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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

October 2019

REQUEST FOR A 40-MONTH ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

In the context of the Request for a 40-month Arrangement Under the Extended Credit Facility, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on October 2, 2019, following discussions that ended on August 6, 2019, with the officials of Democratic Republic of São Tomé and Príncipe on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on September 18, 2019.
- 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 Democratic Republic of São Tomé and Príncipe.

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

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

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October 2, 2019

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Washington, D.C. 20431 USA

IMF Executive Board Approves New US$18.2 Million Extended Credit Facility Arrangement for the Democratic Republic of São Tomé and Príncipe

- The Extended Credit Facility arrangement aims to support São Tomé and Príncipe's economic and structural reforms.
- Structural reforms should help mobilize revenue, enhance control over public spending, reduce contingent liabilities from SOEs, improve financial stability, and promote sustainable and inclusive growth to reduce poverty, including through empowering women economically.
- The Executive Board decision allows an immediate first disbursement of US$2.6 million to São Tomé and Príncipe.

On October 2, 2019 the Executive Board of the International Monetary Fund (IMF) approved a new 40-month arrangement under the Extended Credit Facility (ECF) for São Tomé and Príncipe in the amount of SDR 13.32 million (about US$18.2 million) in support of the country's economic and structural reforms.[1] It will enable an immediate disbursement of about SDR 1.9 million (about US$2.6 million). The remaining amount will be phased over the duration of the arrangement, subject to semi-annual reviews.

The ECF arrangement aims to support the authorities' economic reforms, macroeconomic stability, and private-sector led inclusive growth. It also seeks to alleviate balance of payments pressures and restore fiscal and external sustainability over the medium term.

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

"The ECF arrangement supports the authorities' economic reforms to restore macroeconomic stability, reduce debt vulnerability, and alleviate balance of payment pressures to provide the

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

foundation for strong economic growth. It could also help catalyze additional development support.

"The government plans to undertake sustained fiscal consolidation and reforms to reduce debt vulnerability. To this end, the authorities aim to broaden the tax base and ensure equitable tax burden-sharing, including by introducing a value-added tax and strengthening tax administration. Public expenditure will be restrained, made more efficient, and prioritized to protect essential social services. They are also committed to borrowing only at concessional terms and at a measured pace and to enhance debt management capacity.

"Monetary policy will be tightened to encourage savings, ease demand for foreign exchange, and contain inflation. A new payment system allowing credit card transactions is being developed, which will stimulate tourism and raise foreign exchange receipts. Financial sector supervision will be strengthened.

"Comprehensive structural reforms will also be pivotal in promoting private-sector led inclusive growth and safeguarding macroeconomic stability. Key reforms include implementing the Tourism Development Strategy, publishing a codified procedure for the approval of private investments, rehabilitating the energy sector including EMAE, and promoting women's economic empowerment and financial inclusion. The IMF program is complemented by a World Bank social protection program of $10 million to protect the most vulnerable households."

Recent Economic Developments

São Tomé and Príncipe is a fragile, small island-state with limited resources and capacity. The economy has a very narrow production base and depends heavily on imports and foreign aid. Exports of goods amount to only four percent of GDP. While offshore oil exploration continues, no commercial production is expected in the near term. Tourism, agriculture, and fisheries have potential for growth but require better infrastructure and private-led investment. While tourism grew significantly in recent years, local value-added of the sector is very low due to high import content.

São Tomé and Príncipe faces pressing constraints. In 2018, lower external inflows, election-related disruptions, higher fiscal spending, and severe power outages contributed to a fall in real growth to 2.7 percent from 3.9 percent in 2017 and a sharp decline in gross international reserves by $16.3 million (1.5 months of imports). Higher international oil prices and shortages of local produce led to an increase in inflation to 9.0 percent, up from 7.7 percent at end-2017. Preliminary data suggest economic activity remained sluggish in the first half of 2019, and fuel and power shortages weighed on the economy.

The fiscal position deteriorated significantly in 2018. Unbudgeted increases in personnel and capital spending and failure to cut utility consumption as planned contributed to overspending of almost 3.5 percent of GDP. Consequently, the domestic primary deficit reached 4.1 percent of GDP, 2.8 percent of GDP above the target. Furthermore, some government entities were allowed to spend off-budget, effectively loosening the fiscal stance further and raising the public debt by close to 1 percentage point of GDP. Meanwhile, EMAE accumulated arrears to its fuel supplier of close to $16 million (more than 3.5 percent of GDP), and total public debt rose to over 95 percent of GDP at end-2018.

A new coalition government took office in December 2018 following parliamentary elections. The government's reform program seeks to restore macroeconomic stability and unlock growth potential.

Program Summary

The 40-month program seeks to restore macroeconomic stability, bring the debt down to a sustainable path, and unlock growth potential. Fiscal consolidation supported by debt restructuring and monetary tightening will address pressure on foreign reserves and restore fiscal and external sustainability over the medium term. Structural reforms aim to mobilize revenue, enhance control over public spending, reduce contingent liabilities from SOEs, improve financial stability, and promote inclusive growth to reduce poverty, including through empowering women economically. A floor on pro-poor spending, along with a World Bank social protection program, will protect the most vulnerable. The Fund-supported program will also play a catalytic role and provide positive signals to stakeholders.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

September 18, 2019

REQUEST FOR A 40-MONTH ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

KEY ISSUES

Context. São Tomé and Príncipe is a fragile, small island-state, with limited resources and capacity. The last Extended Credit Facility (ECF) arrangement expired at end-2018 having gone off-track amid parliamentary elections, power outages, internal and external imbalances, and high debt vulnerability. Growth slowed, inflation rose, the fiscal position deteriorated, and foreign reserves declined sharply in 2018, while some critical structural reforms were delayed. Higher and more inclusive growth is needed to reduce poverty and unemployment, particularly among the large youth population.

A new ECF arrangement. The new authorities, who took office in late 2018, request a new 40-month arrangement with SDR 13,320,000 to support their reform program. The program aims to reduce debt vulnerability, alleviate balance of payment pressures, restore fiscal and external sustainability over the medium term, promote sustainable and inclusive growth, and provide positive signals to stakeholders. Main policy recommendations include:

- *Fiscal policy*: Tighten the domestic primary deficit (DPD) by almost 2 percentage points of GDP in 2019 and bring it close to a balanced position over the medium term by mobilizing revenue, particularly by introducing a VAT and rationalizing expenditure. Borrow only on concessional terms and at a measured pace, restructure the public debt to reduce debt vulnerability, and use additional resources to lower the debt. Safeguard social spending.
- *Monetary and financial policy*. Tighten monetary policy to help prevent reserve loss. Improve financial supervision and inclusion.
- *Structural reforms*. Reform state-owned enterprises, particularly the public utility company EMAE, to contain fiscal contingent liabilities. Implement the tourism development strategy and empower women economically to promote inclusive growth.

Risks: Main risks include the possibility of spending pressure, energy shortages, and delayed reforms affected by political fragility. The risks are mitigated by frontloaded measures, including prior actions.

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

Discussions were held in São Tomé during March 20 to April 4 and July 24 to August 6, 2019. The staff team included Xiangming Li (head), Lisa Kolovich, Gabriel Srour, Torsten Wezel, and Yunhui Zhao (all AFR). Nadia Margevich, María Inés Canales Munoz, Vicky Pilouzoue (AFR) provided administrative support, and Yun Liu; Marwa Ibrahim, Weronika Synak (AFR) provided research support (all from headquarters). Kelvio Carvalho da Silveira (OED) joined the mission. João Paulo Galvão, Alexandra Da Souza Costa, and André Marques Fernandes provided interpretation and translation during the mission. The mission met with the President Evaristo Carvalho; Prime Minister Jorge Bom Jesus; President of the National Assembly Delfim Neves; Minister of Planning, Finance, and the Blue Economy Osvaldo Vaz; Minister of Foreign Affairs Elsa Pinto; Minister of Infrastructure Osvaldo Abreu; Governor of the Central Bank Américo Soares De Barros; Attorney General Kelve Nobre de Carvalho; President of the Príncipe Autonomous Region José Cassandra; the Parliamentary Economic Commission; Former Presidents Manuel Pinto da Costa, Miguel Trovoada, and Fradique de Menezes; other government officials; representatives of the private sector including banks; and development partners.

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CONTEXT

1. **São Tomé and Príncipe is a fragile, small island-state with limited resources and capacity.** The economy has a very narrow production base and depends heavily on imports and foreign aid. Exports of goods amount to only four percent of GDP. While offshore oil exploration continues, no commercial production is expected in the near term. Tourism, agriculture, and fisheries have potential for growth but require better infrastructure and private-led investment. While tourism grew significantly in recent years, local value-added of the sector is very low due to high import content.

2. **The latest Ex-Post Peer Reviewed Assessment found that progress under the 2012-15 and 2015-18 ECF arrangements was limited due to low capacity and policy slippages (Annex I).** Overspending, particularly during election years, and large losses by the state-owned utility company EMAE kept public debt high, while a narrow tax base and poor tax administration kept revenue low. The Quantitative Performance Criteria (QPC) on the domestic primary balance (DPD) was missed in six out of seven completed reviews. Growth, averaging four percent during 2012-18, was insufficient to significantly reduce poverty and unemployment, which is disproportionately high for the country's large youth population. Some progress was made on structural reforms; notably, an automatic fuel pricing mechanism, EMAE reform plans, and a tourism strategy were adopted, albeit with delays. A number of other structural reforms however, including the VAT, are pending. Because of low capacity and fragility, some reforms required more than one program cycle to complete. The eventual implementation of some benchmarks of the 2012-15 program during 2015-18 are cases in point. The fragility also requires prioritization and limiting conditionality.

3. **A new coalition government took office in December 2018 following parliamentary elections.** As was often the case in the past, the new government replaced most senior civil servants across public institutions. During 2001-2014, the country saw ten different coalition governments, and a majority government completed its term for the first time in 2014-2018. Frequent government turnovers hindered reforms and growth and contributed to the fragility.

4. **The authorities' reform program seeks to restore macroeconomic stability and unlock growth potential.** An immediate challenge will be to arrest losses at EMAE and bring debt under control, tighten fiscal and monetary policy to address the external and internal imbalances, and mobilize revenue. The impact of these contractionary policies will be mitigated by the launch of foreign-supported projects, structural reforms to promote inclusive growth, a floor on social spending, and a World Bank supported program to protect the most vulnerable.

RECENT ECONOMIC DEVELOPMENTS

5. **Economic growth slowed and inflation accelerated in 2018 and the first half of 2019.** Real growth in 2018 fell by more than one percentage point to 2.7 percent, reflecting lower external inflows, election-related disruptions, and severe power outages in the last quarter due to breakdowns of aging generators. Inflation rose to 9.0 percent at end-2018, up from 7.7 percent at end-2017, driven by higher

international oil prices and shortages of local produce affected by changing weather patterns. Preliminary data suggest economic activity remained sluggish in the first half of 2019, although the small export sector showed strong growth—non-cocoa exports grew by 27 percent and tourist and business arrivals by 14 percent, both from a low base. Inflation slightly decreased to 8.6 percent at end-June. Fuel and power shortages during May-June 2019 also weighed on the economy.

6. The fiscal position deteriorated significantly in 2018 (Text Table 1). Domestic revenue was about ½ percent of GDP higher than projected, as tax arrears collection and higher import tax revenue from rising international oil prices more than offset a shortfall in direct tax revenue due to the economic slowdown. However, overspending amounted to almost 3.5 percent of GDP, due to unbudgeted increases in personnel and capital spending and failure to cut utility consumption as planned. As a result, the DPD reached 4.1 percent of GDP, 2.8 percent of GDP above the target. Furthermore, some public entities outside the central government were allowed to spend off-budget, effectively loosening the fiscal stance further and raising the public debt by an additional ¾ percent of GDP. Domestic financing and arrears increased accordingly to finance the overspending and to replace €3 million in undisbursed EU budget support because of delays in reform.

Text Table 1. Fiscal Performance 2018
(Percent of GDP)

	2017	2018	
	Actual	5th Rev	Actual
I. Revenue (ex. oil and grants)	**13.8**	**12.5**	**13.2**
Tax revenue	12.7	11.8	12.5
Import taxes	4.8	4.9	5.5
Profit taxes	1.8	1.8	1.1
Personal income taxes	3.0	1.1	2.8
Consumption taxes	1.7	2.5	1.8
Other taxes	1.5	1.4	1.3
Nontax revenue	1.7	2.9	3.0
of which: oil revenue	0.6	2.1	2.4
II. Domestic primary expenditure (ex. capitalization)	**16.1**	**13.9**	**17.3**
Current expenditure	15.8	14.1	16.4
Personnel costs	8.3	7.7	9.1
Interest due	0.5	0.5	0.4
Goods and services	3.1	2.2	3.0
Transfers	2.9	3.0	3.1
Other current expenditure	0.9	0.7	0.8
Capital spending fin. by the Treasury and HIPC-eligible	0.9	0.3	1.5
of which : Capitalization of BIRD	...	...	0.2
III. Domestic primary balance (=I-II) [1, 2]	**-2.4**	**-1.3**	**-4.1**
Off-budget expenditure	...	...	0.7
Domestic primary balance (incl. off-budget exp.) [1, 2]	**-2.4**	**-1.3**	**-4.8**
Program target	-2.0	-1.3	-1.3
Memorandum items			
Net change in domestic arrears	0.1	-0.7	0.9
Net bank credit (ex. National Oil Account)	1.3	0.7	2.4

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

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

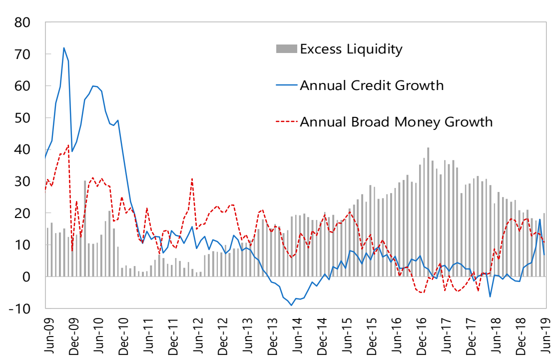
[2] Includes carve out from EU budget support financed investment in 2017 and unidentified spending as measured from financing in 2018.

7. The 2019 DPD through end-June was significantly higher than expected, partly due to policy slippages. Consumption and import tax revenue fell short, mainly reflecting substantial cuts in tariffs on alcoholic beverages, delayed implementation of tax-enhancing revenue measures, and administered fuel prices that were left unchanged despite higher shipping costs. Furthermore, taxes owed by the oil importer ENCO, amounting to almost ½ percent of GDP, were not paid until July. Personnel costs were also significantly higher, due to an increase in wages for military personnel. Thus, the end-June DPD reached 1.8 percent of GDP, 1 percent of GDP higher than projected.

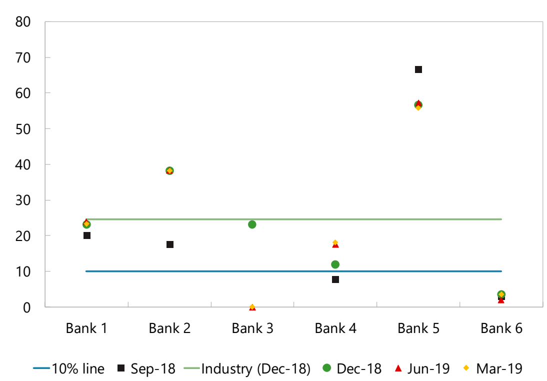
8. **Gross international reserves (GIR) fell sharply in 2018 but recovered partially in early 2019.** The current account deficit narrowed by more than two percentage points to 10.9 percent in 2018, reflecting lower imports due to lower FDI and project loans. Nonetheless, foreign outflows outpaced inflows because of the fiscal expansion, large public outlays, notably for the new central bank building, and the issuance of redenominated bills.[1] This brought GIR (excluding the oil fund) down by $16.3 million (1.5 months of prospective imports) to 3.3 months of imports at end-2018, below the IMF LIC reserve adequacy metric of 3.8 months of imports.[2] As of end-June 2019, disbursements of external grants raised GIR to $45 million (4.1 months of imports), although this level is bound to fall as projects are implemented.

9. **Credit to the economy contracted.** Lending fell by 1.6 percent in 2018 and continued to be anemic during the first semester of 2019, as banks were hesitant to lend while the economy was slowing. Non-performing loans (NPLs) remained high at about 25 percent at end-June 2019. A weak judiciary system impedes collection on defaulted loans, and government-payment delays further impaired suppliers' loan servicing. Banks' balance sheets are also constrained by loan exposures to state-owned enterprises (SOEs), particularly to loss-making EMAE. The recently-concluded asset quality review (AQR) found widespread loan misclassification, requiring additional provisioning and re-capitalization by some banks. As a result, the banking system is barely breaking even, and the market dominance of a large partially state-owned bank could contribute to losses at smaller banks. Meanwhile, banks' excess liquidity declined, driven by higher government borrowing, but is still elevated (Text Figures 1 and 2).

Text Figure 1. Credit Growth and Excess Liquidity
(Percent)



Text Figure 2. Non-Performing Loan Ratios by Bank
(Percent)



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

[1] About $4 million was paid for a new central bank building in 2018. The redenomination of the dobra cost $1.7 million in 2018 and $1.1 million in 2017.

[2] The inclusion of the country's oil fund would raise GIR to 5.1 months of imports; and a €25 million contingent credit facility with the Portuguese Treasury also provides some buffer.

PROGRAM PERFORMANCE IN 2018

10. Performance under the program of 2015-18 unraveled in the fall of 2018, and the last review was not completed. While all end-June performance criteria (PC) and indicative targets were met, except the net international reserves (NIR) PC target (MEFP Table 1), performance deteriorated subsequently. The end-2018 indicative targets for the DPD, net bank financing of the central government, and NIR were missed by large margins due to public overspending.

11. Structural reforms were delayed (MEFP Table 2). A VAT law was submitted to parliament in May 2018 but not approved. It was resubmitted by the new government and passed a general (first) reading in parliament in August 2019. The submission of a monthly monitoring table of tax payments was uneven. EMAE's least cost energy-production plan and the Management Improvement Plan (MIP) were not adopted until July 2019. The re-formulated benchmark on the completion of the inception report on the asset quality review (AQR) report was met, and the final report was competed in April 2019 instead of the initial target of end-2017. Meanwhile, the tourism development strategy was launched. The authorities pointed out that the delays in implementing reforms partly reflected their development partners' lengthy procedures.

ECONOMIC OUTLOOK AND RISKS

12. The economy is projected to recover gradually from last year's slowdown. GDP growth is projected to remain unchanged at 2.7 percent in 2019 and reach 4.5 percent over the medium term, as externally-financed projects are launched and reforms at EMAE enable more reliable and cheaper power supply. With feasibility studies now completed, externally-supported road construction and a Chinese grant-financed airport expansion will start early next year.[3] Inflation is projected to decline to 7.8 percent by end-2019. However, with the introduction of the VAT in 2020, it is expected to increase to 10 percent before easing to 3 percent in the medium term, reflecting the recovery of local food production from weather shocks, expected lower oil prices and energy costs, and fiscal and monetary tightening.

13. São Tomé and Príncipe remains in debt distress due to long-standing external arrears, but public debt is deemed sustainable. The authorities have been in discussions with Angola, Brazil, and Equatorial Guinea to regularize the outstanding external arrears (2.6 percent of GDP), and with Nigeria over a disputed loan. The large arrears of EMAE to its fuel supplier ENCO also reflect the severe liquidity constraints of the public sector. Nonetheless, debt sustainability analysis (DSA) shows that the external public and publicly guaranteed (PPG) debt is sustainable in the medium term under the program—all external PPG debt ratios remain well below the high-risk thresholds throughout the baseline scenario. The recent formalization of EMAE's arrears to ENCO

[3] The World Bank road project is financed by $29 million in grants. The EIB is working with the Dutch government on a Road Rehabilitation and Coastal Protection project with €12.5 million in concessional loans from the EIB and a €12.5 million grant from the Netherlands. The airport expansion focuses on extending the runway and improving airport facilities.

also achieved a significant discount in present value terms with this repayment schedule to be applied also to any new arrears that may arise until EMAE returns to an operating surplus. As a result, total PPG debt (which includes EMAE's arrears to ENCO and the government's arrears to suppliers) is deemed sustainable provided the country continues to borrow externally only at concessional terms at a measured pace, and EMAE's planned reforms are implemented (see DSA ¶8, and MEFP ¶9). Regarding the external arrears owed by São Tomé and Príncipe to private creditors, the authorities continue to make good faith efforts to reach a collaborative agreement. Regarding non-sovereign external arrears owed to the private creditor and resulting from exchange controls (ENCO's arrears to its Angolan parent company Sonangol), the authorities continue to make good faith efforts to facilitate a collaborative agreement between the private debtor and its creditor.

14. The outlook is subject to important risks. Limited tax administration capacity could hinder revenue collection and reduce gains from planned revenue-enhancing measures. Policy slippages and additional public outlays due to poor public financial management could put further pressure on already-elevated public debt and international reserves. Delayed EMAE reforms could prolong power shortages, raise arrears accumulation, and elevate risks from ENCO's associated arrears to its parent company Sonangol. Political instability and low capacity could delay reforms and project implementation as well as the associated external official inflows. In addition, the implementation of the VAT could hinder the decline of inflation, which will be reassessed once the VAT introduction plan is firmed up. On the upside, implementing externally-financed projects such as the airport expansion and road rehabilitation on schedule could spur higher growth than expected (Annex II). Maintaining strong policies can help mitigate the risks.

PROGRAM OBJECTIVES AND POLICIES

The 40-month program seeks to restore macroeconomic stability, bring the debt down to a sustainable path, and unlock growth potential. Fiscal consolidation supported by debt restructuring and monetary tightening will address pressure on foreign reserves and restore fiscal and external sustainability over the medium term. Structural reforms aim to mobilize revenue, enhance control over public spending, reduce contingent liabilities from SOEs, improve financial stability, and promote inclusive growth to reduce poverty, including through empowering women economically. A floor on pro-poor spending, along with a World Bank social protection program, will protect the most vulnerable. The Fund-supported program will also play a catalytic role and provide positive signals to stakeholders.

A. Address Balance of Payments Pressures and Restore Fiscal Sustainability

15. Fiscal adjustment is critical to addressing balance of payments pressures and ensuring sustainability (Text Table 2). The programmed adjustment aims to bring the DPD down from 4.1 to 2.1 percent of GDP in 2019. Revenue measures planned for the second semester, including the collection of tax arrears and oil price differential from ENCO (1 percent of GDP), an oil tax surcharge (¼ percent of GDP), a reduction in tax allowances and an increase in sales tax on telecommunication in anticipation of the VAT introduction, would raise around 2 percent of GDP and offset the shortfall in import and direct tax revenue in the first half of the year, while non-tax revenue, including from new fishing license agreements, would add around 0.6 percent of GDP (MEFP ¶16). Expenditure savings are achieved from restraining personnel costs, maintaining rationalization of utility consumption, and cutting non-priority capital expenditure, which accounted for over one percent of GDP in 2018 (MEFP ¶17). To avoid a reemergence of demand pressures on foreign reserves and to ensure the DPD target is met, discretionary spending will be held back until expected resources become available, while off-budget expenditures, which amounted to ¾ percent of GDP last year, will be prevented through strengthened public financial management. The DPD target will be tightened if budget support is not disbursed to limit domestic borrowing.

Text Table 2. Financial Operations of the Central Government, 2018–20

(Percent of GDP)

	2018	2019			2020
	Actual	H1 Actual	H2 Prog.	Prog.	Prog.
Total revenue (ex. payment to ENCO and oil revenue)	13.2	5.9	7.7	13.7	13.8
Tax revenue (ex. payment to ENCO)	12.5	5.2	7.3	12.5	12.6
Import taxes (ex. payment to ENCO)	5.5	1.7	3.7	5.4	5.2
Other taxes	7.0	3.5	3.6	7.1	7.5
Nontax revenue	3.0	1.3	0.5	1.8	1.8
of which: oil revenue	2.4	0.6	0.0	0.6	0.6
Total domestic primary expenditure (ex. capitalization)	17.3	7.8	8.0	15.8	15.5
Current expenditure	16.4	8.0	8.1	16.1	15.7
Personnel costs	9.1	4.8	4.4	9.2	8.8
Interest due	0.4	0.3	0.3	0.6	0.6
Goods and services	3.0	1.3	1.3	2.5	2.4
Transfers	3.1	1.4	1.7	3.1	3.3
Other current expenditure	0.8	0.3	0.4	0.6	0.6
Capital spending fin. by the Treasury and HIPC-eligible	1.5	0.0	0.3	0.3	0.4
Of which: capitalization of BIRD	0.2	0.0	0.0	0.0	0.0
Domestic primary balance[1]	**-4.1**	**-1.8**	**-0.3**	**-2.1**	**-1.7**
Memorandum items					
Payment to ENCO	…	…	0.0	0.0	0.3

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

[1] Exclude oil related revenues and a fraction of the oil surcharge for ENCO debt repayment, grants, interest earned, scheduled interest payments, capitalization of BIRD, and foreign-financed capital outlays.

16. **Revenue mobilization and fiscal consolidation will continue over the medium term to entrench fiscal and external sustainability and help raise social spending and investment (Table 2).** The DPD gradually falls and turns into a slight surplus by the end of the program through a combination of revenue mobilization and expenditure restraint. A floor on social spending and a five-year $10 million social protection program supported by the World Bank will further help

mitigate the impact of consolidation on the poor (Annex III). New external borrowing will be limited to concessional loans capped at three percent of GDP annually to allow a steady decline in public debt, as shown in the DSA.

17. The government plans to introduce the VAT early next year to achieve a revenue gain of two percent of GDP over the medium term (MEFP ¶22).[4] Preparations for the introduction of the VAT have taken longer than expected, due to the country's limited capacity and the authorities' concerns about the potential impact on the economy and vulnerable citizens. However, the authorities are committed to accelerate work towards the transition and meet next year's schedule. Priorities include launching an educational campaign, implementing an adequate IT system, finalizing some design parameters of VAT, and realigning other taxes, especially excise taxes. Adoption of the VAT law by October 15 and start of a public communication campaign by end-September 2019 are both structural benchmarks. The impact of the VAT on the poor is likely to be limited as they mostly rely on subsistence agriculture and the informal sector. However, further efforts will be made to lessen the impact, including by allowing lower rates on a small set of items.

18. Personnel costs and spending on goods and services will be restrained, while social and domestically-financed capital spending is slowly increased. Nominal wages will be broadly frozen next year, permitting savings of close to ½ percent of GDP and then maintained in line with GDP growth, while civil service reforms are launched to rationalize the wage bill. Meanwhile, transfers will be prioritized to increase social spending, for which a floor is established. The floor on social spending and the protection program supported by the World Bank, as noted previously, will help cushion the impact of expenditure restraint.

19. Other fiscal structural reforms aim to strengthen tax administration and public financial management (PFM). Priorities include adopting modern compliance risk management practices, including audit programs that exploit information from third parties and better monitoring of large taxpayers to ensure timely tax payments; strengthening budget forecasts, execution, and cash management to prevent arrears accumulation; and ensuring reconciliation of budget execution data with financing (MEFP ¶20, 21, 23, and 24). The government is committed to not accumulating new arrears and will use treasury bill issuances to cover current payments as needed and clear previous arrears. It will also strengthen the enforcement of public procurement laws and regulations to ensure efficiency of public spending, including by public entities, and reduce vulnerabilities to corruption.

20. The government continues to implement the main recommendations of the Debt Management Performance Assessment (DeMPA). Ongoing efforts include a medium-term debt management strategy, a debt database, and training on debt management, including treasury bill issuance. Efforts to regularize post-HIPC arrears also continue (MEFP ¶38, 39).

[4] The program assumes gains of less than 0.3 percent of GDP from VAT and tax administration reforms in 2020 to be conservative and take account of potential initial difficulties.

B. Tighten Monetary Policy and Enhance Central Bank Management to Support the Peg

21. Monetary policy will continue to be anchored by the peg to the euro. The pegged exchange rate (introduced in 2010) has helped contain inflation in this small-island economy that depends extensively on imports. The authorities recognize that the most important tools to safeguard the peg are sound fiscal policies, structural reforms to boost exports and reduce energy imports, and timely implementation of externally funded projects.

22. Tighter monetary policy will complement fiscal consolidation to rebuild adequate foreign reserves. Currently, market term deposit rates average 3.5 percent, well below inflation, and banks' excess reserves at the central bank are not remunerated. A tightening of monetary policy can help raise deposit rates to encourage dobra savings, ease demand for foreign reserves, and contain inflation (MEFP ¶25). Initial steps include issuing central bank certificates of deposit of at least D50 million (end-March 2020, structural benchmark), supported by IMF Monetary and Capital Markets Department technical assistance. Given the weak lending channel, the tightening is likely to have a limited impact on lending. Nevertheless, the potential fiscal costs of draining liquidity call for a gradual approach, with recalibration based on the observed effectiveness of the new monetary instruments.

23. Internal control, independence, and oversight will be strengthened to ensure the efficient and effective operation of the Central Bank of São Tomé and Príncipe (BCSTP) (MEFP ¶29, 35). In line with the safeguards assessment, the Central Bank (Organic) Law will be revised to strengthen central bank independence, provide for a governance structure for independent oversight of central bank operations, and improve financial reporting and bank resolution, with the financial institutions law also revised accordingly (submission to parliament of both laws is an end-December 2019 structural benchmark). To improve capacity in internal audit, the BCSTP has appointed a new director of audit, and a risk-based approach to audit planning will be adopted.

C. Safeguard Financial Stability

24. The authorities are committed to implementing the AQR recommendations and other measures to safeguard banking sector soundness (end-March 2020 structural benchmark; MEFP ¶30-31, Annex IV). This will require additional provisions and an increase in capital—provided by private bank owners—where necessary. The BCSTP will also consider running stress tests on a regular basis to better assess the adequacy of banks' buffers under severely adverse conditions (MEFP ¶30). Capacity to identify and correct regulatory infractions will also be strengthened, partly by undertaking more frequent on-site inspections supported by appropriate staffing, better training, and improving the enforcement mechanism. Furthermore, the authorities are implementing a bank rating model for on- and off-site supervision, upgrading regulations on risk and asset management, and working with the World Bank to update the credit registry.

25. Efforts towards resolution of legacy NPLs will be stepped up. Preliminary data from June 2019 indicate that the NPL ratio remains high. To bring about a meaningful reduction in the NPL ratio, the BCSTP will give guidance to banks for more rapid write-offs of defaulted loans, improve the efficiency of the judicial loan enforcement process, and reinvigorate the project of arbitration tribunals for out-of-court settlements.

26. The authorities will speed up the resolution of the two failed banks. The liquidation of Banco Equador is expected to be concluded this year and with proceeds expected to cover most of the payouts to small depositors. If asset recovery is insufficient, the central bank advancement for the payouts (€1.7 million or 0.5 percent GDP) will be absorbed by the budget.[5] Voluntary liquidation is being discussed with the shareholders of Banco Privado (BPSTP) in accordance with the law as the bank's license was withdrawn over governance concerns and repeated non-compliance with BCSTP directives. Liquidation through the court system is the next step.

27. Several projects have been initiated to improve access to finance by small and medium enterprises and promote financial inclusion (MEFP ¶34). The authorities adopted a microfinance law in September 2018 and completed a survey on financial inclusion. With World Bank assistance, a collateral registry is being developed to facilitate lending to small firms (end-June 2020 structural benchmark). A national financial inclusion strategy will be completed by end-2019, and the national action plan on gender equality also focuses on financial inclusion.

D. Accelerate Structural Reforms for Sustainable and Inclusive Growth

28. Comprehensive reforms in the energy sector are critical to support growth (Annex V). The high cost and unreliability of electricity supply hinders economic activity and undermines competitiveness. Despite some improvements in collections and involuntary cuts in production, EMAE's large losses (about $16 million) did not abate in 2018 and increased in the first half of 2019 ($9.4 million), reflecting the inefficiency of the energy sector and higher international oil prices. Comprehensive reforms are underway with World Bank support to rehabilitate the energy sector, reduce the cost of energy, and achieve cost recovery over the medium term. Such reforms would also help reduce fuel imports and boost international reserves in the medium to long term. In the meantime, the authorities are implementing various short-term measures to contain EMAE's losses by installing pre-paid and smart meters to reduce commercial losses, enforcing payment discipline for large consumers, switching to LED lightbulbs—to be financed by the World Bank— to reduce peak energy consumption by 10 percent within 12 months, and implementing tariff reforms (MEFP ¶44).

29. Regulatory and other structural reforms will be undertaken to promote private sector-led growth (MEFP ¶41-43)**.** Though the World Bank's 2019 Doing Business survey shows some improvement from the 2018 scores, the country's overall score is 45.1 compared with the sub-

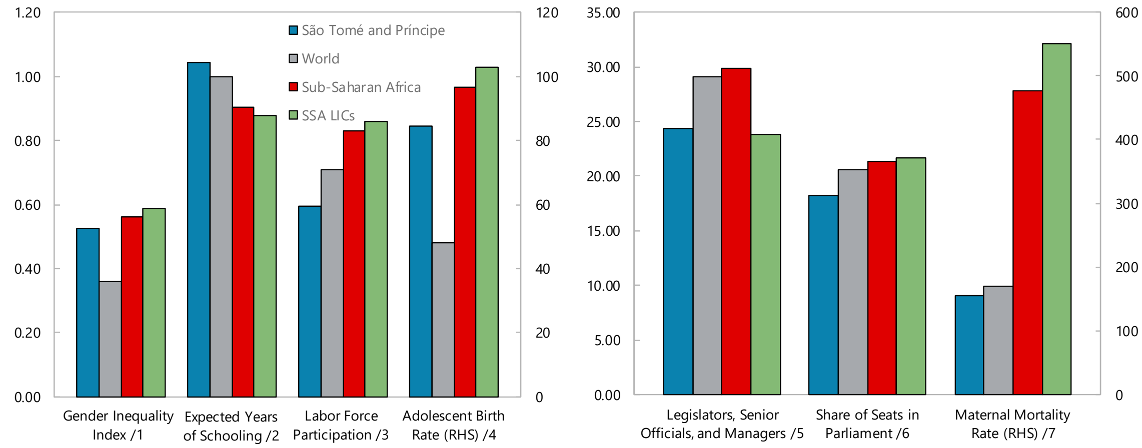
[5] The liquidation cost, largely in the form of payouts to small non-connected depositors, has so far not exceeded 0.3 percent of GDP. With expected asset recovery, the net fiscal cost, which will be excluded from the domestic primary deficit target, is expected to be minimal and not included in the baseline macro-framework.

Saharan regional average of 51.6. Data from the 2017 Worldwide Governance Indicators survey show that São Tomé and Principe is below the regional average for Government Effectiveness and Regulatory Quality. Specific measures to improve the business environment include implementation of key recommendations of the Tourism Development Strategy (end-June 2020 structural benchmark), including publication of a codified procedure for the approval of private investments, which will increase transparency, strengthen confidence, and reduce vulnerabilities to corruption. Efforts will continue to develop a payment system with the capability of processing international credit cards, which would stimulate tourist spending. Better infrastructure will support local agriculture and fishing, as well as facilitate business creation. A tourism school supported by the World Bank is expected to open by the end of 2019 and will help develop local capacity and fill demand locally.

30. The country has made progress on some of the Sustainable Development Goals (SDGs) including Zero Hunger, Good Health and Well-Being, Climate Action, and Life Below Water. However, indicators on Quality Education, Gender Equality, and Clean Water and Sanitation show fewer signs of improvement. In partnership with UN agencies, the authorities held a steering committee meeting to further develop strategies for achieving the SDG targets (MEFP ¶40).

31. The authorities are preparing a national action plan to promote women's economic empowerment and financial inclusion with broad consultation with stakeholders (MEFP ¶40 and end-December 2019 structural benchmark). Though gender gaps in education have been closed and gender equality is enshrined in the legal framework, gender gaps in wages, labor force participation, and access to finance remain, and the enforcement of laws and regulations on gender equality needs be strengthened (Text Figure 3.). Participants at a workshop in June 2019, which was co-organized by the authorities, the IMF, and the United Nations, drafted a preliminary version of the action plan. In July, the same organizing group hosted a high-level conference focusing on developing policy solutions to increase women's economic empowerment and financial inclusion. The authorities will finalize the national action plan by December 2019 and thereafter, together with other stakeholders, will monitor progress over time.

Text Figure 3. Selected Gender Inequality Measures



Sources: UNDP, Human Development Reports; and IMF staff calculations.
Note: Data may not be available for all countries. Latest available data (2015-2018) were used to construct this presentation.
1/ Gender Inequality Index (GII), developed by the UNDP, measures gender inequalities in three areas: reproductive health, female empowerment, and economic status.
2/ Ratio between the expected years of schooling for girls and the expected years of schooling for boys.
3/ Ratio between the female labor force participation rate and the male labor force participation rate.
4/ Births per 1,000 women ages 15-19.
5/ Percent of total legislators, senior officials, and managers who are female.
6/ Percent of total seats occupied by women in the country's parliament.
7/ Measured in deaths per 100,000 live births.

PROGRAM MODALITIES

32. The authorities have requested a 40-month arrangement under the ECF. The arrangement provides access to PRGT funds at 90 percent of the quota (SDR 13,320,000) to cover balance of payments needs (Table 6), part of which are related to budget financing needs, bring reserve coverage back to an adequate level. It also supports the government's strong reforms, including on the VAT, PFM, the electricity sector, enhancing social protection, and increasing women's economic empowerment. As revenue mobilization will take time to yield results, additional resources are needed for social protection and priority public investment. The financing gap is projected to close during the program period as reforms are implemented. The IMF-supported program will comprise six reviews, with disbursements phased evenly throughout the arrangement (Table 9). The disbursements would be made available as indirect budget support and would be deposited at the Treasury's account at the BCSTP and then withdrawn, as needed, to finance the budget. A memorandum of understanding has been established between the central bank and the government on their respective roles and obligations.

33. The program is subject to important downside risks. In particular, limited administrative capacity or slackening of policy reforms could hinder program implementation, which in turn could delay external financing. Delayed EMAE reform could elevate debt vulnerability and energy pressures.

34. To mitigate the risks, program performance will be monitored through semi-annual program reviews based on quantitative performance criteria, indicative targets, and structural

benchmarks (MEFP Tables 3 and 4). In light of the country's fragility, conditionality is prioritized and selective. Critical unmet structural benchmarks under the 2015–18 ECF arrangement, such as implementing a VAT and strengthening central bank governance, were re-introduced. Other benchmarks seek to contain EMAE's large losses, improve monetary operations and financial sector oversight, empower women economically, and promote inclusive growth. Prior actions for program approval include the adoption of (i) a government decree to align the 2019 budget with the program and necessary legislation to introduce revenue measures agreed (including an oil tax surcharge, a reduction in tax allowances, and an increase in sales tax on telecommunication) and the revised VAT law in line with IMF recommendation (MEFP ¶16-18), (ii) a management improvement plan and least cost energy-production plan for EMAE, and (iii) a monthly budget allocation plan for the remainder of 2019.

35. Continued, hands-on capacity development is essential to build capacity and address fragility and risk. Technical assistance in the near term will focus on tax administration, in preparation for the introduction of the VAT; public financial management to avert further expenditure slippages and accumulation of arrears; monetary policy implementation to design appropriate instruments to reduce excess liquidity; and implementation of the recommendations of the safeguards assessment (Annex VI).

36. Staff consider that the capacity to repay the IMF is adequate (Table 8). Requisite financing assurances exist, and the program is fully financed as there are firm commitments in place for financing over the next 12 months and good prospects thereafter. Repayments to the IMF will remain below 0.7 percent of exports of goods and services during the program period and peak at 1.9 percent of exports of goods and services in 2028. The program would play a catalytic role and would stimulate some donors' support (Text Table 3).

Text Table 3. IMF Disbursement and Official Inflows

	2019	2020	2021	2022	2019-22
Proposed IMF program					
in million SDR	1.9	3.8	3.8	3.8	13.3
in million USD	2.7	5.3	5.3	5.3	18.6
Offical external inflow (in million dollars) 1/					
Total	31.9	44.4	44.5	44.5	165.3
Grants	25.2	37.8	37.0	36.3	136.3
Budget support grants	8.4	8.4	8.4	8.4	33.7
European Union (EU)	3.4	3.4	3.4	3.4	13.7
World Bank	5.0	5.0	5.0	5.0	20.0
Project grants (excluding HIPC)	17	29	29	28	103
Concessional loans	6.6	6.6	7.5	8.2	28.9

1/ Including from the World Bank, African Development Bank, EU, and European Investment Bank.

37. The authorities are also requesting a one-year temporary approval for the retention of the measures that give rise to exchange restrictions and a multiple currency practice subject to IMF jurisdiction under Article VIII, Sections 2(a) and 3, respectively. These exchange measures include: (i) an exchange restriction arising under Articles 3(g) and 18 of the Investment Code of 2016 due to limitations on the transferability of net income from investments; and (ii) an exchange restriction arising from limitations on the availability of foreign exchange for payments of current international transactions, due to the rationing of foreign exchange by BCSTP. The latter exchange restriction also gives rise to a multiple currency practice as it has resulted in the channeling of transactions to the parallel market where the exchange rate is at a spread of more than two percent from the exchange rate in the formal market.[6] The authorities have requested approval of these measures for a period of twelve months because they are temporary, non-discriminatory, and needed for balance of payments reasons. The IMF Executive Board had previously granted a one-year approval until July 2019. Under the program reforms the authorities envisage to remove the restrictions in the near term.

38. An updated safeguards assessment of the BCSTP was completed in August. While external audits continue to be conducted by reputable firms, staff found slow progress in implementing recommendations from the previous assessment. Key recommendations include i) strengthening the central bank law, in particular in the areas of governance and autonomy, ii) transition to international standards to improve financial reporting practices, iii) establishing a governance structure that provides for independent oversight of central bank operations, iv) improving internal auditing capacity, and v) diversifying reserve holdings to reducing credit risk. The central bank is taking steps to address the identified vulnerabilities, including through IMF TA on legal amendments.

39. Economic data need to improve further, although they are broadly adequate for program monitoring. Work is ongoing to implement the enhanced General Data Dissemination System (e-GDDS), a welcome step in fostering greater data accessibility and identifying priority areas for data quality improvements. More efforts are needed to enhance macroeconomic statistics, particularly leading indicators of economic activity and tourism data (MEFP ¶41, 45). Micro-level data from recent financial inclusion and household surveys can help to further inform monitoring.

STAFF APPRAISAL

40. São Tomé and Príncipe's economy is facing serious challenges over the near and medium term. Recent growth has been too slow to reduce poverty, and large fiscal and external imbalances that emerged in 2018 threaten macroeconomic stability. An inefficient energy sector continues to accumulate debt and hinder businesses; tax revenue is too low to meet social development needs; and a vulnerable banking sector is impeding the financing of private investment. Addressing these challenges requires immediate and sustained macroeconomic policy

[6] Anecdotal evidence suggests that exchange rate spreads between the formal and informal rates are around 2 percent for euros.

adjustments centered around fiscal consolidation and comprehensive structural reforms to mobilize revenue, reduce debt, improve financial stability, and unlock growth potential.

41. The authorities are committed to tightening fiscal and monetary policy to address immediate balance of payment pressures. The DPD will be appropriately reduced by about two percent of GDP in 2019 through revenue measures and expenditure rationalization, while borrowing by autonomous public entities for non-budgeted spending will be prevented. Monetary policy will also be tightened as needed to encourage dobra savings, taking into account the costs to the central bank.

42. Fiscal consolidation over the medium term will continue to entrench fiscal and external sustainability. The DPD is targeted to fall close to a balanced position over the medium term through a combination of revenue mobilization and expenditure restraint, while social and domestically-financed capital spending are gradually expanded. The impact of these policies is mitigated by measures to protect the most vulnerable and the planned launch of large foreign-supported projects.

43. Domestic revenue mobilization is critical to enable higher social spending and investment. The planned introduction of a VAT next year, together with tax administration reforms, will broaden the tax base and help raise tax revenue by about two percentage points over the medium term. However, preparations for the transition, especially the educational campaign, hiring and training dedicated personnel, implementation of an adequate IT system, and tax realignment, should be accelerated to meet this schedule.

44. PFM needs to be strengthened to prevent arrears accumulation. The government is committed to not accumulating new arrears and will issue treasury bills to cover current payments as needed and to clear previous arrears. The planned strengthening of public procurement and supervisory procedures to ensure strict enforcement of procurement laws and prevent large commitments by autonomous public entities will also be important.

45. Public debt is deemed to be sustainable with the recent formalization of EMAE's arrears to ENCO and assuming reforms under the program are implemented. The country is in debt distress due to longstanding external arrears. The recent EMAE and ENCO agreement achieved a significant reduction of the debt in present value terms, while discussions continue to regularize the outstanding external arrears. Given the high debt level, external loans will be contracted only at concessional terms and limited to less than three percent of GDP per year. Work should continue to implement recommendations under the DeMPA and finalize the medium-term debt management strategy.

46. Rehabilitating the energy sector is a priority. The high cost of energy is hindering growth, and EMAE's recurrent losses pose a serious fiscal risk. In this context, the short-term measures to contain EMAE's losses and the comprehensive World Bank-supported reform strategy to rehabilitate the sector and achieve cost recovery over the medium term should be implemented without further delay. Implementation of these reforms will also help reduce oil imports and external imbalances.

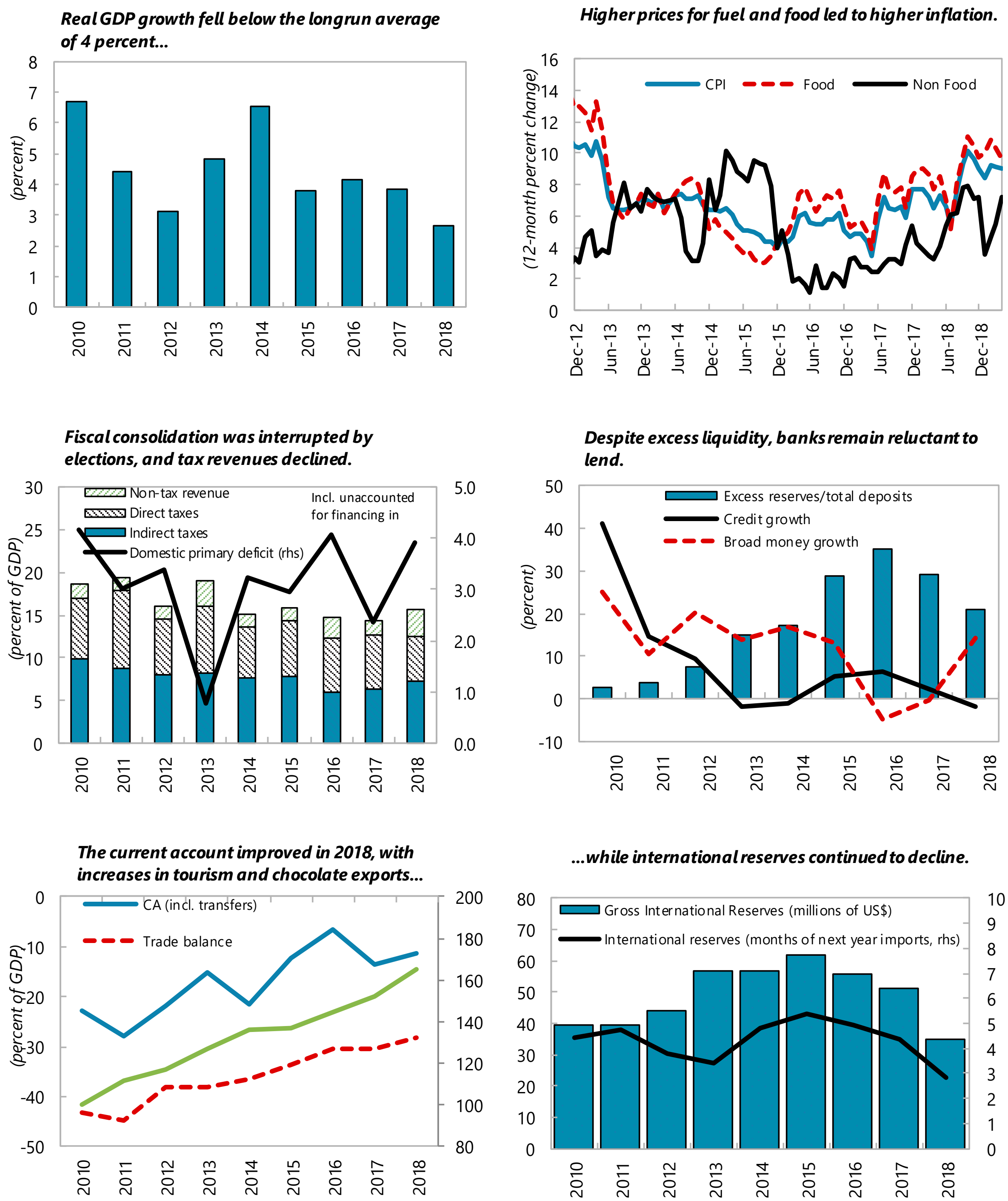
47. The AQR recommendations on provisioning and recapitalization need to be implemented to strengthen banking sector soundness. Additional provisions stemming from loan reclassifications and updated collateral valuation need to be enforced and adequate capital cushions replenished where necessary. Staffing and capacity at BCSTP need to be strengthened to ensure effective supervision and enforcement. Ongoing work to improve regulations, staff capacity on risk and asset management, and the credit registry is important.

48. Further efforts are needed to reduce the high level of NPLs. The BCSTP should give guidance to banks for more rapid write-offs of defaulted loans. To assist loan recovery, concerted efforts are required to reform the legal system, increase the capacity of the courts, and establish arbitration tribunals for out-of-court settlement. The recommendations of the safeguards assessment should be implemented without further delay.

49. Reforms to the business environment and greater gender equality are essential to promoting inclusive growth and reducing poverty. Planned infrastructure projects, including road rehabilitation and airport expansion, will support key sectors such as tourism, agriculture, and fisheries. Implementation of the recently adopted tourism development strategy would help promote this sector and create jobs. A codified procedure for the approval of private investments should be published to increase transparency, and a payment system capable of processing international credit cards is needed to facilitate local tourism activity. Adoption of a national action plan by end-2019 will help promote women's economic empowerment and financial inclusion.

50. Staff supports the authorities' request for a new 40-month arrangement under the ECF, with access level of 90 percent of quota. Staff also supports the authorities' request for a one-year extension of the temporary approval for the retention of measures resulting in exchange restrictions and a multiple currency practice subject to IMF jurisdiction under Article VIII, Sections 2(a) and 3 because these measures are temporary, non-discriminatory and needed for balance of payments reasons.

Figure 1. Democratic Republic of São Tomé and Príncipe: Recent Macroeconomic Developments, 2010–18

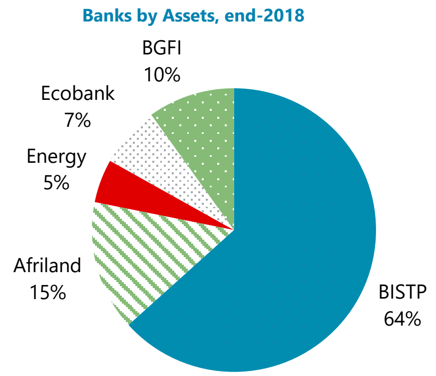


Sources: São Tomé and Príncipe authorities; and IMF staff estimates.

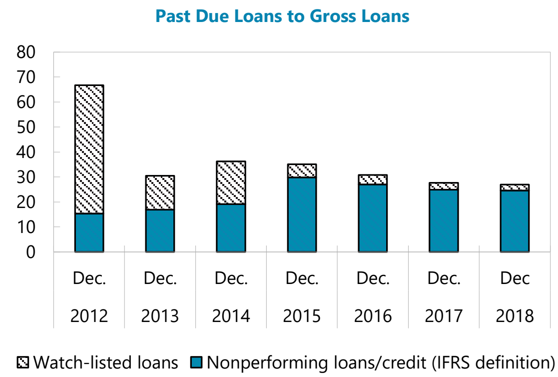
Figure 2. Democratic Republic of São Tomé and Príncipe: Financial Sector Developments, 2012–18[1]

(In percent)

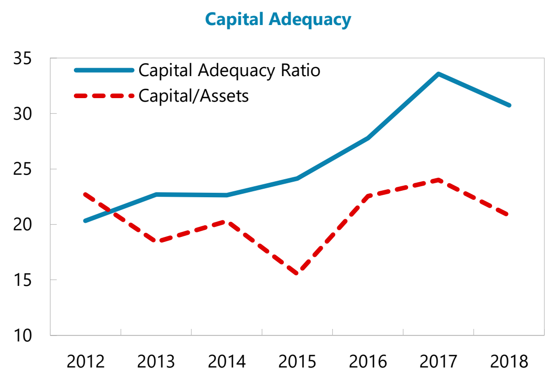
The largest bank has almost two-thirds of the total assets in a highly-concentrated banking system.



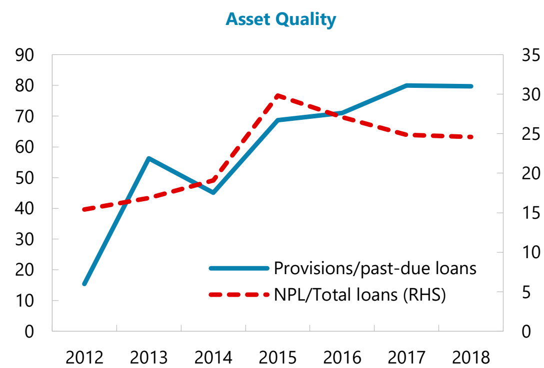
Past due loans show little change since end-2017, while watch listed loans declined slightly.



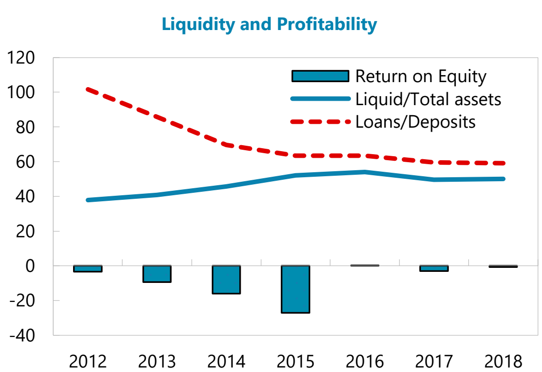
Capital ratios have fallen but remain well above the regulatory requirements.



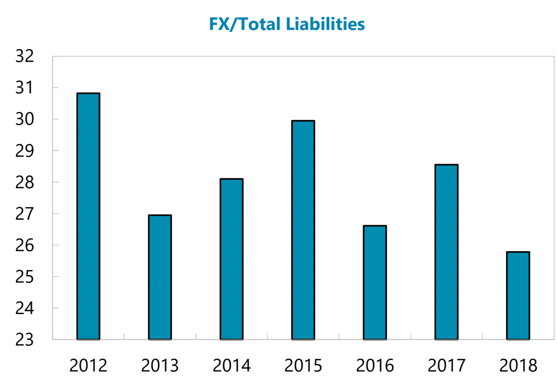
The NPL reduction strategy has reached a plateau, but provisioning remains high.



Profitability is weak but much better than in previous years.



Foreign currency liabilities have been volatile and declined recently.



Sources: São Tomé and Príncipe authorities' data and IMF staff estimates and projections.
[1] Excluding Banco Equador (beginning December 2016) and BPSTP (beginning June 2018).

Table 1. Democratic Republic of São Tomé and Príncipe: Selected Economic Indicators, 2015–22

(Annual change in percent, unless otherwise indicated)

	2015	2016	2017	2018		2019	2020	2021	2022
	Actual	Actual	Actual	5th Rev	Est.	Proj.	Proj.	Proj.	Proj.
National income and prices									
GDP at constant prices	3.8	4.2	3.9	4.0	2.7	2.7	3.5	4.0	4.5
GDP deflator	5.1	5.1	2.0	3.9	4.7	3.7	3.5	3.0	3.0
Consumer prices									
End of period	4.0	5.1	7.7	6.0	9.0	7.8	10.0	4.0	3.0
Period average	5.3	5.4	5.7	6.8	8.2	8.4	8.9	6.9	3.5
External trade									
Exports of goods and nonfactor services	3.3	7.3	-10.8	5.4	14.1	10.5	11.0	14.9	10.4
Imports of goods and nonfactor services	-18.8	-0.6	4.5	13.1	2.6	1.5	6.7	6.0	7.8
Exchange rate (new dobras per US$; end of period) [1]	22.4	23.4	20.5	…	21.7	…	…	…	…
Real effective exchange rate (period average, depreciation = -)	0.6	5.7	4.9	…	8.7	…	…	…	…
Money and credit									
Base money	37.5	5.0	-9.6	9.3	0.8	-0.5	2.6	7.1	7.6
Broad money (M3)	13.1	-4.8	-0.4	12.6	14.3	0.0	7.1	7.1	7.6
Credit to the economy	5.4	6.6	2.5	5.8	-1.6	-6.7	0.6	6.6	7.1
Velocity (GDP to broad money; end of period)	2.5	2.9	3.0	3.1	3.0	3.0	3.0	3.0	3.0
Central bank reference interest rate (percent)	10.0	10.0	9.0	…	9.0	…	…	…	…
Average bank lending rate (percent)	23.3	19.6	19.6	…	19.9	…	…	…	…
Government finance (in percent of GDP)									
Total revenue, grants, and oil signature bonuses	28.0	28.2	24.9	27.5	23.7	21.0	23.6	23.5	23.8
Of which: tax revenue	14.3	12.3	12.7	11.8	12.5	12.5	13.0	13.8	14.8
Nontax revenue	1.5	2.3	1.7	2.9	3.0	1.8	1.8	1.6	1.7
Grants	11.4	13.5	10.5	12.8	8.2	6.7	8.9	8.1	7.3
Total expenditure and net lending	34.2	32.4	27.6	27.2	25.6	21.9	23.9	23.3	22.9
Personnel costs	8.9	8.9	8.3	7.7	9.1	9.2	8.8	8.8	8.8
Interest due	0.8	0.4	0.5	0.6	0.4	0.6	0.6	0.6	0.6
Nonwage noninterest current expenditure	8.5	8.0	6.9	5.9	6.9	6.3	6.3	6.4	6.6
Treasury funded capital expenditures	0.7	0.7	0.7	0.1	1.4	0.1	0.2	0.2	0.2
Donor funded capital expenditures	14.7	14.2	11.0	12.8	7.7	5.5	7.8	7.2	6.7
HIPC Initiative-related capital expenditure	0.6	0.2	0.2	0.2	0.1	0.2	0.2	0.1	0.2
Domestic primary balance [2]	-2.9	-4.1	-2.4	-1.3	-4.1	-2.1	-1.7	-0.8	0.1
Net domestic borrowing	-0.5	2.8	1.8	0.8	3.4	0.7	1.2	0.5	-0.2
Overall balance (commitment basis)	-6.3	-4.2	-2.7	0.3	-1.9	-0.9	-0.3	0.2	0.9
Public Debt [3]	89.6	94.5	84.3	…	95.5	94.2	93.8	91.3	87.6
External sector									
Current account balance (percent of GDP)									
Including official transfers	-12.2	-6.6	-13.2	-6.8	-10.9	-11.5	-9.0	-7.9	-8.0
Excluding official transfers	-24.8	-20.5	-24.3	-6.8	-19.4	-18.2	-17.9	-16.0	-15.3
PV of external debt (percent of GDP)	39.7	31.5	26.6	26.9	27.1	25.6	24.0	20.9	21.0
External debt service (percent of exports) [4]	3.8	3.3	3.8	4.6	4.2	5.1	5.3	4.7	4.5
Export of goods and non-factor services (US$ millions)	90.0	96.6	86.1	111.5	98.2	108.6	120.5	138.5	152.9
Gross international reserves [5]									
Millions of U.S. dollars	61.9	55.9	51.4	58.2	35.1	36.0	40.0	45.4	50.7
Months of imports of goods and nonfactor services [6]	5.4	4.9	4.6	4.4	3.3	3.3	3.6	3.9	4.2
National Oil Account (US$ millions)	10.3	11.5	11.3	11.4	19.5	18.5	17.8	16.9	16.5
Memorandum Item									
Gross Domestic Product									
Millions of new dobra	7,031	7,698	8,154	9,222	8,763	9,333	9,997	10,709	11,527
Millions of U.S. dollars	318.3	347.5	375.8	466.1	422.6	429.8	462.6	499.3	541.0
Per capita (in U.S. dollars)	1,570	1,673	1,768	2,143	1,943	1,933	2,036	2,152	2,283
Unemployment rate (percent)	13.4	13.4	13.5	11.7	…	…	…	…	…

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] Total public and publicly guaranteed debt as defined in DSA, which includes EMAE's arrears to ENCO (and excludes the government's arrears to EMAE due to consolidation). The 5th review had "..." because this concept was not used then.

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

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

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

Table 2a. Democratic Republic of São Tomé and Príncipe: Financial Operations of the Central Government, 2015–22
(Millions of new dobra)

	2015	2016	2017	2018		2019	2020	2021	2022
	Actual	Actual	Actual	5th Rev	Actual	Proj.	Proj.	Proj.	Proj.
Total revenue and grants [1]	1965	2168	2034	2537	2081	1956	2362	2516	2744
Total revenue	1108	1130	1174	1353	1365	1335	1472	1651	1900
Tax revenue	1006	949	1036	1084	1099	1166	1297	1474	1707
Import taxes	455	371	388	451	486	502	547	586	631
of which: oil surcharge for budget spending	…	…	…	…	…	44	30	46	51
oil surcharge to pay ENCO	…	…	…	…	…	0	32	21	21
Other taxes	550	578	647	633	613	664	750	888	1076
Nontax revenue	102	181	138	269	266	169	175	177	193
of which: oil revenue	0	74	51	198	212	60	60	54	60
Grants	804	1038	860	1184	715	621	889	865	844
Project grants	610	891	594	908	557	366	635	613	593
Nonproject grants [2]	61	81	198	192	125	182	182	181	180
HIPC Initiative-related grants	133	65	67	83	33	73	72	71	70
Total expenditure	2405	2494	2253	2508	2243	2042	2390	2494	2643
Of which: domestic primary expenditure	1315	1370	1316	1279	1536	1472	1550	1657	1812
Current expenditure	1274	1334	1287	1303	1436	1503	1569	1684	1833
Personnel costs	623	684	681	706	798	856	875	937	1009
Interest due	54	34	43	50	34	60	61	64	64
of which: covered by HIPC grants						73	72	71	70
Goods and services	239	249	253	205	260	236	243	255	285
Transfers	248	282	234	278	273	290	325	359	401
Other current expenditure	110	84	76	64	71	61	65	69	75
Capital expenditure	1087	1141	952	1191	795	522	799	795	791
Financed by the Treasury	51	50	58	12	122	13	20	21	23
of which: Capitalization of BIRD	…	0	0	0	21	0	0	0	0
Financed by external sources	1036	1090	894	1179	673	509	779	774	768
HIPC Initiative-related capital expenditure	44	19	15	14	12	17	22	15	20
Domestic primary balance [3]	-207	-314	-193	-124	-362	-198	-170	-82	7
Overall fiscal balance (commitment basis)	-440	-326	-219	29	-162	-86	-28	21	100
Net change in domestic arrears	-82	0	6	-66	76	0	-66	-81	-76
Float and statistical discrepancies	10	0	-53	0	-24	0	0	0	0
Overall fiscal balance (cash basis)	-524	-30	-215	-37	-111	-86	-94	-59	25
Financing	524	30	215	37	111	86	94	59	-25
Net external	576	62	103	123	67	0	-11	6	13
Disbursements [4]	742	143	160	200	116	143	143	161	174
Program financing (loans) [5]	20	32	37	37	16	…	…	…	…
Scheduled amortization	-187	-112	-94	-114	-65	-143	-154	-155	-161
of which: covered by HIPC grants						0	0	0	0
Net domestic	-51	-32	112	-86	44	86	105	53	-37
Net bank credit to the government	-51	-32	112	-86	44	86	137	74	-16
Banking system credit (net, excluding National Oil Account) [5]	-42	-5	103	66	210	61	117	52	-28
Banking system credit (gross, excluding National Oil Account)	-33	218	103	221	286	347	465	517	489
Of which: central bank on-lending of Fund resources	…	…	…	…	…	58	114	113	113
Of which: Privatisation account	0	0	0	0	0	0	0	0	0
Amortization of domestic debt	…	…	…	-155	0	-286	-348	-465	-517
National Oil Account	-10	-27	9	-152	-167	25	20	22	12
Nonbank financing	0	0	0	0	0	0	-32	-21	-21
Financing gap	0	0	0	0	0	0	0	0	0
Financing gap without IMF program	…	…	…	…	…	166	296	294	293
Of which: budget support	…	…	…	…	…	109	182	181	180
IMF loan	…	…	…	…	…	58	114	113	113
Memorandum items									
EMAE loss	122	438	285	…	349	…	…	…	…

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

[1] Revenue is measured on a cash basis.

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

[3] Excludes oil related revenues and a fraction of the oil surcharge for ENCO debt repayment, grants, interest earned, scheduled interest payments, foreign-financed capital outlays, and capitalization of regional organizations per definition in TMU.

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

[5] Includes use of IMF program support.

Table 2b. Democratic Republic of São Tomé and Príncipe: Financial Operations of the Central Government, 2015–22
(In percent of GDP)

	2015	2016	2017	2018		2019	2020	2021	2022
	Actual	Actual	Actual	5th Rev	Actual	Proj.	Proj.	Proj.	Proj.
Total revenue and grants [1]	**28.0**	**28.2**	**24.9**	**27.5**	**23.7**	**21.0**	**23.6**	**23.5**	**23.8**
Total revenue	15.8	14.7	14.4	14.7	15.6	14.3	14.7	15.4	16.5
Tax revenue	14.3	12.3	12.7	11.8	12.5	12.5	13.0	13.8	14.8
Import taxes	6.5	4.8	4.8	4.9	5.5	5.4	5.5	5.5	5.5
of which: oil surcharge for budget spending	…	…	…	…	…	0.5	0.3	0.4	0.4
oil surcharge to pay ENCO	…	…	…	…	…	0.0	0.3	0.2	0.2
Other taxes	7.8	7.5	7.9	6.9	7.0	7.1	7.5	8.3	9.3
Nontax revenue	1.5	2.3	1.7	2.9	3.0	1.8	1.8	1.6	1.7
of which: oil revenue	0.0	1.0	0.6	2.1	2.4	0.6	0.6	0.5	0.5
Grants	11.4	13.5	10.5	12.8	8.2	6.7	8.9	8.1	7.3
Project grants	8.7	11.6	7.3	9.9	6.4	3.9	6.4	5.7	5.1
Nonproject grants [2]	0.9	1.1	2.4	2.1	1.4	2.0	1.8	1.7	1.6
HIPC Initiative-related grants	1.9	0.8	0.8	0.9	0.4	0.8	0.7	0.7	0.6
Total expenditure	**34.2**	**32.4**	**27.6**	**27.2**	**25.6**	**21.9**	**23.9**	**23.3**	**22.9**
Of which: Domestic primary expenditure	18.7	17.8	16.1	13.9	17.5	15.8	15.5	15.5	15.7
Current expenditure	18.1	17.3	15.8	14.1	16.4	16.1	15.7	15.7	15.9
Personnel costs	8.9	8.9	8.3	7.7	9.1	9.2	8.8	8.8	8.8
Interest due	0.8	0.4	0.5	0.6	0.4	0.6	0.6	0.6	0.6
Goods and services	3.4	3.2	3.1	2.2	3.0	2.5	2.4	2.4	2.5
Transfers	3.5	3.7	2.9	3.0	3.1	3.1	3.3	3.3	3.5
Other current expenditure	1.6	1.1	0.9	0.7	0.8	0.6	0.6	0.6	0.6
Capital expenditure	15.5	14.8	11.7	12.9	9.1	5.6	8.0	7.4	6.9
Financed by the Treasury	0.7	0.7	0.7	0.1	1.4	0.1	0.2	0.2	0.2
of which: Capitalization of BIRD	…	…	…	…	0.2	…	…	…	…
Financed by external sources	14.7	14.2	11.0	12.8	7.7	5.5	7.8	7.2	6.7
HIPC Initiative-related capital expenditure	0.6	0.2	0.2	0.2	0.1	0.2	0.2	0.1	0.2
Domestic primary balance [3]	-2.9	-4.1	-2.4	-1.3	-4.1	-2.1	-1.7	-0.8	0.1
Overall fiscal balance (commitment basis)	-6.3	-4.2	-2.7	0.3	-1.9	-0.9	-0.3	0.2	0.9
Net change in domestic arrears	-1.2	0.0	0.1	-0.7	0.9	0.0	-0.7	-0.8	-0.7
Float and statistical discrepancies	0.1	0.0	-0.7	0.0	-0.3	0.0	0.0	0.0	0.0
Overall fiscal balance (cash basis)	**-7.5**	**-0.4**	**-2.6**	**-0.4**	**-1.3**	**-0.9**	**-0.9**	**-0.6**	**0.2**
Financing	**7.5**	**0.4**	**2.6**	**0.4**	**1.3**	**0.9**	**0.9**	**0.6**	**-0.2**
Net external	8.2	0.8	1.3	1.3	0.8	0.0	-0.1	0.1	0.1
Disbursements [4]	10.6	1.9	2.0	2.2	1.3	1.5	1.4	1.5	1.5
Program financing (loans) [5]	0.3	0.4	0.5	0.4	0.2	…	…	…	…
Scheduled amortization	-2.7	-1.5	-1.2	-1.2	-0.7	-1.5	-1.5	-1.4	-1.4
Net domestic	-0.7	-0.4	1.4	-0.9	0.5	0.9	1.1	0.5	-0.3
Net bank credit to the government	-0.7	-0.4	1.4	-0.9	0.5	0.9	1.4	0.7	-0.1
Banking system credit (net, excluding National Oil Account) [5]	-0.6	-0.1	1.3	0.7	2.4	0.7	1.2	0.5	-0.2
National Oil Account	-0.1	-0.3	0.1	-1.7	-1.9	0.3	0.2	0.2	0.1
Nonbank financing	0.0	0.0	0.0	0.0	0.0	0.0	-0.3	-0.2	-0.2
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap without IMF program	…	…	…	…	…	1.8	3.0	2.7	2.5
Of which: budget support	…	…	…	…	…	1.2	1.8	1.7	1.6
IMF loan	…	…	…	…	…	0.6	1.1	1.1	1.0
Memorandum items									
EMAE loss	1.7	5.8	3.7	…	3.8	…	…	…	…

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

[1] Revenue is measured on a cash basis.

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

[3] Excludes oil related revenues and a fraction of the oil surcharge for ENCO debt repayment, grants, interest earned, scheduled interest payments, foreign-financed capital outlays, and capitalization of regional organizations per definition in TMU.

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

[5] Includes use of IMF program support.

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

	2015	2016	2017	2018		2019	2020
	Actual	Actual	Actual	5th Rev	Actual	Proj.	Proj.
Net foreign assets	**1,903**	**1,775**	**1,474**	**1,590**	**1,416**	**1,448**	**1,469**
Claims on nonresidents	2,243	2,144	1,840	1,958	1,798	1,851	1,861
Official foreign reserves	1,864	1,752	1,442	1,588	1,352	1,402	1,465
Other foreign assets	379	392	398	370	446	449	396
Liabilities to nonresidents	-341	-368	-366	-368	-382	-403	-393
Short-term liabilities to nonresidents	-120	-144	-158	-175	-169	-188	-179
Other foreign liabilities	-221	-224	-208	-193	-213	-215	-213
Net domestic assets	**-341**	**-135**	**9**	**31**	**80**	**41**	**58**
Net domestic credit	130	259	172	93	133	54	187
Claims on other depository corporations	128	198	195	195	195	145	145
Net claims on central government	-113	-69	-157	-244	-201	-125	9
Claims on central government	266	446	260	371	310	370	484
Of which: use of SDRs/PRGF	*196*	*180*	*211*	*83*	*147*	*205*	*315*
Liabilities to central government	-380	-515	-417	-615	-511	-494	-475
Ordinary deposits of central government	-11	-33	-41	-262	-20	-20	-20
Counterpart funds	-120	-82	-60	-60	-65	-65	-65
Foreign currency deposits	-249	-400	-316	-293	-426	-409	-390
Of which: National oil account	*-230*	*-271*	*-234*	*-224*	*-419*	*-402*	*-383*
Claims on other sectors	115	131	135	142	139	33	33
Other items (net)	-470	-394	-163	-62	-53	-13	-129
Base money (M0)	**1,562**	**1,640**	**1,484**	**1,621**	**1,496**	**1,488**	**1,527**
Currency issued	315	309	324	354	393	461	504
Bank reserves	1,247	1,332	1,160	1,267	1,103	1,027	1,023
Of which: domestic currency	980	1,183	1,013	1,107	947	867	863
Of which: foreign currency	266	149	147	160	157	160	160
Memorandum items:							
Gross international reserves (US$ millions) [1]	61.9	55.9	51.4	58.2	35.1	36.0	40.0
Months of imports of goods and nonfactor services [2]	5.4	4.9	4.6	5.4	3.3	3.3	3.6
Net international reserves (US$ millions) [3]	56.5	49.7	43.8	49.3	27.2	27.4	31.6
Months of imports of goods and nonfactor services [2]	4.9	4.4	3.9	3.7	2.5	2.5	2.8
National Oil Account (US$ millions)	10.3	11.5	11.3	11.4	19.5	18.5	17.8
Commercial banks reserves in foreign currency (US$ millions)	11.9	6.3	7.1	8.2	7.3	7.4	7.4
Guaranteed deposits (US$ millions)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Base money (annual percent change)	37.5	5.0	-9.6	9.3	0.8	-0.5	2.6

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

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

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

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

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

	2015	2016	2017	2018		2019	2020
	Actual	Actual	Actual	5th Rev	Actual	Proj.	Proj.
Net foreign assets	**2,527**	**2,105**	**1,582**	**1,709**	**1,636**	**1,615**	**1,639**
Net foreign assets of the BCSTP	1,903	1,775	1,474	1,590	1,416	1,448	1,469
Net foreign assets of other depository corporations	624	330	108	119	220	167	171
Net domestic assets	**301**	**586**	**1,099**	**1,310**	**1,429**	**1,450**	**1,644**
Net domestic credit	1,680	1,779	1,972	2,011	2,228	2,165	2,316
Net claims on central government	-303	-336	-196	-283	94	175	314
Claims on central government	275	483	687	798	977	1,041	1,161
Liabilities to central government	-578	-819	-883	-1,081	-883	-866	-847
Budgetary deposits	-11	-33	-41	-262	-20	-20	-20
Counterpart funds	-120	-82	-60	-60	-65	-65	-65
Foreign currency deposits	-448	-704	-782	-759	-798	-781	-762
Of which: National Oil Account	-230	-271	-234	-224	-419	-402	-383
Claims on other sectors	1,984	2,115	2,168	2,293	2,134	1,990	2,003
Of which: claims in foreign currency	609	515	442	468	395	388	390
(Millions of $US)	27	22	21	24	18	18	18
Other items (net)	-1,379	-1,193	-873	-700	-799	-715	-672
Broad money (M3)	**2,828**	**2,691**	**2,681**	**3,019**	**3,066**	**3,065**	**3,283**
Local currency liabilities included in broad money (M2)	1,894	1,898	1,966	2,213	2,325	2,325	2,490
Money (M1)	1,431	1,522	1,578	1,777	1,849	1,849	1,981
Currency outside depository corporations	247	259	295	323	314	296	317
Transferable deposits in dobra	1,184	1,264	1,283	1,454	1,535	1,553	1,664
Other deposits in dobra	463	375	388	436	476	476	509
Foreign currency deposits	934	794	716	806	741	740	793
Memorandum items:							
Velocity (ratio of GDP to M3; end of period)	2.5	2.9	3.0	3.1	3.0	3.0	3.0
Money multiplier (M3/M0)	1.8	1.6	1.8	1.9	2.0	2.1	2.2
Base money (12-month growth rate)	37.5	5.0	-9.6	9.3	0.8	-0.5	2.6
Claims on other resident sectors (12-month growth rate)	5.4	6.6	2.5	5.8	-1.6	-6.7	0.6
M3 (12-month growth rate)	13.1	-4.8	-0.4	12.6	14.3	0.0	7.1
Eurorization ratio	35.9	32.3	27.1	28.5	26.2	23.9	23.7

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

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

(Percent)

	2012 Dec.	2013 Dec.	2014 Dec.	2015 Dec.	2016 Dec.	2017 Dec.	2018 Mar.	2018 Jun.	2018 Sep.	2018 Dec.
Capital Adequacy										
Regulatory capital to risk-weighted assets	20.3	22.7	22.6	24.1	27.8	33.6	34.9	31.9	31.2	30.7
Percentage of banks (out of total number) with regulatory capital to risk-weighted assets										
... greater or equal to 10 percent	87.5	75.0	75.0	85.7	100.0	100.0	100.0	100.0	100.0	100.0
... between 6 and 10 percent	0.0	12.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
... below 6 percent minimum	12.5	12.5	25.0	14.3	0.0	0.0	0.0	0.0	0.0	0.0
Capital (net worth) to assets	22.7	18.4	20.3	15.5	22.5	24.0	23.8	22.3	21.4	20.8
Deposits with banks below 6 percent capital to assets										
... (in millions of dobras)	83.2	59.0	325.1	455.3	0.0	0.0	0.0	0.0	0.0	0.0
... (percent of deposits)	4.6	2.9	13.7	17.5	0.0	0.0	0.0	0.0	0.0	0.0
... (percent of GDP)	1.7	1.1	5.1	6.5	0.0	0.0	0.0	0.0	0.0	0.0
Asset quality										
Foreign exchange loans to total loans	57.9	53.9	46.5	42.1	27.5	17.2	16.5	14.3	9.9	9.7
Past-due loans to gross loans	66.7	30.4	36.2	35.0	30.7	27.6	28.3	26.6	23.4	26.9
Nonperforming loans/credit (IFRS definition)	15.4	16.9	19.1	29.8	27.0	24.9	25.4	22.0	17.9	24.6
Watch-listed loans	51.3	13.6	17.2	5.2	3.7	2.8	2.9	4.6	5.5	2.3
Provision as percent of past-due loans	15.4	56.3	45.1	68.7	71.2	80.0	80.8	80.8	73.9	79.7
Earnings and profitability										
Return on assets	-0.8	-2.1	-3.2	-5.2	0.0	-0.6	0.4	0.4	0.7	-0.1
Return on equity	-3.3	-9.3	-15.9	-27.1	0.2	-3.0	1.8	1.9	3.5	-0.8
Expense (w/ amortization & provisions)/income	117.8	471.1	164.5	215.9	108.6	112.8	92.0	96.6	92.0	106.7
Liquidity										
Liquid assets/total assets	37.8	40.8	45.8	52.0	54.0	49.7	50.8	47.2	50.0	50.1
Liquid assets/short term liabilities	61.5	39.6	72.7	72.5	84.6	69.1	68.2	62.4	66.4	66.3
Loan/total liabilities	64.7	56.3	47.3	47.1	47.0	53.1	50.2	55.6	50.9	51.6
Foreign exchange liabilities/total liabilities	30.8	27.0	28.1	30.0	26.6	28.6	27.8	26.6	25.1	25.8
Loan/deposits	101.7	85.8	69.6	63.5	63.5	59.7	57.3	63.8	58.2	59.1
Sensitivity to market risk										
Foreign exchange liabilities to shareholders funds	105.0	119.3	110.3	162.8	91.5	90.5	88.7	88.5	92.2	98.2

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

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

[1] Excluding Banco Equador (beginning December 2016) and BPSTP (beginning June 2018).

Table 6a. Democratic Republic of São Tomé and Príncipe: Balance of Payments, 2015–22

(Millions of U.S. dollars)

	2015	2016	2017	2018		2019	2020	2021	2022
	Actual	Actual	Actual	5th Rev	Est.	Proj.	Proj.	Proj.	Proj.
Trade balance	**-107.6**	**-105.5**	**-112.1**	**-141.3**	**-116.8**	**-119.0**	**-125.1**	**-132.8**	**-144.5**
Exports, f.o.b.	11.3	13.6	15.6	14.0	16.0	16.2	19.7	20.7	21.6
Cocoa	7.9	8.6	8.6	11.3	8.2	8.0	11.0	11.3	11.8
Re-export	2.2	3.2	4.7	5.1	6.8	5.5	5.3	5.5	5.5
Imports, f.o.b.	-118.9	-119.1	-127.7	-155.3	-132.9	-135.2	-144.7	-153.5	-166.1
Food	-34.3	-36.1	-31.6	-38.4	-31.1	-32.6	-34.3	-36.1	-38.8
Petroleum products	-31.3	-21.7	-27.6	-39.2	-33.6	-30.6	-29.1	-29.4	-30.6
Non-oil investment goods	-27.9	-31.2	-33.5	-42.4	-31.3	-33.5	-41.0	-45.5	-51.0
Oil sector related investment goods	-15.9	-12.7	-21.2	-25.9	-28.7	-36.6	-40.4	-45.9	-51.0
Other	-9.6	-17.4	-13.8	-9.4	-8.1	-1.9	-0.1	3.4	5.3
Services and income (net)	**10.6**	**18.2**	**3.9**	**29.1**	**18.6**	**25.0**	**26.2**	**35.4**	**42.9**
Exports of nonfactor services	78.7	82.9	70.5	97.4	82.2	92.4	100.9	117.8	131.3
Of which : travel and tourism	62.1	68.8	59.9	81.4	71.9	81.6	89.5	105.7	118.6
Imports of nonfactor services	-67.1	-65.7	-65.5	-63.1	-65.4	-66.1	-70.1	-74.2	-79.3
Factor services (net)	-1.0	1.0	-1.1	-5.2	1.8	-1.2	-4.6	-8.2	-9.1
Of which: oil related	0.0	0.0	-1.1	0.1	0.1	0.2	0.2	0.2	0.2
Private transfers (net)	**18.1**	**15.9**	**16.7**	**19.1**	**16.3**	**15.8**	**16.3**	**17.4**	**18.8**
Official transfers (net)	**40.0**	**48.5**	**41.7**	**61.3**	**36.0**	**28.6**	**41.2**	**40.3**	**39.6**
Of which : project grants (excluding HIPC grants)	27.6	40.2	27.4	45.9	26.9	16.8	29.4	28.6	27.9
HIPC Initiative-related grants	6.0	2.9	3.1	4.2	1.6	3.4	3.4	3.3	3.3
Current account balance									
Including official transfers	-38.9	-22.9	-49.8	-31.7	-46.0	-49.5	-41.5	-39.7	-43.2
Excluding official transfers	-78.9	-71.4	-91.5	-93.0	-82.0	-78.1	-82.6	-80.0	-82.9
Capital and financial account balance	**59.2**	**-9.5**	**74.8**	**36.9**	**26.0**	**47.0**	**40.9**	**39.9**	**44.4**
Capital transfer	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	60.2	-9.5	74.8	36.9	26.0	47.0	40.9	39.9	44.4
Foreign Direct Investment	25.3	22.3	33.9	50.0	28.8	39.2	43.2	49.1	54.7
Petroleum related investment	24.2	19.3	32.1	39.3	30.2	38.5	42.5	48.3	53.7
Portfolio Investment (net)	0.3	0.2	0.6	0.0	0.1	0.0	0.0	0.0	0.0
Oil signature bonuses	2.4	3.3	2.3	10.0	10.2	2.8	2.8	2.5	2.8
Other investment (net)	31.3	-35.4	37.9	-13.1	-13.1	5.1	-5.1	-11.8	-13.0
Assets	9.5	-19.5	2.2	-9.5	-9.5	-9.7	-9.9	-10.1	-10.3
Public sector (net)	26.1	2.7	3.1	3.5	2.5	0.4	-0.5	0.3	0.6
Project loans	33.6	6.4	7.4	10.1	5.6	6.6	6.6	7.5	8.2
Program loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-7.5	-3.7	-4.3	-6.0	-3.1	-6.2	-7.1	-7.2	-7.6
Of which : HIPC Initiative-related grants	-5.1	-2.5	-2.6	-3.3	-1.4	-2.9	-2.9	-2.9	-2.9
Private sector (net)	-4.3	-18.6	32.6	-7.1	-6.1	14.4	5.3	-2.0	-3.4
Commercial banks	9.7	13.8	8.8	-0.8	-5.0	2.5	-0.2	-0.2	-0.2
Short-term private capital	-14.0	-32.3	23.8	-6.3	-1.1	11.8	5.5	-1.8	-3.2
Errors and omissions	30.9	27.8	-35.6	0.0	11.8	0.0	0.0	0.0	0.0
Overall balance	**18.5**	**-4.6**	**-10.6**	**4.4**	**-8.2**	**-2.5**	**-0.5**	**0.2**	**1.2**
Financing	-18.5	4.6	10.6	-4.4	8.2	-0.2	-4.8	-5.6	-6.5
Change in official reserves, excl. NOA (increase= -)	-18.2	5.0	6.6	-5.7	15.9	-0.8	-5.3	-6.0	-6.3
Use of Fund resources (net)	0.0	0.9	2.8	1.4	0.5	-0.3	-0.3	-0.4	-0.6
Purchases	0.9	1.8	2.8	1.8	0.9	0.0	0.0	0.0	0.0
Repurchases (incl. MDRI repayment)	-0.9	-0.9	0.0	-0.4	-0.4	-0.3	-0.3	-0.4	-0.6
National Oil Account (increase = -)	-0.4	-1.3	0.2	-0.1	-8.2	0.9	0.7	0.9	0.4
Financing Gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**-2.7**	**-5.3**	**-5.3**	**-5.3**
Proposed IMF program	…	…	…	…	…	2.7	5.3	5.3	5.3
Memorandum items:									
Current account balance (percent of GDP)									
Including official transfers	-12.2	-6.6	-13.2	-20.0	-10.9	-11.5	-9.0	-7.9	-8.0
Excluding official transfers	-24.8	-20.5	-24.3	-6.8	-19.4	-18.2	-17.9	-16.0	-15.3
Debt service ratio (percent of exports) [1]	3.8	3.3	3.8	4.6	4.2	5.1	5.3	4.7	4.5
Gross international reserves [2]									
Millions of U.S. dollars	61.9	55.9	51.4	58.2	35.1	36.0	40.0	45.4	50.7
Months of imports of goods and nonfactor services [3]	5.4	4.9	4.6	4.4	3.3	3.3	3.6	3.9	4.2

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

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

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

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

Table 6b. Democratic Republic of São Tomé and Príncipe: Balance of Payments, 2015–22

(In percent of GDP)

	2015	2016	2017	2018		2019	2020	2021	2022
	Actual	Actual	Actual	5th Rev	Est.	Proj.	Proj.	Proj.	Proj.
Trade balance	**-33.8**	**-30.3**	**-29.8**	**-30.3**	**-27.6**	**-27.7**	**-27.0**	**-26.6**	**-26.7**
Exports, f.o.b.	3.6	3.9	4.1	3.0	3.8	3.8	4.3	4.1	4.0
Cocoa	2.5	2.5	2.3	2.4	1.9	1.9	2.4	2.3	2.2
Re-export	0.7	0.9	1.3	1.1	1.6	1.3	1.2	1.1	1.0
Imports, f.o.b.	-37.4	-34.3	-34.0	-33.3	-31.4	-31.4	-31.3	-30.7	-30.7
Food	-10.8	-10.4	-8.4	-8.2	-7.4	-7.6	-7.4	-7.2	-7.2
Petroleum products	-9.8	-6.2	-7.3	-8.4	-8.0	-7.1	-6.3	-5.9	-5.7
Non-oil investment goods	-8.8	-9.0	-8.9	-9.1	-7.4	-7.8	-8.9	-9.1	-9.4
Oil sector related investment goods	-5.0	-3.7	-5.6	-5.6	-6.8	-8.5	-8.7	-9.2	-9.4
Other	-3.0	-5.0	-3.7	-2.0	-1.9	-0.4	0.0	0.7	1.0
Services and income (net)	**3.3**	**5.2**	**1.0**	**6.2**	**4.4**	**5.8**	**5.7**	**7.1**	**7.9**
Exports of nonfactor services	24.7	23.9	18.8	20.9	19.5	21.5	21.8	23.6	24.3
Of which : travel and tourism	19.5	19.8	15.9	17.5	17.0	19.0	19.3	21.2	21.9
Imports of nonfactor services	-21.1	-18.9	-17.4	-13.5	-15.5	-15.4	-15.2	-14.9	-14.7
Factor services (net)	-0.3	0.3	-0.3	-1.1	0.4	-0.3	-1.0	-1.6	-1.7
Of which: oil related	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Private transfers (net)	**5.7**	**4.6**	**4.4**	**4.1**	**3.9**	**3.7**	**3.5**	**3.5**	**3.5**
Official transfers (net)	**12.6**	**14.0**	**11.1**	**13.2**	**8.5**	**6.7**	**8.9**	**8.1**	**7.3**
Of which : project grants (excluding HIPC grants)	8.7	11.6	7.3	9.9	6.4	3.9	6.4	5.7	5.1
HIPC Initiative-related grants	1.9	0.8	0.8	0.9	0.4	0.8	0.7	0.7	0.6
Current account balance									
Including official transfers	-12.2	-6.6	-13.2	-6.8	-10.9	-11.5	-9.0	-7.9	-8.0
Excluding official transfers	-24.8	-20.5	-24.3	-20.0	-19.4	-18.2	-17.9	-16.0	-15.3
Capital and financial account balance	**18.6**	**-2.7**	**19.9**	**7.9**	**6.1**	**10.9**	**8.9**	**8.0**	**8.2**
Capital transfer	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	18.9	-2.7	19.9	7.9	6.1	10.9	8.9	8.0	8.2
Foreign Direct Investment	7.9	6.4	9.0	10.7	6.8	9.1	9.3	9.8	10.1
Petroleum related investment	7.6	5.6	8.5	8.4	7.2	9.0	9.2	9.7	9.9
Portfolio Investment (net)	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Oil signature bonuses	0.8	1.0	0.6	2.1	2.4	0.6	0.6	0.5	0.5
Other investment (net)	9.8	-10.2	10.1	-2.8	-3.1	1.2	-1.1	-2.4	-2.4
Assets	3.0	-5.6	0.6	-2.0	-2.3	-2.3	-2.1	-2.0	-1.9
Public sector (net)	8.2	0.8	0.8	0.8	0.6	0.1	-0.1	0.1	0.1
Project loans	10.6	1.9	2.0	2.2	1.3	1.5	1.4	1.5	1.5
Program loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-2.4	-1.1	-1.1	-1.3	-0.7	-1.5	-1.5	-1.4	-1.4
Of which : HIPC Initiative-related grants	-1.6	-0.7	-0.7	-0.7	-0.3	-0.7	-0.6	-0.6	-0.5
Private sector (net)	-1.4	-5.3	8.7	-1.5	-1.4	3.3	1.1	-0.4	-0.6
Commercial banks	3.0	4.0	2.3	-0.2	-1.2	0.6	-0.1	0.0	0.0
Short-term private capital	-4.4	-9.3	6.3	-1.4	-0.3	2.8	1.2	-0.4	-0.6
Errors and omissions	**9.7**	**8.0**	**-9.5**	**0.0**	**2.8**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**5.8**	**-1.3**	**-2.8**	**0.9**	**-1.9**	**-0.6**	**-0.1**	**0.0**	**0.2**
Financing	-5.8	1.3	2.8	-0.9	1.9	0.0	-1.0	-1.1	-1.2
Change in official reserves, excl. NOA (increase= -)	-5.7	1.4	1.8	-1.2	3.8	-0.2	-1.1	-1.2	-1.2
Use of Fund resources (net)	0.0	0.3	0.7	0.3	0.1	-0.1	-0.1	-0.1	-0.1
Purchases	0.3	0.5	0.7	0.4	0.2	0.0	0.0	0.0	0.0
Repurchases (incl. MDRI repayment)	-0.3	-0.3	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
National Oil Account (increase = -)	-0.1	-0.4	0.1	0.0	-1.9	0.2	0.2	0.2	0.1
Financing Gap	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**-0.6**	**-1.1**	**-1.1**	**-1.0**
Proposed IMF program	…	…	…	…	…	0.6	1.1	1.1	1.0
Memorandum items:									
Debt service ratio (percent of exports) [1]	3.8	3.3	3.8	4.6	4.2	5.1	5.3	4.7	4.5
Gross international reserves [2]									
Millions of U.S. dollars	61.9	55.9	51.4	58.2	35.1	36.0	40.0	45.4	50.7
Months of imports of goods and nonfactor services [3]	5.4	4.9	4.6	4.4	3.3	3.3	3.6	3.9	4.2

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

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

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

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

Table 7. Democratic Republic of São Tomé and Príncipe: External Financing Requirements and Sources, 2015–22

(Millions of U.S. dollars)

	2015	2016	2017	2018		2019	2020	2021	2022
	Actual	Actual	Prel.	5th Rev	Proj.	Proj.	Proj.	Proj.	Proj.
Gross financing requirements	**-105.6**	**-70.1**	**-92.0**	**-105.7**	**-69.6**	**-86.0**	**-95.4**	**-93.8**	**-97.2**
Current account, excluding official transfers	-78.9	-71.4	-91.5	-93.0	-82.0	-78.6	-82.7	-80.2	-82.8
Exports, f.o.b.	11.3	13.6	15.6	14.0	16.0	16.2	21.0	21.7	22.6
Imports, f.o.b.	-118.9	-119.1	-127.7	-155.3	-132.9	-135.7	-146.0	-154.5	-167.0
Services and income (net)	10.6	18.2	3.9	29.1	18.6	25.0	26.0	35.2	42.8
Private transfers	18.1	15.9	16.7	19.1	16.3	15.8	16.3	17.4	18.8
Financial account	-8.5	-3.6	-7.1	-7.0	-3.5	-6.6	-7.4	-7.6	-8.2
Scheduled amortization	-7.5	-3.7	-4.3	-6.0	-3.1	-6.2	-7.1	-7.2	-7.6
IMF repayments	-0.9	-0.9	0.0	-0.4	-0.4	-0.3	-0.3	-0.4	-0.6
Change in external reserves (-ve = increase)	-18.2	5.0	6.6	-5.7	15.9	-0.8	-5.3	-6.0	-6.3
Available funding	**138.1**	**71.0**	**88.2**	**106.5**	**69.6**	**83.3**	**90.1**	**88.5**	**91.9**
National Oil Fund (net)	2.0	2.1	2.6	9.9	2.1	3.7	3.5	3.4	3.2
Oil signature bonuses	2.4	3.3	2.3	10.0	10.2	2.8	2.8	2.5	2.8
Saving (-ve = accumulation of oil reserve fund)	-0.4	-1.3	0.2	-0.1	-8.2	0.9	0.7	0.9	0.4
Expected disbursements	73.6	54.9	49.1	71.4	41.6	35.2	47.8	47.8	47.8
Multilateral HIPC interim assistance	6.0	2.9	3.1	4.2	1.6	3.4	3.4	3.3	3.3
Grants	34.0	45.6	38.6	57.1	34.4	25.2	37.8	37.0	36.3
Concessional loans	33.6	6.4	7.4	10.1	5.6	6.6	6.6	7.5	8.2
Project loans	33.6	6.4	7.4	10.1	5.6	6.6	6.6	7.5	8.2
Program loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector (net)	61.6	12.2	33.7	23.3	25.0	44.4	38.8	37.3	40.9
IMF	0.9	1.8	2.8	1.8	0.9	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	-2.7	-5.3	-5.3	-5.3
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	0.0	0.0	0.0	-2.7	-5.3	-5.3	-5.3
Proposed IMF program	...	...	...	...	...	2.7	5.3	5.3	5.3

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

Table 8. Democratic Republic of São Tomé and Príncipe: Indicators of Capacity to Repay the Fund, 2019–33
(as of July 31, 2019)

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Fund obligations based on existing credit (millions of SDRs)															
Principal	0.11	0.26	0.41	0.60	0.75	0.76	0.76	0.57	0.38	0.13	0.00	0.00	0.00	0.00	0.00
Charges and interest	0.04	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
Fund obligations based on existing and prospective credit (millions of SDRs)															
Principal	0.11	0.26	0.41	0.60	0.75	0.76	1.33	1.90	2.47	2.79	2.66	2.09	1.33	0.57	0.00
Charges and interest	0.04	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
Total obligations based on existing and prospective credit															
Millions of SDRs	0.15	0.33	0.48	0.67	0.82	0.83	1.40	1.97	2.54	2.86	2.73	2.16	1.40	0.64	0.07
Millions of U.S. dollars	0.21	0.46	0.68	0.95	1.18	1.19	2.01	2.82	3.64	4.10	3.91	3.10	2.01	0.92	0.10
Percent of exports of goods and services	0.20	0.40	0.51	0.66	0.75	0.71	1.13	1.48	1.79	1.88	1.68	1.24	0.75	0.32	0.03
Percent of debt service [1]	3.77	7.28	10.50	13.84	15.42	10.63	18.64	27.02	35.56	41.08	39.62	30.06	19.68	9.12	1.00
Percent of quota	1.01	2.23	3.24	4.53	5.54	5.61	9.46	13.31	17.16	19.32	18.45	14.59	9.46	4.32	0.47
Percent of gross international reserves [2]	0.60	1.20	1.54	1.92	2.27	2.15	3.41	4.83	6.30	7.19	6.95	5.59	3.69	1.72	0.19
Outstanding Fund credit															
Millions of SDRs	6.5	10.1	13.5	16.7	15.9	15.2	13.8	11.9	9.5	6.7	4.0	1.9	0.6	0.0	0.0
Millions of U.S. dollars	9.1	14.2	19.1	23.7	22.8	21.7	19.8	17.1	13.5	9.5	5.7	2.7	0.8	0.0	0.0
Percent of exports of goods and services	8.6	12.3	14.4	16.3	14.6	13.1	11.1	9.0	6.7	4.4	2.5	1.1	0.3	0.0	0.0
Percent of debt service [1]	163.9	222.1	294.3	344.4	299.4	194.2	184.1	163.5	132.3	95.7	58.0	26.4	8.0	0.0	0.0
Percent of quota	44.1	68.0	90.9	112.6	107.6	102.4	93.4	80.5	63.9	45.0	27.0	12.8	3.9	0.0	0.0
Percent of gross international reserves [2]	26.1	36.5	43.1	47.9	44.0	39.4	33.7	29.2	23.4	16.7	10.2	4.9	1.5	0.0	0.0
Memorandum items:															
Exports of goods and services (millions of U.S. dollars)	106.0	115.3	132.1	145.5	156.4	166.5	178.0	190.4	203.6	217.8	233.0	249.2	266.6	285.2	305.2
Debt service (millions of U.S. dollars)	5.6	6.4	6.5	6.9	7.6	11.2	10.8	10.5	10.2	10.0	9.9	10.3	10.2	10.1	10.0
Quota (millions of SDRs)	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8	14.8
Gross international reserves [2]	34.9	38.8	44.2	49.6	51.9	55.2	58.8	58.4	57.8	57.0	56.3	55.4	54.4	53.3	52.1
GDP (millions of U.S. dollars)	437	472	510	552	594	641	689	739	792	849	910	976	1046	1122	1203

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

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

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

Table 9. Democratic Republic of São Tomé and Príncipe: Schedule of Disbursements Under an ECF Arrangement, 2019–22

Availability Date[1]	Disbursement conditions	SDR Amount	Percent of Quota
10/02/19	Board approval of arrangement.	1,902,857	12.86
03/15/20	Observance of continuous and end-December 2019 PCs and completion of the first review.	1,902,857	12.86
09/15/20	Observance of continuous and end-June 2020 PCs and completion of the second review.	1,902,857	12.86
03/15/21	Observance of continuous and end-December 2020 PCs and completion of the third review.	1,902,857	12.86
09/15/21	Observance of continuous and end-June 2021 PCs and completion of the fourth review.	1,902,857	12.86
03/15/22	Observance of continuous and end-December 2021 PCs and completion of the fifth review.	1,902,858	12.86
09/15/22	Observance of continuous and end-June 2022 PCs and completion of the sixth review.	1,902,857	12.86
	Total	13,320,000	90.0

Source: International Monetary Fund.

[1] Based on Board approval upon completion of each review.

Annex I. Ex-Post Peer Reviewed Assessment (EPA)

A. Overview

1. **São Tomé and Príncipe became an IMF member in 1977, two years after it gained independence from Portugal**. The country has had a series of Fund-supported programs. The most recent Ex-Post Assessment (EPA) of Longer-Term Program Engagement (SM/12/129) was completed in June 2012, covering three lending arrangements and one staff-monitored program during 2000-2011.

2. **The country is fragile in several aspects. Low capacity and political instability have impeded reform implementation; smallness, insularity, a lack of natural resources, and high vulnerability to external shocks constrained economic development**. Between 2001-2014, there were ten different coalition governments. For the first time during 2014-2018, a majority government completed one full term. A new coalition government took office in December 2018 following the election in October 2018 and might face challenges similar to those faced by previous coalition governments.

3. **This report reviews two arrangements with São Tomé and Príncipe since 2012**.

- An Extended Credit Facility (ECF) arrangement (2012-15) was approved in July 2012 (SDR 2.6 million, 35 percent of quota) with two reviews completed.
- An ECF arrangement (2015-18) was approved in July 2015 (SDR 4.4 million, 60 percent of quota). The program completed five out of six reviews and expired at end-2018, shortly after a new coalition government took office.

B. Program Objectives

4. **The 2012-15 ECF arrangement focused on maintaining macroeconomic stability and accelerating structural reforms**. The program aimed to strengthen public finances, monetary policy, banking supervision, and anti-money laundering. Oil production was expected to begin in 2015 but did not materialize due to high extraction costs.

5. **The 2015–18 ECF arrangement's overall objective was to address high debt vulnerability while also creating conditions for sustained growth**. It sought to strengthen domestic revenue mobilization; improve public debt and public financial management, including addressing government arrears issues; enhance financial stability; and improve the business environment.

C. Program Performance

6. **The 2012-15 ECF arrangement achieved limited progress**. It went off track when a loan contracted in March 2014 failed to meet the required concessionality; subsequently, fiscal policy slipped in the run-up to the 2014 election. The quantitative performance criteria (QPC) on domestic primary balance (DPD)[1] was missed at both reviews, reflecting poor revenue performance (Table 1, Figure 1) from a lack of progress in tax administration, including expanding the number of tax-payers. While some progress was observed in public financial management and a domestic treasury bills market was introduced (Table 3), other structural reforms were delayed, including arrears regularization among the Treasury, the oil supplier ENCO, and the state-owned utility company EMAE, and the implementation of a new Consumer Price Index (CPI) and the public information management system.

7. **Progress under the 2015-18 ECF arrangement was also limited**. During 2015-18, central government debt (the focus of the ECF) declined by 2 percentage points of GDP; however, total public debt (including EMAE's arrears to its oil supplier and government's arrears to private suppliers) increased by 6 percentage points of GDP due to the large arrears accumulated by EMAE and the government. The economic base remained narrow, inflation increased, and international reserves declined, with the loss accelerating to 1.5 months of imports in 2018.

8. **Failure to implement fiscal consolidation and declining external inflows contributed to the reserve loss**. Particularly during the election years of 2016 and 2018, fiscal targets were exceeded by over two percent of GDP. The QPC on DPD was missed in four out of five reviews, reflecting poor revenue collection, which declined from 14.1 to 11.8 percent of GDP during 2014- 2018. Key contributing factors included a narrow tax base that relied heavily on import taxes, little progress on tax administration, and poor collection of income taxes during elections. During this period, a decline in world oil prices significantly reduced tax revenue from imports. Though fiscal policies served as the primary tool given the fixed exchange rate regime, implementation of effective instruments for monetary policy could have incentivized the holding of domestic currency deposits and alleviated pressure on foreign exchange reserves.

9. **Some progress was made on the structural front, albeit with delays (Table 4)**. In particular, the government's arrears to ENCO on oil price subsides were regularized; an automatic price mechanism, a plan to reform EMAE, a comprehensive NPL strategy, and a new CPI were adopted; and a new Bank Resolution Law was submitted to the National Assembly. However, some key reforms including the adoption of a VAT and tax administration reforms are pending.[2] Though the management improvement plan and least cost electricity production plan for EMAE were prepared, their adoption was delayed by the election. In addition, an Asset Quality Review (AQR) of

[1] It excludes grants from revenue and, hence, focuses on domestic revenue mobilization. Investment financed by external project loans and grants was also excluded to reduce the potential for mis-reporting caused by weak capacity to monitor these highly volatile activities. Debt limits were used to manage debt vulnerability.

[2] A VAT law was submitted to the parliament in July 2018 and was resubmitted by the new government. Parliament passed a general reading of the law in August 2019.

the banking system was completed in April 2019, a substantial delay from the initial expected completion date of December 2017. Even though the economy grew steadily at three to four percent annually, it was insufficient to generate enough employment for the rapidly growing young population.

10. Low capacity, the small size, and dependence on external financing also contributed to delays in reform implementation. For example, it took the authorities some time to obtain funding to conduct the AQR. Subsequently, the authorities also faced challenges in procuring consultants because of the project's small size.

D. Program Design

11. Because the country is a low-income, fragile state, a 40-month ECF arrangement was the most appropriate instrument. While the access levels under the arrangement of the 2012-15 appeared to be adequate, a bigger 2015-18 program could have been beneficial in light of significantly lower external inflows than initially expected. Some key assumptions, such as on growth, impacts of tax administrative measures, and external inflows, could have been more conservative.

12. Several features of the program design contributed to more expansive underlying fiscal policy. Specifically, the program allowed for a carve-out from the DPD target of investments linked to EU budget grant conditionality and additional equivalent amount of domestic borrowing to finance the DPD. In 2017 such carve-outs accounted for about 1.2 percent of GDP. In addition, the program allowed for domestic borrowing when external inflows fell short for up to $3 million (close to one percent of GDP). In 2017, this adjustor was fully utilized.

E. Lessons Learned

13. Program targets should be ambitious but realistic, while recognizing structural reforms require time and persistence in a fragile environment. For instance, the projections of revenue impacts from tax measures could have been more conservative in retrospect. This is because major reforms require change management and take time to generate results. Some may require more than one program cycle to complete, particularly in an environment of low capacity, fragility, and susceptibility to external shocks. The eventual implementation of some benchmarks of the 2012-15 ECF arrangement during 2015-18, such as a new Consumer Price Index and the public information management system (SAFEe), are cases in point.

14. Fiscal targets should be designed to mitigate the impact of large fluctuations in external inflows on foreign reserves under a pegged exchange rate. Mobilizing revenue, including by broadening the tax based through a VAT and strengthening revenue administration, will be vital to meeting the fiscal target and buttressing the peg. In addition, external inflow projections should be conservative; when considering carve-outs from budget support, the potential impact from the attendant domestic borrowing should be fully taken into account, and domestic borrowing must be limited in the face of persistent shortfalls in external inflows.

15. Program design should account for political fragility candidly and explicitly. Both programs showed that the government tended to overspend and under-collect taxes in election years. Timing of the review, prior actions, performance criteria, and benchmarks should be set to mitigate the risk of slippages. In addition, reforms should be prioritized, and the program needs to be adjusted to account for changing conditions.

16. Development and use of monetary policy tools are important for supporting the peg. As illustrated by the large reserve loss in 2018, tightening monetary policy could help stem and reverse reserve losses through stimulating savings and demand for domestic currency.

17. Future programs should further emphasize promoting sustainable, inclusive growth in coordination with other partners. In a country with a young and rapidly growing population, accelerated growth is needed to make a dent on poverty. Given large gender gaps in labor force participation, promoting female entrepreneurship and economic opportunities could be low-hanging fruit in this regard; furthermore, this could help build support for the overall program by supporting inclusive growth in a fragile environment. Because gender equality, as well as other key structural reforms, such as promoting tourism and addressing energy sector issues, fall outside the IMF's core areas of expertise, closer collaboration with development partners is essential.

18. Sustained engagement and hands-on technical assistance (TA) are critical for structural reforms. As noted in the EPA of 2012, the successful 2005-08 program coincided with the presence of a resident representative and other long-term advisors, indicating that close policy dialogue, particularly through a resident representative or long-term advisors, is critical to responding promptly to evolving needs. Most TA missions, which provided valuable diagnostics and recommendations, are short. Thus, they need to be complemented with sustained follow-up and hands-on support, particularly by longer-term advisors, in a country with very low capacity to ensure implementation. For example, a peripatetic expert who visited the country for up to a few months each time was crucial in helping the authorities prepare a draft VAT law and start the preparation for its eventual implementation.

19. Authorities' views: In a fixed exchange rate regime, the effectiveness of monetary policy is limited, which requires the authorities to have a conservative and coordinated fiscal policy to ensure the sustainability of the exchange rate regime as a nominal anchor of monetary policy. Notwithstanding the value of short-term TA missions as a source of diagnosis and recommendations, practical and extended hands-on support by advisors with relevant expertise is essential. In particular, TA by experts with experience of monetary policy under a fixed exchange rate is critical to program implementation.

Annex I. Table 1. Quantitative Performance Criteria for the Three-Year ECF Arrangement, 2012–15

Description	Status of Conditionality			
		R1	R2	Next Prog. Request
	Board Date	Jun-13	Dec-13	Jul-15
	Test Date	Dec-12	Jun-13	Dec-14
Floor on domestic primary balance				
Ceiling on changes in net bank financing of the central government (at program exchange rate)				
Floor on net international reserves of the central bank				
Ceiling on central government's outstanding external payment arrears (stock)				
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				
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				

Met
Not met

Annex I. Table 2. Quantitative Performance Criteria for the Three-Year ECF Arrangement, 2015–18

Description	Status of Conditionality						
		R1	R2	R3	R4	R5	
	Board/obs. Date	Jun-16	Dec-16	Dec-17 (Combined)	Dec-17 (Combined)	Jul-18	Jun-19
	Test Date	Dec-15	Jun-16	Dec-16	Jun-17	Dec-17	Jun-18
Floor on domestic primary balance							
Ceiling on changes in net bank financing of the central government (at program exchange rate)							
Floor on net international reserves of the central bank							
Ceiling on central government's outstanding external payment arrears (stock)							
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							
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							

Met
Not met

Annex I. Table 3. Structural Benchmarks Under the Three-Year ECF Arrangement, 2012–15

Category	Description	Status of Conditionality			
			R1	R2	Next Prog. Request
		Test Date	Dec-12	Jun-13	Dec-14
		Board/obs. Date	Jun-13	Dec-13	Jul-15
Program Request	Develop a reform strategy plan to modernize tax administration in line with FAD recommendations.				
	Strengthen external control, by preparing the general government accounts for 2012 and sending them to the Court of Audit.				
	Strengthen internal control, by reconciling and certifying the cross-arrears between ENCO, EMAE, and the Treasury, and agreeing on a strategy to address these and to prevent future accumulation of arrears between these entities.				
	Improve liquidity management, by setting up a framework for forecasting liquidity, international reserves, and government accounts to identify the level of excess or deficit in liquidity.				
	Strengthen banking supervision and regulation, by – Completing the on-site supervision process for remaining two commercial banks.				
	Strengthen banking supervision and regulation, by – Completing the on-site supervision process for the largest commercial bank.				
	Strengthen banking supervision and regulation, by – Completing the on-site supervision process for two commercial banks.				
	Strengthening AML/CFT, by submitting to parliament appropriate draft amendments to the AML/CFT law.				
R1	Customs administration: Complete the second phase of ASYCUDA WORLD implementation, by Activating all the functionalities and the establishing a fully computerized procedure.				
	Tax administration: Improve taxpayer management and compliance with tax obligations, by Enhancing the security of the Taxpayer Registry, creating a dedicated large taxpayer unit, and creating a single taxpayer computerized file system.				
	Strengthen internal control, by finalizing a plan to clear over time EMAE's arrears to ENCO and to avoid a recurrence in the future of the problem of cross-arrears.				
	CPI statistics: Improve consumer price index statistics, by Reweighting the CPI components and introducing new goods and services to the CPI basket.				
	Expand the tax base by launching the "Operation Taxpayer Inclusion" project and: Registering 500 new tax payers from the date of the program's launch.				
	Expand the tax base by launching the "Operation Taxpayer Inclusion" project and: Registering 800 new tax payers from the date of the program's launch.				
	Undertake preparatory arrangements for the installation of a One-Stop-Shop for foreign trade by: Eliminating hardcopy documents and introducing electronic signing and approval				
	Undertake preparatory arrangements for the installation of a One-Stop-Shop for foreign trade by: Establishing the connectivity and management of customs/Tax NIF.				
	Strengthen internal control by Eliminating all arrears between the Treasury and EMAE.				
	Strengthen banking supervision and regulation by: Preparing a revised draft Central Banking Law that strengthens autonomy of the central bank in line with international standards, including in the resolution of problem banks.				
	Strengthen banking supervision and regulation by: Ensuring that all commercial banks publish audited financial accounts for 2013, or applying penalties for non-compliance.				
	Strengthen banking supervision and regulation by: Ensuring that all commercial banks that are open to the public have a capital-to-risk-weighted-asset ratio of at least 12 percent.				

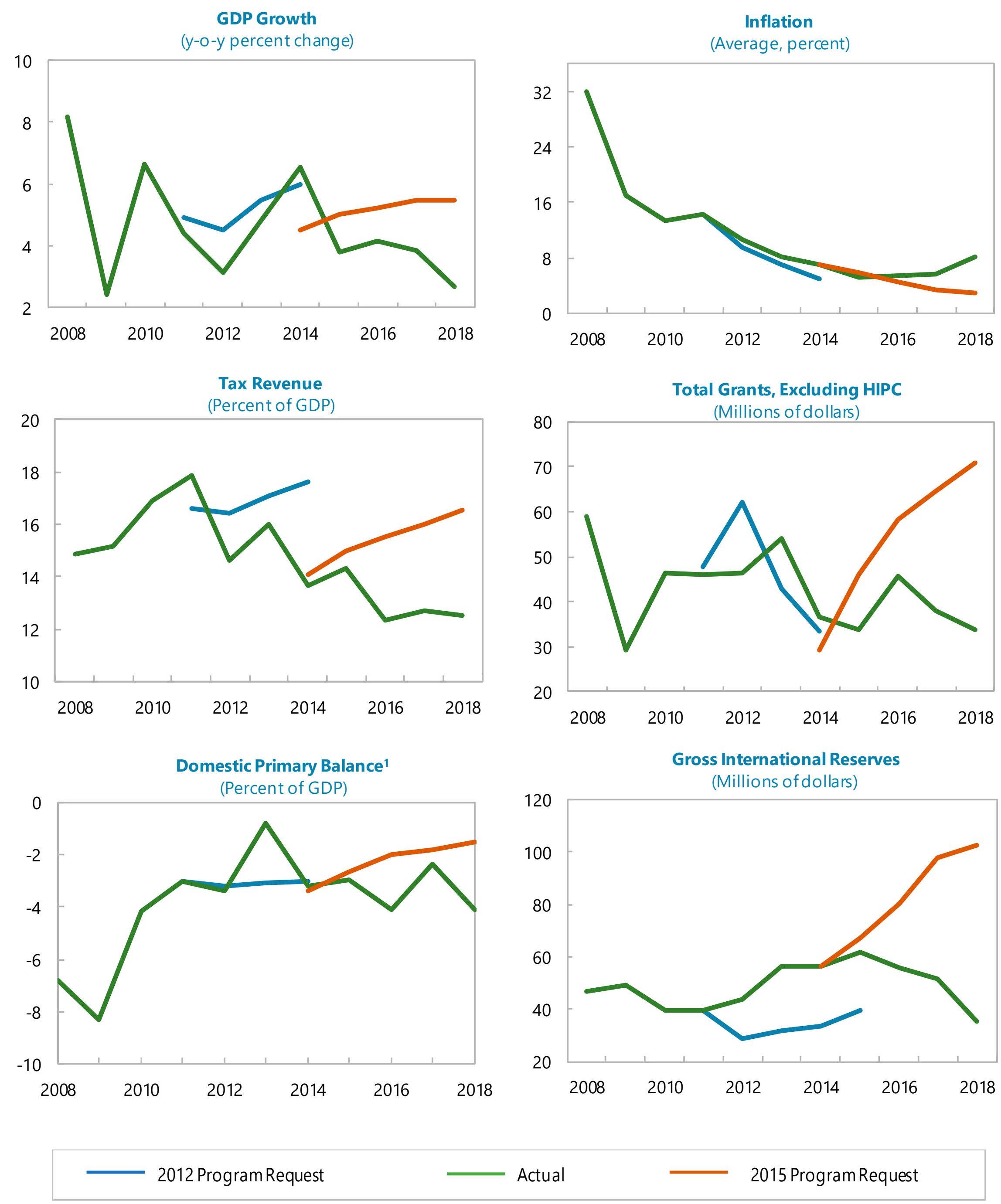
Met
Not met
Partially met
Implement with delay
To be confirmed
Prior Actions

Annex I. Table 4. Structural Benchmarks Under the Three-Year ECF Arrangement, 2015–18

Category	Description		Status of Conditionality				
			R1	R2	R3 & R4 Combined	R5	
		Test Date	Dec-15	Jun-16	Dec-16 & Jun-17	Dec-17	Jun-18
		Board/Obs. Date	Jun-16	Dec-16	Dec-17	Jul-18	Mar-19
Program Request	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 accumulations of new ones.						
	Adopt a plan to reform EMAE (state-owned electricity and water utilities company) to ensure full cost-recovery.						
	Adopt an automatic fuel price adjustment mechanism that allows timely pass-through of import costs with a view to its gradual introduction in 2016. (Prior action at 2nd review)						
	Complete detailed assessment of compliance with Basel Core Principles.						
	Prepare and submit to staff a comprehensive strategy to help banks deal with high NPLs on their balance sheets.						
	Submit to the National Assembly a new Bank Resolution Law.						
	Publish revised national accounts series through 2013.						
	Start monthly compilation of the new re-weighted and expanded CPI series.						
	Develop and submit to the National Assembly a National Export Diversification Strategy document.						
R1	Submit to the National Assembly a new VAT law.						
	Introduce legislation to transfer the execution for collection of tax arrears from fiscal court judge to the tax administration.						
	Complete a public investment management assessment (PIMA) and submit to staff a reform plan to strengthen public investment management practices.						
	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.						
R2	Submit the draft public private partnership (PPP) law to the National Assembly.						
	Complete an independent detailed asset quality review (AQR) of banks.						
	Complete assessment of regulation and supervision in lieu of a full assessment of compliance with Basel Core Principles.						
R3 & R4	Adopt a 2018 budget that is consistent with the program parameters.						
	Adopt financial management plan and least cost enegery-production plan for EMAE.						
	Adopt measures to contain EMAE's loss in the near term.						
R5	Submit monthly monitoring table of tax payments by top 10 taxpayers during June-October 2018.						
	Require the external consultant to complete an inception report for asset quality review of banks.						
	Issue a resolution to incorporate expenditure measures in the 2018 budget in line with the program.						
	Collect tax arrears owed by Rosema and other large taxpayers (Dobras 38 million).						
	Collect tax liabilities accumulated in 2018 from large taxpayers (Dobra 60 million)						

Met
Not met
Implement with delay
To be confirmed
Prior Actions

Annex I. Figure 1. Program Indicators, 2008–18



Sources: STP authorities and IMF staff calculations.

[1] 2018 includes financing unaccounted for.

Annex II. Risk Assessment Matrix 2019[1]

Source of Risks	Relative Likelihood	Time Horizon	Potential Impact	Policy Response
Domestic risks				
Fiscal policy slippages	Medium	**ST**	High. Additional public spending and poor revenue collection could put further pressures on international reserves and inflation.	Concrete measures are identified for meeting 2019 fiscal targets including prior actions to safeguard consolidation and reform.
Political risk	Medium	**ST, MT**	High. Political fragility and could disrupt policy continuity, deter private investments, as well as delay reforms and project implementation.	Improve governance, codify procedure for the approval of private investments, and institutionalize key reform agenda.
Limited implementation capacity	High	**ST, MT**	Medium. It could affect tax collection and spending controls, as well as slow down structural reforms (e.g., EMAE reform) and project implementation.	Continued hands-on technical assistance.
Continued weakness in banking sector	Medium	**ST, MT**	Low. Continued high NPLs could further stall already anemic credit growth, and insufficient banking regulation could overlook financial stability risks.	Structural benchmarks for implementing measures to reduce vulnerabilities and upgrading banking regulation.
External risks				
Delays in donor disbursements	Medium	**ST, MT**	High. The country heavily depends on external support, and delayed disbursements would undermine growth and exacerbate loss of international reserves.	Appointment of the Treasury to coordinate externally financed projects to avoid delay.
Sharp tightening of global financial conditions. This causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn. The tightening could be a result of:			Low. It could lead to lower availability of concessional lending and higher interest payments for new loans.	Mobilize fiscal revenues and continue fiscal consolidation to reduce the external financing needs. Diversify the financing sources.
• **Market expectation of tighter U.S. monetary policy** triggered by strong wage growth and higher-than-expected inflation.	Low	**ST**		
• **Sustained rise in risk premium** in reaction to concerns about debt levels in some euro area countries; a disorderly Brexit; or idiosyncratic policy missteps in large emerging markets.	Low	**ST**		

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

Source of Risks	Relative Likelihood	Time Horizon	Potential Impact	Policy Response
Weaker-than-expected global growth. The global growth slowdown could be synchronized as weakening outlooks in the U.S., Europe and China feed off each other and impact on earnings, asset prices and credit performance.				Implement the tourism development strategy, improve agricultural productivity, and gradually reduce the reliance on external grants.
• **U.S.:** Confidence wanes against a backdrop of a long expansion with stretched asset valuations, rising leverage, and unwinding of the fiscal stimulus, leading to abrupt closure of the output gap rather than a smooth landing.	Medium	ST, MT	Low. The economic linkages between São Tomé and Príncipe and the U.S. are weak, hence the potential impact would be low.	
• **Europe:** In the near term, weak foreign demand makes euro area businesses delay investment, while faltering confidence reduces private consumption. Adverse financial market reaction to debt sustainability concerns further dampens growth. A disorderly Brexit could cause market disruption with negative spillovers. In the medium term, disregard for the common fiscal rules and rising sovereign yields for high-debt countries test the euro area policy framework, with adverse impact on confidence and growth.	High	ST, MT	Low. Weakness in external demand could dampen the country's exports, especially its tourism industry, leading to lower real GDP growth and slower reserves accumulation.	
• **China:** In the short term, intensification of trade tensions and/or a housing market downturn prompt a slowdown, which is not fully offset by policy easing. Deleveraging is delayed and financial stresses, including capital outflow and exchange rate pressures, emerge. In the medium term, insufficient progress in deleveraging and rebalancing reduces growth and raises the probability of a larger disruptive adjustment. There would be negative spillovers on the global economy through trade volumes, commodity prices, and financial markets.	Medium	ST, MT	Low. China's support, all in grants so far, is unlikely to be affected given that the amount involved is very low and the diplomatic relationship between China and São Tomé and Príncipe was recently renewed.	
Intensification of security risks in parts of Africa, Asia, Europe, Latin America, and/or the Middle East cause regional socio-economic and political disruptions, with potential global spillovers.	High	ST, MT	Low. This risk could negatively affect the overall growth of the African continent, potentially reducing the demand for Sao Tomean exports and the tourist arrivals to this country. However, the security situation of this country and neighboring countries has been quite stable, and African tourists constitute a relatively small portion of its total exports, so the impact is likely to be low.	Continue to maintain a stable and secure environment, and to diversify the tourist base.
Large swings in energy prices. Risks to prices are broadly balanced, reflecting offsetting—but large and uncertain—supply and demand shocks. In the near term, uncertainty surrounding the shocks translates to elevated price volatility, complicating economic management and adversely affecting investment in the energy sector. As shocks materialize, they may cause large and persistent price swings. While, on aggregate, higher oil prices would harm global growth, they would benefit oil exporters.	Medium	ST, MT	Medium. The impact of *lower* energy prices is mixed: On the one hand, the country is an oil importer, so lower oil prices tends to improve its current account; On the other hand, oil import tax is an important source for the country's fiscal revenue, so lower oil prices would dampen its customs revenue and impose further fiscal pressure. Accordingly, the higher *volatility* in energy prices would have a medium impact on managing the customs revenue as well as implementing the fiscal budget.	Improve the efficiency of electricity generation to reduce oil imports. Mobilize fiscal revenues and diversify its revenue sources.

Annex III. Safeguarding Social Spending and Analyzing Policy Impacts on Inclusive Growth

1. **IMF staff will coordinate with development partners and other international organizations that focus on inclusive growth**. For example, staff, together with the UN and the authorities, held a two-day workshop in June to begin outlining the key components for a national action plan on boosting female economic empowerment and participation and financial inclusion. In July, a one-day high-level event featured panel discussions with experts on gender equality to further refine and inform the national action plan.

2. **Several planned development projects are set to begin in 2019 with the aim of protecting the country's most vulnerable and promoting economic development**. The World Bank approved a five-year in early 2019, $10 million poverty reduction project with two key components: a cash transfer program and skills development initiatives. The emphasis of the first year will be on enhancing government capacity and institutions for the social safety net system and skills development sectors. The project will also develop a targeting system to properly identify the poorest households in the selected municipalities and a proper payment mechanism for delivery of cash transfers. Both are expected to enhance efficiency and transparency. Cash transfers will be complemented by skills development initiatives to promote a sustainable graduation out of poverty.

3. **The project will help scale up conditional cash transfers, behavioral change activities, and training in entrepreneurial skills and tourism in the country**. It is expected that 2570 households will be provided with cash transfers (equivalent to 91 percent of all households in extreme poverty) at a cost of approximately $1 million annually (representing 0.28 percent of the country's GDP in 2016), which the government would likely be able to maintain moving forward. Reaching all poor households in São Tomé and Príncipe would require an investment of $7.2 million per year (2.0 percent of the country's GDP), which is within international standards for expenditures on social assistance. The conditional transfer mechanism is expected to be operational by end-2019.

4. **In addition, the project will support the establishment of a hospitality and tourism school to support labor skills development and entrepreneurship training in secondary education**. The proposed project is expected to increase employability of beneficiaries, provide sustainable opportunities for economic gain, and reduce poverty in the short and longer term particularly among the extreme poor.

5. **The International Labour Organization announced plans to spend $1 million for youth employment projects in São Tomé and Príncipe**. One focus of the project is on self-employment. Female youth unemployment stood at 33 percent in 2017, more than double the male rate.

Annex IV. Findings and Implications of the Asset Quality Review

1. A comprehensive Asset Quality Review (AQR) of banks' exposures was concluded in March 2019. Supported by the World Bank, the AQR by Deloitte assessed the classification and valuation of a sample of loan exposures as of end-June 2018. More specifically, the AQR analyzed whether exposures were misclassified as performing when there was evidence of impairment in line with specific criteria and how much additional provisioning was required in such cases. The number of sampled loans ranged from 21 to 57 clients per bank, covering between 55 and 88 percent of total loans. The review also assessed the value of samples of collateral (mostly real estate) obtained by the banks in lieu of loan repayment, and it applied default probabilities to banks' exposure to central government and public sector entities (both securities and direct loans) to calculate expected losses deemed to require additional provisioning (although by regulation no such provision is necessary).

2. The results of the AQR point to widespread loan misclassification and overvalued collateral. The AQR found that close to 30 percent of performing loans (35 percent of loan amounts) were misclassified, with the highest share of any one bank at 90 percent (existing NPLs, however, were adequately provisioned overall). Banks' clients were assessed against their capacity to service the loans from operations and, where deemed not possible, the value of the underlying collateral. In cases of attested non-viability, specific provisioning rates were then applied for different cases of operational difficulties, in many cases leading to sizable provisioning gaps to be closed with additional provisions (overall about two-thirds of net loan amounts plus provisions on accrued interest). Similarly, the properties ceded to banks were assessed by directly applying different discount factors and, alternatively, by way of local expert judgment. The two methods led to broadly similar valuations requiring large haircuts and thus provisions of about half of book value. Moreover, in the case of one bank, a questionable large exposure to a related party was flagged as requiring a full provision.

3. As a result of the additional provisions that reduce the net asset value, banks' regulatory capital is set to drop considerably, likely requiring replenishment in some cases. Using data from June 2018, the AQR calculated that if all the recommended provisions were recognized, the system-wide capital adequacy ratio for non-risk-weighted assets would fall by almost eight percentage points, from 21.2 percent to 13.5 percent, and some banks would likely require recapitalization.

4. The AQR findings also point to the need for strengthening BCSTP's supervisory process and banks' control mechanisms. As a consequence of the deficiencies encountered, the AQR recommends an increase in staffing at BCSTP's supervision department. Evident understaffing may have contributed to the widespread infractions of prudential regulation, with on-site inspections occurring rather infrequently (prior to the AQR two banks had not had an inspection for four years). In addition to hiring more supervisors, the AQR calls for capacity building, notably towards better planning of supervisory action. Furthermore, the AQR recommends improving the enforcement of current regulation by way of better monitoring of banks' credit operations, which will require additional resources, as well as imposing additional requirements for banks' internal control systems and governance.

5. **Ongoing reform efforts, supported by IMF technical assistance, aim at remedying the shortcomings found by the AQR.** A multi-year TA project on implementing risk-based supervision at the BCSTP includes (i) developing a bank rating system to improve off-site monitoring and (ii) new regulations on risk management requirements for banks. However, for these measures to have an impact, the ability of supervisors to identify misclassifications and enforce remedial action needs to be strengthened. The TA project also foresees additional capacity building for BCSTP staff and its understaffing needs to be tackled.

Annex V. Reforms at EMAE and the Energy Sector

1. EMAE has been registering large losses and accumulating arrears with suppliers. After an expansion of the electricity network, the loss surged to about 4 of GDP annually during 2016-18, compared to an average of 1.5 percent of GDP in sub-Saharan Africa (SSA). The losses mainly reflect very high technical and commercial losses (totaling 42 percent of the energy injected to the grid in 2018). Meanwhile, the collection rate (91 percent in 2018), including from public institutions, is suboptimal. The losses have been predominantly financed by accumulating arrears to the domestic oil company ENCO[1], which reached about 20 percent of GDP at end-2018.

Annex V. Table 1. Energy Sector Selected Indicators

Parameter	EMAE 2018 figures	Comparator
Electricity access rate (%)	59	43[1]
Electricity customers	44,535 in 2018	
Installed capacity	29.9 MW with only 15 MW guaranteed	
Energy mix (%)	94.5 diesel, remaining hydroelectric	
Average cost of service	$0.27/kWh	$0.21/kWh[2]
Average tariff	$0.23/kWh	$0.15/kWh[2]
Average transmission and distribution losses (%)	37 (25 being commercial losses)	15[3]
Bill collection rate (%)	91	93[2]

Notes:

[1] Weighted average across SSA.

[2] Median value across 39 SSA countries.

[3] Weighted average value across 39 SSA countries.

Sources: Tracking SDG7: The Energy Progress Report https://trackingsdg7.esmap.org/results. World Bank, Washington, DC.; Kojima, Masami; Trimble, Chris. 2016. Making Power Affordable for Africa and Viable for Its Utilities. World Bank, Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/25091 License: CC BY 3.0 IGO.

2. The World Bank Power Sector Recovery Project supports a long-term structural improvement of EMAE and the whole energy sector in São Tomé and Príncipe. The project has four main components covering the energy supply chain from generation to distribution: (i) improving the physical infrastructure, including rehabilitating and expanding the main hydropower plant, rehabilitating the electricity grid, and installing meters; (ii) developing sectoral planning, particularly the Least Cost Development Plan; (iii) establishing regulatory frameworks and strengthening the capacity of the regulator AGER, including a tariff study; and (iv) implementing a

[1] Majority owned by Sonangol, an Angolan state-owned company.

Management Improvement Plan (MIP) of EMAE. The goal is to achieve cost recovery over the medium term by reducing production costs and distribution losses, as well as by protecting revenue through adapted tariff structure, improving billing and collection and reducing commercial losses. In addition, the project is proposing an updated tariff structure in accordance with a new production cost structure and set in place the regulatory framework to align the tariff to cost of services, every 4 years. Addressing operational inefficiencies (mainly non-technical losses) could reduce losses to below one percent of GDP.

3. The project is expected to yield the following medium-term results:

- Rehabilitating and expanding the capacity of the only operating hydropower plant on the island, Contador HPP, by end-2021 to 3.2 MW to reduce overall generation cost.

- Focusing on identifying resources for the timely development of the recently approved Least Cost Development Plan that identified as a priority the development of 8.8 MW of dual-fueled thermal units heavy fuel oil (HFO) or liquified natural gas (LNG) and about 2MW of a photovoltaic solar plant, while mobilizing partnerships to study and develop existing hydropower potential.

- Improving collections, particularly from large consumers through the installation of advanced metering infrastructure, adopting modern billing practices, procuring and installing a state-of-the-art management information system (MIS), and linking cost of services to payment through tariff reform.

- Improving operational efficiency of EMAE by implementing a new organizational structure in the Commercial Direction and redefining the functions of the Finance Direction and Management support units. This would include selection of personnel according to the competences of each position in the new organizational structure, with the support of a specialized HR firm under selection.

- Reducing commercial losses by establishing a dedicated loss-reduction unit within the company with explicit annual performance targets, holding key managers responsible for achieving annual loss reduction targets.

- Implementing a new tariff structure based on an actual estimate of the cost of services for each customer tranche, reducing disproportionate cross subsidies while preserving a social tranche to protect the most vulnerable.

- Implementing demand-side management (DSM) measures to suppress peak electricity demand and lower overall electricity consumption, including (i) a program to “swap” incandescent light bulbs for LED light bulbs for residential consumers and (ii) a National Energy Efficiency Program within Public Administration to reduce energy consumption.

- Continuing to implement the communication campaign to ensure social acceptance of the reform and behavioral change of customers to strengthen payment discipline and reduce electricity theft.

4. More specifically, the following targets can be achieved, with a strong government commitment:

Annex V. Table 2. Medium-Term Targets

Year	**2018**	**2020**	**2021**	**2022**
Commercial Losses (percent)	25	19	17	15
Conditions	Baseline	MIP[1] and sensitization campaign	MIP and sensitization and RPP[2]	MIP plus sensitization and RPP plus network reinforcement
Technical Losses (percent)	12	10	10	10
Conditions	Baseline	Upgrade work started	Upgrade completed	Improved planning/operation of network
Revenue Collection (percent)	91	92	95	95
Conditions	MIP implemented, new organization and public sensitization.	Management performance objective	Management performance objective	Management performance objective

[1]MIP: Management Improvement Plan.
[2]RPP: Revenue Protection Program.

5. A study on the tariff structure has been completed, and a new tariff grid has been recommended to reach cost-recovery within a regulatory period of 4 years. The draft legal documentation has been prepared and is pending government approval. This World Bank-financed study confirmed that the current tariff structure has two interrelated deficiencies: (i) the system's average tariffs are low when compared with costs of service and when compared with other insular systems, and (ii) the tariff structure is inefficient—there are high cross-subsidies across customer groups. Over time, the new tariff structure for non-individual consumer categories is aligned with the cost of supply and indexed to the cost of fuel. Cross-category subsidies have been carefully crafted to maintain a social tariff to the poorest customers. For individual customers, the tariffs have been benchmarked to the willingness-to-pay and affordability assessment from a household energy survey that was completed in 2018. A tariff adjustment, foreseen over the regulatory period 2020-2024, will also need to be aligned with improvements in quality of service to avoid an increase in theft and nonpayment or loss of clients to self-generation. The current average tariff in São Tomé and Príncipe is already higher than the average tariff in SSA. The implementation of the tariff reform in 2020 is expected to bring around $2 million of additional revenues from electricity generation in the current context.

6. The impact of the Bank's project on EMAE's balance is estimated in the table below:

Annex V. Table 3. Energy Sector Operations, Baseline 2017–24

		Actual	Actual	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
		2017	2018	2019	2020	2021	2022	2023	2024
Customers	**u.**	**43,642**	**44,535**	**47,126**	**49,718**	**52,156**	**54,594**	**57,033**	**59,471**
Production	**GWh**	**109**	**108**	**104**	**133**	**144**	**172**	**184**	**201**
Thermal	GWh	104.03	102.93	98.33	127.36	124.49	142.09	141.40	128.04
Hydro	GWh	5.05	5.13	5.18	5.18	16.89	27.03	39.66	70.10
Solar	GWh	0.00	0.00	0.00	0.00	2.80	2.80	2.80	2.80
Losses at plant	GWh	4.18	3.53	3.55	3.98	4.24	5.07	5.43	5.94
Energy Injected in the grid	**GWh**	**104.9**	**104.5**	**100.0**	**128.6**	**139.9**	**166.9**	**178.4**	**195.0**
Total system losses	%	34%	37%	37%	37%	37%	37%	37%	37%
Technical losses	%	11%	12%	12%	12%	12%	12%	12%	12%
Commercial losses	%	23%	25%	25%	25%	25%	25%	25%	25%
Collection rate	%	89%	91%	91%	91%	91%	91%	91%	91%
Invoiced	**GWh**	**68.7**	**65.4**	**63.0**	**80.4**	**88.2**	**104.3**	**112.4**	**121.9**
Revenues	**GWh**	**61.2**	**59.5**	**57.3**	**73.1**	**80.2**	**94.9**	**102.3**	**110.9**
Total electricity revenues	**M.USD**	**12.9**	**12.7**	**12.3**	**15.9**	**17.5**	**21.7**	**23.6**	**26.0**
EMAE Costs and charges for electricity	**M.USD**	**26.9**	**27.1**	**27.2**	**27.4**	**27.5**	**27.7**	**27.8**	**28.0**
Average cost of energy produced	**USD per kWh**	**0.25**	**0.25**	**0.26**	**0.21**	**0.19**	**0.16**	**0.15**	**0.14**
Gross Result	**M.USD**	**-14.0**	**-14.4**	**-14.9**	**-11.4**	**-10.0**	**-5.9**	**-4.2**	**-2.0**
Amortization	**M.USD**	**2.3**	**2.4**	**2.5**	**3.2**	**4.2**	**4.9**	**5.8**	**7.7**
Net Result	**M.USD**	**-16.3**	**-16.7**	**-17.4**	**-14.6**	**-14.2**	**-10.9**	**-10.1**	**-9.7**

As can be seen in this model, without a drastic change of cost of production or an in-depth tariff revision (or a combination thereof), EMAE losses will continue to accumulate in the short to medium term. Immediate actions are therefore needed to reduce the fiscal burden from the energy sector.

Priority Measures for Turnaround:

- Accelerating the implementation of the Management Improvement Plan (MIP) to reduce non-technical losses and improve payment. This should include measures to prevent the leakage and theft of diesel for power generation, which is estimated at eleven percent of the total volume bought for energy generation. Commercial losses should be reduced by four percentage points in the first year of its implementation (2020) and two percentage points per year subsequently.

- Urgently implement DSM measures to suppress peak electricity demand and lower overall electricity consumption. To the extent peak demand can be reliably reduced, a DSM program can provide "Nega-Watts" that function as a type of negative-capacity. According to the demand study, 68 percent of the evening demand peak load is related to residential consumption, for which lighting requirements are about 70 percent of consumption. Currently, lighting requirements are now mainly met by inefficient incandescent lighting (74 percent of households use incandescent bulbs) or moderately efficient CFL bulbs (29 percent of households). If EMAE or the government were to undertake a DSM program that "swapped" incandescent light bulbs for LED light bulbs for residential consumers (around three bulbs per account), a significant reduction in peak electricity demand as well as overall demand may be achieved. The estimated reduction in peak load capacity is about 8 MW and an overall annual energy generation reduction by 15 percent. This campaign would also reduce individual customers' bills and the risk of arrears from residential customers. This approach should be coupled with a prohibition (or tax) on incandescent bulbs. All government agencies should also be directed to ensure efficient use of energy in their offices, such as reducing the use of air conditioners and full implementation of an LED light bulbs program in the administrations.

- Switching from an expensive energy mix dominated by diesel generation to a more affordable mix, consisting of hydropower, solar energy, HFO or LNG, depending on market trends, as recommended in the Least Cost Development Plan (LCDP). The elimination of diesel would also stop its theft. At this stage the main option available would be to secure an independent power project (IPP) for an HFO/LNG dual plant (which would take up to 18 months) and a 2 MW solar photovoltaic plant.

Short Term Policy Actions Required:

Objective 1: Reduce commercial losses by four (six) percentage points and improve the collection rate by three (six) percentage points by June 2020 (June 2021) to lower commercial losses below 15 percent and raise the collection rate to 95 percent by June 2021. This will be achieved by:

a. Approving and implementing the MIP. Signing a performance contract with the CEO of EMAE and setting in place by September 2019 a dedicated team at EMAE to implement measures and achieve the above objectives.

b. Reducing theft of diesel by half by June 2020 to lower the loss to below five percent of the volume supplied for energy generation.

c. Arrears clearance plans are agreed with large private consumers, small and medium enterprises, as well as residential consumers. Government defines essential (non-disconnectable) and non-essential (disconnectable) consumption facilities. Services are cut off due to non-payment, to be implemented by October 2019. In the meantime, a communication package is launched to explain that collective action is needed to improve electricity services.

d. Modernizing billing and install pre-paid and smart meters. EMAE installs 1200 prepayment meters to all facilities categorized as disconnectable by the government by June-2020. Continue to disconnect non-essential consumption for nonpayment.

e. Government establishes a mechanism with EMAE to cap consumption and ensure timely bills payment by public entities, including by cutting EMAE's services and direct transfers from Treasury to pay EMAE to be implemented by June 2019.

Objective 2: Reduce overall energy consumption by 15 percent within 12 months and facilitate the phase-out of incandescent bulbs within two years. This will lead to a net reduction in demand given annual growth is currently seven percent per annum. This is achieved through:

a. Government will roll out a program to replace incandescent/fluorescent with LED program, which can be implemented within nine months. The $1 million program will be funded by the World Bank.
b. Government will pass a law that bans the importation of incandescent/fluorescent lamps within the two-year timeframe. Conduct outreach to stakeholders such as light importers, raising awareness and helping them access LED suppliers.

Objective 3: reform the tariff through (i) establishing a mechanism and (ii) implementing the first tariff reform once the prepaid meters are in place for the large consumers (planned within 12 months).

a. The tariff analysis has been completed and identified the need for an in-depth tariff reform to be led by the regulator AGER. In order to gradually achieve a cost-reflective tariff structure by 2024, the government needs to immediately enforce through a decree the proposed adjustments regarding (i) tariff structure definition, (ii) customer category definition, (iii) social tariffs adjustments, and (iv) agreed timeline to achieve full cost-recovery structure. A draft decree has been submitted to the government, and it should be approved by October 2019.
b. The first tariff increase to be implemented once meters in place for large consumers, in 2020.

In sum below are the short-term targets and actions:

	Baseline	Target June 2020	June 2021
Reducing commercia loss to	23 percent	19 percent	17 percent
Reducing technical loss to	11 percent	10 percent	
Raising bill collection rate	89 percent	93 percent	95 percent
Reduce diesel loss	10 percent	5 percent	

	Actions to be taken	Target date
1	Signing contract with EMAE CEO and establish a dedicated team implemented to achieve the objective	Sep-19
2	Approve a decree to adjust the tariffs	Oct-19
3	Develop arrears clearance plan with customers and cut off nonpaying costumers	Oct-19
4	Install 1200 prepayment meters to all disconnectable users and continue to disconnect non-paying customers	Jun-20
5	Implement a LED program and stop importing incandescent and fluorescent lights	Jun-20
6	First tariff adjustment to be implemented	end-20

7. **These measures would have the following impact on EMAE's accounts, assuming that the cost of production is reduced from $0.25 per kWh in 2017 to $0.14 per kWh in 2024 as per the results of the LCDP**:

Annex V. Table 4. Energy Sector Operations

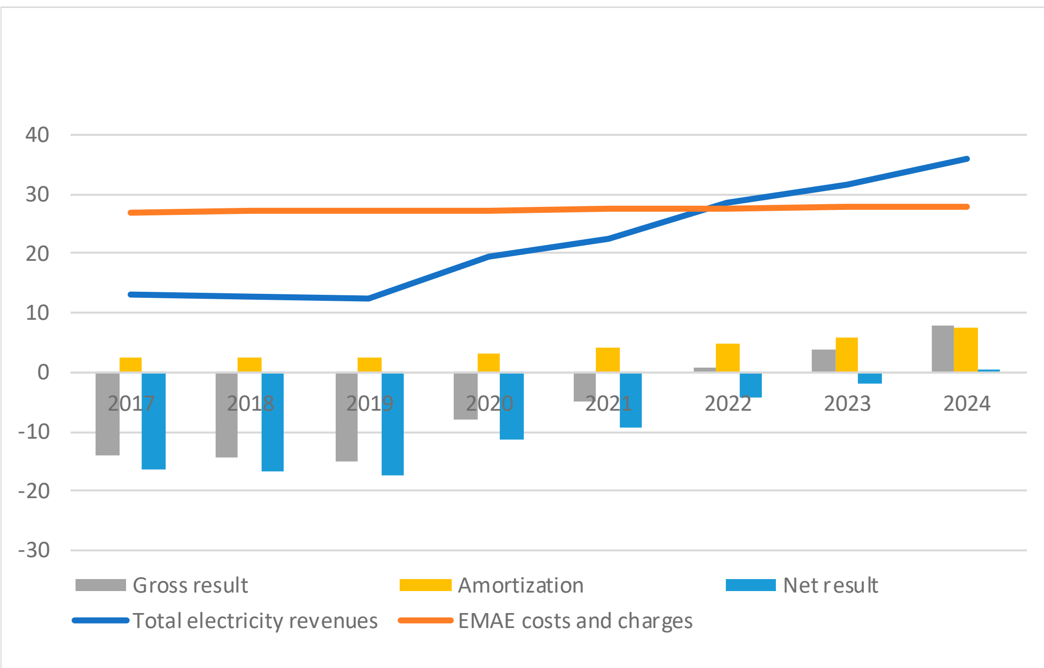
		Actual	Actual	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
		2017	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
Customers	**u.**	**43,642**	**44,535**	**47,126**	**49,718**	**52,156**	**54,594**	**57,033**	**59,471**
Production	**GWh**	**109**	**108**	**104**	**133**	**144**	**172**	**184**	**201**
Thermal	GWh	104.03	102.93	98.33	127.36	124.49	142.09	141.40	128.04
Hydro	GWh	5.05	5.13	5.18	5.18	16.89	27.03	39.66	70.10
Solar	GWh	0.00	0.00	0.00	0.00	2.80	2.80	2.80	2.80
Losses at plant	GWh	4.18	3.53	3.55	3.98	4.24	5.07	5.43	5.94
Energy Injected in the grid	**GWh**	**104.9**	**104.5**	**100.0**	**128.6**	**139.9**	**166.9**	**178.4**	**195.0**
Total system losses	%	34%	37%	**37%**	29%	27%	25%	25%	25%
Technical losses	%	11%	12%	**12%**	10%	10%	10%	10%	10%
Commercial losses	%	23%	25%	**25%**	19%	17%	15%	15%	15%
Collection rate	%	89%	91%	**91%**	93%	95%	95%	95%	95%
Invoiced	**GWh**	**68.7**	**65.4**	**63.0**	**91.3**	**102.2**	**125.1**	**133.8**	**146.2**

Annex V. Table 4. Energy Sector Operations (concluded)

Revenues	**GWh**	**61.2**	**59.5**	**57.3**	**84.9**	**97.1**	**118.9**	**127.1**	**138.9**
Total electricity revenues	**M.USD**	**12.9**	**12.7**	**12.3**	**19.4**	**22.5**	**28.5**	**31.6**	**36.0**
EMAE Costs and charges for electricity	**M.USD**	**26.9**	**27.1**	**27.2**	**27.4**	**27.5**	**27.7**	**27.8**	**28.0**
Average cost of energy produced	**USD per kWh**	**0.25**	**0.25**	**0.26**	**0.21**	**0.19**	**0.16**	**0.15**	**0.14**
Gross Result	**M.USD**	**-14.0**	**-14.4**	**-14.9**	**-8.0**	**-5.0**	**0.8**	**3.8**	**8.0**
Amortization	**M.USD**	**2.3**	**2.4**	**2.5**	**3.2**	**4.2**	**4.9**	**5.8**	**7.7**
Net Result	**M.USD**	**-16.3**	**-16.7**	**-17.4**	**-11.2**	**-9.3**	**-4.1**	**-2.0**	**0.3**

Note: this simulation comprises (i) the timely implementation of the LCDP, (ii) a drastic reduction in commercial losses and increase in collection rate and (iii) the implementation of the proposed tariff reform in 2020)

Reform Agenda Implementation
(Millions of US dollars)



The arrears structure by customers reflected in EMAE annual accounts in 2018 is as follows, and a corresponding schedule of arrears could be agreed with the largest customers to improve EMAE's financials in the next three years.

Annex V. Table 5. Arrears Owed to EMAE in New Dobras

Description	12/31/2018	% of total
Central government	37,261,754	12.6%
Autonomous state institution	28,814,671	9.8%
District government	71,090,079	24.1%
Regional administration	6,401,508	2.2%
ENASA (airport authorities)	21,075,607	7.2%
Other public enterprises	2,405,789	0.8%
Industrial clients	6,662,196	2.3%
Commercial clients	23,361,742	7.9%
Individual clients	88,855,714	30.2%
Diplomatic missions	957,942	0.3%
Telecommunication sector	2,571,267	0.9%
Financial Sector	2,689,400	0.9%
Airlines	190,912	0.1%
Private organization	2,102,141	0.7%
EMAE workers	147,380	0.1%
Other entities	0	0.0%
Clients creditors	-10,928	0.0%
TOTAL	**294,577,174**	

Type of Client	12/31/2018	% of total
Private Clients, including individual	127,391,314	57%
Public Clients	167,185,860	43%
Private companies excluding individual	38,535,600	27%
Individual customers	88,855,714	30%

Annex VI. Technical Assistance Priorities

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

Key achievements include:

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

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

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

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

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

Priorities	**Objectives**
Tax Policy and Revenue Administration	Transition to VAT regime Strengthen the operational capacity of the tax administration Implement a medium-term modernization process of the tax administration
Public Financial Management	Improve budget preparation and forecasting Improve budget execution and control of arrears Strengthen capital spending framework Introduce MTEF
Financial Sector Regulation and Supervision	Implement NPL reduction strategy Enhance credit and liquidity risk assessment
Expenditure Policy	Rationalize current expenditure and improve public spending efficiency Create fiscal space
Monetary policy and central bank operations	Develop monetary policy instruments; Strengthening the central bank law and financial institutions law and establishing a governance structure that provides for independent oversight of central bank operations.
Financial Crisis Management	Improve resolution frameworks Support ongoing bank liquidation
Debt Management	Improve debt and cash flow management Foster interbank market development
Financial & Fiscal Law Reform	Strengthen financial sector legal and regulatory framework
Systemic Risk Analysis	Implement stress testing
Compilation of Statistics	Improve macroeconomic data (specifically, Improve GDP and CPI series Improve quarterly BOP and IIP statistics Improve monetary and government finance statistics)

Authorities' Views

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

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

7. In particular, TA that includes on-the-job training has also been shown to be quite effective in the context of Banking Supervision and Statistics.

Appendix I. Letter of Intent

São Tomé, September 17, 2019

Mr. David Lipton
Acting Managing Director
International Monetary Fund
700 19th Street N.W.
Washington, D.C. 20431
USA

Dear Mr. Lipton:

A new government led by Prime Minister Jorge Bom Jesus took office in December 2018 in the Democratic Republic of São Tomé and Príncipe following parliamentary elections. It intends to continue strengthening the relationship with the International Monetary Fund (IMF) to implement far-reaching economic reforms to unleash the country's growth potential.

A three-year arrangement under the Extended Credit Facility (ECF) was approved by the IMF Executive Board in July 2015 and expired at end-2018. The program's objective was to promote sustainable growth and poverty reduction. The last review was not completed due to the elections and the associated slippages in policy implementation.

Economic conditions are challenging as noted in the attached Memorandum of Economic and Financial Policies (MEFP). In 2018, reserve loss reached about $16.3 million, end-year inflation picked up to 9 percent, and real growth slowed to 2.7 percent from the average of 4 percent in the past few years.

The new government requests a new forty-month ECF arrangement to support our medium-term economic reform program for 2019 to 2022. The key objective is to generate sustainable, higher, and more inclusive growth to create jobs, significantly reduce poverty, and improve the living standards of our population. To this end, the government is committed to enhancing macroeconomic stability, which is key to economic development and growth. The government also requests that the IMF Executive Board extend its approval of the measures resulting in exchange restrictions and a Multiple Currency Practice by one year.

Fiscal consolidation and monetary tightening will be implemented to address the external and internal imbalances as evidenced by the large loss of reserves and acceleration of inflation in 2018. Fiscal consolidation is fundamental to manage excess domestic demand under a pegged exchange rate. To ensure adequate resources for boosting growth and providing public services, including social protection, health, education, and maintenance of public infrastructure, it is important to mobilize domestic revenue efficiently and equitably by expanding the revenue base, particularly by introducing a value added tax (VAT) and enforcing tax laws. It is equally important to rationalize public expenditure so that state employment will not crowd out private economic activities. The government is also committed to expediting the reform of state-owned enterprises, particularly the utility company (EMAE) to cut losses and improve services, which is essential to contain fiscal risks and improve the business environment. Monetary policy tightening will also be important to reduce balance of payments pressures. These actions will also help support the removal of exchange restrictions in the near term. The government also views the economic empowerment of women as essential to promoting inclusive growth.

To help achieve the objectives of this program, the government requests access of SDR 13,320,000 (90 percent of quota) including the first disbursement of SDR 1,902,857 upon approval of the arrangement by the IMF Executive Board. To monitor progress in implementing our reform agenda, the program includes a set of periodic and continuous performance criteria, indicative targets, prior actions, and structural benchmarks outlined in the MEFP and the Technical Memorandum of Understanding (TMU). As a sign of our commitment to the program, we have completed the prior actions for the approval of the ECF arrangement.

The government believes that the policies contained in the attached MEFP are adequate to achieve the objectives of the program, but it will take further measures that may become appropriate for this purpose. We will consult the IMF in advance on the adoption of these measures and revisions to the policies contained in the MEFP, in accordance with IMF policies on such consultations. We will also consult in advance with IMF staff on the terms of possible external borrowing to ensure that such borrowing does not jeopardize debt sustainability and is in line with the IMF's debt limits policy. Furthermore, we are committed to not (i) introducing or intensifying any exchange restrictions (ii) introducing or imposing import restrictions, (iii) introducing or modifying multiple currency practices, or (iv) concluding bilateral payment agreements in violation of Article VIII of the Articles of Agreements, which are continuous performance criteria under the ECF arrangement.

In line with its commitment to transparency and accountability, the government authorizes the IMF to publish this letter, its attachments, and related staff report, including placement of these on the IMF website in accordance with IMF procedures, following the IMF Executive Board's approval of the request.

Sincerely yours,

/s/

Mr. Osvaldo Vaz,
Minister of Finance, Commerce and the Blue Economy

/s/

Mr. Américo Soares De Barros,
Governor of the Central Bank of São Tomé and Príncipe

Attachments

1. Memorandum of Economic and Financial Policies (MEFP)
2. Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies for 2019–23

INTRODUCTION

1. This Memorandum of Economic and Financial Policies (MEFP) outlines the main objectives of the government of São Tomé and Príncipe's economic reform program for the period September 2019–January 2023, for which the government is seeking support from the International Monetary Fund (IMF) through a new forty-month arrangement under the Extended Credit Facility (ECF). The new ECF arrangement succeeds the one that was approved by the IMF Executive Board in July 2015 and expired at end-2018 with the last review not completed. The program aims to lay the foundation for stronger, more inclusive growth, and to catalyze financial support from bilateral and multilateral partners. The ECF arrangement addresses the immediate pressure on the balance of payments through fiscal consolidation while stressing social protection and supporting women's empowerment and participation in the formal labor market.

2. This MEFP also reviews recent economic developments and performance. Furthermore, it assesses the economic outlook and risks and presents macroeconomic policies for 2019 and beyond.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

3. The economy faces pressing constraints, as international reserves fell sharply, growth slowed, and inflation rose in 2018 and remained high during the first half of 2019. Foreign exchange reserves declined by $16.3 million in 2018, mainly driven by declining foreign inflows and higher fiscal spending. This is despite significant growth in tourist receipts, which rose by about 18 percent. Consequently, gross international reserves (GIR) at end-2018 reached about $35 million (3.3 months of imports),[1] falling below the IMF low-income country reserve adequacy metric of 3.8 months of imports. The declining foreign inflows, along with the disruption from parliamentary elections and energy shortages, contributed to a slowdown of real GDP growth of more than one percentage point to 2.7 percent. Year-on-year inflation accelerated to 9.0 percent in December 2018. Credit to the economy contracted by 1.6 percent in 2018. The macroeconomic environment continues to be challenging. As of end-June 2019, disbursements of external grants raised GIR to 45 million (4.1 months of imports), and inflation decreased to 8.6 percent in June 2019. Nevertheless, preliminary information suggests economic activities and credit to economy remained sluggish. The current account deficit in 2019 is expected to widen due to lower grants and higher oil-related FDI, despite the significant growth in

[1] When computing reserve coverage in month of imports, imports of investment goods and technical assistance, which are largely externally financed, are excluded from the base of imports of goods and nonfactor services.

non-cocoa exports (by 27 percent year-on-year) and tourist arrivals (by 14 percent) during the first half of 2019, both from a low base.

4. **Expansive fiscal policy in 2018 contributed to the pressure on foreign exchange reserves.** Domestic primary deficit (DPD) reached over 4 percent of GDP in 2018, exceeding the last program's indicative target of 1.3 percent of GDP significantly**.** The underlying position was even more expansive and reached almost 5 percent of GDP when borrowing by autonomous budgetary entities approved by the Ministry of Finance is included. Direct taxes fell sharply with the economic slowdown and possible election-related collection disruptions. The revenue shortfall was partially offset by a successful tax arrears collection, higher oil import tax revenue from higher international oil prices, and cuts in domestic spending. Delayed disbursement of EU budget support (€3 million) further increased domestic debt and arrears.

5. **The fiscal position remained precarious in the first semester of 2019.** Despite improved tax collection, notably from the beer manufacturer Rosema, and recovery of almost D11 million in tax arrears, domestic revenue continued to deteriorate, reflecting the continued sluggish economy and cuts in tariffs on alcoholic beverages. Furthermore, higher oil shipping costs, associated with tight fuel supply in Angola, were not passed on to consumers, further reducing the revenue. Meanwhile, commitments made by the former government, including significantly higher military personnel wages, offset savings on goods and services and transfers. As a result, the end-June DPD reached 1.8 percent of GDP, twice the targeted level.

6. **The banking sector suffers from challenging lending conditions, elevated operational costs, and additional provisioning uncovered by the asset quality review (AQR) and supervision by the BCSTP**. The contraction of credit to the economy observed in 2018 continued this year. Banks are hesitant to lend due to a weak economy and a high non-performing loan (NPL) ratio (22 percent at end-Jun 2019) caused by a poorly functioning judiciary system and banks' slow write-off. The cost-to-income ratio is also high. Nevertheless, provisioning on NPLs remained high, even though they have fallen over the last four years. The recently-concluded AQR found evidence of widespread loan misclassification. The resulting additional provisioning will likely require re-capitalization in some cases. Macro-financial linkages loom large as payment delays by government entities have impaired suppliers' loan servicing, collection of defaulted loans remains difficult, and lending is likely to remain slow due to the weak economy and banks' balance sheet constraints.

7. **Total public and publicly guaranteed (PPG) debt—which includes debt from EMAE, borrowings by public entities (such as parliament and courts), and government's arrears to suppliers—stood at over 90 percent of GDP at end-June 2019**. During 2015-18, EMAE's continued arrears accumulation to its fuel supplier ENCO[2] more than offset the debt reduction from real economic growth, government's repayment of past oil price subsidies debt using yields from higher domestic prices than import costs, and limited new external loan disbursement. EMAE's arrears rose by US$50 million during this period, from 14 percent of GDP in 2015 to 23 percent of

[2] ENCO is the country's only oil supplier, which is majority-owned by an Angolan state-owned company. EMAE's arrears to ENCO have increased substantially since 2016 due to an expansion of electricity distribution network.

GDP in 2018. The arrears accumulation increased further by US$9.4 million during the first semester of 2019 and may rise by a higher amount in the second semester based on seasonality. In addition, a comprehensive review by the Ministry of Finance identified additional government's arrears to domestic suppliers (other than EMAE and the telecommunication company (CST) of about US$25 million (around 6 percent of GDP) accumulated in recent years, due to a shortfall of project grants and loans. Work is ongoing to identify the circumstances around these arrears.

8. **The country remains in debt distress due to prolonged unsettled external arrears.** In total, unsettled external arrears stood at 2.6 percent of 2018 GDP (US$10.7 million), which are owed to Angola (US$4.8 million), Brazil (US$4.3 million), and Equatorial Guinea (US$1.7 million). We have been actively following up with our creditor countries. Letters were sent out in February 2019, and in-person discussions were carried out subsequently with Equatorial Guinea in May and Angola in July. An agreement with the Brazilian government was reached, pending ratification by the Brazilian Senate.

9. **In addition, continued large arrears of EMAE to ENCO elevate the country's debt vulnerability**. The arrears of EMAE to ENCO were recently formalized with an extended repayment period (including on any new arrears that may arise until EMAE returns to an operating surplus), which helped to bring the present value of total public debt—which includes EMAE's arrears to ENCO and the recently-found government's arrears to private suppliers—to below the benchmark of 55 percent established under the IMF and World Bank debt sustainability framework. However, the continued accumulation of arrears by EMAE also raised the risk of large arrears of ENCO to its parent company, Sonangol. In addition, the significant arrears of EMAE to its supplier also reflect the severe liquidity constraints of the public sector. As we are committed to borrowing at only concessional terms at a measured pace, financing large projects such as the airport expansion and rehabilitation by grants, and revamping EMAE to eliminate its large losses, our debt-to-GDP ratio is expected to decline.

10. **As the government is committed to implementing far-reaching reforms, the outlook will improve over the medium term.** The economy is projected to recover gradually from last year's election-related and energy disruptions. Real GDP growth is projected at 2.7 percent in 2019, remaining unchanged compared with 2018. As power supply recovers and externally-financed projects are implemented, we expect growth to increase to 3.5 percent in 2020, 4.0 percent in 2021, and 4.5 percent beyond. External inflows (including FDI), which were disrupted by election-related uncertainties, are rebounding to pre-election levels. Preparations for an airport expansion with grants from China and road construction supported by the World Bank are at an advanced stage and could start early next year. Down the road, these projects could boost both tourism and agri-business. Inflation is projected to decrease to 7.8 percent by end-2019, driven by fiscal consolidation and monetary tightening. With the one-off effect from the planned introduction of the VAT in 2020, inflation is projected to increase to 10 percent but should gradually ease to 3 percent in the medium term with significant fiscal consolidation. The VAT may increase fiscal revenue by 2 percent of GDP eventually. After two years of preparation, we expect EMAE reforms to begin to reduce losses and oil imports over time. Increased, reliable, lower-cost electricity would also promote economic activity.

PAST PROGRAM PERFORMANCE

11. Progress under the last program supported by the ECF was limited. Although the central government debt (targeted under the ECF) declined by about 2 percent of GDP during 2015-18, total public debt increased by roughly 6 percent of GDP[3] mainly due to the continued arrears accumulation from EMAE to ENCO and government's arrears to suppliers. The economic base also remained narrow. Inflation increased, and international reserves declined. The limited progress reflects low capacity and policy slippages. Fiscal consolidation was interrupted by elections, and the DPD exceeded the targets by over 2 percent of GDP during the election years of 2016 and 2018. Furthermore, tax revenue declined from 14.5 to 12.5 percent of GDP during 2014-18 in part due to high reliance on import taxes and low tax compliance.

12. The sixth review was disrupted by the elections and was not completed. Almost all end-June performance criteria and indicative targets for the last test date were met with the exception of the net international reserves target. However, the end-2018 indicative targets for DPD, net bank financing of the central government, and net international reserves were all missed by large margins.

13. Some progress was made on the structural fronts, albeit with delays. For instance, we adopted an automatic fuel price mechanism, a comprehensive NPL strategy, and a new consumer price index. EMAE's least cost electricity production plan was adopted in April 2019 and Management Improvement Plan in July 2019, compared with the initial target of June 2018 for both. A VAT law passed a general (first) reading in August 2019, after being submitted to parliament in September 2018. An Asset Quality Review (AQR) of the banking system was completed in April 2019, a substantial delay from the initial expected completion date of December 2017. Some key reforms, including the introduction of a VAT and the central banking law and tax administration reforms, are still pending.

POLICY OBJECTIVES FOR 2019–2022

To address the high debt, we will pursue fiscal consolidation, which is the key instrument for reining in domestic demand under a pegged exchange rate, complemented by tighter monetary policy. We will reform EMAE to reduce its arrears accumulation to ENCO to reduce debt vulnerability. We will also strengthen supervision to enhance financial stability and remove structural bottlenecks. These policies will help maintain macro stability, which is key to supporting sustainable and inclusive growth. Over the medium term, we will continue to implement structural reform to expand economic base, reduce reliance on oil imports via electricity sector reforms, and promote progress on meeting key Sustainable Development Goals (SDGs).

[3] Including the state-owned utility company EMAE's arrears to its oil supplier ENCO, which is the country's only oil supplier and majority-owned by an Angolan state-owned company (excluding the central government's arrears to EMAE in the consolidation).

A. Fiscal Policy

14. As in the last ECF, the arrangement will target the DPD, which excludes grants from the revenue side. Thus, the focus is squarely on the country's revenue mobilization efforts. In addition, the government will limit domestic borrowing in line with the borrowing ceiling established under the program (measured by the change in the net banking credit to government, a performance criterion). We will not allow borrowing by public entities (excluding state-owned enterprises) with the ministry of finance's approval, and if such borrowing occurs, it will be included as part of the DPD and net banking credit to government.

15. Revenue mobilization and expenditure rationalization are both required. Over the medium term, continued revenue mobilization and spending containment will help safeguard the peg and reduce the debt burden, while gradually raising social and capital spending. In particular, the World Bank is supporting our social program with a five-year, $10 million project, which includes a conditional cash transfer subcomponent ($3.5 million) and is expected to reach 91 percent of extremely poor households.

16. The 2019 budget will target a DPD of close to 2 percent of GDP or D198 million. On the revenue side, effective in August, the fuel price differential from the import costs (retroactively from the beginning of 2019) previously collected by ENCO will be transferred to Treasury, and the government will adopt an oil price surcharge equivalent to D2 per litre of gasoline and diesel (other than that used by EMAE) in the second semester. Revenue in the second semester of 2019 will be boosted by the increased sales tax on telecommunications from 5 to 15 percent (D21 million), suspension of the deduction in Article 74 (D15 million), and the reversal of the tariff cuts on alcoholic beverages. Meanwhile, we have strengthened tax administration to raise tax collection receipts, particularly from large tax payers such as Rosema, and recover tax arrears of at least D17 million this year. A new protocol with the EU on commercial fishing in our waters is expected to yield €7 million in licensing fees over 2019-23. We will take steps to ensure that nationals working at international organizations (and oil companies) operating in our country pay income tax dues (D4.2 million) in accordance with the law.

17. On the expenditure side, specific measures include:

- Containing personnel costs and using attrition of overall government staff to mitigate the cost of hiring the 25 individuals selected last year to modernize our tax administration, which over the medium term is expected to improve revenue collection to more than offset the costs. Wage bills will continue to be contained over the medium term including through rationalizing and reforming public administration.

- Reducing electricity and water consumption at public institutions, particularly by setting ceilings and instructing EMAE to cut off supply to entities exceeding their allocation.

- Containing the increase in transfers to less than 10 percent, including by limiting the transfer to parliament to D47 million, while reducing consigned (*despesas consignadas (dos servicos de* *cobrança*)) expenditures. In this regard, the government will not approve borrowing by public entities to offset lower transfers from Treasury.

- Executing domestic primary expenditure cautiously to match available revenues and limit it to D1472 million. More specifically, the government will be guided by the following breakdown:

	End-December 2019 (millions of new dobras)
Total domestic primary expenditure	1472
Total primary current expenditure	1442
Personnel costs	856
Goods and services	236
Transfers	290
Other	61
Treasury-financed capital expenditure	13
HIPC-related social expenditure	17

18. A government decree will be issued to align the budget with the above parameters and relevant legislation will be passed to implement the revenue measures, including revising the VAT law with a rate of 15 percent for specific discussion by Parliament (prior action), and we will adopt a monthly budget allocation plan for the remainder of 2019 (prior action).

19. Over the medium term we will continue fiscal consolidation to bring our domestic primary expenditures in line with domestic revenues. Continued revenue mobilization would achieve tax revenue gains of 2 percent of GDP by 2022 as the benefits of the VAT gradually take hold and further tax arrears are collected. Furthermore, we will maintain or reinforce revenue measures introduced this year, including the oil surcharge, as needed to achieve our revenue and fiscal objectives while the VAT is being implemented. At the same time, we will contain the wage bill and expenditures on goods and services while slowly raising priority social and capital spending. We will also review and rationalize the government employment to support containment of wage bill while providing space for private sector development.

20. Recommendations on strengthening tax administration by the IMF will be implemented. Priorities include: (i) reorganization of the *Direção dos Impostos* to improve management and strategic planning focused on tax compliance; (ii) adoption of modern compliance risk management practices, including audit programs that exploit information from third parties; and (iii) overhaul of current performance monitoring framework including key performance indicators and rewards program. The 25 individuals selected last year will be hired and trained to modernize our tax administration.

21. Furthermore, tax collection, especially that of large taxpayers, will be closely monitored to ensure timely tax payments. Monthly reports on tax payments and outstanding tax arrears will be prepared and shared with the IMF mission. The authorities will stand ready to apply legal and administrative procedures to ensure payments are made.

22. The government aims to introduce the VAT by March 2020. A general reading of the VAT bill has been approved by parliament in August 2019, and the government plans to set the rate at 15 percent for Parliament's specific and final approval of the law by mid-October (*structural benchmark*), and a system of e-invoicing will be in place by September. Other preparations continue according to the time table below, including starting immediately to implement the publicity campaign as recommended by the IMF; providing adequate space and equipment to new staff; implementing an intermediate IT system tailored for VAT implementation, which could later be expanded to a more comprehensive system; and setting up four taxpayer centers. Training will also cover local tax administrators including those from Principe. In addition, the authorities will seek agreements with banks to receive VAT payments. The authorities will decide by end-September 2019 on other design specifics of the tax system, particularly the VAT thresholds, and review other taxes, especially excise duties to bring them in line with the VAT. Related legislation and regulations will be submitted to enact these decisions into law.

Activity	**Deadline**
Final approval of the VAT Law (Government of STP)	October 15, 2019
Implementation of the invoice oversight system (Tax Authority)	August-September 2019
Hiring an expert on VAT law (IMF)	September 2019
Drafting and approval of the Excise Duty Law (Tax Authority, IMF lawyer)	September-October 2019
Hiring 5 local IT staff members (MoF, Tax Authority)	September 2019
Drafting and approval of reimbursement rules (Tax Authority, IMF lawyer)	September-October 2019
Drafting and approval of the small taxpayers' scheme (Tax Authority, IMF lawyer)	September-October 2019
Communication and education program (Tax Authority)	August 2019-March 2020
Hiring a systems design software expert for the Tax Authority (IMF)	September 2019
Development of the registration system (Tax Authority)	October 2019
Development of the electronic tax return system (Tax Authority)	November-December 2019
Development of the payments system (Tax Authority)	November-December 2019
Development of the VAT current account system (Tax Authority)	December 2019-February 2020
Hiring an expert specialized in cross verification (IMF)	January 2020
Development of the cross verification system (Tax Authority)	February 2020
Upgrading ASYCUDA to collect VAT (Customs)	January-February 2020
Effective introduction of the VAT (Tax Authority and Customs)	1st of March 2020

23. The government will continue its efforts to put in place a proper computerized information management system that could encompass the whole tax system. We are looking for support as the earlier AfDB-supported project has stalled. The system will have key functionalities, such as automatic notification of taxpayers in default, extraction of statistical data, surveillance, and oversight support.

24. The government is committed to continuing public management reforms and reducing government arrears. Specific reforms include:

1) Improve the macro-fiscal framework projections (revenues and expenditures), and in particular, have realistic revenue forecasts. In particular we will adopt a monthly budget allocation plan for the remainder of this year to strengthen fiscal discipline (*prior action*).

2) Strengthen cash management and internal capacities at the Treasury Department. For this purpose, we will develop and update regularly a monthly financing plan to guide the issuance of new treasury bills, consistent with the annual budget and financing plan;

3) Strengthen expenditure control, prevent the accumulation of arrears and update the arrears clearance plan to cover all domestic arrears. Meticulous work recently undertaken by Treasury has shown that significant amounts of arrears are outstanding to private suppliers for projects contracted by the government over the last several years. To prevent this from recurring, more work will be carried out on identifying the causes, nature, and timing of these arrears.[4] Going forward, Treasury will be the sole public entity in the central government allowed to contract loans. The government is committed to not accumulating new arrears and will use treasury bill issuances to cover payments if needed. Furthermore, it will dedicate all additional resources available to pay down domestic arrears;

4) Enhance fiscal reporting and improve consistency of fiscal data from above and below the line. The Treasury will reconcile the financing data with the BCSTP on a monthly basis. Monthly TOFE will be provided to the IMF by the 21th of the following month.

5) Enhance the enforcement of the procurement laws to improve the efficiency of public expenditure and reduce vulnerabilities to corruption. The procurement law was adopted in 2009 and is broadly in line with the World Bank's recommendations. It is being updated with the support of the World Bank to address sustainability and e-procurement, environmental, social, and hygiene issues, framework contracts, and the complaint mechanism.

B. Monetary Policy and Foreign Exchange Reserves

25. We will implement a set of measures to increase foreign reserves. Continued fiscal consolidation will be complemented by tightening monetary policy to encourage more dobra savings and to reduce pressure on foreign exchange reserves. Given the ineffective lending channel,

[4] Currently these arrears are not accounted for in the budget.

the adverse effect of the policy on the macroeconomy is expected to be limited. The Monetary Policy Committee decided to implement open market operations (OMOs) through liquidity-absorbing operations (Article 9 of NAP 018/2014-OMO). In consultation with the IMF and its monetary policy technical assistance experts, the BCSTP will start issuing certificates of deposit in the first half of 2020 (*structural benchmark*) and will calibrate and adjust the size, frequency, and interest rate of this instrument based on assessment of pressures on the foreign exchange and inflation. Other measures to help stabilize reserves include limiting public spending that requires foreign exchange and attracting diaspora capital inflows.

26. Medium-term structural reforms will also help boost reserves. As detailed in the section on structural reforms, ongoing plans to expand the economy base (centered around tourism, agriculture, and fisheries) and efforts to reduce reliance on oil imports via electricity sector reforms will both generate and save reserves.

27. Future oil exploration rights within the administrative areas will also generate needed foreign exchange for the country through attendant social programs, even though the associated signing bonuses are not considered for the calculation of the program target on reserves. The recent sale of one exploration right added US$2.5 million oil signature bonus to the National Oil Account in 2019.

28. Over the medium term, we will promote interbank market and secondary trading. Currently, there is no secondary market for the T-bills. Interest in T-bills remains strong, as the issuance in March 2019, like those before it, was oversubscribed. We will aim to improve coordination between fiscal and monetary policy management. Currently, the Committee for Public Debt meets before T-bill issuance; however, with IMF TA, BCSTP and the Treasury will work to develop and publish an annual schedule of T-bill issuance that aligns with cash flow forecasts and borrowing plans and continue regular meetings of the Committee for Public Debt.

29. The Central Bank is committed to sound governance and transparency. As noted in the subsequent section, we will implement the recommendations of safeguards assessment to strengthen the governance and operation of the Central Bank. In addition, we undertook an audit in early 2019 regarding costs of constructing a new Central Bank building and the issuance of the newly redenominated dobra banknotes.[5] We have also appointed a new director of audit at the Central Bank in response to the recommendations of the safeguards assessment.

C. Financial Sector Policy

30. We are committed to implementing measures to address issues found in the AQR (structural benchmark), while taking additional measures to safeguard banking sector soundness. After discussing the recommendations with commercial banks, guidelines on implementation are expected to be issued in September on loan reclassification, additional

[5] On January 1, 2018, we successfully redenominated the currency, removing three digits, and introduced a note of greater face value.

provisioning requirements, and consequent recapitalization as needed to be enforced by March 2020 (structural benchmark). With IMF technical assistance, we are working towards adopting risk assessment and stress testing methodologies to better assess and inform about the adequacy of banks' buffers under severely adverse conditions.

31. Measures to strengthen banking supervision are clearly needed, while several reforms are already underway. The findings of the AQR shed light on shortcomings in identifying misclassified exposures and other regulatory infractions, to which relatively infrequent on-site inspections due to understaffing may have contributed. We will intensify off-site monitoring and on-site inspections to identify risks and non-compliance early-on and increase staffing and capacity at the supervision department. With IMF technical assistance, we are implementing a bank rating model for on- and off-site supervision, upgrading banking regulations, and training staff by end-December 2019 (structural benchmark). We have completed an initial draft of an operational manual for rating credit institutions, will finalize the manual by December 2019 and a new prudential regulation on risk management by November 2019.

32. The resolution of legacy NPLs must be accelerated. Preliminary data show that the NPL ratio remains high. Because banks are unwilling to write off even long-defaulted but fully-provisioned loans, we plan to prepare guidance for banks on more rapid write-offs. Still-needed reforms include improving the efficiency of the judicial loan enforcement process and reinvigorating the project to establish arbitration tribunals for out-of-court settlement, particularly as the formal judicial system faces severe capacity constraints.

33. We will make every effort to facilitate the swift liquidation of the two banks whose licenses have been revoked, one for insolvency and one for governance problems. The liquidation of Banco Equador is proceeding, with the sale of moveable assets largely completed. The lack of electronic records has led to delays in the sale of immoveable assets; however, we will continue to work to expedite the process, aiming to conclude assets sale by end-2019. The resolution of Banco Privado (BPSTP) is more complex as the bank's license was withdrawn over governance concerns and repeated non-compliance with BCSTP directives instead of insolvency. Resolution options include liquidation through the court system or an out-of-court agreement with the banks' shareholders on voluntary liquidation. We have also established a technical team that will focus on establishing the legal framework necessary to allow BPSTP debtors to repay their debts at BCSTP. In any case, we are committed to liquidating BPSTP as swiftly and cost-efficiently as possible.

34. Access to finance by SMEs, and financial inclusion more generally, is difficult but several remedial projects have been initiated. Banks are often unwilling to lend to small firms for lack of collateral and other safeguards. However, Banco Internacional de Sao Tome e Principe (BISTP) has established a financial inclusion program with preferential loan rates and reduced fees. With World Bank assistance, we are creating the legal framework for a collateral registry, which is expected to be operational by 2020. The registry would allow SMEs to pledge real estate and movable collateral and thus attain access to bank financing more easily. As part of our action plan for financial sector development, the microfinance law was adopted in September 2018, and approval is underway for regulations related to the licensing and exercise of microfinance, microcredit risk management, and adequacy of own funds and solvency ratio. We have also conducted surveys on financial inclusion issues from the supply and demand side. After discussion of the survey findings with stakeholders, the government has been developing a national financial inclusion strategy, which will be published by end-2019. Lastly, the government will review the high cost of using ATMs, which has been a longstanding issue, with the aim of reducing the costs and promoting financial inclusion.

35. We will complete the implementation of the remaining recommendations from the last safeguards assessment and review the staffing structure. In coordination with IMF TA, the Central Bank (Organic) Law will be revised to improve auditing, oversight, and resolution in line with the recommendations of the safeguards assessment, particularly with the establishment of new audit committee. In addition, regulations and procedures will be enhanced to require perforation of currency notes immediately after they are earmarked for destruction, depositing foreign exchange reserves only in investment-grade banks when possible, and avoiding conflicts of interest. The financial institutions law will also be revised to align with the proposed changes to the organic law regarding oversight and resolution. These two laws will be submitted to the Parliament by end-2019 (*structural benchmark*). The new Central Bank building opened in August 2019, removing the space constraints for the recruitment of staff for supervision and internal audit.

36. The central bank is also working on other medium-term financial sector reforms, particularly expediting the implementation of a new payment system. These initiatives are in line with our Financial Sector Development Implementation Plan (FSDIP). With AfDB support, we will work to upgrade the payment system so that it is capable of supporting international credit cards to boost tourism and buttress foreign exchange reserves. One constraint we face is that the cost of the payment system exceeds the available funding for this project. We are exploring different options, including support from bilateral partners and the private sector. In addition, the establishment of a corporate balance sheet repository center is in progress with the technical support of Bank of Portugal and the World Bank (funding is pending).

D. External Sector Policies

Exchange Restrictions

37. The IMF Executive Board granted temporary approval of exchange restrictions and a multiple currency practice.[6] The one-year approval expired in July 2019. Given the current balance

[6] These exchange measures include: (i) an exchange restriction arising under Articles 3(g) and 18 of the Investment Code of 2016 due to limitations on the transferability of net income from investments; and (ii) an exchange restriction arising from limitations on the availability of foreign exchange for payments of current international transactions, due to the rationing of foreign exchange by BCSTP. The latter exchange restriction also gives rise to a multiple currency practice as it has resulted in the channeling of transactions to the parallel market where the exchange rate is at a spread of more than two percent from the exchange rate in the formal market. These measures were approved by the IMF Board in July 2018 for twelve months because they are temporary, non-discriminatory and needed for balance of payments reasons.

of payment issues, we will request extending the approval for another year. Efforts to boost reserves noted above will also support the removal of the restricting measures in the near term.

External Debt

38. Given the high debt level, we will continue to borrow cautiously. We will borrow only at concessional terms. Continued EMAE reform (see ¶9) will reduce fiscal liabilities. All these measures will ensure the present value debt ratio to GDP falls below the high-risk debt distress threshold by 2024 (Borrowing Plan). Contracting of new loans will be limited to 3 percent of GDP. We also strive to keep external debt disbursements below 1.5 percent of GDP. These parameters will be adjusted according to the development of debt vulnerability and can be eased once debt vulnerability decreases. We will also continue to engage actively with bilateral creditors to regularize post-HIPC arrears.

39. The government is implementing measures to strengthen debt management. Some main recommendations of the Debt Management Performance Assessment (DeMPA), which was completed with the support of the World Bank in November 2016 are being implemented, including a draft medium-term debt management strategy. With the help of the World Bank, a debt database is being established, which is critical for improving debt service projections, conducting risk analyses, and reporting more detailed information on the debt stock. Training of officials on debt management, including T-Bill issuance and risk management, is planned with the help of the World Bank and the AfDB. The government will develop and publish an annual schedule of T-Bill issuance that aligns with cash flow forecasts and borrowing plans.

Borrowing Plan 2019-21

(For Investment, Millions of U.S. dollars)

	2019	
New public debt contracted or guaranteed	Volume 1/	Present value 1/
Sources of debt financing	12.9	8.4
Concessional debt of which 2/	12.9	8.4
Non-concessional debt of which 2/	0.0	0.0
Semi-concessional debt 3/	0.0	0.0
Commercial terms 4/	0.0	0.0
Uses of debt financing	12.9	8.4
Memorandum items		
Indicative projections		
2020	13.9	9.0
2021	15.0	9.7

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

E. The Implementation of Other Structural Reforms

Development Planning

40. We chose to focus on five Sustainable Development Goals (SDGs). These are: eradication of poverty; decent work and economic growth; industry, innovation and infrastructure; life below water; and justice and equity. We are making progress on each of these goals, and São Tomé and Príncipe ranks tenth out of 51 African countries on overall performance on the SDG targets. However, poverty remains high, a large share of school-aged children is estimated to be working, and infrastructure remains inadequate. In March 2019, we held a steering committee meeting with UN agencies to discuss strategies and progress on meeting the SDGs. In addition, we are committed to gender equality, which is another SDG. We began drafting a new national action plan on women's economic empowerment and financial inclusion at a June 2019 workshop we hosted in coordination with the IMF and United Nations and the High Commission of Canada (*structural benchmark*) and continued the discussion during a high-level international conference on July 31, 2019.

Business Climate to Promote Tourism

41. The government will redouble the effort to implement the tourism strategy, with the following specific actions as a structural benchmark:

- Publish a clearly-codified procedure for the approval of investment to facilitate investment in tourism.
- Publish quarterly tourist arrival data, which will be agreed upon by relevant agencies (e.g. Border Control, BCSTP, Tourism, INE), within two months the period ending.
- Expand the annual BCSTP tourist survey on expenses to include information about overall visit and experience satisfaction. This will be completed with the cooperation among BCSTP, Ministry of Tourism, and INE. With the World Bank support, the Tourism Directorate did a first round of exit survey at the airport in 2016.

42. Other near-term actions are underway to improve the payment system, train workers, enhance coordination, reduce transportation costs, and facilitate licensing. As noted previously, we will expedite the development of a payment system with the capability of processing international credit cards to not only stimulate the tourism sector but also boost international reserves. With the support of the World Bank, we have been working to establish a tourism school to develop local capacity, and we anticipate that the school will open at the end of 2019. To enhance coordination and planning efforts, we will also create a high-level commission on tourism with all relevant ministries, the Principe government, and business associations. In addition, we will aim to improve the port of Principe, which will help reduce the cost of imports (currently on average 20 percent higher than in São Tomé) and ensure a steady supply of goods. Finally, we will integrate tourism licensing requests in the GUEnet portal (online portal for starting a business). With support from the World Bank, the platform has been developed, and the validation will be completed by September 2019 to increase transparency on tourism licensing procedures.

43. Over the medium term, we will work to develop fisheries and eco-agriculture to expand the local supply chain to the tourism sector. This holds great potential to promote inclusive and sustainable growth and reduce poverty, as about 15 percent of the population directly or indirectly relies on fishing for their livelihood (currently mostly using small-scale vessels) and 75 percent depend on subsistence agriculture. We will support local agriculture and fishing by improving and expanding infrastructure across the country, including in Principe. This includes projects focused on roads, green houses, fishing docks, and irrigation systems as well as those geared towards improving the management of the agricultural cooperatives to incentivize production. We are actively looking for funding to conduct a new agricultural survey to guide policy making, as the latest survey was conducted in 1991.

Energy Sector Reform

44. Implementation of the Least Cost Development Plan and Management Improvement Plan (MIP) is underway. Helping EMAE to achieve cost recovery is crucial for ensuring the country's energy safety, as EMAE has been unable to pay most of its bills for fuel supply. Current developments show that the country is vulnerable to shortages of fuel supply. As discussed elsewhere, stable, low cost, and increased power supply are key to robust growth. Specifically, we will implement the measures listed below at the specified time frame. The measures will reduce commercial loss by 4 percent and peak consumption by 10 percent, improve billings, and implement tariff reform.

Objective 1: Reduce commercial losses by 4 (6) percentage points and improve collection rate by 3 (6) percentage points by June 2020 (June 2021) to lower commercial losses below 15 percent and raise the collection rate to 95 percent by June 2021. This will be achieved by:

a. Approve and implement the MIP. Sign a performance contract with the CEO of EMAE and setting in place by September 2019 a dedicated team at EMAE in charge of implementing the measures and achieve the above objectives.
b. Reduce diesel losses by half by June 2020 to lower the loss to below five percent.
c. Arrears clearance plans are agreed with large private consumers, small medium enterprises, as well as residential consumer. Government defines essential (non-disconnectable) and non-essential (disconnectable) consumption facilities. Services are cut off due to non-payment, to be implemented by October 2019. In cases where disconnection is not appropriate, we will use other enforcement tools such as seizing the bank account of the offending company.
d. Launch a communication campaign to explain that collective action is needed to improve electricity services.
e. Modernize billing and install pre-paid and smart meters. EMAE installs 1200 prepayment meters to all facilities categorized as disconnectable by government by June-2020. Continue to disconnect non-essential consumption for nonpayment.
f. Government establishes a mechanism with EMAE to cap consumption and ensure timely bills payment by public entities, including by cutting EMAE's services, deducting from budget allocation, and transferring directly from Treasury to pay EMAE to be implemented by September 2019 (see ¶17).

Objective 2: Reduce overall energy consumption by 15 percent within 12 months and facilitate the phase-out of incandescent bulbs by end-2020. This is achieved through:

g. Government will roll out a program to replace incandescent/fluorescent with LED program, which can be implemented within nine months. The $1 million program will be funded by the World Bank.
h. Government will pass a law that bans the importation of incandescent/fluorescent lamps by the end of 2020. Conduct outreach to stakeholders such as light importers, raising awareness and helping them access LED suppliers.

Objective 3: reform the tariff through (i) establishing a mechanism and (ii) implementing the first tariff reform once the prepaid meters are in place for the large consumers.

i. The preliminary tariff analysis has been completed and identified the need for an in-depth tariff reform to be led by the regulator AGER. In order to gradually achieve cost-effective tariff structure, the government needs to immediately enforce through a decree the proposed adjustments regarding (i) tariff structure definition, (ii) customer category definition, (iii) social tariffs adjustments, and (iv) agreed timeline to achieve full cost-recovery structure. A draft decree has been submitted to the government and it should be approved by October 2019.

j. The first tariff increase is to be implemented once meters are in place by June 2020 for large consumers.

In sum below are the short-term targets and actions (*structural benchmarks*)

		Target	
	Baseline	June 2020	June 2021
Reducing commercial loss to	23 percent	19 percent	17 percent
Reducing technical loss to	11 percent	10 percent	
Raising bill collection rate	89 percent	93 percent	95 percent
Reducing diesel loss	10 percent	5 percent	

Actions to be taken		Target date
1	Signing contract with EMAE CEO and establish a dedicated team implemented to achieve the objective	Sep-19
2	Approve a decree to adjust the tariffs	Oct-19
3	Develop arrears clearance plan with customers and cut off nonpaying customers.	Oct-19
4	Install 1200 prepayment meters to all disconnectable users and continue to disconnect non-paying customers	Jun-20
5	First tariff adjustment to be implemented	Jun-20
6	Implement a LED program and stop importing incandescent and fluorescent lights	end-20

Improve Economic Statistics

45. We are continuing to improve economic data. An IMF mission in March 2019 helped us to implement the enhanced General Data Dissemination System (e-GDDS) to foster greater data accessibility and identify priority areas for data quality improvements. We committed to publishing data essential for surveillance through a National Summary Data Page (NSDP) by May 5, 2019 using Statistical Data and Metadata Exchange (SDMX) for machine-to-machine data transfer.

Capacity Development

46. We will continue to build our capacity with the support of international institutions. Given limited staff capacity, on-the-job training has been particularly important. Therefore. we will seek to complement short-term technical assistance with that provided by long-term or peripatetic experts, who not only produces the diagnosis of the problems but also supports the implementation of the recommendations. In addition, we will also request Portuguese speaking experts to facilitate interactions, expedite the identification of the core of the problems, and help the transfer of knowledge.

PROGRAM MONITORING

47. The program will be monitored on a semi-annual basis, through quantitative performance criteria and indicative targets (Table 3) and structural benchmarks (Table 4). Quantitative targets set for end-December 2019 and end-June 2020, while those for end-September 2019 and end-March 2020 are indicative targets. The first review should be completed on or after April 15, 2020, and the second review should be completed on or after August 15, 2020.

MEFP Table 1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2018 Under the Previous ECF Arrangement

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

	2018							
	June				December			
	Performance Criteria [1]				Indicative Target[1]			
	4th rev.	w/adjusts	Prel.	Status	5th rev.	w/adjusts	Prel.	Status
Performance Criteria:								
Floor on domestic primary balance (as defined in the TMU) [2]	-90	-90	-43	Met	-124	-124	-362	Not met
Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	75	86	10	Met	70	9	219	Not met
Floor on net international reserves of the central bank (US$ millions) [2, 4]	52	51	39	Not met	50	47	27	Not met
Ceiling on the accumulation of central government's new external payment arrears (US$ millions) [5, 6, 7, 8]	0	…	0	Met	0	…	0	Met
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the central government or the BCSTP (US$ millions) [5, 6, 7, 8, 9]	0	…	0	Met	0	…	0	Met
Indicative Targets:								
Ceiling on change of central government's new domestic arrears	0	…	-17	Met	0	…	76	Not met
Floor on pro-poor expenditures	289	…	302	Met	551	…	690	Met
Floor on tax revenue	535	…	556	Met	1,084	…	1,099	Met
Memorandum items:								
Ceiling on dobra base money (stock) [10]	1,578	…	1,224	…	1,499	…	1,339	…
New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the BCSTP (US$ millions) [5, 7, 8, 11]	17	…	0	…	17	…	0	…
Transfer from NOA to the budget (US$ millions)	1.5	…	2.1	…	2.2	…	2.1	…
Net external debt service payments [12]	68	…	43	…	79	…	87	…
Official external program support [12]	85	…	19	…	179	…	144	…
Budget support grants [13]	66	…	0	…	142	…	125	…
Treasury-funded capital expenditure	13	…	6	…	12	…	14	…

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

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

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

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

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

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

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

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

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

[9] Only applies to debt with a grant element of less than 35 percent. For further details refer to the TMU, ¶12 and 17.

[10] Changed to a memorandum item.

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

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

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

MEFP Table 2. São Tomé and Príncipe: Structural Benchmarks for 2018 Under the Previous ECF Arrangement

Policy Objectives and Measures	Timing	Macro Rationale	TA involved	Status
Strengthening Public Finances				
Submit to the National Assembly a new VAT law.	End-June 2018	To support the introduction of VAT	FAD/LEG	Met.
Adopt financial management plan and least cost energy-production plan for EMAE.	End-September 2018	To contain fiscal risk	With World Bank support	Not met.
Submit monthly monitoring table of tax payments by top 10 taxpayers during June-October 2018.	End-November 2018	To mobilize domestic revenue	No TA involved	Not met.
Enhancing Monetary Policy and Financial Stability				
Require the external consultant to complete an inception report for asset quality review of banks.	End-September 2018	To support financial sector stability and growth	With World Bank support	Met.
Facilitating Business Activities				
Develop and submit to the National Assembly a National Export Diversification Strategy document.	End-June 2018	To promote economic diversification and employment opportunities	With World Bank support	Met.

MEFP Table 3. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2019–20

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

	2019	2020		
	December	March	June	September
	Performance Criteria [1] Proposed	Indicative Target Proposed	Performance Criteria Proposed	Indicative Target Proposed
Performance Criteria:				
Floor on domestic primary balance (as defined in the TMU) [2]	-198	-38	-76	-130
Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	61	20	40	140
Floor on net international reserves of the central bank (US$ millions) [2, 4]	27	28	30	31
Ceiling on the accumulation of central government's new external payment arrears (US$ millions) [5, 6, 7, 8]	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
Not to (i) introduce or intensify any exchange restrictions (ii) introduce or impose import restrictions, (iii) introduce or modify multiple currency practices, or (iv) conclude bilateral payment agreements in violation of Article VIII of the Articles of Agreements	Continuous	Continuous	Continuous	Continuous
Indicative Targets:				
Ceiling on change of central government's new domestic arrears	0	0	0	0
Floor on pro-poor expenditures	584	155	310	464
Floor on tax revenue	1166	327	654	973
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]	13	14	14	14
Memorandum items:				
Ceiling on dobra base money (stock)	1,488	1,498	1,517	1,522
Transfer from NOA to the budget (US$ millions)	3.9	3.7	3.7	3.7
Net external debt service payments [11]	116	33	67	100
Official external program support [11]	237	0	129	129
IMF program disbursement	56	0	56	56
Budget support grants	182	0	74	74
Domestic arrears clearance (-, exclude debt payment to ENCO)	0	-17	-33	-50
Treasury-funded capital expenditure	13	4	8	15

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

[1] Performance at the December 2019 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 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 and 17.

[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, excludes HIPC-related amortization.

MEFP Table 4. São Tomé and Príncipe: Prior Actions and Structural Benchmarks Under ECF Arrangement

Policy Objectives and Measures	Timing	Macro Rationale	TA involved	Status
Prior Actions				
Adopt a government decree to align the 2019 budget to be consistent with the program and necessary legislation to introducing revenue measures agreed and revise the VAT law for specific discussion by Parliament in line with IMF recommendation. (MEFP ¶16-18)		To demonstrate commitment to fiscal consolidation	No TA involved	
Government adopt Management Improvement Plan and Least Cost Energy-production Plan for EMAE recommended by World Bank		To contain fiscal risk	With World Bank support	Met
Adopt a monthly budget allocation plan for the remainder of the year to ensure expenditures remain within the budget		To contain expenditures	No TA involved	
Strengthening Public Finances				
Adopt a VAT law in line with the IMF recommendation (MEFP ¶22)	October 15, 2019	To support the introduction of VAT	FAD/LEG	
Start to implement the communication plan to explain the VAT to the public as recommended by the IMF	End-September 2019	To support the introduction of VAT	With IMF support	
Implement key measures of Management Improvement Plan and Least Cost Development Plan for EMAE (MEFP ¶44)	Continuous	To contain fiscal risk	With World Bank support	
Raise fuel prices in line with the costs, consistent with the automatic fuel price adjustment mechanism.	Continuous	To enhance revenue	No TA involved	
Enhancing Monetary Policy and Financial Stability				
Tighten monetary policy by issuing central bank certificate of deposits of at least D50 million to maintain stock of reserves (MEFP ¶25)	End-March 2020	Support the peg	MCM	
Implement recommendations of the Asset Quality Review of banks including asset reclassification and provisioning; require banks that have inadequate captial as a result to recapitalize (MEFP ¶30)	End-March 2020	To support financial sector stability and growth	No TA involved	
Submit to Parliament an amended BCSTP Law to strengthen autonomy and governance of BCSTP and a revised financial institutions law, in consultation with IMF staff (MEFP ¶35)	End-December 2019	To strengthen financial supervision and improve governance and oversight	MCM/LEG	
Implement a bank rating model to support effective on- and off-site supervision (MEFP ¶31); upgrade banking regulation to align with effective on- and off-site supervisions as recommended by IMF TA and train staff on its effective enforcement	End-June 2020	To better detect infractions of prudential regulation and enforce remedial measures.	IMF Afritac Central	
Establish registry of real estate and movable collateral	End-June 2020	To facilitate access to finance, particularly for small-and medium-sized	With World Bank Support	
Facilitating Business Activities				
Submit to the IMF the national strategy on women's economic empowerment and financial inclusion (MEFP ¶40)	End-December 2019	To promote economic participation and gender equality	No TA involved	
Implement recommendations of the Tourism Development Strategy as specified in (MEFP ¶41)	End-June 2020	To promote economic growth and employment opportunities	With World Bank support	

Attachment II. Technical Memorandum of Understanding, August 2019

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 2019-23. 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[7] will be the rates at end-2018, specifically 21.6925 new dobras per U.S. dollar, 24.5 new dobras per euro, and 29.17221 new dobras per SDR.

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

DEFINITIONS

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

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

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

[7] Data refer to the mid-point exchange rates published on the BCSTP's webpage for the last day of 2018.

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

8. Domestic primary expenditure comprises all government spending assessed on a commitment basis (*base compromisso*), excluding (1) capital expenditure financed with external concessional loans and project grants, (2) the cost assumed by the budget to pay off small depositors following the liquidation of banco Equador, and (3) scheduled interest payments. Reporting of government domestic expenditure will be based on the state budget execution prepared every month by the Directorate of Budget and the Directorate of Treasury in the MOF. All capital expenditures financed by budget support grants (including EU's) are treated as part of domestic primary spending, with no exception.

Official External Program Support

	2019	2020 H1	Currency Unit
Projected budgetary support grants			
World Bank	5	0	million US dollars
European Union	3	3	million euros
IMF ECF program	1.9	1.9	million SDR

PERFORMANCE CRITERIA

9. Performance criterion on the floor on domestic primary balance. This performance criterion refers to the difference between government domestic revenue (including oil tax surcharge and excluding oil revenue) and domestic primary expenditure. Planned payment of (price differential) debt to ENCO (¶22) are deducted from the oil surcharge revenue. To control spending, MoF will not approve borrowing by any public entity in the central government other than Treasury (MEFP ¶14, 17). Accordingly, for the purpose of program monitoring, borrowing by any public entity other than Treasury recorded in the monetary survey as loans to the central government will be added as additional expenditure to the DPD. For reference, the domestic primary balance for end 2019 based on hypothetical outturns would be -173.7 million new dobras, broken down as follows:

Domestic Primary Balance
(2019, millions of new dobras)

I.	**Total revenue and grants (=1+2+3)**	2154.4
I.A	**of which domestic revenue (=I-2.1-3=1+2-2.1)**	1270.3
1.	Tax revenue	1187.8
1.1	*of which:* oil surcharge	50.0
2.	Nontax revenue	134.6
2.1	*of which:* oil revenue	52.0
3.	Grants	832.1
II.	**Total expenditure (=4+5+6)**	2157.3
II.A	**of which: domestic primary expenditure (=4-4.2+5.1+6)**	1384.0
4.	Current expenditure	1398.6
4.1	Personnel costs	752.6
4.2	Interest due	50.3
4.3	Goods and services	243.0
4.4	Transfers	279.5
4.5	Other current expenditure	73.1
5.	Capital expenditure	737.0
5.1	Financed by the Treasury	13.8
5.2	Financed by external sources	723.1
6.	HIPC Initiative-related social expenditure	21.8
III.	**Domestic primary balance (= I.A-II.A+IV-V)**	-173.7
	Memorandum items	
IV.	**Planned payment to ENCO (reduction = -)**	-10.0
V.	**Borrowing by other entities**	50.0

10. Performance criterion on the ceiling on changes in net bank financing of the central government (NCG). This performance criterion refers to the increase (decrease) of net bank financing of the central government, which equals the stock of all outstanding claims on the central government held by the BCSTP and by other depository corporations (ODCs), less the stock of all deposits held by the central government with the BCSTP and with ODCs, plus the increase, if any (with the approval of the ministry of finance) of ODC's credit to the public entities. The balance of the National Oil Account (NOA), deposits from project grants and project loans, contingent liabilities, and social security operations are not included in NCG. All foreign exchange-denominated accounts will be converted to new dobras at the program exchange rate. The relevant data are reported monthly by the BCSTP to the IMF staff. For reference, at end-2018, outstanding net bank financing of the central government (excluding NOA) was 231 million new dobras, as follows:

Net Bank Financing
(millions of new dobras)

		2017	2018
I	***Net credit to government by the BCSTP (=I.1-I.2)***	**93**	**231**
I.1	BCSTP credit, including use of IMF resources:	260	310
I.2	Government deposits with the BCSTP (excluding NOA)	167	79
	Treasury dobra-denominated accounts	23	7
	Treasury foreign currency-denominated accounts	84	7
	Counterpart deposits	60	65
II	***Net credit to government by ODCs***	**427**	**667**
II.1	ODC's credit to the government	427	667
II.2	Central government deposits with ODCs1/	0	0
III	***Net bank financing of the government (excluding NOA) (=I-II)***	**334**	**436**
IV	**Changes during 2018 in net bank financing of the central government (NCG)**		**102**

1/ No deposits in ODCs that were under the central government (Treasury) control in 2017 and 2018.

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 2018 NIR was 609 million new dobras (or $28 million, using the exchange rate of 21.6925 new dobras per U.S. dollar), calculated as follows:

		End 2018
I	***Gross international reserves***	**934**
	Cash	**25**
	Demand deposits	**81**
	Term deposits (incl. banks' deposits in foreign currency)	**138**
	Securities other than shares	**677**
	Portuguese Treasury Bond I	98
	Portuguese Treasury Bond II	243
	Portuguese Treasury Bond III	123
	US Treasury Bill I	107
	US Treasury Bill II	107
	Accrued interest on securities	8
	Reserve position in the Fund	0
	SDR holdings	**6**
II	***Foreign exchange liability***	**325**
	Short-term bilateral liabilities	21
	Liabilities to the IMF	147
	Banks' reserves denominated in foreign currency	157
	Banks' guaranteed deposits denominated in foreign currency	0
III	***Net international reserves (NIR) (=I - II)***	**609**
IV	***Net other foreign assets***	**235**
	Other foreign assets	446
	Medium and long-term liabilities (including SDR allocation)	211
V	***Net foreign assets (III+IV)***	**844**
	Memorandum item: National Oil Account (NOA)	**419**

12. Performance criterion on the ceiling on the contracting or guaranteeing of new nonconcessional external debt by the central government or the BCSTP. This continuous performance criterion covers the contracting or guaranteeing of new external debt of any maturity (including overdraft positions but excluding short-term import-related and supplier credits) by the central 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 debt and its net present value, expressed as a percentage of the nominal value. The net present value of the debt at the date on which it is contracted is calculated by discounting the stream of debt service payments at the time of the contracting. The discount rate used for this purpose is 5 percent. For program purposes, a debt is considered contracted on the signature date of the contract, unless it is specified in the contract that it becomes effective upon ratification by the parliament. In the latter case, the debt is considered contracted upon ratification by parliament. This performance criterion does not apply to IMF resources. Debt being rescheduled or restructured is excluded from this ceiling to the extent that such non-concessional debt is used for debt management operations that improve the overall public debt profile. Medium- and long-term debt will be reported by the Debt Management Department of the MOF (as appropriate), measured in U.S. dollars at the prevailing exchange rates published by the BCSTP. The government should consult with IMF staff before contracting or guaranteeing new debt obligations.

13. Performance criterion on the ceiling on the accumulation of central government's new external payment arrears. This is a continuous performance criterion. New central government external payment arrears consist of external debt service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreement, subject to any applicable grace period. This performance criterion does not apply to arrears resulting from the nonpayment of debt service for which a clearance framework has been signed by the debtor and creditor before the relevant payment comes due or for which the government has sought rescheduling or restructuring as of March 2019.

INDICATIVE TARGETS

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

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

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

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

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

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

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

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

17. New concessional external debt contracted or guaranteed by the central government or the BCSTP measures such debt with a grant element of at least 35 percent, and the limits on this debt are cumulative from the end of the previous calendar year.

MEMORANDUM ITEMS

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

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

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

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

22. Planned payment of debt to ENCO is the targeted amount to be deducted from the oil surcharge to pay back debt to ENCO during the year as discussed in paragraph 9. Higher than planned payments are not excluded from the revenue and will be included in domestic debt service. The planned annual payment is D0, D32 million in 2019 and 2020, respectively, half of which will be paid during the first semester.

23. Arrear clearance is measured as changes in the stock of government arrears to domestic suppliers as defined in paragraph 15.

USE OF ADJUSTERS

24. The performance criterion on the domestic primary balance will have one adjuster. The floor on the domestic primary balance will be adjusted upward for the shortfall of budgetary grants and downward if the government receives more than projected budget support grants and privatization receipts in 2019 and 2020; the adjustment down will be capped at 25 million new dobras (a little over ¼ percent of 2018 GDP) for 2019 and 15 million new dobras for the first semester of 2020.[8] For program purpose, the projected privatization proceeds are 0 in 2019 and 2020.

25. The performance criteria on net bank financing of the central government and net international reserves of the central bank will be subject to the following adjusters based on deviations calculated cumulatively from end-December 2018 or end-December 2019, as appropriate (MEFP Attachment I, Table 3):

- ***Adjusters on ceilings on changes in net bank financing of the central government (NCG)***: Quarterly differences between actual and projected receipts of budget transfers from the NOA, budgetary support grant~~,~~ net external debt service payments, and domestic arrears will be converted to new dobras at the program exchange rate and aggregated from end-

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

December 2018 or end-December 2019, as appropriate, to the test date. The ceilings will be adjusted:

- (i) downward (upward) by cumulative deviations downward (upward) of actual from projected net external debt service payments (exclude HPIC),
- (ii) downward (upward) by deviation upward (downward) in budget transfers from the NOA,
- (iii) downward by deviation upward of budgetary support grants in excess of 25 and 15 million new dobras in 2019 and the first semester of 2020 respectively.
- (iv) downward (upward) by deviation upward (downward) of domestic arrears.

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

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

  - (i) by the cumulative deviation downward (upward) of actual from projected net external debt service payments of the central government;
  - (ii) by deviations upward (downward) for budget transfers from the NOA, and
  - (iii) by deviations upward (downward) of official external program support. Budget support loans in 2019 and 2020 are projected to be 0.

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

DATA REPORTING

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

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

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

- Monthly data on net credit to the government by the BCSTP, recorded account by account in a format fully compatible with the monetary accounts of the BCSTP;
- Monthly detailed data on tax and nontax revenues;
- Monthly detailed data on domestically financed capital expenditure on commitment (*compromisso*) and cash payments (*caixa*);
- Monthly data on domestic arrears by type and by creditor;
- Quarterly data on implicit arrears to ENCO on account of fuel retail prices eventually not covering import costs, distribution margins and applicable taxes;
- Quarterly data on EMAE's arrears to ENCO;
- Monthly data on official external program support (non-project);
- Quarterly data on the execution of the public investment program (PIP) by project and sources of financing;
- Quarterly data on the execution of Treasury-funded capital expenditure by project type, amount, timetable of execution, and progress of execution;
- Quarterly data on project grant and loan disbursement (HIPC and non-HIPC);
- Quarterly data on bilateral HIPC debt relief;
- Quarterly information on the latest outstanding petroleum price structures and submission of new pricing structures (within a week of becoming available).
- Quarterly pro-poor expenditure.

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

- Daily data on exchange rates, to be posted on the central bank's web site;
- Daily data on interest rates, to be posted on the central bank's web site;
- Daily liquidity management table, including base money (in new dobras) and currency in circulation, to be posted on the central bank's web site;
- Daily net international reserve position, to be posted on the central bank's web site;

- Monthly balance sheet data of BCSTP (in IMF report form 1SR, with requested memorandum items);
- Monthly consolidated balance sheet data of other depository corporations (in IMF report form 2SR);
- Monthly consolidated depository corporations survey (in IMF survey 3SG);
- Monthly central bank foreign exchange balance (*Orçamento cambial*);
- Quarterly table on bank prudential ratios and financial soundness indicators;
- Quarterly data on the BCSTP's financial position (profit and loss statement, deficit, budget execution, etc.).

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

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

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

- Monthly consumer price index data provided by the National Institute of Statistics within one month after the end of each month;
- Monthly data on imports (value of imports, import taxes collected, and arrears) and commodity export values, provided by the Customs Directorate at the MOF, within two months after the end of each month;
- Monthly data on petroleum shipments and consumption (volumes and c.i.f. prices, by product), provided by the Customs Directorate.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

September 18, 2019

REQUEST FOR A 40-MONTH ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—INFORMATIONAL ANNEX

Prepared By | The African Department (in consultation with other departments)

CONTENTS

RELATIONS WITH THE FUND

(As of August 31, 2019)

Membership Status

Joined: September 30, 1977; Article XIV

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

SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	7.10	100.00
Holdings	0.20	2.79

Outstanding Purchases and Loans:	**SDR Million**	**% Quota**
ECF Arrangements	4.69	31.71

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ECF	07/13/2015	12/31/2018	4.44	3.81
ECF	07/20/2012	07/13/2015	2.59	1.11
ECF[1]	03/02/2009	03/01/2012	2.59	0.74

1/ Formerly PRGF.

Projected Payments to Fund[2]

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

	Forthcoming				
	2019	2020	2021	2022	2023
Principal	0.07	0.26	0.41	0.60	0.75
Charges/Interest	0.02	0.06	0.06	0.06	0.06
Total	0.09	0.32	0.48	0.67	0.81

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

Implementation of HIPC Initiative:

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

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

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

Implementation of Multilateral Debt Relief Initiative (MDRI):

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

Debt Relief by Facility (SDR Million)

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

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

Safeguards Assessments:

Safeguards assessments were conducted in 2009, 2013, 2015, and 2019. Limited progress has been made on strengthening safeguards at the Central Bank of Sao Tome and Principe (BCSTP). While external audits continue to be conducted by reputable audit firms, capacity constraints have contributed to a weak safeguards framework at the BCSTP. The central bank law needs to be amended in the areas of autonomy and governance, the financial position is weak and financial reporting practices have not yet been aligned with international standards, and the internal audit function continues to face capacity constraints. In addition, independent oversight of daily operations continues to be lacking. Technical assistance is necessary to advance the needed reforms in the areas of the central bank legislation, financial reporting, and internal audit.

Exchange Arrangements:

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

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

Article IV Consultation:

São Tomé and Príncipe is currently under a 24-month consultation cycle. The Executive Board concluded the last Article IV consultation on July 23, 2018.

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 2014–19:

Date of Delivery	Department/Purpose
September 2019	STX mission on government finance statistics
September 2019	AFRITAC Customs revenue mobilization
September 2019	STX mission tax administration
August 2019	MCM mission on open market operations
July 2019	STX mission tax administration
June 2019	STX mission revenue administration
May 2019	AFRITAC mission on banking reg. and supervision
May 2019	STX mission on revenue administration
May 2019	FAD mission on revenue administration
April 2019	MCM safeguard assessment mission
April 2019	AFRITAC mission on national accounts statistics
Mars 2019	AFRITAC mission on government finance statistics
December 2018	AFRITAC mission on government finance statistics
December 2018	AFRITAC mission on banking reg. and supervision
October 2018	AFRITAC mission on government finance statistics
October 2018	AFRITAC mission on debt management
September 2018	AFRITAC mission on government finance statistics
August 2018	STX mission on tax policy
August 2018	FAD mission on revenue administration
August 2018	FAD mission on PFM
June 2018	AFRITAC mission on national accounts statistics
June 2018	FAD mission on preparation for VAT
May 2018	FAD mission on customs administration
May 2018	AFRITAC training workshop on debt management
May 2018	AFRITAC mission on banking reg. and supervision

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

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

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

A: World Bank

http://www.worldbank.org/en/country/saotome

B: African Development Bank

https://www.afdb.org/en/countries/southern-africa/sao-tome-and-principe/

STATISTICAL ISSUES

(As of August 21, 2019)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, particularly in terms of its timeliness, although it is broadly adequate for surveillance. More effort is needed to enhance macroeconomic statistics collection, particularly for leading indicators of economic activity and tourism data. Serious financial, human capital, and technological resource constraints have delayed efforts to strengthen the statistical system. Key shortcomings are in the national accounts and fiscal sector.
National Accounts: The authorities compile and publish an annual GDP time series, using an outdated base year (2008) and inadequate source data. The GDP time series contains several shortcomings, including an intermediate consumption ratio assumed to be fixed over time at current prices, and estimates of GDP using the expenditure approach that estimates household final consumption expenditure as the residual. The authorities continue to work on improvements to source data. The latest estimate of GDP is for calendar year 2018, which is still subject to revision. Quarterly estimates of GDP are not compiled, but AFRITAC Central has started to provide technical assistance for their development.
Consumer Price Statistics: The INE began to disseminate a new CPI (base: 2014 = 100) from January 2016. With the assistance of AFRISTAT, the product mix was changed and the weights were updated, using the results of a household expenditure survey conducted in 2010. Due to financial constraints, the new CPI only covers the capital city. A technical assistance mission in fiscal year 2018 reviewed the re-referenced index, performed diagnostics on the entire series, linked the pre- and post-rebased series to produce an analytical series for the IMF database and statistical purposes, and considered INE's plans for further updates to the CPI upon completion of the new HES that is underway with World Bank support.
Government Finance Statistics: Detailed revenue and expenditure data are compiled and reported to AFR. The main areas that need to be strengthened are: (i) monitoring of expenditures on projects financed by donors; and (ii) financing operations. All project loans (financed by donors) are programmed in the budget, but some are executed independently. The government has requested development partners to help in recording all external financing in the budget. The recording of financing operations and stocks is expected to improve since the debt data management capacity is expected to be strengthened. The 2010–16 government accounts have been finalized and submitted to the Court of Audit. The authorities are working on the 2017 government account. STP joined the AFRITAC Central project in 2017 with plans to develop GFS. TA missions completed in 2017 and 2018 focused on: i) identifying the priorities in terms of the GFS compilation and suggested to the authorities a migration path towards the full adoption of the Government Finance Statistics Manual 2014 (GFSM 2014) principles; and ii) assisting the Ministry of Finance to compile GFS for the budgetary central government for one fiscal year in accordance with the

GFSM 2014. A TA mission in March 2019 supported the authorities in the ongoing capacity development program aimed at improving fiscal data compilation (implementing the framework of the Government Finance Statistics Manual 2014 (GFSM 2014). An AFRITAC Central workshop in 2019 focused on the i) selection of data sources for compiling the TOFE; ii) procedures and mechanisms for producing GFS from government entities trial balances and financial statements; and iii) transmission of GFS and public sector debt statistics to STA.
Monetary and Financial Statistics: STA missions provided technical assistance on monetary statistics in December 2004, April/May 2006, June 2007 and September 2010. As a result, the accuracy and timeliness of the monetary data reported in the standardized report forms (SRF) for the central bank and the other depository corporations' data improved significantly. The BCSTP has resumed reporting monthly data to STA for the central bank and other depository corporations (ODCs) on a regular basis. The BCSTP monthly trial balance sheet is broadly adequate to compile monetary statistics in line with the *Monetary and Financial Statistics Manual and Compilation Guide (MFSMCG)*. A new plan of accounts for ODCs was introduced in January 2010. The September 2010 mission reviewed the new plan of accounts for the financial system, and found it adequate for a proper classification, sectorization, and valuation of financial instruments, and in line with the methodology of the *MFSMCG*. However, the mission detected serious shortcomings in the information reported by some banks and an inconsistent approach in the way banks report to the BCSTP. Following the mission's recommendations, the BCSTP worked towards eliminating those problems. The central bank has begun to collect data from insurance companies that opened in the past few years. The asset sizes of insurance companies remain small enough not to warrant inclusion in monetary statistics at this time. The central bank produces a quarterly FSI table. MCM TA missions on banking supervision have helped expand the coverage of the table and improved the data quality. TA missions in December 2018 and May 2019, led by AFC, focused on supporting the BCSTP in implementing risk-based banking supervision. AFC plans to fund two banking regulation and supervision missions to BCSTP each fiscal year to support the authorities with operational and hands-on technical assistance. BCSTP reports some data and indicators to the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).
External Sector Statistics (ESS): The BCSTP compiles quarterly balance of payments and international investment position (IIP) statistics consistent with the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)*. Data submission to STA is regular, although timeliness should be improved (lags exceed two quarters) and further work is needed to improve coverage, reliability, and level of detail. Response rates to surveys of the nonfinancial sector are low and the net errors and omissions are still very large; the BCSTP is evaluating other data collection methods to be relied on until the

survey response rate is deemed adequate. Direct access by compilers to oil trade data is essential to improve the quality of ESS. Further work is also needed improve the compilation and consistency of financial transactions and IIP statistics. The most recent technical assistance mission (February 2018) found challenges related to the low response rate to surveys, limited granularity and coverage of the goods account, and constrained staff resources.
II. Data Standards and Quality
São Tomé and Príncipe is a participant in the Fund's enhanced General Data Dissemination System (eGDDS) and has published critical data on the National Summary Data Page.

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

(As of August 21, 2019)

	Date of Last Actual Observation	Date Received	Frequency of Data[6]	Frequency of Reporting	Frequency of Publication
Exchange rates	July 2019	August 2019	M	M	M
International reserve assets and reserve liabilities of the monetary authorities[1]	July 2019	August 2019	M	M	M
International investment position	Q4 2018	May 2019	Q	Q	Q
Reserve/base money	July 2019	August 2019	M	M	M
Broad money	June 2019	August 2019	M	M	M
Central bank balance sheet	July 2019	August 2019	M	M	M
Consolidated balance sheet of the banking system	June 2019	August 2019	M	M	M
Interest rates[2]	Apr 2019	August 2019	M	M	M
Consumer Price Index	Apr 2019	July 2019	M	M	M
Revenue, expenditure, balance and composition of financing[3] – general government[4]	May 2018	Jun 2018	M	M	M
Revenue, expenditure, balance and composition of financing[3] – central government	May 2018	Jun 2018	M	M	M
Stocks of central government and central government-guaranteed debt[5]	Dec 2017	Mar 2018	M	Q	Q
External current account balance	Q1 2019	Jun 2019	Q	Q	Q
Exports and imports of goods	Q1 2019	June 2019	Q	Q	Q
GDP/GNP[6]	2017	Mar 2018	A	A	A
Gross external debt	Dec 2017	Mar 2018	M	Q	Q

[1] Includes reserve asset pledged or otherwise encumbered as well as net derivative positions.
[2] Central bank's reference rate.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); not available (NA).

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

September 18, 2019

REQUEST FOR A 40-MONTH ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS[1]

Approved By
David Owen and Kevin Fletcher (IMF) and Marcello Estevão (IDA)

Prepared by the staffs of the International Monetary Fund and International Development Association.

São Tomé and Príncipe: Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	*In debt distress*
Overall risk of debt distress	*In debt distress*
Granularity in the risk rating	*Sustainable*
Application of judgement	*No*

The country remains in debt distress due to prolonged unsettled external arrears, the same rating as in the previous debt sustainability analysis (DSA). *In addition, the significant domestic arrears of the large loss-making state-owned utility company (EMAE) reflect severe liquidity constraints of the public sector. Staff assesses that the country has the capacity to repay the external arrears (2.6 percent of GDP) over time, as external debt ratios under the baseline scenario remain well below the high-risk thresholds throughout. While total public and publicly guaranteed (PPG) debt is currently above the high-risk benchmark, it can be deemed sustainable as the present value of total PPG debt falls below the benchmark with the terms of formalized arrears of EMAE to its fuel supplier (ENCO) and the government to ENCO taken into account, and the country is committed to borrow externally only at concessional terms at a measured pace and implement EMAE's planned reforms.*

[1] The DSA update was prepared by IMF and World Bank staffs in collaboration with the authorities of São Tomé and Príncipe. The analysis updates the previous Joint DSA dated July 9, 2018 (IMF Country Report No. 18/251). The DSA follows the IMF and World Bank Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework (DSF) for Low-Income Countries (LICs) (February 2018). The country's Composite Indicator score was 2.698 and its debt carrying capacity was assessed at to be medium under the revised LIC DSF and the cross-country assessment updated in April 2019.

PUBLIC DEBT COVERAGE

1. In line with the revised DSA framework, the coverage of total PPG debt relative to the previous DSA has been expanded to include the arrears of a state-owned enterprise (SOE)—a utility company (EMAE), to its oil supplier ENCO (Text Table 1).[2] [3] There are three other fully state-owned enterprises: ENAPORT that runs the country's ports, ENASA that runs the country's airport, and Correios that provides postal service. ENASA and ENAPORT have been able to cover their expenses in recent years and seem to be able to service their own debt (although no reliable data is available); Correios is much smaller and no data is available about its debt either. Therefore, their commercial borrowings are not included under the baseline scenario in the public debt. To account for the potential contingent liabilities associated with SOEs other than EMAE, the default value of 2.0 percent of GDP is used.[4] The complete coverage of the contingent liability stress test is presented in Text Table 2.[5] Contingent liabilities from financial markets are set at their default value of 5 percent of GDP, representing the average cost to the government of a financial crisis since 1980 in LICs.[6] The $30 million disputed loan from Nigeria is covered in the contingent liability stress tests for prudence. Finally, an additional contingent liability shock is also considered for the *external* DSA, where ENCO's external arrears of $189.4 million (46.5 percent of GDP) at end-2018 to its parent company Sonangol in Angola are included in the country's external PPG debt and are assumed to be fully repaid in 20 years, starting from 2019.[7]

[2] The country's debt stocks are zero for some new elements covered under the revised DSA framework, including the social security fund and central bank debt borrowed on behalf of the government. There is no other government guaranteed debt that is excluded from this DSA.

[3] ENCO registers domestically in São Tomé and Príncipe, with 77.6 percent of its shares owned by Sonangol (an Angolan SOE) and 16.0 percent owned by São Tomé and Príncipe's government. The government's arrears to ENCO were regularized in 2016, and EMAE's arrears of $104.4 million as of end-July 2019 were regularized in August 2019.

[4] Based on preliminary data, at end-2018, ENAPORT had commercial loans amounting to about $2.2 million that mature in August 2028; ENASA had two commercial loans of $0.3 million (maturing in September 2028) and $2.0 million (maturing in June 2029), respectively. In total, these loans amount to $4.5 million, or about 1 percent of GDP. There are four other profitable enterprises, in which the government has a minority stake.

[5] Consistent with the previous DSA, pre-HIPC initiative arrears (13.5 percent of GDP) are excluded, on the assumption of debt forgiveness. One pre-HIPC PPP debt of 11.2 percent of GDP is excluded, consistent with the treatment of other pre-HIPC debt. Details about this loan are presented in Text Table 4.

[6] "Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries," February 2018, Paragraph 68.

[7] In the event that ENCO is liquidated, its claims on the government, EMAE, and other elements of the public sector could be transferred mostly to Sonangol, which may demand repayments. Note that ENCO's claims on EMAE and the government are not included in the baseline external debt stock even though they are denominated in USD, as the DSA uses the residency-based assumption (these claims are regarded as domestic debt in the baseline). The size of the Sonangol shock (46.5 percent of GDP) is calibrated to capture the maximum amount of liabilities that would need to be assumed by the government should the contingency materializes; this is a worst-case scenario given that ENCO is a joint venture that is majority (77.6 percent) owned by Sonangol, an Angolan company. The government and private entities of São Tomé and Príncipe hold 16.0 and 6.4 percent of stakes, respectively.

Text Table 1. São Tomé and Príncipe: Public Debt Coverage under The Baseline Scenario

	Subsectors of the public sector	Subsectors covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	X
4	o/w: Social security fund	X
5	o/w: Extra budgetary funds (EBFs)	X
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

Sources: IMF and World Bank staff.

Text Table 2. São Tomé and Príncipe: Coverage of the Contingent Liabilities' Stress Test

1	The country's coverage of public debt	The central government plus social security and extra budgetary funds, central bank, government-guaranteed debt			
		Default		Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0	percent of GDP	Inclusion of the disputed Nigeria loan (7.4) for both public and external DSA, and ENCO's arrears to Sonangol (46.5) in external DSA. 2/	These are potential risks.
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	2	
4	PPP	35	percent of PPP stock	0	The PPP project is pre-HIPC and is excluded from the DSA analysis.
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5	
	Total (2+3+4+5) (in percent of GDP)	14.4 for public DSA, and 60.9 for external DSA.			

1/ The default shock of 2 percent of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.).

2/ The ENCO to Sonangol arrears shock is not applied to the public DSA because ENCO's claims on the government and EMAE are already included in the domestic PPG debt.

Sources: IMF and World Bank staff.

BACKGROUND

A. Debt

2. Central government direct and guaranteed debt declined by 2 percent of GDP during the recently-expired program (2015-18); but total PPG debt increased by 6 percent of GDP to 96 percent (Text Table 3).[8] The decline is attributed to steady GDP growth, repayment of past oil price subsidy debt using yields from higher domestic than import prices, no new debt contracting, and delayed disbursements of some existing loans. However, this decline was more than offset by EMAE's arrears to its fuel supplier, ENCO, accumulated during the same period.[9] In 2018, such arrears rose by US$16 million, at a higher pace than the US$14 million accumulation in 2017. The arrears increased further by US$9.4 million during the first half of 2019 and may rise by a higher amount in the second half based on seasonality. In addition, a comprehensive review by the Ministry of Finance identified additional government arrears to domestic suppliers of about US$25 million (around 6 percent of GDP), due to poor budgetary planning and a shortfall of project grants and loans. Total PPG debt also includes debt by some central public entities (such as the parliament and the court), which borrowed with the approval by the Ministry of Finance.

3. The country continues to engage actively with bilateral creditors to regularize post-HIPC arrears. In total, such arrears stood at 2.6 percent of 2018 GDP (US$10.7 million), which are to Angola (US$4.8 million), Brazil (US$4.3 million), and Equatorial Guinea (US$1.7 million). An agreement with the Brazilian government was reached, pending ratification by the Brazilian Senate. The government has actively sought debt rescheduling agreements with Angola and Equatorial Guinea. These arrears are reflected in the debt stock.

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[8] Due to the broadened debt coverage discussed above, the "central government direct and guaranteed debt" in this DSA has the same coverage as the "total PPG debt" in the previous DSA. Consistent with the new DSF framework, the term "total PPG debt" refers to the broadened coverage that includes the central government and EMAE (the government's arrears to EMAE are excluded during the consolidation).

[9] These arrears include those by HidroEquador, which belongs to the EMAE parent company but reports losses separately. EMAE's arrears to ENCO have increased substantially since 2016 due to an expansion of the electricity distribution network.

Text Table 3. São Tomé and Príncipe: PPG Debt Stock

(As of end 2018)	Million USD		Share of GDP (%)	
	End 2015	End 2018	End 2015	End 2018
Total PPG debt (incl. EMAE's arrears to ENCO, but excl. gov's arrears to EMAE)	**280.9**	**388.7**	**89.6%**	**95.5%**
Central government direct and guaranteed debt (excl. EMAE's arrears to ENCO, but incl. gov's arrears to EMAE)	**237.5**	**300.2**	**75.8%**	**73.7%**
Total PPG external debt	**185.2**	**194.5**	**59.1%**	**47.8%**
Multilateral Creditors	**44.6**	**49.5**	**14.2%**	**12.2%**
IDA	13.8	11.8	4.4%	2.9%
BADEA	9.4	12.0	3.0%	2.9%
FIDA	6.7	5.4	2.1%	1.3%
AfDB	5.2	11.8	1.7%	2.9%
IMF	6.7	6.9	2.1%	1.7%
OPEC	2.8	1.7	0.9%	0.4%
Bilateral Creditors	**115.7**	**133.2**	**36.9%**	**32.7%**
Portugal	54.5	57.2	17.4%	14.0%
Angola[1]	44.4	55.6	14.2%	13.7%
China	10.0	10.0	3.2%	2.5%
Brazil	4.3	4.3	1.4%	1.0%
Equatorial Guinea	1.6	1.7	0.5%	0.4%
Belgium	0.8	0.8	0.3%	0.2%
Other[2]	0.0	3.7	0.0%	0.9%
Government's arrears to external suppliers	**6.9**	**11.7**	**2.2%**	**2.9%**
Domestic debt	**52.3**	**105.7**	**16.7%**	**26.0%**
ENCO (oil importing company; regularized arrears)	**48.4**	**37.8**	**15.4%**	**9.3%**
Government's arrears to domestic suppliers[3]	**3.5**	**36.9**	**1.1%**	**9.1%**
CST (telecom)	3.5	6.7	1.1%	1.7%
EMAE (water and electricity)	0.0	4.9	0.0%	1.2%
Other suppliers	0.0	25.3	0.0%	6.2%
Central Government T-bills	**0.0**	**19.3**	**0.0%**	**4.7%**
Credit of ODC to Central Government (excl. T-bills)	**0.4**	**11.7**	**0.1%**	**2.9%**
Arrears from EMAE to ENCO[4]	**43.4**	**93.4**	**13.8%**	**22.9%**
Memorandum items:				
Pre-HIPC legacy arrears		**54.9**		**13.5%**
Italy[5]		24.3		6.0%
Angola		30.6		7.5%
Nigeria Loan		**30.0**		**7.4%**

Sources: Country authorities, EMAE, ENCO, and IMF staff estimates

[1] Including the 4.8 million USD debt with Angola contracted after the 2007 HIPC debt relief.

[2] Due to the statistical discrepancy in the authorities' debt data.

[3] Commitment-based, and these suppliers reside domestically in the country.

[4] Including the arrears from HidroEquador S.A. to ENCO.

[5] Commercial debt guaranteed by the government.

Text Table 4. São Tomé and Príncipe: Arrears and Disputed Debt
(As of end-2018)

Type	Description	DSA Treatment
Pre-HIPC legacy arrears (13.5 percent of GDP)	São Tomé and Príncipe has pre-HIPC legacy arrears to Angola ($30.6 million) and Italy ($24.3 million), in total $54.9 million. São Tomé and Príncipe is making best efforts to reach an agreement consistent with the representative Paris Club agreement. In 2017 São Tomé and Príncipe was able to secure relief from pre-HIPC legacy arrears to China of $18.4 million.	Not included in the DSA on the assumption of expected forgiveness.
Post-HIPC bilateral arrears (2.6 percent of GDP)	São Tomé and Príncipe has post-HIPC arrears to Angola ($4.8 million), Brazil ($4.3 million), and Equatorial Guinea ($1.7 million), in total $10.7 million.[10] The government has actively sought debt rescheduling agreements with Angola and Equatorial Guinea through correspondence and high-level meetings. However, responses are pending from these two countries on continuing the negotiations. These arrears are the result of weak debt management, and staff assesses that São Tomé and Príncipe has the capacity to repay them over time.	Included in the DSA.
Domestic arrears (9.1 percent of GDP)	São Tomé and Príncipe has domestic arrears to the telecom company CST ($6.7 million), the water and electricity company EMAE ($4.9 million), and other private suppliers ($25.3 million, mostly construction companies). In total, the domestic arrears amount to $36.9 million.	Included in the DSA.
Disputed debt (7.4 percent of GDP)	A loan from Nigeria in the amount of $30 million was excluded from the debt stock, as there is no signed contract with repayment conditions between the two countries. Nonetheless, the authorities acknowledged the receipt of the funds, which were spent as evidenced by budget documents. This loan was extended as advances on oil revenues in the context of the joint development zone between these two countries, but this project has stalled. According to São Tomé and Príncipe authorities, this loan is under dispute since it should only be repaid in case revenues from oil materialize.	Included in the contingent liability stress tests for both the public DSA and external DSA.

[10] These amounts remained unchanged as of end-June 2019.

B. Macroeconomic Forecast

4. The macroeconomic assumptions are updated. The current DSA assumes slightly slower real GDP growth (4.3 percent) and a more moderate GDP deflator (2.8) than the previous DSA (Text Table 5), reflecting recent developments, including the revision of GDP that lowered the GDP deflator in recent years. Inflation is revised upwards to capture the high inflation at end-2018 and end-June 2019, as well as the one-off impact of the introduction of the VAT that is expected in 2020. Meanwhile, FDI remains similar as that in the July 2018 DSA, reflecting still high external interest in the country's oil explorations. In addition, exports are expected to accelerate as the tourism strategy is being implemented with World Bank support, and the sector boosted gradually by improvement of infrastructure, a new international payment system (currently expected to be completed in about three years), and a new tourism school. In line with an IMF Extended Credit Facility arrangement requested by the government, it is assumed that the budget deficit will be mainly financed by grants and concessional loans. In addition, the current account will also be financed by FDI. The realism tools indicate that the baseline fiscal adjustment is optimistic. This is mainly because the primary deficit includes EMAE's loss, which stood at 3.8 percent of GDP in 2018 and is expected to decline significantly (to 1.0 percent of GDP by 2023) as the company is being revamped under a program supported by the World Bank and European Investment Bank.

Text Table 5. São Tomé and Príncipe: Macroeconomic Assumptions

	Historical			Forecasts	
	2017 DSA[1]	2018 DSA[1]	Last 4 years	July 2018 DSA[1]	This DSA
	2007-16	2008-17	2014-17	2018-38	2018-38
Real GDP growth (percent)	4.3	4.8	4.6	4.9	4.3
Inflation (percent average)	13.2	11.9	5.8	3.4	4.0
GDP deflator (percent)	5.6	5.8	2.4	2.9	2.8
Domestic primary balance (percent of GDP)	-4.5	-3.9	-3.1	-1.0	-0.9
Grants (percent of GDP)	17.3	16.7	11.8	7.4	5.2
New borrowing (percent of GDP)	7.6	7.5	5.5	2.3	1.4
FDI (percent of GDP)	15.7	13.0	7.8	11.9	11.8
USD export growth (percent)	21.9	24.6	24.3	6.2	8.3
USD import growth (percent)	9.6	10.3	3.3	6.3	5.9
Current account balance, excluding grants (percent of GDP)	-38.7	-36.3	-24.2	-17.1	-11.8
Current account balance, including grants (percent of GDP)	-21.4	-19.6	-12.4	-9.7	-6.8

[1] IMF Country Report No. 18/251

C. Country Classification

5. The country's debt carrying capacity is assessed to be medium under the new LIC DSF and the cross-country assessment updated in April 2019. The new Composite Index (CI) of debt carrying capacity reflects macroeconomic variables, such as real GDP growth, remittances, reserves, and world growth (Text Table 6), in addition to CPIA, which was the only indicator under the previous framework. This along with other revisions to the framework confirms São Tomé and Príncipe as a medium debt-carrying capacity country. The applicable thresholds for the ratios of the present value (PV) of PPG external debt relative to GDP and exports are 40 percent and 180 percent, compared with 30 and 100 percent respectively in the last DSA that assessed the country as having a weak debt-carrying capacity. The threshold for the PV of total PPG debt also rose to 55 percent (from 38) of GDP. The thresholds for PPG external debt service (to exports and to revenue) remain unchanged.

Text Table 6. São Tomé and Príncipe: Classification of Debt Carrying Capacity

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintages
Medium	Medium	Medium	Medium
	2.698	2.780	2.800

DEBT SUSTAINABILITY

D. External Debt Sustainability

6. Under the baseline scenario, all external PPG debt stock and debt service ratios stay well below their thresholds (Figure 1). This is an improvement relative to the last DSA, where the PV of debt-to-exports breached its threshold. This improvement is mostly driven by the aforementioned increases of the thresholds. Solvency indicators improve over time under the baseline and the most extreme shock scenarios due to economic growth, fiscal consolidation, slow debt accumulation, expansion of the tourism sector, and constrained imports, while liquidity indicators remain steady and comfortably below their associated thresholds throughout the projection horizon. These results suggest that the external PPG debt is sustainable.

7. Under the most extreme shocks, two indicators breach their associated thresholds (Figure 1). The PV of debt service-to-exports ratio and the debt-service-to-revenue ratio remain below their thresholds under the most extreme shocks, which are an exports shock and a combined contingent liabilities shock, respectively. By contrast, the PV of debt-to-GDP ratio and PV of debt-to-exports ratio breach their respective thresholds from 2019 to 2029 but decline gradually under the most extreme shocks, both of which are also a combined contingent liabilities shock. As Text Table 2 shows, the main contingent liabilities in this extreme scenario is ENCO's external arrears to Sonangol (46.5 out of 60.9 percent of GDP), which may ultimately fall on the government.[11] These results highlight the importance of developing a clearance plan for EMAE's arrears to ENCO, as well as promoting strong export growth.

[11] The size of the Sonangol shock (46.5 percent of GDP) is calibrated to capture the maximum amount of liabilities that would need to be assumed by the government should the contingency materializes.

E. Public Debt Sustainability

8. Total PPG debt can be deemed sustainable under programmed policies.[12] Under the baseline, the PV of the total PPG debt-to-GDP ratio breaches the benchmark, mainly because of the inclusion of EMAE's arrears to ENCO[13] and newly identified government arrears to private suppliers (see ¶2) (Figure 2). Note that the DSF uses the nominal value of domestic PPG debt while calculating the PV of total PPG debt. The PV of PPG debt as calculated, taking into account the PV of the terms of payments to ENCO by the government and EMAE is also presented (the black dash line in Figure 2).[14] Both agreements have extended payment periods and bring the PV of total PPG debt-to-GDP ratio below the benchmark of 55 percent of GDP starting in 2019. Hence, staff assesses that total PPG debt is sustainable provided EMAE's planned reforms are implemented and the country continues to borrow externally only at concessional terms at a measured pace.

9. All the three total PPG debt ratios (PV of debt-to-GDP, PV of debt-to-revenue, and debt service-to-revenue) are most sensitive to a primary balance shock. Under such a shock, the three ratios would rise in the near term before declining gradually in the medium-to-long term. In addition, given that EMAE's arrears to ENCO are denominated in foreign currency, the country's debt is subject to currency risk, even though such arrears are treated as domestic debt under the residency-based definition.

DEBT DISTRESS QUALIFICATION AND CONCLUSIONS

10. São Tomé and Príncipe's classification remains to be in debt distress. This is because the regularization of São Tomé and Príncipe's post-HIPC sovereign arrears (to Angola, Brazil, and Equatorial Guinea, totaling around 2.6 percent of GDP) is still ongoing. The significant arrears of EMAE to its supplier also reflect the severe liquidity constraints of the public sector. Staff assesses that São Tomé and Príncipe has the capacity to repay these arrears over time. São Tomé and Príncipe continues to actively seek rescheduling agreements with the creditors.

11. Compared with the last DSA, there are fewer threshold breaches of external PPG debt indicators, while the total PPG debt indicators have deteriorated. All external PPG debt indicators remain below their respective thresholds under the baseline scenario. These results can be attributed largely to a stronger debt-carrying capacity based on the revised Composite Indicator under the new DSF and the associated higher indicator thresholds. However, for total PPG debt, additional government arrears to suppliers identified recently and a more comprehensive coverage of public sector liabilities, including the inclusion of EMAE's arrears, have revealed previously

[12] As in the previous DSA template, only one of the three total PPG debt ratios (debt-to-GDP ratio) has a benchmark (instead of a strict threshold) in the new template. In addition, the negative real interest rates on domestic debt in Figure 2 are due to the low nominal interest rates (relative to inflation), which are in turn due to the excess liquidity in the banking system.

[13] After an expansion of the electricity network, EMAE's losses rose to about 4 percent of GDP on average annually during 2016-18, compared with an average of 1.5 percent of GDP in Sub-Saharan Africa.

[14] The repayment schedule for EMAE to ENCO covers both the existing stock of debt and any new arrears that may arise until EMAE returns to an operating surplus.

uncaptured debt vulnerabilities and led to a large baseline breach of the PV of debt-to-GDP indicator benchmark. While this ratio falls below the benchmark if the PV of the repayments to ENCO by the government and EMAE are taken into account, EMAE's large losses and associated arrears nonetheless highlight the importance of reforming EMAE to containing fiscal risk.

12. **Risks around the baseline are substantial**. In particular, stress tests show that the country's debt is especially vulnerable to shocks to exports, combined contingent liabilities, and the fiscal primary balance. The stress test based on a customized extreme scenario reveals that the risk stemming from ENCO's large external arrears to Sonangol could be high in the near term, even though some key external debt ratios fall below the thresholds in the medium term and the strong diplomatic tie between São Tomé and Príncipe and Angola could be a potential mitigating factor to this extreme scenario.

13. **Overall, the analysis highlights the importance of containing EMAE's losses and maintaining strong policies in order to reduce debt-related risks**. Such policies include deepening EMAE reforms, continuing fiscal consolidation and revenue mobilization, eschewing non-concessional loans, improving the business climate to attract non-debt flows, strengthening macroeconomic policies as envisaged under the program to support the exchange rate peg, and promoting tourism and private sector-led growth. In addition, the country should eschew non-concessional loans. To balance debt sustainability concerns while address the country's large investment need, contracting of new concessional loans should be limited to 3 percent of GDP, and external debt disbursements should not exceed 1.5 percent of GDP. These parameters can be adjusted according to the development of debt vulnerability and can be relaxed once the vulnerability decreases. In this context, the country should strive to finance large projects with non-debt generating means, including by grants.

Authorities' Views

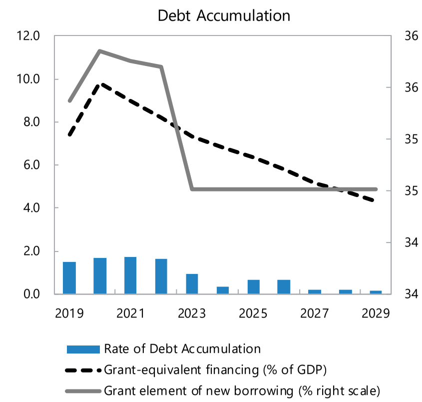
14. **The authorities broadly agreed with the assessment.** They are committed to continuing the effort to regularize the long-standing external arrears. They also recognized the significant risk to debt sustainability from the large and persistent loss by EMAE, which have translated to large arrears to ENCO, and are committed to implementing EMAE reforms to achieve debt sustainability. They also pledge to borrow only at concessional terms and at a measured pace to reduce debt vulnerability over time.

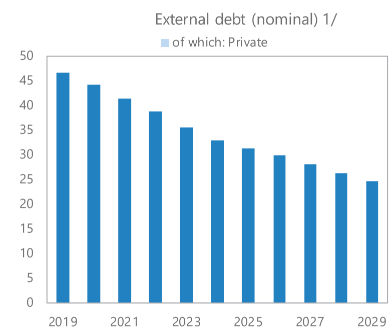
Table 1. São Tomé and Príncipe: External Debt Sustainability Framework, Baseline Scenario, 2017–2039

(In percent of GDP, unless otherwise indicated)

	Actual		Projections								Average 8/	
	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
External debt (nominal) 1/	48.2	47.8	46.5	44.1	41.5	38.8	35.6	33.0	24.7	15.9	48.3	34.5
of which: public and publicly guaranteed (PPG)	48.2	47.8	46.5	44.1	41.5	38.8	35.6	33.0	24.7	15.9	48.3	34.5
Change in external debt	-14.4	-0.5	-1.2	-2.4	-2.7	-2.6	-3.2	-2.6	-1.6	-0.1		
Identified net debt-creating flows	-0.5	-1.3	1.3	-1.9	-3.5	-3.8	-4.9	-5.6	-7.0	-8.9	4.8	-4.5
Non-interest current account deficit	12.9	10.4	11.2	8.6	7.6	7.6	6.6	6.0	5.5	6.0	17.4	6.9
Deficit in balance of goods and services	28.5	23.7	21.7	20.4	17.9	17.1	15.6	14.4	11.4	11.4	33.1	15.5
Exports	22.9	23.2	25.3	26.4	27.9	28.5	28.4	28.0	27.7	27.2		
Imports	51.4	46.9	47.0	46.8	45.9	45.5	44.0	42.4	39.1	38.6		
Net current transfers (negative = inflow)	-15.5	-12.4	-10.3	-12.4	-11.6	-10.8	-10.2	-9.7	-7.4	-7.0	-19.6	-9.6
of which: official	-11.1	-8.5	-6.7	-8.9	-8.1	-7.3	-6.8	-6.3	-3.9	-3.6		
Other current account flows (negative = net inflow)	-0.1	-0.9	-0.2	0.6	1.2	1.3	1.3	1.3	1.4	1.6	4.0	1.1
Net FDI (negative = inflow)	-9.0	-6.8	-9.1	-9.3	-9.8	-10.1	-10.3	-10.4	-11.7	-14.6	-9.4	-10.5
Endogenous debt dynamics 2/	-4.4	-4.9	-0.8	-1.1	-1.2	-1.3	-1.2	-1.1	-0.8	-0.4		
Contribution from nominal interest rate	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.2		
Contribution from real GDP growth	-2.2	-1.1	-1.3	-1.5	-1.6	-1.7	-1.6	-1.5	-1.1	-0.7		
Contribution from price and exchange rate changes	-2.5	-4.2	...	...	...	...	...	...	...	...		
Residual 3/	-13.9	0.8	-2.5	-0.5	0.8	1.2	1.7	3.0	5.3	8.8	-1.9	2.5
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators												
PV of PPG external debt-to-GDP ratio	...	27.8	28.8	28.3	27.8	27.2	26.1	24.5	18.8	10.4		
PV of PPG external debt-to-exports ratio	...	119.4	113.8	107.4	99.6	95.6	91.9	87.4	67.7	38.2		
PPG debt service-to-exports ratio	3.8	4.2	5.1	5.3	4.8	4.8	5.0	6.8	5.5	2.8		
PPG debt service-to-revenue ratio	5.1	5.9	7.7	8.2	7.5	7.2	7.3	9.5	6.9	2.8		
Gross external financing need (Million of U.S. dollars)	27.8	19.4	14.5	2.9	-4.6	-6.3	-13.3	-16.1	-41.6	-139.4		
Key macroeconomic assumptions												
Real GDP growth (in percent)	3.9	2.7	2.7	3.5	4.0	4.5	4.5	4.5	4.5	4.5	4.3	4.2
GDP deflator in US dollar terms (change in percent)	4.1	9.5	-1.0	4.0	3.8	3.7	3.2	3.3	2.6	2.6	4.3	2.7
Effective interest rate (percent) 4/	0.6	1.1	0.9	1.0	1.0	1.1	1.1	1.2	1.4	1.6	0.8	1.2
Growth of exports of G&S (US dollar terms, in percent)	-10.8	14.1	10.5	12.3	14.4	10.4	7.6	6.5	7.0	7.0	21.6	8.8
Growth of imports of G&S (US dollar terms, in percent)	4.5	2.6	1.8	7.2	5.8	7.6	4.1	4.2	5.8	7.1	7.7	5.3
Grant element of new public sector borrowing (in percent)	...	...	35.4	35.9	35.8	35.7	34.5	34.5	34.5	34.5	...	34.9
Government revenues (excluding grants, in percent of GDP)	17.0	16.6	16.9	17.2	18.0	18.9	19.3	19.9	22.2	26.9	13.7	19.7
Aid flows (in Million of US dollars) 5/	50.7	42.6	31.3	46.5	45.6	44.9	39.7	39.7	35.1	64.6		
Grant-equivalent financing (in percent of GDP) 6/	...	...	7.4	9.8	9.0	8.2	7.3	6.8	4.3	4.0	...	6.8
Grant-equivalent financing (in percent of external financing) 6/	...	...	84.2	85.6	84.5	83.7	87.8	87.0	85.4	84.4	...	85.0
Nominal GDP (Million of US dollars)	376	423	430	463	499	541	584	630	893	1,796		
Nominal dollar GDP growth	8.1	12.4	1.7	7.6	7.9	8.4	7.9	8.0	7.2	7.3	8.8	7.0
Memorandum items:												
PV of external debt 7/	...	27.8	28.8	28.3	27.8	27.2	26.1	24.5	18.8	10.4		
In percent of exports	...	119.4	113.8	107.4	99.6	95.6	91.9	87.4	67.7	38.2		
Total external debt service-to-exports ratio	3.8	4.2	5.1	5.3	4.8	4.8	5.0	6.8	5.5	2.8		
PV of PPG external debt (in Million of US dollars)		117.3	123.6	130.9	138.9	147.2	152.3	154.3	167.5	186.1		
(PVt-PVt-1)/GDPt-1 (in percent)			1.5	1.7	1.7	1.7	0.9	0.4	0.1	0.5		
Non-interest current account deficit that stabilizes debt ratio	27.3	10.9	12.4	11.0	10.2	10.2	9.8	8.6	7.1	6.2		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	Yes





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g) + Εα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ε=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

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

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

6/ 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).

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

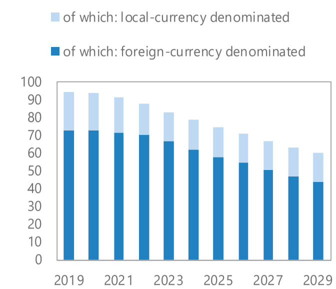
8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

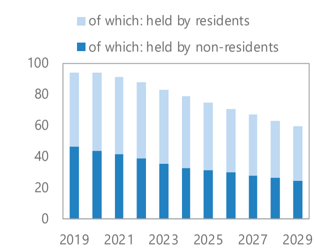
Table 2. São Tomé and Príncipe: Public Sector Debt Sustainability Framework, Baseline Scenario, 2017–2039
(In percent of GDP, unless otherwise indicated)

	Actual		Projections								Average 6/	
	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
Public sector debt 1/	84.3	95.5	94.2	93.8	91.3	87.6	83.1	78.7	59.9	36.6	67.8	78.6
of which: external debt	48.2	47.8	46.5	44.1	41.5	38.8	35.6	33.0	24.7	15.9	48.3	34.5
Change in public sector debt	-13.3	11.1	-1.3	-0.4	-2.5	-3.7	-4.5	-4.4	-3.4	-1.7		
Identified debt-creating flows	-8.2	4.8	-0.6	-1.9	-3.4	-4.5	-4.0	-4.9	-3.5	-1.4	7.4	-3.6
Primary deficit	6.7	7.9	4.7	4.8	3.1	2.1	2.1	0.8	0.3	0.6	12.9	1.7
Revenue and grants	27.6	24.7	23.5	26.1	26.1	26.3	26.1	26.2	26.1	30.5	27.6	25.9
of which: grants	10.5	8.2	6.7	8.9	8.1	7.3	6.8	6.3	3.9	3.6		
Primary (noninterest) expenditure	34.3	32.6	28.2	31.0	29.3	28.4	28.2	27.0	26.4	31.1	40.5	27.6
Automatic debt dynamics	-14.1	-2.7	-4.5	-6.0	-5.9	-6.0	-5.5	-5.1	-3.4	-1.9		
Contribution from interest rate/growth differential	-4.9	-3.7	-3.8	-4.5	-5.0	-5.2	-4.8	-4.5	-3.3	-1.8		
of which: contribution from average real interest rate	-1.3	-1.5	-1.3	-1.3	-1.4	-1.3	-1.0	-0.9	-0.5	-0.2		
of which: contribution from real GDP growth	-3.6	-2.2	-2.5	-3.2	-3.6	-3.9	-3.8	-3.6	-2.7	-1.6		
Contribution from real exchange rate depreciation	-9.2	1.0	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	-0.8	-0.4	-0.8	-0.7	-0.7	-0.6	-0.6	-0.6	-0.3	-0.1	-1.0	-0.5
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	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)	-0.8	-0.4	-0.8	-0.7	-0.7	-0.6	-0.6	-0.6	-0.3	-0.1		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	-5.1	6.4	-1.3	0.0	0.0	0.0	-1.1	-0.1	-0.1	-0.3	0.2	-0.2
Sustainability indicators												
PV of public debt-to-GDP ratio 2/	...	76.5	76.4	77.9	77.6	75.9	73.5	70.1	53.9	31.0		
PV of public debt-to-revenue and grants ratio	...	309.3	324.8	298.3	297.2	289.0	281.9	267.2	206.2	101.6		
Debt service-to-revenue and grants ratio 3/	...	...	85.8	66.1	69.3	67.1	64.0	66.4	63.5	41.5		
Gross financing need 4/	9.9	8.8	24.0	21.4	20.6	19.1	18.2	17.6	16.5	13.2		
Key macroeconomic and fiscal assumptions												
Real GDP growth (in percent)	3.9	2.7	2.7	3.5	4.0	4.5	4.5	4.5	4.5	4.5	4.3	4.2
Average nominal interest rate on external debt (in percent)	0.7	1.0	1.0	1.0	1.0	1.0	1.1	1.2	1.4	1.6	0.8	1.2
Average real interest rate on domestic debt (in percent)	-1.9	-4.5	-3.1	-2.8	-2.2	-2.0	-1.5	-1.1	-0.8	-0.3	-6.7	-1.6
Real exchange rate depreciation (in percent, + indicates depreciation)	-11.8	1.5	...	...	...	...	...	...	...	...	-2.1	...
Inflation rate (GDP deflator, in percent)	2.0	4.7	3.7	3.5	3.0	3.0	2.6	2.6	2.6	2.6	7.7	2.8
Growth of real primary spending (deflated by GDP deflator, in percent)	-13.4	-2.3	-11.3	13.7	-1.7	1.3	3.7	0.2	5.3	6.2	8.4	2.4
Primary deficit that stabilizes the debt-to-GDP ratio 5/	20.0	-3.3	5.9	5.2	5.6	5.8	6.6	5.2	3.7	2.3	7.6	5.0
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Memorandum Item												
Primary deficit with HIPC grants and without EMAE loss	0.5	4.2	0.1	-0.5	-1.0	-1.5	-1.2	-0.9	-0.1	0.5	10.9	-0.5
EMAE loss	5.4	3.2	3.7	4.6	3.4	3.0	2.6	1.1	0.0	0.0	1.0	1.7

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government plus social security and extra budgetary funds, central bank, government-guaranteed debt. Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

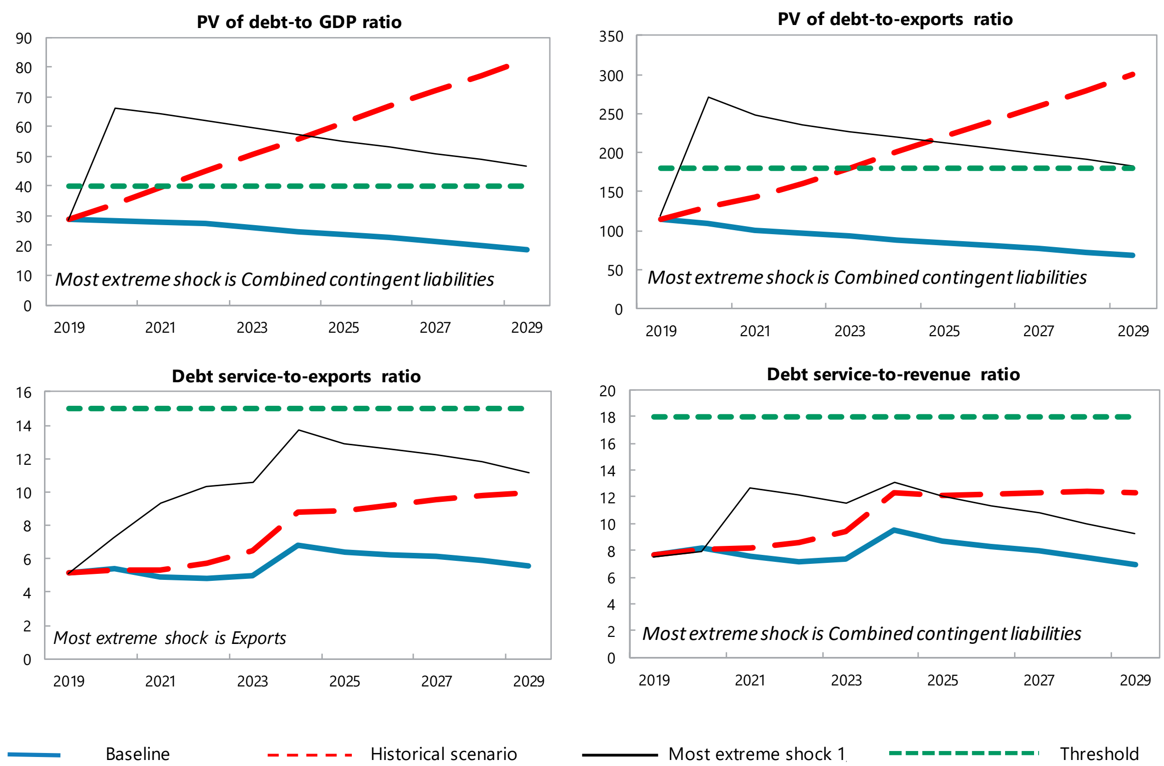
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ 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 and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Figure 1. São Tomé and Príncipe: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2019–2029[1/]



Customization of Default Settings		
	Size	Interactions
Tailored Tests		
Combined CLs	Yes	
Natural Disasters	No	No
Commodity Prices [2/]	n.a.	n.a.
Market Financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing Assumptions for Stress Tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.8%	1.8%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	23	23
Avg. grace period	9	9

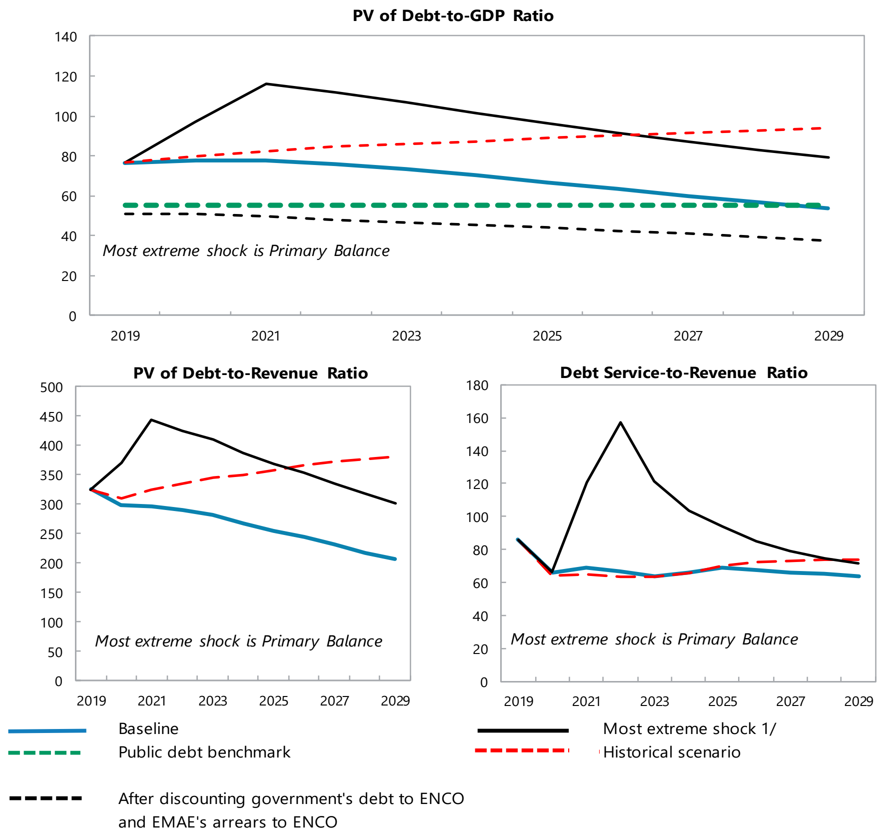
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. São Tomé and Príncipe: Indicators of Public Debt Under Alternative Scenarios, 2019–2029



Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	25%	25%
Domestic medium and long-term	10%	10%
Domestic short-term	234%	64%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.8%	1.8%
Avg. maturity (incl. grace period)	23	23
Avg. grace period	9	9
Domestic MLT debt		
Avg. real interest rate on new borrowing	-2.8%	-2.8%
Avg. maturity (incl. grace period)	100	100
Avg. grace period	99	99
Domestic short-term debt		
Avg. real interest rate	-1.0%	-1.0%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2019–2029

	Projections 1/										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of debt-to GDP ratio											
Baseline	29	28	28	27	26	24	23	23	21	20	19
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	29	34	40	**45**	**51**	**56**	**61**	**67**	**72**	**77**	**82**
B. Bound Tests											
B1. Real GDP growth	29	29	29	28	27	26	25	24	22	21	20
B2. Primary balance	29	**42**	**55**	**53**	**51**	**49**	**47**	**46**	**44**	**42**	40
B3. Exports	29	34	**42**	**41**	39	37	36	34	33	31	30
B4. Other flows 3/	29	35	**41**	**40**	39	37	35	34	32	31	29
B5. One-time 30 percent nominal depreciation	29	35	30	30	28	27	25	24	23	21	20
B6. Combination of B1-B5	29	37	39	38	36	34	33	32	30	29	27
C. Tailored Tests											
C1. Combined contingent liabilities	29	**68**	**66**	**64**	**61**	**58**	**56**	**55**	**52**	**50**	**48**
C2. Natural disaster	29	35	35	34	33	31	30	29	28	27	26
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	40	40	40	40	40	40	40	40	40	40	40
PV of debt-to-exports ratio											
Baseline	114	109	100	96	92	88	85	81	77	72	68
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	114	129	143	160	179	**200**	**220**	**240**	**260**	**280**	**299**
B. Bound Tests											
B1. Real GDP growth	114	109	100	96	92	88	85	81	77	72	68
B2. Primary balance	114	160	**199**	**189**	**182**	175	170	164	157	151	145
B3. Exports	114	167	**253**	**242**	**232**	**223**	**215**	**207**	**198**	**188**	179
B4. Other flows 3/	114	135	150	143	137	132	127	123	117	112	106
B5. One-time 30 percent nominal depreciation	114	109	87	84	80	76	73	70	66	62	58
B6. Combination of B1-B5	114	151	131	163	157	150	145	140	133	126	120
C. Tailored Tests											
C1. Combined contingent liabilities	114	**260**	**237**	**225**	**217**	**210**	**203**	**197**	**189**	**182**	175
C2. Natural disaster	114	138	128	123	119	114	111	107	103	99	94
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	180	180	180	180	180	180	180	180	180	180	180
Debt service-to-exports ratio											
Baseline	5	5	5	5	5	7	6	6	6	6	6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	5	5	5	6	6	9	9	9	10	10	10
B. Bound Tests											
B1. Real GDP growth	5	5	5	5	5	7	6	6	6	6	6
B2. Primary balance	5	5	6	7	7	9	8	8	8	8	7
B3. Exports	5	7	9	10	11	14	13	13	12	12	11
B4. Other flows 3/	5	5	6	6	6	8	7	7	7	7	6
B5. One-time 30 percent nominal depreciation	5	5	5	4	5	7	6	6	6	6	5
B6. Combination of B1-B5	5	6	7	7	7	10	9	9	9	8	8
C. Tailored Tests											
C1. Combined contingent liabilities	5	5	8	8	8	10	9	9	9	8	8
C2. Natural disaster	5	6	6	6	6	8	7	7	7	7	6
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	15	15	15	15	15	15	15	15	15	15	15
Debt service-to-revenue ratio											
Baseline	8	8	8	7	7	10	9	8	8	7	7
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	8	8	8	9	9	12	12	12	12	12	12
B. Bound Tests											
B1. Real GDP growth	8	8	8	7	8	10	9	9	8	8	7
B2. Primary balance	8	8	9	11	11	13	12	11	10	10	9
B3. Exports	8	8	9	9	9	11	10	10	9	9	8
B4. Other flows 3/	8	8	8	9	9	11	10	10	9	9	8
B5. One-time 30 percent nominal depreciation	8	10	9	8	9	11	10	10	10	9	8
B6. Combination of B1-B5	8	9	9	9	9	11	10	10	9	9	8
C. Tailored Tests											
C1. Combined contingent liabilities	8	8	13	12	12	14	13	12	11	11	10
C2. Natural disaster	8	8	8	8	8	10	9	9	9	8	8
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	18	18	18	18	18	18	18	18	18	18	18

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

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

3/ Includes official and private transfers and FDI.

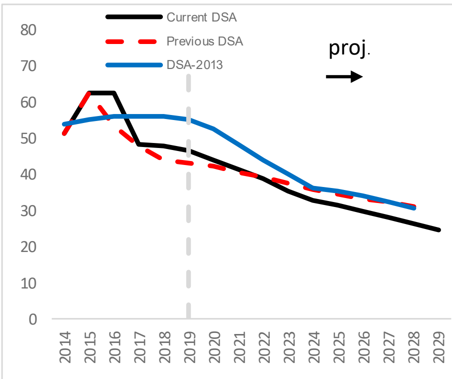
Table 4. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public Debt, 2019–2029

	Projections 1/										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of Debt-to-GDP Ratio											
Baseline	**76**	**78**	**78**	**76**	**74**	**70**	**67**	**63**	**60**	**57**	54
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	**76**	**80**	**82**	**85**	**86**	**87**	**89**	**90**	**92**	**93**	**94**
B. Bound Tests											
B1. Real GDP growth	**76**	**80**	**82**	**82**	**80**	**77**	**74**	**71**	**69**	**66**	**63**
B2. Primary balance	**76**	**97**	**116**	**112**	**107**	**101**	**96**	**92**	**87**	**83**	**79**
B3. Exports	**76**	**82**	**89**	**87**	**85**	**81**	**77**	**73**	**70**	**66**	**63**
B4. Other flows 3/	**76**	**85**	**91**	**89**	**86**	**82**	**78**	**75**	**71**	**68**	**64**
B5. One-time 30 percent nominal depreciation	**76**	**82**	**80**	**78**	**75**	**71**	**66**	**61**	**57**	53	49
B6. Combination of B1-B5	**76**	**90**	**97**	**89**	**83**	**77**	**72**	**67**	**63**	**59**	**56**
C. Tailored Tests											
C1. Combined contingent liabilities	**76**	**91**	**90**	**87**	**84**	**80**	**76**	**72**	**69**	**65**	**62**
C2. Natural disaster	**76**	**88**	**88**	**85**	**83**	**79**	**76**	**72**	**69**	**66**	**63**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public debt benchmark	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Revenue Ratio											
Baseline	325	298	297	289	282	267	255	244	231	218	206
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	325	310	324	335	345	350	359	366	373	377	381
B. Bound Tests											
B1. Real GDP growth	325	304	311	306	303	291	281	272	261	250	240
B2. Primary balance	325	371	443	425	409	386	369	353	335	318	302
B3. Exports	325	314	343	332	324	308	294	282	268	254	241
B4. Other flows 3/	325	325	349	339	330	314	300	288	274	259	246
B5. One-time 30 percent nominal depreciation	325	324	316	304	294	274	257	240	223	205	189
B6. Combination of B1-B5	325	348	375	343	321	296	276	260	244	228	216
C. Tailored Tests											
C1. Combined contingent liabilities	325	349	343	331	322	305	291	278	264	250	237
C2. Natural disaster	325	337	334	324	316	301	289	277	264	250	239
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	86	66	69	67	64	66	69	67	66	65	64
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2029 2/	86	64	65	63	63	66	70	72	73	74	74
B. Bound Tests											
B1. Real GDP growth	86	67	72	72	70	73	76	75	74	73	72
B2. Primary balance	86	66	121	157	121	103	94	85	79	75	71
B3. Exports	86	66	70	68	65	67	70	68	67	66	64
B4. Other flows 3/	86	66	70	68	65	68	70	69	67	66	64
B5. One-time 30 percent nominal depreciation	86	64	67	63	62	65	67	65	64	63	61
B6. Combination of B1-B5	86	65	85	116	93	82	77	71	66	64	62
C. Tailored Tests											
C1. Combined contingent liabilities	86	66	103	88	77	75	74	71	69	67	65
C2. Natural disaster	86	67	94	83	75	74	75	73	71	69	67
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

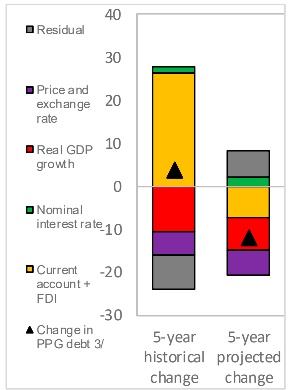
Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Figure 3. São Tomé and Príncipe: Drivers of Debt Dynamics – Baseline Scenario–External Debt

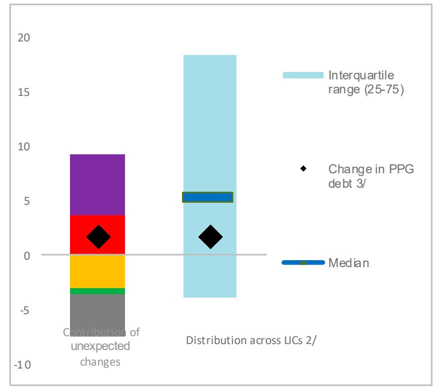
Gross Nominal PPG External Debt
(in percent of GDP; DSA vintages)



Debt-creating flows
(percent of GDP)

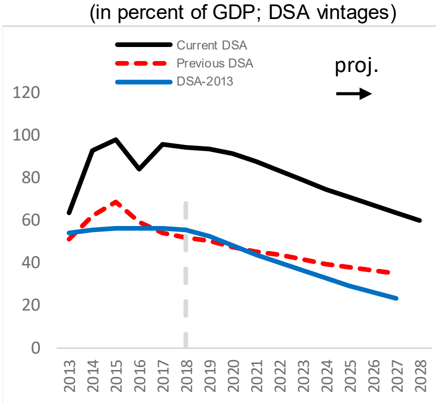


Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)

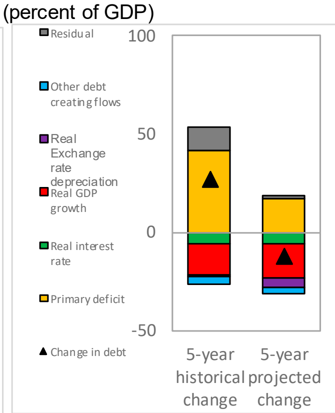


Public debt

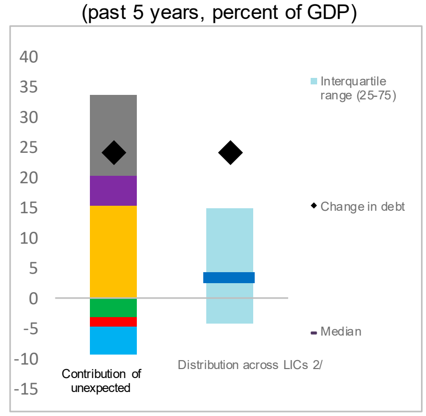
Gross Nominal Public Debt
(in percent of GDP; DSA vintages)



Debt-creating flows
(percent of GDP)



Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)



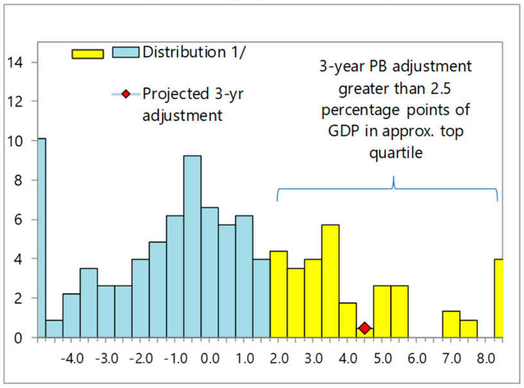
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

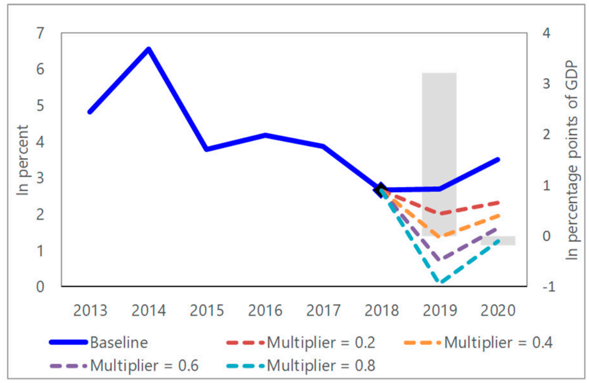
Figure 4. São Tomé and Príncipe: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



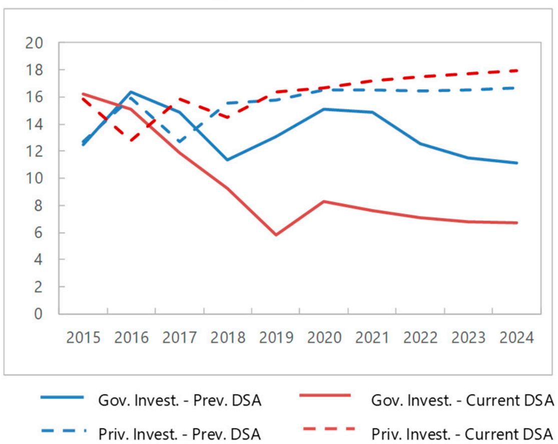
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/

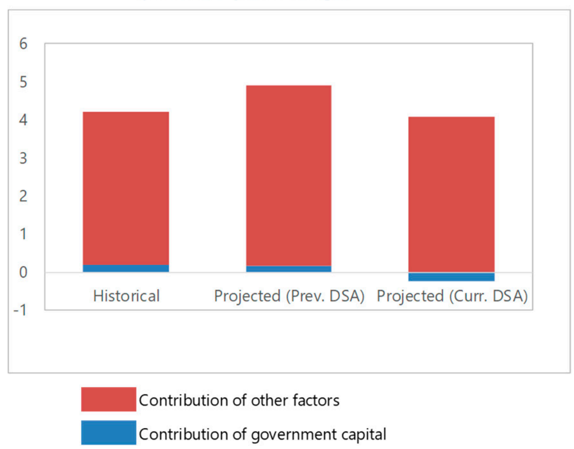


1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(% of GDP)



Contribution to Real GDP growth
(percent, 5-year average)



Statement by Mr. Raghani, Executive Director and Mr. Carvalho da Silveira, Advisor to the Executive Director on Democratic Republic of São Tomé and Príncipe October 2, 2019

1. Our Sao Tomean authorities would like to express their appreciation to staff and Management for the constructive policy discussions held in March and July 2019 in the context of negotiations for a new arrangement under the Extended Credit Facility (ECF).

2. Upon taking office in December 2018, the new Government faced immediate economic and fiscal challenges, including significant financing pressures. Sao Tome and Principe's distinctive features, as a fragile small island-state, make development particularly challenging, given the limited capacity and high vulnerability to climate change. Therefore, addressing these challenges calls for a comprehensive approach to development, with a particular focus on growth, as stressed in the Staff Guidance Note on Fund's engagement with Small Developing States.

3. Given the country's high fragility, successfully implementing an ambitious reform program requires building capacity and maintaining close engagement with technical partners. In this regard, the Government would like to express its strong interest in the reopening of the resident representative office in Sao Tome. They believe the country would benefit immensely from such engagement.

4. Our authorities are strongly committed to pursue their policy and reform agenda aimed at reinstating macroeconomic stability, addressing structural bottlenecks to boost inclusive growth while bringing down the high debt level. To ensure that their efforts are sustained, they seek Fund assistance over the medium term. As such, they request a new 40- month arrangement under the Extended Credit Facility (ECF). They would also appreciate a one-year extension of the temporary approval for the retention of measures resulting in exchange restrictions and a multiple currency practice subject to IMF jurisdiction under Article VIII, Sections 2(a) and 3.

Recent Developments and Outlook

5. The Sao Tomean economy has continued to grow amid difficult circumstances. In 2018, real GDP moderated to 2.7 percent, compared to 3.9 percent in 2017, mostly influenced by the impact of power outages on business and services, and lower foreign inflows. Inflation, on the other hand, increased to 9.0 percent at year-end, but began slowly falling in the first half of 2019. Although the current account deficit decreased in 2018 to 10.9 percent of GDP, high dependence on imports for private consumption continues to create imbalances and, as a result, international reserves fell to 3.3 months of imports from 4.6 months in 2017. The domestic primary fiscal deficit (DPD) stood at 4.1 percent of GDP in 2018.

6. Regarding debt, the 2019 debt sustainability analysis (DSA) continues to classify the country as being in debt distress due to outstanding external arrears. Nevertheless, Sao Tome and Principle's debt remains sustainable over the medium-term and the country has the capacity to repay its external arrears over time, as external debt ratios under the baseline scenario remain continuously below the high-risk thresholds. The new Government have re-

initiated negotiations with external creditors recently with a view to find an agreement on clearing the arrears, which would improve the country's debt distress risk.

7. Looking forward, the economic outlook of Sao Tome and Principe is positive. Real GDP is projected to continue growing in 2019 and top 4 percent over the medium-term, driven by the implementation of infrastructure projects as well as lower energy prices. Inflation is expected to decline to 7.8 percent in 2019 and fall further to about 3 percent over the medium-term. Risks to the outlook could stem from domestic and external factors, including limited institutional capacity and high dependency on timely disbursement from development partners. The Sao Tomean authorities are of the view that the start of key infrastructure projects, together with the promotion of small-scale entrepreneurs, women and youth economic empowerment would unleash the country's potential growth.

Policy Priorities for 2019 and the Medium-Term

Restoring Fiscal Sustainability

8. The new Government aims to ensure a more rigorous budget execution, with a view to achieving the domestic primary deficit target under the program and keeping public debt on a downward path. In this regard, a Council of Ministers' Resolution Decree Law was adopted in June 2019 to align the budget with program objectives, including the adoption of a monthly expenditure plan for the remainder of the year.

9. In order to meet the 2019 DPD target of 2.1 percent of GDP, the authorities' fiscal consolidation efforts will focus on both revenue-enhancing and expenditures-controlling measures. On the revenue front, (i) an oil surcharge was adopted, (ii) an agreement was reached with ENCO to transfer the positive fuel price differential, (iii) tax allowances for households have been reduced; and (iv) a new sales tax on telecom has been introduced. In addition, the newly-signed fishing agreement with the European Union and the efforts underway to collect tax arrears as well as income tax, will increase revenue in the near-term. On the expenditure side, wage growth freeze will be preserved, and stricter control will be exercised over spending on goods and services as well as on treasury-financed capital spending.

10. The authorities will pursue structural fiscal reforms over the medium-term to sustain the fiscal consolidation. Prompt steps are being taken for the Parliament to approve the value-added tax (VAT) Law by October 2019, with a view to implementing it in early 2020. In the meantime, the preparative work for the implementation of the VAT is proceeding. As part of the preparation, the authorities will implement an electronic invoicing system in January 2020. They are currently running a pilot exercise with 10 largest corporate tax payers. The e-invoicing will also play a major role in combating informality and tax evasion. The authorities recognize the benefits inherent to the VAT while remaining concerned about the adverse impact of the high rate of 15% on the economy and the most vulnerable. The World Bank recently approved a five-year program aimed at enhancing the social safety net.

11. Emphasis will be also placed on strengthening tax administration and public financial management (PFM). The IMF recommendations to increase tax compliance, promote risk management practices and establish a monitoring framework will be implemented. To prevent the accumulation of arrears and improve the arrears clearance plan, the authorities will use available funds from an overperformance of end-2019 DPD to paydown arrears. Arrears payment plans for SOEs are also being developed and the Treasury is officially the

only entity authorized to contract loans. Greater attention will be paid to updating and more stringently enforcing public procurement laws to curb corruption and the misuse of public funds.

12. Addressing Sao Tome's debt vulnerabilities ranks high in the Government's policy priorities. The government, in its efforts to bring down the debt level, reiterates its commitment to limit concessional borrowing to 3 percent of GDP and avoid non-concessional loans. Given the large arrears of the public utility company EMAE and its fiscal risks, the authorities have secured a formal agreement between EMAE and its creditor ENCO (national oil company) for a longer repayment plan, which help reduce the present value of total public debt. Appropriate steps have also been taken to implement the recommendations of the Debt Management Performance Assessment (DeMPA).

Supporting the Peg through Tight Monetary Policy and Improved Central Bank Management

13. The authorities are cognizant of the importance of continued fiscal consolidation to control inflation and that of promoting exports to build reserve buffers indispensable to protect the peg. Nonetheless, they share the view that tightening monetary policy could also be useful to achieve these objectives. In this vein, efforts are being made to carry out open market operations and issue central bank certificates of deposits with the support of Fund technical assistance. To preserve foreign exchange, the authorities will limit public spending that requires foreign exchange and elaborate an adequate strategy to further attract remittances and investments from the diaspora. In line with the new Government's program, the independence and transparency of the Central Bank of Sao Tome and Principe will be strengthened. In this regard, the recommendations of the recent Safeguard Assessment will be effectively implemented, apart from the one related to the creation of a non-Executive Board for the Central Bank given the distortions it may create to the functioning of the institution.

Preserving Financial Stability

14. The authorities will continue their efforts towards safeguarding financial stability. The asset quality review (AQR) of the banking system was finally concluded and the findings and recommendations will be used by the central bank to update its loan classification system as well as strengthen prudential regulations. Consideration will be given to regular stress tests and on-site inspections. Moreover, steps will be taken to introduce a bank rating model and upgrade banking resolution in line with IMF technical assistance's recommendations.

15. Progress was made on the resolution of non-performing loans (NPLs) while the default rate on newly-issued bank loans is on the decline. To speed up the reduction of the stock of NPLs, the Central Bank is preparing a guidance for rapid write-offs, the loan enforcement process will be strengthened and an arbitration tribunal for out-of-court settlements will be established. Regarding the two failed banks, Banco Equador and Banco Privado, the authorities expect to conclude their liquidation in 2019.

16. Sao Tome and Principe is making strides on financial inclusion. In September 2018, the microfinance law was adopted, and all relevant regulations are expected to be approved this year. A survey on financial inclusion issues was also conducted and, as a result, a national financial inclusion strategy will be formulated and published by end-

2019. Under the promotion of small and medium-sized enterprises (SMEs), a legal framework for a collateral registry is being developed with the support of the World Bank and is expected to be operational in 2020. The registry will be instrumental in helping SMEs access to financing.

Promoting Sustainable and Inclusive Growth

17. The authorities will pursue structural reforms to reduce the cost of doing business, improve the investment climate and boost sustainable and inclusive growth. They are restructuring the energy sector to enhance energy provision, contain EMAE's losses, ensure a more transparent and efficient pricing of electricity to allow cost recovery over the medium- term. They have approved and are now implementing the Least Cost Productions Plans and the Management Improvement Plan. The Government is also committed to adopt the recommendations of the Tourism Development Strategy. Work is ongoing for expediting the upgrade of the payment system for international credit cards, with the assistance of the African Development Bank.

18. Sao Tome and Principe is making good progress towards the Sustainable Development Goals (SDGs). The 2018 Africa SDGs Index Report ranks Sao Tome and Principe tenth out of 51 African countries on overall performance on the SDGs targets. With the support of development partners, the authorities continue to explore ways to close the identified gaps. In this connection, the country hosted a High-level International Conference on "Women's Economic Empowerment and Financial Inclusion" in July 2019. The resulting action plan will be finalized by December 2019. Moreover, a tourism school will be created, and a youth employment project will be launched with the support of the International Labor Organization (ILO) to address the skill mismatch and promote entrepreneurship.

Conclusion

19. The new Government recognizes the daunting economic challenges the country faces and are cognizant of the need to restore macroeconomic stability and unleash growth potential. They reiterate their strong commitment to their reform agenda which should be supported by the ECF given the balance-of-payment needs. To improve the chances of the program success, the authorities look forward to Fund's consideration for reopening the resident representative office as well as the timely delivery of hands-on technical assistance from development partners. On behalf of our Sao Tomean authorities, we would appreciate Executive Directors' support for a new 40-month arrangement under the ECF and a one-year extension of the temporary approval for the retention of measures resulting in exchange restrictions and a multiple currency practice.