

Sao Tomé
2011





This map is for illustrative purposes and is without prejudice to the status of or sovereignty over any territory covered by this map.

São Tomé & Príncipe

Overview

The gross domestic product (GDP) of the Democratic Republic of São Tomé and Príncipe (STP) slowed down in 2009 but picked up timidly in 2010 to an estimated 4.5%. Growth was sustained by foreign aid and the tertiary sector, including tourism, construction and retail. The economy is forecast to expand by 5.0% in 2011 and 6.0% in 2012, supported by foreign direct investment (FDI) in oil exploration and the construction of a new deepwater seaport. The longer-term outlook, however, remains highly dependent on uncertain oil prospects, with production not expected before 2016.

Macroeconomic policies will remain restrictive. Fiscal policy aims to contain further current primary expenditure through better management of public finances. At the same time, legal and technical measures, combined with higher import duties related to future investment projects, should gradually improve fiscal revenues. Monetary policy is geared towards maintaining the euro currency peg introduced in January 2010. Inflation, still largely determined by imported food and oil prices, slowed to about 11.4% in 2010, down from 16.7% in 2009, thanks to the economic rigour imposed by the peg. This downward trend is expected to continue, provided fiscal policies stay on track and international food prices remain stable. In the meantime, major structural challenges remain: the growing debt burden, vulnerability to external shocks and the lack of economic diversification.

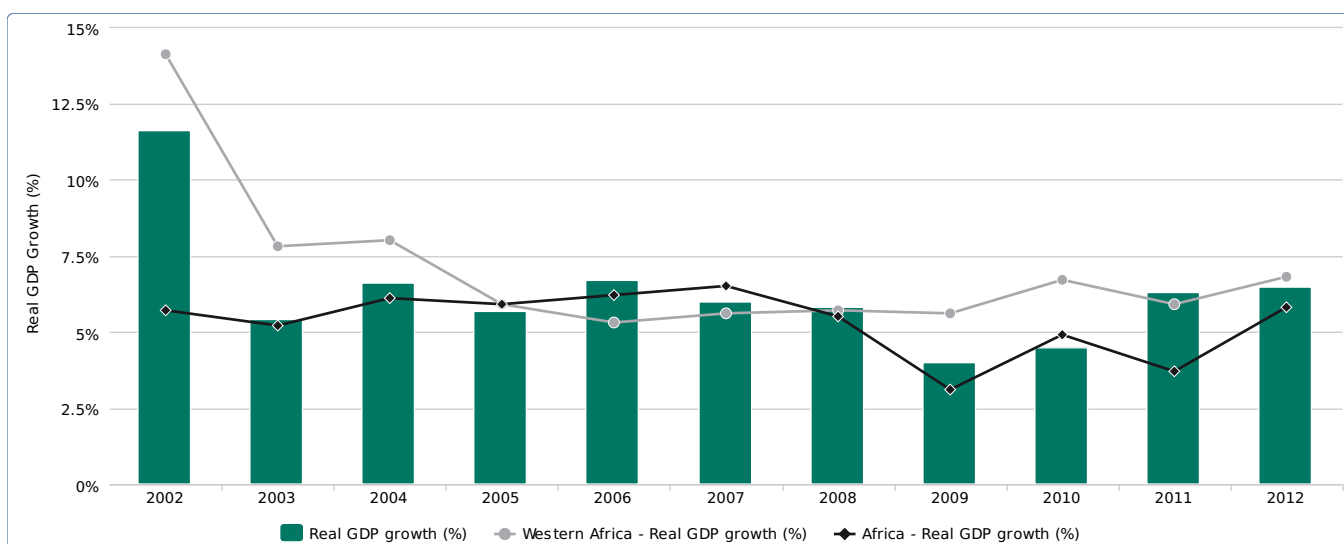
Until and unless oil revenues materialise, the government will remain heavily dependent on external financing. FDI is not expected to return to its pre-crisis levels until after the presidential elections in 2011. In 2010, investments were driven by the public sector, financed by grants and concessional loans. Official development assistance (ODA) remained at the same level as in 2009, although disbursements were held back until after the legislative elections in August. So far, ODA compensated for sluggish FDI throughout 2010, sustaining the slight increase in economic growth. ODA might drop in 2011, however, given the increasing pressures on donors' budgets.

Emerging partners have long played a crucial role in STP's economic and social development. Chinese Taipei has the longest track record, but India and Brazil are intensifying their bilateral co-operation. Nigeria, Angola and increasingly other neighbouring countries are engaging more pro-actively with STP. The new Prime Minister has expressed his interest in diversifying trade and diplomatic ties with emerging partners in order to spur STP's development. In a time of increased competition for scarce resources, STP is seeking to engage with various emerging partners while nurturing the collaboration with traditional partners.

The most pivotal event in 2010 was the local government and parliamentary election in August, resulting in a minority government that may struggle to pass legislation or even remain in charge for long. The new Prime Minister remains committed to transforming STP's economy into a regional hub for transshipment activity. He will promote the diversification of the economy in order to lessen the country's dependence on uncertain oil prospects. Prospects for the economy in the short term will depend on the stability of the new government and the success of presidential elections in June 2011.

Poverty, estimated at about 54% in 2009, remains widespread in rural and periurban areas. The search for employment opportunities is resulting in urban migration, which puts increasing pressure on the capital's infrastructure and feeds the informal sector – estimated at 63% of the economy. Public services such as electricity, sanitation, health and waste management need to be ramped up if STP's social indicators are to maintain their upward trend.

Figure 1: Real GDP growth (W)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink  <http://dx.doi.org/10.1787/888932404503>

Table 1: Macroeconomic indicators

	2009	2010	2011	2012
Real GDP growth	4	4.5	5	6
CPI inflation	16.7	11.4	7.5	6.7
Budget balance % GDP	17.6	-7.7	3.3	-8.4
Current account % GDP	-26.2	-28.1	-35.8	-34.2

Source: National authorities' data; estimates and predictions based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink  <http://dx.doi.org/10.1787/888932406859>

Recent Economic Developments and Prospects

Table 2: GDP by sector (in percentage)

	2005	2009
Agriculture, forestry, fishing & hunting	17.6	17.1
Agriculture, livestock, fishery, forestry and logging	-	-
of which agriculture	-	-
of which food crops	-	-
Mining and quarrying	0.4	0.6
Mining, manufacturing and utilities	-	-
of which oil	-	-
Manufacturing	6.7	6.7
of which hydrocarbon	-	-
Electricity, gas and water	2.2	2.2
Electricity, water and sewerage	-	-
Construction	6.5	8.3
Wholesale and retail trade, hotels and restaurants	24.4	26.5
of which hotels and restaurants	1.3	1.5
Transport, storage and communication	14.2	14.1
Transport and storage, information and communication	-	-
Finance, real estate and business services	6.7	12.3
Financial intermediation, real estate services, business and other service activities	-	-
General government services	13.4	8.3
Public administration & defence; social security, education, health & social work	-	-
Public administration, education, health	-	-
Public administration, education, health & other social & personal services	-	-
Public administration, education, health & social work, community, social & personal services	-	-
Public administration, education, health & social work, community, social services	-	-
Other community, social & personal service activities	-	-
Other services	7.8	4
Gross domestic product at basic prices / factor cost	100	100

Source: AfDB Statistics Department, National Institute of Statistics data.

Figures for 2010 are estimates; for 2011 and later are projections.

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GDP growth is estimated at 4.5% for 2010, slightly better than the 4.0% in 2009 but still lower than the

average growth of over 6.2% during 2004-08. The legislative election in August slowed down the economic recovery by holding up ODA disbursements and further delaying pending FDI. ODA, construction, housing and the informal sector sustained economic growth in 2010, boosted by an inflow of electoral related spending, estimated at around USD 10 million. Growth is not expected to return to pre-crisis levels until after the presidential elections planned in 2011. Oil exploration investment, as well as the start of the construction of the deepwater seaport, will underpin growth from 2012 onwards.

The agricultural sector accounts for only 17.1% of GDP but employs over 60% of the active population. The sector is characterised by low overall productivity due to inadequate infrastructure, inexistent public services and a large number of small producers. Consequently, a large share of food, notably rice, needs to be imported.

In 2010, agricultural output was severely affected by a drought lasting eight months. This has strengthened inflation and undermined food security, as domestic supply relies heavily on fragile subsistence farming. Cocoa production, representing 88% of exports, is estimated to have dropped by some 20%. The decline in volume has been somewhat compensated by an increase in the international cocoa price, currently at a 30-year high. Agricultural output from 2011 onwards should gradually increase, reflecting the government's investments in machinery and fertilisers to boost productivity, as well as increased private sector investment.

Foreign investors are contributing to the diversification and increase of agricultural output. Malongo, a French company, plans to rehabilitate "*Roça Monte Café*" in 2011, a former coffee plantation worth USD 3 million. Another French company, growing pepper and vanilla since 2008, plans to export 400 tonnes by 2015. Organically certified cocoa production is gaining momentum, accounting for 400 tonnes out of a total cocoa production of 3 500 tonnes in 2010. It offers a price premium to producers of over six times the price of regular cocoa. Further increasing cocoa production, however, remains strongly constrained by fragmentation of land ownership.

Developing fisheries has great economic potential and could boost employment, income, food security and diversification. Local fishermen are limited to small-scale fishing, while industrial fishing has been embedded in a fishing agreement with the EU that allowed vessels mainly from Spain, Portugal and France to fish in the São Toméan waters. Covering the period from June 2006 to May 2010, the agreement included a financial contribution of EUR 663 000, 50% of which was earmarked to support STP's fisheries policy. A new agreement is under negotiation. The AfDB and the government will upgrade the existing certification facility to stimulate exports of fish products to the EU, currently limited due to lack of compliance with phytosanitary requirements.

Production of oil and gas in STP's offshore "Exclusive Economic Zone" (EEZ) could transform its economy. The bidding round due to be concluded in September was extended by 60 days to attract more bidders. Yet only six companies (from Angola, Nigeria, South Africa and STP) placed a bid, and no oil major participated. No commercially viable oil has been found yet. Currently, the most promising oil prospects still emanate from the Nigeria-STP Joint Development Zone (JDZ), an area of overlapping maritime boundary claims. Drilling prospects are still uncertain and have been marred by contractual disagreements about asymmetric profit sharing.

Sinopec, the Chinese national oil company and the dominant player in the JDZ, has found hydrocarbon reserves in exploration blocks 2, 3 and 4, while block 1 is thought to contain gas reserves of around 1 trillion cubic feet. So far, Sinopec hasn't started production in any of the blocks, casting doubt about the commercial viability of the reserves. Chevron drilled a well in 2006, which did not meet its expectations. In 2010, Total acquired a 45.9% stake in Chevron's block.

Efforts to promote transparency in STP's fledgling oil sector have taken a blow with the country's expulsion from the Extractive Industries Transparency Initiative (EITI) in April 2010. STP's notable lack of progress towards meeting EITI objectives had prompted the government to request a suspension from the process. The EITI board voted to expel STP, however, concluding that it had not demonstrated exceptional and unforeseeable circumstances outside its control to justify a further extension.

Utilities and construction, driven by the building of tourism infrastructure, housing and road maintenance, make up much of the secondary sector, which represents 17.8% of GDP. The country has only a few companies, most of them engaged in food processing. They include a brewery, a fruit juice company, a palm oil plant, a high-end chocolate factory and half a dozen bakeries. Manufacturing, which accounts for 6.7% of GDP, suffers from the small domestic market, the lack of human capital, high energy costs, and reliance on imported raw materials. The low quality of local production perpetuates the island's increasing demand for higher quality and more affordable foreign products.

Transport and utilities infrastructure are central to the Government's ambition to turn the archipelago into a service and tourist hub. As of 2010, however, the main infrastructure works underpinning this vision still had to commence. Príncipe's investment projects remained on hold due to the need to build a new offloading crane for the port. Since the existing one broke down in December 2009, development partners are evaluating long-term

solutions, but rehabilitation is not expected before mid-2011.

The São Toméan economy is driven by the tertiary sector, which generates over 65% of GDP. It is highly informal and consists mainly of small retail, transport and financial services. The government projects tourism will play an increasing role in the country's economic development. Tourism has gradually picked up, in pace with increased accommodation capacity, with around 7 000 tourists in 2010. The country's cultural and architectural legacies are unique assets underlying tourism's great potential. Structural constraints still need to be addressed, however, including offering lower airfares and providing alternative flying routes to the archipelago. Currently, only two commercial flights connect the island with Europe, keeping airfares artificially high.

Private consumption and public investments drove demand in 2010. Private consumption structurally accounts for the largest share of GDP. In 2010, it was supported by election-related spending. Yet this buying of votes or "Banhos", estimated at some USD 10 million (or some 5% of GDP), couldn't compensate entirely for the loss of revenue following the severe drought. Private consumption is projected to gradually increase in the future, due to employment generated by the construction of the deep-water seaport and tourism infrastructure. Additionally, household income should be sustained by the projected gradual increase in agricultural production and export.

Public investment counterbalanced the continued drop in private investment projects triggered by the global economic crisis. Energy and transport infrastructure absorbed the bulk of public investment, while no new large private investment projects were announced, and projected ones were still affected by the global crisis and the political uncertainty related to the elections. The share of public investment is expected to grow much more slowly in 2011 and 2012, however, as FDI is expected to pick up with the construction of the deepwater seaport in 2011. The acceleration of investment in oil exploration activities and tourism infrastructure should underpin private investment from 2012 onwards. Government spending, mainly on basic infrastructure, maintenance and the wage bill, remains a small component of demand and is not projected to increase strongly in the coming years, due to the restrictive fiscal stance. The heavy reliance on external financing, in the form of aid flows and FDI, remains the main risk to STP's economic outlook.

Table 3: Demand composition

	Percentage of GDP (current price)		Percentage changes, volume			Contribution to real GDP growth		
	2002	2009	2010	2011	2012	2010	2011	2012
Gross capital formation	36.4	48.6	13.3	9.4	7.7	7.1	5.4	4.7
Public	17.7	29.6	20	9	7	6.5	3.4	2.7
Private	18.7	19	2.8	10	9	0.6	2.1	1.9
Consumption	97.4	98.5	-0.2	2.9	4.4	-0.2	2.5	3.8
Public	17.9	16.7	2.5	2.5	2.5	0.4	0.4	0.4
Private	79.4	81.8	-0.8	2.9	4.8	-0.6	2.1	3.4
External sector	-33.8	-47.1	-	-	-	-2.4	-2.9	-2.5
Exports	16.5	10.9	3.9	5.7	7.9	0.4	0.5	0.7
Imports	-50.2	-58	5	6.3	5.8	-2.8	-3.5	-3.3
Real GDP growth rate	-	-	-	-	-	4.5	5	6

Source: Data based on estimations using National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Fiscal Policy

The second three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) signed by the authorities in March 2009 provides the framework for fiscal policy. The aim is to maintain the strong fiscal consolidation by limiting discretionary expenditure and increasing fiscal revenues. Despite the revenue generated from oil licences and debt relief prior to the global crisis, the fiscal situation remains fragile, as volatile import duties make up around half of fiscal revenues.

Notwithstanding a restrictive fiscal policy, the overall fiscal balance turned negative in 2010, reflecting a drop in foreign grants as well as the lingering effect of the crisis on private investment. Oil signature bonuses are expected to boost revenues temporarily in 2011, but the fiscal balance is expected to remain negative from 2012 onwards. Past deficits have been partly financed with withdrawals from the National Oil Account (NOA), as well as privatisation earnings. As a result, the NOA had dwindled to less than USD 10 million by 2010, compared to the USD 49 million in 2005. Without new oil signature bonuses from the latest bidding round in November 2010, the NOA might run out of funds within the next five years.

Government revenues for 2010 were around 30% lower than expected. This is due to a lagged response of private sector activity after the lowering of the corporate tax rate in 2009, and to lower ODA disbursement due to elections. Expected oil signature bonuses for 2010, worth USD 30 million, are projected to materialise in 2011 instead. Import duties suffered from the lack of FDI in 2010, but should pick up gradually, as major projects start in 2011 and 2012.

The government reacted by cutting 10% of recurrent discretionary spending in early 2010. Public sector wages were frozen, following a substantial increase in 2009. The newly elected government maintained these measures and introduced new, largely symbolic ones, such as limiting official travels and the use of state cars, reducing fuel expenses by 10%. Public investment, financed over 90% by grants and loans, remained largely unaffected.

Difficulties in increasing domestic revenues are threefold: the omnipresent informal economy; the obsolete infrastructure, in particular unreliable energy provision; and tax evasion. Corporate taxes are supported by only 20 enterprises, including commercial banks, the telecom company CST, hotels and major import/export companies. Other companies remain informal or benefit from tax exemptions. The introduction in 2010 of a unique fiscal number for each person and enterprise should help to slowly expand the narrow tax base, in particular through the expansion of payroll taxes, currently paid only by civil servants and employees from international enterprises.

Structural reforms, including an integrated computerised public financial management system (eSAFE), are being implemented to increase efficiency and the transparency of government cash management. This project, slated for the end of 2009, was still under implementation at the end of 2010 because of disagreements over software. It includes the decentralisation of public expenditure management in order to improve the budget execution rate, structurally below 80%. It also provides for government revenue to be deposited in the Central Bank and managed by the Treasury, and for all salaries of civil servants to be paid by bank transfer.

Table 4: Public finances (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Total revenue and grants	29.2	161.9	48.4	58.8	36.9	47.2	33.6
Tax revenue	10.8	37.7	16.4	16.7	17	16.7	16.2
Oil revenue	-	-	-	-	-	-	-
Grants	16	121.3	30.4	39.8	17.6	28.2	15.2
Other revenues	-	-	-	-	-	-	-
Total expenditure and net lending (a)	38.9	40.3	33.5	41.2	44.5	43.9	42.1
Current expenditure	14.7	28.7	24.8	21.5	21.4	20.6	19.4
Excluding interest	10.5	27.4	23.9	20.9	20.7	19.8	18.6
Wages and salaries	4.7	9	8.7	8.9	8.1	7.4	6.8
Goods and services	2.5	5.7	6.5	5.3	5.7	5.5	5.2
Interest	4.1	1.3	0.9	0.6	0.7	0.8	0.8
Capital expenditure	24.2	11.6	8.7	19.7	23.1	23.2	22.6
Primary balance	-5.5	122.9	15.8	18.1	-7	4.1	-7.6
Overall balance	-9.7	121.5	14.9	17.6	-7.7	3.3	-8.4

a. Only major items are reported.

Source: Data based on estimations using National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

StatLink  <http://dx.doi.org/10.1787/888932409766>

Monetary Policy

In January 2010, the dobra (STD) became pegged to the euro. The peg, backed by a five-year concessional credit line worth EUR 25 million from Portugal, should help maintain monetary stability and raise the credibility of the government's macroeconomic policy. The peg's positive impact was already felt through the very low inflation in the first semester. The potential downside of the peg is the risk of overvaluation of the dobra, resulting in a lower purchasing power of revenues in US dollars, mainly ODA flows and future oil signature bonuses. So far the slight depreciation of the euro against the dollar in 2010 has resulted in a depreciation of the dobra against the dollar.

Throughout 2010, monetary policy was dictated by the need to contain inflation, increase the country's foreign exchange reserves and maintain the peg (set at STD 24 500 to the euro). In the second half of 2010, inflation picked up, however, due to the effect of the drought, strong election spending and the depletion of sugar and rice stocks. Inflation will remain largely determined by world prices for oil and food, which constitute an increasing share of the consumer goods basket, reaching 60% in 2010.

Besides the peg, the Central Bank's sterilisation efforts also contributed to reducing inflation from 16.7% in 2009 to 11.4% in 2010, although this remained above the 10% target for the year-end. This positive evolution benefited from a lower readjustment of inflationary expectations. The country's inflation is projected at 7.5% for 2011, to be reduced to 6.7% in 2012. Whether these forecasts materialise will depend upon the government's ability to deal with volatile international food and oil prices, as well as with future foreign currency inflows from oil signature bonuses in 2011 and FDI in 2012.

Despite sterilisation efforts, foreign currency bank deposits had increased by 37% by August 2010, resulting in a base money growth of about 10% in 2010. This was an improvement over the 21.9% registered in 2009, however. The discount rate has been held stable at 16% to stimulate commercial credit to the economy, and

the compulsory reserve requirement has been maintained at 24.5%.

The government is expected to consolidate the economic reforms undertaken during the past two years, improving fiscal performance and safeguarding international reserves and the exchange rate peg. This consolidation should lay the ground for a moderate acceleration of economic growth from 2012 onwards. This increased macroeconomic rigour should help meet inflation targets.

External Position

A structural imbalance between high imports and low exports has led to persistent current account and trade deficits since 2001. The trade balance worsened significantly in 2010, due to a strong drop in cocoa exports, while the drought resulted in higher food imports. Rising international oil and food prices added to the deterioration of the trade balance. Further trade deficits are expected in the coming years, as cocoa exports and tourism receipts are unlikely to make up for imports associated with the projected FDI inflows.

Cocoa remains the main export product, generating 88% of STP's exports. The devaluation of the Dobra and high international cocoa prices have boosted the value of exports. Pending the resolution of the political crisis in Côte d'Ivoire, cocoa prices are expected to remain high. STP's export capacity, however, is too limited to take full advantage of these beneficial terms of trade. In 2009, food, oil and machinery accounted for 57% of total imports, up from 51% in 2000.

The European Union remains STP's largest trading partner, accounting for 80% of exports and 60% of imports, although its share has been declining. Portugal remains by far the most important bilateral trading partner, with 56% of imports and 32% of exports. The Netherlands and Belgium absorb 45% of STP's exports. Throughout the last decade, the share of imports from emerging economic partners gradually increased from around 20% to 30% in 2009. Angola and Brazil's combined share of STP's imports has risen fast over the past few years to reach 25%. Exports to emerging partners, on the other hand, have slightly diminished to a mere 8% in 2009.

The government has not yet signed an Economic Partnership Agreement (EPA) with the European Union, arguing that the São Toméan economy is not mature enough and that its export industry cannot cope with the certification and phytosanitary requirements to enter the European market. Although STP is formally entitled to preferential trade treatment under the African Growth and Opportunities Act (AGOA), its exports to the United States have so far been subject to full import duties, as the country is unable to comply with certification requirements.

In 2010, FDI recovered to USD 25 million, equivalent to 13% of GDP, from USD 7.5 million in 2009 (4% of GDP). The uncertainty related to the elections and the lingering effect of the crisis slowed down a full recovery of FDI, but future oil exploration is expected to boost FDI back to the record level of over USD 33 million attained in 2008. Additionally, the new deepwater seaport is scheduled to begin operation in 2011, attracting USD 570 million. The main project to boost tourism, the construction of two hotels by Libyan company LAICO (worth around USD 30 million), has remained on hold since 2008. The strong unrest in Libya and the São Toméan presidential election in 2011 could potentially further delay these investments.

STP is heavily dependent on external assistance to finance its capital expenditures as well as a share of its current expenditures. Grants made up 47.6% of total revenue in 2010, down from 68% in 2009, due to the end of HIPC-related grant disbursements in 2009. Grants — which amounted to USD 30.7 million, equal to 17.6% of GDP — cover 54% of public investment needs, while loans finance around 38%. Over 95% of external assistance remains "project support", contrary to the principles of the Paris Declaration to increase budget support. The World Bank is the only institution granting its assistance fully through budget support.

Portugal and Chinese Taipei are the two largest bilateral donors, accounting each for around 20% of STP's public investments in 2010. Traditional donors are feeling budgetary pressures following the economic crisis. Consequently, Spain has announced it will fully withdraw its technical co-operation on the archipelago, worth USD 1.5 million, by 2011. Japanese rice donation, which covers over half of STP's annual consumption for rice, dropped slightly from 4 000 tonnes in 2009 to 3 320 tonnes in 2010.

Multilateral donors are involved in education, health, food security and the fight against HIV, as well as infrastructure. The European Development Fund provides slightly less than 20% of the public investment budget, focusing particularly on infrastructure, road maintenance as well as technical support and capacity building for the public administration. The AfDB's 5-year plan (2011-15) aims to support the governments' goal of combating rural poverty. The AfDB covers 11% of public investment and focuses on agriculture, fisheries and food security; technical and vocational training; and rural roads.

This diversity of development partners poses a significant burden on the São Toméan administration, resulting in an ODA disbursement rate averaging 60% for the last couple of years. All materials need to be imported through STP's dysfunctional port, slowing down the execution of projects and exacerbating the already low

absorption capacity. Better co-ordination between the Ministry of Foreign Affairs and the Ministry of Planning and Finance, as well as the UNDP's project to improve co-ordination amongst donor programmes, should improve aid effectiveness.

Fuelled by privatisation proceeds and foreign aid, net foreign assets of the Central Bank have been steadily increasing from EUR 40.9 million by the end of 2007 to EUR 57.8 million in May 2010. They covered 5.4 months of average monthly imports in 2009, up from 4.3 months in 2008. The state-owned utilities company "Empresa de Agua e Electricidade" (EMAE) will be privatised in the course of the coming years to improve its financial viability and service delivery.

STP reached the HIPC completion point in 2007, resulting in a debt write-off of USD 327 million, equal to 91% of its multilateral external debt. By 2010, however, the ratio of net present value of external debt already increased to 21.5% of GDP from 11% of GDP after HIPC debt relief. Around 68% of STP's debt is external. STP's limited export and production base, unlikely to expand over the short term, exacerbate the country's high risk of falling back into debt distress. To minimise this risk, the government has made a commitment to rely on external grants and highly concessional loans to finance its development programmes, avoiding commercial borrowing. A new law requiring the national assembly to approve all government borrowing, both internal and external, should also be finalised by the end of 2011.

Remittances remain important to local households in order to finance private consumption. Around 30 000 São Toméans are estimated to live in Portugal alone, making up roughly a third of the total active population on the Archipelago. Remittance flows are highly informal, but the World Bank estimates they amounted to USD 2 million for 2010. This amount has been relatively stable during the past decade, with the exception of a pre-crisis peak of nearly USD 3 million in 2008.

Table 5: Current account (percentage of GDP)

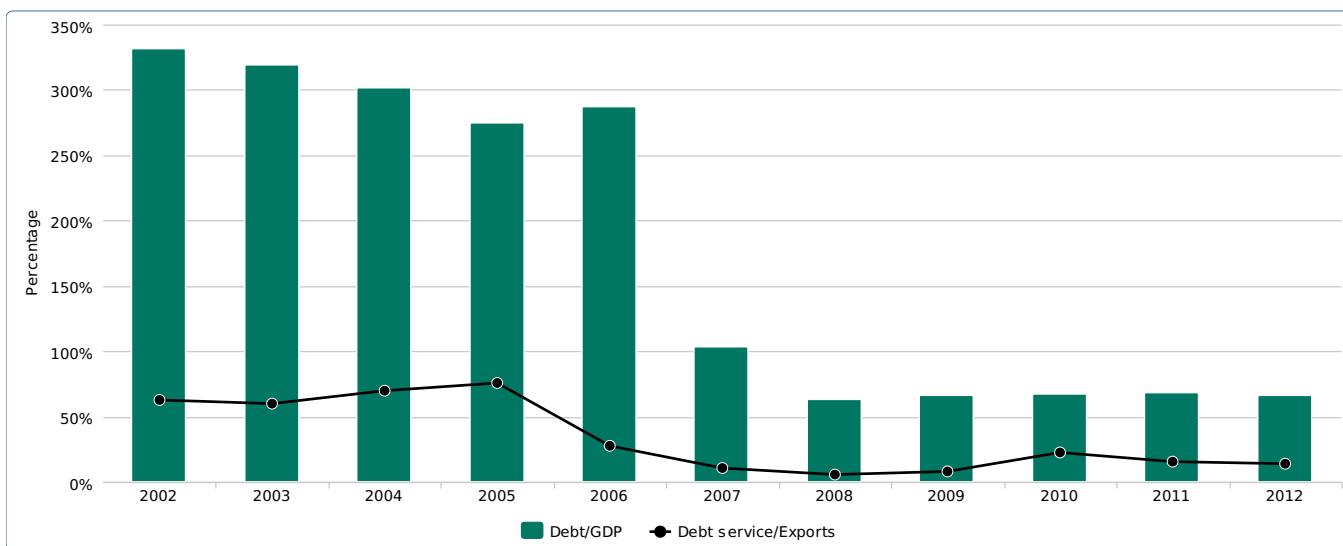
	2002	2007	2008	2009	2010	2011	2012
Trade balance	-24.4	-41.8	-47.6	-37.5	-41.2	-41.2	-39.7
Exports of goods (f.o.b.)	7	4.7	5.9	5.2	5.2	4.7	4.4
Imports of goods (f.o.b.)	31.3	46.5	53.5	42.7	46.4	45.9	44.1
Services	-9.4	-12.7	-7.8	-7.1	-10.2	-11.2	-9.8
Factor income	-2	4.2	2.3	1.8	1.6	1.3	1.7
Current transfers	18.8	11.7	14.7	16.6	21.7	15.2	13.6
Current account balance	-17	-38.6	-38.4	-26.2	-28.1	-35.8	-34.2

Source: Data based on estimations using National Institute of Statistics data; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Figure 2: Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Structural Issues

Private Sector Development

The private sector in STP is characterised by a small number of firms that specialise in trade, construction and tourism. The World Bank's *Doing Business* 2011 report ranks STP 178th out of 183 countries. This ranking reflects the lax regulatory enforcement, inadequate infrastructure and past political unrest. Investment laws and regulations are onerous, and bureaucracy can be cumbersome and prone to corruption. Other deterrents to investment include foreign exchange controls, some restrictions to capital transactions, land ownership issues and the influence the government maintains on everyday business. Foreign and domestic firms are treated equally under the law.

In 2010, the Chamber of Commerce opened a one-stop shop for entrepreneurs to stimulate and facilitate starting a new business. This major improvement was counterbalanced by the introduction of a minimum capital requirement for limited liability companies.

STP's financial system is small, underdeveloped and highly dollarised. The financial sector is healthy, with less than 1% of non-performing loans. The largest and oldest commercial bank is the Banco Internacional de São Tomé e Príncipe (BISTP), a consortium between the STP government, Portugal's Caixa Geral de Depósitos and Angola's leading deposit bank BAI. BISTP controls two-thirds of the credit and deposit market. The other six commercial banks have so far not been very active.

Domestic credit to the private sector remains limited and expensive, although it is available to both foreign and local investors without discrimination. The market for retail banking is very limited given the average monthly salary of STD 1.5 million, equivalent to EUR 60, and the high entry costs. Consequently, the majority of the population lacks access to formal banking services. Foreign currency deposits account for about 60% of commercial banks' deposit liabilities, while about 70% of loans to the private sector are denominated in foreign currency.

An international payment system, SPAUT STP, is to be launched in the second quarter of 2011. The system, which will include 20 ATMs and 40 point of sales, will use VISA and is being set up by the Central Bank, Companhia Santomense de Telecomunicações (CST) and a bank syndicate. Insurance companies are gradually increasing their activities on the Archipelago, but overall the nonbank financial sector remains underdeveloped.

Other Recent Developments

The government's programme seeking to transform the country and diversify its economy is articulated around strengthening *i)* good governance; *ii)* economic growth and development; *iii)* national and social cohesion; and *iv)* the rule of law. So far, the new government has pledged to continue the reforms in public finance management undertaken by the previous administration. The main change in 2010 has been the transfer of the department of co-operation from the Ministry of Foreign Affairs to the Ministry of Planning and Finance (MPF), in order to highlight the importance of ODA to the budget. The judicial system is currently the weakest link in the STP's administration as legal enforcement of contracts is close to inexistent.

EMAE, the water and electricity state-owned company, is being reformed with the World Bank's assistance. Efforts to attract private capital and improve financial viability are meant to prepare the company for future privatisation, along the lines of what was achieved with the telecommunications company. The government has allowed ENCO, the state national oil distribution company, to adjust prices in line with market fluctuations to gradually phase out oil subsidies.

Sonangol, Angola's state-owned oil company is increasing its presence in the country. The government granted it the concessions to manage the country's main port in Ana Chavez, as well as the international airport. Sonangol is to upgrade the airport, extending the runway by 300 metres, installing lighting and modernising the terminal building. Talks about Sonangol acquiring a stake in EMAE and ENCO, as well as building a fuel storage in Neves, have been revived, but progress remains slow.

The major investment project has been the rehabilitation of the National highway N° 2, to be concluded by 2011 and worth EUR 24.5 million. Financed with a Portuguese credit line, it will connect the capital with Ribeira Peixe in the country's poorest District Caué. Meanwhile, construction of the deep-water port proposed by French multinational CMA-CGM was delayed due to the financial crisis. Preliminary development is scheduled to begin in 2011, and the port should be operational by 2014. The project is estimated at USD 570 million. The finalisation of this port should enable STP to become the regional hub for transatlantic shipping, but other similar projects in neighbouring countries risk undermining the economic potential of the port if it is delayed much further.

Access to reliable and affordable energy remains problematic. The recent inauguration of Chinese Taipei's power plant in Santa Amaro, however, should enable the country to cover its needs by nearly doubling the island's wattage supply. The remaining challenge resides in building an adequate distribution grid to limit losses, which can go up to 40% of energy production. One solution could be to connect the independent grids used by the former Portuguese plantations with the national distribution grid, thus connecting an additional 25% of the population. Alternative renewable energy solutions are currently being studied, including mini hydro electrical plants and solar energy for rural communities.

The World Bank is pushing for the telecommunication market, currently a monopoly by Companhia Sãotomense de Telecomunicação (CST), to be liberalised to increase efficiency and dynamism. After expanding by 60% in 2009, STP's mobile phone market grew by another 25% in 2010. With 100 000 mobile subscribers, the market penetration stands at 60%. STP's connection to a marine fibre optic cable linking Africa's west coast to Europe, expected in 2012, should drastically improve telecommunications in the country. CST announced the conclusion of the USD 25 million contracts in June 2010. The project will be jointly financed by CST, the World Bank and Portugal Telecom. Once the cable is operational, CST plans to launch third-generation communication services.

The 'Carta Agrícola', a roadmap for agriculture spanning 2006-15, includes distributing subsidised fertilisers, seeds and machinery to farmers in order to raise productivity. In addition, the government, supported by donors, plans to improve rural infrastructure, improve access to internal and external markets, and develop farmers' managerial skills with regular targeted courses.

Environmental challenges are closely related to rural poverty. Deforestation is increasing as forest dwellers turn tropical wood into coal or sell it abroad. There is a lack of capacity and staff to preserve the archipelago's rich and unique endemic fauna and flora. The OBO natural park, the country's main tourist site, is underfunded and its touristic potential underutilised. There is an urgent need to strengthen its management and maintenance in order to preserve and expand its botanical garden and unique herbarium.

Emerging Economic Partnerships

Given STP's small size and overwhelming dependence on external financing, the government has adopted a pragmatic approach towards development co-operation. Authorities are keen to broaden the long-standing relationship with Portugal, STP's former colonial power, and other western donors by developing relationships with emerging economic partners such as Brazil, Chinese Taipei and India, as well as strengthening regional ties, notably with Angola and Nigeria. European Union partners still dominate trade flows, although oil imports from Angola now account for approximately 20% of STP's total imports. STP's strategy is to encourage FDI from emerging economic partners to develop oil exploration, tourism and other economic activities.

Chinese Taipei, Brazil and India have become active development partners in areas such as technical co-operation, capacity building, infrastructure and culture. The Prime Minister has identified Nigeria, Libya, Gabon, Qatar and Turkey as future potential partners. In 2008, Angola and Libya announced their interest in building hotels and developing STP's nascent tourism sector.

Since 1997, STP has maintained relations with Chinese Taipei instead of the People's Republic of China. Since then, Chinese Taipei is estimated to have donated more than USD 140 million to STP. However, trade flows are minimal, and economic relations consist primarily of concessional loans, budget support and aid. Project support from Chinese Taipei has been very successful in combating malaria in the archipelago, and STP has reduced its rate of infection by 44% to its current 3.7%. In October 2010, a new generator built by Taiwan Electrical and Mechanical Engineering Services (TEMES), doubling electricity supply on the archipelago, was inaugurated. The power plant will be managed by the Chinese Taipei contractors for a year before being handed over to São Toméan engineers.

Diplomatic relations with Chinese Taipei might come under pressure after Sinopec, China's national oil company, became the dominant player in STP's Joint Development Zone by acquiring Addax Petroleum Corp in 2009. So far China maintains neither diplomatic ties nor trade relations with the archipelago, but STP's government expressed its interest in exploring potential ways of future collaboration. Both Chinese Taipei and STP expressed their interest in continuing their longstanding relationship, however.

Diplomatic ties with India, although strengthened over the last two years, remain relatively limited. STP's foreign affairs minister visited India in December 2009 for the first time since independence. India agreed to provide a credit line of USD 5 million and a grant of USD 1 million to set up a "technology incubation centre" for the development of small and medium enterprises. India will also provide technical co-operation in agriculture, infrastructure and the hydrocarbon sector. STP was the 47th African nation to join the Indian government's Pan-African e-Network Project. This project will link STP to the other countries of the African Union via video conference, focusing on health services and linking the main hospital on the island of São Tomé with more than 10 Indian hospitals. Indian imports are close to nonexistent, while exports to STP include organic chemicals, pharmaceuticals, cotton and medical instruments, estimated at an annual average of only USD 1 million.

Oil prospects in STP convinced the Brazilian authorities to open their first embassy on the island in 2003. Relations with STP are part of Brazil's policy of South-South co-operation and co-operation with Africa's Lusophone countries, which underpin initiatives such as the Brazil-Africa Forum. Brazil's aid, unlike some other partners, is neither tied to the procurement of goods and services from its enterprises nor to political conditions. In 2010, Brazil and STP concluded a USD 5.8 million co-operation agreement seeking to support SMEs, social housing policy, implementation of a minimum salary policy, the second phase of the school feeding programme, technical assistance to the water management policy and malaria prevention. The Brazilian Ambassador also announced that construction of a professional training centre would begin in early 2011. Brazil operates a vibrant cultural centre in the capital, São Tomé.

The emergence of new partners has had a positive impact on STP's economic development. Energy, health and education have been the three areas most targeted by development assistance from emerging partners. With no higher education institute in the archipelago, STP relies on access to foreign schools to develop human capital. Portugal has long been offering scholarships, but emerging partners, mainly Brazil, Chinese Taipei and Cuba, are increasingly helping STP students access higher education as well.

Emerging partners are also expected to invest in key areas such as tourism, ports and oil, which have the potential of unlocking long-term economic growth and helping to reduce STP's dependence on external assistance. The archipelago's ambition to become a service hub for the Gulf of Guinea will rely heavily on co-operation with African neighbours, and the recent tender in the Exclusive Economic Zone (EEZ) indicates that private investment will come from African investors.

STP's new Prime Minister plans to strengthen commercial and economic ties with the region and reinforce regional integration. Whereas the previous administration favoured Portugal and Angola as strategic partners, the newly elected government is increasingly opening up to the sub region, notably Gabon, Cameroon,

Equatorial Guinea, Congo and Nigeria. This strategic shift, reflected in the Prime Minister's selection of official visits during his first months in office, should facilitate the development strategy of becoming a service hub for the sub region.

Political Context

Long-delayed local and legislative elections were held in August 2010. Following 32 years of 'Movimento de Libertação de São Tomé e Príncipe-Partido Social Democrata' (MLSTP-PSD) in power, 'Acção Democrática Independente' (ADI) obtained the most votes, securing 26 seats out of 55 in the National Assembly. No single party secured an outright majority, however, resulting in a hung parliament and a minority government. President Fradique's party 'Movimento Democrático Forças da Mudança-Partido Liberal' (MDFM-PL) incurred a humiliating defeat, obtaining only one seat. ADI's support was strongest among the urban youth and the most populous provinces (Água Grande, Trindade and Santana).

Potential candidates for the upcoming presidential elections, due in mid-2011, are still unknown, and President Fradique de Menezes cannot seek a third term. The MDFM-PL has not yet recovered fully from its defeat and is looking to reinvent itself by attracting young talent.

Minor social unrest occurred in 2010, related to the demand for better working conditions and higher salaries in state-owned companies, such as EMAE and the airport.

Social Context and Human Resource Development

Economic growth has not managed to overcome social and developmental challenges, and only three Millennium Development Goals (MDGs) may be achieved by STP by 2015: universal primary education, the reduction of infant mortality and improved maternal health. STP, with the help of its development partners, has made considerable headway towards the eradication of HIV and malaria and is getting close to achieving this sixth MDG as well.

The government's poverty reduction strategy continues to rely on raising rural income levels by boosting agricultural productivity and employment in rural communities. Chances of achieving the MDG on extreme poverty, gender equality and the establishment of partnership for development, however, are minimal. Poverty, estimated at 54% in 2009, is widespread in rural and periurban areas. Decent housing is scarce, particularly in the southern region and on Principe. The official minimum wage is STD 400 000 (USD 25) per month, and salaries for civil servant average STD 1.5 million. Malnutrition remains a constant threat.

The literacy rate is high, reaching almost 90%. According to UNICEF, net schooling rate is around 83% and is expected to reach 100% by 2015. Challenges remain with regards to dropouts in secondary education, however, and in generating employment for graduates.

During the last decade, unemployment has been increasing steadily, particularly in the capital, and is now estimated at 26.8%. Unless job opportunities improve, graduates returning from their scholarship programs abroad are unlikely to remain in the country. Job opportunities in remote rural areas are becoming increasingly scarce, fuelling the exodus of the rural poor to the capital to work in the informal sector, currently estimated at 63% of the economy. The agricultural policy is part of the government action plan to create opportunities for those rural communities.