September 2008
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Democratic Republic of São Tomé and Príncipe: 2008 Article IV Consultation and Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and Request for Waivers of Performance Criteria—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Democratic Republic of São Tomé and Príncipe

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2008 Article IV consultation with the Democratic Republic of São Tomé and Príncipe and sixth review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waivers of performance criteria, the following documents have been released and are included in this package:

- The staff report for the combined 2008 Article IV Consultation and Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waivers of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on March 26, 2008, with the officials of the Democratic Republic of São Tomé and Príncipe on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 4, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement on the joint IMF/World Bank debt sustainability analysis.

- A Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its June 18, 2008 discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- A statement by the Executive Director for the Democratic Republic of São Tomé and Príncipe.

The documents listed below have been or will be separately released.

Selected Issues Paper
Letter of Intent sent to the IMF by the authorities of the
Democratic Republic of São Tomé and Príncipe*
Memorandum of Economic and Financial Policies by the authorities of the
Democratic Republic of São Tomé and Príncipe *
Technical Memorandum of Understanding*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

Staff Report for the 2008 Article IV Consultation and Sixth Review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility, and Request for Waivers of Performance Criteria

Prepared by the African Department
(In consultation with other departments)

Approved by Jean A. P. Clément and Scott Brown

June 4, 2008

Main topics

Program review. Overall economic performance has been mixed. Staff supports the authorities' request for waivers of nonobservance of two quantitative performance criteria and one structural performance criterion for end-December 2007, based on remedial measures and policy commitments for the remainder of the program.

Article IV consultation. Based on a review of São Tomé and Príncipe's recent adjustment experience, this report discusses policy challenges over the medium-term. The discussions focused on the need to consolidate the macroeconomic environment and develop the country's production and export base, to achieve a sustainable private sector-led growth and reduce poverty.

The exchange rate system is a managed float. Sustainability of the country's external position depends critically on finding commercially extractable oil reserves. If oil prospects do not materialize, maintaining external stability will require further economic adjustment, including that of the real exchange rate.

Mission

Discussions were held in São Tomé during March 13-26, 2008. The staff team comprised Mr. Wang (head), Ms. Farhan, Ms. Takebe, and Mr. Fernandez (All AFR). Mr. Shanghavi (AFR) helped prepare the staff report. The mission met with Mr. Trovoada, the Prime Minister, Mr. Cravid, Minister of Planning and Finance, Ms. Soares, former Acting Governor of the Central Bank (BCSTP), other senior government and central bank officials, members of the National Assembly, trade unions, and representatives of the private sector, the donor community, and the press.

Selected issues papers

Two selected issues papers were prepared, based on a seminar held in São Tomé during the mission, on the policy mix to achieve a sustainable reduction in inflation and domestic revenue mobilization.

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Abbreviations and Acronyms

GDP	Gross Domestic Product
NIR	Net international reserves
AML/CFT	Anti-Money-Laundering/Combating Financial Terrorism
BCSTP	Central Bank of São Tomé and Príncipe
DPO	Development Policy Operation of the World Bank
DSA	Debt Sustainability Analysis
EEZ	Exclusive Economic Zone
EITI	Extractive Industries Transparency Initiative
JDA	Joint Development Agency (with Nigeria)
ORML	Oil Revenue Management Law
NA	National Assembly
EMAE	Water and electricity state enterprise
ENASA	Airport state enterprise
ENAPORT	Port state enterprise
INE	National Institute of Statistics
SAFE	Public financial management system
eSAFE	Integrated computerized SAFE
SAFINHO	Pilot system for eSAFE
PRSP	Poverty Reduction Strategy Paper
HIPC	Heavily indebted poor countries
MDRI	Multilateral Debt Relief Initiative
IDA	International Development Association (of the World Bank Group)
MCC	Millennium Challenge Corporation
LOI	Letter of Intent
MEFP	Memorandum of Economic and Financial Policies
TMU	Technical Memorandum of Understanding

EXECUTIVE SUMMARY

Economic performance under the PRGF-supported program has been mixed. While economic activity remained robust, inflation accelerated in the second half of 2007, reflecting surging international prices of food and fuel, as well as a budgetary expenditure overrun, which put pressure on base money growth. As a result, the performance criteria for end-December 2007 related to the domestic primary fiscal deficit and net credit to the government were not met. The structural performance criterion for end-2007 on a pilot system to strengthen budget execution and monitoring was implemented with delay—the intended steps were taken in early 2008.

Discussions for the sixth and final review under the PRGF arrangement focused on corrective measures to restore financial stability. The authorities are committed to strengthening expenditure control and reducing the domestic primary deficit in 2008. To mitigate the impact of the recent shocks, the fiscal program has been eased to provide targeted assistance to the poor, drawing on additional World Bank grants. A more active monetary policy has led to a slow down in base money growth and currency depreciation in the first quarter of 2008.

Maintaining external stability over the medium term requires further economic adjustment, continued donor support, and a significant improvement in export earnings. São Tomé and Príncipe's medium-term outlook depends critically on the prospects for oil exports and revenue, which remain uncertain at this time. The main challenges are to maintain fiscal sustainability and to develop the country's production and export base. The pursuance of fiscal consolidation and an active monetary policy in the context of a flexible exchange rate regime will be important to buttress macroeconomic stability. Prudent policy on external borrowing will also be important for maintaining debt sustainability.

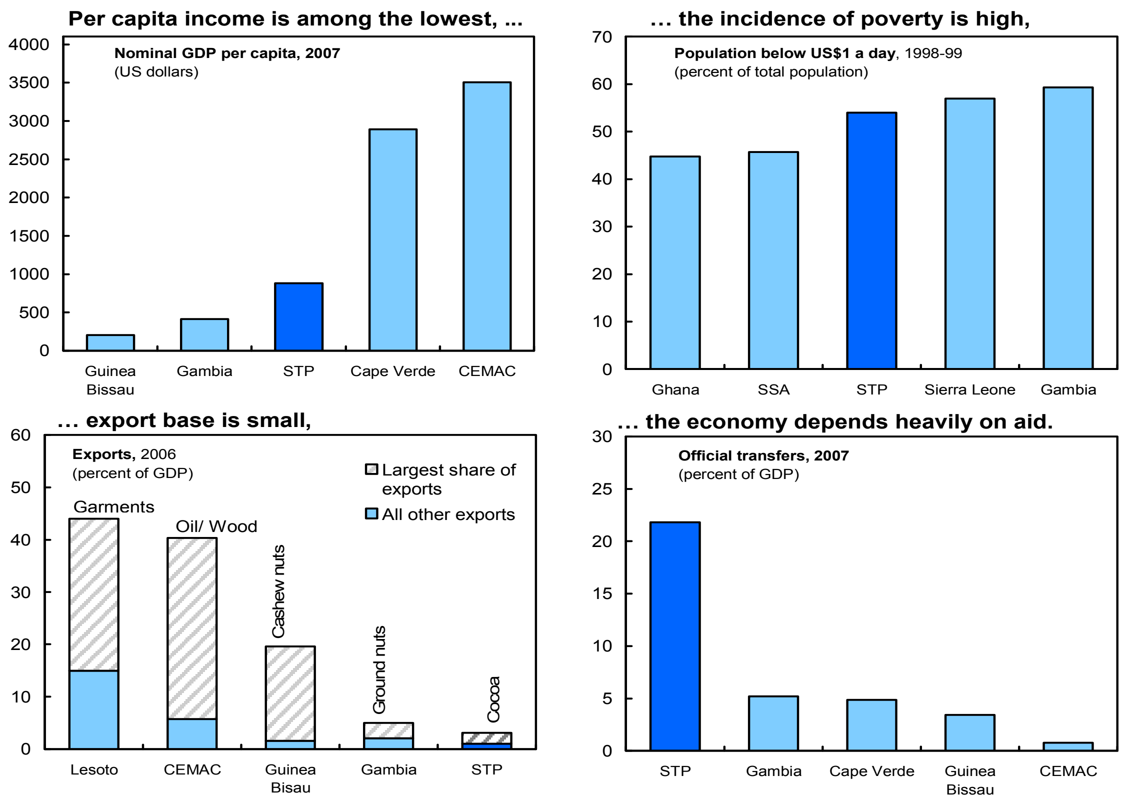
There was broad agreement that structural reforms need to be accelerated to achieve a sustainable private sector-led growth. The improvement of the investment climate through regulatory reform and upgrading infrastructure are vital for attracting private investment. The authorities welcomed the staff's assessment of the country's monetary and exchange arrangements and are committed to maintaining an open exchange and trade regime.

Staff recommends completion of the sixth review based on understandings reached on policy implementation. Staff supports the authorities' request for waivers for the nonobservance of the afore-mentioned quantitative and structural performance criteria for end-December 2007, based on the authorities' remedial actions to contain budgetary expenditure and base money growth below the indicative targets and policy commitments for the remainder of the program.

I. Background

1. **São Tomé and Príncipe is a small, open, low-income economy, with a very narrow production and export base** (Figure 1). The country's main export commodity is cocoa but the once-dominant agriculture sector has declined over the last three decades. Tourism is relatively small and brings in little net foreign exchange receipts because it relies heavily on imported goods and services. In recent years, public finances have been supported by large oil signature bonuses, but exploratory drilling for oil has not yet confirmed the existence of commercially extractable reserves.

Figure 1. São Tomé and Príncipe: Income and Exports in a Regional Context



Source: World Development Indicators, São Tome and Príncipe authorities, and IMF staff estimates.

2. **The authorities have embarked on economic adjustment and reform supported by the Fund under the PRGF since August 2005**. Growth has been robust and progress has been made in reducing fiscal imbalances and the pubic debt burden. The country reached the completion point under the enhanced HIPC Initiative in March 2007 and benefited from HIPC/MDRI debt relief. By September 2007, creditors representing over 80 percent of the country's external debt at the completion point had agreed to deliver HIPC debt relief, enabling the Fund to disburse its share of topping-up assistance.

3. **The cabinet has been reshuffled in late 2007 and early 2008**. A coalition government took office in February 2008 but suffered recently a vote of no confidence in the National Assembly (NA). Under the constitutional arrangements, the current government remains in power until it is replaced democratically by a new government.

4. **In the last Article IV consultation, Directors emphasized the importance of developing solid institutions to secure transparent management of oil revenue, strengthening macroeconomic policies and accelerating structural reforms to broaden the economy's productive base**. Progress has been made in strengthening the management of oil-related resources. The country is now a Candidate State of the Extractive Industries Transparency Initiative (EITI). However, broadening the country's production and export base remains a challenge.

II. Recent Developments and Performance under the Program

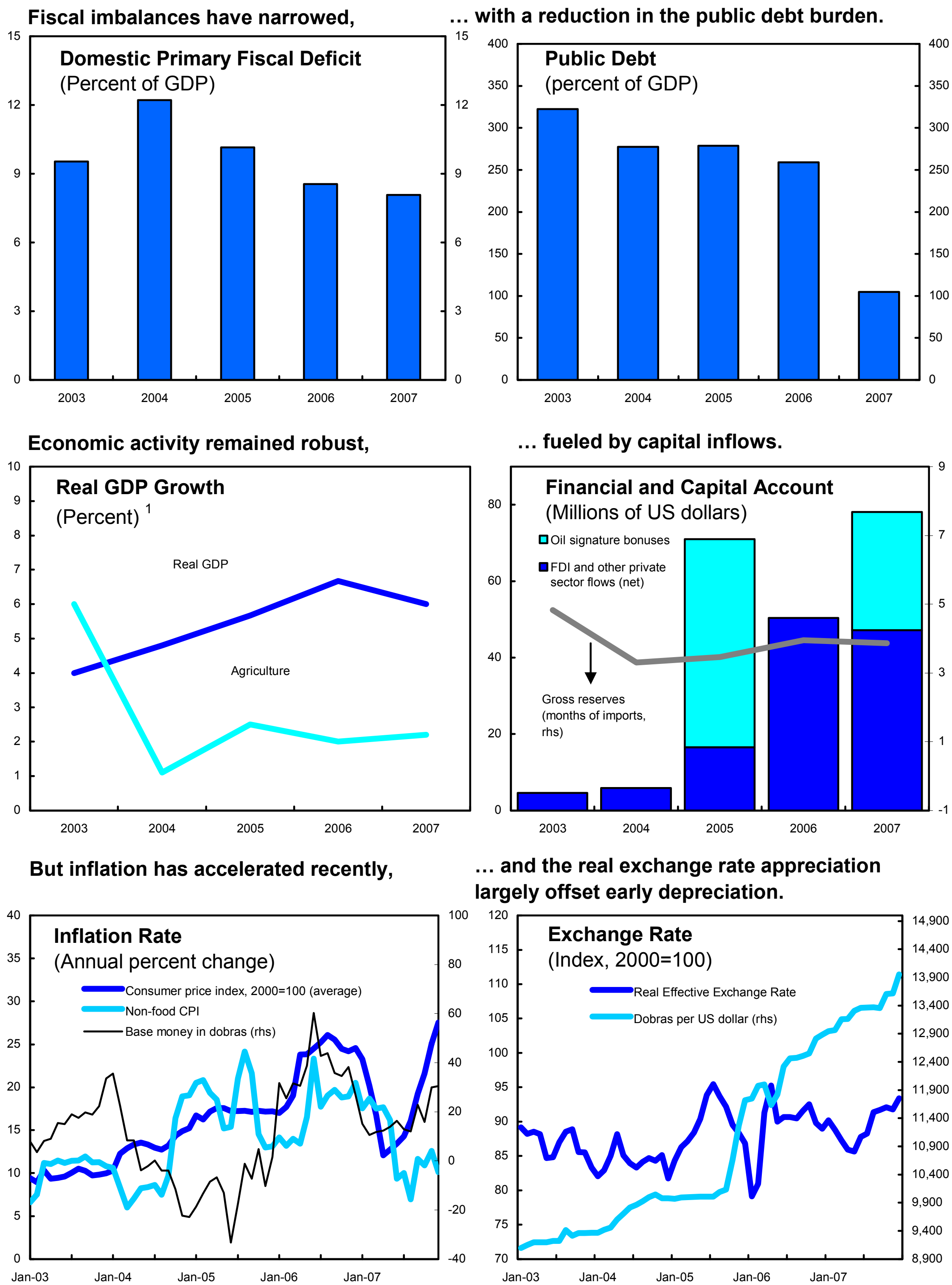
5. **Real GDP grew at an estimated 6 percent in 2007** (Figure 2 and Table 1). Growth was led by the construction and services sectors boosted by tourism-related foreign direct investment.[1] However, spillover from foreign-funded tourism projects to local employment and income is still limited because of the high import content of these projects. Exports recovered slightly on the back of rising international price of cocoa.

6. **After declining to 14 percent in the first half of the year, annual inflation rose to 28 percent by the end of 2007**. This rebound was spurred by surging food and oil prices, upward adjustments of utility tariffs to cover the bulk of the costs, and depreciation of the dobra, particularly against the euro, the main invoicing currency for imports. Excluding food items, inflation was 10 percent (year-on-year) at the end of 2007, compared to 20 percent a year ago (Box 1). In real effective terms, the exchange rate changed little as appreciation in the second half of 2007 largely offset the depreciation early in the year.

7. **The domestic primary deficit was larger than programmed in 2007, despite higher revenue** (Table 2 and Table I.1). This was on account of a large increase in current spending, especially payments to EMAE, the state-owned utility company, to cover part of the costs to households arising from the utility tariff hike. High current spending also crowded out funding available for domestically financed capital expenditure. The domestic primary deficit, at 1.1 percent of GDP higher than the program target, was financed by a larger-than-projected drawdown of government deposits at the central bank (BCSTP), including from the National Oil Account (NOA).

[1] The building of a hotel complex by Grupo Prestana, a Portuguese company, is underway, with total investment amounting to €35 million.

Figure 2. São Tomé and Príncipe: Recent Macroeconomic Developments, 2003–2007



Sources: São Tome and Príncipe authorities; and IMF staff estimates.

[1] There is a break in the GDP data series between 2003 and 2004.

Box 1. Recent Rise in Inflation: Domestic Policies vs. External Shocks

Headline inflation went up sharply in the second half of 2007. During this period, a 30 percent general wage increase and faster-than-programmed liquidity growth resulted in a significant depreciation of the dobra against the euro and the U.S. dollar. In response to rising international prices, the authorities raised domestic prices of petroleum products (by 14-25 percent) and electricity and water tariffs (by 40-60 percent) in September 2007. Moreover, rising import prices for food items contributed to higher inflation.

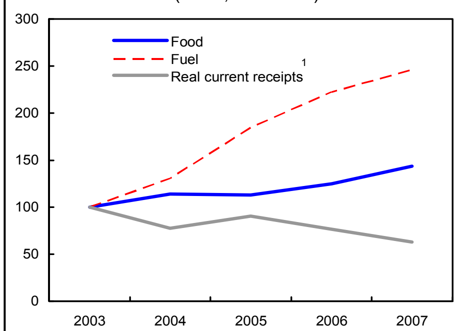
Food consumption in São Tomé and Príncipe depends heavily on imports, and food items account for 72 percent of the CPI basket. Retail prices for food increased by 38 percent in 2007.

Staff estimates suggest that of the 3 percent increase in inflation in February 2008, about 1 percent can be attributable to base money growth and exchange rate depreciation, 1.5 percent to food and oil import prices, and the remaining 0.6 percent to other factors.[1]

As a result of higher import prices, the country's external current receipts declined by an estimated 18 percent in real terms in 2007.

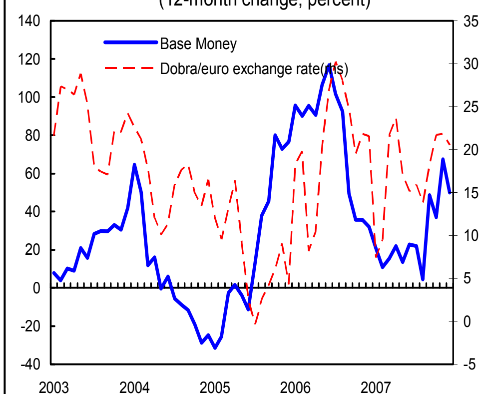
[1] See the accompanying selected issues paper for more details.

Food and Fuel Import Prices
(Index, 2003=100)



Source: World Economic Outlook and staff estimates.
[1] Defined as the sum of all receipts in external current account deflated by an index of food (56 percent weight) and fuel (44 percent weight) prices.

Base Money and Exchange Rate
(12-month change, percent)



Sources: IFS and São Tome and Príncipe authorities.

8. **Monetary policy implementation was complicated by volatile capital inflows and was not adequate in controlling base money growth** (Table 3). The BCSTP's sterilization of budgetary use of oil bonuses fell short of what was needed to mop up excess liquidity. As a result, net international reserves of the BCSTP were US$6 million above the program target at the end of 2007. The excess liquidity put downward pressure on the exchange rate and the spread between central bank and commercial bank exchange rates widened to over 2 percent.

9. **São Tomé and Príncipe has maintained an open trade regime**. The tariff reform, which started in 2002, has lowered the simple average tariff rate to 11.7 percent and reduced non-tariff trade barriers. In late 2007, the authorities decided not to sign the European Union Economic Partnership Agreement (EPA), emphasizing the importance of first creating competitive export sectors, particularly in agriculture, and reducing reliance on trade taxes before joining the EPA.

10. **Progress continued on structural reforms albeit slower than envisaged**. The end-December 2007 structural performance criterion on upgrading the pilot system (SAFINHO) to strengthen budget execution and monitoring was implemented in early 2008 (Table I.2). The 2008 budget, prepared in line with the PRGF-supported program, was approved by the NA in mid-May 2008. The NA also started the process for final approval of the direct taxation reform package consisting of a new corporate income tax code, a personal income tax code, and an urban property tax code. On financial sector reform, the BCSTP issued in early 2008 the new prudential regulations on capital adequacy, internal control and auditing, bank financial reporting, and credit to employees. In late April 2008, the NA gave its final approval to the anti-money laundering (AML/CFT) law, paving the way for an operational AML/CFT regime in São Tomé and Príncipe.

11. **Progress has been made in enhancing the transparency of managing current and prospective oil resources**. The Oil Revenue Management Law (ORML) was enacted. The law ensures parliamentary authority and supervision over the use of signature bonuses and other oil-related receipts. Under the ORML, the Petroleum Oversight Committee and the Public Registration and Information Office were created, and the ORML Handbook was posted on the official website. The authorities formally declared their adherence to the principles of the EITI and set up a national committee and appointed a national coordinator for implementation. To lay the ground for launching licensing for the Exclusive Economic Zone (EEZ), the National Oil Agency prepared a Petroleum Sector Strategy and related laws, but their adoption has been delayed due to changes in government.

12. **Some progress was made to improve the investment climate**. In line with the recommendations of the 2005 Diagnostic Trade Integration Study, a new investment code was submitted to the NA, the labor code was revised, and customs procedures were simplified. Arbitration tribunals for business litigation were established in 2006. Legislation to reduce the cost and duration of starting a business were drafted in consultation with the private sector. The restructuring of the electricity sector and the airport and seaport authorities were initiated. Under a reform strategy for EMAE, the electricity and water company, utility tariffs were increased to cover production costs. EMAE also installed prepaid electricity meters to strengthen payment collection.

III. Policy Discussions

A. Lessons from the Past

13. **As part of the Article IV consultation discussions, the authorities and staff exchanged views on the key lessons from the country's recent adjustment experience**. They agreed that the policy and reform agenda since 2005 was underpinned by a Poverty Reduction Strategy. While a large number of reforms have been introduced, notably in public resource management and banking supervision, financial policy implementation has not

always been consistent. The resulting stop-go pattern of macroeconomic policies created pressures on inflation, compounding the country's vulnerability to external shocks.

14. **To improve macroeconomic management, staff and the authorities agreed on the following priorities**:

- **Effective implementation of an appropriate policy mix to achieve a sustainable reduction in inflation**. Staff analysis, taking into account relations between fiscal policy, money supply, the exchange rate, and import prices, suggests that a prudent fiscal policy needs to play a central role, supported by a proactive monetary policy. The former is particularly important because of São Tomé and Príncipe's limited monetary policy instruments for liquidity management and the need to maintain adequate usable reserves (Box 2).

- **Revenue mobilization**. São Tomé and Príncipe's domestic revenue is smaller than its current expenditure. To meet rising demand for developmental and poverty reduction expenditures and to avoid putting undue pressure on limited official reserves, in addition to mobilizing external support, domestic revenue must be increased through a combination of tax policy reform and improvement in tax administration, based on an expanded economy.

- **Developing the supply side of the economy**. While real GDP has recently grown at 6-7 percent a year, recorded output growth has not yet translated into broad gains in income and employment. Indeed, the traditional agriculture sector has been shrinking, the emerging tourism sector remains small, and the government has become the largest employer in recent years. Reforms to attract investment therefore will have to be accompanied by public sector reform to make room for private sector development. Better use of available resources, including oil bonuses and donor funding, to boost the country's growth potential, notably in tourism and agriculture, would help raise living standards and reduce poverty.

B. Medium-Term Outlook and Challenges

15. **São Tomé and Príncipe's medium-term outlook depends critically on the prospects for oil export earnings and revenue**. Available information suggests that the outlook for further inflows of oil signature bonuses from Blocks 5 and 6 of the Joint Development Zone (JDZ) and from the EEZ remains uncertain at this time.[2] In Blocks 1-4 of

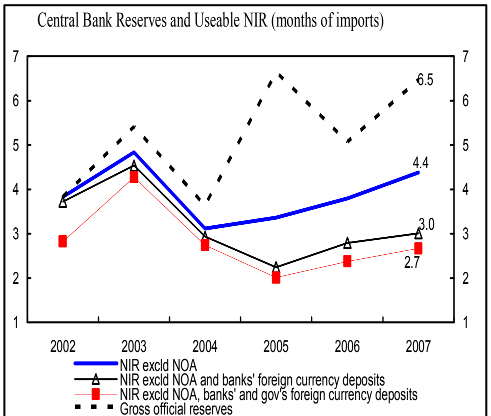
[2] Unsettled disagreements among the stakeholders of Blocks 5 and 6 have put on hold oil signature bonuses of $26.1 million for the two blocks.

the JDZ, where investors have paid their signature bonuses, oil exploration is ongoing but discovering commercially extractable reserves continues to be an uncertain process (Box 3).

Box 2. Policy Mix, Sustainable Disinflation, and Revenue Mobilization[1]

Appropriate policy mix. The two recent inflation spikes (mid-2006 and end-2007) were heavily influenced by domestic policies but also affected by external factors. Staff analysis suggests that the increase in excess liquidity during the two episodes can be largely explained by larger-than-projected withdrawals from the government's deposits at the central bank to finance public spending and by inadequate central bank sterilization.

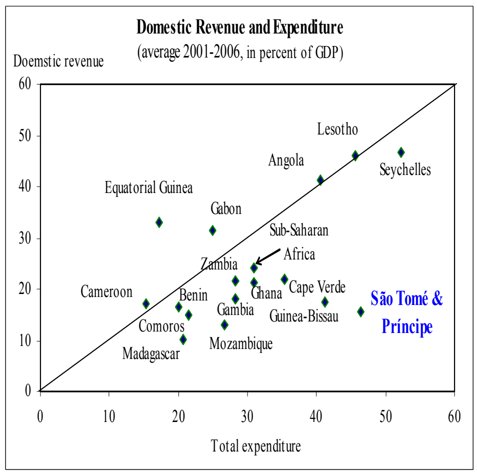
Although sterilization can be an effective tool to contain liquidity in the short term, continuous selling of foreign exchange to mop up liquidity may not be sustainable. The level of usable net international reserves is rather modest when excluding commercial bank and government deposits at the central bank.



1/ In months of imports of goods and services excluding oil project-related imports in a subsequent year.

To achieve a sustainable reduction in inflation, fiscal policy therefore will need to play a central role, not only in directly reducing domestic demand pressures on prices but also reducing the need for foreign exchange sales by the central bank for sterilization. A prudent fiscal policy, together with a proactive monetary policy, is essential to contain liquidity growth and anchor inflation and depreciation expectations. Fiscal and monetary anchors are important for sustainable disinflation.

Domestic Revenue Mobilization. São Tomé and Príncipe's small and undiversified economy leaves it with a narrow tax base to depend on. At the same time, its revenue performance has increasingly depended on trade taxes, both custom tariffs and excise duties.



Compared to neighboring countries in sub-Saharan Africa and other island economies around the world, São Tomé and Príncipe's tax revenue-to-GDP ratio, at 16.3 percent in 2007 is rather low, suggesting room for increasing revenue. Pressing ahead with the direct taxation reform, improving tax and customs administration, and, in due course, introducing the reform of indirect taxation will help broaden the tax base and increase revenue buoyancy to meet the country's rising expenditure needs.

[1] See the accompanying selected issues papers.

Box 3. São Tomé and Príncipe: Status of Oil Exploration

For oil exploration purposes, São Tomé and Príncipe's territory can be divided into three distinctive geographical zones:

The off-shore **Joint Development Zone** operated jointly with Nigeria. Oil exploration in the JDZ has started but, as of April 2008, has not yet confirmed the existence of commercially extractable reserves.

The off-shore **Exclusive Economic Zone**. Preparatory work is under way for launching licensing for oil exploration in the EEZ, which is located in areas with deeper water than the JDZ.

On-shore area includes the island of São Tomé and that of Príncipe. The potential for hydrocarbon discoveries on-shore is considered low and, to date, the authorities have no plans for promoting exploration in this area.

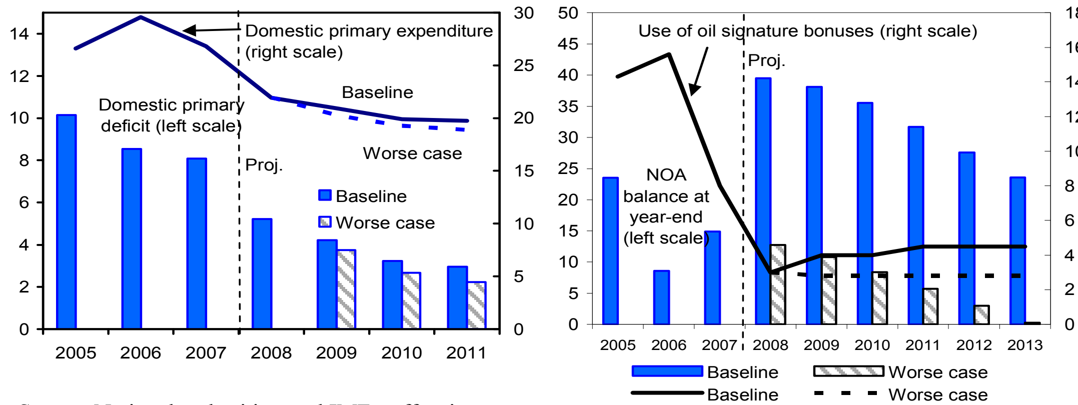
Joint Development Zone: Status of Exploration

Block No	Area (sq. km)	Main Investors and Operators	Share in the Block (percent)	Drilling	Results
1	704	Chevron Texaco	51	Early 2007	Found oil, but not commercial reserves.
2	692	SINOPEC/ERHC/ADDAX	65	Scheduled for late 2008	
3	666	Anadarko	51	Proposal made in 2007	
4	857	ADDAX/ERHC	60	Scheduled for late 2008	
5	1091	ICC/OEOC Consortium	75	Signature bonuses not yet paid to STP	
6	558	Filthim-Huzod	85	Signature bonuses not yet paid to STP	

Sources: National Oil Agency of São Tomé and Príncipe (www.anp-stp.gov.st)

16. **To illustrate the down side risks and their implications for macroeconomic policies, staff discussed with the authorities two medium-term scenarios**. The baseline scenario assumes that oil signature bonuses for Blocks 5 and 6 are received in 2008 and oil production starts in 2014, as previously projected. Under a worse-case scenario where oil bonuses for Blocks 5 and 6 are delayed indefinitely and there is no oil production, the NOA could be depleted quickly (Figure 3). Moreover, external budgetary support is expected to be limited in the next few years. Under the worse-case scenario, large expenditure compression would be unavoidable, and depletion of official reserves, high inflation, and currency depreciation are also likely.

Figure 3. Medium-term Fiscal Scenarios[1]
(percent of GDP)



Source: National authorities, and IMF staff estimates.

[1] Baseline scenario assumes oil signature bonuses for Blocks 5 and 6 are received in 2008. Worse case scenario assumes oil bonuses are delayed indefinitely.

17. **São Tomé and Príncipe is vulnerable to adverse external developments and has a high risk of debt distress, despite HIPC and MDRI debt relief**. The government has not contracted any new debt since reaching the completion point under the HIPC Initiative. However, as indicated in the Debt Sustainability Analysis which has been jointly updated with the World Bank staff (Supplement I), in the event of a large output loss or terms-of-trade deterioration, key debt ratios could exceed the relevant indicative thresholds. Moreover, the risk of debt distress would increase significantly should oil prospects diminish further. Under these circumstances, the authorities agreed that they should rely primarily on non-debt-creating external financing, attracting foreign direct investment and donor grants. They stood ready to reassess their external financing strategies after further oil exploration drillings.

18. **There was a consensus that the key challenges facing the authorities include maintaining fiscal sustainability and developing the domestic production and export base**. In view of the uncertain oil revenue outlook, staff argued for continued reduction of fiscal imbalances, bringing recurrent outlays, particularly on budgetary personnel costs, in line with available domestic revenue and donor budgetary support. Improving the composition of public expenditure and increasing the efficiency of public investment are also important not only for fiscal sustainability but also for increasing the growth orientation of the budget.

19. **The authorities pointed out that the country's productive base must be developed and broadened to sustain growth and reduce external vulnerability**. They noted that São Tomé and Principe has a low saving rate and a very small domestic market. To unlock the country's growth potential, it is imperative that the investment climate be significantly improved by removing the regulatory impediments to private sector

development, upgrading infrastructure, improving access to financing, and developing agriculture and other sectors based on the country's comparative advantages.

C. Macroeconomic Policies for the Remainder of the Program

20. **Against the backdrop of an external shock stemming from rising food and fuel prices, the authorities emphasized their commitment to strengthen policy implementation and restore financial stability**. The discussions centered on actions to correct the policy slippages that occurred in the second half of 2007, particularly in expenditure control, liquidity management, and structural reforms. With an additional grant from the World Bank, the discussions also covered the need to support the vulnerable segments of the population.

Fiscal Policy

21. **The 2008 budget envisages a reduction of the domestic primary fiscal deficit to 5.2 percent of GDP, from 8.1 percent of GDP in 2007** (MEFP ¶11). The domestic primary deficit for 2008 is higher than the 4.8 percent of GDP originally programmed, to mitigate the impact of high import prices for food and petroleum products. This will be financed by an additional budgetary support grant from the World Bank, part of which will be saved for future use.[3] The fiscal program is fully financed by the use of the World Bank grant of $4.5 million (2.8 percent of GDP), a drawdown from the NOA of $3 million (1.9 percent of GDP), and other external budget support of 0.6 percent of GDP.

Financing of the Domestic Primary Deficit
(Percent of GDP)

	2007		2008	
	CR/08/95	Est.	CR/08/95	Proj.
Domestic revenue [1]	**17.2**	**18.7**	**17.4**	**16.7**
Domestic primary spending	**24.2**	**26.8**	**22.2**	**21.9**
Of which: Wages	9.1	7.8	8.8	8.6
Transfers to JDA	2.1	2.2	0.6	0.6
Other [2]	13.0	16.8	12.8	12.7
Domestic primary balance	**-7.0**	**-8.1**	**-4.8**	**-5.2**
Financing	**7.0**	**8.1**	**4.8**	**5.2**
Use of oil bonuses [3]	5.8	7.0	1.9	1.9
Foreign budget support [4]	0.0	0.0	2.5	3.5
Other, net [5]	1.2	1.1	0.4	-0.1

Sources: São Tomé and Príncipe authorities; and IMF staff estimates and projections.
1 Excludes receipts of oil signature bonuses.
2 Includes goods and services, non-essential current spending, domestically financed capital expenditure, and HIPC-related spending.
3 For 2007, $15 million of the oil bonus was used to pay back a Nigeria loan.
4 Includes the World Bank Public and Natural Resource Management Development Policy Grant.
5 For 2007, includes debt relief of about US $1.0 million.

[3] The World Bank is to provide São Tomé and Príncipe with a grant of $6 million under its Public and Natural Resource Management Development Policy (PNRMD), instead of an initially expected $4 million.

22. **Fiscal consolidation under the 2008 budget would come mainly from expenditure reform** (Figure 4). The full-year effect of the 2007 general wage increase will be felt in 2008. In addition to measures to strengthen expenditure control, the authorities are committed to initiating wage reform, as a first step toward a broader civil service reform strategy, to help contain recurrent spending within the budget envelope (MEFP ¶13). A comprehensive wage study to rationalize the public service salary structure and integrate fringe benefits into the wage bill will be launched with the support of the World Bank.

23. **To prevent the recurrence of an expenditure overrun, the authorities agreed to tighten control on non-wage current expenditure**. Key measures include:

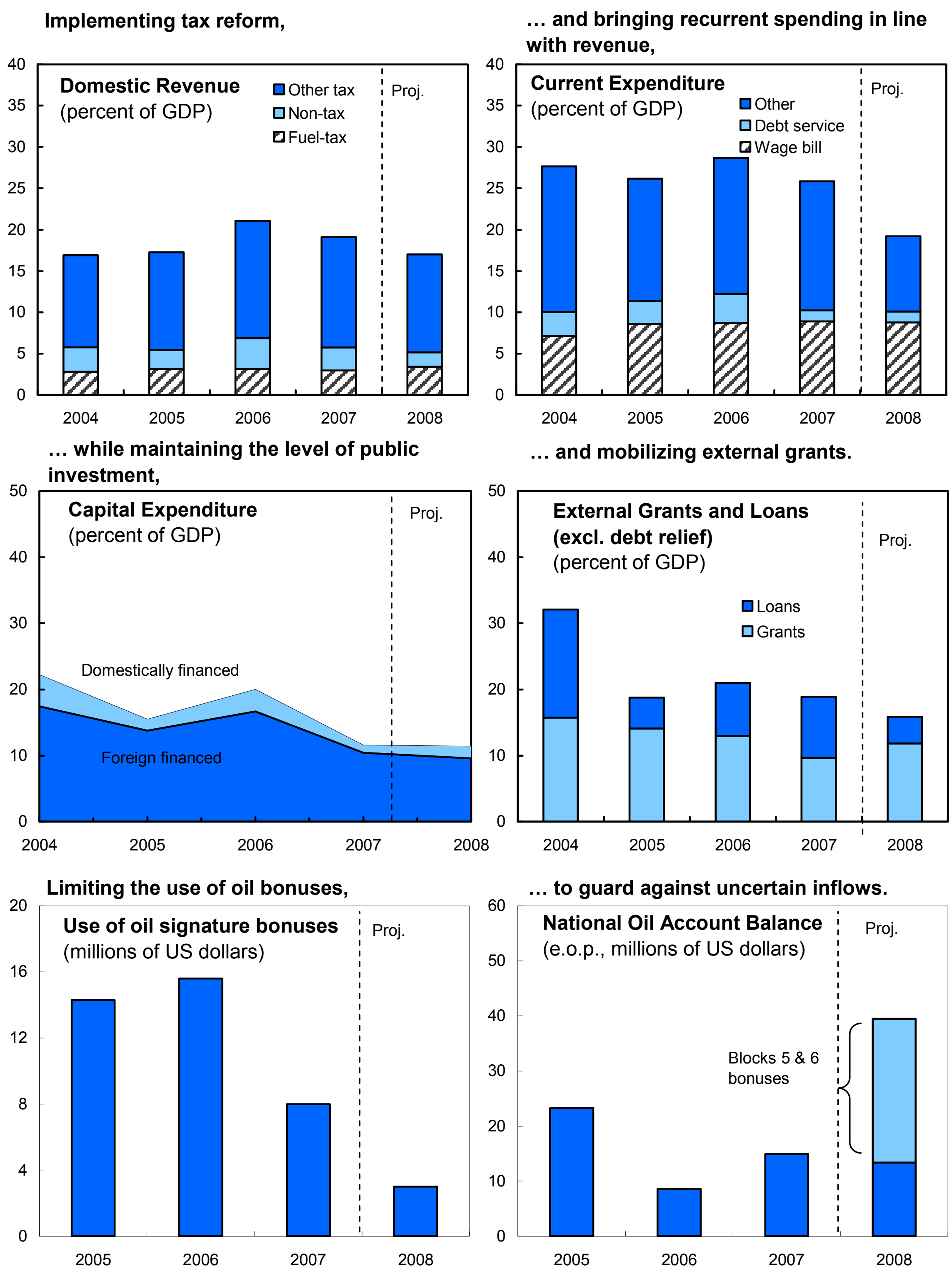
- Strictly limiting nonessential current spending, particularly on goods and services and transfers not funded by donors (see text table below).
- Reassessing transfers to the Joint Development Authority to take into account oil revenue prospects and budget constraints.
- Putting in place a functioning computerized public financial management system to effectively manage expenditure commitments. In addition to upgrading information technology hardware, the authorities intend to make progress in training users at the level of spending entities, and take other steps to elevate SAFINHO to a fully-fledged eSAFE system.
- Strictly complying with the provisions of the ORML on withdrawals from the National Oil Account.

São Tomé and Príncipe - Indicative Targets
(billion dobra, unless indicated otherwise)

	End-March, 2008	
	Targets	Actual
Indicative Targets		
Dobra base money [1/]	215	196
Net international reserves (million US $) [1/]	32	38
Primary non-wage current expenditure	53	49
External payment arrears	0	0
Benchmarks for April 2008		
Adopt the 2008 budget	Adopted on May 15, 2008	
Adopt the direct taxation laws	Pending final NA approval	

1/ Preliminary data suggest that dobra base money growth was below the indicative path and NIR was above the indicative floor for April 2008.

Figure 4. São Tomé and Príncipe: 2008 Fiscal Program



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

24. **In response to the rising import prices for food and fuel, the fiscal program was modified to provide extra room (about 0.4 percent of GDP) for temporary, targeted assistance to the poor and the most vulnerable** (MEFP ¶13). Staff pointed out that implicit general subsidies, such as those made through EMAE in the last quarter of 2007, are neither efficient nor effective in delivering assistance to the most needy. Staff encouraged the authorities to work closely with the World Bank to put in place a scheme, based on income or other criteria, to provide targeted support to the poor. This extra spending, together with the HIPC/MDRI debt relief-supported expenditure programs and efforts to align budgetary allocations with the Priority Action Plan of the Poverty Reduction Strategy Paper (PRSP), is expected to help mitigate the impact of the recent external shocks on the population.

25. **On the revenue side, timely implementation of the direct taxation reform package after NA approval is crucial for the 2008 program**. Although the reform is expected to be revenue neutral for the first few years of implementation, it will help broaden the tax base, reduce tax distortions, and over time reduce the country's heavy reliance on taxation on foreign trade (MEFP ¶14). To ensure that revenue collections are improved, the authorities have intensified their effort to strengthen tax and customs administration. In this regard, they are being assisted by the U.S. Millennium Challenge Corporation (MCC) under its Threshold Program, including in auditing tax returns, keeping track of large tax payers, and collecting tax arrears.

Monetary and Exchange Rate Policies

26. **The BCSTP is committed to use foreign exchange auctions more actively to reduce base money growth, in the context of a flexible exchange regime** (MEFP ¶17). Since extensive use of foreign currencies and weak financial intermediation severely limit the effectiveness of interest rates and other monetary policy instruments, the authorities have to rely on fiscal restraints and foreign exchange sales to control liquidity. Accordingly, the BCSTP held more frequent foreign exchange auctions in March 2008, while maintaining net international reserves (NIR) above the program target. As a result, annual base money growth slowed down from 50 percent at the end of 2007 to 27 percent by the end of March 2008. Depreciation of the dobra also slowed from 6.5 percent against the U.S. dollar in the last quarter of 2007 to 2.6 percent in the first quarter of 2008.

27. **To increase the effectiveness of liquidity control, the fiscal and monetary authorities agreed to improve their coordination to ensure timely sterilization of budgetary use of oil bonuses and donor funding** (MEFP ¶18). Aside from information-sharing among staff of the Treasury and the BCSTP, the Finance Minister and the BCSTP Governor also intend to meet regularly on the government's cash outlays and the BCSTP's liquidity forecast. To enhance the accuracy of liquidity management, the BCSTP has started monitoring the weekly average commercial bank minimum reserve requirement, instead of the monthly average. These steps are expected to strengthen implementation of the monetary

program for the remainder of the year, which aims to bring inflation on a downward path, while preserving NIR equivalent to about 4 months of imports**.**

28. **The authorities remain committed to deepening foreign exchange market reform** (MEFP ¶19). The recent external shock has complicated the implementation of the reform by worsening supply-demand imbalances in the foreign exchange market. The authorities reiterated their intention, in due time, to remove all multiple currency practices and restrictions (see Informational Annex I), de facto or de jure, and on that basis, to accept the obligations under Article VIII, Sections 2(a), 3, and 4 of the Fund's Articles of Agreement. In the near term, they will focus on expediting approval by the NA of the new investment code, which contains provisions aiming to remove the exchange restrictions on transferring dividends abroad. The BCSTP will also revise the mechanism for setting the daily central bank exchange rate, after a review of domestic market conditions in 2008, to ensure that the spread between the official and commercial bank exchange rates does not exceed 2 percent.

Structural Reforms

29. **For the remainder of the program, the authorities intend to make progress in several areas where significant preparatory work has already been done**. These include: (i) putting in place new modules to implement the public accounting system and preparing regulations for the organic budget law (SAFE), as part of the effort to upgrade public financial management; (ii) completing the revision of the commercial code, an important regulatory reform to reduce the cost of doing business in the country (MEFP, ¶21); (iii) adopting the Petroleum Sector Strategy and the related laws before launching the licensing round for the EEZ (MEFP, ¶22).

30. **Financial sector reform will continue to focus on strengthening the regulatory framework and the BCSTP's implementation capacity** (MEFP ¶23). There are five banks in São Tomé and Príncipe. Recently, the BCSTP has received a new bank application and two more foreign banks have expressed interest in entering the market. To reduce the risk of money laundering and bank distress, the authorities have given top priority to making the AML/CFT regime operational through issuing and implementing the enabling regulations that the BCSTP already prepared. Moreover, they plan to strengthen the requirements for issuing bank licenses by raising the minimum capital requirement and improving the standards for feasibility studies, among other conditions.

Program Monitoring

31. **Indicative targets for selected fiscal and monetary variables are set to facilitate program implementation prior to the expiration of the PRGF arrangement in August 2008** (MEPF, ¶28). These include indicative ceilings on primary nonwage current spending and 12-month dobra base money growth, as well as floors for the BCSTP's net international

reserves for end-March and end-June 2008 (Table I.1). Two structural benchmarks are added to help monitor progress in fiscal structural reform (Table I.2).

IV. Exchange Rate Arrangement and Other Issues

A. Exchange Rate Arrangement and External Stability

32. **The exchange rate regime is currently classified as a de facto managed float**. The BCSTP has mostly been the sole seller in the official foreign exchange market for the last two years while seldom buying foreign exchange from market participants. Empirical evidence, while limited by the weak database, does not suggest a significant misalignment of the real exchange rate from its equilibrium level. The authorities are making efforts to remove the remaining exchange restrictions.[4] In view of the uncertain timeframe of implementation, staff does not recommend Fund approval for maintaining these restrictions. Staff assessment based on the updated DSA (¶16-17) also indicates that sustainability of the country's external position depends critically on finding commercially extractable oil reserves. If oil prospects do not materialize, i.e., there would be no oil exports and revenue, maintaining external stability will require further economic adjustment, including that of the real exchange rate (Box 4).

33. **The authorities expressed interest in reassessing the country's monetary and exchange rate arrangements**. They have commissioned experts from the European Union to conduct a study on this issue. After a seminar held by the mission in October 2007, the authorities noted that São Tomé and Príncipe could benefit from a strongly anchored currency arrangement, including possible membership in a monetary union or an agreement to allow for parity between the dobra and a strong currency. Staff analyzed the pros and cons of various exchange systems, putting together the monetary history of São Tomé and Príncipe and relevant international experience.[5] The analysis highlights the benefits under certain conditions of a firmly anchored currency arrangement for a small, open, low-income country, emphasizing that prudent fiscal and debt policies are preconditions for a sustainable regime.

B. Debt Management

34. **The authorities are conscious of the need to maintain debt sustainability**. They are committed to refraining from new external borrowing, especially on non-concessional terms. To strengthen their debt management and analysis capacity, they have installed the Commonwealth Secretariat debt management system (DS-DRMS) and plan to utilize the system to obtain a debt payment schedule and other information to analyze the country's debt sustainability.

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[4] See ¶28 and Informational Annex, Appendix I for a description of the exchange system and the remaining exchange restrictions.

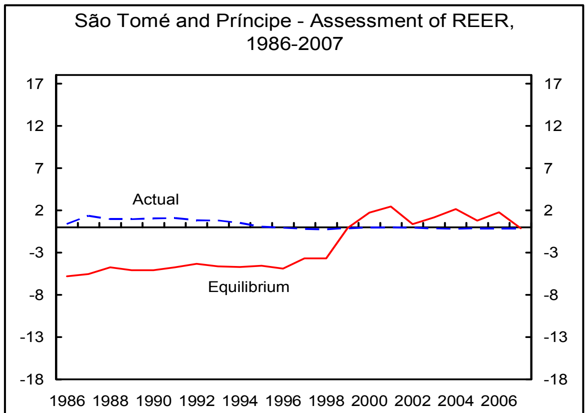
[5] See IMF working paper (WP/08/118) for more details of the staff analysis.

35. **The authorities are seeking full delivery of HIPC relief from the remaining creditors.** Having initiated the negotiations, they have concentrated their efforts to conclude debt relief agreements with Angola and Portugal, the two largest remaining creditors.

Box 4. The Equilibrium Exchange Rate and External Competitiveness

A simple empirical approach was used to assess exchange rate developments against equilibrium levels. Due to data weaknesses and lack of high frequency statistics, the model used real per capita GDP and government consumption to assess developments in the REER.

The results show that the REER moved from overvaluation to slight undervaluation in 2000-2001 and the gap between actual REER and its equilibrium level has narrowed in recent years. These developments do not seem to have had an adverse effect on the competitiveness of exports, since export volumes of cocoa—the main export commodity—are small, targeted to niche markets in Europe, and are mostly affected by weather conditions. Tourism is a high value-added sector that attracts relatively wealthy eco-tourists and mainly depends on large FDI inflows. Foreign reserves (excluding the National Oil Account) grew from 4.1 months of imports in 2005 to 4.5 months in 2007.



Source: IMF staff estimates

Ranking on the ease of doing business	2008	2007	Change [1]
South Africa	35	29	-6
Cape Verde	132	125	-7
Mozambique	134	140	6
ECOWAS	149	144	-6
São Tomé and Príncipe	**163**	**169**	**6**
CEMAC	165	157	-7
Angola	167	156	-11

Source: World bank's Doing Business database.
[1] A positive change means an improvement in the rank.

Institutional indicators suggest a modest improvement in the business environment and competitiveness, although significant weaknesses remain. Cumbersome regulations for opening businesses and rigid rules on hiring and firing employees are the main obstacles to doing business in the country. Moreover, inadequate energy, water, and transport infrastructure continues to hamper São Tomé and Príncipe's competitiveness.

Maintaining external stability will require prudent macroeconomic management, continued donor support and private inflows, including FDI, and a significant improvement in export earnings. The large external current account deficit, at about 50 percent of GDP before official transfers, is projected to persist over the medium term. Given the limited external assets, the country's production and export base must be developed and broadened. If oil prospects do not materialize, maintaining external sustainability will require further economic adjustment, including that of the real exchange rate.

C. Statistics, Capacity Building, and Other Issues

36. **Data provision is generally adequate for surveillance purposes, although there are still weaknesses in national accounts, government financial operations statistics, and balance of payments data**. The National Institute of Statistics has made significant progress

in updating GDP statistics, but the lack of reliable data still hampers analysis in areas such as private sector development and progress toward the Millennium Development Goals. To further improve data quality, staff recommended that within the tight budget constraint, the government provide funding for a new household expenditure survey in order to improve compilation of the consumer price index.

37. **On capacity building, the authorities have showed willingness to follow Fund technical advice but their ability to implement remains weak**. Noting that São Tomé and Príncipe is not a member of AFRITAC and, therefore, cannot benefit from its technical assistance, the authorities hoped that the extension of AFRITAC currently under consideration will cover the country. The BCSTP welcomed a Fund assessment of their future technical assistance needs, particularly in banking supervision and development.

38. **The authorities have submitted to the Fund and the World Bank the second Annual Progress Report of the PRSP.** In the Joint Staff Advisory Note (JSAN), the staffs noted that the authorities need to enhance monitoring and evaluation to ensure effective implementation of the PRSP. Moreover, the staffs believe that an update of the PRSP would be warranted when oil prospects are updated in late 2008-early 2009.

V. Staff Appraisal

39. **São Tomé and Príncipe's economic performance under the PRGF-supported program has been mixed**. While economic activity remains robust, inflation accelerated in the second half of 2007. The higher inflation reflected surging international prices for food and fuel which represented a severe shock to São Tomé and Príncipe's external current receipts. However, an expenditure overrun and the lack of effective control of base money growth also fueled inflation and currency depreciation.

40. **To lower inflation and restore financial stability, it is important that the authorities significantly strengthen fiscal discipline and liquidity management**. In this regard, staff supports the 2008 budget that aims to reduce the domestic primary deficit. The authorities are committed to tightening expenditure control. As the 2008 fiscal program has been modified to provide funding to mitigate the impact of the recent external shock, staff encourages the authorities to refrain from generalized price subsidies and work closely with the World Bank staff to implement direct, targeted assistance to the poor.

41. **Timely implementation of the direct taxation reform package is crucial for the 2008 program**. The tax reform would help broaden the tax base and reduce tax distortions. Staff encourages the authorities to promptly begin implementation, following approval by the National Assembly, along with continued effort to improve tax and customs administration.

42. **Recent progress by the BCSTP in curbing liquidity growth is encouraging**. Although base money is an indicative target, it serves as the anchor for the program, playing a

central role in restoring price stability. The central bank therefore needs to continue using foreign exchange auctions more actively to bring dobra base money growth to a downward path while observing the NIR floor. In addition, monetary policy needs to be supported by fiscal restraint. In the event that the program's NIR target is at risk, the government will have to support monetary tightening by further curtailing non-essential domestic primary spending.

43. **The main challenges facing the authorities over the medium term are to maintain fiscal sustainability and to develop the economy's production and export base**. In view of the uncertain outlook for oil revenue, fiscal consolidation needs to continue beyond 2008 by increasing growth orientation of the budget and bringing recurrent spending, particularly on personnel costs, in line with domestic revenue and available donor budgetary support. In this regard, the country's adjustment experience since 2005 provides valuable lessons, particularly in avoiding stop-go patterns of policy implementation. Staff also recommends that the authorities strengthen debt management and rely primarily on concessional financing.

44. **Accelerated structural reforms are needed to achieve sustained, private sector-led growth**. The authorities are to be commended for obtaining the National Assembly's final approval of the anti-money laundering legislation. Staff encourages the BCSTP to take other steps to advance financial sector reform, including tightening the requirements for issuing new bank licenses. High priority should be attached to improving the investment climate. The authorities should press ahead with regulatory reform to reduce the cost of investing and doing business and attract foreign investment and donor support to upgrade infrastructure and the key economic sectors, particularly tourism and agriculture. Staff encourages the authorities to make further progress under the EITI to increase the transparency and accountability of oil-related resource management.

45. **Staff encourages the authorities to maintain an open exchange system**. Efforts need to be made to remove all remaining restrictions in order for the authorities to accept the obligations under Article VIII of the Fund's Articles of Agreement. Staff welcomes the authorities' interest in reconsidering the country's monetary and exchange arrangements. Fiscal discipline and prudent debt management are the main prerequisites for a sustainable exchange rate regime.

46. **Staff recommends completion of the sixth review based on the country's performance and policy commitments**. Staff supports the authorities' request for waivers for the nonobservance of the end-December 2007 quantitative performance criteria related to the domestic primary deficit and net credit to the government and the structural performance criterion on public financial management reform, based on remedial measures (summarized in ¶ 23 and 26) and policy commitments for the remainder of the program.

47. **It is proposed that the next Article IV consultation be held in accordance with the decision on consultation cycles approved on July 15, 2002**.

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2005–2013

	2005	2006	2007		2008		2009	2010	2011	2012	2013
			CR/08/95	Est.	CR/08/95	Proj.			Proj.		
			(Annual percentage changes, unless otherwise specified)								
National income and prices											
GDP at constant prices	5.7	6.7	6.0	6.0	6.0	6.0	6.0	6.0	6.0	7.5	8.0
Consumer prices											
End of period	17.2	24.6	19.6	27.6	9.5	13.0	9.0	7.0	6.0	4.0	4.0
Period average	16.3	23.1	19.9	18.5	14.1	19.4	9.8	6.5	5.5	5.0	4.0
External trade											
Exports, f.o.b. [1]	22.6	-1.4	12.2	1.9	7.2	2.8	3.9	2.5	0.2	-0.8	-4.0
Imports, c.i.f.	15.7	65.9	-4.1	-6.0	15.8	13.8	7.5	8.0	1.2	6.8	8.5
Exchange rate (dobras per US$; end of period) [2]	11,748	12,945	…	14,220	…	…	…	…	…	…	…
Real effective exchange rate (depreciation = -)	6.5	2.9	…	4.9	…	…	…	…	…	…	…
Money and credit (end of period)											
Base money [3]	76.6	32.0	21.2	50.0	17.4	7.7	17.0	16.0	11.4	11.8	11.7
Broad money (M3)	45.9	39.3	25.2	36.4	21.0	21.0	22.0	17.9	12.5	12.9	12.9
Velocity (GDP to average broad money)	3.3	3.0	3.0	3.1	3.0	3.1	3.0	2.9	2.9	2.9	2.9
Central bank reference interest rate (percent)	18.2	28.0	…	28.0	…	…	…	…	…	…	…
Bank lending rate (percent)	29.8	29.3	…	32.4	…	…	…	…	…	…	…
Bank deposit rate (percent)	11.5	10.8	…	12.8	…	…	…	…	…	…	…
			(Percent of GDP, unless otherwise specified)								
Government finance											
Total revenue, grants, and oil signature bonuses [4]	81.0	37.1	164.7	160.3	48.8	73.6	26.2	26.8	27.2	27.6	27.9
Of which : tax revenue	15.0	17.4	15.2	16.3	15.6	15.3	15.4	15.6	15.8	16.0	16.2
nontax revenue	2.3	3.7	2.8	2.8	2.3	1.8	1.6	1.6	1.6	1.6	1.6
grants	17.0	16.0	125.6	120.1	14.4	40.3	9.1	9.6	9.8	10.0	10.1
oil signature bonuses	46.8	0.0	21.2	21.1	16.5	16.3	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	44.0	51.0	39.3	40.0	37.1	31.9	31.0	30.5	30.9	31.0	30.9
Of which: personnel costs	8.6	8.7	9.1	8.9	8.8	8.6	8.3	8.0	7.8	7.5	7.5
nonwage noninterest current expenditure	14.8	16.5	11.5	15.6	9.1	9.1	8.4	7.8	7.9	7.6	7.6
capital and HIPC-related social expenditures	17.8	22.3	17.2	14.2	17.9	12.8	13.1	13.7	14.3	15.1	15.1
Domestic primary balance [5]	-10.1	-8.5	-7.0	-8.1	-4.8	-5.2	-4.2	-3.2	-3.0	-2.6	-2.4
Overall balance (commitment basis)	37.1	-13.9	125.4	120.3	11.7	41.8	-4.8	-3.8	-3.6	-3.4	-3.1
External sector											
Current account balance											
Including official transfers	-10.3	-41.3	-35.8	-30.2	-36.6	-31.0	-31.8	-33.2	-31.3	-31.9	-32.0
Excluding official transfers	-39.5	-66.3	-57.5	-52.1	-59.1	-51.5	-48.8	-50.2	-47.4	-47.3	-47.0
NPV of external debt	171.1	161.2	16.0	15.9	16.3	7.9	8.2	8.6	8.8	9.0	8.7
External debt service (percent of exports) [6]											
Before HIPC and MDRI debt relief	75.6	70.0	59.7	83.2	48.9	60.0	…	…	…	…	…
After HIPC and MDRI debt relief	62.1	35.9	7.5	27.8	6.7	4.2	5.9	5.5	5.4	4.5	8.4
Export of goods and services (US$ millions)	15.9	16.1	15.3	11.0	20.1	14.0	14.9	15.7	15.9	15.1	15.0
Gross foreign reserves [7]											
Months of imports of goods and nonfactor services	4	4	4	5	4	4	4	4	4	4	4
Millions of U.S. dollar	26.6	33.3	31.7	38.0	28.9	31.8	32.1	33.8	36.5	39.5	46.5
National Oil Account (US$ millions) [8]	23.5	8.6	16.2	14.9	40.0	39.5	38.1	35.5	31.7	27.6	23.6
Memorandum Item											
GDP											
Billions of dobras	1,202	1,536	1,952	1,959	2,361	2,409	2,837	3,228	3,631	4,100	4,627
Millions of U.S. dollars	115	124	145	145	158	160	173	186	200	220	243

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

[1] Production in the traditional export sector (such as cocoa) is projected to decline in 2012 and 2013 because production resources are expected to shift to the oil sector.

[2] Central bank (BCSTP) buying rate.

[3] Projected base money growth for 2008 reflects the high level of base money at the end of 2007, which was significantly reduced in subsequent months through the BCSTP's foreign exchange sales.

[4] Includes HIPC and MDRI debt relief.

[5] Excluding oil revenue, grants, interest earned, scheduled interest payments, and foreign-financed scholarships and capital outlays.

[6] In percent of exports of goods and nonfactor services. The difference between debt service before and after HIPC relief is larger than debt service saving in cash terms because this table is on an accrual basis.

[7] Gross reserves exclude the National Oil Account and guarantee deposits placed at the BCSTP by financial institutions waiting for operating licenses.

[8] Based on the assumption that dispute will be settled to allow disbursement of bonuses for Blocks 5 and 6 (US$ 26 million) in 2008.

Table 2. São Tomé and Príncipe: Financial Operations of the Central Government, 2005–2008

	2005	2006	2007		2008
			CR/08/95	Est.	Prog.
	(billion dobra)				
Total revenue and grants	**974**	**570**	**3215**	**3141**	**1773**
Total revenue	207	324	351	374	410
Tax revenue	180	267	296	320	368
Nontax revenue	27	57	55	55	42
Grants	204	247	2450	2353	970
Project grants	152	197	222	168	202
Nonproject grants	17	2	15	21	83
HIPC Initiative-related grants [1]	35	47	2213	2164	685
Oil signature bonuses	562	0	413	413	394
Total expenditure	**528**	**783**	**766**	**784**	**767**
Current expenditure [2]	314	441	431	506	460
Of which: personnel costs	103	133	177	174	207
interest on external debt due	32	52	30	26	31
goods and services	66	91	74	112	96
transfers	83	108	117	140	98
Of which : JDA	33	38	41	42	15
other	28	54	33	54	26
Capital expenditure	186	307	277	227	243
Financed by the Treasury	21	51	29	22	44
Financed by external sources	165	256	248	205	200
HIPC Initiative-related social expenditure	28	35	58	51	64
Domestic primary balance [3]	**-122**	**-131**	**-137**	**-158**	**-125**
Overall fiscal balance (commitment basis)	**445**	**-213**	**2448**	**2356**	**1006**
Net change in arrears (reduction = -)	-134	21	0	6	0
External arrears [4]	-52	21	0	0	0
Domestic arrears	-82	0	0	6	0
Overall fiscal balance (cash basis)	**311**	**-192**	**2448**	**2362**	**1006**
Financing	**-311**	**192**	**-2448**	**-2362**	**-1006**
Net external [5]	-37	31	-2350	-2312	-635
Disbursements (projects)	14	99	26	37	29
Program financing (loans)	0	24	27	47	30
Net short-term loans	0	0	-202	-200	0
Scheduled amortization [1]	-93	-92	-2224	-2199	-701
Change in arrears (principal) [6]	-102	0	-140	-137	0
Bilateral rescheduling [7]	144	0	164	140	7
Net domestic	-274	162	-98	-50	-371
Net bank credit to the government	-277	162	-98	-44	-371
Banking system credit (excluding National Oil Account) [8]	-14	-23	5	31	-23
National Oil Account	-263	184	-104	-75	-349
Nonbank financing	3	0	0	-6	0
Financing gap [9]	0	0	0	0	0
Memorandum items:					
Overall balance (commitment basis, incl. grants, excl. oil bonuses)	-117	-213	2035	1943	612
Domestic primary spending	320	454	473	525	526
MDRI debt relief (flow in US$ million)	0	0	1.1	1.1	1.2
National Oil Account (US$ million, excl. transfers to budget)	23.5	8.6	16.2	14.9	39.5

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

[1] For 2007, includes IDA and AfDB MDRI debt relief as a stock of debt reduction.

[2] For 2007, includes the repayment of three $5 million loans disbursed by Nigeria in 2002–04 upon receipt of oil signature bonuses for Blocks 2–4 in the Joint Development Zone.

[3] Excluding oil revenue, grants, interest earned, scheduled interest payments, foreign-financed scholarships, and foreign-financed capital outlays.

[4] For 2006, refers to a temporary accumulation of technical arrears with bilateral creditors, pending reconciliation of debt records.

[5] For 2008, the consistency and quality of debt data need to be improved.

[6] For 2005, reflects impact of Paris Club rescheduling in the last quarter of 2005.

[7] For 2007, assumes rescheduling agreement with non-Paris Club bilateral creditors for current maturities and stock of arrears.

[8] Net of valuation changes. For 2007, includes IMF MDRI debt relief as a stock of debt reduction.

[9] For 2007, data between monetary and fiscal accounts need to be reconciled on mission, owing to the difference in treatment of $2.3 million inflow into the National Oil Account.

continued...

Table 2. São Tomé and Príncipe: Financial Operations of the Central Government, 2005–2013

	2005	2006	2007		2008	2009	2010	2011	2012	2013
			CR/08/95	Est.	Prog.			Proj.		
	(Percent of GDP) [1]									
Total revenue and grants	**81.0**	**37.1**	**164.5**	**160.3**	**73.9**	**26.2**	**26.8**	**27.2**	**27.6**	**27.9**
Total revenue	17.3	21.1	18.0	19.1	17.1	17.0	17.1	17.4	17.6	17.7
Tax revenue	15.0	17.4	15.2	16.3	15.3	15.4	15.6	15.8	16.0	16.2
Nontax revenue	2.3	3.7	2.8	2.8	1.8	1.6	1.6	1.6	1.6	1.6
Grants	17.0	16.0	125.4	120.1	40.4	9.1	9.6	9.8	10.0	10.1
Project grants	12.6	12.8	11.4	8.6	8.4	8.5	9.0	9.2	9.4	9.5
Nonproject grants	1.5	0.2	0.8	1.1	3.5	0.6	0.6	0.6	0.6	0.6
HIPC Initiative-related grants [2]	2.9	3.1	113.3	110.5	28.5	0.0	0.0	0.0	0.0	0.0
Oil signature bonuses	46.8	0.0	21.2	21.1	16.4	0.0	0.0	0.0	0.0	0.0
Total expenditure	**44.0**	**51.0**	**39.2**	**40.0**	**32.0**	**31.0**	**30.5**	**30.9**	**31.0**	**30.9**
Current expenditure [3]	26.2	28.7	22.1	25.8	19.2	17.9	16.9	16.6	15.9	15.8
Of which: personnel costs	8.6	8.7	9.1	8.9	8.6	8.3	8.0	7.8	7.5	7.5
interest on external debt due	2.7	3.4	1.6	1.3	1.3	1.2	1.1	0.9	0.8	0.8
goods and services	5.5	5.9	3.8	5.7	4.0	3.7	3.4	3.4	3.2	3.2
transfers	6.9	7.0	6.0	7.2	4.1	3.7	3.4	3.4	3.4	3.4
Of which : JDA	2.7	2.5	2.1	2.2	0.6	0.6	0.5	0.5	0.5	0.4
other	2.3	3.5	1.7	2.8	1.1	1.0	1.0	1.0	1.0	1.0
Capital expenditure	15.5	20.0	14.2	11.6	10.1	10.4	10.9	11.6	12.3	12.4
Financed by the Treasury	1.7	3.3	1.5	1.1	1.8	1.9	1.9	2.0	2.4	2.4
Financed by external sources	13.8	16.7	12.7	10.4	8.3	8.5	9.1	9.5	9.9	10.0
HIPC Initiative-related social expenditure	2.3	2.3	3.0	2.6	2.7	2.7	2.7	2.7	2.7	2.7
Domestic primary balance [4]	**-10.1**	**-8.5**	**-7.0**	**-8.1**	**-5.2**	**-4.2**	**-3.2**	**-3.0**	**-2.6**	**-2.4**
Overall fiscal balance (commitment basis)	**37.1**	**-13.9**	**125.3**	**120.3**	**41.9**	**-4.9**	**-3.8**	**-3.6**	**-3.4**	**-3.1**
Net change in arrears (reduction = -)	-11.2	1.4	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0
External arrears [5]	-4.3	1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic arrears	-6.8	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall fiscal balance (cash basis)	**25.9**	**-12.5**	**125.3**	**120.6**	**41.9**	**-4.9**	**-3.8**	**-3.7**	**-3.4**	**-3.1**
Financing	**-25.9**	**12.5**	**-125.3**	**-120.6**	**-41.9**	**4.8**	**3.8**	**3.6**	**3.4**	**3.1**
Net external [6]	-3.1	2.0	-120.2	-118.0	-26.5	1.7	1.6	1.4	1.3	1.2
Disbursements (projects)	1.1	6.4	1.3	1.9	1.2	1.1	1.0	1.0	0.9	0.8
Program financing (loans)	0.0	1.6	1.4	2.4	1.3	1.2	1.1	1.0	0.9	0.8
Net short-term loans	0.0	0.0	-10.3	-10.2	0.0	0.0	0.0	0.0	0.0	0.0
Scheduled amortization [2]	-7.7	-6.0	-113.8	-112.3	-29.2	-0.6	-0.6	-0.6	-0.5	-0.5
Change in arrears (principal) [7]	-8.5	0.0	-7.2	-7.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral rescheduling [8]	12.0	0.0	8.4	7.1	0.3	0.1	0.1	0.1	0.1	0.1
Net domestic	-22.8	10.5	-5.0	-2.6	-15.5	3.1	2.1	2.2	2.0	1.9
Net bank credit to the government	-23.1	10.5	-5.0	-2.3	-15.5	3.1	2.1	2.2	2.0	1.9
Banking system credit (excluding National Oil Account) [9]	-1.2	-1.5	0.3	1.6	-0.9	0.8	0.0	0.0	0.0	0.0
National Oil Account	-21.9	12.0	-5.3	-3.9	-14.5	2.3	2.1	2.2	2.0	1.9
Nonbank financing (including earmarked funds and residual)	0.2	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap [10]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Overall balance (commitment basis, incl. grants, excl. oil bonuses	-9.7	-13.9	104.1	99.2	25.5	-4.8	-3.8	-3.6	-3.4	-3.1
Domestic primary spending	26.6	29.6	24.2	26.8	21.9	20.9	20.1	20.1	20.0	19.9
MDRI debt relief (flow in US$ million)	0	0	1.1	1.1	1.2	1.2	1.3	1.5	1.7	1.7
National Oil Account (US$ million, excl. transfers to budget)	23.5	8.6	16.2	14.9	39.5	38.1	35.5	31.7	27.6	23.6

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

[1] Based on 2001 census and survey-based GDP series.

[2] For 2007, includes IDA and AfDB MDRI debt relief as a stock of debt reduction.

[3] For 2007, includes the repayment of three $5 million loans disbursed by Nigeria in 2002–04 upon receipt of oil signature bonuses for Blocks 2–4 in the Joint Development

[4] Excluding oil revenue, grants, interest earned, scheduled interest payments, foreign-financed scholarships, and foreign-financed capital

[5] For 2006, refers to a temporary accumulation of technical arrears with bilateral creditors, pending reconciliation of debt records.

[6] For 2008 onwards, the consistency and quality of debt data need to be improved.

[7] For 2005, reflects impact of Paris Club rescheduling in the last quarter of 2005.

[8] For 2007, assumes rescheduling agreement with non-Paris Club bilateral creditors for current maturities and stock of arrears.

[9] Net of valuation changes. For 2007, includes IMF MDRI debt relief as a stock of debt reduction.

[10] For 2007, data between monetary and fiscal accounts need to be reconciled on mission, owing to the difference in treatment of $2.3 million inflow into the National Oil

Table 3. São Tomé and Príncipe: Summary Accounts of the Central Bank, 2006–2008

	2006	2007		2008			
	Dec.	Dec.		Mar.	Jun.	Sep.	Dec.
	Actual	Prog.	Prel.	Proj.	Proj.	Proj.	Proj.
	(Billions of dobras, end of period)						
Net foreign assets	**619.5**	**708.6**	**852.9**	**807.3**	**1,245.4**	**1,229.7**	**1,242.6**
Net international reserves	528.7	656.4	737.8	684.0	1,128.7	1,109.9	1,119.8
Gross reserves [1, 2]	557.2	688.0	776.9	716.2	1,161.8	1,143.8	1,154.6
Of which: National Oil Account (NOA)	111.1	232.4	212.1	221.1	577.3	600.6	624.2
Of which: guarantee deposits	15.5	0.0	24.9	24.9	25.6	26.2	26.9
Short-term liabilities [1]	-28.5	-31.6	-39.1	-32.2	-33.1	-33.9	-34.8
Other foreign assets	143.3	103.5	170.6	175.4	180.2	185.0	189.7
Other liabilities [3]	-52.4	-51.2	-55.5	-52.1	-63.6	-65.2	-66.9
Net domestic assets	**-341.5**	**-371.7**	**-435.7**	**-415.8**	**-856.2**	**-791.9**	**-793.2**
Net domestic credit	-121.3	-198.7	-152.3	-142.3	-596.8	-574.4	-574.9
Net credit to government	-108.3	-208.3	-162.5	-155.3	-609.6	-584.5	-581.3
Claims [3]	105.6	105.7	111.7	107.0	118.8	120.9	122.9
Of which: use of SDRs/PRGF Facility	64.5	64.6	69.3	65.9	77.7	79.8	81.8
Deposits [2]	-213.9	-314.0	-274.2	-262.3	-728.4	-705.3	-704.2
Ordinary	-33.9	-21.5	-12.8	4.9	-71.4	-23.2	3.5
Of which: HIPC Initiative resources	-12.2	-6.7	-7.9	-7.9	-7.9	-7.9	-7.9
Counterpart funds	-22.6	-22.6	-8.2	-8.2	-8.2	-8.2	-8.2
Foreign currency [2]	-157.4	-269.9	-253.2	-259.0	-648.8	-674.0	-699.5
Of which: NOA [2]	-111.1	-232.4	-212.1	-221.1	-577.3	-600.6	-624.2
Rediscount to commercial banks	2.5	2.0	0.9	2.7	2.7	2.1	1.3
Other claims	9.5	7.6	9.3	10.3	10.2	8.0	5.0
Central Bank certificates of deposit	-25.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items (net)	-220.2	-173.0	-283.4	-273.4	-259.4	-217.5	-218.3
Base money	**278.0**	**337.0**	**417.1**	**391.6**	**389.2**	**437.8**	**449.4**
Currency issued	102.7	124.5	126.2	135.2	122.0	128.7	146.2
Bank reserves	175.3	212.5	290.9	256.4	267.2	309.1	303.3
Of which: domestic currency	64.9	78.6	126.1	80.1	79.4	109.7	92.3
Of which: foreign currency	110.4	133.9	164.8	176.3	187.8	199.4	210.9
Memorandum items:							
Gross international reserves (US$ millions) [1, 2]	43.0	47.9	54.6	49.0	77.3	74.2	73.0
Excluding NOA and guarantee deposits	33.3	31.7	38.0	32.2	37.2	33.5	31.8
Net international reserves (US$ millions) [2]	40.8	45.7	51.9	46.8	75.1	72.0	70.8
Of which: National Oil Account (US$ millions) [2]	8.6	16.2	14.9	15.1	38.4	38.9	39.5
Net international reserves (US$ millions; excl. NOA)	32.3	29.5	37.0	31.7	36.7	33.0	31.3
Of which: Commercial banks reserves in foreign currenc	8.5	9.3	11.6	12.1	12.5	12.9	13.3
Net international reserves (US$ millions)							
Excluding NOA and banks reserves in foreign currency	23.7	20.2	25.4	19.6	24.2	20.1	18.0
Base money (annual percent change)	32.0	21.2	50.0	26.5	22.3	7.7	7.7
Currency Issued (annual percent change)	26.6	21.2	22.9	68.5	37.5	33.0	15.8

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

[1] Includes guarantee deposits by prospective financial institutions waiting for operating licenses.

[2] Oil signature bonuses for Blocks 5 and 6 in JDZ, totalling US$26.1 million are projected for 2008.

Table 4. São Tomé and Príncipe: Monetary Survey, 2006–2008

	2006	2007	2008			
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.
	Actual	Prog.	Proj.			
	(Billions of dobras; end of period)					
Net foreign assets	**860.0**	**975.8**	**1,112.0**	**1,558.4**	**1,551.0**	**1,572.1**
Central bank	619.5	708.6	807.3	1,245.4	1,229.7	1,242.6
Commercial banks	240.4	267.1	304.7	313.0	321.3	329.5
Net domestic assets	**-257.5**	**-221.4**	**-237.1**	**-715.8**	**-642.2**	**-578.4**
Net domestic credit	238.2	214.0	493.3	0.8	35.2	103.5
Net credit to government	-115.3	-213.3	-172.1	-626.4	-601.3	-598.1
Of which: valuation changes	-22.4	-21.9	1.4	-382.9	-390.7	-398.7
Claims	105.6	105.7	107.0	118.8	120.9	122.9
Deposits	-220.9	-319.0	-279.1	-745.2	-722.2	-721.0
Budgetary deposits	-40.9	-26.5	-11.9	-88.2	-40.0	-13.3
Counterpart funds	-22.6	-22.6	-8.2	-8.2	-8.2	-8.2
Foreign currency deposits	-157.4	-269.9	-259.0	-648.8	-674.0	-699.5
Of which: National Oil Account	-111.1	-232.4	-221.1	-577.3	-600.6	-624.2
Credit to the economy	353.5	427.3	665.4	627.1	636.5	701.5
Of which : credit in foreign currency	260.2	290.1	518.3	488.5	495.8	546.5
Other items (net)	-495.7	-435.4	-730.4	-716.6	-677.4	-681.9
Broad money (M3)	**602.5**	**754.4**	**874.8**	**842.6**	**908.8**	**993.7**
Local currency	253.3	325.0	333.3	321.0	346.2	378.6
Money	225.5	293.7	304.5	293.2	316.3	345.8
Currency outside banks	92.3	109.6	117.4	113.1	121.9	133.3
Demand deposits	133.2	184.1	187.1	180.2	194.3	212.5
Time deposits	27.8	31.3	28.9	27.8	30.0	32.8
Foreign currency deposits	349.2	429.4	541.5	521.6	562.5	615.1
	(Change in percent of beginning-of-period money stock, unless otherwise specified)					
Net foreign assets	8.1	19.2	-4.5	49.8	48.9	56.1
Net domestic assets	31.2	6.0	11.0	-47.3	-38.3	-30.5
Of which: net credit to government	32.2	-16.3	0.9	-54.4	-51.4	-51.0
credit to the economy	26.4	12.2	7.3	2.6	3.7	11.7
Broad money (M3)	39.3	25.2	6.5	2.6	10.6	21.0
Memorandum items:						
Velocity (ratio of GDP to average broad money	3.0	3.0	...	...	...	3.1
Money multiplier (M3/M0)	2.2	2.2	2.2	2.2	2.1	2.2
Base money (12-month growth rate)	32.0	21.2	26.5	22.3	7.7	7.7
Credit to the economy (12-month growth rate)	47.6	20.9	66.7	47.6	11.8	15.8
M3 (12-month growth rate)	39.3	25.2	34.0	29.4	27.7	31.7

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

Table 5. São Tomé and Príncipe: Balance of Payments, 2005–2013

	2005	2006	2007	2008	2009	2010	2011	2012	2013
			Est.	Projections					
	(Millions of U.S. dollars)								
Trade balance	**-34.8**	**-62.3**	**-58.1**	**-66.9**	**-72.2**	**-78.4**	**-78.4**	**-79.4**	**-85.3**
Exports, f.o.b.	6.8	6.7	6.8	7.0	7.3	7.4	7.4	7.5	7.4
Of which : cocoa	3.0	2.5	3.5	3.2	3.1	3.0	3.0	2.9	2.8
re-export	3.4	3.9	2.9	3.1	3.2	3.3	3.4	3.5	3.5
Imports, f.o.b.	-41.6	-69.0	-64.9	-73.9	-79.4	-85.8	-85.8	-86.8	-92.7
Of which : food	-14.8	-17.0	-17.6	-19.3	-21.0	-22.5	-22.5	-24.3	-26.6
petroleum products	-9.8	-15.0	-14.6	-18.1	-18.4	-19.3	-19.3	-20.4	-21.9
Services and income (net)	-12.0	-21.6	-19.6	-17.5	-14.9	-17.9	-17.9	-18.8	-21.8
Exports of nonfactor services	9.2	9.5	4.2	7.0	7.6	8.3	8.3	8.5	7.7
Of which : travel and tourism [1]	7.3	6.7	3.3	6.0	6.6	7.3	7.3	7.4	7.1
Imports of nonfactor services	-19.2	-33.4	-30.0	-31.9	-31.3	-33.8	-33.8	-34.4	-36.4
Factor services (net)	-2.0	2.4	6.1	7.5	8.8	7.7	7.7	7.1	7.0
Interest due	-3.2	-3.8	-0.7	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
National Oil Account (NOA) interest earnings	0.2	0.9	0.7	1.5	2.6	1.4	1.4	0.7	0.4
Private transfers (net)	1.5	1.6	2.0	2.2	2.5	2.8	2.8	3.1	3.3
Official transfers (net)	33.5	31.0	31.8	32.6	29.4	31.6	31.6	32.4	33.9
Of which : project grants	25.6	25.5	28.4	25.4	26.8	28.8	28.8	30.4	32.6
HIPC Initiative-related grants	3.2	3.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current account balance									
Including official transfers	-11.8	-51.3	-43.9	-49.6	-55.2	-61.9	-61.9	-62.7	-70.0
Excluding official transfers	-45.3	-82.4	-75.7	-82.2	-84.6	-93.4	-93.4	-95.0	-103.8
Capital and financial account balance	**46.3**	**46.3**	**47.2**	**66.8**	**53.9**	**60.9**	**60.9**	**61.3**	**68.7**
Capital transfer [2]	0.0	0.0	162.7	45.4	0.0	0.0	0.0	0.0	0.0
Financial account	46.3	46.3	-115.5	21.4	53.9	60.9	60.9	61.3	68.7
Public sector (net)	29.7	-7.3	-148.4	-17.9	2.0	2.0	2.0	2.0	2.1
Project loans	1.3	4.4	1.4	1.9	1.9	1.9	1.9	1.9	1.9
Program loans	0.0	0.0	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Oil signature bonuses	49.2	0.0	28.6	26.1	0.0	0.0	0.0	0.0	0.0
Amortization	-8.9	-7.4	-178.2	-46.3	-0.9	-0.9	-0.9	-0.9	-0.8
Other investment	-11.9	-4.3	-2.3	-1.7	-1.0	-1.0	-1.0	-1.0	-1.0
Of which : Nigerian and Angolan advances (net)	0.0	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
transfers to JDA	-11.4	-3.1	-3.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Private sector (net)	16.5	53.6	32.9	39.4	51.8	58.8	58.8	59.3	66.5
Direct foreign investment [3]	6.2	41.8	24.0	32.5	35.8	39.5	39.5	39.7	41.6
Commercial banks	-8.5	0.8	-2.3	0.0	0.0	0.0	0.0	0.0	0.0
Short-term private capital	18.8	11.0	11.1	6.9	16.0	19.3	19.3	19.6	25.0
Errors and omissions	**-2.2**	**-6.1**	**8.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**32.3**	**-11.2**	**11.7**	**17.3**	**-1.3**	**-1.0**	**-1.0**	**-1.3**	**-1.3**
Financing	-32.3	11.2	-11.7	-17.3	1.3	1.0	1.0	1.3	1.3
Change in official reserves, excl. NOA (increase= -)	-8.6	-6.6	-4.7	6.1	-0.2	-1.7	-1.7	-2.7	-3.0
Use of Fund resources (net)	0.5	1.2	-0.8	0.7	0.0	0.0	0.0	0.0	0.0
Purchases	0.6	1.2	1.2	0.7	0.0	0.0	0.0	0.0	0.0
Repurchases (incl. MDRI repayment)	-0.1	0.0	-2.1	0.0	0.0	0.0	0.0	0.0	0.0
National Oil Account (increase = -)	-23.3	14.9	-6.3	-24.6	1.4	2.6	2.6	3.8	4.1
Change in arrears (net; decrease = -)	-14.6	1.7	-10.2	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief	13.5	0.0	10.4	0.5	0.2	0.2	0.2	0.2	0.2
Memorandum items:	(Specified unit)								
Current account balance (percent of GDP)									
Before official transfers	-39.5	-66.3	-52.1	-51.5	-48.8	-50.2	-50.2	-47.4	-47.3
After official transfers	-10.3	-41.3	-30.2	-31.0	-31.8	-33.2	-33.2	-31.3	-31.9
Debt service ratio (percent of exports) [4]									
Before HIPC and MDRI relief	75.6	70.0	83.2	…	…	…	…	…	…
After HIPC and MDRI relief	62.1	35.9	27.8	4.2	5.9	5.5	5.5	5.4	4.5
Gross reserves [5]									
Millions of U.S. dollars	26.6	33.3	38.0	31.8	32.1	33.8	33.8	36.5	39.5
Months of imports of goods and nonfactor services	4	4.2	5.1	4	4	4	4	4	4

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

[1] Following the closure of the national airline, tourism receipts fell in 2006 and 2007. The airline was privatized in 2007.

[2] Include HIPC and MDRI debt relief delivered at the completion point in 2007.

[3] From 2006, FDI increases due to oil drilling by foreign companies as well as FDI in the hotel sector.

[4] Percent of exports of goods and nonfactor services. The difference between debt service before and after HIPC relief is larger than debt service saving in cash terms because this table is on an accrual basis.

[5] Gross reserves exclude the National Oil Account and guarantee deposits placed at the central bank by financial institutions pending operating licenses; imports exclude oil sector-related imports of capital goods and services.

Table 6. São Tomé and Príncipe: External Financing Requirements and Sources, 2005–2008

(Millions of U.S. dollars)

	2005	2006	2007 Est.	2008 Proj.
Gross financing requirements	**-89.5**	**-99.1**	**-273.2**	**-124.0**
Current account, excluding official transfers	-45.3	-82.4	-75.7	-82.2
Exports, f.o.b.	6.8	6.7	6.8	7.0
Imports, f.o.b.	-41.6	-69.0	-64.9	-73.9
Services and income (net)	-12.0	-21.6	-19.6	-17.5
Private transfers	1.5	1.6	2.0	2.2
Financial account	-20.9	-11.8	-182.6	-48.0
Scheduled amortization [1]	-8.9	-7.4	-178.2	-46.3
IMF repayments [2]	-0.1	0.0	-2.1	0.0
Other public sector investment (net)	-11.9	-4.3	-2.3	-1.7
Change in external reserves (increase = -)	-8.6	-6.6	-4.7	6.1
Change in arrears (net)	-14.6	1.7	-10.2	0.0
Available funding	**89.5**	**99.1**	**273.2**	**124.0**
National Oil Fund (net)	25.9	14.9	22.3	1.5
Oil signature bonuses	49.2	0.0	28.6	26.1
Saving (accumulation of oil reserve fund = -)	-23.3	14.9	-6.3	-24.6
Expected disbursements	34.8	35.5	198.0	81.9
Multilateral HIPC interim assistance	3.2	3.8	0.0	0.0
Capital transfers [1, 2]	0.0	0.0	162.7	45.4
Grants [3]	30.4	27.2	31.8	32.6
Concessional loans	1.3	4.4	3.5	3.9
Project loans	1.3	4.4	1.4	1.9
Program loans	0.0	0.0	2.1	2.0
Private sector (net)	14.4	47.5	41.3	39.4
IMF [4]	0.6	1.2	1.2	0.7
Financing gap	13.8	0.0	10.4	0.5
HIPC debt relief (bilateral creditors) [2]	0.2	0.0	0.2	0.5
Reschedualable arrears (bilateral creditors) [5]	13.5	0.0	10.2	0.0
Residual financing gap	0.0	0.0	0.0	0.0

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

[1] Includes HIPC and MDRI debt relief delivered at the completion point in 2007.

[2] Includes MDRI assistance from the IMF as a stock of debt reduction.

[3] Includes aid in kind received from Nigeria.

[4] Includes projected PRGF disbursements.

[5] In 2005, includes the new Paris Club rescheduling agreement.

Table 7. São Tomé and Príncipe: Financial Soundness Indicators for the Banking Sector, 2003–07 [1]

	2003	2004	2005	2006	2007
	(in percent)				
Capital Adequacy					
Regulatory capital to risk-weighted assets	. . .	. . .	. . .	. . .	. . .
Capital (net worth) to assets	21.2	29.6	9.6	19.8	16.8
Asset quality					
Foreign exchange loans to total loans	67.4	72.1	81.2	83.2	82.1
Past-due loans to gross loans [2/]	. . .	. . .	. . .	. . .	26.8
Nonperforming loans	. . .	. . .	. . .	. . .	. . .
Watch-listed loans	. . .	. . .	. . .	. . .	. . .
Provision as percent of past-due loans	153.9	52.0	12.9	27.7	53.4
Earnings and profitability					
Net profit (before tax)/net income [3/]	. . .	. . .	. . .	-47.6	. . .
Return on assets	1.1	-4.3	-11.3	-2.8	. . .
Return on equity	19.2	-10.0	-44.2	-11.7	. . .
Expense (w/amortiz. & provisions)/ net income	. . .	. . .	. . .	126.6	422.6
Interest rate spread (deposit money banks)					
Lending rates minus demand deposit rates	. . .	. . .	. . .	. . .	. . .
Lending rates minus saving deposit rates	. . .	. . .	. . .	. . .	. . .
Liquidity					
Liquid assets/total assets	69.0	44.7	46.2	43.5	36.1
Liquid assets/short term liabilities	85.3	70.0	69.2	82.0	72.8
Loan/deposits	32.9	63.1	56.5	77.2	74.3
Foreign exchange liabilities/total liabilities	50.8	49.7	50.5	71.7	48.7
Sensitivity to market risk					
funds	. . .	. . .	. . .	227.0	116.6

Source: São Tomé and Príncipe authorities; and MCM technical assistance report July 2007.

[1] Simple average. The data were only recently provided by commercial banks to the BCSTP. Consistency and quality of the data need to be improved for a comprehensive analysis of the banking sector. The BCSTP is in the process for

[2] For 2008, weighted average estimated by an external financial sector expert.

[3] Gains on foreign currency transactions are included in special reserves not in income.

Table 8. São Tomé and Príncipe: Millennium Development Goals

	1990	1994	1997	2000	2003	2004
Goal 1. Eradicate extreme poverty and hunger						
Target 1: Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day.						
1. Population below US$1 a day (percent)	..	..	..	..	..	..
2. Poverty gap ratio at US$1 a day (percent)	..	..	..	..	..	..
3. Share of income or consumption held by poorest 20 percent (percent)	..	..	..	..	..	..
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger.						
4. Prevalence of child malnutrition (percent of children under 5)	..	..	..	12.9	..	..
5. Population below minimum level of dietary energy consumption (percent)	..	..	..	..	..	..
Goal 2. Achieve universal primary education						
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling.						
6. Net primary enrolment ratio (percent of relevant age group)	..	..	85.5	97.1	..	..
7. Percentage of cohort reaching grade 5	..	..	..	61.5	..	..
8. Youth literacy rate (percent age 15–24)	..	..	..	..	..	..
Goal 3. Promote gender equality and empower women						
Target 4: Eliminate gender disparity in primary and secondary education, preferably by 2005, and to all levels of education by 2015.						
9. Ratio of girls to boys in primary and secondary education (percent)	..	..	..	92.1	..	..
10. Ratio of young literate females to males (percent ages 15–24)	..	..	..	..	..	..
11. Share of women employed in the nonagricultural sector (percent)	..	..	..	..	..	..
12. Proportion of seats held by women in the national parliament (percent)	12.0	..	7.0	9.0	9.0	9.0
Goal 4. Reduce child mortality						
Target 5: Reduce by two-thirds, between 1990 and 2015, the under-5 mortality rate.						
13. Under-5 mortality rate (per 1,000)	118.0	118.0	..	118.0	118.0	118.0
14. Infant mortality rate (per 1,000 live births)	75.0	75.0	..	75.0	75.0	75.0
15. Immunization against measles (percent of children under 12 months)	71.0	65.0	60.0	69.0	87.0	87.0
Goal 5. Improve maternal health						
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.						
16. Maternal mortality ratio (modelled estimate, per 100,000 live births)	..	..	..	..	..	..
17. Proportion of births attended by skilled health personnel	..	..	..	58.5	..	79.8
Goal 6. Combat HIV/AIDS, malaria, and other diseases						
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS.						
18. HIV prevalence among females (percent ages 15–24)	..	..	..	..	..	1.3
19. Contraceptive prevalence rate (percent of women ages 15–49)	..	..	..	29.0	..	..
20. Number of children orphaned by HIV/AIDS	..	..	..	..	..	..
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases.						
21. Prevalence of death associated with malaria	..	..	..	..	..	..
22. Share of population in malaria risk areas using effective prevention and treatment	..	..	..	80.0	..	..
23. Incidence of tuberculosis (per 100,000 people)	136.1	126.6	120.0	113.7	107.8	107.8
24. Tuberculosis cases detected under DOTS (percent)	..	..	..	..	..	..

Continued

Table 8. São Tomé and Príncipe: Millennium Development Goals (Concluded)

	1990	1994	1997	2000	2003	2004
Goal 7. Ensure environmental sustainability						
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources.						
25. Forest area (percent of total land area)	28.1	..	..	28.1	..	..
26. Nationally protected areas (percent of total land area)	..	..	..	..	..	..
27. GDP per unit of energy use (PPP $ per kg oil equivalent)	..	..	..	..	..	..
28. CO2 emissions (metric tons per capita)	0.6	0.6	0.6	0.6	..	..
29. Proportion of population using solid fuels	..	..	..	..	..	..
Target 10: Halve, by 2015, the proportion of people without access to safe drinking water.						
30. Access to improved water source (percent of population)	..	..	..	..	79.0	..
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers.[1]						
31. Access to improved sanitation (percent of population)	..	..	..	..	24.0	..
32. Access to secure tenure (percent of population)	..	..	..	..	..	..
Goal 8. Develop a Global Partnership for Development						
Target 16: Develop and implement strategies for productive work for youth.						
45. Unemployment rate of population ages 15–24 (total)						
Female	..	..	..	..	..	..
Male	..	..	..	..	..	..
Target 17: Provide access to affordable essential drugs						
46. Proportion of population with access to affordable essential drugs.	..	..	..	..	..	..
Target 18: Make available new technologies, especially information and communications.						
47. Fixed line and mobile telephones (per 1,000 people)	19.2	19.8	31.2	31.0	77.6	77.6
48. Personal computers (per 1,000 people)	..	..	..	..	..	..

Sources: World Development Indicators database.

[1] Targets 33–44 are excluded because they cannot be measured on a country-specific basis. They are related to official development assistance, market access, and the HIPC Initiative.

Table 9. São Tomé and Príncipe: Schedule of Disbursements under the PRGF Arrangement, 2005-2008 [1]

SDR Millions	Percent of Quota	Date Available	Disbursement Conditions
0.423	5.7	Aug. 2005	Board approval of arrangement
0.423	5.7	Mar. 2006	Observance of PCs for end-September 2005 and completion of the first review
0.423	5.7	Aug. 2006	Observance of PCs for end-December 2005 and completion of the second review
0.423	5.7	Jan. 2007	Observance of PCs for end-June 2006 and completion of the third review
0.423	5.7	Jun. 2007	Observance of PCs for end-December 2006 and completion of the fourth review
0.422	5.7	Dec. 2007	Observance of PCs for end-June 2007 and completion of the fifth review
0.423	5.7	Jun. 2008	Observance of PCs for end-December 2007 and completion of the sixth review

Source: IMF.

1 As a result of a typographical error in the review decision for the fifth review, the sixth loan disbursement was made in an amount of SDR 0.422 million instead of SDR 0.423 foreseen under the arrangement. To ensure that total loan disbursements to São Tomé and Príncipe amount to the total access approved under the arrangement, the seventh loan disbursement will be SDR 0.423 million instead of SDR 0.422 million.

Table 10. São Tomé and Príncipe: Indicators of Capacity to Repay the Fund, 2007-2013

		Projections					
	2007	2008	2009	2010	2011	2012	2013
Fund obligations based on existing credit							
(in millions of SDRs)							
Principal	1.92	0.00	0.00	0.00	0.00	0.00	0.40
Charges and interest	0.04	0.03	0.03	0.03	0.03	0.03	0.03
Fund obligations based on existing and prospective credit 1							
(in millions of SDRs)							
Principal	…	0.00	0.00	0.00	0.00	0.00	0.44
Charges and interest	…	0.03	0.03	0.03	0.03	0.03	0.03
Total obligations based on existing and prospective credit 1							
In millions of SDRs	1.95	0.03	0.03	0.03	0.03	0.03	0.47
In millions of U.S. dollars	3.07	0.05	0.05	0.05	0.05	0.05	0.76
In percent of exports of goods and services	27.93	0.34	0.32	0.30	0.30	0.32	5.07
In percent of debt service 2	14.39	4.29	4.40	4.48	4.50	5.20	45.66
In percent of quota	26.40	0.40	0.41	0.41	0.41	0.41	6.35
In percent of gross international reserves	8.09	0.15	0.15	0.14	0.13	0.12	1.63
Outstanding Fund credit							
In millions of SDRs	1.6	2.5	2.5	2.5	2.5	2.5	2.0
In millions of U.S. dollars	2.6	3.9	3.9	3.9	3.9	4.0	3.3
In percent of exports of goods and services	23.2	27.9	26.3	25.0	24.8	26.3	21.9
In percent of debt service 2	12.0	356.8	362.5	368.9	370.5	428.1	197.2
In percent of quota	21.9	33.4	33.4	33.4	33.4	33.4	27.4
In percent of gross international reserves	6.7	12.2	12.2	11.6	10.8	10.1	7.1
Memorandum items:							
Exports of goods and services (millions of U.S. dollars)	11.0	14.0	14.9	15.7	15.9	15.1	15.0
Debt service (millions of U.S. dollars) 2	21.3	1.1	1.1	1.1	1.1	0.9	1.7
Quota (millions of SDRs)	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Gross international reserves (excl. oil account and security deposits by banks, millions of U.S.	38	32	32	34	36	39	46
GDP (millions of U.S. dollars)	145	160	173	186	200	220	243

Sources: Sao Tome and Principe authorities; and Fund staff estimates and projections.

1 Assumes disbursement of SDR 0423 million in June 2008.
2 Including IMF repurchases and repayments in total debt service.

LETTER OF INTENT

São Tomé, June 4, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

1. The attached Memorandum of Economic and Financial Policies (MEFP) sets out the objectives and policies that the Government of the Democratic Republic of São Tomé and Príncipe intends to pursue for the remainder of 2008. 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 the Democratic Republic of São Tomé and Príncipe has made progress in economic adjustment and structural reforms over the past year, amid a difficult external economic environment. Economic growth has remained robust. In response to rising international prices for food and fuel, the Government raised the domestic prices for petroleum products, electricity, and water in the second half of 2007 to reduce implicit subsidies. It also intensified efforts to mobilize aid and took steps to strengthen public financial management. However, annual inflation rebounded since mid-2007, reflecting the higher prices of our imports and depreciation of the dobra, especially against the euro, the main invoicing currency for imports. Our domestic primary fiscal deficit was higher than envisaged under the program owing mainly to higher energy prices.

3. To bring inflation to a downward path, we are determined to strengthen policy implementation, particularly in containing domestic primary expenditure and in curtailing liquidity growth. Our policies for the remainder of 2008 aim to consolidate financial stability, 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, 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 sixth review and the disbursement of the seventh 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-December 2007 performance criteria on net bank credit to the Government and the domestic primary fiscal deficit, based on the corrective measures we are taking. The Government also requests a waiver for the nonobservance of the end-December 2007 structural performance criterion related to upgrading the computerized public financial management system. The intended policy steps were taken in early 2008.

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

6. The Government believes that the policies and measures set forth in the MEFP are adequate to achieve the objectives of the 2008 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.

7. 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 IMF staff report on the sixth PRGF review, available to the public and authorizes the IMF to arrange for them to be posted on the IMF website, subsequent to Executive Board completion of the sixth review.

Yours truly,

s./	s./
Mr. Raul António da Costa Cravid Minister of Planning and Finance	Mr. Luis Fernando Moreira de Sousa Governor of the Central Bank of São Tomé and Príncipe

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

São Tomé and Príncipe: Memorandum of Economic and Financial Policies
March 26, 2008

I. Introduction

1. This Memorandum of Economic and Financial Policies (MEFP) supplements that of October 20, 2007 and our Letter of Intent dated December 1, 2007. The new coalition Government, which took office in February 2008 with a majority in the National Assembly, is committed to the policies under the PRGF-supported program. This MEFP describes (i) performance under the PRGF arrangement through December 2007, (ii) economic developments in 2007 and early 2008, 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 the 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 remained robust in 2007, with real GDP growth estimated at 6 percent**. Tourism-related construction, communication, and other services sectors continued to be the main drivers of output growth, boosted by foreign direct investment. Cocoa exports increased on the back of rising world market prices and higher export volume but the traditional agriculture sector remains depressed.

3. **Consumer price inflation rebounded to 27.6 percent (year-on-year) at the end of December 2007, after a significant decline in the first half of the year**. This acceleration reflected the impact of exogenous factors such as rising import prices for food and fuel and appreciation of the euro, the main invoicing currency for our imports.[6] It was also influenced by higher public expenditure and faster than programmed liquidity growth. In addition, the Government sharply raised domestic prices of petroleum products (by 14-25 percent) and electricity and water tariffs (by 40-60 percent) in September 2007, after increases in international oil prices, in order to reduce implicit subsidies. The dobra depreciated against the U.S. dollar and the euro by 10 and 26 percent, respectively, in 2007.

4. **Despite higher than projected domestic revenue, the domestic primary fiscal deficit exceeded the performance criterion for end-December 2007** (Table I.1). Domestic revenue recovered in the second half of the year, led by higher income tax receipts, as well as

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[6] Food items account for 72 percent of the basket for the consumer price index. About 80 percent of food consumption in the country depends on imports. All oil products are imported.

tax arrear collections. However, the domestic revenue gains of about 1.2 percent of GDP vis-à-vis the program target were more than offset by a sharp rise in current spending, especially on utilities, transfers, and medical expenses. A significant part of the utility payments to EMAE, the state-owned electricity and water company, was to mitigate the impact of the sharp utility tariff hike on the population. Higher current spending also contributed to lower funding available for domestically financed capital expenditure. The widening domestic primary deficit, at 8.1 percent of GDP, was financed by a larger-than-projected drawdown of government deposits at the central bank (BCSTP), including from the National Oil Account (NOA). The Government also made efforts to mobilize external financing, which helped in clearing arrears on scholarships and other current outlays.

5. **Base money growth accelerated from 23 percent (year-on-year) in June 2007 to 50 percent by the end of the year**. While part of base money growth was due to strong foreign currency flows to the banking system, the excess increase in dobra liquidity reflected the fact that the BCSTP's sterilization of budgetary use of oil bonuses and donor grants fell short of what was needed to adequately bring down liquidity growth. As a result, base money grew much faster than programmed, while net international reserves exceeded the program target by a large margin.

6. **The exchange rate of the dobra remains market-determined**. 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 and 60 percent of its own previous day's selling rate. The excess liquidity put pressure on the exchange rate and the spread between the reference exchange rate of the central bank and commercial banks exchange rate widened in the second half of 2007 to over 2 percent.

7. **Progress on structural reforms has been mixed**. The end-December 2007 structural performance criterion on public financial management system was met with delay—the intended policy steps were taken in early 2008 (Table I.2). On structural benchmarks, the 2008 budget was prepared and submitted to the National Assembly (NA) in mid-December 2007. It has since been withdrawn and needs to be resubmitted with an updated public investment program. In early 2008, the BCSTP issued the new regulations on capital adequacy, internal control and auditing, bank financial reporting, and credit to employees. The Oil Revenue Management Law (ORML) handbook was posted on the internet in December 2007. However, the direct taxation reform package (new corporate and personal income tax and urban property tax laws) has not yet been approved pending resubmission by the new Government of the draft income tax law. The NA has not yet given its final approval to the anti-money laundering (AML/CFT) law. The National Oil Agency has prepared a Petroleum Sector Strategy and a set of laws for launching licensing for the Exclusive Economic Zone (EEZ), but their adoption has been delayed.

8. **Implementation of public enterprise reform has been slow**. Under a reform strategy for EMAE, utility tariffs were increased to cover production costs. EMAE has also

introduced prepaid electricity meters to strengthen payment collection. Nevertheless, EMAE's facilities need repair and investment, its financial standing remains weak, and its operational efficiency is low. Similarly, ENASA, the airport authority, has difficulties in covering its operating costs, with large arrears on electricity. Overstaffing and other problems led to a bloated cost structure in ENAPPORT, the seaport authority.

III. Economic Policies for the Rest of 2008

9. **Against the backdrop of strong negative terms-of-trade shocks, the authorities attach high priority to restoring financial stability**. The Government and the central bank of São Tomé and Príncipe are determined to make a concerted effort to strengthen expenditure control and liquidity management prior to the Executive Board consideration of the sixth review.

10. **For the rest of 2008, our macroeconomic framework aims to maintain real GDP growth at 6 percent, reduce annual inflation to 13-15 percent by the end of the year, and safeguard international reserves equivalent to 4 months of imports**. We will make every effort to speed up structural reforms, which are critically important for addressing our economy's supply constraints, restoring fiscal sustainability over the medium term, and mobilizing support from the World Bank and other multilateral and bilateral development partners.

A. Fiscal Policy

11. **The Government plans to further reduce the domestic primary deficit to 5.2 percent of GDP in 2008, from 8.1 percent in 2007**. Fiscal consolidation in the 2008 budget would come mainly from the expenditure side, because the revenue impact of the envisaged direct tax reforms, which aim to reduce distortions, would be largely neutral in 2008. The domestic primary deficit is expected to be financed by the use of IDA Development Policy Operation (DPO) grant of US$4.5 million and a draw-down of up to US$3 million from the National Oil Account (NOA). There should be no recourse to domestic banking system credits (excluding the NOA).

12. **In the period immediately ahead, the Ministry of Planning and Finance will significantly tighten expenditure control to prevent the recurrence of an expenditure overrun**. Specifically,

- To put in place a functioning computerized public financial management system (SAFINHO), the Ministry of Planning and Finance will establish a Directorate of Accounting and an IT office by end-March 2007, in addition to procuring and installing IT equipment. We intend to make progress in training users of the upgraded SAFINHO at the level of spending entities in the following months.

- Strict (quarterly) limits will be set on nonessential current spending, particularly on goods and services and transfers not funded by donors.

- Withdrawals from the National Oil Account will be in strict compliance with the provisions of the ORML.

13. **Other expenditure measures planned for 2008 include**:

- **Containing budgetary personnel costs**. The full year impact of the 2007 general wage increase will be felt in 2008. The Government will closely monitor all components of the wage bill and strictly limit the payments of bonuses and benefits to ensure that the wage-bill-to-GDP ratio declines from 8.9 percent in 2007 to 8.6 percent in 2008.

- **Public wage reform**. As part of its civil service reform strategy to be supported by the World Bank under the DPO, the Government plans to integrate fringe benefits into the wage bill and adopt a revised salary structure, based on a comprehensive wage study, with incentives for public servants, as a first step in its strategy. These reforms are critically important for restoring fiscal sustainability and enhancing the growth orientation of the budget.

- **Adjusting nonwage current spending**. Transfers to the Joint Development Authority (JDA) will need to be reassessed, taking into account budget constraints, oil revenue prospects, and the execution of the JDA budget. Discretionary expenditures on goods, services, and other items will have to be restrained to correspond with available resources.

- **Assisting the most vulnerable segments of the population**. We plan to achieve this goal through better implementation of HIPC-related expenditure programs and a temporary, targeted scheme for the most vulnerable groups. The latter scheme, to be financed by part of the IDA DPO grant (US$0.5 million), will facilitate adjustment to higher import prices for food and fuel. While aligning allocations with the PRSP priorities set out in the Priority Action Plan for 2006–08, we will improve the monitoring of pro-poor spending.

- **Improving the execution of public investment projects**. Increasing infrastructure investment, especially in transportation and the electricity sector, will help address supply bottlenecks and enhance growth potential. We will work closely with our external development partners to accelerate implementation of foreign-funded projects, while ensuring adequate resources for domestically funded investment projects.

14. **On the revenue side, the Government will focus on the following measures**:

- **Timely adoption and implementation of the new direct taxation laws**. The Government has resubmitted the draft income tax law to the NA, aiming to obtain NA approval of the tax reform package by the end of April 2008. The package of legislation includes a reduction in the corporate tax rate from 45 to 25 percent, a move to a progressive personal income tax from the current flat rate of 13 percent, and application of the urban tax code. Timely implementation after NA approval would help broaden the tax base, reduce distortions, and increase revenue buoyancy.

- **Strengthened tax and customs administration**. With support from the US Millennium Challenge Corporation (MCC), the tax authorities will step up efforts to audit tax returns, keep track of large tax payers, and compile and collect tax arrears, particularly from large tax payers. To facilitate tax arrear collections, the Government intends to set up tribunals to settle tax disputes.

15. **To strengthen the monitoring and execution of the 2008 budget, the Government will further improve the public financial management system**. With assistance from multilateral and bilateral donors, efforts will be made to put in place new modules to implement the public accounting system, prepare regulations for the organic budget law (SAFE law), and develop SAFINHO into a fully fledged eSAFE system incorporating all public accounts, including patrimony and debt.

16. **Prudent use of donor budgetary support and the remaining oil bonuses is essential for maintaining macroeconomic stability in the next several years**. Total grants from IDA under the DPO are expected at US$6 million. As no additional DPO grants are envisaged in the next few years, the Government intends to save part of the grant (US$1.5 million) for future use. In view of the rapidly declining NOA balance, high uncertainty regarding additional oil signature bonuses in 2008, and further delays in oil exploration drilling in Blocks 2 and 4, annual draw-down of the NOA will be strictly limited. The Government is 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 2014.

B. Monetary and Exchange Rate Policies

17. **We recognize that to return inflation to a downward path, the BCSTP must step up its effort to mop up excessive liquidity and significantly bring dobra base money growth down.** Weak financial intermediation and high currency substitution in our economy severely limit the effectiveness of interest rates and other monetary policy instruments. We therefore have to rely on fiscal restraint and foreign exchange sales to control liquidity. The BCSTP will use foreign exchange auctions more actively, consistent with the program's NIR target, aiming to lower the 12-month growth rate of dobra base money from 50 percent in December 2007 to 35 percent by the end of March 2008 and 25 percent by the end of June 2008. Our monetary program for the rest of 2008 aims to keep base money growth on a declining trend, in order to achieve the program's objective of reducing inflation.

18. **The BCSTP and the Treasury Department of the Ministry of Planning and Finance intend to strengthen their cooperation to ensure that the BCSTP takes timely action to sterilize budgetary use of oil bonuses, donor funds, and HIPC and MDRI savings**. Regular information-sharing among the Ministry of Planning and Finance and BCSTP officials will include the Treasury's cash outlays (in both domestic and foreign currency), which are important for the BCSTP's liquidity forecast and foreign exchange market operations. To help liquidity forecast, the BCSTP will use the weekly average, rather than the monthly average, in measuring commercial banks' compliance with the minimum reserve requirements. Because public expenditure is a major component of aggregate demand that also 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 domestic primary expenditures.

19. **The BCSTP is committed to deepening foreign exchange market reform**. While accepting the obligations under Article VIII, Sections 2(a), 3, and 4, of the IMF's Articles of Agreement remains our goal, in the near term, the Government will focus on expediting approval by the National Assembly of the new investment code, which contains provisions aiming to remove the exchange restriction on transferring dividends abroad. To remove the remaining multiple currency practices, the BCSTP will consider revising the mechanism for setting the daily official exchange rate, based on a careful review of domestic market conditions. The revised mechanism would ensure that the spread between the official and commercial bank exchange rates will not exceed 2 percent. The BCSTP will continue implementing the current policies of holding regular foreign exchange auctions and progressively expanding the foreign exchange auction market to ensure a fuller and faster market determination of the exchange rate.

20. **The BCSTP will continue with its communication strategy of informing the market of its monetary and exchange policies.** In addition to the BCSTP regular meetings with the banking community and the media, data on monetary and macroeconomic aggregates will be posted daily on the central bank's website. The BCSTP will also post yearly audited financial statements. Its budget execution and profit and loss accounts on a cash basis will be reported at least quarterly, as part of the program's monetary data.

C. Structural Reforms

21. **Reducing the cost of investing and doing business in São Tomé and Príncipe is crucial for developing our economy's productive and export potential**. The Government intends to press ahead with the following reforms: (i) with external technical assistance, complete the revision of the commercial codes; (ii) enact and implement the new investment code and the revised labor code. The investment code would provide equal treatment to foreign and domestic investors. Revisions to the labor code would aim to more clearly define hiring and firing rules, remove ambiguities in contractual employment arrangements, and increase labor market flexibility by eliminating regulatory impediments; and (iii) submit and

obtain NA approval of the draft legislation, prepared in consultation with the private sector, to reduce red tape and other regulatory impediments to start a business.

22. **We will build on our recent progress to further enhance transparency and accountability in managing current and prospective oil resources**. The Minister of Natural Resources and Environment issued an order in August 2007 verifying São Tomé and Príncipe's formal adherence to the Extractive Industries Transparency Initiative (EITI). A national coordinator for implementation of the EITI has also been appointed. More recently, the International Board of the EITI has accepted São Tomé and Príncipe as a Candidate State of the Initiative, in recognition of our serious commitment to transparently manage oil revenues. To make further progress, we will adopt the Petroleum Sector Strategy and submit to the NA the legal framework for the EEZ including the Framework Law On Oil-Related Activities, the Taxation Law, and the Production-Sharing Contract Model. The National Oil Agency will strive to conduct the licensing round for the EEZ transparently and consistent with the ORML and the EITI.

23. **Regarding financial sector reform, our top priority is to obtain NA final approval of the AML/CFT law**. We are aware that the country would be negatively affected if we do not catch up in this important area. We therefore will work closely with the NA to expedite the legislative process. Once the NA gives final approval to the AML/CFT law, the implementation regulations, which the BCSTP has already prepared, will be issued. In addition, based on a review which has already been undertaken, the BCSTP intends to strengthen the requirements for issuing bank licenses, including by raising the minimum capital requirement. To reduce the risk of bank distress arising from non-performing loans, the BCSTP, with IMF technical assistance, will further strengthen its capacity to enforce banking supervision regulations through training, implementing the new chart of accounts and quarterly financial reporting by banks, and setting up a central credit unit to facilitate credit information sharing among banks.

24. **Pressing ahead with reforms in key sectors, such as agriculture, transportation, and energy, is of fundamental importance if living standards are to improve on a sustainable basis**. We will continue working closely with the World Bank and other development partners to promote agricultural marketing, commercial fishing, and tourism-related services. We will also address EMAE's financial and technical weaknesses through tariff and other reforms, increase the productivity of ENAPORT through outsourcing (e.g. cleaning, security guards), and attract investment to upgrade our infrastructure, including the airport runway and seaport.

D. Debt Management

25. **The Government is fully aware of the importance of ensuring debt sustainability after HIPC and MDRI debt relief**. We will refrain from new external borrowing, particularly on commercial terms, and redouble our efforts to seek full delivery of HIPC debt

relief from the remaining official creditors. We have initiated discussions on debt cancellation with Angola and Portugal and will try to conclude these agreements as soon as possible. The Government will further improve debt management by utilizing the Commonwealth Secretariat debt management system (CS-DRMS).

E. Capacity Building

26. **São Tomé and Príncipe continues to need international support to build capacity for policy monitoring and implementation**. The World Bank is providing support for our public financial management reform. A resident macroeconomic advisor, supported by Portugal, is now working in the Ministry of Planning and Finance. Under the US MCC's Threshold program, technical advisors are assisting our tax and customs administration and providing advice to help improve the business environment. We have benefited from IMF technical assistance in central banking, public finances, and statistics and will strive to use such assistance more effectively in the future. We welcome a mission from the IMF's Monetary and Capital Market Department to assess our technical assistance needs and a mission from the Finance Department to conduct a safeguard assessment after the current PRGF arrangement expires in August 2008.

27. **We will further improve our economic statistics**. Within our very tight budget constraints, we will provide support for a new household expenditure survey in order to improve compilation of the consumer price index. Further progress will also be made to improve budget classification and the consistency between monetary and fiscal data.

F. Program Monitoring

28. **To facilitate expenditure control and liquidity management, indicative targets for selected fiscal and monetary variables are set for end-March and end-June 2008** (Table I.1). These include indicative ceilings for primary nonwage current spending, 12-month dobra base money growth, and net international reserves of the BCSTP. The non-accumulation of external payment arrears (as defined in the attached Technical Memorandum of Understanding) is a continuous performance criterion, as are the injunctions against imposing or intensifying restrictions on current payments, introducing new or modifying existing multiple currency practices, concluding bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement, or imposing new or intensifying existing import restrictions for balance of payments purposes. Two structural benchmarks are added, one on the adoption of the 2008 budget, in line with the PRGF-supported program, and another on approval of the direct taxation reform package for end-April 2008 (see Table I.2).

29. **The attached Technical Memorandum of Understanding sets out the modalities of program monitoring.** These include definitions of performance criteria and indicative targets; application of adjustors 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.

30. **We have recently provided the second Annual Progress Report on the PRSP to the Fund and the World Bank**. We welcome the positive assessment of the staff of the two institutions conveyed by the mission and look forward to the Joint Staff Advisory Note. Looking forward, we will enhance monitoring and evaluation to ensure effective and successful implementation of the PRSP and update the PRSP when new information on oil prospects, especially after further oil exploration drilling in the JDZ, becomes available.

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

(Billion of dobras, cumulative from September 2006, unless other wise specified)

	2006		2007					2008	
	Sep. 30		Jun. 30		Dec. 31			Mar. 31	Jun. 30
	Base (stocks)	Base (stocks, excl. NOA)	Perf. Criteria CR/07/102	Actual	Perf. Criteria CR/07/267	Perf. Criteria CR/07/267 (with adjustors)	Actual	Ind.Target	Ind.Target
1. Floor on domestic primary balance (as defined in the TMU; cumulative from beginning of year)	...	...	-97.0	-97.0	-137.3	-137.3	-158.4	-22.6	-80.0
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	-20.8	-32.4	-60.7	-33.8	-83.2	-30.9	70.8	-21.7
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	-183.8	-19.6	-86.5	26.3	-23.1	-65.0	52.3	-8.4
4. Floor on changes in the net international reserves of the central bank (cumulative from end–September 2006; US$ millions) [3,4]	41.8	33.4	1.9	4.9	1.0	4.5	10.1	-2.1	2.7
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	0.0	1.6	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	0.0	1.0	1.0	1.0	1.0	1.0
Memorandum items:									
Base money (ceiling; billions of dobras) [9]	273.2	...	302.5	318.2	337.0	...	417.1	391.6	389.2
Currency Issued (ceiling; billions of dobras)	94.4	...	105.0	88.7	124.5	...	126.2	135.2	122.0
Oil signature bonuses including accrued interest on NOA (US$ millions, cumulative from beginning of year)	0.5	...	28.8	16.0	29.0	...	30.9	0.2	26.5
Transfer from NOA to the budget (US$ millions, cumulative from beginning of year)	...	...	8.0	8.0	8.0	...	10.3	0.0	3.0
Net external debt service payments (cumulative from beginning of the year, billions of dobras at program exchange rate) [10]	-35.4	...	-211.0	-213.2	-220.0	...	-229.4	-4.2	-8.5
Official external program support (cumulative from beginning of the year, billions of dobras at program exchange rate) [11]	7.8	...	0.0	0.0	41.8	...	62.7	12.3	81.3

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

[1] For 2007 and 2008, the ceiling will be adjusted downward or upward according to definitions in the TMU.
[2] The ceiling will be adjusted downward by the amount of accumulated domestic arrears.
[3] The National Oil Account (NOA) at the Central Bank is included in 2007 and excluded in 2008.
[4] For 2007 and 2008, the floor on net international reserves will be adjusted upward or downward according to defnitions in the TMU.
[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.
[8] Debt is defined as in point 9 of the *Guidelines on Performance Criteria with Respect to Foreign Debt* (August 24), 2000.
[9] BCSTP targets the dobra component of base money, rather than total base money, since the latter includes a large, volatile foreign currency component.
[10] Includes US$15 million repayment to Nigeria in 2007.
[11] 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 I.2. São Tomé and Príncipe: Structural Performance Criteria and Benchmarks June 2007–December 2008

Action	Performance Criteria / Benchmark	Status
June 2007		
• Issue new prudential regulations on credit classification, liquidity, transactions with related parties, and limits on bank net open foreign currency positions.	Performance Criteria	Three regulations (credit classification, liquidity, and transactions with related parties) were issued in August; the regulation on net open foreign currency positions was issued in November 2007.
• Produce the monthly budget execution report (TOFE) using upgraded SAFINHO.	Benchmark	Reports are prepared monthly.
• Finalize the installation of 3,000 prepaid electricity metering systems.	Benchmark	About 1,000 meters installed by September 2007.
September 2007		
• Prepare the 2008 budget in line with the new organic budget law (SAFE) for submission to the National Assembly.	Benchmark	The 2008 budget is in line with the new SAFE and was submitted to the NA on December 12, 2007.
December 2007		
• Make progress toward the fully integrated computerized public financial management system (eSAFE) by: (i) the issuance of an administrative decree by the Minister of Finance to establish the IT office; and (ii) the issuance of tenders for the procurement of IT equipment for upgrading SAFINHO.	Performance Criteria	In early 2008, the administrative decree to establish the IT office and the Directorate of Accounting were approved by the Council of Ministers and the tender for the procurement of IT equipment was issued.
• Adopt Petroleum Sector Strategy to develop the Exclusive Exploration Zone (EEZ).	Benchmark	Petroleum Sector Strategy prepared by the National Petroleum Agency, pending approval by the Council of Ministers.
• Issue new regulations on capital adequacy, internal control and auditing, bank financial reporting, and credit to employees.	Benchmark	All new regulations issued in the early 2008.
March 2008		
• Establish a Directorate of Accounting and an IT office. Install IT equipment.	Benchmark	Bill passed to establish offices but due to delays in donor funding, the offices are not yet established and the IT equipment not yet purchased.
• Revise the commercial codes, with external technical assistance, in order to reduce the cost and time of doing business.	Benchmark	External technical still ongoing.
• Adopt the new income tax code, corporate tax code, and urban property tax code.	Benchmark for April 2008	Expected in late June.
• Adopt the 2008 budget in line with the PRGF-supported program.	Benchmark for April 2008	Adopted on May 7, 2008 in line with the program.
June 2008		
• Revise the mechanism for setting the daily official exchange rate to keep the spread between the official and commercial banks exchange rates within the permissible range.		
• Prepare regulations under the SAFE law.		
• Put in place new modules to implement the public accounting system and train users.		
• Initiate preparation of an action plan to compile the payment arrears of EMAE and ENAPORT.		

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 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.

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 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.

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 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 *compromisso*), 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 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. **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, defined in the matrix above, 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 DB –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 (amounts past due and unpaid).

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),[7] less all deposits held by the central government with DMBs as they are reported monthly by the BCSTP to the IMF staff. The National Oil Account (NOA) at the BCSTP is included in 2007 and excluded in 2008. 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 Db –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
Of which:	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[8]	Db 20.3 billion
	Account for MDRI relief[9]	Db 0.0 billion
	Counterpart deposits	Db 22.6 billion
	PRGF disbursement account	Db 4.7 billion

[7] Deposit money banks (DMBs) refer to other depository corporations, as defined in the *Monetary and Financial Statistics Manual.*

[8] Pending the use of HIPC debt relief for propoor spending.

[9] 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
Of which:	Cash in vaults:		Db 13.7 billion
	Currency outside banks:		Db 80.7 billion
Plus:	Bank reserves:		Db 178.7 billion
	Of which:	In dobras	Db 80.5 billion
		In foreign currency	Db 98.2 billion
Equals:	Base money:		Db 273.2 billion
	Of which:	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. The NOA at the BCSTP is included in 2007 and excluded in 2008. 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 Db 524.6 billion, calculated as follows:

Net international reserves:			Db 524.6 billion
Of which:	Gross reserves:		Db 552.3 billion
	Of which: 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 items:

Net international reserves minus 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. The NOA at the BCSTP is included in 2007 and excluded in 2008. 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 –289.8 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.[10] At end-September 2006 the stock of short-term external debt stood at US$16.0 million.[11]

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.[12] [13] Debt rescheduling and restructuring are

[10] 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).

[11] This amount includes three nonconcessional loans from Nigeria totaling US$15 million that 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.

[12] This performance criterion applies not only to debt as defined in point 9 of the *Guidelines on Performance Criteria with Respect to Foreign Debt* adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received.

[13] 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. 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. 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 Fund resources.

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 non-accumulation 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 arrears have 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 1.

III. 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 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 will be adjusted downward by the amount of accumulated domestic arrears. For 2007 the ceilings on NCG and NDA 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 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. For 2008, the ceilings 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 transfers from the NOA to the budget that exceed US$3 million. 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.

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. For 2007, the floor on NIR 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. For 2008, the floor on NIR will be adjusted upward or downward by the cumulative deviation in the opposite direction in external debt service, and by deviations in the same direction for transfers from the NOA to the budget that exceed US$3 million. 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. In addition, the NIR floor will be lowered by the amount that disbursements under the PRGF arrangement are lower than expected.

IV. 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 (compromisso) and cash payments (caixa)
- Monthly data on domestic arrears by type
- Quarterly 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 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, 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 base money and currency in circulation (see attachment), to be posted on the central bank's web site.
- Weekly net international reserve position, to be posted on the central bank's web site
- 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 on 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), provided by Customs.

INTERNATIONAL MONETARY FUND
INTERNATIONAL DEVELOPMENT ASSOCIATION

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

Joint IMF-World Bank Debt Sustainability Analysis for Low-Income Country Framework Update[1]

Prepared by the staffs of the International Development Association and the International Monetary Fund

Approved by Carlos Alberto Primo Braga and Sudhir Shetty (WB) Jean A. P. Clément and Scott Brown (IMF)

1. **São Tomé and Príncipe has a high risk of debt distress even after debt relief under the HIPC Initiative and the Multilateral Debt Relief Initiative (MDRI)**. Upgrading the country's risk of debt distress classification in the future will hinge on the beginning of oil production. The results suggest that the attainment of debt relief at the HIPC completion point and MDRI debt relief brought about a substantial improvement in the country's debt outlook, though debt ratios will continue to be vulnerable to shocks until oil production starts in 2014.[2] The debt outlook remains vulnerable even under the baseline scenario, as indicated by a breach of debt thresholds prior to the production of oil. The risk of debt distress increases significantly under a scenario with no oil production and no fiscal adjustment. Reducing the risk of debt distress will therefore depend critically on maintaining sound fiscal policy consistent with a prudent borrowing strategy for the medium and long term as well as policies oriented to achieving broad-based long-run economic growth.

I. Background

2. **The country reached the completion point under the enhanced HIPC Initiative in March 2007 and benefited from HIPC/MDRI debt relief**. The debt service-to-GDP ratio was about 3.2 percent of GDP in 2006 and is expected to decline to 0.7 percent in 2008—a result of both enhanced HIPC and MDRI debt relief. Debt relief under the MDRI, in

[1] This report updates the debt sustainability analysis (DSA) prepared for the HIPC Completion Point Document in February 2007 (CR/07/173). This LIC DSA incorporates revised debt repayment and disbursement schedule, macroeconomic projections and oil prospects.

[2] São Tomé and Príncipe is currently classified as a "Weak Performer" in IDA's Country Policy and Institutional Assessment (CPIA) index. Under the joint IDA/IMF debt sustainability framework the thresholds are: 30 percent for the NPV of debt-to-GDP ratio, 100 percent for NPV of debt-to-exports ratio, and 15 percent for the debt service-to-exports ratio.

particular, resulted in substantial debt service savings, reflecting the large share of debt to the IDA, AfDF, and IMF in the country's total debt before MDRI.

3. **São Tomé and Príncipe's medium- and long-term external debt at the end of 2007 is estimated at US $150 million in nominal terms, corresponding to a NPV of debt-to-export ratio of 119 percent**. The share of multilateral debt is 24 percent, of which about 39 percent is owed to the IDA, African Development Bank, and IMF. The share of official bilateral debt is about 76 percent, of which 31 percent is owed to Portugal. São Tomé and Príncipe is current with its obligations to multilateral creditors and has cleared most of its arrears with Paris Club creditors as part of a debt rescheduling agreement on Cologne terms (September 2005). The authorities have signed bilateral agreements with all its Paris Club creditors with the exception of Russia to implement the terms of the May 2007 Agreed Minute.[3] They are also reconciling debt records with other non-Paris Club creditors.[4]

Outstanding of external debt
(as of the end of 2007, in million US dollars)

Total	149.7
Multilateral creditors	35.5
IDA	9.7
African Development Bank	2.2
Arab Development Bank	2.5
IMF	2.0
Others	19.0
Bilateral creditors	114.2
Portugal	34.8
Angola	25.4
Others	54.0

II. Medium-Term Macroeconomic Framework

4. **The macroeconomic framework underlying the long-term sustainability outlook has been revised to take into account developments since the HIPC completion point**. The revisions include (i) a delay of the start of oil production by two years from 2012 to 2014, reflecting the result of recent oil exploration, (ii) a reduction of oil production level to 42 percent of the previous assumption, (iii) an upward revision of GDP data series and a downward revision of exports data series,[5] (iv) the inclusion of topping-up assistance into the baseline scenario, and (v) a revision of debt services and disbursement schedule reflecting the latest projections. The framework is in line with the government's medium-term program, which is supported by the PRGF arrangement (Box 1). São Tomé and Príncipe could start

[3] São Tomé and Príncipe and Russia have been working since the HIPC completion point to conclude bilateral agreement.

[4] Since São Tomé and Príncipe is still in the process of signing bilateral agreement with Paris Club creditors, the country has technical arrears to some of Paris Club creditors.

5 See IMF Country Report No. 07/267. Ratios in this document refer to new GDP and export data series.

producing oil in 2014 at the earliest. Development of the non-oil economy is expected mainly in the service sector, principally banking and tourism, and secondly in fishery and agriculture.

5. **Other baseline assumptions are mostly unchanged compared to the one performed at the time of the HIPC completion point** (Box 1). The baseline scenario assumes full delivery of debt relief under the HIPC Initiative (including topping up) and MDRI. GDP growth is expected to accelerate over the medium term to 8 percent and then slow gradually to 5 percent in the long term. Domestic investment would increase sharply in the medium term, largely on account of oil sector investment initiatives. The rise in the investment will require continuing reliance on foreign savings, although national savings are forecast to increase on account of higher private savings once stability and economic growth become firmly established.

6. **Inflation is expected to decline gradually to 6 percent by 2011 and over the long term level off at 4 percent, reflecting a balanced budget and the central bank's commitment to control inflation**. On fiscal policy, oil revenues are assumed to accrue in the National Oil Account (NOA) and be used to finance the government budget according to a permanent income rule established by the Oil Management Revenue Law. The permanent income generated by the NOA would cover all São Tomé and Príncipe's public budget needs in the long term.

7. **The external current account deficit is projected to remain in deficit until 2016, as a result of large imports related to the development of the oil sector and public investment, and revert to a surplus in 2017–23, as a result of oil exports**. In the long term, the external current account is projected to have a small deficit, which is to be financed by the permanent income generated by the NOA.

8. **Risks to the macro framework arise from a possible weakening of the fiscal consolidation effort, potential shortfalls in foreign assistance triggered by the expected oil boom, and lower or no oil production**. All scenarios assume no domestic public debt (no significant development of a domestic-based market for government debt is foreseen) and most of the scenarios assume external borrowing on concessional terms. In particular, the scenario of no oil production assumes no fiscal adjustment, as in DSA performed at the time of the HIPC completion point. This scenario also assumes less concessional terms for external borrowing, reflecting the worsening of the fiscal stance.

III. Fiscal Debt Sustainability Analysis

9. **In the baseline scenario, São Tomé and Príncipe's debt outlook shows a significant improvement after HIPC/MDRI debt relief, but remains vulnerable until oil production starts** (Figure 1 and Table 1). Both the NPV of debt-to-GDP and NPV of debt-to-revenue ratios remain low throughout the projection period. The debt service-to-revenue ratio is projected to remain below 10 percent, declining further once oil production starts.

10. **The sensitivity analysis shows that the debt indicators are particularly vulnerable to deterioration of the primary balance before oil production starts**. Under the most extreme stress test, which assumes that the primary balance is at historical average minus one standard deviation, all debt indicators increase substantially above the baseline scenario from 2009 (Figure 1 and Table 1).

11. **Under a scenario with no oil production and no fiscal adjustment, the public debt dynamics become explosive in São Tomé and Príncipe** (Figure 1 and Table 1). In this scenario, all debt indicators are projected to increase rapidly. Both the NPV of debt-to-GDP and the NPV of debt-to-revenue ratios are projected to increase substantially throughout the projection period, leading to an increasing debt service-to-revenue ratio.

Box 1. Baseline Macroeconomic Assumptions, 2008–26

- **Real non-oil GDP growth** is expected to reach 8 percent by 2013 with investments in the service sector and infrastructure in anticipation of the oil era and development of the tourism and fishery sectors. After oil production starts to decline from 2018, non-oil GDP growth should slow gradually to a sustainable 5 percent in the long term.

- **Oil production of one well is assumed to start in 2014.** The country's share in the oil output of the Joint Development Zone (JDZ), 15,000 barrels a day, at an average price of US$70 per barrel on average would yield US$380 million in annual exports for 20 years and would require total investment by São Tomé and Príncipe of US$1.2 billion. Preliminary staff estimates indicate that, on the assumption that only one of the six blocks auctioned in the JDZ with Nigeria is found to be commercially exploitable, oil production would still have a sizeable effect on São Tomé and Príncipe's economic prospects.

- **Inflation** is projected to fall gradually to 6 percent in 2011 and over the long term hold steady at 4 percent, reflecting a smaller budget deficit and the central bank's commitment to control inflation.

- **Fiscal policy** will be supportive of economic growth and poverty reduction. The domestic primary balance is expected to continue recording deficits of around 3-4 percent of GDP through 2014, reflecting large social and infrastructure expenditures.

- **The current account deficit (including grants)** is expected to average 35 percent of GDP for 2008–14 because of large investment-related imports. Between 2017 and 2023, the current account is projected to turn into a surplus as a result of oil exports. After 2024, it is expected to return to a deficit, which would be financed by the permanent income from the NOA.

- **External borrowing** on concessional terms is assumed to be about US$4 million a year, mainly from the African Development Bank and IDA.

IV. External Debt Sustainability Analysis

12. **The baseline scenario shows unfavorable external debt dynamics before oil production starts.** Debt relief under the HIPC Initiative and MDRI allows the debt ratios to improve substantially; however, some of the ratios exceed or rise close to the policy-dependent thresholds until oil production starts (Figure 2 and Table 2b). The NPV of debt-to-GDP ratio is projected to remain below the 30 percent policy-dependent debt-burden threshold throughout the projection period. However, the NPV of debt-to-exports ratio is projected to exceed the policy-dependent threshold before oil production starts. Then it falls sharply after 2014, when oil production starts. The debt service-to-exports ratio is also projected to rise close to the policy-dependent threshold in 2012-14 before declining sharply once oil production starts.[6]

13. **The sensitivity analysis shows that the debt indicators are particularly vulnerable to low export growth**. In the most extreme stress test, which assumes that export value grows at historical average minus one standard deviation, São Tomé and Príncipe's NPV of debt-to-exports ratio is projected to increase well above the policy-dependent thresholds from 20010 to 2014, then fall sharply after oil production starts in 2014 (Figure 2).

14. **In a scenario with no oil production and no fiscal adjustment, external debt vulnerability becomes acute in São Tomé and Príncipe** (Figure 2). In this scenario, all debt indicators are projected to increase rapidly. Both the NPV of debt-to-GDP and the NPV of debt-to-exports ratios are projected to remain above the policy-dependent threshold, leading to an ever increasing debt service-to-exports ratio in the absence of fiscal adjustment.

V. Conclusion

15. **São Tomé and Príncipe's risk of debt distress is high even after debt relief under the HIPC Initiative and MDRI.** Despite the significant reduction obtained under these two Initiatives, São Tomé and Príncipe's NPV of debt-to-exports ratio breaches its indicative threshold prior to the production of oil. São Tomé and Príncipe's external debt will remain vulnerable to shocks to exports and foreign grants, at least until oil production starts in 2014.[7] External debt vulnerability would be further exacerbated in the absence of sound macroeconomic policies and undue delays in oil production. These risks underline the need for prudent fiscal and debt management policies, continued reliance on concessional financing, and implementation of structural reforms essential to support broad-based long term economic growth.

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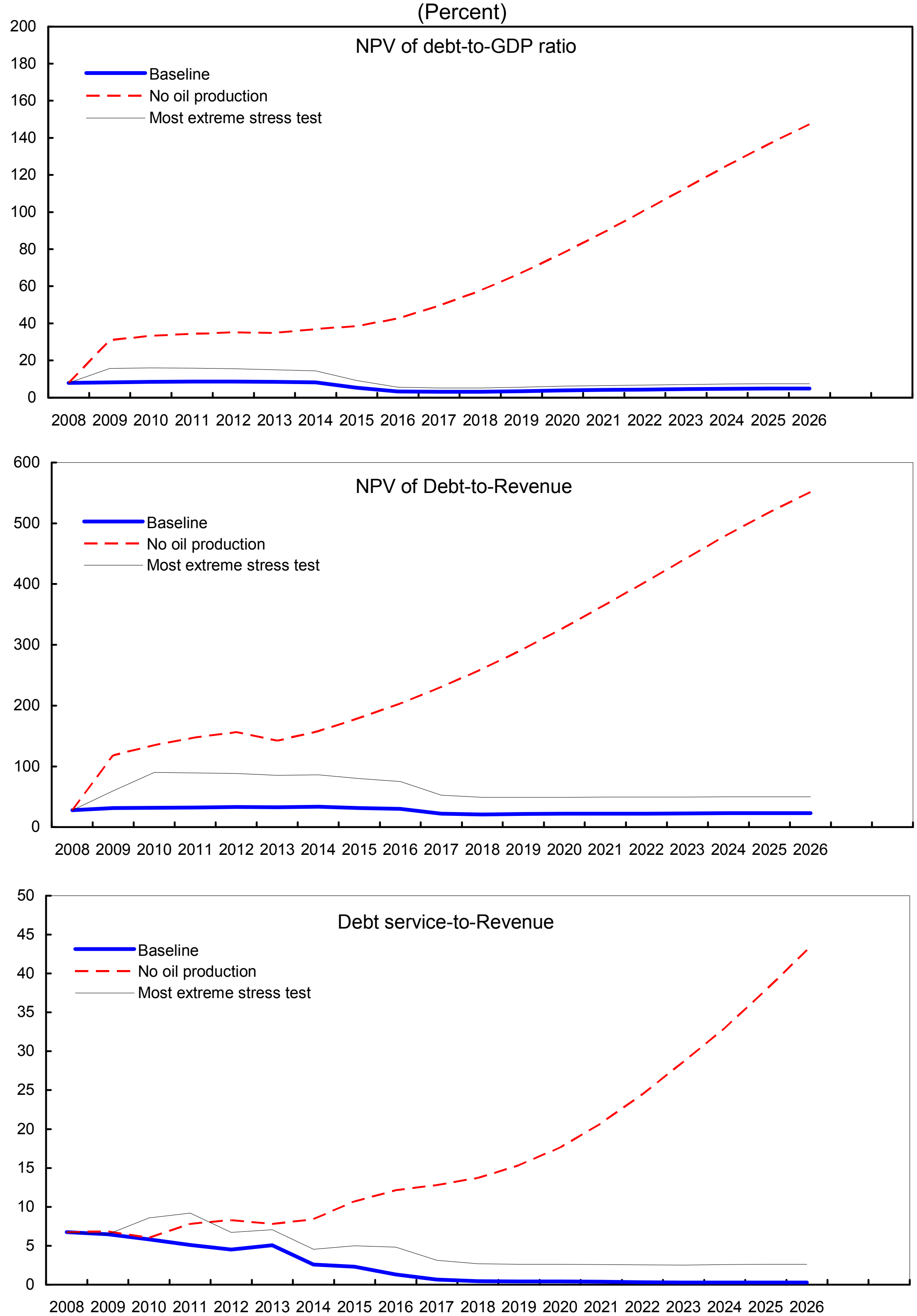
[6] The debt ratios of the LIC DSA may differ from the HIPC debt relief analysis as they use different methodologies. The LIC uses the same-year exports, while HIPC DSA uses a three-year backward average. The LIC DSA uses a fixed 5 percent discount rate, while the HIPC DSA uses currency-specific discount rates. Finally, the LIC DSA debt service projections use WEO exchange rates, while the HIPC DSA uses fixed exchange rates (end-2005).

[7] Scenario under the shocks to foreign grants are presented in "B4. Net non-debt creating flows at historical average minus one standard deviation" in Table 2b.

Figure 1. São Tomé and Príncipe: Indicators of Public Debt, 2008-26
(Percent)



Source: Staff projections.

Table 1a.São Tomé and Príncipe: Public Sector Debt Sustainability Framework, Baseline Scenario, 2007-2026
(In percent of GDP, unless otherwise indicated)

	Actual			Estimate	Projections								
	2007	Historical Average 5/	Standard Deviation 5/	2008	2009	2010	2011	2012	2013	2008-13 Average	2015	2018	2026
Public sector debt 1/	103.0			67.7	63.5	59.9	56.6	53.0	48.9		28.6	14.5	18.7
o/w foreign-currency denominated	103.0			67.7	63.5	59.9	56.6	53.0	48.9		28.6	14.5	18.7
Change in public sector debt	-159.8			-35.3	-4.2	-3.6	-3.3	-3.6	-4.0		-17.4	-0.2	0.0
Identified debt-creating flows	-34.4			-8.1	-2.7	-1.6	-1.3	-1.8	-1.9		-16.4	-4.0	-8.1
Primary deficit	9.9	11.7	2.7	2.9	4.8	3.7	3.7	3.4	3.1	3.6	2.0	-3.1	-7.2
Revenue and grants	28.8			28.8	26.1	26.5	26.8	26.1	25.8		16.9	14.9	21.2
of which : grants	9.7			11.8	9.1	9.5	9.7	9.8	10.0		5.6	2.6	2.8
Primary (noninterest) expenditure	38.7			31.8	30.9	30.2	30.4	29.6	28.9		18.9	11.8	14.0
Automatic debt dynamics	-42.0			-8.9	-6.5	-4.5	-4.2	-4.5	-4.4		-18.0	-0.6	-0.5
Contribution from interest rate/growth differential	-22.7			-6.2	-4.0	-3.7	-3.6	-4.2	-4.1		-18.1	-0.6	-0.5
of which : contribution from average real interest rate	-5.6			-0.1	0.0	0.0	-0.1	-0.2	-0.2		-0.5	-0.2	-0.3
of which : contribution from real GDP growth	-17.1			-6.2	-4.0	-3.7	-3.5	-4.0	-4.0		-17.7	-0.4	-0.2
Contribution from real exchange rate depreciation	-19.3			-2.7	-2.5	-0.8	-0.6	-0.3	-0.2		0.2	...	...
Other identified debt-creating flows	-2.3			-2.1	-1.0	-0.8	-0.8	-0.7	-0.7		-0.4	-0.2	-0.5
Privatization receipts (negative)	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0
Debt relief (HIPC and other)	-2.3			-2.1	-1.0	-0.8	-0.8	-0.7	-0.7		-0.4	-0.2	-0.5
Other (specify, e.g. bank recapitalization)	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0
Residual, including asset changes	-159.8			-29.7	-3.2	-2.4	-2.4	-2.1	-2.1		-2.0	3.8	8.1
NPV of public sector debt	15.9			7.9	8.2	8.4	8.6	8.7	8.4		5.3	3.1	4.9
o/w foreign-currency denominated	15.9			7.9	8.2	8.4	8.6	8.7	8.4		5.3	3.1	4.9
o/w external	15.9			7.9	8.2	8.4	8.6	8.7	8.4		5.3	3.1	4.9
NPV of contingent liabilities (not included in public sector debt)	...			...	...	...	...	...	...		...	...	...
Gross financing need 2/	17.4			4.9	6.5	5.2	5.0	4.6	4.4		2.4	-3.1	-7.1
NPV of public sector debt-to-revenue ratio (in percent) 3/	55.2			27.5	31.3	31.6	32.0	33.1	32.6		31.2	20.8	23.0
o/w external	55.2			27.5	31.3	31.6	32.0	33.1	32.6		31.2	20.8	23.0
Debt service-to-revenue ratio (in percent) 3/ 4/	25.8			6.7	6.5	5.8	5.1	4.5	5.1		2.3	0.4	0.3
Primary deficit that stabilizes the debt-to-GDP ratio	169.7			38.3	9.0	7.3	7.0	7.0	7.1		19.4	-2.9	-7.2
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	6.0	7.0	2.3	6.0	6.0	6.0	6.0	7.5	8.0	6.6	61.5	2.7	0.8
Average nominal interest rate on forex debt (in percent)	0.6	0.9	0.5	1.5	1.9	1.9	1.7	1.6	1.6	1.7	0.1	0.2	0.1
Average real interest rate on domestic currency debt (in percent)	...	...	...	...	...	...	...	...	...		...	...	...
Real exchange rate depreciation (in percent, + indicates depreciation)	-6.9	-0.7	7.3	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	21.0	11.9	6.8	16.0	11.1	7.4	6.1	4.6	4.5	8.3	3.0	3.5	3.4
Growth of real primary spending (deflated by GDP deflator, in percent)	-14.0	5.3	19.1	-13.0	3.1	3.7	6.7	4.4	5.6	1.8	11.2	1.9	0.6

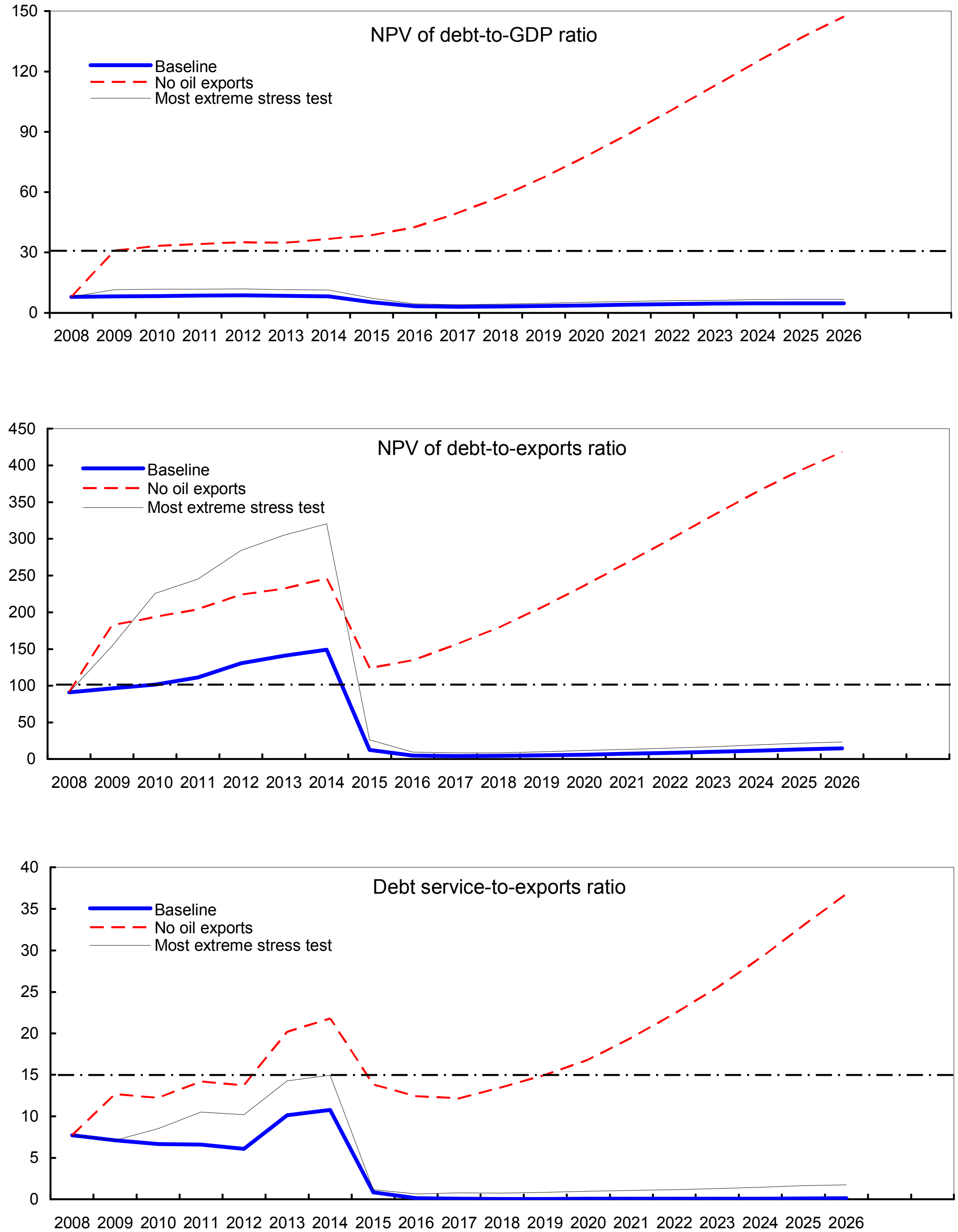
Sources: Country authorities; and Fund staff estimates and projections.
1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues including grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the period of 2002-07, subject to data availability.

Table 1b. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public Debt 2008-26
(Percent)

	Est.	Projections						
	2008	2009	2010	2011	2012	2015	2018	2026
				NPV of Debt-to-GDP Ratio				
Baseline	7.9	8.2	8.4	8.6	8.7	5.3	3.1	4.9
A. Alternative scenarios								
A1. No oil production	7.9	30.9	33.3	34.3	35.1	38.6	57.6	147.2
A2. Primary balance is unchanged from 2007	7.9	8.2	9.3	10.3	11.4	10.8	19.1	101.5
A3. Permanently lower GDP growth [1/]	7.9	8.2	8.4	8.7	8.8	5.5	3.3	5.4
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	7.9	8.3	8.8	8.9	9.1	5.5	3.3	5.1
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	7.9	15.5	23.8	23.6	22.9	13.4	7.3	10.5
B3. Combination of B1-B2 using one half standard deviation shocks	7.9	14.6	22.2	21.3	19.8	10.1	4.5	3.1
B4. One-time 30 percent real depreciation in 2009	7.9	12.1	12.8	13.3	13.7	8.5	5.0	7.8
B5. 10 percent of GDP increase in other debt-creating flows in 2009	7.9	15.8	16.0	15.8	15.5	9.2	5.1	7.5
				NPV of Debt-to-Revenue Ratio [2/]				
Baseline	27.5	31.3	31.6	32.0	33.1	31.2	20.8	23.0
A. Alternative scenarios								
A1. No oil production	27.5	118.0	135.0	147.2	156.5	179.7	259.9	551.1
A2. Primary balance is unchanged from 2009	27.5	31.4	35.0	38.6	43.8	63.7	128.0	480.1
A3. Permanently lower GDP growth [1/]	27.5	31.3	31.6	32.0	33.1	31.2	20.8	23.0
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	27.5	30.9	31.0	31.4	32.5	30.6	20.4	22.6
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	27.5	59.5	90.2	88.9	88.3	79.9	49.0	49.8
B3. Combination of B1-B2 using one half standard deviation shocks	27.5	55.3	81.2	77.0	73.5	57.6	29.2	14.2
B4. One-time 30 percent real depreciation in 2009	27.5	46.6	48.5	50.1	52.9	50.7	33.6	37.1
B5. 10 percent of GDP increase in other debt-creating flows in 2009	27.5	60.6	60.6	59.5	59.8	54.8	34.5	35.4
				Debt Service-to-Revenue Ratio [2/]				
Baseline	6.7	6.5	5.8	5.1	4.5	2.3	0.4	0.3
A. Alternative scenarios								
A1. No oil production	6.7	6.8	6.0	7.8	8.3	10.7	13.7	43.0
A2. Primary balance is unchanged from 2007	6.7	6.5	5.8	5.4	5.0	3.4	5.4	26.8
A3. Permanently lower GDP growth [1/]	6.7	6.5	5.8	5.1	4.5	2.3	0.4	0.3
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	6.7	6.5	5.8	5.1	4.5	2.3	0.4	0.3
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	6.7	6.5	8.6	9.2	6.7	5.0	2.7	2.6
B3. Combination of B1-B2 using one half standard deviation shocks	6.7	6.5	8.2	8.6	6.0	3.9	1.6	0.2
B4. One-time 30 percent real depreciation in 2009	6.7	7.5	7.8	6.8	6.2	2.6	0.7	0.6
B5. 10 percent of GDP increase in other debt-creating flows in 2009	6.7	6.5	8.7	6.2	5.5	4.1	1.5	1.4

Sources: Country authorities; and Fund staff estimates and projections.
[1/] Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).
[2/] Revenues are defined inclusive of grants.

Fig. 2. São Tomé and Príncipe: Indicators of External Debt, 2008–26
(Percent)



Source: World bank and IMF staff projections.

Table 2a. São Tomé and Príncipe: External Debt Sustainability Framework, Baseline Scenario, 2007-2026 1/
(Percent of GDP, unless otherwise indicated)

	Actual 2007	Historical Average 6/	Standard Deviation 6/	Est. 2008	Projections 2009	2010	2011	2012	2013	2009-13 Average	2015	2018	2026
External debt (nominal) 1/	**103.0**			**67.7**	**63.5**	**59.9**	**56.6**	**53.0**	**48.9**		**28.6**	**14.5**	**18.7**
Of which : public and publicly guaranteed (PPG)	103.0			67.7	63.5	59.9	56.6	53.0	48.9		28.6	14.5	18.7
Change in external debt	-159.8			-35.3	-4.2	-3.6	-3.3	-3.6	-4.0		-17.4	-0.2	0.0
Identified net debt-creating flows	-42.1			-1.9	-1.9	-1.7	-1.3	-5.5	-7.8		-1.3	-40.0	0.4
Non-interest current account deficit	**29.7**	**18.9**	**13.0**	**31.5**	**32.2**	**33.6**	**31.5**	**31.9**	**31.9**		**77.2**	**-27.0**	**7.9**
Deficit in balance of goods and services	57.7			58.1	55.6	55.8	52.3	51.5	50.9		58.2	-49.7	0.8
Exports	7.6			8.7	8.5	8.3	7.7	6.6	6.0		43.2	73.7	33.2
Imports	65.3			66.8	64.1	64.1	60.0	58.2	56.9		101.4	23.9	34.0
Net current transfers (negative = inflow)	-23.3	-24.0	4.0	-21.8	-18.3	-18.1	-17.4	-16.6	-16.1		-9.1	-4.3	-4.8
Other current account flows (negative = net inflow)	-4.7			-4.8	-5.1	-4.1	-3.5	-3.1	-2.9		28.1	27.1	12.0
Net FDI (negative = inflow)	**-34.1**	**-15.2**	**13.3**	**-24.3**	**-30.5**	**-31.9**	**-29.5**	**-33.5**	**-35.9**		**-61.3**	**-12.7**	**-7.4**
Endogenous debt dynamics 2/	**-37.7**			-9.1	**-3.6**	**-3.4**	**-3.2**	**-3.8**	**-3.8**		**-17.2**	**-0.4**	**-0.1**
Contribution from nominal interest rate	0.5			0.1	0.1	0.1	0.1	0.0	0.0		0.0	0.0	0.0
Contribution from real GDP growth	-13.5			-5.6	-3.7	-3.5	-3.3	-3.9	-3.8		-17.2	-0.4	-0.2
Contribution from price and exchange rate changes	-24.7			-3.6	…	…	…	…	…		…	…	…
Residual (3-4) 3/ 4/	**-117.6**			**-33.4**	**-2.3**	**-1.9**	**-2.0**	**1.9**	**3.7**		**-16.0**	**39.8**	**-0.4**
NPV of external debt	15.9			7.9	8.2	8.4	8.6	8.7	8.4		5.3	3.1	4.9
(Percent of exports)	210.0			90.9	96.3	101.6	111.1	130.4	140.8		12.2	4.2	14.7
NPV of PPG external debt	**15.9**			**7.9**	**8.2**	**8.4**	**8.6**	**8.7**	**8.4**		**5.3**	**3.1**	**4.9**
In percent of exports	210.0			90.9	96.3	101.6	111.1	130.4	140.8		12.2	4.2	14.7
Debt service-to-exports ratio (percent)	29.8			7.7	7.1	6.7	6.6	6.1	10.1		0.8	0.1	0.1
PPG debt service-to-exports ratio (percent)	29.8			7.7	7.1	6.7	6.6	6.1	10.1		0.8	0.1	0.1
Non-interest current account deficit that stabilizes debt ratio	189.5			66.8	36.4	37.2	34.8	35.5	35.9		94.6	-26.8	7.9
Key macroeconomic assumptions													
Real GDP growth (percent)	6.0	7.0	2.3	6.0	6.0	6.0	6.0	7.5	8.0	6.7	61.5	2.7	0.8
GDP deflator in US dollar terms (percent change)	10.4	4.1	3.6	3.6	3.4	2.7	2.5	2.0	2.4	2.6	1.6	1.8	1.7
Effective interest rate (percent) 5/	0.2	0.8	0.4	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Growth of exports of goods and services (U.S. dollar terms, percent)	-31.8	-4.9	16.3	26.9	6.4	5.9	1.3	-5.4	-0.6	1.5	1184.6	2.3	-7.6
Growth of imports of goods and services (U.S. dollar terms, percent)	-7.4	15.4	27.3	12.5	5.1	8.9	1.7	6.3	8.2	6.0	119.3	-39.9	5.0
Grant element of new public sector borrowing (including IMF; percent)	...	...	...	...	48.0	48.0	40.5	40.5	40.5	43.5	40.5	40.5	40.5
Grant element of new public sector borrowing (excluding IMF; percent)	...	...	...	...	48.0	47.8	47.8	47.8	47.8	47.9	47.8	47.8	47.8
Memorandum item:													
Nominal GDP (billions of U.S. dollars)	0.1			0.2	0.2	0.2	0.2	0.2	0.3		0.4	1.0	0.9

Source: World Bank and IMF staff projections.

1/ External public debt only.
2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Includes deposits and withdrawals from the National Oil Account.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations for the 2002-07 period.

Table 2b. São Tomé and Príncipe: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2008-2026
(Percent)

	Est.	Projections					
	2008	2009	2010	2011	2012	2015	2026
	NPV of debt-to-GDP ratio 1/						
Baseline	7.9	8.2	8.4	8.6	8.7	5.3	4.9
A. Alternative Scenarios							
A1. No oil exports 2/	7.9	30.9	33.3	34.3	35.1	38.6	147.2
A2. New public sector loans on less favorable terms in 2009-26 3/	7.9	8.2	8.4	10.0	10.0	6.1	5.7
B. Bound Tests							
B1. Real GDP growth at historical average minus one standard deviation in 2009-10	7.9	8.3	8.8	8.9	9.1	5.5	5.1
B2. Export value growth at historical average minus one standard deviation in 2009-10 4/	7.9	9.4	9.5	9.7	9.7	5.8	4.0
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-10	7.9	8.4	8.8	9.0	9.1	5.6	5.2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-10 5/	7.9	8.4	8.9	9.1	9.2	5.6	5.1
B5. Combination of B1-B4 using one-half standard deviation shocks	7.9	8.4	8.8	9.0	9.1	5.5	5.0
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 6/	7.9	11.5	11.8	11.8	11.9	7.3	6.8
	NPV of debt-to-export ratio						
Baseline	90.9	96.3	101.6	111.1	130.4	12.2	14.7
A. Alternative Scenarios							
A1. No oil exports 2/	90.9	182.4	193.5	204.1	224.0	123.8	418.0
A2. New public sector loans on less favorable terms in 2009-26 3/	90.9	96.3	101.3	129.7	150.6	14.1	17.0
B. Bound Tests							
B1. Real GDP growth at historical average minus one standard deviation in 2009-10	90.9	98.3	101.4	110.9	130.1	12.2	14.7
B2. Export value growth at historical average minus one standard deviation in 2009-10 4/	90.9	154.3	225.6	245.2	284.3	26.1	23.2
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-10	90.9	99.0	101.3	110.8	130.1	12.2	14.7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-10 5/	90.9	99.4	108.0	117.8	137.9	12.9	15.5
B5. Combination of B1-B4 using one-half standard deviation shocks	90.9	119.4	156.2	171.6	201.2	18.8	22.1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 6/	90.9	135.6	101.6	108.6	127.6	12.0	14.6
	Debt service-to-exports ratio						
Baseline	7.7	7.1	6.7	6.6	6.1	0.8	0.1
A. Alternative Scenarios							
A1. No oil exports 2/	7.7	12.7	12.2	14.2	13.8	13.9	36.8
A2. New public sector loans on less favorable terms in 2009-26 3/	7.7	7.0	6.7	6.9	6.2	0.7	0.1
B. Bound Tests							
B1. Real GDP growth at historical average minus one standard deviation in 2009-10	7.7	7.3	6.7	6.6	6.1	0.8	0.1
B2. Export value growth at historical average minus one standard deviation in 2009-10 4/	7.7	10.0	13.3	13.8	13.4	1.8	0.9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009-10	7.7	7.4	6.7	6.6	6.1	0.8	0.1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009-10 5/	7.7	7.1	8.5	10.5	10.2	1.2	1.8
B5. Combination of B1-B4 using one-half standard deviation shocks	7.7	8.9	10.1	10.0	9.5	1.3	0.3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 6/	7.7	10.0	6.6	6.6	6.0	0.8	0.1
Memorandum item:							
Grant element assumed on residual financing (i.e., financing required above baseline) 7/	53.5	51.2	49.4	47.5	45.5	38.9	31.6

Source: World Bank and IMF staff projections.

1/ By the year 2023 real GDP growth slows down significantly due to the projected decline in petroleum production.
2/ Variables include real GDP growth, growth of GDP deflator (U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

3/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.
4/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
5/ Includes official and private transfers and FDI.
6/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
7/ Based on historical level of concessionality. Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

Staff Report for the 2008 Article IV Consultation and Sixth Review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility—Informational Annex

Prepared by the African Department
(In consultation with other departments)

Approved by Jean A. P. Clément and Scott Brown

- **Relations with the Fund**. Describes financial and technical assistance by the IMF and provides information on the safeguards assessment and exchange rate system. At end-January 2008, outstanding PRGF loans amounted to SDR 2.54 million. Completion of the sixth review would allow a disbursement equivalent to SDR 0.423 million.

- **Relations with the World Bank Group**. Describes IDA program and portfolio; and IMF-World Bank collaboration in specific areas.

- **Relations with the African Development Group**. Describes the African Development Fund (ADF) and Technical Assistance Facility (TAF) ongoing projects.

- **Statistical Issues**. Describes the availability and quality of macroeconomic statistics.

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Appendices

APPENDIX I—RELATIONS WITH FUND

(As of April 30, 2008)

I. Membership Status: Joined: September 30, 1977; Article XIV

II. General Resources Account:	**SDR Million**	**Percent Quota**
Quota	7.40	100.00
Fund holdings of currency	7.40	100.00

III. SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	0.62	100.00
Holdings	0.02	3.04

IV. Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
PRGF Arrangements	2.05	27.65

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	Aug 01, 2005	Jul 31, 2008	2.96	2.54
PRGF	Apr 28, 2000	Apr 27, 2003	6.66	1.90
SAF	Jun 02, 1989	Jun 01, 1992	2.80	0.80

VI. Projected Payments to Fund
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2008	2009	2010	2011	2012
Principal	...	...	…	…	…
Charges/Interest	0.02	0.03	0.03	0.03	0.03
Total	0.02	0.03	0.03	0.03	0.03

VII. Implementation of HIPC Initiative:

	Enhanced Framework
Commitment of HIPC assistance	
Decision point date	December 2000
Assistance committed	
by all creditors (US$ Million) [1]	124.30
Of which: IMF assistance (US$ million)	1.24
(SDR equivalent in millions)	0.82
Completion point date	March 2007
Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	0.82
Interim assistance	…
Completion point balance	0.82
Additional disbursement of interest income [2]	0.04
Total disbursements	0.87

[1] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts can not be added.

[2] Under the enhanced framework, an additional disbursement is made corresponding to interest income earned on the amount of HIPC assistance committed but not disbursed

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI):

I.	MDRI-eligible debt (SDR Million)[1]	1.43
	Financed by: MDRI Trust	1.05
	Remaining HIPC resources	0.38

II. Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGF**	**Total**
March 2007	N/A	1.05	1.05
December 2007	N/A	0.38	0.38

[1] The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

IX. Safeguards Assessments:

Under the Fund's safeguards assessment policy, Central Bank of Sao Tome and Principe (BCSTP) was subject to a full safeguards assessment with respect to the PRGF arrangement approved on August 1, 2005. The assessment, which was completed on August 2, 2004, found vulnerabilities in the area of financial reporting, internal audit and internal control. Measures to strengthen the control framework and help safeguard Fund resources were proposed. Some recommendations have been implemented, including contracting annual external audits, endorsing plans to modernize the BCSTP's internal audit function, and adopting International Financial Reporting Standards (IFRS) as the bank's accounting framework. Progress in the implementation of IFRS has been slow.

X. Exchange Arrangements:

The IMF classifies São Tomé and Príncipe’s exchange rate regime as managed floating with no pre-announced path for the exchange rate. The official exchange rate is determined daily as the sum of 40 percent of previous day’s selling rate quoted by commercial banks and 60 percent of previous day’s central bank selling rate. São Tomé and Príncipe’s exchange rate system has been liberalized in recent years and a number of exchange restrictions/multiple currency practices have been eliminated. In particular, current data indicate that there is no earmarking in foreign exchange to specific importers and a multiple currency practice resulting from the central bank’s auction system has been eliminated with the move to a single price auction.

Two measures subject to Fund approval remain: (i) a multiple currency practice and exchange restriction arise from the existence of multiple exchange markets with multiple effective exchange rates for spot transactions with no mechanism to ensure that the spreads among rates for spot transactions in these markets do not diverge by more than 2 percent at any given time; and (ii) an exchange restriction arises from Article 23(b) of the Investment Code which limits the amount of investment income that can be transferred abroad by non-residents.

Under the PRGF-supported program, the BCSTP intends to revise, based on a careful review of the domestic market conditions in 2008, the mechanism for setting the daily official exchange rate and to establish a mechanism to keep the spread between the central bank rate and commercial bank exchange rate within 2 percentage points. The government is also committed to expedite the approval by the National Assembly of the new Investment Code which contains provisions aiming to eliminate the restrictions on transfers of dividends. The intervention currency for the dobra is the U.S. dollar. The official selling exchange rate was Db. 14,882 per U.S. dollar on April 30, 2008.

XI. Article IV Consultation:

The Executive Board concluded the last Article IV consultation with São Tomé and Príncipe on March 6, 2006.

XII. Financial Sector Assessment Program (FSAP), Reports on Observance of Standards and Codes (ROSCs), and Offshore Financial Center (OFC) Assessments:

None.

XIII. Technical Assistance:

March 2008: MCM mission on banking supervision

September 2007: STA mission on government finance statistics.

July 2007: STA mission on monetary and financial statistics.

July 2007: MCM mission on banking supervision

March 2007: FAD mission on public financial management.

March 2007: MCM mission on the foreign exchange market.

March 2007: STA mission on balance of payment statistics.

February 2007: LEG mission on tax laws.

November/December 2006: LEG mission on tax codes.

November/December 2006: MCM mission on banking supervision.

November/December 2006: MFD missions on foreign exchange market and monetary operations.

August 2006: MFD mission on banking supervision.

June 2006: MFD mission to assess implementation of technical assistance.

April/May 2006: STA mission on monetary and financial statistics.

February 2006: MFD mission on monetary operations and liquidity management.

January 2006: MFD mission on the foreign exchange market.

December 2005: LEG/MFD mission on the exchange system.

August/September 2005: MFD mission on banking supervision and foreign exchange operations.

February 2005: STA technical assistance mission on national accounts statistics.

January 2005: MFD mission on monetary operations and liquidity management.

December 2004: STA mission to advice on compilation and reporting of monetary statistics.

October 2004: STA technical assistance mission on government finance statistics.

September 2004: MFD multi-sector mission to develop foreign exchange and interbank money markets.

July–September 2004: MFD expert mission on banking supervision.

June 2004: STA technical assistance mission on balance of payments statistics.

July 2004: MFD expert mission on monetary operations.

June 2003: STA technical assistance mission on balance of payments statistics.

March and June 2003: STA technical assistance missions on national accounts statistics.

March 2003 and April 2004: Visits by MFD advisors on monetary policy and banking supervision.

March 2003: STA technical assistance mission on national accounts statistics.

January 1998–December 2001: MFD advisor on the conduct of monetary policy, banking supervision, and foreign exchange management.

June 2001: MFD mission on handling of banking crisis and foreign exchange market organization.

XIV. Resident Representative:

The Fund does not have a Resident Representative office in São Tomé and Príncipe since October 2006.

APPENDIX II—RELATIONS WITH THE WORLD BANK GROUP
Joint Managerial Action Plan (JMAP) for São Tomé and Príncipe

(As of April 30, 2008)

1. The IMF and World Bank São Tomé and Príncipe teams met on March 3, 2008 to discuss a joint managerial action plan, under this initiative. The team from the World Bank comprised Mr. Bell (lead economist) and Mr. Munoz (country economist) and from the IMF, Mr. Wang and Ms. Takebe

2. The World Bank's work program entails moving forward with the following components: (i) Development Policy Operation of US$ 6 million to be approved by the Bank Board June 10, 2008; (ii) a Country Economic Memorandum to be delivered in FY09; and (iii) CAS Progress Report.

- The two teams discussed the need to coordinate the up-coming joint products to be delivered in FY 08, the Joint Staff Assessment Note and the Debt Sustainability Analysis.

- The two teams have agreed to coordinate missions to the extent possible and to meet regularly to update each other on progress.

Title	Products (for example)	Provisional timing of missions (if relevant)	Expected delivery date
A. Mutual information on relevant work programs			
Bank work program in next 12 months	DPL Country Economic Memorandum CAS Progress Report	Last mission April 2008 Next mission April 2008 Last mission February 2008	June 10, 2008 FY2009 December 2008
IMF work program in next 12 months	Article IV Staff visit/program review ROSC	March 2008 October 2008	June 2008
B. Requests for work program inputs (as needed)			
Fund request to Bank (with summary justification)	Public Expenditure Review to provide quantitative inputs for budget framework PSIA Analysis of supply-side implications of sectoral composition of aid Economic and Sector Work	October 2008	November 2008
Bank request to Fund (with summary justification)	Macroeconomic scenarios associated with scaling up of aid	October 2008	November 2008
C. Agreement on joint products and missions (as needed)			
Joint products in next 12 months	JSAN DSA	No mission expected IMF Mission in March 2008	April 2008 June 2008

APPENDIX III—RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of April 21, 2008)

1. São Tomé and Príncipe became a member of the African Development Bank Group in 1976. To date, the Bank Group has financed 25 operations in the country. The net commitments amount to UA 90.4 million,[1] comprising UA 89.4 million of African Development Fund (ADF) [2] and Technical Assistance Facility (TAF) resources and UA 1.00 million of Nigerian Trust Fund (NTF) resources. The sectors benefiting from AfDB Group financing are agriculture (26 percent), transport (25 percent), multi-sector [3] (21 percent), social sector (17 percent), and public utilities (11 percent). These operations have helped build and rehabilitate basic economic and social infrastructure (roads, airport, electricity, water, schools, and health centers) and have strengthened São Tomé and Príncipe's economic and institutional capacities. The AfDB has had a national program office since 1999.

2. The AfDB has two ongoing projects in human resource development and agriculture (the second phase of the livestock development project). These projects, in accordance with the PRSP, focus on the main factors affecting poverty. The disbursement rate was 35.20 percent as of August 2007. The two projects have started recently (2005 and 2006). The second phase of the livestock development project was approved in May 2006 and signed in July 2006. The human resource development project was signed in June 2003 and began in March 2005. This project tackles cross-sectoral capacity-building by providing for training in literacy, information, and community organization, as well as specialized vocational training adapted to specific demands, particularly in the oil and tourist sectors.

3. The AfDB Group assistance strategy for 2005–09 (Country Strategy Paper 2005–09) rests on two pillars: poverty reduction in rural area and promotion of governance in public finance management. The country allocation on ADF-X resources (2005–07) is UA 5.15 million in the form of grants. The first pillar will help promote and diversify the country's economic base, especially the agricultural and rural sector, and reinforce operations in the social sectors. Under this pillar, the livestock development support project-phase II (UA 4 millions) was approved in May 2006. The second pillar will support macroeconomic reforms and governance, through an institutional support project on governance and a technical assistance on the PRSP process, which will help improve public finance management and institutional capacity building to prepare the country for the forthcoming oil era. Given the considerable needs for institutional capacity building, the AfDB will finance

[1] The exchange rate for August 2007 is UA 1 = US$1.53122.

[2] ADF is the concessional window (or grant for ADF-X for high debt countries), on the same conditions as IDA, of the African Development Bank Group.

[3] Institutional support and structural adjustment programs.

strategic economic and sector studies, such as the Country Governance Profile; the joint study with the World Bank on the integrated fiduciary assessment (PER/CFAA/CPAR); the transport sector study; and the insular costs study. Furthermore, the AfDB will finance regional capacity building initiatives, within CEMAC, ECCAS, the African Portuguese-speaking countries and the small insular countries.

4. In addition, the AfDB will continue to provide the country with financial assistance through the enhanced HIPC initiative. In April 2001 the AfDB approved debt relief of US$34.35 million in end 1999 NPV terms. In light of the delay in the HIPC process, the AfDB extended its interim debt relief period until the country reaches the completion point in May 2007 with an additional assistance (topping up) of US$ 9.08 million in end-2005 NPV terms.

Table 1. Ongoing Projects as of April, 2008

(Millions of UA) [1]

Title of Projects	Window	Commitment	Disbursement Rate
Support for human resource development	ADF ADF grant	3.50 0.50	13.6 percent 43.6 percent
Livestock Development Project – Phase II	ADF grant	4.0	1.44 percent
Total		*8.0*	*9.4 percent*

[1] Exchange rate for August 2007 is UA 1 = US$1.53122

APPENDIX IV—STATISTICAL ISSUES

Introduction

1. Although economic data are generally adequate for surveillance, serious financial, human, and technological resource constraints have slowed down efforts to strengthen the statistical system.

2. The country has participated in the Fund's General Data Dissemination System (GDDS) since April 20, 2004. The metadata and plans for improvement have not been updated since the original metadata were posted on the DSBB. Over the period 2003–06, the country has benefited from technical assistance from STA and other providers, largely under the GDDS project for Lusophone Africa.

National accounts

3. Statistics on GDP/GNP are compiled on a yearly basis and provided at the time of the Article IV consultation. STA provided technical assistance in national accounts to the National Statistics Institute in February and March 2005 and in January 2006 in the context of a GDDS project for Lusophone countries. Low response rates and/or insufficient rigor of the responses to the business surveys, including those from important enterprises, continue to affect the quality of the business data compiled.

4. A new GDP series for the period 2001-2006 with base year 2001 became available in early-2007. The new estimates cover: (i) GDP by production approach at current and constant prices; and (ii) cross-classification tables by industry sectors. The revised series reflect more accurately recent economic developments. Based on the most recent population census, corporation census, and living conditions survey, higher weights are now attributed to the sectors that experienced faster growth, such as trade, transportation and communication, and services. Despite the considerable upward revision in GDP, São Tomé and Príncipe remains a low income country, with GDP per capita amounting to about $771 in 2006, compared to $497 before this revision. While the revision of the GDP series is a significant improvement, a number of shortcomings remain. Further improvements would require input from a new household expenditure survey (rather than living conditions survey), using producer prices, and better estimates for agricultural production.

Consumer prices

5. Since 1997 the CPI weights have been based on a three-month household survey conducted in 1995. An updated and more comprehensive household expenditure survey is needed. Current price surveys only cover the capital, although there are plans to implement regional surveys.

Government finance statistics

6. Detailed revenue and expenditure data are compiled and reported to AFR. The main areas that need to be strengthened at the Ministry of Planning and Finance (MPF) are (i) monitoring of expenditures on projects financed by donors; and (ii) financing operations. All project loans financed by donors are programmed in the budget, but some are executed independently. The government has requested development partners to help in recording all external financing in the budget. The recording of financing operations and stocks is expected to improve since the debt data management capacity is expected to be strengthened.

7. An October 2004 government finance statistics (GFS) mission helped the MPF to compile and disseminate GFS for the general government in accordance with the *Government Finance Statistics Manual 2001* (*GFSM 2001*). The mission prepared bridge tables between national budget classification and *GFSM 2001* classifications to be used to compile GFS for reporting to STA and AFR, as well as in MOF policy work. Given the importance of oil-related revenues, the mission also reviewed the classification of oil revenues under the Oil Revenue Management Law and made recommendations on classification of such transactions. A September 2007 follow-up mission found some progress with regard to the recommendations made by the 2004 mission. In particular, in January 2007 a new budget law was approved that significantly improved national budget classifications. Notwithstanding these efforts, faster statistical progress is hampered by an inadequate accounting system.

Monetary and financial statistics

8. STA missions provided technical assistance on monetary statistics in December 2004, April/May 2006, and June 2007. As a result, the accuracy and timeliness of the monetary data reported in the standardized report forms (SRF) for the central bank and the other depository corporations data have improved. However, the lags with which the Central Bank of São Tomé and Principe (BCSTP) reports monetary data based on the old reporting forms have increased again in recent months.

9. The missions found that the BCSTP monthly trial balance sheets were broadly adequate to compile monetary statistics in line with the *Monetary and Financial Statistics Manual (MFSM).* However, the plan of accounts of the other depository corporations is not adequate to derive monetary statistics consistent with the *MFSM*, particularly with regard to the sectorization of institutional units.

10. The June 2007 follow-up mission assisted in implementing the SRFs for reporting monetary and financial statistics to the Fund. The mission assisted in finalizing the SRFs beginning with March 2006 and December 2006 data for the BCSTP and Other Depository Corporations respectively. It also provided on-the-job-training to compilers. For the integrated monetary database that will meet the data needs of STA, AFR, and BCSTP to be finalized, STA needs to reconstruct the historical data starting from December 2001.

External sector statistics

11. There are significant weaknesses in the collection of source data related to merchandise trade. Some transactions, including certain imports related to investment, are not fully captured in the balance of payments (BOP). Monthly data on the main exports and imports are reported to AFR regularly but with some lags in recent months, and unit prices and volumes of exports are only occasionally included.

12. The GDDS Lusophone project has targeted a substantial improvement in the source data, including the response rate to the surveys, and in the methodology for compiling the BOP in line with the *Fifth Edition of the Balance of Payments Manual*. A June 2003 mission reviewed the shortcomings of reported current and financial account transactions and concluded that weaknesses were mainly due to under coverage, including of foreign direct investment and commercial bank reports on international transactions.

13. A June 2004 mission found that despite efforts to implement the previous recommendations, several measures, in particular those related to improving source data were at best partially implemented. As a result, inconsistencies in the classification of BOP operations persisted and certain components continued to be largely estimated. Resource constraints, particularly with regard to qualified staff, contribute to the lack of improvement in the response rate to surveys. The mission recommended improving coordination and data sharing among data-producing agencies, intensifying contacts with survey respondents, and using alternative sources to improve source data. A March 2007 mission found that little progress had been achieved in implementing recommendations of previous missions, primarily due to resource constraints in the BCSTP. The mission assisted the authorities in reconciling balance of payments data and outlined a set of recommendations and detailed work plan to improve compilation capacity.

14. In 2007, the central bank reported balance of payments data to STA for the years 2001-2003.

15. The authorities have built on previous efforts to strengthen debt data management, and a unit was created in late 2003 within the MOF. The authorities are reconciling debt records with creditors and the Commonwealth Secretariat debt recording and management system is being operationalized.

Common Indicators Required for Surveillance
(As of April 31, 2008)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange rates	April 2008	April 2008	D	D	D
International reserve assets and reserve liabilities of the monetary authorities [1]	Mar 2008	Apr 2008	M	M	M
Reserve/base money	Apr 2008	Apr 2008	D	D	D
Broad money	Mar 2008	Apr 2008	M	M	M
Central bank balance sheet	Mar 2008	Apr 2008	M	M	M
Consolidated balance sheet of the banking system	Mar 2008	Apr 2008	M	M	M
Interest rates [2]	Apr 2008	Apr 2008	D	D	D
Consumer Price Index	Mar 2007	Apr 2008	M	M	M
Revenue, expenditure, balance and composition of financing [3] – general government [4]	NA	NA	NA	NA	NA
Revenue, expenditure, balance and composition of financing [3]– central government	Mar 2007	May 2008	M	M	M
Stocks of central government and central government-guaranteed debt [5]	Mar 2006	May 2007	A	I	A
External current account balance	Dec 2006	Sep 2007	A	I	A
Exports and imports of goods	Jan 2008	Mar 2008	M	I	M
GDP/GNP	2007	Mar 2008	A	I	A
Gross external debt	Dec 2007	Mar 2008	Q	Q	I

[1] Includes reserve asset pledged or otherwise encumbered as well as net derivative positions.
[2] Central bank's reference rate
[3] Foreign, domestic bank, and domestic non-bank financing.
[4] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); not available (NA).

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 08/89
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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes the 2008 Article IV Consultation with the Democratic Republic of São Tomé and Príncipe

On June 18, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Democratic Republic of São Tomé and Príncipe.[1]

Background

São Tomé and Príncipe is a small, open, low-income economy with a very narrow production and export base. The country's main export commodity is cocoa but the once-dominant agriculture sector has declined over the last three decades. Tourism is relatively small and brings in little net foreign exchange because it relies heavily on imported goods and services. In recent years, public finances have been supported by large oil signature bonuses, but exploratory drilling for oil has not yet confirmed the existence of commercially extractable reserves.

The authorities have embarked on economic adjustment and reform supported by the Fund's Poverty Reduction and Growth Facility since August 2005. Growth has been robust and progress has been made in reducing fiscal imbalances and the pubic debt burden. São Tomé and Príncipe reached the completion point under the enhanced HIPC Initiative in March 2007 and has benefited from debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).

In 2007 real GDP grew at an estimated 6 percent, led by activities in construction and services, financed by an inflow of foreign direct investment (FDI). However, spillover from these projects to local employment and income is still limited because of the high import content of these projects. Annual inflation rose from 14 percent in mid-2007 to 28 percent by the end of the year, reflecting surging food and oil prices, as well as a budgetary expenditure overrun, which put

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

pressure on base money growth and currency depreciation. The domestic primary deficit was larger than programmed in 2007, despite higher revenue. This was due to a large increase in current spending, partly to cover the rising utility costs of households. Implementation of monetary policy was complicated by volatile capital inflows and did not adequately control growth of base money. The central bank's sterilization of budgetary use of oil bonuses fell short of what was needed to mop up excess liquidity.

Against the backdrop of rising food and fuel prices, the authorities are taking steps to strengthen policy implementation and restore financial stability. The National Assembly recently approved the 2008 budget, which envisages a reduction in the domestic primary fiscal deficit, while providing funding to mitigate the impact of the high prices for food and fuel on the poor. A more active monetary policy slowed base money growth and currency depreciation in the first quarter of 2008.

Executive Board Assessment

Directors noted that São Tomé and Príncipe's growth performance under the PRGF-supported program has been robust and progress has been made in reducing fiscal imbalances and the public debt burden. However, these favorable developments have been accompanied by accelerating inflation. While surging international prices of food and fuels have contributed to recent higher inflation, public expenditure overruns and weak control of base money growth have also played a role in increasing the pressures on prices and currency depreciation.

Against this background, Directors noted that the main challenges facing the authorities over the medium term are to maintain fiscal sustainability and to develop the economy's production and export base through a deepening of structural reforms. These policies would be particularly important in view of the still unclear prospects for oil revenue and the economy's continuing vulnerability to external shocks.

Directors underscored the need to continue fiscal adjustment and strengthen expenditure control so as to lower inflation and restore financial stability. They supported the authorities' 2008 fiscal program that aims to reduce the domestic primary deficit relative to GDP, introduce direct taxation reform, and provide additional fiscal space to mitigate the impact of rising food and fuel prices on the poor. Directors encouraged the authorities to avoid generalized price subsidies and instead implement targeted assistance to the most vulnerable segments of the population.

Directors supported the efforts of the central bank to improve liquidity management. More active use of foreign exchange auctions to sterilize promptly the budgetary use of oil bonuses and donor funding would help slow base money growth. Directors also emphasized the critical role of fiscal policy in supporting monetary tightening and helping safeguard international reserves.

Directors agreed that maintaining fiscal sustainability in the medium-term will call for enhancing the growth orientation of the budget and bringing recurrent spending— particularly on personnel costs—in line with domestic revenue and available foreign budgetary support. Moreover, to maintain debt sustainability, Directors emphasized the importance of continued efforts by the authorities to strengthen debt management and rely on non-debt-creating inflows and other concessional external financing.

Directors emphasized the need for accelerated structural reform in order to achieve sustained private sector-led growth. In particular, they called on the authorities to significantly improve the investment climate by reducing regulatory impediments to investing and doing business in São Tomé and Príncipe, upgrading infrastructure, and attracting private investment to key economic sectors, especially agriculture. Directors welcomed the progress that the authorities have made in putting in place the legal framework for anti-money laundering and combating the financing of terrorism. Advancing financial sector reform will be crucial to support private sector development. Directors also encouraged the authorities to build on the progress under the Extractive Industries Transparency Initiative, which would further improve the management of oil-related resources.

Directors noted the staff's assessment that the exchange rate in real effective terms does not show a significant misalignment from its equilibrium level. They underscored the importance of deepening foreign exchange market reform. Pressing ahead with measures designed to remove all remaining exchange restrictions would improve the functioning of the foreign exchange market and enable the authorities to accept the obligations under Article VIII of the Fund's Articles of Agreement. Directors supported the authorities' intention to reconsider São Tomé and Príncipe's monetary and exchange arrangements, and noted some possible benefits and limitations of alternative exchange rate regimes. They emphasized, however, that fiscal discipline and prudent debt management are the main prerequisites for any sustainable exchange rate regime.

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2005–2008

	2005	2006	2007 Est.	2008 Proj.
	(Annual percentage changes, unless otherwise specified)			
National income and prices				
GDP at constant prices	5.7	6.7	6.0	6.0
Consumer prices (end of period)	17.2	24.6	27.6	13.0
Consumer prices Period average	16.3	23.1	18.5	19.4
External trade				
Exports, f.o.b.	22.6	-1.4	1.9	2.8
Imports, c.i.f.	15.7	65.9	-6.0	13.8
Exchange rate (dobras per US$; end of period) [1]	11,748	12,945	14,220	…
Real effective exchange rate (depreciation = -)	6.5	2.9	4.9	…
Money and credit (end of period)				
Base money [2]	76.6	32.0	50.0	7.7
Broad money (M3)	45.9	39.3	36.4	21.0
Velocity (GDP to average broad money)	3.3	3.0	3.1	3.1
Central bank reference interest rate (percent)	18.2	28.0	28.0	…
Bank lending rate (percent)	29.8	29.3	32.4	…
Bank deposit rate (percent)	11.5	10.8	12.8	…
	(in percent of GDP, unless otherwise specified)			
Government finance				
Total revenue, grants, and oil signature bonuses [3]	81.0	37.1	160.3	73.6
Of which: tax revenue	15.0	17.4	16.3	15.3
nontax revenue	2.3	3.7	2.8	1.8
oil signature bonuses	46.8	0.0	21.1	16.3
Total expenditure and net lending	44.0	51.0	40.0	31.9
Of which: personnel costs	8.6	8.7	8.9	8.6
nonwage noninterest current expenditure	14.8	16.5	15.6	9.1
capital and HIPC-related social spending	17.8	22.3	14.2	12.8
Domestic primary balance [4]	-10.1	-8.5	-8.1	-5.2
External sector				
Current account balance, including official transfers	-10.3	-41.3	-30.2	-31.0
Current account balance, excluding official transfers	-39.5	-66.3	-52.1	-51.5
NPV of external debt	171.1	161.2	15.9	7.9
External debt service (in percent of exports) [5]				
Before HIPC and MDRI debt relief	75.6	70.0	83.2	60.0
After HIPC and MDRI debt relief	62.1	35.9	27.8	4.2
Gross foreign reserves, in millions of U.S. dollars [6]	26.6	33.3	38.0	31.8
in months of imports of goods and nonfactor services	4	4	5	4
National Oil Account (in millions of U.S. dollars) [7]	23.5	8.6	14.9	39.5
Memorandum Items				
GDP (in billions of dobras)	1,202	1,536	1,959	2,409
GDP (in millions of U.S. dollars)	115	124	145	160

Sources: São Tomé and Príncipe authorities and IMF staff estimates and projections.
[1] Central bank (BCSTP) buying rate.

[2] In 2008, projected base money growth reflects the high level of base money at the end of 2007, which was significantly reduced in early 2008 through the BCSTP's foreign exchange sales.

[3] Includes HIPC and MDRI debt relief.
[4] Excluding oil revenue, grants, interest payments, and foreign-financed scholarships and capital outlays.

[5] In percent of exports of goods and nonfactor services. The difference between debt service before and after HIPC relief is larger than debt service saving in cash terms because this table is on an accrual basis.

[6] Excluding the National Oil Account and guarantee deposits at the BCSTP by financial institutions' waiting for operating licenses.
[7] For 2008, assumes receipt of oil signature bonuses for Blocks 5 and 6 (US$ 26 million).

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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Washington, D.C. 20431, USA

IMF Executive Board Completes Sixth Review under PRGF Arrangement for São Tomé and Príncipe's and Approves US$680,000 Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the sixth review of the Democratic Republic of São Tomé and Príncipe's economic performance under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement. The completion of the review allows for a disbursement of an amount equivalent to SDR 423,000 (about US$680,000), which would bring total disbursements under the arrangement to SDR 2.96 million (about US$4.77 million).

The Executive Board approved the three-year arrangement on August 1, 2005 (see Press Release No. 05/187), for a total amount of SDR 2.96 million (about US$4.77 million) to support the government's economic program for 2005-2008.

In completing the review, the Executive Board approved waivers of the nonobservance of the quantitative performance criteria for end-December 2007 related to the domestic primary fiscal deficit and net credit to the government, and a structural performance criterion for end-December 2007 related to public financial management, based on the authorities' policy commitments and remedial actions.

Following the Executive Board's discussion, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

"São Tomé and Príncipe's growth performance under the PRGF-supported program has been robust and progress has been made in reducing fiscal imbalances and the public debt burden. However, these favorable developments have been accompanied by accelerating inflation. An expenditure overrun and the lack of effective control of base money have added to the pressures on inflation and depreciation of the currency.

“The authorities are committed to strengthening fiscal discipline and liquidity management to lower inflation and restore financial stability. Their 2008 fiscal program is designed to reduce the domestic primary deficit, introduce direct taxation reform, and provide resources to mitigate the impact of high food and fuel prices on the poor. In addition to fiscal adjustment, the authorities need to implement a proactive monetary policy in order to effectively curb liquidity growth. It is important that the authorities support a tight monetary policy with fiscal restraint, if necessary by further reducing nonessential domestic primary spending to safeguard the program’s international reserve targets.

“Over the medium term, the authorities face the challenge of maintaining fiscal and debt sustainability. With uncertain oil prospects, the authorities will need to continue fiscal consolidation beyond 2008, strengthen debt management, and rely on non-debt-creating inflows and other concessional external financing.

“Furthermore, it is crucial that the authorities accelerate structural reforms in order to develop the economy’s production and export base and reduce its vulnerability to external shocks. In particular, advancing financial sector reform and improving the investment climate should be given high priority.

“The authorities are committed to deepening foreign exchange market reform. They intend to make efforts to eliminate all remaining restrictions, with the aim of accepting the obligations under Article VIII of the Fund’s Articles of Agreement,” Mr. Portugal said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

Statement by Laurean W. Rutayisire, Executive Director for Democratic Republic of São Tomé and Príncipe

June 18, 2008

On behalf of my São Tomé and Príncipe authorities, I would like to thank the Board, Management and Staff for their continued support and useful advice to São Tomé and Príncipe. My authorities are grateful to the international community for their continued assistance to São Tomé and Príncipe.

I. Recent Developments

As expected at the time of the fifth review, economic activity has been robust in 2007, with a real GDP growth estimated at 6 percent, mainly driven by tourism-related construction, communication, and other services. Cocoa exports, the main exports, increased owing to both higher international prices and increased export volume.

After declining to 14 percent in June 2007, inflation reaccelerated in the second half of the year to reach 27.6 percent at end-December 2007 and 34 percent in March 2008, due to a combination of factors including higher fuel and food prices, depreciation of the dobra, and higher-than-programmed liquidity growth.

In the **fiscal sector**, higher income tax receipts and increased tax arrears collection boosted revenue performance over the program objective by 1.2 percent of GDP. Expenditures also increased higher than programmed on account of higher utilities, transfers and medical expenses. A significant part of utility payments to EMAE, the state-owned electricity and water company, was to mitigate the impact of the sharp utility tariff hike (40-60 percent) on the population. It is also worth noting that in light of continued increase in international fuel prices, the prices of domestic petroleum products were also increased by 14-25 percent in order to reduce implicit subsidies. In addition, capital expenditure has been cut in order to accommodate the increase in other expenditure items. Despite the mitigating measures taken, the net effect has been a higher-than-programmed domestic primary deficit, which has been financed by drawdown of government deposits.

The authorities made further progress toward a fully integrated computerized public financial management system (eSAFE) by issuing an administrative decree establishing an IT office and a Directorate of Accounting, and issuing a tender for the procurement of IT equipment for upgrading SAFINHO. They submitted to the Parliament a direct taxation reform that will help broaden the tax base, reduce distortions and increase revenue buoyancy over time. To ensure that revenue collections are improved, the authorities have intensified their effort to strengthen tax and customs administration, with notably the assistance of the U.S. Millennium Challenge Corporation (MCC). The budget for 2008, which is consistent with the program and the Poverty Reduction Strategy, has been approved in May 2008.

In the **monetary sector**, base money grew much faster than programmed and net international reserves exceeded the program target by a large margin, as result of a partial sterilization of budgetary use of oil bonuses and donor grants, in a context of market-determined exchange rate. In light of the inflation developments, the central bank (BCSTP) has increased its use of foreign exchange sales since March 2008 to mop up excess liquidity. Since then, base money growth decreased from 50 percent in December 2007 to 27 percent in March 2008. On the financial sector reform, the central bank (BCSTP) issued the new regulations on capital adequacy, internal control and auditing, bank financial reporting, and credit to employees. In April 2008, the National Assembly (NA) gave its final approval to the anti-money laundering (AML/CFT) law, paving the way for an operational AML/CFT regime in Sao Tome and Principe.

On **structural reforms**, the government has prepared and submitted to the National Assembly numerous legislations aimed at reducing the cost of investing and doing business in Sao Tome and Principe, and is awaiting their approval by Parliament. These legislations include a new investment code that will provide equal treatment to foreign and domestic investors, a revised labor code that will increase labor flexibility, and a draft legislation, prepared in consultation with the private sector, to reduce impediments to start a business.

Progress has also been made in the implementation of the institutional framework of the **oil sector**. To lay ground for launching licensing for the Exclusive Economic Zone (EEZ), the National Oil Agency (NOA) prepared a Petroleum Sector Strategy and related laws –the framework law on oil-related activities, the taxation law, and the production sharing contract model– and submitted them to the National Assembly for approval.

II. Economic Policies for the Rest of 2008

My authorities remain committed to strengthening policy implementation, particularly in containing domestic primary expenditure and in curtailing liquidity growth in order to bring inflation to a downward path. In this regard, policies for the rest of this year will ensure sound management of oil-related and debt relief resources, and lay the groundwork for sustained private sector-led growth. The objectives of the program are to maintain real GDP growth at 6 percent, reduce annual inflation from its current level 34 percent to 13-15 percent by the end of the year, and safeguard international reserves equivalent to 4 months of imports.

Fiscal policy

In the **fiscal sector**, the objective is to reduce further the domestic primary deficit to 5.2 percent of GDP in 2008, through fiscal consolidation. Specifically, expenditures will be contained through (i) strict quarterly limits on nonessential current spending, particularly on goods and services, (ii) strict controls of personnel cost to ensure that the wage bill-to-GDP ratio does not increase, and (iii) a reassessment of transfer to the Joint Development Authority (JDA), taking into account budget constraints, oil revenue prospects, and the execution of the JDA budget. My authorities intend to assist the most vulnerable segments of the population through better implementation of HIPC-related expenditure program and a temporary, targeted scheme that will facilitate adjustment to higher import prices for food and fuel. They will continue to improve the execution of public investments projects. In particular, they work closely with external development partners to accelerate implementation of foreign-funded projects, while ensuring adequate resources for domestically-funded investment projects. The projected deficit will be financed in part by the use of IDA's Development Policy Operation (DPO) grant of US$4.5 million and by statutory drawings from the NOA.

Fiscal reforms will essentially continue to focus on strengthening tax and customs management and public expenditure management. In particular, a comprehensive wage study will be undertaken as part of the DPO-supported program with a view to revising the salary structure with improved incentives for civil servants, and thereby avoiding the recourse to ad hoc increases in wages. In order to strengthen the monitoring and execution of the 2008 budget, including the use of debt relief resources, my authorities will continue to upgrade SAFINHO and turn it into a fully fledged eSAFE system incorporating all public accounts, with the assistance from multilateral and bilateral donors.

My authorities are cognizant of the uncertainty regarding future receipts of oil bonuses. Accordingly, they will continue to make good use of donor budgetary assistance and the remaining oil bonuses to maintain fiscal sustainability in the next several years. They stand ready to revise their fiscal program, if the prospects in the oil sector do not materialize as expected.

Monetary, exchange rate and financial policies

The central bank will pursue a tighter monetary policy to complement fiscal consolidation efforts in order to achieve the inflation objective for 2008. The monetary program aims to keep the base money growth on a declining trend. To this end, given the limited effectiveness of interest rates and other monetary policy instruments, the central bank will continue to use foreign exchange sales to mop up liquidity, consistent with the NIR objective. The central bank and the treasury department of the ministry of planning and finance will strengthen their cooperation, through regular information-sharing, to ensure that the BCSTP takes timely action to sterilize budgetary use of oil bonuses, donor funds and HIPC and MDRI savings. To help the liquidity forecast, the BCSTP will use the weekly average, rather than the monthly average, in measuring commercial banks' compliance with the minimum reserve requirements.

The central bank is committed to deepening foreign exchange market reform and complying with obligations under Article VIII, Sections 2(a), 3, and 4 of the IMF's Articles of Agreement. In this regard, the new investment code, which foresees, among others, the elimination of exchange restriction on transfer abroad of dividends is yet to be approved by the National Assembly. To remove the remaining multiple currency practices, the BCSTP will consider revising the mechanism for setting the daily official exchange rate, which will ensure that the spread between the official and commercial exchange rates will not exceed 2 percent. The BCSTP will continue implementing the current policies of holding regular foreign exchange auctions and progressively expanding the foreign exchange auction market to ensure a fuller and faster market determination of the exchange rate.

The central bank intends to continue with its communication strategy of informing the market of its monetary and exchange policies through regular meetings with the banking community and the media, and the posting of various monetary data and financial statements on the central bank's website.

Regarding the financial sector reform, the BCSTP intends to further strengthen the requirements for issuing bank licenses, including by raising the minimum capital requirement. The central bank also intends to enhance its banking supervision. In this regard, with IMF technical assistance, it will further strengthen its capacity to enforce banking supervision regulations through training, implementing the new charts of accounts and quarterly financial reporting by banks and setting up a central credit unit to facilitate information sharing among banks.

Other issues

My authorities remain determined to enhance the **investment climate** through regulatory reform and upgrading infrastructure. They are hopeful that the completion of abovementioned reforms in the fiscal, monetary and financial sectors and the approval of business-related legislations will significantly improve the business climate and will contribute to the development of the private sector. They will work closely with donors to press ahead with reforms in key areas such agriculture, transportation and energy. They will also proceed with the reform of public enterprises to improve their financial situation.

As regards **debt management**, my authorities will continue to ensure debt sustainability after HIPC and MDRI debt relief by refraining from new external borrowing, particularly on commercial terms, and redouble their efforts to seek full delivery of HIPC debt relief from the remaining official creditors.

III. Conclusion

Overall, performance under the program in 2007 has been broadly satisfactory, despite that two quantitative performance criteria at end-December 2007 on the fiscal primary balance and net credit to the government have not been observed and the structural performance criterion on public financial management reform was met with delay. In light of the remedial actions taken and the policy commitments for the remainder of the program, my authorities are requesting Board approval for the requested waivers and the completion of the sixth and final review of the PRGF-supported program.