

International Monetary Fund

[Democratic Republic of São Tomé and Príncipe](#) and the IMF

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

Press Release:

[IMF Executive Board Approves Three-Year, US\\$6.2 Million Extended Credit Facility Arrangement for the Democratic Republic of São Tomé and Príncipe](#)
December 19, 2014

June 19, 2015

[Country's Policy Intentions Documents](#)

E-Mail Notification
[Subscribe](#) or [Modify](#)
your subscription

The following item is a Letter of Intent of the government of Democratic Republic of São Tomé and Príncipe, which describes the policies that 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 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.

Letter of Intent

São Tomé, June 19 2015

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700, 19th Street, N.W.
Washington, D.C. 20431
United States

Dear Ms. Lagarde:

1. São Tomé and Príncipe had a peaceful and successful change of government in November 2014, following the general election in October 2014 which was won, with an absolute parliamentary majority, by the main opposition party (ADI-Independent Democratic Action Party), led by former Prime Minister Patrice Trovoada.
2. On July 20, 2012, the Executive Board of the International Monetary Fund (IMF) approved a three-year arrangement under the Extended Credit Facility (ECF) to support the government of São Tomé and Príncipe's economic reform program to promote sustainable growth and reduce poverty, underpinned by the national poverty reduction strategy (PRSP-II). The program supported under this arrangement went off-track after the completion of the second review in December 2013, on account of the contraction of a loan from Angola with a level of concessionality below the threshold of 50 percent stipulated under the program and the delays in introducing corrective measures due to the general elections in October the same year and the subsequent change of government.
3. The government of São Tomé and Príncipe wishes to cancel the current ECF arrangement, which is due to expire in July 2015. In its place, we request a new three-year ECF arrangement to support our medium-term economic reform program for the period 2015 to 2018. The new ECF arrangement allows the government to design a new program that does not assume prospects of future oil production due to the significant delays and setbacks in oil exploration. It will also afford the new government a clean slate to reestablish credibility in program implementation.
4. To help achieve the objectives of this program, the government requests access of SDR 4,440,000 (60 percent of quota) including first disbursement of SDR634,285 upon approval of the arrangement by the IMF Executive Board. This arrangement will be used to anchor the government's macroeconomic policies. The half-yearly reviews under the arrangement will serve also to send a clear signal to São Tomé and Príncipe's development partners regarding the quality of the macroeconomic and financial policies implemented by the government.

5. The attached Memorandum of Economic and Financial Policies (MEFP) describe recent developments in São Tomé and Príncipe's economy and the progress made in implementing our program in 2013–14. As explained in the MEFP, nearly all the program indicators at end-December 2014 were achieved and many of the measures subject to structural benchmarks were implemented.

6. The MEFP also sets out the economic and financial policies that the São Tomé and Príncipe government intends to implement between now and the end of this year and during the course of the next three years to preserve macroeconomic stability, boost economic growth, improve the management of public finances and the financial system, and facilitate export-oriented private sector development.

7. The MEFP and the Technical Memorandum of Understandings (TMU) present quantitative performance criteria, indicative targets, and structural benchmarks to be used to monitor the implementation of the program. The government believes that the measures and policies described in the attached MEFP are adequate to attain the objectives of this program. It will take any additional measures necessary to that end. It will consult with the IMF on the adoption of such measures prior to any revision of the policies indicated in the attached MEFP, in accordance with the Fund's policies on such consultation.

8. The government will provide Fund staff with all relevant information mentioned in the Technical Memorandum of Understanding (TMU) concerning progress made under the program. During the program, the government will not introduce or strengthen any exchange restriction, multiple currency practice, or import restrictions for balance of payments purposes, nor will it conclude any bilateral payment agreements in violation of Article VIII of the Fund's Articles of Agreement.

9. The government of São Tomé and Príncipe authorizes the IMF to make this letter and attached MEFP and TMU, and the IMF staff report and the Debt Sustainability Analysis (DSA) update available to the public, including through the IMF internet website.

Yours truly,

/s/

Mr. Américo d'Oliveira Ramos,
Minister of Finance and Public
Administration

/s/

Ms. Maria do Carmo Trovoada Silveira,
Governor of the Central Bank of São Tomé
and Príncipe

Attachments:

1. Memorandum on Economic and Financial Policies.
2. Technical Memorandum of Understanding.

Attachment I. Memorandum on Economic and Financial Policies for 2015–18

INTRODUCTION

1. **This memorandum of economic and financial policies outlines the main objectives of the government of São Tomé and Príncipe’s economic reform program for the period July 2015–June 2018**, for which the government is seeking support from the International Monetary Fund through a new three-year arrangement under the Extended Credit Facility (ECF). The new ECF arrangement succeeds the one approved by the IMF Executive Board in July 2012. That program went off-track after the completion of the second review in December 2013, on account of the contracting of a loan from Angola with a level of concessionality below the threshold of 50 percent stipulated under the program and the delays in introducing corrective measures due to the general elections in October that same year and the subsequent change of government.

2. **The government of São Tomé and Príncipe is committed to pursuing an economic reform program to promote sustainable growth and poverty reduction.** The Independent Democratic Action Party led by Mr. Patrice Trovoada won an absolute majority in the 2014 Parliamentary elections. More than half of the population lives below the poverty line, and there is limited access to clean water and electricity, and to services such as education and health care. The lack of basic infrastructure constrains our economic development and limits improvement in living standards. Prospects worsened somewhat over the last years with the dire indebtedness situation and the dwindling chances of discovering commercially viable quantities of oil in our offshore territory.

3. **The new government sees a Fund-supported program as an appropriate platform for continued reforms and also to catalyze donor support and participation in São Tomé and Príncipe.** The government’s medium-term economic program is rooted in the national poverty reduction strategy paper (PRSP-II) and the new government’s vision statement which seeks to consolidate gains made under the current ECF-supported program with the IMF. In particular, the medium term objectives aims to continue the fiscal consolidation to further anchor debt sustainability but at the same time create enough space to support the much-needed public investment program (PIP) to promote sustained and shared growth and poverty reduction.

4. **The medium-term program of the government is designed to assume no future oil production.** With the withdrawal of Total Oil Company from the joint development zone in 2013, prospects of oil production in the near future are no longer feasible. Therefore, the government sees this new ECF arrangement as an opportunity to re-design a program with less probability of oil production coming on stream. In response, the government has identified alternative options of creating fiscal space (both domestic and external) to support the identified growth-enhancing spending underpinning the medium-term program.

RECENT ECONOMIC DEVELOPMENTS, PROSPECTS AND PERFORMANCE UNDER THE ECF-SUPPORTED PROGRAM

5. **Macroeconomic performance since 2012** has been positive but has not resulted in the stronger and more diversified economic growth that can decisively improve economic prospects and living standards overall:

- From 2012 through 2014, real GDP growth averaged 4½ percent, lower than the growth pick-up envisaged under the current ECF arrangement, mainly as a result of the setback to oil production and the challenging external environment, particularly in the main European trading partners. However, economic activity appears to be improving in 2015 driven by a higher than anticipated increase in foreign direct investment that started in 2014, the launching of new donor-financed projects, and improved tourism receipts. Following the adoption of the peg to the euro in January 2010, inflation has fallen significantly from 16 percent to 6.5 percent in March 2015— its lowest 12-month rate in two decades—but still not aligned with inflation in the Euro area.
- The fiscal consolidation effort has been mixed. The domestic primary deficit which improved to 0.8 percent in 2013, mainly on account of one-off revenues of 1.7 percent of GDP. It increased sharply again to 3.4 percent of GDP in 2014 as a result of revenue underperformance (non-payment of import duties by ENCO, the main oil importer) and expenditure overruns in the run-up to the general elections in October 2014. Government arrears also accumulated on a net basis every year since 2012 despite efforts to clear them.
- Growth in monetary aggregates continues to decline. On the other hand, after surging in 2010–12, bank credit to the private sector started contracting in 2013 as over-indebted businesses and households were not extended further loans and banks struggled with non-performing loans and shortage of bankable projects.
- Between 2012–14, the external current account deficit slowly declined to 30.3 percent in line with weak economic activity but the trade deficit remained unchanged at about 37.4 percent of GDP despite encouraging growth in cocoa exports. The Central Bank's international reserves, standing at 3.8 months of import cover at end-March 2015, have remained at comfortable levels, even though still below what is deemed adequate for a small commodity exporting economy with fixed exchange rate regime.
- The financial system has been under stress over the last few years following a loose credit stance and weak enforcement of prudential standards during the oil prospects boom years of 2010–12. Non-performing loans have soared to 18 percent in 2014 and the central bank had to intervene in two banks in two years while successive years of loss making have eaten away banking system capital.

6. **Program performance.** The ECF-supported program of the government was approved on July 20, 2012 (with 35 percent of quota access) and is due to expire on July 19, 2015. All of the 2013 quantitative performance criteria were met; some by large margins, and the first two reviews were concluded as scheduled. But in 2014 there were

slippages and delays in program implementation. While the monetary quantitative targets continued to be comfortably met, the domestic primary deficit exceeded the end-year program target by a 0.4 percentage points of GDP mainly due to revenue underperformance and slippages on personnel cost and significant arrears accumulation of energy and communications bills by government agencies. Structural reform implementation recorded delays, and some key measures were not implemented, in particular the tripartite arrears clearance plan between the Treasury, ENCO, and EMAE (Tables 1 and 2).

7. **Program interruption.** The contracting in March 2014 of a loan from Angola, at less than 50 percent concessional terms, delayed the conclusion of the third ECF review. The government was able to renegotiate the terms of the loan at near concessional terms (46 percent concessional) by July 2014. In the meantime, national elections were called in October 2014 and the outgoing government postponed further program discussions until the new government was in office. This resulted in a loss of momentum in policy implementation, which contributed to the decision of the new government to resume program relations with the Fund by requesting a new arrangement instead of continuing with the existing ECF arrangement which is due to expire soon.

8. **Prospects for 2015 and beyond.** The outlook for 2015 is for a pick-up in economic activity as early trends for agriculture, tourism and foreign-investment-driven construction all look favorable. Some smaller oil companies remain active in exploration, but even if they find commercially viable oil, actual production would take several more years. The current context of low international oil prices further hampers production prospects. As a result, São Tomé and Príncipe's economic policies and outlook will continue to be constrained by the acute scarcity of budgetary resources.

MEDIUM-TERM MACROECONOMIC FRAMEWORK

9. **In the medium term, economic activity is projected to expand driven by scaled-up investment and expansion in tourism and agriculture.** Accordingly, growth is projected at around 5 percent in 2015 and steadily rising to 5.5 percent by 2017. The scaling up of investment in infrastructure is expected to unleash the tourism potential of São Tomé and Príncipe by addressing production of cheaper and reliable energy, upgrading the airports, and providing transportation to link up tourism sites across the country. Better macroeconomic conditions in trade partners' economy will also contribute to the country's economic growth. Investments to upgrade port equipments and energy are also expected to yield benefit in agriculture. Against the backdrop of subdued international price pressures, inflation is targeted at 3 percent by 2018 in line with Euro zone inflation. Monetary aggregates' expansion will be consistent with maintaining the sustainability of the peg. The domestic primary balance will serve as the anchor for fiscal policy and will be targeted to decline to around 1.5 percent of GDP by 2018.

10. **The government's medium-term economic program will be underpinned by an updated PRSP (National Strategy Document).** In the foreseeable future, São Tomé and Príncipe will continue to face the challenges of overcoming its insularity, small market size, lack of human capital, and limited tradable resources to generate sustainable and inclusive growth. The existing Poverty Reduction Strategy Paper (PRSP-II), adopted in July 2012, and

the economic guidelines of the Program of the Constitutional Government of São Tomé and Príncipe approved by Parliament in December 2014, will serve as reference for the 2015–18 economic and financial policies. The governance, economic and social objectives of the PRSP-II remain valid and priority will continue to be given to its four strategic axes:

(i) promoting good governance and public sector reform, (ii) supporting sustainable and inclusive economic growth, (iii) enhancing human capital and extending basic social services, and (iv) reinforcing social cohesion and social protections, particularly for vulnerable groups. Since the PRSP-II only covers the 2012–16, the government intends to produce in 2016 a National Strategy Document through 2018 that will benefit from the recently concluded evaluation exercise of implementation of PRSP-II and, if necessary, from new consultations with stakeholders.

SUPPORTING MACROECONOMIC STABILITY THROUGH FISCAL AND DEBT SUSTAINABILITY

11. **The government remains committed to maintaining fiscal and debt sustainability to support sustainable growth and poverty reduction.** With prospects of oil production now very low, fiscal policy will continue to entrench fiscal consolidation to anchor debt sustainability, while at the same time creating space for the much-needed growth-enhancing spending and social priorities. This will require aggressive domestic revenue mobilization and reforms to improve the effectiveness of public spending. Accordingly, the government will aim to reduce the domestic primary fiscal balance to the 1.5 percent target by 2018 while keeping the overall fiscal balance (including project grants, sectoral budgetary support, and capital expenditure financed from external resources) at a level compatible with public debt sustainability.

12. **For 2015–18, the key macroeconomic objectives will be to:** (i) strengthen domestic revenue mobilization and expenditure rationalization to restore fiscal discipline and reduce the risk of debt distress; (ii) improve the business environment to diversify the economy and boost growth; (iii) maintain financial sector stability; and (iv) enhance the capacity of key government institutions, inter alia, by more actively seeking technical assistance (TA). Achieving these outcomes will require fiscal reforms to enhance domestic revenue mobilization to create space for increased capital spending and improved public financial management, financial sector reforms to improve the sector’s role in facilitating private sector led growth, agricultural sector modernization and other targeted reforms designed to improve the business climate, external competitiveness and promote private investment to broaden the export base.

FISCAL POLICY

13. **The 2015 budget was designed to restore the thrust of the fiscal stance under the original ECF-supported program** by redressing the budgetary slippages incurred in 2014, in particular, poor tax collection, rising personnel costs, and a net increase in arrears.

14. **Social spending in 2015 and the medium-term will however, be safeguarded.** Budget alignment with the government’s PRSP-II remains critical for further progress

towards the MDGs. The government is committed to increasing social spending (indicative target) from the levels of 2014 (Table 3).

15. In line with these commitments, the government proposes the following medium-term (2015–18) fiscal framework:

- The domestic primary deficit is targeted at 2.7 percent of GDP (performance criterion) in 2015 and will be reduced to 1.5 percent of GDP by 2018.
- Tax revenues are targeted at 15 percent of GDP in 2015 and the government will seek to raise them by a cumulative 1.5 percent of GDP to 16½ percent of GDP by 2018. To that effect, and drawing on TA recommendations, the government will take the necessary measures to improve tax administration and mobilize new revenue sources.
- Personnel costs will be scaled back to their historical average of 8.5 percent of GDP over the program period. For 2015, the government envisages a reduction in personnel costs of 0.3 percentage points of GDP relative to 2014 by foregoing the annual general salary increase and preventing unbudgeted non-wage remunerations, namely on overtime and cost allowances.
- Spending on goods and services, which has been compressed in recent years to make up for overruns in other expenditure categories, will be capped at 3.2 percent of GDP.
- Transfers are set to increase by 29 percent in 2015 to address pressing social needs and the decentralization of government functions, but are expected to slow-down over the program period.
- To boost the development of the domestic treasury bill market, the government plans its first issue of treasury bills in 2015 in an amount to be capped at 75 billion dobra, which could be drawn on to finance the budget in case of delays and/or shortfalls in donor financing. Apart from this contingency, the government will not resort to domestic bank financing other than drawing on its 2015 access level from the National Oil Account.
- The government has prepared and submitted to the Fund a comprehensive plan (prior action) to clear the longstanding domestic arrears which continues to serve as a drag on fiscal consolidation.

16. Budget support in the amount of US\$ 10 million has been identified for 2015 in the form of grants. On the basis of current trends, an additional US\$ 30.6 million could be expected in 2016–18. Further budget support for 2016–18 and for stepping up public investment and social programs would be firmed up at a donors' conference to be co-organized with the UNDP in São Tomé in September 2015.

17. Angola loan. The bulk of first tranche of the Angola loan (US\$17 million), disbursed in March 2014, was used to finance public investment projects. About US\$4.3 million was however, used as budget support to close shortfalls in donor

support. The second tranche of US\$17 million was disbursed in March 2015 and earmarked to support the government's public investment projects.

MONETARY POLICY AND FINANCIAL SECTOR REFORMS

18. **Monetary policy will continue to be anchored by the dobra peg with the Euro**, which has enabled the government to reduce inflation, and maintain a stable exchange rate and a reasonable level of foreign exchange reserves. Broad money growth is projected to moderate only slightly to 14.7 percent in 2015 in line with declining inflation objective under the peg. The BCSTP is seeking to reverse the fall in credit to the private sector by reducing minimum required reserves on local currency deposits to 15 percent for banks with intermediation rate greater than 80 percent.

19. **Liquidity management remains a key priority.** The BCSTP has introduced an interbank money market and open market operations (OMO) to effectively manage the growing excess liquidity. In addition, a deposit standing facility will be introduced, by end-June 2016, as an interim measure to passively manage excess liquidity in the banking system.

20. **The banking sector is under some stress but the government is introducing measures to safeguard financial stability.** A sound and more inclusive financial sector is indispensable to keeping São Tomé and Príncipe on the path to sustainable growth. In that context, the government will prepare by end-June 2016, in consultation with the Fund (MCM), an analysis of the causes for the relatively large amount of past due and nonperforming loans (NPLs) on the banks' balance sheets, and a comprehensive strategy to help banks deal with such NPLs (end-June 2016 structural benchmark).

21. **The government has stepped up its enforcement of prudential requirements.** On January 27, 2015, the Banco Central de São Tomé e Príncipe (BCSTP) intervened in Angolan-owned Banco Equador that had, since 2013, failed to meet the minimum required risk-weighted capital ratio of 12 percent and saw its NPLs rise to 43 percent in 2014. The bank failed to recapitalize by the April 27, 2015 deadline, and the intervention period was extended till mid-August 2015. In the meantime, the BCSTP, with the help of IMF TA, has drafted a new Bank Resolution Law to be submitted to the National Assembly before end-September 2015 (structural benchmark). In addition three banks have been directed to raise their capitals above the minimum required to operate a bank by end-December 2015. The BCSTP will put in place a comprehensive plan to help banks deal with high NPLs on their balance sheet by end-June 2016 (structural benchmark). Onsite inspections of all banks have been achieved with the completed inspection of the last bank in May 2015.

22. **Going forward, the BCSTP will continue to strengthen its oversight of all commercial banks.** The BCSTP will take other steps to strengthen banking supervision with a view to detect and deal with any persisting weaknesses in the system. It is our intention to conduct, with the help of IMF, a detailed assessment of banks compliance with Basel Core Principles by end-December 2016 (structural benchmark). Plans are advanced to revise the legal and regulatory frameworks to enhance the mandate of the BCSTP. Revised Central Banking and Financial Institutions Laws will be submitted to the National Assembly by end-

December 2015. These laws are expected to comprehensively fill a number of gaps in the existing legislation some of which are partially being filled by generally applicable regulations.

STRUCTURAL REFORMS

23. **The government is committed to mobilizing domestic resources to support the much-needed growth enhancing spending.** The government's immediate priority in 2015 is to prevent the tax collection shortfalls verified in 2014 and in the first half of 2015, in particular, the unpaid duties on fuel imports by ENCO (estimated at about 1.2 percent of GDP). With the conclusion of the arrears clearance plan in June 2015, ENCO is expected to resume full payment of customs duties, which should yield the additional 1 percent of GDP in revenues envisaged for 2015 and 2016.

24. **In addition, the following measures will be introduced to increase domestic revenue from 2016:**

- The government has concluded the "Operation Taxpayer Inclusion" survey in all of São Tomé's districts and in the Autonomous Region of Príncipe, yielding 16,000 new taxpayers. The survey is yet to be completed in the autonomous region of Príncipe. As a follow up to the "Operation Taxpayer Inclusion", the government will be introducing the minimum tax value in the 2016 budget. This will help to broaden the tax base and permanently increase the tax revenue.
- The government will finalize a tax maximization plan (being developed under the BAD's PAGEF credit operation) in time to incorporate eventual measures in the 2016 budget.
- The government has already started discussions to prepare the grounds for the introduction of Value Added Tax (VAT) by unifying the ISCPL and ISCSP taxes. The government is seeking technical assistance from the Fund to help with the design and introduction of the VAT later during the program period.

25. **Domestic arrears clearance.** As at end-March 2015, claims by ENCO (due to implicit fuel subsidy) and domestic suppliers put the stock of government domestic arrears at 1.352 billion dobra (15.9 percent of GDP). The bulk of these arrears, about 944 billion dobra are claimed by ENCO from the government on account of keeping pump prices below import and distribution costs since 2011. The balance corresponds to 148 billion in outstanding utilities and communications bills and 50 billion owed to other domestic suppliers for debts outstanding since before 2012. The government has however, started paying off arrears to suppliers in line with understandings with the suppliers. There is also an additional claim by ENCO of 842 billion in arrears (12 percent of GDP) owed by state-enterprise EMAE on account of unpaid bunker oil deliveries. As a result, ENCO has since 2014 stopped paying import duties and fuel taxes due to the government. A ministerial team put together by the government has prepared a comprehensive plan (prior action) to address the domestic arrears problem. The team will also audit and confirm these arrears and negotiate to seek concessions from creditors, support from donors, and provide a timetable for clearing arrears accordingly. The government will revise the macroeconomic

framework to reflect the outcome of the auditing and negotiation of the stock of arrears at the time of the first review of the program.

26. **Removal of fuel price differential and introduction of automatic price adjustment.** The recent fall in international oil prices presents a timely opportunity to end the cost-price differential. Starting April 2015, the cost of imported fuel products had fallen sufficiently to restore, at current pump price levels, full cost recovery for the importer and tax collections for the government. With petroleum prices currently aligned with cost, the government is committed to maintaining future prices to be in line with cost recovery while the government designs and establishes an automatic price adjustment mechanism by end-June, 2016 (structural benchmark). The government however, will implement this by assessing the social consequences of higher pump prices on the poorest with a view to providing a safety mechanism targeted at the poor and vulnerable.
27. **Reforming EMAE.** The government is receiving assistance from the World Bank to address structural problems at EMAE to ensure full cost recovery for electricity and water prices and in generating cash-flow to finance grid network repairs and upgrades. To that effect, the government will introduce a restructuring plan by end-December 2016 (structural benchmark).
28. **In the meantime, the government will introduce “quick fix” measures to improve efficiency at EMAE.** Overdue measures will be taken to address some of the most pressing problems of EMAE. The government will prepare adequate legislation to address the widespread loss through illegal connections of electricity and water. The government will also support EMAE to install water meters to increase its revenues and prevent wasteful usage at flat-rates.

STRENGTHENING PUBLIC FINANCIAL MANAGEMENT

29. **Public financial management (PFM).** Attempts to improve and modernize PFM since 2012 have hinged on the adoption of a new, donor-recommended, information management system—SAFEe—that was custom-designed for São Tomé and Príncipe but has yet to be fully operational. Its pilot stage of implementation has covered four ministries but it fell short of the initial objective of consolidating and producing the 2012 budget execution results. As remaining information processing and security issues are addressed, the government intends to use it to produce the 2013 and 2014 final accounts and to extend the SAFEe system to all remaining government ministries and agencies starting with the 2016 budget.
30. **Expenditure control.** In addition to SAFEe’s enhanced monitoring capabilities, tighter expenditure control procedures will be introduced to ensure that non-budgeted expenditures do not take place, in particular as regards non-wage personnel costs such as overtime and expense allowances that have in the last few years been exceeding annually budgeted amounts.
31. **Medium-term fiscal framework.** The government will, by end-2016, take actions to fully implement a move comprehensive medium-term fiscal framework, by consolidating the

current framework. Furthermore, if necessary, the government will seek Fund FAD TA and a training workshop, during which key steps for developing such framework will be put in place.

32. **Debt Management.** The government will continue to strengthen debt management, including by improving reporting and debt service forecasts. Prospective new loans will be carefully assessed in terms of their debt sustainability implications prior to their contracting.

IMPROVING THE BUSINESS ENVIRONMENT FOR EXPORT DIVERSIFICATION AND PRIVATE SECTOR DEVELOPMENT

33. **Business environment.** The government will seek to boost private sector investment and exports trade by improving the business climate through greater trade facilitation, stronger property and investor rights, easier access to credit, simplified payment of taxes and reduction of administrative bureaucracy in general. The successful setting up in 2011 of a one-stop-shop that reduced costs and paperwork for foreign investors was complemented in 2014 by the launching of another one-stop shop for foreign trade that will support national producers' efforts in accessing foreign markets.

34. **Export diversification.** Accelerating and sustaining economic growth in São Tomé and Príncipe at levels that will structurally reduce unemployment and improve social conditions will only be possible by taking advantage of the potential to expand production to export markets. To that effect, the government will develop and submit to the National Assembly, a national export diversification strategy and action plan (end-December 2016 structural benchmark), targeting the tourism sector and high-value horticultural production, that are recognized as having the greatest potential.

35. **Revamp the functioning of credit reference bureau.** The BCSTP launched the Central de Risco de Crédito (CRC) in 2011 to provide a sound and comprehensive credit reporting to support the assessment and pricing of risks. However, the potential of the CRC has largely been tapped due to the imperfect coverage and data quality. The BCSTP will be investing in additional resources (both human and infrastructure) to extend its coverage and enhance its usage. Going forward, the BCSTP will strictly enforce the requirement that reporting financial institutions provide relevant, accurate, complete, and timely information to the CRC and apply sanctions when breached.

36. **Addressing challenges in the judiciary system to enhance enforcement of collateral.** The government will prepare an action plan of legal reforms with a view to making the domestic judiciary system more expedite and predictable as regards contracts' enforcement and execution of guarantees.

BORROWING OPTIONS

37. **Investment priorities.** Despite recent gains with cocoa exports and tourism receipts, São Tomé and Príncipe remains at high risk of debt distress and the government will continue to pursue policies consistent with debt sustainability. The 2012–15 ECF-supported programs maintained a cautious fiscal stance under the assumption that oil revenue over

the medium term would come on stream to support social and infrastructure needs. But with oil production now unlikely for many years, there is the need to explore options to create space to support the government public investment program.

38. **External borrowing constraints.** The government's 2015–18 programs makes room for some additional concessional borrowing of an average of 6.6 percent of GDP annually over the three year ECF program, at a lower concessionality threshold of 35 percent in line with other LICs. Such reduction appears warranted by the current global low interest rates environment that has narrowed the differential between concessional and non-concessional rates. The Fund staff's DSA exercise suggests that there is room for the additional borrowing and for reducing the grant element from 50 to 35 percent without significantly changing the debt sustainability dynamics.

39. **Strengthening debt management capacity.** The government is updating the medium-term debt management strategy which is expected to be submitted to cabinet for approval by end-June 2016. This updated strategy is critical to support the government's debt reduction objective in the program.

STATISTICS

40. **The government will continue to make progress to strengthen the statistical system.** The National Statistics Institute (INE) is taking steps, with the help of TA from the Fund and donors, to improve the CPI and the national accounts. The household survey completed in 2011 will provide the basis for reweighting the CPI components and introducing new goods and services to its basket. By end-December 2015, the government will start monthly compilation of the new CPI and will publish the revised national accounts series (structural benchmarks).

PROGRAM MONITORING

41. **The program will be evaluated based on quantitative performance criteria and structural benchmarks** (Tables 3 and 4 in attachment I), and semi-annual reviews. Definitions of key concepts and indicators, as well as reporting requirements, are set out in the accompanying Technical Memorandum of Understandings (TMU). The first, second, and third reviews are scheduled to be completed on or after April 15, 2016, October 15, 2016, and April 15, 2017 respectively, based on test dates for periodic PCs of end-December 2015, end-June 2016, and end-December 2016 respectively.

Table 1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2014
(Billions of Dobra, cumulative from beginning of year, unless otherwise specified)

| | 2014 | | | | | | | | | | | | | |
|---|-------------------|--------------------|-----------|-----------------------------------|----------------------|-----------|-----------|-------------------|--------------------|-----------|-----------------------------------|----------------------|-----------|---------|
| | March | | | June | | | | September | | | December | | | |
| | Indicative Target | Indicative Targets | | Performance Criteria ¹ | Performance Criteria | | | Indicative Target | Indicative Targets | | Performance Criteria ¹ | Performance Criteria | | |
| | | w/adjustment | Actual | | w/adjustment | Actual | Status | | w/adjustment | Actual | | w/adjustment | Actual | Status |
| 31-Mar-14 | 31-Mar-14 | 31-Mar-14 | 30-Jun-14 | 30-Jun-14 | 30-Jun-14 | 30-Jun-14 | 30-Sep-14 | 30-Sep-14 | 30-Sep-14 | 31-Dec-14 | 31-Dec-14 | 31-Dec-14 | 31-Dec-14 | |
| Performance criteria: | | | | | | | | | | | | | | |
| Floor on domestic primary balance (as defined in the TMU) ² | -50 | -86 | -79 | -119 | -169 | -165 | Not Met | -159 | -159 | -167 | -198 | -198 | -210 | Not Met |
| Ceiling on changes in net bank financing of the central government (at program exchange rate) ^{3,4,5} | 0 | 18 | -15 | 0 | -56 | -129 | Met | 0 | -56 | -54 | 0 | -56 | -9 | Not Met |
| Floor on net international reserves of the central bank (US\$ millions) ^{2,4} | 27.50 | 26.55 | 47.04 | 27.50 | 30.50 | 55.56 | Met | 27.50 | 30.50 | 49.76 | 27.50 | 30.50 | 50.88 | Met |
| Ceiling on central government's outstanding external payment arrears (stock, US\$ millions) ^{5,6,7,8} | 0 | ... | 0 | 0 | ... | 0 | Met | 0 | ... | 0 | 0 | ... | 0 | Met |
| 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 (US\$ millions) ^{5,6,7,8,9,10} | 0 | ... | 40 | 0 | ... | 40 | Not Met | 0 | ... | 40 | 0 | ... | 40 | Not Met |
| Ceiling on the outstanding stock of external debt with original maturity of up to and including one year owed or guaranteed by the central government or the BCSTP (stock, US\$ millions) ^{5,7,8,9,10} | 0 | ... | 0 | 0 | ... | 0 | Met | 0 | ... | 0 | 0 | ... | 0 | Met |
| Indicative targets: | | | | | | | | | | | | | | |
| Ceiling on central government's outstanding domestic arrears (stock) | 0 | ... | 90 | 0 | ... | 129 | Not Met | 0 | ... | 75 | 0 | ... | 129 | Not Met |
| Ceiling on central government's outstanding arrears to EMAE (stock) | 0 | ... | -5 | 0 | ... | 18 | Not Met | 0 | ... | 56 | 0 | ... | 71 | Not Met |
| Ceiling on dobra base money (stock) | 954 | ... | 757 | 1,030 | ... | 868 | Met | 1,071 | ... | 886 | 1,145 | ... | 971 | Met |
| Floor on pro-poor expenditures | 110 | ... | n.a | 219 | ... | n.a | Unknown | 329 | ... | n.a | 438 | ... | n.a | Unknown |
| Memorandum items: | | | | | | | | | | | | | | |
| Transfer from NOA to the budget (US\$ millions) | 2.5 | ... | 0.0 | 2.5 | ... | 0.0 | | 2.5 | ... | 0.0 | 2.5 | ... | 2.4 | |
| Net external debt service payments ¹¹ | 24 | ... | 48 | 59 | ... | 86 | | 97 | ... | 23 | 139 | ... | 160 | |
| Official external program support ¹¹ | 0 | ... | 36 | 36 | ... | 152 | | 172 | ... | 0 | 246 | ... | 183 | |
| Treasury-funded capital expenditure | 28 | ... | 6 | 72 | ... | 33 | | 102 | ... | 43 | 111 | ... | 58 | |

Sources: São Tomé and Príncipe authorities; and IMF staff estimates and projections.

¹ Performance at the December 2013, June 2014, and December 2014 test dates are assessed on the third, fourth, and fifth reviews respectively.

² The floor will be adjusted upward or downward according to definitions in the TMU.

³ The ceiling will be adjusted downward or upward according to definitions in the TMU.

⁴ Excluding the National Oil Account (NOA) at the Central Bank.

⁵ The term "government" is defined as in ¶ 3 of the TMU, which excludes the operations of state-owned enterprises.

⁶ This criterion will be assessed as a continuous performance criterion.

⁷ The term "external" is defined in accordance with the residency of the creditor as indicated in point 2 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009).

⁸ This performance criterion applies not only to debt as defined in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009) but also to commitments contracted or guaranteed for which value has not been received. For further details on the definition of debt and external arrears refer to the TMU, ¶ 15-17.

⁹ Only applies to debt with a grant element of less than 50 percent as defined in point 8 g (i) of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective October 11, 2013). For further details on the definition of concessionality refer to the TMU, Footnote 4.

¹⁰ Debt is defined as in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009). For further details on the definition of debt refer to the TMU, ¶ 15-17.

¹¹ As defined in the TMU, valued at the program exchange rate.

Table 2. São Tomé and Príncipe: Structural Benchmarks, 2013–14
 (Billions of Dobra, cumulative from beginning of year, unless otherwise specified)

| Category | Structural Benchmarks | Economic rationale | Original timeframe | Revised or set at 2 nd review timeframe | Implementation Status |
|------------------------|--|--|------------------------------------|--|--------------------------------------|
| | Strengthening Public Finances | | | | |
| External control | i. Strengthen external control by: Preparing the general government accounts for 2012 and sending them to the Court of Audit. | Strengthen PFM | End-June. 2013 | End-Dec. 2013 | Not met. Implemented January 2015 |
| Internal control | ii. Strengthen internal control by: Finalizing a plan to clear over time EMAE's arrears to ENCO and to avoid a recurrence in the future of the problem of cross arrears. Eliminating all arrears between the Treasury and EMAE. | Strengthen PFM | End-Sep. 2013 | End-Mar. 2014 | Not met |
| Tax administration | iii. Improve taxpayer management and compliance with tax obligations by: Enhancing the security of the Taxpayer Registry, creating a dedicated large taxpayer unit, and creating a single taxpayer computerized file system. iv. Expand the tax base by launching the "Operation Taxpayer Inclusion" project and: | Strengthen revenue administration | End-Dec. 2013 | Not revised | Not met. |
| | Registering 500 new tax payers from the date of the program's launch. | Strengthen revenue administration | Set at 2 nd review only | End-Jun. 2014 | Met |
| | Registering 800 new tax payers from the date of the program's launch. | | Set at 2 nd review only | End-Dec. 2014 | Met |
| Customs administration | v. Complete the second phase of ASYCUDA WORLD implementation by: Activating all the functionalities and the establishing a fully computerized procedure for customs clearance. | Strengthen revenue administration | End-Dec. 2013 | Deemed "On-going" | Met |
| | vi. Undertake preparatory arrangements for the installation of a One-Stop-Shop for foreign trade by: Establishing the connectivity and management of customs/Tax NIF. Eliminating hardcopy documents and introducing electronic signing and approval of documents. | Strengthen revenue administration and trade facilitation | Set at 2 nd review only | End-Jun. 2014 | Met |
| | | | Set at 2 nd review only | End-Dec. 2014 | Met |
| | Enhancing Monetary Management and Financial Stability | | | | |
| Bank supervision | vii. Strengthen banking supervision and regulation by: Completing the on-site supervision process for the largest commercial bank. Ensuring that all commercial banks that are open to the public have a capital-to-risk-weighted-asset ratio of at least 12 percent. Completing the on-site supervision process for the remaining two commercial banks. Ensuring that all commercial banks publish audited financial accounts for 2013, or applying penalties for non-compliance. Preparing a revised draft Central Banking Law that strengthens autonomy of the central bank in line with international standards, including in the resolution of problem banks. | Ensure financial stability and transparency and enhance the effectiveness of | End-June 2013 | End-June 2014 | Met |
| | | | End-Mar. 2014 | End-June 2014 | Not met. |
| | | | | End-June 2014 | Not met. Implemented May 2015. |
| | | | | End-Sep. 2014 | Met |
| | | | | End-Sep. 2014 | Not met |
| | Statistics | | | | |
| CPI Statistics | viii. Improve consumer price index statistics by: Reweighting the CPI components and introducing new goods and services to the CPI basket. | Strengthen statistical system | End-Dec. 2013 | Deemed "On-going" | Not met |

Table 3. São Tomé and Príncipe: Proposed Performance Criteria and Indicative Targets for 2015–16
(Billions of Dobra, cumulative from beginning of year, unless otherwise specified)

| | 2015 | | 2016 | | | |
|--|-------------------|-----------------------------------|-------------------|-----------------------------------|-------------------|-----------------------------------|
| | September | December | March | June | September | December |
| | Indicative Target | Performance Criteria ¹ | Indicative Target | Performance Criteria ¹ | Indicative Target | Performance Criteria ¹ |
| | 30-Sep-15 | 31-Dec-15 | 31-Mar-16 | 30-Jun-16 | 30-Sep-16 | 31-Dec-16 |
| Performance criteria: | | | | | | |
| Floor on domestic primary balance (as defined in the TMU) ² | -153 | -190 | -23 | -54 | -100 | -154 |
| Ceiling on changes in net bank financing of the central government (at program exchange rate) ^{3,4,5} | 0 | 0 | 0 | 0 | 0 | 0 |
| Floor on net international reserves of the central bank (US\$ millions) ^{2,4} | 50 | 50 | 62 | 62 | 62 | 62 |
| Ceiling on central government's outstanding external payment arrears (stock, US\$ millions) ^{5,6,7,8} | 0 | 0 | 0 | 0 | 0 | 0 |
| 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 (US\$ millions) ^{5,6,7,8,9} | 0 | 0 | 0 | 0 | 0 | 0 |
| Ceiling on the outstanding stock of external debt with original maturity of up to and including one year owed or guaranteed by the central government or the BCSTP (stock, US\$ millions) ^{5,7,8,9} | 0 | 0 | 0 | 0 | 0 | 0 |
| Indicative targets: | | | | | | |
| Ceiling on change of central government's new domestic arrears | 0 | 0 | 0 | 0 | 0 | 0 |
| Ceiling on dobra base money (stock) | 990 | 1,113 | 1,062 | 1,085 | 1,052 | 1,237 |
| Floor on pro-poor expenditures | 357 | 447 | 168 | 289 | 409 | 481 |
| Floor on tax revenue | 732 | 1,073 | 181 | 422 | 783 | 1,209 |
| Memorandum items: | | | | | | |
| New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the BCSTP (US\$ millions) ^{5,7,8,10,12} | 19 | 35 | 14 | 14 | 14 | 14 |
| Transfer from NOA to the budget (US\$ millions) | 2.0 | 2.0 | 1.6 | 1.6 | 1.6 | 1.6 |
| Net external debt service payments ¹¹ | 106 | 143 | 18 | 43 | 81 | 125 |
| Official external program support ¹¹ | 192 | 220 | 20 | 47 | 88 | 219 |
| Treasury-funded capital expenditure | 48 | 63 | 12 | 28 | 50 | 78 |

Sources: São Tomé and Príncipe authorities; and IMF staff estimates and projections.

¹ Performance at the December 2015 test date is assessed on the first review and the June and December 2016 test dates are assessed on the second and third reviews respectively.

² The floor will be adjusted upward or downward according to definitions in the TMU.

³ The ceiling will be adjusted downward or upward according to definitions in the TMU.

⁴ Excluding the National Oil Account (NOA) at the Central Bank.

⁵ The term "central government" is defined as in ¶ 3 of the TMU, which excludes the operations of state-owned enterprises.

⁶ This criterion will be assessed as a continuous performance criterion.

⁷ The term "external" is defined in accordance with the residency of the creditor as indicated in point 2 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009).

⁸ This performance criterion or memo item applies not only to debt as defined in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009) but also to commitments contracted or guaranteed for which value has not been received. For further details on the definition of debt and external arrears refer to the TMU, ¶ 4 and 14.

⁹ Only applies to debt with a grant element of less than 35 percent as defined in point 8 g (i) of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective October 11, 2013). For further details on the definition of concessionality refer to the TMU, ¶ 20.

¹⁰ Only applies to debt with a grant element of at least 35 percent.

¹¹ As defined in the TMU, valued at the program exchange rate.

¹² Cumulative from December 2014 and December 2015 respectively.

Table 4. São Tomé and Príncipe: Prior Action and Structural Benchmarks Under the Proposed ECF-Supported Program

| Policy Objectives and Measures | Timing | Macro Rationale | TA involved |
|---|--------------------|--|--|
| Strengthening Public Finances | | | |
| Prepare, in consultation with ENCO and EMAE, and submit to the Fund, a comprehensive plan with a clear timeline to regularize all arrears outstanding and prevent the accumulation of new ones. | Prior action | To restore timely financial flows between all parties concerned, in particular the timely payment of all applicable taxes. | Team worked with authorities. |
| Adopt an automatic fuel price adjustment mechanism that allows timely pass-through of import costs with a view to its gradual introduction in 2016. | End-June 2016 | To remove implicit fuel price subsidies and loss of fiscal revenues. | TA to be sought on design of automatic price adjustment mechanism. |
| Adopt a plan to reform EMAE (state-owned electricity and water utilities company) to ensure full cost-recovery. | End-December 2016 | To support arrears clearance plan | With World Bank and EU support |
| Enhancing Financial Stability | | | |
| Submit to the National Assembly a new Bank Resolution Law. | End-September 2015 | To improve soundness of financial system | Forthcoming MCM TA |
| Complete detailed assessment of compliance with Basel Core Principles. | End-December 2016 | To improve soundness of financial system | Forthcoming MCM TA |
| Prepare and submit to staff a comprehensive strategy to help banks deal with high NPLs on their balance sheets. | Ecd-June 2016 | To support financial sector stability and growth | Forthcoming MCM TA |
| Improving National Statistics | | | |
| Start monthly compilation of the new reweighted and expanded CPI series. | End-December 2015 | To make available more representative statistics for policy evaluation and design. | Ongoing AfDB TA |
| Publish revised national accounts series through 2013. | End-December 2015 | | Ongoing STA TA |
| Facilitating Business Activities | | | |
| Develop and submit to the National Assembly a National Export Diversification Strategy document. | End-December 2016 | To promote economic diversification and employment opportunities | TA yet to be identified by authorities |

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) contains definitions and adjuster mechanisms that clarify the measurement of quantitative performance criteria and indicative targets in Table 3, which are attached to the Memorandum of Economic and Financial Policies for 2015 and 2016. Unless otherwise specified, all quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from the beginning of each calendar year.
2. **The program exchange rate** for the purposes of this TMU¹ will be 20,299 dobra per U.S. dollar, 24,500 dobra per euro, and 29,236 dobra per SDR for both 2015 and 2016.

PROVISION OF DATA TO THE FUND

3. Data with respect to all variables subject to performance criteria and indicative targets will be provided to Fund staff on the frequency described below (paragraph 27) with a lag of no more than four weeks for data on net international reserves of the Central Bank of São Tomé and Príncipe (BCSTP) and six 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 the appropriate way of measuring and reporting. Performance criteria included in the program are defined below and refer to the floor on domestic primary balance; the ceiling on changes in net bank financing of the central government; the floor on net international reserves of the central bank; the ceiling on central government's outstanding external payments arrears; the 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; and the ceiling on the outstanding stock of external debt with original maturity of up to and including one year owed or guaranteed by the central government or the BCSTP.

DEFINITIONS

4. For the purposes of this TMU, **external** and **domestic** shall be defined on a residency basis.
5. **Central government** is defined for the purposes of this TMU to comprise the central government, which includes all governmental departments, offices, establishments, and other bodies that 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.

¹ Data refer to the mid-point exchange rates published on the BCSTP's webpage for the last day of 2014.

6. **Debt** is defined as in point 9 of the IMF *Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF*, as amended effective December 1, 2009. Debt will be understood to mean a current, i.e., not contingent, liability, created under a contractual agreement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract.

7. **Government domestic revenue (excluding oil revenue)** comprises all tax and non-tax revenue of the government (in domestic and foreign currencies), excluding: (1) foreign grants, (2) the receipts from the local sale of in-kind grants (e.g., crude oil received from Nigeria, food aid, etc.), and (3) any gross inflows to the government on account of oil signature bonus receipts and accrued interest on the National Oil Account (NOA). Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and the Directorate of Treasury in the Ministry of Finance and Public Administration.

8. **Domestic primary expenditure** comprises all government spending assessed on a commitment basis (*base compromisso*), excluding (1) capital expenditure financed with external concessional loans and grants and (2) scheduled interest payments. Reporting of government domestic expenditure will be based on the state budget execution prepared every month by the Directorate of Budget and the Directorate of Treasury in the Ministry of Finance and Public Administration.

PERFORMANCE CRITERIA

9. **Performance criterion on the floor on domestic primary balance.**

This performance criterion refers to the difference between government domestic revenue (excluding oil revenue) and domestic primary expenditure. For reference, this balance for end-December 2014 was 226 billion dobra, broken down as follows:

| | |
|--|----------------------|
| Government domestic revenue: | 973 billion |
| Less: Government primary expenditure: (As defined in paragraph 8) | <u>1,184 billion</u> |
| Equals: Domestic primary balance: | 210 billion |

10. **Performance criterion on the ceiling on changes in net bank financing of the central government (NCG).** This performance criterion measures the increase (decrease) in the stock of all outstanding claims on the central government held by the BCSTP and by other depository corporations (ODCs), less all deposits held by the central government with the BCSTP and with ODCs, as they are reported monthly by the BCSTP to the IMF staff. The balance of the National Oil Account (NOA) is not included in NCG. All foreign exchange-denominated accounts will be converted to dobra at the program exchange rate. For reference, at end-December 2014, outstanding net bank financing of the central government (excluding NOA) was -9 billion dobra, broken down as follows:

| | | |
|----------------|---|--------------------|
| | BCSTP credit, including use of IMF resources: | 255 billion |
| <i>Less:</i> | Government deposits with the BCSTP (excluding NOA) | 140 billion |
| | <i>Of which:</i> Treasury dobra-denominated accounts | 18 billion |
| | Treasury foreign currency-denominated accounts | 29 billion |
| | Counterpart deposits | <u>93 billion</u> |
| <i>Equals:</i> | Net credit to government by the BCSTP | 116 billion |
| <i>Plus:</i> | ODC's credit to the government | 3 billion |
| <i>Less:</i> | Government deposits with ODCs (including counterpart funds) | <u>127 billion</u> |
| <i>Equals:</i> | Net bank financing of the government (excluding NOA) | 9 billion |

11. **Performance criterion on the floor on net international reserves (NIR) of the BCSTP.** The NIR of the BCSTP are defined for program-monitoring purposes as short-term (i.e., original maturities of one year or less), tradable foreign assets of the BCSTP minus short-term external liabilities, including liabilities to the IMF. All short-term foreign assets that are not fully convertible external assets nor 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. Securities whose market value on the last day of the year differs by over 20 percent from their original nominal issue price will be assessed at their market value as reported by the BCSTP's Markets Department. The balance of (1) NOA at the BCSTP, (2) banks' deposits related to capital or licensing requirements, and (3) banks' reserves denominated in foreign currency are excluded from the program definition of NIR. All values are to be converted to U.S. dollars at the actual mid-point market exchange rates prevailing at the test date. For reference, at end-December 2014 NIR was 999 billion dobra, calculated as follows:

| | | |
|----------------|---|--------------------|
| | Gross international reserves: | 1,282 billion |
| | <i>Of which:</i> Cash | 28 billion |
| | Demand deposits | 129 billion |
| | Term deposits (including banks' deposits in foreign currency) | 692 billion |
| | Securities other than shares | 412 billion |
| | <i>Of which:</i> Portuguese Treasury bonds | 100 billion |
| | <i>Rede Ferroviaria Nacional</i> bonds | 123 billion |
| | Mortgage-backed securities of CDG | 189 billion |
| | Accrued interest on securities | 8 billion |
| | Reserve position in the Fund | 0 billion |
| | SDR holdings | 14 billion |
| <i>Less:</i> | Short-term liabilities (including liabilities to the IMF) | 116 billion |
| <i>Less:</i> | Banks' reserves denominated in foreign currency | 165 billion |
| <i>Less:</i> | Banks' guaranteed deposits denominated in foreign currency | <u>2 billion</u> |
| <i>Equals:</i> | Net international reserves | 999 billion |
| <i>Plus:</i> | Other foreign assets | 313 billion |
| <i>Less:</i> | Medium and long-term liabilities (including SDR allocation) | <u>207 billion</u> |

| | |
|--|---------------|
| <i>Equals:</i> Net foreign assets | 1,104 billion |
| <i>Memorandum item:</i> National Oil Account (NOA) | 200 billion |

12. **Performance criterion on the ceiling on the outstanding stock of external debt with original maturity of up to and including one year owed or guaranteed by the central government or the BCSTP.** This performance criterion refers to the outstanding stock of external debt with an original maturity of one year or less (“short-term debt”) (including overdraft positions but excluding normal import credits) owed or guaranteed by the government and/or the BCSTP. With respect to the precautionary line of credit from Portugal to support the pegging of the dobra to the euro, unpaid balances outstanding during the first three quarters of a given calendar year will be excluded from this ceiling. However, outstanding balances at the end of a given calendar year will be included in the assessment of compliance with this performance criterion. For reference, at end-December 2014 the stock of short-term external debt was zero.

13. **Performance criterion on the 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.** This is a continuous performance criterion that refers to the contracting or guaranteeing of new external debt with original maturity of more than one year (“medium- or long-term debt”) by the government and/or the BCSTP. Debt is considered nonconcessional if it includes a grant element less than 35 percent. The grant element is the difference between the nominal value of the loan and its net present value, expressed as a percentage of the nominal value. The net present value of the debt at the date on which it is contracted is calculated by discounting the debt service payments at the time of the contracting of the debt. The discount rate used for this purpose is 5 percent. This performance criterion does not apply to IMF facilities. Debt being rescheduled or restructured is excluded from this ceiling. Medium- and long-term debt will be reported by the Debt Management Department of the Ministry of Finance and Public Administration (as appropriate) by the BCSTP, measured in U.S. dollars at the prevailing exchange rates. The government should consult with IMF staff before contracting or guaranteeing new medium- or long-term debt obligations.

14. **Performance criterion on the ceiling on central government’s outstanding external payment arrears.** This is a continuous performance criterion. Central government external payment arrears consist of external debt service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreement, subject to any applicable grace period. This performance criterion does not apply to arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or for which the government is actively seeking a rescheduling agreement.

INDICATIVE TARGETS

15. **Ceiling on change of central government’s new domestic arrears** is set on the difference between expenditure on a commitment basis and cash payments (amounts past due after 40 days and unpaid).

16. **Ceiling on dobra base money** is set on the sum of currency issued—which consists of currency outside depository corporations and cash in vaults—and banks reserves denominated in dobra. Bank reserves refer to reserves of commercial banks – in dobra – held with the central bank and include reserves in excess of the reserve requirements. For reference, at end-December 2014 dobra base money was 971 billion dobra, calculated as follows:

| | |
|---|--------------------|
| Currency issued: | 267 billion |
| <i>Of which:</i> Cash in vaults | 44 billion |
| Currency outside depository corporations | 222 billion |
| <i>Plus:</i> Bank reserves denominated in dobra | <u>704 billion</u> |
| <i>Equals:</i> Dobra base money | 971 billion |

17. Within domestic primary expenditure, **the floor on pro-poor expenditure** refers to the floor on government outlays recorded in the budget that have a direct effect on reducing poverty, as agreed with the IMF and World Bank staffs. These expenditures, which include both current and capital outlays, are defined as follows:

- a. **Pro-poor current spending:** These cover the following functional classifications and expenditure categories (by budget code) as described in the matrix below:

| Code | Economic classification of current expenditure | Education | Health | Social Security and Assistance | Housing and Community Services | Culture and Sport | Fuel and Energy | Agriculture and Fisheries |
|-------------|--|-----------|--------|--------------------------------|--------------------------------|-------------------|-----------------|---------------------------|
| 310000 | Personnel Expenses | x | x | | | | | |
| 331210 | Specialty Durable Goods | x | x | | | | | |
| 331290 | Other Durable Goods | x | x | | | | | |
| 331120 | Fuels and Lubricants ¹ | x | x | | | | | |
| 331130 | Foodstuffs, Food ¹ and Accommodation | x | x | | | | | |
| 331140 | Specialized Current Consumable Materials (Specific to Each Sector) | x | x | | | | | |
| 331190 | Other Consumer Non Durable Goods | x | x | | | | | |
| 332110 | Water and Energy Services | x | x | | | | | |
| 332120 | Communication Services | x | x | | | | | |
| 332130 | Health services | x | x | | | | | |
| 332220 | Maintenance and Conservation Services | x | x | | | | | |
| 353900 | Other Miscellaneous Current Expenses | x | x | x | | | | |
| 352200 | Transfers to non-profit institutions (private) | | x | x | | | | |
| 352310 | Retirement Pension and Veterans | | x | x | | | | |
| 352320 | Family Benefit | | x | x | | | | |
| 352330 | Scholarships | x | | | | | | |
| 352390 | Other Current Transfers to Families | | x | x | | | | |
| 353100 | Unemployment Fund | | x | x | | | | |
| Code | Economic classification of capital expenditure | | | | | | | |
| 411110 | Feasibility Study and Technical Assistance | x | x | x | x | x | x | x |
| 411120 | Procurement and Construction of Real Estate | x | x | x | x | x | x | x |
| 411200 | Rehabilitation Works and Facilities | x | x | x | x | x | x | x |
| 411300 | Means and Equipments of Transportation | x | x | x | x | x | x | x |
| 411400 | Machinery and Equipment | x | x | x | x | x | x | x |
| 411900 | Other Fixed Capital Goods | x | x | x | x | x | x | x |
| 412000 | Stocks | x | x | x | x | x | x | x |

Source: Diário da República de São Tomé e Príncipe No. 21 - May 7, 2008, pages 12-13.
¹ Expenditures on fuels and lubricants (combustíveis e lubrificantes) that are affected for administrative purposes are excluded. Likewise, food (alimentação) and clothing and shoes (roupas e calçados) supplied to administrative staff are excluded.

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

18. **Floor on tax revenue** is set on tax revenue that includes direct and indirect taxes as well as recovery of tax arrears and additional collection efforts.

MEMORANDUM ITEMS

19. **New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the BCSTP** measures such debt with a grant element of at least 35 percent.

20. **Net external debt service payments by the central government** are defined as debt service due less the accumulation of any new external payment arrears, as defined under the performance criterion on the ceiling on central government's outstanding external payment arrears.

21. **Official external program support** is defined as grants and loans, including in-kind aid when the products are sold by the government and the receipts are earmarked for a budgeted spending item, and other exceptional financing provided by foreign official entities and incorporated into the budget.

22. **Treasury-funded capital expenditure** is classified as part of domestic primary expenditure and covers public investment projects that are not directly financed by project grants and concessional loans or that have to be partially co-financed with government resources. It includes spending on new construction, rehabilitation, and maintenance. Expenditure on wages and salaries and the purchase of goods and services related to the projects will not be classified as capital expenditure.

USE OF ADJUSTERS

23. **The performance criterion on the domestic primary balance will have one adjuster.** The limit on the domestic primary balance will be adjusted upward if the government finds budget support and privatization receipts in 2015 and 2016 in addition to that described in the MEFP; this adjuster will be capped at 62 billion dobra (about 1 percent of 2014 GDP) for 2015 and 2016.²

24. **The performance criteria on net bank financing of the central government and net international reserves of the central bank will be** adjusted in line with deviations from amounts projected in the program for budget transfers from the NOA, official external program support, net external debt service payments, and domestic arrears will trigger adjustments on the above mentioned performance criteria. These deviations will be calculated cumulatively from end-December 2014 or end-December 2015, as appropriate (MEFP, Table 3). The following is an explanation of these adjustments:

² Grants and related expenditures to cover the cost of the elections will be excluded from the measurements of the domestic primary deficit.

- Adjustors on ceilings on changes in net bank financing of the central government (NCG): Quarterly differences between actual and projected receipts of budget transfers from the NOA, official external program support, net external debt service payments, and domestic arrears will be converted to dobra at the program exchange rate and aggregated from end-December 2014 or end-December 2015, as appropriate, to the test date. The ceilings will be adjusted downward (upward) by cumulative deviations downward (upward) of actual from projected net external debt service payments, and by deviations upward (downward) in budget transfers from the NOA, official external program support, and domestic arrears. The combined application of all adjusters at any test date is capped at the equivalent to US\$3 million at the program exchange rate.
- Adjustors for the floor on net international reserves (NIR) of the BCSTP: Quarterly differences between actual and projected receipts of budget transfers from the NOA, official external program support, net external debt service payments, and domestic arrears in dobra, will be converted to U.S. dollars at the program exchange rate and aggregated from end-December 2014 or end-December 2015, as appropriate, to the test date. The floor will be adjusted upward (downward) by the cumulative deviation downward (upward) of actual from projected net external debt service payments of the central government, and by deviations upward (downward) for budget transfers from the NOA, official external program support, and domestic arrears. The combined application of all adjusters at any test date is capped in such a way that the adjusted floor does not fall short of US\$47 million in 2015 and US\$59 million in 2016.

DATA REPORTING

25. The following information will be provided to the IMF staff for the purpose of monitoring the program.

- 1) **Fiscal Data:** The Directorate of Treasury and Directorate of Budget at the Ministry of Finance and Public Administration will provide the following information to IMF staff, within six weeks after the end of each month or quarter, except for the public investment program (PIP), which will be provided three months after each quarter:
 - Monthly data on central government operations for revenues, expenditure, and financing, including detailed description of net earmarked resources (*recursos consignados*), on commitment (*compromisso*) and cash payments (*caixa*);
 - Monthly data on net credit to the government by the BCSTP, recorded account by account in a format fully compatible with the monetary accounts of the BCSTP;
 - Monthly detailed data on tax and nontax revenues;
 - Monthly detailed data on domestically financed capital expenditure on commitment (*compromisso*) and cash payments (*caixa*);
 - Monthly data on domestic arrears by type and by creditor;

- Quarterly data on implicit arrears to ENCO on account of fuel retail prices eventually not covering import costs, distribution margins and applicable taxes.
 - Quarterly data on EMAE's arrears to ENCO.
 - Monthly data on official external program support (non-project);
 - Quarterly data on the execution of the public investment program (PIP) by project and sources of financing;
 - Quarterly data on the execution of Treasury-funded capital expenditure by project type, amount, timetable of execution, and progress of execution;
 - Quarterly data on project grant and loan disbursement (HIPC and non-HIPC);
 - Quarterly data on bilateral HIPC debt relief;
 - Latest outstanding petroleum price structures and submission of new pricing structures (within a week of becoming available).
- 2) **Monetary Data:** The BCSTP will provide the IMF staff, within three weeks from the end of each month, the monetary accounts of the BCSTP. Other monetary data will be provided within six weeks after the end of each month for monthly data, within two months after the end of each quarter for quarterly data, and within two months after the end of the year for annual data. The BCSTP will provide the following information to IMF staff:
- Daily data on exchange rates, to be posted on the central bank's web site;
 - Daily data on interest rates, to be posted on the central bank's web site;
 - Daily liquidity management table, including dobra base money and currency in circulation, to be posted on the central bank's web site;
 - Daily net international reserve position, to be posted on the central bank's web site;
 - Monthly balance sheet data of BCSTP (in IMF report form 1SR, with requested memorandum items);
 - Monthly consolidated balance sheet data of other depository corporations (in IMF report form 2SR);
 - Monthly consolidated depository corporations survey (in IMF survey 3SG);
 - Monthly central bank foreign exchange balance (*Orçamento cambial*);
 - Quarterly table on bank prudential ratios and financial soundness indicators;

- Quarterly data on the BCSTP's financial position (profit and loss statement, deficit, budget execution, etc.).
- 3) **External Debt Data:** The Directorate of Treasury at the Ministry of Finance and Public Administration will provide the IMF staff, within two months after the end of each month the following information:
- Monthly data on amortization and interest on external debt by creditor; paid, scheduled, and subject to debt relief or rescheduled;
 - Quarterly data on disbursements for foreign-financed projects and program support loans.
 - Annual data on future borrowing plans.
- 4) **National Accounts and Trade Statistics:** The following data will be provided to the IMF staff:
- Monthly consumer price index data, provided by the National Institute of Statistics within one month after the end of each month;
 - Monthly data on imports (value of imports, import taxes collected, and arrears) and commodity export values, provided by the Customs Directorate at the Ministry of Finance and Public Administration , within two months after the end of each month;
 - Monthly data on petroleum shipments and consumption (volumes and c.i.f. prices, by product), provided by the Customs Directorate.