**Statement by Mr. Andrianarivelo, Mr. Sylla, and Mr. Carvalho da Silveira on Democratic Republic of São Tomé and Príncipe**
**August 31, 2022**

## Introduction

1. On behalf of our Sao Tomean authorities, we thank the Executive Board, Management, and Staff for their continuous support to the country's economic reform agenda. The authorities broadly agree with staff's assessment and policy advice. They are grateful for the dedication and relentless efforts during the extensive virtual discussions held in the context of the Fifth Review under the Extended Credit Facility (ECF). The presence of the IMF Resident Representative on the ground has allowed for more constructive dialogues, assistance, and deeper program implementation. However, in-presence review missions should always be given priority to avoid lengthy discussions.

2. In the face of consecutive and multiple exogenous shocks, exacerbated by the effects of the war in Ukraine, the authorities have continued to make efforts to implement measures and policies under their ECF-supported program aimed at achieving macroeconomic stability and promoting sustainable and inclusive growth. Being a small and remote island country and heavily impacted by rising temperature and sea levels, the government is very concerned about the implications of the upcoming country's reclassification to "non-fragile state" by the IMF. In addition, the country continues to face severe institutional, economic and social fragility. They note that several indicators show that the country has not yet reached levels that justify the reclassification. In the past, similar events, such as the upgrade of the country's classification to lower middle income by the World Bank, led to lower engagement and assistance from development partners. Therefore, they stress that persistent engagement and support from the international community remains critical, particularly during such uncertain and challenging times for a small and fragile state like Sao Tome and Principe (STP). They also look forward to the forthcoming Staff Guidance Note on the Implementation of the FCS Strategy with details regarding the uses and operational implications of the new FCS list, including internal arrangements for situations when countries transition on and off the list to minimize the impact of Fund engagement and resource allocations.

## Recent Developments

3. The authorities reiterate that a confluence of shocks continues to pose significant economic and social challenges to STP and threaten the outlook. These include notably electricity shortages, more frequent natural disasters, spillovers from the war in Ukraine as

well as the lingering effects of the pandemic. Higher global fuel prices have aggravated the situation of both ENCO and EMAE. ENCO reduced the fuel supply to the electricity company, EMAE, which in turn began to rationalize the supply of electricity to the population.

4. The island is paying a heavy toll from the effects of climate change. The torrential rains and floods in December 2021, which caused substantial damages ranging from loss of human lives to property damages with an estimated recovery cost of about 7 percent of GDP, the country was hit by two subsequent climate events. In March 2022, the rains again caused damages in the district of Lembá, resulting in the destruction of infrastructure, including bridges, leading to the declaration of a State of Calamity in that district. In May 2022, in the Autonomous Region of Príncipe, the heavy rains felt were the most intense in recent years and caused enormous material damage in terms of road infrastructures, agricultural land, losses for families, State services, and private companies. The only fuel tank on the island was also damaged.

5. As a result of these developments, economic growth decreased to 1.9 percent in 2021 from 3.0 percent in 2020 and is expected to slow further in 2022 to 1.4 percent. Although tax revenue declined, efforts were made to accommodate Covid-19 related assistance to vulnerable households and businesses while containing and even reducing non-essential spending to reach the program's fiscal targets. Therefore, the fiscal deficit stood at 3.2 percent at year-end 2021, compared to the program target of 3.5 percent. Inflation has increased to 14.9 percent in May 2022 from 9.5 percent in December 2021, as the increase in fuel and food prices and the effects of climate change on the weather have continued to exert pressure on inflation. The current account deficit has widened slightly from 11.0 in 2020 to 11.3 percent in 2021, also driven by increased international fuel prices. Gross international reserves stood at about 2.8 months of projected imports. Credit growth to the private sector slowed down at the end-December 2021 compared to the previous year but showed signs of recovery in the first half of 2022.

6. In the context of slower and lower-than-expected external disbursement, SDR allocations were critical in providing helpful relief. STP has used US $10 million of its SDR allocation received in August 2021 to: (i) meet pandemic-related spending needs; and (ii) address health, education, transport, and energy infrastructure gaps; and another US $53 million in February 2022 to cover expenses related to the flood experienced in December 2021, out of which US $2.5 million has been repaid by the Ministry of Finance to the BCSTP.

**Performance under the ECF**

7. Despite the headwinds, the implementation of the ECF-supported program in STP continues to advance. As emphasized during the previous program review, although tax revenue underperformed due to the challenges imposed by the pandemic and electricity

blackouts, the authorities have continued their efforts to contain non-priority spending to ensure that the program remained on track. Consequently, all five quantitative performance criteria (PCs) for end-December 2021 were met. Three out of four Indicative Targets (ITs) were also met except the one on the floor of tax revenue. For end-March 2022, the preliminary assessment indicates that all PCs and ITs are broadly on track, apart from the PC on ceiling on the accumulation of new external payment arrears due to temporary liquidity issues. In this regard, corrective measures have been taken to prioritize debt service payments and prevent the reoccurrence of these breaches.

8. With respect to structural benchmarks (SBs), important steps were also taken to implement reforms despite the delays caused by the effect of the pandemic, as well as capacity constraints. All four prior actions set for this review were completed, notably the submission of the Financial Institutions Law; launch of the VAT awareness and information campaigns; settlement of debt service payment and issuance of Ministerial order to improve debt service management; and publishing of the 2020 Covid-19 spending audit report. Moreover, good progress was made on the publication of procurement contracts, and a platform will be launched soon to expedite the publication, management and transparency of public contracts going forward. The continuous benchmark on the fuel price adjustment mechanism was not met at the end-December 2021 due to high and increasing social tensions but was later implemented in April 2022.

**Outlook and Risks**

9. For 2022, the authorities expect real GDP growth to slow down to 1.4 percent and an acceleration of the average annual inflation to reach 15 percent, reflecting the impact of the war in Ukraine on fuel and food prices, electricity shortages, and climate events. Over the medium-term, they still expect growth to firm up at around 4.0 percent and inflation to decline as global prices stabilize. They agree that new Covid-19 variants, delayed revenue and energy reforms, legislative elections as well as delayed or insufficient grant disbursement from development partners could also add to the downside risks. The authorities fully understand the importance of avoiding setbacks in fiscal adjustment and advancing the reform agenda under the program. However, they reiterate their concerns about the impact of the high fuel and food prices on rising social tensions. On the upside, the materialization of the deep seaport and other large infrastructure projects could boost growth prospects.

**Policy Priorities for 2022 and Beyond**

*Fiscal Policy*

10. The authorities remain fully committed to continuing the fiscal consolidation path to achieve the 2022 program targets. Due to growing social tensions amid rising inflation,

floods, electricity shortages, and demand for higher wages, labor unions and the authorities have decided to grant a wage supplement to civil servants in the lowest income bracket after lengthy negotiations. In this connection, several efforts are being made to ensure that this additional spending can be accommodated within the approved 2022 budget. Non-essential administrative costs and domestically financed capital spending are being cut further, while the February 2022 hiring freeze of civil servants to contain personnel costs remains in place. Pro-poor spending will be maintained in line with the indicative targets, and cash transfer programs will be boosted to help protect the most vulnerable from the impact of inflation with support from the World Bank. On the revenue front, the awareness and information campaign has started for the introduction of the VAT at a 15 percent rate in September 2022. Actions are being taken to implement a new tax on small businesses, a new tax surcharge on alcohol beverages, and a new income tax bracket.

11. Over the medium-term, emphasis remains on implementing policies and actions to reach a balanced domestic primary balance by 2025. These include (i) gradually reducing the wage bill in terms of GDP ratio; (ii) maintaining transfers and other current expenditures constant in nominal terms; and (iii) strengthening public financial management (PFM) and tax administration in line with IMF recommendations.

*Debt Policy and Management*

12. The authorities note the unchanged debt sustainability analysis (DSA), which indicates that STP remains in debt distress rating due to prolonged unsettled external arrears. Fiscal consolidation efforts will continue as envisaged under the program and energy sector reforms will be stepped up to ensure the debt is on a downward path to preserve its sustainability. They will also continue to pursue prudent debt management and keep engaging with creditors in an open and transparent manner to regularize arrears and restructure all outstanding debt. Work is also ongoing to strengthen public financial management systems and prevent the accumulation of new arrears. A new Ministerial order was issued to prioritize external debt payment in August 2022.

*Monetary and Exchange Rate Policies*

13. Against the challenging backdrop of higher inflation and weaker growth for 2022, the BCSTP Monetary Policy Committee met in June 2022 and took several steps to tighten monetary policy. Notably increase the reference interest rate, the interest rate of the BCSTP liquidity facility and the reserve requirement for domestic currency. The issuance of CDs at variable rates was also resumed to absorb excess liquidity. The short-term credit line with the Portuguese government was activated to help support reserve buffers, meet essential import- related needs as well as safeguard further the exchange rate peg to the Euro. A recapitalization plan for BCSTP is also currently being developed. In this regard, an IMF TA was requested.

14. Progress was made toward the implementation of the outstanding recommendations of the 2019 Safeguard Assessment. The external audit of the financial statements was completed, and the draft Financial Institutions Law was submitted to the government while the Organic Law is pending Parliamentary approval by September. Moreover, efforts are ongoing to finalize the memorandum of agreement on legacy government debt and ensure the country's membership is preserved in the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA) to protect the integrity of the financial system and avoid potential losses of corresponding banking relationships.

15. BCSTP notes the jurisdictional assessment conducted by LEG/MCM in light of the Fund's revised Multiple Currency Practices Policy (MCP) and welcomes the indication that the existing MCP is therefore eliminated as of July 1, 2022.

*Financial Sector Policies*

16. BCSTP views maintaining financial sector stability as crucial to supporting the economy. The monetary authorities note that the sector has been broadly sound and resilient. Although the systemwide non-performing loans (NPLs) ratio has been fairly stable, it increased slightly in Q12022. In this connection, the two new regulations on Asset Classification and Provisions, and Capital Adequacy which came into effect in April 2022 will be helpful in improving further this indicator. Regarding the troubled banks, despite the authorities' efforts, Energy Bank shall be referred to the Courts for bankruptcy and liquidation in the forthcoming months pending the closure of additional negotiations with potential investors. With respect to Banco Equador, some fixed assets remain on sale and the liquidation process is also expected to be concluded this year. On the other hand, after several diligences with shareholders of Banco Privado, BCSTP successfully concluded the extrajudicial process, and the assets were handed over to them.

*Structural Reforms*

17. The authorities share staff's view on the criticality of advancing structural reforms to support growth and external competitiveness. To this end, they plan to implement the VAT in 2022 to generate resources to help support growth and address the large human capital and infrastructure financing gap essential to meeting the SDGs by 2030. The authorities are cognizant that recent international fuel price hikes and electricity shortages make reforms to the public utility company EMAE and the energy sector even more urgent. The authorities remain fully committed to continuing to implement the Least Cost Productions Plan and the Management Improvement Plan with the view to help increase the efficiency and reliability of electricity supply, facilitate the transition towards renewable sources as well as ensure public debt sustainability. In the same vein, efforts will be made to apply the automatic fuel price adjustment mechanism to prevent implicit fuel subsidies and curtail fiscal risks. It is important to reiterate that, under the current circumstances of growing social tensions, attention should also be given to the

socio-political environment when considering future price adjustments. Targeted social transfers will continue to play an important role in cushioning the impact on vulnerable groups. The World Bank's support has been greatly appreciated in this regard.

18. The authorities acknowledge that exiting the European Union's Air Safety blacklist is essential to promote tourism, create jobs and boost growth potential. Work is currently ongoing to finalize the plan to remove STP from the list in September, including updating relevant laws and regulations. With support from Chinese development partners, funding has also been secured to upgrade the airport infrastructure. Moreover, the government has recently signed a build-operate-transfer agreement with an international consortium for a deep seaport in Fernao Dias, as well as the management of two ports in both islands. According to the contract, the project is estimated at around US450 million and the authorities expect this project to have a major impact on job creation and economic growth.

**Conclusion**

19. The authorities of Sao Tome and Principe reiterate their commitment to the ECF-supported program aimed at achieving fiscal and external sustainability and promoting inclusive growth amid the Covid-19 pandemic. In light of the recrudescence of the climatic phenomena and the remoteness of the island, combined with new vulnerabilities triggered by the war in Ukraine, continued and timely support from the development partners to STP remains critical. They look forward to the Executive Board's completion of the Fifth Review under the ECF. They also count on the Board's approval of the waiver of nonobservance of the continuous performance criterion on non-accumulation of external debt service arrears considering corrective measures implemented.