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July 19, 2018

**Statement by Mr. Saito on Democratic Republic of São Tomé and Príncipe
(Preliminary)
Executive Board Meeting
July 23, 2018**

We thank staff for the informative papers and Mr. Sembene and Mr. Carvalho da Silveira for their helpful statement. Although the growth rate decelerated slightly in 2017, São Tomé and Príncipe's macroeconomic stability has been maintained with the growth rate of around 4 percent. However, higher growth is needed to absorb the sizable number of youth entering the labor force. In this respect, continued efforts in revenue mobilization, building fiscal buffers, and structural reforms are essential to strengthen economic stability and reduce poverty. Regarding the program performance, it is disappointing that three out of five end-2017 performance criteria (PCs) were missed. In particular, continuous underperformance of tax revenues is a source of concern and definitive measures to enhance revenues are imperative. Given that the authorities have taken corrective measures to keep the program on track, and economic policies for 2018 are consistent with the program objectives, **we support the completion of the fifth review under the ECF arrangement and the request for waivers for nonobservance of the PCs.** As we agree with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal and Debt Policy

Further fiscal consolidation to improve the fiscal position and reduce public debt mainly through the revenue mobilization and SOE reform is necessary. We welcome that the authorities took revenue enhanced measures such as collection of tax arrears owed by large tax payers. We also positively note that the authorities commit to cut expenditures through maintaining the cuts in transfers and personnel costs to complement revenue measures. To reduce debt to a more sustainable level, we urge the authorities to continue expenditure rationalization and step up efforts to prepare for the introduction of VAT with support from the Fund TA. *While we note that preparations for the adoption of the VAT have taken longer than expected, we would ask staff's view on the risk of delay in introducing the VAT regime in early 2019.*

While the debt ratios have improved since the previous DSA, São Tomé and Príncipe’s classification has been updated to stand in “debt distress” due to the prolonged negotiations on rescheduling external arrears. Under this situation, it is important to eschew non-concessional loans and continue to rely on grants and concessions for external financing while strengthening debt management capacity. We also underscore that a large amount of loans, even at concessional terms, would threaten debt sustainability. In this context, it is encouraging that the authorities commit to limit concessional borrowing below 4 percent of GDP per year. That said, the limit should be reviewed when revenues and the GDP growth is underperformed.

Considering that the high cost of energy is hindering growth and the loss-making state-owned utility company (EMAE) poses fiscal risk, reforming the company should be a priority. In this context, we welcome that the audit of all SOEs, including EMAE, by an international firm with the support of the World Bank has been conducted. *Would staff comment on the expected timeline of the completion of the audit?*

Financial Sector

Further efforts are needed to address the high level of NPLs. It is encouraging that stringent bank supervision by the BCSTP has strengthened asset classifications and NPL ratio continues to fall. However, we note with concern that the asset quality review (AQR) of the banking system is delayed with a longer international selection process for the consultants. We concur with staff that concerted efforts to reform the legal system to assist loan recovery are necessary to lower the NPL ratio and for the banking sector to support economic growth.

Structural Reform

Structural reforms are essential to diversify the economy and reduce poverty while addressing the impact of climate changes. We welcome that the National Development Plan, which highlights the country’s development priorities, has been developed and a tourism development strategy, supported by the World Bank, has been adopted. We encourage authorities to step up efforts to implement infrastructure projects, including road rehabilitation, airport expansion, and water and sanitation. Given that São Tomé and Príncipe is vulnerable to climate changes, we positively note that authorities’ initiatives for mitigating the impact of climate change are underway. Finally, we underscore the importance of the Fund TA to help authorities’ reform agenda. Given the limited human capacity, we urge staff to prioritize the areas and deepen engagement with the authorities to enhance the effectiveness. *In this context, we take note that authorities call for the assignment of resident and Portuguese-speaking experts for their benefit. Staff’s comments are welcome.*