

Letter of Intent

April 14, 2020

Madame Kristalina Georgieva

Managing Director

International Monetary Fund

Washington, D.C.

Dear Managing Director Georgieva:

1. This letter requests additional financial support from the IMF in an amount of SDR 9.028 million (61 percent of quota) under the exogenous shocks window of the Rapid Credit Facility (RCF) to help the Government of Democratic Republic of São Tomé and Príncipe mitigate the continued adverse impact of the COVID-19 pandemic on the country's fiscal and external positions. We have also requested debt relief under the Catastrophic Containment and Relief Trust (CCRT).

2. The pandemic severely affects our economy, the budget, and the balance of payments, and first four cases were confirmed on April 6. The collapse of the tourism industry, delays in the implementation of externally financed infrastructure projects, and international supply-chain disruptions weigh heavily on the economy. The fiscal balance has been put under severe stress with the urgent need to scale up health spending and social assistance while revenues decline. Our preliminary analysis indicates that the economy will contract by 6 percent in 2020 with immediate and large fiscal needs. For 2021, under an optimistic scenario, global demand, as well as tourism, will recover partially to its pre-crisis level. This, along with the implementation of long delayed construction projects, could raise GDP to close to the 2019 level, implying a growth rate of 5.5 percent year-on-year. However, if the negative impact of the pandemic lasts longer globally, the economy in Sao Tome and Principe may only grow at 2.2 percent, with tourism slow to recover and construction projects further delayed.

3. The requested disbursement under the RCF will contribute towards filling the external financing gap and supporting the timely execution of our budget. RCF resources will be fully on-lent to the government to help mitigate revenue shortfalls and expenditure pressures. A Memorandum of Understanding will be signed by the central bank and the Ministry of Finance to specify the responsibilities for servicing financial obligations to the IMF. We believe IMF financing will play a catalytic role in attracting grants and other concessional financing from our development partners. We are seeking support from other partners, mainly in the form of grants given our high debt level. We have requested a grant of US\$2.5 million from the World Bank under its COVID-19 Strategic Preparedness and Response Program (SPRP).

4. Our plan is spelled out in more detail below. In particular, we plan to implement countercyclical fiscal policy in the short-term, taking into consideration available financing. Our

immediate priority will be implementing our COVID-19 contingency plan to protect the population from the virus, assist the most vulnerable, and apply countercyclical measures including offering incentives for businesses to retain workers, supporting the unemployed, and facilitating access to credit. While revenue is expected to be negatively impacted by the economic contraction, we intend to mitigate this by keeping retail fuel prices unchanged to generate revenue from the drop in international oil prices. We have reaffirmed the agreement with the oil importer ENCO for it to fully transfer the oil price differential to the State. We will also levy a small solidarity contribution on public servants' salaries who are otherwise relatively insulated from the shock. In light of the uncertainty, we will continuously prioritize to match spending with available resources and avoid arrears.

Crisis Mitigation Plan Details

5. Key elements of the plan include the following:
- *Implementation of the health contingency plan* prepared in coordination with the WHO, including associated health spending (for example, medicine, equipment, staffing, and treatment centers), to protect against COVID-19. The estimated cost, around US\$3 million, is expected to be largely financed by the WB and WHO.
 - *Expand the WB-supported cash-transfer program* from 2600 to at least 5200 vulnerable households, and switch to monthly instead of bi-monthly cash payments to cover immediate cash needs, over a period of six months. Provide support to the disadvantaged and nursing homes (the elderly, disabled and abandoned children).
 - *Support businesses*, particularly those in tourism, that are expecting over a 50 percent drop in revenue in 2020 by:
 - Suspending for 3 months administrative penalties (interest on arrears, legal fees, foreclosure) on late payment of 2019 profit taxes, 2020 advance payments of profit taxes, and late payment of liabilities owed to the state.
 - Contributing over a period of 6 months two-thirds of workers' salaries (based on the average base salary during January-February) with a cap of four times the minimum wage for civil servants (STD 1100, or US\$50 per month), provided the employers also contribute a small, uniform share of the salary (the exact share to be determined).

Where applicable, consumption tax and personal income tax will continue to be withheld at the source and transferred to the state.

- *To further encourage employment*, the scheme described in the last bullet above will also apply to newly hired workers by any registered, already established business, for instance in agriculture, fishing, or sanitation, provided the employer can demonstrate the new employment is a net addition to his/her past employment.

- For *formally registered workers affected by the shock*, including those who lost their jobs and members employed in the artistic and cultural sector, the state will contribute one-half of the worker's average base salary during January-February, with a cap of four times the minimum wage (STD 1100), over a three-month period.

Estimated Costs of Key Crisis-Mitigation Measures		
	millions of dobras	percent of GDP
Implementation of the health plan	63	0.7
Expanded social programs	11	0.1
Contribution to workers' salaries	44	0.5
Unemployment benefits in the formal sector	12	0.1
Support to unemployed in the informal sector	16	0.2
Total	146	1.6

- For *unregistered workers* (i.e. those in the informal sector) who can demonstrate that they lost their jobs, payment of STD 600 over a period of 3 months will be made, provided they register with the labor force and social security.
- *Where supply chains are disrupted*, the state will procure seeds, feedstock, and other essential inputs to be sold to farmers at market price.
- *To generate savings*:
 - Retail fuel prices will be kept unchanged at their present level.
 - Total wage bill at SOEs and autonomous public entities will be reduced by 20 percent over a period of 6 months to avoid the dismissal of staff and cover losses.
 - Civil servants outside the education and health sectors, who are relatively unaffected by the shock, will contribute between 5 and 10 percent of their wages as a solidarity tax for a period of 6 months. Given school closures, savings will also be automatically generated from the absence of overtime normally paid to teachers.

6. The budget will be revised to incorporate the above policies and in line with the following breakdown.

7. Negotiations are ongoing with some commercial banks to establish a state-guaranteed credit line (around US\$6 million with equal risk assumed by the state and banks) for SMEs affected by the slowdown. The government will consider extending the state-guaranteed credit line to finance viable businesses provided resources are available.

Central Government Expenses, 2020 (millions dobras)	
Total domestic primary expenditure	1822
Current expenditure	1846
Personnel costs	880
Goods and services	314
Transfers	369
Other current expenditure	216
Capital spending fin. by Treasury	20
HIPC Initiative-related social expenditure	22

Transparency

8. We will ensure proper monitoring of all expenditure relating to the pandemic and improve transparency in public procurement. The government will ensure adequate control of total pandemic-related expenses and adopt measures by end-April 2020 to ensure better transparency and publicity regarding public procurement, particularly by publishing on the website of Ministry of Finance (MOF) or through announcements on other media (i) public procurement contracts, once signed, that require prior authorization from the Court of Accounts as per the Organic Law (no. 11/2019) and the ex-post validation of delivery of the contracts and (ii) monthly COVID-19 related expenditure. The crisis mitigation measures described in paragraphs 5-7 have been authorized by the parliament, and a revised budget consistent with the above policies will be submitted to parliament when conditions allow, at the latest by end-July. The government will also conduct an independent audit of spending after the crisis abates and publish the results to confirm that funds were used for their intended purpose. An IMF safeguards assessment was recently completed in August 2019 and we are committed to addressing the remaining issues.

Monetary and financial sector policies

9. Monetary and financial sector policies will seek to strike an appropriate balance between maintaining price and financial stability and sustaining economic activity. The BCSTP has prepared a contingency plan to minimize the impact of the COVID-19 crisis. Moreover, the BCSTP will continue to actively manage liquidity in the banking system, taking into account liquidity generated by RCF financed public spending, by reducing the minimum cash reserve requirement for both foreign and national currencies by 4 percentage points to 17 and 14 percent, respectively, to enable banks to continue to provide credit to the economy. The authorities will request a moratorium of 8 months on bank dividend payouts to ensure adequate capital to support lending. It will also advise banks to be flexible in renegotiating debt payments or to offer a moratorium on repayment for temporarily distressed but fundamentally sound borrowers. Nevertheless, loan reporting, classification, and provisioning standards will be maintained to safeguard financial stability; restructured loans will be classified accordingly to avoid compromising the information on loan quality; and any loan forbearance measures will be limited to the crisis period.

Medium-term policies

10. Our medium-term macroeconomic policies will be guided by our program supported by the Extended Credit Facility. Once the crisis has passed, we will continue to improve domestic revenue mobilization and contain public spending to help improve the fiscal position, safeguard the peg, and reduce the debt burden to ensure sustainability and alleviate the pressure on foreign exchange reserves. The government will also follow through with plans to introduce a VAT, reform our utility company (EMAE), and improve the business environment. In particular, we will develop a plan, in coordination with the National Institute for Civil Aviation, to remove the country from the European Union's Air Safety blacklist to facilitate the recovery of the tourism sector.

11. We believe that the economic and financial policies set forth in this letter provide an adequate basis at this moment for achieving our macroeconomic and poverty reduction and growth

objectives and address the balance of payments and fiscal difficulties caused by the pandemic. We do not intend to introduce exchange measures, multiple currency practices, trade restrictions that would worsen the current balance-of-payments difficulties.

12. In line with its commitment to transparency and accountability, we authorize the IMF to publish this letter and the staff report for the request for disbursement under the RCF, including placement of these on the IMF website in accordance with IMF procedures, following the IMF Executive Board's approval of the request.

Sincerely yours

/s/
Mr. Osvaldo Vaz,
Minister of Finance, Commerce and the Blue
Economy

/s/
Mr. Américo Soares De Barros, Governor of
the Central Bank of São Tomé and
Príncipe