Democratic Republic of São Tomé and Príncipe: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

July 14, 2006

The following item is a Letter of Intent of the government of the Democratic Republic of São Tomé and Príncipe, which describes the policies that the Democratic Republic of São Tomé and Príncipe intends to implement in the context of its request for financial support from the IMF. The document, which is the property of the Democratic Republic of São Tomé and Príncipe, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.
São Tomé, July 14, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

1. On behalf of the government of São Tomé and Príncipe, we hereby transmit an attached memorandum of economic and financial policies (MEFP) that sets out the objectives and policies that the government intends to pursue for the remainder of 2006, consistent with the government’s Poverty Reduction Strategy (Estratégia Nacional para Redução da Pobreza; PRSP) and its underlying medium-term economic framework. We understand that São Tomé and Príncipe could reach HIPC Completion point if it successfully completes the second review under the Poverty Reduction and Growth Facility (PRGF) arrangement and meets all completion point triggers laid out in the HIPC decision point document.

2. The government of São Tomé and Príncipe has made substantial progress in advancing the fiscal consolidation process that started in 2005, while prioritizing social spending, as well as in developing indirect monetary instruments to support an active anti-inflationary monetary policy stance. Looking forward, the policies set out in the attached MEFP, aim at correcting the fiscal slippages that appeared in the first quarter of 2006 and solidifying the fiscal consolidation process in the period ahead. The performance criteria and benchmarks and quarterly indicative targets through end-2006, are set out in Tables I.1 and I.2 of the MEFP. In addition, our government requests that the third review under the PRGF arrangement be completed no later than end-December 2006.

3. In support of our objectives and policies, the government of São Tomé and Príncipe hereby requests the completion of the second review and the disbursement of the second loan under the PRGF in an amount equivalent to SDR 0.423 million (5.7 percent of quota).

4. The government of São Tomé and Príncipe will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

5. The government of São Tomé and Príncipe believes that the policies and measures set forth in the MEFP are adequate to achieve the objectives of the 2006 program supported by the PRGF arrangement, but will take further measures to that end if deemed necessary. During the implementation of the arrangement, the government of São Tomé and Príncipe will consult with the Managing Director on the adoption of any measures that may be appropriate, at the initiative of the government or whenever the Managing Director requests such a consultation.
6. The government intends to make the contents of this letter and those of the attached MEFP and technical memorandum of understanding (TMU), as well as the staff report on the second review under the PRGF arrangement, available to the public and authorizes the IMF to arrange for them to be posted on the IMF website, subsequent to Board completion of the second review.

7. We can assure you, Mr. Managing Director, that the government of São Tomé and Príncipe is determined to fully implement the program supported by the PRGF arrangement and meet all completion point triggers laid out in the HIPC decision point document.

Yours truly,

/s/

Mrs. Maria dos Santos Tebúz Torres
Deputy Prime Minister and Minister of Planning and Finance

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding
I. INTRODUCTION

1. This Memorandum of Economic and Financial Policies (MEFP) supplements that of February 2006, as well as the letter of intent dated February 9, 2006. It describes: (i) performance under the PRGF arrangement through December 2005, (ii) economic and political developments in the first half of 2006, and (iii) the government’s economic program for the remainder of this year. The thrust of the policies embodied in this memorandum is consistent with the medium-term strategy underpinning the three-year PRGF arrangement that was approved by the IMF Executive Board on August 1, 2005. The satisfactory performance under the PRGF-supported program in 2005, combined with the plans and policies set forth in this memorandum for the remainder of 2006, should help São Tomé and Príncipe attain the medium-term objectives set out in our PRSP and reach the completion point for the Heavily Indebted Poor Countries (HIPC) initiative. Our government is committed to sustaining the pace of economic growth, reversing the rising inflation that started in late 2005, and making further inroads on poverty.

II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

Performance During 2005

2. In 2005, real GDP registered 3.8 percent growth, significantly higher than had been projected. The pace reflected brisk economic activity in the construction and services sectors. According to the National Institute of Statistics, residential and commercial building on the island of São Tomé increased notably over previous years. Several large-scale tourism projects were initiated. Also, a significant expansion in banking and insurance activities is underway, prompted by prospects of an expanding domestic oil economy.

3. The inflation rate of 17.2 percent at the end of 2005 exceeded the target of 15.2 percent as international oil prices rose and conditions in the foreign exchange market changed. Our government’s assessment is that at least two percentage points of the inflation estimate in 2005 reflected both the first-round effects from passing rising international oil prices through to domestic consumers and the impact of large hikes in electricity tariff rates that were implemented in October 2005 to cover the increasing costs of producing thermal electricity. Prices for imported foods and other staples, which have a significant weight in the consumer price index (CPI), also rose substantially after the depreciation of the dobra in the last quarter of 2005. The depreciation of the dobra occurred in the context of technical changes to the central bank’s foreign exchange auction made to better reflect supply and demand for dollars.
4. **During 2005, all fiscal quantitative performance criteria under the PRGF arrangement were met.** The domestic primary deficit as a measure of fiscal stance declined from 20.6 percent of GDP in 2004 to 16.3 percent in 2005. Consistent with our anti-inflationary policy objective, the deficit was tighter than planned because budgetary execution was very cautious. Tax revenue was in line with the program, although overall government receipts fell short of projections due to delays in the receipt of fees from fishing licenses granted to the European Union pending completion of a new fisheries agreement for 2007-09. Primary spending was lower than projected because capital spending financed by the Treasury was contained, and cuts in current transfers more than offset overruns in goods and services. The latter largely reflected hikes in the government’s bill for transportation, water, and electricity, which rose in tandem with the pass-through of international oil prices and the increase in electricity rates in 2005. Nevertheless, other goods and services items, such as outlays for communications and missions abroad, showed significant consolidation.

5. **All monetary performance criteria for 2005 were met.** The central bank’s net international reserves at year end exceeded the program’s target by US$6 million, even after excluding the National Oil Account (NOA), which was not originally considered in determining the NIR performance criteria. Net credit to the government from the banking system was below the program’s ceiling due to a tighter than envisioned fiscal stance. The central bank’s net domestic assets (NDA) also stood within program’s limits by year end 2005, although, net of the NOA, the NDA would have marginally exceeded the target due to higher than envisioned expansion in “other items net”.

6. **Structural reforms remained on track in 2005, though there have been some delays:**

   - The terms of reference for a study on land tenure have been prepared (structural benchmark for December 2005) by a working group of experts from the Ministries of Infrastructure and Public Works. The study will seek to identify measures to:
     (i) assess the economic effects of a lack of complete property rights for landholders,
     (ii) strengthen institutional land management capacity, and
     (iii) establish best practices in crop rotation, including introduction of new crops, efficient marketing practices, and training for specific rural communities. The government has requested financing and technical advice from the World Bank’s Global Environment Fund to firm up the scope of the project and launch the necessary studies if possible during the second half of 2006.

   - Feasibility studies for the restructuring of the airport (ENASA) and the seaport (ENAPORT) authority (a structural benchmark for December 2005) are not yet completed, despite government efforts. Replies to a public call for applicants to conduct the studies were unsuccessful. Our government is now evaluating a list of consultants provided by the World Bank, who are currently expected to begin working on this subject matter in late-July 2006. We expect the studies to be completed no later than end-September 2006 (structural benchmark).

   - The submission to the National Assembly of proposed legislation criminalizing money laundering and financing of terrorism (a structural benchmark for
September 2005) has been delayed, although we expect progress in this area over the coming months. A working group of experts from the Ministry of Justice and the BCSTP has drafted an antimony-laundering law; the central bank recently sent this draft to the Fund’s Legal (LEG) and Monetary Financial Systems (MFD) departments to initiate an exchange of ideas on its technical and administrative implementation. The central bank is thus taking a proactive policy stance in this important policy area. As noted in the context of the first review under the program, the law will be submitted to the National Assembly by end-December 2006, after it has been discussed by the Council of Ministers.

**Performance in the First Half of 2006**

7. **Political developments during 2006 have tested the fundamentals of our country’s democracy and brought to the fore the urgent need to address poverty.** Three elections—legislative, regional and local government, and presidential elections—are conducted in the first seven months of the fiscal year. The legislative elections that took place on March 26, 2006, were aligned with international norms and commended by international observers. The Presidential elections scheduled for July 30, and the regional and autarchic elections scheduled for August 27 will further cement the democratic credentials of our country.

8. **It appears from preliminary information that economic growth continues to be robust in 2006 and may accelerate substantially because of the bold initiation of large private construction projects on the islands of both São Tomé and Príncipe and the sustained growth in services connected with the development of the oil sector.** With regard to the latter, exploratory drillings in Block 1 of the Joint Development Zone (JDZ), conducted by Chevron-Texaco, were completed in March 2006. While there are indications of substantial oil, its commercial viability will not be known until the operator has completed further analysis and made public its evaluation. Drillings in blocks 2, 3, and 4 may start next year; the Joint Development Agency (JDA) and the winning oil consortiums signed production-sharing contracts (PSCs) in March 2006, and oil signature bonuses have been paid.

9. **In spite of robust growth, price stabilization faced serious challenges in the first half of 2006.** The 12-month inflation rate climbed from 17 percent at year end 2005 to 23.8 percent by April 2006. Our view is that the acceleration of inflation in 2006 reflects: (i) the pass-through of the large depreciation of the dobra in the last quarter of 2005, (ii) shortages of food staples, both imported and locally produced, and (iii) a higher-than-programmed expansion in central bank credit to the government that boosted base money growth. Our assessment is that at least 4 percentage points of the inflation rate at the end of April reflect supply breakdowns that led to sharp transitory price increases for items such as sugar, flour, oil, beans, powdered milk, and meats, which are heavily weighted in the CPI. This analysis is corroborated by a 32 percent decline in US dollar imports of foods and staples in the first quarter of 2006 compared with the same quarter last year.

10. **The domestic primary deficit in the first four months of the year was larger than envisioned under the program due to lagging tax receipts and some expenditure**
Despite significant increases in oil taxes and excise duties on services, total government revenue lagged behind targets because tax arrears grew. The main unpaid liabilities were for profit taxes and for consumption taxes on fuel products payable by the oil-importing company (ENCO), which was awaiting an increase in domestic fuel prices to address its weak financial position. Through mid-June, a large part of these arrears had already been paid. Expenditure overruns occurred in a number of areas:

- The wage bill of the Ministry of Defense was higher than expected due to a one-off payment of wage bonuses totaling dobras 5.1 billion that has been pending since 2003.

- The government’s electricity bill rose sharply because budgetary units paid a cumulative 54 percent increase in electricity costs to the water and electricity company (EMAE) between late October 2005 and January 2006. The further 40 percent increase in rates activated at the end of March will amplify this spending category for the rest of the year. The increase in electricity costs to the public sector, which was accompanied by a simultaneous increase in charges to the private sector, has been a fundamental policy change. The increase has led to (i) a better financial position for EMAE because utility prices now cover costs of production and operating margins, (ii) better resource allocation for the economy as a whole, and (iii) the prospect of profit transfers from EMAE to the budget in 2007 as higher receipts exceed operating costs.

- The cost of holding legislative elections in March was higher than expected, as donor support for this spending category was lower than expected. The US$1 million appropriation in the 2006 budget for all three elections has been largely exhausted. The program had assumed a more even distribution of these outlays throughout the year.

- The government made a short-term net loan to rice importers in the amount of dobras 4.6 billion to partially address supply breakdowns of this imported food staple. The loan is currently being repaid. Full repayment is expected by the end of September 2006 at the latest.

From January through April 2006, the higher fiscal deficit was financed by net credit from the central bank and foreign borrowing, partly due to a significant delay in the annual transfer of resources from the National Oil Account to the budget. Central bank credit to the government increased by 21 percent between December 2005 and April 2006 against a programmed 4 percent decline. At the same time, a loan from Angola amounting to US$4 million (5.7 percent of GDP) helped finance a social inclusion project that had been incorporated into the 2006 budget to compensate workers laid off when public agricultural enterprises were privatized in the 1990s. A number of international and local NGOs coached workers in identifying investment projects for which disbursements could be used effectively. The government borrowed because of strong social pressures to move the project forward and the fact that it faced a treasury cash flow problem because the transfer of National Oil Account resources had been delayed. Lower-than-expected foreign aid in the first four months of 2006 further heightened pressures on the government cash flow position.
Domestic arrears of dobras 28.9 billion, accumulated mostly in March and April, were cancelled soon after the transfer from the National Oil Account reached the budget in late May.

12. Monetary and credit aggregates continued to grow rapidly in the first four months of 2006, although the structural changes in the domestic banking system may have altered their information content. The 12-month growth rate of base money was 91 percent at the end of April 2006. Concurrently, broad money grew by 91 percent and banking sector credit to the economy grew by 41 percent through March. Commercial bank reserves with the central bank have been artificially high so far in 2006 because of guarantee deposits held with the monetary authority pending its granting of bank operating licenses. Also, the increase in banks’ reserves with the central bank mirrored large foreign currency-denominated bank deposits of non-residents that were not moved into the domestic economy but rather held offshore by local banks. The growth of credit aggregates has also been affected by cross-border lending, which has posed new challenges to monetary policy and banking regulation.

13. Our government’s view is that the acceleration of inflation and the rapid growth of monetary and credit aggregates—even after correcting for structural breaks in the financial sector—warrants an active monetary policy to mop up any excess liquidity. We have therefore implemented a number of policies:

- The central bank’s reference interest rate was increased from 18.2 percent to 24 percent on May 19, 2006. This is consistent with the government’s commitment under the Fund program to keep this interest rate above the inflation rate.
- On May 19, 2006, reserve requirements for banks were increased from 24 to 24.5 percent. This increase should help to slow down the growth of credit to the economy, especially for banks with limited reserve holdings at the central bank.
- As MFD recommended, a single-price (Dutch) foreign exchange auction has been implemented. Auctions are currently being held every week to address the economy’s demand for dollars, absorb liquidity, and support the price-discovering process.
- The central bank is taking further steps toward issuing certificates of deposit (CDs). The introduction of CDs, combined with active sales of foreign exchange, will allow the central bank to simultaneously (i) sterilize the liquidity impact of the fiscal deficit and other sources of base money expansion and (ii) provide foreign exchange to the economy while keeping international reserves at an adequate level.

14. São Tomé and Príncipe is current in servicing its external obligations with multilateral and Paris Club creditors. Relations with Paris Club creditors have been normalized since the September 2005 rescheduling agreement on Cologne terms. At the same time, the debt unit at the Ministry of Planning and Finance is currently collecting information from most bilateral creditors to reconcile debt records ahead of an update of the HIPC debt sustainability analysis (DSA), with the aim that São Tomé and Principe will reach the HIPC completion point over the coming months. Also, as part our efforts to improve debt
management, the government is now installing, with financial support from the World Bank, the Commonwealth Secretariat debt recording system (CS-DRMS).

15. **Among the structural reforms advanced in the first half of 2006:**

- A draft amendment of the laws defining internal control and administrative regulations governing the Inspectorate General of Finance (IGF) was approved and submitted by the previous government to the Office of the President of the Republic for promulgation in February 2006. Taking into account recommendations received from the President’s Office, our government intends to resubmit these draft laws no later than the end of July 2006 for proclamation by the President of the Republic (a structural benchmark for March 2006).

- A database to record and monitor follow-up actions on infractions and irregularities identified by the IGF in each inspected sector within its jurisprudence has been successfully established (a structural benchmark for June 2006). The databank has information dating back to 2003 on some 25 operating sectors by budgetary unit.

- EMAE’s installation of prepaid electricity metering systems in designated urban locations (a structural benchmark for April 2006) is expected to be completed in September 2006. Though the metering systems are already being installed, they cannot be activated until the Contadora hydroelectric power plant comes on stream to provide the necessary electricity tension for operating them.

- The submission to the National Assembly of proposals to revise the Customs Law, the customs’ organic law (*Estatuto das Alfandigas*) and the General Code on Customs Infractions (*Regime Geral das Infracóes Aduaneiras*), with a view to update accounting practices and customs procedures, and modernize the customs system (a structural benchmark for end-June 2006) is expected for the third quarter of 2006.

**III. ECONOMIC POLICIES FOR THE REST OF 2006**

16. Our government is committed to continuing macroeconomic stabilization and structural reform as the main channels for sustaining economic growth and making further progress in reducing poverty. To this end, we plan to:

- Continue with the fiscal consolidation that started in 2005, while protecting priority expenditures consistent with the government’s Poverty Reduction and Strategy Paper (PRSP).

- Pursue an active monetary policy to achieve the targeted reduction of inflation.

- Establish a mechanism to guarantee the pass-through of international oil prices to domestic consumers.

- Improve governance and transparency practices in the management of oil resources.
• Advance preparations for reaching the HIPC completion point in 2006, including the implementation completion point triggers.

A. Fiscal Policy

17. The fiscal stance during the second half of 2006 will support disinflation by mobilizing revenue and strictly controlling expenditures, while protecting pro-poor outlays. The 2006 program targets a domestic primary deficit of 15.5 percent of GDP. Government revenues (excluding grants and oil signature bonuses) are projected to increase from 27.7 percent of GDP in 2005 to 32.2 percent in 2006. A very strict expenditure policy in the second half of the year should provide savings to accommodate much higher domestic primary spending (2.3 percent of GDP) for spending on electricity and gasoline and financing the 2006 elections. The wage bill as a share of GDP is projected to remain constant.

18. A number of policy measures will support the program’s fiscal targets in the second half of 2006. On the revenue side, the measures will (i) consolidate tax measures introduced in 2005, (ii) marginally increase excise duties, in the absence of a general sales tax, (iii) pass through to domestic consumers rises in international oil prices, and (iv) expedite the settlement of corporate and individual tax arrears. On the expenditure side, the objective will be to secure an austere spending path for nonpriority spending.

Revenue Measures

19. Among the revenue measures already taken or contemplated for the second half of 2006:

• The reference prices used to assess excise duties on a core group of nonfood imports have been set in euros to protect collections against the impact of the depreciation of the dobra; the exchange rate used to convert these reference prices into dobras will be updated weekly. Collections from this measure are expected to yield an estimated dobras 3.3 billion during the second half of this year, equivalent to 0.4 percent of GDP.

• The excise tax on the provision of services, excluding water and electricity, will be increased from 5 percent to 7 percent in July 2006. This measure is expected to yield an estimated 5 billion dobras for the rest of the year, equivalent to 0.5 percent of GDP.

• In keeping with the government’s policy to keep retail fuel prices in line with world market prices, on June 2, 2006, the retail price of gasoline was increased by 28 percent and of gas oil by 27.3 percent. The price of kerosene was also increased by 8 percent. These measures complement a 40 percent increase in wholesale prices of gas oil sold by ENCO to EMAE, which were implemented in mid-April 2006. The new fuel prices should restore ENCO’s financial sustainability and prevent oil tax arrears in the future.

• We have taken action to expedite the settlement of tax arrears on corporate and individual income taxes while tackling tax evasion. In particular, the Tax Directorate is implementing a resolution (despacho) from the Ministry of Planning and Finance to collect arrears dating from 2003. We expect this measure to yield about dobras 0.6 billion
through end-September 2006 and dobras 1.2 billion by the end of the year (equivalent to 0.1 percent of GDP).

- Our government has drafted an action plan to improve collections and address the mounting arrears on excise taxes on domestically produced beer that accumulated in the last quarter of 2005. Successful implementation of this plan should yield additional revenue of dobras 1 billion for the rest of the year, equivalent to 0.1 percent of GDP.

- In the third quarter of 2006, the government will resubmit to the National Assembly a thorough tax reform package, including new codes on personal income and corporate taxation, a new tax procedural code, new guidelines on urban property taxation, and new legislation on inheritance taxes. The previous government submitted this tax reform package for National Assembly consideration in 2005, but practices in São Tomé and Príncipe require that the new government resubmit it. A new investment code will also be resubmitted to the National Assembly in the third quarter of 2006. The new investment code will provide equal treatment for domestic and foreign investors operating in São Tomé and Príncipe and, together with the new corporate income tax code, will rationalize preferential tax regimes. A summary description of the draft codes was included in the MEFP of June 2005 that underpinned the government’s request for a three-year PRGF arrangement.

**Expenditure Measures**

20. **We have undertaken policy commitments and implemented measures to correct the expenditure over-runs registered in the first four months of this year.** The policy objective has been to keep domestic primary expenditure to levels consistent with the policy understandings reached in the first review of the Fund program while allowing for partial accommodation of the higher costs of electricity and gasoline and the 2006 elections. Specific expenditure policies:

- The 2006 wage bill will stay constant as a share of GDP compared with 2005 (13.8 percent of GDP), despite growing social pressures stemming from the increase in prices of domestic fuel and utilities.

- With regard to nonwage expenditure, the Budget Directorate issued an ordinance on May 19, 2006, establishing that, effective immediately, all expenditure by budgetary units—except for appropriations consistent with the 2006 budget for wages, fuel, food, medicine, basic office supplies, and telecommunications—require prior authorization by the budget director. Subsequent ordinances limited the number of public employee missions abroad to the essential and established strict controls on calling cards for mobile phones used by civil servants.

- The net lending to rice importers during the first quarter of 2006 will be repaid by the end of September 2006. No new net lending will take place in the second half of 2006. Pro-poor spending will remain a government’s priority throughout 2006.
• Pro-poor spending increased substantially in 2005, reaching 25.7 percent of GDP, despite an overall drop in capital expenditure with respect to the previous year and to the original program projections. Consistent with the priorities set forth in the PRSP, the health and education sectors explained almost all the pro-poor current spending, the latter which explained 36.5 percent of the total. Pro-poor capital expenditures concentrated in health and infrastructure (roads), with 29 percent each. For 2006, the program envisages a further increase in pro-poor spending, to 28.4 percent of GDP, explained by higher HIPC spending and a rebound in capital expenditures financed by external sources. Health, education and infrastructure, are expected to remain the priority sectors.

B. Monetary and Exchange Rate Policy

21. To reduce 12-month inflation from 23.8 percent at the end of April to 22 percent by the end of 2006, despite rising fuel and electricity prices, the BCSTP will pursue an active monetary policy, including a judicious mix of foreign exchange sales and issuance of central bank certificates of deposit to mop up liquidity while keeping the central bank’s reference interest rate above the inflation rate. Strict compliance with reserve requirement ratios will also support disinflation.

22. Coordination of fiscal and monetary policy has been stepped up through the establishment of a working group to forecast the sources of expansion and contraction of base money on a weekly basis. In this regard, the short-term liquidity management framework devised in consultation with MFD in early-April 2006 has been made operational. The framework has helped the central bank in assessing its current and prospective sterilization needs on a regular basis. Weekly reporting to the Fund in this area has further strengthened the central bank’s analysis in this area.

23. The monetary program will guard against any increases in base money arising from central bank efforts to stabilize the economy. The central bank’s operating surplus in 2005, which was supported by effective reserve management and an increase in profits on the sales of foreign exchange (ganhos cambiais) throughout the year, is likely to decline as the dobra depreciation decelerates in the second half of 2006. The central bank will therefore closely monitor its operating balance with a view to (i) preventing year-end operating losses and (ii) identifying potential sources of financing in case operating losses become unsustainable.

24. The monetary program is consistent with a comfortable central bank international reserve position and a stable velocity of money. The program limits the change in net domestic assets of the central bank at dobras -175.2 billion (at program exchange rates; see Table I.1) by December 31, 2006, while the floor in NIR gains will be set at US$14.2 million. This floor should allow 2006 gross NIR to remain above 4 months of imports of goods and services. A stable velocity of money is consistent with broad money growth projected at 19.6 percent. This, in turn, is consistent with a 21.5 percent in private sector credit growth.

25. The BCSTP remains committed to continuing the managed float exchange rate regime, which has allowed the monetary authorities to address the volatility of external
inflows and cushion exogenous shocks. Central bank sales of foreign currency will be conducted using the single-price exchange rate auction system that has been in place since March 2006. The scope and timing of foreign exchange auctions will be consistent with the NIR targets under the program.

26. **The BCSTP will continue to implement MFD’s technical assistance recommendations on banking supervision, development of interbank money markets, and foreign exchange auctions.** In particular, the BCSTP is strengthening its capacity to supervise licensing of new banks, devise on-site and off-site prudential regulation indicators, and assess foreign exchange positions and operating risks of banks. Our government is of the view that an efficient and sound domestic banking system is essential to sustaining economic growth. While new banks are likely to register limited profitability in their first years of operation, the BCSTP will closely monitor developments to assess whether there is any need for bank recapitalizations. A regular system for reporting prudential regulation indicators to the Fund has now been established.

**C. External Sector Policies and Debt Management**

27. **During the rest of 2006, we will continue to assess major trade policy issues by participating in the Integrated Framework Process and implementing the 2005 Diagnostic Trade Integration Study (DTIS) for São Tomé and Príncipe.** The thrust of the policies will be to facilitate and expand export-oriented production by the poor, improve the business environment, improve infrastructure and public services, and reduce trading costs.

28. **With regard to debt management, the government is mindful of the need to secure concessional external budget financing to avoid exacerbating the already high external indebtedness.** We will also continue to seek financial support from development partners.

29. **Our government is committed to accepting obligations under Article VIII, Sections 2(a), 3, and 4, of the Fund’s Articles of Agreement.** The BCSTP is working closely with the Fund’s Legal (LEG) and MFD departments to review the relevant laws and regulations. In December 2005, a mission from LEG and MFD visited São Tomé to review the exchange system and on March 31, 2006, submitted its final report to the BCSTP for consideration. We have recently submitted to LEG an action plan to lift any remaining exchange restrictions and multiple currency practices to pave the way for São Tomé and Príncipe to accept its Article VIII obligations. We hope to reach understanding with the Fund on a timetable for this in the coming months.

**D. Domestic Fuel Pricing**

30. **The current fuel price-setting mechanism is quite transparent, reflecting ENCO’s average oil import costs, the ad valorem surcharges, and the company’s profit margins.** Increases in fuel prices in recent years have been triggered by a rise in CIF oil import prices, which automatically increases import costs and ENCO’s tax liabilities to the Treasury. The practice has been for the company and the government to jointly decide the timing and the magnitude of price hikes, which sometimes causes temporary cash flow
problems for ENCO. These in turn have created recurrent delays with the payment of
ENCO’s taxes that have complicated the Treasury’s cash flow situation, given the relative
large share of oil-related taxes in total government receipts.

31. **To avoid misalignments between domestic and international oil prices, as of June 2006 ENCO will no longer need to consult with the government to raise domestic fuel prices.** Instead, domestic prices will be automatically adjusted whenever there is a change in international oil prices. During the next review mission, our government plans to discuss with the Fund possible measures to ameliorate the social impact on the poor of further fuel price increases.

### E. Governance and Transparency Issues

32. **Our government is committed to strengthening governance and transparency in our management of prospective oil resources.** Critical areas of reform include:

- Better technical cooperation with the Economic Commission at the National Assembly, which is in charge of petroleum issues; this would expedite submission to the Plenary of draft legislation that would establish the Petroleum Oversight Commission and the Public Registration and Information Office to audit and monitor oil revenue flows and disseminate oil-related information. Establishing the Petroleum Oversight Commission promptly would also be instrumental in following up, in consultation with the Attorney General’s Office, on the allegations of a lack of transparency and technical flaws in the licensing of Blocks 2-6.

- Publication by end-September 2006 of the implementation handbook for the Oil Revenue Management Law (ORML), which has been written in cooperation with the World Bank. The handbook identifies actions in a variety of budgetary units that need to be in place to effectively implement the ORML.

33. **For the last nine months, our government has been addressing the structural weaknesses identified in the safeguards assessment of the BCSTP that the Fund’s Finance Department conducted in March and April 2004:**

- On December 31, 2005, the BCSTP and the Ministry of Planning and Finance signed a protocol to confirm the outstanding stock of government debt to the BCSTP as of July 31, 2005. Discussions are proceeding to set the interest rate the government is to pay on the debt and the amortization schedule.

- The BCSTP has posted on its website ([www.bcstp.st](http://www.bcstp.st)) its complete 2004 audited financial statements, with detailed explanatory notes and the auditor’s letter. Publication of the 2005 audited financial statements is expected later this year.

- Investment guidelines for foreign reserves are being drawn up in consultation with international experts. Also, instruments like the swift system and Reuters and Bloomberg terminals are being installed at the central bank, though there are still concerns about the availability of human and physical capital.
F. HIPC Completion Point Triggers

34. **Reaching the HIPC completion point in 2006 is an overriding policy objective for our government.** We believe we have made significant progress in (i) implementing the social measures required, (ii) setting in place institutional mechanisms to ensure efficient and transparent use of HIPC interim debt relief, and (iii) increasing transparency and accountability in the management of public resources,

- The sectoral strategies for education and health have been formulated and costed.

- In the education sector, by mid-year 2006 the government had built the number of primary and secondary school classrooms set as a HIPC completion trigger. Further, between 1999 and 2004, 134 more primary school teachers and 174 kindergarten teachers were hired.

- In the health sector, since 1999 the government has built and equipped 10 health care centers and rehabilitated 2 medical posts. Vaccination against major childhood diseases (DPT3, Polio, BCG, and measles) has either met or surpassed the HIPC completion targets. The antimalarial campaign launched in Príncipe in 2003, which incorporated family education, fumigation, and antimosquito nets and which was extended to São Tomé in 2004, has sharply reduced our country’s under-5 morbidity rate caused by malaria.

- A special treasury account was established at the central bank to monitor the use of HIPC interim debt relief. Annual reports and external audits on the use of HIPC relief for 2001-02 were posted on the website of the Poverty Observatory in July 2006. We are now auditing the use of HIPC debt relief during 2003-05.

- The Ministry of Planning and Finance has enhanced its control of the programming and execution of foreign-financed capital expenditure. All expected project loans are in principle included in the fiscal budget and accounted for in the Public Investment Program (PIP). Also, the government has asked its development partners to help us consolidate all foreign aid in the fiscal budget.

- The National Committee on Petroleum (NCP) was formalized as a legal entity early in 2004 to supervise development of and strategy for the sector. The ORML of December 2004 provides for a new oversight committee to audit and supervise petroleum receipts and expenditures. Regulations related to the ORML are currently before the National Assembly.

- The Auditor General’s Office (AGO) has been operating since 2003 and is expected to audit the government’s full financial accounts starting in 2007.
• The tribunal for arbitration of business and contract matters is expected to become operational in the third quarter of 2006.

G. MDRI Issues

35. **The government is aware that the eventual use of MDRI resources should take duly into account the country’s absorptive capacity.** Annual debt service payments could be reduced by about 2 percent of GDP on average during 2006-08, on account of MDRI. MDRI resources could be used to help cover the Priority Actions Program (PAP) for 2006-08, that was discussed at the donors’ roundtable in Brussels in early-December 2005. For 2006, the MDRI resources would be deposited with the central bank, while the government prioritizes projects under the PAP. The 2007 budget would incorporate the use of these resources.

H. Program Monitoring

36. **Technical Memorandum of Understanding (TMU).** The program will be monitored using the definitions, data sources, and frequency of monitoring set out in the accompanying TMU. The government will make available to the Fund all data specified in the TMU, appropriately reconciled and on a timely basis.

37. **Performance criteria.** Table I.1 shows the quantitative indicative targets for end-September 2006 and the performance criteria for end-December 2006. Structural performance criterion and benchmarks for 2006 with corresponding dates are identified in Table I.2. In addition, the government recognizes that avoiding accumulation of external payment arrears (as defined in the TMU) is a continuous performance criterion, as are the injunctions against imposing or intensifying restrictions on current payments, introducing or modifying multiple currency practices, concluding bilateral payments agreements that are inconsistent with Article VIII, or imposing or intensifying import restrictions for balance of payments reasons.
Table I.1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2005–06  
(Billions of dobras, unless otherwise specified)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Floor on domestic primary balance (as defined in the TMU; cumulative from beginning of year)</td>
<td>-130.6</td>
<td>-130.6</td>
<td>-121.9</td>
<td>-121.9</td>
<td>-15.2</td>
</tr>
<tr>
<td>2. Ceiling on domestic primary spending (cumulative from beginning of the year) 3</td>
<td>329.4</td>
<td>329.4</td>
<td>319.7</td>
<td>319.7</td>
<td>65.1</td>
</tr>
<tr>
<td>3. Ceiling on changes in net domestic financing of the government (cumulative from beginning of year, billions of dobras at program exchange rate) 2 3 4</td>
<td>0.8</td>
<td>-11.3</td>
<td>-255.6</td>
<td>-18.1</td>
<td>-109.8</td>
</tr>
<tr>
<td>4. Ceiling on changes in net domestic assets of the central bank (cumulative from beginning of year, billions of dobras at program exchange rate) 2 3 4</td>
<td>9.9</td>
<td>-2.2</td>
<td>-234.6</td>
<td>2.9</td>
<td>-109.8</td>
</tr>
<tr>
<td>5. Floor on changes in the net international reserves of the central bank (cumulative from beginning of the year, millions of U.S. dollars) 4 5</td>
<td>0.9</td>
<td>2.1</td>
<td>32.2</td>
<td>8.7</td>
<td>11.1</td>
</tr>
<tr>
<td>6. Ceiling on central government's outstanding external payment arrears (stock, millions of U.S. dollars) 6</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>7. Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the central government or the BCSTP (stock, millions of euros) 7 8</td>
<td>1.7</td>
<td>1.7</td>
<td>0.0</td>
<td>0.0</td>
<td>1.7</td>
</tr>
<tr>
<td>8. Ceiling on the outstanding stock of external debt with original maturity of less than one year owed or guaranteed by the central government or the BCSTP (stock, millions of U.S. dollars) 9</td>
<td>15.0</td>
<td>15.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
</tbody>
</table>

**Memorandum items:**

- **Base Money (ceiling, billions of dobras):**
  - 2005 end-Dec.: 185.0
  - 2006 end-Mar.: 268.4
  - 2006 end-June: 195.0
  - 2006 end-Sept.: 247.3
  - 2006 end-Dec.: 205.0

- **Currency Issued (ceiling, billions of dobras):**
  - 2005 end-Dec.: 247.3
  - 2006 end-Mar.: 268.4
  - 2006 end-June: 195.0
  - 2006 end-Sept.: 247.3
  - 2006 end-Dec.: 205.0

- **Oil signature bonuses (millions of U.S. dollars, cumulative from beginning of year):**
  - 2005 end-Dec.: 49.2
  - 2006 end-Mar.: 49.2
  - 2006 end-June: 49.2
  - 2006 end-Sept.: 49.2
  - 2006 end-Dec.: 49.2

- **Official external program support as defined in the TMU (billions of dobras at program exchange rate):**
  - 2005 end-Dec.: 21.6
  - 2006 end-Mar.: 21.6
  - 2006 end-June: 15.2
  - 2006 end-Sept.: 15.2
  - 2006 end-Dec.: 15.2

**Sources:** São Tomé and Príncipe authorities, and staff estimates and projections.

1. Equal to government domestic expenditure, as defined in the TMU, excluding all interest payments.
2. The ceiling will be adjusted downward (upward) by the cumulative negative (positive) deviation in external debt service and the cumulative positive (negative) deviation of actual from projected disbursements of external program support and oil signature bonuses. The upward adjustment of higher than programmed external program support will not take place to the extent that the additional support is used to accommodate higher capital outlays of the government, up to US$1 million.
3. The ceiling will be adjusted downward by the amount of accumulated domestic arrears.
4. For 2005, excludes the National Oil Account, consistent with the assumption under EBS/05/109 that such resources would be deposited in a correspondent bank and would not be reflected in Central Bank accounts. For 2006, includes the National Oil Account Central Bank, consistent with EBS/06/23.
5. The floor on net international reserves will be adjusted upwards (downwards) by the cumulative positive (negative) deviation in external debt service and the cumulative positive (negative) deviation of actual from projected disbursements of external program support. The upward adjustment of higher than programmed external program support will not take place to the extent that the additional support is used to accommodate higher capital outlays of the government, up to US$1 million.
6. This is a continuous performance criterion.
7. This performance criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been a grant element of less than 50 percent. Includes a US$2 million loan received from Angola to finance a social inclusion project.
8. With a grant element of less than 50 percent. Includes three US$5 million loans disbursed by Nigerian 2002-2004, to be repaid from signature bonuses in Blocks 5 and 9.
10. Using adjusters for shortfalls in program support and foreign debt service.
11. For comparison purposes against original program assumptions. Monetary numbers (EBS/05/109, Tables 4 and 5, and Appendix IV, Table I.1), for end-December 2005 have been adjusted in Tables 4, 5, 8 and Appendix I, Table I.1, attached, by removing the balance of the National Oil Account (NOA) from the definition of central bank net international reserves and net domestic assets. Originally, the NOA was supposed to be held directly by the government in an account with the Federal Reserve, not with the central bank, as indicated.
Table I.2. Structural Performance Criterion and Benchmarks Under the 2006 PRGF-Supported Program (March-December 2006)

<table>
<thead>
<tr>
<th>Action</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Structural Performance Criterion</strong></td>
<td></td>
</tr>
<tr>
<td>By end-December 2006, implement the fully integrated, computerized budget and public expenditure system (SIGFE).</td>
<td>On Track</td>
</tr>
<tr>
<td><strong>Structural Benchmarks</strong></td>
<td></td>
</tr>
<tr>
<td>By end-September 2005, submit to the National Assembly legislation criminalizing money laundering and the financing of terrorism.</td>
<td>Delayed to end-December 2006</td>
</tr>
<tr>
<td>By end-March 2006, amend the laws defining internal control and administrative regulations governing the Inspectorate General of Finance (IGF), to increase IGF’s powers regarding the oversight and auditing of the financial operations of the central government, public enterprises, and local governments.</td>
<td>Delayed to end-July 2006</td>
</tr>
<tr>
<td>By end-June 2006, submit to the National Assembly proposals to revise the Customs Law, the Customs’ Organic Law (Estatuto das Alfandigas) and the General Code on Customs Infractions (Regime Geral das Infracós Aduaneiras), to update accounting practices and customs procedures, and modernize the system to increase the efficiency of the overall customs service.</td>
<td>Delayed to third quarter of 2006</td>
</tr>
<tr>
<td>By end-April 2006, complete the installation of EMAE’s pre-paid electricity metering systems in designated urban locations with a view to address the public utilities’ financial weaknesses in the short-run.</td>
<td>Delayed to September 2006</td>
</tr>
<tr>
<td>By end-June 2006, establish a database to record and monitor follow-up actions of problems identified by the Inspectorate General of Finance (IGF) in each inspected sector within its jurisprudence, including the applicable sanctions and penalties.</td>
<td>On Track</td>
</tr>
<tr>
<td>By end-September 2006, adopt a sectoral strategy to address the development of suitable infrastructure for electricity production, transportation, and distribution, as well as business modalities to secure dynamic private sector participation in the electricity sector.</td>
<td>On Track</td>
</tr>
<tr>
<td>By end-December 2005, complete feasibility studies on the restructuring of ENASA and ENAPORT.</td>
<td>Delayed to end-September 2006</td>
</tr>
<tr>
<td>By end-December 2006, implement the Commonwealth Secretariat debt recording management system (CS-DRMS) to improve the government’s external debt management capacity.</td>
<td>On Track</td>
</tr>
</tbody>
</table>
ATTACHMENT II

SÃO TOMÉ AND PRÍNCIPE:
TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This technical note contains definitions and adjuster mechanisms that are intended to clarify the measurement of items in Table I.1, Quantitative Performance Criteria, PRGF Arrangement, 2005-06, attached to the Memorandum of Economic and Financial Policies. Unless otherwise specified, all quantitative performance criteria and benchmarks will be evaluated in terms of cumulative flows from December 31, 2005.

Provision of Data to the Fund

2. Data with respect to all variables subject to performance criteria and indicative targets will be provided to Fund staff on a monthly basis with a lag of no more than four weeks for data on the net domestic assets and net international reserves of the Central Bank of São Tomé and Príncipe (BCSTP), and eight weeks for other data. The authorities will transmit promptly to Fund staff any data revisions. For variables that are relevant for assessing performance against program objectives but are not specifically defined in this memorandum, the authorities will consult with Fund staff as needed on appropriate measurement and reporting.

Definitions

3. Government is defined for the purposes of this memorandum to comprise the central government. The central government includes all governmental departments, offices, establishments, and other bodies which are agencies or instruments of the central authority of São Tomé and Príncipe. The central government does not include the operations of state-owned enterprises.

4. Government domestic revenue comprises all tax and non-tax revenue of the government (in domestic and foreign currency), excluding foreign grants, the receipts from the local sale of crude oil received from Nigeria as in-kind grant, and any gross inflows to government on account of oil signature bonus payments. Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and Directorate of Treasury in the Ministry of Planning and Finance.

5. Domestic primary expenditure comprises all government spending assessed on a commitment basis, excluding: (i) foreign-financed capital expenditure, (ii) expenditure under the overseas scholarship program that are externally-financed, and (iii) other foreign-financed current expenditures, for which data are reported by the Directorate of Budget and Directorate of Treasury. Reporting of government domestic expenditure will be based on the state budget execution prepared every month by the Directorate of Budget and Directorate of Treasury in the Ministry of Planning and Finance.

6. Within the above total, pro-poor expenditure refers to government outlays that, as it has been agreed with the IMF and World Bank staffs, have a direct effect in reducing...
poverty. These expenditures, which includes both current and capital outlays, are defined as follows:

a. **Pro-poor current spending**: These cover the following ministries and expenditure categories (by budget code) as described in the matrix below, with items marked with an “x” representing social expenditures by the referred ministries.

<table>
<thead>
<tr>
<th>Code</th>
<th>MINISTRY OF EDUCATION AND CULTURE</th>
<th>MINISTRY OF HEALTH</th>
<th>MINISTRY OF LABOUR AND SOLIDARITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>01.00.00</td>
<td>Despesa com Pessoal</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>02.01.05</td>
<td>Outros bens duradouros</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>02.02.02</td>
<td>Combustíveis e lubrificantes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>02.02.04</td>
<td>Alimentação</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>02.02.05</td>
<td>Medicamentos</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>02.02.06</td>
<td>Roupas e calçados</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>02.02.09</td>
<td>Outros bens não duradouros</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>02.03.01.01</td>
<td>Água e energia</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>02.03.02</td>
<td>Conservação de bens</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>02.03.06</td>
<td>Comunicações</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>04.01.01</td>
<td>Orçamento do estado</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>04.02.01</td>
<td>Instituições particulares</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>04.03.01</td>
<td>Particulares</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>04.04.02</td>
<td>Outras transferências para exterior</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>06.01.00</td>
<td>Ensino e formação</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>06.04.01</td>
<td>Custos recorrentes de projectos</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>06.04.04.02</td>
<td>Outros Diversos</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

Expenditures on “combustíveis e lubrificantes” (fuels and lubricants) that are effected for administrative purposes are excluded. Likewise, “alimentação” (food) and “roupas e calçados” (clothing and shoes) supplied to administrative staff are excluded.

b. **Pro-poor capital spending**: This covers selected projects, which are deemed to have a direct impact on alleviating poverty in the following sectors: education, health, social safety nets, agriculture and fisheries, rural development, planning and finance, youth and sports, provision of potable water, and electrification.

c. **Reporting Requirements**: Data on execution of pro-poor current and capital spending will be provided on a quarterly basis to the staff by the Directorate of Budget (for current expenditure) and by the Directorate of Planning (for capital expenditure) at the Ministry of Planning and Finance.

7. The **domestic primary balance** is defined as the difference between government domestic revenue and noninterest government domestic expenditure. This balance for the year 2004 was assessed at dobras -128.1 billion, broken down as follows:

Government domestic revenue: Db 165.0 billion
Less: government primary expenditure, excluding foreign-financed investment,

foreign-financed scholarships, and transfers to the JDA: Db 293.1 billion

Equals: Domestic primary balance: Db -128.1 billion

8. The program exchange rate for the purposes of this memorandum will be Db10,104 per US dollar. The exchange rate of the dobra against the euro will be 12,314 and against the SDR will be 15,558.

9. Net domestic financing of the government is defined as the change in net credit to government by the banking system—that is, the stock of all outstanding claims on the government held by the BCSTP, less all deposits held by the central government with the BCSTP, plus the stock of all outstanding claims on the government held by deposit money banks (DMBs)¹, less all deposits held by the central government with DMBs—as they are reported monthly by the BCSTP to the IMF. All foreign exchange denominated accounts will be converted to dobras at the program exchange rate. At end-December 2004, outstanding net credit to the government was assessed at dobras 35.8 billion, broken down as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>BCSTP credit, including use of IMF resources:</td>
<td>Db 83.6 billion</td>
</tr>
<tr>
<td>Less: government deposits with BCSTP:</td>
<td>Db 41.0 billion</td>
</tr>
<tr>
<td>Equals: Net credit to government by the BCSTP:</td>
<td>Db 42.6 billion</td>
</tr>
<tr>
<td>Plus: DMBs credit:</td>
<td>Db 0.0 billion</td>
</tr>
<tr>
<td>Less: government deposits with DMBs (including counterpart funds):</td>
<td>Db 6.9 billion</td>
</tr>
<tr>
<td>Equals: Net domestic financing of the government:</td>
<td>Db 35.8 billion</td>
</tr>
</tbody>
</table>

10. Base money is defined as the sum of currency issued—which consists of currency outside banks and cash in vaults—and bank reserves. Bank reserves refer to reserves of commercial banks held with the central bank, and include reserves in excess of the legal reserve requirement. At end-December 2004, base money was assessed at dobras 119.2 billion, calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency issued:</td>
<td>Db 67.2 billion</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
</tr>
<tr>
<td>Cash in vaults:</td>
<td>Db 7.2 billion</td>
</tr>
<tr>
<td>Currency outside banks:</td>
<td>Db 60.0 billion</td>
</tr>
</tbody>
</table>

¹ Deposit money banks (DMBs) refers to Other Depository Corporations as stated in the Monetary and Financial Statistics Manual.
Plus: Bank reserves: Db 52.1 billion

Equals: Base money: Db 119.2 billion

11. **Net international reserves** (NIR) of the BCSTP are defined for program monitoring purposes as short term-term foreign assets of the BCSTP minus short-term external liabilities. All short-term foreign assets that are not fully convertible external assets readily available to and controlled by the BCSTP (i.e., they are pledged or otherwise encumbered external assets, including, but not limited to, the HIPC umbrella SDR account, and assets used as collateral or guarantees for third party liabilities) will be excluded from the definition of NIR. All values are to be converted to U.S. dollars at actual market exchange rates prevailing at the test date. At end-December 2004, NIR was assessed at dobras 169.2 billion, calculated as follows:

Net Foreign Assets: Db 189.3 billion

Less: Other foreign assets: Db 49.5 billion

Plus: Other liabilities: Db -29.4 billion

Equals: Net international reserves: Db 169.2 billion

*Of which:* Gross reserves: Db 197.1 billion

Short-term liabilities: Db -27.9 billion

12. **Net domestic assets** of the central bank of São Tomé and Príncipe are defined as the difference between base money and net foreign assets of the BCSTP. All foreign denominated accounts will be converted to dobras at the program exchange rate. At end-December 2004, net domestic assets were assessed at dobras -70.0 billion, calculated as follows:

Base money: Db 119.2 billion

Less: Net foreign assets: Db 189.3 billion

Equals: Net domestic assets of the BCSTP: Db -70.0 billion
13. The performance criterion on **short-term external debt** refers to the outstanding stock of external debt with original maturity of one year or less, including overdraft positions and debt owed or guaranteed by the government or the BCSTP. At end-December 2005, the stock of short-term external debt stood at US$16.0 million.

14. The performance criterion on **nonconcessional medium- and long-term external debt** refers to the contracting or guaranteeing of external debt with original maturity of more than one year by the government or the BCSTP. Debt reschedulings and restructurings are excluded from the ceilings set on nonconcessional borrowing. Medium- and Long-term debt will be reported by the Debt Management Unit of the Ministry of Finance and Planning and (as appropriate) by the BCSTP, measured in US dollars at current exchange rates. The government of São Tomé and Príncipe will consult with Fund staff before contracting obligations if it is uncertain as to whether those obligations are included in the performance criterion limits.

15. The nonaccumulation of new **external payment arrears** is a continuous performance criterion. Government external payment arrears are defined as all unpaid external public debt obligations, according to the data established by the Debt Management Unit of the Ministry of Planning and Finance and (as appropriate) by the BCSTP, with the exception of arrears pending rescheduling arrangements. Debt would be deemed to be in arrears when it has not been paid by the time it is due, unless the definition of an arrear has been otherwise contractually defined. The performance criterion relating to external arrears does not apply to external arrears pending the conclusion of debt-rescheduling agreements with the Paris Club and Portugal.

16. **Official external program support** is defined as grants and loans provided by foreign official entities that are received by the budget—excluding project grants and loans—and other exceptional financing. Amounts assumed in the program consistent with

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2 The term “debt” is defined in accordance with point 9 of the Guidelines on Performance Criteria with respect to Foreign Debt (Decision No. 12274-(00/85) August 24, 2000).

3 This amount includes three nonconcessional loans from Nigeria totaling US$15 million, which were previously classified under nonconcessional medium term external debt. These loans have been reclassified as short-term debt, following a joint World Bank-IMF mission DSA mission in April 2006.

4 This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 but also to commitments contracted or guaranteed for which value has not been received.

5 The concessionality of loans is assessed according to the reference interest rate by currency published by the Development assistance Committee of the Organization for Economic Cooperation and Development (OECD).

   For loans of terms of no less than 15 years, the ten-year average of commercial interest reference rates (CIRR) for the currency in which the loan is denominated will be used. For loans of shorter terms, the six month average will apply. A loan is deemed to be on concessional terms if, on the initial date of disbursement, the ratio of the present value of the loan, calculated on the basis of the reference interest rate, to the nominal value of the loan is less than 50 percent (in other words, a grant element of at least 50 percent, excluding Fund resources).

   For currencies with no available reference interest rates, the SDR rate will be used.
this definition are shown in the memorandum item entitled “external program support” of Table I.1.

**Adjusters**

17. **Deviations in official external program support** from the amounts programmed in Table I.1. will trigger adjusters for domestic financing of the government, net domestic assets of the BCSTP and net international reserves as indicated below. These and other adjusters as set out below will be measured cumulatively from December 31, 2005.

18. **Ceilings on net domestic financing (NDF) of the government and net domestic assets (NDA) of the BCSTP.** Monthly differences between projected and actual receipts of signature bonuses, official external program support and external debt service payments in foreign exchange will be converted to dobras at the actual monthly average exchange rate and cumulated to the test date. The ceilings on NDF and NDA will be reduced by the sum of: (i) excess receipts of oil signature bonuses, (ii) excess official external program support (as defined in paragraph 16 above); and (iii) the shortfall in external debt service payments. Ceilings will be increased by 100 percent of any cumulative shortfall in receipts of oil signature bonuses, official external program support, or excess in external debt service. The downward adjustment to NDF and NDA for higher than programmed official external program support will not take place to the extent that additional external program support is used to accommodate higher capital outlays by the government, up to US$1 million, converted to dobras at actual exchange rates, as indicated in Table I.1.

19. **Floor on net international reserves (NIR) of the BCSTP.** Quarterly difference between projected (see Table I.1) and actual receipts of oil signature bonuses, official external program support and external debt service payments will be converted to U.S. dollars at the actual exchange rates prevailing at the test date. The floor on NIR will be raised by the sum of: (i) excess receipts on oil signature bonuses, (ii) excess external program support and (iii) any shortfall in external debt service payments. The upward adjustment to NIR for higher than programmed official external program support will not take place to the extent that additional external program support is used to accommodate higher capital outlays by the government, up to US$1 million, converted to dobras at actual exchange rates, as indicated in Table I.1. The NIR floor will be lowered by 100 percent of any shortfall in receipts of oil signature bonuses, official external program support and excess in external debt service payments.

**Data reporting**

20. The following information will be provided to the IMF staff for the purpose of monitoring the program. Except for net domestic assets and net international reserves, for which data are to be provided by the BCSTP within four weeks at the end of each month, other monetary data will be furnished within eight weeks after the end of each month for monthly data, within eight weeks after the end of each quarter for quarterly data, and within eight weeks after the end of each year for annual data.
i. **Fiscal data**

The Directorate of Budget at the Ministry of Planning and Finance will provide to IMF staff:

- Monthly data on central government operations for revenues, expenditure and financing
- Monthly detailed tax and non-tax revenues
- Monthly detailed current and capital expenditure data
- Quarterly data on official external program support (non-project)
- Quarterly data on the execution of the public investment program (PIP) and sources of financing
- Quarterly data on project grant disbursement (HIPC and Non-HIPC)
- Quarterly data on project loans disbursement

ii. **Monetary data**

The BCSTP will provide the IMF staff:

- Daily data on exchange rates on a weekly basis
- Daily data on interest rates on a weekly basis
- Daily liquidity management table, including base money and currency in circulation, on a weekly basis (see attachment)
- Weekly balance sheet data of BCSTP (in BCSTP and IMF formats)
- Monthly balance sheet data of BCSTP (in BCSTP and IMF formats)
- Monthly balance sheet data of individual deposit money banks (in BCSTP and IMF formats)
- Monthly consolidated balance sheet data of deposit money banks (in BCSTP and IMF formats)
- Monthly monetary survey (in BCSTP and IMF formats)
- Monthly central bank foreign exchange balance (Balança cambial)
- Latest position of NIR and liquid reserves of the BCSTP (last available; monthly)

iii. **External debt data**

The Debt Management Unit at the Ministry of Planning and Finance will provide the IMF staff:

- Monthly data on amortization of external debt (HIPC and Non-HIPC)
- Monthly data on paid interest on external debt (HIPC and Non-HIPC)
- Monthly data on disbursements external project and BOP support loans
iv. National accounts and trade statistics

The National Institute of Statistics will provide the IMF staff:

- Monthly consumer price index data
- Monthly data on imports as reported by Customs (value and import taxes collected)
- Monthly commodity export values