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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

June 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION, FIRST REVIEW UNDER THE EXTENDED CREDIT FACILITY, AND REQUEST FOR WAIVER FOR NONOBSERVANCE OF PERFORMANCE CRITERION AND MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

In the context of the Staff Report for the 2016 Article IV Consultation, First Review under the Extended Credit Facility, and Request for Waiver for Nonobservance of Performance Criterion and Modification of Performance Criteria, 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 and summarizing the views of the Executive Board as expressed during its June 10, 2016 consideration of the staff report that concluded the Article IV consultation and the IMF arrangement with the Democratic Republic of São Tomé and Príncipe.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 10, 2016, following discussions that ended on March 24, 2016, with the officials of the Democratic Republic of São Tomé and Príncipe on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 20, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- 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 the Democratic Republic of São Tomé and Príncipe*
Memorandum of Economic and Financial Policies by the authorities of the Democratic Republic of São Tomé and Príncipe*
Technical Memorandum of Understanding*
Selected Issues
*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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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 16/275
FOR IMMEDIATE RELEASE
June 10, 2016

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Completes the First Review under the ECF Arrangement for São Tomé and Príncipe and Approves US$0.9 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of São Tomé and Príncipe's performance under the economic program supported by an Extended Credit Facility (ECF) arrangement.[1] Completion of the review enables the disbursement of SDR 634,285 (about US$ 0.9 million), bringing total disbursements under the arrangement to SDR 1.27 million (about US$ 1.8 million).

In completing the review, the Executive Board also approved a waiver for the nonobservance of the end-December 2015 performance criterion on the domestic primary deficit, based on the corrective measures introduced by the authorities. The Executive Board also approved new program targets for 2016.

São Tomé and Príncipe's three-year ECF arrangement for SDR 4.44 million (about US$ 6.3 million or 60 percent of quota) was approved by the Executive Board on July 13, 2015 (see Press Release No. 15/336). It supports the government's economic reform program for stronger and more inclusive growth, and it also plays a catalytic role for bilateral and multilateral assistance.

Following the Executive Board's discussion on São Tomé and Príncipe, Mr. Min Zhu, Deputy Managing Director and Acting Chair, made the following statement:

[1] The ECF is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted balance of payments problems.

“São Tomé and Príncipe’s economy has been resilient even after prospects for commercial oil production became uncertain with the withdrawal of a large oil company from exploration. In addition, performance under the program supported by the Extended Credit Facility has been satisfactory. International reserves have increased, and inflation has continued to decline, reaching its lowest level in the past two decades. Fiscal performance was, however, impacted by tax revenue underperformance.

“GDP growth is projected to pick up to 5 percent in 2016—albeit below the authorities’ medium-term target of 6 percent needed to significantly impact poverty—aided by higher public investments, a recovery in cocoa production, and increased foreign direct investment in the tourism sector. Inflation is expected to remain around 4 percent in 2016 and stabilize around 3 percent over the medium term, while the current account deficit is set to contract further.

“The authorities’ 2016 economic program focuses appropriately on sustaining the fiscal consolidation to help bring debt toward a moderate risk of debt distress. This will require sustained efforts to boost tax revenue collection, clear arrears, strengthen expenditure monitoring and control, and gradually scale up the infrastructure program, which will be backed by enhanced investment management capacity in project selection, implementation, and evaluation. Strengthening debt management capacity and continued reliance on grants and concessional financing will help mitigate the high risk of debt distress.

“The outlook is facing macro-financial challenges. Elevated bank lending risks and potential contingent claims on the budget, in an environment marked by rising nonperforming loans and highly indebted households and businesses, will continue to hold back private sector credit expansion and the prospects for higher growth. Against this backdrop, the authorities are working to increase the banking system’s efficiency, profitability, and resilience.

“Looking ahead, it is important that the authorities maintain the policy resolve and commitment demonstrated so far, especially in an election year, to mitigate these risks and bring the benefits of reforms to a broader segment of the population.”

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 16/289
FOR IMMEDIATE RELEASE
June 17, 2016

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

IMF Executive Board Concludes 2016 Article IV Consultation with São Tomé and Príncipe

On June 10, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the 2016 Article IV consultation[1] with the Democratic Republic of São Tomé and Príncipe.

São Tomé and Príncipe's economy has been resilient even after prospects for commercial oil production, which dominated the political and economic narrative until end-2013, became uncertain with the withdrawal of a large oil company from exploration in the Joint Development Zone shared with Nigeria. São Tomé and Príncipe's economic performance has been positive, despite a slowdown in growth in 2015. Real GDP in 2015 is estimated to have fallen below the projected 5 percent by almost 1 percentage point, driven by poor rains affecting crop yields, particularly, cocoa production and delayed implementation of public investment projects. Inflation fell below the projected 5 percent, aided by weakened demand and falling international prices of oil and other commodities.

The medium-term outlook is favorable but challenges remain. GDP is projected to grow by 5 percent in 2016—below the authorities' medium-term sustained target of 6 percent needed to significantly impact poverty—aided by higher public investments, a recovery in cocoa production, and increased foreign direct investment in the tourism sector. The authorities are however, facing macro-financial challenges. Elevated bank lending risks and potential contingent claims on the budget, in an environment marked by rising nonperforming loans (NPLs) and highly indebted households and businesses, will continue to hold private sector credit expansion and the prospects for higher growth. Inflation is expected to remain around 4 percent in 2016, and further stabilize around 3 percent over the medium term, on the back of falling international prices of food and petroleum products. The current account deficit is set to contract further in line with weaker-than-estimated demand and lower-than-expected commodity prices.

Executive Board Assessment[2]

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

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

Executive Directors agreed with the thrust of the staff appraisal. They welcomed São Tomé and Príncipe's progress toward greater macroeconomic stability, marked by sustained growth, declining inflation, and stable international reserves, even after prospects for commercial oil production became uncertain. Directors noted, however, that while some progress has been made, challenges remain and poverty is still high. Against this backdrop, they called for further efforts to enhance the economy's resilience by strengthening the financial sector, maintaining fiscal discipline, and implementing reforms to support sustainable and inclusive growth.

Directors supported the authorities' commitment to sustain the fiscal consolidation in order to bring debt toward a moderate risk of debt distress. In this regard, they stressed the importance of boosting tax revenue collection, clearing arrears, strengthening expenditure monitoring and control, and gradually scaling up the infrastructure program, which should be backed by enhanced investment management capacity. Directors also called for strengthening debt management capacity and for continued reliance on grants and concessional financing to mitigate the high risk of debt distress.

Directors stressed that maintaining financial stability is crucial. In this regard, they welcomed the authorities' decision to develop a strategy to address the large stock of non-performing loans and, where necessary, review provisioning practices and minimum capital requirements to ensure that banks are well capitalized. Directors also encouraged the introduction of a contingency plan to deal with potential fiscal risks. In addition, they called on the authorities to conduct a detailed asset quality review to reduce the uncertainty surrounding the quality of banks' assets and to work with commercial banks to increase the banking system's efficiency, profitability, and resilience.

Directors noted the authorities' commitment to the pegged exchange rate regime and the current level of the peg, which has served the country well as an effective anchor for inflation in the context of a prudent fiscal stance and an adequate level of international reserves. At the same time, they recognized the need to ensure external competitiveness through continued tight demand management and structural reforms aimed at enhancing the country's physical infrastructure, improving the business climate, promoting diversification, raising productivity, and boosting private investment.

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

São Tomé and Príncipe: Selected Economic Indicators, 2014–19

(Annual change in percent, unless otherwise indicated)

	2014	2015		2016		2017		2018		2019
		EBS/15/71		EBS/15/71		EBS/15/71		EBS/15/71		
	Actual	Program	Est.	Program	Proj.	Program	Proj.	Program	Proj.	Proj.
National income and prices										
GDP at constant prices	4.5	5.0	4.0	5.2	5.0	5.5	5.5	5.5	5.5	5.5
Consumer prices										
End of period	6.4	5.2	4.0	4.0	4.0	3.0	3.0	3.0	3.0	3.0
Period average	7.0	5.8	5.3	4.6	3.9	3.5	3.5	3.0	3.0	3.0
External trade										
Exports of goods and nonfactor services	64.3	5.8	-9.2	8.5	9.2	6.9	7.2	6.9	6.5	8.2
Imports of goods and nonfactor services	28.6	-8.3	-17.4	15.5	11.8	9.1	7.0	8.5	5.8	2.9
Exchange rate (dobras per US$; end of period) [1]	20,148	...	22,424	...	...	...	...	...	...	...
Real effective exchange rate (depreciation = -)	7.0	...	0.8	...	...	...	...	...	...	...
Money and credit										
Base money	23.2	14.6	37.5	11.1	10.4	7.1	6.3	8.0	7.2	9.7
Broad money (M3)	16.8	15.1	13.1	11.4	11.6	6.6	6.3	7.5	7.2	7.9
Credit to the economy	-1.0	-0.7	3.8	1.6	7.0	3.4	4.8	5.3	5.2	7.5
Velocity (GDP to broad money; end of period)	2.6	2.6	2.6	2.4	2.5	2.4	2.5	2.4	2.5	2.5
Central bank reference interest rate (percent)	12.0	...	10.0	...	...	...	...	...	...	...
Average bank lending rate (percent)	23.2	...	23.3	...	...	...	...	...	...	...
Average bank deposit rate (percent)	8.9	...	6.9	...	...	...	...	...	...	...
Government finance (figures in percent of GDP)										
Total revenue, grants, and oil signature bonuses	25.9	31.8	28.0	33.9	35.1	34.9	33.4	35.6	33.7	33.5
Of which: tax revenue	14.1	15.0	14.3	15.5	14.9	16.0	15.4	16.5	15.9	16.5
Nontax revenue	1.5	1.7	1.5	1.7	2.2	1.7	1.3	1.7	1.3	1.3
Grants	10.3	15.1	11.4	16.6	17.3	17.1	16.6	17.3	16.4	15.6
Oil signature bonuses	0.0	0.0	0.8	0.0	0.7	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	31.4	40.6	34.2	36.2	44.1	36.9	37.3	35.9	36.2	33.9
Personnel costs	9.1	8.8	8.9	8.7	8.6	8.6	8.5	8.5	8.4	8.4
Interest due	0.7	0.4	0.8	0.4	0.7	0.7	0.7	0.7	0.7	0.7
Nonwage noninterest current expenditure	8.7	8.7	8.5	8.7	8.1	8.4	7.9	8.2	7.6	7.6
Treasury funded capital expenditures	0.9	0.9	0.7	1.0	0.7	1.9	1.6	2.5	2.2	2.5
Donor funded capital expenditures	11.8	20.8	14.7	16.6	20.2	16.6	17.9	15.5	16.7	14.0
HIPC Initiative-related social expenditure	0.2	1.0	0.6	0.9	0.9	0.6	0.6	0.6	0.5	0.7
Domestic primary balance [2]	-3.3	-2.7	-3.0	-2.0	-2.0	-1.8	-1.8	-1.5	-1.5	-1.4
Overall balance (commitment basis)	-5.5	-8.8	-6.3	-2.3	-9.0	-2.0	-3.8	-0.4	-2.5	-0.4
External sector										
Current account balance (percent of GDP)										
Including official transfers	-21.9	-12.4	-16.7	-15.2	-12.2	-16.4	-12.7	-17.0	-12.6	-10.5
Excluding official transfers	-32.6	-28.5	-28.2	-32.7	-29.5	-34.3	-29.7	-35.1	-29.3	-26.4
PV of external debt (percent of GDP)	30.1	32.5	39.7	32.5	36.2	32.0	38.3	31.7	39.4	37.9
External debt service (percent of exports) [3]	3.7	4.8	4.3	4.2	4.8	3.9	4.3	3.7	4.0	3.8
Export of goods and non-factor services (US$ millions)	88.5	93.5	80.4	101.5	87.7	108.4	94.1	115.9	100.2	108.5
Gross international reserves [4]										
Millions of U.S. dollars	56.5	66.9	61.0	80.5	72.8	97.7	75.9	102.7	82.4	87.6
Months of imports of goods and nonfactor services [5]	4.2	4.0	4.4	4.5	5.0	5.1	5.0	5.1	5.1	5.0
National Oil Account (US$ millions)	9.9	8.0	10.3	6.5	11.5	5.3	9.3	4.3	7.6	6.2
Memorandum Item										
GDP										
Billions of dobras	6,242	7,171	7,028	7,790	7,847	8,251	8,287	8,820	8,839	9,533
Millions of U.S. dollars	338.0	325.6	318.2	356.3	349.2	381.8	371.2	412.9	396.0	428.8

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

[1] Central Bank (BCSTP) mid-point rate.
[2] Excludes oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.
[3] Percent of exports of goods and nonfactor services.
[4] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.
[5] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

May 20, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION, FIRST REVIEW UNDER THE EXTENDED CREDIT FACILITY, AND REQUEST FOR WAIVER FOR NONOBSERVANCE OF PERFORMANCE CRITERION AND MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Context: São Tomé and Príncipe's economic development is constrained by its insularity, fragility, limited resources, and low capacity as a small island state. GDP growth has averaged over 4 percent per year since 2012, faster than many small island states. Inflation has also fallen sharply from 28 percent down to about 4 percent, the lowest in the past two decades. These developments notwithstanding, growth has not been sufficiently strong and diversified to meaningfully improve economic prospects and reduce poverty significantly. The poverty rate is high at 66 percent.

Focus: Discussions centered on aligning fiscal policy to bring debt to a downward trajectory toward a moderate risk of debt distress; addressing the liquidity overhang to enhance monetary management; improving competitiveness; and safeguarding financial sector stability to support growth. São Tomé and Príncipe is participating in the second round pilot of countries to mainstream macro-financial linkages.

Review: The program is broadly on track. The authorities met all the end-December 2015 quantitative performance criteria except for marginally missing the performance criterion (PC) on the domestic primary deficit. Some indicative targets were also missed. The government has, however, made progress in implementing structural reforms as planned.
Staff recommends completion of the first review under the Extended Credit Facility and modification of the indicative targets for end-September and performance criteria for end-December 2016, and supports the authorities' request for a waiver for nonobservance of the end-December 2015 PC on the domestic primary deficit.

Outlook and risks: The macroeconomic outlook is favorable in the near term but challenges remain. The main sources of short-term risks to the outlook are the forthcoming presidential election (July 2016), with the risk of extra-budgetary spending, and continued weakness in the banking sector. In addition, the economy will remain vulnerable to global developments, including weak demand in the key European and emerging markets.

Approved By
David Owen (AFR) and Andrea Richter Hume(SPR)

Discussions were held in São Tomé during March 9–24. The staff team included Maxwell Opoku-Afari (head), Dalmacio F. Benicio, Jehann Jack, Luiz Felipe Almeida (all AFR) and Burcu Hacibedel (FIN). The mission was assisted in headquarters by Bakar Ould Abdallah and Estanislao Rengifo. The IMF team met with the Minister of Finance and Public Administration Américo Ramos, Central Bank Governor Maria do Carmo Silveira, Minister of Public Works and Natural Resources, Carlos Vila Nova, Minister of Agriculture and Rural Development, Teodorico de Campos, Minister of Labor and Social Protection, Carlos Gomes, Acting President of the autonomous Island of Príncipe, Francisco Gula, other senior government officials, representatives of the private sector, and representatives of the donor community.

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CONTEXT: A STRATEGY FOR DEBT REDUCTION AND INCLUSIVE GROWTH IN A SMALL ISLAND FRAGILE STATE

1. **São Tomé and Príncipe's economic development is constrained by its insularity, fragility, limited resources, and low capacity as a small island state** (Figure 1). Its export base is undiversified and consists basically of cocoa and a nascent tourism industry that is yet to be fully tapped. Prospects for commercial oil production dominated the government's political and economic narrative until the end of 2013. However, Total Oil Company subsequently withdrew from exploration in the Joint Development Zone shared with Nigeria.[1] The banking sector grew rapidly from expansion in foreign liabilities, in anticipation of intermediating the prospective financial flows from the oil sector. However, profitability remains weak, and loan quality has deteriorated significantly. With prospects for commercial oil production now uncertain, implementation of the government's infrastructure program, initially planned to be financed by oil revenue, has stalled; the high public debt and weak revenues limit the space for infrastructure spending to overcome constraints to development.

2. **São Tomé and Príncipe has however, made commendable progress toward greater macroeconomic stability.** GDP growth has averaged over 4 percent per year since 2012, faster than many small islands states, but not sufficiently strong and diversified to meaningfully improve economic prospects and reduce poverty significantly. The poverty rate is high at 66 percent. Inflation has fallen sharply from 28 percent down to 4 percent, the lowest in the past two decades.

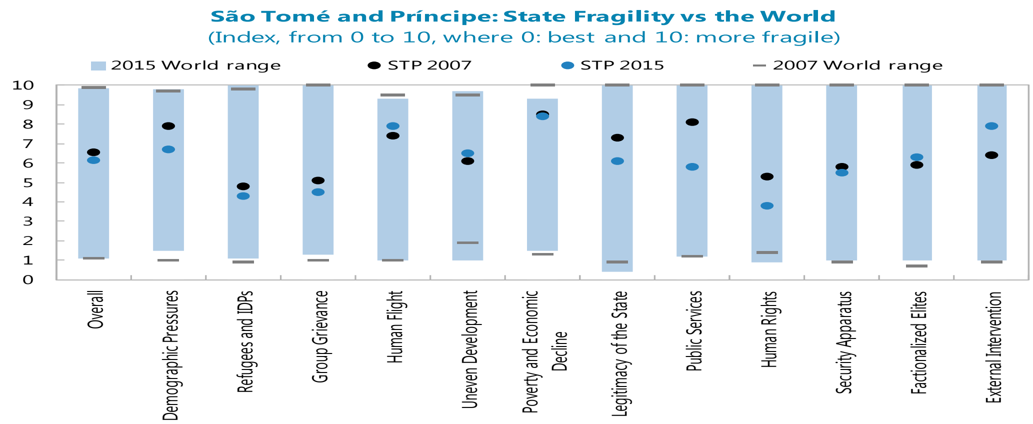
3. **Implementation of the 2012 National Poverty Reduction Strategy (PRSP-II) has been a top priority but progress in achieving the Millennium Development Goals (MDGs) was mixed.** São Tomé and Príncipe achieved less than half of the MDGs (achieving universal primary education, reducing child mortality and improving maternal health) and came close to achieving two others (combating HIV/AIDS, malaria and other diseases and ensuring environmental sustainability). However, the country did not achieve the goal of eradicating extreme poverty and hunger. 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, and to government instability. The government is currently working on integrating the Sustainable Development Goals (SDGs) into an updated national development strategy that will replace the PRSP-II after it ends in 2016.

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

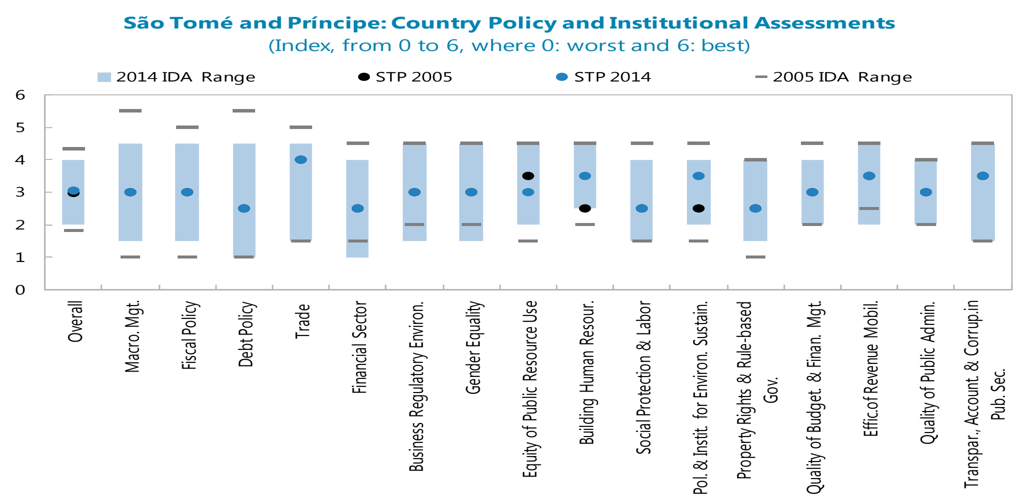
4. São Tomé and Príncipe's Article IV consultation has been delayed at the request of the new government[2]. The government saw a new program as a priority and an opportunity to re-calibrate their broad policy objectives after the previous ECF arrangement, which was set to expire on July 19, 2015, went off-track with four reviews outstanding. The last Article IV consultation was concluded by the Executive Board on December 16, 2013. There has been some progress toward implementing Fund policy advice (Box 1) such as ongoing strengthening of banking supervision, the approval of a new banking resolution law and the introduction of an interbank market and open market operations underpinned by the issuance of treasury bills for the first time in 2015.

Figure 1. São Tomé and Príncipe: Evolving Fragility from Two Lenses

Despite stagnation or worsening in the economic indicators of fragility, the Fund for Peace's overall Fragile State Index shows modest improvement in the last nine years, with gains mainly in social and political indicators such as human rights, demographic pressures, group grievance, legitimacy of the state and delivery of public services



…and the World Bank's overall CPIA rating shows a marginal improvement over the last ten years, with gains made in only two indicators of policies for social inclusion and equity: building human resources and policies and institutions for environmental sustainability.



Sources: The Fund for Peace and World Bank.

[2] The new government was elected in October 2014 and did not assume office until January 2015.

Box 1. Main Recommendations of the 2013 Article IV Consultation and their Current Status

Advice	Status
Banking supervision	
Strengthen supervision and enforce prudential requirements throughout the banking system, including the strict enforcement of the minimum capital-to-risk-weighted asset ratio of 12 percent.	Achieved. Presently all banks have capital-to-risk-weighted asset ratio above 12 percent. Three banks which had capital shortfall raised their capitals to the minimum required in the last quarter of 2015, following supervisory actions.
Enforce the legal requirement that all commercial banks publish their financial accounts to enhance transparency and facilitate assessments of counterparty risks.	Achieved de jure but not de facto. According to BCSTP all banks publish their financial accounts regularly albeit with some delays. However, a commercial bank has complained that not all published accounts are audited or in Portuguese, limiting their usefulness.
Financial sector restructuring	
Encourage banks to revisit their business plans and investment strategies in light of more uncertain oil prospects, and to adjust their balance sheets accordingly.	Ongoing. All commercial banks, including those that had to raise their capital recently, have been strongly encouraged to develop new business plans consistent with the current economic reality.
Foster merger of some small banks to increase the banking system's efficiency and profitability, and promote financial stability.	Partially achieved. The number of operating commercial banks has dropped by one to seven after one of the smallest and troubled banks was acquired by a larger bank in 2014 as a part of a resolution process due to failure to comply with supervisory requirements.
Develop a comprehensive market strategy to deal with nonperforming loans by: (i) conducting a realistic evaluation of distressed assets and facilitate strict enforcement of classification based on international norms; (ii) continuing to strengthen the oversight of risk management practices at the commercial banks and credit enforcement laws; and (iii) exploring options for restructuring some of the loans.	Ongoing. This recommendation has been elevated to a structural benchmark under the ECF supported program with a due date of end-June 2016.
Monetary policy management and competitiveness	
Step up efforts toward more proactive liquidity management to including the development of an interbank market to address the excess reserves.	Partially achieved. Interbank money market was formalized in 2015; however, not a single transaction has taken place yet due to the perception of stigma attached to participation. BCSTP is working with the banks to overcome this challenge and to further enhance liquidity forecasting and management.
Maintain a comfortable international reserves position, a continuation of ongoing efforts to further diversify and expand the export base by targeting reforms that improve the country's competitiveness and business climate.	Ongoing. Maintenance of a comfortable international reserve position is a key objective under the program (a performance criterion) and the development of a national export diversification strategy has been elevated to a structural benchmark under the program with a due date of end-December 2016. While the international reserve coverage is just at the recommended benchmark level, it may be desirable to build additional buffer.
Safeguards assessments	
Strengthen the internal audit function and coordination of the audits by senior BCSTP management to ensure prompt remedial actions on audit findings.	Partially achieved. The internal audit committee was restructured and a new Director with recognized competences was appointed. Further actions are scheduled to be completed in 2016, including the updating of the Internal Audit Charter and establishment of a database to monitor and prioritize audit recommendations, establishing an Audit Board policy and conducting risk-based audits of high-risk areas.
Implement formal investment policies for BCSTP.	Achieved. An investment policy, together with a guideline, was adopted in 2014-15.

Source: IMF staff estimates.

RECENT ECONOMIC DEVELOPMENTS, OUTLOOK AND RISKS

5. Delayed approval of the 2015 budget hindered performance of key macroeconomic indicators.[3] Economic activity slowed as public investment projects were kept on hold due to the late approval of the 2015 budget. In addition, poor rains affected crop yields, particularly, cocoa production. As a result, GDP growth in 2015 is estimated to have fallen below the projected 5 percent by almost 1 percentage point. The end-December 2015 inflation fell below the projected 5 percent, aided by weakened demand and falling international prices of oil and other commodities.

6. Fiscal consolidation efforts have been hampered by tax revenue underperformance and a mismatch between the timing of donor budget support grants and corresponding expenditure. Tax revenue is estimated to have fallen short of the end of year target by about 0.7 percent of GDP, in part due to a lower collection effort of tax arrears and delayed inclusion of the 15,000 new taxpayers registered during the operation tax inclusion project. In addition, ENCO (the oil importing company) continues to accumulate new tax arrears (estimated at 0.3 percent of GDP) in 2015. There was also about 2.2 percent of GDP shortfall in donor budget support grants.[4] While the authorities made modest offsetting cuts in expenditure to accommodate domestic revenue underperformance, these were insufficient, resulting in a domestic primary deficit of about 3.0 percent of GDP, higher than the program target of 2.7 percent of GDP.

7. The authorities have begun implementing the domestic arrears clearance plan agreed under the ECF-supported program. The arrears clearance plan proposes clearing government's outstanding arrears to the utility company (EMAE), general suppliers and to ENCO while also preventing the accumulation of new arrears. In particular, the plan outlines that the government would amortize all arrears to: (i) EMAE in 2015; (ii) general suppliers in five years starting from 2015; and (iii) ENCO over 40 years with no interest charges starting from 2016. These amortizations which add to about 1 percent of GDP on average annually through 2020 and 0.2 percent of GDP thereafter have been incorporated into the program. An automatic fuel price adjusted mechanism is to be introduced by end-June 2016 to prevent the accumulation of new arrears. The plan also proposes clearing EMAE's arrears to ENCO over 10 years, starting in 2015. The government has already cleared all arrears to EMAE in 2015, 1.2 percent of GDP (0.5 percent of GDP higher than budgeted). EMAE in turn paid the equivalent of 2.6 percent of GDP of its arrears to ENCO. Despite this payment,

[3] The change in government and late assumption of office by the new government delayed the approval of the 2015 budget. The 2016 budget was however approved on time.

[4] World Bank budget support grant for 2015 did not materialize due to delays by the authorities to provide documentation on MOUs signed with China Harbor Engineering on the deepwater port project to assess whether the terms in the MOU are consistent with the ECF-supported program.

EMAE's arrears to ENCO in 2015 increased on net basis by 2.2 percent of GDP, albeit, by less than initially projected under the plan. Going forward, EMAE may face difficulties in making full payments to ENCO, in line with the plan, due to delays in reaching agreement with investors on alternative energy sources over the purchase price of energy. Clearance of government arrears to ENCO will start this year, and are included in the 2016 budget.

8. **The external current account deficit fell to 17 percent of GDP, reflecting weak economic activity and contraction in oil imports that more than offset the decline in cocoa exports.** Gross international reserves, estimated at US$61 million (4.4 months of import cover) at the end of 2015, remain at comfortable levels.

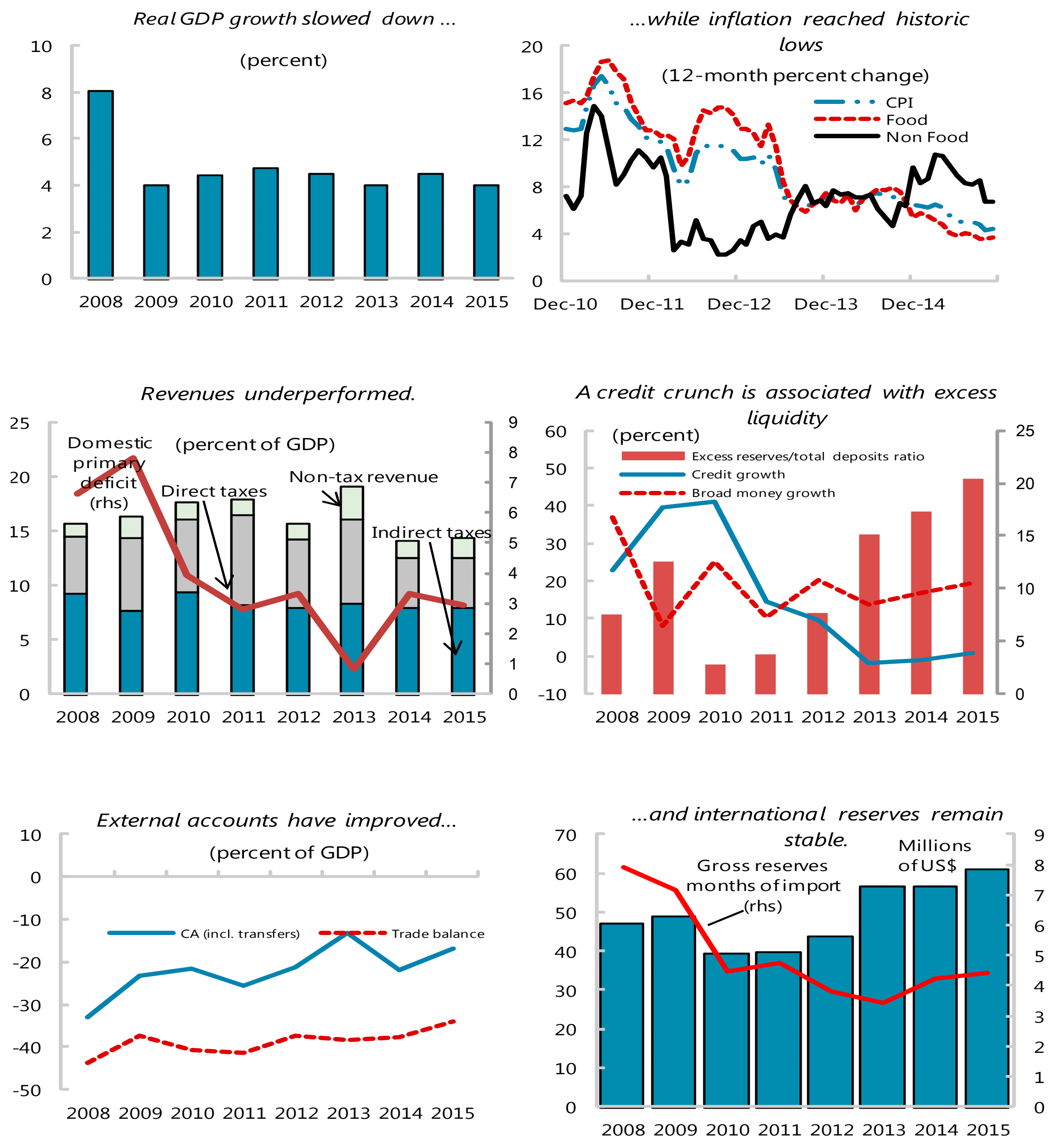
9. **There are signs that the stress in the financial system has intensified.** The capital adequacy ratio for the entire banking system fell from 20.3 percent in December 2014 to 15.5 percent at the end of 2015, while capital to risk-weighted assets ratio increased to 24.1 percent from 22.6 percent, following recent capital injections by several banks. Moreover, non-performing loans have increased to a historic high of about 30 percent following the reclassification of overdue overdrafts in Banco Equador's books as bad loans and a downgrade in a sizeable share of the largest bank's loan classification to loss.

10. **The macroeconomic outlook is favorable in the near term but challenges remain.** GDP is projected to grow by 5 percent in 2016 aided by higher and a more timely execution of public investments, recovery in cocoa production and increased foreign direct investment (FDI) in the tourism sector. However, the current slowdown in credit expansion as a result of large and rising NPLs, in particular to small enterprises, is negatively affecting economic activities and the economic growth acceleration prospects. Inflation is expected to remain around 4 percent on the back of falling international prices of food and petroleum products, but still higher than the euro area inflation. Staff's medium-term projection shows real GDP growth falling short of the authorities' target of 6 percent; inflation stabilizing at 3 percent; and the current account deficit contracting further.

11. **Risks are tilted to the downside** (see Box 2). The forthcoming presidential election slated for July 2016, with the risk of extra budgetary spending[5], and continued weakness in the banking sector and potential contingent claims on the budget, are the main sources of short-term risks to the outlook. Authorities have however, expressed firm commitment to avoid electoral spending beyond what is budgeted and are working swiftly to address weaknesses in the banking sector including a comprehensive asset quality review and a strategy to address the high and rising NPLs (to be implemented in June 2016). Additional downside risks could arise from weak demand in key advanced and emerging economies, which could dampen FDI and tourism inflows and reduce exports to those economies. Adoption of policies that increase fiscal space would serve as a buffer.

[5] In the past, fiscal consolidation efforts have been undermined during elections.

Figure 2. São Tomé and Príncipe: Recent Macroeconomic Developments



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

Box 2. São Tomé and Príncipe: Risk Assessment Matrix 2016

Source of Risks	Relative Likelihood	Potential Impact	Policy Response
Domestic risks			
Early start to the political cycle for the 2016 Presidential election could result in extra budgetary spending.	Medium	**High**. Significant election related spending would lead to additional borrowing needs and derail gains in fiscal rectitude.	Maintain fiscal prudence by ensuring that spending plans for 2016 proceed as budgeted.
Continued weakness in banking intermediation.	High	**High**. Continued high levels of nonperforming loans and low profitability of banks would prevent a bottoming out of the credit cycle and adversely affect economic growth. In the worst case scenario, there is a potential for a significant cost from bank restructuring.	Require a comprehensive strategy, including a detailed asset quality review, to address the high stock of nonperforming loans. In addition, there is the need for increased enforcement of prudential requirements including increased provisioning and recapitalization of affected banks.
External risks			
A surge in global financial volatility and decompression of credit spreads following slow growth as well as protracted policy uncertainty in the euro area.	High	**Low**. Increased financial volatility could cause foreign investors to become more risk averse and reduce financial flows, elevate inflationary pressures and undermine growth prospects.	Keep fiscal discipline and step up liquidity management to back the growth and inflation objectives; maintain adequate foreign reserves.
Weak demand in key advanced and emerging economies.	High	**Medium**. Weakness in external demand could dampen São Tomé and Príncipe's exports and contribute to lower real GDP growth.	Adopt policies to increase fiscal space to be able to respond to slowdown in external financing.
Increased volatility of energy prices due to uncertainty about the oil supply shock.	Medium	**Medium**. The associated price fluctuations could add to existing macroeconomic uncertainties.	Take advantage of the current low international crude oil price environment to introduce reforms in domestic fuel pricing to ensure full cost recovery.

Source: IMF staff estimates.

PROGRAM PERFORMANCE

12. The program is broadly on track (Table 1 of MEFP attachment I). Although budget execution was challenged due to shortfalls in tax revenue and donor budget support, all but one end-December 2015 performance criteria (PCs) were met. The PC on domestic primary deficit was missed by about 0.3 percent of GDP due mainly to tax revenue underperformance and the absence of corresponding expenditure cuts. The indicative targets on tax revenue (a floor) and on dobra money (ceiling) were missed by 0.7 percent of GDP and 16 percent above target respectively, due mainly to slowdown in economic activities and faster-than-programmed accumulation of net foreign assets and net government deposits respectively. The indicative target on pro-poor spending (floor), on the other hand, was missed marginally (2 percent lower than target) due to oversight difficulties which will be enhanced with the expansion of the electronic information management system (SAFEe) to all ministries and government agencies. Corrective measures to address tax revenue under-performance have been introduced (see ¶ 20 and MEFP ¶ 12 and 13).

13. The government has made progress in implementing structural reforms as planned (Table 2 of MEFP attachment I). In particular, the new bank resolution law was submitted to the National Assembly[6], and the two structural benchmarks related to improvements in the national accounts and consumer price statistics were also implemented. The policy resolve and commitment demonstrated so far are still needed, especially in an election year, to maintain momentum, and importantly, bring the benefits of reform and sacrifices made thus far to a broader segment of the population.

POLICY DISCUSSIONS

14. Policy discussions focused on addressing critical medium-term challenges. Emphasis was placed on aligning fiscal policy to ensure a decline in the debt trajectory over the medium term while creating space for growth-enhancing and social spending; addressing the liquidity overhang to enhance monetary management; improving competitiveness and setting the stage for higher sustainable and inclusive growth; and enhancing the role of macro-financial linkages to improve financial stability and support economic growth.

A. Staying the Course on Debt Reduction while Improving the Quality of Spending

15. Debt vulnerabilities remain high. The updated debt sustainability analysis (DSA), which reflects lower upfront borrowing and disbursements in 2015, still shows that São Tomé and Príncipe remains at high risk of debt distress, after receiving HIPC debt relief in 2007. With challenges in budget execution in 2015, stronger implementation effort and oversight is required in order to maintain the deficit target path in the program, which is consistent with the available non-debt creating financing—aimed at bringing debt toward a moderate risk of debt distress.

16. São Tomé and Príncipe has outstanding arrears to non-Paris Club creditors—Angola and the People's Republic of China. These arrears predate the HIPC completion point and amount to US$53 million at end-2015. They are the only debt obligations to these creditors and there is no other debt service falling due on them.

17. In past Fund programs, these arrears have been deemed away, reflecting the HIPC agreement and the best efforts of the São Tomé and Príncipe authorities to resolve the arrears to non-Paris Club creditors. The authorities have approached non-Paris Club creditors

[6] The law was subsequently passed by the National Assembly and gazetted.

in order to negotiate debt relief on comparable terms but no bilateral agreement has been reached so far.

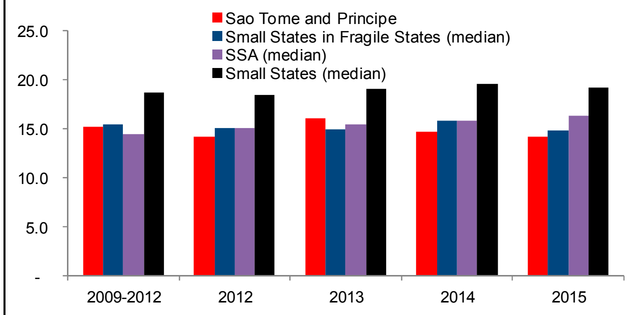
18. The staff assesses that the arrears can continue to be deemed away under the revised lending-into-official arrears policy approved by the Board in December 2015. Under the new policy the arrears can be deemed away if the underlying Paris Club agreement is assessed to be adequately representative, i.e., if Paris Club creditors provide the majority of the financing contributions required from official bilateral creditors. In the case of São Tomé and Príncipe, the Paris Club creditors' share of required contributions from official bilateral creditors amounted to about 52 percent and hence can be considered representative for the purposes of the new policy. Even though the deadline set out in the Paris Club agreed minutes to conclude bilateral agreements with non-Paris Club creditors has passed, staff assesses that the São Tomé and Príncipe authorities have since continued making best efforts to conclude the agreements with Angola and the People's Republic of China. As under the old policy, staff will continue to revisit this assessment at each review, to make a judgment about whether the authorities continue to make best efforts to resolve the arrears.

19. The authorities share staff's recommendation to anchor medium-term fiscal policy on bringing debt to a downward trajectory toward a moderate risk of debt distress. At the heart of achieving this objective is sustained adjustment to the domestic primary deficit (MEFP attachment I ¶ 11). Experience across smaller countries offers support to the policy of reducing debt by reducing the domestic primary deficit through boosting tax revenues and containing discretionary expenditure. Such an effort will require a significant social and political commitment over the course of several years. The authorities confirmed their determination to a medium-term domestic primary deficit of 1–1½ percent of GDP. Consistent with the above, the projected domestic primary deficit target of 2 percent of GDP, in the 2016 budget, is in line with the program. The sharp increase in the overall fiscal deficit in 2016 is due to higher capital spending financed mostly from planned privatization proceeds from government's shares in the largest bank and the telecom company and from disbursements of already contracted project loans and previously programmed new concessional loans from Kuwait and Turkey. The increase in the overall fiscal deficit, as a result of increased capital spending, does not affect the program debt trajectory. It however, helps to offset the negative impact of the slowdown in tourism and stressed financial sector on growth, thereby maintaining the medium-term growth path originally envisaged under the program. The authorities agreed to staff's recommendation to stand ready to make timely offsetting cuts in primary domestic expenditure while safeguarding pro-poor spending should the full amount of expected budget support fail to materialize, but noted that given the very rigid expenditure profile, any shortfall in budget support could result in some cuts in social spending.

20. Accelerating improvements in revenue collection should be an integral part of the medium-term fiscal policy strategy (MEFP attachment I ¶ 12). The goal is to increase tax revenue collection to the levels of the peers by 2018. The tax collection effort has been low relative to the recent past and compared to peers. This has been, in part, due to poor collection of tax arrears including from ENCO, and non-collection from new taxpayers identified during the operation tax inclusion. Reversing the current situation and improving the collection require decisive effort to curb fraud and tax evasion through greater, more rigorous, and regular audits, improving the capacity and incentives at the large taxpayer unit, increasing the number of products subject to imposition of minimum custom value, and introducing a number of legislative changes, including lowering the minimum taxable income, raising the minimum presumptive levy charged to individuals and firms, and transferring the execution powers for collection of tax arrears from the fiscal court judge to the tax administration (end-June 2016 structural benchmark).

Text Chart 1. Tax Revenue

(Percent of GDP)



Source: World Economic Outlook Data.

21. The government has delayed the introduction of value added tax (VAT) beyond 2017 (MEFP attachment I ¶ 12). While VAT introduction would significantly widen the tax base and enhance domestic revenue collection, staff welcomes the government's decision to shift the introduction to 2018 to allow for more comprehensive preparatory work, including the drafting and passing of the VAT law, the tax policy design, introduction of revenue administration structures to support the implementation of VAT, training of staff, and a public education campaign (Box 3). The IMF and other partners (including the AfDB) are providing the necessary assistance. The current program does not yet assume the revenue impact of the introduction of VAT.

22. On the spending side, the authorities are placing emphasis on strengthening public financial management and transparency (MEFP attachment I ¶ 14). The main goal is to ensure efficiency in public expenditure. Although the authorities have taken some initial steps to improve its information management system and data analysis capacities, swift implementation of further measures is critical. Specific measures will include rolling out of SAFEe from the current pilot stage to cover all ministries, autonomous services, other sovereign institutions, regional and local government to strengthen public financial oversight. The authorities are considering enhancing SAFEe with added functionality such as reconciliation of treasury bank accounts, revenue tracking, management of fixed assets and a government contracts registry to facilitate the preparation of more comprehensive general government accounts. In addition, the authorities intend to move towards medium-term fiscal and expenditure frameworks in 2017.

Box 3. Conditions for Success of Value Added Tax in São Tomé and Príncipe

Broad legislative reform. The introduction of VAT should be conceived as part of a broader reform plan of indirect taxation (introduction of excise consumption tax, revision of the customs tariff). Changes in income tax legislation will be necessary to maintain the coherence in the tax system (for example, harmonization of thresholds subject to the real regime).

With regard to **the VAT legislation** specifically, the experience of countries that have adopted this tax in recent years points to the following best practices: (i) a broad tax base with a fairly small number of exemptions to ensure good performance of the tax and prevent economic distortions created by tax incentives; (ii) a single rate to simplify the tax system and facilitate administration, reduce compliance costs of taxpayers' obligations and minimize the risk of evasion; (iii) adoption of a zero rate applied only to exports; and a relatively high application threshold to eliminate incidence on small operators, reduce the number of collectors and facilitate management of the tax by the tax administration. The use of a single threshold for all companies, whatever their legal form, is a good practice.

Preparation of tax administration. Apart from the quality of the VAT law, the successful introduction of the tax depends critically on the capacity of the tax and customs administrations to administer it. The launch of VAT project is not recommended before the tax administration is properly prepared. In the current stage, the tax directorate needs both an organizational restructuring and deep reforms to strengthen the tax administration. There is a need to adopt a functional organization in line with modern tax administrations, where central services are dedicated primarily to supporting task, steering, coordinating, monitoring and evaluating the activities of operational services. The new organization should also include proper segmentation of taxpayers, an internal audit function to prevent moral hazard, and an enhanced tax enforcement function. Beyond organizational restructuring, there is an urgent need to strengthen the tax administration in the following areas: (i) developing human capacity; (ii) improving working conditions and (iii) strengthening fiscal operations, including needs for more dynamic and secured management of a taxpayer database, management of taxpayer files based on risk analysis that reflects strong concentration of revenue in a small number of taxpayers, and reorienting inspection activity towards broadening the tax base and imposing fines on tax evasion, and adopting a computer application with basic functionality such as automatic notification of defaulting taxpayers and the extraction of statistics and support for oversight and improved education of taxpayers and services to users. A premature launch of the VAT would exacerbate the existing obstacles and could lead to failure of the project. In 2016, efforts should be concentrated on measures to strengthen fiscal operations to continue to ensure the mobilization of fiscal resources.

23. The authorities are going ahead with the introduction of an automatic fuel price adjustment mechanism, taking advantage of the current low international crude oil price environment (MEFP attachment I ¶ 13). This will ensure full cost recovery, prevent the accumulation of new domestic arrears to ENCO and reduce pressure on the budget.
The government has committed to use the initial positive price differential at the time of the introduction of the automatic fuel price mechanism to partially lower prices at the pump while the rest of the differential will be locked in by raising the surcharge rates on fuel, and using the proceeds to accelerate arrears reduction to ENCO.

24. The government has identified key growth-enhancing infrastructure spending needed to increase growth to around 6 percent—the minimum required to significantly impact poverty. Some of these key projects are: the deepwater port project for which the government has already signed MOUs[7] (about US$800 million) with China Harbor Engineering Company to design a PPP with financing from the private sector; the extension of the airport runway in São Tomé; and the development of alternative sources of cheaper energy (other than thermal). Staff welcomes the authorities' decision to focus on the extension of the airport runway and alternative sources of energy, and only embark on the deepwater port project if a careful and comprehensive feasibility study establishes its economic viability and also if it is entirely private sector financed without government contingent liabilities.

25. A successful implementation of the infrastructure program depends critically on implementing the existing debt framework law and strengthening debt management capacity (MEFP attachment I ¶ 17). This will involve policy actions that include the preparation of a national debt strategy that fixes a ceiling on the overall debt of the non-financial public sector and annual debt policies that fix annual ceilings for each public entity. The government plans to carry out a new debt management performance assessment (DeMPA) by end-December 2016 with the support of development partners. This will highlight areas of focus for improvements. Enhanced capacity for debt management will be anchored on an updated medium-term debt management strategy, a manual of procedures for debt management, a computer-based debt management system and staff training. Also, the government has prepared a comprehensive draft public private partnership (PPP) law and framework to guide the growing expressions of interests for PPPs following the London investors' conference in October 2015. The PPP law is expected to be finalized by end-September 2016.

26. This should be backed by enhanced investment management capacity (MEFP attachment I ¶ 16). The government's fairly low project execution ratio suggests a need for improving capacity in project implementation and evaluation and gradually scaling up capital expenditure to ensure that the authorities have adequate time to build their technical expertise. Staff urged the authorities to introduce: (i) a centralized framework for appraising and prioritizing capital expenditure projects and (ii) a public investment management assessment (PIMA) framework and associated implementation plan (end-December 2016). This should help reconcile competing funding demands with available resources while ensuring consistency with the government's policies and objectives.

27. The authorities agreed with the risks flagged by the updated DSA. There was general recognition of these vulnerabilities and there is an ongoing effort to mitigate them through the range of fiscal reforms discussed above, including efforts at strengthening debt management and improving debt recording and monitoring. The authorities are committed to continuing to prioritize grants and focus on priority projects financed by concessional loans. The authorities have also prepared a borrowing plan (MEFP ¶ 18, MEFP Text Table 1) including sources and uses of the planned financing.

[7] Staff's view, after reviewing the existing MOUs, is that there were no liabilities that are not contingent on further negotiations/agreement by the government, and that the MOUs as they stood, did not breach the PC on nonconcessional borrowing.

B. Addressing Liquidity Overhang to Enhance Monetary Management

28. The large and growing excess liquidity is undermining the authorities' effort at monetary management. Excess liquidity was estimated at 24 percent of deposits or about 5 percent of GDP at the end of 2015. It is distributed asymmetrically among banks, with the bulk concentrated in the largest bank, while a couple of banks struggle to meet the minimum required reserve levels. Excess liquidity has built up mainly from net inflows of external resources, and its persistence suggests that involuntary excess liquidity is more than a temporary deviation away from the optimal structure of commercial banks' balance sheets. While current headline inflation is in line with the authorities' target of keeping inflation around 4 percent in 2016 and declining further to 3 percent over the medium term, there are risks of elevating underlying inflationary pressures coming from growing excess liquidity which could fuel aggregate demand pressures.

29. Staff underscored the need to further refine the liquidity forecasting and management tools (MEFP attachment I ¶ 18–19). The current forecasting tools allow for improved information gathering and better analysis of the autonomous factors that drive liquidity. However, forecasting errors (though reduced) still hamper an accurate assessment of the liquidity needs of the banking system; further minimizing these errors and determining banks' needs would inform the timing and quantum of issuance of new treasury bills and bonds in the nascent money market. Moreover, the recently-introduced interbank money market has not generated the required participation by banks due to perceptions of stigma, while the successful introduction of government treasury bills in June 2015 and the doubling of the amount on offer to about 2 percent of GDP this year, though bold, are insufficient to address the liquidity overhang. The implementation of the strategy to address the large and growing NPLs (¶ 38), further development of the financial infrastructure (¶ 37), and reforms to improve the business environment (¶ 41 and 42) will encourage commercial banks to start lending on the margins to reduce involuntary reserves in an environment of positive real interest rates.

30. The BCSTP believes the lack of participation by banks in the interbank money market is only temporary given recent developments in the domestic financial market. The BCSTP is working with banks to address these challenges while at the same time improving the functioning of the government securities market—creating the conditions for longer-term liquidity management—as well as developing the secondary market.

C. Macro-Financial Linkages and Financial Sector Stability

31. Prospects for commercial oil production increased the size of the banking sector significantly. The financial sector is highly-concentrated and characterized by excess liquidity and low profitability (SIP section II). One large bank accounts for about half of the system's deposits and loans; six small banks account for the other half (Figure 4). Total assets of the banking system increased from 25.9 percent of GDP in 2001 to 86.8 percent of GDP by 2012 before falling to 79.9 percent of GDP in 2015. Foreign currency denominated deposits and loans have been trending downward since the introduction of the peg to the euro in 2010, but remain high and subject to risks of capital flight in the absence of appropriate prudential measures. The number of banks also increased from 1 in 2001 to 7 by 2015, all in anticipation of increased economic activity in relation to commercial oil production.

32. Indicators of profitability remain weak, amidst high operating cost and weak demand for loans, with only the largest bank remaining profitable while other banks face negative (some highly) returns on assets. Return on equity has also been deteriorating and was estimated at -27 percent in 2015, eroding the capital base of some banks. However, the central bank's intervention and corrective measures are beginning to yield results. Three out of seven banks have increased their capital to the minimum required level. BCSTP is moving—under the new bank resolution law which provides the necessary legal framework for swift and orderly resolution of banks—to create a transition bank as a first step toward resolving Banco Equador which has been under administration over the past year. The BCSTP has now introduced a regulatory framework on bridge banks, based on the recently passed banking resolution law, to help guide any potential resolution and restructuring of banks, including private sector solutions.

33. The quality of banks' aggregated loan book deteriorated significantly since the last Article IV in 2013. The asset quality of most banks has been weakening as reflected in increasing NPLs, and presents significant vulnerabilities as well as hindering financial intermediation (Figure 5 and SIP section II). The ratio of NPLs to total loans almost doubled from around 16 percent to about 30 percent. This increase in NPLs was driven by substandard and loss loans, which indicates further deterioration in asset quality. As a result, the BCSTP has demanded increases in provisioning (doubling it in the last year alone). Bank-by-bank NPLs show a worrying picture, with only one bank with an NPL ratio of less than 10 percent. Two banks have NPLs close to 50 percent while the remaining banks have NPLs ranging between 20 and 30 percent, reflecting similar trends in other small financial systems (SIP section IV).[8]

34. Staff stressed the urgent need for a comprehensive strategy to address the large stock of NPLs in the banking system and the introduction of a contingency plan to deal with potential fiscal risks. The NPL strategy, among other things, should also look at reforming the debt enforcement and insolvency regimes, introducing out-of-court workout that aims at rehabilitating viable debtors, and measures to improve the operational capacity of banks to work out NPLs. This should be backed by a more detailed asset quality review (AQR) involving stocktaking, review of provisioning requirements, in-depth examination of banks' large exposure, and where necessary, recapitalization of affected banks to reduce the uncertainty currently surrounding the quality of assets carried by banks. This will also require appropriate measures at the bank level (e.g., addressing weak

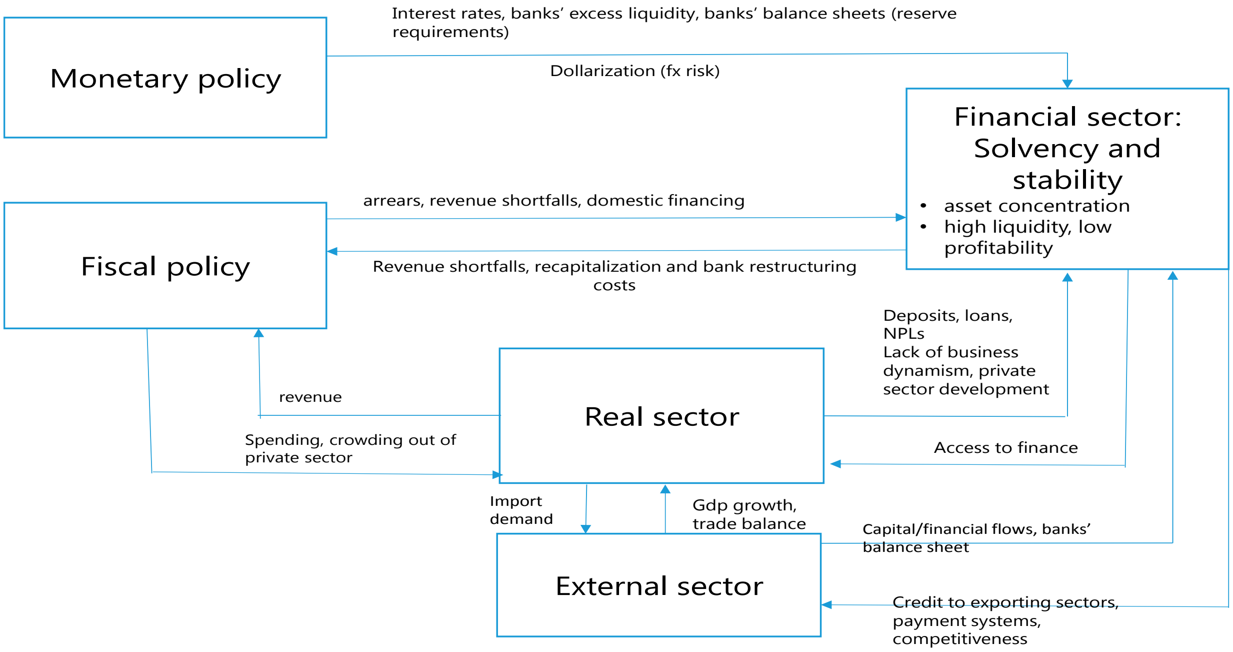
[8] The domestic arrears is mainly due to the oil importing company and the electricity generating company, and does not significantly affect suppliers nor contribute to the large and rising NPLs.

underwriting standards including improvements in credit policies and governance) and beefing up risked-based supervision to minimize spillovers from the banking sector to the rest of the economy. Enhancing both on- and off-site supervision, tightening and enforcing prudential norms are critical to containing credit risk. The authorities are strongly urged to use all legal tools available (including the recently passed banking resolution law), combined with private sector solutions (backed by the new regulation on bridge banks) to address any vulnerabilities identified during the comprehensive AQR, and where necessary, set up a contingency plan in subsequent budgets to address any residual fiscal risk.

35. Linkages between developments in the financial sector and the overall economy are bi-directional (Figure 3 and SIP section II). Continued vigilance over the financial sector is warranted given the adverse impacts of macro-related risks on the financial sector and the negative spillback to the real economy. More recently, the lack of dynamism in the real economy, following the declining prospects for commercial oil production, has constrained credit expansion as banks struggle to find new businesses. This has impacted negatively on banks' balance sheet and profitability. The BCSTP has had to intervene in 3 banks in the last 3 years, with one bank currently under administration. A potential resolution of the bank under administration, if new shareholders are not identified, could induce a cost of about 4 percent of GDP to the budget. There is also a negative feedback from the current slowdown in credit expansion, in particular to small enterprises, on economic activities and the economic growth acceleration prospects, with already tangible negative impact on domestic revenue mobilization—frustrating the authorities' drive to raise domestic resources to supplement the financing of the government's infrastructure project. There is also a negative spillover from the slowdown in domestic capital expenditure implementation (weak public sector demand) on the financial sector—mainly the significant reduction in loan demands from government contractors and the subsequent rising loan default rates (SIP section II).

36. Macro stress tests highlight credit risk as the most relevant given the limited debt instruments, excess liquidity, and currency peg. In addition, large exposure to few borrowers exposes banks to concentration risk. A default of about three large borrowers will lead to a system-wide drop in capital adequacy ratio (CAR) below the minimum required (SIP section II). Overall, the stress test results show that banks in São Tomé and Príncipe are vulnerable to shocks simulated and give some indication that the industry's overall capitalization could be undermined should these shocks materialize.

Figure 3. Macro-Financial Linkages in São Tomé and Príncipe

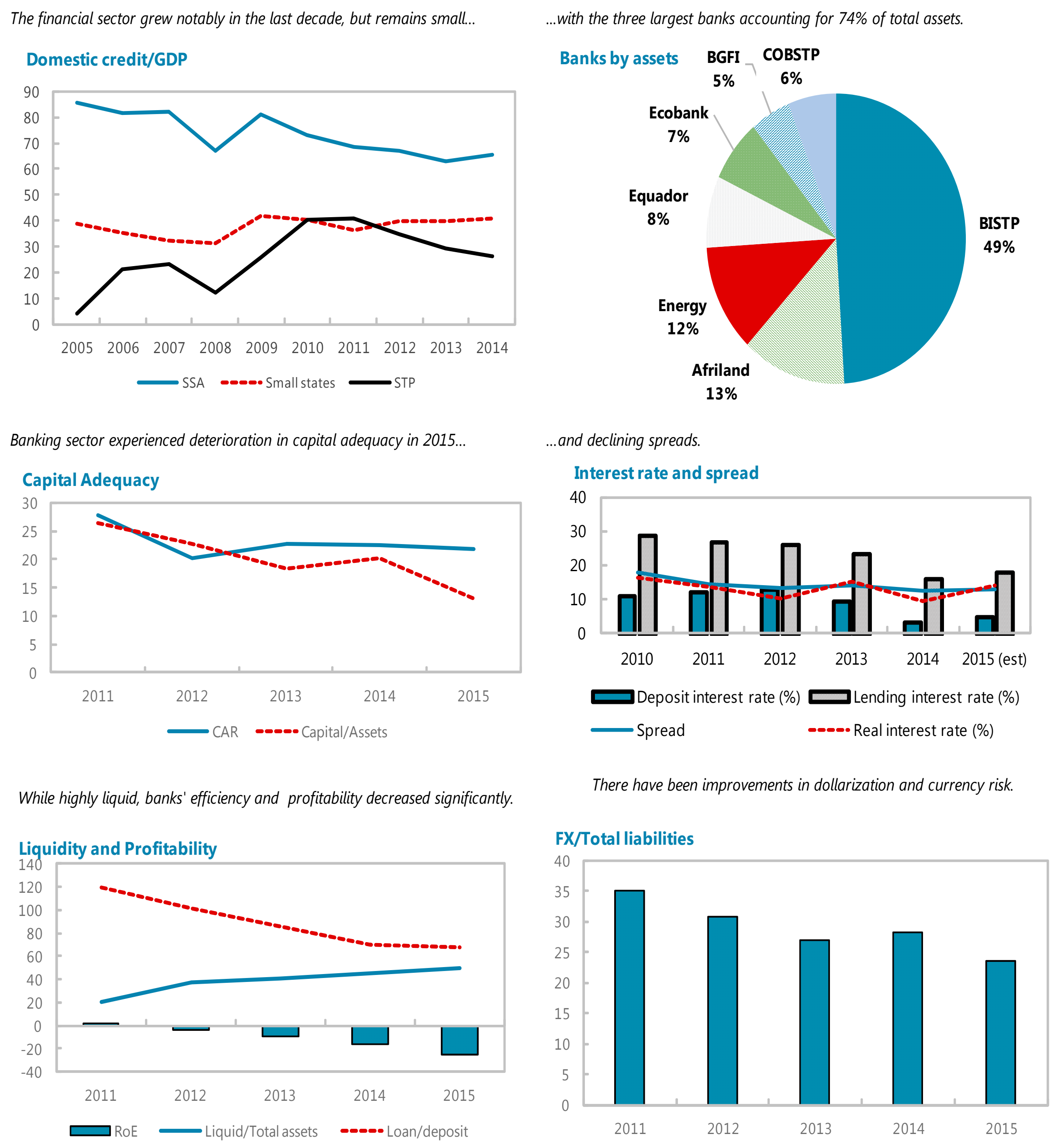


Sources: São Tomé and Príncipe authorities' data; and IMF staff estimates.

37. Access to financial services needs to be broadened to the unbanked segments of the population, including SMEs (SIP section II). Credit delivery to these under-served sectors has been hampered by the lack of collateral, poor enforcement when available and information asymmetry in the banking system. This has made base lending rates sticky downwards and cut off segments of the population from gaining access to financial services. To resolve this problem, reforms are needed to lower operational costs, increase competition, and enhance business practices by SMEs, in particular: (i) improving the coverage and effectiveness of the credit reference bureaus; (ii) streamlining procedures to ensure collateral enforcement, including reforms to the judiciary; and (iii) training SMEs in basic accounting, financial management, and preparation of bankable projects.

38. The BCSTP shared staff's recommendation to swiftly address weaknesses in the financial system in order to support private sector development and promote financial inclusion. The authorities are moving quickly to produce a comprehensive strategy for the resolution of the large stock of NPLs (*structural benchmark June 2016*) backed by a detailed AQR. In addition, the authorities have initiated processes (with the help of development partners) to address structural bottlenecks in the economy, including a comprehensive review of the judiciary to restore confidence in contract enforcement by reducing the lengthy court resolution of default cases, backed by a review of the collateral processes.

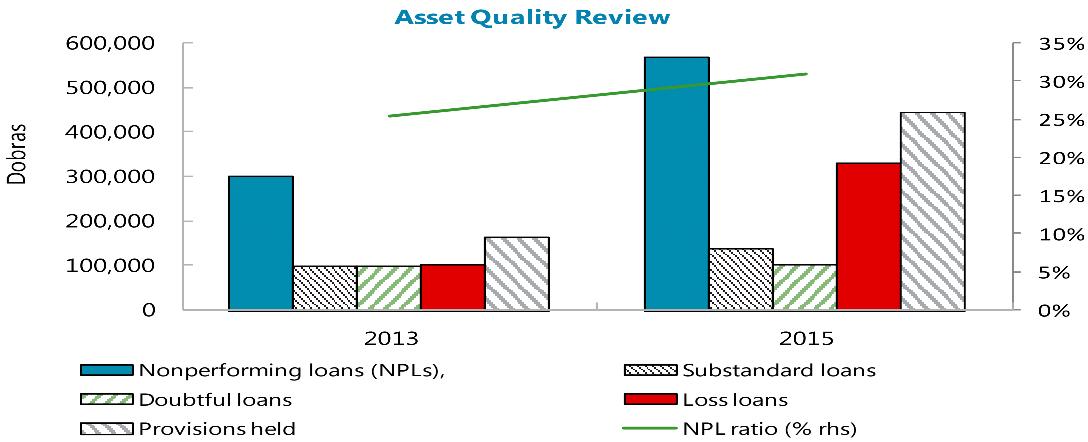
Figure 4. São Tomé and Príncipe: Financial Sector Developments



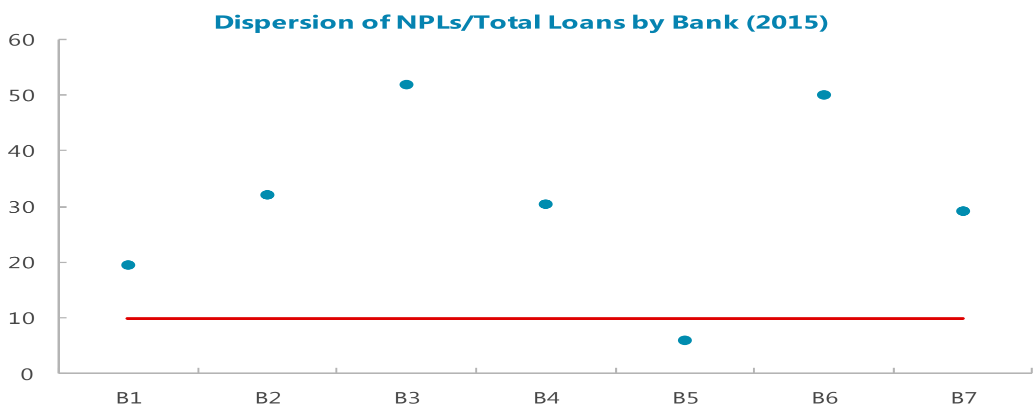
Sources: São Tomé and Príncipe authorities' data and IMF staff estimates.

Figure 5. São Tomé and Príncipe: Asset Quality

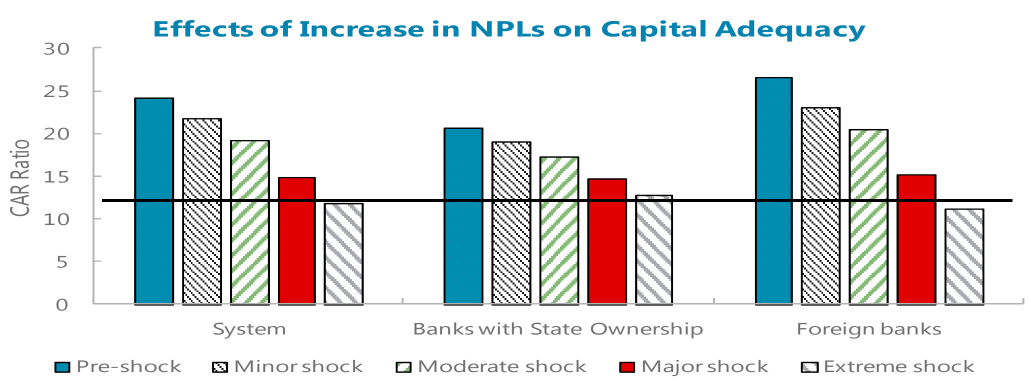
Asset quality deteriorated relative to the last Article IV consultations in 2013.



...deterioration in asset quality is widespread across most banks.



CAR of the system and of foreign banks may fall below minimum under extreme shock.



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

D. Improving Competitiveness and Setting the Stage for Higher Sustainable and Inclusive Growth

39. Achieving economic diversification and inclusive growth remains a challenge. The broad outlines of the government's 2030 Transformation Agenda identify the priorities for medium to long-term growth, social cohesion and external credibility, including most notably diversifying the economy, broadening the production base and modernizing the economic and social infrastructure. While the services sector has driven growth historically, São Tomé and Príncipe's tourism potential is yet to be tapped (MEFP attachment I ¶ 21). The way forward is for São Tomé and Príncipe to focus on high value-added tourism activities, broader diversification of source markets, and more open, competitive air transport connections, including direct links to the neighboring countries in the sub region, Europe, and Brazil (SIP section I). This would require further work on the existing airport to extend the runway to accommodate larger aircrafts, including chartered aircrafts.

40. There should also be targeted efforts to support the traditional sectors (agriculture and fisheries) to boost job creation and reduce poverty. While still accounting for a sizable share of employment, the combined share of agriculture and fisheries in real GDP has been declining and their contribution to growth has been meager—a trend that has to be reversed.

41. Staff assesses the real effective exchange rate (REER) as moderately over-valued in 2015 (Annex I). Addressing this would require further diversifying the economy and exports beyond the traditional sectors through targeted actions to improve the business environment to attract FDI. The low level of competitiveness remains a challenge to economic diversification and inclusive growth. Indicators of doing business are lagging behind the average for sub-Saharan Africa and other small states based on the 2016 World Bank Doing Business survey. While some progress was made in some areas—the indicator measuring starting a business topped the rankings in the region—special attention is needed in the areas where the country ranks in the bottom quarter in the region: getting electricity, registering property, access to credit, protecting minority investors, and paying taxes. Some large infrastructure projects, for example, in electricity generation, the airport, and the existing port, could significantly enhance doing business and make São Tomé and Príncipe one of the preferred tourist destinations in the region. Staff welcomes the authorities' effort to put together a national export diversification strategy by the end of December 2016.

42. The authorities agreed with staff's assessment of the level of the exchange rate. They stressed their commitment to the pegged exchange rate regime and the current level of the peg, which has served them well as an effective anchor for inflation. To ensure external competitiveness, they recognize that it needs to be supported by continued tight demand management and structural reforms designed to raise productivity and boost private investment. The authorities also agree with the need for diversification and enhancing the competitiveness of traditional sectors to promote sustained and broad-based and shared growth. For example, in agriculture, the authorities are prioritizing access to credit by small farmers as a way to reclaim lost grounds in cocoa and coffee production, with the goal of, at least, doubling cocoa production and exports by 2020.

PROGRAM ISSUES, SAFEGUARDS AND RISKS

43. The end-December 2015 PC on the domestic primary deficit was missed by a small margin (0.3 percent of GDP) and staff supports corrective measures introduced by the authorities to address this slippage. Staff agrees with the introduction of legislations to lower the minimum taxable income, raise the minimum presumptive levy charged to individuals and firms, and transfer the execution powers for collection of tax arrears from the fiscal court judge to the tax administration unit (¶ 20) aimed at boosting tax collection. Staff also supports corrective measures introduced by the authorities to address the missed indicative targets on the floor of pro-poor spending (¶ 12) and the ceiling on dobra money.

44. Program monitoring. All PCs and indicative targets for the first half of 2016 remain the same as approved by the Executive Board. Staff and the authorities have however, agreed to propose a modification to the PCs on the domestic primary deficit and net international reserves (while staff proposes to modify the two PCs slightly, they remain the same in percent of GDP and in terms of months of imports respectively) and indicative targets on tax revenue and base money in the second half of 2016 to align with the pace of reforms in revenue administration and faster-than-programmed accumulation of net foreign assets and net government deposits in 2015 (Table 3 of MEFP attachment I). Four new structural benchmarks for 2016 have been proposed covering a change in tax administration legislation, a public investment management assessment (PIMA) and the associated implementation plan, VAT law, and establishment of an Audit Board policy at BCSTP (Table 4 of MEFP attachment I). The second review is expected to be completed by December 2016, the third review by June 2017, and the fourth review by December 2017.

45. The program is fully financed and staff's assessment of São Tomé and Príncipe's capacity to repay the Fund remains broadly unchanged from the ECF arrangement request (Table 11). São Tomé and Príncipe's capacity to repay the Fund remains strong, as obligations remain small relative to exports and reserves.

46. An updated safeguards assessment, completed in February 2016, found that severe capacity constraints contributed to a weak safeguards framework at the central bank. In particular, independent oversight on audit and control mechanisms was lacking and the BCSTP law needs to be amended to strengthen the autonomy of the central bank. In addition, to strengthen independent oversight on the bank's operations, the BCSTP should establish an Audit Board Policy that includes roles and responsibilities similar to a conventional audit committee (end-December 2016 structural benchmark), and identify a qualified external expert to assist the Audit Board. Reforms to the BCSTP law, currently underway, should be done in consultation with the Fund.

47. Risks to the program are high. Apart from slower growth than envisaged, financial sector vulnerabilities could become more pressing, risks to reform commitment in a presidential election year could crystallize and weak capacity could constrain program implementation. Continued technical assistance particularly in banking supervision, PFM and tax administration and policy would in part mitigate risks related to capacity.

OTHER SURVEILLANCE ISSUES

48. Although the provision of economic data has some shortcomings, it is broadly adequate for surveillance. There is ample scope to improve the balance of payments statistics, which are being revised with the help of STA TA. INE has completed the rebasing of the national accounts to 2008 (as opposed to 2001) and a new CPI, reflecting price movements in a broader basket of goods and services and using 2014 (instead of 1996) as the base year. The next steps include improving GDP statistics by developing data on the components of GDP on the demand side, strengthening trade statistics, and extending coverage of the international investment position.

49. Exchange System and Exchange Rate Arrangement. São Tomé and Príncipe continues to avail itself of the transitional arrangements under Article XIV, but does not maintain restrictions under Article XIV. However, it maintains one exchange restriction subject to Fund approval under Article VIII. The authorities should work towards removing the existing exchange restriction, which arises 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 investments. The country's exchange rate arrangement is, since 2010, a de facto fixed peg to the euro. The exchange system is free of multiple currency practices.

STAFF APPRAISAL

50. The strong progress in implementation of structural reforms needs to be maintained to bring the full benefits of reforms to a broader segment of the population. Staff welcomes the authorities' continued commitment to program implementation and supports the corrective measures introduced to boost domestic revenue mobilization (¶ 20 and 43). Measures are to be introduced by the end of 2016 to ensure proper monitoring of pro-poor spending, i.e., expansion of the electronic information management system (SAFEe) to all ministries and government agencies (¶ 12) and dobra money.

51. Staff also welcomes the authorities' resolve to maintain the strong medium-term fiscal adjustment to bring down debt toward a moderate risk of debt distress. The continued underperformance of tax revenue calls for steadfast implementation of identified revenue administration measures and introduction of legislations to address weaknesses in collection of tax arrears and to bring on board the identified 15,000 new tax payers to support the medium-term objective of bringing the domestic primary deficit down to 1–1½ percent of GDP. This would have to be complemented by enhancing the growth impact of public investment spending, including structured and centralized investment planning, prioritization, and budgeting, to ensure fiscal policy supports the overriding objective of debt sustainability, by walking a fine line between debt reduction and scaling up of the needed growth-enhancing spending.

52. Strengthening debt management capacity while continuing to rely on grants and concessional loans is at the core of the debt reduction program. Staff welcomes the authorities' decision to prepare a national debt strategy that fixes a ceiling on the overall debt of the non-financial public sector, updates the medium-term debt management strategy, and prepares guidelines on debt management. The authorities are therefore encouraged to conduct a new debt management performance assessment (DeMPA) to set the basis for the new debt management strategy and also to finalize the draft public private partnership (PPP) law and framework to guide the government's public investment program given the increased expressions of interests following the successful investor's conference in London, in October 2015.

53. The timing is right to implement the automatic fuel pricing mechanism as planned. Addressing the high stock of domestic arrears needs to be backed by a comprehensive reform to the government's fuel subsidy program to prevent future accumulation of arrears. The current low international crude oil price presents the right environment to introduce this key reform to further strengthen the authorities' fiscal consolidation efforts.

54. Staff welcomes the BCSTP's efforts at enhancing liquidity management, and also notes that challenges remain. While the liquidity forecasting tool introduced so far allows for improved information gathering and a more accurate analysis of the autonomous factors that drive liquidity, it needs further refining to minimize forecasting errors, due to poor information sharing on treasury spending, to better support BCSTP's liquidity management operations. Staff strongly recommends that the BCSTP leads the effort to address banks' transparency concerns and perceived stigma associated with accessing the interbank market in order to boost participation.

55. Vulnerabilities within the financial system need to be swiftly addressed. There is evidence of bi-directional linkages between the financial sector and the real, fiscal, and external sectors of the economy. The lack of dynamism in the real economy has impacted banks' ability to lend, resulting in large and fast build-up of excess liquidity in the banking system, with a negative feedback loop to the real and fiscal sectors of the economy. These have jointly resulted in a sharp and sustained increase in NPLs and raised the risk of potential cost to the budget should some of the existing weak and unprofitable banks require restructuring. The BCSTP should immediately develop a strategy to address the large stock of NPLs, and where necessary, review provisioning practices and minimum capital requirements to ensure banks are well capitalized. This should be backed by a detailed AQR to reduce the uncertainty currently surrounding the quality of assets carried by banks and further safeguard the stability of the financial system. Once the comprehensive AQR is completed, the BCSTP should use all legal tools available (including private sector solutions) to address any vulnerabilities identified, and if required, set up a contingency plan in subsequent budgets to address any residual fiscal risk.

56. In light of the broadly satisfactory program implementation so far and the authorities' commitment to maintaining the momentum, staff supports the completion of the first review under the ECF arrangement. Staff recommends a waiver for the nonobservance of the PC on the floor of domestic primary deficit based on corrective measures committed by the authorities (¶ 20 and 43) and also supports the proposed establishment and modification of PCs, indicative targets, structural benchmarks for 2016, and the request to combine the two continuous PCs on non-concessional external borrowing. Staff also supports the second disbursement in the amount of SDR 634,285.

57. It is proposed that the next Article IV Consultation be held on a 24-month cycle, in accordance with the Decision on Article IV Consultation Cycles (Decision No. 14747-(10/96), as amended).

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2014–19

(Annual change in percent, unless otherwise indicated)

	2014	2015		2016		2017		2018		2019
		EBS/15/71		EBS/15/71		EBS/15/71		EBS/15/71		
	Actual	Program	Est.	Program	Proj.	Program	Proj.	Program	Proj.	Proj.
National income and prices										
GDP at constant prices	4.5	5.0	4.0	5.2	5.0	5.5	5.5	5.5	5.5	5.5
Consumer prices										
End of period	6.4	5.2	4.0	4.0	4.0	3.0	3.0	3.0	3.0	3.0
Period average	7.0	5.8	5.3	4.6	3.9	3.5	3.5	3.0	3.0	3.0
External trade										
Exports of goods and nonfactor services	64.3	5.8	-9.2	8.5	9.2	6.9	7.2	6.9	6.5	8.2
Imports of goods and nonfactor services	28.6	-8.3	-17.4	15.5	11.8	9.1	7.0	8.5	5.8	2.9
Exchange rate (dobras per US$; end of period) [1]	20,148	...	22,424	...	...	...	...	...	...	...
Real effective exchange rate (depreciation = -)	7.0	...	0.8	...	...	...	...	...	...	...
Money and credit										
Base money	23.2	14.6	37.5	11.1	10.4	7.1	6.3	8.0	7.2	9.7
Broad money (M3)	16.8	15.1	13.1	11.4	11.6	6.6	6.3	7.5	7.2	7.9
Credit to the economy	-1.0	-0.7	3.8	1.6	7.0	3.4	4.8	5.3	5.2	7.5
Velocity (GDP to broad money; end of period)	2.6	2.6	2.6	2.4	2.5	2.4	2.5	2.4	2.5	2.5
Central bank reference interest rate (percent)	12.0	...	10.0	...	...	...	...	...	...	...
Average bank lending rate (percent)	23.2	...	23.3	...	...	...	...	...	...	...
Average bank deposit rate (percent)	8.9	...	6.9	...	...	...	...	...	...	...
Government finance (figures in percent of GDP)										
Total revenue, grants, and oil signature bonuses	25.9	31.8	28.0	33.9	35.1	34.9	33.4	35.6	33.7	33.5
Of which: tax revenue	14.1	15.0	14.3	15.5	14.9	16.0	15.4	16.5	15.9	16.5
Nontax revenue	1.5	1.7	1.5	1.7	2.2	1.7	1.3	1.7	1.3	1.3
Grants	10.3	15.1	11.4	16.6	17.3	17.1	16.6	17.3	16.4	15.6
Oil signature bonuses	0.0	0.0	0.8	0.0	0.7	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	31.4	40.6	34.2	36.2	44.1	36.9	37.3	35.9	36.2	33.9
Personnel costs	9.1	8.8	8.9	8.7	8.6	8.6	8.5	8.5	8.4	8.4
Interest due	0.7	0.4	0.8	0.4	0.7	0.7	0.7	0.7	0.7	0.7
Nonwage noninterest current expenditure	8.7	8.7	8.5	8.7	8.1	8.4	7.9	8.2	7.6	7.6
Treasury funded capital expenditures	0.9	0.9	0.7	1.0	0.7	1.9	1.6	2.5	2.2	2.5
Donor funded capital expenditures	11.8	20.8	14.7	16.6	20.2	16.6	17.9	15.5	16.7	14.0
HIPC Initiative-related social expenditure	0.2	1.0	0.6	0.9	0.9	0.6	0.6	0.6	0.5	0.7
Domestic primary balance [2]	-3.3	-2.7	-3.0	-2.0	-2.0	-1.8	-1.8	-1.5	-1.5	-1.4
Overall balance (commitment basis)	-5.5	-8.8	-6.3	-2.3	-9.0	-2.0	-3.8	-0.4	-2.5	-0.4
External sector										
Current account balance (percent of GDP)										
Including official transfers	-21.9	-12.4	-16.7	-15.2	-12.2	-16.4	-12.7	-17.0	-12.6	-10.5
Excluding official transfers	-32.6	-28.5	-28.2	-32.7	-29.5	-34.3	-29.7	-35.1	-29.3	-26.4
PV of external debt (percent of GDP)	30.1	32.5	39.7	32.5	36.2	32.0	38.3	31.7	39.4	37.9
External debt service (percent of exports) [3]	3.7	4.8	4.3	4.2	4.8	3.9	4.3	3.7	4.0	3.8
Export of goods and non-factor services (US$ millions)	88.5	93.5	80.4	101.5	87.7	108.4	94.1	115.9	100.2	108.5
Gross international reserves [4]										
Millions of U.S. dollars	56.5	66.9	61.0	80.5	72.8	97.7	75.9	102.7	82.4	87.6
Months of imports of goods and nonfactor services [5]	4.2	4.0	4.4	4.5	5.0	5.1	5.0	5.1	5.1	5.0
National Oil Account (US$ millions)	9.9	8.0	10.3	6.5	11.5	5.3	9.3	4.3	7.6	6.2
Memorandum Item										
GDP										
Billions of dobras	6,242	7,171	7,028	7,790	7,847	8,251	8,287	8,820	8,839	9,533
Millions of U.S. dollars	338.0	325.6	318.2	356.3	349.2	381.8	371.2	412.9	396.0	428.8

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

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

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

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

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

[5] 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, 2014–19
(Billions of Dobra)

	2014	2015		2016			2017		2018		2019
		EBS/15/71		EBS/15/71			EBS/15/71		EBS/15/71		
	Actual	Program	Est.	Program	Budget	Proj.	Program	Proj.	Program	Proj.	Proj.
Total revenue and grants	1618	2279	1965	2638	2625	2754	2878	2771	3137	2981	3194
Total revenue	973	1196	1108	1343	1276	1343	1464	1391	1610	1528	1704
Tax revenue	879	1073	1006	1209	1170	1170	1323	1279	1458	1408	1575
Nontax revenue	94	123	102	134	106	172	142	112	152	119	129
Grants	645	1083	804	1295	1349	1355	1413	1380	1527	1453	1490
Project grants	500	730	610	989	995	995	1114	1051	1235	1121	1249
Nonproject grants	103	220	61	219	205	212	216	180	214	184	125
of which unconfirmed	…	…	…	…	0	0	…	37	…	42	47
HIPC Initiative-related grants	42	133	133	87	149	149	83	149	78	149	116
Oil signature bonuses	0	0	53	0	0	56	0	0	0	0	0
Total expenditure	1960	2910	2405	2818	3460	3460	3043	3088	3169	3199	3236
Of which: Domestic primary expenditure	1181	1387	1315	1497	1819	1819	1614	1543	1743	1664	1836
Current expenditure	1157	1284	1274	1381	1366	1366	1463	1417	1530	1475	1594
Personnel costs	569	631	623	676	676	676	708	706	748	742	800
Interest due	44	31	54	29	56	56	60	60	59	59	65
Goods and services	223	229	239	248	240	240	263	254	281	271	292
Transfers	230	315	248	342	311	311	343	311	346	312	336
Other current expenditure	92	78	110	85	82	82	90	87	96	93	100
Capital expenditure	793	1556	1087	1369	2025	2025	1528	1619	1590	1675	1573
Financed by the Treasury	58	64	51	78	53	53	158	134	223	199	238
Financed by privatization proceeds	…	…	…	…	0	0	…	0	…	0	0
Financed by external sources	735	1493	1036	1291	1584	1584	1370	1485	1367	1476	1335
HIPC Initiative-related social expenditure	10	70	44	68	68	68	52	52	49	49	70
Domestic primary balance [1]	-208	-190	-207	-154	-155	-155	-149	-152	-133	-136	-132
Overall fiscal balance (commitment basis)	-342	-631	-440	-180	-835	-706	-166	-317	-33	-218	-42
Net change in arrears, float, and stat. discrepancies (reduction = -)	135	-62	-93	-61	-85	-85	-36	-86	-52	-86	-86
External arrears	11	-11	-12	0	0	0	0	0	0	0	0
Domestic arrears	35	-51	-82	-61	-85	-85	-36	-86	-52	-86	-86
Float and statistical discrepancies	89	0	1	0	0	0	0	0	0	0	0
Overall fiscal balance (cash basis)	-207	-692	-533	-241	-919	-790	-202	-403	-84	-304	-128
Financing	207	692	533	241	919	790	202	403	84	304	129
Net external	199	651	576	206	478	478	175	353	63	286	109
Disbursements (projects)	236	763	742	302	659	659	256	434	132	355	217
Program financing (loans)	80	0	20	0	0	0	0	0	0	0	0
Net short-term loans	0	0	0	0	0	0	0	0	0	0	0
Scheduled amortization	-117	-112	-187	-96	-181	-181	-81	-81	-69	-69	-108
Change in arrears (principal)	0	0	0	0	0	0	0	0	0	0	0
Bilateral rescheduling	0	0	0	0	0	0	0	0	0	0	0
HIPC flow savings	0	0	0	0	0	0	0	0	0	0	0
Net domestic	7	42	-43	35	441	312	27	49	21	18	19
Net bank credit to the government	7	42	-43	35	53	-76	27	49	21	18	19
Banking system credit (excluding National Oil Account)	-37	0	-33	0	0	0	-1	-2	-2	-24	-14
National Oil Account	44	42	-10	35	53	-76	28	51	23	42	34
Nonbank financing	0	0	0	0	388	388	0	0	0	0	0
Of which: Privatisation	0	0	0	0	388	388	0	0	0	0	0
Financing gap	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	0.0
Privatisation account balance (US$ million)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Oil Account balance (US$ million, excl. transfers to budget)	9.9	8.0	10.3	6.5	5.6	11.5	5.3	9.3	4.3	7.6	6.2

Sources: São Tomé and Príncipe authorities' data 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, 2014–19

(Percent of GDP)

	2014	2015		2016			2017		2018		2019
		EBS/15/71		EBS/15/71			EBS/15/71		EBS/15/71		
	Actual	Program	Est.	Program	Budget	Proj.	Program	Proj.	Program	Proj.	Proj.
Total revenue and grants	**25.9**	**31.8**	**28.0**	**33.9**	**33.5**	**35.1**	**34.9**	**33.4**	**35.6**	**33.7**	**33.5**
Total revenue	15.6	16.7	15.8	17.2	16.3	17.1	17.7	16.8	18.3	17.3	17.9
Tax revenue	14.1	15.0	14.3	15.5	14.9	14.9	16.0	15.4	16.5	15.9	16.5
Nontax revenue	1.5	1.7	1.5	1.7	1.3	2.2	1.7	1.3	1.7	1.3	1.3
Grants	10.3	15.1	11.4	16.6	17.2	17.3	17.1	16.6	17.3	16.4	15.6
Project grants	8.0	10.2	8.7	12.7	12.7	12.7	13.5	12.7	14.0	12.7	13.1
Nonproject grants	1.7	3.1	0.9	2.8	2.6	2.7	2.6	2.2	2.4	2.1	1.3
of which unconfirmed	…	…	…	…	0.0	0.0	…	0.4	…	0.5	0.5
HIPC Initiative-related grants	0.7	1.9	1.9	1.1	1.9	1.9	1.0	1.8	0.9	1.7	1.2
Total expenditure	**31.4**	**40.6**	**34.2**	**36.2**	**44.1**	**44.1**	**36.9**	**37.3**	**35.9**	**36.2**	**33.9**
Of which: Domestic primary expenditure	18.9	19.3	18.7	19.2	23.2	23.2	19.6	18.6	19.8	18.8	19.3
Current expenditure	18.5	17.9	18.1	17.7	17.4	17.4	17.7	17.1	17.3	16.7	16.7
Personnel costs	9.1	8.8	8.9	8.7	8.6	8.6	8.6	8.5	8.5	8.4	8.4
Interest due	0.7	0.4	0.8	0.4	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Goods and services	3.6	3.2	3.4	3.2	3.1	3.1	3.2	3.1	3.2	3.1	3.1
Transfers	3.7	4.4	3.5	4.4	4.0	4.0	4.2	3.7	3.9	3.5	3.5
Other current expenditure	1.5	1.1	1.6	1.1	1.0	1.0	1.1	1.0	1.1	1.0	1.0
Capital expenditure	12.7	21.7	15.5	17.6	25.8	25.8	18.5	19.5	18.0	18.9	16.5
Financed by the Treasury	0.9	0.9	0.7	1.0	0.7	0.7	1.9	1.6	2.5	2.2	2.5
Financed by privatization proceeds	…	…	…	…	0.0	0.0	…	0.0	…	0.0	0.0
Financed by external sources	11.8	20.8	14.7	16.6	20.2	20.2	16.6	17.9	15.5	16.7	14.0
HIPC Initiative-related social expenditure	0.2	1.0	0.6	0.9	0.9	0.9	0.6	0.6	0.6	0.5	0.7
Domestic primary balance [1]	-3.3	-2.7	-3.0	-2.0	-2.0	-2.0	-1.8	-1.8	-1.5	-1.5	-1.4
Overall fiscal balance (commitment basis)	-5.5	-8.8	-6.3	-2.3	-10.6	-9.0	-2.0	-3.8	-0.4	-2.5	-0.4
Net change in arrears, float, and stat. discrepancies (reduction = -)	2.2	-0.9	-1.3	-0.8	-1.1	-1.1	-0.4	-1.0	-0.6	-1.0	-0.9
External arrears	0.2	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic arrears	0.6	-0.7	-1.2	-0.8	-1.1	-1.1	-0.4	-1.0	-0.6	-1.0	-0.9
Float and statistical discrepancies	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall fiscal balance (cash basis)	**-3.3**	**-9.7**	**-7.6**	**-3.1**	**-11.7**	**-10.1**	**-2.4**	**-4.9**	**-1.0**	**-3.4**	**-1.3**
Financing	**3.3**	**9.7**	**7.6**	**3.1**	**11.7**	**10.1**	**2.4**	**4.9**	**1.0**	**3.4**	**1.3**
Net external	3.2	9.1	8.2	2.6	6.1	6.1	2.1	4.3	0.7	3.2	1.1
Disbursements (projects)	3.8	10.6	10.6	3.9	8.4	8.4	3.1	5.2	1.5	4.0	2.3
Program financing (loans)	1.3	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net short-term loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Scheduled amortization	-1.9	-1.6	-2.7	-1.2	-2.3	-2.3	-1.0	-1.0	-0.8	-0.8	-1.1
Change in arrears (principal)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral rescheduling	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
HIPC flow savings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic	0.1	0.6	-0.6	0.4	5.6	4.0	0.3	0.6	0.2	0.2	0.2
Net bank credit to the government	0.1	0.6	-0.6	0.4	0.7	-1.0	0.3	0.6	0.2	0.2	0.2
Banking system credit (excluding National Oil Account)	-0.6	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	-0.3	-0.1
National Oil Account	0.7	0.6	-0.1	0.4	0.7	-1.0	0.3	0.6	0.3	0.5	0.4
Nonbank financing	0.0	0.0	0.0	0.0	5.0	5.0	0.0	0.0	0.0	0.0	0.0
Of which: Privatisation	0.0	0.0	0.0	0.0	5.0	5.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
MDRI debt relief (flow in US$ million)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatisation account balance (US$ million)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Oil Account balance (US$ million, excl. transfers to budget)	9.9	8.0	10.3	6.5	5.6	11.5	5.3	9.3	4.3	7.6	6.2
Nominal GDP (Billions of dobras)	6,242	7,171	7,028	7,790	7,847	7,847	8,251	8,287	8,820	8,839	9,533

Sources: São Tomé and Príncipe authorities' data 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, 2014–19
(Billions of Dobra)

	2014	2015		2016		2017		2018		2019
		EBS/15/71		EBS/15/71		EBS/15/71		EBS/15/71		
	Actual	Program	Est.	Program	Proj.	Program	Proj.	Program	Proj.	Proj.
Net foreign assets	**1,474**	**1,805**	**1,903**	**2,011**	**2,180**	**2,384**	**2,200**	**2,432**	**2,316**	**2,437**
Claims on nonresidents	1,795	2,175	2,243	2,418	2,561	2,773	2,595	2,845	2,740	2,847
Official foreign reserves	1,482	1,834	1,864	2,080	2,182	2,440	2,218	2,516	2,363	2,472
Other foreign assets	313	340	379	338	379	333	378	330	377	375
Liabilities to nonresidents	-321	-370	-341	-407	-381	-389	-395	-414	-424	-411
Short-term liabilities to nonresidents	-114	-144	-120	-183	-161	-168	-175	-195	-205	-193
Other foreign liabilities	-207	-226	-221	-224	-220	-221	-220	-218	-219	-218
Net domestic assets	**-338**	**-503**	**-341**	**-565**	**-455**	**-835**	**-367**	**-759**	**-346**	**-281**
Net domestic credit	117	164	110	198	86	225	136	246	154	175
Claims on other depository corporations	106	106	128	106	128	106	128	106	128	128
Net claims on central government	-84	-41	-133	-10	-160	14	-113	33	-98	-80
Claims on central government	255	276	247	274	247	271	246	269	246	246
Of which: use of SDRs/PRGF	*207*	*225*	*196*	*223*	*196*	*221*	*195*	*218*	*195*	*194*
Liabilities to central government	-339	-317	-380	-284	-407	-257	-360	-236	-344	-326
Ordinary deposits of central government	-18	-18	-11	-18	-11	-19	-13	-20	-37	-51
Counterpart funds	-93	-93	-120	-93	-120	-93	-120	-93	-120	-120
Foreign currency deposits	-228	-206	-249	-173	-276	-145	-227	-123	-188	-155
Of which: National oil account	*-200*	*-175*	*-230*	*-142*	*-257*	*-114*	*-208*	*-92*	*-169*	*-136*
Claims on other sectors	95	99	115	102	118	104	121	107	124	126
Other items (net)	-455	-667	-451	-763	-541	-1,060	-503	-1,005	-500	-456
Base money	**1,136**	**1,302**	**1,562**	**1,446**	**1,725**	**1,549**	**1,833**	**1,672**	**1,966**	**2,155**
Currency issued	267	286	315	333	348	356	370	385	397	435
Bank reserves	869	1,016	1,247	1,114	1,376	1,193	1,463	1,288	1,569	1,720
Of which: domestic currency	704	826	980	936	1,083	1,003	1,151	1,083	1,234	1,353
Of which: foreign currency	165	189	266	177	294	190	312	205	335	367
Memorandum items:										
Gross international reserves (US$ millions) [1]	56.5	66.9	61.0	80.5	72.8	97.7	75.9	102.7	82.4	87.6
Months of imports of goods and nonfactor services [2]	4.2	4.0	4.4	4.5	5.0	5.1	5.0	5.1	5.1	5.0
Net international reserves (US$ millions) [3]	50.8	60.3	55.6	63.9	65.6	81.0	68.0	83.9	73.2	78.9
Months of imports of goods and nonfactor services [2]	3.8	3.6	4.0	3.6	4.5	4.2	4.5	4.1	4.5	4.5
National Oil Account (US$ millions)	9.9	8.0	10.3	6.5	11.5	5.3	9.3	4.3	7.6	6.2
Commercial banks reserves in foreign currency (US$ millions)	8.2	8.6	11.9	8.2	13.1	8.8	14.0	9.7	15.0	16.6
Guaranteed deposits (US$ millions)	0.1	0.1	0.0	0.1	0.0	0.1	0.0	0.1	0.0	0.0
Base money (annual percent change)	23.2	14.6	37.5	11.1	10.4	7.1	6.3	8.0	7.2	9.7

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

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

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

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

Table 5. São Tomé and Príncipe: Monetary Survey, 2014–19
(Billions of Dobra)

	2014	2015		2016		2017		2018		2019
		EBS/15/71		EBS/15/71		EBS/15/71		EBS/15/71		
	Actual	Program	Est.	Program	Proj.	Program	Proj.	Program	Proj.	Proj.
Net foreign assets	**2,230**	**2,535**	**2,527**	**2,767**	**2,836**	**3,160**	**2,885**	**3,219**	**3,020**	**3,142**
Net foreign assets of the BCSTP	1,474	1,805	1,903	2,011	2,180	2,384	2,200	2,432	2,316	2,437
Net foreign assets of other depository corporations	756	730	624	756	656	776	685	787	704	706
Net domestic assets	**270**	**342**	**301**	**439**	**320**	**258**	**470**	**455**	**577**	**737**
Net domestic credit	1,630	1,624	1,630	1,685	1,740	1,978	1,887	2,100	2,208	2,398
Net claims on central government	-252	-245	-323	-214	-350	14	-304	33	-98	-80
Claims on central government	258	280	255	278	255	271	255	269	246	246
Liabilities to central government	-510	-526	-578	-492	-606	-257	-559	-236	-344	-326
Budgetary deposits	-18	-18	-11	-18	-11	-19	-13	-20	-37	-51
Counterpart funds	-93	-93	-120	-93	-120	-93	-120	-93	-120	-120
Foreign currency deposits	-399	-415	-448	-382	-475	-145	-426	-123	-188	-155
Of which: National Oil Account	-200	-175	-230	-142	-257	-114	-208	-92	-169	-136
Claims on other sectors	1,882	1,869	1,953	1,899	2,091	1,963	2,191	2,067	2,306	2,478
Of which: claims in foreign currency	766	788	608	916	1,006	837	931	882	982	1,058
(Millions of $US)	38	36	27	42	45	39	42	42	44	48
Other items (net)	-1,360	-1,282	-1,329	-1,245	-1,420	-1,719	-1,417	-1,645	-1,631	-1,661
Broad money (M3)	**2,500**	**2,877**	**2,828**	**3,206**	**3,156**	**3,418**	**3,355**	**3,674**	**3,597**	**3,880**
Local currency liabilities included in broad money (M2)	1,563	1,799	1,894	2,004	1,988	2,137	2,114	2,297	2,266	2,444
Money (M1)	1,106	1,273	1,431	1,419	1,502	1,513	1,597	1,626	1,712	1,846
Currency outside depository corporations	222	256	247	285	259	289	260	303	270	245
Transferable deposits in dobra	884	1,017	1,184	1,134	1,243	1,224	1,337	1,323	1,442	1,602
Other deposits in dobra	456	525	463	585	486	624	517	671	554	598
Foreign currency deposits	937	1,078	934	1,202	1,168	1,281	1,241	1,377	1,331	1,436
Memorandum items:										
Velocity (ratio of GDP to M3; end of period)	2.6	2.6	2.6	2.4	2.5	2.4	2.5	2.4	2.5	2.5
Money multiplier (M3/M0)	2.2	2.2	1.8	2.2	1.8	2.2	1.8	2.2	1.8	1.8
Base money (12-month growth rate)	23.2	14.6	37.5	11.1	10.4	7.1	6.3	8.0	7.2	9.7
Claims on other resident sectors (12-month growth rate)	-1.0	-0.7	3.8	1.6	7.0	3.4	4.8	5.3	5.2	7.5
M3 (12-month growth rate)	16.8	15.1	13.1	11.4	11.6	6.6	6.3	7.5	7.2	7.9

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

Table 6. São Tomé and Príncipe: Financial Soundness Indicators, 2010–15

	2010 December	2011 December	2012 December	2013 December	2014 December	2015 March	2015 June	2015 September	2015 December
Capital Adequacy									
Regulatory capital to risk-weighted assets	n.a.	27.7	20.3	22.7	22.6	24.1	23.4	21.9	24.1
Percentage of banks greater or equal to 10 percent	85.7	100.0	87.5	75.0	75.0	71.4	71.4	71.4	85.7
Percentage of banks below 10 and <6 percent minimum	n.a.	n.a.	n.a.	12.5	0.0	0.0	0.0	0.0	0.0
Percentage of banks below 6 percent minimum	14.3	0.0	12.5	12.5	25.0	28.6	28.6	28.6	14.3
Capital (net worth) to assets	n.a.	26.5	22.7	18.4	20.3	17.1	15.7	13.0	15.5
Deposits with banks below 6% (in billions of dobras)	n.a.	0.0	83.2	59.0	325.1	299.6	482.0	368.3	455.3
Asset quality									
Foreign exchange loans to total loans	77.5	68.5	57.9	53.9	46.5	48.3	43.8	42.0	42.1
Past-due loans to gross loans	n.a.	33.2	66.7	30.4	36.2	40.8	40.6	37.6	35.0
Nonperforming loans/credit (IFRS definition)	n.a.	15.6	15.4	16.9	19.1	27.0	26.5	24.9	29.8
Watch-listed loans	n.a.	17.5	51.3	13.6	17.2	13.9	14.1	12.7	5.2
Provision as percent of past-due loans	42.2	46.1	39.4	56.3	45.1	59.0	58.1	62.4	68.7
Earnings and profitability									
Return on assets	0.7	0.5	-0.8	-2.1	-3.2	-3.5	-3.7	-4.5	-5.2
Return on equity	1.8	1.5	-3.3	-9.3	-15.9	-17.8	-19.4	-25.0	-27.1
Expense(w/amortization & provisions)/income	98.2	119.3	117.8	471.1	164.5	350.2	255.3	226.3	215.9
Liquidity									
Liquid assets/total assets	21.9	20.4	37.8	40.8	45.8	49.7	51.6	49.3	52.0
Liquid assets/short term liabilities	36.1	36.7	61.5	39.6	72.7	79.5	79.7	71.1	72.5
Loan/total liabilities	109.7	83.0	64.7	56.3	47.3	47.5	43.2	45.9	47.1
Foreign exchange liabilities/total liabilities	57.4	35.0	30.8	27.0	28.1	27.6	27.5	23.4	30.0
Loan/deposits	104.2	119.5	101.7	85.8	69.6	71.4	64.5	68.3	63.5
Sensitivity to market risk									
Foreign exchange liabilities to shareholders funds	203.8	97.0	105.0	119.3	110.3	134.3	147.8	157.4	162.8

Sources: São Tomé and Príncipe authorities' data 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, 2014–19

(Millions of U.S. Dollars)

	2014	2015		2016		2017		2018		2019
		EBS/15/71		EBS/15/71		EBS/15/71		EBS/15/71		
	Actual	Program	Est.	Program	Proj.	Program	Proj.	Program	Proj.	Proj.
Trade balance	**-127.4**	**-102.3**	**-108.5**	**-139.1**	**-113.3**	**-152.8**	**-122.1**	**-166.7**	**-133.8**	**-134.4**
Exports, f.o.b.	17.2	18.8	12.3	22.3	16.0	24.5	18.0	26.6	19.3	21.8
Of which: oil	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cocoa	9.1	10.6	7.8	11.3	11.4	11.1	12.1	11.8	13.3	13.8
Re-export	7.0	7.1	3.3	9.8	3.4	11.5	4.0	13.1	4.3	5.1
Imports, f.o.b.	-144.6	-121.1	-120.8	-161.4	-129.2	-177.3	-140.0	-193.3	-153.1	-156.2
Of which : food	-42.5	-31.5	-34.6	-38.7	-34.3	-40.9	-35.9	-43.0	-37.7	-39.7
Petroleum products	-41.1	-30.6	-33.2	-52.7	-23.8	-59.0	-29.7	-64.1	-34.0	-38.3
Investment goods	-30.3	-40.9	-27.7	-50.2	-41.3	-59.1	-47.3	-66.8	-52.6	-49.2
Oil sector related investment goods	0.0	-2.1	0.0	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	0.0
Services and income (net)	**-7.9**	**-17.2**	**-0.8**	**-6.4**	**-10.0**	**-8.9**	**-9.7**	**-11.1**	**-5.1**	**-3.2**
Exports of nonfactor services	71.3	74.7	68.1	79.2	71.8	84.0	76.1	89.3	80.9	86.7
Of which : travel and tourism	56.0	60.3	51.8	64.0	54.7	68.0	58.2	72.5	62.0	66.7
Imports of nonfactor services	-84.9	-100.1	-68.8	-94.1	-82.8	-101.5	-87.0	-109.1	-87.2	-91.1
Factor services (net)	5.7	8.3	-0.1	8.5	1.0	8.6	1.1	8.7	1.1	1.2
Of which: oil related	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Private transfers (net)	**25.2**	**26.8**	**19.6**	**29.2**	**20.3**	**30.9**	**21.4**	**33.0**	**22.8**	**24.6**
Official transfers (net)	**36.0**	**52.2**	**36.4**	**62.2**	**60.3**	**68.4**	**63.1**	**74.5**	**66.2**	**67.9**
Of which : project grants	27.9	39.2	33.6	49.2	50.9	55.4	53.7	61.5	56.9	61.4
HIPC Initiative-related grants	0.8	6.0	6.0	4.0	6.6	3.8	6.7	3.6	6.7	5.2
Current account balance										
Including official transfers	-74.2	-40.5	-53.3	-54.2	-42.7	-62.5	-47.3	-70.3	-49.9	-45.1
Excluding official transfers	-110.2	-92.7	-89.7	-116.4	-103.0	-130.9	-110.4	-144.8	-116.1	-113.1
Capital and financial account balance	**37.4**	**48.5**	**35.2**	**64.6**	**55.9**	**78.9**	**47.9**	**73.9**	**55.3**	**50.9**
Capital transfer [1]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	37.4	48.5	35.2	64.6	55.9	78.9	47.9	73.9	55.3	50.9
Direct foreign investment	18.9	16.8	19.9	23.1	4.2	29.6	9.9	36.8	15.9	24.1
Of which: Oil signature bonuses	0.0	0.0	2.4	0.0	2.5	0.0	0.0	0.0	0.0	0.0
Petroleum related investment	11.1	3.1	24.0	3.2	3.2	3.2	3.2	3.2	3.2	0.0
Recovery of oil capital expense	-11.1	-3.1	-24.0	-3.2	-3.2	-3.2	-3.2	-3.2	-3.2	0.0
Portfolio Investment (net)	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	18.6	31.7	15.0	41.5	51.7	49.3	38.0	37.0	39.4	26.8
Assets	15.5	7.3	5.7	7.4	5.8	7.5	5.9	7.6	5.9	6.0
Public sector (net)	15.6	32.8	32.9	10.8	26.8	8.8	16.9	2.8	13.1	5.3
Project loans	13.1	34.6	34.7	13.8	29.3	11.8	19.5	6.2	15.9	9.8
Program loans	4.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.7	-1.8	-1.6	-1.8	-1.3	-1.8	-1.4	-2.0	-1.6	-4.8
Other investment	-1.1	-0.1	-0.1	-1.2	-1.1	-1.3	-1.2	-1.4	-1.3	0.4
Of which : transfers to JDA	-0.3	-0.5	-0.2	-0.5	-0.5	-0.6	-0.5	-0.6	-0.5	-0.5
Private sector (net)	-12.5	-8.3	-23.7	23.3	19.0	33.0	15.3	26.6	20.4	15.5
Commercial banks	-17.5	-4.2	-9.7	1.5	1.5	1.4	1.4	0.9	0.9	0.3
Short-term private capital	5.0	-4.1	-14.0	21.8	17.6	31.7	13.9	25.7	19.4	15.2
Errors and omissions	**46.3**	**0.0**	**36.6**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**9.5**	**8.0**	**18.5**	**10.4**	**13.2**	**16.4**	**0.6**	**3.5**	**5.4**	**5.7**
Financing	-9.5	-8.0	-18.5	-10.4	-13.2	-16.4	-0.6	-3.5	-5.4	-5.7
Change in official reserves, excl. NOA (increase= -)	-10.5	-10.0	-18.2	-13.1	-13.0	-18.9	-3.9	-5.9	-8.4	-6.7
Use of Fund resources (net)	-1.4	0.1	0.0	1.2	1.0	1.3	1.1	1.4	1.2	-0.5
Purchases	0.0	0.9	0.9	1.8	1.8	1.8	1.8	1.9	1.8	0.0
Repurchases (incl. MDRI repayment)	-1.4	-0.8	-0.9	-0.6	-0.7	-0.6	-0.6	-0.5	-0.5	-0.5
National Oil Account (increase = -)	2.3	1.9	-0.4	1.4	-1.2	1.2	2.2	1.0	1.8	1.4
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Current account balance (percent of GDP)										
Before official transfers	-32.6	-28.5	-28.2	-32.7	-29.5	-34.3	-29.7	-35.1	-29.3	-26.4
After official transfers	-21.9	-12.4	-16.7	-15.2	-12.2	-16.4	-12.7	-17.0	-12.6	-10.5
Debt service ratio (percent of exports) [2]	3.7	4.8	4.3	4.2	4.7	3.9	4.3	3.7	3.9	3.7
Gross international reserves [3]										
Millions of U.S. dollars	56.5	66.9	61.0	80.5	72.8	97.7	75.9	102.7	82.4	87.6
Months of imports of goods and nonfactor services [4]	4.2	4.0	4.4	4.5	5.0	5.1	5.0	5.1	5.1	5.1

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

[1] Includes HIPC debt relief.

[2] 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, 2014–19

(Percent of GDP)

	2014	2015		2016		2017		2018		2019
		EBS/15/71		EBS/15/71		EBS/15/71		EBS/15/71		
	Actual	Program	Est.	Program	Proj.	Program	Proj.	Program	Proj.	Proj.
Trade balance	**-37.7**	**-31.4**	**-34.1**	**-39.0**	**-32.4**	**-40.0**	**-32.9**	**-40.4**	**-33.8**	**-31.4**
Exports, f.o.b.	5.1	5.8	3.9	6.3	4.6	6.4	4.8	6.4	4.9	5.1
Of which: oil	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cocoa	2.7	3.2	2.5	3.2	3.3	2.9	3.3	2.9	3.4	3.2
Re-export	2.1	2.2	1.0	2.7	1.0	3.0	1.1	3.2	1.1	1.2
Imports, f.o.b.	-42.8	-37.2	-38.0	-45.3	-37.0	-46.4	-37.7	-46.8	-38.7	-36.4
Of which : food	-12.6	-9.7	-10.9	-10.9	-9.8	-10.7	-9.7	-10.4	-9.5	-9.3
Petroleum products	-12.2	-9.4	-10.4	-14.8	-6.8	-15.5	-8.0	-15.5	-8.6	-8.9
Investment goods	-9.0	-12.6	-8.7	-14.1	-11.8	-15.5	-12.7	-16.2	-13.3	-11.5
Oil sector related investment goods	0.0	-0.6	0.0	-0.6	-0.6	-0.6	-0.6	-0.5	-0.5	0.0
Services and income (net)	**-2.3**	**-5.3**	**-0.3**	**-1.8**	**-2.9**	**-2.3**	**-2.6**	**-2.7**	**-1.3**	**-0.8**
Exports of nonfactor services	21.1	22.9	21.4	22.2	20.5	22.0	20.5	21.6	20.4	20.2
Of which : travel and tourism	16.6	18.5	16.3	18.0	15.7	17.8	15.7	17.6	15.7	15.6
Imports of nonfactor services	-25.1	-30.8	-21.6	-26.4	-23.7	-26.6	-23.4	-26.4	-22.0	-21.2
Factor services (net)	1.7	2.5	0.0	2.4	0.3	2.3	0.3	2.1	0.3	0.3
Of which: oil related	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private transfers (net)	**7.4**	**8.2**	**6.2**	**8.2**	**5.8**	**8.1**	**5.8**	**8.0**	**5.8**	**5.7**
Official transfers (net)	**10.6**	**16.0**	**11.4**	**17.5**	**17.3**	**17.9**	**17.0**	**18.0**	**16.7**	**15.8**
Of which : project grants	8.2	12.0	10.6	13.8	14.6	14.5	14.5	14.9	14.4	14.3
HIPC Initiative-related grants	0.2	1.9	1.9	1.1	1.9	1.0	1.8	0.9	1.7	1.2
Current account balance										
Including official transfers	-21.9	-12.4	-16.7	-15.2	-12.2	-16.4	-12.7	-17.0	-12.6	-10.5
Excluding official transfers	-32.6	-28.5	-28.2	-32.7	-29.5	-34.3	-29.7	-35.1	-29.3	-26.4
Capital and financial account balance	**11.1**	**14.9**	**11.1**	**18.1**	**16.0**	**20.7**	**12.9**	**17.9**	**14.0**	**11.9**
Capital transfer [1]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	11.1	14.9	11.1	18.1	16.0	20.7	12.9	17.9	14.0	11.9
Direct foreign investment	5.6	5.1	6.3	6.5	1.2	7.8	2.7	8.9	4.0	5.6
Of which: Oil signature bonuses	0.0	0.0	0.8	0.0	0.7	0.0	0.0	0.0	0.0	0.0
Petroleum related investment	3.3	1.0	7.6	0.9	0.9	0.8	0.9	0.8	0.8	0.0
Recovery of oil capital expense	-3.3	-1.0	-7.6	-0.9	-0.9	-0.8	-0.9	-0.8	-0.8	0.0
Portfolio Investment (net)	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	5.5	9.7	4.7	11.6	14.8	12.9	10.2	9.0	9.9	6.3
Assets	4.6	2.2	1.8	2.1	1.7	2.0	1.6	1.8	1.5	1.4
Public sector (net)	4.6	10.1	10.4	3.0	7.7	2.3	4.5	0.7	3.3	1.2
Project loans	3.9	10.6	10.9	3.9	8.4	3.1	5.2	1.5	4.0	2.3
Program loans	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.2	-0.5	-0.5	-0.5	-0.4	-0.5	-0.4	-0.5	-0.4	-1.1
Other investment	-0.3	0.0	0.0	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	0.1
Of which : transfers to JDA	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Private sector (net)	-3.7	-2.6	-7.4	6.5	5.5	8.7	4.1	6.4	5.1	3.6
Commercial banks	-5.2	-1.3	-3.0	0.4	0.4	0.4	0.4	0.2	0.2	0.1
Short-term private capital	1.5	-1.3	-4.4	6.1	5.0	8.3	3.7	6.2	4.9	3.6
Errors and omissions	**13.7**	**0.0**	**11.5**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**2.8**	**2.5**	**5.8**	**2.9**	**3.8**	**4.3**	**0.2**	**0.9**	**1.4**	**1.3**
Financing	-2.8	-2.5	-5.8	-2.9	-3.8	-4.3	-0.2	-0.9	-1.4	-1.3
Change in official reserves, excl. NOA (increase= -)	-3.1	-3.1	-5.7	-3.7	-3.7	-4.9	-1.0	-1.4	-2.1	-1.6
Use of Fund resources (net)	-0.4	0.0	0.0	0.3	0.3	0.3	0.3	0.3	0.3	-0.1
Purchases	0.0	0.3	0.3	0.5	0.5	0.5	0.5	0.5	0.4	0.0
Repurchases (incl. MDRI repayment)	-0.4	-0.2	-0.3	-0.2	-0.2	-0.1	-0.2	-0.1	-0.1	-0.1
National Oil Account (increase = -)	0.7	0.6	-0.1	0.4	-0.4	0.3	0.6	0.2	0.4	0.3
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Debt service ratio (percent of exports) [2]	3.7	4.8	4.3	4.2	4.7	3.9	4.3	3.7	3.9	3.7
Gross international reserves [3]										
Millions of U.S. dollars	56.5	66.9	61.0	80.5	72.8	97.7	75.9	102.7	82.4	87.6
Months of imports of goods and nonfactor services [4]	4.2	4.0	4.4	4.5	5.0	5.1	5.0	5.1	5.1	5.1

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

[1] Includes HIPC debt relief.

[2] 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, 2014–19
(Millions of U.S. Dollars)

	2014	2015		2016		2017		2018		2019
		EBS/15/71		EBS/15/71		EBS/15/71		EBS/15/71		
	Actual	Program	Est.	Program	Proj.	Program	Proj.	Program	Proj.	Proj.
Gross financing requirements	**-123.8**	**-105.4**	**-110.5**	**-133.1**	**-119.2**	**-153.4**	**-117.5**	**-154.5**	**-127.9**	**-124.7**
Current account, excluding official transfers	-110.2	-92.7	-89.7	-116.4	-103.0	-130.9	-110.4	-144.8	-116.1	-113.1
Exports, f.o.b.	17.2	18.8	12.3	22.3	16.0	24.5	18.0	26.6	19.3	21.8
Imports, f.o.b.	-144.6	-121.1	-120.8	-161.4	-129.2	-177.3	-140.0	-193.3	-153.1	-156.2
Services and income (net)	-7.9	-17.2	-0.8	-6.4	-10.0	-8.9	-9.7	-11.1	-5.1	-3.2
Private transfers	25.2	26.8	19.6	29.2	20.3	30.9	21.4	33.0	22.8	24.6
Financial account	-3.2	-2.7	-2.6	-3.6	-3.2	-3.6	-3.2	-3.8	-3.4	-4.9
Scheduled amortization [1]	-0.7	-1.8	-1.6	-1.8	-1.3	-1.8	-1.4	-2.0	-1.6	-4.8
IMF repayments	-1.4	-0.8	-0.9	-0.6	-0.7	-0.6	-0.6	-0.5	-0.5	-0.5
Other public sector flows (net)	-1.1	-0.1	-0.1	-1.2	-1.1	-1.3	-1.2	-1.4	-1.3	0.4
Change in external reserves (-ve = increase)	-10.5	-10.0	-18.2	-13.1	-13.0	-18.9	-3.9	-5.9	-8.4	-6.7
Available funding	**123.8**	**105.4**	**110.5**	**133.1**	**119.2**	**153.4**	**117.5**	**154.5**	**127.9**	**124.7**
National Oil Fund (net)	2.3	1.9	2.0	1.4	1.3	1.2	2.2	1.0	1.8	1.4
Oil signature bonuses	0.0	0.0	2.4	0.0	2.5	0.0	0.0	0.0	0.0	0.0
Saving (-ve = accumulation of oil reserve fund)	2.3	1.9	-0.4	1.4	-1.2	1.2	2.2	1.0	1.8	1.4
Expected disbursements	53.4	86.8	71.1	76.0	89.6	80.2	82.6	80.7	82.2	77.7
Multilateral HIPC interim assistance	0.8	6.0	6.0	4.0	6.6	3.8	6.7	3.6	6.7	5.2
Capital transfers [1]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants [2]	35.2	46.1	30.4	58.3	53.7	64.6	56.5	70.8	59.6	62.7
Concessional loans	17.4	34.6	34.7	13.8	29.3	11.8	19.5	6.2	15.9	9.8
Project loans	13.1	34.6	34.7	13.8	29.3	11.8	19.5	6.2	15.9	9.8
Program loans	4.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector (net)	68.1	15.7	36.5	53.8	26.6	70.1	31.0	71.0	42.2	45.6
IMF	0.0	0.9	0.9	1.8	1.8	1.8	1.8	1.9	1.8	0.0
Financing gap	0.0	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	0.0
Residual financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: São Tomé and Príncipe authorities' data 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	4.29
04/15/16	Observance of continuous and end-Decemebr 2015 PCs and completion of the first review.	634,285	4.29
10/15/16	Observance of continuous and end-June 2016 PCs and completion of the second review.	634,285	4.29
04/15/17	Observance of continuous and end-December 2016 PCs and completion of the third review.	634,285	4.29
10/15/17	Observance of continuous and end-June 2017 PCs and completion of the fourth review.	634,285	4.29
04/15/18	Observance of continuous and end-December 2017 PCs and completion of the fifth review	634,285	4.29
06/15/18	Observance of continuous and end-March 2018 PCs and completion of the sixth review.	634,290	4.29
	Total	4,440,000	30

Source: International Monetary Fund.

Table 11. São Tomé and Príncipe: Indicators of Capacity to Repay the Fund, 2016–28

				Projections									
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Fund obligations based on existing credit (millions of SDRs)													
Principal	0.29	0.44	0.39	0.33	0.26	0.35	0.35	0.24	0.13	0.13	0.00	0.00	0.00
Charges and interest	0.00	0.00	0.00	0.01	0.01	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00
Fund obligations based on existing and prospective credit (millions of SDRs)													
Principal	0.29	0.44	0.39	0.33	0.26	0.41	0.67	0.87	0.89	0.89	0.70	0.44	0.13
Charges and interest	0.00	0.00	0.00	0.02	0.02	0.02	0.01	0.01	0.01	0.01	0.01	0.00	0.00
Total obligations based on existing and prospective credit													
Millions of SDRs	0.29	0.44	0.39	0.35	0.28	0.43	0.68	0.88	0.90	0.90	0.71	0.44	0.13
Millions of U.S. dollars	0.40	0.62	0.55	0.49	0.39	0.61	0.96	1.24	1.27	1.27	1.00	0.62	0.00
Percent of exports of goods and services	0.46	0.65	0.54	0.45	0.33	0.47	0.70	0.84	0.80	0.75	0.55	0.32	0.00
Percent of debt service [1]	9.76	15.34	13.84	12.10	5.45	7.59	11.89	15.05	13.03	12.81	10.27	6.37	0.00
Percent of quota	3.92	5.95	5.27	4.73	3.78	5.81	9.19	11.89	12.16	12.16	9.59	5.95	1.76
Percent of gross international reserves [2]	0.47	0.69	0.56	0.47	0.36	0.52	0.79	0.97	0.94	0.89	0.67	0.39	0.00
Outstanding Fund credit													
Millions of SDRs	3.9	4.7	5.6	5.3	5.0	4.6	3.9	3.0	2.2	1.3	0.6	0.1	0.0
Millions of U.S. dollars	5.4	6.6	7.8	7.4	7.0	6.4	5.5	4.3	3.0	1.8	0.8	0.2	0.0
Percent of exports of goods and services	6.2	7.0	7.8	6.8	5.9	5.0	4.0	2.9	1.9	1.1	0.4	0.1	0.0
Percent of debt service [1]	130.6	163.9	198.4	181.5	97.2	80.9	68.5	52.0	31.3	18.1	8.2	1.9	0.0
Percent of quota	52.4	63.5	75.5	70.9	67.6	61.9	53.0	41.1	29.2	17.2	7.7	1.8	0.0
Percent of gross international reserves [2]	6.3	7.3	8.0	7.1	6.4	5.5	4.5	3.4	2.3	1.3	0.5	0.1	0.0
Memorandum items:													
Exports of goods and services (millions of U.S. dollars)	87.7	94.1	100.2	108.5	118.9	128.2	137.3	147.1	157.6	168.8	180.9	193.8	207.6
Debt service (millions of U.S. dollars)	4.1	4.0	3.9	4.1	7.2	8.0	8.0	8.2	9.7	9.9	9.7	9.7	8.8
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]	85.9	89.9	97.4	104.2	110.8	116.5	121.8	127.4	135.1	141.8	149.0	157.0	165.6
GDP (millions of U.S. dollars)	349	371	396	429	468	507	547	588	632	679	730	785	843

Sources: São Tomé and Príncipe authorities; and IMF 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

Table 12. São Tomé and Príncipe: Millennium Development Goals

	1990	1995	2000	2005	2010	2015	Status
Goal 1: Eradicate extreme poverty and hunger							Not Met
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 severely underweight, percentage	--	--	10.1	8.0[8/]	14.4[11/]	8.8[13/]	
Population undernourished, percentage	22.6[1/]	24	14.8	8.9	7.5	7.0[13/]	
Goal 2: Achieve universal primary education							Met
Total net enrollment ratio in primary education, both sexes	--	--	89.5[4/]	99.3	98.6	99.1	
Percentage of pupils starting grade 1 who reach last grade of primary, both sexes	--	--	58.8[5/]	68.9[7/]	68.0[10/]	98.0	
Literacy rates of 15-24 years old, both sexes, percentage	93.8[1/]	--	95.4[5/]	--	95.3	90.0	
Goal 3: Promote gender equality and empower women							Not Met
Gender Parity Index in primary level enrollment	--	--	0.97[4/]	0.97	1.00	1.00[13/]	
Gender Parity Index in secondary level enrollment	--	--	--	1.07	1.03	1.11[13/]	
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	20.0	
Goal 4: Reduce child mortality							Met
Children under five mortality rate, per 1,000 live births	96.0	94.1	92.5	90.8	89.1	45.0[13/]	
Infant mortality rate (0-1 year) per 1,000 live births	62.2	61.2	60.3	59.3	58.3	38.0[13/]	
Children 1 year old immunized against measles, percentage	71.0	74.0	69.0	88.0	92.0	89.0[13/]	
Goal 5: Improve maternal health							Met
Maternal mortality ratio per 100,000 live births	150	120	110	87	70	76[13/]	
Births attended by skilled health personnel, percentage	--	--	79	81[8/]	82[10/]	92.5[13/]	
Current contraceptive use among married women 15–49 years old, any method, percentage	--	--	29	31[8/]	38[11/]	40.6[13/]	
Adolescent birth rate, per 1,000 women	107[1/]	--	91[5/]	110[8/]	--	92[13/]	
Antenatal care coverage, at least one visit, percentage	--	--	91	97[8/]	98[11/]	97.5[13/]	
Antenatal care coverage, at least four visits, percentage	--	--	--	--	72[11/]	--	
Unmet need for family planning, total, percentage	--	--	--	--	38[11/]	32.7[13/]	
Goal 6: Combat HIV/AIDS, Malaria and other diseases							Met
Condom use at last high-risk sex, 15–24 years old, women, percentage	--	--	--	56[8/]	54[11/]	65.2[13/]	
Condom use at last high-risk sex, 15–24 years old, men, percentage	--	--	--	--	64[11/]	82.5[13/]	
Men 15–24 years old with comprehensive correct knowledge of HIV/AIDS, percentage	--	--	--	--	43[11/]	42.2[13/]	
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/]	0	
Malaria death rate per 100,000 population, all ages	--	--	--	--	8[11/]	0	
Malaria death rate per 100,000 population, ages 0–4	--	--	--	--	3[11/]	0	
Children under 5 sleeping under insecticide-treated bed nets, percentage	--	--	23	42[8/]	56[11/]	61.1[13/]	
Children under 5 with fever being treated with anti-malarial drugs, percentage	--	--	61	25[8/]	8[11/]	1.4[13/]	
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							Likely Met
Proportion of land area covered by forest, percentage	28	--	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 $1 GDP (PPP) (CDIAC)	--	--	0.51	0.50	0.63[11/]	--	
Consumption of all Ozone-Depleting Substances in ODP metric tons	2.5	4.8	4.0	2.3	0.2	--	
Proportion of total water resources used, percentage	--	0.3	--	--	--	--	
Terrestrial and marine areas protected to total territorial area, percentage	0.0	0.0	0.0	0.0	0.0	--	
Proportion of the population using improved drinking water resources, total	--	75	79	85	89	93.9[13/]	
Proportion of the population using improved sanitation facilities, total	--	20	21	24	26	40.9[13/]	
Goal 8: Develop a global partnership for development							Not Met
Debt relief committed under HIPC initiative, cumulative million US$ in end-2009 NPV terms	--	--	--	--	--	164[13/]	
Debt relief delivered in full under MDRI initiative, cumulative million US$ in end-2009 NPV terms	--	--	--	--	--	46[13/]	
Debt service as a percentage of exports of goods and services and net income	29	27[3/]	22	61	3	15.1[13/]	
Fixed telephone lines per 100 inhabitants	1.9	2.0	3.3	4.7	4.7	3.4[13/]	
Mobile cellular subscriptions per 100 inhabitants	--	--	--	8	62	64.9[13/]	
Internet users per 100 population	--	--	5	14	19	24.4[13/]	
Net ODA received per capita (current US$)	466	657	247	213	298	284[13/]	
ODA received in small islands developing states as a percentage of their GNI	--	--	--	29	25	16.79[13/]	
Developed country imports from developing countries, admitted duty free, percent	--	--	97	100	100	--	
Developed country imports from the LDCs, admitted duty free, percentage	--	--	97	100	100	--	
Other							
Fertility rate, total (births per woman)	5.4	5.0	4.6	4.1	3.7	4.6[13/]	
GNI per capita, Atlas method (current US$)	--	--	--	750	1240	1670[13/]	
GNI, Atlas method (current US$, millions)	--	--	--	114	205	312[13/]	
Life expectancy at birth, total (years)	61	62	62	63	64	66[13/]	
Population, total (thousands)	116	128	141	153	165	186[13/]	
Trade (% of GDP)	--	--	79	67	76	84[13/]	

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 13/ Correspond to 2014

Annex I. External Balance Assessment

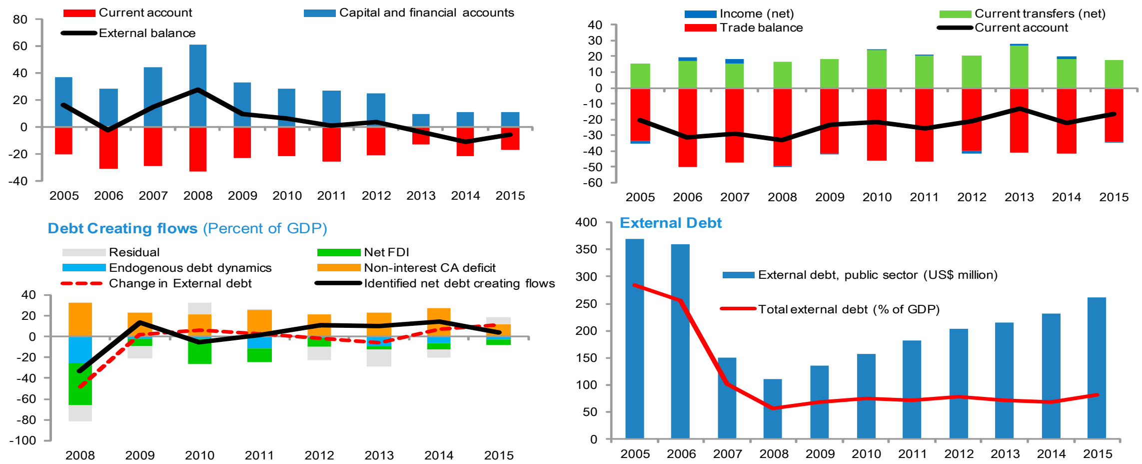
São Tomé and Príncipe's external position is moderately weak and vulnerable owing to the country's narrow export base. Staff analysis suggests that the immediate risks to the external position appear manageable. In particular, the real effective exchange rate is assessed as moderately overvalued on current policy and the international reserves are adequate compared to the traditional and IMF Low Income Country (LIC) reserve metrics, especially when the extra buffers of the balance of the National Oil Account (NOA) and contingent credit line with Portugal are considered. However, medium-term vulnerabilities remain significant and need to be addressed through continued fiscal consolidation and structural reform to support diversification and enhance the competitiveness of the economy.

A. Evolution of the Balance of Payments

1. São Tomé and Príncipe's external position is moderately weak and vulnerable owing to the country's narrow export base. The external account balance has been worsening since the HIPC debt relief, reflecting both a trend decrease in the current account and limited capital and financial inflow[1]. Current account trends have been dominated by the gradual contraction in the trade deficit in line with weaker activities and driven more recently by lower international prices of oil and other commodities. Capital and financial accounts have registered declining surplus and have been dominated by foreign aid, FDI and public sector borrowing. The external debt has increased reflecting a shift in the composition of sources of financing of the current account deficit, with a declining role of FDI and rising share of debt creating flows. Going forward, the external position and the current account are expected to improve, supported by planned fiscal consolidation, further import compression due to lower commodity prices and expected pick up in exports. However, medium-term vulnerabilities remain significant and need to be addressed through continued fiscal consolidation and structural reform to support diversification and enhance competitiveness of the economy.

[1] São Tomé and Príncipe's balance of payments (BOP) statistics have some shortcomings, reflected in the very large Net Errors and Omissions (NEO), especially in recent years (2013–14). The signs of the recent NEOs suggest that on balance, credits (and net incurrence of liabilities) have been underestimated, or debits (and net acquisitions of financial assets) have been overestimated, or a combination of both. This masks the underlying magnitudes of the BOP aggregates.

Annex Figure 1. São Tomé and Príncipe: External Sector Development

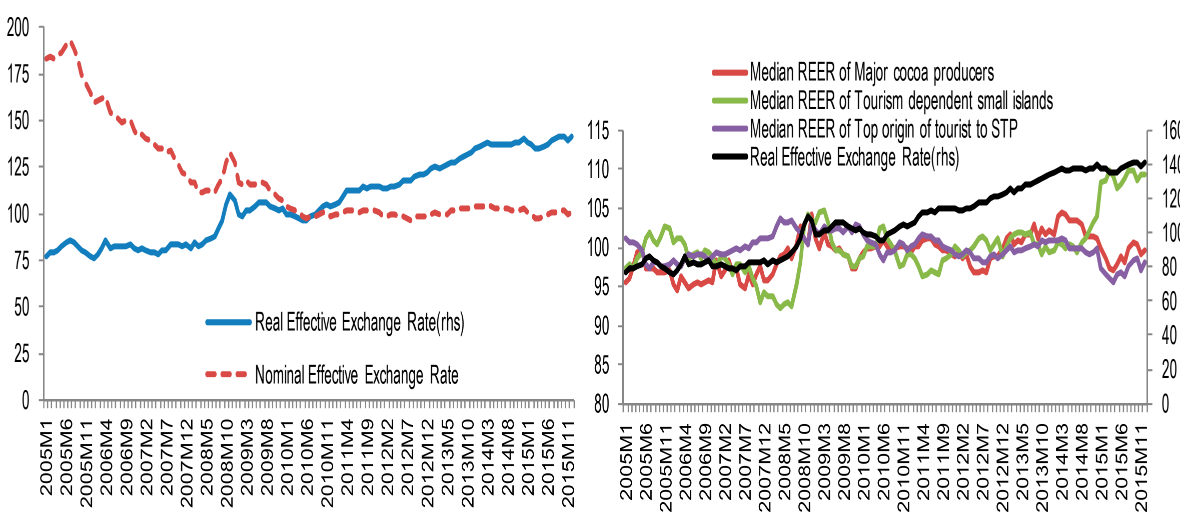


Sources: São Tomé and Príncipe authorities' data; and IMF staff estimates.

B. Exchange Rate Assessment

2. São Tomé and Príncipe's real effective exchange rate (REER) has appreciated considerably since the introduction of the peg to the euro in January 2010. Since then, there has been a gradual disinflation process which has been too slow in closing the inflation differential with trading partners. As a result, the REER exhibits a more pronounced trend appreciation compared to that of countries with similar exports (Figure 2, right chart).

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



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

3. **EBA-lite model-based indicators of REER suggest that, on current policies, the 2015 level of real effective exchange rate ranges from slightly undervalued to strongly overvalued** (Table 1). However, the results should be interpreted with caution given the inherent difficulties in benchmarking external stability for a fragile and small country with severe data limitations like São Tomé and Príncipe.

Annex Table 1. São Tomé and Príncipe: Real Effective Exchange Rate Assessment, Model Results

(Percent of GDP, unless otherwise indicated)

EBA lite current account model		**EBA lite Index REER model**	
Fitted current account (A)[1]	-10.9	Fitted LN(REER) (G)[6]	4.6
Policy gap (B)[2]	-2.0	Policy gap (H)[2]	0.0
Current account norm (C=A-B)	-8.9	LN(REER) norm, in percent (I=G-H)	4.6
Observed current account in 2015 (D)[3]	-16.7	LN(REER)- Actual, in percent (J)[7]	4.9
Current account gap (E=D-C)	**-7.9**	**REER gap, in percent (K=J-I)[4,5]**	**33.4**
REER gap, in percent (F=E/P)[4,5]	**7.5**		

	Stabilizing IIP at: Scenario 1: -153.2 of GDP	Scenario 2: -127.4 percent of GDP	Scenario 3: -127.4 percent of GDP in 2035
External sustainability approach			
Current account norm (L)	-13.5	-11.3	-10.8
Underlying current account (M)[8]	-6.2	-6.2	-6.2
Current account gap N=(M-L)	**7.2**	**5.0**	**4.6**
REER gap, in percent (O=N/P)[3,4]	**-6.9**	**-4.8**	**-4.4**
Memorandum item:			
Trade elasticity (P)[9]	-1.05		

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

[1] Fitted model of current account based on the EBA-lite methodology.
[2] Deviations of São Tomé and Príncipe's actual policies from its optimal level and also the average policy misalignment relative to the rest of the world.
[3] Observed current account in 2015.
[4] " + " overvaluation, " - " undervaluation.
[5] Change in the REER (in percentage) needed to close gap.
[6] Fitted model of REER based on the EBA-lite methodology.
[7] Observed LN(REER) in 2015.
[8] Using 2020 projected current account as the medium-term reference period.
[9] Trade elasticities derived from a panel study of low income countries by Tokarick (WP/10/180), page 31.

- **The EBA-lite current account model relating the current account to policy and non-policy fundamentals predicts a modest overvaluation** (Figure 3). The model fits reasonably well. It predicts a current account norm of -8.9 percent of GDP, net of a policy gap of -2 percent of GDP (or the sum of deviations of São Tomé and Príncipe's actual fiscal balance, change in reserves and private sector credit from their optimal levels and the world's averages of the same policy variables from their optimal levels). With the observed 2015 current account at -16.7 percent of GDP, it implies a current account gap of -7.9 percent of GDP or a modest overvaluation of the REER of about 7.5 percent assuming an elasticity of current account to REER of -1.05.

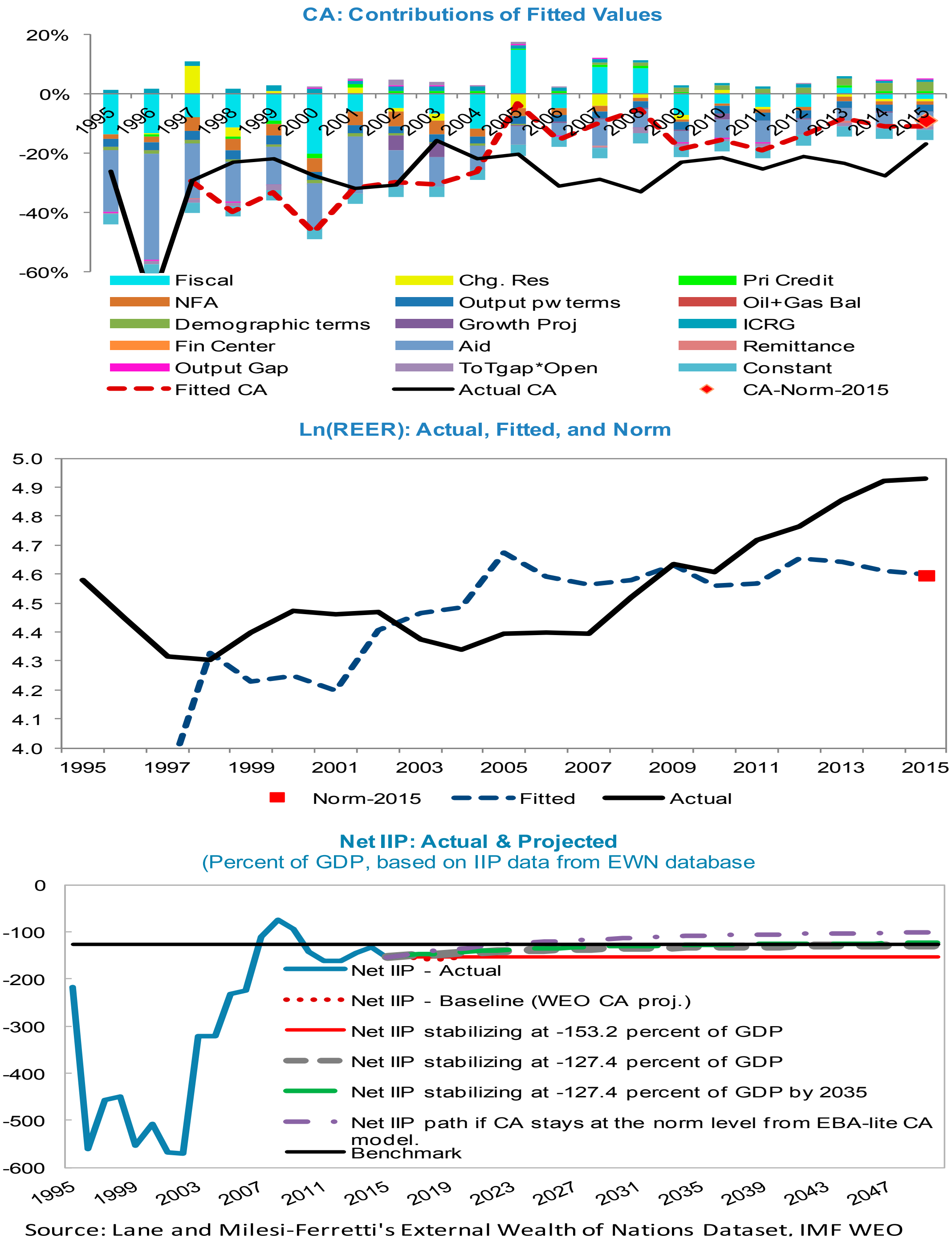
- **The EBA-lite EREER model predicts a stronger REER overvaluation (33.4 percent).** However, like its predecessor equilibrium real exchange rate approach under CGER methodologies, the Index REER model is not adequate for economies with major structural changes or limited data. The model is not a good fit for São Tomé and Príncipe. It provides an unreliable account of the REER developments over the last 5 years due to difficulties in capturing important structural changes such as the introduction of the peg with euro in 2010 and the subsequent slow disinflation dynamics (see the middle chart of the panel Figure 3). As such, the result should be interpreted with caution.

- **On the other hand, the external sustainability approach shows that the REER is slightly undervalued.** Targeting a net IIP at its most recent historical level (-153.2 percent of GDP) entails a current account norm of -13.5 percent which in turn implies an undervaluation of (-6.9 percent) based on an underlying current account of -6.2 percent and an elasticity of current account to REER of -1.05. Reducing the net IIP target to (-127.4 percent of GDP), a level consistent with the current account norm from EBA-lite CA model, results in a slightly less undervalued REER (-4 to -5 percent) or broadly consistent with the fundamentals (see the bottom chart of the panel Figure 3).

4. **Staff bottom line assessment is that the dobra REER in 2015 is modestly overvalued.** The assessment is in line with the EBA-lite CA model prediction, which shows the most reliable fit to São Tomé and Príncipe's case. The EBA-lite EREER model is not a good fit because of a significant structural change (i.e. dobra peg to the euro since 2010) and limited data while the predictions of the external sustainability approach are less reliable given the inherent difficulties in benchmarking the appropriate level of the net IIP.

5. **São Tomé and Príncipe's pegged exchange rate regime has served the country well by ending the inflation-depreciation cycle.** Correcting external imbalance through nominal depreciation is unlikely to deliver a more depreciated REER in the medium term because of the high pass-through to domestic prices. Policies to address external imbalances will have to focus on increasing savings through fiscal consolidation and fostering competitiveness (see section D of this annex).

Annex Figure 3. São Tomé and Príncipe: Exchange Rate Assessment Models Fit

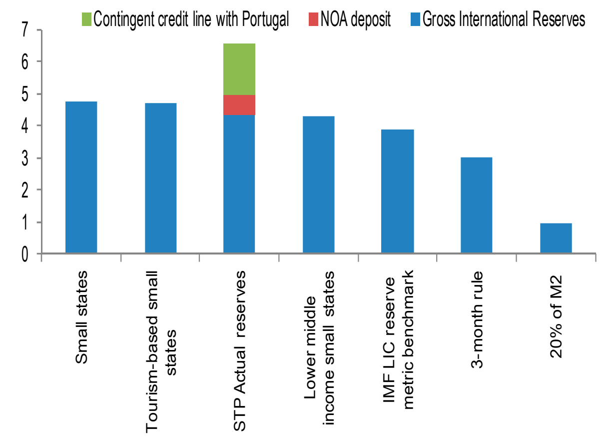


Sources: São Tomé and Príncipe authorities' data; IMF WEO; and IMF staff estimates.

C. Reserve Adequacy Assessment

6. **São Tomé and Príncipe needs to build strong international reserves buffers given the persistence and magnitude of shocks it faces as a small and fragile LIC with a pegged exchange rate regime.** Staff assessment relied on the traditional approaches, including the 3-months of import rule and 20 percent of broad money coverage as well as reserve assessment for LICs using the new Fund approach based on the analytical framework that (i) takes into account country specificities and multiple motives for holding reserves and (ii) balances benefits of holding reserves (i.e. prevention and mitigation of external shocks) against the associated opportunity cost while taking the country's fundamentals into account. The reserve assessment for LICs framework estimates the optimal reserve level for São Tomé and Príncipe at 3.9 months of imports.

Annex Figure 4. São Tomé and Príncipe: Reserve Adequacy, 2015
(Months of imports)



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

7. **São Tomé and Príncipe's 2015 gross international reserves were just at the benchmark level** (Figure 4). While gross international reserves coverage was just at the level of the IMF LIC reserve metrics, it was below that of its peers. However, the country has extra reserve buffers in the form of exceptional access to a supplemental US$10 million deposit in the National Oil Account (NOA) and €25 million from a contingent credit line with Portugal, should reserves fall below 3 months of import cover.

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
						Prel.		Projection		
In months of prospective imports of G & S	4.0	4.6	3.5	3.3	4.0	4.1	4.5	4.5	4.8	4.9
In percent of:										
External debt service (Guidotti rule)	3010	2215	2159	1381	1956	2106	2076	2242	2496	2596
Gross PPG External Debt (contracted, ex. IMF)	31	29	26	30	27	28	26	24	24	26
Broad money	64	63	52	53	51	58	61	60	61	60
GDP	23	21	20	21	19	23	25	24	25	25
Ratio to:										
FX deposits	109	118	100	145	137	175	165	162	165	163
Exports	200	178	158	119	72	91	98	96	98	97
Oil and food imports	160	98	96	84	77	110	180	152	145	137
Reserve adequacy metrics (IMF)										
Fix: 3.9 month of imports	48	44	58	75	62	69	74	78	80	84
Sao Tome and Principe, percent of the metric	102	118	90	86	103	106	117	115	123	125
Memorandum items:										
International reserves ($ million)	49	52	52	64	64	73	86	90	98	105
Nominal GDP ($ million)	209	254	260	303	338	318	349	371	396	429

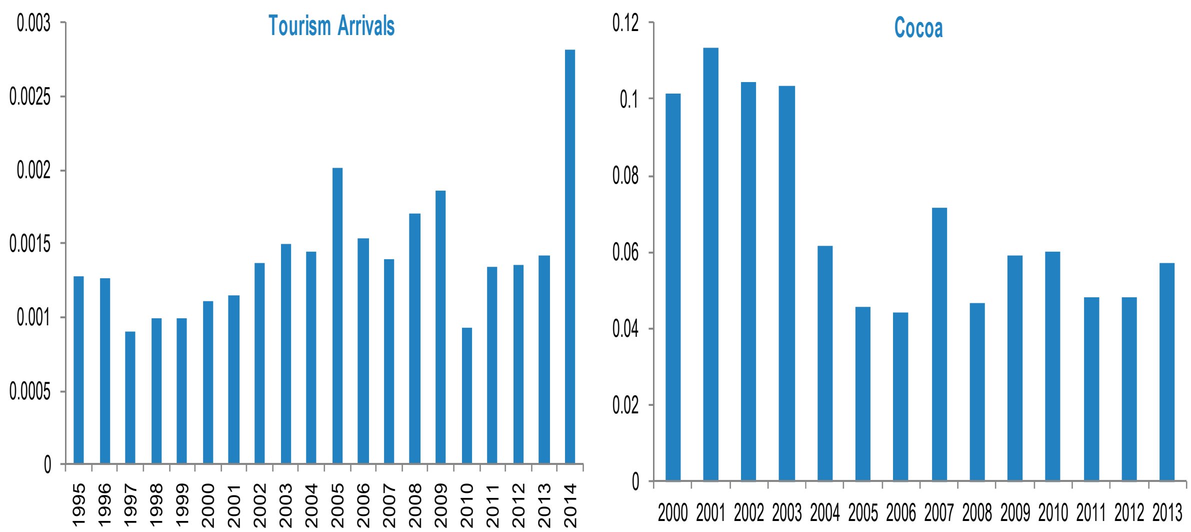
Sources: São Tomé and Príncipe authorities' data; and IMF staff calculations.

D. Non-price Competitiveness Assessment

8. Non-price competitiveness indicators all point to some loss of competitiveness. While São Tomé and Príncipe's market share for tourism showed a strong rebound in 2014, reversing the decline caused by the crisis in Europe, its market share for cocoa has generally been declining in recent years, signaling loss of competitiveness. The 2016 World Bank's Doing Business survey also suggests more vigorous reform actions are needed to improve the business environment. It shows only a modest improvement in São Tomé and Príncipe's overall distance to the top reformers at the frontier over the last six years. The country is lagging relative to the average for sub-Saharan Africa and for small states. Areas with greatest distance to the frontier are getting credit, resolving insolvency, paying taxes, protecting minority investors and enforcing contracts.

Annex Figure 5. São Tomé and Príncipe: Indicators of Exports Competitiveness

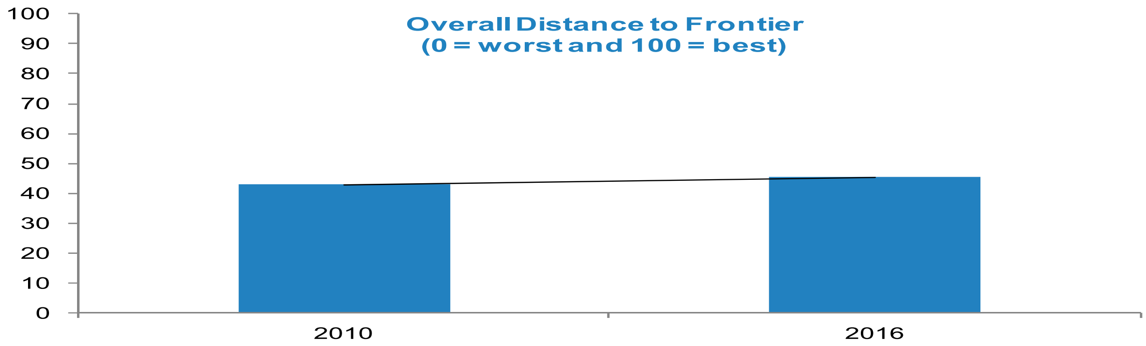
(Percent share of world's total)



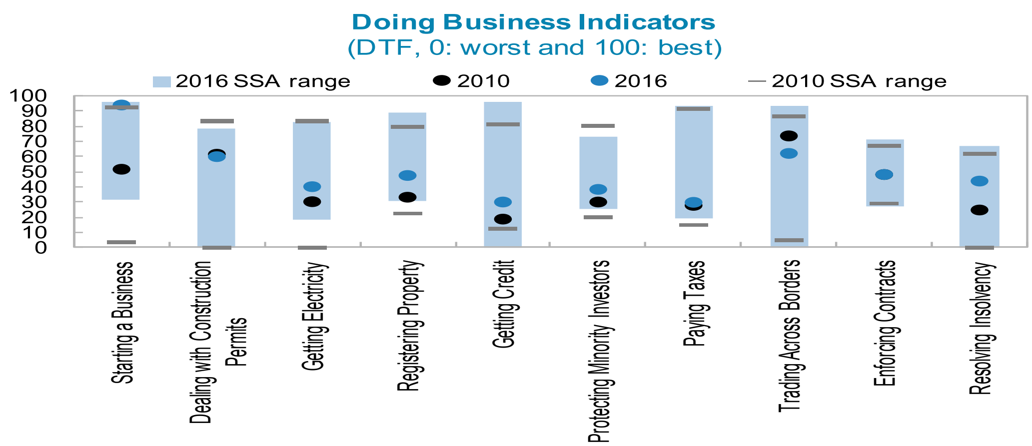
Sources: UN WTO; FAO; and São Tomé and Príncipe authorities' data.

Annex Figure 6. São Tomé and Príncipe: Doing Business Indicators

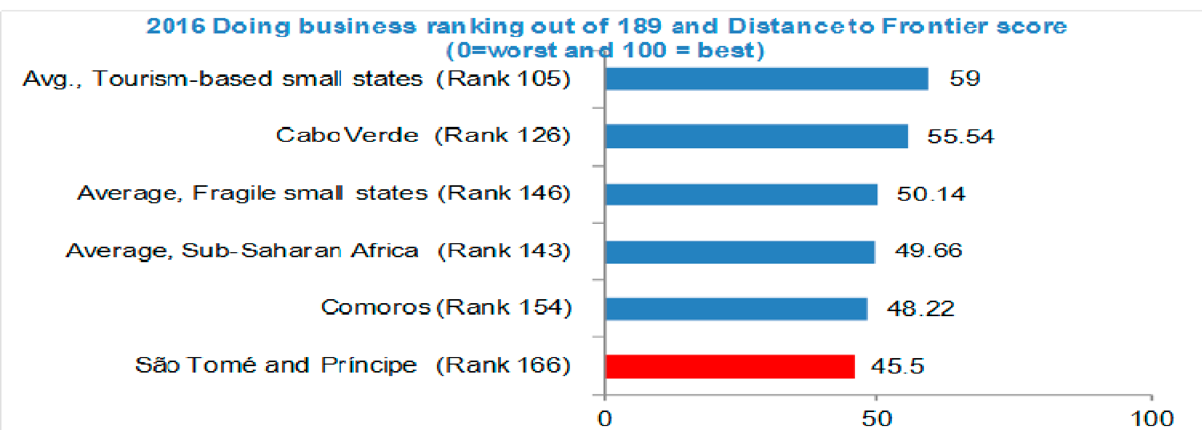
The overall position has only marginally improved…



…as its competitiveness is still hampered by an inefficient electricity sector, lack of credit and weak insolvency resolution framework …



…compares poorly relative to peers.



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

Appendix I. Letter of Intent

São Tomé, May 18, 2016

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

Dear Ms. Lagarde:

1. The Democratic Republic of São Tomé and Príncipe has made progress in implementing its economic reform program, supported by an IMF arrangement under the Extended Credit Facility (ECF) since July 2015. Despite the country's fragility and an uncertain environment, the government's efforts to strengthen macroeconomic stability, foster sustainable and inclusive growth, and reduce poverty in the context of the second National Poverty Reduction Strategy Paper (PRSP-II) have begun to bear fruit. In general, macroeconomic stability improved, economic growth stabilized, and inflation declined further. However, the economy continues to face significant challenges in terms of rising debt and weak competitiveness, undermining the job creation and poverty reduction efforts. We have stepped-up our engagement with creditors and donors toward reaching a cooperative and meaningful solution for the country's large infrastructural needs. Our ambitious structural reform agenda—primarily aimed at addressing bottlenecks to higher, sustained, and inclusive growth and strengthening the financial sector—is also being implemented with technical and financial assistance from our international partners.

2. The government believes that measures and policies described in the July 2015 Memorandum of Economic and Financial Policies (MEFP attachment I) remain appropriate for attaining the objectives of our program. The attached supplement to the MEFP discusses performance under the program thus far and updates policies toward meeting these objectives. Our key focus going forward will be to: align fiscal policy to anchor medium-term debt reduction; address the liquidity overhang to enhance monetary management; improve competitiveness; and safeguard financial sector stability to support growth.

3. Recently, the government concluded discussions on the first review under the ECF-supported program with an IMF staff mission, with focus on program implementation through end-December 2015, as well as on measures to be implemented during 2016. Performance under the ECF-supported program has been satisfactory. Although budget execution was challenged due to tax revenue underperformance, all but one of the end-December 2015 performance criteria (PCs) were met. The PC on domestic primary deficit was missed by about 0.3 percent of GDP. The indicative targets on tax revenue (a floor), pro-poor spending (floor), and dobra money (ceiling) were also missed. On the other hand, all of the structural benchmarks were implemented. The government has since introduced corrective

measures to address the revenue shortfall and believes these are well-entrenched to prevent future occurrence.

4. The attached MEFP describes government policies for 2016 that would support achieving program objectives under the ECF arrangement. We remain fully committed to achieve the objectives of the program and will take any additional measures necessary to that end. We will consult with the IMF on the adoption of such measures prior to any revision of the policies indicated in the MEFP.

5. In light of the progress in implementing the program, we request the IMF Executive Board to approve the waiver for non-observance of domestic primary deficit performance criteria with test date at end-December 2015, modification of performance criteria on domestic primary deficit and net international reserves, and request for the completion of the first review as well as the second disbursement of SDR 634,285 under this arrangement. Without prejudice to the original intent, we request that the two continuous performance criteria on non-concessional external borrowing be combined into one that establishes a ceiling on the contracting or guaranteeing of new external debt of any maturity (including overdraft positions but excluding normal import credits) by the government and/or the BCSTP.

6. The government will continue to provide Fund staff with all relevant information mentioned in the Technical Memorandum of Understanding (TMU), concerning further progress made under the program. During the program period, the government will not introduce or strengthen any exchange controls, multiple exchange rate practices, 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.

7. The government agrees to make public this Letter of Intent, along with the attached MEFP and TMU, the debt sustainability analysis (DSA) performed by the IMF and World Bank staff, as well as the entire IMF staff report on the first review and Article IV consultation. We hereby authorize their publication and posting on the IMF website, once the IMF Executive Board approves the completion of the Article IV consultation and the first review under the three-year arrangement under the ECF.

Sincerely yours,

/s/	/s/
Mr. Américo d'Oliveira Ramos, Minister of Finance and Public Administration	Ms. Maria do Carmo Trovoada Silveira, Governor of the Central Bank of São Tomé and Príncipe

Attachments:

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

Attachment I. Memorandum of Economic and Financial Policies for 2016–18

This Memorandum of Economic and Financial Policies (MEFP) updates the one outlined in the ECF-supported program approved by the IMF Executive Board on July 13, 2015. It describes recent macroeconomic developments, implementation of the ECF-supported program, the economic outlook and risks, and macroeconomic policies.

RECENT ECONOMIC DEVELOPMENTS

1. **São Tomé and Príncipe continued to make progress towards macroeconomic stability but delayed approval of the 2015 budget slowed down the pace of consolidation.** GDP growth for 2015, estimated at 4 percent, fell short of the projected 5 percent due to delayed implementation of public investment projects and poor rains that affected cocoa production. Inflation, on the other hand, was at 4 percent at the end of 2015 (the lowest in the past two decades), reflecting the slowdown in economic activity.

2. **The government's fiscal operations yielded mixed results.** Fiscal consolidation efforts have been hampered by tax revenue underperformance. Tax revenue is estimated to have fallen short of the end of year target by about 0.8 percent of GDP, in part due to a lower collection effort of tax arrears and delayed inclusion of the 15,000 new taxpayers registered during the operation tax inclusion project. In addition, ENCO (the oil importing company) continued to accumulate new tax arrears in 2015. While the government made modest offsetting cuts in expenditure, these were insufficient, resulting in a domestic primary deficit of about 3.0 percent of GDP, higher than the program target of 2.7 percent of GDP.

3. **Growth in monetary aggregates also decelerated in line with the slowdown in economic activity.** Broad money (M3) grew by 13.1 percent at the end of 2015, down from 16.8 percent at the end of the previous year. Similarly, the rate of growth in net foreign assets more than halved to 13.3 percent from 35.3 percent. Net domestic assets increased by 11.7 percent after declining by 45.2 percent in 2014; the turnaround mirrored a small rebound in credit to the economy, largely to households.

4. **The financial sector continues to face challenges.** The banking system's capital adequacy ratio (measured as capital to assets ratio) declined from 20.3 percent in December 2014 to 15.5 percent at the end of 2015, while the capital to risk-weighted assets ratio increased to 24.1 percent from 22.6 percent. Non-performing loans (NPLs) also increased to 29.8 percent, following the reclassification of overdue overdrafts in Banco Equador's books as bad loans and a downgrade in a sizeable share of the largest bank's loan classification to loss.

5. **There was however, an improvement in the balance of payments helped by lower commodity prices.** The external current account deficit fell to 16.7 percent of GDP, reflecting weak economic activity and a contraction in oil and other commodity imports that more than offset the decline in exports due to lower cocoa production. The central bank's

gross international reserves, estimated at US$61 million (4.4 months of imports), remain at comfortable levels.

PERFORMANCE UNDER THE ECF-SUPPORTED PROGRAM

6. **The program performance through end-December 2015 was satisfactory.** All continuous and quantitative performance criteria (PC) were met with the exception of the PC on domestic primary deficit. The PC on domestic primary deficit was missed by about 0.3 percent of GDP on account of lower-than-expected tax revenue following under-recovery of tax arrears and delays in including new taxpayers in the tax base. Nonetheless, the government has introduced corrective measures to aggressively collect tax arrears and to include the new taxpayers in the tax base this year. New legislative instruments to this effect will be submitted to Parliament by end-September 2016. In addition, indicative targets on tax revenue (a floor), pro-poor expenditure (floor) and on dobra money (ceiling) were also missed.

7. **Progress continues towards implementation of the structural reform agenda.** The government began to execute the domestic arrears clearance plan, which was developed as prior action for approval of the ECF arrangement. Overall, there was a net reduction in domestic arrears to utility companies by 1.2 percent of GDP, 0.4 percent of GDP higher than budgeted, eliminating arrears to the utility company (EMAE). EMAE in turn reduced its arrears to ENCO by 2.6 percent of GDP. However EMAE arrears to ENCO in 2015 increased on net basis (by 2.2 percent of GDP), albeit, by less than initially projected. Clearance of treasury arrears to ENCO will start this year. This has been included in the 2016 budget. The National Assembly passed the bank resolution law (end-September 2015 structural benchmark). This provides the necessary legal framework for the swift and orderly resolution of Banco Equador. To make available more representative statistics for policy evaluation and design, the statistical agency (INE) began to compile the new re-weighted and expanded monthly CPI series, and to publish revised national accounts series through 2013 (both structural benchmarks for end-December 2015).

ECONOMIC OUTLOOK AND RISKS

8. **The macroeconomic outlook is favorable in the near term but challenges remain.** GDP is projected to grow by 5 percent in 2016, based on higher and timely execution of the public sector investment program, recovery in cocoa production, and improved external conditions (and a consequent improvement in tourism and FDI). Inflation is expected to remain stable at around 4 percent given current forecasts for international food and fuel prices, but still higher than the euro area inflation. The government will have to continue to rely on concessional financing and grants; with difficulty in identifying new budget financing prospects, fiscal tightening will have to continue to ensure that gains from macroeconomic stability are protected.

9. **Downside risks weigh on these prospects.** Facing high risk of debt distress, the economy remains vulnerable to external shocks, which complicate the conduct of macroeconomic policies and discourage investment with resulting adverse consequences for

growth and poverty reduction. The forthcoming presidential election, slated for July 2016, with the risk of extra budgetary spending during the electoral period, and continued weakness in the banking sector pose significant short-term risks to the outlook. However, the government is fully committed to mitigating these near-term risks by maintaining the momentum of fiscal discipline in the run up to the presidential election, and enhancing supervision and oversight of banks. Additional downside risks could arise from weak demand in key advanced and emerging economies, which could dampen FDI and tourism inflows and reduce exports to those economies.

MACROECONOMIC POLICIES

A. Staying the Course on Debt Reduction while Improving the Quality of Spending

The Debt Reduction Program and 2016 Fiscal Framework

10. **As debt vulnerabilities remain high, the government reaffirms its commitment to fiscal prudence.** The 2016 fiscal program, presented in the government's budget, targets a domestic primary deficit of 2 percent of GDP, which is consistent with the program and in line with the goal of ensuring that the path of debt returns to a downward trajectory toward moderate risk of debt distress over the medium term. The fiscal program for 2016 is fully funded despite a sharp increase in capital spending which would mostly be financed by privatization proceeds from government's shares in the largest bank and the telecom company (5 percent of GDP), HIPC grants and disbursements of already contracted project loans (4.3 percent of GDP). There are also new concessional loans from Kuwait and Turkey (4.3 percent of GDP) to be used primarily for investments in rural roads and bridges, construction and rehabilitation of schools, improvement of the national health system, including maintenance and equipment of a hospital and health centers. This notwithstanding, the government is committed to frontload fiscal adjustment in 2016 to achieve the domestic primary deficit target that is consistent with the available non-debt creating financing.

The Medium-Term Fiscal Framework

11. **The government sees the need, over the medium-term, to ensure that fiscal policy walks a fine line between maintaining fiscal consolidation and creating space for growth-enhancing infrastructure spending.** To achieve the above, the government is committed to bring the domestic primary deficit further down to around 1–1½ percent of GDP by 2018 to ensure that debt remains on a downward trajectory, and at the same time create enough space for domestically-financed infrastructure spending to complement donor support. This would imply a significant step-up in domestic revenue mobilization through a combination of tax policies (introduction of VAT), customs and tax administration measures, including greater and more disciplined inspections and audits (to start immediately), integration of Príncipe's tax delegation, introduction and use of more modern computer information systems with updated taxpayer database (to be implemented by end-June 2017).

Structural Reforms to Strengthen Public Finances

12. **Fiscal policy would concentrate on efforts to enhance domestic revenue mobilization and improve the quality of spending.** On the revenue side, we would take the necessary steps to increase tax revenue collection to the levels of São Tomé and Príncipe's peer groups by 2018. Specific actions in 2016 will include:

- Start the payment of arrears to ENCO, latest by the end-June 2016, as a good-faith measure to address ENCO's nonpayment of import duties.

- Introduce more comprehensive and disciplined inspections and audits to curb fraud and tax evasion.

- Extend tax collection coverage to new taxpayers and aggressively collect tax arrears. To this effect, the government will implement a number of legislative changes, including lowering the minimum taxable income and raising the minimum presumptive levy charged to individuals and firms and transferring the execution powers for collection of tax arrears from the fiscal court judge to the tax administration (end-September 2016 structural benchmark).

- Introduce structures and measures to support the introduction of VAT to widen the tax base and enhance domestic revenue collection. In particular, the government will submit to the National Assembly a new VAT law by (end-December 2016 structural benchmark).

13. **The government is committed to the introduction of the automatic fuel price adjustment mechanism** (end-June 2016 structural benchmark). The technical team for petroleum price adjustment is currently reviewing the recommendations from the IMF TA in November 2015, to design a roadmap for implementation of the automatic fuel price adjustment. The technical team has been mandated to work on the following by end March 2016:

- Specify the pricing formula, including choosing a proper international reference price, raise the surcharge rate on fuel products to lock in an eventual positive price differential, deciding on the frequency of the price adjustment and the width of the price band. This will require the National Assembly authorizing the Minister to be able to make changes in surcharges.

- Decide on the short-run revenue target for gasoline and diesel.

- Decide on whether to maintain the pretax subsidy on kerosene, and if maintained, it has to be presented in the budget.

- An agency/secretariat has to be set up to be responsible for the implementation of the price adjustment mechanism. This agency, among other things will be responsible for monitoring the responsibilities of parties involved in the pricing mechanism and the processes for its regular and transparent application. A request will be sent to the IMF/FAD to help decide on the terms of reference for the creation of this agency.

- Select a third party to carry out a detailed study on fuel product and margin components.

- Select targeted mitigating measures that will be introduced in tandem with the new pricing mechanism.

- Design and launch a public information campaign.

14. **On the spending side, strengthening public financial management and transparency will be the focal point for ensuring efficiency in public expenditure.** Specific measures will include:

- Roll out the electronic information management system (SAFEe) from the current pilot stage to cover all ministries, autonomous services, other sovereignty institutions, regional and local government to strengthen public financial oversight.

- Enhanced SAFEe's functionality to facilitate the preparation of a more comprehensive and transparent general government accounts by including features such as reconciliation of treasury bank accounts, tracking of revenue, management of fixed assets and registry of government contracts that give rise to new liabilities.

- Reactivate and ensure a fully operational macro-fiscal unit and implement needed changes in the SAFEe Law (Lei 3/2007) and budget classification decree (decreto 4/2007) by end of March 2017 to support the move towards the introduction of a medium-term fiscal and expenditure frameworks.

15. **The government has identified key growth-enhancing infrastructure spending needed to increase real GDP growth to the minimum required target of 6 percent to significantly impact poverty.** In particular the government is considering the extension of the airport runway in São Tomé to attract larger aircrafts to boost tourism, and also investment in alternative sources of energy (beyond thermal) to bring down the energy cost compared to its peers. In 2015, the government signed MOUs (about US$800 million) with China Harbor Engineering Company to design a PPP with financing from the private sector to build a deepwater port in São Tomé. The government reiterates its commitment that there will be no fiscal cost and contingent liabilities to be borne by the government in this project. The government will not go ahead with this project if it is not fully financed by the private sector. The government is fully aware and is committed to relying on concessional financing and grants to support key infrastructure projects in order to ensure that debt returns to a downward trajectory over the medium term.

16. **To this end, the government is committed to enhancing investment capacity to support growth-enhancing infrastructure spending.** The government will introduce a centralized framework for appraising and prioritizing capital expenditure projects in addition to the introduction of a public investment management assessment (PIMA) framework (end-March 2017 structural benchmark).

17. **The government is committed to implementing the debt framework law (Lei 1/2013 de 17 de Janeiro de 2013) and to strengthening debt management**

capacity. In that context, the government will: (i) prepare a national debt strategy, as required by the debt framework law, that will fix a ceiling on the overall debt of the non-financial public sector as well as annual debt policies that fix annual ceilings for each public entity; (ii) update the medium-term debt management strategy; (iii) seek technical assistance to prepare a manual of procedures for debt management and to carry out a new debt management performance assessment (DeMPA) by the end of 2016; and (iv) prepare a comprehensive public private partnership (PPP) law and framework by end-September 2016 to guide the growing expressions of interests for PPPs following the London donors' conference in October 2015. In addition, the debt office will recover and update the existing debt database in the debt management system (CS-DRMS 2000+) and get the Crown Agent to validate it and provide training to new staff.

18. **The government will continue to give priority to concessional financing.** Consistent with the IMF's new policy on debt limits, the government has prepared a borrowing plan (Text Table 1). Under this plan, the government is committed to a prudent borrowing target, for 2016–18, of about US$45.4 million in nominal terms for priority projects.[11] This target implies an average annual PV of new external debt of 2.6 percent of GDP. All loans are expected to be on concessional terms, with the bulk to finance infrastructure projects and social spending. The government reserves the right to revise this plan during the next ECF review.

Text Table 1. Summary Table of Projected External Borrowing Program

PPG external debt	Volume of new debt in 2016		PV of new debt in 2016 (program purposes)	
	USD million	Percent	USD million	Percent
By sources of debt financing	**28.8**	**100**	**18.1**	**100**
Concessional debt, of which	**27.0**	**94**	**16.9**	**93**
Multilateral debt	0.0	0	0.0	0
Bilateral debt	27.0	94	16.9	93
Other	0.0	0	0.0	0
Non-concessional debt, of which	**1.8**	**6**	**1.2**	**7**
Semi-concessional	1.8	6	1.2	7
Commercial terms	0.0	0	0.0	0
By Creditor Type	**28.8**	**100**	**18.1**	**100**
Multilateral	1.8	6	1.2	7
Bilateral - Paris Club	0.0	0	0.0	0
Bilateral - Non-Paris Club	27.0	94	16.9	93
Other	0.0	0	0.0	0
Uses of debt financing	**28.8**	**100**	**18.1**	**100**
Infrastructure	10.0	35	6.3	35
Social Spending	17.0	59	10.7	59
Budget Financing	0.0	0	0.0	0
Other	1.8	6.1	1.2	6.7
Memo Items				
Indicative projections				
Year 2	**11.8**		**7.5**	
Year 3	**4.8**		**3.1**	

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

[1]This excludes financing for key infrastructure projects like the extension of the airport runway and selected energy related projects which will be considered separately.

B. Addressing the Liquidity Overhang to Enhance Monetary Management

19. **Slowdown in credit growth since 2013 as a result of rising NPLs and lack of bankable projects has resulted in a build-up of excess liquidity in the banking system which is complicating liquidity management.** At the moment, it is estimated that the excess liquidity in the banking system topped 5 percent of GDP at the end of 2015. The central bank of São Tomé and Príncipe (BCSTP) has introduced some tools to help with liquidity management. In 2015, the BCSTP introduced an interbank market but unfortunately, this has not taken off due to perceived stigma banks associate to participating in the interbank market. However, we expect it is only temporary given the recent developments in the domestic financial market. The BCSTP is working with the banks to address this challenge. In addition, the government introduced treasury bills which have been well-received by banks and participation has increased with the second issue of the 9-month treasury bills oversubscribed. The BCSTP is working towards developing a treasury bonds market, creating the conditions for longer-term liquidity management, as well as developing the secondary market.

20. **Work on developing BCSTP's monetary liquidity management framework continues.** The existing liquidity forecasting tool allows for improved information gathering and more accurate analysis of the autonomous factors that drive liquidity. In 2015 the central bank implemented a new payment methodology for the commercial banks; such that payment orders issued by the Treasury to commercial banks in the period t are now paid in the period t+1 thus enabling the BCSTP to include them in its liquidity forecasting, considerably reducing forecasting errors.

C. Improving Competitiveness and Setting the Stage for Sustainable and Inclusive Growth

21. **The government plans to promote private sector-led growth to set the stage for higher sustainable growth and distribute its benefits more widely.** The broad outlines of the government's *2030 Transformation Agenda* identify the priorities for medium to long-term growth, social cohesion and external credibility, including diversifying the economy, broadening the production base, and modernizing the economic and social infrastructure. The government is seeking to create conditions conducive to support the traditional sectors, such as agriculture, fisheries, and tourism to boost job creation and reduce poverty.

22. **The untapped tourism potential of São Tomé and Príncipe offers much promise.** Medium-term structural reforms will focus on high-yielding tourism activities, broader diversification of source markets, and more open, competitive air transport connections. Specific policy initiatives in 2016 will include:

- Introducing targeted reforms to address the poor performing indicators in the World Bank's Doing Business survey.

- Diversifying tourism source markets and supporting open, competitive air transport policy, including allowing direct links to the sub region, Europe, and Brazil.

- Developing a national export diversification strategy (end-December 2016 structural benchmark).

D. Macro-Financial Linkages and Financial Sector Stability

23. **São Tomé and Príncipe's highly-concentrated banking system is not only challenged with excess liquidity but also low profitability.** The largest bank accounts for about half of the system's deposits and loans, and the remaining six small banks account for the other half. NPLs have almost since 2013 and reached 30 percent of total credit in 2015. Indicators of profitability suggest pervasive weakness, with only the largest bank profitable while other banks face negative (some highly) returns on assets. Return on equity has also been deteriorating and was reported as -27 percent in 2015. Corrective measures by BCSTP are beginning to yield results. As a result of supervision actions, three out of seven banks increased their capital in the last quarter of 2015, to meet the minimum requirement. BCSTP is at the early stage of building adequate crisis management and bank resolution frameworks to deal with risks in the financial system. The new banking resolution law provides the legal framework for a swift and orderly resolution of banks, including Banco Equador. A transition bank is being created with quality assets and liabilities of Banco Equador, and steps are being taken to identify potential buyers and conclude the process within 1 year from the establishment of the transition bank. If a potential buyer is not identified within one year of the establishment of the transition bank, the BCSTP will proceed with the final liquidation of Banco Equador.

24. **The BCSTP is putting together a comprehensive strategy to address the large stock of NPLs** (end-June 2016 structural benchmark). This would involve stocktaking, provisioning and recapitalizing specific banks if needed. In addition, the BCSTP will conduct detailed asset quality reviews for all banks to reduce the uncertainty surrounding bank assets, and where necessary demand recapitalization of affected banks, bearing in mind an additional objective of consolidation in the banking system.

25. **To further safeguard financial stability, the BSCTP will strengthen on-site and off-site banking supervision by increasing the number of direct inspections.** This will ensure stricter direct follow-up. A cycle of bank inspections, which began in 2015, was completed, and another cycle commenced in 2016.

26. **The BCSTP welcomes São Tomé and Príncipe's selection as a pilot country for mainstreaming macro-financial linkages as part of the Article IV consultation.** BCSTP shares the recommendations of the exercise and is looking forward to implementing the key recommendations. In particular, BCSTP will take the necessary steps to:

- Implement necessary measures to tackle the large stock and growing NPLs which are beginning to have negative spillback on growth.

- Strengthen financial sector stability by: requiring that banks with below minimum capital ratios increase their capital base, and conducting regular asset quality reviews to identify problem banks that will require swift corrective measures.

- Further develop the treasury bills market, while ensuring its consistency with the fiscal sector.

27. **While measures of financial inclusion in São Tomé and Príncipe compare well with its regional peers, the impact on poverty reduction and private sector development is unclear.** Low financial, documentation and barriers to entry contribute to relatively high access levels. Bank branches are relatively evenly dispersed and minimum requirements are comparatively low, and the number of adults with savings accounts is larger than the regional average. However, important challenges remain in terms of achieving universal inclusion. Specific actions in 2016 include:

- Improving the coverage and effectiveness of the credit reference bureaus.

- Streamlining procedures to ensure collateral enforcement, including reforms to the judiciary.

- Capacity building of SMEs in basic accounting, financial management, and preparation of bankable projects.

OTHER PROGRAM ISSUES

28. **Initiatives to strengthen safeguards and improve transparency have been introduced since 2015.** A safeguards assessment mission was conducted by the IMF's Finance Department in September 2015, which recommended independent oversight of the audit mechanisms, internal controls, and financial reporting. Given capacity constraints, it was also recognized that external audits done by a reputable audit firm continued to serve as a critical safeguard. In order to further strengthen internal controls, several measures were adopted including the restructuring of the internal audit committee and the appointment of a new Director with recognized competences. Furthermore BCSTP is in the process of acquiring new equipments that automatically sort and destroy mutilated bills and thus reduce human intervention in the process. With respect to financial reporting, the BCSTP has sought TA from Brazil and the IMF to migrate statements of accounts to the International Financial Reporting Standards (IFRS), and the work on the revising the organic central bank law is ongoing. In 2016, the BCSTP plans to:

- Update the Internal Audit Charter and establish a database to monitor and prioritize audit recommendations by end-June 2016.

- Establish an Audit Board policy (end-December 2016 structural benchmark), similar to an Audit Committee Charter, that specifies roles and responsibilities similar to that of a conventional Audit Committee, which would include oversight of the internal and external audit mechanism.

- Conduct risk-based audits of high-risk areas, including foreign reserves, currency and vault operations, and banking operations by end-December 2016.

- Submit the draft central bank law to the National Assembly by end-September 2016 (structural benchmark) to align its legal framework with leading practices for central banks.

PROGRAM MONITORING

29. **The PCs, ITs, and structural benchmarks for 2016 are presented in Tables 3 and 4.** The definitions of quantitative PCs and ITs are provided in the attached Technical Memorandum of Understanding (TMU), which also defines the scope and frequency of data to be reported for program monitoring purposes. The second review is expected to be completed by December 2016, the third review by June 2017, and the fourth review by December 2017.

Table 1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2015

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

	2015						
	September			December			
	Indicative Target	Indicative Target w/ adjustments	Actual	Performance Criteria [1]	Performance Criteria [2] w/ adjustments	Preliminary	Status
	30-Sep-15			31-Dec-15			
Performance criteria:							
Floor on domestic primary balance (as defined in the TMU) [2, 12]	-153	-153	-174	-190	-190	-207	Not met
Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	0	61	-238	0	61	-43	Met
Floor on net international reserves of the central bank (US$ millions) [2, 4]	50	47	62	50	47	57	Met
Ceiling on central government's outstanding external payment arrears (stock, US$ millions) [5, 6, 7, 8]	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]	0	...	0	0	...	0	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]	0	...	0	0	...	0	Met
Indicative targets:							
Ceiling on change of central government's new domestic arrears	0	...	-70	0	...	-82	Met
Ceiling on dobra base money (stock)	990	...	1,111	1,113	...	1,296	Not met
Floor on pro-poor expenditures	357	...	307	447	...	440	Not met
Floor on tax revenue	732	...	722	1,073	...	1,006	Not met
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	...	30	35	...	30	
Transfer from NOA to the budget (US$ millions)	2.0	...	2.0	2.0	...	2.0	
Net external debt service payments [11]	106	...	208	143	...	239	
Official external program support [11]	192	...	0	220	...	61	
Treasury-funded capital expenditure	48	...	34	63	...	46	

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

[1] Performance at the December 2015 test date is assessed on the first review.

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

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

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

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

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

[7] The term "external" is defined 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, ¶ 6 and 13.

[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, ¶ 12.

[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.

Table 2. São Tomé and Príncipe: Structural Benchmarks, 2015

Policy Objectives and Measures	Timing	Macro Rationale	TA involved	Status
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 for approval of arrangement	To restore timely financial flows between all parties concerned, in particular the timely payment of all applicable taxes.	Team worked with authorities.	Met.
Enhancing Monetary Policy and Financial Stability				
Submit to the National Assembly a new Bank Resolution Law.	End-September 2015	To improve soundness of financial system	MCM TA	Met.
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.	AfDB and AFRITAC TAs	Met.
Publish revised national accounts series through 2013.	End-December 2015		STA TA	Met.

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

Table 3. São Tomé and Príncipe: Proposed Performance Criteria and Indicative Targets for 2016–17

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

	2016				2017	
	March	June	September	December	March	June
	Indicative Target	Performance Criteria [1]	Indicative Target	Performance Criteria [1]	Indicative Target	Performance Criteria [1]
	31-Mar-16	30-Jun-16	30-Sep-16	31-Dec-16	31-Mar-17	30-Jun-17
Performance criteria:						
Floor on domestic primary balance (as defined in the TMU) [2, 12]	-23	-54	-100	-155	-27	-70
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]	62	62	53	53	55	55
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 by the central government or the BCSTP (US$ millions) [5, 6, 7, 8, 9]	0	0	0	0	0	0
Indicative targets:						
Ceiling on change of central government's new domestic arrears	0	0	0	0	0	0
Ceiling on dobra base money (stock)	1,062	1,085	1,102	1,465	1,187	1,137
Floor on pro-poor expenditures	168	289	359	448	171	301
Floor on tax revenue	181	422	783	1,170	186	455
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]	14	14	14	14	26	26
Transfer from NOA to the budget (US$ millions)	1.6	1.6	1.6	1.6	1.3	1.3
Net external debt service payments [11]	18	43	107	233	23	50
Official external program support [11]	20	47	88	205	22	50
Treasury-funded capital expenditure	12	28	50	101	15	31

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

[1] Performance at the June and December 2016 test dates are assessed on the second and third reviews respectively and performace at the June 2017 is assessed on the fourth review.

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

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

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

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

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

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

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

[9] Only applies to debt with a grant element of less than 35 percent. For further details refer to the TMU, ¶ 12.

[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 2015 and December 2016 respectivelly.

Table 4. São Tomé and Príncipe: Structural Benchmarks, 2016

Policy Objectives and Measures	Timing	Macro Rationale	TA involved
Strengthening Public Finances			
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	FAD TA 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
Introduce legislation to transfer the execution for collection of tax arrears from fiscal court judge to the tax administration.[1]	End-June 2016	To boost tax arrears collection	No TA involved
Submit to the National Assembly a new VAT law.[2]	End-December 2016	To support the introduction of VAT	Forthcoming FAD/LEG TA
Complete a public investment management assessment (PIMA) and submit to staff a reform plan to strengthen public investment management practices.[3]	End-December 2016	To enhance capacity for efficient public investment decision-making	With World Bank support
Enhancing Monetary Policy and Financial Stability			
Prepare and submit to staff a comprehensive strategy to help banks deal with high NPLs on their balance sheets.	End-June 2016	To support financial sector stability and growth	Forthcoming MCM TA
Establish an Audit Board policy for BCSTP that specifies a role similar to a conventional audit committee, with responsibilities for oversight of internal and external audit mechanisms, and financial reporting.[4]	End-December 2016	To enhance independent oversight of the audit and control mechanisms	
Complete detailed assessment of compliance with Basel Core Principles.	End-December 2016	To improve soundness of financial system	Forthcoming MCM 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

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

[1, 2, 3, 4] Newly-proposed structural benchmarks.

Attachment II. Technical Memorandum of Understanding June 2016

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 2016 and 2017. 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 2016 and 2017.

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

PERFORMANCE CRITERIA

9. **Performance criterion on the floor on domestic primary balance.**
This performance criterion refers to the difference between government domestic revenue (excluding oil revenue) and domestic primary expenditure. For reference, this balance for end-December 2015 was -207 billion dobra, broken down as follows:

	Government domestic revenue:	1,108 billion
Less:	Government primary expenditure:	
	(As defined in paragraph 8)	1,315 billion
Equals:	Domestic primary balance:	-207 billion

10. **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 2015, outstanding net bank financing of the central government (excluding NOA) was -43.2 billion dobra, broken down as follows:

	BCSTP credit, including use of IMF resources:		246.6 billion
Less:	Government deposits with the BCSTP (excluding NOA)		150.6 billion
	Of which:	Treasury dobra-denominated accounts	11.4 billion
		Treasury foreign currency-denominated accounts	18.9 billion
		Counterpart deposits	120.3 billion
Equals:	Net credit to government by the BCSTP		96 billion
Plus:	ODC's credit to the government		8.6 billion
Less:	Government deposits with ODCs (including counterpart funds)		147.8 billion
Equals:	Net bank financing of the government (excluding NOA)		-43.2 billion

11. **Performance criterion on the floor on net international reserves (NIR) of the BCSTP.** The NIR of the BCSTP are defined for program-monitoring purposes as short-term (i.e., original maturities of one year or less), tradable foreign assets of the BCSTP minus short-term external liabilities, including liabilities to the IMF. All short-term foreign assets that are not fully convertible external assets nor readily available to and controlled by the BCSTP (i.e., they are pledged or otherwise encumbered external assets, including but not limited to the HIPC umbrella SDR account and assets used as collateral or guarantees for third-party liabilities) will be excluded from the definition of NIR. Securities whose market value on the last day of the year differs by over 20 percent from their original nominal issue price will be assessed at their market value as reported by the BCSTP's Markets Department. The balance of (1) NOA at the BCSTP, (2) banks' deposits related to capital or licensing requirements, and (3) banks' reserves denominated in foreign currency are excluded from the program definition of NIR. All values are to be converted to U.S. dollars at the actual mid-point market exchange rates prevailing at the test date. For reference, at end-December 2015 NIR was 1,267.4 billion dobra, calculated as follows:

Gross international reserves:				1,633.9 billion
	Of which:	Cash		23 billion
		Demand deposits		240.1 billion
		Term deposits (including banks' deposits in foreign currency)		991.8 billion
		Securities other than shares		346.3 billion
		Of which:	Portuguese Treasury bonds	223.6 billion
			Rede Ferroviaria Nacional bonds	122.7 billion
			Mortgage-backed securities of CDG	0 billion
		Accrued interest on securities		23.1 billion
		Reserve position in the Fund		0 billion
		SDR holdings		9.5 billion
Less:	Short-term liabilities (including liabilities to the IMF)			100.3 billion
Less:	Banks' reserves denominated in foreign currency			266.2 billion
Less:	Banks' guaranteed deposits denominated in foreign currency			0 billion
Equals:	Net international reserves			1,267.4 billion
Plus:	Other foreign assets			379.2 billion
Less:	Medium and long-term liabilities (including SDR allocation)			220.7 billion

Equals: Net foreign assets	1,425.9 billion
Memorandum item: National Oil Account (NOA)	230.1 billion

12. **Performance criterion on the ceiling on the contracting or guaranteeing of new nonconcessional external debt by the central government or the BCSTP.** This is a continuous performance criterion that refers to the contracting or guaranteeing of new external debt of any maturity (including overdraft positions but excluding normal import and suppliers credits) by the government and/or the BCSTP. Debt is considered nonconcessional if it includes a grant element less than 35 percent. The grant element is the difference between the nominal value of the loan and its net present value, expressed as a percentage of the nominal value. The net present value of the debt at the date on which it is contracted is calculated by discounting the debt service payments at the time of the contracting of the debt. The discount rate used for this purpose is 5 percent. 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. 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.

13. **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

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

15. **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 2015 dobra base money was 1,295.7 billion dobra, calculated as follows:

Currency issued:			315.3 billion
Of which:	Cash in vaults		68.3 billion
	Currency outside depository corporations		246.9 billion
Plus:	Bank reserves denominated in dobra		980.4 billion
Equals:	Dobra base money		1,295.7 billion

16. 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 Principe 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.

17. **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

18. **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.

19. **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.

20. **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.

21. **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

22. **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 2016 and 2017 in addition to that described in the MEFP; this adjuster will be capped at 70.3 billion dobra (about 1 percent of 2015 GDP) for 2016 and 2017.[2]

23. **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 2015 or end-December 2016, as appropriate (MEFP attachment I, Table 3). The following is an explanation of these adjustments:

- Adjusters on ceilings on changes in net bank financing of the central government (NCG): Quarterly differences between actual and projected receipts of budget

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

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 2015 or end-December 2016, 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$3million at the program exchange rate.

- Adjusters for the floor on net international reserves (NIR) of the BCSTP: Quarterly differences between actual and projected receipts of budget transfers from the NOA, official external program support, net external debt service payments, and domestic arrears in dobra, will be converted to U.S. dollars at the program exchange rate and aggregated from end-December 2015 or end-December 2016, 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$50 million in 2016 and US$52 million in 2017.

DATA REPORTING

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

1) **Fiscal Data:** The Directorate of Treasury and Directorate of Budget at the 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

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION, FIRST REVIEW UNDER THE EXTENDED CREDIT FACILITY AND REQUEST FOR WAIVER FOR NONOBSERVANCE OF PERFORMANCE CRITERION AND MODIFICATION OF PERFORMANCE CRITERIA—INFORMATIONAL ANNEX

May 20, 2016

Prepared By The African Department (in Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of March 31, 2016)

Membership Status

Joined: September 30, 1977; Article XIV

General Resources Account:	SDR Million	% Quota
Quota	14.80	100.00
Fund holdings of currency (exchange rate)	14.80	100.02
Reserve tranche position	1.85	12.50

SDR Department:	SDR Million	% Allocation
Net cumulative allocation	7.10	100.00
Holdings	0.31	4.41

Outstanding Purchases and Loans:	SDR Million	% Quota
ECF Arrangements	2.90	19.57

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF[1]	07/13/2015	07/12/2018	4.44	0.63
ECF[1]	07/20/2012	07/19/2015	2.59	1.11
ECF[1]	03/02/2009	03/01/2012	2.59	0.74

[1]Formerly PRGF.

Projected Payments to Fund [2]

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

	Forthcoming				
	2016	2017	2018	2019	2020
Principal	0.29	0.44	0.39	0.33	0.26
Charges/Interest	0.00	0.00	0.00	0.01	0.01
Total	0.29	0.45	0.39	0.34	0.27

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

Implementation of HIPC Initiative:

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

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

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

Implementation of Multilateral Debt Relief Initiative (MDRI):

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

Debt Relief by Facility (SDR Million)

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

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

Safeguards Assessments:

The recent update of safeguards assessment found that severe capacity constraints have contributed to a weak safeguards framework at the BCSTP. In particular, safeguards relating to independent oversight on audit, financial reporting, and control mechanisms need strengthening. In addition, the BCSTP's legal framework will need to be revised to align it with leading practices for central banks. While external audits conducted by a reputable audit firm continue to serve as a critical safeguard, ongoing institutional development will be needed to strengthen capacity and bolster the safeguards framework. Further, the engagement of the Audit Board with revised roles and responsibilities will be needed for better oversight.

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 percent for the euro and 4 percent for other currencies. Purchases of euro 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 percent of qualified capital, a net position in total foreign currency less than 25 percent 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 it does not maintain restrictions under Article XIV. However, it maintains one measure subject to Fund approval under Article VIII: an exchange restriction arising from Article 3(i) and Article 10.1(b) of the Investment Code (Law No. 7/2008) regarding limitations on the transferability of net income from investment. The restriction results from the requirement that taxes and other obligations to the government have to be paid/full-filled 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
March 2016	MCM mission on banking supervision
November 2015	STA mission on national accounts statistics
November 2015	FAD mission on automatic fuel pricing mechanism
September 2015	MCM mission on banking supervision
July 2015	FAD mission on tax administration
June 2015	STA mission Balance of Payment and IIP
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 of 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

Date of Delivery	Department/Purpose
January 2013	FAD mission on public accounting
November 2012	FAD mission on medium-term fiscal framework
November 2012	FIN mission on safeguards assessment
November 2012	LEG follow-up mission on AML/CFT
October 2012	MCM mission on banking supervision
October 2012	FAD diagnostic mission on customs
October 2012	FAD mission on public accounting
September 2012	MCM mission on liquidity management
July 2012	LEG diagnostic mission on AML/CFT
April 2012	FAD mission on revenue administration
March 2012	FAD mission on public financial management
March 2012	STA mission on balance of payments
February 2012	LEG diagnostic mission on AML/CFT
February 2012	FAD mission on implementation of SAFEe
January 2012	FAD diagnostic mission on tax administration
November 2011	MCM TA needs assessment mission
November 2011	MCM mission on liquidity management
November 2011	FAD mission on public accounting
October 2011	FAD mission on public financial management
August 2011	FAD mission on public accounting
June 2011	MCM mission on liquidity management
June 2011	FAD mission on public accounting
February 2011	MCM mission on bank resolution framework
January 2011	FAD mission on public accounting
September 2010	MCM mission on liquidity management
August/September 2010	STA mission on monetary and financial statistics
December 2009	MCM mission on banking supervision
August 2009	MCM mission on banking supervision
June 2009	FIN mission on safeguards assessment
May 2009	FAD mission on public financial management

RELATIONS WITH THE WORLD BANK GROUP

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

(As of April, 2016)

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 current ECF-supported program that discusses policies and financing during the prospective program period 2015–18, and for the prospective financial sector development plan (a World Bank initiative).

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. The Bank has suggested the government to formally ask for a follow-up DeMPA mission.

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 2016–17			
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 • STP Programmatic DPO Series • Adaptation to Climate Change – Additional Finance • EITI • Financial sector support to Bank supervision • South-South support to investment promotion	N.A. June 2016 N.A. N.A. N.A. N.A.	FY2016 FY2017 FY2017 FY2017 FY2017
IMF work program in the next 12 months	• ECF first review and Article IV • ECF second review • Technical Assistance from FAD: ○ Tax policy (VAT) ○ PFM • MCM: ○ Contingency planning and crisis management ○ Banking Supervision	March 2016 September 2016 September 2015 April 2016 November 2016	June 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 2016 -17 fiscal program	October 2016
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, 2016)

1. São Tomé and Príncipe (STP) became a member of the African Development Bank Group (AfDB) in 1976. To date, the AfDB has financed 40 operations in the country. This comprises of 30 projects, including institutional support, and 10 studies, for a total net commitment of UA 134 million under the African Development Fund (ADF) (98.9 percent), and one special support operation of UA 1 million under the Nigeria Trust Fund (NTF). The vast majority of these operations (94 percent) were financed through loans with the remaining 6 percent through grants.

2. As of May 31, 2016, the AfDB's ongoing portfolio comprised of six active projects for a total commitment of UA 26.2 million. These are: the Infrastructure Rehabilitation for Food Security (PRIASA I); Infrastructure Rehabilitation for Food Security (PRIASA II); the Public Finance Management Project (PAGEF); the National Planning Scheme study; the Study on Water Supply and Sanitation Programme Rural; the Trade Facilitation project (second phase of ASYCUDA); (Table 1). The portfolio is relatively young. The average age of the ongoing portfolio is 3 years against 5.4 years recorded in 2011. Such improvement is mainly linked to new projects approved in the first quarter of 2013 and 2015. The portfolio's average disbursement rate stands at 25.8 percent lower than 29.3 percent reported in the last portfolio review conducted in 2014. In terms of sector distribution, agriculture contributes a substantial proportion, representing 71 percent of the total value of the portfolio, followed by multi-sector (26 percent) and water and sanitation (3 percent). There is no ongoing private sector or multinational projects.

3. The AfDB current involvement in STP is guided by the Country Strategy Paper (CSP) 2012–16, 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 concluded the private sector strategy

2015–2024 for STP. Within the context of its project, the AfDB will also undertake the following studies; (i) study on the accreditation of the Technology and Agronomic Centre (CIAT); (ii) study on the cartography and selectivity of energy including network protection of EMAE-Electricity and Water Company). 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 US$99.56 million in debt service according to the terms of the MDRI. The AfDB's total assistance under HIPC and MDRI amounted to US$187.92 million in debt relief. At the end of December 2008, the AfDB provided US$13.33 million in debt relief under HIPC and US$99 million under MDRI.

Table 1. AfDB Ongoing Projects (Millions of UA)

Title of Projects	Window	Commitment	Disbursement Rate (Percent)
PRIASA I	ADF Grant	5.0	90.8
PRIASA II	ADF Loan	14.04	0
Study on water supply and sanitation Programme	RWSSI Trust Fund	0.7	45.1
PAGEF	ADF+FSF Grants	7	29.3
National Planning Scheme	ADF Loan	2	NA
Trade Facilitation Project	Trust Fund	0.355	NA
Total		***28.6***	***24 (Average)***

STATISTICAL ISSUES

(As of April, 2016)

I. Assessment of Data Adequacy for Surveillance
General: Economic data are broadly adequate for surveillance. At the same time, 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. Weak source data affect the quality national accounts estimates. A technical assistance mission is planned early during FY2017 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. The current GDP series (base year 2001) became available in mid–2011. Compared with the previous series, the revised ones reflect more accurately recent economic developments. 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: From January 2016, the INE is disseminating a new CPI (base 100 = 2014). With the assistance of AFRISTAT, the product mix was changed and the weights were updated, using the results of a household expenditure survey conducted in 2010. Due to financial constraints, the new CPI only covers the capital city.
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 improved significantly. The BCSTP was reporting monthly data to STA for the central bank and other depository corporations (ODCs) on regular basis, but since February 2015 stopped the data transmission, notwithstanding repeated requests from STA to resume reporting.

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. STA contacted the BCSTP to receive FSI data on a regular basis according to the methodology of the *FSI Compilation Guide* for their posting on the IMF's website: after an initial exchange, the BCSTP stopped responding to STA's requests.

External Sector Statistics: The BCSTP 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. Quarterly IIP data on a *BPM6* basis (for December 2014 and March 2015) were submitted to STA in June 2015 during a TA mission. However, since then the BCSTP has not submitted additional IIP data. The BCSTP should compile and submit quarterly IIP data for later periods consistent with the balance of payments data. The BCSTP 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). However, the response rates of the surveys addressed to the nonfinancial private sector and oil and gas sector need to improve and these data should be carefully validated before addition to the ESS to assure the accuracy of the disseminated data. The net errors and omissions figures for 2014 are still very large.

A June 2015 mission recommended improving coordination and data sharing among data-producing agencies, increasing staff dedicated to the compilation and collection of ESS, and discussing with the Joint Development Authority the establishment of mechanisms for receiving regular data on production sharing agreement contracts. The National Petroleum Agency has started submitting regular data.

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

II. Data Standards and Quality

São Tomé and Príncipe has participated in the Fund's General Data Dissemination System (GDDS) since April 20, 2004. Currently, it is in its successor data dissemination initiative, eGDDS.

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

(As of April 30,2016)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting	Frequency of Publication
Exchange rates	Apr. 2016	Apr. 2016	D	D	D
International reserve assets and reserve liabilities of the monetary authorities [1]	Mar. 2016	Apr. 2016	D	D	D
International investment position	Mar. 2015	Jun. 2015	Q	Q	Q
Reserve/base money	Mar. 2016	Apr. 2016	D	D	D
Broad money	Mar. 2016	Apr. 2016	M	M	M
Central bank balance sheet	Mar. 2016	Apr. 2016	M	M	M
Consolidated balance sheet of the banking system	Mar. 2016	Apr. 2016	M	M	M
Interest rates [2]	Mar. 2016	Apr. 2016	M	M	M
Consumer Price Index	Mar. 2016	Apr. 2016	M	M	M
Revenue, expenditure, balance and composition of financing [3] – general government [4]	Mar. 2016	Apr. 2016	Q	Q	Q
Revenue, expenditure, balance and composition of financing [3]– central government	Mar. 2016	Apr. 2016	Q	Q	Q
Stocks of central government and central government-guaranteed debt [5]	Mar. 2016	Apr. 2016	Q	I	Q
External current account balance	Mar. 2016	Apr. 2016	A	I	A
Exports and imports of goods	Mar. 2016	Apr. 2016	M	M	A
GDP/GNP	2013	Mar. 2016	A	I	A
Gross external debt	Mar. 2016	Mar. 2016	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).

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

May 20, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION, FIRST REVIEW UNDER THE EXTENDED CREDIT FACILITY AND REQUEST FOR WAIVER FOR NONOBSERVANCE OF PERFORMANCE CRITERION AND MODIFICATION OF PERFORMANCE CRITERIA—DEBT SUSTAINABILITY ANALYSIS UPDATE[1]

Approved By
David Owen and Andrea Richter Hume (IMF) and John Panzer (IDA)

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

Risk of external debt distress:	*HIGH*
Augmented by significant risks stemming from domestic public and/or private external debt?	*NO*

The update of analysis based on the joint IMF-World Bank debt sustainability framework (DSF) for low income countries shows that São Tomé and Príncipe is at a high risk of debt distress. *The assessment of high risk of debt distress is unchanged from the previous Debt Sustainability Analysis (DSA). This update reflects US$14 million of planned new borrowing in 2016, recent economic data and forecasts, including a slightly lower than originally projected end-2015 debt stock out-turns. Debt ratios are projected to follow roughly the same trajectories as in the previous DSA. The risks continue manageable over the medium term if the authorities are able to move forward with a planned fiscal adjustment of 1.5 percent of GDP over 2016–18, and they stay committed to mainly grants and concessional borrowing to fund the public investment program from 2016 onwards.*

[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 24, 2015 (IMF Country Report No. 15/196, Supplement 2). 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). São Tomé and Príncipe's CPIA score of 3.05 classifies it as a 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.

A. Underlying Assumptions

1. **The basic macroeconomic assumptions have changed little from those in the previous DSA.** The long-term forecasts for growth, inflation and the primary deficit are essentially unchanged. Exports and imports growths are also unchanged belittling decline in their levels in 2015 with forward rippled effects. Moreover, there is a marked improvement in the long term current account deficit on account of lower commodities prices and slightly lower FDI.

Macroeconomic Assumptions (Averages)

	2015 DSA[1]	2016 DSA	
	2015–35	2015–35	2016–36
Real GDP Growth (%)	5.56	5.48	5.55
Inflation (average)	3.23	3.17	3.07
Domestic Primary Deficit (% of GDP)	-1.30	-1.33	-1.24
Grants (% of GDP)	2.51	1.79	1.79
New Borrowing (% of GDP)	1.53	1.86	1.37
FDI (% of GDP)	9.72	8.55	8.75
US$ Export growth (%)	7.16	6.65	7.43
US$ Import Growth (%)	6.00	4.90	6.01
Current Account Balance, excluding grants (% of GDP)	-24.99	-20.18	-19.43
Current Account Balance, including grants (% of GDP)	-12.66	-8.57	-8.02

[1] IMF Country Report No. 15/196, Supplement 2.

2. **The 2016 DSA starts with a lower stock of external debt in comparison to the previous DSA because actual borrowing and disbursements in 2015 were lower than projected.** Staff had projected US$35 million in new concessional borrowing in 2015. The actual new borrowing and disbursement of new loan in 2015 ended up US$5 million and US$20 million lower respectively. This resulted in a lower PV of debt-to-GDP ratio in 2015 under the current DSA. The HIPC initiative legacy arrears which were included in the historical stock of external debt but excluded from PV calculations in the previous DSAs on the assumption of expected forgiveness have been completely excluded in this DSA. Their exclusion does not impact debt trajectory.

B. External DSA

3. **Like the previous DSA, the three solvency-based indicators remain significantly above their relevant indicative thresholds over the next few years** (Figures 1 and 3). However, the PV of PPG external debt- to-exports and to-revenue ratios deteriorate slightly, prolonging periods of the breach of the thresholds by one year relative to the previous DSA. This is due mainly to the level effects of lower 2015 revenue and exports on their projected values. The PV of public and publicly guaranteed (PPG) external debt-to-GDP ratio follows broadly similar trajectory as in the previous DSA, breaching the thresholds until 2022 and remain below thereafter. All indicators of debt service remain below their respective thresholds while showing a modest improvement in the early years of projection relative to

the previous DSA due to lower actual disbursements in 2015. Historical scenarios (Figure 1, red dashed lines) for all debt indicators present a generally more deteriorated picture than the previous DSA because of both lower growth and higher primary deficit in 2015. Large residuals in 2016–19 which are in line with recent history are mainly explained by net private financial inflows[2], drawdown from the National Oil account and price changes.

4. 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).[3] The export based indicators are most sensitive to exports shocks while the remaining indicators are most sensitive to a one-time depreciation shock.

C. Public DSA

5. There is essentially no difference between the external and public sector DSAs[4]. The debt indicators continue to rise throughout the projection period when real GDP growth and the primary balance are at historical averages (Figure 2, grey dashed line) or when the primary balance is unchanged from 2016 (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-to-GDP is most sensitive to a worsening primary balance while the public debt and debt service-to-revenue ratios are most sensitive to worsening primary balance and a one-time 30 percent depreciation of the dobra.

D. Conclusion

6. São Tomé and Príncipe remains at a high risk of external debt distress. However, the country is able to service its current obligations and while some external debt indicators are projected to remain above their respective thresholds they show a clear downward trend in the long term. In this context, to mitigate risks, the DSA underlines the need for the authorities to:

- Maintain an adequate level of international reserves to reinforce the peg and boost confidence in the wake of reduced oil prospects;
- Maintain fiscal prudence, particularly in the run-up to the 2016 presidential elections;
- 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 concessional borrowing; and

[2] The stock of private sector external debt is not included in the DSA as there is no reliable data.

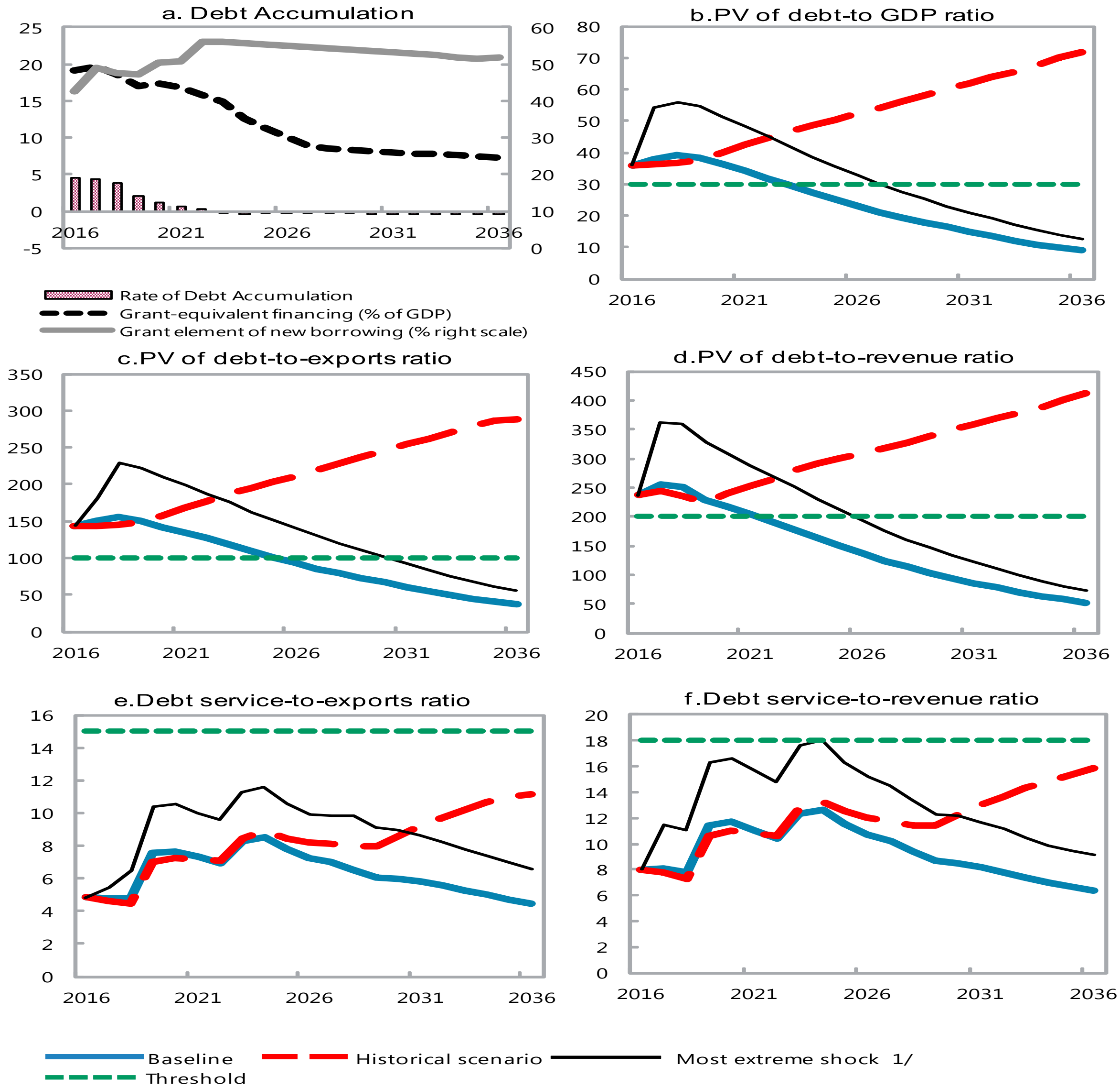
[3] In the previous DSA, the country's debt stock indicators were most vulnerable to non-debt flows shocks while debt service indicators were most vulnerable to exports and one-time depreciation shocks.

[4] Fuel products supplier (ENCO)'s domestic claims on the central government were not included pending the conclusion of formal review to establish the definitive amount.

- Develop and implement a comprehensive strategy to reduce the cost of doing business and attract private investment that can broaden the export base.

7. The biggest risks to external debt sustainability come from exchange rate shocks and shocks to export growth. Debt sustainability could also deteriorate in the event of sharp increase in the international prices of fuel and other commodities, raising the import bill and putting pressure on the current account. The risks appear manageable over the medium term if the authorities are able to move forward with the planned fiscal adjustment in the coming years and build international reserves buffer. 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 prioritization of the future public investments and their financing.

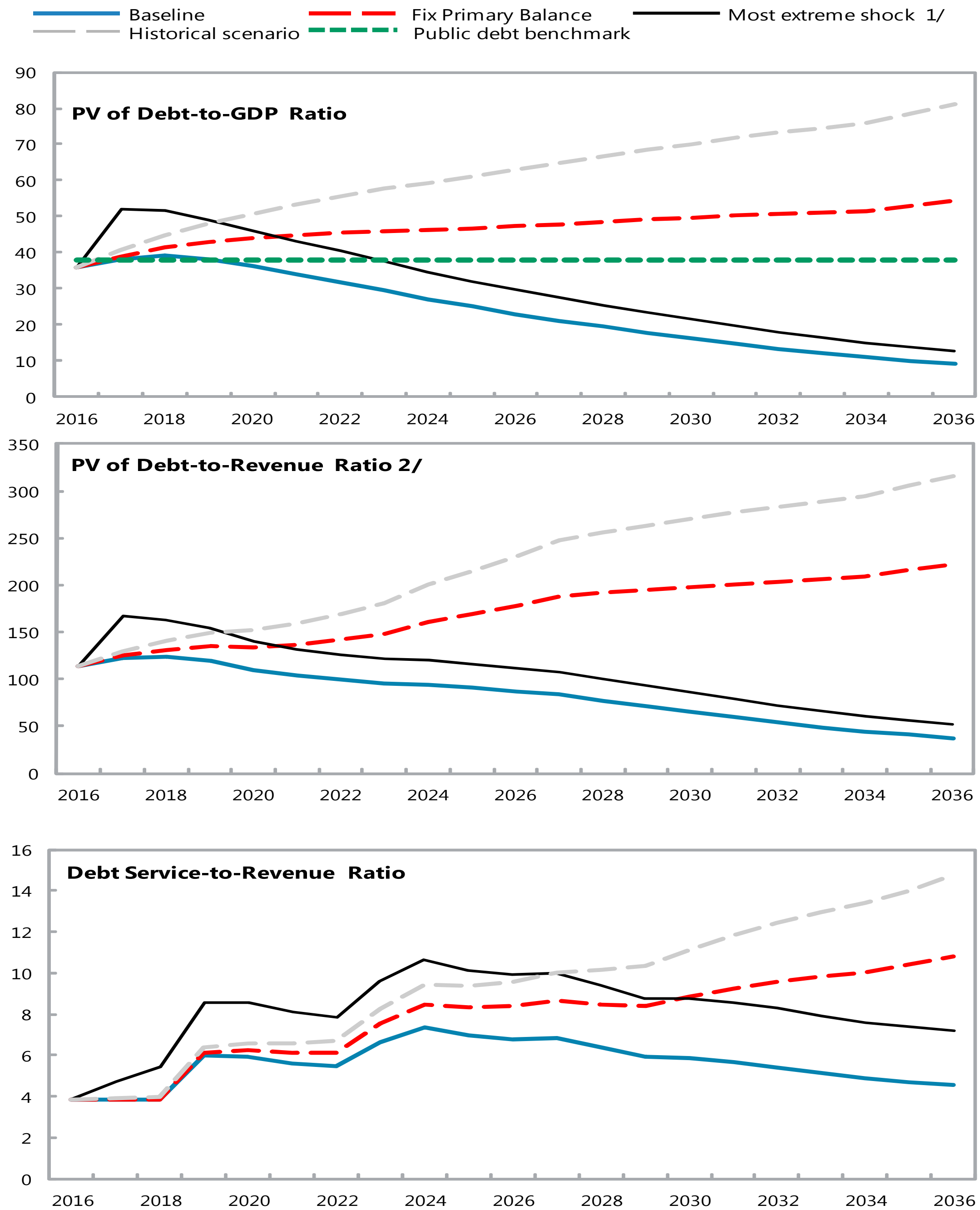
Figure 1. São Tomé and Príncipe: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2016–36 1/



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

1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a 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, 2016–36 1/



Sources: São Tomé and Príncipe authorities' data; and IMF staff estimates.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2026.
2/ Revenues are defined inclusive of grants.

Table 1. São Tomé and Príncipe: External Debt Sustainability Framework, Baseline Scenario, 2012–36 1/

(Percent of GDP, unless otherwise indicated)

	Actual				Historical 6/ Average	Standard 6/ Deviation	Projections									
	2012	2013	2014	2015			2016	2017	2018	2019	2020	2021	2016-2021 Average	2026	2036	2022-2036 Average
External debt (nominal) 1/	**47.3**	**44.2**	**50.0**	**59.0**			**58.5**	**61.8**	**63.0**	**60.8**	**57.1**	**53.3**		**34.7**	**14.2**	
of which: public and publicly guaranteed (PPG)	47.3	44.2	50.0	59.0			58.5	61.8	63.0	60.8	57.1	53.3		34.7	14.2	
Change in external debt	4.1	-3.1	5.8	9.0			-0.5	3.3	1.2	-2.2	-3.7	-3.7		-3.2	-1.2	
Identified net debt-creating flows	11.9	5.0	11.8	13.6			8.4	7.1	5.4	1.7	-3.3	-4.3		-4.3	-6.1	
Non-interest current account deficit	**20.9**	**12.9**	**21.3**	**16.4**	**23.2**	**6.1**	**11.6**	**12.1**	**11.9**	**9.9**	**8.6**	**7.6**		**7.2**	**5.1**	6.5
Deficit in balance of goods and services	-65.2	-76.7	-94.1	-84.9			-85.9	-86.5	-86.0	-83.0	-82.9	-81.5		-73.0	-69.1	
Exports	12.7	17.8	26.2	25.3			25.1	25.3	25.3	25.3	25.4	25.3		24.8	24.9	
Imports	-52.5	-58.9	-67.9	-59.6			-60.7	-61.1	-60.7	-57.7	-57.5	-56.2		-48.3	-44.2	
Net current transfers (negative = inflow)	-20.3	-27.0	-18.1	-17.6	-19.5	3.6	-23.1	-22.8	-22.5	-21.6	-22.6	-22.4		-15.6	-13.8	-15.5
of which: official	-18.4	-18.4	-10.6	-11.4			-17.3	-17.0	-16.7	-15.8	-16.8	-16.6		-9.6	-7.1	
Other current account flows (negative = net inflow)	106.4	116.6	133.5	118.9			120.5	121.3	120.4	114.4	114.0	111.4		95.9	88.0	
Net FDI (negative = inflow)	**-8.3**	**-1.5**	**-5.6**	**-6.3**	**-15.0**	**12.0**	**-1.2**	**-2.7**	**-4.0**	**-5.6**	**-9.2**	**-9.4**		**-9.9**	**-10.6**	-10.1
Endogenous debt dynamics 2/	**-0.6**	**-6.4**	**-4.0**	**3.5**			**-2.1**	**-2.4**	**-2.5**	**-2.5**	**-2.6**	**-2.5**		**-1.6**	**-0.6**	
Contribution from nominal interest rate	0.4	0.4	0.6	0.3			0.6	0.7	0.7	0.7	0.7	0.6		0.4	0.2	
Contribution from real GDP growth	-1.9	-1.6	-1.8	-2.1			-2.7	-3.0	-3.2	-3.2	-3.3	-3.2		-1.9	-0.8	
Contribution from price and exchange rate changes	0.9	-5.1	-2.8	5.2			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-7.8**	**-8.1**	**-5.9**	**-4.7**			**-8.8**	**-3.8**	**-4.2**	**-3.9**	**-0.4**	**0.5**		**1.1**	**4.9**	
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	0.0	
PV of external debt 4/	...	...	...	35.7			36.0	38.1	39.2	38.2	36.1	34.1		23.1	9.1	
In percent of exports	...	...	...	141.4			143.4	150.4	155.1	150.9	142.1	134.8		93.1	36.6	
PV of PPG external debt	**...**	**...**	**...**	**35.7**			**36.0**	**38.1**	**39.2**	**38.2**	**36.1**	**34.1**		**23.1**	**9.1**	
In percent of exports	**...**	**...**	**...**	**141.4**			**143.4**	**150.4**	**155.1**	**150.9**	**142.1**	**134.8**		**93.1**	**36.6**	
In percent of government revenues	**...**	**...**	**...**	**257.4**			**236.8**	**254.3**	**251.5**	**229.1**	**216.6**	**203.6**		**136.5**	**52.2**	
Debt service-to-exports ratio (in percent)	**7.3**	**5.1**	**3.2**	**3.2**			**4.9**	**4.8**	**4.8**	**7.5**	**7.7**	**7.3**		**7.3**	**4.5**	
PPG debt service-to-exports ratio (in percent)	**7.3**	**5.1**	**3.2**	**3.2**			**4.9**	**4.8**	**4.8**	**7.5**	**7.7**	**7.3**		**7.3**	**4.5**	
PPG debt service-to-revenue ratio (in percent)	**6.2**	**4.9**	**5.7**	**5.8**			**8.0**	**8.1**	**7.7**	**11.5**	**11.7**	**11.0**		**10.7**	**6.4**	
Total gross financing need (Billions of U.S. dollars)	0.0	0.0	0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	-0.1	
Non-interest current account deficit that stabilizes debt ratio	16.8	16.0	15.5	7.5			12.1	8.8	10.7	12.1	12.3	11.4		10.4	6.3	
Key macroeconomic assumptions																
Real GDP growth (in percent)	4.5	4.0	4.5	4.0	4.8	2.3	5.0	5.5	5.5	5.5	6.0	6.0	5.6	5.5	5.5	5.5
GDP deflator in US dollar terms (change in percent)	-2.0	12.2	6.8	-9.5	4.7	9.4	4.5	0.8	1.1	2.6	3.0	2.1	2.4	1.9	-0.2	1.7
Effective interest rate (percent) 5/	0.9	0.9	1.5	0.6	0.9	0.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.0	1.2	1.1
Growth of exports of G&S (US dollar terms, in percent)	12.5	63.1	64.3	-9.2	20.2	27.0	9.2	7.2	6.5	8.2	9.6	7.8	8.1	7.1	7.2	7.2
Growth of imports of G&S (US dollar terms, in percent)	-7.3	30.8	28.6	-17.4	14.3	22.0	11.8	7.0	5.8	2.9	8.8	5.7	7.0	5.0	5.8	5.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	...	42.7	48.9	47.7	47.3	50.3	51.0	48.0	55.0	51.8	53.9
Government revenues (excluding grants, in percent of GDP)	15.0	18.3	14.9	13.9			15.2	15.0	15.6	16.7	16.7	16.7		16.9	17.4	17.1
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	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	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	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...	...			19.1	19.6	18.7	17.0	17.4	16.9		10.1	7.4	9.7
Grant-equivalent financing (in percent of external financing) 8/	...	...	...	...			83.9	84.5	86.2	89.1	93.5	95.5		96.2	96.6	96.4
Memorandum items:																
Nominal GDP (Billions of US dollars)	0.3	0.3	0.3	0.3			0.3	0.4	0.4	0.4	0.5	0.5		0.7	1.5	
Nominal dollar GDP growth	2.4	16.6	11.6	-5.9			9.8	6.3	6.7	8.3	9.2	8.2	8.1	7.5	5.3	7.3
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)							4.5	4.4	3.8	2.1	1.1	0.7	2.8	-0.3	-0.4	-0.3
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.1	
PV of PPG external debt (in percent of GDP + remittances)		...	...	33.6			34.1	36.0	37.1	36.1	34.2	32.2		21.8	8.5	
PV of PPG external debt (in percent of exports + remittances)		...	...	113.7			116.5	122.5	126.3	123.0	116.1	109.9		74.9	28.8	
Debt service of PPG external debt (in percent of exports + remittances)		...	...	2.6			3.9	3.9	3.9	6.2	6.3	5.9		5.9	3.5	

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

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

Table 2a. São Tomé and Príncipe: Sensitivity Analysis of Key Indicators of Public and Publicly Guaranteed External Debt, 2016–36 1/

(Percent)

	Projections							
	2016	2017	2018	2019	2020	2021	**2026**	2036
PV of debt-to GDP ratio								
Baseline	36	38	39	38	36	34	**23**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	36	36	37	37	40	42	**52**	72
A2. New public sector loans on less favorable terms in 2016-2036 2	36	40	42	42	41	39	**28**	15
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	36	39	42	41	38	36	**24**	9
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	36	40	44	43	40	38	**26**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	36	40	44	43	40	38	**26**	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	36	41	46	45	43	40	**28**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	36	39	42	41	38	36	**25**	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	36	54	56	55	51	48	**33**	13
PV of debt-to-exports ratio								
Baseline	143	150	155	151	142	135	**93**	37
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	143	144	146	148	157	167	**211**	289
A2. New public sector loans on less favorable terms in 2016-2036 2	143	157	167	167	160	153	**115**	60
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	143	150	155	151	142	134	**93**	36
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	143	181	229	223	209	198	**140**	55
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	143	150	155	151	142	134	**93**	36
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	143	164	183	178	168	159	**114**	45
B5. Combination of B1-B4 using one-half standard deviation shocks	143	150	158	154	144	136	**94**	37
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	143	150	155	151	142	134	**93**	36
PV of debt-to-revenue ratio								
Baseline	237	254	252	229	217	204	**136**	52
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	237	243	236	225	239	252	**310**	412
A2. New public sector loans on less favorable terms in 2016-2036 2	237	266	272	254	244	231	**169**	85
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	237	262	267	244	229	215	**144**	54
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	237	266	282	257	242	227	**157**	60
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	237	269	282	258	242	227	**152**	58
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	237	276	297	271	255	240	**167**	64
B5. Combination of B1-B4 using one-half standard deviation shocks	237	259	269	245	231	216	**145**	55
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	237	362	359	327	308	289	**193**	73

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

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 2b. São Tomé and Príncipe: Sensitivity Analysis of Key Indicators of Public and Publicly Guaranteed External Debt, 2016–36 1/

(Percent)

	Projections							
	2016	2017	2018	2019	2020	2021	**2026**	2036
Debt service-to-exports ratio								
Baseline	5	5	5	8	8	7	**7**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	5	5	4	7	7	7	**8**	11
A2. New public sector loans on less favorable terms in 2016-2036 2	5	5	5	8	8	8	**8**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	5	5	5	8	8	7	**7**	4
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	5	5	6	10	11	10	**10**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	5	5	5	8	8	7	**7**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	5	5	5	8	8	8	**8**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	5	5	5	8	8	7	**7**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	5	5	5	8	8	7	**7**	4
Debt service-to-revenue ratio								
Baseline	8	8	8	11	12	11	**11**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	8	8	7	11	11	11	**12**	16
A2. New public sector loans on less favorable terms in 2016-2036 2	8	8	8	12	13	12	**12**	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	8	8	8	12	12	12	**11**	7
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	8	8	8	12	12	12	**11**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	8	9	9	13	13	12	**12**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	8	8	8	12	12	12	**11**	8
B5. Combination of B1-B4 using one-half standard deviation shocks	8	8	8	12	12	12	**11**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	8	11	11	16	17	16	**15**	9
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	49	49	49	49	49	49	**49**	49

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

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, 2013–36

(Percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2013	2014	2015	Average 5/	Standard Deviation 5/	2016	2017	2018	2019	2020	2021	2016-21 Average	2026	2036	2022-36 Average
Public sector debt 1/	44.2	50.0	59.0			58.5	61.8	63.0	60.8	57.1	53.3		34.7	14.2	
of which: foreign-currency denominated	44.2	50.0	59.0			58.5	61.8	63.0	60.8	57.1	53.3		34.7	14.2	
Change in public sector debt	-3.1	5.8	9.0			-0.5	3.3	1.2	-2.2	-3.7	-3.7		-3.2	-1.2	
Identified debt-creating flows	-6.8	6.9	8.3			1.3	2.8	0.7	-2.8	-3.8	-3.0		-2.0	-0.1	
Primary deficit	0.0	5.5	8.6	9.9	5.5	6.9	5.4	3.9	1.5	0.4	0.6	3.1	0.3	0.5	0.3
Revenue and grants	31.2	25.2	25.3			31.6	31.2	31.6	31.8	32.9	32.8		26.5	24.5	
of which: grants	12.9	10.3	11.4			16.4	16.2	16.0	15.1	16.2	16.0		9.6	7.1	
Primary (noninterest) expenditure	31.2	30.8	33.9			38.5	36.6	35.5	33.3	33.2	33.3		26.8	25.0	
Automatic debt dynamics	-6.9	1.3	-0.3			-5.6	-2.6	-3.3	-4.2	-4.2	-3.5		-2.3	-0.6	
Contribution from interest rate/growth differential	-2.1	-1.9	-2.1			-2.9	-3.4	-3.8	-3.9	-4.0	-3.7		-2.4	-0.9	
of which: contribution from average real interest rate	-0.3	0.0	-0.2			-0.1	-0.3	-0.5	-0.6	-0.5	-0.5		-0.4	-0.1	
of which: contribution from real GDP growth	-1.8	-1.9	-1.9			-2.8	-3.1	-3.2	-3.3	-3.4	-3.2		-2.0	-0.8	
Contribution from real exchange rate depreciation	-4.7	3.3	1.8			-2.7	0.8	0.5	-0.4	-0.2	0.2		...	...	
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	3.8	-1.1	0.6			-1.7	0.5	0.6	0.5	0.1	-0.8		-1.2	-1.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	35.7			36.0	38.1	39.2	38.2	36.1	34.1		23.1	9.1	
of which: foreign-currency denominated	...	...	35.7			36.0	38.1	39.2	38.2	36.1	34.1		23.1	9.1	
of which: external	...	...	35.7			36.0	38.1	39.2	38.2	36.1	34.1		23.1	9.1	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	0.9	6.4	9.4			8.1	6.6	5.1	3.4	2.3	2.4		2.1	1.6	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	141.1			114.0	122.2	124.3	120.0	109.8	104.0		86.9	37.1	
PV of public sector debt-to-revenue ratio (in percent)	...	...	257.4			236.8	254.3	251.5	229.1	216.6	203.6		136.5	52.2	
of which: external 3/	...	...	257.4			236.8	254.3	251.5	229.1	216.6	203.6		136.5	52.2	
Debt service-to-revenue and grants ratio (in percent) 4/	2.9	3.4	3.2			3.9	3.9	3.8	6.0	5.9	5.6		6.8	4.5	
Debt service-to-revenue ratio (in percent) 4/	4.9	5.7	5.8			8.0	8.1	7.7	11.5	11.7	11.0		10.7	6.4	
Primary deficit that stabilizes the debt-to-GDP ratio	3.1	-0.3	-0.4			7.3	2.1	2.7	3.7	4.1	4.3		3.5	1.7	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.0	4.5	4.0	4.8	2.3	5.0	5.5	5.5	5.5	6.0	6.0	5.6	5.5	5.5	5.5
Average nominal interest rate on forex debt (in percent)	0.9	1.5	0.6	0.9	0.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.0	1.2	1.1
Average real interest rate on domestic debt (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Real exchange rate depreciation (in percent, + indicates depreciation)	-10.4	7.8	3.8	-3.3	7.3	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	8.5	6.9	8.3	12.6	7.4	6.3	0.1	1.1	2.2	2.4	2.6	2.5	2.8	2.8	2.8
Growth of real primary spending (deflated by GDP deflator, in percent)	-27.3	3.1	14.6	-0.9	10.3	19.2	0.2	2.4	-1.1	5.9	6.3	5.5	1.3	5.5	3.6
Grant element of new external borrowing (in percent)	...	...	...	...	...	42.7	48.9	47.7	47.3	50.3	51.0	48.0	55.0	51.8	...

Sources: São Tomé and Príncipe authorities' data; and IMF staff estimates.
1/ The analysis covers gross debt of the central government.
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, 2016–36

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of Debt-to-GDP Ratio								
Baseline	36	38	39	38	36	34	23	9
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	36	41	45	48	51	53	63	81
A2. Primary balance is unchanged from 2016	36	39	41	43	44	45	47	54
A3. Permanently lower GDP growth 1/	36	38	40	39	37	35	26	18
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	36	39	42	42	40	38	28	17
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	36	43	50	48	46	43	31	14
B3. Combination of B1-B2 using one half standard deviation shocks	36	42	48	47	45	43	32	17
B4. One-time 30 percent real depreciation in 2017	36	52	52	49	46	43	30	13
B5. 10 percent of GDP increase in other debt-creating flows in 2017	36	43	44	43	40	38	27	11
PV of Debt-to-Revenue Ratio 2/								
Baseline	114	122	124	120	110	104	87	37
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	114	130	141	150	152	159	230	317
A2. Primary balance is unchanged from 2016	114	125	131	135	133	136	178	222
A3. Permanently lower GDP growth 1/	114	123	125	122	112	107	97	70
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	114	125	130	127	118	113	105	68
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	114	138	158	152	139	132	116	56
B3. Combination of B1-B2 using one half standard deviation shocks	114	135	151	146	135	129	118	69
B4. One-time 30 percent real depreciation in 2017	114	167	163	154	140	132	112	52
B5. 10 percent of GDP increase in other debt-creating flows in 2017	114	138	139	134	123	117	100	46
Debt Service-to-Revenue Ratio 2/								
Baseline	4	4	4	6	6	6	7	5
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	4	4	4	6	7	7	10	15
A2. Primary balance is unchanged from 2016	4	4	4	6	6	6	8	11
A3. Permanently lower GDP growth 1/	4	4	4	6	6	6	7	6
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-2018	4	4	4	6	6	6	7	6
B2. Primary balance is at historical average minus one standard deviations in 2017-2018	4	4	4	7	7	6	7	6
B3. Combination of B1-B2 using one half standard deviation shocks	4	4	4	7	7	6	7	6
B4. One-time 30 percent real depreciation in 2017	4	5	5	9	9	8	10	7
B5. 10 percent of GDP increase in other debt-creating flows in 2017	4	4	4	6	6	6	7	5

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

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

2/ Revenues are defined inclusive of grants.

Statement by Mr. Yambaye, Executive Director
and Mr. Lopes Varela, Advisor to the Executive Director,
on the Democratic Republic of São Tomé and Príncipe
June 10, 2016

On behalf of our São Toméan authorities, we would like to express our gratitude to the Board, Management and Staff for their continued support and valuable advice to São Tomé and Príncipe. The authorities are thankful to Fund Staff for the constructive discussions held in São Tomé in March 2016, during the 2016 Article IV Consultation and the first review of São Tomé and Príncipe's economic program supported by the Extended Credit Facility (ECF).

The authorities have made great efforts in achieving macroeconomic stability, sustainable economic growth and poverty reduction under the National Poverty Reduction Strategy Paper (PRSP-II), including improving macroeconomic stability, stabilizing economic growth, and declining inflation. Despite this progress, the economy continues to face significant challenges in terms of rising public debt and weak competitiveness. The authorities broadly concur with the main policy recommendations of the staff report as a support for better implementation of PRSP-II.

As regards performance under the ECF, all end-December 2015 performance criteria (PC) were met with exception of just one. The PC on domestic primary deficit was missed by a small margin, about 0.3 percent of GDP, due mainly to tax revenue underperformance and the absence of corresponding expenditure cuts. Regarding structural reforms, the authorities have made strong progress by implementing all structural benchmarks through end-December, including the new banking law and two other measures related to improvements in the national accounts and consumer price statistics. Overall performance is satisfactory and the program is on track.

Recent Economic Developments and Performance under the ECF Arrangement

Although highly vulnerable to external shocks, the economy of São Tomé and Príncipe has grown faster than many small islands states, with average GDP growth over 4 percent per year since 2012. However, as noted by staff, these macroeconomic performance has not been sufficiently strong and diversified to improve economic prospects and reduce poverty significantly. Real GDP growth is estimated to have fallen below the budget target of 5 percent in 2015, by almost 1 percentage point, mainly due to late approval of the 2015 budget-which slowed down the execution pace of public investment projects-and poor rains, that resulted in a decrease of agricultural output (cocoa production). Helped by weakened demand and falling international prices of oil and other commodities, inflation has fallen to its lowest level in two decades, from 28 percent to below 5 percent at end December 2015.

In the fiscal area, the authorities' efforts have been affected by lower than expected tax revenue and donor budget support. As a result, the domestic primary deficit was 0.3 percent of GDP, higher than the program target of 2.7 percent of GDP. Lower collection of arrears is a main cause of the tax revenue short fall, although more arrears were collected in 2015 (24 percentage points) compared to 2014. Efforts to increase arrears collection are being strengthened.

The authorities have also started to implement a comprehensive plan to clear the outstanding stock of arrears, including to the oil importing company (ENCO) and the state utility company (EMAE). In this regard, it is worth noting that the government has cleared all arrears to EMAE in 2015, 1.2 percent of GDP (0.5 percent of GDP higher than budgeted). EMAE in turn paid the equivalent of 2.6 percent of GDP of its arrears to ENCO. For its part the government will start clearing its arrears to ENCO this year and provision has been made accordingly in the 2016 budget. In addition, the automatic fuel price adjustment mechanism will also be implemented and will help to prevent accumulation of new arrears.

In line with the weaker economic activity and contraction in oil and other commodity imports, the external current account deficit declined to 17 percent of GDP in 2015, which offset the drop in cocoa exports as production declined. Gross international reserves remained at a comfortable level of 4.4 months of imports cover at end 2015.

Monetary policy has been adversely affected by the excess liquidity, low profitability, and high NPLs in the economy. The capital adequacy ratio for the entire banking system fell from 20.3 percent in December 2014 to 15.5 percent at the end of 2015, while capital to risk-weighted assets ratio increased to 24.1 percent from 22.6 percent, following recent capital injections by several banks. NPLs increased to a record high of about 30 percent in 2015, following the reclassification of overdue overdrafts in Banco Equador's books as bad loans and a downgrade in a sizeable share of the largest bank's loan classification to loss.

2016 and Medium-term Policies

The prospects for São Tomé and Príncipe are favorable in the near term but challenges remain. On the basis of higher and timely execution of public investments, recovery in cocoa production and increased foreign direct investment (FDI) in the tourism sector, real GDP is projected to grow by 5 percent in 2016. Inflation is expected to remain around 4 percent aided by falling international prices of food and petroleum products.

Over the medium term, real GDP growth is expected to be maintained at 5 percent; inflation is expected to continue to decline to 3 percent; and the current account deficit contracting further.

In the fiscal area, the authorities remain committed to bring the primary deficit down to around 1–1 ½ percent of GDP by 2018 and to ensure that debt remains on a downward path.

At the same time the authorities will take steps to create fiscal space to meet the expenditure need for domestically-financed infrastructure spending to complement donor support.
To achieve these objectives, the authorities will strengthen revenue collection efforts through a combination of tax policies (including the introduction of VAT), and customs and tax administration measures as well as improving the quality of spending.

Various measures will be implemented to attain this objective, including, greater and more rigorous audits, improving the capacity and incentives at the large taxpayer unit, increasing the number of products subject to imposition of minimum custom value, and introducing a number of legislative changes. The authorities will also submit to the National Assembly a new VAT law, a step toward to the introduction of VAT.

On the expenditures side, the authorities are focused on strengthening public financial management and transparency. They intend to steadfastly implement key measures, notably, rolling out of SAFEe (the electronic information management system) from the current pilot stage to cover all ministries and others state institutions to strengthen public financial oversight; enhancing SAFEe with added functionality such as reconciliation of treasury bank accounts, revenue tracking, management of fixed assets and a government contracts registry to facilitate the preparation of more comprehensive general government accounts. In addition, the authorities intend to move towards medium-term fiscal and expenditure frameworks in 2017. As regards, extra budgetary spending in the run-up to the presidential election, the authorities are fully commitment not to exceed the amount budgeted.

Mindful of the need to preserve debt sustainability, our authorities are committed to implement the debt framework law and strengthening debt management capacity. In pursuit of these objectives, among other measures, they will: (i) prepare a national debt strategy, as required under the debt framework law, that will put a ceiling on the overall debt of the nonfinancial public sector as well as annual debt policies that fix annual ceilings for each public entity; (ii) update the medium-term debt management strategy; (iii) seek technical assistance to prepare a manual of procedures for debt management and to carry out a new debt management performance assessment (DeMPA) by the end of 2016. Concerning external borrowing, the authorities will continue to pursue policies consistent with debt sustainability, by giving priority to concessional financing for infrastructure projects and social spending.

Monetary Policy

The monetary authorities are focusing their efforts on removing the excess liquidity in the economy and in this regard the central bank of São Tomé and Príncipe (BCSTP) has introduced the interbank market and treasury bills. In addition, the BCSTP is working towards developing a treasury bonds market, creating the conditions for longer-term liquidity management, as well as developing the secondary market.

The BCSP has continued its efforts in developing monetary liquidity management framework by implementing a new payment methodology for the commercial banks in 2015, to allow payment orders issued by the Treasury to commercial banks in a given period to be paid in the following period, thus enabling the BCSTP to include them in its liquidity forecasting, considerably reducing forecasting errors.

Macro-Financial Linkages and Financial Sector Stability

The authorities are mindful of the need to address the weakness in the financial sector, as to enhance fiscal and financial stability to support growth. In this regard, The BCSTP has been making efforts to strengthen its capacity in banking regulation and supervision. Three out of seven banks increased their capital in the last quarter of 2015, to meet the minimum requirement. BCSTP is at the early stage of building adequate crisis management and bank resolution frameworks to deal with risks in the financial system. The new banking resolution law provides the legal framework for a swift and orderly resolution of banks, including Banco Equador. A transition bank is being created with quality assets and liabilities of Banco Equador, and steps are being taken to identify potential buyers and conclude the process within 1 year from the establishment of the transition bank.

In order to reverse the trend of NPLs and credit to the private sector, the BCSTP is implementing necessary measures to tackle the large stock of NPLs, notably by stocktaking, provisioning and recapitalizing specific banks if needed, conduct detailed asset quality reviews for all banks to reduce the uncertainty surrounding bank assets, and where necessary demand recapitalization of affected banks.

Furthermore, the authorities will take additional measures to address other weakness in the financial sector, including, improving the coverage and effectiveness of the credit reference bureaus, streamlining procedures to ensure collateral enforcement, and capacity building of SMEs in basic accounting, financial management, and preparation of bankable projects.

Improving Competitiveness and Setting the Stage for Sustainable and Inclusive Growth

The authorities recognize the need to promote private sector-led growth in order to set the stage for higher and sustainable growth. Consistent with this goal, our authorities have listed in their 2030 Transformation Agenda the priorities for medium to long-term growth, social cohesion and external credibility, including diversifying the economy, broadening the production base, and modernizing the economic and social infrastructure. In addition, the authorities are seeking to create the conditions conducive to support the traditional sectors, such as agriculture, fisheries, and tourism to boost job creation and reduce poverty.

In order to maximize the great tourism potential, the authorities are focusing their efforts on medium-term structural reforms on high-yielding tourism activities, broader diversification of source markets, and more open, competitive air transport connections. They will also continue efforts to diversify tourism source markets and take steps to support open, competitive air transport policy, including allowing direct links to the sub region. Furthermore, they will seek to implement policy initiatives in 2016 aimed at introducing targeted reforms to improve the indicators in the World Bank's Doing Business survey, and pursue efforts to encourage diversification of production and exports.

CONCLUSION

Our São Toméan authorities remain committed to fiscal prudence and to undertake crucial reforms so as to lower the public debt level and increase São Tome and Principe's competitiveness and business environment. They will also continue their efforts in enhancing liquidity management and banking supervision in order to maintain financial stability. In this regard, they will rely on the IMF and other partners' support to help consolidate their efforts to achieve the goal of sustained growth and poverty reduction. We therefore, call on Directors for a favorable consideration of our authorities' request for the completion of the first review, waiver for nonobservance of performance criterion and modification of performance criteria.