INTERNATIONAL MONETARY FUND

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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

July 2015

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND CANCELLATION OF THE CURRENT ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

In the context of the request for a three-year arrangement under the Extended Credit Facility and cancellation of the current arrangement under the Extended Credit Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 13, 2015, following discussions that ended on May 7, 2015, with the officials of the Democratic Republic of São Tomé and Príncipe on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on June 24, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for the Democratic Republic of 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 [country]*
Memorandum of Economic and Financial Policies by the authorities of [country]*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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July 13, 2015

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IMF Executive Board Approves Three-Year, US$6.2 Million Extended Credit Facility Arrangement for the Democratic Republic of São Tomé and Príncipe

The Executive Board of the International Monetary Fund (IMF) today approved a new arrangement under the Extended Credit Facility (ECF) for SDR 4.44 million (about US$6.2 million or 60 percent of quota) for the Democratic Republic of São Tomé and Príncipe. The approval enables the immediate disbursement of SDR 634,285 (about US$887,308).

The new ECF arrangement seeks to underpin the government's economic reform program which aims to strengthen public finances, reduce balance-of-payments vulnerabilities, and clear large domestic arrears. The program also lays the foundation for stronger, more inclusive growth, and plays a catalytic role for bilateral and multilateral assistance.

At the conclusion of the Executive Board's discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair issued the following statement:

"São Tomé and Príncipe's economy has strengthened in recent years, but high public debt and pervasive poverty continue to present policy challenges. Real GDP growth has picked up; inflation has been low, and international reserves have risen. Medium-term prospects are generally favorable, with stronger growth led by higher tourism-related foreign direct investment and increased donor-financed projects.

"The new Fund-supported program aims to entrench macroeconomic and financial stability and underpins the authorities' existing poverty reduction strategy. Decisive implementation will be critical to buttress policy credibility and catalyze additional financing.

"The program is anchored on maintaining debt on a sustainable path through continued fiscal consolidation, while creating space for growth-enhancing and social spending. It also seeks to address the longstanding and growing domestic arrears problem.

"The authorities' monetary policy and the fixed exchange regime have contributed to lowering inflation. Addressing excess liquidity problems in the banking system will further support the disinflation process and the exchange rate arrangement. Strengthening regulatory oversight and better enforcing prudential requirements will help address remaining weaknesses in the banking sector.

"The authorities plan to implement comprehensive structural reforms to improve domestic fuel pricing, diversify and broaden the export base, facilitate access to credit, and promote private-sector led growth."

Recent economic developments

Macroeconomic performance since 2012 has been positive, with sustained growth and declining inflation, but poverty and debt remain high. GDP growth picked up slightly to 4.5 percent in 2014 driven by an increase in foreign direct investment, the launching of new donor-financed projects, and improved tourism receipts. Supported by the exchange rate peg to the euro, inflation reached a year-end historic low of 6.4 percent at end–2014 and is projected to decline further to 5.2 percent in 2015.

Fiscal consolidation remained a challenge in 2014 as a result of revenue underperformance and expenditure overruns in the run-up to the October 2014 Parliamentary elections. The domestic primary deficit which had improved to 0.8 percent of GDP in 2013 (lower than programmed) increased sharply to 3.4 percent of GDP in 2014. Government domestic arrears also accumulated on a net basis. Growth in monetary aggregates has moderated since 2013 as expected. Bank credit to the private sector, however, has been contracting since 2013 as banks struggle with high non-performing loans and shortage of bankable projects.

The external position has been improving. The current account deficit (excluding transfers) improved by 1.2 percent of GDP in 2014 on the back of strong cocoa exports and improved tourism receipts, and the Central Bank's international reserves stood at 3.8 months of import cover.

Program Summary

The authorities' program for 2015–18 remains in line with the 2012 national poverty reduction strategy (PRSP-II) that will be updated in 2016.

The program focuses on maintaining debt on a sustainable path through continued fiscal consolidation, while at the same time creating space for growth-enhancing capital spending. This will include measures to: (i) address the growing domestic arrears problem which has become a drag on fiscal consolidation; (ii) enhance domestic revenue mobilization and improved public financial management to create space for increased capital and social spending; (iii) promote financial sector reforms to improve the sector's role in facilitating private sector led growth; and (iv) introduce reforms in energy, the agriculture sector, and other targeted reforms designed to improve the business climate and promote private investment to broaden the export base.

Structural reforms will ramp up progressively, over the course of the program, in line with implementation capacity.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

June 24, 2015

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND CANCELLATION OF THE CURRENT ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

EXECUTIVE SUMMARY

Context: São Tomé and Príncipe's economic development is constrained by its insularity, fragility, limited resources, and low capacity as a small island state. The current ECF arrangement is set to expire on July 19, 2015, with four reviews outstanding. Program performance was satisfactory during the first year and half of implementation but went off track in early 2014 upon the contracting of a loan resulting in nonobservance of the performance criterion on non-concessional debt, and expenditure slippages in the run up to national elections further delayed program resumption. In the meantime, the key assumptions of the macroeconomic framework agreed under the current program changed significantly due to a lower probability of commercial oil production.

Extended Credit Facility. The São Toméan authorities have requested a three-year arrangement under the ECF in an amount equivalent to SDR 4,440,000 (60 percent of quota) to rebuild buffers and catalyze financing in support of their medium-term economic reform program. The existing program would be cancelled.

Main elements of the program. The program seeks to address the high debt vulnerability while also creating the conditions for sustained growth, anchored by the PRSP II. This involves reforms to:

- Strengthen domestic revenue mobilization, expenditure rationalization, public debt management, and public financial management to restore fiscal discipline and reduce the risk of debt distress.
- Introduce a comprehensive plan to eliminate the stock of arrears and also prevent the accumulation of new arrears.
- Enhance the capacity of key government institutions through well-tailored technical assistance (TA).
- Enhance financial sector stability through strengthened supervisory, regulatory, crisis management and bank resolution frameworks.

- Improve the business environment (including through targeted improvements in physical infrastructure) to boost growth.

Risks. Risks to the program include delayed or partial implementation of policies, including next year in the run-up to presidential elections, financial sector vulnerabilities, and continued slower growth in Europe.

Staff supports the authorities' request for a new ECF arrangement.

Approved By
David Owen (AFR) and Chris Lane (SPR)

Discussions on the authorities' economic and financial program took place in Washington, DC (April 14–19) and in São Tomé (April 24–May 7). The IMF staff team included Maxwell Opoku-Afari (head), Paulo Lopes, Dalmacio F. Benicio, Albert Touna Mama and George Rooney (All AFR). The IMF team met with the Prime Minister Patrice Trovoada, Minister of Finance and Public Administration Américo Ramos, Central Bank Governor Maria do Carmo Silveira, Minister at the Presidency Afonso Valera, Minister of Economy Agostinho Fernandes, Minister of Works and Natural Resources, Carlos Vila Nova, other senior government officials, representatives of the private sector, and representatives of the donor community. For the preparation of the report, Bakar Ould Abdallah and Estanislao Rengifo provided research and administrative support respectively.

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BACKGROUND

1. **The government's absolute parliamentary majority following the 2014 national elections presents an opportunity to consolidate gains made in reforms over the past decade.** On October 12, 2014, the main opposition party (ADI-Independent Democratic Action Party), led by former Prime Minister Patrice Trovoada, won an absolute parliamentary majority and returned to power. This is the first time in over a decade that a government has secured a parliamentary majority to ensure a full four-year term in office. This stability presents a clear opportunity to undertake strong reforms and catalyze donor support.

2. **São Tomé and Príncipe's economic development is constrained by its insularity, fragility, limited resources, and low capacity as a small island state.** Its export base is undiversified and consists basically of cocoa and a nascent tourism industry that is yet to be fully tapped. With prospects for oil production now uncertain, following Total Oil Company's withdrawal from exploration activities in the Joint Development Zone (JDZ) shared with Nigeria, fiscal policy must walk a fine line between entrenching fiscal consolidation to contain debt and eliminate arrears, while also creating space for growth-enhancing spending to tackle successfully the widespread unemployment and the protracted external imbalances (large current account deficits and high indebtedness).

3. **Implementation of the 2012 National Poverty Reduction Strategy (PRSP-II) has been a top priority but the poverty rate still remains high at 66 percent.** In its recently issued 2012–13 PRSP-II implementation review report, the government acknowledges that the reduction in poverty rates since 2000 has been marginal and that economic growth has fallen well short of the sustained 6 percent annual rates considered minimum to meaningfully improve social conditions. The PRSP-II's implementation shortcomings are attributed primarily to lack of financial resources, that did not materialize as envisaged, and to government instability. The government is currently working on an updated national development strategy to replace the PRSP-II after it ends in 2016.

Assessment of the Last ECF-Supported Program

4. **The ECF arrangement (with an access level of 35 percent of quota) which was approved by the IMF Executive Board on July 20, 2012 is set to expire on July 19, 2015.** Program performance was initially satisfactory with the first two reviews completed successfully, but went off-track in March 2014 when the authorities contracted a $40 million (11 percent of GDP) loan from Angola with a grant element well below the 50 percent floor specified under the program. Despite successful renegotiation to bring the loan to near-concessional terms, expenditure slippages in the run up to the national elections further delayed program resumption. In the meantime, key assumptions under the program changed significantly with a lower probability of commercial oil production.

5. **Performance under the ECF-supported program in 2014 was mixed** (Tables 1 and 2 in attachment I). While the net international reserves target continued to be comfortably met, the adjusted ceiling on change in the net bank credit to central government was not observed, the domestic primary deficit exceeded the end-year program target by 0.3 percentage points of GDP and significant arrears were accumulated on a net basis due to non-payment of energy and communications bills by government agencies.

6. **Structural reform implementation recorded delays.** Some key measures were not implemented, in particular the tripartite arrears clearance plan between the Treasury, ENCO, and EMAE, and the implementation of a new Consumer Price Index. Progress was made in the areas of public financial management and external debt management but the SAFEe (Sistema de Administração Financeira do Estado)—the public information management system—could not roll out beyond pilot stages due to technical challenges, capacity limitations, and delayed technical assistance.

7. **São Tomé and Príncipe remains dependent on technical assistance.** There were a total of 26 technical assistance (TA) missions under the ECF-supported program approved in 2012 (information annex). Significant gains have been made from these well-tailored TAs, mostly in PFM, banking supervision (including the recently passed bank resolution law), and monetary operations. A substantial number of recommendations have been implemented; in particular, the introduction of the interbank money market and a domestic treasury bills market, but limited human resource capacity has slowed down the full implementation of recommendations.

RECENT ECONOMIC DEVELOPMENTS

8. **Macroeconomic performance has been good but remains too weak to support poverty reduction** (Figure 1 and Table 1). Economic activity picked up slightly to 4.5 percent in 2014 (4.2 percent in 2013). Supported by the exchange rate peg arrangement (which has served São Tomé and Príncipe well), inflation reached year-end historic low of 6.4 percent at end-2014 and is projected to decline further to 5.2 percent in 2015.

9. **Fiscal consolidation remained a challenge in 2014** (Figure 2 and Tables 2 and 3). The domestic primary deficit which had improved to 0.8 percent in 2013 (lower than programmed) increased sharply to 3.4 percent of GDP in 2014 as a result of revenue underperformance (non-payment of import duties by ENCO, the main oil importer) and expenditure overruns in the run-up to the general elections in October 2014. Government arrears also accumulated on a net basis despite efforts to clear them.

10. **Broad money growth has moderated as expected** (Figure 3 and Tables 4 and 5). It is set to slow further to 15 percent in 2015 in line with the expected growth in net foreign assets (NFA). Bank credit to the private sector, however, has been contracting since 2013 as

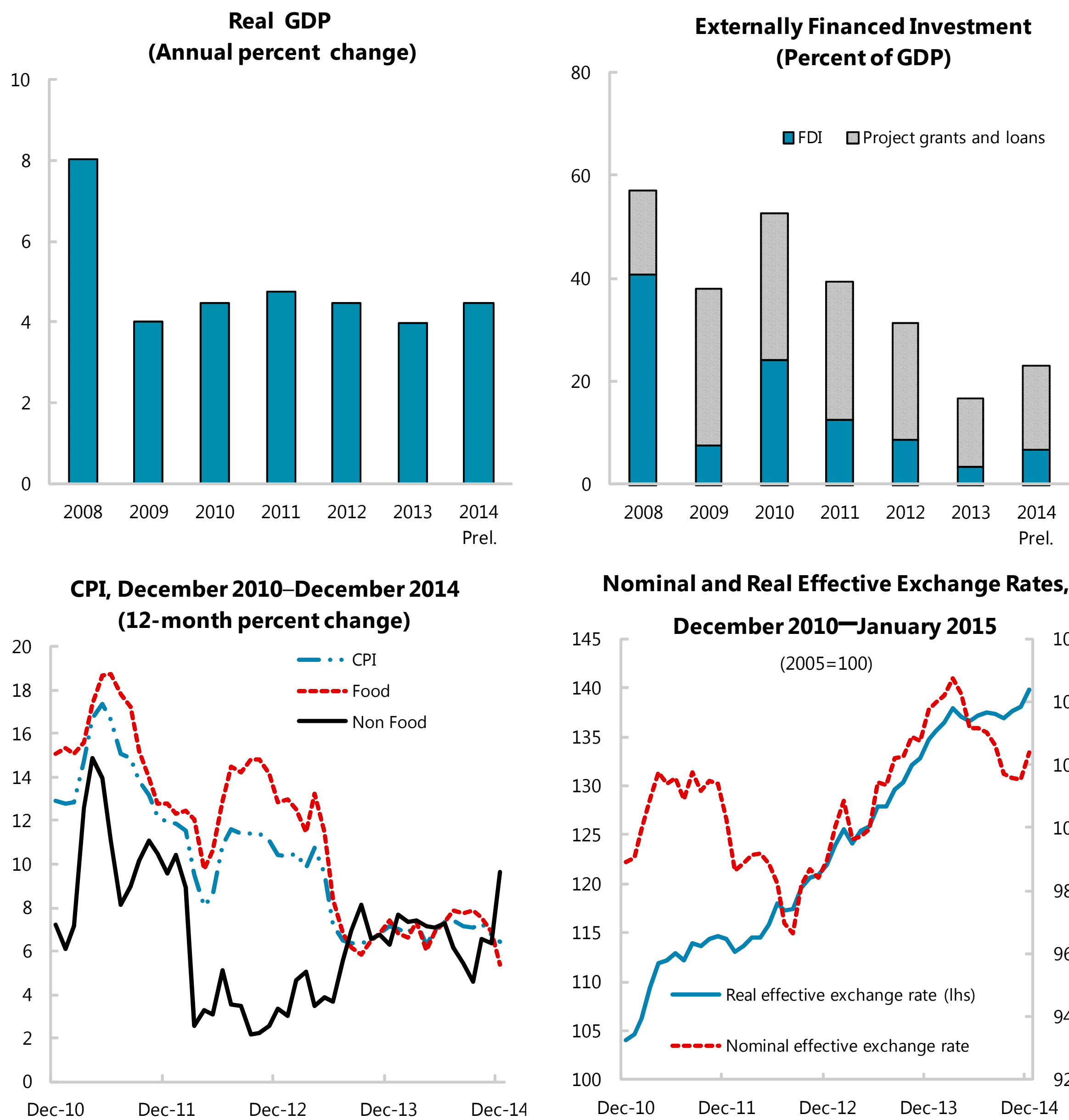
over-indebted businesses and households were not extended further loans and banks struggled with non-performing loans and shortage of bankable projects.

11. The external position has been improving (Figure 4 and Tables 7 and 8). Notwithstanding the recent depreciation of the Euro, the current account deficit (excluding official transfers) improved by 1.2 percent of GDP to 36.6 percent of GDP in 2014 on the back of strong cocoa exports. The bulk of this deficit was financed by transfers, project loans, and foreign direct investment (FDI). The Central Bank's international reserves stood at 3.8 months of import cover in 2014, still below the 5 to 6 months of imports deemed adequate for a small commodity exporting economy with fixed exchange rate regime.

12. The first tranche of the Angola loan was fully spent in 2014 and the new government drew on the second tranche in March 2015. The outgoing government spent the first tranche of the Angola loan (US$17 million) on mainly investment projects with about US$4.3 million on current outlays before the 2014 elections. The second tranche of US$23 million, was disbursed in March 2015 tied to the public investment program (MEFP ¶17).

13. The financial system is under some stress as a result of lax lending practices and weaknesses in supervision. Though most banks meet the minimum required risk-weighted capital ratio of 12 percent, the average capital adequacy ratio has been declining due to a string of losses in the sector. Despite excess liquidity in the system, lending activities have been curtailed largely because of elevated lending risks and because banks are saddled with bad loans in their books (NPL rose to 18 percent in 2014), reflecting unsound lending practices and poor risk management.

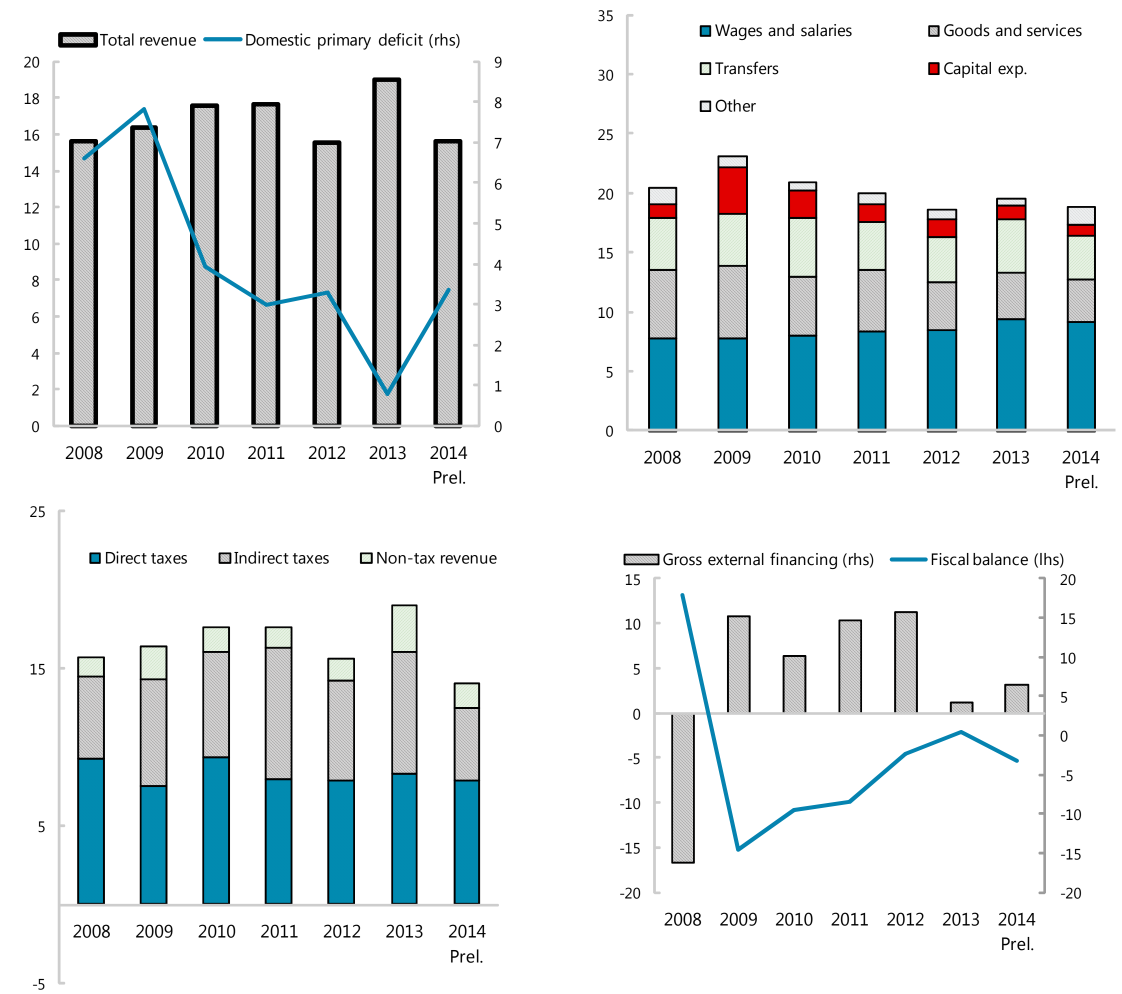
Figure 1. São Tomé and Príncipe: Recent Macroeconomic Developments



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

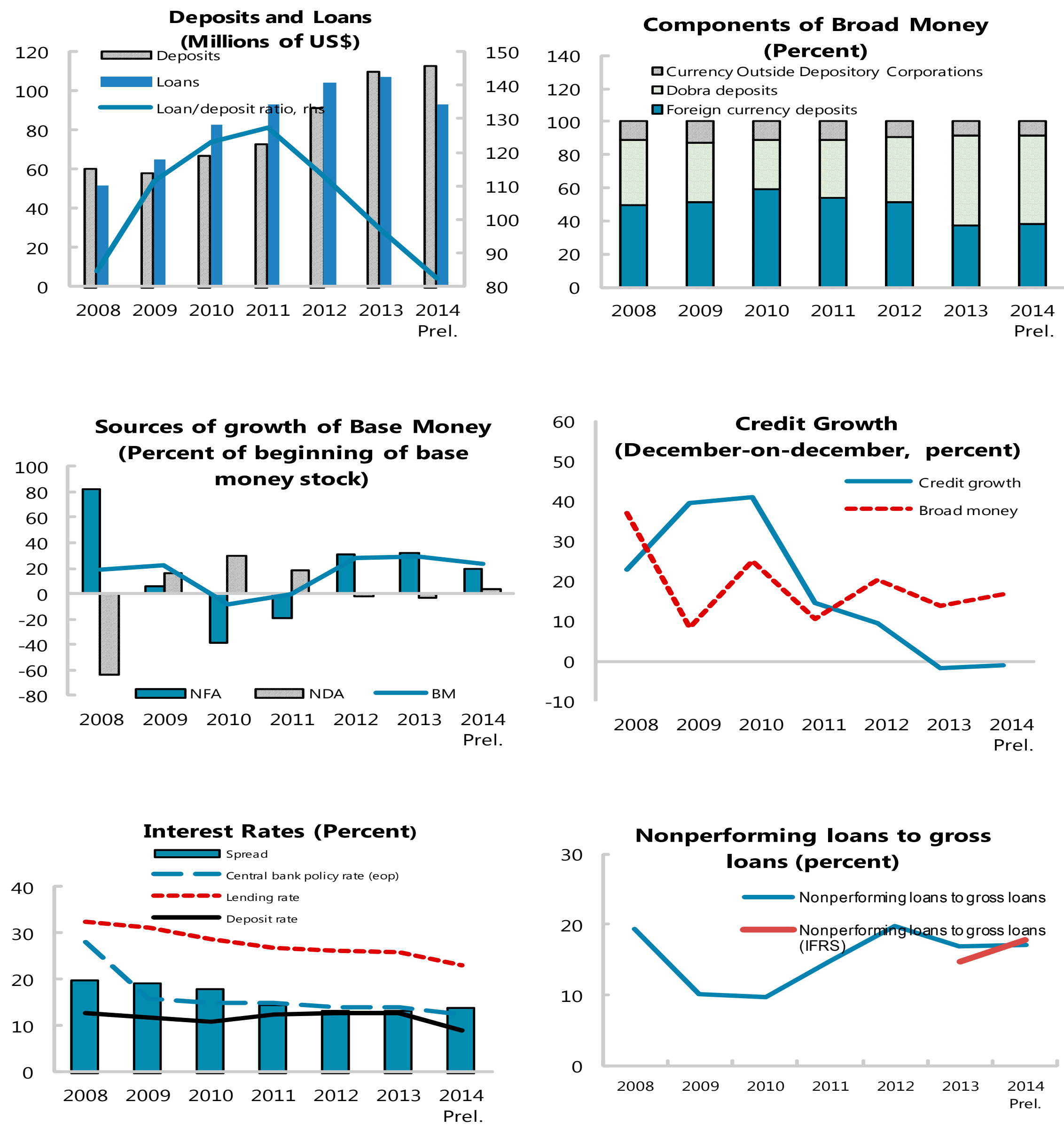
Figure 2. São Tomé and Príncipe: Fiscal Indicators 2008–14

(Percent of GDP)



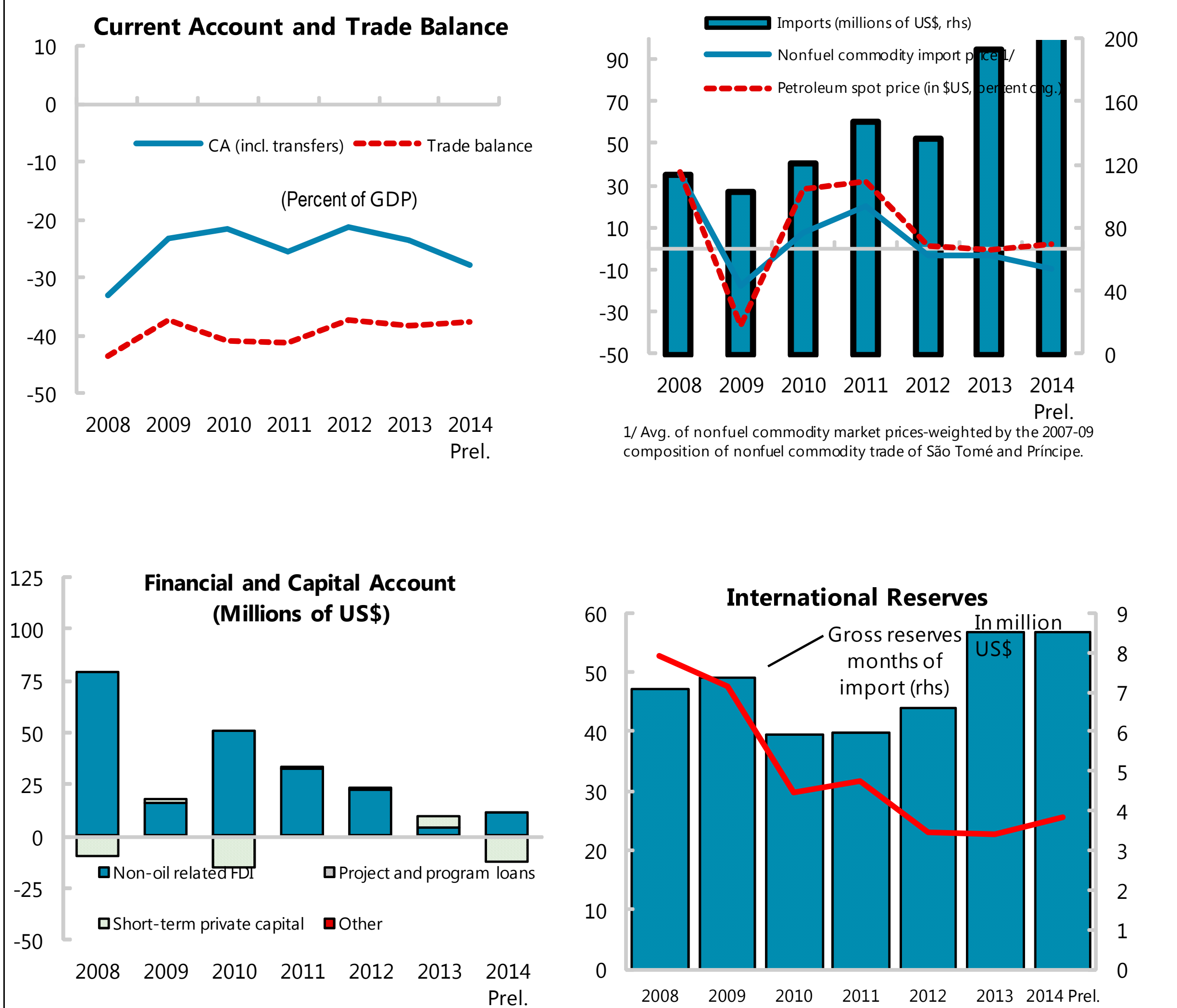
Sources: Data provided by the authorities and IMF staff estimates.

Figure 3. São Tomé and Príncipe: Money and Credit Developments, 2008–14



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

Figure 4. São Tomé and Príncipe: External Sector Developments, 2008–14



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

POLICY DISCUSSIONS

A. Medium-Term Macroeconomic Framework

14. The medium-term macroeconomic framework underpinning the ECF arrangement is consistent with the non-oil scenario of the existing PRSP-II. The government's reform agenda focuses on maintaining debt on a sustainable path through continued fiscal consolidation, while at the same time creating space for growth-enhancing capital spending. The government's program also aims to promote macroeconomic and financial stability, including through achieving and sustaining a lower domestic primary deficit to ensure debt remains on a sustainable path, and implementing a comprehensive set of structural measures to diversify and broaden the export base, promote private-sector led growth, and ensure social stability by safeguarding priority spending.

- Growth prospects for 2016–18 are driven by scaling up of investment in infrastructure, growth in tourism, and agriculture. Accordingly, growth is projected to accelerate to 5.5 percent in 2017. The medium-term growth projection could increase further if all planned growth-enhancing projects are implemented.

- Inflation is expected to continue to decline and to eventually converge to the Euro area inflation by 2018 in line with the peg and supported by improved central bank liquidity management.

- The current account deficit would revert to a level slightly higher than 2014 as imports recover over the medium term on account of rising commodity prices and higher donor-financed imports. The reserve coverage however, is expected to improve to 5 months of imports by 2018.

15. Achieving these outcomes will require comprehensive reforms. Specifically to: (i) address the growing domestic arrears problem which has become a drag on fiscal consolidation; (ii) enhance domestic revenue mobilization and improved public financial management to create space for increased capital and social spending; (iii) promote financial sector reforms to improve the sector's role in facilitating private sector led growth; and (iv) introduce reforms in the agriculture sector and other targeted reforms designed to improve the business climate and promote private investment to broaden the export base.

16. There are near-term risks. Key risks arise from the uncertain prospects in Europe, where another slowdown in economic activity could squeeze trade and reduce demand for São Tomé and Príncipe's exports, including tourism. Regarding domestic policies, measures will be needed to ensure that fiscal targets are met; while careful implementation of the resolution of non-performing banks (i.e., Banco Equador) will be necessary to safeguard financial sector stability.

B. Fiscal Policy and Debt Sustainability

17. Fiscal adjustment remains critical to maintaining debt on a sustainable path. The updated debt sustainability analysis (DSA) confirms that the risk of debt distress remains high. Any slippages in the fiscal program—allowing the domestic primary deficit to continue at its historical path—would reverse the downward debt trajectory under the baseline. Compared to the last DSA assessment in the 2013 Article IV Consultation staff report, the debt to export ratio indicator, which is the main source of vulnerability, has improved significantly due to better recording of services (travel and tourism) and recent good performance of cocoa production.

18. The approved 2015 budget sets the foundation to anchor debt while creating space for growth-enhancing capital spending. Achieving such balance remains critical to ensure shared-growth and poverty reduction (MEFP ¶ 14–15). A steady decline in the domestic primary deficit[1] to 1.5 percent of GDP by 2018, and thereafter stabilizing at around 1.2 percent of GDP, should be consistent with lowering the PV of debt-to-GDP ratio to close to the sustainable threshold by 2020, while at the same time creating some room for scaled-up capital spending and domestic arrears clearance.

- On the revenue side, the 2015 budget envisages a partial recovery to the 2013 revenue levels through more rigorous tax administration. Decisive measures will be introduced to boost domestic revenue mobilization by 2½ percent of GDP by 2018 (MEFP ¶ 24). The authorities intend to achieve this by addressing the cross-arrears issue with ENCO and start collecting duties on all oil imports (accounting for over 1 percent of GDP annually). A combination of additional measures including a recently concluded tax registration drive (Operation Tax Inclusion) which added 16,000 new taxpayers to the base, and the Tax Maximization Plan (being developed under the BAD's PAGEF credit operation), are expected to boost tax revenue collection over the medium-term.

- The authorities intend to finalize plans, over the program period, to introduce a Value Added Tax (VAT) regime and a minimum presumptive taxation with technical assistance from development partners including the Fund (MEFP ¶ 24).

- On the expenditure side, there is the need to contain relatively high transfers and civil service personnel costs, in particular non-wage remuneration, and bring it down by 0.6 percentage points of GDP to the historical average of 8.5 percent of GDP. Social spending will however, be safeguarded as budget alignment with the government's PRSP-II remains critical for further progress towards the MDGs. In that context, the authorities are committed to increasing social spending both in 2015 and 2016 (MEFP ¶ 14).

[1] Defined as non-oil revenue minus current non-interest expenditure and domestically-financed capital spending.

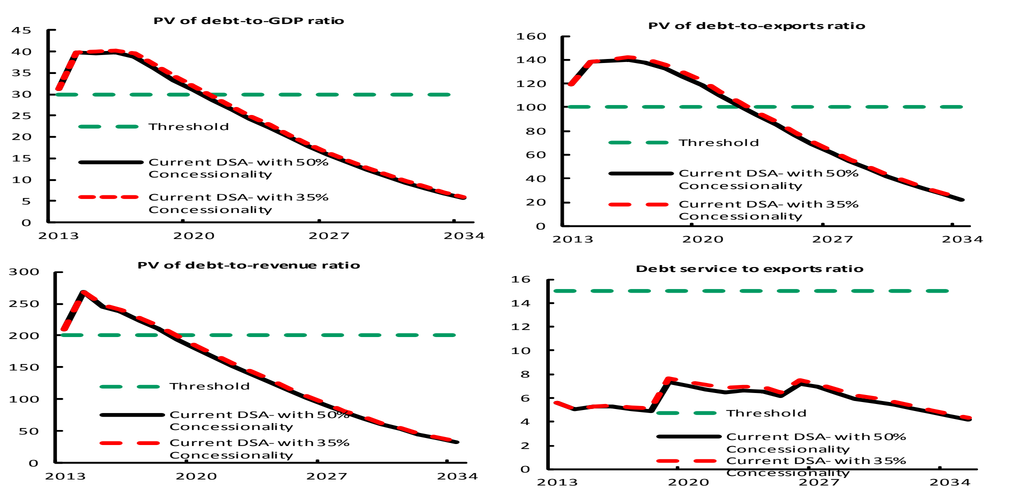
19. The 2015 budget is fully financed and financing prospects for the remainder of the program period are strong. Budget support in the amount of US$10 million has been identified for 2015 in the form of grants (World Bank, EU and counterpart funds from Japan). The authorities, however, stand ready to cut spending in case any commitment fails to materialize. Staff estimates additional grants of about US$30 million could be expected in 2016–18. The planned donors' conference to be organized in São Tomé in September 2015, in response to the Fund-supported program, would firm up further budget support for 2016 –18 to support the government's public investment and social programs.

Borrowing Policies

20. Given the high debt vulnerabilities, the authorities should continue to meet financing needs primarily through grants and concessional external loans (MEFP ¶ 38). However, with oil production now unlikely for many years, there is a need to explore alternative options to finance the authorities' public investment program (PIP). The updated DSA suggests that there is room for some concessional borrowing, averaging some 6.6 percent of GDP annually over the three year ECF-supported program.

21. Improvements in the DSA and clearly identified growth-enhancing medium-term investments support a lower concessionality threshold without jeopardizing debt sustainability. In particular, reducing the grant element to the presumed 35 percent and limiting the amount of concessional borrowing does not significantly change the debt dynamics relative to a scenario with a grant element of 50 percent (Text Chart 1). This reduction will continue to anchor debt on a sustainable path and at the same time create space for growth-enhancing spending and make it less onerous for the authorities to contract concessional loans (beyond the multilateral institutions) to support the PIP.

Text Chart 1. Comparison of Indicators of Public and Publically Guaranteed External Debt Ratios, 50 percent vs. 35 percent Concessionality



Sources: Data provided by the authorities and IMF staff estimates

22. To further strengthen debt and fiscal sustainability, staff called for strengthened debt management capacity. Staff welcomes progress in updating the medium-term debt management strategy which will be approved by cabinet by end-June 2016 (MEFP ¶39). Improving debt management capacity is critical to support the debt reduction objective in the program. Staff will identify clear actions to be monitored as part of the program once the strategy has been approved.

C. Monetary Policy and Financial Stability

23. Managing the excess liquidity to support growth remains the central challenge for the conduct of monetary policy. Banco Central de São Tomé and Príncipe (BCSTP) recognizes that resolving the excess liquidity situation is critical to the maintenance of the conventional peg exchange rate regime and is responding to the challenge. The BCSTP has introduced an interbank money market to formalize liquidity swapping among banks and has also launched an open market operation where newly introduced treasury bills and bonds will be used to mop liquidity (MEFP ¶19). However, BCSTP will have to provide a long-term solution to excess liquidity by addressing the causes of elevated lending risks, in particular, unsound lending practices and poor risk management.

24. The banking sector is under some stress. Though most banks meet the minimum required risk-weighted capital ratio of 12 percent, the average capital adequacy ratio has been declining due to a string of losses in the sector. Despite excess liquidity in the system, lending activities have been curtailed largely because banks are saddled with bad loans, reflecting unsound lending practices and poor risk management.

25. To safeguard financial stability, the BCSTP will strengthen its regulatory oversight and start enforcing prudential requirements to deal with remaining weaknesses in the financial system (MEFP ¶21–22). On-site supervision has been completed for all banks and a new round of inspections is scheduled for this year for the two largest banks; three banks have been given a deadline of end-June this year to raise own capitals above the minimum required to operate a bank in São Tomé and Príncipe. In addition, the BCSTP, in January this year, placed one bank (Banco Equador) under administration, pending resolution, for repeatedly missing the minimum capital requirements. The draft Bank Resolution Law (put together with assistance from MCM and LEG), when passed by the National Assembly, will allow for swift and orderly resolution of banks.

D. Structural Reforms

Strengthening Public Financial Management

26. Adoption of a new information management system—SAFEe— has been the center piece of efforts to modernize and improve PFM (MEFP ¶ 29–30). The pilot stage of implementation has so far covered four ministries but it fell short of the initial objective of consolidating and producing annual budget execution reports. As remaining information processing and security issues are addressed, the government should be able to use the SAFEe to produce final government accounts and extend the SAFEe system to all government ministries and institutions starting with the 2016 budget. In addition to SAFEe's enhanced monitoring capabilities, tighter expenditure control procedures will have to be undertaken to ensure that non-budgeted expenditure do not take place, in particular, as regards non-wage personnel costs such as overtime and expense allowances that have in the last few years been exceeding annually budgeted amounts.

27. The authorities have also committed to implementing the 2013 PEFA recommendations, moving towards a medium-term fiscal framework, and strengthening debt management (MEFP ¶ 32). The authorities will seek assistance from development partners to develop a comprehensive plan for the implementation of key recommendations from the latest Public Expenditure and Financial Accountability (PEFA) report, including the establishment of a public procurement agency. Based on recommendations from a recent FAD TA mission, the authorities intend to gradually move toward a medium-term fiscal framework in line with existing capacity. Debt management capacity will be strengthened starting with back office functions such as debt monitoring and recording and assessing implications of future borrowings on debt sustainability.

Clearance of Domestic Arrears

28. Unaudited claims from ENCO (due to implicit fuel subsidy) and domestic suppliers put the government's stock of domestic arrears at about 16 percent of GDP as of end-March 2015, significantly larger than previously known (Box 1)**.**
New information became available on ENCO's (the country's main fuel importer) claims on government on account of its operating losses as a result of selling petroleum products below full cost recovery since 2010 (13 percent of GDP). In addition, there are outstanding utilities and communications bills (2 percent of GDP) and arrears to domestic suppliers dating back to 2012 (0.7 percent of GDP) which the authorities have started paying off.
The government-owned electricity and water producing company (EMAE) has also accumulated arrears from unsettled bills to ENCO estimated at about 12 percent of GDP.

29. The government is committed to addressing this long-standing domestic arrears problem. A ministerial team put together by the government in April 2015 will audit and confirm claims by creditors in the context of developing a comprehensive plan that will clear the outstanding stock of arrears over the coming five years through a combination of cash payments and possible securitization of arrears to ENCO (Prior action, MEFP ¶ 25). About 2.5 percent of GDP of outstanding arrears is currently programmed to be repaid over the program period, with the rest expected to be cleared based on the agreed arrears clearance plan after auditing and negotiations with ENCO and EMAE. The macroframework and debt sustainability would be adjusted at the time of the first review if needed, to reflect the clearance plan after the auditing and negotiation of the stock of arrears. The government is also committed to accelerate arrears clearance as revenue efforts bear fruit.

Box 1. São Tomé and Príncipe: Domestic Arrears

The bulk of domestic arrears in São Tomé and Príncipe is related to the energy sector, (the electricity and water utility EMAE and the oil importer and distributor ENCO).[1] As a result, clearance of these arrears is important for energy supply and more generally for economic activity. There are three main causes for these arrears:

(i) The government has not been compensating the oil importer ENCO for the implicit subsidy arising from the difference between retail fuel prices and actual supply costs. Retail fuel prices have been fixed and unchanged by the government since 2010, and until end-2014 were below cost-recovery for all fuel types. Only in March 2015 did the lower international fuel prices restore cost-recovery at the prevailing retail prices. ENCO claims accumulated "price differential" arrears since 2011 is equivalent to 13 percent of GDP.

(ii) The state-owned electricity company EMAE has not been paying ENCO for its supply of diesel used for electricity generation. EMAE capacity to repay is hampered by accumulated financial losses, obsolete production and distribution equipments, and illegal usage. As a result, electricity prices, which are also fixed by government, are well below cost-recovery. As of end-March 2015, EMAE's arrears to ENCO for unpaid oil supplies were the equivalent of 12 percent of GDP.

(iii) In the last year, the government has accumulated about 3 percent of GDP of arrears related to unpaid utilities and communications bills and arrears to domestic suppliers. The Government has however, started paying off the arrears to suppliers.

Political concerns with the inflationary effects of higher oil prices and close ties with the oil supplier Angola have allowed the below-cost pricing status quo to prevail for years. Despite the fixed energy prices, Angola's oil parastatal Sonangol which is a shareholder in both ENCO and EMAE has continued to supply oil products at a loss through ENCO. However, at mid-2014, ENCO stopped paying import duties to cover for its accumulated losses, resulting in domestic revenue underperformance and escalating the arrears problem. The cross-arrears situation has complicated the government's fiscal consolidation effort.

To address this longstanding arrears problem, the new ECF arrangement envisages, as a prior action, the conclusion of an arrears clearance and prevention plan that was overdue since 2013 under the previous ECF program. The thrust of the plan consists of conducting a comprehensive audit of all domestic arrears (including to creditors other than ENCO) with a view to their securitization and eventual write offs to be agreed with creditors. To prevent the recurrence of oil-related arrears, the plan includes the introduction of an automatic fuel prices adjustment mechanism from 2016 and of a corporate restructuring plan for EMAE to be undertaken with donor support.

[1] Both ENCO (Empresa Nacional de Combustiveis e Oleos, S.A.R.L.) and EMAE (Empresa de Água e Electricidade) are mixed capital companies with participation of Angola's oil Parastatal Sonangol that holds a majority share in ENCO, while in EMAE it is the government that holds the majority share.

30. The recent fall in international oil prices presents an opportunity to address accumulation of unpaid petroleum price subsidies and to establish full cost recovery petroleum products pricing (MEFP ¶ 26). As part of the arrears clearance plan, and to prevent their reoccurrence, the government will adopt an automatic price mechanism by end-June, 2016 (structural benchmark) after receiving technical assistance from the Fund. In the meantime, the government is committed to ensuring that, prices of petroleum products, from now on, do not fall below cost while technical assistance is sought to establish the automatic price adjustment mechanism. The government will assess the social consequences of higher pump prices on the poorest with a view to providing a safety mechanism targeted at the poor and vulnerable.

31. The government has also committed to taking swift actions to reduce inefficiencies at EMAE supported by far-reaching reforms (MEFP ¶ 27–28). A reform plan for EMAE and tariff adjustments which have been under discussion since 2013 would be finalized and considered for implementation in the first review. In addition, the authorities are committed to implementing immediate measures to crack down on illegal tapping of electricity and water by setting up meters to increase revenues and prevent wasteful usage at flat-rates and by replacing old electricity generation equipments to reduce generation costs. The World Bank is assisting to help address structural problems at EMAE to ensure full cost recovery in both the electricity and water tariff structure and in generating cash-flow to finance grid network repairs and upgrades over the medium-term.

Improving the Business Environment for Export Diversification and Private Sector Development

32. The government will introduce more focused structural reforms to diversify exports and boost private sector investment through an improved business climate (MEFP ¶33–34). Key initiatives will include well-targeted improvements to physical infrastructure (sea ports and airports), key legislative and administrative reforms to enhance trade facilitation, strengthen property and investor rights, increase access to credit, and simplify business processes and the payment of taxes. The government will develop and submit to the National Assembly, a national export diversification strategy and action plan, targeting the tourism sector and high-value horticultural production that are recognized as having the greatest potential.

33. The BCSTP will revamp the functioning of the credit reference bureau to ensure efficiency in the assessment and pricing of risks and enhance access to finance by small and medium enterprises (MEFP ¶35). The BCSTP launched the Central de Risco de Crédito (CRC) in 2011 to ensure a sound and comprehensive credit reporting to support the assessment and pricing of risks. However, the credit reporting system is not being fully utilized by banks due to the imperfect coverage and poor data quality. The BCSTP has committed to invest additional resources (both hard and soft infrastructure) to extend the CRC's coverage and enhance its usage. Going forward, the BCSTP will strictly enforce the requirement that reporting financial institutions provide relevant, accurate, complete, and timely information to the CRC and apply sanctions when breached.

34. These efforts will be complemented by addressing challenges in the judiciary system to enhance enforcement of collateral (MEFP ¶36). Banks are attributing the slow pick up in credit to the private sector to the lack of enforcement of collateral and extensive delays in the judiciary system in dealing with defaults. The BCSTP, with the help of the World Bank, has put together a financial sector development plan (FSDP), which among other things, proposes reforms to the judiciary system, including the option of setting up a commercial court to boost collateral enforcement, training and improvement in working conditions of judges.

STATISTICS

35. The authorities aim to make progress to strengthen the statistical system. The National Statistics Institute (INE) is taking steps, with the help of TA from the Fund and donors, to improve the CPI and the national accounts. The household survey completed in 2011 will provide the basis for reweighting the CPI components and introducing new goods and services into the basket (which was last updated 20 years ago). New CPI and revised national accounts will be published by end–2015 after the two supporting TA missions are completed (MEFP ¶ 40).

PROGRAM MODALITIES, SAFEGUARDS, AND RISKS

36. The authorities request the cancellation of the ECF arrangement approved by the Executive Board in July 2012 and in support of their revised objectives, the authorities have requested a new ECF-supported program, in the amount of SDR4,440,000 (60 percent of quota). This access level, which is phased in seven equal installments (Table 10), is based on staff's assessment of the outlook, the projected balance of payments financing needs, including the need to build up reserves to the recommended five to six months of imports for low-income commodity exporters with a conventional peg exchange rate[2,3], and the strength of the policy adjustment in the program. The ECF funding will complement the existing credit line arrangement with Portugal[4] to ensure that reserves

[2] See São Tomé and Príncipe 2013 Article IV Consultation staff report, for analysis on reserve adequacy for low income commodity exporters with conventional peg exchange rate.

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

[4] The agreement with Portugal provides the central bank with additional resources to support the peg if needed, in the form of a credit line of up to €25 million.

remain at comfortable levels to back the conventional peg exchange rate regime. The first test date for the program will be end-December 2015, with indicative targets set for end-September 2015.

37. Program conditionality. Quantitative targets are set on the domestic primary balance, net bank financing of the central government, international reserves, contracting and guaranteeing of non-concessional external debt, the outstanding stock of external debt, and external payment arrears (Table 3 in attachment I). Given the high risk of debt distress, the program establishes a zero limit on non-concessional borrowing. The concessionality threshold is 35 percent, a reduction from the 50 percent in the previous program, without adding more stress on the DSA. In addition, contracting of concessional external debt is monitored as a memorandum item to help build debt monitoring capacity. Proposed structural benchmarks are in line with macroeconomic priorities and capacity constraints, focusing on putting in place basic institutions in the areas of tax revenue mobilization, PFM, monetary management, financial stability, business environment, and statistics (Table 4 in attachment I). A prior action to submit to staff a comprehensive plan outlining measures and a timeline to reduce the stock of domestic arrears provides up-front assurance on the commitment to address the longstanding domestic arrears problem.

38. São Tomé and Príncipe has adequate capacity to meet its debt service obligations to the Fund (Table 11). In addition, the updated DSA indicates that even though the risk of debt distress remains high, debt indicators improve over the program period. São Tomé and Príncipe has a good track record of timely payment of external debt obligations, including to the Fund.

39. An update of the 2013 safeguard assessment has been initiated and will be completed before the first program review. The previous assessment noted severe capacity constraints faced by the BCSTP, including the lack of independent oversight. External audits conducted by reputable audit firms continued to serve as a critical safeguard, 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 the internal audit function and implementation of formal investment policies. The BCSTP has been taking steps to address these and staff will assess the progress made during the update assessment.

40. The program entails significant economic, institutional and political risks.

- Fiscal adjustment is critical to maintaining debt on a sustainable path. This highlights the high risk of fiscal policy implementation slippages.
- A protracted period of slower growth in Europe could significantly depress exports, tourism, and FDI and aid flows.

- A presidential election in 2016 is expected to be strongly contested. In the past, fiscal consolidation efforts have been undermined during elections.
- On the upside, there is the possibility that commercially viable oil would be found by one of the small operators still undertaking exploration.

STAFF APPRAISAL

41. São Tomé and Príncipe's performance under the previous ECF supported program was mixed. While there were important macroeconomic gains in the first year and a half of the program, there were slippages in 2014. Fiscal consolidation effort suffered a setback, with the domestic primary deficit exceeding the end-year program, and new arrears were accumulated on a net basis. Structural reform implementation recorded delays, and some key measures were not implemented, in particular the tripartite arrears clearance plan between the Treasury, ENCO, and EMAE.

42. Staff welcomes the authorities' commitment to address the identified slippages in the existing ECF-supported program. The government's 2015 budget, approved by the National Assembly, and the medium-term macroeconomic framework build on recent reform efforts. Forceful and sustained implementation of the program is critical to entrench macroeconomic stability to support sustained broad-based growth and poverty reduction.

43. The government recognizes the importance of enhancing domestic revenue mobilization to support the much-needed growth enhancing spending.
Decisive measures will be needed, including a possible introduction of value added tax (VAT) during the program period, to further boost domestic revenue mobilization which has remained a major drag on fiscal consolidation. While the government is appropriately putting in place measures to raise tax revenue mobilization, it should avoid policy slippage and stand ready to take additional measures to ensure the domestic primary deficit remains on track to keep debt on a downward trajectory.

44. In view of São Tomé and Príncipe's high debt vulnerabilities, the government should continue to meet financing needs through grants and concessional external loans. Staff also supports the assessment that reducing the concessionality threshold from 50 percent applied under the existing ECF-supported program to 35 percent will continue to anchor debt and at the same time make it less onerous to borrow concessionally to support growth-enhancing spending.

45. It is important that the government implements the arrears clearance plan in such a way to maintain fiscal and debt sustainability. The government's arrears clearance plan provides a strong basis to address the large stock of outstanding domestic arrears and prevent the accumulation of new ones. For the plan to be sustainable, EMAE will have to be reformed to improve efficiency and ensure full cost recovery. Also, the government will have to push ahead with the adoption of an automatic fuel price adjustment mechanism to prevent new accumulation of arrears due to fuel price differentials.

46. The program remains consistent with the PRSP-II. Staff welcomes the government's commitment to draw on lessons learned under the implementation of the PRSP-II in the design of the new National Strategy Document after the PRSP-II expires in 2016. The new National Strategy Document will underpin the rest of the program period. The 2015 budget and the agreed medium-term macroeconomic framework underscore the government's commitment to social programs and pro-poor spending.

47. Actions are needed to increase the role of the financial sector to support growth. The greatest challenge for monetary policy implementation is to effectively manage excess liquidity in the banking system, which continues to grow, as banks tighten their credit stance in the wake of rising NPLs. Current efforts by the BCSTP to introduce an inter-bank money market and a domestic treasury bill market should enhance the financial sector's role to intermediate the excess liquidity in the system to support growth. Resolving the excess liquidity situation is critical to reducing risks to the maintenance of the conventional peg exchange rate regime, which has served São Tomé and Príncipe well.

48. Persistent weaknesses in the banking sector require close vigilance to ensure financial stability. The authorities should ensure that BCSTP has adequate resolution powers to swiftly and orderly resolve problem banks, and in particular, Banco Equador which is currently under administration. To safeguard stability, the BCSTP must strengthen banking supervision and enforce prudential requirements throughout the banking system, including strictly enforcing the required minimum capital-to-risk-weighted asset ratio.

49. Staff supports the authorities request for a three-year arrangement under the ECF, with access level of 60 percent of quota.

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2012–18

(Annual change in percent, unless otherwise indicated)

	2012	2013	2014		2015		2016	2017	2018
	Actual	Actual	Prog.	Preliminary	Second ECF Review	Proj.	Projections		
National income and prices									
GDP at constant prices	4.5	4.0	5.0	4.5	5.5	5.0	5.2	5.5	5.5
Consumer prices									
End of period	10.4	7.1	6.0	6.4	4.0	5.2	4.0	3.0	3.0
Period average	10.6	8.1	7.1	7.0	5.0	5.8	4.6	3.5	3.0
External trade									
Exports of goods and nonfactor services	12.5	48.0	7.0	80.8	10.2	5.8	8.5	6.9	6.9
Imports of goods and nonfactor services	-7.3	40.8	9.1	25.7	7.5	-8.3	15.5	9.1	8.5
Exchange rate (dobras per US$; end of period) [2]	18,585	17,776		20,148	...	...	...	...	...
Real effective exchange rate (depreciation = -)	5.1	9.5	...	7.0	...	...	...	...	...
Money and credit									
Base money	28.6	29.4	10.0	23.2	9.0	14.6	11.1	7.1	8.0
Broad money (M3)	20.3	13.9	13.1	16.8	9.5	15.1	11.4	6.6	7.5
Credit to the economy	9.6	-1.7	9.9	-1.0	10.2	-0.7	1.6	3.4	5.3
Velocity (GDP to broad money; end of period)	2.8	2.7	2.8	2.7	2.7	2.6	2.4	2.4	2.4
Central bank reference interest rate (percent)	14.0	14.0	...	12.0	...	...	...	...	...
Bank lending rate (percent)	26.2	25.9	...	15.4	...	...	...	...	...
Bank deposit rate (percent)	12.9	12.6	...	8.9	...	...	...	...	...
Government finance (figures in percent of GDP)									
Total revenue, grants, and oil signature bonuses	34.0	33.5	31.9	25.9	32.7	31.8	33.9	34.9	35.6
Of which: tax revenue	14.2	16.0	15.3	14.1	15.6	15.0	15.5	16.0	16.5
Nontax revenue	1.4	3.0	1.3	1.5	1.3	1.7	1.7	1.7	1.7
Grants	17.7	12.9	15.3	10.3	15.8	15.1	16.6	17.1	17.3
Oil signature bonuses	0.8	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	44.9	31.6	38.9	31.5	38.6	40.6	36.2	36.9	35.9
Personnel costs	8.5	9.3	8.2	9.1	8.1	8.8	8.7	8.6	8.5
Interest due	0.6	0.5	0.6	0.7	0.6	0.4	0.4	0.7	0.7
Nonwage noninterest current expenditure	8.6	9.1	9.2	8.8	9.2	8.7	8.7	8.4	8.2
Treasury funded capital expenditures	1.5	1.1	1.7	0.9	1.7	0.9	1.0	1.9	2.5
Donor funded capital expenditures	25.5	11.3	18.6	11.8	18.6	20.8	16.6	16.6	15.5
HIPC Initiative-related social expenditure	0.3	0.3	0.5	0.2	0.5	1.0	0.9	0.6	0.6
Domestic primary balance [3]	-3.3	-0.8	-3.0	-3.4	-2.6	-2.7	-2.0	-1.8	-1.5
Overall balance (commitment basis)	-10.9	1.9	-7.0	-5.5	-6.0	-8.8	-2.3	-2.0	-0.4
External sector									
Current account balance (percent of GDP)									
Including official transfers	-21.3	-23.4	-15.9	-27.7	-14.5	-12.4	-15.2	-16.4	-17.0
Excluding official transfers	-39.7	-38.3	-32.0	-36.6	-31.0	-28.5	-32.7	-34.3	-35.1
PV of external debt (percent of GDP)	30.7	27.0	30.4	30.1	28.0	32.5	32.5	32.0	31.7
External debt service (percent of exports) [4]	7.3	9.5	15.0	5.0	13.6	4.8	4.2	3.9	3.7
Export of goods and non-factor services (US$ millions)	33.0	48.9	36.6	88.3	40.3	93.5	101.5	108.4	115.9
Gross international reserves [5]									
Millions of U.S. dollars	43.8	56.5	59.0	56.5	65.2	66.9	80.5	97.7	102.7
Months of imports of goods and nonfactor services [6]	3.5	3.4	5.7	3.9	6.0	4.0	4.5	5.1	5.1
National Oil Account (US$ millions)	9.0	12.2	9.9	9.9	8.0	8.0	6.5	5.3	4.3
Memorandum Item									
GDP									
Billions of dobras	4,952	5,582	6,524	6,237	7,064	7,171	7,790	8,251	8,820
Millions of U.S. dollars	259.7	302.6	359.1	337.8	393.9	325.6	356.3	381.8	412.9

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

[1] Revised program figures agreed upon during March 2014 mission.

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

[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.

[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] 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, 2012–18

(Billions of dobra)

	2012	2013	2014		2015			2016	2017	2018
	Actual	Actual	Prog.	Actual	Second ECF Review	Draft Budget	Proj.	Projections		
Total revenue and grants	1685	1869	2079	1618	2308	2280	2279	2638	2878	3137
Total revenue	771	1061	1081	973	1193	1196	1196	1343	1464	1610
Tax revenue	704	895	998	879	1102	1073	1073	1209	1323	1458
Nontax revenue	67	166	83	94	90	123	123	134	142	152
Grants	876	720	998	645	1115	1084	1083	1295	1413	1527
Project grants	730	509	705	500	848	730	730	989	1114	1235
Nonproject grants	119	173	246	103	218	220	220	219	216	214
HIPC Initiative-related grants	28	38	46	42	49	134	133	87	83	78
Oil signature bonuses	38	89	0	0	0	0	0	0	0	0
Total expenditure	2225	1763	2535	1962	2730	2909	2910	2818	3043	3169
Of which: Domestic primary expenditure	934	1105	1280	1184	1377	1386	1387	1497	1614	1743
Current expenditure	875	1056	1178	1159	1261	1284	1284	1381	1463	1530
Personnel costs	419	521	535	569	575	631	631	676	708	748
Interest due	30	28	40	44	39	31	31	29	60	59
Goods and services	198	216	262	223	277	229	229	248	263	281
Transfers	190	256	300	230	326	315	315	342	343	346
Other current expenditure	39	34	41	94	44	78	78	85	90	96
Capital expenditure	1336	690	1326	793	1434	1556	1556	1369	1528	1590
Of which: financed by the Treasury	74	60	111	58	120	63	64	78	158	223
Financed by external sources	1262	630	1215	735	1314	1493	1493	1291	1370	1367
HIPC Initiative-related social expenditure	14	17	31	10	35	70	70	68	52	49
Domestic primary balance [1]	-163	-44	-198	-210	-184	-190	-190	-154	-149	-133
Overall fiscal balance (commitment basis)	-540	106	-456	-344	-422	-629	-631	-180	-166	-33
Net change in arrears, float, and stat. discrepancies (reduction = -)	87	-81	0	138	0	-63	-62	-61	-36	-52
External arrears	0	0	0	11	0	0	-11	0	0	0
Domestic arrears	33	-43	0	35	0	-63	-51	-61	-36	-52
Float and statistical discrepancies	54	-38	0	91	0	0	0	0	0	0
Overall fiscal balance (cash basis)	-119	25	-456	-207	-422	-692	-692	-241	-202	-84
Financing	453	-25	456	207	422	692	692	241	202	84
Net external	558	67	411	199	410	651	651	206	175	63
Disbursements (projects)	532	121	511	236	466	763	763	302	256	132
Program financing (loans)	75	37	0	80	0	0	0	0	0	0
Net short-term loans	0	0	0	0	0	0	0	0	0	0
Scheduled amortization	-49	-91	-99	-117	-56	-112	-112	-96	-81	-69
Change in arrears (principal)	0	0	0	0	0	0	0	0	0	0
Bilateral rescheduling	0	0	0	0	0	0	0	0	0	0
HIPC flow savings	0	0	0	0	0	0	0	0	0	0
Net domestic	-104	-92	45	7	12	41	42	35	27	21
Net bank credit to the government	-104	-92	45	7	12	41	42	35	27	21
Banking system credit (excluding National Oil Account)	-66	-37	0	-37	-23	0	0	0	-1	-2
Of which: Privatisation account	0	-13	0	0	0		0	0	0	0
National Oil Account	-38	-55	45	44	35	41	42	35	28	23
Nonbank financing	0	0	0	0	0	0	0	0	0	0
Financing gap	334	0	0	0	0	0	0	0	0	0
Memorandum items:										
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
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
National Oil Account balance (US$ million, excl. transfers to budget)	9.0	12.2	9.9	9.9	8.0	8.0	8.0	6.5	5.3	4.3

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

[1] 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, 2012–18

(Percent of GDP)

	2012	2013	2014		2015			2016	2017	2018
	Actual	Actual	Prog.	Actual	Second ECF Review	Draft Budget	Proj.	Projections		
Total revenue and grants	**34.0**	**33.5**	**31.9**	**25.9**	**32.7**	**31.8**	**31.8**	**33.9**	**34.9**	**35.6**
Total revenue	15.6	19.0	16.6	15.6	16.9	16.7	16.7	17.2	17.7	18.3
Tax revenue	14.2	16.0	15.3	14.1	15.6	15.0	15.0	15.5	16.0	16.5
Nontax revenue	1.4	3.0	1.3	1.5	1.3	1.7	1.7	1.7	1.7	1.7
Grants	17.7	12.9	15.3	10.3	15.8	15.1	15.1	16.6	17.1	17.3
Project grants	14.7	9.1	10.8	8.0	12.0	10.2	10.2	12.7	13.5	14.0
Nonproject grants	2.4	3.1	3.8	1.7	3.1	3.1	3.1	2.8	2.6	2.4
HIPC Initiative-related grants	0.6	0.7	0.7	0.7	0.7	1.9	1.9	1.1	1.0	0.9
Oil signature bonuses	0.8	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	**44.9**	**31.6**	**38.9**	**31.5**	**38.6**	**40.6**	**40.6**	**36.2**	**36.9**	**35.9**
Of which: Domestic primary expenditure	18.9	19.8	19.6	19.0	19.5	19.3	19.3	19.2	19.6	19.8
Current expenditure	17.7	18.9	18.1	18.6	17.9	17.9	17.9	17.7	17.7	17.3
Personnel costs	8.5	9.3	8.2	9.1	8.1	8.8	8.8	8.7	8.6	8.5
Interest due	0.6	0.5	0.6	0.7	0.6	0.4	0.4	0.4	0.7	0.7
Goods and services	4.0	3.9	4.0	3.6	3.9	3.2	3.2	3.2	3.2	3.2
Transfers	3.8	4.6	4.6	3.7	4.6	4.4	4.4	4.4	4.2	3.9
Other current expenditure	0.8	0.6	0.6	1.5	0.6	1.1	1.1	1.1	1.1	1.1
Capital expenditure	27.0	12.4	20.3	12.7	20.3	21.7	21.7	17.6	18.5	18.0
Of which: financed by the Treasury	1.5	1.1	1.7	0.9	1.7	0.9	0.9	1.0	1.9	2.5
Financed by external sources	25.5	11.3	18.6	11.8	18.6	20.8	20.8	16.6	16.6	15.5
HIPC Initiative-related social expenditure	0.3	0.3	0.5	0.2	0.5	1.0	1.0	0.9	0.6	0.6
Domestic primary balance [1]	-3.3	-0.8	-3.1	-3.4	-2.6	-2.6	-2.7	-2.0	-1.8	-1.5
Overall fiscal balance (commitment basis)	-10.9	1.9	-7.0	-5.5	-6.0	-8.8	-8.8	-2.3	-2.0	-0.4
Net change in arrears, float, and stat. discrepancies (reduction = -)	1.8	-1.5	0.0	2.2	0.0	-0.9	-0.9	-0.8	-0.4	-0.6
External arrears	0.0	0.0	0.0	0.2	0.0	0.0	-0.2	0.0	0.0	0.0
Domestic arrears	0.7	-0.8	0.0	0.6	0.0	-0.9	-0.7	-0.8	-0.4	-0.6
Float and statistical discrepancies	1.1	-0.7	0.0	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Overall fiscal balance (cash basis)	**-2.4**	**0.4**	**-7.0**	**-3.3**	**-6.0**	**-9.6**	**-9.7**	**-3.1**	**-2.4**	**-1.0**
Financing	**9.1**	**-0.4**	**7.0**	**3.3**	**6.0**	**9.6**	**9.7**	**3.1**	**2.4**	**1.0**
Net external	11.3	1.2	6.3	3.2	5.8	9.1	9.1	2.6	2.1	0.7
Disbursements (projects)	10.7	2.2	7.8	3.8	6.6	10.6	10.6	3.9	3.1	1.5
Program financing (loans)	1.5	0.7	0.0	1.3	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
Scheduled amortization	-1.0	-1.6	-1.5	-1.9	-0.8	-1.6	-1.6	-1.2	-1.0	-0.8
Change in arrears (principal)	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
HIPC flow savings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic	-2.1	-1.7	0.7	0.1	0.2	0.6	0.6	0.4	0.3	0.2
Net bank credit to the government	-2.1	-1.7	0.7	0.1	0.2	0.6	0.6	0.4	0.3	0.2
Banking system credit (excluding National Oil Account)	-1.3	-0.7	0.0	-0.6	-0.3	0.0	0.0	0.0	0.0	0.0
Of which: Privatisation account	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Oil Account	-0.8	-1.0	0.7	0.7	0.5	0.6	0.6	0.4	0.3	0.3
Nonbank financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	6.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
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
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
National Oil Account balance (US$ million, excl. transfers to budget)	9.0	12.2	9.9	9.9	8.0	8.0	8.0	6.5	5.3	4.3
Nominal GDP (Billions of dobras)	4,952	5,582	6,524	6,237	7,064	7,171	7,171	7,790	8,251	8,820

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

[1] 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, 2012–18
(Billions of dobra)

	2012	2013	2014		2015	2016	2017	2018
	Actual	Actual	Prog.	Preliminary	Projections			
Net foreign assets	**1,062**	**1,292**	**1,347**	**1,474**	**1,805**	**2,011**	**2,384**	**2,432**
Claims on nonresidents	1,385	1,611	1,682	1,795	2,175	2,418	2,773	2,845
Official foreign reserves	1,136	1,355	1,450	1,482	1,834	2,080	2,440	2,516
Other foreign assets	249	256	232	313	340	338	333	330
Liabilities to nonresidents	-324	-319	-335	-321	-370	-407	-389	-414
Short-term liabilities to nonresidents	-121	-125	-138	-114	-144	-183	-168	-195
Other foreign liabilities	-203	-194	-197	-207	-226	-224	-221	-218
Net domestic assets	**-349**	**-370**	**-227**	**-338**	**-503**	**-565**	**-835**	**-759**
Net domestic credit	71	54		117	164	198	225	246
Claims on other depository corporations	41	72	72	106	106	106	106	106
Net claims on central government	-30	-101	-45	-84	-41	-10	14	33
Claims on central government	233	244	227	255	276	274	271	269
Of which: use of SDRs/PRGF Facility [1]	*186*	*198*	*181*	*207*	*225*	*223*	*221*	*218*
Liabilities to central government	-263	-345	-272	-339	-317	-284	-257	-236
Ordinary deposits of central government	-4	-11	-4	-18	-18	-18	-19	-20
Counterpart funds	-65	-91	-65	-93	-93	-93	-93	-93
Foreign currency deposits	-194	-242	-203	-228	-206	-173	-145	-123
Of which: National oil account	*-168*	*-218*	*-178*	*-200*	*-175*	*-142*	*-114*	*-92*
Claims on other sectors	60	83	80	95	99	102	104	107
Other items (net)	-421	-424	-334	-455	-667	-763	-1,060	-1,005
Base money	**712**	**922**	**1,120**	**1,136**	**1,302**	**1,446**	**1,549**	**1,672**
Currency issued	217	226	188	267	286	333	356	385
Bank reserves	495	695	932	869	1,016	1,114	1,193	1,288
Of which: domestic currency	399	582	780	704	826	936	1,003	1,083
Of which: foreign currency	97	113	152	165	189	177	190	205
Memorandum items:								
Gross international reserves (US$ millions) [2]	43.8	56.5	59.0	56.5	66.9	80.5	97.7	102.7
Months of imports of goods and nonfactor services [3]	3.5	3.4	5.7	3.9	4.0	4.5	5.1	5.1
Net international reserves (US$ millions) [4]	37.3	49.5	51.3	50.9	60.3	63.9	81.0	83.9
Months of imports of goods and nonfactor services [3]	3.0	3.0	4.9	3.5	3.6	3.6	4.2	4.1
National Oil Account (US$ millions)	9.0	12.2	9.9	9.9	8.0	6.5	5.3	4.3
Commercial banks reserves in foreign currency (US$ millions)	5.2	6.4	8.4	8.2	8.6	8.2	8.8	9.7
Guaranteed deposits (US$ millions)	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Base money (annual percent change)	28.6	29.4	10.0	23.2	14.6	11.1	7.1	8.0

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] 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 requirements.

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

[4] 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, 2012–18
(Billions of dobra)

	2012	2013	2014		2015	2016	2017	2018
	Actual	Actual	Prog.	Preliminary	Projections			
Net foreign assets	**1,630**	**1,648**	**1,947**	**2,230**	**2,535**	**2,767**	**3,160**	**3,219**
Net foreign assets of the BCSTP	1,062	1,292	1,347	1,474	1,805	2,011	2,384	2,432
Net foreign assets of other depository corporations	568	356	600	756	730	756	776	787
Net domestic assets	**250**	**493**	**422**	**270**	**342**	**439**	**258**	**455**
Net domestic credit	1,810	1,651	2,087	1,630	1,624	1,685	1,978	2,100
Net claims on central government	-123	-250	-237	-252	-245	-214	14	33
Claims on central government[1]	236	246	229	258	280	278	271	269
Liabilities to central government	-359	-496	-466	-510	-526	-492	-257	-236
Budgetary deposits	-4	-11		-18	-18	-18	-19	-20
Counterpart funds	-65	-91	-65	-93	-93	-93	-93	-93
Foreign currency deposits	-290	-394	-397	-399	-415	-382	-145	-123
Of which: National Oil Account	-168	-218	-178	-200	-175	-142	-114	-92
Claims on other sectors	1,934	1,902	2,325	1,882	1,869	1,899	1,963	2,067
Of which: claims in foreign currency	1,162	896	1,235	766	788	916	837	882
(In Millions of $US)	63	50	68	38	36	42	39	42
Other items (net)	-1,561	-1,159	-1,665	-1,360	-1,282	-1,245	-1,719	-1,645
Broad money (M3)	**1,879**	**2,140**	**2,369**	**2,500**	**2,877**	**3,206**	**3,418**	**3,674**
Local currency liabilities included in broad money (M2)	913	1,355	1,427	1,563	1,799	2,004	2,137	2,297
Money (M1)	734	1,059	993	1,106	1,273	1,419	1,513	1,626
Currency outside depository corporations	173	187	170	222	256	285	289	303
Transferable deposits in dobra	561	872	823	884	1,017	1,134	1,224	1,323
Other deposits in dobra	180	297	435	456	525	585	624	671
Foreign currency deposits	966	785	942	937	1,078	1,202	1,281	1,377
Memorandum items:								
Velocity (ratio of GDP to M3; end of period)	2.8	2.7	2.8	2.7	2.6	2.4	2.4	2.4
Money multiplier (M3/M0)	2.6	2.3	2.1	2.2	2.2	2.2	2.2	2.2
Base money (12-month growth rate)	28.6	29.4	10.0	23.2	14.6	11.1	7.1	8.0
Claims on other resident sectors (12-month growth rate)	9.6	-1.7	9.9	-1.0	-0.7	1.6	3.4	5.3
M3 (12-month growth rate)	20.3	13.9	13.1	16.8	15.1	11.4	6.6	7.5

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.

Table 6. São Tomé and Príncipe: Financial Soundness Indicators, 2012–14

	2012 December	2013 March	2013 June [1]	2013 September	2013 December	2014 March	2014 June	2014 September	2014 December
	(in percent, unless otherwise stated)								
Capital Adequacy									
Regulatory capital to risk-weighted assets									
Percentage of banks greater or equal to 10 percent	87.50	87.50	75.00	87.50	75.00	75.00	75.00	75.00	75.00
Percentage of banks below 10 and <6 percent minimum	n.a.	n.a.	12.50	0.00	12.50	12.50	12.50	12.50	0.00
Percentage of banks below 6 percent minimum	12.50	12.50	12.50	12.50	12.50	12.50	12.50	12.50	25.00
Capital (net worth) to assets	24.39	22.46	20.40	19.59	18.43	18.04	20.54	19.48	20.82
Deposits with banks below 6% (in billions of dobras)	83.21	n.a.	60.36	60.36	58.96	58.96	58.55	57.89	319.24
Asset quality									
Foreign exchange loans to total loans	57.91	54.73	49.82	51.11	53.89	53.31	49.00	44.80	46.48
Past-due loans to gross loans	66.68	n.a.	30.66	29.41	30.42	32.98	31.67	36.05	36.52
Non-performing loans/Total Credit	19.79	24.47	25.94	22.90	23.90	24.90	25.90	26.90	26.90
Nonperforming loans/Credit (IFRS Definition)	19.79	n.a.	12.55	14.77	16.86	17.19	18.34	17.70	17.61
Watch-listed loans	51.26	n.a.	18.25	14.83	13.56	15.79	13.33	18.35	18.91
Provision as percent of past-due loans	39.43	52.64	41.69	47.45	56.48	47.21	44.12	41.96	44.60
Earnings and profitability									
Return on assets	-0.04	0.00	-0.47	-1.27	-2.10	-1.40	-1.53	-1.93	-2.90
Return on equity	-0.16	-0.02	-2.06	-5.48	-9.34	-6.18	-6.94	-9.04	-14.58
Expense(w/amortization & provisions)/income	97.84	102.89	398.81	442.22	471.09	231.71	159.74	156.17	155.78
Liquidity									
Liquid assets/total assets	36.25	38.00	39.33	42.55	40.82	38.43	40.96	43.87	46.24
Liquid assets/short term liabilities	55.89	57.00	59.76	64.31	68.85	59.27	65.51	69.92	72.72
Loan/total liabilities	135.82	143.58	61.62	59.43	56.29	53.89	53.87	51.96	48.05
Foreign exchange liabilities/total liabilities	58.46	59.61	28.41	53.76	26.95	28.57	26.37	28.37	28.76
Loan/deposits	102.11	100.06	98.42	91.86	85.75	81.62	81.17	77.61	69.73
Sensitivity to market risk									
Foreign exchange liabilities to shareholders funds	141.06	150.45	110.87	220.61	119.31	129.77	102.04	117.27	109.40

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

[1] Beginning June 2013, data are based on improved methodology and not strictly comparable with earlier data.

Table 7. São Tomé and Príncipe: Balance of Payments, 2012–18

(Millions of US Dollars)

	2012	2013	2014		2015	2016	2017	2018
	Actual	Actual	Prog.	Actual	Projections			
Trade balance	**-96.6**	**-115.8**	**-114.0**	**-127.4**	**-102.3**	**-139.1**	**-152.8**	**-166.7**
Exports, f.o.b.	15.1	12.9	15.2	17.2	18.8	22.3	24.5	26.6
Of which: oil	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cocoa	5.3	5.4	6.2	9.1	10.6	11.3	11.1	11.8
Re-export	8.8	5.9	9.0	7.0	7.1	9.8	11.5	13.1
Imports, f.o.b.	-111.7	-128.6	-129.2	-144.6	-121.1	-161.4	-177.3	-193.3
Of which: food	-33.5	-38.4	-35.6	-35.6	-31.5	-38.7	-40.9	-43.0
Petroleum products	-27.2	-38.2	-26.7	-41.1	-30.6	-52.7	-59.0	-64.1
Investment goods	-35.0	-38.5	-40.5	-41.1	-40.9	-50.2	-59.1	-66.8
Oil sector related investment goods	0.0	0.0		0.0	-2.1	-2.1	-2.1	-2.1
Services and income (net)	**-11.4**	**-24.7**	**-12.3**	**-19.7**	**-17.2**	**-6.4**	**-8.9**	**-11.1**
Exports of nonfactor services	17.9	36.0	21.4	71.1	74.7	79.2	84.0	89.3
Of which: travel and tourism	12.6	30.6	16.5	57.3	60.3	64.0	68.0	72.5
Imports of nonfactor services	-24.6	-63.3	-30.7	-96.5	-100.1	-94.1	-101.5	-109.1
Factor services (net)	-4.7	2.6	-2.9	5.8	8.3	8.5	8.6	8.7
Of which: oil related	1.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Private transfers (net)	**4.9**	**24.6**	**11.5**	**23.3**	**26.8**	**29.2**	**30.9**	**33.0**
Official transfers (net)	**47.9**	**44.9**	**57.7**	**30.1**	**52.2**	**62.2**	**68.4**	**74.5**
Of which: project grants	38.7	29.4	41.4	27.9	39.2	49.2	55.4	61.5
HIPC Initiative-related grants	1.4	1.9	2.6	0.8	6.0	4.0	3.8	3.6
Current account balance								
Including official transfers	-55.2	-70.9	-57.0	-93.6	-40.5	-54.2	-62.5	-70.3
Excluding official transfers	-103.1	-115.9	-114.7	-123.7	-92.7	-116.4	-130.9	-144.8
Capital and financial account balance	**64.3**	**34.3**	**60.8**	**44.9**	**48.5**	**64.6**	**78.9**	**73.9**
Capital transfer [1]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	64.3	34.3	60.8	44.9	48.5	64.6	78.9	73.9
Direct foreign investment	21.7	10.2	25.1	22.0	16.8	23.1	29.6	36.8
Of which: Oil signature bonuses	2.0	4.8	0.0	0.0	0.0	0.0	0.0	0.0
Petroleum related investment	0.0	6.6	0.0	11.2	3.1	3.2	3.2	3.2
Recovery of oil capital expense	0.0	-6.6	0.0	-11.2	-3.1	-3.2	-3.2	-3.2
Portfolio Investment (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	42.7	24.1	35.7	23.0	31.7	41.5	49.3	37.0
Assets	26.9	16.1	12.5	7.3	7.3	7.4	7.5	7.6
Public sector (net)	15.2	3.1	23.4	28.2	32.8	10.8	8.8	2.8
Project loans	20.1	10.2	28.1	27.2	34.6	13.8	11.8	6.2
Program loans	1.4	0.0	0.0	4.3	0.0	0.0	0.0	0.0
Amortization	-6.9	-7.7	-4.7	-2.1	-1.8	-1.8	-1.8	-2.0
Other investment	0.6	0.6	0.0	-1.3	-0.1	-1.2	-1.3	-1.4
Of which: transfers to JDA	-0.4	-0.3	0.0	-0.3	-0.5	-0.5	-0.6	-0.6
Private sector (net)	0.6	5.0	-0.2	-12.5	-8.3	23.3	33.0	26.6
Commercial banks	-11.0	10.6	-1.5	-17.5	-4.2	1.5	1.4	0.9
Short-term private capital	11.7	-5.6	1.3	5.0	-4.1	21.8	31.7	25.7
Errors and omissions	**-10.3**	**48.1**	**0.0**	**55.7**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**-1.2**	**11.6**	**3.8**	**7.0**	**8.0**	**10.4**	**16.4**	**3.5**
Financing	1.2	-11.6	-3.8	-7.0	-8.0	-10.4	-16.4	-3.5
Change in official reserves, excl. NOA (increase= -)	1.4	-9.1	-6.4	-8.6	-10.0	-13.1	-18.9	-5.9
Use of Fund resources (net)	0.6	0.7	0.2	-0.7	0.1	1.2	1.3	1.4
Purchases	0.6	1.1	1.1	0.0	0.9	1.8	1.8	1.9
Repurchases (incl. MDRI repayment)	0.0	-0.4	-1.0	-0.7	-0.8	-0.6	-0.6	-0.5
National Oil Account (increase = -)	-0.8	-3.2	2.4	2.3	1.9	1.4	1.2	1.0
Exceptional financing	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
Memorandum items:								
Current account balance (percent of GDP)								
Before official transfers	-39.7	-38.3	-32.0	-36.6	-28.5	-32.7	-34.3	-35.1
After official transfers	-21.3	-23.4	-15.9	-27.7	-12.4	-15.2	-16.4	-17.0
Debt service ratio (percent of exports) [2]	7.3	9.5	15.0	5.0	4.8	4.2	3.9	3.7
Gross international reserves [3]								
Millions of U.S. dollars	43.8	56.5	59.0	56.5	66.9	80.5	97.7	102.7
Months of imports of goods and nonfactor services [4]	3.5	3.4	5.7	3.9	4.0	4.5	5.1	5.1

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

[1] Includes HIPC debt relief.

[2] In percent of exports of goods and nonfactor services.

[3] 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.

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

Table 8. São Tomé and Príncipe: Balance of Payments, 2012–18

(Percent of GDP)

	2012	2013	2014		2015	2016	2017	2018
	Actual	Actual	Prog.	Actual	Projections			
Trade balance	**-37.2**	**-38.3**	**-31.7**	**-37.7**	**-31.4**	**-39.0**	**-40.0**	**-40.4**
Exports, f.o.b.	5.8	4.3	4.2	5.1	5.8	6.3	6.4	6.4
Of which: oil	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cocoa	2.0	1.8	1.7	2.7	3.2	3.2	2.9	2.9
Re-export	3.4	2.0	2.5	2.1	2.2	2.7	3.0	3.2
Imports, f.o.b.	-43.0	-42.5	-36.0	-42.8	-37.2	-45.3	-46.4	-46.8
Of which: food	-12.9	-12.7	-9.9	-10.5	-9.7	-10.9	-10.7	-10.4
Petroleum products	-10.5	-12.6	-7.4	-12.2	-9.4	-14.8	-15.5	-15.5
Investment goods	-13.5	-12.7	-11.3	-12.2	-12.6	-14.1	-15.5	-16.2
Oil sector related investment goods	0.0	0.0		0.0	-0.6	-0.6	-0.6	-0.5
Services and income (net)	**-4.4**	**-8.2**	**-3.4**	**-5.8**	**-5.3**	**-1.8**	**-2.3**	**-2.7**
Exports of nonfactor services	6.9	11.9	5.9	21.1	22.9	22.2	22.0	21.6
Of which: travel and tourism	4.8	10.1	4.6	17.0	18.5	18.0	17.8	17.6
Imports of nonfactor services	-9.5	-20.9	-8.6	-28.6	-30.8	-26.4	-26.6	-26.4
Factor services (net)	-1.8	0.9	-0.8	1.7	2.5	2.4	2.3	2.1
Of which: oil related	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private transfers (net)	**1.9**	**8.1**	**3.2**	**6.9**	**8.2**	**8.2**	**8.1**	**8.0**
Official transfers (net)	**18.4**	**14.9**	**16.1**	**8.9**	**16.0**	**17.5**	**17.9**	**18.0**
Of which: project grants	14.9	9.7	11.5	8.2	12.0	13.8	14.5	14.9
HIPC Initiative-related grants	0.5	0.6	0.7	0.2	1.9	1.1	1.0	0.9
Current account balance								
Including official transfers	-21.3	-23.4	-15.9	-27.7	-12.4	-15.2	-16.4	-17.0
Excluding official transfers	-39.7	-38.3	-32.0	-36.6	-28.5	-32.7	-34.3	-35.1
Capital and financial account balance	**24.8**	**11.4**	**16.9**	**13.3**	**14.9**	**18.1**	**20.7**	**17.9**
Capital transfer [1]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	24.8	11.4	16.9	13.3	14.9	18.1	20.7	17.9
Direct foreign investment	8.3	3.4	7.0	6.5	5.1	6.5	7.8	8.9
Of which: Oil signature bonuses	0.8	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Petroleum related investment	0.0	2.2	0.0	3.3	1.0	0.9	0.8	0.8
Recovery of oil capital expense	0.0	-2.2	0.0	-3.3	-1.0	-0.9	-0.8	-0.8
Portfolio Investment (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	16.4	8.0	10.0	6.8	9.7	11.6	12.9	9.0
Assets	10.3	5.3	3.5	2.2	2.2	2.1	2.0	1.8
Public sector (net)	5.8	1.0	6.5	8.4	10.1	3.0	2.3	0.7
Project loans	7.7	3.4	7.8	8.1	10.6	3.9	3.1	1.5
Program loans	0.5	0.0	0.0	1.3	0.0	0.0	0.0	0.0
Amortization	-2.7	-2.6	-1.3	-0.6	-0.5	-0.5	-0.5	-0.5
Other investment	0.2	0.2	0.0	-0.4	0.0	-0.3	-0.3	-0.3
Of which: transfers to JDA	-0.2	-0.1	0.0	-0.1	-0.1	-0.2	-0.1	-0.1
Private sector (net)	0.2	1.7	-0.1	-3.7	-2.6	6.5	8.7	6.4
Commercial banks	-4.2	3.5	-0.4	-5.2	-1.3	0.4	0.4	0.2
Short-term private capital	4.5	-1.8	0.4	1.5	-1.3	6.1	8.3	6.2
Errors and omissions	**-4.0**	**15.9**	**0.0**	**16.5**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**-0.5**	**3.8**	**1.1**	**2.1**	**2.5**	**2.9**	**4.3**	**0.9**
Financing	0.5	-3.8	-1.1	-2.1	-2.5	-2.9	-4.3	-0.9
Change in official reserves, excl. NOA (increase= -)	0.5	-3.0	-1.8	-2.6	-3.1	-3.7	-4.9	-1.4
Use of Fund resources (net)	0.2	0.2	0.0	-0.2	0.0	0.3	0.3	0.3
Purchases	0.2	0.4	0.3	0.0	0.3	0.5	0.5	0.5
Repurchases (incl. MDRI repayment)	0.0	-0.1	-0.3	-0.2	-0.2	-0.2	-0.1	-0.1
National Oil Account (increase = -)	-0.3	-1.1	0.7	0.7	0.6	0.4	0.3	0.2
Exceptional financing	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
Memorandum items:								
Debt service ratio (percent of exports) [2]	7.3	9.5	15.0	5.0	4.8	4.2	3.9	3.7
Gross international reserves [3]								
Millions of U.S. dollars	43.8	56.5	59.0	56.5	66.9	80.5	97.7	102.7
Months of imports of goods and nonfactor services [4]	3.5	3.4	5.7	3.9	4.0	4.5	5.1	5.1

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

[1] Includes HIPC debt relief.

[2] In percent of exports of goods and nonfactor services.

[3] 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.

[4] 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, 2012–18
(Millions of US Dollars)

	2012	2013		2014		2015	2016	2017	2018
	Actual	Second ECF Review	Actual	Prog.	Actual	Projections			
Gross financing requirements	**-108.0**	**-120.7**	**-132.5**	**-126.8**	**-136.4**	**-105.4**	**-133.1**	**-153.4**	**-154.5**
Current account, excluding official transfers	-103.1	-105.9	-115.9	-114.7	-123.7	-92.7	-116.4	-130.9	-144.8
Exports, f.o.b.	15.1	15.1	12.9	15.2	17.2	18.8	22.3	24.5	26.6
Imports, f.o.b.	-111.7	-119.1	-128.6	-129.2	-144.6	-121.1	-161.4	-177.3	-193.3
Services and income (net)	-11.4	-11.0	-24.7	-12.3	-19.7	-17.2	-6.4	-8.9	-11.1
Private transfers	4.9	9.0	24.6	11.5	23.3	26.8	29.2	30.9	33.0
Financial account	-6.3	-8.1	-7.5	-5.6	-4.1	-2.7	-3.6	-3.6	-3.8
Scheduled amortization [1]	-6.9	-8.6	-7.7	-4.7	-2.1	-1.8	-1.8	-1.8	-2.0
IMF repayments	0.0	-0.6	-0.4	-1.0	-0.7	-0.8	-0.6	-0.6	-0.5
Other public sector flows (net)	0.6	1.1	0.6		-1.3	-0.1	-1.2	-1.3	-1.4
Change in external reserves (-ve = increase)	1.4	-6.7	-9.1	-6.4	-8.6	-10.0	-13.1	-18.9	-5.9
Available funding	**108.0**	**120.7**	**132.5**	**126.8**	**136.4**	**105.4**	**133.1**	**153.4**	**154.5**
National Oil Fund (net)	1.2	1.7	1.6	2.4	2.3	1.9	1.4	1.2	1.0
Oil signature bonuses	2.0	4.9	4.8	0.0	0.0	0.0	0.0	0.0	0.0
Saving (-ve = accumulation of oil reserve fund)	-0.8	-3.2	-3.2	2.4	2.3	1.9	1.4	1.2	1.0
Expected disbursements	69.4	78.4	55.2	85.8	61.7	86.8	76.0	80.2	80.7
Multilateral HIPC interim assistance	1.4	1.7	1.9	2.6	0.8	6.0	4.0	3.8	3.6
Capital transfers [1]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants [2]	46.5	41.4	43.0	55.1	29.3	46.1	58.3	64.6	70.8
Concessional loans	21.5	35.3	10.2	28.1	31.6	34.6	13.8	11.8	6.2
Project loans	20.1	32.1	10.2	28.1	27.2	34.6	13.8	11.8	6.2
Program loans	1.4	3.3	0.0	0.0	4.3	0.0	0.0	0.0	0.0
Private sector (net)	36.8	39.4	74.6	37.4	72.4	15.7	53.8	70.1	71.0
IMF	0.6	1.1	1.1	1.1	0.0	0.9	1.8	1.8	1.9
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

[1] Includes HIPC debt relief.

[2] Includes revenue from Nigeria oil program.

Table 10. São Tomé and Príncipe: Proposed Schedule of Disbursements Under the ECF Arrangement, 2015–18

Date	Disbursement conditions	SDR Amount	Percent of Quota
07/13/15	Board approval of arrangement.	634,285	8.57
04/15/16	Observance of continuous and end-Decemebr 2015 PCs and completion of the first review.	634,285	8.57
10/15/16	Observance of continuous and end-June 2016 PCs and completion of the second review.	634,285	8.57
04/15/17	Observance of continuous and end-December 2016 PCs and completion of the third review.	634,285	8.57
10/15/17	Observance of continuous and end-June 2017 PCs and completion of the fourth review.	634,285	8.57
04/15/18	Observance of continuous and end-December 2017 PCs and completion of the fifth review	634,285	8.57
06/15/18	Observance of continuous and end-March 2018 PCs and completion of the sixth review.	634,290	8.57
	Total	4,440,000	60

Source: IMF

Table 11. São Tomé and Príncipe: Indicators of Capacity to Repay the Fund, 2015–27

					Projections								
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Fund obligations based on existing credit (millions of SDRs)													
Principal	0.53	0.61	0.44	0.39	0.33	0.26	0.22	0.22	0.11	0.00	0.00	0.00	0.00
Charges and interest	0.00	0.00	0.00	0.00	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Fund obligations based on existing and prospective credit (millions of SDRs)													
Principal	0.53	0.61	0.44	0.39	0.33	0.26	0.41	0.67	0.81	0.89	0.89	0.70	0.44
Charges and interest	0.05	0.05	0.05	0.05	0.23	0.22	0.21	0.19	0.16	0.13	0.10	0.07	0.06
Total obligations based on existing and prospective credit													
Millions of SDRs	0.58	0.66	0.49	0.44	0.56	0.48	0.62	0.86	0.97	1.02	0.99	0.77	0.50
Millions of U.S. dollars	0.81	0.93	0.70	0.63	0.81	0.70	0.90	1.25	1.41	1.48	1.44	1.12	0.73
Percent of exports of goods and services	0.87	0.92	0.64	0.54	0.66	0.53	0.63	0.82	0.86	0.85	0.77	0.56	0.34
Percent of debt service [1]	18.24	21.71	16.45	14.50	10.60	8.97	11.46	15.50	16.73	17.18	16.68	13.61	9.25
Percent of quota	7.84	8.92	6.62	5.95	7.57	6.49	8.38	11.62	13.11	13.78	13.38	10.41	6.76
Percent of gross international reserves [2]	1.08	1.05	0.65	0.56	0.63	0.51	0.62	0.82	0.87	0.86	0.79	0.58	0.35
Outstanding Fund credit													
Millions of SDRs	3.2	3.9	4.7	5.6	5.3	5.0	4.6	3.9	3.1	2.2	1.3	0.6	0.2
Millions of U.S. dollars	4.5	5.5	6.7	8.0	7.6	7.3	6.7	5.7	4.5	3.2	1.9	0.9	0.3
Percent of exports of goods and services	4.8	5.4	6.2	6.9	6.2	5.5	4.7	3.7	2.8	1.8	1.0	0.5	0.1
Percent of debt service [1]	101.2	127.6	157.8	184.2	99.4	93.2	84.6	70.7	53.6	37.4	22.4	11.1	3.5
Percent of quota	43.5	52.4	63.5	75.5	70.9	67.4	61.9	53.0	42.0	30.0	18.0	8.5	2.6
Percent of gross international reserves [2]	6.0	6.2	6.3	7.1	5.9	5.3	4.6	3.7	2.8	1.9	1.1	0.5	0.1
Memorandum items:													
Exports of goods and services (millions of U.S. dollars)	93.5	101.5	108.4	115.9	122.8	131.9	142.4	152.7	163.6	175.4	188.0	201.5	216.0
Debt service (millions of U.S. dollars)	4.5	4.3	4.2	4.3	7.6	7.8	7.9	8.1	8.4	8.6	8.6	8.2	7.9
Quota (millions of SDRs)	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Gross international reserves [2]	75.5	88.6	106.5	112.4	127.8	135.8	144.3	152.4	161.2	172.2	182.5	193.5	205.6
GDP (millions of U.S. dollars)	326	356	382	413	453	500	546	588	631	677	726	779	835

Sources: Sao Tome and Principe authorities and Fund staff estimates.

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

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

Table 12. São Tomé and Príncipe: Millennium Development Goals

	1990	1995	2000	2005	2010	2012
Goal 1: Eradicate extreme poverty and hunger						
Population below $1 (PPP) per day, percentage	--	--	28.2[5/]	--	--	--
Population below national poverty line, total, percentage	--	--	53.8[5/]	--	66.2[11/]	--
Poverty gap ratio at $1 a day (PPP), percentage	--	--	7.9[5/]	--	--	--
Poorest quintile's share in national income or consumption, percentage	--	--	5.2[5/]	--	--	--
Employment to population ratio, both sexes, percentage	42.9[1/]	--	40.6	--	--	--
Proportion of own-account and contributing family workers in total employment, both sexes, percentage	0.8[1/]	--	--	--	--	--
Children under 5 moderately or serverely underweight, percentage	--	--	10.1	8.0[8/]	14.4[11/]	--
Population undernourished, percentage	22.6[1/]	24	14.8	8.9	7.5	7.7[12/]
Goal 2: Achieve universal primary education						
Total net enrollment ratio in primary education, both sexes	--	--	89.5[4/]	99.3	98.6	--
Percentage of pupils starting grade 1 who reach last grade of primary, both sexes	--	--	58.8[5/]	68.9[7/]	68.0[10/]	--
Literacy rates of 15-24 years old, both sexes, percentage	93.8[1/]	--	95.4[5/]	--	95.3	--
Goal 3: Promote gender equality and empower women						
Gender Parity Index in primary level enrollment	--	--	0.97[4/]	0.97	1.00	0.97[12/]
Gender Parity Index in secondary level enrollment	--	--	--	1.07	1.03	1.15[12/]
Gender Parity Index in tertiary enrolment	--	--	--	--	0.98	--
Share of women in wage enployment in the non-agricultural sector	32[1/]	--	--	--	--	--
Seats held by women in national parliament, percentage	11.8	7.3[3/]	9.1	9.1	7.3	18.2
Goal 4: Reduce child mortality						
Children under five mortality rate, per 1,000 live births	96.0	94.1	92.5	90.8	89.1	88.8[12/]
Infant mortality rate (0-1 year) per 1,000 live births	62.2	61.2	60.3	59.3	58.3	58.2[12/]
Children 1 year old immunized against measles, percentage	71.0	74.0	69.0	88.0	92.0	--
Goal 5: Improve maternal health						
Maternal mortality ratio per 100,000 live births	150	120	110	87	70	--
Births attended by skilled health personnel, percentage	--	--	79	81[8/]	82[10/]	--
Current contraceptive use among married women 15-49 years old, any method, percentage	--	--	29	31[8/]	38[11/]	--
Adolescent birth rate, per 1,000 women	107[1/]	--	91[5/]	110[8/]	--	--
Antenatal care coverage, at least one visit, percentage	--	--	91	97[8/]	98[11/]	--
Antenatal care coverage, at least four visits, percentage	--	--	--	--	72[11/]	--
Unmet need for family planning, total, percentage	--	--	--	--	38[11/]	--
Goal 6: Combat HIV/AIDS, Malaria and other diseases						
Condom use at last high-risk sex, 15-24 years old, women, percentage	--	--	--	56[8/]	54[11/]	--
Condom use at last high-risk sex, 15-24 years old, men, percentage	--	--	--	--	64[11/]	--
Men 15-24 years old with comprehensive correct knowledge of HIV/AIDS, percentage	--	--	--	--	43[11/]	--
Women 15-24 years old with comprehensive correct knowledge of HIV/AIDS, percentage	--	--	11	44[8/]	43[11/]	--
Notified cases of malaria per 100,000 population	--	--	--	--	2[11/]	--
Malaria death rate per 100,000 population, all ages	--	--	--	--	8[11/]	--
Malaria death rate per 100,000 population, ages 0-4	--	--	--	--	3[11/]	--
Children under 5 sleeping under insecticide-treated bed nets, percentage	--	--	23	42[8/]	56[11/]	--
Children under 5 with fever being treated with anti-malarial drugs, percentage	--	--	61	25[8/]	8[11/]	--
Tuberculosis prevalence rate per 100,000 population (mid-point)	258	253	189	134	141	--
Tuberculosis death rate per year per 100,000 population (mid-point)	28	29	18	10	13	--
Tuberculosis incidence rate per year per 100,000 population (mid-point)	135	124	114	105	96	--
Tuberculosis detection rate under DOTS, percentage (mid-point)	11	--	60	85	76	--
Tuberculosis treatment success rate under DOTS, percentage	--	--	78	98	98[11/]	--
Goal 7: Ensure environmental sustainability						
Proportion of land area covered by forest, percentage	28	--	28	28	28	--
Carbon dioxide emmisions (CO_2), thousand metric tons of CO_2 (CDIAC)	66	77	88	128	128[11/]	--
Carbon dioxide emmisions (CO_2), metric tons of CO_2 per capita (CDIAC)	0.57	0.60	0.62	0.84	0.79[11/]	--
Carbon dioxide emmisions (CO_2), kg CO_2 per $1 GDP (PPP) (CDIAC)	--	--	0.51	0.50	0.63[11/]	--
Consumption of all Ozone-Depleting Substances in ODP metric tons	2.5	4.8	4.0	2.3	0.2	--
Proportion of total water resources used, percentage	--	0.3	--	--	--	--
Terrestrial and marine areas protected to total territorial area, percentage	0.0	0.0	0.0	0.0	0.0	--
Proportion of the population using improved drinking water resources, total	--	75	79	85	89	--
Proportion of the population using improved sanitation facilities, total	--	20	21	24	26	--
Goal 8: Develop a global partnership for development						
Debt relief committed under HIPC initiative, cumulative million US$ in end-2009 NPV terms	--	--	--	--	--	171
Debt relief delivered in full under MDRI initiative, cumulative million US$ in end-2009 NPV terms	--	--	--	--	--	38
Debt service as a percentage of exports of goods and services and net income	29	27[3/]	22	61	3	--
Fixed telephone lines per 100 inhabitants	1.9	2.0	3.3	4.7	4.7	4.7[12/]
Mobile cellular subscriptions per 100 inhabitants	--	--	--	8	62	68[12/]
Internet users per 100 population	--	--	5	14	19	20[12/]
Net ODA received per capita (current US$)	466	657	247	213	298	--
ODA received in small islands developing states as a percentage of their GNI	--	--	--	29	25	--
Developed country imports from developing countries, admitted duty free, percent	--	--	97	100	100	--
Developed country imports from the LDCs, admitted duty free, percentage	--	--	97	100	100	--
Other						
Fertility rate, total (births per woman)	5.4	5.0	4.6	4.1	3.7	3.5
GNI per capita, Atlas method (current US$)	--	--	--	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
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 2006 9/ Correspond to 2007 10/ Correspond to 2008 11/ Correspond to 2009 12/ Correspond to 2011

Appendix I. Letter of Intent

São Tomé, June 19, 2015

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

Dear Ms. Lagarde:

1. São Tomé and Príncipe had a peaceful and successful change of government in November 2014, following the general election in October 2014 which was won, with an absolute parliamentary majority, by the main opposition party (ADI-Independent Democratic Action Party), led by former Prime Minister Patrice Trovoada.

2. On July 20, 2012, the Executive Board of the International Monetary Fund (IMF) approved a three-year arrangement under the Extended Credit Facility (ECF) to support the government of São Tomé and Príncipe's economic reform program to promote sustainable growth and reduce poverty, underpinned by the national poverty reduction strategy (PRSP-II). The program supported under this arrangement went off-track after the completion of the second review in December 2013, on account of the contraction of a loan from Angola with a level of concessionality below the threshold of 50 percent stipulated under the program and the delays in introducing corrective measures due to the general elections in October the same year and the subsequent change of government.

3. The government of São Tomé and Príncipe wishes to cancel the current ECF arrangement, which is due to expire in July 2015. In its place, we request a new three-year ECF arrangement to support our medium-term economic reform program for the period 2015 to 2018. The new ECF arrangement allows the government to design a new program that does not assume prospects of future oil production due to the significant delays and setbacks in oil exploration. It will also afford the new government a clean slate to reestablish credibility in program implementation.

4. To help achieve the objectives of this program, the government requests access of SDR 4,440,000 (60 percent of quota) including first disbursement of SDR634,285 upon approval of the arrangement by the IMF Executive Board. This arrangement will be used to anchor the government's macroeconomic policies. The half-yearly reviews under the arrangement will serve also to send a clear signal to São Tomé and Príncipe's development partners regarding the quality of the macroeconomic and financial policies implemented by the government.

5. The attached Memorandum of Economic and Financial Policies (MEFP) describe recent developments in São Tomé and Príncipe's economy and the progress made in implementing our program in 2013–14. As explained in the MEFP, nearly all the program indicators at end-December 2014 were achieved and many of the measures subject to structural benchmarks were implemented.

6. The MEFP also sets out the economic and financial policies that the São Tomé and Príncipe government intends to implement between now and the end of this year and during the course of the next three years to preserve macroeconomic stability, boost economic growth, improve the management of public finances and the financial system, and facilitate export-oriented private sector development.

7. The MEFP and the Technical Memorandum of Understandings (TMU) present quantitative performance criteria, indicative targets, and structural benchmarks to be used to monitor the implementation of the program. The government believes that the measures and policies described in the attached MEFP are adequate to attain the objectives of this program. It will take any additional measures necessary to that end. It will consult with the IMF on the adoption of such measures prior to any revision of the policies indicated in the attached MEFP, in accordance with the Fund's policies on such consultation.

8. The government will provide Fund staff with all relevant information mentioned in the Technical Memorandum of Understanding (TMU) concerning progress made under the program. During the program, the government will not introduce or strengthen any exchange restriction, multiple currency practice, or import restrictions for balance of payments purposes, nor will it conclude any bilateral payment agreements in violation of Article VIII of the Fund's Articles of Agreement.

9. The government of São Tomé and Príncipe authorizes the IMF to make this letter and attached MEFP and TMU, and the IMF staff report and the Debt Sustainability Analysis (DSA) update available to the public, including through the IMF internet website.

Yours truly,

/s/

Mr. Américo d'Oliveira Ramos,
Minister of Finance and Public Administration

/s/

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

Attachments:

1. Memorandum on Economic and Financial Policies.
2. Technical Memorandum of Understanding.

Attachment I. Memorandum on Economic and Financial Policies for 2015–18

INTRODUCTION

1. **This memorandum of economic and financial policies outlines the main objectives of the government of São Tomé and Príncipe's economic reform program for the period July 2015–June 2018,** for which the government is seeking support from the International Monetary Fund through a new three-year arrangement under the Extended Credit Facility (ECF). The new ECF arrangement succeeds the one approved by the IMF Executive Board in July 2012. That program went off-track after the completion of the second review in December 2013, on account of the contracting of a loan from Angola with a level of concessionality below the threshold of 50 percent stipulated under the program and the delays in introducing corrective measures due to the general elections in October that same year and the subsequent change of government.

2. **The government of São Tomé and Príncipe is committed to pursuing an economic reform program to promote sustainable growth and poverty reduction.** The Independent Democratic Action Party led by Mr. Patrice Trovoada won an absolute majority in the 2014 Parliamentary elections. More than half of the population lives below the poverty line, and there is limited access to clean water and electricity, and to services such as education and health care. The lack of basic infrastructure constrains our economic development and limits improvement in living standards. Prospects worsened somewhat over the last years with the dire indebtedness situation and the dwindling chances of discovering commercially viable quantities of oil in our offshore territory.

3. **The new government sees a Fund-supported program as an appropriate platform for continued reforms and also to catalyze donor support and participation in São Tomé and Príncipe.** The government's medium-term economic program is rooted in the national poverty reduction strategy paper (PRSP-II) and the new government's vision statement which seeks to consolidate gains made under the current ECF-supported program with the IMF. In particular, the medium term objectives aims to continue the fiscal consolidation to further anchor debt sustainability but at the same time create enough space to support the much-needed public investment program (PIP) to promote sustained and shared growth and poverty reduction.

4. **The medium-term program of the government is designed to assume no future oil production.** With the withdrawal of Total Oil Company from the joint development zone in 2013, prospects of oil production in the near future are no longer feasible. Therefore, the government sees this new ECF arrangement as an opportunity to re-design a program with less probability of oil production coming on stream. In response, the government has identified alternative options of creating fiscal space (both domestic and external) to support the identified growth-enhancing spending underpinning the medium-term program.

RECENT ECONOMIC DEVELOPMENTS, PROSPECTS AND PERFORMANCE UNDER THE ECF-SUPPORTED PROGRAM

5. **Macroeconomic performance since 2012** has been positive but has not resulted in the stronger and more diversified economic growth that can decisively improve economic prospects and living standards overall:

- From 2012 through 2014, real GDP growth averaged 4½ percent, lower than the growth pick-up envisaged under the current ECF arrangement, mainly as a result of the setback to oil production and the challenging external environment, particularly in the main European trading partners. However, economic activity appears to be improving in 2015 driven by a higher than anticipated increase in foreign direct investment that started in 2014, the launching of new donor-financed projects, and improved tourism receipts. Following the adoption of the peg to the euro in January 2010, inflation has fallen significantly from 16 percent to 6.5 percent in March 2015— its lowest 12–month rate in two decades—but still not aligned with inflation in the Euro area.

- The fiscal consolidation effort has been mixed. The domestic primary deficit which improved to 0.8 percent in 2013, mainly on account of one-off revenues of 1.7 percent of GDP. It increased sharply again to 3.4 percent of GDP in 2014 as a result of revenue underperformance (non-payment of import duties by ENCO, the main oil importer) and expenditure overruns in the run-up to the general elections in October 2014. Government arrears also accumulated on a net basis every year since 2012 despite efforts to clear them.

- Growth in monetary aggregates continues to decline. On the other hand, after surging in 2010–12, bank credit to the private sector started contracting in 2013 as over-indebted businesses and households were not extended further loans and banks struggled with non-performing loans and shortage of bankable projects.

- Between 2012–14, the external current account deficit slowly declined to 30.3 percent in line with weak economic activity but the trade deficit remained unchanged at about 37.4 percent of GDP despite encouraging growth in cocoa exports. The Central Bank's international reserves, standing at 3.8 months of import cover at end-March 2015, have remained at comfortable levels, even though still below what is deemed adequate for a small commodity exporting economy with fixed exchange rate regime.

- The financial system has been under stress over the last few years following a loose credit stance and weak enforcement of prudential standards during the oil prospects boom years of 2010–12. Non-performing loans have soared to 18 percent in 2014 and the central bank had to intervene in two banks in two years while successive years of loss making have eaten away banking system capital.

6. **Program performance.** The ECF-supported program of the government was approved on July 20, 2012 (with 35 percent of quota access) and is due to expire on July 19, 2015. All of the 2013 quantitative performance criteria were met; some by large margins, and the first two reviews were concluded as scheduled. But in 2014 there were

slippages and delays in program implementation. While the monetary quantitative targets continued to be comfortably met, the domestic primary deficit exceeded the end-year program target by a 0.4 percentage points of GDP mainly due to revenue underperformance and slippages on personnel cost and significant arrears accumulation of energy and communications bills by government agencies. Structural reform implementation recorded delays, and some key measures were not implemented, in particular the tripartite arrears clearance plan between the Treasury, ENCO, and EMAE (Tables 1 and 2).

7. **Program interruption.** The contracting in March 2014 of a loan from Angola, at less than 50 percent concessional terms, delayed the conclusion of the third ECF review. The government was able to renegotiate the terms of the loan at near concessional terms (46 percent concessionality) by July 2014. In the meantime, national elections were called in October 2014 and the outgoing government postponed further program discussions until the new government was in office. This resulted in a loss of momentum in policy implementation, which contributed to the decision of the new government to resume program relations with the Fund by requesting a new arrangement instead of continuing with the existing ECF arrangement which is due to expire soon.

8. **Prospects for 2015 and beyond.** The outlook for 2015 is for a pick-up in economic activity as early trends for agriculture, tourism and foreign-investment-driven construction all look favorable. Some smaller oil companies remain active in exploration, but even if they find commercially viable oil, actual production would take several more years. The current context of low international oil prices further hampers production prospects. As a result, São Tomé and Príncipe's economic policies and outlook will continue to be constrained by the acute scarcity of budgetary resources.

MEDIUM-TERM MACROECONOMIC FRAMEWORK

9. **In the medium term, economic activity is projected to expand driven by scaled-up investment and expansion in tourism and agriculture.** Accordingly, growth is projected at around 5 percent in 2015 and steadily rising to 5.5 percent by 2017. The scaling up of investment in infrastructure is expected to unleash the tourism potential of São Tomé and Príncipe by addressing production of cheaper and reliable energy, upgrading the airports, and providing transportation to link up tourism sites across the country. Better macroeconomic conditions in trade partners' economy will also contribute to the country's economic growth. Investments to upgrade port equipments and energy are also expected to yield benefit in agriculture. Against the backdrop of subdued international price pressures, inflation is targeted at 3 percent by 2018 in line with Euro zone inflation. Monetary aggregates' expansion will be consistent with maintaining the sustainability of the peg. The domestic primary balance will serve as the anchor for fiscal policy and will be targeted to decline to around 1.5 percent of GDP by 2018.

10. **The government's medium-term economic program will be underpinned by an updated PRSP (National Strategy Document).** In the foreseeable future, São Tomé and Príncipe will continue to face the challenges of overcoming its insularity, small market size, lack of human capital, and limited tradable resources to generate sustainable and inclusive growth. The existing Poverty Reduction Strategy Paper (PRSP-II), adopted in July 2012, and

the economic guidelines of the Program of the Constitutional Government of São Tomé and Príncipe approved by Parliament in December 2014, will serve as reference for the 2015–18 economic and financial policies. The governance, economic and social objectives of the PRSP-II remain valid and priority will continue to be given to its four strategic axes: (i) promoting good governance and public sector reform, (ii) supporting sustainable and inclusive economic growth, (iii) enhancing human capital and extending basic social services, and (iv) reinforcing social cohesion and social protections, particularly for vulnerable groups. Since the PRSP-II only covers the 2012–16, the government intends to produce in 2016 a National Strategy Document through 2018 that will benefit from the recently concluded evaluation exercise of implementation of PRSP-II and, if necessary, from new consultations with stakeholders.

SUPPORTING MACROECONOMIC STABILITY THROUGH FISCAL AND DEBT SUSTAINABILITY

11. **The government remains committed to maintaining fiscal and debt sustainability to support sustainable growth and poverty reduction.** With prospects of oil production now very low, fiscal policy will continue to entrench fiscal consolidation to anchor debt sustainability, while at the same time creating space for the much-needed growth-enhancing spending and social priorities. This will require aggressive domestic revenue mobilization and reforms to improve the effectiveness of public spending. Accordingly, the government will aim to reduce the domestic primary fiscal balance to the 1.5 percent target by 2018 while keeping the overall fiscal balance (including project grants, sectoral budgetary support, and capital expenditure financed from external resources) at a level compatible with public debt sustainability.

12. **For 2015–18, the key macroeconomic objectives will be to:** (i) strengthen domestic revenue mobilization and expenditure rationalization to restore fiscal discipline and reduce the risk of debt distress; (ii) improve the business environment to diversify the economy and boost growth; (iii) maintain financial sector stability; and (iv) enhance the capacity of key government institutions, inter alia, by more actively seeking technical assistance (TA). Achieving these outcomes will require fiscal reforms to enhance domestic revenue mobilization to create space for increased capital spending and improved public financial management, financial sector reforms to improve the sector's role in facilitating private sector led growth, agricultural sector modernization and other targeted reforms designed to improve the business climate, external competitiveness and promote private investment to broaden the export base.

FISCAL POLICY

13. **The 2015 budget was designed to restore the thrust of the fiscal stance under the original ECF-supported program** by redressing the budgetary slippages incurred in 2014, in particular, poor tax collection, rising personnel costs, and a net increase in arrears.

14. **Social spending in 2015 and the medium-term will however, be safeguarded.** Budget alignment with the government's PRSP-II remains critical for further progress

towards the MDGs. The government is committed to increasing social spending (indicative target) from the levels of 2014 (Table 3).

15. **In line with these commitments, the government proposes the following medium-term (2015-18) fiscal framework:**

- The domestic primary deficit is targeted at 2.7 percent of GDP (performance criterion) in 2015 and will be reduced to 1.5 percent of GDP by 2018.
- Tax revenues are targeted at 15 percent of GDP in 2015 and the government will seek to raise them by a cumulative 1.5 percent of GDP to 16½ percent of GDP by 2018. To that effect, and drawing on TA recommendations, the government will take the necessary measures to improve tax administration and mobilize new revenue sources.
- Personnel costs will be scaled back to their historical average of 8.5 percent of GDP over the program period. For 2015, the government envisages a reduction in personnel costs of 0.3 percentage points of GDP relative to 2014 by foregoing the annual general salary increase and preventing unbudgeted non-wage remunerations, namely on overtime and cost allowances.
- Spending on goods and services, which has been compressed in recent years to make up for overruns in other expenditure categories, will be capped at 3.2 percent of GDP.
- Transfers are set to increase by 29 percent in 2015 to address pressing social needs and the decentralization of government functions, but are expected to slow-down over the program period.
- To boost the development of the domestic treasury bill market, the government plans its first issue of treasury bills in 2015 in an amount to be capped at 75 billion dobra, which could be drawn on to finance the budget in case of delays and/or shortfalls in donor financing. Apart from this contingency, the government will not resort to domestic bank financing other than drawing on its 2015 access level from the National Oil Account.
- The government has prepared and submitted to the Fund a comprehensive plan (prior action) to clear the longstanding domestic arrears which continues to serve as a drag on fiscal consolidation.

16. **Budget support in the amount of US$ 10 million has been identified for 2015 in the form of grants.** On the basis of current trends, an additional US$ 30.6 million could be expected in 2016–18. Further budget support for 2016–18 and for stepping up public investment and social programs would be firmed up at a donors' conference to be co-organized with the UNDP in São Tomé in September 2015.

17. **Angola loan. The bulk of first tranche of the Angola loan (US$17 million), disbursed in March 2014, was used to finance public investment projects.**
About US$4.3 million was however, used as budget support to close shortfalls in donor

support. The second tranche of US$17 million was disbursed in March 2015 and earmarked to support the government's public investment projects.

MONETARY POLICY AND FINANCIAL SECTOR REFORMS

18. **Monetary policy will continue to be anchored by the dobra peg with the Euro,** which has enabled the government to reduce inflation, and maintain a stable exchange rate and a reasonable level of foreign exchange reserves. Broad money growth is projected to moderate only slightly to 14.7 percent in 2015 in line with declining inflation objective under the peg. The BCSTP is seeking to reverse the fall in credit to the private sector by reducing minimum required reserves on local currency deposits to 15 percent for banks with intermediation rate greater than 80 percent.

19. **Liquidity management remains a key priority.** The BCSTP has introduced an interbank money market and open market operations (OMO) to effectively manage the growing excess liquidity. In addition, a deposit standing facility will be introduced, by end-June 2016, as an interim measure to passively manage excess liquidity in the banking system.

20. **The banking sector is under some stress but the government is introducing measures to safeguard financial stability.** A sound and more inclusive financial sector is indispensable to keeping São Tomé and Príncipe on the path to sustainable growth. In that context, the government will prepare by end-June 2016, in consultation with the Fund (MCM), an analysis of the causes for the relatively large amount of past due and nonperforming loans (NPLs) on the banks' balance sheets, and a comprehensive strategy to help banks deal with such NPLs (end-June 2016 structural benchmark).

21. **The government has stepped up its enforcement of prudential requirements.** On January 27, 2015, the Banco Central de São Tomé e Príncipe (BCSTP) intervened in Angolan-owned Banco Equador that had, since 2013, failed to meet the minimum required risk-weighted capital ratio of 12 percent and saw its NPLs rise to 43 percent in 2014. The bank failed to recapitalize by the April 27, 2015 deadline, and the intervention period was extended till mid-August 2015. In the meantime, the BCSTP, with the help of IMF TA, has drafted a new Bank Resolution Law to be submitted to the National Assembly before end-September 2015 (structural benchmark). In addition three banks have been directed to raise their capitals above the minimum required to operate a bank by end-December 2015. The BCSTP will put in place a comprehensive plan to help banks deal with high NPLs on their balance sheet by end-June 2016 (structural benchmark). Onsite inspections of all banks have been achieved with the completed inspection of the last bank in May 2015.

22. **Going forward, the BCSTP will continue to strengthen its oversight of all commercial banks.** The BCSTP will take other steps to strengthen banking supervision with a view to detect and deal with any persisting weaknesses in the system. It is our intention to conduct, with the help of IMF, a detailed assessment of banks compliance with Basel Core Principles by end-December 2016 (structural benchmark). Plans are advanced to revise the legal and regulatory frameworks to enhance the mandate of the BCSTP. Revised Central Banking and Financial Institutions Laws will be submitted to the National Assembly by end-

December 2015. These laws are expected to comprehensively fill a number of gaps in the existing legislation some of which are partially being filled by generally applicable regulations.

STRUCTURAL REFORMS

23. **The government is committed to mobilizing domestic resources to support the much-needed growth enhancing spending.** The government's immediate priority in 2015 is to prevent the tax collection shortfalls verified in 2014 and in the first half of 2015, in particular, the unpaid duties on fuel imports by ENCO (estimated at about 1.2 percent of GDP. With the conclusion of the arrears clearance plan in June 2015, ENCO is expected to resume full payment of customs duties, which should yield the additional 1 percent of GDP in revenues envisaged for 2015 and 2016.

24. **In addition, the following measures will be introduced to increase domestic revenue from 2016:**

- The government has concluded the "Operation Taxpayer Inclusion" survey in all of São Tomé's districts and in the Autonomous Region of Príncipe, yielding 16,000 new taxpayers. The survey is yet to be completed in the autonomous region of Príncipe. As a follow up to the "Operation Taxpayer Inclusion", the government will be introducing the minimum tax value in the 2016 budget. This will help to broaden the tax base and permanently increase the tax revenue.

- The government will finalize a tax maximization plan (being developed under the BAD's PAGEF credit operation) in time to incorporate eventual measures in the 2016 budget.

- The government has already started discussions to prepare the grounds for the introduction of Value Added Tax (VAT) by unifying the ISCPL and ISCSP taxes. The government is seeking technical assistance from the Fund to help with the design and introduction of the VAT later during the program period.

25. **Domestic arrears clearance.** As at end-March 2015, claims by ENCO (due to implicit fuel subsidy) and domestic suppliers put the stock of government domestic arrears at 1.352 billion dobra (15.9 percent of GDP). The bulk of these arrears, about 944 billion dobra are claimed by ENCO from the government on account of keeping pump prices below import and distribution costs since 2011. The balance corresponds to 148 billion in outstanding utilities and communications bills and 50 billion owed to other domestic suppliers for debts outstanding since before 2012. The government has however, started paying off arrears to suppliers in line with understandings with the suppliers. There is also an additional claim by ENCO of 842 billion in arrears (12 percent of GDP) owed by state-enterprise EMAE on account of unpaid bunker oil deliveries. As a result, ENCO has since 2014 stopped paying import duties and fuel taxes due to the government. A ministerial team put together by the government has prepared a comprehensive plan (prior action) to address the domestic arrears problem. The team will also audit and confirm these arrears and negotiate to seek concessions from creditors, support from donors, and provide a timetable for clearing arrears accordingly. The government will revise the macroeconomic

framework to reflect the outcome of the auditing and negotiation of the stock of arrears at the time of the first review of the program.

26. **Removal of fuel price differential and introduction of automatic price adjustment.** The recent fall in international oil prices presents a timely opportunity to end the cost-price differential. Starting April 2015, the cost of imported fuel products had fallen sufficiently to restore, at current pump price levels, full cost recovery for the importer and tax collections for the government. With petroleum prices currently aligned with cost, the government is committed to maintaining future prices to be in line with cost recovery while the government designs and establishes an automatic price adjustment mechanism by end-June, 2016 (structural benchmark). The government however, will implement this by assessing the social consequences of higher pump prices on the poorest with a view to providing a safety mechanism targeted at the poor and vulnerable.

27. **Reforming EMAE.** The government is receiving assistance from the World Bank to address structural problems at EMAE to ensure full cost recovery for electricity and water prices and in generating cash-flow to finance grid network repairs and upgrades. To that effect, the government will introduce a restructuring plan by end-December 2016 (structural benchmark).

28. **In the meantime, the government will introduce "quick fix" measures to improve efficiency at EMAE.** Overdue measures will be taken to address some of the most pressing problems of EMAE. The government will prepare adequate legislation to address the widespread loss through illegal connections of electricity and water. The government will also support EMAE to install water meters to increase its revenues and prevent wasteful usage at flat-rates.

STRENGTHENING PUBLIC FINANCIAL MANAGEMENT

29. **Public financial management** (PFM). Attempts to improve and modernize PFM since 2012 have hinged on the adoption of a new, donor-recommended, information management system—SAFEe—that was custom-designed for São Tomé and Príncipe but has yet to be fully operational. Its pilot stage of implementation has covered four ministries but it fell short of the initial objective of consolidating and producing the 2012 budget execution results. As remaining information processing and security issues are addressed, the government intends to use it to produce the 2013 and 2014 final accounts and to extend the SAFEe system to all remaining government ministries and agencies starting with the 2016 budget.

30. **Expenditure control.** In addition to SAFEe's enhanced monitoring capabilities, tighter expenditure control procedures will be introduced to ensure that non-budgeted expenditures do not take place, in particular as regards non-wage personnel costs such as overtime and expense allowances that have in the last few years been exceeding annually budgeted amounts.

31. **Medium-term fiscal framework.** The government will, by end–2016, take actions to fully implement a move comprehensive medium-term fiscal framework, by consolidating the

current framework. Furthermore, if necessary, the government will seek Fund FAD TA and a training workshop, during which key steps for developing such framework will be put in place.

32. **Debt Management.** The government will continue to strengthen debt management, including by improving reporting and debt service forecasts. Prospective new loans will be carefully assessed in terms of their debt sustainability implications prior to their contracting.

IMPROVING THE BUSINESS ENVIRONMENT FOR EXPORT DIVERSIFICATION AND PRIVATE SECTOR DEVELOPMENT

33. **Business environment.** The government will seek to boost private sector investment and exports trade by improving the business climate through greater trade facilitation, stronger property and investor rights, easier access to credit, simplified payment of taxes and reduction of administrative bureaucracy in general. The successful setting up in 2011 of a one-stop-shop that reduced costs and paperwork for foreign investors was complemented in 2014 by the launching of another one-stop shop for foreign trade that will support national producers' efforts in accessing foreign markets.

34. **Export diversification.** Accelerating and sustaining economic growth in São Tomé and Príncipe at levels that will structurally reduce unemployment and improve social conditions will only be possible by taking advantage of the potential to expand production to export markets. To that effect, the government will develop and submit to the National Assembly, a national export diversification strategy and action plan (end-December 2016 structural benchmark), targeting the tourism sector and high-value horticultural production, that are recognized as having the greatest potential.

35. **Revamp the functioning of credit reference bureau.** The BCSTP launched the Central de Risco de Crédito (CRC) in 2011 to provide a sound and comprehensive credit reporting to support the assessment and pricing of risks. However, the potential of the CRC has largely been tapped due to the imperfect coverage and data quality. The BCSTP will be investing in additional resources (both human and infrastructure) to extend its coverage and enhance its usage. Going forward, the BCSTP will strictly enforce the requirement that reporting financial institutions provide relevant, accurate, complete, and timely information to the CRC and apply sanctions when breached.

36. **Addressing challenges in the judiciary system to enhance enforcement of collateral.** The government will prepare an action plan of legal reforms with a view to making the domestic judiciary system more expedite and predictable as regards contracts' enforcement and execution of guarantees.

BORROWING OPTIONS

37. **Investment priorities.** Despite recent gains with cocoa exports and tourism receipts, São Tomé and Príncipe remains at high risk of debt distress and the government will continue to pursue policies consistent with debt sustainability. The 2012–15 ECF-supported programs maintained a cautious fiscal stance under the assumption that oil revenue over

the medium term would come on stream to support social and infrastructure needs. But with oil production now unlikely for many years, there is the need to explore options to create space to support the government public investment program.

38. **External borrowing constraints.** The government's 2015–18 programs makes room for some additional concessional borrowing of an average of 6.6 percent of GDP annually over the three year ECF program, at a lower concessionality threshold of 35 percent in line with other LICs. Such reduction appears warranted by the current global low interest rates environment that has narrowed the differential between concessional and non-concessional rates. The Fund staff's DSA exercise suggests that there is room for the additional borrowing and for reducing the grant element from 50 to 35 percent without significantly changing the debt sustainability dynamics.

39. **Strengthening debt management capacity.** The government is updating the medium-term debt management strategy which is expected to be submitted to cabinet for approval by end-June 2016. This updated strategy is critical to support the government's debt reduction objective in the program.

STATISTICS

40. **The government will continue to make progress to strengthen the statistical system.** The National Statistics Institute (INE) is taking steps, with the help of TA from the Fund and donors, to improve the CPI and the national accounts. The household survey completed in 2011 will provide the basis for reweighting the CPI components and introducing new goods and services to its basket. By end-December 2015, the government will start monthly compilation of the new CPI and will publish the revised national accounts series (structural benchmarks).

PROGRAM MONITORING

41. The program will be evaluated based on quantitative performance criteria and structural benchmarks (Tables 3 and 4 in attachment I), and semi-annual reviews. Definitions of key concepts and indicators, as well as reporting requirements, are set out in the accompanying Technical Memorandum of Understandings (TMU). The first, second, and third reviews are scheduled to be completed on or after April 15, 2016, October 15, 2016, and April 15, 2017 respectively, based on test dates for periodic PCs of end-December 2015, end-June 2016, and end-December 2016 respectively.

Table 1. 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	Indicative Targets w/adjustment	Actual	Performance Criteria[1]	Performance Criteria w/adjustment	Actual	Status	Indicative Target	Indicative Targets w/adjustment	Actual	Performance Criteria[1]	Performance Criteria w/adjustment	Actual	Status
	31-Mar-14	31-Mar-14	31-Mar-14	30-Jun-14	30-Jun-14	30-Jun-14	30-Jun-14	30-Sep-14	30-Sep-14	30-Sep-14	31-Dec-14	31-Dec-14	31-Dec-14	31-Dec-14
Performance criteria:														
Floor on domestic primary balance (as defined in the TMU)[2]	-50	-86	-79	-119	-169	-165	Not Met	-159	-159	-167	-198	-198	-210	Not Met
Ceiling on changes in net bank financing of the central government (at program exchange rate)[3, 4, 5]	0	18	-15	0	-56	-129	Met	0	-56	-54	0	-56	-9	Not Met
Floor on net international reserves of the central bank (US$ millions)[2, 4]	27.50	26.55	47.04	27.50	30.50	55.56	Met	27.50	30.50	49.76	27.50	30.50	50.88	Met
Ceiling on central government's outstanding external payment arrears (stock, US$ millions)[5, 6, 7, 8]	0	...	0	0	...	0	Met	0	...	0	0	...	0	Met
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	...	40	0	...	40	Not Met	0	...	40	0	...	40	Not Met
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	Met	0	...	0	0	...	0	Met
Indicative targets:														
Ceiling on central government's outstanding domestic arrears (stock)	0	...	90	0	...	129	Not Met	0	...	75	0	...	129	Not Met
Ceiling on central government's outstanding arrears to EMAE (stock)	0	...	-5	0	...	18	Not Met	0	...	56	0	...	71	Not Met
Ceiling on dobra base money (stock)	954	...	757	1,030	...	868	Met	1,071	...	886	1,145	...	971	Met
Floor on pro-poor expenditures	110	...	n.a	219	...	n.a	Unknown	329	...	n.a	438	...	n.a	Unknown
Memorandum items:														
Transfer from NOA to the budget (US$ millions)	2.5	...	0.0	2.5	...	0.0		2.5	...	0.0	2.5	...	2.4	
Net external debt service payments[11]	24	...	48	59	...	86		97	...	23	139	...	160	
Official external program support[11]	0	...	36	36	...	152		172	...	0	246	...	183	
Treasury-funded capital expenditure	28	...	6	72	...	33		102	...	43	111	...	58	

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

[1] Performance at the December 2013, June 2014, and December 2014 test dates are assessed on the third, 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, 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, 2013–14

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

Category	Structural Benchmarks	Economic rationale	Original timeframe	Revised or set at 2nd review timeframe	Implementation Status
	Strengthening Public Finances				
External control	***i. Strengthen external control by:***	Strengthen PFM			
	Preparing the general government accounts for 2012 and sending them to the Court of Audit.		End-June. 2013	End-Dec. 2013	Not met. Implemented January 2015
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	End-Mar. 2014	Not met
	Eliminating all arrears between the Treasury and EMAE.		End-Dec. 2013	Not revised	Not met
Tax administration	***iii. Improve taxpayer management and compliance with tax obligations by:***	Strengthen revenue administration			
	Enhancing the security of the Taxpayer Registry, creating a dedicated large taxpayer unit, and creating a single taxpayer computerized file system.		End-Dec. 2013	Not revised	Not met.
	iv. 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.		Set at 2nd review only	End-Jun. 2014	Met
	Registering 800 new tax payers from the date of the program's launch.		Set at 2nd review only	End-Dec. 2014	Met
Customs administration	***v. Complete the second phase of ASYCUDA WORLD implementation by:***	Strengthen revenue administration			
	Activating all the functionalities and the establishing a fully computerized procedure for customs clearance.		End-Dec. 2013	Deemed "On-going"	Met
	vi. 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.		Set at 2nd review only	End-Jun. 2014	Met
	Eliminating hardcopy documents and introducing electronic signing and approval of documents.		Set at 2nd review only	End-Dec. 2014	Met
	Enhancing Monetary Management and Financial Stability				
Bank supervision	***vii. Strengthen banking supervision and regulation by:***	Ensure financial stability and transparency and enhance the effectiveness of			Met
	Completing the on-site supervision process for the largest commercial bank.		End-June 2013		Met
	Ensuring that all commercial banks that are open to the public have a capital-to-risk-weighted-asset ratio of at least 12 percent.		End-Mar. 2014	End-June 2014	Not met.
	Completing the on-site supervision process for the remaining two commercial banks.			End-June 2014	Not met. Implemented May 2015.
	Ensuring that all commercial banks publish audited financial accounts for 2013, or applying penalties for non-compliance.			End-Sep. 2014	Met
	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.			End-Sep. 2014	Not met
	Statistics				
CPI Statistics	***viii. Improve consumer price index statistics by:***	Strengthen statistical system			
	Reweighting the CPI components and introducing new goods and services to the CPI basket.		End-Dec. 2013	Deemed "On-going"	Not met

Table 3. São Tomé and Príncipe: Proposed Performance Criteria and Indicative Targets for 2015–16

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

	2015		2016			
	September	December	March	June	September	December
	Indicative Target	Performance Criteria [1]	Indicative Target	Performance Criteria [1]	Indicative Target	Performance Criteria [1]
	30-Sep-15	31-Dec-15	31-Mar-16	30-Jun-16	30-Sep-16	31-Dec-16
Performance criteria:						
Floor on domestic primary balance (as defined in the TMU) [2]	-153	-190	-23	-54	-100	-154
Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	0	0	0	0	0	0
Floor on net international reserves of the central bank (US$ millions) [2, 4]	50	50	62	62	62	62
Ceiling on central government's outstanding external payment arrears (stock, US$ millions) [5, 6, 7, 8]	0	0	0	0	0	0
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]	0	0	0	0	0	0
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]	0	0	0	0	0	0
Indicative targets:						
Ceiling on change of central government's new domestic arrears	0	0	0	0	0	0
Ceiling on dobra base money (stock)	990	1,113	1,062	1,085	1,052	1,237
Floor on pro-poor expenditures	357	447	168	289	409	481
Floor on tax revenue	732	1,073	181	422	783	1,209
Memorandum items:						
New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the BCSTP (US$ millions) [5, 7, 8, 10, 12]	19	35	14	14	14	14
Transfer from NOA to the budget (US$ millions)	2.0	2.0	1.6	1.6	1.6	1.6
Net external debt service payments [11]	106	143	18	43	81	125
Official external program support [11]	192	220	20	47	88	219
Treasury-funded capital expenditure	48	63	12	28	50	78

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

[1] Performance at the December 2015 test date is assessed on the first review and the June and December 2016 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 "central 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 or memo item 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, ¶ 4 and 14.

[9] Only applies to debt with a grant element of less than 35 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, ¶ 20.

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

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

[12] Cumulative from December 2014 and December 2015 respectively.

Table 4. São Tomé and Príncipe: Prior Action and Structural Benchmarks Under the Proposed ECF-Supported Program

Policy Objectives and Measures	Timing	Macro Rationale	TA involved
Strengthening Public Finances			
Prepare, in consultation with ENCO and EMAE, and submit to the Fund, a comprehensive plan with a clear timeline to regularize all arrears outstanding and prevent the accumulation of new ones.	Prior action	To restore timely financial flows between all parties concerned, in particular the timely payment of all applicable taxes.	Team worked with authorities.
Adopt an automatic fuel price adjustment mechanism that allows timely pass-through of import costs with a view to its gradual introduction in 2016.	End-June 2016	To remove implicit fuel price subsidies and loss of fiscal revenues.	TA to be sought on design of automatic price adjustment mechanism.
Adopt a plan to reform EMAE (state-owned electricity and water utilities company) to ensure full cost-recovery.	End-December 2016	To support arrears clearance plan	With World Bank and EU support
Enhancing Financial Stability			
Submit to the National Assembly a new Bank Resolution Law.	End-September 2015	To improve soundness of financial system	Forthcoming MCM TA
Complete detailed assessment of compliance with Basel Core Principles.	End-December 2016	To improve soundness of financial system	Forthcoming MCM TA
Prepare and submit to staff a comprehensive strategy to help banks deal with high NPLs on their balance sheets.	Ecd-June 2016	To support financial sector stability and growth	Forthcoming MCM TA
Improving National Statistics			
Start monthly compilation of the new reweighted and expanded CPI series.	End-December 2015	To make available more representative statistics for policy evaluation and design.	Ongoing AfDB TA
Publish revised national accounts series through 2013.	End-December 2015		Ongoing STA TA
Facilitating Business Activities			
Develop and submit to the National Assembly a National Export Diversification Strategy document.	End-December 2016	To promote economic diversification and employment opportunities	TA yet to be identified by authorities

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) contains definitions and adjuster mechanisms that clarify the measurement of quantitative performance criteria and indicative targets in Table 3, which are attached to the Memorandum of Economic and Financial Policies for 2015 and 2016. Unless otherwise specified, all quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from the beginning of each calendar year.

2. **The program exchange rate** for the purposes of this TMU[1] will be 20,299 dobra per U.S. dollar, 24,500 dobra per euro, and 29,236 dobra per SDR for both 2015 and 2016.

PROVISION OF DATA TO THE FUND

3. Data with respect to all variables subject to performance criteria and indicative targets will be provided to Fund staff on the frequency described below (paragraph 27) with a lag of no more than four weeks for data on net international reserves of the Central Bank of São Tomé and Príncipe (BCSTP) and six weeks for other data. The authorities will transmit promptly to Fund staff any data revisions. For variables that are relevant for assessing performance against program objectives but are not specifically defined in this memorandum, the authorities will consult with Fund staff as needed on the appropriate way of measuring and reporting. Performance criteria included in the program are defined below and refer to the floor on domestic primary balance; the ceiling on changes in net bank financing of the central government; the floor on net international reserves of the central bank; the ceiling on central government's outstanding external payments arrears; the 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; and the 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.

DEFINITIONS

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

5. **Central government** is defined for the purposes of this TMU to comprise 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.

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

6. **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.

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

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

9. **PERFORMANCE CRITERIA**

10. **Performance criterion on the floor on domestic primary balance.**
This performance criterion refers to the difference between government domestic revenue (excluding oil revenue) and domestic primary expenditure. For reference, this balance for end-December 2014 was 210 billion dobra, broken down as follows:

	Government domestic revenue:	973 billion
Less:	Government primary expenditure:	
	(As defined in paragraph 8)	<u>1,184 billion</u>
Equals:	Domestic primary balance:	210 billion

11. **Performance criterion on the ceiling on changes in net bank financing of the central government (NCG).** This performance criterion measures the increase (decrease) in 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 2014, outstanding net bank financing of the central government (excluding NOA) was -9 billion dobra, broken down as follows:

	BCSTP credit, including use of IMF resources:		255 billion
Less:	Government deposits with the BCSTP (excluding NOA)		140 billion
	Of which:	Treasury dobra-denominated accounts	18 billion
		Treasury foreign currency-denominated accounts	29 billion
		Counterpart deposits	93 billion
Equals:	Net credit to government by the BCSTP		116 billion
Plus:	ODC's credit to the government		3 billion
Less:	Government deposits with ODCs (including counterpart funds)		127 billion
Equals:	Net bank financing of the government (excluding NOA)		-9 billion

12. **Performance criterion on the floor on net international reserves (NIR) of the BCSTP.** The NIR of the BCSTP are defined for program-monitoring purposes as short-term (i.e., original maturities of one year or less), tradable foreign assets of the BCSTP minus short-term external liabilities, including liabilities to the IMF. All short-term foreign assets that are not fully convertible external assets nor readily available to and controlled by the BCSTP (i.e., they are pledged or otherwise encumbered external assets, including but not limited to the HIPC umbrella SDR account and assets used as collateral or guarantees for third-party liabilities) will be excluded from the definition of NIR. Securities whose market value on the last day of the year differs by over 20 percent from their original nominal issue price will be assessed at their market value as reported by the BCSTP's Markets Department. The balance of (1) NOA at the BCSTP, (2) banks' deposits related to capital or licensing requirements, and (3) banks' reserves denominated in foreign currency are excluded from the program definition of NIR. All values are to be converted to U.S. dollars at the actual mid-point market exchange rates prevailing at the test date. For reference, at end-December 2014 NIR was 999 billion dobra, calculated as follows:

Gross international reserves:				1,282 billion
	Of which:	Cash		28 billion
		Demand deposits		129 billion
		Term deposits (including banks' deposits in foreign currency)		692 billion
		Securities other than shares		412 billion
		Of which:	Portuguese Treasury bonds	100 billion
			Rede Ferroviaria Nacional bonds	123 billion
			Mortgage-backed securities of CDG	189 billion
		Accrued interest on securities		8 billion
		Reserve position in the Fund		0 billion
		SDR holdings		14 billion
Less:	Short-term liabilities (including liabilities to the IMF)			116 billion
Less:	Banks' reserves denominated in foreign currency			165 billion
Less:	Banks' guaranteed deposits denominated in foreign currency			2 billion
Equals:	Net international reserves			999 billion
Plus:	Other foreign assets			313 billion
Less:	Medium and long-term liabilities (including SDR allocation)			207 billion

Equals: Net foreign assets	1,104 billion
Memorandum item: National Oil Account (NOA)	200 billion

13. **Performance criterion on the 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.** This performance criterion refers to the outstanding stock of external debt with an original maturity of one year or less ("short-term debt") (including overdraft positions but excluding normal import credits) owed or guaranteed by the government and/or the BCSTP. 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 calendar year will be excluded from this ceiling. However, outstanding balances at the end of a given calendar year will be included in the assessment of compliance with this performance criterion. For reference, at end-December 2014 the stock of short-term external debt was zero.

14. **Performance criterion on the 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.** This is a continuous performance criterion that refers to the contracting or guaranteeing of new external debt with original maturity of more than one year ("medium- or long-term debt") by the government and/or the BCSTP. Debt is considered nonconcessional if it includes a grant element less than 35 percent. The grant element is the difference between the nominal value of the loan and its net present value, expressed as a percentage of the nominal value. The net present value of the debt at the date on which it is contracted is calculated by discounting the debt service payments at the time of the contracting of the debt. The discount rate used for this purpose is 5 percent. This performance criterion does not apply to IMF facilities. Debt being rescheduled or restructured is excluded from this ceiling. Medium- and long-term debt will be reported by the Debt Management Department of the Ministry of Finance and Public Administration (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.

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

INDICATIVE TARGETS

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

17. **Ceiling on dobra base money** is set on the sum of currency issued—which consists of currency outside depository corporations and cash in vaults—and banks reserves denominated in 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 2014 dobra base money was 971 billion dobra, calculated as follows:

	Currency issued:		267 billion
	Of which:	Cash in vaults	44 billion
		Currency outside depository corporations	222 billion
Plus:	Bank reserves denominated in dobra		<u>704 billion</u>
Equals:	Dobra base money		971 billion

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

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

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

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

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

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

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

MEMORANDUM ITEMS

20. **New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the BCSTP** measures such debt with a grant element of at least 35 percent.

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

22. **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.

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

USE OF ADJUSTERS

24. **The performance criterion on the domestic primary balance will have one adjuster.** The limit on the domestic primary balance will be adjusted upward if the government finds budget support and privatization receipts in 2015 and 2016 in addition to that described in the MEFP; this adjuster will be capped at 62 billion dobra (about 1 percent of 2014 GDP) for 2015 and 2016.[2]

25. **The performance criteria on net bank financing of the central government and net international reserves of the central bank will be** adjusted in line with 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 2014 or end-December 2015, as appropriate (MEFP, Table 3). The following is an explanation of these adjustments:

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

- 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 2014 or end-December 2015, 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 2014 or end-December 2015, 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 all adjusters at any test date is capped in such a way that the adjusted floor does not fall short of US$47 million in 2015 and US$59 million in 2016.

DATA REPORTING

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

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

    - Monthly data on central government operations for revenues, expenditure, and financing, including detailed description of net earmarked resources (*recursos consignados*), on commitment (*compromisso*) and cash payments (*caixa*);

    - Monthly data on net credit to the government by the BCSTP, recorded account by account in a format fully compatible with the monetary accounts of the BCSTP;

    - Monthly detailed data on tax and nontax revenues;

    - Monthly detailed data on domestically financed capital expenditure on commitment (*compromisso*) and cash payments (*caixa*);

    - Monthly data on domestic arrears by type and by creditor;

- Quarterly data on implicit arrears to ENCO on account of fuel retail prices eventually not covering import costs, distribution margins and applicable taxes.
- Quarterly data on EMAE's arrears to ENCO.
- Monthly data on official external program support (non-project);
- Quarterly data on the execution of the public investment program (PIP) by project and sources of financing;
- Quarterly data on the execution of Treasury-funded capital expenditure by project type, amount, timetable of execution, and progress of execution;
- Quarterly data on project grant and loan disbursement (HIPC and non-HIPC);
- Quarterly data on bilateral HIPC debt relief;
- Latest outstanding petroleum price structures and submission of new pricing structures (within a week of becoming available).

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 Directorate of Treasury at the Ministry of Finance and Public Administration 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.

- Annual data on future borrowing plans.

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

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

- Monthly data on imports (value of imports, import taxes collected, and arrears) and commodity export values, provided by the Customs Directorate at the Ministry of Finance and Public Administration , 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.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND CANCELLATION OF THE CURRENT ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS[1]

June 24, 2015

Approved By
David Owen and Chris Lane (IMF) and Mark Roland Thomas and John Panzer (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 joint Bank-IMF low-income country debt sustainability analysis (DSA). Despite the significant upward revision of exports in 2013–14, the assessment of high risk of debt distress is unchanged from the DSA completed in June 2014. The PV of external debt-to-exports ratio, however, is now projected to fall significantly and to breach the country specific indicative thresholds for a shorter period of time while the debt service-to exports ratio no longer breaches the threshold. Like in the previous DSA, the PV of debt-to-GDP and the PV of debt to-revenues ratios are above their thresholds early in the projection period partly because of a large nominal depreciation (a cumulative 21 percent since 2013) of the national currency relative to dollar. Public debt indicators worsened compared to the previous DSA, but it does not fundamentally alter the assessment of São Tomé and Principe's debt sustainability. Reaching a projected debt profile that is consistent with manageable – if high risk – debt dynamics would require continued fiscal consolidation efforts, enhance credibility of the exchange rate peg, continued heavy reliance on grants and concessional lending, and further efforts to diversify the economy and expand the export base over the medium term.

[1] The DSA update 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 June 30, 2014. The DSA follows the IMF and World Bank Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries (November 5, 2013). The DSA uses the unified discount rate of 5 percent set out in Decision No 15462 (October 11, 2013). For the purpose of defining debt burden thresholds under the DSF, São Tomé and Príncipe is classified as a weak policy performer. São Tomé and Príncipe's rating on the World Bank's Country Policy and Institutional Assessment (CPIA) is 3.05.

BACKGROUND

1. The previous full DSA for São Tomé and Príncipe was undertaken as part of the 2013 Article IV consultation and the second review under the Extended Credit Facility.[2] An updated DSA was subsequently completed in June 30 2014 following the contracting of a $40 million non-concessional line of credit from Angola. Both DSAs concluded that São Tomé and Príncipe was at a high risk of debt distress, however, the current DSA shows a slightly lower future 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. Total public debt, including domestic arrears to suppliers is estimated at 74.5 percent of GDP ($254 million) in 2014, with medium- and long-term public and publicly guaranteed external debt accounting for 68 percent of GDP ($233 million)(Table 1).[3] The external debt burden increased from $216 million at end-2013 to $233 million in 2014 (due to disbursements of Angolan loan) 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 19 percent. Angola is now the country's main bilateral creditor, and IDA is its main multilateral creditor. On the domestic front, payments arrears amounting to 6 percent of GDP ($21 million) were accumulated largely vis-à- vis suppliers.[4]

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

(As of end-December 2014)

	Million USD	Share
Multilateral Creditors	43.4	17%
IDA	14.0	6%
FIDA	7.8	3%
BADEA	7.1	3%
IMF	4.6	2%
OPEC	4.0	2%
AfDB	5.4	2%
EIB	0.3	0%
Bilateral Creditors	189.6	75%
Portugal	47.5	19%
Angola [1]	52.4	21%
Nigeria [1, 2]	30.0	12%
Italy [1, 3]	24.3	10%
China [1]	18.8	7%
Yugoslavia [1]	8.8	3%
Brazil [1, 3]	4.3	2%
Belgium	1.4	1%
Equatorial Guinea	2.1	1%
Domestic Arrears	21.0	8%
Total	253.9	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.

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[2] IMF (2013), Country Report for São Tomé and Príncipe 14/2.

[3] $77 million of this debt consists of technical arrears (including accrued interest) to Italy ($24 million), Angola ($25 million), People's Republic of China ($19 million), and former-Yugoslavia ($9 million). The arrears to former-Yugoslavia resulted from a debt guaranteed by Angola which Serbia inherited and has sold to a private entity. The private entity has sued Angola over the debt which is now being treated as part of arrears to Angola. Arrears to Angola are under discussions, there's expectation that they could receive treatment comparable to Paris Club. China has not responded to authorities' letter requesting comparable treatment to Paris Club. Arrears to Italy are a result of a commercial debt that Sao Tome and Principe does not recognize.

[4] 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.

MACROECONOMIC ASSUMPTIONS

4. The main assumptions in the baseline scenario for 2015–35 have changed very little from last year's DSA update. The main difference with the last DSA are the result of a significant decline in the value of projected imports in 2015 due to low prices of oil and non fuel commodities, a large base increase in 2013–14 exports of goods and services due to strong production and the high price of cocoa and also on account of improved data coverage of exports of services. These have resulted in a slightly more improved long run current account deficit. **The key assumptions are:**

- While ***growth assumptions have remained similar to the last DSA,*** the sources of financing have shifted towards non-debt creating flows with higher FDI inflows now projected relative to the previous DSA. Growth pick up to 5 percent in 2015 and 5½ percent in 2016. Over the long-term, growth is projected to be sustained at around 5.6 percent per year, similar to the historical norm and unchanged from the growth assumption under the baseline scenario of the last 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.

- Average annual ***inflation declines*** from 7 percent in 2014 to 5.8 percent in 2015 and further to around 4.6 percent in 2016. 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 in 2015 is projected to contract by 6.1 percent. It will however pickup to around 3 percent in 2016 before settling at around 1.7 percent over the long term.

Text Table 2. Key Macroeconomic Assumptions (averages)

	EBS/13/148	June 2014 DSA	2015 DSA	
	2013-2033	2014-2034	2014-2034	2015-2035
Real GDP Growth (%)	5.55	5.62	5.51	5.56
Inflation (average)	3.56	3.30	3.42	3.23
Domestic Primary Deficit (% of GDP)	-1.14	-1.09	-1.41	-1.30
Grants (% of GDP)	2.06	1.94	2.48	2.51
New Borrowing (% of GDP)	2.41	1.95	1.76	1.53
FDI (% of GDP)	7.17	7.40	9.53	9.72
US$ Export growth (%)	9.34	9.39	10.67	7.16
US$ Import Growth (%)	5.99	6.34	6.91	6.00
Current Account Balance, excluding grants (% of GDP)	-23.41	-22.58	-25.79	-24.99
Current Accout Balance, including grants (% of GDP)	-11.51	-10.77	-13.40	-12.66

Sources: Authorities data and IMF staff estimates.

- ***A steady decline in the domestic primary deficit*** from 3.5 percent of GDP in 2014 to 1.5 percent of GDP by 2018 consistent with available non-debt creating financing while at the same time creating space for scaled-up capital spending. Any financing needs are assumed to be met via a drawdown of National Oil Account (NOA) deposits and budget support grants. The fiscal adjustment in the medium-term would come mainly through measures to enhance revenue mobilization and control personnel expenditure. Over the long-term, expenditure bears the brunt of adjustment in proportion to drop in grants. No domestic borrowing is envisaged.

- ***Total grants are projected to increase*** from their current level of about 10 percent of GDP in 2014 to an average of 16.4 percent of GDP a year in 2015–18. After peaking at over 17 percent of GDP in 2019, grants will decline in importance and average around 10 percent of GDP a year over the longer term.

- Unlike the previous DSA, this assessment assumes a ***lower loan concessionality*** thresholds of 35 percent (previous threshold was 50 percent). To fund the government's capital investment program, additional loans of about 12.1 percent of GDP are projected for 2015. New borrowing will average about 4.2 percent of GDP a year from 2016–18 and about 0.4 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 9.6 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 27 percent of GDP, is projected to gradually decline to a longer-term average of 16 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 and benefits from the higher frequency of flights from Europe since 2014.

- ***Downside risks*** include significant spending overruns in the run-up to the 2016 presidential elections. The outlook could also be adversely impacted by supply shocks (leading to higher inflation and lower growth). A protracted period of slower growth in Europe could significantly depress exports, tourism, and FDI flows.

EXTERNAL DEBT SUSTAINABILITY

A. Baseline

5. Under the baseline scenario three out of five (against four out of five in the previous DSA) external debt indicators remain signifi*cantly above their relevant indicative thresholds over the next few years* (Figure 1, blue lines)**.**[5] ***However, significant differently fro*m** previous DSA assessments, the PV of public and publicly guaranteed (PPG) external debt-to-exports ratio fell from almost three times the indicative threshold of 100 percent in the previous DSA to less than 50 percent above it. The drop is due in

[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 2011–13 is 3.05 (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.

large measure to a large base increase in exports in 2013–14 on account of enhanced data coverage. The PV of external debt-to-revenues and the PV of PPG external debt-to GDP ratios spike in 2015 partly due to a 21 percent nominal depreciation, since 2013, of the national currency relative to the US dollars. They remain above their threshold through 2020 and 2021. Unlike in the previous DSA, all debt service indicators (debt service -to-exports and debt service-to-revenues ratios) remain 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.

6. External balance must improve through a combination of improved competitiveness and lower domestic absorption to maintaining debt on a sustainable path. Slippages—for example setting the non-interest current account deficit and FDI to continue at their historical levels—would drastically worsen debt trajectory relative to the baseline (Figure 1, red dotted line).

B. Sensitivity Analysis

7. Stress tests show the highest vulnerability of debt sustainability extends the period of breach of thresholds for a few additional years beyond those observed in the baseline (Figure 1, solid black lines).[6] Solvency-based indicators are most vulnerable to non-debt flows shocks while liquidity-based indicators are most vulnerable to exports shocks and one-time depreciation shocks. This highlights the need to keep future borrowing in check, maintain the credibility of the exchange rate peg and 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 additional periods beyond those observed in the baseline scenario. The stress test results for the debt-to-exports ratio extends the period of breach of the threshold for 4 more years. The debt service indicators never breach their respective thresholds under the stress tests.

PUBLIC DEBT SUSTAINABILITY

8. Public debt indicators worsened compared to the previous DSA, but it does not fundamentally alter the assessment of São Tomé and Principe debt sustainability (Figure 2, solid light blue line)**.** The PV of debt-to-GDP indicator breached the threshold in the first two years of projection, followed by quick and steady improvements as depicted in the baseline scenario. 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 gray line) or when the primary balance is unchanged from 2015 (Figure 2, red 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 the bound test on the primary balance at the historical average minus one standard deviation in 2016–17. The public debt service-to-revenue ratio is most sensitive to a one-time 30 percent depreciation of the dobra.

[6] The country was most vulnerable to a one-time 30 percent depreciation shock in the previous DSA.

DEBT DISTRESS QUALIFICATION AND CONCLUSIONS

9. **São Tomé and Príncipe remains at a high risk of debt distress.** However, the country is able to service its current obligations and while some external debt indicators are projected to remain above their respective thresholds they show a clear downward trend in the long term. The current assessment displays an improved debt dynamics compared to the prior DSA partly because of lower future borrowing. The PV of debt-to-exports ratio improved markedly due to upward revisions to exports. In this context, the DSA underlines the need for measures to mitigate risks:

- Remain committed to maintaining the exchange rate peg and an adequate level of international reserve to boost confidence in the wake of reduced oil prospects;
- Maintain fiscal prudence by enhancing revenue mobilization and expenditure control;
- Accelerate reforms to improve policy and institutional performance to enhance the growth potential of the country;
- 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.

10. **The biggest risks to external debt sustainability come from exchange rate, exports and primary balance shocks.** Debt sustainability could deteriorate if protracted periods of slower growth in Europe significantly depress exports, tourism, and FDI flows. 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.

11. **The DSA was presented to the authorities and was generally well received.** The authorities were especially glad to see that the DSA results support the reduction in the concessionality threshold from 50 percent to 35 percent (see Figure 4). They also expressed concerns about lack of space to borrow for investment purposes in light of restrictions on nonconcessional borrowing implied by the high risk of debt distress classification

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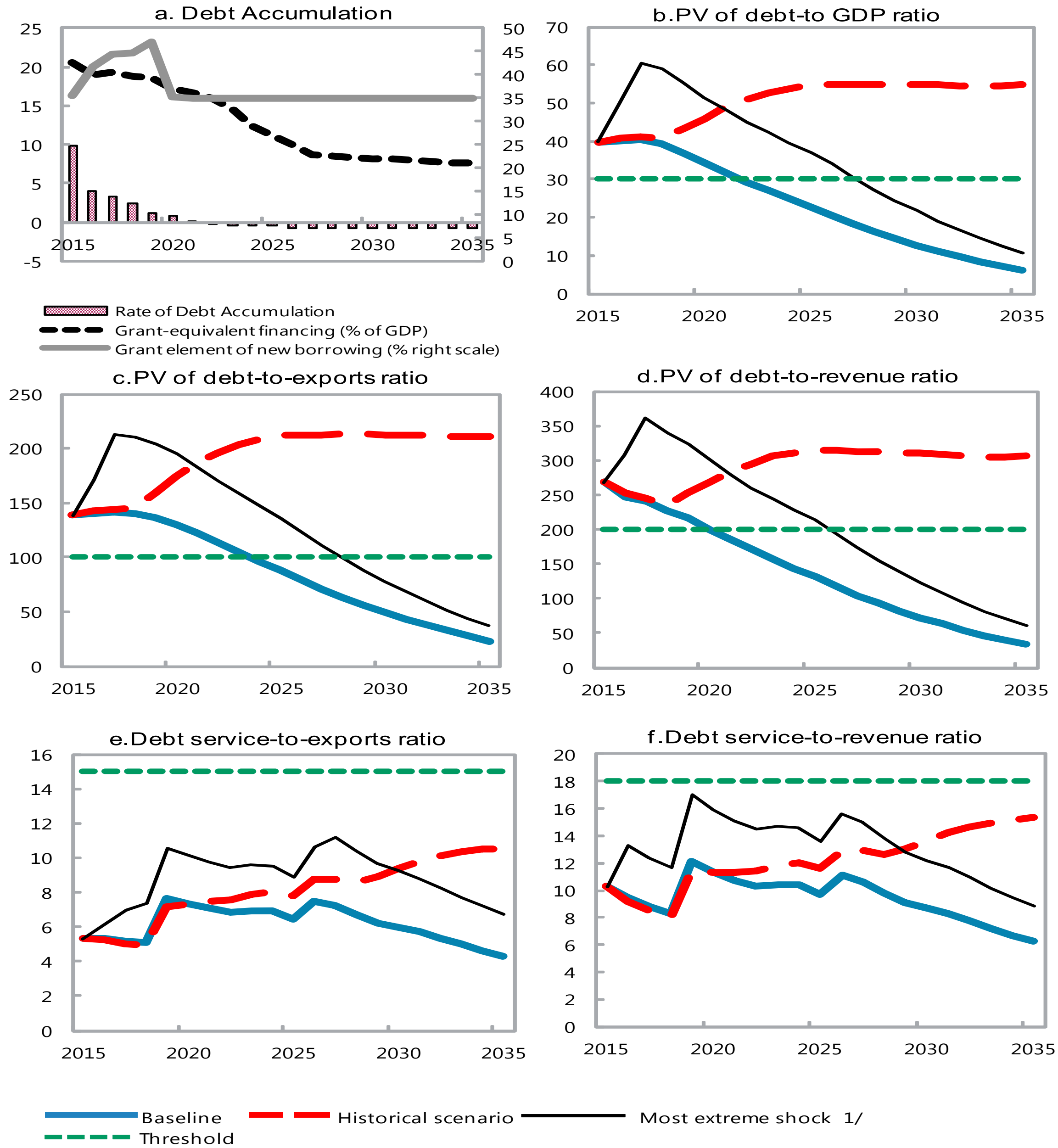
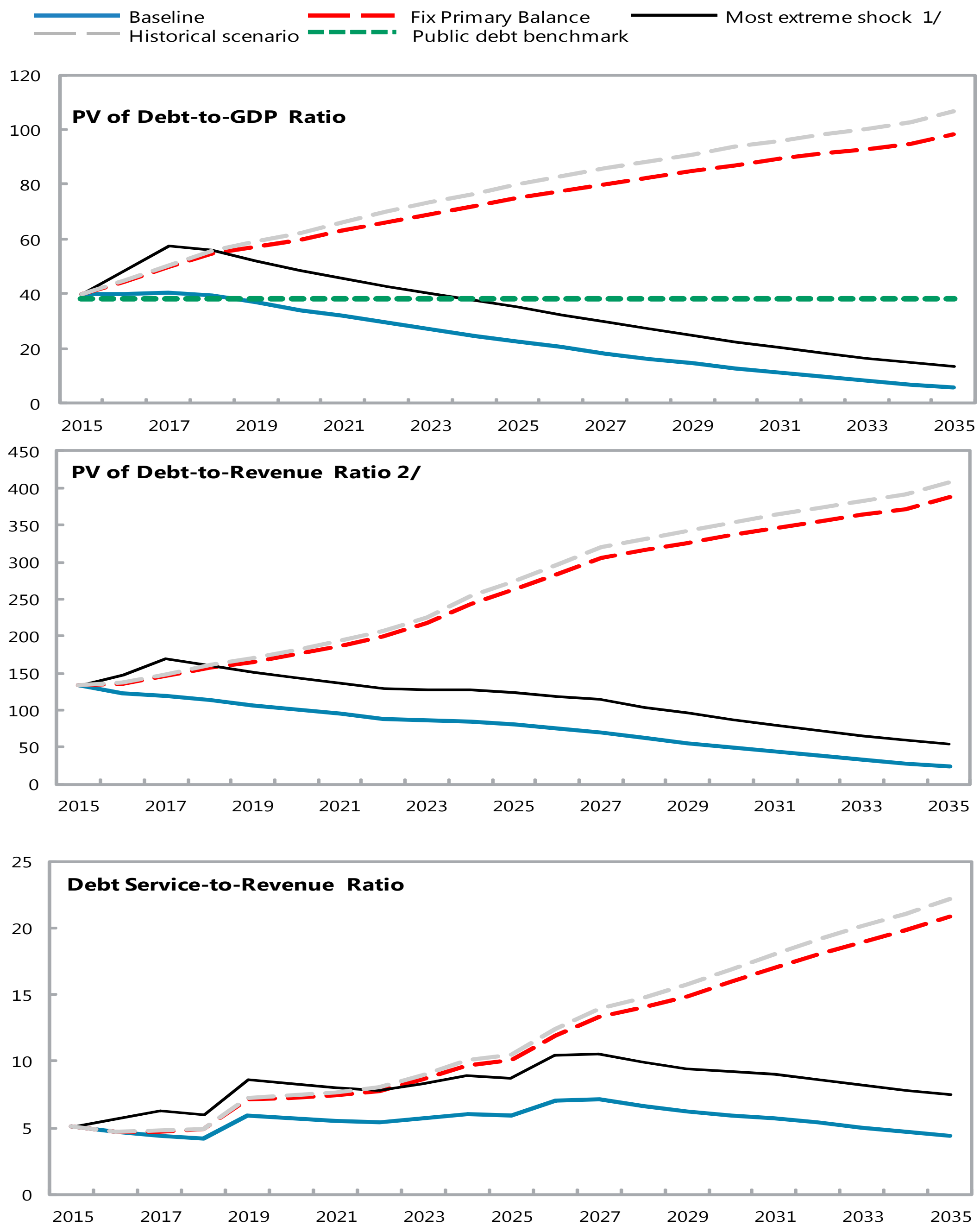
Figure 1. São Tomé and Príncipe: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2015–2035 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a Non-debt flows shock; in c. to a Exports shock; in d. to a Non-debt flows shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. São Tomé and Príncipe: Indicators of Public Debt Under Alternative Scenarios, 2015–2035 1/

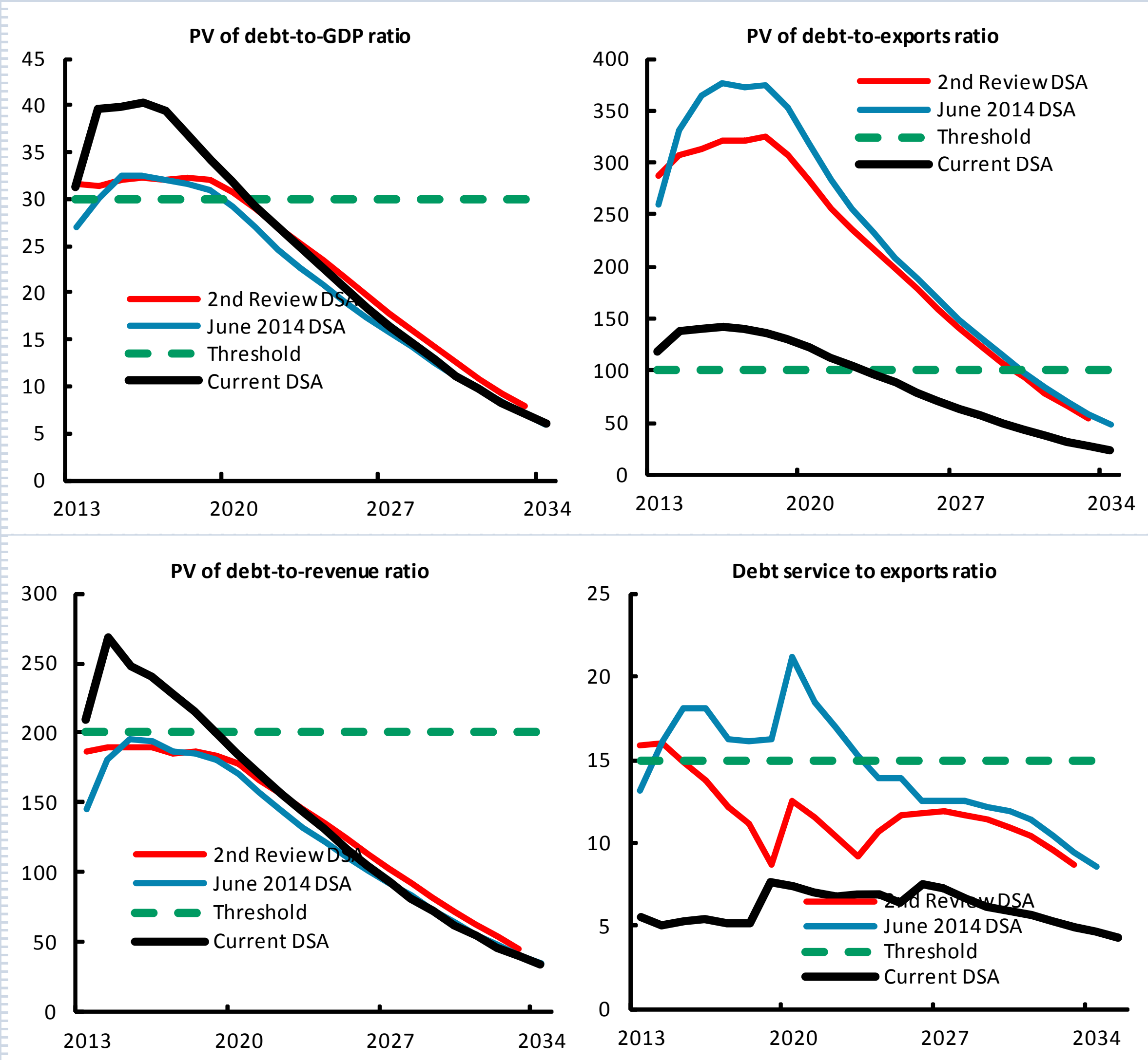


Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.

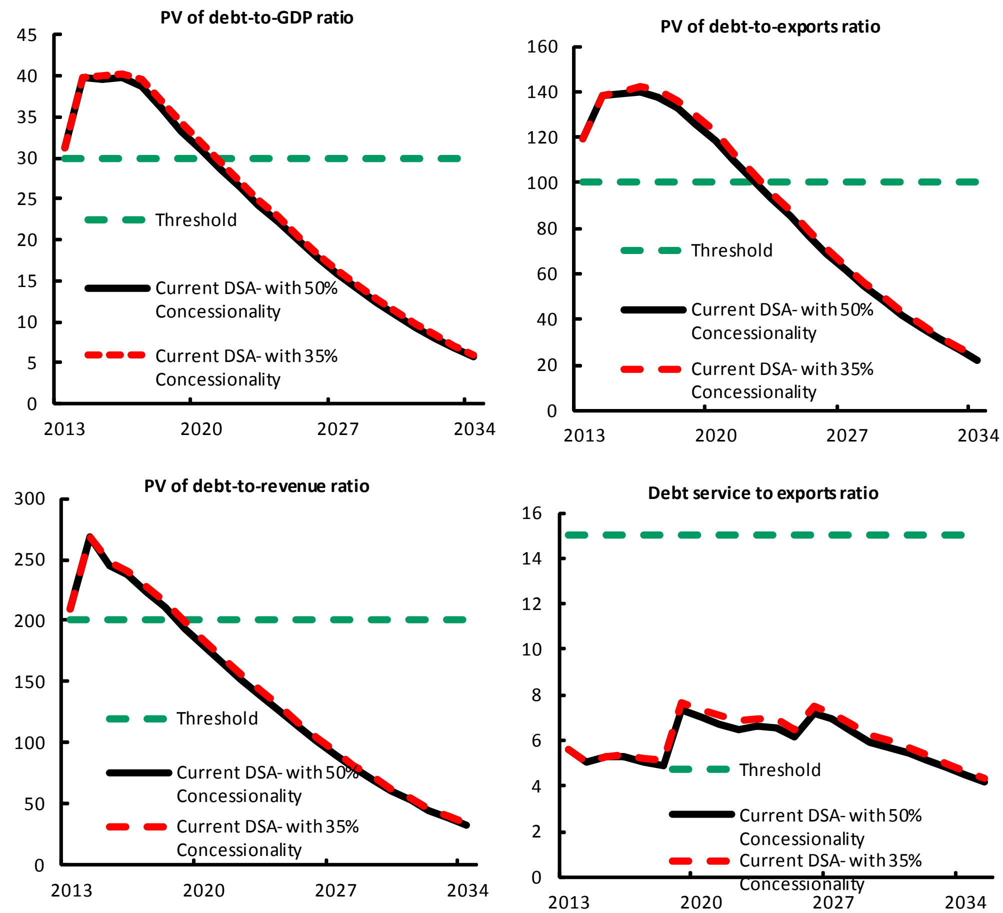
2/ Revenues are defined inclusive of grants.

Figure 3. São Tomé and Príncipe: Comparison of Indicators of Public and Publicly Guaranteed External Debt Ratios



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

Figure 4. São Tomé and Príncipe: Comparison of Indicators of Public and Publically Guaranteed External Debt Ratios, 50 percent vs. 35 percent Concessionality



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

Table 1. São Tomé and Príncipe: External Debt Sustainability Framework, Baseline Scenario, 2012–2035 1/

(Percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**67.8**	**61.8**	**68.5**			**79.6**	**77.7**	**76.8**	**73.5**	**68.0**	**62.0**		**39.0**	**12.0**	
of which: public and publicly guaranteed (PPG)	67.8	61.8	68.5			79.6	77.7	76.8	73.5	68.0	62.0		39.0	12.0	
Change in external debt	-1.8	-6.0	6.7			11.1	-1.8	-1.0	-3.2	-5.6	-6.0		-4.0	-1.5	
Identified net debt-creating flows	11.3	10.4	14.8			3.8	4.9	4.6	4.2	-1.7	-2.6		-0.6	1.1	
Non-interest current account deficit	**20.9**	**23.1**	**27.2**	**25.0**	**4.5**	**11.7**	**14.3**	**15.5**	**16.2**	**11.8**	**10.7**		**11.5**	**12.1**	11.7
Deficit in balance of goods and services	39.8	47.3	45.2			39.2	43.2	44.6	45.2	40.7	38.3		32.6	29.6	
Exports	12.7	16.1	26.2			28.7	28.5	28.4	28.1	27.1	26.4		25.9	26.0	
Imports	52.5	63.4	71.4			67.9	71.7	73.0	73.3	67.8	64.7		58.5	55.7	
Net current transfers (negative = inflow)	-20.3	-23.0	-15.8	-18.7	3.2	-24.3	-25.6	-26.0	-26.0	-26.1	-25.1		-19.2	-16.5	-18.6
of which: official	-18.4	-14.9	-8.9			-16.0	-17.5	-17.9	-18.0	-18.2	-17.3		-11.1	-7.6	
Other current account flows (negative = net inflow)	1.4	-1.2	-2.2			-3.3	-3.2	-3.1	-3.0	-2.8	-2.6		-1.9	-1.0	
Net FDI (negative = inflow)	**-8.3**	**-3.4**	**-6.5**	**-14.5**	**12.6**	**-5.1**	**-6.5**	**-7.8**	**-8.9**	**-10.3**	**-10.3**		**-10.3**	**-10.4**	-10.3
Endogenous debt dynamics 2/	**-1.2**	**-9.2**	**-6.0**			**-2.7**	**-2.9**	**-3.1**	**-3.1**	**-3.2**	**-3.0**		**-1.8**	**-0.6**	
Contribution from nominal interest rate	0.4	0.4	0.5			0.8	0.9	0.9	0.8	0.8	0.7		0.4	0.1	
Contribution from real GDP growth	-3.1	-2.3	-2.5			-3.6	-3.8	-4.0	-3.9	-4.0	-3.7		-2.2	-0.7	
Contribution from price and exchange rate changes	1.4	-7.3	-3.9			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-13.1**	**-16.4**	**-8.1**			**7.3**	**-6.8**	**-5.6**	**-7.4**	**-3.9**	**-3.4**		**-3.4**	**-2.6**	
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/	...	...	31.2			39.7	39.9	40.3	39.5	36.9	34.2		22.8	6.1	
In percent of exports	...	...	119.4			138.4	140.1	141.9	140.6	136.2	129.7		88.0	23.3	
PV of PPG external debt	**...**	**...**	**31.2**			**39.7**	**39.9**	**40.3**	**39.5**	**36.9**	**34.2**		**22.8**	**6.1**	
In percent of exports	**...**	**...**	**119.4**			**138.4**	**140.1**	**141.9**	**140.6**	**136.2**	**129.7**		**88.0**	**23.3**	
In percent of government revenues	**...**	**...**	**209.3**			**267.8**	**247.4**	**240.8**	**227.2**	**216.1**	**199.4**		**131.1**	**33.9**	
Debt service-to-exports ratio (in percent)	**7.3**	**5.6**	**5.0**			**5.3**	**5.4**	**5.2**	**5.1**	**7.6**	**7.3**		**6.5**	**4.3**	
PPG debt service-to-exports ratio (in percent)	**7.3**	**5.6**	**5.0**			**5.3**	**5.4**	**5.2**	**5.1**	**7.6**	**7.3**		**6.5**	**4.3**	
PPG debt service-to-revenue ratio (in percent)	**6.2**	**4.9**	**8.8**			**10.3**	**9.5**	**8.8**	**8.3**	**12.1**	**11.3**		**9.6**	**6.3**	
Total gross financing need (Billions of U.S. dollars)	0.0	0.1	0.1			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	22.7	29.1	20.6			0.6	16.2	16.5	19.4	17.3	16.6		15.5	13.5	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.5	4.0	4.5	5.1	2.4	5.0	5.2	5.5	5.5	6.0	6.0	5.5	5.5	5.5	5.6
GDP deflator in US dollar terms (change in percent)	-2.0	12.0	6.8	6.9	8.2	-8.2	4.0	1.6	2.5	3.6	4.1	1.3	1.7	0.7	1.7
Effective interest rate (percent) 5/	0.6	0.6	0.9	0.5	0.2	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.1	1.0	1.1
Growth of exports of G&S (US dollar terms, in percent)	12.5	48.0	80.8	21.8	27.0	5.8	8.5	6.9	6.9	5.9	7.4	6.9	7.2	7.2	7.3
Growth of imports of G&S (US dollar terms, in percent)	-7.3	40.8	25.7	17.0	20.5	-8.3	15.5	9.1	8.5	1.6	5.4	5.3	5.8	6.6	6.3
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	35.4	41.9	44.4	44.8	47.2	35.3	41.5	34.9	34.9	34.9
Government revenues (excluding grants, in percent of GDP)	15.0	18.3	14.9			14.8	16.1	16.7	17.4	17.1	17.1		17.4	17.9	17.6
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/	...	...	...			20.6	19.0	19.3	18.7	18.7	17.3		11.2	7.6	10.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			67.2	85.0	87.6	91.5	93.6	94.3		98.8	98.3	98.5
Memorandum items:															
Nominal GDP (Billions of US dollars)	0.3	0.3	0.338			0.3	0.4	0.4	0.4	0.5	0.5		0.7	1.4	
Nominal dollar GDP growth	2.4	16.5	11.6			-3.6	9.4	7.2	8.1	9.8	10.3	6.9	7.3	6.2	7.4
PV of PPG external debt (in Billions of US dollars)			0.1			0.1	0.1	0.2	0.2	0.2	0.2		0.2	0.1	
(PVt-PVt-1)/GDPt-1 (in percent)						9.8	4.0	3.3	2.4	1.1	0.9	3.6	-0.4	-0.7	-0.6
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		0.1	0.1	
PV of PPG external debt (in percent of GDP + remittances)	...	...	29.2			36.7	36.9	37.3	36.5	34.2	31.7		21.1	5.6	
PV of PPG external debt (in percent of exports + remittances)	...	...	94.5			107.5	108.8	110.5	109.4	105.4	100.1		67.1	17.3	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	4.0			4.1	4.2	4.1	4.0	5.9	5.7		4.9	3.2	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and publicly-guaranteed and private sector external debt.
2/ Derived as $[r - g - \rho(1+g)]/(1+g+\rho+g\rho)$ 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 of Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035 1/

(Percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to GDP ratio								
Baseline	40	40	40	39	37	34	**23**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	40	41	41	41	43	46	**55**	55
A2. New public sector loans on less favorable terms in 2015-2035 2/	40	42	43	43	41	39	**27**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	40	41	43	42	39	36	**24**	6
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	40	42	47	46	43	40	**27**	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	40	42	44	43	40	37	**25**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	40	50	60	59	55	52	**37**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	40	46	52	51	48	45	**31**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	40	56	57	56	52	48	**32**	8
PV of debt-to-exports ratio								
Baseline	138	140	142	141	136	130	**88**	23
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	138	143	145	145	159	174	**212**	211
A2. New public sector loans on less favorable terms in 2015-2035 2/	138	146	152	153	151	146	**103**	38
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	138	141	143	141	137	131	**88**	23
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	138	170	213	210	204	195	**136**	37
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	138	141	143	141	137	131	**88**	23
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	138	175	213	210	204	196	**143**	41
B5. Combination of B1-B4 using one-half standard deviation shocks	138	158	177	175	170	163	**115**	32
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	138	141	143	141	137	131	**88**	23
PV of debt-to-revenue ratio								
Baseline	268	247	241	227	216	199	**131**	34
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	268	252	245	235	253	268	**315**	307
A2. New public sector loans on less favorable terms in 2015-2035 2/	268	257	258	248	240	225	**153**	55
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	268	255	255	240	229	212	**137**	35
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	268	263	280	264	252	233	**157**	42
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	268	262	262	247	236	218	**141**	36
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	268	308	361	339	324	301	**213**	60
B5. Combination of B1-B4 using one-half standard deviation shocks	268	286	313	294	281	260	**179**	49
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	268	350	340	321	306	283	**183**	47

Table 2. São Tomé and Príncipe: Sensitivity Analysis of Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035 (concluded)

(Percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
Debt service-to-exports ratio								
Baseline	5	5	5	5	8	7	**6**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	5	5	5	5	7	7	**8**	11
A2. New public sector loans on less favorable terms in 2015-2035 2/	5	5	5	5	8	7	**7**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	5	5	5	5	8	7	**6**	4
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	5	6	7	7	11	10	**9**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	5	5	5	5	8	7	**6**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	5	5	6	7	9	9	**8**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	5	5	6	6	8	8	**7**	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	5	5	5	5	8	7	**6**	4
Debt service-to-revenue ratio								
Baseline	10	9	9	8	12	11	**10**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	10	9	8	8	11	11	**12**	15
A2. New public sector loans on less favorable terms in 2015-2035 2/	10	9	8	8	12	11	**10**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	10	10	9	9	13	12	**10**	7
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	10	9	9	9	13	12	**10**	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	10	10	10	9	13	12	**10**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	10	9	10	11	15	14	**12**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	10	10	10	10	14	13	**11**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	10	13	12	12	17	16	**14**	9
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	35	35	35	35	35	35	**35**	35

Sources: Country authorities; and staff estimates and projections.

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

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. São Tomé and Príncipe: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–2035

(Percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	67.8	61.8	68.5			79.6	77.7	76.8	73.5	68.0	62.0		39.0	12.0	
of which: foreign-currency denominated	67.8	61.8	68.5			79.6	77.7	76.8	73.5	68.0	62.0		39.0	12.0	
Change in public sector debt	-1.8	-6.0	6.7			11.1	-1.8	-1.0	-3.2	-5.6	-6.0		-4.0	-1.5	
Identified debt-creating flows	4.0	-9.9	7.1			7.0	-3.5	-2.2	-4.5	-5.6	-5.5		-2.8	-0.5	
Primary deficit	11.9	0.0	5.7	10.4	5.6	9.9	2.6	2.2	0.4	0.3	0.2	2.6	-0.3	0.0	-0.3
Revenue and grants	32.7	31.2	25.3			29.9	32.7	33.9	34.7	34.6	33.9		28.5	25.4	
of which: grants	17.7	12.9	10.3			15.1	16.6	17.1	17.3	17.6	16.7		11.1	7.6	
Primary (noninterest) expenditure	44.6	31.2	31.0			39.8	35.3	36.0	35.1	34.9	34.0		28.2	25.4	
Automatic debt dynamics	-7.8	-9.9	1.4			-2.9	-6.1	-4.4	-4.9	-5.9	-5.6		-2.5	-0.5	
Contribution from interest rate/growth differential	-3.8	-3.2	-3.1			-3.6	-4.3	-4.9	-4.7	-4.8	-4.4		-2.7	-0.8	
of which: contribution from average real interest rate	-0.8	-0.6	-0.4			-0.3	-0.4	-0.8	-0.7	-0.7	-0.6		-0.4	-0.1	
of which: contribution from real GDP growth	-3.0	-2.6	-2.7			-3.3	-3.9	-4.1	-4.0	-4.2	-3.8		-2.2	-0.7	
Contribution from real exchange rate depreciation	-4.0	-6.7	4.5			0.7	-1.8	0.5	-0.2	-1.1	-1.2		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-5.8	3.9	-0.5			4.1	1.7	1.2	1.3	0.1	-0.5		-1.1	-0.9	
Other Sustainability Indicators															
PV of public sector debt	...	...	31.2			39.7	39.9	40.3	39.5	36.9	34.2		22.8	6.1	
of which: foreign-currency denominated	...	...	31.2			39.7	39.9	40.3	39.5	36.9	34.2		22.8	6.1	
of which: external	...	...	31.2			39.7	39.9	40.3	39.5	36.9	34.2		22.8	6.1	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	12.8	0.9	7.0			11.4	4.1	3.6	1.9	2.3	2.1		1.3	1.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	123.6			132.7	121.8	119.0	113.8	106.5	101.0		79.9	23.8	
PV of public sector debt-to-revenue ratio (in percent)	...	...	209.3			267.8	247.4	240.8	227.2	216.1	199.4		131.1	33.9	
of which: external 3/	...	...	209.3			267.8	247.4	240.8	227.2	216.1	199.4		131.1	33.9	
Debt service-to-revenue and grants ratio (in percent) 4/	2.8	2.9	5.2			5.1	4.7	4.4	4.1	6.0	5.7		5.9	4.4	
Debt service-to-revenue ratio (in percent) 4/	6.2	4.9	8.8			10.3	9.5	8.8	8.3	12.1	11.3		9.6	6.3	
Primary deficit that stabilizes the debt-to-GDP ratio	13.7	6.0	-1.0			-1.2	4.4	3.1	3.6	5.8	6.1		3.6	1.5	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.5	4.0	4.5	5.1	2.4	5.0	5.2	5.5	5.5	6.0	6.0	5.5	5.5	5.5	5.6
Average nominal interest rate on forex debt (in percent)	0.6	0.6	0.9	0.5	0.2	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.1	1.0	1.1
Real exchange rate depreciation (in percent, + indicates depreciation	-6.1	-10.4	7.7	-3.5	7.0	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.0	8.4	6.9	13.7	7.6	9.5	3.3	0.4	1.3	2.5	2.5	3.2	2.7	2.7	2.7
Growth of real primary spending (deflated by GDP deflator, in percer	-2.4	-27.2	3.7	-2.5	8.8	35.1	-6.7	7.6	2.8	5.4	3.4	7.9	1.5	5.3	3.6
Grant element of new external borrowing (in percent)	...	...	...	...	...	35.4	41.9	44.4	44.8	47.2	35.3	41.5	34.9	34.9	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

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

3/ Revenues excluding grants.

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

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

Table 4. São Tomé and Príncipe: Sensitivity Analysis of Key Indicators of Public Debt, 2015–2035

		Projections						
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	40	40	40	39	37	34	23	6
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	40	45	51	56	59	62	80	106
A2. Primary balance is unchanged from 2015	40	45	50	55	57	60	75	98
A3. Permanently lower GDP growth 1/	40	40	41	40	38	36	27	17
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	40	41	43	43	41	38	29	15
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	40	48	57	56	52	49	35	14
B3. Combination of B1-B2 using one half standard deviation shocks	40	47	55	54	51	48	35	17
B4. One-time 30 percent real depreciation in 2016	40	55	54	52	48	45	32	12
B5. 10 percent of GDP increase in other debt-creating flows in 2016	40	46	46	45	42	39	27	9
PV of Debt-to-Revenue Ratio 2/								
Baseline	133	122	119	114	106	101	80	24
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	133	137	149	160	169	181	275	407
A2. Primary balance is unchanged from 2015	133	136	147	157	165	176	264	387
A3. Permanently lower GDP growth 1/	133	122	120	116	109	105	92	65
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	133	124	124	121	114	110	98	57
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	133	148	169	161	151	144	123	54
B3. Combination of B1-B2 using one half standard deviation shocks	133	143	160	153	145	139	123	65
B4. One-time 30 percent real depreciation in 2016	133	168	160	151	140	132	112	48
B5. 10 percent of GDP increase in other debt-creating flows in 2016	133	141	137	131	123	117	96	35
Debt Service-to-Revenue Ratio 2/								
Baseline	5	5	4	4	6	6	6	4
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	5	5	5	5	7	7	11	22
A2. Primary balance is unchanged from 2015	5	5	5	5	7	7	10	21
A3. Permanently lower GDP growth 1/	5	5	4	4	6	6	6	6
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-2017	5	5	4	4	6	6	6	6
B2. Primary balance is at historical average minus one standard deviations in 2016-2017	5	5	5	5	7	7	7	7
B3. Combination of B1-B2 using one half standard deviation shocks	5	5	5	5	7	7	7	7
B4. One-time 30 percent real depreciation in 2016	5	6	6	6	9	8	9	7
B5. 10 percent of GDP increase in other debt-creating flows in 2016	5	5	5	5	6	6	6	5

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

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

June 24, 2015

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND CANCELLATION OF THE CURRENT ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—INFORMATIONAL ANNEX

Prepared By

The African Department
(in Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of April 30, 2015)

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	0.21	3.02

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ECF Arrangements	2.96	40.00

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ECF[1]	07/20/2012	07/19/2015	2.59	1.11
ECF[1]	03/02/2009	03/01/2012	2.59	0.74
ECF[1]	08/01/2005	07/31/2008	2.96	2.96

[1]Formerly PRGF.

Projected Payments to Fund [1]

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

	Forthcoming				
	2015	2016	2017	2018	2019
Principal	0.37	0.61	0.44	0.39	0.33
Charges/Interest	0.00	0.00	0.00	0.00	0.01
Total	0.37	0.62	0.45	0.39	0.34

[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. The BCSTP has followed up with action to address weaknesses in internal auditing, portfolio management guidelines, and auditing of the 2014 accounts by an external auditor.

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 current exchange rate system has effectively eliminated the multiple currency practice related to the existence of numerous exchange rate markets with differing exchange rates for spot transactions that existed in previous years.

São Tomé and Príncipe continue to avail itself of the transitional arrangements under Article XIV, but do 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/fulfill 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 December 13, 2013.

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
April 2015	FAD mission on medium term framework
March 2015	FAD mission on tax administration
March 2015	MCM mission on banking supervision
November 2014	MCM mission on banking supervision
September 2014	STA mission on national accounts statistics
September 2014	MCM mission on liquidity management
April 2014	STA mission Balance o Payment and IIP
April 2014	MCM mission on liquidity management
March 2014	MCM mission on banking supervision
February 2014	FAD mission on public accounting
December 2013	FAD short-term expert visit on public accounting
November 2013	MCM mission on banking supervision
August 2013	FAD mission on revenue administration
August 2013	MCM mission on banking supervision
June 2013	FAD mission on public accounting
March 2013	MCM mission on banking supervision
January 2013	MCM mission on liquidity management
January 2013	FAD mission on public accounting
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

Date of Delivery	Department/Purpose
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 May, 2015)

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

2. The World Bank's work program is guided by a Country Assistance Strategy for the fiscal years 2014 to 2018 approved in 2014 that focuses on supporting growth and job creation through two broad themes: macroeconomic stability and national competitiveness, and reducing

vulnerability and strengthening human capacity. Gender, partnership, and capacity- building are elements that cut across all the proposed engagements. A 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 second review under the ECF-supported program, together with the 2013 Article IV consultation, a staff visit in February 2015, mission in April 2015 to negotiate a new ECF-supported program, and assistances 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 2014, and a new update has recently been prepared to accompany the new ECF-supported program request.

Work Program for Period 2015–16			
Title	*Products*	*Provisional timing of missions*	*Expected delivery date*
A. Mutual information on relevant work programs			
World Bank work program in the next 12 months	• STP Power Sector Recovery Project • Economic Governance and Competitiveness II DPO • EITI • Financial sector • Business environment • South-South Collaboration support	N.A. July 2015 N.A. N.A. N.A. N.A.	FY2016 FY2016 FY2015 N.A N.A. FY2016
IMF work program in the next 12 months	• ECF first review and Article IV • ECF second review • Technical Assistance from STA: o National Accounts o Balance of Payments and IIP • Technical Assistance from FAD: o Tax administration o PFM o PFM (SAFE-e and government accounts) o Budget preparation and fiscal reporting • MCM: o Contingency planning and crisis management o Banking Supervision	March 2016 September 2016 November 2015 June 2015 July 2015 July 2015 October 2015 November 2015 July 2015 July 2015	May 2016 November 2016

B. Requests for work program inputs			
Fund request to Bank	• Information on Bank budget support operations and disbursement schedule	To support the 2015 - 16 fiscal program	November 2015
Bank request to Fund	• Collaboration on providing full set of macroeconomic framework and tables		Ongoing

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of May, 2015)

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 31 March, 2015, the AfDB's ongoing portfolio comprised of five active projects for a total commitment of UA 13.2 million. These are: 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 to the Court of Justice and Supreme Tribunal[2]; the Study on Water Supply and Sanitation Programme Rural (Table 1). In June 2014, the Bank conducted its portfolio performance review for the country. The review concluded that the portfolio performance is rated satisfactory at 2.16 on a scale of 0 to 3, lower than 2.18 reported in 2013. The decline was mainly linked to delays in project compliance with conditions and local contractors' weak performance to complete the programmed activities. During the review period, the portfolio's average disbursement rate stood at 31 percent, compared to 28.8 percent in 2013. The average age of the active portfolio is 2.2 years which is lower than the 2.4 years recorded in 2013. Such improvement is mainly linked to new projects approved in the first quarter of 2013. In terms of sector distribution, multi-sector contributes a substantial proportion, representing 56.8 percent of the total value of the portfolio, followed by agriculture-sector (37.8 percent) and water and sanitation (5.4 percent). There is not ongoing private sector or multinational projects.

[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.

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. A mid-term review of the strategy was concluded in 2014. During the review process the AfDB and the Government agreed to add a second pillar in order to respond to the country's development needs. Therefore, the AfDB's strategy focuses on **Pillar I**- Strengthening Governance; and **Pillar II**- Promotion of Agriculture Infrastructure. Both pillars are consistent with the authorities' priorities as well as with the AfDB's priorities outlined in the 2013–2022 strategy for the continent. 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. In addition, it will also help to address the issues of food security, job creation, transformation of local products and global value chains.

4. As part of its strategy and knowledge products, the AfDB also envisages to undertake the following economic and sector works; (i) the study on agriculture transformation; (ii) the study on national planning scheme; and (iii) the study on accreditation of the agriculture research and investigation centre (CIAT). In addition, the AfDB also started the preparation of the private sector strategy for STP. 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)
PRIASA	ADF Grant	5.0	69.5
Study on water supply and sanitation Programme	RWSSI Trust Fund	0.7	2.6
PAGEF	ADF+FSF Grants	7	11.5
Capacity Building	ALSF/ORSB	0.2	NA
General Population and Housing Census	FSF III	0.5	86.8
Total		***13.4***	***42.6 (average)***

STATISTICAL ISSUES

(As of April, 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, 2009, 2013 and 2014. Weak source data affect the quality national accounts estimates. A technical assistance mission is planned for November 2015 to further help (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) migrate 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.

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. More recently, the authorities are revising all financial statements of government operations for 2010 through 2014 and GFS series are expected to be aligned by July. 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 significantly improved. The BCSTP is reporting monthly data to STA for the central bank and other depository corporations (ODCs) on regular basis.

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

A new plan of accounts for ODCs was introduced in January 2010. The September 2010 mission reviewed the new plan of accounts for the financial system, and found it adequate for a proper classification, sectorization, and valuation of financial instruments, and in line with the methodology of the *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. Following the mission's recommendations, the BCSTP worked towards eliminating those problems. The central bank has begun to collect data from insurance companies which opened in the past few years.

The asset sizes of insurance companies remain small enough not to warrant inclusion in monetary statistics at this time.

The central bank produces a quarterly FSI table. MCM TA missions on banking supervision have helped expand the coverage of the table and improved the data quality. The additional information compiled could permit the beginning of stress testing exercises in the near future.

External Sector Statistics: The CBSTP compiles quarterly balance of payments statistics consistent with the guidelines of the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* which was implemented in 2014. International investment position (IIP) data are not yet compiled by the CBSTP.

The coverage of the external transactions of the nonfinancial private sector is scarce. The CBSTP has recently started conducting quarterly surveys to collect balance of payments and IIP data from the private sector and improve the coverage of the external sector statistics (ESS).

An April 2015 mission found inconsistencies in the classification of BOP operations and that certain components continued to be largely estimated. The mission recommended improving coordination and data sharing among data-producing agencies, increasing staff dedicated to the compilation and collection of ESS, discussing with the National Petroleum Agency and the Joint Development Authority the establishment of mechanisms for receiving regular data on production sharing agreement contracts, developing new surveys to improve the coverage of ESS statistics; and developing a preliminary IIP statement on a *BPM6* basis. The mission assisted the authorities in implementing BPM6 standards 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.

A follow up mission is scheduled in June 2015 to review the data recently collected from the oil and gas sector; to assist in developing an IIP statement consistent with the financial account of the balance of payments; to identify potential reasons for the net errors and omissions figures, and to review the results of the new surveys conducted by the CBSTP to collect balance of payments and IIP data from the private sector, both in terms of quality and coverage.

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 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.

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

(As of June 10, 2015)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting	Frequency of publication
Exchange rates	May 2015	Jun. 2015	D	D	D
International reserve assets and reserve liabilities of the monetary authorities [1]	May 2015	Jun. 2015	D	D	D
Reserve/base money	May 2015	Jun. 2015	D	D	D
Broad money	Apr. 2015	Jun. 2015	M	M	M
Central bank balance sheet	Apr. 2015	Jun. 2015	M	M	M
Consolidated balance sheet of the banking system	Apr. 2015	Jun. 2015	M	M	M
Interest rates [2]	Apr. 2015	Jun. 2015	M	M	M
Consumer Price Index	Apr. 2015	Jun. 2015	M	M	M
Revenue, expenditure, balance and composition of financing [3] – general government [4]	Mar. 2015	Apr. 2015	Q	Q	Q
Revenue, expenditure, balance and composition of financing [3]– central government	Mar. 2015	Apr. 2015	Q	Q	Q
Stocks of central government and central government-guaranteed debt [5]	Mar. 2015	Apr. 2015	Q	I	Q
External current account balance	Mar. 2015	Apr. 2015	A	I	A
Exports and imports of goods	Mar. 2015	Apr. 2015	M	M	A
GDP/GNP	2012	Jan. 2015	A	I	A
Gross external debt	Mar. 2015	Apr. 2015	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).

Statement by Mr. Yambaye, Executive Director and Mr. Diakite, Advisor to the Executive Director on Democratic Republic of São Tomé e Príncipe
July 13, 2015

1. The Executive Board, in July 2012, approved a three-year arrangement under the Extended Credit Facility (ECF) in support of São Tomé and Príncipe's economic reform program. Important macroeconomic gains were made in the first year and a half of the program. However, by 2014, the program went off track due to a number of factors, including lower than projected prospects for oil production, a challenging external environment, delays in introducing measures due to the general elections in October of 2014, and the contraction of an external loan with a level of concessionality below the threshold of 50 percent stipulated under the program.

2. Following the general elections which was won by a strong majority of the main opposition party, the new government that was formed has expressed its commitment to pursue the reforms started earlier to address the economic and financial challenges facing São Tomé and Príncipe and put the economy on a strong growth path while also addressing the issue of poverty.

3. The authorities consider that corrective measures cannot realistically be implemented before the expiration of the current Arrangement in July 2015. Therefore, they have decided to cancel the existing ECF arrangement and request a new three-year ECF arrangement to support their medium-term economic reform program. The new ECF supported program is expected to address the priorities of the new government, notably in the social sectors, while consolidating the gains achieved thus far. It will also play a critical role in catalyzing support from the donors' community.

Recent Economic Developments and Performance under the ECF Arrangement

4. The economy of São Tomé and Príncipe is highly vulnerable to developments in the global economy. While macroeconomic performance has been positive since 2012, it has not been sufficiently strong and diversified to improve economic prospects and reduce poverty significantly. Real GDP growth averaged 4.5 percent during the period 2012-14, but has been less than envisaged in the ECF program because of the challenging external environment and less favorable prospects for oil production. However, in 2015, economic activity appears to be picking up fueled by higher than anticipated increase in foreign direct investment, the launching of new donor-financed projects, and improved performance in the tourism sector. Helped by the exchange rate peg to the euro since 2010, inflation has fallen significantly from 16 percent to 6.5 percent in March 2015, the lowest 12-month rate in two decades.

5. In the fiscal area, the authorities continued their efforts to improve the domestic primary deficit which reached 0.8 percent of GDP in 2013. However, in 2014, it increased again to 3.4 percent of GDP as a result of revenue underperformance and expenditures overruns. Despite the authorities' efforts, Government arrears have

accumulated on a net basis since 2012. The authorities are concerned about the arrears and have taken steps to make progress in the resolution of cross arrears among the Treasury, the oil importing enterprise and the state electricity company. In this regard, they have put together a ministerial team in April 2015 to audit and confirm claims by creditors, and they have developed a comprehensive plan to clear the outstanding stock of arrears over the next five years. This plan was a prior action for the new ECF supported program.

6. In the monetary sector, the growth of monetary aggregates continues to be in line with the requirements of maintaining the exchange rate peg arrangements. Bank credit to the private sector, after a boom in 2010–12, started to contract in 2013 as a result of the over-indebtedness of the business sector and households, rising non-performing loans (NPLs) and the lack of bankable projects.

7. In line with the weaker economic activity, the external current account deficit declined to 30.3 percent of GDP in 2012–14, but the trade deficit remained at about 37.4 percent despite the encouraging growth in cocoa exports. The Central Bank's international reserves remained at a comfortable level of 3.8 months of imports cover at end-March 2015.

8. The financial sector has been adversely impacted in recent years by loose credit stance and weak enforcement of prudential standards during the oil prospects boom years of 2010–12. NPLs increased to 18 percent in 2014 and the Central Bank had to intervene in two banks.

9. The performance of the ECF-supported program approved in 2012 has been mixed. While all of the 2013 quantitative targets performance criteria were met, and the first two reviews concluded as scheduled, there were slippages and delays in program implementation in 2014, notably as regards fiscal targets and structural reforms. Also, the contracting in March 2014 of a loan to finance public investment projects which did not meet the level of concessionality required under the program delayed subsequent reviews and resulted in a loss of momentum.

Medium term Policy and Reform Agenda

10. 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 (PRSP-II) covering the period 2012–16, and the Program of the Constitutional Government of São Tomé and Príncipe approved in 2014. The PRSP-II, whose coverage ends in 2016, will be updated so that both documents continue to serve as reference for the 2015–18 economic and financial policies.

Fiscal policy and debt sustainability

11. The authorities will continue to rely on a cautious non-oil baseline scenario. The 2015 budget was developed with this concern and aims at restoring the thrust of the previous program's fiscal stance by redressing the budgetary slippages incurred in 2014. In this regard, the authorities have focused on addressing poor tax collection, rising personnel costs and the net increase in arrears.

12. A primary deficit of 2.7 percent of GDP will be targeted in 2015 and will be further reduced to 1.5 percent by 2018. To achieve these outcomes, the authorities are mindful of the need to improve tax administration and enhance revenue mobilization. In this regard, tax revenues are targeted at 15 percent of GDP in 2015 and the Government will seek to raise them by a cumulative 1.5 percent to 16.5 percent by 2018. The authorities have adopted a comprehensive plan to resolve the problem of cross-arrears, and its implementation should also yield additional customs revenue from the oil importing company ENCO. Other measures envisaged to further expand the tax base are the survey of tax payers which should yield 16,000 new taxpayers and the introduction of the VAT during the program period for which the technical assistance of the Fund will be requested.

13. On the expenditures side, the authorities intend to scale back personnel costs to their historical average of 8.5 percent of GDP over the program period. To this effect, they envisage to take measures in 2015 which will reduce personnel costs by 0.3 percent of GDP relative to 2014. Spending on goods and services which has been compressed in recent years will be capped at 3.2 percent of GDP. The authorities are committed to make progress in the social sectors and will therefore increase and safeguard social spending by aligning the budget with the objectives of the PRSP-II. To this end, they will continue to improve and modernize public financial management notably by making operational the information management system SAFEe.

14. With regards to financing, the authorities intend to gather budget support to step up public investment and social programs at a donor's conference to be co-organized with the UNDP in September 2015. However, they will boost the development of the domestic Treasury bill market which could provide contingency resources if delays or shortfalls occur in donor financing.

15. Concerning external borrowing, the government will continue to pursue policies consistent with debt sustainability while implementing its public investment program. The authorities' plans make room for some additional concessional borrowing of an average of 6.6 percent of GDP annually during the program with a grant element of 35 percent. This borrowing option is consistent with the debt sustainability analysis and does not significantly change the debt sustainability dynamics. The authorities will also strengthen debt management capacity which will be essential for achieving the debt reduction objective under the program. In this regard, the medium-term debt management strategy is being updated and reporting and debt service forecasts improved. Prospective

new loans will be carefully assessed in terms of their impact on debt sustainability prior to their contracting.

Monetary policy and financial sector reforms.

16. The authorities will continue to anchor their monetary policy to the fixed peg between the Dobra and the Euro. This policy stance has succeeded in significantly reducing inflation, maintaining a stable exchange rate and an adequate level of international reserves. In order to reverse the fall in credit to the private sector experienced previously, the Central Bank intends to reduce the minimum required reserves on local currency deposits. The Central Bank has introduced an interbank money market and open market operations with the aim to effectively manage the growing excess liquidity in the banking system. It will also establish a deposit standing facility to this effect.

17. Our authorities are mindful that a sound and more inclusive financial sector is paramount for strengthening the resilience of the economy to shocks and achieving sustainable growth. In this regard, they will introduce measures to safeguard financial stability based on an analysis of the causes of past due amounts and NPLs on banks' balance sheets. A comprehensive strategy will be developed with Fund TA to address these issues.

18. With respect to the regulatory and supervisory framework, the authorities will continue to focus on reinforcing compliance with prudential requirements. In this context, the Central Bank intervened in January 2015 in a bank that failed to meet the minimum requirements and directed three other banks to raise their capital above the minimum required to operate a bank. It has also achieved the process of on-site inspection of all banks as of May 2015. Moreover, the authorities have drafted a new Bank Resolution Law with the assistance of the Fund, which will be submitted to the National Assembly by end-September 2015. A comprehensive plan to help banks deal with high NPLs on their balance sheet will also be implemented by 2016.

19. The Central Bank will continue to strengthen its oversight of all commercial banks. A detailed assessment of banks' compliance with Basel Core Principles is expected to be carried out by end-December 2016 and Fund TA will be requested for that purpose. Furthermore, the mandate of the Central Bank will be enhanced through a revision of the Central Banking and Financial Institutions Law which will be submitted to the National Assembly by end-December 2015.

The business environment and private sector development.

20. Our authorities recognize the need to continue improving the business climate in order to increase the export base and diversify the economy. They will seek to implement reforms aimed at greater trade facilitation, simplified payment of taxes and reduction of administrative requirements. In this regard, the authorities made an important progress in 2014 by establishing a one-stop-shop for foreign trade which will help exporters' efforts

to access foreign markets. To further increase the economy's external competiveness, they will develop and submit to the National Assembly by end 2016, a national export diversification strategy and action plan targeting the sectors in which the country has the greatest potential. The implementation of such a plan will entail significant investments in infrastructure notably for the port, airport, roads, and energy to spur growth and the structural transformation of the economy. The authorities will continue to work with the IMF and other partners on creating a window for non concessional borrowing while preserving debt sustainability.

21. Furthermore, they will aim at providing stronger property and investor rights by addressing challenges in the judiciary system, notably the enforcement of collateral. To facilitate easier access to credit, the credit reference bureau will be revamped with the Central Bank investing additional human and infrastructure resources to extend its coverage and enhance its usage. Measures will also be taken to enforce the reporting of relevant, accurate, complete and timely information to the credit bureau by financial institutions.

Conclusion

22. Our São Toméan authorities are requesting a new ECF arrangement which will consolidate their efforts to pursue sound macroeconomic policies, strengthen and diversify the economy. They are committed to implement prudent fiscal and monetary policies and continue to strengthen debt management. In support of their efforts, they are requesting Fund assistance under an ECF arrangement. We would appreciate Directors' favorable consideration of our authorities' request.