International Monetary Fund

São Tomé and Príncipe and the IMF

Press Release:
IMF Executive Board Completes First Review under the ECF for São Tomé and Príncipe and Approves US$ 0.564 Million Disbursement
June 13, 2013

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

May 29, 2013

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

Letter of Intent

São Tomé, May 29, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

On July 20, 2012, the Executive Board of the International Monetary Fund (IMF) approved a new three-year arrangement under the Extended Credit Facility (ECF) in favor of the Democratic Republic of São Tomé and Príncipe. This arrangement intends to support the Government's medium-term efforts to strengthen macroeconomic stability, foster sustainable and inclusive growth, and reduce poverty. The Government recently discussed the first review under this arrangement with an IMF staff mission. The mission focused on program implementation through end-December 2012, as well as on the outlook and the fiscal and financial measures to be implemented during 2013.

Despite a challenging international environment, particularly in Europe, overall program implementation through end-December 2012 was good. All performance criteria were observed, and there was good progress on structural reforms. Negotiations between the Government, the Water and Electricity Company, EMAE, and the National Fuel Company, ENCO, on a lasting plan to clear EMAE's arrears to ENCO and to avoid a recurrence of this problem in the future have been more difficult than expected and are likely to be completed only by end-September 2013.

The Government is fully committed to build on these achievements in 2013. In this connection, fiscal policy will be set to support macroeconomic stability and ongoing efforts to lower inflation, by ensuring that the domestic primary deficit is in line with available non-debt-creating financing. Given the critical role of liquidity management and banking supervision in financial stability, the Government intends to ensure that the central bank remain independent to conduct its highly technical work.

The Government believes that the policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) are adequate to achieve the program's objectives, but it will take additional measures, if needed, to safeguard those objectives. São Tomé and Príncipe will consult with the IMF on the adoption of these measures, and in advance of any revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. The

Government will furnish the IMF with the necessary data for monitoring purposes on a timely basis. That information as well as arrangements for monitoring program implementation and the definitions of indicative targets and performance criteria are detailed in the Technical Memorandum of Understanding (TMU), which is also attached to this letter. During the program period, the Government will not introduce or intensify any exchange rate restrictions or multiple currency practice that are inconsistent with Article VIII of the IMF's Articles of Agreement, or introduce or intensify import restrictions for balance of payments purposes.

In light of the appreciable progress in implementing the program supported by the ECF arrangement, the Government is requesting the completion of the first review as well as the second disbursement of SDR 0.37 million under this arrangement.

The Government wishes to make this letter available to the public, along with the attached MEFP and TMU, as well as the IMF staff report on the first review. We therefore authorize their publication and posting on the IMF website, subject to Executive Board approval.

Yours truly,

/s/
Mr. Hélio Almeida
Minister of Planning and Finance

/s/
Ms. Maria do Carmo Silveira
Governor of the Central Bank of São Tomé and Príncipe

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

Attachment I—Democratic Republic of São Tomé and Príncipe: Memorandum of Economic and Financial Policies for 2013

I. INTRODUCTION

1. **A coalition government has been in office since late 2012**. The previous minority government of the ADI party, which took office in August 2010, was censured by the National Assembly on November 26, 2012, and formally dismissed by President Pinto da Costa on December 4, 2012. A new government consisting of the other three political parties with representation in the National Assembly was formed under the leadership of Prime Minister Gabriel Costa and sworn in by the President on December 12, 2012.

2. **The new government is committed to pursuing structural reforms and maintaining fiscal prudence and financial stability in line with the policies outlined in the ECF-supported program approved by the IMF Executive Board in July 2012**. The government's policies aim to create the foundations for economic development, focusing on job creation and poverty alleviation through sustainable and inclusive growth. In this connection, fiscal policy will be set to support macroeconomic stability and ongoing efforts to lower inflation by ensuring that the domestic primary deficit is in line with available non-debt creating financing. Given the critical role of liquidity management and banking supervision in macroeconomic and financial stability, the government intends to ensure that the central bank remain independent to conduct its highly technical work.

II. RECENT ECONOMIC DEVELOPMENTS AND NEAR-TERM OUTLOOK

3. **The economy remains vulnerable to shocks**. Growth decelerated to 4 percent in 2012—slightly lower than the programmed 4½ percent—reflecting persistent global uncertainties, particularly in Europe, which contributed to a slowdown in both foreign direct investment and the execution of the foreign-financed public investment program. After an initial decline to 8 percent in April 2012, its lowest level in a decade, inflation rose in the following months due to unseasonably heavy rains that disrupted the supply of perishables, reaching 10½ percent at end-2012—higher than the program's 8¼ percent. Credit growth came almost to a halt in 2012 as household debt levels reached record highs, and banks increased provisions for non-performing loans. The external current account deficit improved slightly in 2012 as weaker economic activity led to lower import growth, which more than offset rising international food and fuel prices.

4. **The government contained public spending to offset a revenue shortfall**. Revenue underperformance stemmed mainly from lower-than-projected customs duties and consumption and profit taxes given the weakening economy, and the accumulation of fuel tax arrears by the National Fuel Company (ENCO). The government contained domestic primary expenditures, primarily through a lower execution of transfers and domestically-financed capital expenditure, while lower goods and services outlays were largely related to unpaid utility bills. The domestic primary deficit reached 3.2 percent of GDP, as programmed.

5. **The near-term economic outlook is challenging**. Economic growth for 2013 has been revised downward, from 5½ to 4½ percent, in light of lingering uncertainties from a difficult external environment and weak external financing prospects for both private and public investment projects. Delayed execution of some construction projects, such as improvements to the airport, port, and roads, contribute to the projected small pickup in economic growth. Upside risks to this projection stem mainly from a stronger-than-expected pickup in Europe, and downside risks are mainly linked to possible further delays in project execution due to financing shortfalls. Inflation at end-2013 has been revised upward, from 6 percent to a range of 7–9 percent, reflecting a more realistic disinflation path in line with the experience so far with the exchange rate peg to the euro as well as vulnerabilities to supply shocks.[1] Foreign exchange reserves at the central bank are expected to remain above the program's floor of three months of imports in 2013.

III. PERFORMANCE UNDER THE ECF-SUPPORTED PROGRAM

6. **All continuous and end-December performance criteria (PCs) have been met** (Table 1). After missing the end-September 2012 indicative target (IT) on the domestic primary balance by about 0.4 percent of GDP, the government met the end-December PC by containing expenditure, fully offsetting revenue shortfalls. The end-September IT on net bank financing of the central government was missed as the central bank temporarily advanced funds to the government in line with existing legislation, and the end-December PC was met as the advance was fully repaid on October 26, 2012. The central bank met with large margins both the end-September IT and end-December PC on net international reserves as the government repaid in foreign currency the central bank's advance and the market valuation of central bank's securities improved. This unexpected increase in net international reserves led to a larger than projected increase in base money and, as a result, the IT on base money was exceeded for both end-September and end-December.

7. **Four structural benchmarks have been met (although two with a delay) and one partially met** (Table 2). As expected, the government developed a reform strategy plan to modernize the tax administration in line with IMF's Fiscal Affairs Department (FAD) recommendations, and the central bank set up a framework for liquidity forecasting with technical assistant (TA) from the IMF's Monetary and Capital Markets Department (MCM). The central bank finalized in November 2012 the on-site inspection of one commercial bank but, due to capacity constraints, finalization of the inspection of a second commercial bank happened only in April 2013. With TA from the IMF's Legal Department (LEG), the government drafted amendments to Law on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) and submitted the revised draft law to the National Assembly in May 2013, after receiving and analyzing the report of GIABA's December 2012 mutual assessment mission.[2] The government partially met the benchmark on reconciling and certifying cross-arrears between ENCO, the Water and Electricity Company (EMAE), and the Treasury and devising a plan to clear

[1] The dobra (Dbs) has been pegged to the euro (€) at a rate of Dbs 24,500 per € since 2010.

[2] GIABA is the regional intergovernmental action group against money laundering. São Tomé and Príncipe became a member of GIABA in June 2012.

these arrears and avoid this problem from recurring: (i) arrears between the Treasury and EMAE have been certified and brought down in February 2013 to Db 12 billion, from Db 72 billion; (ii) the Treasury plans to remain current on its payments to EMAE and clear the remaining Db 12 billion in arrears during the course of 2013; and (iii) EMAE's arrears to ENCO have been verified and certified. However, negotiations between the government, EMAE and ENCO on a plan to clear EMAE's arrears to ENCO and, more generally, to avoid a recurrence of cross-arrears, have been more difficult than expected and are likely to be completed only by end-September 2013.

IV. MACROECONOMIC POLICIES

A. Strengthening Public Finances

The 2013 Fiscal Framework

8. **The government is fully committed to maintaining fiscal prudence**. It has targeted in the recently approved budget a domestic primary deficit of 3.1 percent of GDP for 2013, which is slightly below last year's target and outcome. To meet the 2013 fiscal target, the government will strengthen revenue collections, by modernizing the tax and customs administrations and broadening the tax base (see below), and it will continue to contain non-priority spending. For example, the government has capped in the 2013 budget the nominal growth of the wage bill to 7 percent, by only granting wage adjustments to implement career plans in the areas of education and health. The fiscal program for 2013 is fully funded given that, in addition to National Oil Account (NOA) financing for US$ 1.8 million, the government has already secured budget support from the World Bank in the amount of US$ 4.2 million and from regional donors, including Nigeria, in the total amount of US$ 6.0 million.

Structural Reforms to Strengthen Public Finances

9. **The government's reform program to strengthen public finances will focus on tax and customs administration and public financial management (PFM)**. Specific actions in 2013 will include:

- Increasing taxpayer voluntary compliance by improving the quality of services to taxpayers, simplifying and harmonizing tax procedures, extending tax services to the more remote areas of the country, and conducting visits to newly created firms.

- Enhancing taxpayer management at the tax administration by increasing the security of the Taxpayer Registry, consolidating the segmentation of taxpayers, and creating a single taxpayer computerized file system.

- Combating tax fraud and evasion by improving the selection of taxpayers for audit through risk analysis, expanding tax coverage throughout the country, and strengthening the National Tax Court, by allowing it to perform its duties with own resources.

- Completing the second phase of ASYCUDA World implementation, by activating all its functionalities and fully establishing its computerized procedures.

- Providing the tax and customs administrations with the necessary resources, including additional staff and equipment, to implement the reforms mentioned above.

- Taking steps to make the government's financial administration system (SAFE-e) fully operational, including by activating the system's accounting module.

- Preparing by end-June 2013 the general government accounts for 2012, and presenting them to the National Assembly and Audit Court shortly thereafter. This will be the first time in two decades that the general government accounts will be prepared and discussed.

- Establishing by end-June 2013 a multi-sector unit, with representatives from the ministry of finance, central bank, and national institute of statistics, to develop an action plan for implementing a medium-term fiscal framework (MTFF).

- Achieving by end-September 2013 a long-lasting solution to the issue of cross-arrears between the Treasury, EMAE, and ENCO, by completing negotiations on 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.

B. Enhancing Liquidity Management, Financial Stability, and Safeguards

10. **The central bank will continue to modernize its liquidity management practices and strengthen its banking supervision function. In addition, the central bank will take steps to bolster safeguards to its balance sheet.** Specific actions in 2013 will include:

- Completing the on-site inspection of the largest commercial bank in the first half of the year, with on-site inspections of two additional commercial banks in the second half.

- Monitoring carefully the financial soundness of commercial banks and, as needed, requiring shareholders to promptly increase bank capital, against the background of rising non-performing loans and near-term prospects for low profitability and stagnant credit.

- Hiring additional supervisors to help increase the frequency of on-site inspections and improve the analysis of the commercial banks' quarterly reports.

- Strictly enforcing banking regulations, such as reserve requirements and dissemination of data to the credit registry; penalties will be applied to non-compliant institutions.

- Strengthening liquidity management, by expanding the forecasting horizon to one week, and developing a systematic approach toward analyzing forecasting errors and examining the evolution of daily aggregate liquidity surpluses/shortages.

- Supporting the exchange rate peg, by maintaining net international reserves at the central bank above the equivalent to three months of imports, and investing central bank international reserves in high quality and liquid financial assets.

- Improving external communications policies to strengthen credibility in the financial system, including regular publication of reports and economic bulletins, strengthening the capacity of the Office of Consumer Affairs, and promoting financial literacy.

- Encouraging the use of credit and debit cards, point-of-sale terminals, ATMs, and secure mobile-banking, with the objective of expanding the operations of the electronic payments system to the whole country.

- Expanding the role of the Internal Audit Department to track more systematically the implementation of external auditors' recommendations and monitor the main risks to the central bank's balance sheet.

- Introducing a new chart-of-accounts and reporting at the central bank in line with international financial reporting standards (IFRS).

V. STRENGTHENING THE ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (AML/CFT) FRAMEWORK

11. **The government is fully committed to addressing the deficiencies of São Tomé and Príncipe's AML/CFT framework**. With LEG TA, it drafted amendments to the AML/CFT law and submitted the revised draft law to the National Assembly in May 2013. Approval of this law will be an important step toward removing São Tomé and Príncipe from the Financial Action Task Force's list of high risk and non-cooperative jurisdictions. In addition, the government will strengthen the operations of the Financial Intelligence Unit (FIU) by providing it with the needed additional staff and equipment, and facilitating the training of its staff. These actions are meant to strengthen the FIU core functions, such as the receipt, analysis, and submission to the general attorney's office of suspicious transaction reports from financial and non-financial institutions and professions.

VI. STATISTICS

12. **The government continues to work on strengthening the statistical system**. In addition to the expected improvements listed above regarding the preparation of consolidated government accounts and the introduction at the central bank of IFRS consistent reporting and chart-of-accounts, the National Institute of Statistics (INE) is taking steps to improve the outdated consumer price index (CPI). The household survey completed in 2011 will serve as the basis for reweighting the CPI components and introducing new goods and services to the CPI basket (both were last updated twenty years ago). The new CPI is expected to be ready by end-December 2013, greatly improving the measurement of inflation.

VII. PROGRAM MONITORING

13. The government will maintain unchanged the previously agreed PCs, ITs, and structural benchmarks for the second review. Together with those, the new PCs, ITs, and structural benchmarks for the period of July through December 2013 are presented in Tables 3 and 4. The definitions of quantitative PCs and ITs are provided in the attached Technical Memorandum of Understanding (TMU). The second review is expected to be completed by November 2013 and the third by May 2014.

Table 1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2012

(Billions of dobra, cumulative from beginning of year, unless otherwise specified)

	2012					
	September			December		
	Indicative Target	Indicative Targets w/adjustment	Actual	Performance Criteria [1]	Performance Criteria w/adjustment	Actual
	30-Sep-12	30-Sep-12	30-Sep-12	31-Dec-12	31-Dec-12	31-Dec-12
Performance criteria:						
1 Floor on domestic primary balance (as defined in the TMU) [2]	-99	-99	-110	-164	-164	-163
2 Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5, 6]	0	-24	11	0	45	-65
3 Floor on net international reserves of the central bank (US$ millions) [2, 4]	21.97	23.24	27.54	21.97	19.59	39.08
4 Ceiling on central government's outstanding external payment arrears (stock, US$ millions) [5, 7, 8, 9]	0	...	0	0	...	0
5 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, 7, 8, 9, 10, 11]	0	...	0	0	...	0
6 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, 8, 9, 10, 11]	0	...	0	0	...	0
Indicative targets:						
Ceiling on central government's outstanding domestic arrears	0	...	49	0	...	33
Ceiling on dobra base money (stock)	515	...	536	551	...	616
Floor on pro-poor expenditures	213	...	193	285	...	288
Memorandum items:						
Transfer from NOA to the budget (US$ millions)	1.2	...	1.2	1.2	...	1.2
Net external debt service payments [12]	59	...	28	79	...	73
Official external program support [12]	141	...	85	278	...	194
Treasury-funded capital expenditure	58	...	60	96	...	74

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

[1] Performance at the December test date is assessed on the first review.

[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 point 3 of the TMU, which excludes the operations of state-owned enterprises.

[6] The December 2012 figure reflects a small correction in the recording of IMF loans.

[7] This criterion will be assessed as a continuous performance criterion.

[8] 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).

[9] 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, ¶ 14-16.

[10] 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 December 1, 2009). For further details on the definition of concessionality refer to the TMU, Footnote 6.

[11] 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, ¶ 14-15.

[12] As defined in the TMU, valued at the program exchange rate.

Table 2. São Tomé and Príncipe: Structural Benchmarks for 2012

Category		Structural Benchmarks	Economic rationale	Indicative timeframe	Status
		Strengthening Public Finances			
Tax administration	i.	Develop a reform strategy plan to modernize tax administration in line with FAD recommendations.	Strengthen revenue administration	End-Dec. 2012	Met
Internal control	ii.	Strengthen internal control, by Reconciling and certifying the cross-arrears between ENCO, EMAE, and the Treasury, and agreeing on a strategy to address these and to prevent future accumulation of arrears between these entities.	Strengthen PFM	End-Dec. 2012	Partially met
		Enhancing Monetary Management and Financial Stability			
Liquidity management	iii.	Improve liquidity management, by Setting up a framework for forecasting liquidity, international reserves, and government accounts to identify the level of excess or deficit in liquidity.	Strengthen the monetary policy framework	End-Dec. 2012	Met
Bank supervision	iv.	Strengthen banking supervision and regulation, by Completing the on-site supervision process for two commercial banks.	Ensure financial stability	End-Dec. 2012	Met with delay
		Strengthening AML/CFT Framework			
AML/CFT Framework	v.	Strengthening AML/CFT, by Submitting to parliament appropriate draft amendments to the AML/CFT law.	Bring the AML/CFT legislation in line with FATF standards and contribute to delisting from FATF blacklist	End-Dec. 2012	Met with delay

Table 3. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2013

(Billions of dobra, cumulative from beginning of year, unless otherwise specified)

	2013			
	March	June	September	December
	Indicative Target	Performance Criteria [1]	Indicative Target	Performance Criteria [1]
	31-Mar-13	30-Jun-13	30-Sep-13	31-Dec-13
Performance criteria:				
1 Floor on domestic primary balance (as defined in the TMU) [2]	-47	-105	-142	-178
2 Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	0	0	0	0
3 Floor on net international reserves of the central bank (US$ millions) [2, 4]	21.97	21.97	21.97	21.97
4 Ceiling on central government's outstanding external payment arrears (stock, US$ millions) [5, 6, 7, 8]	0	0	0	0
5 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	0	0	0
6 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
Indicative targets:				
Ceiling on central government's outstanding domestic arrears	0	0	0	0
Ceiling on dobra base money (stock)	635	649	675	715
Floor on pro-poor expenditures	73	146	219	292
Memorandum items:				
Transfer from NOA to the budget (US$ millions)	1.8	1.8	1.8	1.8
Net external debt service payments [11]	14	35	57	81
Official external program support [11]	74	158	168	193
Treasury-funded capital expenditure	25	31	90	99

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

[1] Performance at the December test date is assessed on the first review.

[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 point 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, ¶ 14-16.

[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 December 1, 2009). For further details on the definition of concessionality refer to the TMU, Footnote 6.

[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, ¶ 14-15.

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

Table 4. São Tomé and Príncipe: Structural Benchmarks for 2013

Category		Structural Benchmarks	Economic rationale	Indicative timeframe
		Strengthening Public Finances		
External control	i.	Strengthen external control, by Preparing the general government accounts for 2012 and sending them to the National Assembly and the Court of Audit.	Strengthen PFM	End-Jun. 2013
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.	Strengthen PFM	End-Sep. 2013
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.	Strengthen revenue administration	End-Dec. 2013
Customs administration	iv.	Complete the second phase of ASYCUDA WORLD implementation, by Activating all the functionalities and the establishing a fully computerized procedure.	Strengthen revenue administration	End-Dec. 2013
		Enhancing Monetary Management and Financial Stability		
Bank supervision	v.	Strengthen banking supervision and regulation, by	Ensure financial stability	
		Completing the on-site supervision process for the largest commercial bank.		End-Jun. 2013
		Completing the on-site supervision process for the remaining two commercial banks.		End-Dec. 2013
		Statistics		
CPI statistics	vi.	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

Attachment II—Democratic Republic of São Tomé and Príncipe: Technical Memorandum of Understanding

May 2013

1. This Technical Memorandum of Understanding (TMU) contains definitions and adjuster mechanisms that clarify the measurement of quantitative performance criteria and indicative targets in Tables 1 and 3, which are attached to the Memorandum of Economic and Financial Policies for 2013. 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.

I. 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 monthly 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, as defined below, refer to the domestic primary balance and net bank financing of the central government, net international reserves of the central bank, external payments arrears, and non-concessional short-term and medium- and long-term external debt owed or guaranteed by the central government and/or the central bank.

II. 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 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 Planning and Finance.

5. **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 Planning and Finance.

6. Within domestic primary expenditure, **pro-poor expenditure** refers to 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 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	Personnel expenses	x	x	x
02.01.05	Other durable goods	x	x	
02.02.02	Fuel and lubricants[1]	x	x	x
02.02.04	Food[1]	x		
02.02.05	Medicine	x	x	
02.02.06	Clothing and footwear[1]	x	x	x
02.02.09	Other nondurable goods	x	x	
02.03.01.01	Water and energy	x	x	x
02.03.02	Custody of goods	x	x	
02.03.06	Communications	x	x	x
04.02.01	Private institutions	x		x
04.03.01	Individuals	x		x
04.04.02	Other inward transfers		x	
06.01.00	Education and training		x	
06.04.01	Project costs	x		
06.04.04.02	Miscellaneous	x	x	

[1] 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.

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.

7. **Treasury-funded capital expenditure**: This is classified as part of domestic primary expenditure and covers projects that are not directly financed by project grants and concessional loans. Treasury funded capital spending will correspond to the 2012 and 2013 government plans for investment on roads, bridges, schools, water and power. It will include 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. The government investment program will be carried out by the Ministries of Public Works and Natural Resources, Education, and Health.

8. **Domestic primary balance** is defined as the difference between government domestic revenue and domestic primary expenditure. For reference, this balance for end-December 2012 was 163 billion dobra, broken down as follows:

	Government domestic revenue:	771 billion
Less:	Government primary expenditure:	
	(As defined in paragraph 5)	934 billion
Equals:	Domestic primary balance:	-163 billion

9. **Domestic arrears** are defined as the difference between expenditure on a commitment basis and cash payments (amounts past due after 40 days and unpaid).

10. **The program exchange rate** for the purposes of this TMU[1] will be: (i) 19,008 dobra per U.S. dollar, 24,500 dobra per euro, and 28,987 dobra per Special Drawing Right (SDR) for 2012; and (ii) 18,585 dobra per U.S. dollar, 24,500 dobra per euro, and 28,563 dobra per SDR for 2013.

11. **Net bank financing of the central government (NCG)** is defined as 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 2012, outstanding net bank financing of the central government (excluding NOA) was 44 billion dobra, broken down as follows:

	BCSTP credit, including use of IMF resources:		233 billion
Less:	Government deposits with the BCSTP (excluding NOA)		95 billion
	Of which:	Treasury dobra-denominated accounts	4 billion
		Treasury foreign currency-denominated accounts	26 billion
		Counterpart deposits	65 billion
Equals:	Net credit to government by the BCSTP		138 billion
Plus:	ODC's credit to the government		3 billion
Less:	Government deposits with ODCs (including counterpart funds)		96 billion
Equals:	Net bank financing of the government (excluding NOA)		44 billion

12. **Dobra base money** is defined as 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 2012 dobra base money was 616 billion dobra, calculated as follows:

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

	Currency issued:		217 billion
	Of which:	Cash in vaults	41 billion
		Currency outside depository corporations	176 billion
Plus:	Bank reserves denominated in dobra		399 billion
Equals:	Dobra base money		616 billion

13. **Net international reserves** (NIR) of the BCSTP are defined for program-monitoring purposes as short-term, 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 2012 NIR was 717 billion dobra, calculated as follows:

Gross international reserves:				933 billion
	Of which:	Cash		19 billion
		Demand deposits		127 billion
		Term deposits (including banks' deposits in foreign currency)		388 billion
		Securities other than shares		376 billion
		Of which:	Portuguese Treasury bonds	92 billion
			Rede Ferroviaria Nacional bonds	123 billion
			Less: discount (71.60)	35 billion
			Mortgage-backed securities of CDG	195 billion
		Accrued interest on securities		10 billion
		Reserve position in the Fund		0 billion
		SDR holdings		13 billion
Less:	Short-term liabilities (including liabilities to the IMF)			110 billion
Less:	Banks' reserves denominated in foreign currency			97 billion
Less:	Banks' guaranteed deposits denominated in foreign currency			10billion
Equals:	Net international reserves			717 billion
Plus:	Other foreign assets			249 billion
Less:	Medium and long-term liabilities (including SDR allocation)			203 billion
Equals:	Net foreign assets			763 billion
Memorandum item:	National Oil Account (NOA)			168 billion

14. **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 but excluding normal import credits) owed or guaranteed by the government and/or the BCSTP.[2] 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 year will be excluded from the short-term external debt limit. However, outstanding balances at the end of a given year will be included in the assessment of compliance with the short-term external debt performance criterion. For reference, at end-December 2012 the stock of short-term external debt was zero.

15. **The performance criterion on nonconcessional medium- and long-term external debt is a continuous performance criterion** that refers to the contracting or guaranteeing of new external debt with original maturity of more than one year by the government and/or the BCSTP.[3,4] Debt being rescheduled or restructured is excluded from the ceilings set on nonconcessional borrowing. Medium- and long-term debt will be reported by the Debt Management Department of the Ministry of Planning and Finance (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.

16. **The non-accumulation of 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 Department of the Ministry of Planning and Finance and (as appropriate) by the BCSTP, except for arrears pending rescheduling arrangements. The latter are considered as technical arrears. Debt would be deemed to be in arrears when it has not been paid by the time it is due, unless arrears have otherwise been contractually defined. This performance criterion does not apply to those arrears pending the signing of bilateral agreements in the context of debt-rescheduling with the Paris Club, if any, and other bilateral creditors.

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[2] The term "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.

[3] 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.

[4] The level of concessionality of loans is assessed according to the reference interest rate by currency published, by the Export Credit Division of the Organization for Economic Cooperation and Development. For loans of terms of no less than 15 years, the 10-year average of commercial interest reference rates for the currency in which the loan is denominated will be used. For loans of shorter terms, the six-month average will apply. For least developed countries, such as São Tomé and Príncipe, 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 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 IMF facilities.

17. **Net external debt service payments** are defined as debt service due less the accumulation of any new external payment arrears, including technical arrears.

18. **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. Amounts assumed in the program consistent with the definition are shown in Tables 1 and 3 of the MEFP as a memorandum item labeled "official external program support."

III. USE OF ADJUSTERS

19. **The performance criterion on the domestic primary deficit will have one adjuster**. The limit on the domestic primary deficit will be adjusted upward if the government finds budget support and privatization receipts in 2012 and 2013 in addition to that described in the MEFP; this adjuster will be capped at 22 billion dobra (½ percent of 2011 GDP) for 2012, and at 50 billion dobra (1 percent of 2012 GDP) for 2013.[5]

20. **Adjusters for the performance criteria on net bank financing of the central government and net international reserves will be set**. 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 2011 or end-December 2012, as appropriate (MEFP, Tables 1 and 3). The following is an explanation of these adjustments:

- **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 2011 or end-December 2012, 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 2011 or end-December 2012, as appropriate, to the test date. The floor will be

[5] Grants and related expenditures to cover the cost of the elections will be excluded from the measurement of the domestic primary deficit.

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$18.97 million.

IV. Data Reporting

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

1) **Fiscal Data**: The Directorate of Budget at the Ministry of Planning and Finance 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;
- 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 any changes).

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. Weekly data will be provided no later than two weeks after the end of the week. 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 balance sheet data of individual other depository corporations (in IMF report form 2SR);
- 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 Debt Management Unit at the Ministry of Planning and Finance 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.

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 Planning and Finance , 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.