

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 Completes Fourth Review of São Tomé and Príncipe's Three-Year PRGF Arrangement and Approves US\\$600,000 Disbursement](#)
June 25, 2007

May 6, 2007

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.

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São Tomé, May 6, 2007

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

Dear Mr. de Rato:

1. The attached Memorandum of Economic and Financial Policies (MEFP) sets out the objectives and policies that the government of São Tomé and Príncipe intends to pursue for the remainder of 2007. They are consistent with the government's Poverty Reduction Strategy (PRS) and the objectives of the three-year arrangement under the IMF's Poverty Reduction and Growth Facility (PRGF). Our economic adjustment and reform efforts are being supported by the international community, notably through debt relief under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).
2. The government of São Tomé and Príncipe has made substantial progress in macroeconomic stabilization and structural reforms over the past year. Economic growth accelerated in 2006. Inflation has begun declining, reflecting our renewed fiscal consolidation efforts since mid-2006 to redress the expenditure overruns in the first half of the year and a more active use of monetary policy by the Central Bank of São Tomé and Príncipe to curb liquidity growth. We have moved forward to strengthen public finance management and laid the basis for tax reform and actions against money laundering. As a result, all PRGF quantitative performance criteria (as revised in the third program review) and structural benchmarks for end-December 2006 program were met.
3. Looking ahead, our policies for 2007 aim to consolidate the recent stabilization gains, ensure sound management of oil-related and debt relief resources, and lay the groundwork for sustained private sector-led growth. Our program envisages a further reduction of the domestic primary fiscal deficit relative to GDP, combined with a prudent use of oil bonuses, a strengthening of monetary and exchange rate policies to lower inflation, and an acceleration of structural reforms. These are key conditions for sustained growth, which in turn is key for poverty reduction.
4. In support of our objectives and policies, the government hereby requests the completion of the fourth review and the disbursement of the fifth loan under the PRGF arrangement in an amount equivalent to SDR 0.423 million (5.7 percent of quota). The government requests a waiver for the nonobservance of the end-March 2007 structural

performance criterion on issuing a decree to establish the new public accounting plan. This decree has been delayed as we are running into difficulties in obtaining timely technical assistance from a donor-financed consultant. This decree will be issued prior to the Executive Board consideration of the fourth review of our program.

5. The government will provide the IMF with such information as the IMF may request regarding progress in implementing the economic and financial policies and achieving the objectives of the program.

6. The fifth and sixth reviews related to the sixth and seventh disbursements under the PRGF arrangement based on the end-June and end-December 2007 performance criteria are expected for November 2007 and May 2008, respectively.

7. The government believes that the policies and measures set forth in the MEFP are adequate to achieve the objectives of the 2007 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 will consult with the Managing Director of the IMF 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.

8. The government intends to make the contents of this Letter of Intent and those of the attached MEFP and Technical Memorandum of Understanding (TMU), as well as the staff report on the fourth PRGF review, 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 fourth review.

Yours truly,

/s/

/s/

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

Mr. Alindo Afonso de Carvalho
Governor of the Central Bank of São Tomé
and Príncipe

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

ATTACHMENT I**São Tomé and Príncipe:****Memorandum of Economic and Financial Policies****May 2007****I. INTRODUCTION**

1. This Memorandum of Economic and Financial Policies (MEFP) supplements that of December 2006 and our Letter of Intent dated December 27, 2006. It describes (i) performance under the PRGF arrangement through December 2006; (ii) economic developments in 2006 and early 2007, and (iii) the government's economic program for the remainder of this year. The policies set forth in this Memorandum should help achieve the medium-term objectives set out in our PRSP, including efficient use of debt relief resources provided under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI). Our government is committed to creating the conditions for sustained economic growth, which is essential for reducing poverty.

II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

2. **Economic activity picked up in 2006; real GDP grew at an estimated 7 percent.** Growth in the construction, commerce, and services sectors has been particularly strong, boosted by private investment and capital inflows associated with tourism and oil-related projects.

3. **Inflation had begun declining to 17 percent (year-on-year) by the end of March 2007, from 26 percent in August 2006.** This deceleration reflected corrective fiscal measures implemented since mid-2006 and a more active use of monetary policy to curb liquidity growth, which has slowed depreciation of the dobra. The dobra depreciated by 10 percent against the U.S. dollar in the 12 months through December 2006.

4. **Fiscal performance was broadly on the program path through December 2006.** Efforts to strengthen tax administration, the 28 percent increase in petroleum prices in June 2006, and the higher volume of oil imports helped boost tax revenue. Improved control of expenditure commitments on both the wage bill and nonwage current items helped offset the expenditure overruns in the first half of 2006. These measures brought the domestic primary deficit below the performance criteria for end-2006 (Table I.1); it reached 8.6 percent of GDP in 2006, down from 10.3 percent of GDP in 2005.

5. **Monetary aggregates have decelerated markedly since June 2006 as the Central Bank of São Tomé and Príncipe (BCSTP) tightened monetary policy.** The BCSTP raised its reference interest rate by 4 percentage points, to 28 percent, in September 2006 and has since kept the real interest rate positive. More important, it stepped up sales of foreign

exchange to sterilize budgetary use of oil bonuses and foreign inflows. As a result, base money growth (12-month change) declined from 117 percent in June to 32 percent in December 2006 and further to 15 percent in March 2007. By containing its net credit to the government, the BCSTP maintained net international reserves (NIR) above the program's performance criteria for end-December 2006.

6. **The BCSTP has resumed foreign exchange auctions since December 2006 to enhance the functioning of the foreign exchange markets.** These auctions have helped reduce the spread between official and commercial bank exchange rates, while the central bank has continued direct sales to the government and the fuel importer, ENCO, for lumpy transactions. The BCSTP has continued to adjust its exchange rate to market conditions daily by calculating it as the sum of 40 percent of the previous day's selling rate quoted by commercial banks for transactions with the public and 60 percent of its own previous day's selling rate. As a result, the exchange rate of the dobras has remained market determined.

7. **Progress has been made in structural reforms, as envisaged under the program.** All structural benchmarks through December 2006 were met (Table I.2). In October 2006 Legislation for anti-money laundering and the financing of terrorism was submitted to the National Assembly (NA), which granted general approval of the law in January 2007. To improve public debt management, the Commonwealth Secretariat Debt Recording and Management System was introduced in November 2006. Important steps have been taken in public financial management reform—the President promulgated the law establishing the legal and institutional framework for the integrated government financial administration system (SAFE), and a pilot budget preparation and execution program (SAFINHO) was implemented in January 2007. The government has submitted to the NA a new Investment Code, which should improve the investment climate.

III. ECONOMIC POLICIES FOR THE REST OF 2007

8. **Our macroeconomic framework for 2007 aims to significantly reduce inflation by continued fiscal consolidation and a tight and proactive monetary policy.** Achieving the objectives of our program, particularly reducing annual inflation to 10–15 percent by the end of 2007, will require vigorous and timely implementation of agreed policy measures and close cooperation between fiscal and monetary authorities. We will continue to make every effort to speed up structural reforms, notably in the areas of public expenditure management and the investment climate, to achieve sustained, private sector-led growth.

A. Fiscal Policy

9. **The government plans to further reduce the domestic primary deficit to about 7 percent of GDP in 2007 (compared with 8.6 percent in 2006) while increasing pro-poor spending.** Fiscal consolidation under the 2007 budget, which the NA approved on March 15, 2007, would come mainly from containing nonessential spending and the wage bill, because the impact of the envisaged direct tax reform, which aims to reduce distortions,

would be largely neutral in 2007. The domestic primary deficit would be financed mainly by the use of part of the oil bonuses (equivalent to 5.4 percent of GDP).

10. On the revenue side the government is stepping up its efforts to implement the agreed measures:

- **We remain committed to the petroleum pricing and taxation reforms** that were delayed due to planning and procedural issues. In the new pricing structure, ENCO will apply a uniform margin across products to eliminate cross subsidies. The new tax structure, with fewer exemptions and the move to a specific tax, is designed to safeguard petroleum tax revenue in percent of GDP. These reforms are to be introduced by end-June 2007.
- **The NA has postponed its consideration of our proposal to increase the excise tax on services (excluding water and electricity) from 5 percent to 7 percent** and to increase excises on some imported goods, including alcoholic beverages and tobacco. These measures have been delayed because the NA prefers to consider them in conjunction with our proposed cut in the corporate income tax rate. We will work with the NA to seek approval of the excise tax changes.
- **We expect the NA to adopt the direct tax reform laws by end-June 2007.** This package of legislation includes a reduction in the corporate income tax rate from 45 to 25 percent, a new personal income tax code, and a new urban property tax code, all to be implemented in 2008.
- **We have started implementing the action plan to recover tax arrears.** The NA has now adopted the tax administration and procedural codes, which will help strengthen arrears collection. We have lowered ENCO's indirect tax arrears from dobras 24 billion at end-October 2006 to dobras 11 billion at end-2006. Efforts will be made to reduce outstanding income tax arrears, which were estimated at dobras 67 billion at end-October 2006.

11. On the expenditure side the following measures are planned for 2007:

- **The wage bill** will be contained at dobras 161 billion, causing a decline in the wage bill-to-GDP ratio to 8.2 percent (from 8.7 percent projected for 2006). We will closely monitor all the components of salaries and strictly limit the payments of bonuses and emoluments pending the outcome of a study of salary structure and components. Based on this study, the completion of which is expected by end-June 2007, the government intends to adopt a revised salary structure with adequate incentives for public servants as a first step in its civil service reform strategy.
- **Nonwage current expenditure** will be contained by strict application of the budget circulars that require prior authorization by the Minister of Planning and Finance of

all expenditure commitments (*compromisos*) by budgetary units (except for spending within monthly budget allocations for wages, fuel, food, medicines, basic office supplies, and telecommunications). Payments for utilities (electricity and water) will closely follow consumption while continuing to avoid arrears.

- **Propoor spending will further increase.** We plan to achieve this goal by containing nonessential primary spending through systematic application of the execution mechanisms contained in the new Organic Budget Law. While aligning allocations with the PRSP priorities set out in the Priority Actions Plan for 2006–08, we will strictly monitor the use of HIPC and MDRI resources.

12. **The government intends to take additional measures, if needed, to ensure achievement of program objectives.** The delays in implementing the excise and petroleum pricing and taxation reforms discussed above could have an adverse impact on fiscal revenue of *dobras* 10 billion, 0.5 percent of GDP. To offset such revenue losses, the government will reduce nonwage, nonessential spending. Expenditure management will be tightened in the event of further delays or unexpected large declines in oil import prices, to keep domestic financing of the budget below the program ceilings.

13. **The 2007 fiscal plan remains fully financed.** It assumes the use of US\$8 million from the National Oil Account (NOA) and project support from Taiwan-Province of China and the World Bank (consistent with its 2006–09 Country Assistance Strategy). In seeking donor support for its Priority Actions Plan for 2006–08, the government presented a revised list of needs in infrastructure, education, and good governance to the December 2006 Round Table in São Tomé. Receipt of oil signature bonuses from Blocks 2–4 (projected at US\$13.6 million after repayment of oil-related debt of US\$15 million to Nigeria) and any additional bonuses (possibly up to US\$26 million for Blocks 5-6) will be deposited in the NOA for future budgetary use, consistent with the Oil Revenue Management Law (ORML).

14. **The government will build on progress under the pilot program SAFINHO to enhance the monitoring and execution of the 2007 budget, including the use of debt relief resources, while moving progressively to introduce the full system of integrated public finance management (eSAFE).** A decree will be issued as a prior action for the IMF Executive Board consideration of the fourth review to establish the new public finance accounting plan and the related manual of accounting procedures. With assistance from FAD and the World Bank, we will put in place other elements of the eSAFE to make it fully functional for the 2008 budget. We have set additional benchmarks for end-June and end-September 2007 (Table 2) to facilitate reform in this critical area.

15. **Our medium-term fiscal and external financing strategies depend critically on our capacity to mobilize and absorb aid inflows for development and on the prospects of oil export earnings and revenue.** The government will carefully review the impact of developments in commercially extractable reserves on the macroeconomic framework. We

are committed to adjusting the medium-term fiscal and financing strategies, including the use of NOA resources if oil production and exports are seriously delayed, beyond the previous projection of 2012. The government will reassess its oil-related outlays, including its contribution to the Joint Development Authority (JDA), taking into account updated oil revenue prospects, disbursements of signature bonuses, and the execution of the JDA budget.

B. Monetary and Exchange Rate Policies

16. **The monetary program for 2007 aims to reduce inflation through strict control of base money growth, in the context of a flexible exchange rate regime.** Although base money is an indicative target, it serves as the anchor for the program, playing a central role in restoring price stability. Every effort thus needs to be made to ensure 12-month base money growth declines, from 32 percent at end-2006 to 21 percent by end-2007. Achieving this will require the BCSTP to use monetary instruments, primarily foreign exchange sales, proactively, consistent with the NIR target, to mop up liquidity.

17. **Close cooperation between the Treasury and the BCSTP is essential for improving the latter's liquidity forecast and ensuring timely action to offset the monetary impact of budgetary use of oil bonuses and HIPC and MDRI savings.** To facilitate information-sharing and coordination, Ministry of Finance and BCSTP officials will meet at least once a month to discuss the budget's cash outlays (in both domestic and foreign currency), which will help inform the BCSTP's foreign exchange market operations.¹ Because public expenditure is a major component of aggregate demand and affects domestic prices and the exchange rate, if meeting the program's NIR target is at risk, the government will support monetary tightening by curtailing nonwage expenditures.

18. **The BCSTP is committed to further developing the foreign exchange market.** With IMF technical assistance, the BCSTP expects to make further progress toward accepting the obligations of Article VIII, Sections 2(a), 3, and 4, of the IMF's Articles of Agreement. With a view to ensuring a fuller and faster market determination of the exchange rate, the BCSTP will (i) continue implementing the current policies of holding frequent foreign exchange auctions, better matching supply with demand by using information on bank net open positions, and enforcing limits on them; (ii) encourage ENCO's bankers to purchase relatively small amounts of foreign exchange at each auction, in advance of payment requirements, to help spread out ENCO's demand for foreign exchange and progressively bring it into the auction; (iii) remove the remaining multiple currency practices by applying either the official exchange rate, if it is less than 2 percent below the market (commercial bank) rate, or a rate at the 2 percent limit in BCSTP's direct sales to ENCO and the government; (iv) eliminate the exchange restriction on transfers abroad of dividends

¹ This working group could include the Director of Budget, Director of Treasury, Director of Monetary and Exchange Policy, and Director of Exchange Operations.

when the new Investment Code becomes effective, which is expected by June 2007. The BCSTP is committed to maintaining the exchange system free of restrictions on current international transactions.

19. **The BCSTP will continue to develop a communication strategy to inform the market on its monetary and exchange policies.** The Governor of the BCSTP has been meeting at regular preannounced intervals with the banking community and the media to communicate the BCSTP's views on inflation and its monetary objectives. In addition, summary data on monetary and macroeconomic aggregates have been posted weekly on the BCSTP website.

20. **The BCSTP has posted audited financial statements for 2005 on its website and will continue to do the same every year.** Its budget execution and profit and loss account on a cash basis will be reported at least quarterly as part of the program's monetary data. The BCSTP will continue to contain the cost of its office building project, taking into consideration contractual obligations and the impact on its current and future financial situation, in consultation with the government.

C. Structural Reforms in 2007

21. **We will take further steps to ensure transparent management of current and prospective oil resources.** The NA has approved the legislation establishing the Petroleum Oversight Committee for auditing and supervising petroleum receipts and expenditures under ORML. The ORML Handbook has been prepared and is expected to be published soon. We are also implementing the Extractive Industries Transparency Initiative (EITI) process, as expressed at the third EITI conference in Oslo in October 2006. To improve implementation, we will integrate overlapping elements of the ORML and EITI.

22. **To promote private sector-led growth, the cost of investing and doing business in São Tomé and Príncipe must be reduced.** In consultation with the private sector, we have prepared for the NA's consideration draft legislation to reduce red tape and other regulatory impediments to starting a business. Once it is approved, the time needed for starting a business will be reduced from over 140 days to less than 3. We believe this and our other efforts to improve the investment climate will help attract private investment and improve the "doing business indicators" ("cost of starting a business" and "days to start a business") of the International Financial Corporation. Progress in these areas would facilitate our discussion with the U.S. Millennium Challenge Corporation for grant financing of our development projects.

23. **Regarding financial sector reform, the BCSTP intends to further enhance banking supervision, strengthen its internal management in line with the IMF safeguards assessment conducted in 2004, and implement the anti-money laundering law:**

- The BCSTP is strengthening its capacity to supervise licensing of new banks and assess bank foreign currency positions and operating risks. To further strengthen on- and off-site inspections, the BCSTP will by end-June 2007 issue new prudential regulations on credit classification, liquidity, transactions with related parties, and limits on bank net open foreign currency positions.
- The BCSTP has prepared regulations for implementing the AML/CFT law. Once the NA gives final approval of the AML/CFT law, these regulations will be issued, enabling the establishment of a Central Risk Unit within the BCSTP and imposing “know-your-client” rules on banks.
- Regarding safeguards assessment, the BCSTP has adopted investment guidelines for foreign reserves. It intends to develop annual audit plans based on a risk analysis of operations and review the role of the Audit Board to fully align its responsibilities with those of an independent audit committee.

D. External Debt and Debt Relief

24. **The government will work with the Paris Club and other bilateral official creditors for their full delivery of HIPC relief.** A meeting with Paris Club creditors is expected to take place in May 2007 on completion point debt relief. Regarding bilateral agreements using the September 2005 Paris Club terms of reference, the government has contacted its creditors and signed agreements with Germany, France, and Spain.

25. **On debt management, the government is conscious of the importance of ensuring debt sustainability after HIPC and MDRI debt relief.** To improve its capacity to manage external debt, we have put in place a debt recording and management system obtained from the Commonwealth Secretariat (CS-DRMS). Technical problems with the CS-DRMS software have been resolved, the Debt Office of the Ministry of Finance is transferring debt records to the new system, and a technical consultant from the Commonwealth Secretariat (with financial support from the World Bank) is expected to assist the Debt Office in the second half of 2007.

E. Statistical Issues and Capacity Building

26. **The National Institute of Statistics, notwithstanding limited capacity and funding, has made significant progress in improving our national accounts statistics.** It has revised GDP in recent years based on the 2001 population and business census. With improved coverage and updated sectoral weights, the new GDP series reflects more accurately our recent economic developments. The government is aware of the remaining weaknesses in national accounts, balance of payments, and government financial operations statistics (TOFE), for which we will seek further technical assistance from the IMF. To strengthen policy implementation and our capacity building, the government has contacted

the EU for support for a Resident Economic Advisor with technical backstopping from the IMF.

F. Program Monitoring

27. **The revised Technical Memorandum of Understanding (TMU) sets out the modalities of program monitoring.** This includes definitions of performance criteria and indicative targets; application of adjusters for deviations from programmed amounts of oil signature bonuses, budget support, and net external debt service payments; and data sources and frequency of data reporting.

28. **Table I.1 (attached) shows the proposed quantitative performance criteria for end-December 2007 (6th review of the program).** To facilitate implementation of the public financial management reform, structural benchmarks are proposed for end-June and end-September 2007 for the fifth review (Table I.2). The nonaccumulation of external payment arrears (as defined in the attached updated 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 2006–07
(Billions of dobras, unless otherwise specified)

	2006				2007			
	Sep. 30	Dec. 31		Actual	Mar. 31	Jun. 30	Sep. 30	Dec. 31
	Base (stocks)	Perf. Criteria	Perf. Criteria (with adjustors)		Ind. Target EBS/06/175	Perf. Criteria EBS/06/175	Ind. Target Proposed	Perf. Criteria Proposed
1. Floor on domestic primary balance (as defined in the TMU; cumulative from beginning of year)	...	-150.0	-150.0	-131.0	-27.3	-97.0	-115.0	-136.6
2. Ceiling on changes in net bank financing of the government (cumulative from end–September 2006; billions of dobras at program exchange rate) ^{1,2,3}	-126.8	62.1	63.0	14.4	-118.7	-32.4	-73.9	-33.8
3. Ceiling on changes in net domestic assets of the central bank (cumulative from end–September 2006; billions of dobras at program exchange rate) ^{1,2,3}	-289.8	73.1	74.0	-36.1	-79.0	-19.6	-7.8	26.3
4. Floor on changes in the net international reserves of the central bank (cumulative from end–September 2006; US\$ millions) ^{3,4}	41.8	-6.4	-6.7	-1.0	4.6	1.9	2.5	1.0
5. Ceiling on central government's outstanding external payment arrears (stock, US\$ millions) ⁵	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
6. 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 (cumulative flows from January 2005, € millions) ^{6,7}	...	1.6	1.6	1.4	1.6	1.6	1.6	1.6
7. 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) ⁸	...	1.0	1.0	0.0	1.0	1.0	1.0	1.0
Memorandum items:								
Base money (ceiling; billions of dobras)	273.2	269.5	269.5	278.0	282.0	302.5	325.0	336.4
Currency Issued (ceiling; billions of dobras)	94.4	103.6	103.6	102.7	108.8	105.0	112.4	124.3
Oil signature bonuses including accrued interest on NOA (US\$ millions, cumulative from beginning of year)	0.5	0.6	0.6	...	28.7	28.8	28.9	29.0
Net external debt service payments (cumulative from beginning of the year, billions of dobras at program exchange rate) ⁹	-35.4	-46.1	-69.5	...	-205.8	-211.0	-216.6	-220.4
Official external program support (cumulative from beginning of the year, billions of dobras at program exchange rate) ¹⁰	7.8	2.8	25.6	...	0.0	0.0	31.4	41.8

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

¹ The ceiling will be adjusted downward or upward by cumulative deviations in the same direction of actual from projected net payments in external debt service; and by deviations in the opposite direction in external program support and oil bonuses, including accrued interest on the National Oil Account (NOA). The downward 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.

² The ceiling will be adjusted downward by the amount of accumulated domestic arrears.

³ Includes the National Oil Account (NOA) at the Central Bank.

⁴ The floor on net international reserves will be adjusted upward or downward by the cumulative deviation in the opposite direction in external debt service (including repayments to Nigeria), and by deviations in the same direction for oil bonuses, including accrued interest on NOA. 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.

⁵ This is a continuous performance criterion.

⁶ 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* (August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received.

⁷ With a grant element of less than 50 percent. Includes a US\$2 million loan received from Angola to finance a social inclusion project.

⁸ Debt is defined as in point 9 of the *Guidelines on Performance Criteria with Respect to Foreign Debt* (August 24), 2000. Excludes US\$15 million in loans from Nigeria during 2002–04, which are to be repaid from signature bonuses in 2007.

⁹ Includes US\$15 million repayment to Nigeria.

¹⁰ Official external program support, as defined in the TMU, valued at the program exchange rate of 12,549 dobras per U.S. dollar (valued at projected average exchange rate of 13,935 dobras per U.S. dollar in fiscal table).

Table I.2. São Tomé and Príncipe: Structural Performance Criteria and Benchmarks, December 2006–December 2007

Action	Benchmark	Status
Prior action		
Adopt decree establishing the new public accounting plan and the related manual of accounting procedures, consistent with the organic public finance law and the public financial management system (SAFE).		An inter-ministerial commission was established to prepare for the decree. The decree was adopted on May 31, 2007.
December 31, 2006		
Implement the Commonwealth Secretariat debt recording management system (CS-DRMS) to improve the government's capacity to manage external debt.		Met, CS-DRMS installed in November 2006.
Submit to the National Assembly legislation criminalizing money laundering and the financing of terrorism.		Met, draft AML/CFT legislation submitted to the NA in October 2006.
March 31, 2007		
Adopt decree establishing the new public accounting plan and the related manual of accounting procedures, consistent with the organic public finance law and the public financial management system (SAFE).	Performance criteria	Delayed due to difficulties in obtaining timely technical assistance from a donor-financed consultant.
Publish the Handbook of the Oil Resource Management Law (ORML) by posting it on the government website. (planned for January 2007)		Delayed, Handbook prepared for web posting.
Issue regulations to implement the law against money laundering and the financing of terrorism (AML/CFT), notably for the Central Risk Unit within the BCSTP and "know-your-client" rules for banks.		Regulations prepared, pending NA approval of the AML/CFT law.
June 30, 2007		
Issue new prudential regulations on credit classification, liquidity, transactions with related parties, and limits on net open foreign currency positions.	Performance criteria	Regulations being prepared.
Produce the monthly budget execution report (TOFE) using upgraded SAFINHO.		SAFINHO in place, IT platform needs upgrading.
Finalize the installation of prepaid electricity metering systems (3,000).		Over 200 installed as of mid-February, 2007.
September 31, 2007		
Prepare the 2008 budget in line with the new organic budget (SAFE) law.		
December 31, 2007		
Implement the fully integrated computerized public financial management system (eSAFE) with new nomenclature, unified current and investment budgets, and incorporating public accounting (including of patrimony/debt).		
Adopt Petroleum Sector Strategy for development of the Exclusive Exploitation Zone (EEZ).		

ATTACHMENT II

SÃO TOMÉ AND PRÍNCIPE

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This technical memorandum of understanding (TMU) contains definitions and adjuster mechanisms that are intended to clarify the measurement of variables in Table I.1, Quantitative Performance Criteria, PRGF Arrangement, 2006–07, which is 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 end-September 2006.

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 the appropriate way of measuring and reporting. Performance criteria included in the program, as defined below, refer to domestic primary balance of the central government, net bank financing of the central government, net domestic assets and net international reserves of the central bank, external payments arrears, nonconcessional medium and long-term external debt, and short-term external debt.

Definitions

3. **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.

4. **Government non-oil revenue** comprises all tax and nontax revenue of the government (in domestic and foreign currency), excluding foreign grants, the receipts from the local sale of in-kind grants (e.g., crude oil received from Nigeria, food aid, etc.), and any gross inflows to government on account of oil signature bonus receipts and accrued interest in 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 Planning and Finance.

5. **Domestic primary expenditure** comprises all government spending assessed on a commitment basis (base “compromiso”), excluding: (i) foreign-financed capital expenditure; (ii) foreign-financed expenditure under the overseas scholarship program that is externally-financed; and (iii) 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 Planning and Finance.

6. Within domestic primary expenditure, **propoor expenditure** refers to government outlays recorded in the budget nomenclature that have a direct effect in 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. **Propoor current spending:** These cover the following ministries and expenditure categories (by budget code) as described in the matrix below.

Code	Description of expenditure	Ministry of Education	Ministry of Health	Ministry of Labour
01.00.00	Despesa com Pessoal	x	x	x
02.01.05	Outros bens duradouros	x	x	
02.02.02	Combustiveis e lubrificantes	x	x	x
02.02.04	Alimentacao	x		
02.02.05	Medicamentos	x	x	
02.02.06	Roupas e clasados	x	x	x
02.02.09	Outros bens nao duradouros	x	x	
02.03.01.01	Agua e energia	x	x	x
02.03.02	Conservacao de bens	x	x	
02.03.06	Comunicacoes	x	x	x
04.02.01	Instituicoes particulares	x		x
04.03.01	Particulares (Junta de Saude)	x		x
04.04.02	Outras transferencias para exterior		x	
06.01.00	Ensino e formacao		x	
06.04.01	Custos recorrentes de projectos	x		
06.04.04.02	Outros Diversos	x	x	

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

For 2007 onward, the definition of propoor current spending will be based on the new budget nomenclature.

b. **Propoor 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, planning and finance, youth and sports, provision of potable water, and electrification.

7. The **domestic primary balance** is defined as the difference between government domestic revenue and domestic primary expenditure. This balance for end-September 2006 was assessed at dobras –109.6 billion, broken down as follows:

Government domestic revenue:	Db 217.3 billion
Less: government primary expenditure (as defined in paragraph 5)	Db 326.9 billion
Equals: domestic primary balance:	Db -109.6 billion

8. **Domestic arrears** are defined as the difference between expenditure on a commitment basis and cash payments.

9. **The program exchange rate** for the purposes of this TMU will be Db 12,548.5 per U.S. dollar. The exchange rate of the dobra against the euro will be 15,952.93 and against the SDR will be 18,526.31.

10. **Net bank financing of the central government (NCG)** is defined as 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),² less all deposits held by the central government with DMBs, as they are reported monthly by the BCSTP to the IMF staff. All foreign exchange–denominated accounts will be converted to dobras at the program exchange rate. At end-September 2006, outstanding net bank financing of the government was assessed at dobras –126.8 billion, broken down as follows:

BCSTP credit, including use of IMF resources:	Db 105.8 billion
Less: government deposits with BCSTP:	Db 226.3 billion
<i>Of which:</i> National Oil Account (NOA)	Db 106.0 billion
Treasury foreign currency–denominated accounts	Db 43.9 billion
Treasury local currency–denominated accounts	Db 28.7 billion
Account for HIPC relief ³	Db 20.3 billion
Account for MDRI relief ⁴	Db 0.0 billion
Counterpart deposits	Db 22.6 billion
PRGF disbursement account	Db 4.7 billion

² Deposit money banks (DMBs) refers to other depository corporations, as defined in the *Monetary and Financial Statistics Manual*.

³ Pending the use of HIPC debt relief for propoor spending.

⁴ Pending the use of MDRI relief for propoor spending.

Equals: Net credit to government by the BCSTP:	Db –120.5 billion
Plus: DMBs credit:	Db 0.0 billion
Less: government deposits with DMBs (including counterpart funds):	Db 6.3 billion
Equals: Net bank financing of the government:	Db 126.8 billion

11. **Base money** is defined as the sum of currency issued—which consists of currency outside banks and cash in vaults—and bank reserves, at the program exchange rate. Bank reserves refer to reserves of commercial banks held with the central bank and include reserves in excess of the reserve requirements. At end-September 2006 base money was assessed at dobras 273.2 billion, calculated as follows:

Currency issued:	Db 94.4 billion
<i>Of which:</i> Cash in vaults:	Db 13.7 billion
Currency outside banks:	Db 80.7 billion
Plus: Bank reserves:	Db 178.7 billion
<i>Of which:</i> in dobras	Db 80.5 billion
in foreign currency	Db 98.2 billion
Equals: Base money:	Db 273.2 billion
<i>Of which:</i> in dobras	Db 175.0 billion

12. **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-September 2006 NIR was assessed at dobras 524.6 billion, calculated as follows:

Net international reserves:	Db 524.6 billion
<i>Of which:</i> gross reserves:	Db 552.3 billion
<i>Of which:</i> National Oil Account (NOA)	Db 106.0 billion
short-term liabilities:	Db –27.6 billion
Plus: Other foreign assets:	Db 91.9 billion

Plus: Medium and long- term liabilities: Db -53.6 billion

Equals: Net foreign assets: Db 563.0 billion

Memorandum item:

Net international reserves minus National Oil Account (NOA)

minus bank foreign currency deposits with the central bank Db 320.4 billion

13. **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 at programmed exchange rates. All foreign-denominated accounts will be converted to dobras at the program exchange rate. At end-September 2006, net domestic assets were assessed at dobras -70.0 billion, calculated as follows:

Base money: Db 273.2 billion

Less: Net foreign assets: Db 563.0 billion

Equals: Net domestic assets of the BCSTP: Db -289.8 billion

14. **Treasury deficit** of the BCSTP is defined as revenue (excluding unrealized valuation changes) minus costs minus investment.

15. The performance criterion on **short-term external debt** refers to the outstanding stock of external debt with an original maturity of one year or less (including overdraft positions) and owed or guaranteed by the government or the BCSTP.⁵ At end-September 2006 the stock of short-term external debt stood at US\$16.0 million.⁶

16. 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.^{7 8} Debt rescheduling and restructuring are

⁵ 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).

⁶ This amount includes three nonconcessional loans from Nigeria totaling US\$15 million, which were previously classified under nonconcessional medium-term external debt. They were reclassified as short-term debt after a joint World Bank-IMF debt sustainability analysis mission in April 2006.

⁷ 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.

⁸ 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 10-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 date of initial 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

(continued)

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 will consult with IMF staff before contracting obligations if it is uncertain as to whether those obligations are within the performance criterion limits.

17. 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, except for arrears pending rescheduling arrangements. The latter will be considered technical arrears. Debt would be deemed to be in arrears when it has not been paid by the time it is due, unless an arrear has been otherwise contractually defined. The performance criterion relating to external arrears does not apply to those pending the signing of bilateral agreements in the context of debt-rescheduling with the Paris Club and other bilateral creditors.

18. **Net external debt service payments** are defined as debt service due less interim HIPC debt relief (including multilateral and bilateral relief) and the accumulation of any new external payment arrears, including technical arrears.

19. **Official external program support** is defined as grants and loans, including in-kind aid when the products are sold by the government and receipts are freely usable by the budget, and other exceptional financing provided by foreign official entities and incorporated into the budget. Amounts assumed in the program consistent with this definition are shown in the memorandum item entitled “official external program support” of Table I.1.

Use of Adjusters

20. **Deviations in receipts of oil signature bonuses, including accrued interest on NOA, in official external program support, and in net external debt service payments**, from amounts projected for the program (see Table I.1) will trigger adjustments for net bank financing of the central government, net domestic assets of the BCSTP, and net international reserves, as indicated below. These deviations will be calculated cumulatively from end-September 2006 (see Table I.1).

21. **Ceilings on net bank financing (NCG) of the central government and net domestic assets (NDA) of the BCSTP:** Monthly differences between actual and projected receipts of oil signature bonuses, official external program support, and net external debt service payments in foreign exchange will be converted to dobras at the program exchange rate and aggregated from end-September 2006 to the test date. The ceilings on NCG and NDA will be adjusted downward by the positive sum, and upward by the negative sum, of the deviations of actual from projected receipts of oil signature bonuses, including accrued

loan is less than 50 percent (in other words, a grant element of at least 50 percent). For currencies with no available reference interest rates, the SDR rate will be used. This performance criterion does not apply to Fund resources.

interest on NOA; actual from projected official external program support; and projected from actual net external debt service payments. In the case of a negative sum of deviations (i.e., a shortfall), these ceilings will be increased by 100 percent of any cumulative shortfall. In case of a positive sum (i.e., a surplus), the downward adjustment to NCG and NDA 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 program exchange rates.

22. **Floor on net international reserves (NIR) of the BCSTP:** The quarterly difference between actual and projected receipts of oil signature bonuses, including accrued interest on NOA; official external program support; and net external debt service payments will be converted to dobras at the program exchange rate and aggregated from end-September 2006 to the test date. The floor on NIR will be adjusted upward by the positive sum and downward by the negative sum of the deviations of actual from projected receipts of oil signature bonuses, including accrued interest on NOA; actual from projected official external program support; and projected from actual net external debt service payments. In the case of a negative sum of deviations (i.e., a shortfall), this floor will be decreased by 100 percent of any cumulative shortfall. In case of a positive sum (i.e., a surplus), the downward adjustment to NIR 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 at program exchange rates. In addition, the NIR floor will be lowered by the amount that disbursements under the PRGF arrangement are lower than expected.

Data reporting

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

i. Fiscal data

The Directorate of Budget at the Ministry of Planning and Finance will provide to IMF staff, within two months 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”)
- 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 current and domestically financed capital expenditure on commitment (“compromiso”) and cash payments (“caixa”)
- Monthly data on domestic arrears by type
- Quarterly data on official external program support (nonproject)

- Quarterly data on the execution of the public investment program (PIP) by project and sources of financing
- Quarterly data on project grant and loan disbursement (HIPC and non-HIPC)
- Quarterly data on bilateral HIPC debt relief
- Quarterly data on project loan disbursements
- Latest outstanding petroleum price structures and submission of new pricing structures (within a week of any changes)

ii. Monetary data

The BCSTP will provide to 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 each year for annual data. Daily data will be provided every week no later than the Wednesday following the end of the week, and weekly data will be provided no later than two weeks after the end of the week. The BCSTP will provide

- Daily data on exchange rates
- Daily data on interest rates
- Daily liquidity management table, including base money and currency in circulation (see attachment)
- Daily net international reserve position
- 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 (*Orçamento cambial*)
- Quarterly table on bank prudential ratios and financial soundness indicators
- Quarterly data on the BCSTP's financial position (profit and loss statement, treasury deficit, budget execution)

iii. External debt data

The Debt Management Unit at the Ministry of Planning and Finance will provide to IMF staff, within two months after the end of each month

- Monthly data on amortization and interest of external debt by creditor: scheduled, subject to debt relief or rescheduling, and paid

- Quarterly data on disbursements for foreign-financed projects and program support loans

iv. National accounts and trade statistics

The following data will be provided to 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 and import taxes collected and arrears) and commodity export values), provided by Customs, within two months after the end of each month
- Monthly data on petroleum shipments and consumption (volumes and cif prices, by product)