INTERNATIONAL MONETARY FUND

Strengthening Monetary Policy and Liquidity Management in São Tomé and Príncipe

Elsa de Brito, Hector Carcel-Villanova, and Alsis Cruz, led by Bahrom Shukurov

SIP/2025/117

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on July 16, 2025. This paper is also published separately as IMF Country Report No 25/229.

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Strengthening Monetary Policy and Liquidity Management in São Tomé and Príncipe
Prepared by Elsa de Brito, Hector Carcel-Villanova, and Alsis Cruz, led by Bahrom Shukurov

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ABSTRACT: This paper presents strategic recommendations aimed at improving the monetary policy and liquidity management framework in São Tomé and Príncipe. It also includes an analysis of the banking system, an evaluation of the existing monetary policy and liquidity management practices, and an examination of the current liquidity conditions within the banking sector. This paper should not be considered as a replacement for the specialized technical assistance that the authorities of São Tomé and Príncipe may require to effectively address specific issues.

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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

SELECTED ISSUES

July 16, 2025

Approved By **The African Department**

Prepared By Elsa de Brito, Hector Carcel-Villanova, and Alsis Cruz, led by Bahrom Shukurov

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STRENGTHENING MONETARY POLICY AND LIQUIDITY MANAGEMENT IN SÃO TOMÉ AND PRÍNCIPE[1]

This paper presents strategic recommendations aimed at improving the monetary policy and liquidity management framework in São Tomé and Príncipe. It also includes an analysis of the banking system, an evaluation of the existing monetary policy and liquidity management practices, and an examination of the current liquidity conditions within the banking sector. This paper should not be considered as a replacement for the specialized technical assistance that the authorities of São Tomé and Príncipe may require to effectively address specific issues.

A. Introduction

1. São Tomé e Príncipe, a small island nation with limited resources and capacity, is grappling with significant macroeconomic imbalances. The economy heavily relies on imports and foreign aid, stemming from a narrow production base and limited export capabilities. Although the fixed exchange rate regime pegged to the euro has been essential in promoting economic stability and maintaining low inflation rates over the years, recent developments have raised concerns. There has been a noticeable slowdown in economic growth, accompanied by a marked increase in inflation. These trends are associated with rising external and internal imbalances, primarily driven by external shocks and expansionary fiscal policies that have led to domestic price increases. These imbalances, coupled with a decline in foreign inflows, have led to a significant reduction in the country's foreign exchange reserves.

2. At this critical juncture, the authorities are enacting reforms to address significant macroeconomic imbalances. These reforms focus on improving fiscal balances, enhancing domestic production capabilities, reducing reliance on imports, and creating a more resilient economic framework that can withstand external shocks. In alignment with these efforts, the Central Bank of São Tomé and Príncipe (BCSTP) has tightened its monetary policy to support the government's initiatives.

3. In this context, the BCSTP has made significant progress in developing its liquidity management framework, with support from IMF technical assistance. Nonetheless, additional actions are required to ensure these measures are effective. The BCSTP remains dedicated to overcoming the challenges that lie ahead.

4. This paper offers strategic insights aimed at enhancing the effectiveness of the monetary policy and liquidity management framework in São Tomé and Príncipe. The paper aims to provide an overview of the banking system in São Tomé and Príncipe (Section B), assess the current monetary policy and liquidity management framework (Section C), describe the liquidity situation within the banking sector (Section D), and offer pertinent recommendations (Section E)

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[1] Prepared by Elsa de Brito, Hector Carcel Villanova, and Alsis Cruz, led by Bahrom Shukurov.

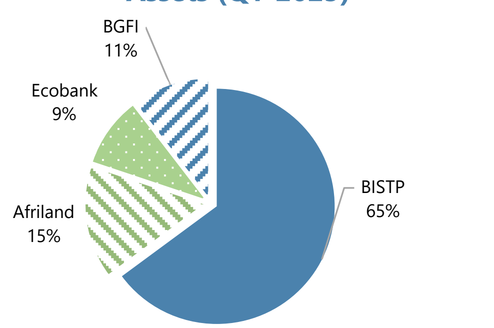
along with a conclusion (Section F). It is important to emphasize that the purpose of this paper is to provide high-level guidance and should not be seen as a replacement for the technical assistance that the authorities of São Tomé and Príncipe may seek to address specific challenges effectively.

B. Overview of the Banking Sector of São Tomé and Príncipe

5. The banking sector of São Tomé and Príncipe is small and faces significant challenges. These include high operating costs and low asset quality and profitability. Following its liberalization in the early 2000s, the sector grew as the Banco Internacional de São Tomé e Príncipe (BISTP) was joined by three new banks in 2004, increasing the total to eight by 2008. However, uncertain prospects in the commercial oil sector led the BCSTP to place three banks under administration within a decade, highlighting weaknesses in regulatory oversight. Limited investment opportunities in the small domestic market hinder banks' financing capabilities. Additionally, a significant portion of deposits is held in foreign currencies, reflecting a lack of confidence in the local currency and economy.

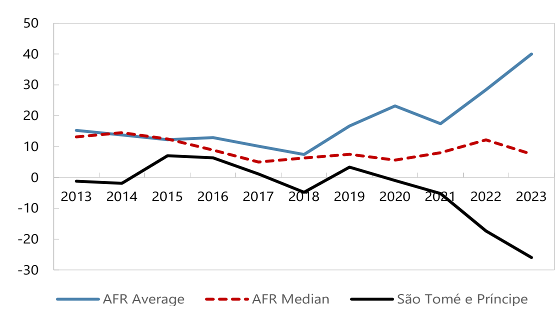
6. The banking sector is marked by significant concentration, with the largest bank controlling 65 percent of total assets (Figure 1). This high level of concentration poses considerable challenges, as it not only hinders competition but also elevates systemic risk within the financial landscape. When a single institution holds such a substantial share of assets, it can lead to a lack of diversity in financial services, limiting choices for consumers and businesses alike. Furthermore, this concentration distorts the overall assessment of the system's liquidity levels, as excess reserves may become disproportionately concentrated in one institution. Such a scenario undermines the BCSTP' ability to effectively manage liquidity, complicating their efforts to implement monetary policy and maintain financial stability. The vulnerability of the financial system to shocks increases, as the failure or distress of the dominant bank could have cascading effects throughout the entire economy, highlighting the urgent need for regulatory reforms aimed at fostering a more competitive and resilient banking environment.

Figure 1. São Tomé and Príncipe: Bank Assets (Q1-2025)



Sources: BCSTP and IMF staff calculations.

Figure 2. São Tomé and Príncipe: Credit to the Private Sector, Growth Rate

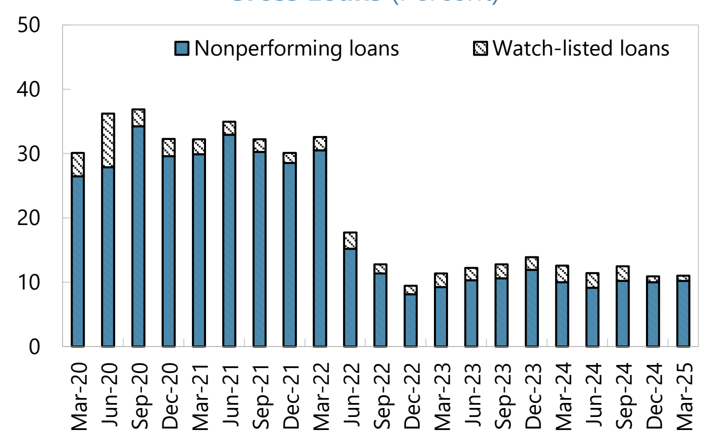


7. Several challenges contribute to the reluctance of banks in São Tomé and Príncipe to lend to the private sector. First, economic instability has affected the country, characterized by a stagnation and uncertain macroeconomic conditions, which have negatively impacted the stability and lending capacity of the banking sector. Additionally, limited financial infrastructure poses significant hurdles, while structural deficiencies such as weak contract enforcement and the absence of a robust credit information system increase the risk of defaults, prompting banks to adopt a more cautious approach. Furthermore, the widespread informal sector complicates lending activities, as many businesses and individuals lack formal registration and bank accounts, making it challenging for banks to accurately assess creditworthiness.

8. **As a result, private sector credit experienced a sharp decline since 2019**. Over the past decade, the growth rate of credit to the private sector in São Tomé and Príncipe has consistently lagged behind that of regional peers, exhibiting a marked decline since 2019 (Figure 2). After nearly five years of contraction, private sector credit has dropped to less than 8 percent of GDP, down from 24 percent pre-pandemic. While credit interest rates have shown a downward trend over the last ten years, the current interest rates remain close to 20 percent, reflecting macroeconomic imbalances and the high operating costs of financial institutions. This elevated rate effectively excludes a significant number of economic agents from accessing the formal financing system.

9. **The high level of non-performing loans (NPLs) makes banks reluctant to extend new credit.** This caution has led banks to prioritize holding more liquid assets as a strategy to mitigate the risks associated with potential loan defaults. Moreover, uncertainties within the judicial system—particularly regarding the enforcement of collateral—further discourage lending, as banks are often uncertain about their ability to recover loans in the event of defaults. As a result, the regulatory environment has become more stringent, prompting banks to adopt conservative lending practices.

Figure 3. São Tomé and Príncipe: Past Due Loans to Gross Loans (Percent)



Source: BCSTP and IMF staff calculations.

10. **Recent regulatory changes introduced in 2022 concerning asset classifications, provisioning, and capital adequacy have positively impacted the sector.** These reforms have contributed to a notable reduction in systemwide NPLs, which decreased to 10 percent of total loans by Q1:2025, down from a pandemic peak of approximately 34 percent in Q3:2020 (Figure 3).

C. The Current Monetary Policy and Liquidity Management Framework

11. **The BCSTP's regulatory framework incorporates a variety of instruments designed to implement monetary policy and manage liquidity.** These include (i) open market operations (OMO), which are initiated by the BCSTP through auctions of its Certificates of Deposit (CDs); (ii) the required reserves (RR) that mandate that banks maintain a certain amount of funds as reserves in their accounts at the BCSTP to help regulate liquidity in the banking system; and (iii) standing

facilities that allow for temporary liquidity absorption or lending. The BCSTP may utilize Treasury Bills (T-bills) for monetary policy purposes in accordance with the T-bills Legal Framework, although their issuance is currently primarily focused on financing budgetary requirements. In exceptional circumstances, the BCSTP may conduct refinancing operations, allowing struggling credit institutions to obtain loans for an extended period as a non-conventional monetary policy measure. The policy reference interest rate is used for these operations; however, this rate is not employed as a benchmark for monetary policy activities, nor do banks use it to set their deposit or lending rates.

Open Market Operations

12. The regulation governing OMOs was established in 2014; however, this instrument has only been actively utilized to absorb excess liquidity in the banking system more effectively since 2020. The regulatory framework allows for a variety of operations, including outright transactions, repo and reverse repo agreements, and foreign exchange swaps, all aimed at managing liquidity effectively. The regulation also specifies a broad range of eligible collateral. Furthermore, the OMO framework facilitates competitive auctions and direct sales or purchases for monetary operations. CDs, which are securities with maturities ranging from 1 to 360 days, can be utilized for both short- and long-term sterilization purposes. Until November 2021, CDs were issued through fixed quantity and rate tenders, predominantly with a one-month maturity. Since July 2022, the issuance of CDs has shifted to a fixed-quantity, variable-rate tender process, thereby enhancing the effectiveness of monetary operations.

Required Reserves

13. The RR remain the cornerstone of the BCSTP's monetary policy and liquidity management framework. Established in 1992, the RR has consistently been the primary tool employed by the BCSTP to regulate liquidity within the financial system. Commercial banks are required to maintain unremunerated reserves, specifically set at 28 percent for their local currency liabilities—an increase from 18 percent prior to mid-2022—and 21 percent for their foreign currency liabilities, which comprise 90 percent in local currency and 10 percent in foreign currency. Notably, these rates are considered high by international standards. The calculation of the RR is based on the monthly average of deposits recorded in the second month prior to the month of compliance, allowing for a maintenance period of one month.

Standing Facilities

14. The BCSTP's monetary policy and liquidity management framework encompasses both deposit and lending facilities. The deposit facility enables commercial banks to deposit their excess reserves, while the lending facility provides marginal liquidity, with both loan and deposit operations limited to a maturity of five days. Recently, neither of these instruments has been utilized in the implementation of monetary policy, and they are not linked to the BCSTP's key policy rate, which is set at 10 percent. The interest rate for the lending facility is 10.5 percent, whereas the deposit facility offers a rate of 0 percent. Due to the unremunerated nature of the deposit facility, banks typically do not utilize it. Additionally, given the significant levels of excess liquidity in the banking system, banks generally find little need to access the lending facility.

15. The BCSTP's strict collateral requirements ensure loan security but may unintentionally restrict borrowing capacity for some institution. Acceptable forms of collateral include BCSTP's securities, CDs, T-bills, and deposits in foreign currencies. The BCSTP's CDs and securities are valued at face value and must be free from encumbrances. For foreign exchange assets, collateral valuation is based on the exchange rate established by the BCSTP, with these securities valued at market value and also free from charges. The total collateral must be at least 125 percent of the requested loan amount. Furthermore, eligible instruments will only be accepted as collateral if their value exceeds the bank's reserve requirement at the BCSTP. While this policy is intended to encourage prudent lending practices, it may limit borrowing capacity for some institutions, potentially affecting their ability to secure loans when needed.

New Monetary Policy Framework

16. To support effective monetary policy, the BCSTP has recently introduced a new monetary policy framework. This framework sets a target for core inflation, calculated as the six-month moving average, at 3.1 percent (the average during the period before the pandemic). The BCSTP aims to keep banks' excess reserves in local currency below a specified threshold by issuing CDs at variable rates until the six-month moving average of core inflation falls below the target (see Box 1 for economic rationale for this framework). The BCSTP currently sets this threshold at STN 275 million (previously STN 200 million). The BCSTP is also committed to introducing 12-month CDs to complement the existing 1-month, 3-month, and 6-month options, thereby helping to absorb structural excess liquidity. Moreover, when excess reserves fall below STN 275 million, the MPC may contemplate offering limited amounts of CDs every month to extract interest rate signals from the market.

Monetary Policy Committee

17. The Monetary Policy Committee (MPC), established in 2013, sets key interest rates and provides guidance on financial stability. The committee is composed of the following members: (i) the Governor of the BCSTP, (ii) the Deputy Governor, (iii) Administrators and Directors responsible for liquidity management, markets, economic studies, statistics, and supervision, and (iv) three senior advisors from the BCSTP with expertise in finance and economics. The MPC is tasked with setting the policy reference rate and the lending facility rate. Moreover, the MPC provides recommendations to local entities on matters related to financial stability, fiscal policy, and government debt management. The MPC convenes quarterly and issues a press release outlining its key decisions.

Box 1. São Tomé and Príncipe: Economic Rationale for the BCSTP's Monetary Policy Framework

The BCSTP focuses on core inflation to implement its price stability commitment. The BCSTP targets core inflation in its monetary framework because core inflation excludes large and volatile components like food and energy prices, providing a clearer view of underlying inflation trends. By concentrating on core inflation, the BCSTP can communicate its commitment to price stability more effectively, ensuring that its policies are informed by persistent economic factors rather than short-term fluctuations.

Interest rates derived from the market through the issuance of the BCSTP's CDs are essential for shaping monetary policy. Central banks typically tighten monetary policy by raising policy rates, a strategy designed to control inflation and stabilize the economy. However, in São Tomé and Príncipe, the policy rate set by the BCSTP has proven ineffective in influencing market behavior or guiding lending and borrowing rates. This ineffectiveness undermines the BCSTP's ability to implement a coherent monetary policy and achieve its economic objectives. Therefore, it is essential to establish a dependable benchmark interest rate that can fulfill this role.

By reducing excess reserves through the issuance of CDs, the BCSTP can facilitate an increase in interest rates. The current threshold of STN 275 million is established to support this goal, representing the lowest feasible level that will not disrupt banks' operational activities. By issuing CDs to meet this threshold, the BCSTP aims to accomplish two key objectives: (i) an increase in CD rates and (ii) the establishment of these rates as a reliable guiding policy rate for the BCSTP, thereby improving the transmission of monetary policy in São Tomé and Príncipe. As the banking system strengthens, the necessity for banks to maintain high excess reserves will decrease, allowing the BCSTP to adjust the threshold accordingly.

Interbank Money Market

18. **The interbank money market (IMM) regulation outlines the framework for banks to exchange funds.** Effective since 2015, this regulation allows banks to exchange funds held in their accounts with the BCSTP for a maximum period of one year. These transactions can be conducted bilaterally and may be either collateralized or non-collateralized. Eligible collateral includes foreign currency deposits, T-bills, and BCSTP CDs. Interest rates are negotiable between banks, with payments settled upon maturity. Transactions are required to be conducted in local currency unless collateral is foreclosed, and the BCSTP oversees these operations. While the BCSTP intends to publish statistical information on IMM activities, the market is currently inactive due to insufficient trust among banks. Moreover, the infrastructure for registering and settling the IMM operations remains underdeveloped. As a result, banks are hesitant to engage in interbank trading and therefore maintain higher excess reserve levels.

Liquidity Forecasting

19. **The BCSTP initiated a liquidity forecasting framework some time ago, but progress has faced significant challenges due to resource limitations and difficulties in obtaining accurate data.** The BCSTP began developing a liquidity forecasting framework in 2011, adopting a

straightforward, step-by-step approach centered around a one-day liquidity forecasting model based on anticipated cash flows from autonomous factors. Efforts were made to extend this forecasting exercise to one month. However, progress was impeded by resource scarcity, which led to a de-prioritization of liquidity forecasting efforts. Additionally, the challenge of obtaining accurate information has hindered the development of longer-term liquidity projections. The Treasury Directorate at the Ministry of Economy and Finance (MEF) has sought to improve the predictability of its cash flows, yet significant obstacles persist. Payments for specific government expenditures are contingent on fund availability, which may not align with the BCSTP's data collection timeline. Furthermore, forecasting government resources deposited at the BCSTP is complicated by the unpredictable timing of withdrawals.

D. Liquidity Situation in the Banking Sector

20. The liquidity dynamics in the system have fluctuated significantly from persistent excess reserves before 2017 to notable changes during and after the pandemic. Before 2017, the system faced persistent structural excess liquidity with excess reserves increasing to a peak of STN 783 million by early 2017. Government spending has been the primary driver of this liquidity expansion, while the banking system has struggled to lend to the private sector due to high levels of NPLs, lending risks, and various judicial and administrative obstacles. From 2017 to 2019, excess reserves steadily decreased, reaching a low of STN 494 million by the end of 2019. This reduction was mainly attributed to decreased external support. In contrast, from 2020 to mid-2022, there was a significant increase in excess reserves during the pandemic crisis, largely due to external support aimed at mitigating the adverse effects of COVID-19 (Figure 4).

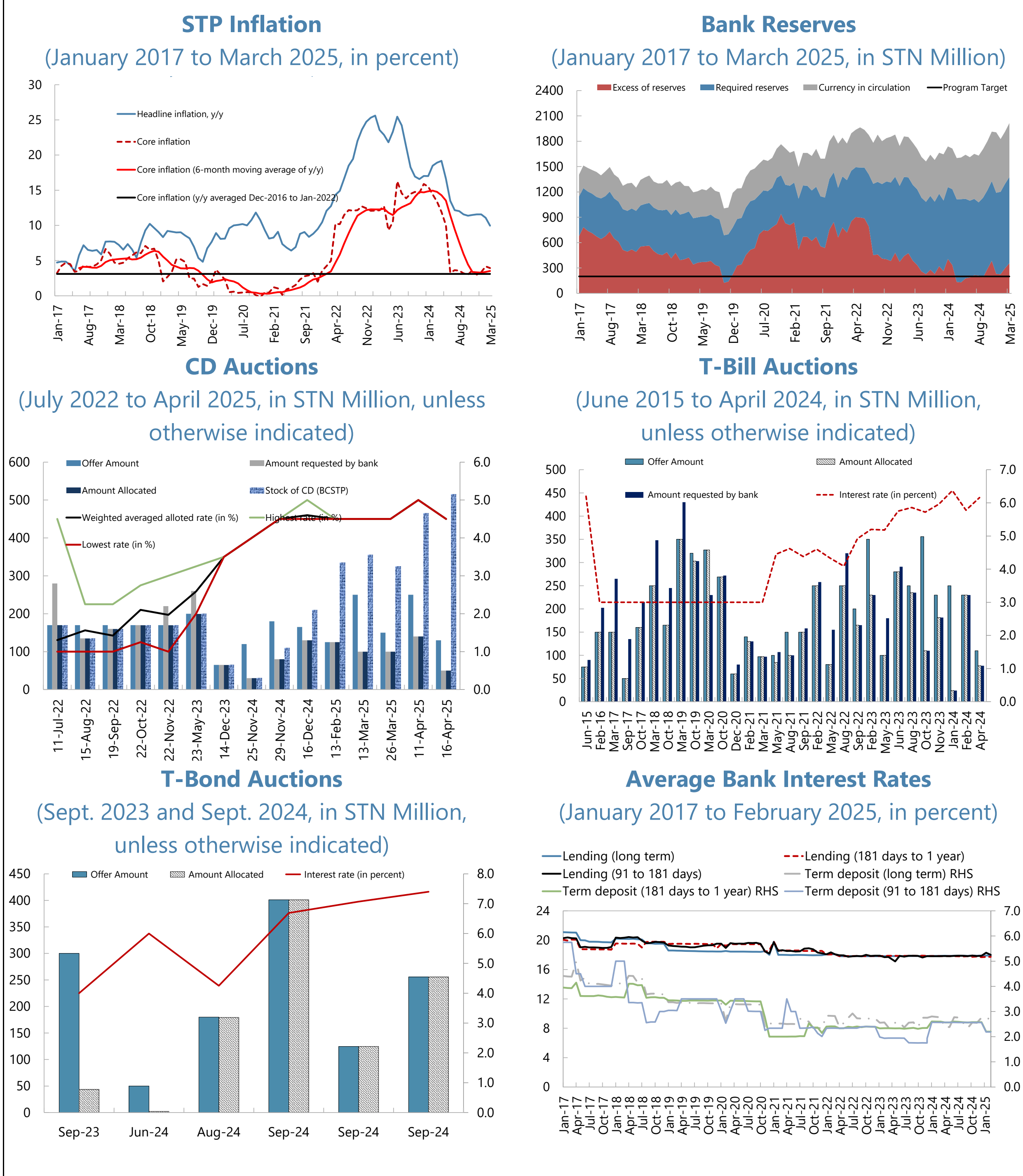
21. Excess liquidity has significantly decreased since mid-2022, driven primarily by a combination of fiscal consolidation measures and monetary policy tightening. The government has focused on improving public financial management and reducing fiscal deficits. Efforts to rein in public spending, along with the introduction of a Value-Added Tax (VAT), have contributed to better fiscal discipline. The BCSTP has also been instrumental in this process by implementing tighter liquidity management policies, including through increasing reserve requirements for commercial banks and enhancing the monitoring of financial institutions to ensure compliance with regulatory standards. The BCSTP has also stopped extending credit to the government. Collectively, these measures have helped stabilize the macroeconomic environment.

22. The implementation of the new monetary policy framework has led to a gradual increase in interest rates and a notable reduction in core inflation. Since mid-2022, the BCSTP has conducted several CD auctions, leading to a gradual increase in the weighted average interest rates, which rose from 1.3 percent in July 2022 to 4.6 percent by December 2024. Concurrently, the BCSTP has continued to rely on T-bill issuances, with T-bill interest rates climbing from approximately 4 percent in mid-2022 to 6.2 percent in April 2024. Additionally, the MEF has initiated the issuance of two-year T-bonds, offering interest rates ranging from 4 to 6 percent. In response, short-term deposit interest rates in the banking system saw only a modest increase, rising from 2.3 percent in mid-2022 to 2.6 percent by December 2024, primarily due to a weak monetary transmission channel. Nevertheless, the measures implemented have helped reduce the six-month moving average of core inflation from approximately 12 percent during the period from mid-2022 to the end of 2023 to 3.3 percent by December 2024 (Figure 4).

23. Excess reserves experienced an increase in the last quarter of 2024 and early 2025, driven by foreign exchange inflows and new regulatory measures. Excess reserves increased despite the sizable issuance of CDs, which saw their stock rise to STN 335 million by mid-February 2025—50 percent higher than excess reserves in January 2025. This growth in excess reserves is attributed to an inflow of foreign exchange, stemming from external disbursements from bilateral and multilateral partners. Additionally, the BCSTP's recent regulation requiring banks to sell 25 percent of their foreign exchange revenues to the BCSTP further contributed to this increase.

24. The uneven distribution of excess liquidity in the banking sector hampers effective liquidity absorption and highlights significant challenges in interbank trading. Excess liquidity within the banking sector is unevenly distributed, with one commercial bank holding around two-thirds of the total liquidity surplus. Consequently, not all of this excess liquidity may be readily available for absorption. Banks need to retain a portion of excess liquidity for transactional and precautionary needs, particularly given the lack of a functioning standing credit facility, a robust interbank market, acceptable collateral, and trust among banks.

Figure 4. São Tomé and Príncipe: Monetary Developments



E. Recommendations

25. The BCSTP's clear objectives and effective monetary policy framework are crucial for maintaining price stability. While fiscal policy plays a key role in controlling inflation in São Tomé and Príncipe, the BCSTP's actions are equally important. The establishment of clear objectives by the BCSTP that align with its overarching goals, particularly in maintaining price stability, is a significant achievement. A well-defined target for core inflation, coupled with the effective implementation of monetary policy and liquidity management tools, serves as a critical benchmark for measuring the BCSTP's success. The interest rates set through the issuance of the BCSTP's CDs can shape monetary policy and act as a reliable benchmark for the institution, influencing overall interest rates within the banking system over time. However, several key issues need to be addressed, including unabsorbed surplus liquidity, low intermediation, and a lack of trust among market participants.

Open Market Operations

26. The BCSTP's implementation of diverse CD options and T-bills is vital for effectively addressing liquidity challenges and enhancing its understanding of market interest rates. It is essential for the BCSTP to introduce 12-month CD options and utilize T-bills for monetary policy purposes. This strategy will help absorb structural excess liquidity in the economy and achieve the target for excess reserves, currently set at STN 275 million. As the banking system becomes more robust, the need for banks to maintain high excess reserves will diminish, allowing the BCSTP to adjust the threshold accordingly. Once excess reserves dip below the established target or core inflation falls below the 3.1 percent target, offering a limited quantity of CDs would enable the BCSTP to effectively assess interest rate signals in the market. To facilitate this evaluation, the BCSTP could either continue conducting CD auctions with one-month maturities or initiate auctions with shorter maturities of 7 or 14 days. By implementing these measures, the BCSTP would gain valuable insights into market demand for these instruments and better gauge prevailing interest rate trends.

27. The BCSTP could enhance the effectiveness of OMOs by promoting transparency, diversifying counterparties, and leveraging technology to foster a more competitive and inclusive market environment. To improve OMOs in an environment of significant market concentration, the BCSTP could enhance transparency by clearly communicating its objectives, strategies, and participation criteria, which fosters a more competitive market environment. Issuing longer-term instruments can provide additional flexibility in managing market conditions. Additionally, diversifying the pool of eligible counterparties to include smaller institutions and non-bank entities can reduce reliance on dominant players. Regular market assessments, improved communication channels with participants, and incentives for smaller institutions to engage in OMOs can encourage broader participation. Furthermore, leveraging technology through electronic trading platforms can enhance efficiency, while establishing a framework for monitoring and reporting the outcomes of OMOs can build trust and further promote inclusivity in the financial market.

Required Reserves

28. The BCSTP could enhance the RR system by calculating the RR base using the average of the last month's data. This adjustment would provide a more accurate reflection of current banking conditions and liquidity needs. The existing practice of relying on banks' liabilities with a two-month lag fails to capture the most recent balance sheet positions of banking institutions. By adopting a more timely approach, the BCSTP can ensure that the RR are aligned with the current economic environment, thereby promoting better stability and responsiveness in the banking sector.

29. The treatment of RR plays an important role in shaping the dynamics between commercial banks' deposit and lending rates, impacting overall liquidity management and the effectiveness of monetary policy. Unremunerated RR affect the spread between deposit and lending rates, as banks need to establish this spread to cover costs and generate profits. When banks are mandated to hold a portion of their assets as non-interest-bearing balances at the central bank, it leads to considerably higher average interest rates on loans compared to deposits. To alleviate this distortion, RR should ideally be remunerated at or near the targeted policy rate. Consequently, the BCSTP's decision on whether to remunerate RR and at what level will depend on their intended purpose. If the objective is to drain liquidity cheaply, RRs should not be (fully) remunerated. In contrast, if the aim is to correct the above-mentioned distortions in the banking system and narrow the spread between lending and deposit rates, remuneration becomes more advantageous. The fact that most central banks do not provide such remuneration indicates a stronger emphasis on the goal of draining liquidity cheaply.

Standing Facilities

30. To enhance the effectiveness of the standing lending facility, the BCSTP could implement key improvements to access and operational parameters. This includes making the facility permanently available instead of limiting it to five days. Additionally, restrictions on access could be lifted, allowing eligible institutions unlimited borrowing as long as they provide acceptable collateral. The lending facility rate could be set above the BCSTP CD rate to serve as a penalty, discouraging unnecessary borrowing and establishing a ceiling for interbank interest rates. It is essential to distinguish between the standing lending facility, which should remain a monetary policy tool for qualifying banks, and the lender of last resort function, which provides loans to solvent institutions that have exhausted other funding options. This differentiation should be reflected in the parameters governing each facility, including maturity, collateral policy, and pricing, to promote effective balance sheet restructuring among banks.

31. The BCSTP could take steps to operationalize the standing deposit facility by ensuring that interest rates are linked to the BCSTP CD rate. By creating a connection between the deposit facility rate and the BCSTP CD rate, the BCSTP could develop a more cohesive framework that influences overall market dynamics. As a result, banks would be motivated to adjust their interest rates in response to changes in the CD and deposit facility rates, contributing to a more stable financial environment. The deposit facility rate could be linked to the BCSTP CD rate in a manner that ensures the former remains below the latter, thereby maintaining a relationship between the two rates while encouraging lending in the interbank market, prompting banks to lend excess reserves rather than depositing them with the BCSTP. This would help ensure that the BCSTP CD rate influences other interest rates and creates a corridor for short-term market rates, facilitating a smoother monetary policy transmission.

Emergency Liquidity Assistance

32. **The BCSTP could enhance the emergency liquidity assistance (ELA) framework to facilitate institutions' access to liquidity during temporary shortages.** Although a framework is currently in place, it lacks a clear distinction between various types of liquidity needs, including short-term liquidity requirements, temporary needs, and those associated with the resolution framework. This ambiguity can lead to confusion among banking institutions regarding the appropriate avenues for liquidity support. To address these issues, the BCSTP could establish well-defined categories for liquidity needs, ensuring that institutions can easily identify and access the necessary support for their specific circumstances. Furthermore, standardizing the rates applied to each facility within the ELA framework would enhance transparency and predictability, allowing institutions to make informed decisions regarding liquidity management. By refining the ELA framework in these ways, the BCSTP can bolster financial stability and support institutions more effectively during times of liquidity stress.

Interbank Money Market

33. **The BCSTP could enhance the IMM by strengthening the legal framework, investing in technology, and promoting the tradability of CDs.** To enhance transactions in the IMM, it is critical to strengthen the legal and regulatory framework, ensuring enforceable contracts and developing reliable systems for sharing information about market conditions to foster trust. Additionally, investing in technology and infrastructure, such as electronic trading platforms, is vital for supporting trading and settlement processes. Making CDs tradable within the interbank market is essential for facilitating smoother transactions among banks and with the BCSTP. This initiative requires establishing a robust collateral framework to instill confidence among market participants, ensuring that banks feel secure in their dealings. By implementing these measures, the BCSTP can create a more dynamic IMM, promote interbank trading, and reduce the need for banks to maintain high levels of excess reserves.

Liquidity Forecasting

34. **It is essential for the BCSTP to initiate liquidity forecasting.** Although there have been advancements in understanding liquidity concepts, challenges in data collection continue, underscoring the need to improve data quality through collaboration with data providers. Developing robust data collection systems that provide accurate and timely information on government transactions, foreign exchange operations, and banking sector activities is critical. Moreover, enhancing coordination between the MEF and the BCSTP is vital, particularly for sharing forecasts of government expenditures and revenues.

35. **Additionally, the BCSTP should have a clear understanding of liquidity situation during the month it needs to decide on liquidity absorption**. There may be instances where current month excess reserves fall below the targeted threshold, even when previous month data—used for assessment—indicates higher levels. In such cases, further reducing excess reserves could be counterproductive. To gain insight into current liquidity levels, the BCSTP could employ simple estimation methods using the available high-frequency data.

36. **The BCSTP could initially focus on liquidity forecasting for one month, with plans to extend this to one year once validated, thereby enhancing liquidity management**. Establishing daily routines for monitoring bank reserves and implementing medium to long-term liquidity assessments is vital. Investments in IT systems and human resources are necessary to automate forecasting processes and improve data analysis capabilities. Regular reviews of forecasting models will enable the BCSTP to respond effectively to changing economic conditions. Additionally, expanding liquidity projections to encompass the maturities of issued CDs, T-bills, and Treasury Bonds (T-bonds) will offer a more comprehensive understanding of liquidity conditions, enhancing the planning process for auctions.

BCSTP Recapitalization

37. **Recapitalizing the BCSTP is a critical step toward enhancing its financial stability and credibility, allowing it to manage liquidity and implement monetary policy more effectively.** Recapitalization would strengthen the BCSTP's balance sheet, ensuring it has the necessary financial resources to effectively conduct monetary policy. This process would involve the government injecting capital into the BCSTP, either through direct transfers or by issuing government bonds. Additionally, the BCSTP could retain a higher portion of its profits to build up its capital reserves over time. By recapitalizing the BCSTP, the authorities can enhance its credibility and ability to absorb liquidity, ultimately supporting economic stability and growth.

Communication

38. **The BCSTP could further enhance its communication strategy with stakeholders, including financial institutions, the government, and the public**. Transparency in policy decisions and the rationale behind them fosters trust and confidence in the central bank's actions. This can be achieved through regular reports, press releases, and public forums that outline the central bank's economic outlook and policy intentions. Additionally, it is crucial to hold regular meetings with commercial banks to explain the rationale behind specific monetary policy decisions and to keep them informed about monetary policy and liquidity management issues. Effective communication will empower the BCSTP to shape market expectations and behaviors, thereby enhancing the overall effectiveness of its monetary policy framework and help build trust among market participants.

Capacity Development

39. **Continuing to enhance the BCSTP’s analytical capacity should be an ongoing process.** Developing the analytical tools and skills necessary for effective implementation of

monetary policy, liquidity management, and other critical areas needs to be a continuous endeavor. This commitment to strengthening analytical capacity is vital for the BCSTP to adapt to changing economic conditions and respond effectively to emerging challenges. The IMF stands ready to support this journey by providing ongoing technical assistance and training to the authorities of São Tomé and Príncipe, ensuring they have the resources and knowledge needed to effectively navigate their specific challenges.

F. Conclusion

40. Strengthening the monetary policy and liquidity management operations in São Tomé e Príncipe is essential for tackling the significant macroeconomic challenges the country faces. The current economic landscape, marked by inflationary pressures, necessitates that the BCSTP implement strategic measures to enhance liquidity management and create a stable financial environment. By setting clear objectives and implementing a coherent monetary policy and liquidity management framework, the BCSTP can effectively help reduce inflation.

41. The recommendations presented in this paper can lead to more effective implementation of monetary policy and strengthen the monetary transmission mechanism. These include introducing diverse CD options, enhancing the RR system, and improving standing facilities, among others. Establishing a robust liquidity forecasting framework and refining communication strategies with stakeholders will also be essential for fostering transparency and trust, both of which are critical for executing effective monetary policy. Moreover, recapitalizing the BCSTP is essential for enhancing its financial stability and credibility, thereby improving liquidity management and monetary policy effectiveness. The IMF is prepared to continue providing technical assistance to the authorities of São Tomé and Príncipe to help address their specific challenges.

42. Ultimately, successfully implementing these strategies will not only aid in reducing inflation but also promote economic growth and development in São Tomé e Príncipe. The continued commitment of the BCSTP, along with collaboration from various stakeholders, is vital in navigating the complexities of the current economic environment and achieving long-term stability. By prioritizing these initiatives and addressing existing challenges, São Tomé e Príncipe can pave the way for a more sustainable and prosperous economic future.

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