets	**-439**	**-337**	**-349**	**-178**	**-278**	**41**	**-227**	**-215**	**-222**	**-218**	**-231**
Net domestic credit	30	85	71	14	59	58	107	120	113	96	71
Claims on other depository corporations	9	1	41	41	72	41	72	72	72	72	72
Net claims on central government	-23	35	-30	-74	-89	-33	-45	-34	-44	-64	-90
Claims on central government	258	262	233	233	230	234	227	225	223	222	223
Of which: use of SDRs/PRGF Facility [2]	*211*	*215*	*186*	*186*	*183*	*187*	*181*	*179*	*177*	*175*	*177*
Liabilities to central government	-281	-228	-263	-307	-319	-267	-272	-260	-267	-285	-313
Ordinary deposits of central government	-33	-25	-4	-4	-4	-4	-4	-28	-64	-104	-148
Counterpart funds	-43	-30	-65	-65	-65	-65	-65	-65	-65	-65	-65
Foreign currency deposits	-205	-173	-194	-238	-249	-198	-203	-167	-139	-116	-100
Of which: National oil account	*-145*	*-157*	*-168*	*-212*	*-224*	*-172*	*-178*	*-142*	*-114*	*-92*	*-76*
Claims on other sectors	44	50	60	47	76	50	80	83	85	87	89
Other items (net)	-469	-422	-421	-192	-337	-17	-334	-335	-335	-313	-302
Base money	**558**	**554**	**712**	**797**	**1,018**	**1,010**	**1,120**	**1,222**	**1,289**	**1,379**	**1,450**
Currency issued	191	204	217	226	207	295	188	193	217	252	290
Bank reserves	367	350	495	571	811	715	932	1,029	1,072	1,127	1,160
Of which : domestic currency	297	268	399	462	672	578	780	863	897	939	963
Of which: foreign currency	71	82	97	108	138	137	152	166	175	187	197
Memorandum items:											
Gross international reserves (US$ millions) [3]	39.3	39.7	43.8	37.3	53.4	37.1	59.0	65.2	70.3	75.8	80.5
Months of imports of goods and nonfactor services [4]	4.5	4.6	4.8	4.0	5.5	4.1	5.7	6.0	6.1	6.2	6.2
Net international reserves (US$ millions) [5]	33.3	24.6	37.3	29.6	45.8	29.5	51.3	57.9	54.0	59.4	64.3
Months of imports of goods and nonfactor services [4]	3.8	2.9	4.1	3.2	4.7	3.3	4.9	5.3	4.7	4.9	4.9
National Oil Account (US$ millions)	7.8	8.3	9.0	11.5	12.2	9.2	9.9	8.0	6.5	5.3	4.3
Commercial banks reserves in foreign currency (US$ millions)	3.8	4.3	5.2	5.9	7.6	7.4	8.4	9.3	9.9	10.7	11.2
Guaranteed deposits (US$ millions)	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Base money (annual percent change)	-7.9	-0.7	28.6	11.8	42.9	26.8	10.0	9.0	5.5	7.0	5.2

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

[1] For 2009, includes new allocation of SDR 6.5 million.

[2] The December 2012 figure reflects a small correction in the recording of IMF loans.

[3] Gross international reserves exclude the National Oil Account and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital

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

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

Table 5. São Tomé and Príncipe: Monetary Survey, 2010–18
(Billions of dobra)

(Billions of dobra)

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Actual			First ECF Review	Revised Program	First ECF Review	Revised Program	Projections			
Net foreign assets	**1,364**	**1,263**	**1,630**	**1,409**	**1,877**	**1,424**	**1,947**	**2,056**	**2,150**	**2,253**	**2,361**
Net foreign assets of the BCSTP	998	891	1,062	975	1,297	969	1,347	1,436	1,511	1,597	1,681
Net foreign assets of other depository corporations	367	372	568	434	580	455	600	619	639	657	679
Net domestic assets	**50**	**299**	**250**	**712**	**219**	**1,247**	**422**	**540**	**684**	**852**	**1,063**
Net domestic credit	1,481	1,743	1,810	1,893	1,843	2,146	2,087	2,326	2,591	2,878	3,178
Net claims on central government	-60	-22	-123	-172	-273	-136	-237	-235	-254	-283	-319
Claims on central government [1]	261	267	236	236	232	237	229	227	225	223	225
Liabilities to central government	-321	-290	-359	-408	-504	-372	-466	-462	-479	-506	-544
Budgetary deposits	-33	-25	-4	-4	-4	-4	-4	-28	-64	-104	-148
Counterpart funds	-43	-30	-65	-65	-65	-65	-65	-65	-65	-65	-65
Foreign currency deposits	-245	-235	-290	-338	-435	-303	-397	-370	-351	-338	-331
Of which: National Oil Account	-145	-157	-168	-212	-224	-172	-178	-142	-114	-92	-76
Claims on other sectors	1,541	1,765	1,934	2,065	2,116	2,281	2,325	2,561	2,845	3,161	3,497
Of which: claims in foreign currency	1,099	1,114	1,162	1,150	1,163	1,227	1,235	1,313	1,408	1,383	1,534
(In Millions of $US)	59	59	63	62	64	66	68	74	80	79	87
Other items (net)	-1,430	-1,444	-1,561	-1,181	-1,624	-899	-1,665	-1,786	-1,907	-2,025	-2,116
Broad money (M3)	**1,415**	**1,562**	**1,711**	**2,121**	**2,096**	**2,671**	**2,369**	**2,596**	**2,834**	**3,105**	**3,421**
Local currency liabilities included in broad money (M2)	585	719	745	978	1,270	1,238	1,427	1,557	1,699	1,861	2,050
Money (M1)	562	670	565	836	889	1,059	993	1,078	1,175	1,287	1,418
Currency outside depository corporations	163	177	4	192	168	252	170	171	183	200	221
Transferable deposits in dobra	399	493	561	644	721	807	823	907	992	1,086	1,197
Other deposits in dobra	23	48	180	143	381	179	435	479	524	574	632
Foreign currency deposits	829	843	966	1,143	826	1,433	942	1,039	1,136	1,244	1,371
Memorandum items:											
Velocity (ratio of GDP to M3; end of period)	2.6	2.8	2.7	2.7	2.7	2.5	2.8	2.7	2.7	2.6	2.6
Money multiplier (M3/M0)	2.5	2.8	2.4	2.7	2.1	2.6	2.1	2.1	2.2	2.3	2.4
Base money (12-month growth rate)	-7.9	-0.7	28.6	11.8	42.9	26.8	10.0	9.0	5.5	7.0	5.2
Claims on other resident sectors (12-month growth rate)	41.1	14.5	9.6	9.4	9.4	10.4	9.9	10.2	11.1	11.1	10.7
M3 (12-month growth rate) [2]	25.1	10.4	20.3	14.7	11.5	25.9	13.1	9.5	9.2	9.6	10.2

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

[1] The December 2012 figure reflects a small correction in the recording of IMF loans.

[2] Revised commercial banks monetary data beginning in Jan. 2010 is not comparable with historical series.

Table 6. São Tomé and Príncipe: Financial Soundness Indicators, 2008–13

	2008	2009	2010	2011	2012	2013	2013
	December	December	December	December	December	March	June
Capital Adequacy							
Regulatory capital to risk-weighted assets							
Percentage of banks greater or equal to 10 percent	71.40	85.70	85.70	100.00	100.00	87.50	75.00
Percentage of banks below 10 and above 6 percent minimum			…	…	…	…	…
Percentage of banks below 6 percent minimum	28.60	14.30	14.30	…	…	12.50	25.00
Capital (net worth) to assets	24.70	23.20	27.90	28.00	24.39	22.46	16.62
Deposits with banks below 6%			…	…	…	…	…
Asset quality							
Foreign exchange loans to total loans	74.20	73.00	77.50	67.08	57.91	54.73	52.64
Nonperforming loans	19.30	10.20	9.73	14.83	18.88	19.61	22.45
Provision as percent of past-due loans	10.90	24.00	42.20	46.05	39.43	52.64	41.73
Earnings and profitability							
Net profit (before tax)/net income	-13.10	-1.20					
Return on assets	-1.00	0.10	0.70	0.07	-0.04	0.00	-0.01
Return on equity	-3.70		1.80	0.23	-0.16	-0.02	-0.04
Expense(w/amortization & provisions)/income	109.30	98.20	98.20	97.48	97.84	102.89	101.41
						54.73	
Liquidity							
Liquid assets/total assets	19.70	18.40	21.90	21.43	36.25	38.00	39.72
Liquid assets/short term liabilities			36.10	36.18	55.89	57.00	56.40
Loan/total liabilities			109.73	103.04	135.82	143.58	148.37
Foreign exchange liabilities/total liabilities	71.00	73.10	57.40	59.22	58.46	59.61	49.61
Loan/deposits			104.20	114.15	102.11	100.06	96.96
Sensitivity to market risk							
Foreign exchange liabilities to shareholders funds	215.70	274.00	203.80	112.29	141.06	150.45	130.89

Table 7. São Tomé and Príncipe: Balance of Payments, 2010–18
(Millions of U.S. dollars)

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Actual		Preliminary	First ECF Review	Revised Program	First ECF Review	Revised Program	Projections			
Trade balance	**-85.3**	**-104.7**	**-98.2**	**-110.9**	**-103.9**	**-116.7**	**-114.0**	**-118.6**	**-125.6**	**-133.5**	**-142.5**
Exports, f.o.b.	10.9	10.9	16.2	11.8	15.1	12.3	15.2	16.8	17.1	18.0	18.5
Of which: oil	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cocoa	5.4	5.3	5.3	5.1	5.6	5.4	6.2	6.6	6.7	6.8	7.0
Re-export	5.2	5.1	8.8	5.6	9.4	5.6	9.0	9.2	9.3	9.6	9.9
Imports, f.o.b.	-96.2	-115.7	-114.4	-122.7	-119.1	-129.0	-129.2	-135.3	-142.7	-151.5	-160.9
Of which : food	-25.5	-33.6	-33.7	-34.4	-34.1	-34.1	-35.6	-36.6	-38.2	-40.2	-42.3
Petroleum products	-18.4	-25.2	-25.9	-25.9	-25.9	-26.7	-26.7	-27.6	-28.6	-29.6	-32.1
Investment goods	-36.0	-40.2	-35.2	-39.2	-35.5	-42.9	-40.5	-43.7	-47.0	-50.7	-54.4
Oil sector related investment goods	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Services and income (net)	**-11.3**	**-13.4**	**-9.1**	**-11.7**	**-11.0**	**-6.1**	**-12.3**	**-15.2**	**-15.1**	**-15.0**	**-14.8**
Exports of nonfactor services	13.4	18.4	17.9	20.9	19.0	25.4	21.4	23.5	26.0	28.7	31.7
Of which : travel and tourism	11.1	15.6	12.6	18.1	14.4	22.2	16.5	18.4	20.5	22.9	25.6
Imports of nonfactor services	-24.3	-31.4	-24.8	-30.2	-27.5	-29.6	-30.7	-36.5	-38.8	-41.5	-44.2
Factor services (net)	-0.4	-0.4	-2.2	-2.3	-2.5	-1.9	-2.9	-2.2	-2.2	-2.2	-2.2
Of which: oil related	0.1	0.3	0.0	0.0	0.0	0.1	0.0	0.1	0.1	0.1	0.1
Private transfers (net)	**3.0**	**2.8**	**4.9**	**5.0**	**9.0**	**5.1**	**11.5**	**11.7**	**11.8**	**12.0**	**12.2**
Official transfers (net)	**47.3**	**49.2**	**48.5**	**65.9**	**43.1**	**52.3**	**57.7**	**65.2**	**73.3**	**82.4**	**92.3**
Of which : project grants	41.3	39.9	39.7	53.8	27.5	40.4	41.4	50.0	57.4	66.2	74.1
HIPC Initiative-related grants	1.2	3.0	1.4	1.7	1.7	2.6	2.6	2.8	3.0	3.3	3.5
Current account balance											
Including official transfers	-46.3	-66.2	-53.9	-51.7	-62.8	-65.4	-57.0	-57.0	-55.5	-54.1	-52.7
Excluding official transfers	-93.6	-115.3	-102.4	-117.6	-105.9	-117.7	-114.7	-122.1	-128.8	-136.5	-145.0
Capital and financial account balance	**59.3**	**68.1**	**66.3**	**47.8**	**72.2**	**64.4**	**60.8**	**62.0**	**60.7**	**59.9**	**57.4**
Capital transfer [1]	0.3	6.6	0.0	0.0	0.0	0.0	0.0	6.1	6.1	0.0	0.0
Financial account	59.0	61.5	66.3	47.8	72.2	64.4	60.8	55.9	54.6	59.9	57.4
Direct foreign investment	50.5	31.9	22.1	19.8	28.0	22.4	25.1	27.6	30.0	32.8	35.5
Of which: Oil signature bonuses	0.0	2.0	2.0	4.2	4.9	0.0	0.0	0.0	0.0	0.0	0.0
Petroleum related investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Recovery of oil capital expense	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio Investment (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	8.4	29.7	44.3	28.0	44.1	41.9	35.7	28.3	24.5	27.1	21.9
Assets	11.2	6.8	28.4	23.7	17.0	24.0	12.5	12.7	12.9	13.1	13.3
Public sector (net)	12.8	22.6	15.2	3.0	27.8	7.2	23.4	20.2	20.4	18.4	17.4
Project loans	17.8	27.7	20.1	8.4	32.1	7.5	28.1	26.0	25.3	23.8	23.2
Program loans	4.2	0.9	1.4	0.0	3.3	4.5	0.0	0.0	0.0	0.0	0.0
Amortization	-5.7	-6.3	-6.9	-4.8	-8.6	-4.7	-4.7	-5.8	-5.8	-6.1	-6.4
Other investment	-3.6	0.2	0.6	-0.5	1.1	-0.2	0.0	-0.1	0.9	0.7	0.6
Of which : transfers to JDA	-0.1	-0.3	-0.4	-0.4	-0.1	-0.4	0.0	0.0	0.0	0.0	0.0
Private sector (net)	-15.5	0.3	0.6	1.3	-0.6	10.7	-0.2	-4.5	-8.8	-4.4	-8.8
Commercial banks	-16.7	0.1	-11.0	0.5	-1.1	0.9	-1.5	1.5	1.5	1.4	0.9
Short-term private capital	1.1	0.2	11.7	0.7	0.5	9.8	1.3	-6.1	-10.2	-5.8	-9.8
Errors and omissions	**-25.9**	**3.1**	**-13.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**-13.0**	**5.0**	**-0.6**	**-3.9**	**9.4**	**-1.0**	**3.8**	**5.0**	**5.2**	**5.8**	**4.7**
Financing	13.0	-5.0	0.6	3.9	-9.4	1.0	-3.8	-5.0	-5.2	-5.8	-4.7
Change in official reserves, excl. NOA (increase= -)	10.5	-4.5	1.4	5.8	-6.7	-1.4	-6.4	-7.0	-5.7	-6.3	-5.1
Use of Fund resources (net)	0.6	0.0	0.0	0.5	0.5	0.2	0.2	0.1	-0.9	-0.7	-0.6
Purchases	0.6	0.0	0.0	1.1	1.1	1.1	1.1	1.1	0.0	0.0	0.0
Repurchases (incl. MDRI repayment)	0.0	0.0	0.0	-0.6	-0.6	-1.0	-1.0	-1.1	-0.9	-0.7	-0.6
National Oil Account (increase = -)	1.9	-0.5	-0.8	-2.4	-3.2	2.2	2.4	1.9	1.5	1.2	1.0
Exceptional financing [2]	0.0	0.0	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	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Current account balance (percent of GDP)											
Before official transfers	-46.5	-46.5	-38.9	-37.7	-34.1	-33.3	-32.0	-31.0	-30.1	-29.3	-28.8
After official transfers	-23.0	-26.6	-20.5	-16.6	-20.2	-18.5	-15.9	-14.5	-13.0	-11.6	-10.5
Debt service ratio (percent of exports) [3]	6.6	8.0	7.1	12.7	15.5	12.4	15.0	13.6	12.2	10.7	9.8
Gross international reserves [4, 5]											
Millions of U.S. dollars	39.3	39.7	43.8	37.3	53.4	37.1	59.0	65.2	70.3	75.8	80.5
Months of imports of goods and nonfactor services [6]	4.5	4.6	4.8	4.0	5.5	4.1	5.7	6.0	6.1	6.2	6.2

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

[1] Includes MDRI debt relief.

[2] For 2009, includes new allocation of SDR 6.5 million.

[3] In 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 and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.

[5] For 2008, includes the proceeds from the privatization of the government's share in the National Fuel Company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the BCSTP to boost reserves.

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

Table 8. São Tomé and Príncipe: Balance of Payments, 2010–18
(Percent of GDP)

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Actual		Preliminary	First ECF Review	Revised Program	First ECF Review	Revised Program	Projections			
Trade balance	**-42.4**	**-42.2**	**-37.3**	**-35.5**	**-33.5**	**-33.0**	**-31.7**	**-30.1**	**-29.4**	**-28.6**	**-28.3**
Exports, f.o.b.	5.4	4.4	6.1	3.8	4.9	3.5	4.2	4.3	4.0	3.9	3.7
Of which: oil	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cocoa	2.7	2.1	2.0	1.6	1.8	1.5	1.7	1.7	1.6	1.5	1.4
Re-export	2.6	2.0	3.3	1.8	3.0	1.6	2.5	2.3	2.2	2.1	2.0
Imports, f.o.b.	-47.8	-46.6	-43.4	-39.3	-38.4	-36.5	-36.0	-34.4	-33.3	-32.5	-31.9
Of which : food	-12.7	-13.5	-12.8	-11.0	-11.0	-9.6	-9.9	-9.3	-8.9	-8.6	-8.4
Petroleum products	-9.1	-10.2	-9.8	-8.3	-8.3	-7.6	-7.4	-7.0	-6.7	-6.4	-6.4
Investment goods	-17.9	-16.2	-13.4	-12.6	-11.4	-12.1	-11.3	-11.1	-11.0	-10.9	-10.8
Oil sector related investment goods	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Services and income (net)	**-5.6**	**-5.4**	**-3.4**	**-3.7**	**-3.6**	**-1.7**	**-3.4**	**-3.9**	**-3.5**	**-3.2**	**-2.9**
Exports of nonfactor services	6.7	7.4	6.8	6.7	6.1	7.2	5.9	6.0	6.1	6.2	6.3
Of which : travel and tourism	5.5	6.3	4.8	5.8	4.6	6.3	4.6	4.7	4.8	4.9	5.1
Imports of nonfactor services	-12.1	-12.6	-9.4	-9.7	-8.9	-8.4	-8.6	-9.3	-9.1	-8.9	-8.8
Factor services (net)	-0.2	-0.2	-0.8	-0.7	-0.8	-0.5	-0.8	-0.6	-0.5	-0.5	-0.4
Of which: oil related	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private transfers (net)	**1.5**	**1.1**	**1.9**	**1.6**	**2.9**	**1.4**	**3.2**	**3.0**	**2.8**	**2.6**	**2.4**
Official transfers (net)	**23.5**	**19.8**	**18.4**	**21.1**	**13.9**	**14.8**	**16.1**	**16.5**	**17.1**	**17.7**	**18.3**
Of which : project grants	20.6	16.1	15.1	17.2	8.9	11.4	11.5	12.7	13.4	14.2	14.7
HIPC Initiative-related grants	0.6	1.2	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Current account balance											
Including official transfers	-23.0	-26.6	-20.5	-16.6	-20.2	-18.5	-15.9	-14.5	-13.0	-11.6	-10.5
Excluding official transfers	-46.5	-46.5	-38.9	-37.7	-34.1	-33.3	-32.0	-31.0	-30.1	-29.3	-28.8
Capital and financial account balance	**29.5**	**27.4**	**25.2**	**15.3**	**23.3**	**18.2**	**16.9**	**15.7**	**14.2**	**12.9**	**11.4**
Capital transfer [1]	0.1	2.6	0.0	0.0	0.0	0.0	0.0	1.5	1.4	0.0	0.0
Financial account	29.3	24.8	25.2	15.3	23.3	18.2	16.9	14.2	12.7	12.9	11.4
Direct foreign investment	25.1	12.8	8.4	6.3	9.0	6.3	7.0	7.0	7.0	7.0	7.0
Of which: Oil signature bonuses	0.0	0.8	0.8	1.3	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Petroleum related investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Recovery of oil capital expense	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio Investment (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	4.2	11.9	16.8	9.0	14.2	11.9	10.0	7.2	5.7	5.8	4.4
Assets	5.6	2.7	10.8	7.6	5.5	6.8	3.5	3.2	3.0	2.8	2.6
Public sector (net)	6.4	9.1	5.8	1.0	8.9	2.0	6.5	5.1	4.8	4.0	3.5
Project loans	8.9	11.2	7.6	2.7	10.3	2.1	7.8	6.6	5.9	5.1	4.6
Program loans	2.1	0.4	0.5	0.0	1.0	1.3	0.0	0.0	0.0	0.0	0.0
Amortization	-2.8	-2.5	-2.6	-1.6	-2.8	-1.3	-1.3	-1.5	-1.4	-1.3	-1.3
Other investment	-1.8	0.1	0.2	-0.2	0.4	0.0	0.0	0.0	0.2	0.1	0.1
Of which : transfers to JDA	0.0	-0.1	-0.2	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Private sector (net)	-7.7	0.1	0.2	0.4	-0.2	3.0	-0.1	-1.2	-2.1	-0.9	-1.7
Commercial banks	-8.3	0.0	-4.2	0.2	-0.4	0.3	-0.4	0.4	0.3	0.3	0.2
Short-term private capital	0.6	0.1	4.4	0.2	0.2	2.8	0.4	-1.5	-2.4	-1.2	-1.9
Errors and omissions	**-12.9**	**1.3**	**-5.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**-6.5**	**2.0**	**-0.2**	**-1.3**	**3.0**	**-0.3**	**1.1**	**1.3**	**1.2**	**1.2**	**0.9**
Financing	6.5	-2.0	0.2	1.3	-3.0	0.3	-1.1	-1.3	-1.2	-1.2	-0.9
Change in official reserves, excl. NOA (increase= -)	5.2	-1.8	0.5	1.9	-2.2	-0.4	-1.8	-1.8	-1.3	-1.3	-1.0
Use of Fund resources (net)	0.3	0.0	0.0	0.2	0.2	0.0	0.0	0.0	-0.2	-0.1	-0.1
Purchases	0.3	0.0	0.0	0.4	0.4	0.3	0.3	0.3	0.0	0.0	0.0
Repurchases (incl. MDRI repayment)	0.0	0.0	0.0	-0.2	-0.2	-0.3	-0.3	-0.3	-0.2	-0.1	-0.1
National Oil Account (increase = -)	0.9	-0.2	-0.3	-0.8	-1.0	0.6	0.7	0.5	0.3	0.3	0.2
Exceptional financing [2]	0.0	0.0	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	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Debt service ratio (percent of exports) [3]	6.6	8.0	7.1	12.7	15.5	12.4	15.0	13.6	12.2	10.7	9.8
Gross international reserves [4, 5]											
Millions of U.S. dollars	39.3	39.7	43.8	37.3	53.4	37.1	59.0	65.2	70.3	75.8	80.5
Months of imports of goods and nonfactor services [6]	4.5	4.6	4.8	4.0	5.5	4.1	5.7	6.0	6.1	6.2	6.2

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

[1] Includes MDRI debt relief.

[2] For 2009, includes new allocation of SDR 6.5 million.

[3] In 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 and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.

[5] For 2008, includes the proceeds from the privatization of the government's share in the National Fuel Company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the BCSTP to boost reserves.

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

Table 9. São Tomé and Príncipe: External Financing Requirements and Sources, 2010–18

(Millions of U.S. dollars)

	2010	2011	2012	2013		2014		2015	2016	2017	2018
	Actual		Preliminary	First ECF Review	Revised Program	First ECF Review	Revised Program	Projections			
Gross financing requirements	**-92.3**	**-126.0**	**-107.3**	**-117.7**	**-120.7**	**-124.8**	**-126.8**	**-136.0**	**-140.4**	**-148.8**	**-156.5**
Current account, excluding official transfers	-93.6	-115.3	-102.4	-117.6	-105.9	-117.7	-114.7	-122.1	-128.8	-136.5	-145.0
Exports, f.o.b.	10.9	10.9	16.2	11.8	15.1	12.3	15.2	16.8	17.1	18.0	18.5
Imports, f.o.b.	-96.2	-115.7	-114.4	-122.7	-119.1	-129.0	-129.2	-135.3	-142.7	-151.5	-160.9
Services and income (net)	-11.3	-13.4	-9.1	-11.7	-11.0	-6.1	-12.3	-15.2	-15.1	-15.0	-14.8
Private transfers	3.0	2.8	4.9	5.0	9.0	5.1	11.5	11.7	11.8	12.0	12.2
Financial account	-9.2	-6.1	-6.3	-6.0	-8.1	-5.8	-5.6	-6.9	-5.8	-6.1	-6.4
Scheduled amortization [1]	-5.7	-6.3	-6.9	-4.8	-8.6	-4.7	-4.7	-5.8	-5.8	-6.1	-6.4
IMF repayments [2]	0.0	0.0	0.0	-0.6	-0.6	-1.0	-1.0	-1.1	-0.9	-0.7	-0.6
Other public sector flows (net)	-3.6	0.2	0.6	-0.5	1.1	-0.2	0.0	-0.1	0.9	0.7	0.6
Change in external reserves (-ve = increase) [3]	10.5	-4.5	1.4	5.8	-6.7	-1.4	-6.4	-7.0	-5.7	-6.3	-5.1
Available funding	**92.3**	**126.0**	**107.3**	**117.7**	**120.7**	**124.8**	**126.8**	**136.0**	**140.4**	**148.8**	**156.5**
National Oil Fund (net)	1.9	1.5	1.2	1.8	1.7	2.2	2.4	1.9	1.5	1.2	1.0
Oil signature bonuses	0.0	2.0	2.0	4.2	4.9	0.0	0.0	0.0	0.0	0.0	0.0
Saving (-ve = accumulation of oil reserve fund)	1.9	-0.5	-0.8	-2.4	-3.2	2.2	2.4	1.9	1.5	1.2	1.0
Expected disbursements	69.6	84.4	70.0	74.3	78.4	64.3	85.8	97.2	104.7	106.2	115.5
Multilateral HIPC interim assistance	1.2	3.0	1.4	1.7	1.7	2.6	2.6	2.8	3.0	3.3	3.5
Capital transfers [1, 2]	0.3	6.6	0.0	0.0	0.0	0.0	0.0	6.1	6.1	0.0	0.0
Grants [4]	46.1	46.2	47.0	64.2	41.4	49.7	55.1	62.4	70.3	79.1	88.8
Concessional loans	22.0	28.7	21.5	8.4	35.3	12.0	28.1	26.0	25.3	23.8	23.2
Project loans	17.8	27.7	20.1	8.4	32.1	7.5	28.1	26.0	25.3	23.8	23.2
Program loans	4.2	0.9	1.4	0.0	3.3	4.5	0.0	0.0	0.0	0.0	0.0
Private sector (net)	20.2	40.1	36.1	40.5	39.4	57.1	37.4	35.8	34.2	41.5	40.0
IMF [3]	0.6	0.0	0.0	1.1	1.1	1.1	1.1	1.1	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing [3]	0.0	0.0	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	0.0	0.0

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

[1] Includes MDRI debt relief.

[2] Includes MDRI assistance from the IMF as a stock of debt reduction.

[3] For 2009, includes new allocation of SDR 6.5 million.

[4] Includes revenue from Nigeria oil program.

Table 10. São Tomé & Príncipe: Millennium Development Goals

	1990	1995	2000	2005	2010	2012
Goal 1: Eradicate extreme poverty and hunger						
1.1 Poverty headcount ratio at $1.25 a day (PPP) (% of population)	--	--	28.18[5/]	--	--	--
1.1 Poverty headcount ratio at national povertyline, total (%)	--	--	53.8[5/]	--	66.2[10/]	--
1.2 Poverty gap at $1.25 a day (PPP) (%)	--	--	7.87[5/]	--	--	--
1.3 Income share held by lowest 20%	--	--	5.23[5/]	--	--	--
1.5 Vulnerable employment, total (% of total employment)	27[1/]	--	--	--	--	--
1.5 Unemployment rate, total	--	--	14.4	--	16.7[8/]	13.9
1.8 Malnutrition prevalence, weight for age (% of children under 5)	--	--	3.0	--	4.3[9/]	--
1.9 Prevalence of undernourishment (% of population)	22.6[2/]	24.4	14.8	8.9	7.5[9/]	7.7[11/]
1.9 Depth of hunger (kilocalories per person per day)	190[2/]	190[3/]	170[6/]	--	160[8/]	--
Goal 2: Achieve universal primary education						
2.1 Total enrollment, primary (% net)	97	--	98.30[6/]	99.35	98.64	99.56
2.1 Persistence to last grade of primary, total (% of cohort)	65	--	58.83[5/]	68.91[7/]	68.03[9/]	--
2.2 Primary completion rate, total (% of relevant age group)	79	--	61.58[6/]	74.34	85.31	99.14
2.3 Literacy rate, youth female (% of females ages 15-24)	92[1/]	--	94.85[5/]	--	95.94	--
2.3 Literacy rate, youth male (% of males ages 15-24)	96[1/]	--	95.97[5/]	--	94.72	--
Goal 3: Promote gender equality and empower women						
3.1 Ratio of female to male primary enrollment (%)	92	--	97[4/]	97	100	97
3.1 Ratio of female to male secondary enrollment (%)	--	--	--	107	103	113
3.1 Ratio of female to male tertiary enrollment (%)	--	--	--	--	98	--
3.2 Proportion of seats held by women in national parliaments (%)	12	7[3/]	9	9	18	18
3.3 Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	32[1/]	--	--	--	--	--
Goal 4: Reduce child mortality						
4.1 Mortality rate, under-5 (per 1,000)	96	94	93	91	89	89[11/]
4.2 Mortality rate, infant (per 1,000 live births)	62	61	60	59	58	58[11/]
4.3 Immunization, measles (% of children ages 12-23 months)	71	74	69	88	92	91[11/]
Goal 5: Improve maternal health						
5.1 Maternal mortality ratio (modeled estimate, per 100,000 live births)	150	120	110	87	70	--
5.2 Births attended by skilled health staff (% of total)	--	--	79	--	82[10/]	--
5.3 Contraceptive prevalence (% of women ages 15-49)	--	--	29	--	38[10/]	--
5.4 Adolescent fertility rate (births per 1,000 women ages 15-19)	--	94[3/]	86	72	60	55
5.5 Pregnant women receiving prenatal care (%)	--	--	91	--	98[10/]	--
5.6 Unmet need for contraception (% of married women, ages 15-49)	--	--	--	--	37[10/]	--
Goal 6: Combat HIV/AIDS, Malaria and other diseases						
6.1 Prevalence of HIV, total (% of population ages 15-49)	0.2	0.5	0.8	1.2	1.0	1.0[11/]
6.1 Prevalence of HIV, female (% ages 15-24)	--	--	--	--	--	0.3[11/]
6.1 Prevalence of HIV, male (% ages 15-24)	--	--	--	--	--	0.4[11/]
6.2 Condom use, population ages 15-24, female (% of females ages 15-24)	--	--	--	--	54[10/]	--
6.2 Condom use, population ages 15-24, male (% of males ages 15-24)	--	--	--	--	64[10/]	--
6.7 Use of insecticide-treated bed nets (% of under-5 population)	--	--	23	--	56[10/]	--
6.8 Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	--	--	61	--	8[10/]	--
6.9 Incidence of tuberculosis (per 100,000 people)	135	124	114	105	96	94[11/]
6.10 Tuberculosis case detection rate (all forms)	11	--	60	85	76	86[11/]
Goal 7: Ensure environmental sustainability						
7.1 Forest area (% of land area)	28	--	28	28	28	--
7.2 CO2 emissions (kg per PPP $ of GDP)			.54[5/]	0.59	0.41[9/]	--
7.2 CO2 emissions (metric tons per capita)	0.57	0.60	0.62	0.84	0.79[9/]	--
7.8 Improved water source (% of population with access)	--	75	79	85	89	--
7.9 Improved sanitation facilities (% of population with access)	--	20	21	24	26	--
Goal 8: Develop a global partnership for development						
8.1 Net ODA received per capita (current US$)	466	657	247	213	298	--
8.12 Debt service (PPG and IMF only, % of exports, excluding workers' remittances)	29	27[3/]	22	61	7	--
8.14 Telephone lines (per 100 people)	1.9	2.0	3.3	4.7	4.7	4.7[11/]
8.15 Mobile cellular subscriptions (per 100 people)	--	--	--	8	62	71
8.16 Internet users (per 100 people)	--	--	5	14	19	22
Other						
Fertility rate, total (births per woman)	5.4	5.0	4.6	4.1	3.7	3.5
GNI per capita, Atlas method (current US$)	--	--	--	750	1240	1350[11/]
GNI, Atlas method (current US$, millions)	--	--	--	114	205	227[11/]
Life expectancy at birth, total (years)	61	62	62	63	64	65
Literacy rate, adult total (% of people ages 15 and above)	73[1/]	--	84[5/]	--	89[10/]	--
Literacy rate, youth total (% of people ages 15-24)	94[1/]	--	95[5/]	--	95[10/]	--
Population, total (thousands)	116	128	141	153	165	169[11/]
Trade (% of GDP)	--	--	79	67	76	69[11/]

Source: World Bank Development Indicators.

1/ Correspond to 1991 2/ Correspond to 1992 3/ Correspond to 1997 4/ Correspond to 1999 5/ Correspond to 2001 6/ Correspond to 2002

7/ Correspond to 2004 8/ Correspond to 2007 9/ Correspond to 2008 10/ Correspond to 2009 11/ Correspond to 2011

Table 11. São Tomé and Príncipe: Schedule of Disbursements Under the ECF Arrangement, 2012–15

Date	Disbursement conditions	SDR Amount	Percent of Quota
07/20/12	Board approval of arrangement.	370,000	5
06/13/13	Observance of continuous and end-December 2012 PCs and completion of the first review.	370,000	5
12/16/13	Observance of continuous and end-June 2013 PCs and completion of the second review.	370,000	5
04/15/14	Observance of continuous and end-December 2013 PCs and completion of the third review.	370,000	5
10/15/14	Observance of continuous and end-June 2014 PCs and completion of the fourth review.	370,000	5
04/15/15	Observance of continuous and end-December 2014 PCs and completion of the fifth review.	370,000	5
06/15/15	Observance of continuous and end-March 2015 PCs and completion of the sixth review	370,000	5
	Total	2,590,000	35

Source: IMF

Appendix I. Letter of Intent

São Tomé, November 25, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

On July 20, 2012, the Executive Board of the International Monetary Fund (IMF) approved a new three-year arrangement under the Extended Credit Facility (ECF) in favor of the Democratic Republic of São Tomé and Príncipe. This arrangement supports the Government's medium-term efforts to strengthen macroeconomic stability, foster sustainable and inclusive growth, and reduce poverty in the context of the National Poverty Reduction Strategy Paper II. The first review under the ECF supported arrangement was completed by the IMF Executive Board on June 13, 2013. Recently, the Government concluded discussions on the second review with an IMF staff mission, with focus on program implementation through end-June 2013, as well as on the fiscal and financial measures to be implemented during the remainder of 2013 and in 2014.

Despite a challenging international environment, overall program implementation through end-June 2013 was good. All performance criteria were observed, and structural reforms progressed, albeit at an uneven pace. Negotiations between the Government, the Water and Electricity Company, EMAE, and the National Fuel Company, ENCO, on a lasting plan to clear EMAE's arrears to ENCO and to avoid a recurrence of this problem in the future continue to be difficult and are expected to be completed by end-March 2014. A critical element of this strategy is to improve EMAE's cash flow. The Government has recently asked the World Bank and the IFC to provide options to address this issue, which may include contracting out the management of EMAE to a reputable international operator.

The Government is fully committed to continue building on recent achievements, which include a reduction of the annual inflation to 6.4 percent in August 2013 (its lowest level in two decades). Fiscal policy will be set to support macroeconomic stability and efforts to lower inflation further, by ensuring that the domestic primary deficit is in line with available non-debt-creating financing. Given the critical role of liquidity management and banking supervision in financial stability, the Government intends to ensure that the Central Bank remain independent to conduct its highly technical work.

São Tomé and Príncipe's economic outlook will depend on strengthening the economy's resilience in the wake of diminished near-term oil prospects. The French oil company Total's unexpected withdrawal last September from Block 1 of the Joint Development Zone (JDZ) with Nigeria is akin to a significant external shock. Until then, this was the most promising oil production field, with the expectation that production could start in 2015. While several medium-size oil companies are interested in taking over from Total the exploration of Block 1 of the JDZ, there is increased uncertainty surrounding both the timing and volume of oil production. In the absence of oil, fiscal and external debt sustainability indicators will improve more slowly than expected. The Government will have to continue relying on grants or highly concessional financing for many years to come, and more difficult budget financing prospects will necessitate a tighter fiscal policy stance. Commercial banks will also have to adapt to the new reality, and the ones that have entered the market lured mainly by the prospects of oil will have to change their market strategy and strengthen their balance sheet, or leave the market. In addition, the Government will have to promote even more forcefully the development of non-oil priority sectors, such as tourism and agriculture, including by further improving the business climate and upgrading the country's infrastructure.

The Government believes that the policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) are adequate to achieve the program's objectives, but it will take additional measures, if needed, to safeguard those objectives. São Tomé and Príncipe will consult with the IMF on the adoption of these measures, and in advance of any revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. The Government will furnish the IMF with the necessary data for monitoring purposes on a timely basis. That information as well as arrangements for monitoring program implementation and the definitions of indicative targets and performance criteria are detailed in the Technical Memorandum of Understanding (TMU), which is also attached to this letter. During the program period, the Government will not introduce or intensify any exchange rate restrictions or multiple currency practice that are inconsistent with Article VIII of the IMF's Articles of Agreement, or introduce or intensify import restrictions for balance of payments purposes.

In light of the appreciable progress in implementing the program supported by the ECF arrangement, the Government is requesting the completion of the second review as well as the third disbursement of SDR 0.37 million under this arrangement.

The Government wishes to make this letter available to the public, along with the attached MEFP and TMU, as well as the IMF staff report on the first review. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval.

Yours truly,

/s/

Mr. Hélio Almeida
Minister of Planning and Finance

/s/

Ms. Maria do Carmo Silveira
Governor of the Central Bank of São Tomé and Príncipe

Attachments:
– Memorandum of Economic and Financial Policies
– Technical Memorandum of Understanding

Attachment 1. Memorandum of Economic and Financial Policies for 2013 and 2014

I. RECENT ECONOMIC DEVELOPMENTS

1. **Real GDP growth decelerated to 4 percent in 2012 and is projected to remain at 4 percent in 2013**. Many of São Tomé and Príncipe's key development and investment partners were hard hit by the global economic slowdown. As a result, São Tomé and Príncipe experienced a scaling back of project financing and foreign direct investment. No acceleration in growth is projected for 2013 in light of lingering uncertainties stemming from the challenging external environment and related weak external financing prospects for investment projects (both official and private).

2. **Annual inflation recently reached record lows**. The adoption of the peg to the euro in early 2010 combined with a prudent fiscal policy stance has helped reduce inflation, despite São Tomé and Príncipe's vulnerability to supply shocks. Although annual inflation reached 10.4 percent at end-2012, following unseasonably heavy rains, which disrupted the supply of perishables, inflationary pressures receded by early 2013 and annual inflation reached 6.4 percent in August 2013 (its lowest level in two decades).

3. **Fiscal performance through end-June 2013 was favorable but cross-arrears flared up again**. Tax collections in the first half of 2013 were lower than projected given the weakening economy and accumulation of fuel tax arrears by ENCO (in lieu of missed payments by EMAE), and the wage bill was higher due to the adoption of new career ladders in the national security sector and overtime payments for teachers that were not foreseen in the budget. These developments, however, were more than offset by higher nontax revenue (frontloading of fishing royalties and transfers from parastatals, and license fees related to the sale of the Government's stake in STP Cabo to an Angolan telecommunications operator), and by lower transfer payments and domestically-financed capital expenditure, as well as lower goods and services outlays.

4. **Improving the banking system's financial soundness remains elusive but its level of dollarization has been gradually declining**. The number of commercial banks in São Tomé and Príncipe seems high in comparison to other small island states. Soundness indicators reveal low overall profitability, a high and rising share of nonperforming loans, and a rapidly declining trend in banks' capital-to-risk-weighted-asset ratios. In addition, two commercial banks—one of them already under Central Bank intervention—need to be recapitalized, sold, or closed. On the positive side, dollarization in São Tomé and Príncipe's commercial banking system continues to decline, reflecting measures taken by the Central Bank to foster the use of the local currency, and increased confidence in the local currency as inflation converges to international levels.

5. **The external current account deficit continues to decline and international reserves to rise**. Lower external financing has led to reduced demand for imports of goods and services

and an improved external current account balance. International reserves at the Central Bank have been boosted by privatization receipts from the sale of the Government's stake in STP Cabo, and by grants from the World Bank and Timor-Leste. Central Bank's international reserves stand comfortably above the program's floor of 3 months of imports and significantly exceeded other traditional norms for reserve adequacy.

II. RECENT PERFORMANCE UNDER THE ECF-SUPPORTED PROGRAM

6. **Program performance through end-June 2013 was satisfactory** (Table 1). All continuous and quantitative performance criteria (PCs) were met. However, the indicative target (IT) on Dobra base money was narrowly missed reflecting higher international reserve accumulation, and the IT on the non-accumulation of domestic arrears was missed stemming from the resurgence of the cross-arrears problem.

7. **Structural reforms have progressed, albeit at an uneven pace** (Table 2):

- The on-site inspection of the country's largest commercial bank was completed by end-June 2013 despite significant staffing constraints at the Central Bank pertaining to the administrative takeover of Island Bank.

- For the first time in over two decades, government accounts were prepared and submitted for review: the 2010 accounts were finalized and presented to the Court of Audit in June 2013. The Government is now working on the 2011 and 2012 accounts, but preparing the latter using the accounting feature of SAFE-e will take longer than initially envisaged given delays in the provision of technical assistance and training in this area.

- The formulation of a plan to clear cross-arrears between ENCO, EMAE, and the Treasury and to avoid their reoccurrence is still pending. A critical element of this strategy is to improve EMAE's cash flow. The Government has recently asked the World Bank and the IFC to provide options to address this issue, which may include contracting out the management of EMAE to a reputable international operator.

III. ECONOMIC OUTLOOK AND RISKS

8. **São Tomé and Príncipe's economic outlook will depend on strengthening the economy's resilience in the wake of diminished near-term oil prospects**. The French oil company Total's unexpected withdrawal last September from Block 1 of the Joint Development Zone (JDZ) with Nigeria, due to concerns about high deep-sea exploration costs and the size of oil reserves, is akin to a significant external shock. Until then, this was the most promising oil production field, with the expectation that production could start in 2015. In the absence of oil, fiscal and external debt sustainability indicators will improve more slowly. The Government will have to continue relying on grants and highly concessional financing for many years to come, and more difficult budget financing prospects will necessitate a tighter fiscal policy stance. Commercial banks will also have to adapt to the new reality, and the ones that have entered the market lured mainly by the prospects of oil will have to change their market strategy and strengthen their balance sheets, including by further recapitalization. There is also a need to

restructure and strengthen the banking system through mergers and/or closure of distressed and weak banks. Finally, the Government will have to promote even more forcefully the development of non-oil priority sectors, such as tourism, agriculture, and fisheries, including by further improving the business climate and upgrading the country's infrastructure with private sector support.

9. **While the Government remains confident about the prospects for oil production in São Tomé and Príncipe, it has decided to cautiously adopt a non-oil baseline scenario**. Several medium-size oil companies are interested in taking over from Total the exploration of Block 1 of the JDZ, and the Government has recently signed a new production sharing contract for exploration rights in the Exclusive Exploration Zone (EEZ). However, there is increased uncertainty surrounding both the timing and volume of oil production, suggesting the importance of strengthening the economy's resilience. In this connection, the Government will implement during 2015-17 a cumulative adjustment in the domestic primary balance of 1 percent of GDP; and the Central Bank will require all commercial banks that operate in São Tomé and Príncipe to have a capital-to-risk-weighted-asset ratio of at least 12 percent by end-March 2014 (structural benchmark). A revised oil scenario will serve as the program's alternative scenario for debt sustainability analysis purposes.

10. **The outlook for 2014 continues to be affected by difficult global conditions**. Real GDP growth has been revised downward, from 5½ to 5 percent, reflecting lingering uncertainties in the world economy, weak external financing prospects for investment projects, and the changed oil outlook. Inflation is projected to reach 6 percent by end-2014, as inflation expectations continue to be anchored by a prudent fiscal policy stance and the peg of the dobra to the euro. The external current account deficit is expected to narrow further, with weaker than previously projected economic activity leading to lower import growth; and the Central Bank's international reserves are expected to remain comfortably above 3½ months of imports (the program's new floor).

11. **Risks to the outlook are manageable**. Downside risks include significant spending overruns in the run-up to next year's local and parliamentary elections, which in past election cycles derailed fiscal rectitude. The Government, however, is fully committed to resisting spending pressures. The outlook could also be adversely affected by the materialization of supply shocks (leading to higher inflation and lower growth), spillovers from a further deterioration in financial conditions in Europe (resulting in delays in project execution due to financing shortfalls), and protracted right-sizing of São Tomé and Príncipe's banking sector (leading to continued low profitability in the sector and stagnant credit). Upside risks include the possibility of stronger growth in Europe, lower-than-projected inflation for 2013, and oil production.

IV. MACROECONOMIC POLICIES

A. Strengthening Public Finances

The fiscal program for 2013 and 2014

12. **The Government is on track to achieving the 2013 domestic primary deficit target of 3.1 percent of GDP**. This target is expected to be met despite higher personnel outlays—an increase of about Db37 billion, or the equivalent to ⅔ percent of GDP, over the budgeted amount—due to higher costs of introduction of new career ladders in the health, education, and national security sectors, and an additional increase of 10 percent in teachers' wages (effective August 2013). Revenue collections will be higher-than-programmed because of higher nontax revenue stemming from license fees associated with the sale of the Government's stake in STP Cabo, while the tax-to-GDP ratio will be unchanged (from 2012 levels) as ongoing efforts to strengthen the tax and customs administrations, broaden the tax base, and collect fuel tax arrears are expected to offset the adverse effect on tax collections of weaker economic growth. Finally, non-interest recurrent spending is projected to remain in line with earlier projections, despite higher personnel costs, due to non-wage recurrent and domestically-financed capital expenditure reprioritization and restraint.

13. **The fiscal program for 2013 is fully funded**. Additional external inflows more than offset a delay in scholarship grants from Nigeria, which are now expected for 2014. Unanticipated inflows in 2013 included: increased budget support from the World Bank (an additional US$1.3 million); budget support from Timor-Leste (US$7 million); and proceeds from the sale of the Government's stake in STP Cabo (US$6.4 million). These inflows have funded a pickup in project execution relative to the first half of year, and will be used to clear Treasury's arrears to EMAE by end-2013 (structural benchmark).

14. **The 2014 budget will maintain fiscal rectitude during an election year**. It will target a domestic primary deficit of 3.0 percent of GDP, which is fully consistent with available non-debt creating financing from the World Bank, Nigeria, and transfers from the National Oil Account (NOA). Gains from the widening of the tax base and improved taxpayer segmentation (designed to enhance compliance among large taxpayers) are projected to result in an increase in the tax effort. On the spending side, the Government is fully committed to containing the growth of the public sector wage bill in line with projected average inflation. The elimination (in 2013) and non-accumulation (in 2014 and beyond) of Treasury's arrears to EMAE is expected to serve as a catalyst for the reduction of EMAE's arrears to ENCO and facilitate the elimination of ENCO's fuel tax arrears.

The medium-term fiscal framework

15. **Looking ahead, fiscal consolidation will be implemented gradually to limit its contractionary impact**. A cumulative adjustment in the domestic primary deficit of 1.0 percent

of GDP will be phased in over three years, starting in the year after local and parliamentary elections. This will enable the Government to weather the initial negative impact of Total's decision and undertake the fiscal adjustment once a recovery is firmly underway. Given the relatively low level of recurrent and domestically-financed capital expenditure, there is limited scope for further expenditure containment. Thus, notwithstanding ongoing efforts at strengthening expenditure prioritization, the needed fiscal adjustment will be more heavily weighted toward revenue enhancement, comprising a mix of customs and tax administrative reforms and, as needed, tax policy measures.

Structural reforms to strengthen public finances

16. **Specific achievements in 2013 in the fiscal area included**:

- Creation of a macro-fiscal unit, with representatives from the Ministry of Planning and Finance, Central Bank, and National Institute of Statistics (INE), which has begun the preliminary work toward implementing a medium-term fiscal framework (MTFF).

- Ongoing steps to make the Government's financial administration system (SAFE-e) fully operational, including the activation of the system's accounting module.

17. **Reforms that are ongoing and slated for 2014 include**:

- Adopting a comprehensive solution to the problem of cross-arrears. The plan to eliminate cross-arrears between the Treasury, EMAE and ENCO and to avoid their recurrence is now expected to be finalized by end-March 2014 (structural benchmark) and the elimination of Treasury's arrears to EMAE by end-December 2013 (structural benchmark). In addition, quarterly ITs have been introduced to monitor during 2014 the non-accumulation of Treasury's arrears to EMAE.

- Expanding the tax base by launching the "Operation Taxpayer Inclusion" project and adopting and executing quarterly metrics for the number of newly registered taxpayers. The project is designed to register on a cumulative basis 500 and 800 new taxpayers, respectively, by end-June 2014 and end-December 2014 (structural benchmarks), and ultimately targets registration of an additional 3,000 taxpayers by the project's end.

- Enhancing taxpayer management within the Tax Directorate by increasing security of the Taxpayer Registry, and by creating a dedicated large taxpayer unit and a single taxpayer computerized file system (structural benchmark, December 2013).

- Progressing toward completion of the second phase of ASYCUDA World through activation of all the functionalities and the establishment of a fully computerized procedure (structural benchmark, December 2013).

- Preparing the general government accounts for 2012 and presenting them to the National Assembly and Court of Audit by end-December 2013 (structural benchmark).

- Combating tax fraud and evasion by improving the selection of taxpayers for audit through risk analysis, expanding tax coverage throughout the country, and strengthening the National Tax Court, by allowing it to perform its duties with own resources.

- Increasing taxpayer voluntary compliance by improving the quality of services provided to taxpayers, simplifying and harmonizing tax procedures, extending tax services to the more remote areas of the country, and conducting visits to newly created firms.

- Providing the tax and customs administrations with the necessary resources, including additional staff and equipment, to implement the reforms mentioned above.

B. Enhancing Liquidity Management, Financial Stability, and Safeguards

18. **The Central Bank continues to develop its monetary liquidity management framework and bank supervision capabilities**. It has now successfully extended the liquidity forecasting horizon to one month and is adopting a systematic approach to analyze forecasting errors as a precursor to the future introduction of money market instruments. In a bid to address capacity constraints, the Central Bank has recently recruited three additional staff to the Banking Supervision Department, but staffing levels remain below optimum. A program of on-site inspections is currently in progress, and all commercial banks are now expected to be inspected by end-June 2014 following the inspection of the two remaining banks that have not yet been subject to on-site inspection (structural benchmark). In addition, the Central Bank, however, will conduct by end-2013 a second on-site inspection of one bank that was previously inspected.

19. **Other specific achievements in 2013 included**:

- Completing the on-site inspection of the largest commercial bank in the first half of the year.

- Supporting the exchange rate peg by maintaining net international reserves at the Central Bank above the equivalent of three months of imports, and investing central bank international reserves in high quality and liquid financial assets.

- Expanding the role of the Internal Audit Department to track more systematically the implementation of external auditors' recommendations and monitor the main risks to the central bank's balance sheet.

- Taking over the operations of Island Bank, following the bank's failure to comply with supervisory requirements and to submit a remedial action plan.

20. **Reforms that are ongoing and planned for 2014 to strengthen the economy's resilience to shocks, bolster the Central Bank's independence and supervisory practices, and promote financial literacy and transparency include**:

- Increasing the program's floor on net international reserves from 3 to 3½ months of imports to boost confidence in the wake of reduced oil prospects.

- Reinforcing compliance with solvency and other regulatory standards by requiring that all commercial banks that are open to the public have a capital-to-risk-weighted-asset ratio of at least 12 percent by end-March 2014 (structural benchmark), and strictly enforcing other banking regulations, such as reserve requirements and dissemination of data to the credit registry, with application of penalties to non-compliant institutions.

- Conducting on-site inspections of the two remaining commercial banks not yet subject to on-site inspection by end-June 2014 (structural benchmark), and increasing the frequency of on-site inspections thereafter, as well as improved analysis of the commercial banks' quarterly reports, made possible in part through the hiring of additional bank supervisors.

- Enhancing commercial bank transparency by ensuring that all commercial banks publish their financial results for 2012 by end-March 2014. Commercial banks should aim to publish their 2013 accounts by end-September 2014, or face penalties for non-compliance (structural benchmark).

- Further strengthening liquidity management by developing a systematic approach toward analyzing forecasting errors and examining the evolution of daily aggregate liquidity conditions, with a view to introducing in due course money market instruments and creating the foundations of an interbank market.

- Developing and beginning to implement a work program to introduce a new chart-of-accounts and reporting at the Central Bank in line with International Financial Reporting Standards (IFRS), with technical assistance from the Central Bank of Brazil.

- Drafting by end-September 2014 a revised draft of the Central Bank Law that strengthens the autonomy of the Central Bank in line with international standards, including in the resolution of problem banks (structural benchmark).

- Improving external communications policies to enhance financial literacy and boost confidence in the financial system, including regular publication of reports and economic bulletins, strengthening the capacity of the Office of Consumer Affairs, and promoting financial literacy.

- Encouraging the use of modern technology, including credit and debit cards, point-of-sale terminals, ATMs, and secure mobile-banking, with the objective of expanding the operations of the electronic payments system to the whole country.

V. BUSINESS CLIMATE

21. **Fostering private sector led economic growth and diversification will require an improved business climate**. São Tomé and Príncipe has recently made progress in improving its business environment, but more needs to be done to diversify production and put the economy on a sustainable growth path. In this regard, the Government plans to undertake additional reforms to strengthen and simplify the country's legal infrastructure, including in the areas of contract enforcement, property registration, and protection to investors. The Government remains committed to the pursuit of fiscal prudence and financial and monetary stability and the maintenance of wage and price flexibility, with a view to keeping the real effective exchange rate broadly consistent with its underlying fundamentals in the context of the fixed exchange rate regime.

22. **Progress is being made toward the establishment of a one-stop-shop to facilitate and promote foreign trade**. Preparatory arrangements are now underway for the launching of the new one-stop-shop by early-2015. Once in place, this facility will reduce transaction costs and thereby enhance São Tomé and Príncipe's external competitiveness. It will also enhance efficiency, transparency, and potentially revenue collections by permitting the single and simultaneous payment of customs duties and other fees and taxes due to all institutions involved in the clearance of imports. Key milestones include: establishing by end-June 2014 the connectivity of the Customs and Tax Directorate (structural benchmark); and the elimination of hard-copy documents and introduction of electronic signing and approval of documents by end-December 2014 (structural benchmark). This facility will complement the one-stop-shop for investors established in 2011, which has centralized and simplified the administrative requirements for establishing a business in São Tomé and Príncipe.

F. ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (AML/CFT)

23. **The Government remains fully committed to addressing the deficiencies of São Tomé and Príncipe's AML/CFT framework**. With technical assistance from the IMF's Legal Department, it drafted amendments to the AML/CFT law and submitted the revised draft law to the National Assembly in May 2013. The draft law was approved unanimously by the National Assembly; and President Pinto da Costa has signed it. Passage of this law facilitated the recent removal of São Tomé and Príncipe from the Financial Action Task Force's list of high risk and non-cooperative jurisdictions. Complementary efforts to strengthen the operations of the financial intelligence unit (FIU) through improved resources, including staffing, equipment and training are expected to strengthen the FIU core functions—including receipt, analysis, and submission to the General Attorney's Office of suspicious transaction report.

G. STATISTICS

24. **The Government continues to strengthen the statistical system**. In addition to the several improvements listed above, INE is taking steps to improve the outdated consumer price index (CPI). The household survey completed in 2011 is providing the basis for reweighting the CPI components and introducing new goods and services to its basket (both were updated last about twenty years ago). The introduction of the new CPI (structural benchmark, end-December 2013) is expected to greatly improve the measurement of inflation.

H. PROGRAM MONITORING

25. The PCs, ITs, and structural benchmarks for the second half of 2013 and for 2014 are presented in Tables 1-4. The definitions of quantitative PCs and ITs are provided in the attached Technical Memorandum of Understanding (TMU). The third review is expected to be completed by April 2014, the fourth review by October 2014, and the fifth review by April 2015.

Table 1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2013

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

	2013							
	March			June			September	December
	Indicative Target	Indicative Targets w/adjustment	Actual	Performance Criteria [1]	Performance Criteria w/adjustment	Actual	Indicative Target	Performance Criteria [1]
	31-Mar-13	31-Mar-13	31-Mar-13	30-Jun-13			30-Sep-13	31-Dec-13
Performance criteria:								
1 Floor on domestic primary balance (as defined in the TMU) [2]	-47	-47	14	-105	-147	-95	-142	-178
2 Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	0	38	-22	0	46	-148	0	0
3 Floor on net international reserves of the central bank (US$ millions) [2, 4]	21.97	19.96	38.28	21.97	19.54	47.46	21.97	21.97
4 Ceiling on central government's outstanding external payment arrears (stock, US$ millions) [5, 6, 7, 8]	0	...	0	0	...	0	0	0
5 Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the central government or the BCSTP (US$ millions) [5, 6, 7, 8, 9, 10]	0	...	0	0	...	0	0	0
6 Ceiling on the outstanding stock of external debt with original maturity of up to and including one year owed or guaranteed by the central government or the BCSTP (stock, US$ millions) [5, 7, 8, 9, 10]	0	...	0	0	...	0	0	0
Indicative targets:								
Ceiling on central government's outstanding domestic arrears	0	...	31	0	...	79	0	0
Ceiling on dobra base money (stock)	635	...	635	649	...	678	675	913
Floor on pro-poor expenditures	73	...	79	146	...	158	219	292
Memorandum items:								
Transfer from NOA to the budget (US$ millions)	1.8	...	0.0	1.8	...	1.8	1.8	1.8
Net external debt service payments [11]	14	...	13	35	...	53	85	110
Official external program support [11]	74	...	37	158	...	51	168	193
Treasury-funded capital expenditure	25	...	0	31	...	38	92	96

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

[1] Performance at the June and December test dates are assessed on the second and third reviews respectively.

[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 "government" is defined as in ¶ 3 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 in accordance with the residency of the creditor as indicated in point 2 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009).

[8] This performance criterion applies not only to debt as defined in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009) 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, ¶ 15-17.

[9] Only applies to debt with a grant element of less than 50 percent as defined in point 8 g (i) of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No 6230-(79/140) of the Executive Board of the IMF (as amended effective October 11, 2013). For further details on the definition of concessionality refer to the TMU, Footnote 4.

[10] Debt is defined as in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009). For further details on the definition of debt refer to the TMU, ¶ 15-17.

[11] As defined in the TMU, valued at the program exchange rate.

Table 2. São Tomé and Príncipe: Structural Benchmarks for 2013

Category		Structural Benchmarks	Economic rationale	Indicative timeframe	Status & Indicative timeframe
		Strengthening Public Finances			
External control	i.	Strengthen external control by:	Strengthen PFM	End-Jun. 2013	Not met Reset for end-Dec. 2013
		Preparing the general government accounts for 2012 and sending them to the National Assembly and the Court of Audit.			
Internal control	ii.	Strengthen internal control by:	Strengthen PFM		
		Finalizing a plan to clear over time EMAE's arrears to ENCO and to avoid a recurrence in the future of the problem of cross arrears.		End-Sep. 2013	Not met Reset for end-Mar. 2014
		Eliminating all arrears between the Treasury and EMAE.		End-Dec. 2013	New structural benchmark
Tax administration	iii.	Improve taxpayer management and compliance with tax obligations by:	Strengthen revenue administration	End-Dec. 2013	On-going
		Enhancing the security of the Taxpayer Registry, creating a dedicated large taxpayer unit, and creating a single taxpayer computerized file system.			
Customs administration	iv.	Complete the second phase of ASYCUDA WORLD implementation by:	Strengthen revenue administration	End-Dec. 2013	On-going
		Activating all the functionalities and the establishing a fully computerized procedure.			
		Enhancing Monetary Management and Financial Stability			
Bank supervision	v.	Strengthen banking supervision and regulation by:	Ensure financial stability		
		Completing the on-site supervision process for the largest commercial bank.		End-Jun. 2013	Met
		Completing the on-site supervision process for the remaining two commercial banks.		End-Dec. 2013	Reset for end-Jun. 2014

		Statistics			
CPI Statistics	vi.	Improve consumer price index statistics by: Reweighting the CPI components and introducing new goods and services to the CPI basket.	Strengthen statistical system	End-Dec. 2013	On-going

Table 3. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2014

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

	2014			
	March	June	September	December
	Indicative Target	Performance Criteria [1]	Indicative Target	Performance Criteria [1]
	31-Mar-14	30-Jun-14	30-Sep-14	31-Dec-14
Performance criteria:				
1 Floor on domestic primary balance (as defined in the TMU) [2]	-50	-119	-159	-198
2 Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	0	0	0	0
3 Floor on net international reserves of the central bank (US$ millions) [2, 4]	27.50	27.50	27.50	27.50
4 Ceiling on central government's outstanding external payment arrears (stock, US$ millions) [5, 6, 7, 8]	0	0	0	0
5 Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the central government or the BCSTP (US$ millions) [5, 6, 7, 8, 9, 10]	0	0	0	0
6 Ceiling on the outstanding stock of external debt with original maturity of up to and including one year owed or guaranteed by the central government or the BCSTP (stock, US$ millions) [5, 7, 8, 9, 10]	0	0	0	0
Indicative targets:				
Ceiling on central government's outstanding domestic arrears	0	0	0	0
Ceiling on central government's outstanding arrears to EMAE	0	0	0	0
Ceiling on dobra base money (stock)	954	1,030	1,071	1,145
Floor on pro-poor expenditures	n.a.	n.a.	n.a.	n.a.
Memorandum items:				
Transfer from NOA to the budget (US$ millions)	2.5	2.5	2.5	2.5
Net external debt service payments [11]	24	59	97	139
Official external program support [11]	0	36	172	246
Treasury-funded capital expenditure	28	72	102	111

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

[1] Performance at the June and December test dates are assessed on the fourth and fifth reviews respectively.

[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 "government" is defined as in ¶ 3 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 in accordance with the residency of the creditor as indicated in point 2 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009).

[8] This performance criterion applies not only to debt as defined in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009) 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, ¶ 15-17.

[9] Only applies to debt with a grant element of less than 50 percent as defined in point 8 g (i) of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No 6230-(79/140) of the Executive Board of the IMF (as amended effective October 11, 2013). For further details on the definition of concessionality refer to the TMU,

[10] Debt is defined as in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009). For further details on the definition of debt refer to the TMU, ¶ 15-17.

[11] As defined in the TMU, valued at the program exchange rate.

Table 4. São Tomé and Príncipe: Structural Benchmarks for 2014

Category		Structural Benchmarks	Economic rationale	Indicative timeframe
		Strengthening Public Finances		
Internal control	i.	Strengthen internal control by:	Strengthen PFM	
		Finalizing a plan to clear over time EMAE's arrears to ENCO and to avoid a recurrence in the future of the problem of cross-arrears.		End-Mar. 2014
Tax administration	ii.	Expand the tax base by launching the "Operation Taxpayer Inclusion" project and:	Strengthen revenue administration	
		Registering 500 new tax payers from the date of the program's launch.		End-Jun. 2014
		Registering 800 new tax payers from the date of the program's launch.		End-Dec. 2014
Customs administration	iii.	Undertake preparatory arrangements for the installation of a One-Stop-Shop for foreign trade by:	Strengthen revenue administration and trade facilitation	
		Establishing the connectivity and management of customs/Tax NIF.		End-Jun. 2014
		Eliminating hardcopy documents and introducing electronic signing and approval of documents.		End-Dec. 2014
		Enhancing Monetary Management and Financial Stability		
Bank supervision	iv.	Strengthen banking supervision and regulation by:		
		Ensuring that all commercial banks that are open to the public have a capital-to-risk-weighted-asset ratio of at least 12 percent.	Ensure financial stability	End-Mar. 2014
		Completing the on-site supervision process for the remaining two commercial banks.	Ensure financial stability	End-Jun. 2014
		Ensuring that all commercial banks publish audited financial accounts for 2013, or applying penalties for non-compliance.	Ensure financial stability and transparency	End-Sep. 2014

	Preparing a revised draft Central Banking Law that strengthens autonomy of the central bank in line with international standards, including in the resolution of problem banks.	Enhance the effectiveness of monetary and financial policies	End-Sep. 2014

Attachment 2. Technical Memorandum of Understanding

November 2013

1. This Technical Memorandum of Understanding (TMU) contains definitions and adjuster mechanisms that clarify the measurement of quantitative performance criteria and indicative targets in Tables 1 and 3, which are attached to the Memorandum of Economic and Financial Policies for 2013 and 2014. 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.

I. Provision of Data to the Fund

2. Data with respect to all variables subject to performance criteria and indicative targets will be provided to Fund staff monthly 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, as defined below, refer to the domestic primary balance and net bank financing of the central government, net international reserves of the central bank, external payments arrears, and non-concessional short-term and medium- and long-term external debt owed or guaranteed by the central government and/or the central bank.

II. Definitions

3. **Government** is defined for the purposes of this TMU to comprise the central government, which includes 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.

4. **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 Planning and Finance.

5. **Domestic primary expenditure** comprises all government spending assessed on a commitment basis (*base compromisso*), excluding (1) capital expenditure financed with external concessional loans and 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 Ministry of Planning and Finance.

6. Within domestic primary expenditure, **pro-poor expenditure** refers to 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 ministries and expenditure categories (by budget code) as described in the matrix below:

Code	Description of expenditure	Ministry of Education	Ministry of Health	Ministry of Labour
01.00.00	Personnel expenses	x	x	x
02.01.05	Other durable goods	x	x	
02.02.02	Fuel and lubricants[1]	x	x	x
02.02.04	Food[1]	x		
02.02.05	Medicine	x	x	
02.02.06	Clothing and footwear[1]	x	x	x
02.02.09	Other nondurable goods	x	x	
02.03.01.01	Water and energy	x	x	x
02.03.02	Custody of goods	x	x	
02.03.06	Communications	x	x	x
04.02.01	Private institutions	x		x
04.03.01	Individuals	x		x
04.04.02	Other inward transfers		x	
06.01.00	Education and training		x	
06.04.01	Project costs	x		
06.04.04.02	Miscellaneous	x	x	

[1] Expenditures on fuels and lubricants (*combustíveis e lubrificantes*) that are effected 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.

7. **Treasury-funded capital expenditure**: This is classified as part of domestic primary expenditure and covers projects that are not directly financed by project grants and concessional loans. Treasury funded capital spending will correspond to the 2013 and 2014 government plans for investment on roads, bridges, schools, water and power. It will include 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. The government investment program will be carried out by the Ministries of Public Works and Natural Resources, Education, and Health.

8. **Domestic primary balance** is defined as the difference between government domestic revenue and domestic primary expenditure. For reference, this balance for end-December 2012 was 163 billion dobra, broken down as follows:

	Government domestic revenue:	771 billion
Less:	Government primary expenditure:	
	(As defined in paragraph 5)	934 billion
Equals:	Domestic primary balance:	-163 billion

9. **Domestic arrears** are defined as the difference between expenditure on a commitment basis and cash payments (amounts past due after 40 days and unpaid).

10. **Arrears to EMAE** are defined as the obligations owed by the government to EMAE but not paid within 40 days.

The program exchange rate for the purposes of this TMU[1] will be 18,585 dobra per U.S. dollar, 24,500 dobra per euro, and 28,563 dobra per SDR for both 2013 and 2014.

11. **Net bank financing of the central government (NCG)** is defined as the stock of all outstanding claims on the central government held by the BCSTP and by other depository corporations (ODCs), less all deposits held by the central government with the BCSTP and with ODCs, as they are reported monthly by the BCSTP to the IMF staff. The balance of the National Oil Account (NOA) is not included in NCG. All foreign exchange-denominated accounts will be converted to dobra at the program exchange rate. For reference, at end-December 2012, outstanding net bank financing of the central government (excluding NOA) was 44 billion dobra, broken down as follows:

	BCSTP credit, including use of IMF resources:		233 billion
Less:	Government deposits with the BCSTP (excluding NOA)		95 billion
	Of which:	Treasury dobra-denominated accounts	4 billion
		Treasury foreign currency-denominated accounts	26 billion
		Counterpart deposits	65 billion
Equals:	Net credit to government by the BCSTP		138 billion
Plus:	ODC's credit to the government		3 billion
Less:	Government deposits with ODCs (including counterpart funds)		96 billion
Equals:	Net bank financing of the government (excluding NOA)		44 billion

12. **Dobra base money** is defined as the sum of currency issued—which consists of currency outside depository corporations and cash in vaults—and banks reserves denominated in dobra. Bank reserves refer to reserves of commercial banks – in dobra – held with the central bank and include reserves in excess of the reserve requirements. For reference, at end-December 2012 dobra base money was 616 billion dobra, calculated as follows:

[1] Data refer to the mid-point exchange rates published on the BCSTP's webpage for the last day of 2012.

	Currency issued:		217 billion
	Of which:	Cash in vaults	41 billion
		Currency outside depository corporations	176 billion
Plus:	Bank reserves denominated in dobra		399 billion
Equals:	Dobra base money		616 billion

13. **Net international reserves** (NIR) of the BCSTP are defined for program-monitoring purposes as short-term, 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-December 2012 NIR was 726 billion dobra, calculated as follows:

Gross international reserves:				933 billion
	Of which:	Cash		19 billion
		Demand deposits		127 billion
		Term deposits (including banks' deposits in foreign currency)		388 billion
		Securities other than shares		376 billion
		Of which:	Portuguese Treasury bonds	92 billion
			Rede Ferroviaria Nacional bonds	123 billion
			Less: discount (71.60)	35 billion
			Mortgage-backed securities of CDG	195 billion
		Accrued interest on securities		10 billion
		Reserve position in the Fund		0 billion
		SDR holdings		13 billion
Less:	Short-term liabilities (including liabilities to the IMF)			110 billion
Less:	Banks' reserves denominated in foreign currency			97 billion
Less:	Banks' guaranteed deposits denominated in foreign currency			10billion
Equals:	Net international reserves			717 billion
Plus:	Other foreign assets			249 billion
Less:	Medium and long-term liabilities (including SDR allocation)			203 billion
Equals:	Net foreign assets			763 billion
Memorandum item:	National Oil Account (NOA)			168 billion

14. **The performance criterion on short-term external debt** refers to the outstanding stock of external debt with an original maturity of one year or less (including overdraft positions but excluding normal import credits) owed or guaranteed by the government and/or the BCSTP.[2] With respect to the precautionary line of credit from Portugal to support the pegging of the dobra to the euro, unpaid balances outstanding during the first three quarters of a given year will be excluded from the short-term external debt limit. However, outstanding balances at the end of a given year will be included in the assessment of compliance with the short-term external debt performance criterion. For reference, at end-December 2012 the stock of short-term external debt was zero.

15. **The performance criterion on nonconcessional medium- and long-term external debt is a continuous performance criterion** that refers to the contracting or guaranteeing of new external debt with original maturity of more than one year by the government and/or the BCSTP.[3,4] Debt being rescheduled or restructured is excluded from the ceilings set on nonconcessional borrowing. Medium- and long-term debt will be reported by the Debt Management Department of the Ministry of Planning and Finance (as appropriate) by the BCSTP, measured in U.S. dollars at the prevailing exchange rates. The government should consult with IMF staff before contracting or guaranteeing new medium- or long-term debt obligations.

16. **The non-accumulation of external payment arrears is a continuous performance criterion**. Government external payment arrears are defined as all unpaid external public debt obligations, according to the data established by the Debt Management Department of the Ministry of Planning and Finance and (as appropriate) by the BCSTP, except for arrears pending rescheduling arrangements. The latter are considered as technical arrears. Debt would be deemed to be in arrears when it has not been paid by the time it is due, unless arrears have otherwise been contractually defined. This performance criterion does not apply to those arrears pending the signing of bilateral agreements in the context of debt-rescheduling with the Paris Club, if any, and other bilateral creditors.

17. **Net external debt service payments** are defined as debt service due less the accumulation of any new external payment arrears, including technical arrears.

[2] The term "debt" is defined as in point 9 of the IMF *Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF*, as amended effective December 1, 2009. 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 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.

[3] This performance criterion applies not only to debt as defined in point 9 of the IMF *Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF*, as amended effective December 1, 2009, but also to commitments contracted or guaranteed for which value has not been received.

[4] The level of concessionality of loans is assessed -using a discount rate of 5 percent. - For least developed countries, such as São Tomé and Príncipe, a loan is deemed to be on concessional terms if, on the date of initial disbursement, the ratio of the present value of the loan, calculated on the basis of the reference interest rate, to the nominal value of the loan is less than 50 percent (in other words, a grant element of at least 50 percent).. This performance criterion does not apply to IMF facilities.

18. **Official external program support** is defined as grants and loans, including 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. Amounts assumed in the program consistent with the definition are shown in Tables 1 and 3 of the MEFP as a memorandum item labeled "official external program support."

III. USE OF ADJUSTERS

19. **The performance criterion on the domestic primary deficit will have one adjuster**. The limit on the domestic primary deficit will be adjusted upward if the government finds budget support and privatization receipts in 2013 and 2014 in addition to that described in the MEFP; this adjuster will be capped at 50 billion dobra (about 1 percent of 2012 GDP) for 2013 and 2014.[5]

20. **Adjusters for the performance criteria on net bank financing of the central government and net international reserves will be set**. Deviations from amounts projected in the program for budget transfers from the NOA, official external program support, net external debt service payments, and domestic arrears will trigger adjustments on the above mentioned performance criteria. These deviations will be calculated cumulatively from end-December 2012 or end-December 2013, as appropriate (MEFP, Tables 1 and 3). The following is an explanation of these adjustments:

- **Adjustors 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, official external program support, net external debt service payments, and domestic arrears will be converted to dobra at the program exchange rate and aggregated from end-December 2012 or end-December 2013, as appropriate, to the test date. The ceilings will be adjusted downward (upward) by cumulative deviations downward (upward) of actual from projected net external debt service payments, and by deviations upward (downward) in budget transfers from the NOA, official external program support, and domestic arrears. The combined application of all adjusters at any test date is capped at the equivalent to US$3 million at the program exchange rate.

- **Adjustors 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 dobra, will be converted to U.S. dollars at the program exchange rate and aggregated from end-December 2012 or end-December 2013, as appropriate, to the test date. The floor will be adjusted upward (downward) by the cumulative deviation downward (upward) of actual from projected net external debt service payments of the central government, and by deviations upward (downward) for budget transfers from the NOA, official external program support, and domestic arrears. The combined application of

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

all adjusters at any test date is capped in such a way that the adjusted floor does not fall short of US$18.97 million in 2013 and US$24.5 million in 2014.

IV. DATA REPORTING

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

1) **Fiscal Data**: The Directorate of Budget at the Ministry of Planning and Finance 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 on arrears to EMAE;
- 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;
- Latest outstanding petroleum price structures and submission of new pricing structures (within a week of any changes).

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 dobra base money 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 Debt Management Unit at the Ministry of Planning and Finance 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, and subject to debt relief or rescheduled;
- Quarterly data on disbursements for foreign-financed projects and program support loans.

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 Ministry of Planning and Finance , 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.

Appendix II. External Balance Assessment[1]

São Tomé and Príncipe's external position is vulnerable owing mainly to the country's narrow export base. The current account is projected to remain in deficit over the long-term, reflecting heavy import dependence for food, fuel, and project-related investment goods needed to unlock growth. The country's external current account deficit is financed mainly though foreign aid and foreign direct investment (FDI). Achieving external sustainability requires accelerated reforms to the business environment to boost growth, create jobs, and expand the export base. The main downside risks to the current account (including transfers) are supply shocks and spillovers from a further deterioration in financial conditions in Europe which would limit the availability of grants and highly concessional loans.

There is no conclusive evidence of a real exchange rate misalignment. The Dobra appears to be somewhat overvalued in the short-run and broadly in line with fundamentals over the medium-term. Although the real effective exchange rate (REER) has appreciated somewhat since the adoption of the peg to the Euro in early 2010, a staff analysis suggests that there is no strong evidence of real exchange rate misalignment that could lead to external instability in the medium term. Quantitative analysis drawing on the CGER methodologies suggests external current account balance norms of -9½ percent of GDP (external sustainability approach) and -13¼ percent of GDP (macroeconomic balance approach) compared with a medium-term projection of -10½ percent of GDP. This translates into an overvaluation of about 1 percent and an undervaluation 2½ percent, respectively. The equilibrium real exchange rate approach—which yielded large uncertainties surrounding estimates due to data limitations —shows that the Dobra is significantly (about 37 percent) overvalued.

The current level of gross foreign exchange reserves – about 5.4 months of imports - appears to be adequate to withstand external shocks. After briefly falling below three months of imports in mid-2012, the authorities have since accumulated international reserves considerably, taking advantage of privatization receipts and inflows from the World Bank, Nigeria, and Timor-Leste. In addition, São Tomé and Príncipe has access to US$7.2 million in National Oil Account (NOA) deposits and €25 million from a contingent credit line with Portugal.[2]

São Tomé and Príncipe has made some progress in improving its business environment but much more remains to be done. The World Bank's 2012 *Doing Business Survey* ranked the country a top reformer in 2011 because the authorities established a one-stop window for investors and eliminated a wide range of licensing and minimum capital requirements. However, the country's ranking slipped a few positions by 2014 and still ranks near the bottom of the list. There is a need for additional structural reforms to boost

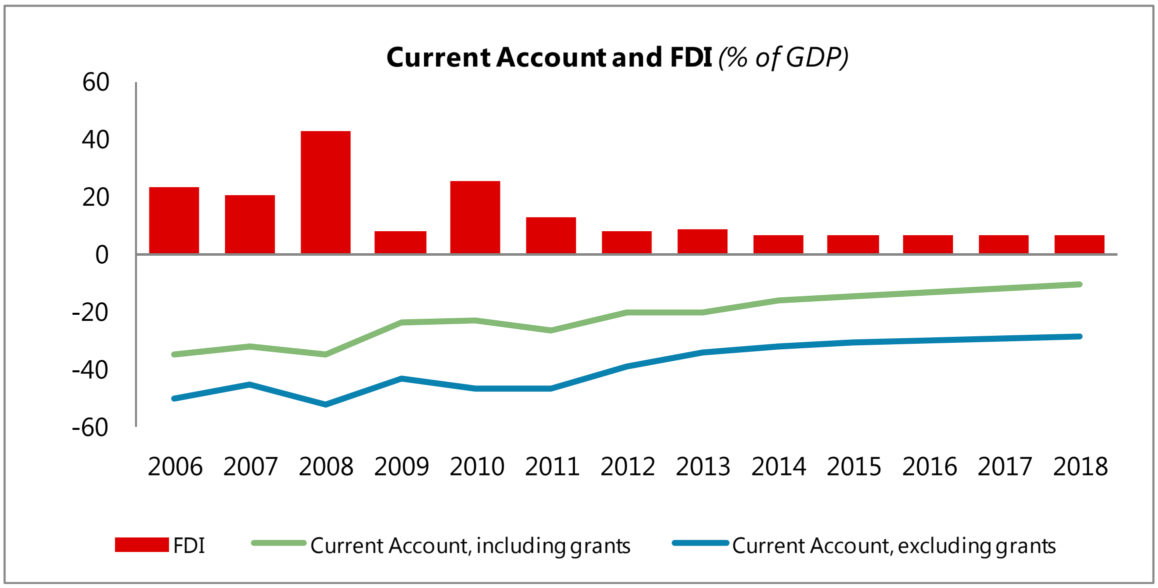
[1] This note was prepared by Justin Matz (AFR).

[2] In support of the exchange rate peg, the authorities have an agreement with Portugal according to which Portugal stands ready to provide support in the form of a credit line of up to €25 million, which would add another 3½ months of imports cushion to international reserves.

productivity and improve the business environment. Such measures include steps to strengthen the country's legal infrastructure (e.g., enforcing contracts, property registry, and protecting investors).

External current account

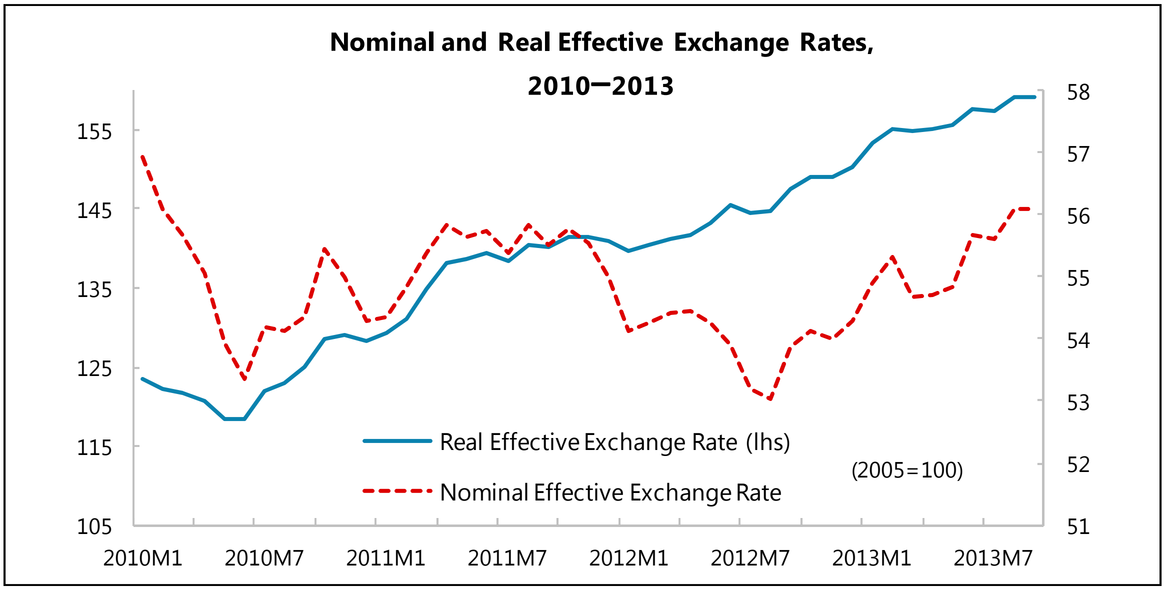
The external current account deficit has narrowed over the past few years as weaker economic activity led to lower import growth. The current account is expected to remain in deficit throughout the medium-term, reflecting the country's heavy reliance on imports, including food, fuels, and capital goods. The deficit is financed primarily by official transfers and FDI, both of which have been reduced by financial conditions in Europe. The optimal path for the current account in the next five years should be a gradual improvement over time as the country broadens its export base, increases food security, and undertakes a fiscal consolidation.



Exchange rate assessment

São Tomé and Príncipe's REER has appreciated considerably since the introduction of the peg to the Euro in January 2010. Since then, there has been a gradual disinflation process, broadly in line with international experience.[3] However, domestic inflation has remained above the inflation in the country's trading partners.

[3] A comparison of São Tomé and Principe's disinflation with the experiences of countries that tried to reduce inflation by pegging their currencies to the currencies of low inflation countries shows that the path followed by São Tomé and Príncipe has so far been closer to successful rather than failed attempts.



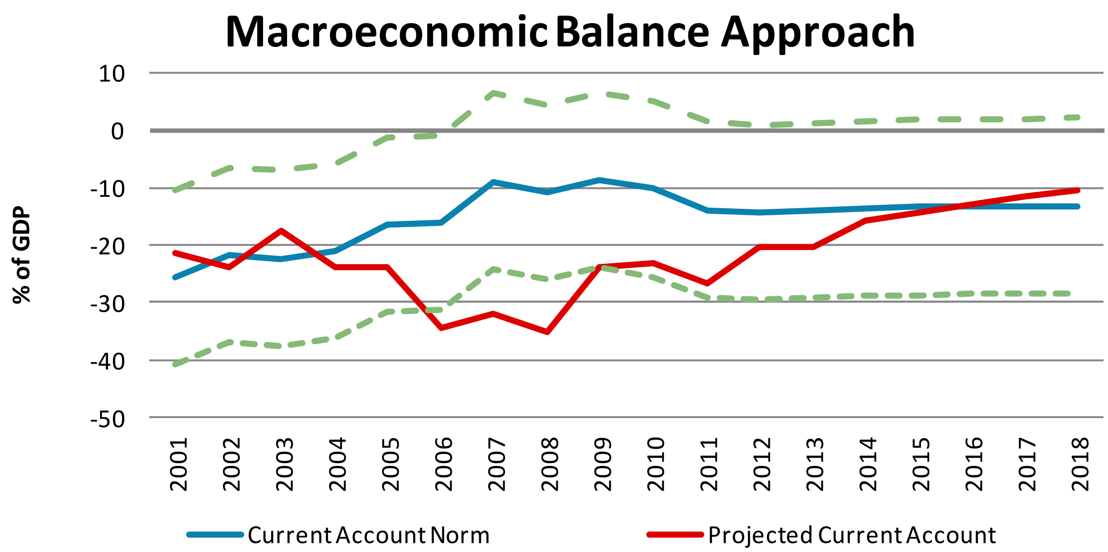
While external stability is particularly difficult to benchmark for a fragile, small country like São Tomé and Príncipe with severe data limitations, the application of the three standard methodologies for exchange rate assessment suggests that the real exchange rate is overvalued in the short-run and broadly in line with fundamentals over the medium-term.

The results of the assessments of São Tomé and Príncipe's exchange rate, based on the IMF's Consultative Group on Exchange Rate (CGER) methodologies, are presented below. The assessments focus on the country's baseline scenario for 2013 and the medium-term, which uses 2018 as the reference period.

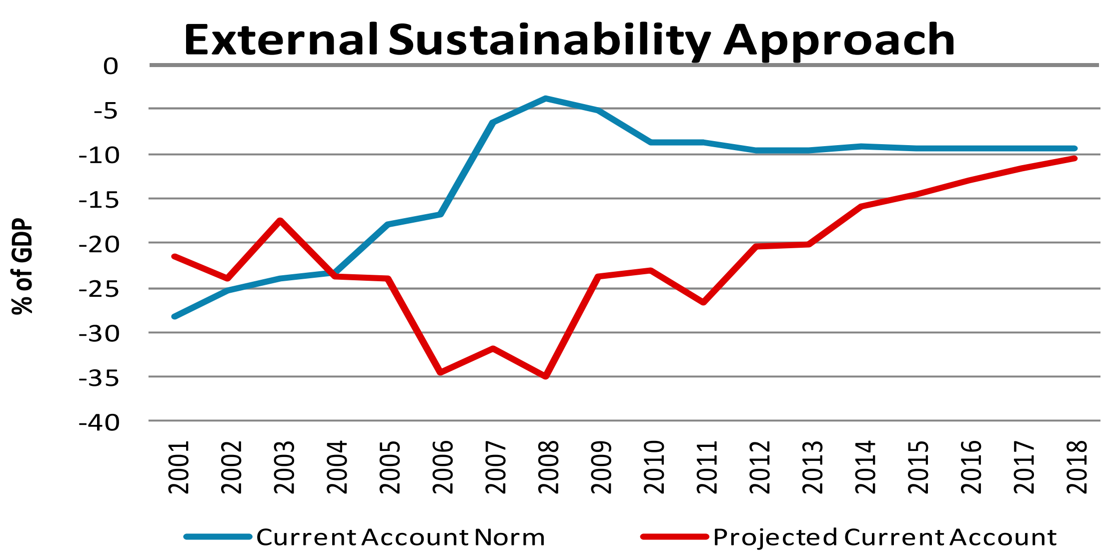
In the macroeconomic balance (MB) approach, an equilibrium current account balance (norm) is estimated by relating the current account balance to macroeconomic fundamentals. Typical fundamentals include the fiscal balance, output growth, real income, oil balance, demographics, trade openness, and relative productivity. In the short-run, applying the coefficients estimated by the CGER methodology extension by Vitek (2013) yields a current account norm for São Tomé and Príncipe of -14 percent of GDP.[4] This compares to the projected current account balance of -20¼ percent of GDP. This would imply a currency overvaluation of 6 percent in 2013 assuming an elasticity of the external current account balance relative to the REER of minus 1.05.[5] For 2018, the current account balance is projected to improve to -10½ percent of GDP while the projected current account norm declines to -13¼ percent of GDP. This implies a current account gap of 2¾ percent of GDP and an undervaluation of the currency of 2.6 percent over the medium-term.

[4] Vitek, Francis, 2013, "Exchange Rate Assessment Tools for Advanced, Emerging, and Developing Economies", IMF Documentation on the Exchange Rate Assessment Toolkit (Washington: International Monetary Fund).

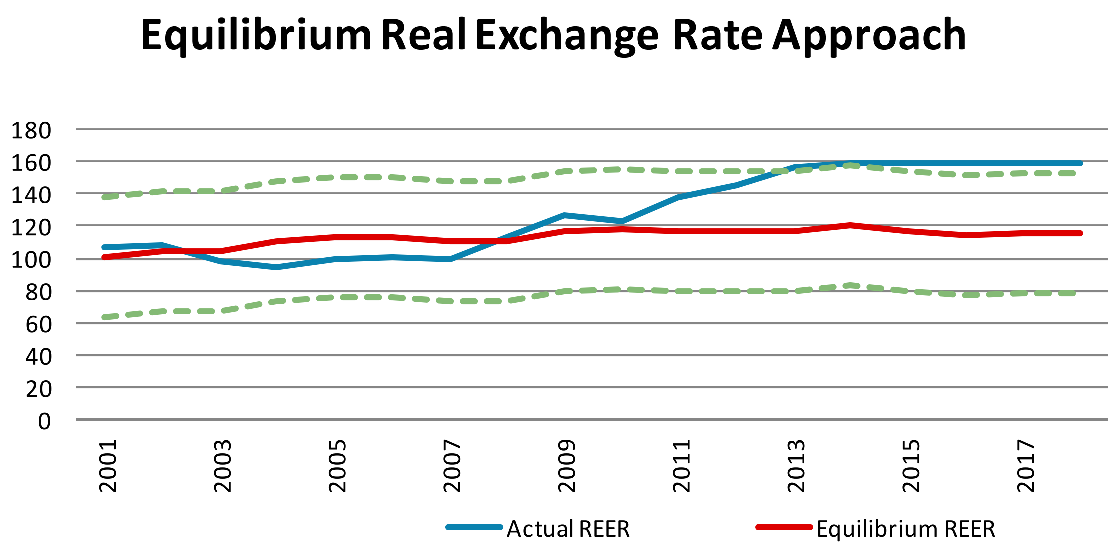
[5] Tokarick, Stephen, 2010, "A Method for Calculating Export Supply and Import Demand Elasticities", IMF Working Paper 10/180 (Washington: International Monetary Fund).



The external sustainability (ES) approach calculates the current account balance that would be consistent with a benchmark value for net foreign assets (NFA). The main challenge in implementing the ES approach is choosing the correct NFA target. This is particularly challenging in the case of São Tomé and Príncipe where there are no reliable international investment position data available, meaning the NFA position can only be broadly estimated. The ES approach shows that the Dobra is somewhat overvalued in 2013 (by 10¼ percent) but becomes less overvalued over time, declining to about a 1 percent overvaluation by 2018.



The equilibrium real exchange rate (ERER) approach is a reduced form regression model, unlike the two other approaches which use behavioral based regression models. It does not perform well when there are data limitations and short historical time series, as in the case of São Tomé and Príncipe. The ERER methodology is also highly sensitive to the choice of variables used in the model. The ERER approach, based on the coefficients estimated by Vitek's CGER extension, yields a short-run currency overvaluation of about 34 percent and a medium-term overvaluation of about 37 percent.



Selected Indicators of Real Effective Exchange Rate Assessment (REER)
(in percent of GDP, unless otherwise indicated)

	Short-run (2013)	Medium-term (2018) [2]
Actual current account [1]	-20.5	..
Underlying current account (A)	-20.2	-10.5
Trade elasticity (B) [3]	-1.05	-1.05
Macroeconomic Balance Approach		
Current account norm (C) [4]	-13.9	-13.2
Current account gap (D=A-C)	-6.3	2.8
REER gap, in percent (D/B) [5, 6]	6.0	-2.6
External Sustainability Approach		
Current account norm (E) [4]	-9.5	-9.5
Current account gap (F=A-E)	-10.7	-1.0
REER gap, in percent (F/B) [5, 6]	10.2	0.9
Equilibrium Real Effecive Exchange Rate Approach		
2018 REER gap, in percent [5, 6]	33.9	37.2

[1] Observed CA in 2012

[2] Using 2018 CA as the medium-term reference period.

[3] Trade elasticities derived from a recent panel study of low-middle income countries by Tokarick (WP/10/180), Page 31.

[4] Coefficients relating CA to macroeconomic fundamentals based on IMF CGER methodology and extension by Vitek (IMF, 2009).

[5] " + " overvaluation, "- " undervaluation.

[6] Change in the REER (in percentage) needed to close gap.

Capital and financial accounts

São Tomé and Príncipe's capital and financial accounts have remained in surplus in recent years despite the global financial crisis. The capital account is dominated by foreign aid (averaging about 20 percent of GDP per year) related to the government's investment program. The financial account has two main components: FDI, and public sector borrowing.

Reflecting the small size of the economy and the lumpy nature of some investments, FDI has been volatile in recent years, accounting for 43 percent of GDP in 2008 (mainly due to the construction of a hotel resort) with a median of 8 percent of GDP from 2000-12. FDI is predominantly composed of equity and, therefore, the risk for sudden reversals is relatively low. Public sector borrowing has remained stable at around 9 percent of GDP per year.

The authorities currently lack the proper tools to sterilize large capital inflows, relying primarily on direct foreign exchange purchases and required reserves. To better manage large capital flows, the central bank is taking steps to develop a liquidity forecasting framework, which is needed for the introduction in due course of money market instruments.

While the lack of International Investment Position (IIP) data hinders the analysis of the country's NFA position, the central bank and commercial banks have been building their NFA positions in recent years. The balance in the National Oil Account is projected to decline over the next few years absent any new signature bonuses from companies wishing to develop São Tomé and Príncipe's Exclusive Economic Zone (EEZ).

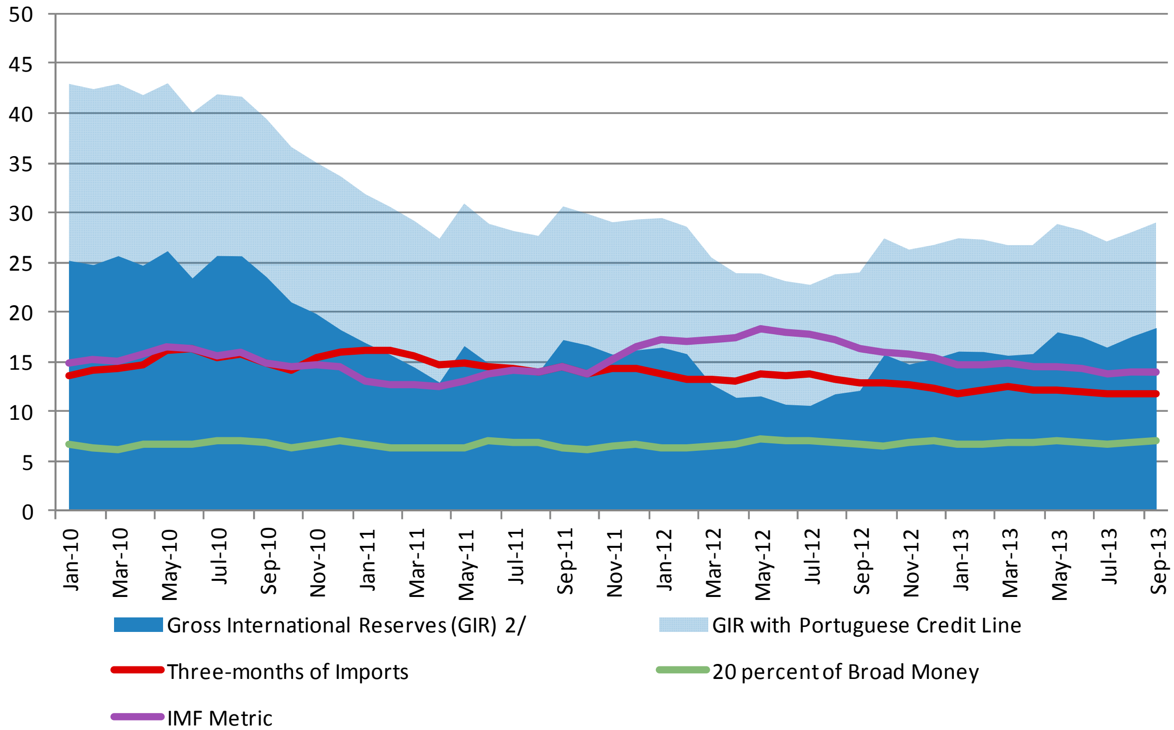
Foreign exchange reserves

The current level of foreign exchange reserves seems to be adequate to withstand external shocks and is broadly in line with peer countries. Reserves provide not only insurance against external shocks but also are a key tool for managing domestic financial instability. After falling below three months of imports in mid-2012,[6] the authorities have since accumulated international reserves considerably, taking advantage of privatization receipts and inflows from the World Bank, Nigeria, and Timor-Leste. São Tomé and Príncipe's GIR reached US$43.8 million (about 5 months of imports) at end-2012, and US$58.5 million (about 5.4 months of imports) at end-September 2013. In addition, the authorities have access to US$7.2 million in NOA deposits and €25 million from a contingent credit line with Portugal.

[6] The level of international reserves fell below three-months of imports in mid-2012 as local commercial banks with long foreign exchange positions increased U.S. dollar purchases from the central bank. But in July 2012 the authorities clarified the procedures for such purchases.

São Tomé and Príncipe: Reserves Adequacy

(In percent of GDP)[1/]



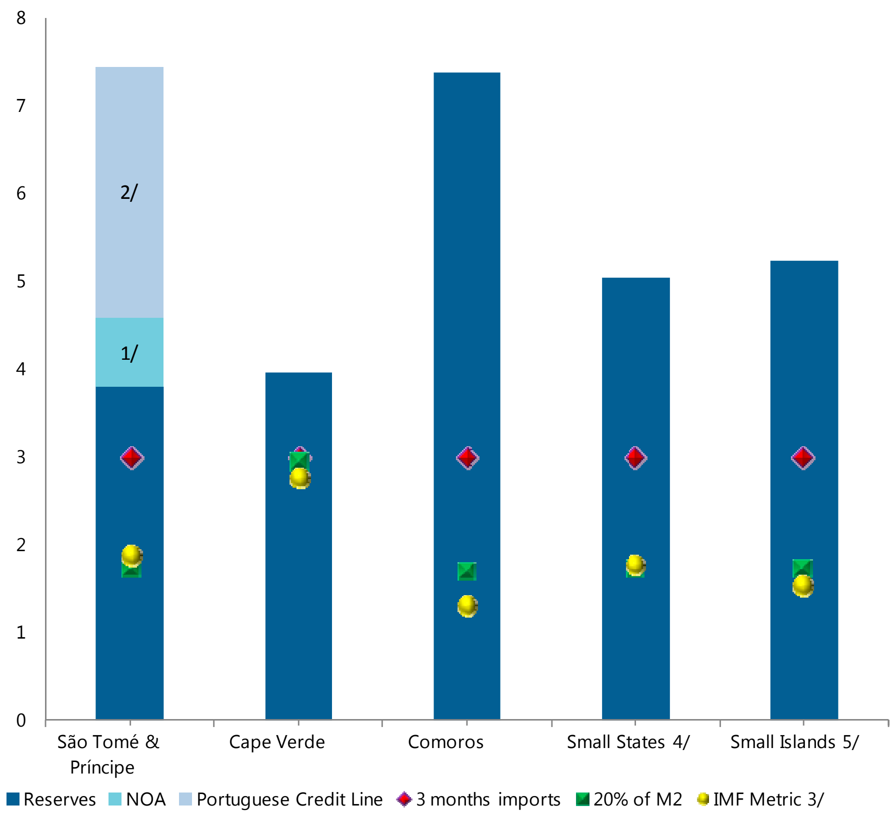
1/ Nominal GDP and import data have been converted from annual to monthly using cubic spline interpolation. As a result, this chart is not comparable to the other charts in this note which are based on annual data.

2/ Gross international reserves exclude the balance of the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements or to comply with new licensing or capital augmentation requirements.

Policymakers often rely on rules of thumb to assess the adequate level of reserves, including import coverage, the reserves-to-M2 ratio and the IMF's reserve adequacy metric. Commonly used thresholds for these measures are three months for the import coverage, and 5–20 percent for the reserves-to-M2 ratio.[7] São Tomé and Príncipe's foreign exchange reserves, as measured by these rules, are above traditional thresholds but slightly lower than the median level for peer countries. However, if NOA deposits and the credit line from Portugal are included, São Tomé and Príncipe's reserves are higher than in comparator countries.

[7] The reserves to short-term debt ratio is used for emerging market economies and could be important for São Tomé and Príncipe as its financial sector develops further, but it is not reported here due to data limitations.

Gross International Reserves (end 2012), traditional metrics and IMF metric (months of imports)

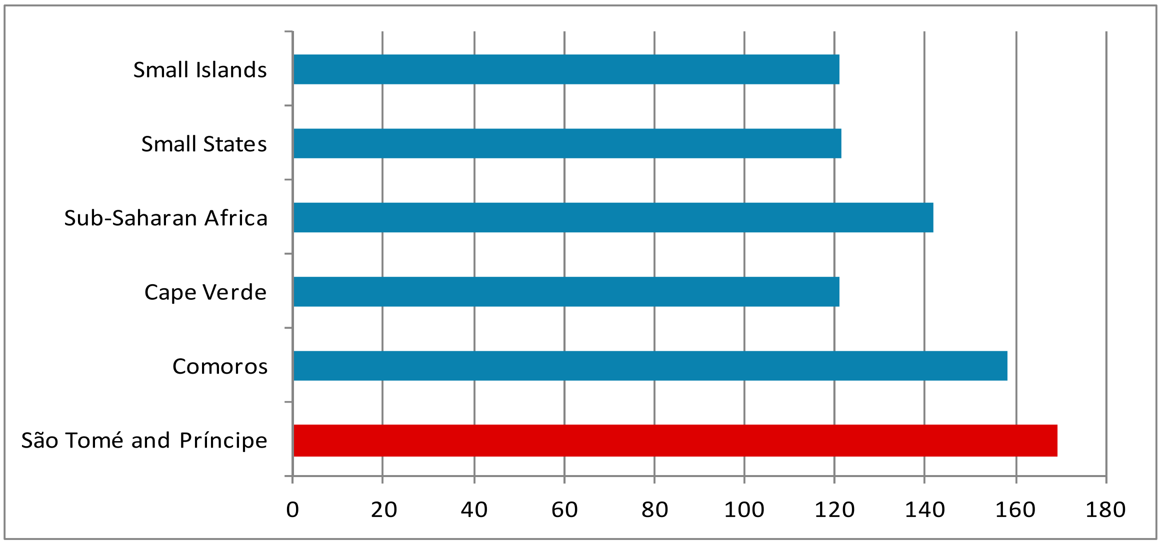


1/ Including the balance of the National Oil Account.
2/ Including Portuguese Credit Line.
3/ Based on IMF Board Paper "Assessing Reserve Adequacy".
http://www.imf.org/external/np/pp/eng/2011/021411b.pdf
4/The sample of comparator low-middle income and low income small state economies includes Belize, Bhutan, Cape Verde, Comoros, Djibouti, Fiji, Guyana, Kiribati, Marshall Islands, Micronesia, Samoa, São Tomé and Príncipe, Solomon Islands, Swaziland, Timor Leste, and Vanuatu.
5/ The sample of comparator low-middle income and low income small island economies is a sub-set of the above, excluding Belize, Bhutan, Djibouti, Guyana, and Swaziland.

External imbalances and competitiveness

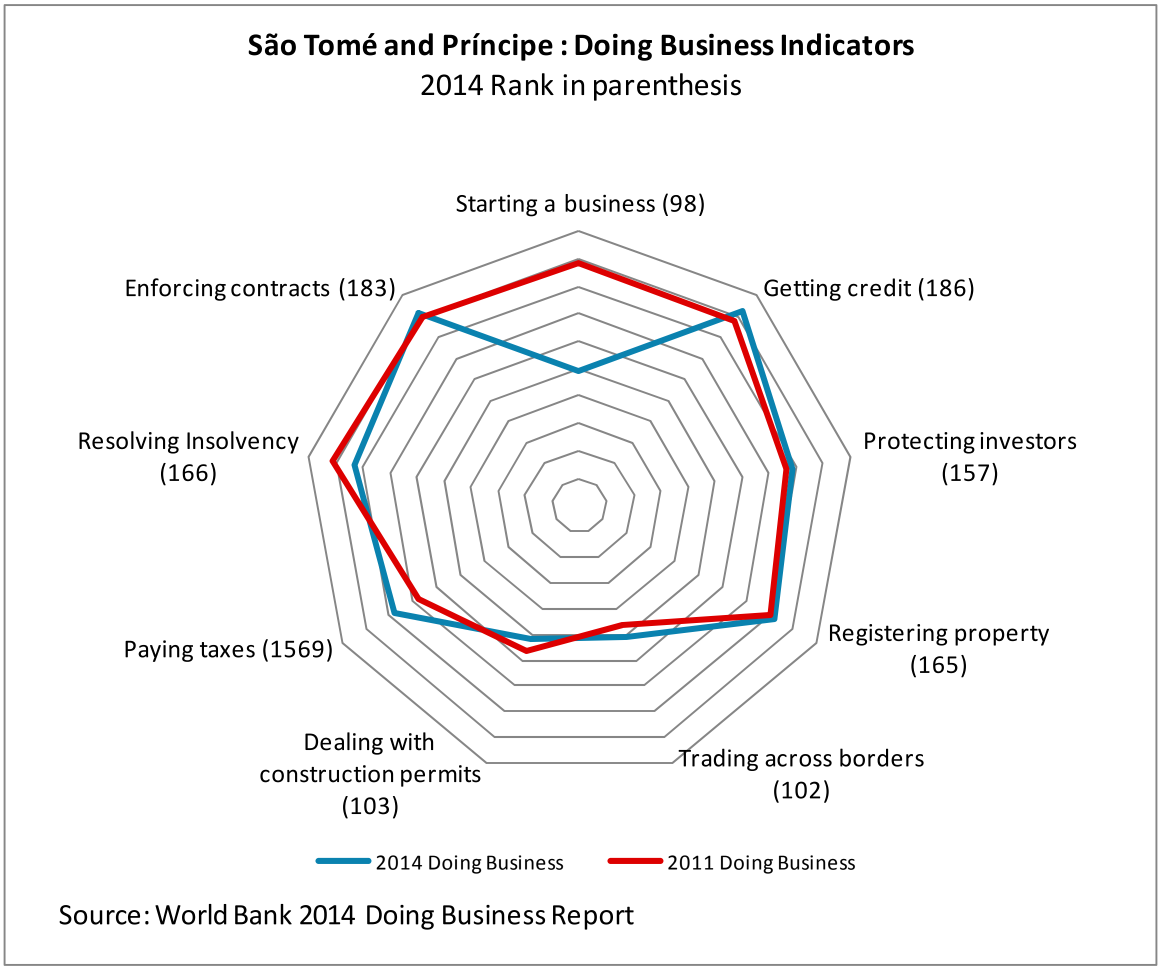
São Tomé and Príncipe's external current account deficit over the past decade was explained by relatively low rates of private and public savings and significant public and private investments financed by foreign aid and FDI. Given that São Tomé and Príncipe continues to have significant investment needs, policies to address this imbalance over time will have to focus on increasing savings and fostering competitiveness. The country will need to develop a comprehensive approach to improve competitiveness. Correcting external imbalances through a nominal depreciation is unlikely to deliver a more depreciated real effective exchange rate in the medium term because of the high pass through to domestic prices. A large price increase of imported goods from an exchange rate depreciation could spill over to the other sectors of the economy, raise the overall domestic production costs, and might lead to unchanged or even weakening international price competiveness.[8] São Tomé and Príncipe's fixed exchange rate regime has served the country well by ending the inflation-depreciation cycle. Therefore, productivity should be enhanced by investments that improve human capital and reduce infrastructure bottlenecks and sporadic shortages of key goods.

Qualitative competitiveness indicators point to significant structural and institutional bottlenecks in São Tomé and Principe. The country is classified as a weak performer under the World Bank's Country Policy and Institutional Assessment (CPIA) and remains near the bottom of the 2014 World Bank's Doing Business Survey.



São Tomé and Príncipe has made some progress in improving its business environment but much more remains to be done. The World Bank's 2012 Doing Business Survey ranked the country as one of the top reformers in 2011 because the authorities established a one-stop window for investors and eliminated a wide range of licensing and minimum capital requirements. However, there is a need for additional structural reforms to boost productivity and improve the business climate. Such measures include steps to strengthen the country's legal infrastructure (e.g., enforcing contracts, property registry, protecting investors). To further improve the business climate, the government could establish platform for public-private sector dialogue aimed at identifying obstacles to private sector development and proposing action plans to overcome them.

[8] Wang, Jian-Ye, and others, 2008, "The Choice of Monetary and Exchange Rate Arrangements for a Small, Open, Low-Income Economy: The Case of São Tomé and Príncipe", IMF Working Paper 08/118, (Washington: International Monetary Fund).


São Tomé and Príncipe : Doing Business Indicators
2014 Rank in parenthesis
Starting a business (98)
Getting credit (186)
Protecting investors (157)
Registering property (165)
Trading across borders (102)
Dealing with construction permits (103)
Paying taxes (1569)
Resolving Insolvency (166)
Enforcing contracts (183)
2014 Doing Business
2011 Doing Business
Source: World Bank 2014 Doing Business Report

Appendix III. Financial Sector Diagnostics[1]

A. São Tomé and Príncipe's Financial Sector

1. **The financial system of São Tomé and Príncipe continues to grow despite a narrow base.** The total assets of the sector as a percent of GDP have grown to about 40 percent in 2012 from 23 percent in 2004. Commercial banks account for about 98 percent of the market, and insurance companies the remaining 2 percent. The microfinance sector is nascent and a draft law for their regulation was submitted to the Government in 2013. There is no capital market. Since the system is predominantly bank-based, the focus of this assessment is on the banking sector.

2. **The banking system is predominantly foreign-owned but with a significant proportion of public sector ownership in the largest bank.** Banco Internacional de São Tomé and Príncipe (BISTP), the largest bank, has about 52 percent of foreign ownership held by CGD, a Portuguese bank, and BAI, an Angolan investment bank. The Government maintains a controlling share of about 48 percent. Banco Equador is also predominantly foreign owned by Grupo Mombanka and Mosquito but retains a local share of 5 percent. The other commercial banks, Afriland First Bank, Island Bank, Commercial Bank of São Tomé and Príncipe, EcoBank, Energy Bank and BGFI Bank, have 100 percent foreign ownership.

Name of Bank	Ownership		Country of Foreign Share Holder(s)
	Domestic	Foreign	
Banco Internacional de São Tomé e Príncipe (BISTP)-1	48%	52%	Angola, Portugal
Afriland First Bank São Tomé e Príncipe		100%	Cameroon
Banco Equador(BE)	5%	94%	Angola
Island Bank S.A		100%	Nigeria
Commercial Bank São Tomé e Príncipe (COBSTP)		100%	Cameroon
Ecobank São Tomé e Príncipe		100%	Ghana, Nigeria, Ivory Coast
Energy Bank São Tomé e Príncipe		100%	Ghana, Nigeria
BGFI Bank São Tomé e Príncipe		100%	Gabon

1- Government holds a 48 percent of the BISTP shares and 52 percent belongs to CGD (a portuguese bank) and BAI (an Angolan investment bank)

B. Methodology for Assessing the Banking Sector

3. **The methodology used in this note for assessing the banking sector is known as quantitative benchmarking.** It involves observing a set of indicators across time and countries. To capture the time dimension, trend analysis of key indicators is conducted since financial sector development is a time-bound process. For the cross-country comparisons, the assessment earmarked a group of small island states[2] with

[1] This note was prepared by Rodgers Chawani (AFR).

[2] Comoros, Cape Verde, Fiji, Kiribati, Marshall Islands, Samoa, Solomon Islands, Timor-Leste, and Vanuatu.

similar characteristics as well as sub-Saharan Africa (excluding South Africa and Nigeria).[3] The São Tomé and Príncipe economy is assessed with respect to its depth, access, efficiency, and stability comparators relative to peer groups. The assessment also considers the status of banking supervision with respect to the BASEL core principles as well as the central bank's strategic plan for 2012-15. Limitations in the availability of data, however, have constrained the scope of the exercise.

C. Trend Analysis

4. **The trend analysis focused on the evolution of the aggregates from 2004 to 2012.** The analysis constituted a static assessment of the banking sector in isolation from the selected comparators.

Table 1: Banking System Trends

	2004	2008	2012	Metric
Broad money as a percent of GDP	28	39	37	Depth
Private Sector Credit as a percent of GDP	17	28	36	
Financial sector deposits as a percent of GDP	23	35	40	
Commercial bank branches per 100,000 adults	5	9	23	Access
Number of ATMs	0	0	22	
Adult banked population (percent)		51	87	
Number of Commercial Banks	4	8	8	Competition
Non-bank intermediaries	1	2	2	
Asset Concentration of the largest bank (percent)		49.8	50	
Asset Concentration of the 3 largest banks (percent)		72.5	69	
Return on assets	-3.8	-1	-0.04	Efficiency
Return on equity	-18.6	-3.7	-0.16	
Nonperforming loans		19.3	18.9	
Foreign currency deposits as a percent of total deposits	51	55	57	$zation
Foreign currency loans as a percent of total loans	60	74	58	
Liquid assets as percent of total assets	18	19	36	Liquidity
	Jan-11	Jan-12	Mar-13	
Excess reserves as a percent of monetary base	11.93	23.72	27.58	

Sources: IMF, and Bankscope.

[3] References to sub-Saharan Africa in this note actually mean sub-Saharan Africa excluding South Africa and Nigeria.

5. **Conventional metrics for measuring financial depth indicate that the banking sector of São Tomé and Príncipe has deepened in recent years.** Financial depth refers to the extent to which the different segments of the population are able to use a range of banking services for savings and investment decisions. Traditionally, the ratios of broad money and private sector credit to GDP are used to measure financial deepening. According to Table 1, the ratio of broad money to GDP has increased from 28 percent in 2004 to about 37 percent in 2012. Similarly, the ratio of private sector credit to GDP has more than doubled from 17 percent in 2004 to 36 percent in 2012.

6. **São Tomé and Príncipe's banking system penetration, as measured by the progress in building more inclusive opportunities for balanced access to financial services, show some remarkable improvements.** According to the Financial Access Survey for 2012, the proportion of the banked population, as proxied by number bank accounts per 100,000 adults, has improved from 51 percent in 2008 to 87 percent in 2012. This growth was supported by a large branch network per 100,000 adults which expanded from a low of 4 percent in 2004 to 23 percent in 2012.

7. **Automatic Teller Machines (ATMs) were introduced in October 2011, and this has facilitated access to banking resources by the population.** Since its inception, the number of machines has grown to 19–22 in 2012, and correspondingly the level of daily transactions has increased significantly. These developments point to a general improvement towards more financial inclusion.

8. **Indicators of competition and efficiency portray a mixed picture for the banking sector in São Tomé and Príncipe.** From the perspective of the number of providers, over the last 8 years the competition environment has improved as banks doubled to 8 in 2008, from 4 in 2004. This increase, however, was not matched by a shift in market shares. The largest bank still retains about 50 percent of the market and the 3 largest banks asset concentration is very high at about 69 percent. Ideally, a well-functioning financial system must offer a wide range of financial services. However, the banking sector in São Tomé and Príncipe has no variety of financial instruments. Moreover, efficiency indicators are very weak as both the return on asset and return on equity ratios have hovered around or below zero percent.

9. **A defining feature of São Tomé and Príncipe's banking sector has been dollarization.** There has been a tendency of holding a large share of assets and liabilities in foreign exchange. As inflation peaked from 9 percent in 2001 to about 28 percent in 2007, concern about an erosion of incomes in the wake of a potential excessive depreciation of the foreign currency led to a high degree of currency substitution. The ratio of foreign currency denominated deposits to broad money rose from 35 percent in 2001 to about 57 percent in 2007. Commercial banks operated largely with foreign currency and correspondingly foreign currency loans accounted for 70–75 percent of the credit portfolio. However, efforts to reduce dollarization in the financial system in recent years, which included prudential regulations regarding reserve requirements, led to a reduction in the share of foreign currency loans from 77 percent in 2010 to 58 percent in 2012.

10. **The liquidity situation has changed significantly since 2011 with banks holding higher involuntary balances over statutory requirements**. Between 2004 and 2008, the ratio of liquid assets to total assets averaged about 18 percent. In March 2010, the central bank introduced a reserve requirement on foreign exchange deposits from 100 percent in foreign exchange to 100 percent in local currency. This policy

shift led to a tightening of liquidity conditions and non-compliance with the reserve requirement. In December 2011, the central bank reduced the reserve requirement on foreign exchange deposits to 90 percent of local currency and further reduced the statutory requirement from 21 percent to 18 percent. Coupled with a slowdown in credit, this led to a sharp pickup in excess reserves from 11.9 percent of reserve money in January 2011 to 27.5 percent in March 2013. Aligned with this development, the ratio of liquid to total assets doubled from 18 percent in 2008 to 36 percent in 2012.

D Benchmarking the Banking Sector of São Tomé and Príncipe

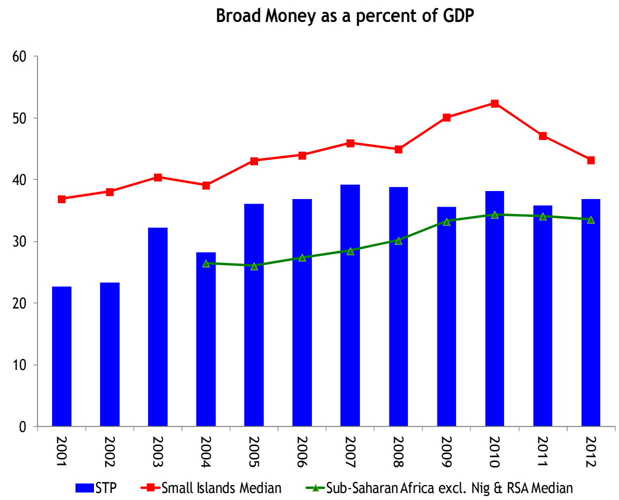
11. **The benchmarking exercise allows an assessment of São Tomé and Príncipe's financial sector performance with respect to depth, access, dollarization, efficiency, stability and supervision**. Normalizing most of the assets and liabilities on GDP facilitates benchmarking the selected indicators and comparisons across countries. The difference between the observed value and the median of the benchmark suggests scope for policy action or successful progress.

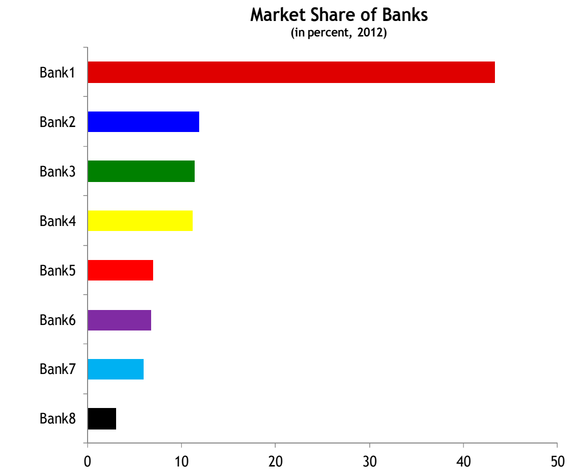
Benchmarking depth

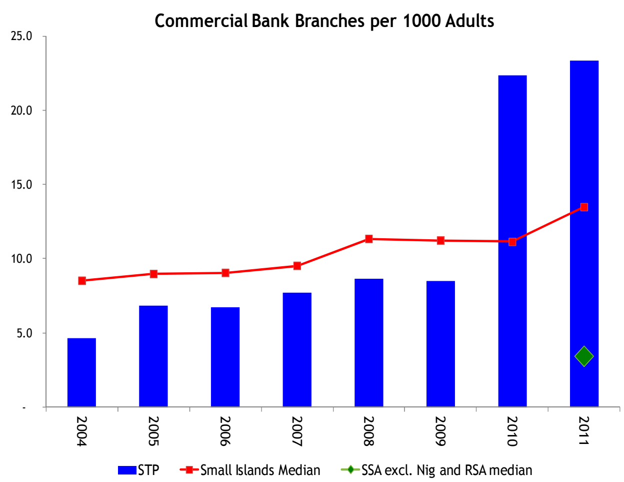
12. **Traditional metrics of depth indicate that São Tomé and Príncipe outperforms sub-Saharan Africa but underperforms small island states.** The ratios of private sector credit and broad money to GDP have been rising since 2004 and have been significantly above their sub-Saharan Africa benchmarks. This implies that over the years the banking sector of São Tomé and Príncipe has developed to levels comparable to its regional peers. This outturn is a positive development but could also be symptomatic of an unsustainable expansion in the wake of excessive risk taking shored up by oil expectations. Despite this performance, São Tomé and Príncipe's banking sector development still lags small island states. This underperformance could be based on economic and structural characteristics such as population density.[4]

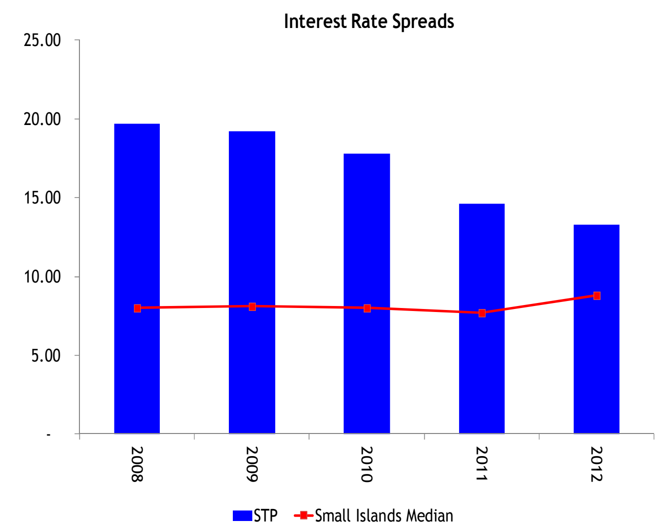
[4] Since countries with lower population density are associated with shallow financial penetration and higher cost of financial intermediation from diseconomies of scale, the size of the population could be an explanatory factor.

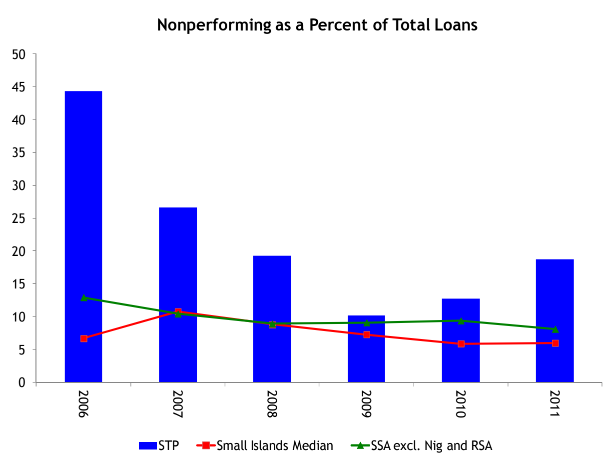
Selected banking sector indicators

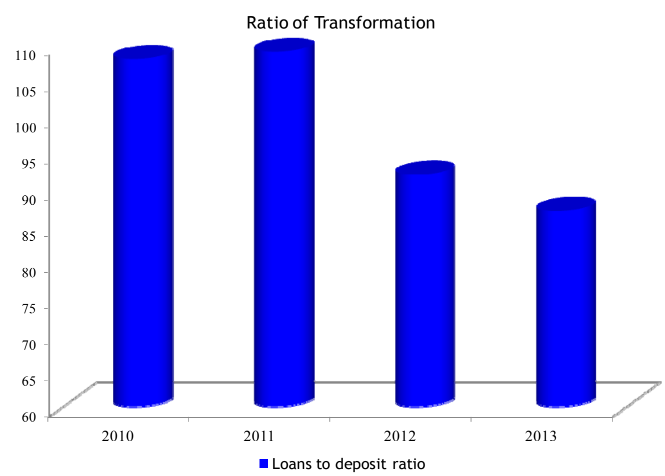












Benchmarking access

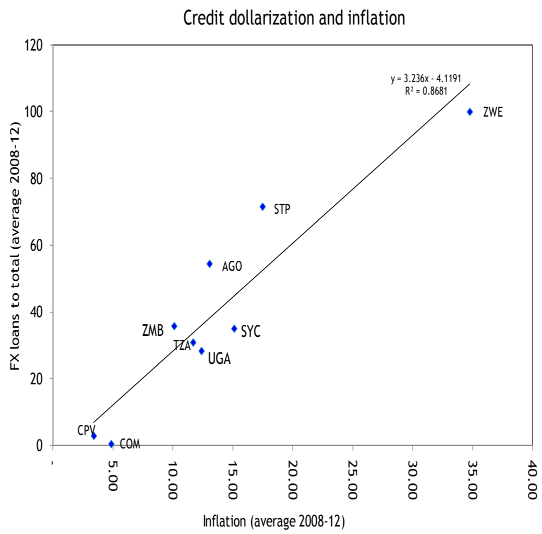
13. **Estimates for outreach of financial services indicate improved penetration of financial services for São Tomé and Príncipe.** Using deposit accounts relative to the adult population to estimate the share of banked population, the high level of access at 70 percent outperforms the median of 29.2 percent for sub-Saharan Africa. This development is supported by the pickup in the percentage of commercial bank branches per 100,000 adults from a low of 4.7 percent in 2004 to about 23.4 percent in 2011, exceeding the regional benchmark of 3.5 percent. Overtime, the number of bank branches relative to the population has closed the gap with small island states and beyond 2010 the industry has significantly outperformed the benchmark for the small island states. Inclusiveness of the banking sector is further buttressed by the belated introduction of ATMs which at 24 exceed the median for small island states (12). In general, the banking system has become more inclusive but the higher performance with respect to branch network also indicates that the country has more commercial banks than optimal. In fact, the median number of commercial banks for the small island states is 4. Further, the costs of maintaining ATMs are higher yet their number exceeds significantly sub-Saharan Africa and the small island states.

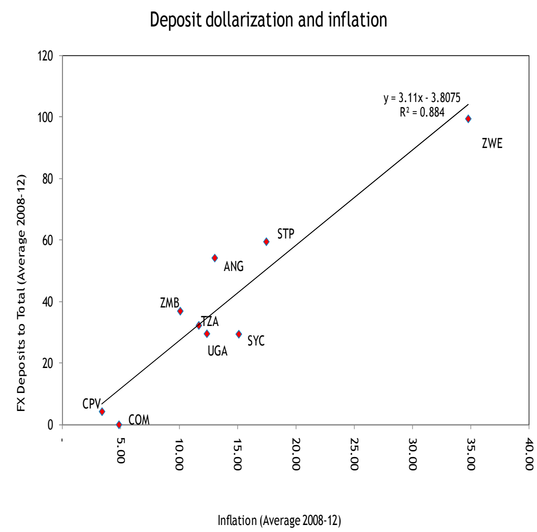
Benchmarking efficiency

14. **Entry of new financial intermediaries has not been matched by gains in the efficiency of the banking sector.** The sustainable development of the financial system and the degree to which it provides support to the real sector depends on the efficiency with which intermediation occurs. When measured as the spread between the lending and deposit rates for commercial banks, interest rate spreads despite narrowing from 19.7 percent in 2008 to about 13.3 percent in 2012 have remained above the median for the small island states. Anecdotal evidence indicates that the source of the spread is high overhead costs, diseconomies of scale due to small size of markets, as well as inefficiency of the banks over the years which have resulted into passing the high costs through to customers.

Benchmarking dollarization

15. **Financial dollarization has been a distinguishing feature of the banking sector of São Tomé and Príncipe for the last 8 years.** Measured as the ratio of foreign currency to total deposits as well as foreign currency denominated loans to total, dollarization increased during 2004-12. The chart plots average inflation for 2008-12 and foreign exchange to total loans for a similar period and it confirms that compared to selected countries in sub-Saharan Africa and small island states, São Tomé and Príncipe is more dollarized.





16. **Financial dollarization has implications for financial stability**. The central bank position can easily become under pressure to be the dollar lender of last resort. Also, banks with larger domestic dollar liabilities must balance their foreign exchange position by extending dollar lending to local currency earners or holding assets abroad. Lending to un-hedged domestic clients creates a credit risk. More importantly, the experience of most countries has been that dollarization is not easily reversed even when the underlying causes have been removed resulting into "dollarization hysteresis" – persistence of dollarization after inflation is subdued. In recent months, the decline in inflation has correlated with reduced dollarization.

17. **Recently, de-dollarization in São Tomé and Príncipe has been the result of market and prudential forces.** The authorities have pursued successful implementation of macroeconomic stabilization policies, which have yielded stronger fundamentals in low inflation and further anchored expectations. In addition, the authorities' active management of reserve requirements and other prudential measures has contributed de-dollarization.

D Benchmarking Soundness of the São Tomé and Príncipe Banking Sector

18. **The soundness of the banking sector is assessed on the basis of tradition Financial Soundness Indicators (FSIs) relating to capital adequacy, liquidity, profitability, and efficiency.** The major finding is that aggregated or system-wide indicators are broadly in line with prudential norms but generally conceal large variations across banks.

Capital adequacy assessment

19. **Available information on solvency indicates that the São Tomé and Príncipe banking sector is well capitalized.** The average solvency ratio as measured by the regulatory capital to risk weighted assets for the last nine years has exceeded the internationally acceptable standard of 8 percent with about six

banks consistently above 10 percent. This level of aggregate capitalization compares favorably with other banking systems especially for sub-Saharan Africa but trails small island states.

20. **However, some banks are weakly capitalized.** The number of banks with capital asset ratio below 6 percent has increased to 2 in March 2013. A prolonged existence of undercapitalized banks has the potential to undermine the confidence in the central bank as a regulatory authority as strict enforcement of capital requirements is critical to financial stability**.**

Benchmarking asset quality

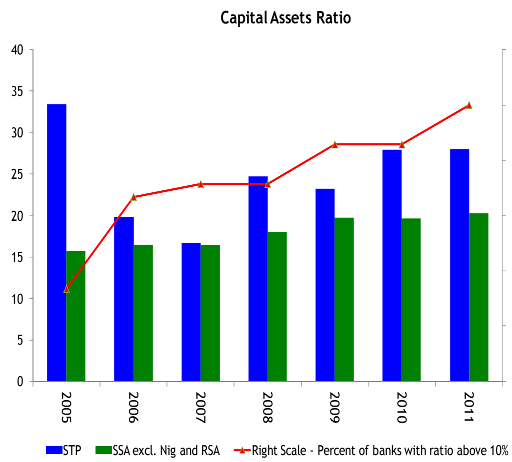
21. **Asset quality, as measured by the ratio of non-performing to total loans has also deteriorated and underperforms small island states and sub-Saharan Africa.** Between 2000 and 2010, the country enjoyed periods of high economic and credit growth. The rapid increase in credit was associated with deterioration in asset quality. The ratio of nonperforming loans to total loans actually peaked at about 44 percent in 2006 but receded to 10.2 percent in 2010 before doubling to 23 percent in 2013. This pick up was attributed to lapses in regulation standards which accommodated misclassification of assets and excessive risk taking as optimism about the economy and oil spurred credit growth.

Benchmarking profitability

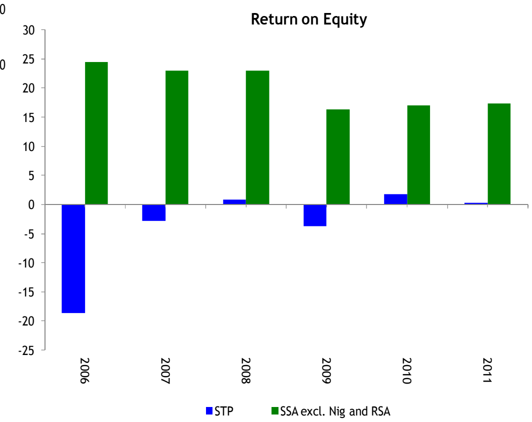
22. **Indicators of profitability for São Tomé and Príncipe's commercial banks are very weak.** Most commercial banks are not profitable and the outturn is the same for both return on assets and return on equity. Banks' return on assets for the last 8 years has averaged -0.9 percent. Return on equity, a measure of the extent to which available capital resources are put to profitable use, also averaged -3.2 percent for the last 8 years. This compares unfavorably with the average for sub-Saharan Africa which was above 20 percent for 2012. Interestingly, shareholders of the loss making banks have been willing to cover their losses and augment their capital to maintain a foothold in anticipation of oil.

Selected stability indicators

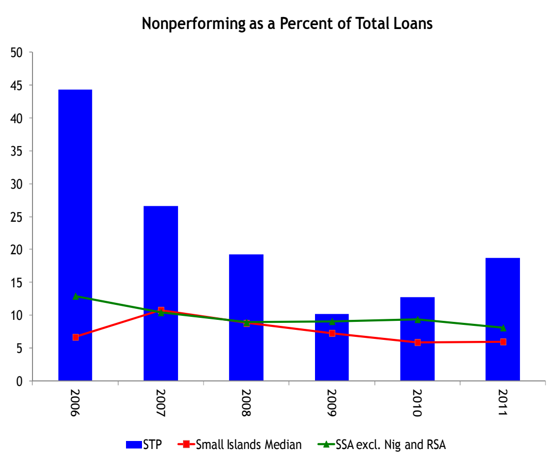
Well capitalized but signs of stress in a few....



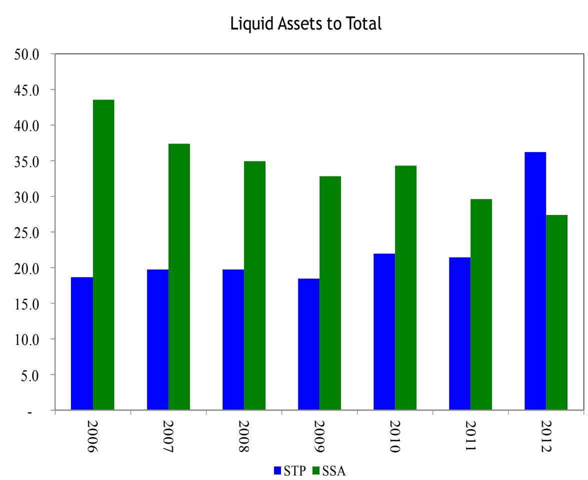
...profitability indicators are weak...



...asset quality has also deteriorated...



....and liquidity has built up.



Benchmarking liquidity

23. **Liquidity ratios are high for São Tomé and Príncipe's banking system**. Prolonged excess liquidity (above the perceived structural minimum) generates perverse market incentives and undermine the credibility of the central bank in its pursuit of the dual goals of monetary and financial stability. To this end, several IMF technical assistance missions have recommended the restoration of more neutral liquidity conditions with a two way risk, i.e., excess or deficit to a larger extent also to preserve the fixed exchange rate regime. Critically, addressing the excess reserves is also seen as a catalyst for the development of an interbank market. It is therefore recommended that the authorities step up their efforts toward more proactive liquidity management. This could be achieved by a proper assessment of the surplus liquidity conditions, extension of the liquidity forecasting framework, and allowing in due course open market operations.

24. **São Tomé and Príncipe's commercial banks are largely deposit funded.** The customers' deposits to loans ratio has been fairly stable. Banks also benefit from funding from foreign banks. The interbank market is largely inoperative hence do not constitute a significant source of bank liquidity funding. This situation is attributed to a number of factors. Despite ample liquidity in the system, this is not evenly distributed. The market remains segmented as trading is infrequent and based on bilateral relationships or with a counterpart deemed reliable based on preference or any other subjective criteria. Banks are generally reluctant to lend to each other due to incapacity to evaluate counterparty risks. The need for an active interbank market cannot be overemphasized as it will foster the efficacy and sustainability of the fixed exchange rate arrangement.

D. Benchmarking Banking Supervision and Regulation

26. **The methodology used for the assessment of banking supervision and regulation relied on the Basel Core Principles (BCPs) for Effective Banking Supervision, developed by the Basel Committee on Banking Supervision (BCBS).** The BCPs provide a benchmark against which the effectiveness of bank supervisory regimes can be assessed. The BCPs were assessed in the context of the progress made in implementing the central bank of São Tomé and Príncipe's Strategic Plan for 2012 and 2015. The BCPs earmark a set of five conditions for a robust financial system which are (i) sound and sustainable macroeconomic policies, (ii) adequacy of public infrastructure, (iii) effective market discipline, (iv) effective procedures for the resolution of a problem bank, and (v) appropriate level of systemic protection. Weaknesses or shortcomings in these areas may significantly impair the ability of the supervisory authority to implement effective supervision.

Sound and sustainable macroeconomic policies

27. **The assessment focused on the capacity of the supervisors to assess vulnerabilities and risks associated with macroeconomic policies both for the financial system and for the effectiveness of bank supervision.** In this regard, efforts made by the central bank to fulfill their strategic objectives pertaining to improving the efficiency of monetary policy as well as strengthening the technical capacity of the supervisory staff were assessed. Important strides have been made in recent years aimed at improving

banking supervision. Following technical assistance from the IMF (MCM), the authorities have managed to develop an overnight liquidity forecasting framework for conducting active liquidity management. The framework has been extended beyond a day to weekly and monthly horizons. The central bank has been challenged however by the persistence of forecasting errors as well as sophistication of the framework. The central bank also managed to design call reports for banks, created an electronic database, recommended standardized reporting forms to the commercial banks, and introduced on-site inspections.

28. **Rounds of on-site inspections have progressed as planned with the central bank conducting examinations of four banks between 2011 and 2012.** The central bank is scheduled to complete the inspection of the remaining commercial banks by end-June 2014. Leveraging on IMF technical assistance, the authorities also developed operational procedures for emergency lending. In order to preserve financial stability, the two banks undertook to raise their capital to risk weighted assets ratio above 10 percent.

29. **While the standards of supervision have evolved and the perimeter of regulation expanded, human resource constraints remain.** The Department of Banking and Insurance Supervision (DBSS) supervisory capacity is insufficient. The central bank continues to struggle with low staff compliment to handle the supervisory demands of the financial sector as well as recurrent staff turnover. The department has a staff complement of 8 which includes a director and board member.

Adequacy of public infrastructure

30. **A well-developed public infrastructure that covers contract enforcement, efficient judicial systems and international accounting standards is key for effective supervision.** Assessment of public infrastructure was made in the context of the central bank objective to modernize its institutional, accounting and legal framework. Progress has been made in drafting procedures for infraction, harmonizing the accounting conventions with internationally acceptable standards. The country also developed a National Payment System, a prerequisite for maintaining and promoting financial stability.

31. **In a bid to encourage banks to extend credit to the private sector beyond the traditional circle of large businesses, São Tomé and Príncipe developed a credit bureau.** Ideally, the Bureau is supposed to collect, manage and disseminate customer information to lenders with a view of improving access. Commercial banks have been generally receptive to the establishment of the Bureau and submission of information has since improved. Currently, it is estimated that 75 percent of creditors have been registered and multiple lending from different banks has since declined.

32. **These developments notwithstanding São Tomé and Príncipe has a comprehensive set of corrective and remedial measures but fails to invoke them on a systematic basis.** The process to establish directives and impose fines or sanctions involves a lengthy series of legal procedures which delays the ultimate decision and compromises effectiveness of regulation. As a consequence, there are inefficiencies in the system, which result into protracted delays in resolving disputes. Most importantly, there is a need to update the Central Bank Organic Law to equip it with the necessary instruments and powers for the pursuit of its objectives.

33. **The effective functioning of financial markets relies heavily on the expectation that high professional, legal, and ethical standards will be observed and enforced.** The authorities have taken concrete steps to address the deficiencies of São Tomé and Príncipe's AML/CFT framework. With technical assistance from the IMF's Legal Department, they drafted amendments to the AML/CFT Law and submitted the draft law to the National Assembly in May 2013, which was later approved by the National Assembly and signed by President Pinto da Costa. Passage of this law has facilitated the recent removal of São Tomé and Príncipe from the Financial Action Task Force's list of high risk and non-cooperative jurisdictions. However, the FATF has noted that Sao Tomé and Principe's AML/CFT regime still exhibits a number of strategic deficiencies and has encouraged the authorities to work with the Inter-Governmental Group against Money Laundering in West Africa (GIABA) to address these issues. This would include measures to strengthen the operations and core functions of the Financial Intelligence Unit (FIU) through improved resources, including staffing, equipment and training. These actions are meant to strengthen the FIU core functions, such as the receipt, analysis, and submission to the general attorney's office of suspicious transaction reports from financial and non-financial institutions and professions.

Effective market discipline

34. **Assessment of the strength of market discipline considered issues of transparency, including quality, timeliness, and clarity of the information available to the public; and the role of the government in the financial system.** Effective market discipline that is based on transparency and disclosure supplements the central banks' assessment of safety and soundness of the financial system. In the absence of financial transparency, banks are denied of reliable financial information that allows assessment of counterparty risk. In this regard, the assessment was contextualized in the central bank's strategic objectives of promoting international best practices with regards to transparency and efficiency. There is no evidence of government efforts to influence banks' lending operations. Despite timely, accurate, and credible financial information for market participants being critical to the successful functioning of market discipline, the central bank is yet to publish economic and financial information with a higher frequency. Efforts have been in place to develop a framework for publishing fees and charges by the commercial banks. Pertinently, the commercial banks do not publish their results as required by the Law. The explanation provided attributed the situation to absence of media outlets and websites as well as apprehension on the part of the central bank to convey to market participants the soundness of the banking system.

Procedures for effective resolution of problem banks

35. **Procedures for effective resolution of problem banks are being developed.** The current state of play is that supervisors have no sufficient and flexible range of procedures to achieve the efficient resolution of problems in banks, including the capacity to conduct an orderly resolution with respect to problem banks.

Mechanism for providing an appropriate level of systemic protection

36. **Aligned with the strategic objectives of modernizing legal frameworks and strengthening the office of consumer support, an assessment of financial safety nets was conducted.** The examination focused on elements designed to prevent situations in which the failure or potential failure of individual

financial institutions disrupts the intermediation function of financial markets and, thus, the broader economic activity. A key element of financial safety nets is investor and policyholder compensation scheme, which is designed to promote investor confidence in the functioning of financial markets and to protect policyholders from the failures of financial institutions. São Tomé and Príncipe established a consumer protection scheme whose funds act to maintain public confidence in the industry by protecting the interest of small entities or uninformed customers and by ensuring a smooth exit mechanism for failing companies.

37. **A framework for management of financial crises is however lacking.** Despite prospects for a crisis being considered as highly remote and large foreign ownership being regarded as a cushion, a contingency plan is needed to demonstrate the national authorities' readiness to tackle a systemic crisis.

E. Areas for Improvement

38. **The main vulnerabilities identified by this assessment can be summarized as follows:**

- Weak indicators of profitability and solvency.
- High level of nonperforming loans.
- Inadequate development of money and capital markets.
- The need to enhance the supervisory infrastructure.

Weak indicators of profitability and solvency

39. **Healthy and sustainable profitability is vital for maintaining the stability of the financial system.** As retained earnings are the primary means of organic capital generation, low profits may prevent banks from expanding and extending additional credit to the real economy. Irrespective of high solvency ratios, poor profitability has the potential of weakening the capacity of banks to absorb more negative shocks, which eventually affect solvency. Profitability is largely a mirror of the quality of the management and shareholders, competitive strategies and efficiency. The low profitability is overshadowing the gains made in financial deepening and underlines a tendency to maintain a foothold in the economy aimed at tapping from oil resources. There is need for the central bank to address the weak profitability of commercial banks to avoid episodic recapitalization by:

- Following through on the commercial banks' commitment to submit new business plans which should include a set of measures and guidelines to ensure profitability.
- Working with commercial banks to increase the system's efficiency, profitability, and resilience. It will be important to adopt a crisis management and bank resolution framework and develop restructuring solutions for banks that are unlikely to restore profitability over the medium term (i.e., recapitalization, or liquidation of institutions in the event of failure to identify new capital or shareholders).

High levels of nonperforming loans

40. **The deterioration in asset quality as proxied by the ratio of nonperforming to total loans is a concern.** Nonperforming loans, which had declined from 44 percent of gross loans in 2006 to 10 percent of gross loans in 2009, have since more than doubled but recently stabilized at above 20 percent. The problem is further compounded by some questions about the reporting accuracy. Some on-site examinations have actually confirmed compliance with international financial reporting standards regarding impaired assets could lead to an upward adjustment of the reported numbers by a few percentage points. There is scope for cleaning up the bank balance sheets. It is therefore recommended that the authorities develop a comprehensive market strategy to deal with nonperforming loans by:

- Conducting a realistic evaluation of distresses assets and facilitate strict enforcement of classification based on international norms.
- Continuing to strengthen the oversight of risk management practices at the commercial banks and credit enforcement laws.
- Exploring options of restructuring some of the loans.

Development of money and capital markets

41. **Despite a progressive trend in headline indicators of depth and breadth of the financial system, São Tomé and Príncipe should benefit from further improvements.** Evidently, the financial sector remains underdeveloped and hence provides inadequate shock absorption capacity. Underdeveloped financial systems constrain the range and efficacy of available policy instruments, impede risk transfer, and can engender adverse macro-financial feedback loops.

42. **Beyond the current efforts, the country could further benefit from increased access to a broader range of instruments**. The absence of avenues for maturity transformation of deposits or alternative investments is what largely perpetuates excess reserves holdings. Also, available evidence suggests that structural excess liquidity encourages buy-and-hold strategies by banks. In this regard, the authorities should explore pursuing the:

- Introduction of more money market instruments to leverage on the excess liquidity and reduce their maintenance costs.
- Resuscitation of interbank activity to play the arbitrative role between supply and demand of liquidity in the banking system.

Enhancing the supervisory infrastructure

43. **There is need to address staff capacity constraints.** The quantity and quality of human capital is critical for banking supervision. Strengthening of the supervisory staff of the central bank is of the essence.

Inadequate staffing is likely to derail the regularity of on-site visits. Equivalently high levels of staff turnover are likely to undermine institutional memory as well as leveraging technical assistance.

44. **The central bank must enforce the publication of financial results by the commercial banks.** The evolving regulatory practices for banks and other financial institutions, in particular the New Basel Capital accord, places a strong emphasis on harnessing market forces, through adequate disclosure and enhanced transparency of financial institutions. The strengthening of transparency and market discipline is designed to complement the capital requirements and supervisory review and other tools of official supervision in promoting soundness. It is therefore expedient for the central bank to enforce publication of results by commercial banks which should also facilitate assessments of counterparty risks.

45. **The authorities must also continue with efforts to improve the legal infrastructure for supporting credit contracts and enforcement.** Strengthening property rights and ensuring proper contract enforcement are critical elements for a better protection of the legal rights of creditors. Such improvements would better the chances of a commercial bank recovering its collateral through prompt and reasonably priced court procedures.

46. **The central bank must establish well-defined guidelines for the management of problem financial institutions and financial crises.** Lack of formal frameworks, combined with limited experience, inadequate staffing levels may frustrate the necessary quick action when problems do arise.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

December 2, 2013

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—INFORMATIONAL ANNEX

Prepared By

African Department
(in consultation with other departments)

CONTENTS

RELATIONS WITH THE FUND

(As of October 31, 2013)

Membership Status

Joined: September 30, 1977; Article XIV

General Resources Account:	**SDR Million**	**%Quota**
Quota	7.40	100.00
Fund holdings of currency (exchange rate)	7.40	100.05
Reserve tranche position	0.00	0.00

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	7.10	100.00
Holdings	0.33	4.64

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ECF Arrangements	3.55	48.00

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ECF	07/20/2012	07/19/2015	2.59	0.74
ECF[a]	03/02/2009	03/01/2012	2.59	0.74
ECF[a]	08/01/2005	07/31/2008	2.96	2.96

[a] Formerly PRGF.

Projected Payments to Fund [1]

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

	Forthcoming				
	2013	2014	2015	2016	2017
Principal		0.63	0.70	0.61	0.44
Charges/Interest	0.00	0.01	0.01	0.01	0.01
Total	0.00	0.64	0.72	0.62	0.45

[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**
March 2007	N/A	1.05	1.05
December 2007	N/A	0.38	0.38

[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:

An updated safeguards assessment of the Central Bank of São Tomé and Príncipe (BCSTP) was completed in May 2013. The assessment noted the severe capacity constraints faced by the BCSTP, including lack of independent oversight. External audits conducted by reputable audit firms continue to serve as a critical safeguard mechanism, and the assessment recommended strengthened coordination of the audits by senior BCSTP management to ensure prompt remedial actions on audit findings. Other recommendations included strengthening of the internal audit function and implementation of formal investment policies.

Exchange Arrangements:

The de jure and de facto exchange rate arrangement is a conventional peg against the euro. Since January 2010 São Tomé and Príncipe has pegged the Dobra to the euro at a rate of Dobra 24,500 per euro. The organic law of the BCSTP authorizes it to make decisions regarding exchange rate policy. The commission on foreign exchange sales cannot be higher than 2% for the euro and 4% for other currencies. Purchases of euros must be done at the rate published by the BCSTP and no commissions are allowed. The official euro–U.S. dollar cross rate is based on the European Central Bank (ECB) reference rate of the previous day. The BCSTP finances current international transactions at the official exchange rate only after verification of the documentation establishing the bona fide nature of the bank’s request. Access to foreign exchange is limited to institutions having a net position in the transaction currency of less than 12% of qualified capital, a net position in total foreign currency less than 25% of qualified capital, and which are in compliance with the central bank’s regulations on bank liquidity and capital adequacy. Financial institutions are allowed access to the central bank’s facilities regardless of the above conditions if the foreign exchange is to be used for importation of goods and services in periods of crisis or for the importation of fuel. Commercial banks that meet these requirements can buy foreign exchange directly from the central bank, which can charge up to 1.5 percent commission on sales of euro and up to a 0.5 percent commission on purchases of euro. The buying rate is mainly indicative because the BCSTP rarely makes purchases. The new exchange rate system has eliminated the multiple currency practice related to the existence of numerous exchange rate markets with differing effective exchange rates for spot transactions that existed in previous years.

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 one measure subject to Fund approval under Article VIII: an exchange restriction arising from Article 3(i) and Article 10.1(b) of the Investment Code (Law No. 7/2008) regarding limitations on the transferability of net income from investment. 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.

Article IV Consultation:

The Executive Board concluded the last Article IV consultation with São Tomé and Príncipe on January 23, 2012.

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:

Date of Delivery	Department/Purpose
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
November 2012	FAD mission on medium-term fiscal framework
November 2012	FIN mission on safeguards assessment
November 2012	LEG follow-up mission on AML/CFT
October 2012	MCM mission on banking supervision
October 2012	FAD diagnostic mission on customs
October 2012	FAD mission on public accounting
September 2012	MCM mission on liquidity management
July 2012	LEG diagnostic mission on AML/CFT
April 2012	FAD mission on revenue administration
March 2012	FAD mission on public financial management
March 2012	STA mission on balance of payments
February 2012	LEG diagnostic mission on AML/CFT
February 2012	FAD mission on implementation of SAFEe
January 2012	FAD diagnostic mission on tax administration
November 2011	MCM TA needs assessment mission
November 2011	MCM mission on liquidity management
November 2011	FAD mission on public accounting
October 2011	FAD mission on public financial management
August 2011	FAD mission on public accounting
June 2011	MCM mission on liquidity management
June 2011	FAD mission on public accounting
February 2011	MCM mission on bank resolution framework
January 2011	FAD mission on public accounting
September 2010	MCM mission on liquidity management
August/September 2010	STA mission on monetary and financial statistics
December 2009	MCM mission on banking supervision
August 2009	MCM mission on banking supervision
June 2009	FIN mission on safeguards assessment
May 2009	FAD mission on public financial management

RELATIONS WITH THE WORLD BANK GROUP

Joint Managerial Action Plan (JMAP) for São Tomé and Príncipe
(As of October, 2013)

1. The IMF and World Bank São Tomé and Príncipe teams held meetings to discuss macro critical structural reforms for São Tomé and Príncipe and their respective work programs for the period 2013–14.

2. The World Bank's work program is guided by an Interim Strategy Note approved in 2011 that focuses on accelerating sustainable and broad-based economic growth and on strengthening governance, public institutions, and human capital. A new Country Assistance Strategy for 2013–2016 will be completed in 2014, following the recent completion of a Joint Staff Assessment Note (JSAN) on the country's second National Poverty Reduction Strategy. Analytical underpinnings for the new Country Assistance Strategy include a Country Economic Memorandum, "Success Beyond Petroleum," completed in 2011, a Diagnostic Trade Integration Study, which is expected to be completed in 2013, and a Poverty Assessment, which is expected to be completed in June 2014. Two Governance and Competitiveness budget support operations were approved in March 2012 and June 2013. They represent the first and second of three annual programmatic budget support operations for 2012–14. A Debt Management and Performance Assessment (DeMPA) report was completed in October 2011, and an accompanying reform plan to improve debt management was completed in March 2012.

3. The IMF's work program includes the Executive Board's consideration of the first review under the ECF-supported program, a staff visit, a mission to conduct the 2013 Article IV consultation discussions and second review under the ECF-supported program, missions for the third and fourth ECF-supported program reviews, and assistance with capacity development in the areas of public financial management, revenue administration, statistics, monetary liquidity management, and banking supervision.

4. The Bank and the Fund are providing complementary support to help São Tomé and Príncipe strengthen public financial management and make progress toward debt sustainability. Regarding the latter, the teams prepared a Joint IMF-World Bank Debt Sustainability Analysis (DSA) update in 2012, and a new update has recently been prepared to accompany the 2013 Article IV Consultation discussions and second review under the ECF-supported program.

Work Program for Period 2013–14			
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	• Poverty Assessment • Country Assistance Strategy • Diagnostic Trade Integration Study • Budget support operation	June 2014 Jan./Feb. 2014 Jan./Feb. 2014 November 2013	FY2014 FY2014 FY2014 FY2014
IMF work program in the next 12 months	• ECF second review and Article IV • ECF third review • ECF fourth review • Technical Assistance from STA: o National Accounts • Technical Assistance from FAD: o PFM (SAFE-e and government accounts) • Technical Assistance from MCM: o Liquidity Management o Banking Supervision	September 2013 March 2014 September 2014 November 2013 Dec. 2013/Jan. 2014 February 2014 March 2014	December 2013 May 2014 November 2014 November 2013
B. Requests for work program inputs			
Fund request to Bank (with summary justification)	• Information on Bank budget support operations and disbursement schedule	To support the 2014 fiscal program	November 2013

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of October, 2013)

1. São Tomé and Príncipe (STP) became a member of the African Development Bank Group (AfDB) in 1976. To date, the AfDB has financed 30 operations in the country. This comprises of 24 projects, including institutional support, and six studies, for a total net commitment of UA 113.099 million under the African Development Fund (ADF) (98.9%), and one special support operation of
UA 1 million under the Nigeria Trust Fund (NTF). The vast majority of these operations (94%) were financed through loans with the remaining 6% through grants.

2. As of November 6, 2013, the AfDB's ongoing portfolio comprised of five active projects for a total commitment of UA 20.4 million. These are: the Livestock Development Project II; the Infrastructure Rehabilitation for Food Security (PRIASA); the General Population and Housing Census; the Public Finance Management Project (PAGEF)[1]; and technical assistance and capacity building at the Ministry of Planning and Finance[2] (Table 1). In June 2013, the Bank conducted its portfolio performance review for the country. The review concluded that the portfolio performance is rated satisfactory at 2.18 on a scale of 0 to 3, representing an improvement when compared to the score of 1.9 in 2011. During the review period, the portfolio's average disbursement rate stood at 28.8 percent, compared to 25 percent in 2011, which represented 12 percent of the annual disbursement ratio. As of November 6, 2013, the disbursement rate stood at 32.7 percent. The average age of the active portfolio is 2.4 years which is significantly lower than the 5.4 years recorded in 2011. Such improvement is mainly linked to new projects approved in the first quarter of 2013. In terms of sector distribution, agriculture contributes a substantial proportion, representing 45 percent of the portfolio, followed by multi-sector (37 percent). There are no ongoing private sector or multinational projects.

3. The AfDB current involvement in STP is guided by the new Country Strategy Paper (CSP) 2012-2016, approved in July 2012. The CSP's main objective is to prepare the authorities for the forthcoming oil production era and the associated challenges and risks to the country's socio-economic development. The current strategy is anchored on a single pillar of Capacity Building and Institutional Strengthening which absorbed the entire African Development Fund (ADF)-12 resources of UA 5 million for STP. More specifically, the strategy aims at improving the capacity of key public administration institutions, including human resource development, country systems, and strategic legal and regulatory frameworks by the time the oil era begins.

[1] PAGEF was approved on January 14, 2013, in the context of the new Country Strategy Paper (CSP) 2012-2016. It aims at improving the economic and financial governance, strategic planning, and to create an environment for private sector development.

[2] Approved on March 4, 2013, joint assistance will be provided by the Regional South Department (ORSB) and the African Legal Support Facility founded by the AfDB to offer legal advice and capacity building to African countries.

4. As part of its strategy and knowledge products, the AfDB organized a validation workshop held in Gabon in November 2012. The findings of the regional study on Private Sector Investment Constraints in the Economic Community of Central African States (ECCAS), of which STP is a member, were presented for discussion to representatives from the government and the private sector.

5. STP reached the Highly Indebted Poor Countries (HIPC) decision and completion points in 2000 and 2007, respectively. To this effect, the country became eligible for the MDRI with an estimated $99.56 million in debt service according to the terms of the MDRI. The AfDB total assistance under HIPC and MDRI amounted to $187.92 million in debt relief. At the end of December 2008, the AfDB provided $13.33 million in debt relief under HIPC and $99 million under MDRI.

Table 1. AfDB Ongoing Projects (Millions of UA)

Title of Projects	Window	Commitment	Disbursement Rate (percent)
Livestock Development Project – Phase II	ADF Grant	4.0	67.87
PRIASA	ADF Grant	5.0	32.96
General Population and Housing Census	ADF Grant	0.5	60.31
PAGEF	ADF+FSF	7	2.46
Technical Assistance and Capacity Building	ADF+FSF	0.2	0.0
Total		***16.7***	***32.72 (average)***

STATISTICAL ISSUES

(As of October, 2013)

I. Assessment of Data Adequacy for Surveillance
General: Although economic data are broadly adequate for surveillance, serious financial, human, and technological resource constraints have slowed down efforts to strengthen the statistical system.
National Accounts: Statistics on GDP/GNP are compiled on a yearly basis and provided at the time of the Article IV consultation and program review missions. STA provided technical assistance in national accounts to the National Statistics Institute (INE) in 2005, 2006, 2008 and 2009. Low response rates and/or insufficient rigor of the responses to the business surveys, including those from important enterprises, continue to affect the quality of the business data compiled. A technical assistance mission is planned for November 2013 to assist the authorities to: (i) change the base year of GDP series to 2008; (ii) assist the authorities to improve the flash GDP estimates based on high frequency indicators; and (iii) assess the progress migrating the GDP series to an improved statistical platform that better captures survey and market information and includes estimates of the informal sector. A new GDP series for the period 2007–10 with base year 2001 became available in mid–2011. The new estimates cover: (i) GDP by production approach at current and constant prices; and (ii) cross-classification tables by industry sectors. The revised series reflect more accurately recent economic developments. This system became the basis for preparing flash estimates of GDP based on data from the most recent population census, corporation census, and living conditions survey. It attributed higher weights to the sectors that experienced faster growth, such as trade, transportation and communication, and services. While the revision of the GDP series represented a significant improvement, a number of shortcomings remain. Further improvements would require input from the recently completed household expenditure survey (rather than living conditions survey), using producer prices, and better estimates for agricultural production.
Consumer price statistics: Since 1997 the CPI weights have been based on a three-month household survey conducted in 1995. A household expenditure survey was conducted in 2010 and AFRISTAT assisted the National Institute of Statistics (INE) to change the product mix and update the weights. Current price surveys only cover the capital, although there are plans to use the results of the 2010 household survey to expand coverage nationwide, provided INE has the resources for field staff. The November 2013 STA mission will provide methodological advice on consolidating the local market series into a single, national consumer price index.
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 government accounts were finalized and presented to the Court of Audit in June 2013 (the first time in over two decades that government accounts have been prepared and submitted). The authorities are working on the 2011 and 2012 government accounts, but preparing the latter using the accounting feature of SAFE-e has taken longer than expected, highlighting the need for additional technical assistance and training in this area.

An October 2004 government finance statistics (GFS) mission helped the Ministry of Finance to compile and disseminate GFS for the general government in accordance with the *Government Finance Statistics Manual 2001 (GFSM 2001)*. The mission prepared bridge tables between national budget classification and *GFSM 2001* classifications to be used to compile GFS for reporting to STA and AFR, as well as in Ministry of Finance policy work. The mission also reviewed the classification of oil revenues under the Oil Revenue Management Law and made recommendations on classification of such transactions. A September 2007 follow-up mission found some progress with regard to the recommendations made by the 2004 mission. In particular, in January 2007 a new budget law was approved that significantly improved national budget classifications. Notwithstanding these efforts, faster statistical progress is hampered by an inadequate accounting system. Successive FAD missions aimed at improving public accounting have begun to address this issue.

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 have improved.

The missions found that the BCSTP monthly trial balance sheets were broadly adequate to compile monetary statistics in line with the *Monetary and Financial Statistics Manual (MFSM)*.

A new plan of accounts of other depository corporations (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 *MFSM*. 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. The central bank has begun to collect data from insurance companies which opened in the past few years. The asset size of insurance companies remains 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.

External sector Statistics: There are significant weaknesses in the collection of source data related to merchandise trade. Some transactions, including certain imports related to investment, are not fully captured in the balance of payments (BOP). Monthly data on the main exports and imports are reported to AFR regularly, and unit prices and volumes of exports are only occasionally included. AFR does not receive any data on São Tomé and Príncipe's international investment position (IIP) as these data are not yet compiled by the BCSTP.

A March 2012 mission found inconsistencies in the classification of BOP operations and that certain components continued to be largely estimated. Resource constraints, particularly with regard to qualified staff, contribute to the lack of improvement in the response rate to surveys. The mission recommended improving coordination and data sharing among data-producing agencies, intensifying contacts with survey respondents, and using alternative sources to improve source data. The mission assisted the authorities in creating a bridge table to report data in the *Balance of Payments Manual (BPM6)* format and outlined a set of recommendations and detailed work plan to improve compilation capacity. Resource constraints at the BCSTP have prevented the development of IIP data.

The authorities have built on previous efforts to strengthen debt data management, and a unit was created in late 2003 within the Ministry of Finance. The authorities are reconciling debt records with creditors and the Commonwealth Secretariat debt recording and management system is being operationalized.

II. Data Standards and Quality

The country has participated in the Fund's General Data Dissemination System (GDDS) since April 20, 2004. The metadata and plans for improvement have not been updated since the original metadata were posted on the DSBB. Over the period 2003–09, the country has benefited from technical assistance from STA and other providers, largely under the GDDS project for Lusophone Africa.

Common Indicators Required for Surveillance

(As of November 13, 2013)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting	Frequency of publication
Exchange rates	Oct. 2013	Nov. 2013	D	D	D
International reserve assets and reserve liabilities of the monetary authorities [1]	Oct. 2013	Nov. 2013	D	D	D
Reserve/base money	Oct. 2013	Nov. 2013	D	D	D
Broad money	Sept. 2013	Oct. 2013	M	M	M
Central bank balance sheet	Sept. 2013	Oct. 2013	M	M	M
Consolidated balance sheet of the banking system	Sept. 2013	Oct. 2013	M	M	M
Interest rates [2]	Oct. 2013	Nov. 2013	M	M	M
Consumer Price Index	Sept. 2013	Oct. 2013	M	M	M
Revenue, expenditure, balance and composition of financing [3] – general government [4]	June 2013	Sept. 2013	Q	Q	Q
Revenue, expenditure, balance and composition of financing [3]– central government	June 2013	Sept. 2013	Q	Q	Q
Stocks of central government and central government-guaranteed debt [5]	March 2013	Sept. 2013	Q	I	Q
External current account balance	Dec. 2012	March 2013	A	I	A
Exports and imports of goods	June 2013	Sept. 2013	M	M	A
GDP/GNP	2010	Aug 2011	A	I	A
Gross external debt	March 2013	Sept. 2013	Q	I	A

[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).

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION AND SECOND REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—DEBT SUSTAINABILITY ANALYSIS[1]

December 2, 2013

Approved By
David Owen and Dhaneshwar Ghura (IMF) and Marcelo Giugale and Jeffrey Lewis (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 at a high risk of debt distress according to this update of the joint Bank-IMF low-income country debt sustainability analysis (DSA). The update reflects the adoption of a non-oil scenario baseline in light of increased uncertainty regarding the volume and timing of the start of oil production following Total's recent withdrawal from Block 1 of the Joint Development Zone (JDZ) with Nigeria, as well as recent economic data and forecasts. Despite the revised projections, the assessment of high risk of debt distress is unchanged from the DSA published in August 2012; the debt ratios, however, are now projected to remain higher for a longer period of time. In particular, the PV of debt-to-exports ratio is expected to remain above the country-specific indicative threshold for an extended period due to the country's narrow export base. Reaching a projected debt profile that is consistent with manageable – if high risk – debt dynamics would require an additional fiscal adjustment of 1 percent of GDP over 2015–17, continued heavy reliance on grants and highly concessional lending, and further efforts to diversify the economy and expand the export base over the medium term.

[1] The DSA was prepared by IMF and World Bank staff in collaboration with the authorities of São Tomé and Príncipe. The analysis updates the previous Joint DSA dated July 6, 2012 (IMF Country Report No. 12/216). 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 (January 22, 2010). The DSA uses the unified discount rate of 5 percent set out in Decision No 15462 (October 11, 2013).

BACKGROUND

1. **The previous DSA for São Tomé and Príncipe was undertaken as part of the 2012 Request for a Three-Year Arrangement under the Extended Credit Facility.**[2] It concluded that São Tomé and Príncipe was at a high risk of debt distress, but showed a more favorable dynamics of debt indicators than the current assessment because its baseline scenario included the start of oil production in 2015. The earlier assessment also assumed that disbursements from the National Oil Account (NOA) would be sufficient to fund the government's capital investment program, mitigating the need for additional borrowing.

2. **São Tomé and Príncipe reached the completion point under the enhanced HIPC initiative in March 2007, received topping-up assistance in December 2007, and later on benefited from HIPC/MDRI debt relief.** MDRI, in particular, brought substantial debt service savings, since 54 percent of total debt before the HIPC completion point was with IDA, AfDB, and IMF. Debt relief from Paris Club members also helped improve the country's debt profile.

3. **São Tomé and Príncipe's medium- and long-term public and publicly guaranteed external debt was estimated at $221.6 million (84 percent of GDP) as of December 2012** (Table 1).[3] The debt burden increased from $200.1 million at end-2011 (due to disbursements from Portugal and Nigeria) yet remains significantly below the pre-debt relief high of $359.5 million at end-2006. Total public sector debt is composed solely of debt contracted or guaranteed by the central government, and there is currently no state-owned enterprise external debt. Debt composition has shifted after the HIPC completion point. The share of multilateral debt declined from nearly 60 percent before the completion point to 20 percent. Portugal is now the country's main bilateral creditor, and IDA is its main multilateral creditor.

Table 1. São Tomé and Príncipe: External Debt Stock

(As of end-December 2012)

	Million USD	Share
Multilateral Creditors	41.0	19%
IDA	14.1	6%
FIDA	8.0	4%
BADEA	5.9	3%
IMF	5.5	2%
OPEC	4.5	2%
AfDB	2.1	1%
EIB	0.9	0%
Bilateral Creditors	162.3	73%
Portugal	39.8	18%
Angola [1]	35.4	16%
Nigeria [1, 2]	30.0	14%
Italy [1, 3]	25.8	12%
China [1]	17.3	8%
Yugoslavia [1]	8.8	4%
Brazil [1, 3]	4.3	2%
Belgium	0.9	0%
Private Creditors [1]	18.3	8%
Total	221.6	100%

Sources: Country authorities and IMF staff estimates

[1] Includes debt in dispute.

[2] Advances on oil revenues

[3] Commercial debt guaranteed by the government.

[2] IMF (2012), Country Report for São Tomé and Príncipe 12/216.

[3] $123.4 million of this debt consists of technical arrears (including accrued interest) to Nigeria ($30 million advance on oil revenues), Italy ($25.8 million), Angola ($25.4million), China ($17.3 million), Yugoslavia ($8.8 million), Brazil ($4.3 million), and two private creditors ($11.9 million). The debt to Yugoslavia is guaranteed by the Angolan government.

4. To implement the terms of the May 2007 Agreed Minutes, the authorities have signed bilateral agreements with all its Paris Club creditors. Russia was the final Paris Club member to sign the bilateral agreement in 2012. São Tomé and Príncipe received debt relief from Algeria in 2011. Efforts are underway to conclude additional debt relief with other non-Paris club creditors.

MACROECONOMIC ASSUMPTIONS

5. The authorities have cautiously migrated to a non-oil baseline scenario given increased uncertainty regarding volume and timing of the start of oil production following Total's recent withdrawal from the JDZ. The main assumptions in the baseline scenario for 2013–33 are as follows:

- A subdued recovery from the global economic crisis, with annual output growing at 4 percent in 2013, 5 percent in 2014, and 5½ percent in 2015. Over the long-term, growth is projected to be sustained at around 5½ percent per year, similarly to the historical norm and unchanged from the growth assumption under the alternative non-oil scenario of last year's DSA. The main drivers of growth are expected to be construction, tourism, agriculture, and fisheries. Stronger macroeconomic policies, further measures to enhance the business climate, and successful implementation of a tourism development strategy would be needed to sustain growth at 5½ percent a year over the long term.

- A decline in average annual inflation from 10.6 percent in 2012 to 8.3 percent in 2013, and further to around 5 percent in 2015. Inflation is then assumed to remain around 3 percent over the long term. This reflects continued fiscal prudence and the effects of the peg of the dobra to the euro, which has been in effect since January 2010. The GDP deflator in US dollar terms is projected to decline from an average of 13.3 percent in 2013 to 10 percent in 2014, and further to around 3 percent by 2015. It is expected to remain around 2 percent over the long term.

- A domestic primary deficit that is in line with available non-debt creating financing. Any domestic financing needs are assumed to be met via a drawdown of National Oil Account (NOA) deposits and budget support grants. The domestic primary deficit will be 3 percent of GDP in 2014 but will be adjusted by a cumulative 1 percent of GDP over 2015–17 (i.e., to 2 percent of GDP by 2017) to keep it in line with projected non-debt creating financing. The fiscal adjustment would come mainly through measures to enhance revenue mobilization. No domestic borrowing is envisaged.

- Total grants are projected to increase from their current level of about 14 percent of GDP in 2013 to an average of 17 percent of GDP a year in 2014-17. After peaking at over 18 percent of GDP in 2018, grants will decline in importance and average around 10 percent of GDP a year over the longer term.

- The DSA assumes a level of loan concessionality of at least 50 percent. To fund the government's capital investment program, additional loans of about 8 percent of GDP are projected for 2014. New borrowing will average about 4 percent of GDP a year from 2015-21 and ¼ percent of GDP thereafter. No financing from future privatization operations, no commercial loans, no domestic borrowing, and no short-term loans are assumed throughout the DSA projection period.

- A recovery in capital inflows, as the economy in Europe improves. The authorities expect continued investment in infrastructure projects to support tourism and agriculture development. FDI is projected to stabilize around 7 percent of GDP over the long-term.

- The non-interest current account deficit (including official grants) is expected to narrow as the government further consolidates its position. The current account deficit, currently over 20 percent of GDP, is projected to gradually decline to a longer-term average of 10 percent of GDP. Export growth will be driven by increases in cocoa production, the start of palm oil production, and increased tourism as São Tomé and Príncipe rehabilitates its infrastructure.

- Downside risks include significant spending overruns in the run-up to the 2014 local and parliamentary elections. The outlook could also be adversely impacted by supply shocks (leading to higher inflation and lower growth), spillovers from a further deterioration in financial conditions in Europe (resulting in delays in project execution), and delayed action on reducing the size of the banking sector (leading to continued low profitability for the sector and stagnant credit growth).

6. São Tomé and Príncipe's prospects to become an oil producer, though more uncertain, remain good. For illustrative purposes, the DSA includes an alternative oil scenario to assess the debt outlook in the event of oil. The details of the alternative oil scenario assumptions are as follows:

- Oil production is expected to begin in 2019 in Block 1 of the JDZ, boosting GDP growth to 19 percent in that year and 27 percent in 2020 as oil production approaches its peak. Non-oil real GDP growth is assumed to be equal to the baseline non-oil scenario. The total available reserves in Block 1 of the JDZ have been revised from 100 million barrels to 60 million barrels.

- Production is assumed to be about 5,000 barrels per day in 2019 and peak at about 18,300 barrels per day in 2021–22. Production will average about 8,000 barrels per day over the 20-year life of the project. This is expected to yield, on average, $294 million of annual export earnings, of which $195 million would go to the JDZ partners, with 40 percent ($78 million) belonging to São Tomé and Príncipe.[4] In accordance with the Oil Revenue Management Law (ORML), once oil production starts, the bulk of current revenues are to be transferred into a sub-account of the NOA—the Permanent Fund of São Tomé and Príncipe. Resources in the Permanent Fund are to be invested with a view to generating a permanent income stream for the NOA. In steady state, all revenues are deposited in the Permanent Fund while a long-term real rate of return (capped at 5 percent) applied to the previous year's closing balance will be used to determine the amount annually transferred to the budget.

[4] The DSA assumes an oil price averaging $111 a barrel from 2019-39. The previous DSA prepared by Fund staff assumed a price of $96 per barrel from 2015-35.

- The country would remain eligible for IDA grants until the start of oil production.

EXTERNAL DEBT SUSTAINABILITY

A. Baseline

7. **Under the baseline non-oil scenario, several external debt indicators remain just around or significantly above their relevant indicative thresholds over the next few years** (Figure 1, blue lines).[5] Reflecting São Tomé and Príncipe's narrow export base, the PV of public and publicly guaranteed (PPG) external debt-to-exports ratio is almost three times the indicative threshold of 100 percent and is expected to remain above the threshold until 2030. The PV of PPG external debt-to GDP ratio remains hovering just above the threshold through 2020 and the debt service-to-exports ratio breaches the threshold through 2014. The PV of external debt-to-revenue and debt service-to-revenue remains below the thresholds for the entire forecast horizon. All of the indicators show improvement over time as a result of growth, fiscal consolidation, slower debt accumulation, and expansion of the export base.

B. Sensitivity Analysis and Alternative Scenario

8. **Stress tests show the highest vulnerability of debt sustainability differs for debt stock and debt service indicators** (Figure 1, dashed red lines).[6] The country's debt-to-GDP and debt-to-revenue ratios are vulnerable to a one-time 30 percent nominal depreciation, while the debt-to-exports ratio is susceptible to a shock to export growth. This highlights the need to maintain the credibility of the exchange rate peg and to maintain international reserves at prudent levels. A one-time depreciation would significantly alter the PV of debt, leading to each of the indicators breaching the threshold for a long period. The stress test results for the debt-to-exports ratio do not fall below the threshold until almost the end of the projection period. The debt service indicators are particularly susceptible to changes in the terms of public sector borrowing. This shows that the country is highly exposed to changes in the level of concessionality of loans and emphasizes the need for the government to seek out only highly concessional financing. A shock to the terms of public sector borrowing would keep the debt service-to-exports ratio hovering around the threshold until 2025 while the debt service-to-revenue ratio remains well below the threshold for the entire projection period.

9. **Under an alternative oil scenario, São Tomé and Príncipe's projected debt indicators would greatly improve and all indicators would fall quickly below the thresholds** (Figure 1, orange lines). Under this scenario the levels of concessional financing could be phased out as the country first moves from IDA grants to IDA loans, and then seeks market financing as needed.

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[5] 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 2010–12 is 3.03 (weak performer). The corresponding indicative thresholds are: 30 percent for the 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.

[6] The country was most vulnerable to a shock to non-debt creating flows in the previous DSA.

PUBLIC DEBT SUSTAINABILITY

10. There is essentially no difference between the external and public sector DSAs. This is because the government of São Tomé and Príncipe does not have any domestic public debt stock and is not projected to issue domestic debt in the baseline scenario.[7] However, the debt dynamics appear unsustainable under two alternate scenarios. The debt indicators continue to rise throughout the projection period when real GDP growth and the primary balance are at historical averages (Figure 2, dotted green line) or when the primary balance is unchanged from 2013 (Figure 2, black dashed line). These shocks highlight the importance of continued fiscal prudence to ensure debt sustainability and structural reforms to improve the business environment and thus support private sector led growth. Public debt is most sensitive to a combined shock to the projected growth of nominal GDP, exports, private transfers and FDI. The public debt service-to-revenue ratio is most sensitive to a one-time 30 percent depreciation of the dobra.

CONCLUSION AND THE AUTHORITIES' VIEW

11. São Tomé and Príncipe remains at a high risk of external debt distress. However, the country is able to service its current obligations and while some external debt indicators are projected remain above their respective thresholds they show a clear downward trend in the long term. Compared to the prior DSA, the indicators remain just around or significantly above the thresholds for longer periods due to the absence of oil. In this context, the DSA underlines the need for measures to mitigate risks:

- Remain committed to maintaining the exchange rate peg. It will be important to maintain an adequate level of international reserve to boost confidence in the wake of reduced oil prospects;
- Maintain fiscal prudence, particularly in the run-up to the 2014 local and parliamentary elections;
- Accelerate reforms to improve policy and institutional performance to enhance the growth potential of the country;
- Restructure and strengthen the banking system through either further recapitalization or mergers and/or closure of distressed and weak banks;
- Ensure favorable financing terms in the form of grants or highly concessional borrowing; and
- Develop and implement a comprehensive strategy to reduce the cost of doing business and attract private investment that can broaden the export base.

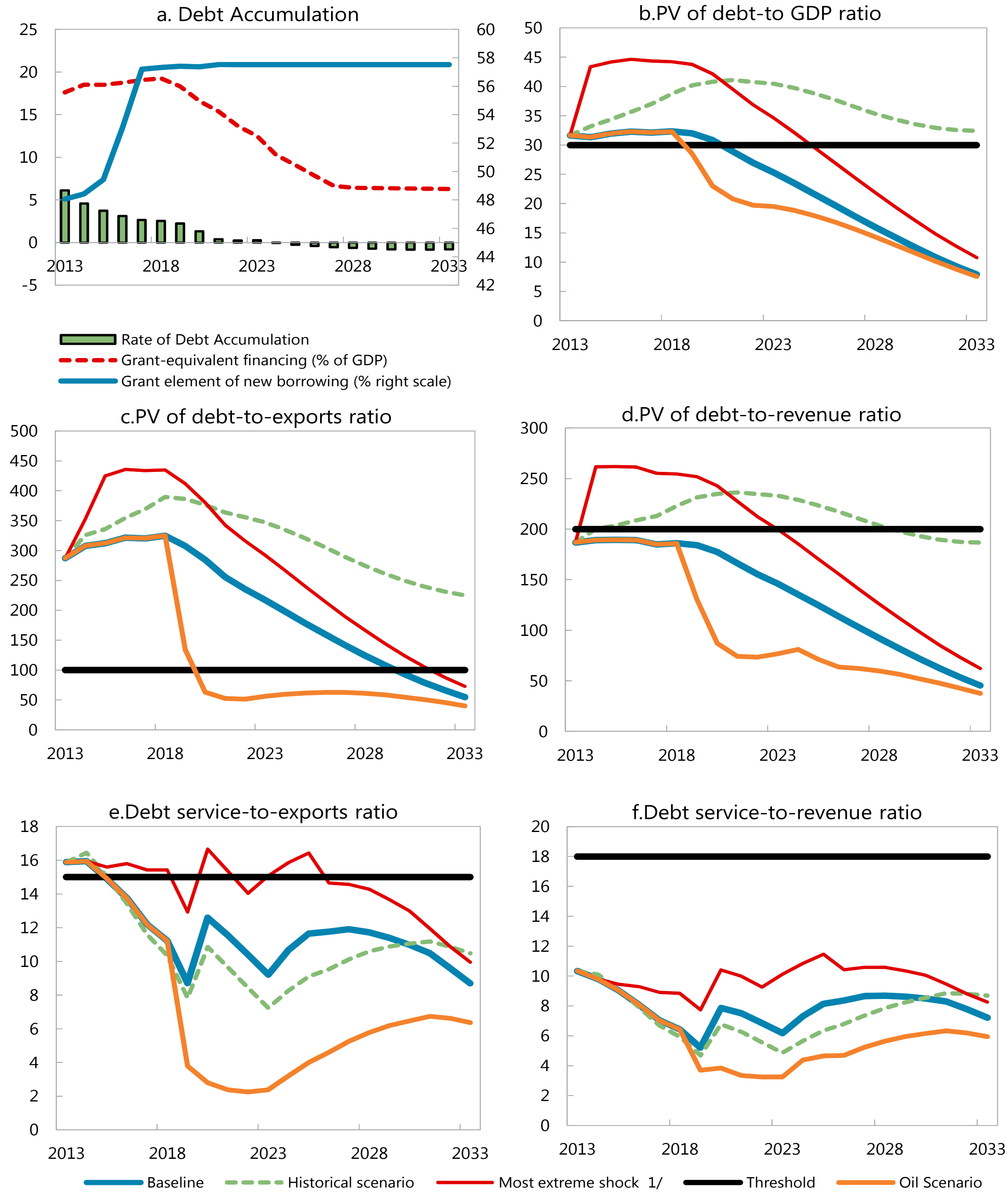
12. The biggest risks to external debt sustainability come from exchange rate shocks and less favorable terms on new public sector loans. Debt sustainability could deteriorate if significantly higher

[7] Data on cross-arrears between the Treasury, the state-owned Water and Electricity Company (EMAE), and National Fuel Company (ENCO) are not included in this analysis as a plan to clear such arrears is being developed.

global food and fuel prices materialize, raising the import bill and putting pressure on the current account. The risks appear manageable over the medium-term if the authorities are able to move forward with the planned fiscal adjustment in the coming years and safeguard international reserves. These vulnerabilities also underscore the importance of sound macroeconomic policies to fulfill the country's growth potential on a sustained basis. The development of sound public debt management, anchored in a medium-term debt management strategy and medium-term fiscal framework, will be essential to guide future development financing. Additionally, with respect to the public investment plan, priority should be given to projects which would help generate high growth and employment as well as exports to help ensure debt service capacity in the future.

13. The authorities broadly agreed with the key macroeconomic assumptions and analysis underpinning the joint DSA. They have cautiously moved to the non-oil baseline scenario following Total's decision to abandon the Block 1 of the JDZ. However, the authorities remain confident about the prospects for future oil production, citing interest from medium-size firms to take over from Total, the recent signing of a production sharing agreement in the EEZ, and the potential for joint off-shore exploration of along the maritime frontier shared with Equatorial Guinea. While acknowledging that São Tomé and Príncipe remains at high risk of falling back into debt distress, they highlighted that supporting growth and diversification requires mobilizing sufficient resources to implement the country's public investment program, which will continue to require highly-concessional borrowing to the extent that sufficient grant financing is not available. Finally, the authorities noted that additional borrowing did not pose an immediate concern as debt service levels are at or below the thresholds.

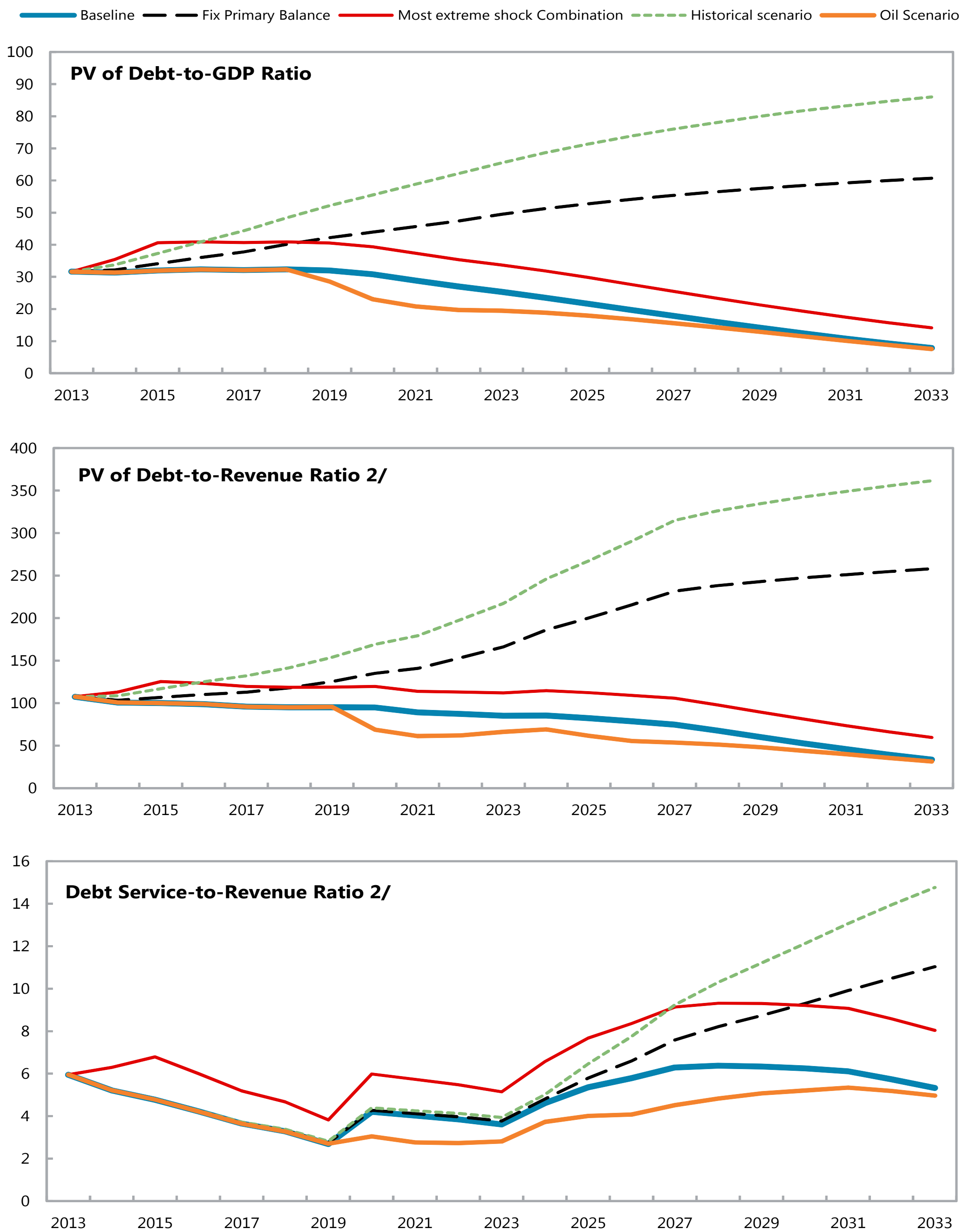
Figure 1. São Tomé and Príncipe: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2013–33[1/]



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2023. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Terms shock and in figure f. to a Terms shock

Figure 2. São Tomé and Príncipe: Indicators of Public Debt under Alternatives Scenarios, 2013–33[1/]



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2023.

2/ Revenues are defined inclusive of grants.

Table 1. São Tomé and Príncipe: External Debt Sustainability Framework, Baseline Scenario, 2010–33 1/

(Percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2010	2011	2012			2013	2014	2015	2016	2017	2018	2013-2018 Average	2023	2033	2019-2033 Average
External debt (nominal) 1/	**32.6**	**38.9**	**49.0**			**51.6**	**51.6**	**52.9**	**53.7**	**53.6**	**53.9**		**38.5**	**10.3**	
of which: public and publicly guaranteed (PPG)	32.6	38.9	49.0			51.6	51.6	52.9	53.7	53.6	53.9		38.5	10.3	
Change in external debt	8.5	6.3	10.1			2.6	0.1	1.2	0.8	-0.1	0.3		-3.6	-1.9	
Identified net debt-creating flows	-2.7	7.6	9.9			9.5	6.6	4.9	3.3	1.6	0.4		1.1	1.4	
Non-interest current account deficit	**22.8**	**26.4**	**20.1**	**25.4**	**5.9**	**19.8**	**15.4**	**14.0**	**12.5**	**11.2**	**10.1**		**10.1**	**9.1**	10.2
Deficit in balance of goods and services	-72.0	-71.1	-65.8			-58.3	-54.7	-53.9	-52.5	-51.4	-50.6		-47.9	-45.2	
Exports	12.1	11.8	12.9			11.0	10.2	10.2	10.1	10.0	10.0		11.7	14.4	
Imports	-59.9	-59.2	-52.8			-47.3	-44.5	-43.6	-42.4	-41.4	-40.7		-36.2	-30.8	
Net current transfers (negative = inflow)	-25.0	-20.9	-20.3	-18.4	3.7	-16.8	-19.3	-19.5	-19.9	-20.3	-20.7		-14.5	-7.3	-11.6
of which: official	-23.5	-19.8	-18.4			-13.9	-16.1	-16.5	-17.1	-17.7	-18.3		-12.7	-6.3	
Other current account flows (negative = net inflow)	119.9	118.4	106.2			94.9	89.4	87.4	84.9	82.9	81.5		72.5	61.7	
Net FDI (negative = inflow)	**-25.1**	**-12.8**	**-8.4**	**-15.3**	**13.5**	**-9.0**	**-7.0**	**-7.0**	**-7.0**	**-7.0**	**-7.0**		**-7.1**	**-7.1**	-7.1
Endogenous debt dynamics 2/	**-0.3**	**-5.9**	**-1.8**			**-1.2**	**-1.8**	**-2.1**	**-2.2**	**-2.5**	**-2.6**		**-1.9**	**-0.6**	
Contribution from nominal interest rate	0.2	0.3	0.4			0.4	0.5	0.5	0.4	0.4	0.4		0.2	0.0	
Contribution from real GDP growth	-1.1	-1.3	-1.5			-1.7	-2.2	-2.6	-2.7	-3.0	-3.0		-2.2	-0.6	
Contribution from price and exchange rate changes	0.5	-4.9	-0.8			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**11.1**	**-1.3**	**0.2**			**-7.0**	**-6.6**	**-3.6**	**-2.5**	**-1.7**	**-0.1**		**-4.7**	**-3.3**	
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/	...	...	30.7			31.6	31.4	32.0	32.3	32.1	32.3		25.3	7.9	
In percent of exports	...	...	237.6			287.2	307.9	312.4	321.4	320.5	324.8		217.2	54.8	
PV of PPG external debt	**...**	**...**	**30.7**			**31.6**	**31.4**	**32.0**	**32.3**	**32.1**	**32.3**		**25.3**	**7.9**	
In percent of exports	**...**	**...**	**237.6**			**287.2**	**307.9**	**312.4**	**321.4**	**320.5**	**324.8**		**217.2**	**54.8**	
In percent of government revenues	**...**	**...**	**200.3**			**186.9**	**189.2**	**189.4**	**189.2**	**184.9**	**186.0**		**145.8**	**45.4**	
Debt service-to-exports ratio (in percent)	**6.6**	**31.9**	**7.1**			**15.9**	**15.9**	**14.9**	**13.8**	**12.2**	**11.2**		**9.2**	**8.7**	
PPG debt service-to-exports ratio (in percent)	**6.6**	**31.9**	**7.1**			**15.9**	**15.9**	**14.9**	**13.8**	**12.2**	**11.2**		**9.2**	**8.7**	
PPG debt service-to-revenue ratio (in percent)	**4.4**	**20.9**	**6.0**			**10.3**	**9.8**	**9.0**	**8.1**	**7.0**	**6.4**		**6.2**	**7.2**	
Total gross financing need (Billions of U.S. dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Non-interest current account deficit that stabilizes debt ratio	14.3	20.1	10.0			17.2	15.3	12.8	11.7	11.3	9.8		13.7	11.0	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.5	4.9	4.0	5.4	3.3	4.0	5.0	5.5	5.5	6.0	6.0	5.3	5.5	5.5	5.6
GDP deflator in US dollar terms (change in percent)	-2.1	17.7	2.0	6.5	7.2	13.3	10.2	4.0	3.0	2.7	2.1	5.9	1.9	1.9	1.9
Effective interest rate (percent) 5/	0.9	1.0	1.0	0.7	0.3	1.1	1.0	1.0	0.9	0.8	0.8	0.9	0.6	0.3	0.5
Growth of exports of G&S (US dollar terms, in percent)	24.0	20.7	16.1	9.5	13.9	0.3	7.0	10.2	6.7	8.6	7.4	6.7	9.5	10.1	10.4
Growth of imports of G&S (US dollar terms, in percent)	17.3	22.0	-5.4	13.2	18.2	5.4	9.1	7.5	5.6	6.4	6.3	6.7	5.0	6.8	5.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	48.1	48.4	49.4	53.1	57.2	57.3	52.3	57.5	57.5	57.5
Government revenues (excluding grants, in percent of GDP)	18.2	18.0	15.3			16.9	16.6	16.9	17.1	17.4	17.4		17.4	17.4	17.4
Aid flows (in Billions of US dollars) 7/	0.1	0.1	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.1	
of which: Grants	0.0	0.0	0.0			0.0	0.1	0.1	0.1	0.1	0.1		0.1	0.1	
of which: Concessional loans	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			17.6	18.5	18.5	18.8	19.1	19.3		12.5	6.3	9.9
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			76.0	81.5	84.1	87.1	89.7	90.8		99.3	98.7	98.1
Memorandum items:															
Nominal GDP (Billions of US dollars)	0.2	0.2	0.3			0.3	0.4	0.4	0.4	0.5	0.5		0.7	1.5	
Nominal dollar GDP growth	2.3	23.5	6.1			17.8	15.7	9.7	8.7	8.9	8.2	11.5	7.6	7.5	7.7
PV of PPG external debt (in Billions of US dollars)			0.1			0.1	0.1	0.1	0.1	0.2	0.2		0.2	0.1	
(PVt-PVt-1)/GDPt-1 (in percent)						**6.1**	4.6	3.7	3.1	2.7	2.5	3.8	0.3	-0.8	-0.1
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	30.2			30.7	30.4	31.1	31.4	31.3	31.6		24.9	7.8	
PV of PPG external debt (in percent of exports + remittances)	...	...	207.5			227.2	234.3	242.4	252.1	254.9	261.2		188.3	51.2	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	6.2			12.6	12.1	11.6	10.8	9.7	9.0		8.0	8.1	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt. Technical arrears which are currently being renegotiated are excluded.
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 2. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–33

(Percent)

	Projections							
	2013	2014	2015	2016	2017	2018	**2023**	2033
PV of debt-to GDP ratio								
Baseline	32	31	32	32	32	32	**25**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	32	33	34	36	37	39	**40**	32
A2. New public sector loans on less favorable terms in 2013-2033 2	32	34	36	38	39	39	**32**	13
A3. Alternative Scenario :[Costumize, enter title]	32	33	34	36	37	38	**35**	16
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	32	32	34	35	34	34	**27**	8
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	32	32	34	34	34	34	**26**	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	32	35	37	38	38	37	**29**	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	32	36	41	41	41	40	**32**	9
B5. Combination of B1-B4 using one-half standard deviation shocks	32	36	40	40	40	40	**31**	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	32	43	44	45	44	44	**35**	11
PV of debt-to-exports ratio								
Baseline	287	308	312	321	320	325	**217**	55
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	287	326	336	354	369	389	**347**	225
A2. New public sector loans on less favorable terms in 2013-2033 2	287	330	350	374	385	395	**277**	89
A3. Alternative Scenario :[Costumize, enter title]	290	325	335	354	368	384	**300**	113
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	287	310	314	323	322	323	**216**	55
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	287	352	425	436	434	435	**292**	73
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	287	310	314	323	322	323	**216**	55
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	287	354	401	408	404	403	**275**	65
B5. Combination of B1-B4 using one-half standard deviation shocks	287	340	394	404	401	401	**271**	67
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	287	310	314	323	322	323	**216**	55
PV of debt-to-revenue ratio								
Baseline	187	189	189	189	185	186	**146**	45
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	187	200	204	209	213	223	**233**	187
A2. New public sector loans on less favorable terms in 2013-2033 2	187	203	212	220	222	226	**186**	74
A3. Alternative Scenario :[Costumize, enter title]	189	200	203	208	212	220	**201**	93
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	187	196	203	202	197	197	**154**	48
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	187	193	200	199	194	193	**152**	47
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	187	211	221	221	216	215	**169**	53
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	187	217	243	240	233	231	**185**	54
B5. Combination of B1-B4 using one-half standard deviation shocks	187	217	238	236	230	228	**181**	55
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	187	262	262	261	255	254	**199**	62

Table 2. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–33 (concluded)

(Percent)

	Projections							
	2013	2014	2015	2016	2017	2018	**2023**	2033
Debt service-to-exports ratio								
Baseline	16	16	15	14	12	11	**9**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	16	16	15	13	12	10	**7**	10
A2. New public sector loans on less favorable terms in 2013-2033 2	16	16	16	16	15	15	**15**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	16	16	15	14	12	11	**9**	9
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	16	18	19	18	16	15	**12**	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	16	16	15	14	12	11	**9**	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	16	16	15	14	12	11	**9**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	16	17	17	16	14	13	**10**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	16	16	15	14	12	11	**9**	9
Debt service-to-revenue ratio								
Baseline	10	10	9	8	7	6	**6**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	10	10	9	8	7	6	**5**	9
A2. New public sector loans on less favorable terms in 2013-2033 2	10	10	9	9	9	9	**10**	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	10	10	10	9	7	7	**7**	8
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	10	10	9	8	7	6	**6**	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	10	11	11	9	8	7	**7**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	10	10	9	8	7	7	**6**	9
B5. Combination of B1-B4 using one-half standard deviation shocks	10	11	10	9	8	7	**7**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	10	13	12	11	10	9	**8**	10
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	54	54	54	54	54	54	**54**	54

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, 2010–33

(Percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2010	2011	2012			2013	2014	2015	2016	2017	2018	2013-18 Average	2023	2033	2019-33 Average
Public sector debt 1/	32.6	38.9	49.0			51.6	51.6	52.9	53.7	53.6	53.9		38.5	10.3	
of which: foreign-currency denominated	32.6	38.9	49.0			51.6	51.6	52.9	53.7	53.6	53.9		38.5	10.3	
Change in public sector debt	8.5	6.3	10.1			2.6	0.1	1.2	0.8	-0.1	0.3		-3.6	-1.9	
Identified debt-creating flows	9.9	7.3	6.0			2.4	0.4	1.6	1.1	0.1	0.3		-3.6	-1.4	
Primary deficit	10.9	12.8	11.4	12.5	5.4	8.7	6.8	5.7	4.8	4.0	3.5	5.6	-0.9	-0.6	-0.4
Revenue and grants	37.4	35.3	32.3			29.4	31.2	32.0	32.7	33.5	34.0		29.8	23.5	
of which: grants	19.1	17.3	16.9			12.5	14.6	15.1	15.6	16.1	16.6		12.4	6.2	
Primary (noninterest) expenditure	48.3	48.1	43.7			38.1	37.9	37.7	37.5	37.5	37.5		28.9	22.9	
Automatic debt dynamics	-1.0	-4.1	-5.4			-6.3	-6.4	-4.1	-3.7	-3.9	-3.2		-2.7	-0.8	
Contribution from interest rate/growth differential	-1.1	-1.9	-1.8			-2.1	-2.7	-3.1	-3.3	-3.6	-3.7		-2.8	-0.8	
of which: contribution from average real interest rate	-0.1	-0.3	-0.3			-0.2	-0.3	-0.5	-0.6	-0.6	-0.7		-0.6	-0.2	
of which: contribution from real GDP growth	-1.0	-1.5	-1.5			-1.9	-2.5	-2.7	-2.8	-3.0	-3.0		-2.2	-0.6	
Contribution from real exchange rate depreciation	0.1	-2.2	-3.6			-4.2	-3.7	-0.9	-0.4	-0.3	0.5		...	...	
Other identified debt-creating flows	0.0	-1.4	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	-1.4	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	-1.4	-1.0	4.1			0.2	-0.3	-0.4	-0.3	-0.2	0.0		0.0	-0.5	
Other Sustainability Indicators															
PV of public sector debt	...	...	30.7			31.6	31.4	32.0	32.3	32.1	32.3		25.3	7.9	
of which: foreign-currency denominated	...	...	30.7			31.6	31.4	32.0	32.3	32.1	32.3		25.3	7.9	
of which: external	...	...	30.7			31.6	31.4	32.0	32.3	32.1	32.3		25.3	7.9	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	11.7	16.6	12.3			10.4	8.4	7.2	6.2	5.2	4.6		0.2	0.7	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	95.3			107.6	100.7	100.0	98.8	95.9	95.0		85.1	33.6	
PV of public sector debt-to-revenue ratio (in percent)	...	...	200.3			186.9	189.2	189.4	189.2	184.9	186.0		145.8	45.4	
of which: external 3/	...	...	200.3			186.9	189.2	189.4	189.2	184.9	186.0		145.8	45.4	
Debt service-to-revenue and grants ratio (in percent) 4/	2.2	10.7	2.8			5.9	5.2	4.8	4.2	3.6	3.3		3.6	5.3	
Debt service-to-revenue ratio (in percent) 4/	4.4	20.9	6.0			10.3	9.8	9.0	8.1	7.0	6.4		6.2	7.2	
Primary deficit that stabilizes the debt-to-GDP ratio	2.4	6.5	1.3			6.1	6.7	4.5	4.1	4.1	3.2		2.7	1.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.5	4.9	4.0	5.4	3.3	4.0	5.0	5.5	5.5	6.0	6.0	5.3	5.5	5.5	5.6
Average nominal interest rate on forex debt (in percent)	0.9	1.0	1.0	0.7	0.3	1.1	1.0	1.0	0.9	0.8	0.8	0.9	0.6	0.3	0.5
Average real interest rate on domestic debt (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Real exchange rate depreciation (in percent, + indicates depreciation)	0.6	-7.2	-9.8	-4.0	5.8	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	11.7	12.1	10.3	14.6	4.7	9.8	8.4	2.6	1.8	1.7	2.1	4.4	2.9	2.9	2.9
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.0	-0.1	0.1	0.3	-0.1	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.1	0.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	48.1	48.4	49.4	53.1	57.2	57.3	52.3	57.5	57.5	...

Sources: Country authorities; and staff estimates and projections.

1/ Includes gross debt of the general government. Technical arrears which are currently being renegotiated are excluded.

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 for Key Indicators of Public Debt, 2013–33

(Percent)

		Projections						
	2013	2014	2015	2016	2017	2018	2023	2033
PV of Debt-to-GDP Ratio								
Baseline	32	31	32	32	32	32	25	8
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	32	34	37	41	44	48	66	86
A2. Primary balance is unchanged from 2013	32	32	34	36	38	40	49	61
A3. Permanently lower GDP growth 1/	32	32	33	33	34	34	30	19
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	32	32	35	35	36	36	31	15
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	32	36	42	42	42	42	33	12
B3. Combination of B1-B2 using one half standard deviation shocks	32	35	41	41	41	41	34	14
B4. One-time 30 percent real depreciation in 2014	32	42	40	39	37	36	29	10
B5. 10 percent of GDP increase in other debt-creating flows in 2014	32	36	36	36	36	36	29	9
PV of Debt-to-Revenue Ratio 2/								
Baseline	108	101	100	99	96	95	85	34
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	108	109	117	125	132	142	217	362
A2. Primary balance is unchanged from 2013	108	103	107	110	113	118	166	258
A3. Permanently lower GDP growth 1/	108	101	101	101	99	99	98	78
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	108	103	105	105	103	104	101	64
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	108	116	132	129	124	122	112	50
B3. Combination of B1-B2 using one half standard deviation shocks	108	113	125	123	120	119	112	60
B4. One-time 30 percent real depreciation in 2014	108	134	126	119	111	107	97	43
B5. 10 percent of GDP increase in other debt-creating flows in 2014	108	115	113	111	108	106	96	40

Table 4. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public Debt, 2013–33 (concluded)

(Percent of Revenue)

		Projections						
	2013	2014	2015	2016	2017	2018	2023	2033
Debt Service-to-Revenue Ratio 2/								
Baseline	6	5	5	4	4	3	4	5
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	6	5	5	4	4	3	4	15
A2. Primary balance is unchanged from 2013	6	5	5	4	4	3	4	11
A3. Permanently lower GDP growth 1/	6	5	5	4	4	3	4	7
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-2015	6	5	5	4	4	3	4	7
B2. Primary balance is at historical average minus one standard deviations in 2014-2015	6	5	5	4	4	3	4	7
B3. Combination of B1-B2 using one half standard deviation shocks	6	5	5	4	4	3	4	7
B4. One-time 30 percent real depreciation in 2014	6	6	7	6	5	5	5	8
B5. 10 percent of GDP increase in other debt-creating flows in 2014	6	5	5	4	4	3	4	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.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with the Democratic Republic of São Tomé and Príncipe

On December 16, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Democratic Republic of São Tomé and Príncipe.

After significant real economic growth volatility and high inflation through 2009, growth has become more stable and inflation has reached record low levels. However, real economic growth slowed to 4 percent in 2012, reflecting a scaling back of project financing and foreign direct investment as many of São Tomé and Príncipe's key partners were hard hit by the global economic slowdown. Growth is projected to remain unchanged at 4 percent in 2013 in light of lingering uncertainties stemming from the challenging external environment. Despite São Tomé and Príncipe's vulnerability to supply shocks, inflation has continued to recede following the adoption in January 2010 of the peg of the dobra to the euro: annual inflation reached 6.4 percent in September 2013 (its lowest level in two decades).

The fiscal stance has been prudent in recent years. After an initial slippage in 2009, the domestic primary balance has improved steadily thereafter, reflecting efforts to increase tax revenues and contain non-priority spending. However, the authorities have had difficulty sustaining the tax effort, which dipped to 14 percent of GDP in 2012, reflecting the effect of the weakening economy on customs duties and consumption and profit taxes, as well as a still narrow tax base and the persistence of fuel tax arrears.

Monetary aggregate growth has been consistent with maintaining the credibility of the exchange rate peg. Broad money growth accelerated in 2012, reflecting a larger than projected accumulation of foreign assets. However, it has since abated and year-on-year growth in broad money is now broadly in line with nominal GDP growth.

[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.

The financial soundness of the banking system was adversely impacted by rapid credit expansion until 2011 in the context of poor risk management and lending practices. The data reveal low overall profitability, a high and rising share of nonperforming loans, and a rapidly declining trend in banks' capital-to-risk-weighted-asset ratios. On the positive side, dollarization in the banking system continues to decline, reflecting measures taken by the central bank to foster the use of the local currency, as well as the public's increased confidence in the dobra as inflation converges to international levels.

The external current account deficit continues to decline and central bank's international reserves to improve. Weaker economic activity has led to reduced imports of goods and services and an improved external current account balance. After falling below three months of imports in mid-2012, the central bank has since accumulated international reserves considerably. International reserves, which have been boosted by privatization receipts and grants, stood at around 5.5 months of imports at end-September 2013.

The outlook for 2014 continues to be affected by difficult global conditions. Real GDP growth has been revised downward, from 5.5 to 5 percent, reflecting lingering uncertainties in the world economy, weak external financing prospects for investment projects, and the changed oil outlook. Inflation is projected to reach 6 percent by end-2014, as inflation expectations continue to be anchored by a prudent fiscal stance and the exchange rate peg. The external current account deficit is expected to narrow further, with weaker than previously projected economic activity leading to lower import growth.

São Tomé and Príncipe's medium-term economic outlook will depend on strengthening the economy's resilience in the wake of more uncertain oil prospects. Fiscal and external debt sustainability indicators are expected to improve more slowly following the French oil company Total's decision in September 2013 to withdraw from Block 1 of the Joint Development Zone (JDZ) with Nigeria. As a result, the authorities will have to continue relying on grants and highly concessional financing for many years to come; commercial banks that have entered the market lured mainly by the prospects of oil will have to change their market strategy and strengthen their balance sheets, or leave the market; and the authorities will have to promote even more forcefully the development of non-oil priority sectors, such as tourism, agriculture, and fisheries, including by improving the business climate and upgrading the country's infrastructure with private sector support.

Executive Board Assessment[2]

Executive Directors noted that economic growth has been sustained while inflation has been reduced notwithstanding a challenging global environment. They also commended the authorities' fiscal prudence in recent years and the steps they have taken to strengthen the financial sector. For the period ahead, Directors encouraged the authorities to maintain fiscal discipline, including in the run-up to elections, given a more uncertain economic outlook. They also recommended taking further steps to bolster the economy's resilience, including strengthening the financial sector and improving competitiveness.

Directors welcomed the authorities' cautious medium-term fiscal plans. They stressed the importance of keeping the domestic primary deficit in line with available non-debt creating financing, and of mobilizing additional domestic revenue to boost priority infrastructure and pro poor spending. Prudent external borrowing will mitigate São Tomé and Príncipe's high risk of debt distress. In particular, grants and concessional loans should be sought to finance the public investment program. Directors looked forward to a comprehensive solution to eliminate the longstanding issue of cross-arrears.

Directors highlighted the importance of preserving financial stability. Noting the relatively high number of commercial banks, they encouraged the authorities to monitor closely banks' profitability and capital adequacy. They also recommended reinforcing compliance with prudential requirements and taking steps to bolster the efficiency of the banking system. Directors welcomed the expeditious approval of a law to combat money laundering and the financing of terrorism and encouraged the authorities to address remaining obstacles to its rigorous enforcement.

Directors agreed that the fixed exchange rate regime has provided economic and financial stability to São Tomé and Príncipe in the context of a prudent fiscal stance and an adequate level of international reserves. Nonetheless, the country's high current account deficit is a source of vulnerability and Directors recommended continued efforts to raise productivity and competitiveness. Further infrastructure investments as well as deeper regulatory and legal reforms will help improve the business climate and promote economic diversification.

[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 summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2010–17

(Annual change in percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017
			Prel.	Projections				
National income and prices								
GDP at constant prices	4.5	4.9	4.0	4.0	5.0	5.5	5.5	6.0
Consumer prices								
End of period	12.9	11.9	10.4	8.0	6.0	4.0	3.0	3.0
Period average	13.3	14.3	10.6	8.3	7.1	5.0	3.5	3.0
External trade								
Exports of goods and nonfactor services	24.0	20.7	16.1	0.3	7.0	10.2	6.7	8.6
Imports of goods and nonfactor services	17.3	22.0	-5.4	5.4	9.1	7.5	5.6	6.4
Exchange rate (dobras per US$; end of period) [1]	18,651	19,008	18,585	...	...	...	...	...
Real effective exchange rate (depreciation = -)	-2.8	11.7	5.0	...	...	...	...	...
Money and credit								
Base money	-7.9	-0.7	28.6	42.9	10.0	9.0	5.5	7.0
Broad money (M3)	25.1	10.4	20.3	11.5	13.1	9.5	9.2	9.6
Credit to the economy	41.1	14.5	9.6	9.4	9.9	10.2	11.1	11.1
Velocity (GDP to broad money; end of period)	2.6	2.8	2.7	2.7	2.8	2.7	2.7	2.6
Central bank reference interest rate (percent)	15.0	15.0	14.0	...	...	...	...	...
Bank lending rate (percent)	28.9	27.0	26.2	...	...	...	...	...
Bank deposit rate (percent)	11.0	12.4	12.9	...	...	...	...	...
Government finance (figures in percent of GDP)								
Total revenue, grants, and oil signature bonuses [2]	38.1	37.1	33.6	31.7	31.9	32.7	33.4	34.2
Of which: tax revenue	16.6	16.6	14.0	15.2	15.3	15.6	15.8	16.1
Nontax revenue	1.6	1.4	1.3	1.7	1.3	1.3	1.3	1.3
Grants	19.9	18.3	17.5	13.2	15.3	15.8	16.3	16.8
Oil signature bonuses	0.0	0.8	0.8	1.6	0.0	0.0	0.0	0.0
Total expenditure and net lending	49.1	49.0	44.3	39.0	38.9	38.6	38.5	38.4
Personnel costs	8.3	8.4	8.4	8.5	8.2	8.1	8.1	8.1
Interest due	0.4	0.5	0.6	0.4	0.6	0.6	0.5	0.5
Nonwage noninterest current expenditure	11.1	10.5	8.5	9.4	9.2	9.2	9.0	9.0
Treasury funded capital expenditures	2.3	1.5	1.5	1.7	1.7	1.7	1.7	1.7
Donor funded capital expenditures	26.3	27.5	25.1	18.6	18.6	18.6	18.6	18.6
HIPC Initiative-related social expenditure	0.6	0.7	0.3	0.5	0.5	0.5	0.5	0.5
Domestic primary balance [3]	-4.1	-3.0	-3.3	-3.1	-3.0	-2.6	-2.3	-2.0
Overall balance (commitment basis)	-11.0	-12.0	-10.8	-7.3	-7.0	-6.0	-5.1	-4.2

External sector								
Current account balance (percent of GDP)								
Including official transfers	-23.0	-26.6	-20.5	-20.2	-15.9	-14.5	-13.0	-11.6
Excluding official transfers	-46.5	-46.5	-38.9	-34.1	-32.0	-31.0	-30.1	-29.3
PV of external debt (percent of GDP)	33.7	33.6	35.7	32.7	30.4	28.0	26.0	23.8
External debt service (percent of exports) [4]	6.6	8.0	7.1	15.5	15.0	13.6	12.2	10.7
Export of goods and non-factor services (US$ millions)	24.3	29.3	34.1	34.2	36.6	40.3	43.0	46.7
Gross international reserves [5, 6, 7]								
Millions of U.S. dollars	39.3	39.7	43.8	53.4	59.0	65.2	70.3	75.8
Months of imports of goods and nonfactor services [8]	4.5	4.6	4.8	5.5	5.7	6.0	6.1	6.2
National Oil Account (US$ millions)	7.8	8.3	9.0	12.2	9.9	8.0	6.5	5.3
Memorandum Item								
GDP								
Billions of dobras	3,719	4,376	5,021	5,732	6,524	7,064	7,589	8,180
Millions of U.S. dollars	201.0	248.3	263.3	310.2	359.1	393.9	428.0	465.9

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

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

[2] Includes HIPC and MDRI debt relief.

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

[4] In percent of exports of goods and nonfactor services. Includes HIPC and MDRI debt relief.

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

[6] For 2008 and 2009, includes the proceeds from the privatization of the government's share in the National Fuel Company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the BCSTP to boost reserves.

[7] For 2009, includes new allocation of SDR 6.5 million.

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

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FOR IMMEDIATE RELEASE
December 16, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Concludes the Second Review under the Extended Credit Facility Arrangement with São Tomé and Príncipe

The Executive Board of the International Monetary Fund (IMF) today completed the second review under the three-year arrangement under the Extended Credit Facility (ECF) for São Tomé and Príncipe. The completion of the review enables the disbursement of an amount equivalent to SDR 0.37 million (about US$ 0.57 million), bringing the total disbursements under the arrangement to SDR 1.11 million (about US$ 1.71 million).

The Executive Board also concluded the 2013 Article IV Consultation with São Tomé and Príncipe. A press release will be issued in due course.

The three-year SDR 2.59 million (then about US$ 3.9 million) ECF arrangement with São Tomé and Príncipe was approved by the IMF's Executive Board on July 20, 2012 (see Press Release No.12/272).

Following the Executive Board's discussion, Mr. Min Zhu, Deputy Managing Director and Acting Chair issued the following statement:

"The authorities are to be commended for a satisfactory performance under the Fund-supported program. Steady economic growth and disinflation have been maintained in a challenging global environment, and a prudent fiscal stance has underpinned the fixed exchange rate regime.

"Looking ahead, it is important to continue to strengthen economic resilience, particularly in light of uncertain prospects for oil production. Fiscal discipline, particularly in the run-up to the 2014 elections, will be crucial. In this regard, improvements in revenue mobilization continue to be necessary to create additional space for public investments and social spending. Reliance on grant and concessional financing will help mitigate the risk of debt distress.

"Policy priorities for the financial sector are to reinforce compliance with prudential requirements and to promote the efficiency and profitability of the banking system.

"Continued efforts to improve productivity and competitiveness are necessary to reduce external vulnerabilities. Upgrades in infrastructure and further regulatory reforms will help improve the business climate and promote economic diversification."

Statement by Kossi Assimaidou, Executive Director for São Tomé and Príncipe and Woury Mamadou Diallo, Alternante Executive Director
December 16, 2013

The São Toméan authorities are grateful to Fund Staff for the constructive discussions held in São Tomé and Washington D.C during the 2013 Article IV consultations and second ECF review in September and October 2013. The policy discussions focused on the need to maintain fiscal and external debt sustainability in light of reduced oil prospects, strengthen the resilience of the economy, and reduce financial sector vulnerabilities. My authorities remain committed to consolidate the progress achieved over the years in strengthening economic growth and macroeconomic stability. They broadly concur with the main policy recommendations of the staff report which will help them implement their National Poverty Reduction Strategy Paper II.

1. Recent Economic Developments and Performance under the ECF Arrangement

The economy of São Tomé and Príncipe has been impacted negatively by the global economic slowdown affecting many of the country's key development and investment partners. After reaching 5 percent in 2011, Real GDP growth slowed to 4 percent in 2012 and is expected to remain at this level in 2013 as a result of weaker external financing prospects for public and private investments. The exchange rate peg to the euro as well as the authorities' prudent fiscal policy stance contributed to a declining trend in inflation from an annual average peak of 32 percent in 2008 to 12 percent in 2012. Annual inflation even reached a record low level of 6.4 percent in August 2013.

The authorities continued to make progress as regards fiscal consolidation. The domestic primary deficit target of 3.1 percent of GDP is expected to be achieved in 2013. Although tax collections in the first semester of 2013 were below projected levels as a result of the slowdown of the economy, non tax revenue as well as expenditures control allowed to compensate for the shortfall. The authorities implemented several structural reforms aimed at strengthening public finances, notably the creation of a macro-fiscal unit comprised of representatives from the Ministry of Planning and Finance, the Central Bank and the National Institute of Statistics. The macro-fiscal unit has started the preliminary work to implement a medium-term fiscal framework (MTFF). Other noteworthy achievements are the completion of the second phase of the implementation of ASYCUDA World in the Customs administration, and enhanced taxpayer management through increased security of the Taxpayer Registry, creation of a dedicated large taxpayer unit and single taxpayer computerized file system. The authorities also continue to work on resolving the issue of cross-arrears between the Treasury, the National Fuel Company ENCO, and the electricity and water company (EMAE) which contributed to the shortfall in tax revenue.

In the monetary sector, the authorities improved monetary policy management by reducing the dollarization of the commercial banking system, promoting the use of the local currency and reducing inflation. They took steps to strengthen the supervisory framework of the banking sector and ensure that troubled banks are recapitalized or restructured in order to improve the soundness of the financial system. In this regard, they have completed the on-site inspection of the largest commercial bank and taken over the operations of another bank, following its failure to comply with supervisory requirements and submit a remedial action plan.
As a result of the weaker economic activity and reduced imports, the external current account deficit declined while international reserves continued to increase boosted by privatization receipts and grants received from the World Bank and Timor-Leste. The authorities have supported the exchange rate peg by maintaining net international reserves at the Central Bank above the equivalent of three months of imports.

The performance of the ECF-supported program at end-June was overall satisfactory. All continuous and quantitative performance criteria were met while two indicative targets related to the Dobra base money and the non-accumulation of domestic arrears were missed. As regards structural reforms, progress was achieved, notably as regards the on-site inspection process of commercial banks and the preparation and submission of the 2010 government accounts to the National Assembly and Court of Audit. The authorities are currently working on the 2011 and 2012 accounts and anticipate a longer than expected period for their submission given the delays in the provision of technical assistance and training in this area.

2. Medium term Policy and Reform Agenda

The authorities are committed to pursue their efforts to achieve macroeconomic stability, sustainable economic growth and poverty reduction as formulated in the National Poverty Reduction Strategy Paper II. While the authorities are confident about the prospects for oil production, despite the withdrawal of the petroleum company Total, they have nonetheless decided to adopt a cautious non-oil baseline scenario as there is still uncertainty regarding the timing and volume of oil production.

Fiscal consolidation and structural reforms

The authorities will pursue gradually their fiscal consolidation efforts with the view to limit its contractionary impact on the economy. The 2014 budget aims to maintain fiscal discipline in an election year and targets a domestic primary deficit of 3 percent of GDP, in line with available non-debt creating financing from external partners and transfers from the National Oil Account. A cumulative adjustment in the primary deficit of 1 percent of GDP will be phased in over three years, starting in the year after the local and parliamentary elections in order to limit the shock created by the withdrawal of Total. The authorities will be in a better position to undertake their fiscal adjustment once economic recovery takes a strong hold.

They are mindful of the need to enhance revenue mobilization, as the scope for further expenditure restrictions is limited given the low level of recurrent and domestically-financed capital expenditure. In this regard, the reforms aimed at improving tax collections and customs and tax administration efficiency will be stepped up while creating additional fiscal space for infrastructure and pro-poor spending, and keeping the domestic primary deficit in line with non-debt creating financing. Among the measures envisaged, the authorities will adopt a comprehensive plan to resolve the problem of cross-arrears with assistance from the IFC and the World Bank by March 2014. Steps will be taken to further expand the tax base by better registering taxpayers, and combat tax fraud and evasion by improving the selection of taxpayers to be audited through risk analysis. However, in order to increase tax payer voluntary compliance, the authorities are aware of the need to improve the quality of services provided to taxpayers and extend them throughout the country, as well as simplify and harmonize tax procedures. They intend to provide the tax and customs administrations with the necessary resources notably additional staff and equipment to allow them to implement these reforms.

Liquidity Management, Financial Stability, and Safeguards

In order to strengthen the resilience of the economy to shocks and promote the sound development and transparency of the financial system, the authorities will reinforce supervisory practices and monetary policy management. With regard to reinforcing the resilience of the economy, they intend to increase the floor on net international reserves from 3 to 3.5 months of imports in order to boost confidence given the less optimistic prospects for oil production.

With respect to the regulatory and supervisory framework, they will focus on reinforcing compliance with solvency and other regulatory requirements. In this context, they will require, among other measures that all banks in operation in the country have a minimum capital-to-risk-weighted-asset ratio of 12 percent. The banks that do not comply would need to be intervened or closed. The process of on-site inspection, which was completed for the largest commercial bank, will also continue for the remaining commercial banks by June 2014, and the Central Bank intends to increase the frequency of these inspections thereafter.

The Central bank will pursue its efforts to introduce as soon as possible money market instruments and create the foundations of an interbank market. In this regard, liquidity management will be strengthened by the development of a systematic approach to analyze forecasting errors and the development of daily aggregate liquidity conditions. The autonomy of the Central Bank will be enhanced through a revision of the Central Bank Law in line with international standards, and a draft law is expected to be prepared by end-September 2014.

Financial transparency will be further promoted by ensuring that all commercial banks publish their financial results for 2012 and 2013 respectively by end-march and end-September 2014, and penalties applied in case of non-compliance. With the technical assistance of Brazil, the authorities are also taking steps to develop and implement a new chart of accounts and reporting at the Central Bank according to international financial reporting standards.

The authorities are committed to ensure that Sao Tome and Principe's financial system is in compliance with the AML/CFT standards. With technical assistance from the IMF, they have drafted amendments to their AML/CFT law which was passed by the National Assembly. Accordingly, Sao Tome and Principe has been removed from the Financial Action Task Force's list of high risk and non-cooperative jurisdictions, and the authorities intend to increase the resources of the financial intelligence unit (FIU) to strengthen its core functions and operations.

My authorities recognize the need to continue to improve the business climate in order to increase the export base and diversify the economy. They have made progress in establishing a one-stop-shop which will facilitate and promote foreign trade by reducing transactions costs and increasing the country's external competiveness. Additional reforms are planned to be implemented in order to strengthen and simplify the country's legal infrastructure, notably for contract enforcement, property registration and the protection of investors.

3. Conclusion

My São Toméan authorities are committed to pursuing sound macroeconomic policies and strengthen and diversify growth. They will continue to build on recent achievements notably by reducing inflation and maintaining the domestic primary deficit in line with available non-debt-creating financing. Their efforts will also focus on improving liquidity management and banking supervision in order to maintain financial stability. My authorities are mindful of the challenges in strengthening the resilience of the economy in the context of diminished near-term oil prospects. Therefore, they will continue to implement prudent fiscal and monetary policies and strengthening debt management will remain a priority, with the authorities relying on grants or highly concessional financing for projects. In light of the satisfactory progress in program implementation, I would appreciate Directors' support for the completion of the second review.