

## São Tomé and Príncipe: Selected Economic Indicators, 2006–2011

	2006	2007	2008	2009	2010	2011
			Proj.	Prog.	Proj.	Proj.
(Annual change in percent, unless indicated)						
<b>National income and prices</b>						
GDP at constant prices	6.7	6.0	5.8	5.5	6.5	7.0
Consumer prices						
End of period	24.6	27.6	24.8	16.0	10.0	7.0
Period average	23.1	18.5	26.0	20.1	12.8	8.4
<b>External trade</b>						
Exports of goods and non-factor services	7.8	-21.5	60.7	-8.5	13.2	13.5
Imports of goods and non-factor services	45.2	9.7	36.8	27.4	-5.4	1.0
Exchange rate (dobras per US\$, end of period) <sup>1</sup>	12,945	14,220	15,077	...	...	...
Real effective exchange rate (depreciation = -)	4.3	1.3	20.0	...	...	...
<b>Money and credit</b> (end of period)						
Base money <sup>2</sup>	32.0	50.0	18.9	10.7	20.7	16.4
Broad money (M3)	39.3	36.4	9.5	13.5	20.7	16.4
Velocity (GDP to average broad money)	2.7	2.8	3.0	3.1	3.1	3.1
Central bank reference interest rate (percent)	28.0	28.0	28.0	...	...	...
Bank lending rate (percent)	29.3	32.4	32.4	...	...	...
Bank deposit rate (percent)	10.8	12.8	12.8	...	...	...
(Percent of GDP, unless otherwise specified)						
<b>Government finance</b>						
Total revenue, grants, and oil signature bonuses <sup>3</sup>	36.8	160.3	47.6	70.7	50.2	34.4
Of which: tax revenue	17.2	16.3	14.7	16.7	15.9	16.0
Non-tax revenue	3.7	2.8	1.9	1.8	1.4	1.3
grants	15.9	120.1	31.0	52.2	20.7	17.0
oil signature bonuses	0.0	21.1	0.0	0.0	12.2	0.0
Total expenditure and net lending	50.5	39.8	31.0	62.9	53.2	47.0
Of which: personnel costs	8.6	8.9	8.6	8.6	8.4	8.2
non-wage noninterest current expenditure	16.3	15.6	12.5	10.1	9.0	8.5
treasury funded capital expenditures	3.3	1.1	0.5	2.8	2.4	2.4
donor funded capital expenditures	16.5	10.2	7.5	39.6	31.5	25.9
Domestic primary balance <sup>4</sup>	-10.7	-8.4	-6.6	-4.5	-3.9	-3.1
Overall balance (commitment basis)	-13.7	120.5	16.6	7.9	-2.9	-12.6
<b>External sector</b>						
Current account balance						
Including official transfers	-28.8	-29.9	-34.0	-43.0	-38.1	-35.1
Excluding official transfers	-53.5	-51.7	-58.8	-69.7	-59.5	-52.5
PV of external debt	159.7	11.8	10.9	19.0	25.9	30.6
External debt service (percent of exports) <sup>5</sup>	33.8	24.3	5.1	5.5	7.1	8.0
Export of goods and non-factor services (US\$ millions)	17.2	13.5	21.7	19.8	22.4	25.5
Gross foreign reserves <sup>6,7</sup>						
Months of imports of goods and nonfactor services	4.8	3.4	6.6	5.0	4.0	4.0
Millions of U.S. dollar	24.7	26.3	46.5	38.6	32.6	34.8
National Oil Account (US\$ millions) <sup>9</sup>	8.6	14.9	12.2	9.9	32.3	30.0
<b>Memorandum Item</b>						
<b>GDP</b>						
Billions of dobras	1,550	1,962	2,568	3,196	3,817	4,398
Millions of U.S. dollars	125	145	176	201	213	230
Privatization account (million US dollars)	0	0	21	17	14	11

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

<sup>1</sup> Central bank (BCSTP) buying rate.

<sup>2</sup> Projected base money growth for 2008 reflects the high level of base money at the end of 2007, which was significantly reduced in subsequent months through the BCSTP's foreign exchange sales.

<sup>3</sup> Includes HIPC and MDRI debt relief.

<sup>4</sup> A new definition is adopted from 2008, retroactively, to exclude oil revenue, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.

<sup>5</sup> In percent of exports of goods and nonfactor services. Includes HIPC and MDRI debt relief.

<sup>6</sup> Gross reserves exclude the National Oil Account and commercial banks' foreign currency deposit at the BCSTP in order to meet the reserve requirement for their foreign currency deposits or as application deposits for new licensing.

<sup>7</sup> For 2008, includes the proceeds from the privatization of the government's share in the fuel distribution company (ENCO) of \$32 million. Of this, \$10 million were used to pay back some of ENCO's debt to Sonangol, \$0.96 million were used to audit the transaction and \$21.4 million were put in the central bank to boost reserves.

<sup>8</sup> Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

<sup>9</sup> For 2010, based on the assumption that dispute will be settled to allow disbursement of bonuses for Blocks 5 and 6 (\$26 million).

**Statement by Laurean Rutayisire, Executive Director for the Democratic Republic of  
São Tomé and Príncipe**

**March 2, 2009**

My authorities would like to thank Management and the staff for their continued support and useful advice to São Tomé and Príncipe (STP) over the past few years. My authorities are also very grateful to the international community for their financial and technical support during the previous Fund arrangement. Since the last review of that PRGF-supported program in June 2008, they followed through on their commitments with the completion of various reforms initiated during the arrangement and pursued an overall satisfactory program implementation through the end of 2008.

My authorities intend to maintain their growth and poverty-reducing efforts going forward with the implementation of a medium-term program of actions whose priorities are (i) increasing domestic food production, (ii) improving basic infrastructure and (iii) promoting tourism as an engine of economic growth. During the implementation of their program, my authorities will continue to pursue macroeconomic stability, which they believe is a necessary condition for the pursuit of their abovementioned priorities in a sustainable way.

In support to their program, my authorities are requesting a new three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), covering the period March 2009-December 2011, as they believe that such arrangement provides an appropriate framework to continue their macroeconomic stabilization efforts and the reforms initiated in the previous arrangement, and to secure international community support to their development program. In this regard, the National Assembly adopted a budget for 2009 in line with the organic law (SAFE) and the program to be implemented under the PRGF arrangement. In addition, they have prepared a set of priority projects that will be implemented in the context of the public investment program, and have established a monitoring framework to ensure the quality of related spending.

**I. Recent developments**

Economy activity remained buoyant in 2008. Output is estimated to have grown by 5.8 percent in 2008, thanks to continued tourism-related construction, commerce and services. The completion of new hotel in the archipelago as well as the increase in the number of international flights to the country and the resulting reduction in airplane tickets has resulted in a growing number of tourists visiting the country in 2008, which in turn contributed to a 61-percent growth in exports of goods and services. Despite this achievement, the current account balance deteriorated by 4 percentage points of GDP due to

higher imports of food and fuel products and investment goods. This deficit was financed by sustained external grants and tourism-related FDI.

In the **fiscal sector**, my authorities managed to pursue their fiscal consolidation efforts with a greater control of expenditures. As a result, the primary fiscal deficit declined for the fifth consecutive year from 8.4 percent of GDP in 2007 to 6.6 percent in 2008. As regards fiscal reforms, the direct tax package, aimed at reducing the corporate income tax rate and replacing the current flat personal income tax rate with a progressive tax structure, was adopted in October 2008. Good progress was also made towards to a fully integrated computerized public financial management system (eSAFE) with the completion of the bidding process for the equipment. My authorities also initiated the bidding process for the eSAFE software. The IT and accounting offices are expected to start operations by end-September 2009, once the purchase and the installation of all IT equipment are completed.

The **monetary tightening** initiated in the second quarter of 2008 to mop up excessive liquidity has been maintained through the end of 2008, with a more extensive use of foreign exchange sales and an increased coordination with the Ministry of Planning and Finance. As a result, money growth declined from 50 percent at end-2007 down to 19 percent at end-2008, and the exchange rate stabilized in the course of the year. In addition, inflation receded from its peak of 37 percent in June to 25 percent at-end 2008, while usable international reserves remained high at 6.6 months, well above the 4-month target.

Given its limited external exposure, the **financial sector** has not been affected by the global financial turbulence. However, in light of the growing number of banks in the country, the BCSTP enhanced its banking supervisory capacity held by Fund assistance. After preliminary off-site inspections revealed some weaknesses in some banks, they intend to start on-site inspections beginning this month, with MCM assistance.

As regards **structural reforms**, the new investment code, which aims to reduce the time to approve investment projects and provides equal treatment to foreign and domestic investors, was approved in December 2008. In the public enterprise sector, my authorities sold a majority stake in ENCO, the national petroleum distribution company, to SONANGOL, the Angolan national oil company. Electricity tariffs have been revised upwards in 2008, in order to improve the financial viability of EMAE, the national electricity company. However, EMAE is still experiencing some collection problems and the continued degradation of its operating infrastructure is affecting the company's efficiency. On the other hand, there has been little improvement in the financial situation of other state-owned enterprises, notably ENASA, the airport operator, and ENAPORT, the seaport managing company, as they continue to suffer from excessive costs and difficulties to cover them. My authorities have initiated efforts to redress these enterprises by involving the private sector.

Developments in the **oil sector** have not been encouraging as exploratory drilling so far has not confirmed the existence of commercially extractable oil reserves. In addition, long-term prospects are more and more uncertain as new drilling scheduled for late 2009 may be further delayed as a result of weak oil prices. The corollary of this uncertain outlook is the greater risk of debt distress in the absence of oil production, as indicated by the Debt Sustainability Analysis Update, which outlines the need for continued prudent macroeconomic policies and diversification of the sources of growth over the medium-term.

## **II. Medium term program, outlook and policies**

### **The government's medium-term program<sup>1</sup>**

As noted above, the government has put forward a medium-term action program, *Programa do XIII Governo*, aimed at taking full advantage of the country's natural resource potential and establishing the conditions for private sector development, consistent with the PRSP, while ensuring macroeconomic stability. This program focuses on three priority areas namely agriculture, infrastructure and tourism.

Specifically, given that a large proportion of the population earns a living in small-scale agriculture and fishing, my authorities believe that there is a huge potential to increase domestic food production if appropriate programs are in place and hence to reduce dependence on imported food stuffs, which are sometimes the source of high food prices and inflation. The strategy here is to develop this sector's productive capacity, with a special emphasis on the provision of material and technical support for small producers. They believe that a successful implementation of programs in this regard will contribute to poverty reduction and lead to food security over time.

My authorities also believe that the continued deterioration of its infrastructure or the lack thereof has been one of the main impediments to private sector development. The emphasis of the program going forward will be primarily on improving the basic infrastructure and mitigating power supply problems. They have already reached agreements with foreign investors on several large projects regarding notably the airport and a deep-water seaport.

My authorities strongly believe that succeeding in the two previous areas, together with continued regulatory reform and public enterprise sector reform, will significantly improve the conditions for private sector development, notably in the tourism sector, which they view as the main engine of growth over the medium-to-long term.

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<sup>1</sup> The full program is available at this website: <http://www.gov.st/content.php?intMenuID=39>

## **Exchange rate arrangement**

As indicated in the MEFP, the government is studying the possible modification of the country's exchange rate regime, for which it is discussing an agreement with Portugal. It expects the joint technical work with the Portuguese authorities to be concluded during the course of 2009, and to make a final decision once this preliminary work is concluded. The government is aware of the need for the strictest discipline in the conduct of fiscal policy for the viability of a fixed exchange rate. The decision on a new regime will be made only after the most careful consideration has been given to these issues and to the design of a transition strategy. The timeline just outlined also allows the BCSTP to make headway in the current disinflation process in advance of the possible pegging of the exchange rate.

## **Medium-term economic outlook and risks**

My authorities foresee that economic growth will remain robust, on average above 5 percent over the next three years, as a result of continued buoyant construction activity fuelled by the public investment program and FDI. The current account deficit is expected to widen as a result of continued investment imports, although the current low levels of international oil prices might dampen this widening, if sustained over time. Macroeconomic policies for the medium-term will be geared towards achieving macroeconomic stability while supporting their development program and putting in place the foundations for reaching an agreement with Portugal on an exchange rate arrangement. My authorities are aware that their macroeconomic framework is subject to significant risks stemming from the effects of the current global economic slowdown and financial turmoil on external demand for STP exports, tourism, FDI and donor support. In the event significant changes in the external environment occur or if long-term oil prospects deteriorate further, they will revise their economic program accordingly.

## **Fiscal policy**

Fiscal consolidation will continue over the medium term, with the objective of reaching a primary fiscal deficit of 3.3 percent by the end of the program in 2011. In particular, an emphasis will put on (i) pursuing the strengthening of the tax administration with the support of the Portuguese authorities and the US Millennium Challenge Corporation (MCC); (ii) completing the public financial management reform; and (iii) undertaking the public wage reform with a view to revising the salary structure, while rationalizing the compensation package and ensuring that all elements thereof are properly reported in the fiscal accounts.

For 2009, the goal is to achieve a primary fiscal deficit of 4.5 percent of GDP. This will be achieved through continued containment of expenditures—in particular the wage bill-related and nonessential current expenditures, while preserving pro-poor spending and increasing treasury-funded capital expenditures—, as the recently approved direct tax reforms would be

largely neutral. The deficit will be financed by statutory withdrawals from the National Oil Account, the remainder of the IDA's Development Policy Operation (DPO) grant and part of the proceeds of the privatization of ENCO. The government will stand ready to adjust its spending if needed to meet the NIR target.

My authorities intend during the program to use the proceeds of the privatization of ENCO and any other non-oil one-off receipts in a way similar to that of the resources in the NOA. In this regard, they create a dobra-denominated account at the BCSTP where all above-mentioned receipts will be deposited. These resources will be financing the fiscal primary deficit up to one fifth of the starting balance each year starting in 2010. The government will ensure that the availability of these temporary resources does not lead to the creation of permanent expenditure obligations. They will also refrain from resorting to domestic banking system credits.

The 2009 fiscal reform program will focus on addressing the issue of protracted tax arrears. In this regard, my authorities intends to establish a temporary facility that will encourage taxpayers to regularize their tax situation by allowing them to settle their tax arrears in several installments, with the possibility in some cases to benefit a partial pardon of some overdue taxes, late interests and fines. My authorities also intend to take advantage of the current low oil prices to implement an automatic pricing mechanism for petroleum products. As indicated above, the public financial management reform will be pursued. They will also proceed with the reform of public enterprises to improve their financial situation.

### **Monetary, exchange rate and financial policies**

The monetary tightening initiated last year will be pursued in 2009. In particular, the monetary program aims to keep base money growth in line with the program's objective of reducing inflation to 16 percent by end-2009 and to single digits by 2011. Given the limited effectiveness of interest rates and other monetary policy instruments, my authorities will continue to use foreign exchange sales to control liquidity, while preserving a strong level of reserves. The BCSTP will also continue their close cooperation with the Ministry of Planning and Finance, which has proven effective in improving the central bank's liquidity management and meeting international reserves target last year. The central bank will continue with its communication strategy of informing the market of its monetary and exchange policies.

The BCSTP will continue to enhance its banking supervision and further strengthen its capacity to enforce banking supervision regulations. In particular, the central bank plans to set up a Bureau of Credit registry to facilitate credit information sharing among banks. It also plans to prepare a framework to facilitate mergers and acquisitions among banks by 2010. My authorities will implement the recently approved AML/CFT law and improve it further with the help of development partners.