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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/70-1

11:10 a.m., July 23, 2018

1. Democratic Republic of São Tomé and Príncipe—2018 Article IV Consultation, Fifth Review Under the Extended Credit Facility, Request for Waivers for Nonobservance of Performance Criteria, and Financing Assurances Review

Documents: EBS/18/68 and Correction 1, and Supplement 1 ; and Supplement 2; and Supplement 2, Correction 1; and Supplement 2, Correction 2, and Supplement 3 ; SM/18/191; and Correction 1

Staff: Li, AFR; Fletcher, SPR

Length: 25 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	D. Mahlinza (AE)
D. Sembene (AF)	
	E. Rojas Ulo (AG), Temporary
	C. Barron (AP)
	P. Fachada (BR)
	S. Fan (CC), Temporary
	J. Rojas (CE), Temporary
N. Horsman (CO)	
M. Erbenova (EC)	
	F. Bellocq (FF), Temporary
S. Meyer (GR)	
	M. Roy (IN), Temporary
	I. Lopes (IT), Temporary
	Y. Saito (JA)
	M. Saadaoui (MD), Temporary
	F. Al-Kohlany (MI), Temporary
	V. Rashkovan (NE)
	K. Virolainen (NO)
	L. Palei (RU)
	B. Alhomaly (SA), Temporary
	A. Machmud (ST), Temporary
M. Panek (SZ)	
	J. Stockill (UK), Temporary
	S. Vitvitsky (US), Temporary

H. Al-Atrash, Acting Secretary
D. Daly, Summing Up Officer
L. Briamonte, Board Operations Officer

Also Present
African Department: M. Canales Munoz, J. Jack, X. Li, G. Srour, Z. Zeidane, Y. Zhao. Legal Department: K. Christopherson Puh, G. Rosenberg, A. Yiadom. Strategy, Policy, and Review Department: K. Fletcher. Statistics Department: J. Hur. World Bank Group: R. Barroso. Executive Director: M. Raghani (AF). Alternate Executive Director: H. Razafindramanana (AF). Senior Advisors to Executive Directors: W. Abdelati (MI). Advisors to Executive

1. DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE—2018 ARTICLE IV CONSULTATION, FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY, REQUEST FOR WAIVERS FOR NONOBSERVANCE OF PERFORMANCE CRITERIA, AND FINANCING ASSURANCES REVIEW

Mr. Sembene and Mr. Carvalho da Silveira submitted the following statement:

On behalf of the Sao Toméan authorities, we would like to express our appreciation to management and staff for the constructive engagement and policy dialogue during the 2018 Article IV consultation and fifth review under the Extended Credit Facility (ECF). The authorities also welcome Fund's invaluable technical assistance provided over the years. The report provides a candid assessment of the macroeconomic situation, including progress achieved to date as well as challenges and policy priorities for 2018 and beyond.

Noticeable progress has been made in advancing fiscal consolidation and addressing some structural bottlenecks. Still, significant challenges related to the country's state of fragility complicates the achievement of the authorities' targeted development outcomes. These include limited institutional capacity, vulnerability to climate change, and high dependency on external assistance. Nevertheless, the authorities remain committed to addressing these vulnerabilities, notably by pursuing their reform efforts in the context of the ECF-supported program and strengthening capacities with the support of the Fund and other partners.

Performance under the ECF Program

Implementation of the ECF arrangement has recently proceeded in a challenging context. As a result, two out of five performance criteria (PCs) were met, while others related to the Domestic Primary Deficit (DPD) and net bank financing of the central government were missed owing to revenue underperformance, combined with unrealized external budget support and critical spending to address a public health concern. In addition, the PC on net international reserves was unmet due to lower-than-expected external financing. On the structural front, all end-December 2017 and most end-June 2018 benchmarks were met.

The introduction of a central bank's foreign exchange regulation in March 2017 was assessed by staff to have inadvertently led to the breach of the continuous PC against the introduction or intensification of exchange restrictions. This move was deemed critical for the successful implementation of the authorities' capital account management strategy. Moving forward, the authorities intend to take steps in due course to roll back measures that contribute to exchange restrictions and multiple currency practice, while taking into account the need to maintain external stability.

Recent Economic Development and Outlook

Fiscal tightening and reduced external inflows contributed to holding back economic activity in 2017, with real GDP growth decreasing to 3.9 percent from 4.2 percent in 2016. Cocoa, tourism and construction sectors continue to be the main drivers of the economy. Inflation continued to increase, reaching 7.7 percent at end-2017. The current account deficit worsened due to stronger imports of capital goods and oil products.

Regarding the outlook, staff expects real GDP growth to pick up modestly from about 4 percent in 2018 to around 5 percent in medium term, as key infrastructure projects start to materialize. Inflation is expected to decline this year and remain below 5 percent in the medium term. The authorities concur with staff that the macroeconomic outlook for 2018 and beyond remains positive, but believe the infrastructure projects could lead to a more buoyant near-term prospect. The staff highlights a number of risks to the outlook that could stem from the upcoming elections, delays in donor disbursement, and limited implementation due to capacity constraints. Notwithstanding these uncertainties, the authorities have restated their commitment to steadfastly implement the reform agenda envisaged under the program, as reflected by the implementation of politically difficult prior actions during election year.

Policy Priorities for 2018 and Beyond

Addressing Revenue Shortfall and Contingent Liabilities, and Reduce Debt Burden over the Medium Term

Although revenue outturn was lower than expected, fiscal consolidation efforts have helped to reduce the DPD in 2017. To meet the 2018 fiscal targets and offset the revenue shortfall, the authorities took steps to collect tax arrears owed by large taxpayers. In this respect, fiscal and legal procedures were initiated against the beer manufacturer, Rosema, to resolve tax arrears comprising mainly consumption and personal income taxes that it collected on behalf of the government. As a result of these efforts, staff preliminary assessment suggests that São Tomé and Príncipe's end-June 2018 fiscal performance under the ECF arrangement was satisfactory.

Fiscal reforms will be undertaken to support revenue mobilization efforts. In particular, preparatory work will continue for the introduction of the VAT in 2019, with a view to ensuring a smooth transition. Emphasis will be placed notably on facilitating the approval of the VAT Law by the parliament, harmonizing other tax laws with the VAT Law, securing appropriate space and equipment, and hiring and training personnel. In line with Fund TA recommendation, a computer-based monitoring system will be implemented for large taxpayers to help boost domestic revenue mobilization. Furthermore, implementation of the automatic price adjustment mechanism led to a rise in domestic pump prices in June 2018 in line with recent international oil price increases.

On the spending front, the focus is put on maintaining fiscal discipline in line with program objectives. This includes streamlining transfers and personnel costs, capping utility consumption of public agencies (including EMAE), containing domestically-financed capital expenditure and freezing real wage growth. If additional resources are available, the authorities are also committed to continuing prioritizing the clearance of arrears to suppliers.

Fiscal risks posed by the public utility company EMAE is still a source of concern for the government. The ongoing reform process should help revamp EMAE’s operational efficiency even though it is expected to continue making losses in the medium-term. At the same time, the authorities also expressed concerns over delays in the provision of technical and financial assistance by development partners which have contributed to slowing down some aspects of reform implementation. Going forward, the authorities agree with staff that additional short-term measures to contain costs in SOEs are critical for improving their operational efficiency, and ultimately address the complex web of domestic cross arrears.

The 2018 Debt Sustainability Analysis (DSA) shows that debt ratios have improved but staff highlights the importance of advancing negotiations with external creditors on resolving external arrears. In this connection, the authorities managed to reach an agreement with Brazil which awaiting legislative approval from Brazilian lawmakers, as noted in the staff report. The authorities reiterated their attachment to prudent debt management, as reflected in their intention to limit concessional borrowing. Steps were also taken by the authorities to implement recommendations of the Debt Management Performance Assessment (DeMPA). In this respect, a draft medium-term debt management strategy was prepared; a detailed debt database is being established with the support of the World Bank; and training activities for officials on debt management are being conducted. This work will also be complemented by the dissemination of an annual schedule of T-Bills issuance, aligned with cash flow forecasts and borrowing plans. Going forward, they will continue to make efforts to reach agreement with external creditors on arrears and strengthen their debt management capacity.

Boosting International Reserve buffers

The authorities take note of staff's assessment that the country's external position is moderately weaker than indicated by fundamentals and desirable policies, and strong reserve buffers are necessary against shocks. To boost reserve buffers, the central bank has started taking steps to strengthen monetary policy tools by amending the regulatory framework to allow the issuance of Treasury Bills and support the development of the securities market. In the medium-term, continued efforts will be consented to advance structural measures aimed at reducing oil dependence by exploring sources of renewal energy, boosting exports, and improving the implementation of externally funded projects. The authorities will also stand ready to conduct joint efforts with the country's partners to improve the predictability of external assistance.

Safeguarding Financial Stability

The central bank continues to make progress in strengthening banking supervision. In line with staff's recommendation to address the high level of NPLs, a requirement to improve write-offs and recoveries for banks was introduced. Collateral guidelines were enforced while the oversight of the credit risk management framework was improved. In addition, financial sector infrastructure and regulation are being revamped with the support of development partners. This entails notably upgrading the credit registry, infrastructure and laws on payment system, and the microfinance legal framework. Looking ahead, the authorities will continue to implement their financial sector reform agenda while making efforts to accelerate the recommendations of the last safeguards assessment.

The staff's correctly report that preparations for the asset quality review (AQR) of the banking system is advancing—albeit at a slow pace. The authorities noted that factors behind the delays in the procurement process were beyond their control. Going forward, the central bank will continue to liaise with local banks in order to smoothen the process. The full AQR report is expected by mid-2019 and the findings will be used by the central bank to update its loan classification system and strengthen prudential regulations.

Accelerate Growth-Enhancing Projects and Structural Reforms

The authorities acknowledge that continued structural reform efforts are critical to promote sustainable long-term growth, improve competitiveness, strengthen resilience to shocks and address impediments to job creation and investments. They developed the National Development Plan (NDP) for 2017-2021 which highlights the country's development priorities, and focuses on inclusive growth, poverty alleviation and climate change resilience. Most recently, the tourism development strategy focused on export diversification was adopted. In line with staff's recommendation, efforts will be geared at working closely with development partners to accelerate key infrastructure projects, such as the airport expansion, energy grid rehabilitation, and coastal requalification. At the same time, the authorities also envisage some reform measures to address inefficiencies in the judicial system, which should help reduce legal process delays and costs.

Capacity development from partners has been instrumental in helping the country advance their reform agenda. We call on the Fund to take good note of the authorities' strong preference for the assignment of resident and Portuguese-speaking experts in the context of Fund's capacity building initiatives conducted by the Fund for the benefit of their country.

Conclusion

Against a challenging backdrop, the Sao Toméan authorities reiterate their strong commitment to the implementation of their ECF-supported program. Continued engagement and timely delivery of technical and financial assistance from development partners will be critical to safeguarding macroeconomic stability and making headways toward inclusive growth and poverty reduction. In particular, Fund's continued support and catalytic role will be key in achieving these objectives. We would therefore appreciate Directors' support for the completion of the fifth ECF Review as well as the authorities' requests for the approval of waivers for the nonobservance of program targets and the continuous PC related to exchange restrictions.

Mr. Fachada and Mr. Cheong submitted the following statement:

We thank staff for the reports and Messrs. Sembene and Carvalho da Silveira for their helpful statement. The São Tomé and Príncipe authorities have made good progress over the past few years in addressing internal imbalances and implementing structural reforms. However, a combination of external and internal factors combined to affect both economic and program performance in 2017. Taking note of the authorities' program commitment to date and with staff assessing that São Tomé and Príncipe's capacity to repay the Fund is adequate, we support completion of the fifth review under the Extended Credit Facility (ECF). We also support the authorities' request for waivers for nonobservance of performance criteria.

Taking into consideration capacity constraints and the recent challenges, program performance has been roughly satisfactory. We support the inclusion of the prior actions to bring the fiscal targets back on track, although collecting tax arrears from specific companies can be challenging. On a positive note, implementation of structural benchmarks has been quite good, and plans are progressing to resolve remaining delays. Meanwhile, with risks to the outlook titled to the downside, the authorities' commitment to strong policies will be required even beyond the program to ensure macroeconomic sustainability.

The authorities' expenditure driven fiscal consolidation effort over the past few years has been quite robust. Although capital expenditure has been reduced, current expenditure was also cut by 3.2 percent of GDP between 2015 and 2017, with staff anticipating a further 1 percent of GDP reduction in 2018. As a result, the overall fiscal position (commitment basis) is expected to swing to a small surplus in 2018, albeit temporarily, following years of large deficits. We welcome plans to mobilize revenues through, inter alia, tightening collections from large taxpayers and the introduction of a value added tax (VAT) in 2019. Given the risks posed by state-owned enterprises (SOE), we agree with staff that SOE reform remains a priority, although diseconomies of scale make difficult any prospects of restructuring and privatization. While we note that government has a minority equity position in ENCO, can staff indicate the other major stakeholders in the company and do staff and/or the authorities have any concerns from a macroeconomic sustainability and governance perspectives arising from these stakeholders?

Decisive actions have been taken to resolve problem banks, but further efforts are needed to address remaining weaknesses. Banks in aggregate seem well capitalized and liquid, but non-performing loans are still extremely elevated. We welcome the recent upgrade of the credit registry, as well as the ongoing efforts by the central bank to complete the Asset Quality Review (AQR), improve the payment system infrastructure and develop a resolution manual. Finally, we commend the authorities for the successful redenomination of the currency in the beginning of the year.

Fostering job-friendly growth will be key to take advantage of São Tomé and Príncipe's favorable demographic. Along with judicial reforms to improve the business environment, the development of various sector strategies and the National Development Plan are commendable. We welcome government's plans to develop the blue economy and renewable energy sources, and encourage them to increase the level of environmental awareness among the citizenry. Noting that oil related investment and FDI continue to be significant, can staff provide any updates on energy exploration activity?

6.São Tomé and Príncipe is a fragile country, with significant technical assistance needs. As the staff report highlights, capacity building is fundamental for sustained reforms and development of São Tomé and Príncipe, and the authorities would welcome more hands-on technical assistance, particularly by long-term resident experts. The crucial role of 'on-the-ground' experts in fragile states has also been one of the main issues raised by the IEO in its last evaluation. Against this background, can staff indicate the reason/s why the longstanding principle that the IMF would maintain a resident representative office in program countries is not being followed in São Tomé and Príncipe? Additionally, what is staff's view about the role of a resident representative in helping program implementation and capacity building in this case?

Mr. Saito submitted the following statement:

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. The staff's comments are welcome.

Mr. Hurtado and Mr. Rojas Ramirez submitted the following statement:

São Tomé and Príncipe's economy has been steadily growing over the last years. Authorities are devoted to achieving stability, inclusive growth, economic diversification, and poverty reduction. Although program performance has experienced some inconveniences, the authorities are committed to its success by leading fiscal consolidation and conducting an appropriate monetary and financial policy. We thank staff for its documents and Messrs. Sembene and Carvalho for their comprehensive buff statement and support the Fifth Review Under the Extended Credit Facility and the Request for Waivers for Nonobservance of Performance Criteria, and Financing Assurances.

On the fiscal stance, we note that the program results were mixed with some performance criteria missed such as the domestic primary deficit (DPD), indicative targets on tax revenue and new domestic arrears, but note that the authorities are fully committed to implementing reforms and fiscal consolidation and that the initial actions aim at reducing DPD by improving tax collection and accumulated tax liabilities and restraining current and capital public expenditures and prioritizing arrears clearance, if possible. We welcome the broadening the financing possibilities by implementing liquidity management and the issuance of T-bills. Although we note that authorities are working on a capacity development (CD) strategy for strengthening public finance administration in the medium term, including enhancement of the tax system by implementing VAT (by 2019), as well as improvement of the Public Financial Management framework—with the assistance of the AfDB—and the transformation of SOEs, we agree with staff that it is necessary to strengthen fiscal consolidation to improve the fiscal position and reduce public debt. The staff's comments on why arrears of EMAE have continue to increase despite measures is welcome.

The financial system shows vulnerabilities regarding the quality of assets, capital adequacy, and the absence of a robust institutional framework on prudential standards. We note the authorities' commitment to working on the bank and financial system soundness by developing an institutional financial framework. We encourage the development and implementation of the instruments for improving the quality of assets and the creation of prudential and regulatory norms. International accounting standards need to be implemented. BCSTP has taken actions for upgrading the credit registry but developing a prudential, and regulatory framework is of the essence for banking system soundness. Promoting financial inclusion is highly recommended.

We welcome the authorities' commitment to achieving sustainable, inclusive growth in the medium and long term, their actions on several fronts, and the design of the development plan (NDP) 2017–2021 with various desirable targets.

Mr. Psalidopoulos, Ms. Lopes, Mr. Rashkovan and Mr. Manchev submitted the following statement:

We thank staff for the insightful reports and Mr. Sembene and Mr. Carvalho da Silveira for their helpful buff statement. São Tomé and Príncipe continues to grow steadily, and progress has been made to foster macroeconomic stability. Nonetheless, the country is in debt distress, and the authorities should step up to achieve a balanced and sustainable fiscal consolidation and implement the reforms to promote medium-term growth. We support the completion of the fifth review and the requested waivers. As we broadly share the thrust of the staff appraisal, we would like to offer just a few comments.

The fiscal consolidation strategy needs to continue and should adequately balance revenue and expenditure measures. It is underwhelming that all fiscal performance criteria have been missed for end-December; a trend that seems to have continued this year, as preliminary data points to the same outcome for March indicative targets. This happened even after sizable corrective measures, many on the expenditure side, were taken to correct for earlier slippages as revenue shortfalls continue to undermine fiscal outcomes. Going forward, it is key to step up domestic revenue mobilization efforts, to ensure that development needs are properly addressed and priority expenditures are not curtailed, in a context of decreasing reliance on donor support.

Public Financial Management (PFM) efforts should be strengthened, and fiscal risks posed by state-owned enterprises (SOE) tackled. Slow progress in the PFM reform agenda has already impacted donor disbursement, and we encourage the authorities to work closely with development partners and the Fund to progress on this front. We agree with the main objectives spelled out in the authorities' capacity development strategy, notably to improve budget preparation and execution, including control of arrears. SOEs, notably ENCO and EMAE, pose significant fiscal risks, and we look forward to the outcome of the ongoing audit. Furthermore, we encourage the authorities to move forward with the adoption of the financial management plan and least cost energy-production plan, of which the completion is already delayed.

Further progress with addressing NPLs is key. While the financial sector soundness indicators have improved and coverage with provision is high, the NPL ratio remains close to 25 percent at end-2017. Although the SIP on the analysis of NPLs based on credit registry data was quite interesting, we wonder why many of these loans have not been written off from the balance sheets. The staff's comments would be appreciated. Going forward, we note that BCSTP agreed with the recommendation to introduce a requirement for banks to write off a loan when it is past-due for a certain period. We look forward to the results of the asset quality review, which has regrettably been delayed.

Program performance has been mixed, and we note that "The continuous PC that prohibits the introduction or intensification of exchange restrictions was inadvertently breached." However, as it is pointed out in the report, this breach occurred in in March of last year, before the discussion on the third and fourth review. So, it is quite surprising to note that this inadvertent infringement did not involve a misreporting incident, as staff was actually informed about the changes in due time. Could staff clarify why they did not perceive these changes as a breach of the PC at that time? Furthermore, while we assume that the commitment of the authorities to this PC is reflected in the Letter of Intent ("(…) the government will not introduce or intensify any exchange restrictions (…)."), we would like to understand why the continuous PC is not included in table 1 of the MEFP.

Mr. Meyer and Mr. Lieber submitted the following statement:

We thank Messrs. Sembene and Carvalho da Silveira for their candid buff statement and staff for their insightful report. We take positive note that the Sao Toméan economy has grown robustly in the past three years and that progress has been made on fiscal consolidation and structural reforms in 2017. This said, the country – being classified as "in debt distress" – still faces a high debt level and structural challenges which need to be addressed decisively.

While program performance does not look satisfactory at first glance with three out of five end-December 2017 PCs being missed, we acknowledge the extenuating circumstances, as explained by staff, and the authorities' resolve demonstrated by the implementation of prior actions and their broader commitment to corrective measures and the program. Against this backdrop, we can go along with the completion of the fifth ECF review and call on the authorities to fully observe the program targets going forward, including the two important (rephased) structural benchmarks on reforming the state-owned utility company and strengthening banking supervision.

In the following, we highlight some of staff's policy recommendations, which we overall agree with, mainly for emphasis:

Steadfast implementation of identified revenue-enhancing measures and prudent expenditure management are essential to improve the fiscal position and reduce public debt.

We fully concur that non-concessional loans should be eschewed and external concessional borrowing be limited, while continued efforts are needed to resolve external arrears and disputed debt with creditors.

Continued fiscal consolidation and structural reforms are also needed with a view to strengthening the external position and improving the competitiveness of the economy, thereby promoting inclusive growth and reducing poverty.

The international reserves position should be closely monitored and boosted.

We welcome the authorities' intention to take steps in due course to roll back measures that contribute to exchange restrictions and multiple currency practice, while taking into account external stability considerations, as indicated in Messrs. Sembene's and Carvalho da Silveira's buff statement.

Finally, we take note of the extensive technical assistance provided to São Tomé and Príncipe and encourage further efforts by the authorities to improve the country's economic data.

Mr. Mahlinza and Mr. Essuvi submitted the following statement:

We thank staff for their insightful report and Messrs. Sembene and Carvalho da Silveira for their informative buff statement.

The Democratic Republic of São Tomé and Príncipe has made progress in fiscal consolidation and structural reforms under extenuating circumstances. Overall program performance under the Extended Credit Facility (ECF) was mixed, with three out of five end-2017 performance criteria missed and structural reforms broadly on track. We note that the authorities have taken steps to implement corrective measures. Consequently, we support completion of the fifth Review under the Extended Credit Facility and the authorities' request for Waivers of Nonobservance of Performance Criteria, and Financing Assurances Review.

Economic activity decelerated slightly after a recovery in 2016. The performance of the economy was affected by a more restrictive fiscal policy and delays in external disbursements that impacted construction projects in 2017. At the same time, inflation rose, driven by increases in the import tariffs on some goods and a low agricultural outcome, due to unfavorable weather conditions. Nonetheless, medium term prospects appear positive, with growth estimated to rise to 5 percent as new infrastructure programs come on stream. Downside risks however abound, including pre-election pressures that could delay implementation of structural reforms, delays in external disbursements, tighter conditions in the external financial markets, and weaknesses in the banking sector. Going forward, we encourage the authorities to maintain fiscal consolidation and implement their structural reform agenda.

Continued fiscal consolidation will improve the fiscal position and bring debt to sustainable levels. We commend the authorities for implementing revenue and expenditure measures to reduce the domestic primary deficit over the last few years. Significant progress has been made in cutting public spending, particularly the wage bill, transfers, and goods and services. At the same time, progress has been made in increasing revenue through collection of tax arrears and introduction of a new consumption tax on imported alcoholic beverages. However more effort is required to improve domestic revenue mobilization in order to reduce the debt burden and meet the large investment needs. We therefore welcome the authorities' commitment to implement revenue enhancing measures, including the collection of tax arrears. In this connection, we support the authorities for undertaking preparatory activities towards the introduction of VAT in 2019. We would appreciate comments by staff on the feasibility of meeting the VAT implementation timeline of early 2019.We also commend the authorities for their commitment to effectively apply the automatic fuel price adjustment mechanism.

A stable financial system is critical for sustained and inclusive growth. We note that stringent bank supervision has strengthened asset classification and urge the authorities to expedite implementation of the recommendations of the last safeguards assessment. We are encouraged by the authorities' efforts to step up recoveries and write-offs by banks, enforce collateral guidelines, and ensure strict oversight of banks' credit risk management frameworks and lending policies. We welcome the swift measures taken by BCSTP to intervene in Banco Privado and successfully completing the process of redenomination of the local currency. Further, we note that there is no information on the implementation of the AML/CFT framework in the staff report. Could staff provide an update as well as information on the status of correspondent banking relationships?

Structural reforms are essential to achieving strong and sustainable growth. In this respect, we welcome the completion of the tourism development strategy and the approval of the National Development Plan (NDP) for 2017–2022. We encourage the authorities to accelerate the implementation of the priorities reflected in the plan with a view to promote a diversified economy and inclusive growth. Further, we urge the authorities to expedite implementation of strategies to address the unreliable supply and high cost of electricity, including the development of cheaper energy sources.

Finally, given that Sao Tomé and Principle is a fragile state, we underscore the importance of continued provision of capacity development and urge staff to prioritize TA in the areas of domestic revenue mobilization, public financial management and financial sector regulation and supervision.

Mr. Lopetegui and Mr. Rojas Ulo submitted the following statement:

We would like to thank staff for a clear and concise report and Mr. Sembene and Mr. Carvalho da Silveira for their informative buff statement.

We support the authorities' request for Fifth Review under the Extended Credit Facility (ECF), Request for Waivers for Nonobservance of Performance Criteria, Financing Review and thus the Proposed Decision. We base our support on the progress achieved in the economy, as reflected in the consistent measures in the economic policy under the ECF arrangement, outcomes achieved in fiscal consolidation and structural reforms agenda, and the agreement on corrective measures reached by staff and the authorities to keep the program on track. As expressed by the authorities in their Letter of Intent, they maintain their commitment to continue applying sound macroeconomic policies and structural reforms in the framework with its development strategies.

São Tomé and Príncipe has made important progress, showing indicators of recovery and the forecast is favorable if structural reforms are strengthened by sustainable and appropriate policies. Economic growth is expected to be 4.0 percent in 2018 and it is projected to rise to 5.0 percent over the medium term, supported by public investments. Overall, the other key macroeconomic indicators are currently stable and exhibit a positive performance. However, risks related to the external position, which is assessed to be moderately weaker, and spending pressures for pre-elections, could delay and affect this positive outlook. We support the implementation of structural reforms to consolidate the gains from macroeconomic stabilization achieved under the ECF agreement to promote sustainable and inclusive growth.

Efforts to enhance the fiscal consolidation process through a prudent fiscal policy remain important. In recent years, the overall balance and the domestic primary deficit (DPD) decreased due to the correctives measures adopted and implemented to improve the fiscal position. However, the staff report shows that the continued underperformance in revenues exposes certain vulnerabilities and the possibility of creating fiscal space to generate resources, expand investment, and reduce public debt will be in jeopardy. We support the target over the medium term to maintain the DPD close to 1 percent of GDP to improve the fiscal consolidation process. We concur with staff's recommendation on strengthening the fiscal sector through the preparation and adoption of VAT, improving public expenditure efficiency, and actions to reduce arrears in state-owned enterprises.

We welcome the country's efforts to improve the public debt outlook trajectory and calls to continue deepening fiscal consolidation in order to reduce debt-related risks. The updated Debt Sustainability Analysis (DSA) indicates that public debt ratios have improved and are sustainable in the medium term, due to the negotiations on rescheduling external arrears with different creditors' countries. Nevertheless, the country faces an increased risk arising from domestic arrears denominated in U.S. dollars and contingent liabilities associated with state-owned enterprises. We support the implementation of policies consistent with the DSA, such as continuing fiscal consolidation, prudence in contracting new debt, and diversification of the economy and export base.

The financial system's soundness indicators improved favorably but further actions are necessary to strengthen supervision and deepen reforms. There has been a remarkable decrease in non-performing loans (NPLs) although we note that they are still high. As the staff report shows the financial system-wide capital has improved from 28 to 33.6 percent in 2017 but, nevertheless, pockets of vulnerability persist and require vigilance. The authorities should continue to closely monitor the performance of the financial sector, maintain the decreasing trend in NPLs, and strengthen the oversight through reforms in the legal system to assist loan recovery and support economic growth. We support staff's recommendation on the implementation of the safeguards assessment without delay.

We support the implementation of structural reforms to promote inclusive growth. São Tomé and Príncipe's economy has particular characteristics as a dual-island state, poverty and unemployment are persistent, and it is vulnerable to climate change. In this framework, the authorities prepared a tourism development strategy and the National Development Plan (NDP 2017-2021) to operationalize their long-term development agenda. We are in favor of the authorities' efforts to continue the implementation of structural reforms to increase the competitiveness of the economy by creating a business climate for private investment and the implementation of infrastructure projects to support key sectors, such as tourism, agriculture, and fisheries.

With these comments, we wish São Tomé and Príncipe and its people success in their future endeavors.

Ms. Horsman, Ms. Barron and Mr. Virolainen submitted the following joint statement:

We thank staff for their comprehensive papers and Messrs. Sembene and Carvalho da Silveira for their informative buff statement. As a small island, fragile state, São Tomé and Príncipe faces myriad challenges. The 2015-18 Fund-supported program has been instrumental in helping to address these challenges through strengthening macroeconomic stability, catalyzing critical development resources, and advancing much-needed structural reforms. However, growth continues to be insufficient, social advancement has been slow, and challenges remain significant. This highlights the need for sustained prudent economic management even beyond the program period. We would be interested in hearing from staff on how best to engage the authorities after the program ends and the authorities' views, if any, in this regard.

We note with concern that program performance is unsteady after some credibility was restored during 2017. Several missed PCs and further delays in implementation of important structural reforms have exacerbated risks and vulnerabilities. However, on the basis of prior actions and corrective measures taken, we support the completion of the fifth review, request for waivers of nonobservance of performance criteria (PCs), and financing assurance review. Going forward, we urge the authorities to demonstrate greater ownership and commitment to their ECF arrangement to ensure successful achievement of program objectives and to maintain close, ongoing dialogue with Fund staff to ensure that performance under the program remains on track. As we broadly support the thrust of staff's analysis and recommendations, we offer the following remarks for emphasis.

We note positively that the authorities are committed to continued fiscal consolidation. The authorities' efforts thus far have contributed to a stronger fiscal position and lower debt levels. We welcome the authorities' decision to eschew non-concessional loans and to limit external concessional borrowing. Further efforts are needed to mobilize revenues, increase the efficiency of spending, and improve debt management. Increasing domestic revenue mobilization is key to making further progress on the fiscal policy front given the country's low revenue-to-GDP ratio. In this regard, we urge the authorities to press ahead with the value-added tax (VAT) implementation and other key fiscal reforms. We note the authorities' efforts to boost near-term revenues through arrears collections. We query whether the projections for arrears collection are not overly optimistic based on past experience. Furthermore, it was not clear from the report whether the authorities were successful in collecting all outstanding arrears owed by the beer company. The staff's comments are welcome. Reducing fiscal risks posed by state-owned enterprises (SOEs) should also be appropriately prioritized. We welcome staff's comments on whether a comprehensive reform plan exists for SOEs, and whether TA is being provided in this important area.

Program implementation continues to be negatively affected by capacity constraints and delays in technical assistance from the Fund and other partners. TA efforts should be appropriately tailored to country-specific circumstances. We welcome indications that staff is exploring how best to deliver TA in light of the country's low absorptive capacity. We encourage Fund staff and other partners to continue to explore ways to better support the authorities' capacity development needs. We also encourage staff to be parsimonious in making recommendations for additional reforms. Given São Tomé and Príncipe's limited capacity and its status as a fragile state, it is important that the program be achievable.

The financial sector continues to strengthen but remains vulnerable. We look forward to the completion of the asset quality review (AQR) to support financial sector stability. Meanwhile, we note positively that the authorities are pressing ahead with financial sector reforms, stepping-up supervision, and taking steps to reduce the high levels of non-performing loans (NPLs). We did not see any references in the report to risks related to correspondent banking relationships (CBRs) or efforts by the authorities to ensure compliance with AML/CFT standards. The staff's comments are welcome.

We see scope for building resilience to climate change. We would be interested in hearing from staff what specific initiatives are underway in this regard. Also, if there are any plans by the authorities to undertake a Climate Change Policy Assessment (CCPA).

Sustained structural reforms remain critical to support robust and inclusive growth. We concur with staff's analysis that structural impediments are limiting growth and keeping poverty and unemployment high, especially among women and the youth. Given São Tomé and Príncipe's many development challenges, the structural reform agenda is indeed extensive and should be appropriately prioritized. In this regard, we welcome efforts by the authorities to address structural bottlenecks related to – inter alia – improving the business climate, strengthening resilience to adverse climate change, promoting gender equality, and harnessing the demographic advantage of the large youthful population.

Mr. Agung and Mr. Machmud submitted the following statement:

We thank staff for a comprehensive set of reports and Messrs. Sembene and Carvalho da Silveira for their informative buff statement.

Under the Extended Credit Facility (ECF) program, the São Tomé and Príncipe economy has exhibited an improvement in macroeconomic stability with the economy growing around 4 percent in recent years and the spike in inflation in 2017 starting to diminish as one-off effects subside. This positive development has been driven by progress in fiscal consolidation and some structural reforms. Nevertheless, the economy still faces substantial headwinds, including limited institutional capacity and high dependence on external assistance, that complicate efforts to attain targeted development outcomes. Implementing comprehensive structural reforms and maintaining macroeconomic stability are crucial to unlock growth potential and support poverty reduction. In terms of program performance, some end-2017 performance criteria, including domestic primary deficit (DPD) and net international reserves, were missed. However, we note that the authorities have taken corrective actions to keep program implementation back on track. With the authorities' strong commitments, we support the completion of the fifth review under ECF arrangement and the request for waivers for nonobservance of performance criteria, and financing assurances review. We broadly agree with staff's appraisal and offer the following comments for emphasis.

Continued fiscal consolidation is necessary to achieve fiscal sustainability and reduce the debt burden in the medium term. To partially offset the revenue shortfall in the near term and as part of corrective actions, we welcome the authorities' measures to further collect tax arrears owed by some large taxpayers that based on staff's preliminary assessment will help the DPD attain its end-June 2018 fiscal target. We note that there were two tax measures implemented in 2017, namely a consumption tax on imported alcoholic beverages and a rise in duty on selected imported commodities. In this regard, we invite staff comments on whether the introduction of these two tax measures are considered "excessive," triggering a fall in import of goods affected by these tax measures and contributing to a lower-than anticipated tax revenue outturn in 2017. On expenditure side, we take positive note that the authorities' intention to maintain the cuts in transfer and personnel costs introduced in 2017, reduce utility consumption of public agencies, and contain domestically-financed capital expenditures. Regarding fiscal risks, the revamp of the public utility company, EMEA, which is likely to continue recording losses in the medium-term, should be conducted in timely manner. In this regard, we note the authorities' concern regarding delays in the provision of technical and financial assistance by development partners that have contributed to slower reform implementation. We invite staff comments on the authorities' concern.

Financial sector reforms are key to improve the resilience of the financial sector. Despite a decrease in 2017, NPL ratios in the banking sector remain relatively high. In this regard, we welcome the central bank's requirement for banks to write off a loan when it is past-due for a certain period. It is also commendable that the authorities have made progress towards the establishment of arbitration centers to facilitate out-of-court settlements. Given its importance, we invite staff comments on whether Fund technical assistance or other resources from development partners could be provided to make these centers operational. To further assist loan recovery, we agree with staff that integrated efforts to reform the legal system will be vital for lowering the NPL ratio and for the banking sector to support economic growth. This reform is expected to address inefficiencies in the judicial system, reducing legal process delays and costs.

Bold structural reforms are vital to attain sustainable growth and reduce poverty. We commend the authorities' efforts to develop a National Development Plan (NDP) for 2017-2021 to operationalize the long-term agenda, including development priorities, poverty alleviation and climate change resilience, over the medium term. In this regard, we welcome the adoption of a tourism development strategy that could further boost the economic activity. Regarding Fund's capacity building initiatives, we note the authorities' preference for the assignment of resident and Portuguese-speaking experts for the benefit of their country. We invite staff comments on the authorities' preference.

With these comments, we wish the authorities success with future implementation of the program.

Ms. Erbenova and Mr. Dogan submitted the following statement:

We thank staff for their comprehensive report, and Messrs. Sembene and Carvalho da Silveira for their in-depth buff statement. Despite São Tomé and Príncipe's steadily growing economy, and progress in fiscal consolidation and structural reforms, program performance under the Extended Credit Facility (ECF) is mixed. Keeping the program on track, will entail strict fiscal measures to bring debt to a more sustainable level. Given the volatile international aid and the high reliance on imports, prudence is essential. Considering the authorities' renewed commitments to take critical measures and staff's assessment, we support the proposed completion of the fifth review under the ECF arrangement. We do urge the authorities to avoid policy slippages, especially in the run-up to the 2019 election. We broadly share staff's assessment and policy recommendations, and provide the following comments.

Consistent and more ambitious policy measures are necessary to improve fiscal sustainability. Tackling weaknesses in the public financial management is critical and will entail measures aimed at addressing arrears in tax collection, strengthening the financial position and oversight of state owned enterprises (SOEs). Could staff elaborate on the contingent liabilities arising from SOEs and whether their privatization could be an option? We welcome the authorities' commitment to implement a revenue-enhancing strategy, rationalize expenditures, and enhance controls to prevent the reemergence of domestic payment arrears while safeguarding social spending. We support the introduction of a value added tax without delay, but underscore staff's call for vigilance to ensure a smooth transition. Considering that São Tomé and Príncipe is in debt distress and in breach of several program thresholds on domestic arrears to suppliers, priority should be given to increasingly shift towards more concessional borrowing, as well as to strengthen the debt management framework and public financial management with a focus on clearing and preventing a further accumulation of arrears. We strongly welcome prioritization of technical assistance in these areas detailed in the Medium-Term Capacity Development Strategy.

The banking system continues to be exposed to significant vulnerabilities. We welcome the progress in strengthening banking supervision and the authorities' commitment to improving the financial sector infrastructure and regulatory framework, and note some improvement in the financial soundness indicators. However, the weak asset quality remains a source of concern and constrains credit growth. We see an urgent need for completing independent asset quality reviews to enforce prudent capitalization and regret that this structural benchmark has not been met timely.

Higher growth over the medium term relies on the successful implementation of structural reforms. We concur with staff and the authorities on the benefits of the exchange rate peg at the current juncture. The peg needs to be supported by a sound fiscal position and further progress on structural reforms. Capacity development and functional institutions as well as a sound judicial system are crucial. With 40 percent of the population under the age of 14 and in view of the low female labor participation, we also see an urgent need for a well-designed labor market reform. In this regard, the adoption of the tourism sector development strategy and the recently prepared National Development Plan (2017-2021) are encouraging steps in terms of reviving the business environment and reducing poverty.

Ms. White, Mr. Castets, Ms. Stockill, and Mr. Bellocq submitted the following statement:

We thank staff for an informative set of reports and Mr. Sembene and Mr. Carvalho da Silveira for their helpful buff statement. We agree with the staff recommendations regarding the completion of the Fifth Review under the Extended Credit Facility and retention of exchange measures for a period of twelve months.

As a small-island state, São Tomé and Príncipe is constrained by limited resources and capacity and is highly vulnerable to exogenous economic and environmental shocks. Whilst there is some reference to climate vulnerability in the Article IV report, we would have appreciated further detail on the potential impact of climate-related risks on the economy and any discussions staff have had with the authorities on building resilience to adverse climatic effects. Could staff elaborate?

Although good progress has been made towards strengthening macro-economic stability, program performance at end-2017 was uneven. We commend the authorities' fiscal consolidation efforts to date, including eschewing non-concessional loans, and we strongly support staff recommendations on the need to reduce fiscal risk related to state-owned enterprises. Revenue underperformance has been an issue, so we are encouraged by the authorities' plans to move away from an over-reliance on customs revenues (given vulnerability to volatility of imports).

Whilst the economic outlook remains positive, generating sufficiently sustainable and inclusive growth is a challenge in São Tomé and Príncipe. We agree that the focus on the tourism and agriculture sectors is realistic strategy given the size and competitive advantages of the São Toméan economy. We also note the importance of World Bank Group initiatives aimed at increasing credit growth, and the continued maintenance of financial sector stability, as key pillars in the São Toméan economic development strategy.

We agree with the importance of continued capacity development support and the strategic focus of the 2018-20 capacity development strategy. Given the limited absorption capacity in a context such as São Tomé and Príncipe, how do staff coordinate with other partners such as the World Bank? Will the Fund be able to provide the sort of long-term expertise and hands-on support that contributed to the most effective technical assistance activities previously?

Mr. Jin and Mr. Fan submitted the following statement:

We thank staff for the comprehensive papers and Messrs. Sembene and Carvalho da Silveira for the informative buff statement. We welcome the progress toward strengthening macroeconomic stability, and see a strong need for sustained reforms to unleash full growth potential and build capacity. We agree with the request for the completion of the fifth review under the ECF program, waiver for nonobservance of Performance Criteria, and the financing assurance review.

Concrete measures are warranted to address the fiscal slippage in 2017 and keep fiscal sustainability in 2018. The correction of the income tax return formula and the large taxpayers' failure in tax arrears clearance resulted in the fiscal underperformance in 2017. The heavy dependence on customs makes tax revenue vulnerable to trade volatility and international oil prices, which may be exacerbated with the lack of compliance on taxation. We thus welcome the introduction of a VAT regime in early 2019 to promote revenue mobilization and diversify the tax base, and commend the implementation of IMF TA recommendations, such as stricter monitoring of large taxpayers' tax payment. The increasing arrears from EMAE to ENCO remain a major fiscal risk, especially under the scenario of global financial condition tightening. We therefore reiterate the importance of SOE reforms to contain contingent fiscal risks and reduce their domestic arrears.

Debt management capability should be strengthened to maintain debt sustainability. While we notice the change of classification from high risk to debt distress due to the prolonged negotiation on rescheduling external arrears, we take positive note of the decline in the public debt level. We encourage authorities to continue their efforts to resolve external arrears and dispute debt with creditors, and welcome staff's further elaboration on the negotiation with the other two countries.

Reserve management is the key for economic and financial stability due to the extensive dependence on imports. Therefore, concrete measures are warranted to address the decline in gross international reserves in 2017 and the large current account deficit. Among these measures, strengthening the efficiency of monetary policy and regulation of monetary authorities are key. We welcome the central bank's revised regulations to introduce a secondary market and longer-term instruments. In addition, we commend the authorities' efforts in amending the regulations to enable the issuance of Treasury Bills, which is a good step towards a better functioning interbank market and, in turn, more effective monetary transmission. To reduce the large current account deficit, we encourage the authorities to further promote the reform of EMAE to reduce the high dependence on oil imports in energy consumption.

Mr. Gokarn and Mrs. Roy submitted the following statement:

We thank the staff for an informative set of papers and Mr. Sembene and Mr. Carvalho da Silveira for their insightful buff statement. We broadly agree with the staff appraisal. While São Tomé and Príncipe's economic issues are defined by its size and natural resource endowments, the ECF-supported program has helped it to maintain macroeconomic stability and carry out needed reforms. However, it also faces several risks: further delays in external financing and reform implementation due to capacity constraints, high debt levels and the legislative elections in October. Mitigating the risks in an import-dependent economy with a production structure dominated by plantations and fishery, reducing poverty rates, raising tax to GDP rates, maintaining fiscal stability, and encouraging sustainable investment would be helpful for engendering sustainable growth.

In the ongoing ECF, at end-December 2017 two out of five performance criteria (PCs) were met, while others related to the Domestic Primary Deficit (DPD) and net bank financing of the central government were missed owing to revenue underperformance, combined with unrealized external budget support and critical spending to address a public health concern. The PC on net international reserves was unmet due to lower-than-expected external financing. On the structural front, all end-December 2017 benchmarks were met. The authorities are requesting waivers for the nonobservance of the performance criteria on the basis of strong remedial measures implemented. As economic policies for 2018 are consistent with the program's objectives, we agree with the staff's evaluation that the program is broadly back on track following slippages in 2017, and support completion of the fifth review and waiver for the nonobservance of the performance criteria and completion of the financing assurances review.

Real GDP grew by 3.9 percent in 2017 from 4.2 percent in 2016, and is expected to recover to 4.0 percent before accelerating to 5.0 percent in the medium-term. While early implementation of large infrastructure projects could accelerate growth, the staff report says that more efforts are needed to speed up implementation of infrastructure projects, including road rehabilitation, airport expansion, and water and sanitation, to support tourism as well as the other key sectors such as agriculture and fisheries. What are the steps planned to accelerate the early implementation of large infrastructure projects?

A decline in external inflows and spillovers of foreign exchange pressures from neighboring countries increased foreign exchange shortages, and the authorities responded by tightening foreign exchange regulations. In the Program review, the staff report says that the continuous PC prohibiting the introduction or intensification of exchange restrictions was inadvertently missed. Since the authorities intensified an existing exchange restriction that predated the current program, in response to the increasing foreign exchange shortage and to prevent further depletion of international reserves and safeguard the exchange rate peg, we believe it is not correct to term this action as “inadvertent.” The authorities have committed to eliminate foreign exchange restrictions over time once balance of payment pressures have eased which seems to be rather open-ended. What are the reasons for decline in external inflows? Are there any consequences for missing the continuous PC prohibiting the introduction or intensification of exchange restrictions and what would the staff have suggested for managing the situation in a different way?

Revenue collection needs to be strengthened as taxpayers owe over 300 million new dobras in tax arrears to the state. To offset the revenue shortfall, and as a prior action for the fifth review, the government will collect close to ½ percent of GDP in tax arrears plus applicable penalties owed by the local beer producer Rosema and other firms, largely consisting of consumption tax on sales and PIT on their employees that the firms collected on behalf of the state. For end 2018, if the collection of tax arrears from Rosema does not materialize, the floor on the domestic primary balance will be adjusted downward (in absolute value) by the market value of Rosema’s assets that the government seizes. Has IMF’s TADAT assessment been done in São Tomé and Príncipe and what are the findings?

Over the last three years, inflation averaged only 5.5 percent. Annual inflation, however, spiked to 7.7 percent at end-2017, driven by increased import taxes on selected goods and a temporary shortage of locally produced foods caused by unfavorable weather conditions. Inflation is expected to moderate to 6 percent in 2018 as the one-off supply and tax effects in 2017 subside, and to fall below 5 percent in the medium term. The buff statement says that implementation of the automatic price adjustment mechanism led to a rise in domestic pump prices in June 2018 in line with recent international oil price increases. What impact is this likely to have on inflation rate, given the dependence on imported oil?

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We thank staff for the reports and Messrs. Sembene and Carvalho da Silveira for a helpful buff statement. We support the completion of the fifth review under the Extended Credit Facility (ECF) and the request for waivers of non-observance of performance criteria. Still, we are concerned over slippage on PCs, particularly large deviations from fiscal ones. We also broadly agree with the recommendations in the Article IV.

Since São Tomé and Príncipe is now in debt distress, the government must improve fiscal policy performance, as its outlook is not sustainable if fiscal performance reflects previous trends. As a result, we are concerned over recent slippages on performance criteria related to the floor on the domestic primary balance (DPD). While we appreciate the large reduction of the DPD by 1.7 percent of GDP in 2017, further fiscal discipline is necessary in 2018. Along these lines, we are pleased that the government appears on track to meet end-June targets.

We strongly support the zero limit on new non-concessional borrowing and are glad to see that authorities have consistently met this PC under the program.

We also encourage the government to follow through on its commitment to create a conducive environment for private sector development, including in the tourism sector. Steps to improve the business climate can help boost growth potential, which will be necessary to absorb the large number of youth entering the labor force and to reduce poverty levels.

Separately, we hope that the Fund and other multilateral institutions can provide requisite technical assistance (TA) across key areas, including public finance management, revenue administration and mobilization, and macroeconomic statistics. At times, there have been both capacity constraints and delays in Fund TA, which underscores the importance of realistic targets and structural reform benchmarks that consider Sao Toméan capacity and donor support. Can staff elaborate on where there has been the most traction with authorities on TA, and where traction is expected going forward?

Finally, we are prepared to go along with the recent intensification of the existing exchange restriction. Amid relatively low reserve coverage and staff's judgment that the euro peg is necessary for the economy, recent steps appear reasonable though we encourage authorities to eventually remove the restriction. Can staff please comment on how these restrictions could feed into the Fund's review of multiple currency practices and exchange restrictions?

The staff representative from the African Department (Ms. Li), in response to questions and comments from Executive Directors, made the following statement:[1]

I thank Directors for the gray statements and associated questions. We have circulated written responses to Directors' technical questions. Today, I would like to add a few more remarks.

First, I am pleased to inform Directors that all the prior actions have been met. These are incorporating, expenditure measures in the budget, collecting past arrears from the large taxpayers, particularly from a beer company, and collecting tax payments that were delayed in early 2018. All of this has been done. We just received some preliminary fiscal data which indicate that the authorities are likely to have met the end-June target. This is largely because they have implemented the prior actions.

I will now turn to some of the remaining questions that Directors have raised. There was a question about how the staff expects to engage with the authorities after the program ends. The authorities have already informally indicated that they would be interested in a follow-up program. However, they would like to make a decision after the legislative elections in October. Meanwhile, we will continue to provide technical assistance (TA) that will help the country build capacity.

There was also another question about why São Tomé and Príncipe do not have a resident representative office. We all know that the Fund is

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

operating under constrained budget, so that means that priorities have to be made and that there have to be selections. Besides having offices in program countries, the Fund also maintains offices in countries that are highly vulnerable and/or have a systemic global or regional impact. Because of this, some countries like São Tomé and Príncipe do not have a resident representative. As a result, staff are prepared to travel more frequently to field more missions, at the same time to travel on short notice when issues arise. So most recently, we had a staff visit in June. That is one of the examples.

There were also some calls to elaborate on the climate change-related vulnerabilities and the measures underway. In the context of Article IV consultations, the staff has discussed with the authorities and their development partners about the vulnerabilities and measures underway. In terms of the risks, luckily the countries are composed of two rocky islands, which means that there is a relatively elevated interior, so they are not at risk of full submersion from rising sea levels. However, that does not mean there are no risks. They are subject to the erosion of coast lines and also some submersion in coastal regions, and that is the area where most of the economic and social activities, as well as assets, are located; so there will be some damages expected if sea levels do rise.

There are some other channels through which climate change could affect the economy. The first one is through agriculture, stemming from the change in climate patterns, particularly the rains. There could be longer dry seasons or more excessive rains during supposedly dry season, or sometimes just extreme weather patterns. This has been shown in the report, as some of the weather-related effects have already shown up in prices for locally produced food. The other part of that is damage to infrastructure, which would disrupt economic activities, including tourism, and will slow the longer run economic development.

I will now turn to the initiatives that the authorities are working on. They are working with a range of partners on these issues. I will just cite a few examples of what they are working on.

The first one is the West Africa Coastal Area Management Program, led by the World Bank. The program will help coastal communities build resilience and also help provide climate forecast services. There is also another program underway, which will be funded by the World Bank, the European Investment Bank (EIB), and also Dutch bilateral corporations. This project would help the countries to build resilient transportation infrastructures. They are also partnering with the Global Change Alliance and would develop climate-informed land plan use.

Finally, they are also working with a number of partners, including the United Nations and African Development Bank, to adapt agricultural and fishery practices to the changing climate.

Mr. Sembene made the following statement:

I will start by thanking Directors, management, and the staff for their support for the conclusion of this first review under the Extended Credit Facility (ECF) arrangement. We also appreciate the respective contribution to the policy discussions that have been held in the context of the 2018 Article IV consultations, and Directors' valuable comments and recommendations will be faithfully shared with the São Tomé authorities. I am particularly thankful to Ms. Li and her team for the fruitful discussion and well-written set of reports. We found the selected issues paper and the policies addressed as part of the Article IV consultation to have been focused on issues of relevance to the authorities, and this is greatly appreciated.

I also would like to address a number of policy issues that were raised by Directors in their written statements, but before that, it may be useful to recall the specific circumstances in which the country has evolved, as well as the daunting policy challenges facing its policymakers.

São Tomé and Príncipe is a fragile micro state country, confronted with daunting challenges and significant vulnerabilities. These include weak human and institutional capacities, high debt levels, infrastructure bottlenecks, a limited production base, vulnerability to climate change, and high exposure to shocks. Against this backdrop, policy implementation has proven to be challenging, and occasional setbacks have been at times unavoidable, notwithstanding the authorities' strong commitment to sound policies.

This is an opportunity for me to address a question one Director asked, namely, why there has not been a resident representative in São Tomé despite the Fund's policy of posting such a representative in program countries. I heard the staff's response to that question—that given the budget constraints, there has to be some prioritization. I cannot help but wonder why a fragile state like São Tomé, a micro state like São Tomé, with so many vulnerabilities and so many weaknesses, would not be prioritized as part of this policy. I cannot help but to convey the need that the authorities have expressed about the need for closer engagement with the staff. Although I understand that the staff is saying that they have been able to go to São Tomé on short notice, this does not substitute for having a resident representative so as to respond to the authorities' needs in a more effective manner. I would encourage management and the staff to look at these policies and their implementation and make sure these countries that are fragile and micro states are prioritized as part of this policy and not necessarily forgotten, which seems to be the case.

Despite the state of fragility, the authorities' have commendably been able to push forward their policy and reform agenda largely in line with the authorities' commitments under the ECF-supported program, and as a result, progress has been made in sustaining macroeconomic stability and promoting a favorable economic outlook.

I will now address three broad thematic issues that were raised by Directors. First, Directors have emphasized the need to take necessary steps to ensure fiscal and debt sustainability. The authorities share this view, and their sustained fiscal consolidation efforts are aimed at achieving this objective, notably by strengthening domestic revenue mobilization and cautiously managing expenditures.

On the revenue side, as we indicated in our buff statement, they have continued to work on successfully introducing the value-added tax, which is scheduled to be introduced in 2018-19. They have also continued to make progress in collecting arrears owed by large taxpayers, and the staff rightly mentioned the fact that these collection efforts have been successful with regard to the beer company, which is one of the largest taxpayers in the country.

On the expenditure side, the Ministry of Finance has taken steps to limit budgetary expenditure in line with program commitments. They also took steps to contain current and domestically financed capital spending. At the same time, the authorities are also taking actions to address fiscal risks emanating from state-owned enterprises (SOEs). As noted by the staff, there is an SOE reform plan that has been prepared, and that will be implemented with the assistance of the World Bank. This SOE reform plan will take into account the conclusion of the pre-audits of the main SOEs, and we agree with Directors that Fund's technical assistance on SOE reform could potentially be useful, and we invite the staff to closely monitor the authorities' need in this regard, keeping in mind that the Fund's contribution has to be in line with its core expertise and mandate.

With regard to public debt, the authorities have reiterated in their Memorandum of Economic and Financial Policies (MEFP) their attachment to prudent debt management consistent with Directors' recommendations. Active efforts will continue to be made to reach an agreement with external creditors on resolving external arrears.

Second, Directors stressed the importance of addressing vulnerabilities in the financial sector, particularly the high-level of NPLs. The authorities fully share this view. As noted in the staff report, various steps were taken to strengthen supervision and regulation of the banking system, including the introduction of asset classification requirements for banks, improvement in the financial sector infrastructure through upgrades to the credit registry and payment system, and the establishment of arbitration centers. In this latter respect, the authorities would welcome financial and technical assistance from development partners to make these centers operational as soon as possible.

At the same time, progress will be sustained toward finalizing the asset quality review of the banking sector by mid-2019. This will help secure further improvement in prudential regulation.

Finally, the authorities concur with Directors that sustaining the reform momentum remains critical to promoting sustainable and inclusive growth, improving competitiveness, strengthening resilience to shocks, and addressing impediments to job creation and investment. The 2017-2021 National Development Plan includes this objective among the country's development priorities, and the timely implementation of the plan will go a long way toward achieving them. The authorities are mindful of their primary responsibility in ensuring that reform implementation proceeds in a timely manner, and they are making every effort to fulfill this responsibility. That being said, it is worth stating once again the critical importance of timely technical and financial assistance from the Fund and other development partners in support of reform implementation in São Tomé and Príncipe.

As far as the Fund is concerned, the authorities welcome this capacity building support. Going forward, they look forward to being provided with longer-term technical assistance, and we appreciate the support expressed by many Directors in this regard. While the use of peripatetic experts and experts from the Africa Regional Technical Assistance Center (AFRITAC) Central will continue to be valuable, the use of those experts does not constitute a perfect substitute for resident advisors, which the authorities are calling for. We encourage the staff to promptly follow up on these requests.

To conclude, I thank Directors again for their support to São Tomé and Príncipe and the staff for their hard work. Thank you.

Mr. Fachada supported Mr. Sembene’s call for a resident representative.

The Acting Chair (Mr. Furusawa) noted that the Democratic Republic of São Tomé and Príncipe is an Article XIV member but no longer maintained transitional measures under that Article. It maintained exchange measures subject to approval under Article VIII. The staff was recommending approval of these exchange measures.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed progress on fiscal consolidation and structural reforms, which has contributed to strengthening macroeconomic stability and the favorable medium-term outlook. Directors noted, however, that program performance has been uneven and downside risks remain. They underscored that continued commitment to structural reforms and prudent fiscal policy is key to maintaining macroeconomic stability and boosting growth to reduce poverty and generate employment for a young population.

Directors welcomed the authorities’ resolve to continue fiscal consolidation to improve the fiscal position and reduce public debt. They underscored the need for steadfast implementation of revenue-enhancing measures to address tax revenue underperformance, including the collection of tax arrears and the introduction of the VAT next year. Directors welcomed the authorities’ commitment to eschew non-concessional loans and limit external concessional borrowing. They encouraged the authorities to strengthen debt management capacity through implementing recommendations under the Debt Management Performance Assessment and finalizing the medium-term debt management strategy.

Directors emphasized the importance of reforming state-owned enterprises, particularly the electricity and water supply company (EMAE). They noted that improving the commercial viability of EMAE will not only reduce fiscal risks, but also strengthen the external position by reducing oil imports, and support growth by improving electricity provision. It will also help boost reserve accumulation, and support the removal of exchange restrictions over the medium term.

Directors welcomed the progress made in strengthening banking supervision. They encouraged the authorities to continue to implement the strategy to reduce the stock of nonperforming loans, including through concerted efforts to reform the legal system to assist loan recovery. The remaining recommendations of the safeguards assessment should be implemented without delay.

Directors highlighted the importance of structural reforms to promote inclusive growth. In this context, they welcomed the recent adoption of the tourism development strategy. Directors encouraged the authorities to focus on high-return infrastructure projects to support tourism and other key sectors of the economy.

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

The Executive Board took the following decisions:

Democratic Republic of São Tomé and Príncipe—Request for Approval of Exchange Restrictions and Multiple Currency Practice Under Article VIII, Sections 2(a) and 3

1. The Democratic Republic of São Tomé and Príncipe maintains the following exchange measures: (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 and multiple currency practice arising from limitations on the availability of foreign exchange for payments of current international transactions, due to the rationing of foreign exchange by the Central Bank of the Democratic Republic of São Tomé and Príncipe.

2. In the circumstances of the Democratic Republic of São Tomé and Príncipe, the Fund grants approval of the retention of these exchange measures for a period of twelve months from the date of this decision. (EBS/18/68, 7/10/18)

Decision No. 16416-(18/70), adopted
July 23, 2018

Democratic Republic of São Tomé and Príncipe—Fifth Review Under the Extended Credit Facility, Request for Waivers of Nonobservance of Performance Criteria, and Financing Assurances Review

1. The Democratic Republic of São Tomé and Príncipe has consulted with the Fund in accordance with paragraph 4.B(b) of the arrangement for Democratic Republic of São Tomé and Príncipe (EBS/15/71, 06/26/2015 the "ECF Arrangement") in order to review program implementation.

2. The letter dated July 9, 2018 from the Minister of Finance, Commerce and Blue Economy and the Governor of the Central Bank of São Tomé and Príncipe (the "July 2018 Letter") together with its attached Memorandum of Economic and Financial Policies (the "July 2018 MEFP") and Technical Memorandum of Understanding (the "July 2018 TMU") shall be attached to the Arrangement and the letter dated June 19, 2015 from the Minister of Finance and Public Administration and the Governor of the Central Bank of São Tomé and Príncipe, together with its attachments, as supplemented and modified, shall be read as further supplemented and modified by the July 2018 Letter and its attachments.

3. Accordingly, the ECF Arrangement for the Democratic Republic of São Tomé and Príncipe shall be amended as follows:

> a. A new paragraph 5.A of the ECF Arrangement shall be added to read as follows:
>
> "5.A The Democratic Republic of São Tomé and Príncipe will not request a disbursement under this Arrangement until the Trustee has determined that a financing assurances review has been completed, for as long as the Democratic Republic of São Tomé and Príncipe, by virtue of its imposition of exchange controls, has outstanding non-sovereign external payment arrears."

4. The Fund decides that the fifth review specified in paragraphs 4.B(b) of the ECF Arrangement and the financing assurances review specified in paragraph 5.A of the ECF Arrangement are completed, and that the Democratic Republic of São Tomé and Príncipe may request the sixth disbursement referred to in paragraph 2(f) of the ECF Arrangement, notwithstanding the nonobservance of the end-December 2017 performance criteria on (i) the floor on domestic primary balance, (ii) the ceiling on changes in net bank financing of the central government and (iii) the floor on net international reserves of the central bank, as set out in paragraph 4.B(a) of the ECF Arrangement, and the nonobservance of the continuous performance criterion prohibiting the imposition or intensification of restrictions on the making of payments and transfers to current international transactions set out

in paragraph 5.(C)(i), of the ECF arrangement, on the condition that the information provided by the Democratic Republic of São Tomé and Príncipe on the performance under these criteria is accurate, and on further condition that the information provided by The Democratic Republic of São Tomé and Príncipe on the implementation of measures specified as prior actions in Table 4 of the July 2018 MEFP are accurate. (EBS/18/68, 7/10/18).

Decision No. 16417-(18/70), adopted
July 23, 2018

APPROVAL: March 5, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. ***The buff statement says that implementation of the automatic price adjustment mechanism led to a rise in domestic pump prices in June 2018 in line with recent international oil price increases. What impact is this likely to have on inflation rate, given the dependence on imported oil?***

- The impact is likely to be limited. The CPI basket is dominated by food (73 percent) with transportation representing less than 2 percent.

2. ***Noting that oil related investment and FDI continue to be significant, can staff provide any updates on energy exploration activity?***

- The authorities noted that the interest in exploring oil prospects in the waters surrounding the country had heightened. A contract was signed on March 9, 2018 with British Petroleum (BP) on exploring two blocks, with a signing bonus of $10 million and social projects of $30 million to be spent in the next four years. More blocks will be offered soon and the authorities expect the bidding to be even more competitive.

Fiscal Policy and Debt Sustainability

3. ***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.***

- Good progress has been made recently to prepare for the VAT adoption, including the submission of a draft VAT law to parliament, installation of an appropriate IT system with the help of AfDB, hiring and training of new staff supported by the World Bank and the IMF, and ongoing TA by the IMF to align the current tax system with the VAT. The ratification of the VAT law by Parliament is, however, still outstanding. The adoption of the VAT should be feasible on time if progress continues, particularly the ratification of the VAT by mid-August 2018.

4. ***We would appreciate comments by staff on the feasibility of meeting the VAT implementation timeline of early 2019.***

- Same as above

5. ***We note that there were two tax measures implemented in 2017, namely a consumption tax on imported alcoholic beverages and a rise in duty on selected imported commodities. In this regard, we invite staff comments on whether the introduction of these two tax measures are considered "excessive", triggering a fall in import of goods affected by these tax measures and contributing to a lower-than anticipated tax revenue outturn in 2017.***

- The increase in duty in mid-2017 on top of the earlier consumption tax appeared to have triggered the fall in imports of these products and contributed to a lower-than anticipated tax revenue in 2017. However, the government implemented the measure also to reduce consumption of alcohol and improve public health. This issue will be reviewed during a forthcoming TA aimed at aligning the current tax system with the VAT.

6. ***We query whether the projections for arrears collection are not overly optimistic based on past experience. Furthermore, it was not clear from the report whether the authorities were successful in collecting all outstanding arrears owed by the beer company. Staff comments are welcome.***

- The planned collection of arrears was indeed ambitious. However, the authorities have successfully collected all outstanding arrears owed by the beer company and reached reasonable agreements to collect arrears from other enterprises.

7. ***We encourage authorities to continue their efforts to resolve external arrears and dispute debt with creditors, and welcome staff's further elaboration on the negotiation with the other two countries.***

- The authorities are actively reaching out to other creditors, including Angola, Equatorial Guinea, and Nigeria. They are waiting for responses to schedule discussions.

8. ***Has IMF's TADAT assessment been done in Sao Tome and Principe and what are the findings?***

- No TADAT yet. The country has very limited capacity and TA has been focused on building the basic functions.

SOEs

9. ***While we note that government has a minority equity position in ENCO, can staff***

indicate the other major stakeholders in the company and do staff and/or the authorities have any concerns from a macroeconomic sustainability and governance perspectives arising from these stakeholders?

- The Angolan National Fuels Company SONANGOL (an Angolan state-owned) currently controls close to 80 percent of ENCO's shares, while the State of STP holds 16 percent and minority shareholders hold the remainder. ENCO is the sole importer and distributor of oil in the country, raising potential concerns about pricing. Furthermore, the Treasury and the utility company EMAE owe close to 26 percent of GDP in debt and arrears to ENCO (related to past oil price subsidies). However, strong diplomatic and historical relations between Angola and STP have somewhat mitigated these concerns. An automatic price mechanism now regulates the price of oil. Also, the government has been paying down its debt to ENCO faster than had been agreed to, while EMAE is implementing reforms to make it commercially viable over the medium term and less dependent on oil (see answers to 10 and 13).

10. ***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?***

- One clarification, the independent audit firms conducted a "pre-audit" in early 2018 to identify weaknesses in accounting practices. Past World Bank experience in other low and low-middle income countries demonstrates that this is more effective than a full audit because the gap between the existing and the minimum standards was so large. The draft pre-audit of three main SOEs (EMAE, ENASA, and ENAPORT) are being revised to incorporate the comments of the SOEs. The recommendations will be incorporated in the SOE reform plan. The final reports are expected before end-September 2018.

11. ***Staff comments on why arrears of EMAE have continue to increase despite measures is welcome.***

- EMAE needs to reduce the energy production cost and to increase its metering and billing capacity to cover production costs, since the energy price in STP is already one of the highest in SSA. Besides taking the short-term measures as noted in the staff report, it needs to rehabilitate and expand its hydroelectric power plant and substitute its transmission line and metering. All of these activities are being carried out with the support from the World Bank and the European Investment Bank. However, those projects take 3 to 5 years to mature.

12. ***Reducing fiscal risks posed by state-owned enterprises (SOEs) should also be appropriately prioritized. We welcome staff's comments on whether a***

comprehensive reform plan exists for SOEs, and whether TA is being provided in this important area.

- The World Bank conducted a thorough diagnostic of all SOEs in which the government is the controlling shareholder, as part of the recently completed Public Expenditure Review. An SOE reform plan from the diagnostic was endorsed by the Council of Ministers, with its implementation being supported by the World bank.

13. ***Could staff elaborate on the contingent liabilities arising from SOEs and whether their privatization could be an option?***

- The Treasury is already incurring some cost (approximately 1 percent of GDP) in the form of tax arrears owed by SOEs. SOEs other than EMAE also owe close to ½ percent of GDP in arrears to suppliers which could become a fiscal liability. However, in recent years, the financial viability of some SOEs, except EMAE, has been turned around thanks to improved governance, easing the fiscal risks. In addition, agreements have been reached to repay their tax arrears. EMAE continues to incur large losses (see answer to question 11), which led to the accumulation of close to 17 percent of GDP in arrears to ENCO as of end-2017, representing a fiscal liability if EMAE fails to achieve cost-recovery over the medium term.

- The World Bank is supporting the government to evaluate how private sector investment could be brought into the energy sector to speed up the increase in renewable and more cost-effective power generation capacity. All types of private sector participation from management contracts to PPPs and full privatization are being assessed in the process of improving the management of EMAE.

Monetary Policy and Financial Sector

14. ***We note that there is no information on the implementation of the AML/CFT framework in the staff report. Could staff provide an update as well as information on the status of correspondent banking relationships?***

- The authorities noted that the risk of correspondent banking relationships is limited as all banks are subsidiaries of regional banks or have a European bank as a major shareholder.

- Sao Tome is a member of GIABA (the Inter-Governmental Action Group Against Money Laundering in West Africa). It underwent a Mutual Evaluation of their AML/CFT framework in May 2013 and made improvement, including passing a 2013 AML/CFT law with LEG's technical assistance. STP was subsequently removed from the Financial Action Task Force's list of high risk and non-cooperative jurisdictions, however it is still named in the ICRG (International Co-Operation Review Group) pool of jurisdictions meeting the 3rd round referral criteria on strategic AML/CFT deficiencies. GIABA's next assessment of STP's progress on the AML/CFT framework is scheduled for March 2022. Authorities should continue efforts to strengthen the AML/CFT framework.

15. ***We did not see any references in the report to risks related to correspondent banking relationships (CBRs) or efforts by the authorities to ensure compliance with AML/CFT standards. Staff comments are welcome.***

(See answer to question 14)

16. ***Although the SIP on the analysis of NPLs based on credit registry data was quite interesting, we wonder why many of these loans have not been written off from the balance sheets. Staff's comments would be appreciated.***

- Commercial banks have generally taken a cautious position on large-scale or frequent write-offs because they fear that the practice would create moral hazard and reinforce the culture of non-payment. The central bank has been insisting that banks carefully assess the probability of repayment and write-off the loans that have low repayment expectations and plan to tighten the regulation.

17. ***It is also commendable that the authorities have made progress towards the establishment of arbitration centers to facilitate out-of-court settlements. Given its importance, we invite staff comments on whether Fund technical assistance or other resources from development partners could be provided to make these centers operational.***

- The establishment of arbitration centers has received support from the International Labor Organization (ILO) and AfDB for training staff. To make the centers operational, initial funding is needed. While providing such funding is outside the remit of the IMF, staff will continue to flag the importance of this initiative to other development partners, some of which may be in a position to help.

External Sector

18. ***Could staff clarify why they did not perceive these changes as a breach of the PC at that time? Furthermore, while we assume that the commitment of the authorities to this PC is reflected in the Letter of Intent ("(…) the government will not introduce or intensify any exchange restrictions (…)."), we would like to understand why the continuous PC is not included in table 1 of the MEFP.***

- In the context of the March-April 2017 mission to conduct discussions for the completion of the third (then combined with the fourth) review under the ECF arrangement for STP, the authorities reported to staff that they had tightened the enforcement of foreign exchange regulations in response to shortfalls in foreign exchange inflows in 2016.

- While staff inquired about this tightening and requested copies of the relevant regulations (NAP 05/2017, effective since March 1, 2017) the comprehensive analysis of these measures to assess their implication for both, STP's obligations under Article VIII, Sections 2(a) and 3 of the IMF's Articles of Agreement as well as its observance of the relevant continuous PC under the ECF arrangement (which call for the non-imposition or intensification of restrictions on making of payments and transfers for current international transactions) was not conducted by staff at the time of the third and fourth reviews under the ECF for STP.
- The comprehensive assessment was conducted by staff only in the context of a staff mission in June 2018, which confirmed that the above-mentioned tightening of the enforcement of foreign exchange regulations of March 2017 indeed contravened STP's obligations under Article VIII, Sections 2(a) and 3, and also caused the non-observance of the continuous PC mentioned above.
- It is in light of this that the authorities are now requesting temporary approval of the retention of the measures that give rise to the exchange restriction and MCP described in the staff report (which will bring STP back in full compliance with its obligations under Article VIII, Sections 2(a) and 3) as well as the corresponding waiver of non-observance of the relevant continuous PC on exchange restrictions needed to allow for the completion of the fifth review under the ECF arrangement for STP.
- Since the assessment by staff was not done on time however, the above-mentioned continuous PC was considered met at the time of completing the third and fourth reviews, when in fact, it has now been determined that they were not observed and that a waiver of non-observance of the above-mentioned PC was required in order to complete the combined third and fourth reviews.
- While STP did not observe the continuous PCs noted above, given that staff led the authorities to believe that they were in compliance with the observance of the continuous PC despite the information shared with them on the tightening of the enforcement of the FX regulations, under the principle of estoppel, staff has concluded that there is no basis for a misreporting case. This is because the authorities indeed reported to staff about the intensification of the enforcement of the FX regulations before completion of the third and fourth reviews.
- As to the presentation of the continuous PCs, it is the long-standing practice of the Fund to include the standard continuous PCs pertaining to the non-introduction or non-intensification/modification of exchange restrictions and MCPs, only in the text of the relevant Fund arrangement, and not in the table of quantitative PCs.

- Indeed, all Fund arrangements (except for FCL arrangements) include a paragraph setting forth the standard continuous PCs referred to above, which if not observed, would require a waiver of non-observance in order to complete a review and allow for disbursements/drawings under the respective arrangement. The standard language of said paragraph reads as follows:
- "if at any time during the period of the [xx] arrangement, [member]
- (i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions, or
- (ii) introduces or modifies multiple currency practices; or
- (iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or
- (iv) imposes or intensifies import restrictions for balance of payments reasons."

19. ***What are the reasons for decline in external inflows? Are there any consequences for missing the continuous PC prohibiting the introduction or intensification of exchange restrictions and what would the staff have suggested for managing the situation in a different way?***

- Capacity constraints and administrative delays are the main reasons for the declined inflows. For example, the World Bank did not disburse in 2017 because the authorities needed more time to conclude the reform agreed under the Development Policy Operation, including on the energy sector. Administrative delays occurred in some bilateral partners' disbursements.
- The consequences for missing a continuous PC on the introduction or intensification of exchange restrictions are the same as for the missing of any other PC, namely, that the non-observance of a PC triggers the immediate stop of disbursements and completion of reviews under a Fund arrangement, until the PC is waived (i.e., until the Executive Board grants a waiver of non-observance of the PC).
- The handling of this situation required the conducting of the comprehensive assessment of the jurisdictional and program implications of the tightening of the enforcement of the FX regulations.

20. ***Can staff please comment on how these restrictions could feed into the Fund's review of multiple currency practices and exchange restrictions?***

- The upcoming policy review will focus only on MCPs and thus, it will not encompass also a review of the IMF's policy on exchange restrictions. However, the above-mentioned review will indeed cover aspects related to the MCP introduced by STP for which it is requesting a temporary approval.

Structural Reforms

21. ***We see scope for building resilience to climate change. We would be interested in hearing from staff what specific initiatives are underway in this regard. Also, if there are any plans by the authorities to undertake a Climate Change Policy Assessment (CCPA).***

- Staff will respond to this question during the Board meeting.

22. ***We would have appreciated further detail on the potential impact of climate-related risks on the economy and any discussions staff have had with the authorities on building resilience to adverse climatic effects. Could staff elaborate?***

- Staff will respond to this question during the Board meeting.

23. ***While early implementation of large infrastructure projects could accelerate growth, the staff report says that more efforts are needed to speed up implementation of infrastructure projects, including road rehabilitation, airport expansion, and water and sanitation, to support tourism as well as the other key sectors such as agriculture and fisheries. What are the steps planned to accelerate the early implementation of large infrastructure projects?***

- The authorities are working on improving coordination with partners, have appointed the Treasury to oversee the coordination, which will provide quarterly updates on partner support.

Program Issues

24. ***We would be interested in hearing from staff on how best to engage the authorities after the program ends and the authorities' views, if any, in this regard.***

- Staff will respond to this question during the Board meeting.

25. ***Against this background, can staff indicate the reason/s why the longstanding principle that the IMF would maintain a resident representative office in program countries is not being followed in São Tomé and Príncipe? Additionally, what is staff's view about the role of a resident representative in helping program implementation and capacity building in this case.***

- Staff will respond to this question during the Board meeting.

26. ***Given the limited absorption capacity in a context such as São Tomé and Príncipe,***

how do staff coordinate with other partners such as the World Bank? Will the Fund be able to provide the sort of long-term expertise and hands-on support that contributed to the most effective technical assistance activities previously?

- Staff works closely with World Bank and other development partners to coordinate TA strategies and avoid overlap. Regular discussions are held both in the field and also via teleconferencing. Regarding TA, please see answer to question 28.

27. ***Can staff elaborate on where there has been the most traction with authorities on TA, and where traction is expected going forward?***

- IMF TA has been helping authorities in all the core areas of IMF expertise, including fiscal, monetary and financial, and statistics. In light of the low capacity, continued TA, particularly hands-on support, in these areas will be needed.

28. ***Regarding Fund's capacity building initiatives, we note the authorities' preference for the assignment of resident and Portuguese-speaking experts for the benefit of their country. We invite staff comments on the authorities' preference.***

- In response to the authorities' preference, staff continues to mobilize resources to provide hands-on, longer-term, and Portuguese-speaking support. For example, with the support of Revenue Mobilization Trust Fund, a Portuguese-speaking peripatetic advisor has helped the authorities prepare for the adoption of the VAT. In addition, the Central African Regional Technical Assistance Center (AFRITAC Central), as well as IMF HQ missions, in the recent past have used at least one Portuguese-speaking expert on each visit.

29. ***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.***

- (see answer to question 28)

30. ***We note the authorities' concern regarding delays in the provision of technical and financial assistance by development partners that have contributed to slower reform implementation. We invite staff comments on the authorities' concern.***

- Staff is coordinating with development partners and encourages the authorities to do the same to ensure that reforms are implemented as close to scheduled arrangements as possible.