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Democratic Republic of São Tomé and Príncipe: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Democratic Republic of São Tomé and Príncipe

In the context of the Request for a three-year arrangement under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- The staff report for the Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on November 20, 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 February 12, 2009. 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 Press Release summarizing the views of the Executive Board as expressed during its March 2, 2009 discussion of the staff report that completed the review.

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

The documents listed below have been separately released.

Letter of Intent sent to the IMF by the authorities of 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

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

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

Approved by Michael Atingi-Ego and David Marston

February 12, 2009

Main topics

- *Recent Developments*. Growth remains robust. Inflation has been high, but tight monetary policy has begun to reduce it. Fiscal consolidation has been slower than programmed. The authorities have started preparations to adopt a fixed exchange rate regime in 2010.

- *Request for New Program.* The new program aims to bolster macroeconomic stability and foster economic growth, while playing a catalytic role for donor support. Key goals are continuing fiscal consolidation, reducing inflation, and promoting non-oil sector growth.

Mission discussions

- Discussions were held in São Tomé during November 7–20, 2008. The staff team comprised Mr. Cuevas (head), Ms. Farhan, Ms. Takebe, and Ms. Randall (All AFR). The team overlapped with an MCM technical assistance mission and a World Bank mission.

- The mission met with Mr. Branco, the Prime Minister, Ms. Santiago, Minister of Planning and Finance, Mr. De Sousa, Governor of the Central Bank, other senior government and central bank officials, members of the National Assembly, trade unions, and representatives of the private sector and the donor community.

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EXECUTIVE SUMMARY

Key Developments

- **Economic performance has been uneven**. Growth has been robust, driven by foreign investment. Fiscal consolidation has continued, albeit more slowly than programmed, and monetary policy has been tightened to reduce inflation, which was boosted by high food and fuel prices.
- **The authorities plan to modify the exchange rate regime.** The government is negotiating with Portugal a framework that would support a peg to the euro (possibly from 2010).
- **The impact of the global financial crisis appears limited so far.** The banking system is dominated by one solid foreign-government owned bank. The crisis raises the risks of tighter credit conditions for foreign firms investing in São Tomé and a decline in donor support.

New PRGF Program. São Tomé and Príncipe is requesting a three-year PRGF-supported program in the amount of SDR 2.59 million (35 percent of quota). Key elements of the program are continuing gradual fiscal consolidation, monetary policies focused on reducing inflation, and structural reforms to improve the business climate.

Outlook and risks. The economic outlook for 2009 is broadly favorable, but subject to significant risks, including from the evolution of commodity prices and developments in partner economies. The program spans a period including major elections; the authorities' ability to meet fiscal objectives and implement monetary policy will be key to the success of the program. The medium-term outlook remains dependent on uncertain oil prospects.

Staff Recommendations

- Staff recommends approval of the new PRGF arrangement based on the country's policy commitments.
- The authorities should continue fiscal consolidation and strong monetary policy implementation, including through a judicious use of foreign exchange auctions to control liquidity and reduce inflation. This would also help prepare for the new exchange rate regime.
- In the financial sector, implementing regulatory reforms is necessary to safeguard stability and facilitate private sector development.

I. Background

1. **São Tomé and Príncipe has a narrow production and export base**. The country's exports, mostly cocoa, are modest; tourism, while growing, is still small. The large external current account deficit has been financed by official transfers, FDI, and oil signature bonuses. The incidence of poverty is high.

2. **São Tomé and Príncipe had a good performance under the last PRGF-supported program, completed in July 2008, but continues to face important challenges**. In the final program review, Executive Directors noted that maintaining economic stability over the medium term, particularly in view of the uncertain future oil prospects, would require strong fiscal and monetary policy and accelerated structural reforms. These recommendations gain force with the authorities' plans to adopt a fixed exchange rate regime with support from Portugal in the near future.

3. **A coalition led by a main political party (MLSTP-PSD) formed a new government in June 2008.** Regional elections are due in 2009, parliamentary elections in 2010, and presidential elections in 2011.

4. **In the attached Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP), the Sãotoménean authorities request a three-year arrangement under the PRGF.** The new arrangement would help the authorities formulate, implement, and monitor macroeconomic policies, while playing an important catalytic role for donor support.[1] The proposed access would help maintain usable gross international reserves at no less than 4 months of imports.

II. Recent Developments

5. **Real GDP growth is estimated at 6 percent in 2007, and is expected to be about the same in 2008**. Boosted by FDI, activities in construction, commerce, services, and tourism have been the main drivers of economic growth (Figure 1).

6. **External inflows (both private and official) have financed the current account deficits.** Exports of goods and services recovered somewhat in 2008 largely due to rising tourism receipts. Imports continued to grow, reflecting demand for investment goods and high international prices of food and fuel. The external current account deficit is estimated at 34 percent of GDP in 2008—fully financed by foreign aid and FDI.

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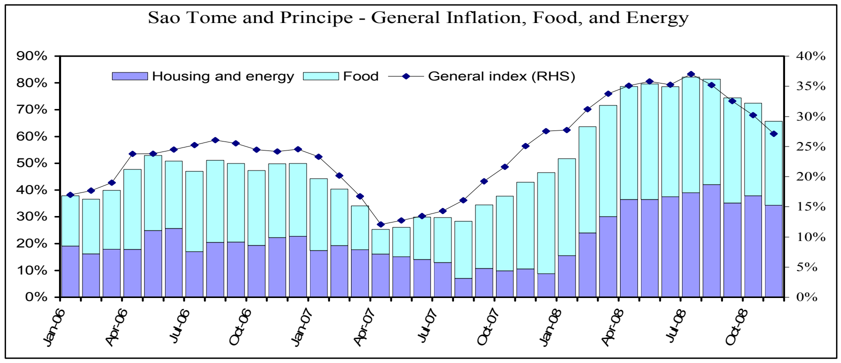
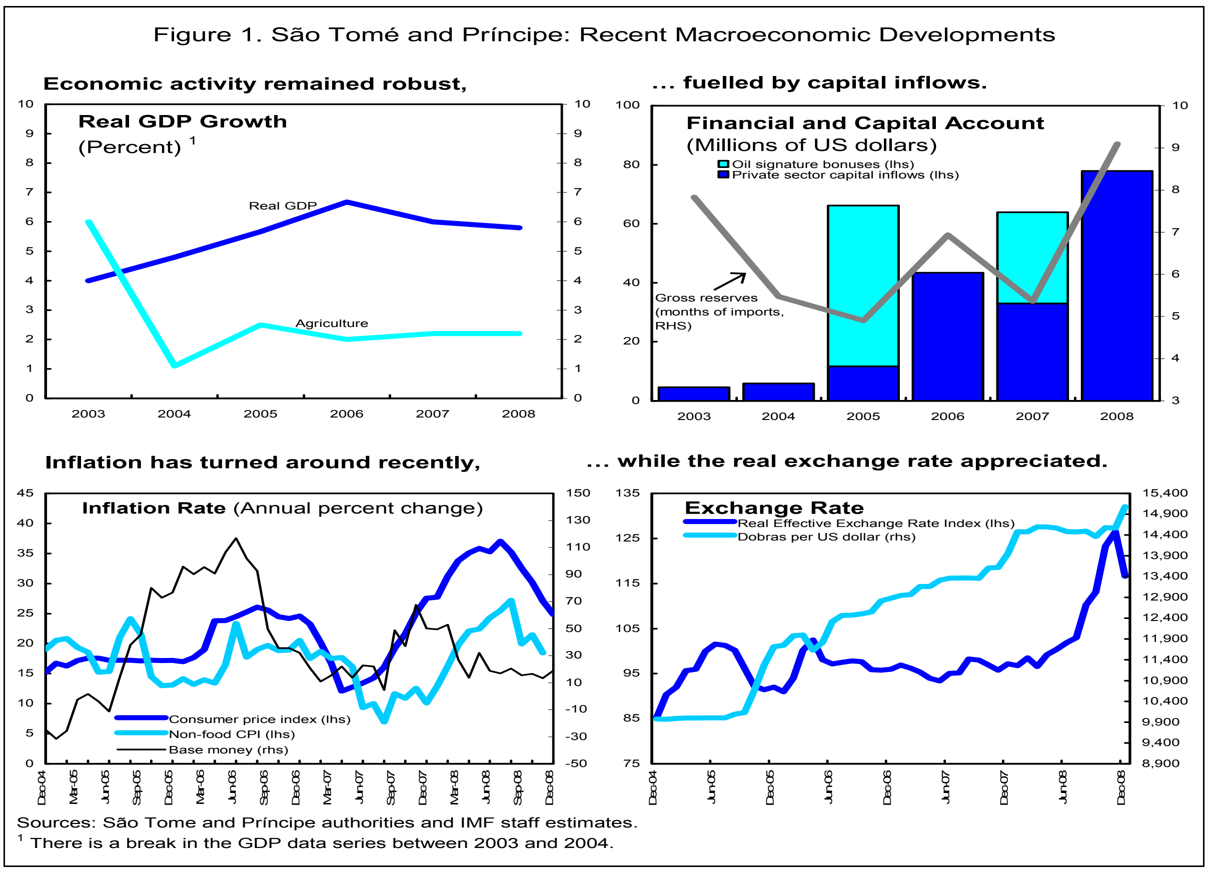
[1] A stability-oriented policy framework will be part of the bi-national agreement with Portugal to underpin a new exchange rate regime for São Tomé and Príncipe.

7. **Inflation was high in 2007–08, reflecting rising international prices of food and fuel and the depreciation of the dobra; but it started to retreat in the second half of 2008.**[2] In 2007, inflation reflected in part un-sterilized liquidity growth arising from the use of National Oil Account (NOA) balances to finance the fiscal deficit. Also, during 2007 and 2008, the authorities raised utility and fuel tariffs to bring them closer to world prices. Domestic fuel prices were significantly higher than international prices at end-2008. In 2008, the authorities tightened monetary policy to stabilize the exchange rate and reduce inflation, which closed 2008 at 25 percent, down from its 37 percent peak in June.





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[2] Food items account for 72 percent of the CPI basket, and many of them are imported. Oil products are imported, and oil prices significantly influence the retail prices of all imported consumer goods.

8. **Fiscal consolidation continued, but performance was weaker than programmed** (Figure 2)**.** The domestic primary deficit reached 8.4 percent of GDP in 2007, reflecting overruns in current spending, including a 30 percent public wage increase and spending to cover part of households' utility bills. The primary fiscal deficit was programmed to fall to 5.8 percent of GDP in 2008, but data through September suggest that it was 6.6 percent of GDP. The deficit was mainly financed by a drawdown from the NOA of $3 million and World Bank direct budget support.

9. **Government cash management has been complicated by domestic payment arrears.** Domestic payment arrears approached 118 billion dobra (4 ½ percent of GDP) by September 2008, mainly due to a shortfall in domestic revenue and higher than planned utility and scholarship bills. The government fell behind in payments to EMAE, the utility company, which accumulated payables to ENCO, the fuel distributor. ENCO, in its turn, had tax arrears (75 billion dobra by September 2008) and a large debt to Sonangol, Angola's oil exporting company, which recently became ENCO's majority shareholder. In December, ENCO cleared most of its tax arrears (70 billion dobra), and the government cleared its arrears to EMAE (86 billion dobra).

10. **Monetary policy was tightened in 2008.** In 2007, the central bank (BCSTP) did not sell enough foreign exchange to retire the liquidity released by the drawdown of the NOA. Thus, net international reserves of the BCSTP were $6 million above target by end-2007, while base money grew by 50 percent, contributing to depreciation of the dobra. In 2008, however, the BCSTP strengthened liquidity control through more extensive foreign exchange sales and increased coordination with the Ministry of Finance.[3] This helped reduce annual base money growth to 18.9 percent by December 2008, and broadly stabilized the exchange rate against the U.S. dollar throughout the year.[4]

Table 1. Sao Tome and Principe - Selected Economic Indicators, 2004-2008

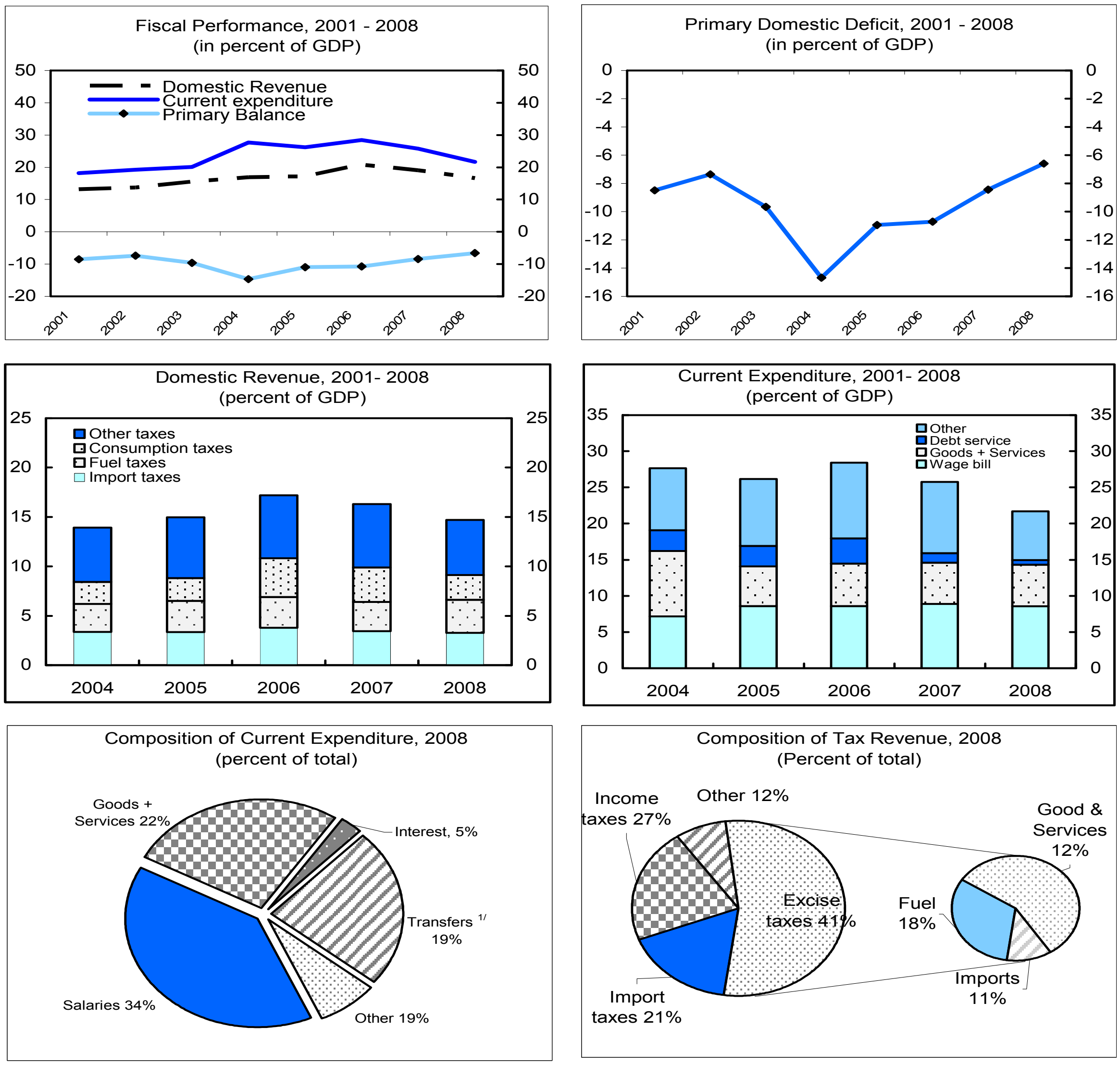
	2004	2005	2006	2007	2008
Real GDP growth (percent)	6.6	5.7	6.7	6.0	5.8
Inflation (end period, percent)	15.2	17.2	24.6	27.6	24.8
Domestic primary balance (percent of GDP)	-14.7	-10.9	-10.7	-8.4	-6.6
Base money growth (percent)	-24.9	76.6	32.0	50.0	18.9
Current account deficit, including grants (percent of GDP)	-16.8	-10.3	-28.8	-29.9	-34.0
Usable net international reserves (in months of imports)	4.7	2.7	4.8	3.4	6.6

Sources: Authorities and Staff estimates.

[3] While maintaining the usable net international reserves above 4 months of imports, the BCSTP sold $10 million in 2008, against $2 million in 2007.

[4] The REER appreciated by about 20 percent, largely reflecting inflation differentials.

Figure 2. São Tomé and Príncipe: Evolution of Fiscal Performance



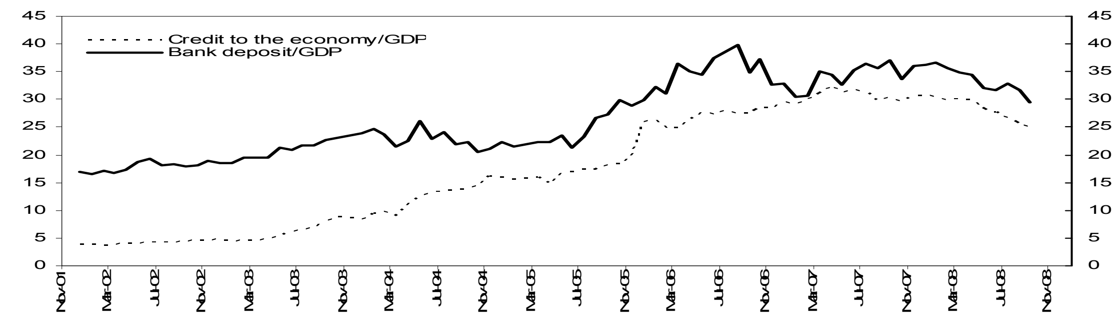
Sources: National authorities and IMF estimates.
1/ Transfers to the Joint Development Agency (JDA), at 2.2 percent of GDP, are included in "other" expenditure.

11. **The financial sector has expanded in the last several years, prompting efforts to enhance supervision.** The number of banks operating in STP rose from one in 2002 to nine by mid-2008, while bank credit to the economy expanded from around 5 percent of GDP to over 25 percent. Eurorization of the banking system also advanced from 50 percent of total deposits and credit in 2002 to over 70 percent in 2007 (Figure 3). The impact of the global financial crisis has been minimal so far.[5] The central bank has focused reform efforts on

[5] The banking system is dominated by one bank (BISTP) whose main shareholder is a Portuguese government-owned bank, which remains solid.

capital adequacy, credit classification, limits on net open foreign currency positions, and bolstering its own supervisory capacity after early off-site inspections raised some concerns about some small banks.

Figure 3. Indicators of Financial Development, 2001-2008



12. **Structural reforms slowed during 2007 and early 2008, though some measures were recently implemented.** After some delays, a new investment code and the direct tax reform package were approved by the National Assembly (NA) in late 2008. Some progress was made in public financial management, with the completion of the bidding process for IT equipment and the initiation of the bidding process for SAFE software—the authorities aim to prepare the 2010 budget under the new system. The NA approved a new AML/CFT law in May 2008, but the government is working with its development partners to further improve the law. In September 2008, the government sold a controlling stake in ENCO for a net $21 million.

13. **Progress to improve the investment climate was uneven**. The new investment code aims to reduce the time to approve investment projects and create a level-playing field for foreign and domestic investors. Although some reforms were undertaken at EMAE, continued collection problems have resulted in frequent power cuts. Other state-owned companies providing key services, such as ENASA (airport) and ENAPORT (seaport), also suffer from financial problems and sub-par service.

III. The New PRGF Policy Framework

A. Medium Term Framework

14. **The new PRGF arrangement aims to support the authorities' efforts to achieve macroeconomic stability and foster economic growth.** The program's objectives are aligned to the government's development objectives and strategic focus on infrastructure, and are consistent with the Poverty Reduction Strategy, completed in 2005.[6] The main pillars of the program are (MEFP ¶11):

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[6] A recent JSAN of the second annual progress report of the PRSP recommended that the authorities revise their PRSP in the near future to reflect recent developments and changes in oil prospects. See IMF CR/08/155.

- Improving fiscal sustainability and public financial management in the face of a more adverse external environment and uncertain oil prospects. In particular, the program aims to gradually reduce the fiscal deficit to about 3 percent of GDP, while ensuring that public investment is protected. The government will not resort to monetary financing of its deficit.

- Reducing inflation to low double digits early in the program and to single digits by its end, including by implementing an active monetary policy that uses foreign exchange auctions, subject to preserving an adequate level of external reserves.[7]

- Maintaining financial stability by enhancing and exercising the central bank's supervisory and regulatory powers.

- Continuing structural reforms aimed at stimulating private investment to develop the country's productive and export base.

15. **Strong implementation of the program will also help São Tomé and Príncipe successfully move to a fixed exchange rate system, if that is its final choice.**[8] The government has begun formal discussions on an exchange rate agreement with Portugal along the lines of that in force between Portugal and Cape Verde (Box 1). Under such an agreement, São Tomé and Príncipe would peg its dobra to the euro, possibly starting in 2010, and Portugal would provide support to the peg with a credit line. Staff is of the view that a successful peg to the euro would help deliver low inflation and deepen integration with Portugal, São Tomé and Príncipe's main economic partner. However, strict macroeconomic discipline will be necessary for the success of a more rigid exchange arrangement—a point on which the authorities agreed.

16. **Over the medium-term, economic growth is expected to continue around its current trend, while inflation should fall to single digits with firm policy implementation.** Annual real GDP growth is projected to average 7.3 percent over the period 2010–13, up from 5 ½ projected for 2009, mainly led by FDI and public investment, both treasury- and donor-financed.[9] The authorities have reached agreements with foreign investors on several large projects, including a deep-water seaport. Preparation for the larger projects is expected to begin in 2009 and physical work in 2010. These activities, though subject to risks, are expected to offset some of the adverse effects of the global crisis on economic growth. The projected growth rates should enable the country to improve social

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[7] If São Tomé and Príncipe goes ahead with the peg, its monetary policy will be geared to guaranteeing the chosen parity, and central bank operational targets and procedures will need to be revised.

[8] Staff discussed the Fund's proposed new exchange rate classification system. The authorities are comfortable with their current system being classified as "stabilized."

[9] Some FDI operations can tap already negotiated credit lines from partner-country governments.

indicators and make progress toward achieving the Millennium Development Goals. At the same time, strengthened macroeconomic policy implementation should help reduce inflation to around 5 percent by 2013.

Box 1. Cape Verde's Agreement with Portugal

In July 1998, Cape Verde pegged its currency to the Portuguese escudo (later the euro), supported by a Foreign Exchange Cooperation Agreement with Portugal.

Under the Agreement, Cape Verde committed to a program of macroeconomic adjustment (guided by the targets of the Maastricht treaty), greater openness, and the modernization of its economy. The Portuguese government would in turn guarantee the convertibility of Cape Verde's currency and make available a precautionary credit line with a limit of 9 billion escudos (€45 million), which could be used to finance imports and external debt service.

The Agreement established a bi-national Committee, whose Macroeconomic Monitoring Unit verifies compliance with the macroeconomic program, drawing attention to potential problems and suggesting corrective measures. The Committee reports annually to both governments, and can recommend the suspension of the credit line if it judges that commitments are in breach.

In 2008, Cape Verde celebrated the 10th anniversary of its Agreement with Portugal.

B. Policies for 2009

17. **The macroeconomic framework envisages real GDP growth of 5.5 percent in 2009, supported by FDI in construction, commerce, and tourism**. In addition, the authorities also have a large investment program to reinvigorate agriculture and tourism and improve the country's infrastructure.

18. **The current account deficit is expected to widen in 2009, reflecting increased imports related to domestically and foreign-financed investment projects.** The gain in export value seen in 2008 is expected to be reversed with a fall in oil re-exports. Imports are expected to increase by about 40 percent, reflecting strong public investment and continued FDI. The reduction in oil prices will mitigate this trend, although a lower oil import bill may be partially offset by higher profit repatriation by ENCO's new majority shareholder if domestic fuel prices remain high. The program envisages maintaining usable gross international reserves at no less than 4 months of imports.[10]

Fiscal Sustainability and Expenditure Management

19. **Gradual fiscal adjustment aims to ensure a stable macroeconomic environment** (MEFP ¶11). The program targets a baseline domestic primary fiscal deficit of 4 ½ percent of GDP in 2009 (Box 2). The deficit will be financed mainly by a drawdown of $2.4 million

[10] Usable reserves exclude the National Oil Account, banks' foreign currency reserves, and foreign currency deposits at the central bank for new bank licensing.

from the NOA, carry-over and new direct budget support from the World Bank and other donors, and use of privatization proceeds. The program also permits an increase in the deficit by up to 0.5 percentage points of GDP if additional budget support is secured.

20. **Most of the fiscal adjustment is expected from curbing the growth in current expenditure.** The authorities agreed to implement measures to control expenditures and improve budget execution (LOI, and MEFP ¶19 & 21), and to keep the wage bill constant in percent of GDP in 2009. The latter implies a significant nominal increase motivated by the authorities' three-year plan to decompress the compensation structure. The authorities also intend to conduct a study on civil service compensation to incorporate fringe benefits into the wage bill. Also, the lower world oil prices should result in a lower utility bill for the government, reducing spending on goods and services. To this end, the government intends to ensure that domestic fuel prices are updated regularly (structural benchmark).

21. **To support the government's plans to improve infrastructure, the program features a substantial increase in treasury-funded capital expenditure** (LOI)**.** Using some of the proceeds from the privatization of ENCO, the 2009 fiscal program includes a large appropriation for capital projects (MEFP Table C).[11] Taking into account implementation capacity, the program targets treasury-funded capital expenditure of 2.8 percent of GDP. If execution exceeds that baseline, additional use of privatization proceeds of up to 2 percent of GDP ($4 million) is allowed. If execution falls short of the baseline, the government will save the unused resources to ensure the funding of unfinished projects after 2009. With help from the World Bank, staff will monitor the budgetary execution of these projects (MEFP ¶18).

22. **Revenues in 2009 will reflect recent tax reforms.** The newly approved tax law changes are expected to be revenue neutral in the first two years. Tax collection, enforcement, and compliance are expected to improve over time. The government agreed that the availability of one-off revenues in 2009 should not lead to permanently higher expenditure obligations (MEFP ¶19).

23. **On the structural side, strengthening public financial management (PFM) and implementing revenue reforms are program priorities**. The reform process will focus on:

- **Improving the budget financial management system (SAFINHO) to enhance budget execution and monitoring** (MEFP ¶ 20 and Table B). These measures are key for preventing domestic arrears and ensuring effective delivery of public expenditure, and are in line with FAD technical assistance and the World Bank's PFM program.

[11] This approach is in line with that recommended in the papers on Public Investment and Fiscal Policy endorsed by the Executive Board in 2004.

- **Phasing out the subsidy on utility payments and resolving the arrears among EMAE, ENCO, and the government.** Stemming the flow of new arrears requires public enterprise reform, including improving the financial standing of EMAE to enable it to pay back its debt to ENCO. Staff encouraged the authorities to negotiate with EMAE and ENCO a settlement of any remaining inter-enterprise and tax arrears.

- **Strengthening tax and customs administration**, including through auditing tax returns, collecting tax arrears,[12] and improving enforcement and collection, supported by the Millennium Challenge Corporation.

Box 2. Highlights of the 2009 Fiscal Plans

- The fiscal component of the program, based on the budget approved in December 2008, envisages a baseline domestic primary deficit of 4 ½ percent of GDP (see table).
- Several exceptional or one-off revenues are expected, including payment of overdue fees by oil companies and fees from two new investment projects (deep-water port and terminal link). No oil signature bonuses are expected in 2009.
- The wage bill grows by 24.5 percent (about 5.5 percent in real terms).
- The government intends to clear all arrears to its foreign scholarship program.
- A large increase in treasury-funded capital projects, taking advantage of available privatization proceeds.
- New budget support from the World Bank for $2 million is assumed.
- Project grants that support donor-funded capital expenditure (concepts which are excluded from the domestic primary balance under the program) are 200 percent larger than in 2008, including grants from Portugal, Nigeria, and Angola.

STP - Selected Central Government Budget Items, 2008-2009
(in percent of GDP, unless otherwise indicated)

	2008		2009
	Proj.	Est.	Program
Domestic revenue	17.9	16.3	18.3
of which, one-off exceptional revenue 1/	0.0	0.0	1.1
Non-interest current expenditure	19.7	21.1	18.7
of which, wage bill	8.6	8.6	8.6
HIPC-related expenditure	2.6	1.4	1.2
Primary current balance 2/	**-4.4**	**-6.1**	**-1.6**
Treasury-funded capital expenditure	1.4	0.5	2.8
Domestic primary balance 2/	**-5.8**	**-6.6**	**-4.5**
Memorandum items:			
Donor-funded capital expenditure	7.5	7.5	39.6
Direct budget support	3.4	3.4	0.6
Direct budget support (US $ million)	6	6	1
Remaining un-used privatisation (US $ million)	22	21	17
National Oil Account (US $ million)	12	12	10

1/ One-off exceptional revenue is revenue from past tax dues from companies that did the seismic studies at the Joint Development Zone and one-off payments from large investment projects expected
2/ Monitorable under IMF programs as a performance criterion.

[12] The stock of tax arrears reached 132 billion dobras by September 2008 - 35 percent of 2008 tax revenues. The government is considering a partial tax amnesty to help taxpayers who need to regularize their situation.

Monetary Policy and Financial Sector Reforms

24. **Under the existing monetary and exchange rate framework, monetary policy will continue to rely on foreign exchange auctions to manage domestic liquidity.** The monetary program aims to reduce inflation to 16 percent by end-2009, while keeping NIR at or above 4 months of imports. Staff agreed with the authorities that the BCSTP will need to continue using foreign exchange auctions to control liquidity (MEFP ¶24 & 25).[13] Continued coordination between the central bank and the Ministry of Finance will be necessary.

25. **Financial sector reforms initiated under the previous program will continue.** In the short-term, improvements to ensure soundness of the banking system and further enhance the supervisory capacity of the BCSTP will dominate (MEFP ¶28). In line with the recommendations of recent technical assistance from MCM on banking supervision, the focus will be on completing the first round of off-site bank inspections and starting on-site inspections (structural benchmark). The BCSTP also intends to strengthen its capacity to enforce banking regulations including through training. By end-2009 a credit registry will be set up to help banks assess and manage risk (structural benchmark).

Structural reforms

26. **Achieving sustained growth in the non-oil sectors will require structural reforms that facilitate private sector activity** (MEFP ¶29 & 31). Staff agreed with the authorities on the following additional measures (structural benchmarks) to boost investment and reduce the cost of doing business: (i) revise the labor code; (ii) create a one-stop window; and (iii) modernize the commercial code.

External Debt

27. **All new external debt will be contracted on concessional terms** (MEFP ¶32). São Tomé and Príncipe reached the HIPC Initiative completion point in March 2007 and benefited from HIPC/MDRI debt relief**.**[14] The authorities plan to seek full debt-relief delivery from their remaining creditors (mainly Angola and the Arab Bank for Economic Development in Africa). They intend to maintain debt sustainability and are committed to refraining from new non-concessional borrowing. They also plan to put in place a framework law for public debt to improve debt management (structural benchmark).

28. **Despite HIPC and MDRI debt relief, the debt outlook remains vulnerable.** In the event of a large output loss or terms of trade deterioration, key debt ratios could exceed the

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[13] If needed, BCSTP may conduct reverse auctions to offset certain large direct foreign exchange purchases that could drain liquidity from the market.

[14] By September 2007, over 80 percent of the country's creditors had agreed to deliver HIPC relief, enabling the Fund to disburse its share of topping-up assistance.

relevant indicative thresholds. The risk of debt distress would increase significantly should oil prospects diminish (www.imf.org).[15]

C. Program Risks

29. **The main near-term risks to the growth outlook are external.** Although the impact of the global financial crisis has been minimal so far, the crisis raises the risks of tighter credit conditions and weaker demand for foreign firms planning to invest in São Tomé and Príncipe. Weaker partner-country growth could affect tourism, while lower donor support and implementation constraints are risks to public investment. In an alternative low-growth scenario the fiscal deficit would widen, calling for additional external support (Figure 4).

30. **The longer-term outlook remains dependent on uncertain oil prospects, which have become more precarious with the decline in oil prices.** The balance of the National Oil Account is low ($12 million in November 2008), and overdue oil bonuses may not arrive as expected in 2010 (Figure 4).[16] Exploratory drilling so far has not confirmed the existence of commercially extractable oil reserves, and new drilling, scheduled for late 2009, may be further delayed as a result of weak oil prices.[17] Medium-term fiscal plans would need to be reassessed should oil prospects fail to improve within the program period.

31. **The main domestic risk stems from local, legislative, and presidential elections** – scheduled for 2009, 2010, and 2011, respectively—which could cause fiscal discipline to relax.

IV. Program Monitoring, Financing Needs, and Capacity to Repay the Fund

32. **Data provision is adequate for program monitoring, although there remain weaknesses in national accounts, government financial operations' statistics, and balance of payments data**. The Fund continues to provide technical assistance to improve the quality of statistics and to help strengthen capacity for economic management.

33. **The prior actions for the program (Table C) were met in December 2008 and February 2009, and Executive Board consideration of the first review of the new PRGF arrangement is expected in October 2009.** The quantitative performance criteria for end-June 2009 and end-December 2009, as well as the structural performance criterion and benchmarks for 2009, are detailed in Tables A and B of the MEFP. Semi-annual program reviews are envisaged.

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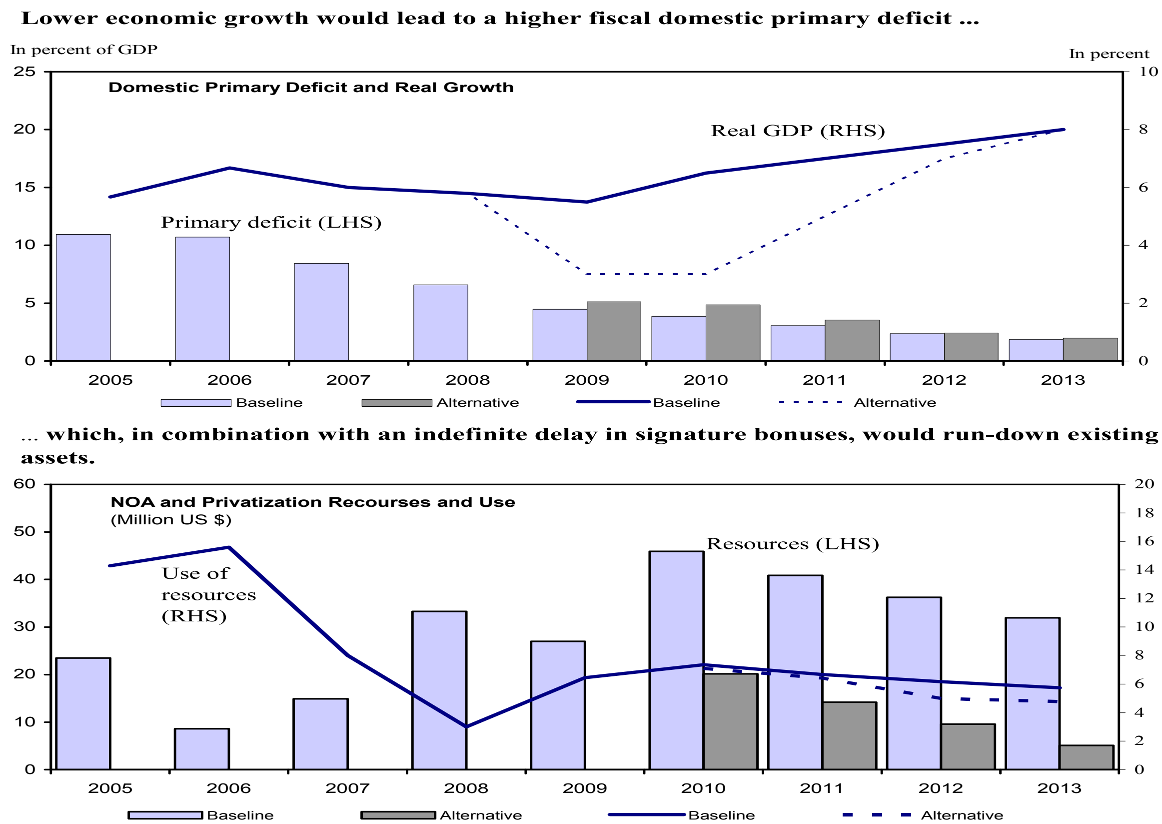
[15] The main conclusions are mostly unchanged from the previous DSA (IMF Country Report 07/173). Larger projected public investment is reflected in higher public debt, while supporting the growth projections.

[16] Unsettled disagreements between the stakeholders of Blocks 5 and 6 and the Joint Development Authority have put on hold oil signature bonuses of $26.1 million for the two blocks since early 2008.

[17] Foreign investors in Blocks 2 and 4 are scheduled to start drilling in late 2009, further pushing back the date for initiating production to 2015 or 2016, if commercial viable oil reserves were confirmed.

Figure 4. Sao Tome and Principe - Alternative Scenario 1/



Source: Authorities and IMF staff.
1/ The baseline scenario assumes that oil signature bonuses for Blocks 5 and 6 are received in 2010 and that downside external risks are contained. The alternative scenario assumes oil bonuses are delayed indefinitely and that downside external risks are significant. Financing needs are assumed to be covered by the gradual use of privatization proceeds, which, as a result, will be exhausted by the end of 2013.

34. **São Tomé and Príncipe's external financing needs in 2009 amount to $187.6 million, expected to be covered mainly with official grants and concessional loans** (Table 7). The proposed access under the new PRGF-supported program is 35 percent of quota, equivalent to SDR 2.59 million, distributed in seven equal tranches (Table 9).

35. **Given the strong adjustment envisaged under the program, the country can be expected to meet its future obligations to the Fund.** By the end of the new arrangement, São Tomé and Príncipe's outstanding aggregate use of Fund resources would be equivalent to 68 percent of quota, totaling SDR 5.1 million. The authorities agreed to receive a Fund safeguard assessment mission in 2009.

V. Staff Appraisal

36. **The economic outlook is broadly favorable, but success will hinge on the authorities' ability to strengthen fiscal and monetary policy implementation in the face of significant risks.** Fund engagement is important to underpin performance and resist

expenditure pressures, especially given the heavy electoral calendar during the program period.

37. **Strong fiscal policy implementation is needed to achieve stability.** The authorities are aware of the impact that fiscal deficits have had on inflation in recent years, and know that monetary policy alone cannot shoulder the burden of reducing inflation, given the need to preserve an adequate level of international reserves. Moreover, the country remains vulnerable to debt distress, especially in a no-oil scenario. Thus, the domestic primary fiscal deficit should continue on a consolidation trajectory.

38. **The drive to increase treasury-funded capital spending financed with privatization proceeds is welcome.** In the short run, it will help support economic activity. In the longer term, it will help address infrastructure deficiencies which hamper non-oil growth. The authorities will need to carefully control this spending to ensure value for money.

39. **Staff welcome the recent progress in fiscal structural reforms and encourage steadfast implementation.** Especially important are efforts to strengthen tax administration and collect tax arrears, along with putting in place a fully-functioning computerized public financial management system. Phasing out the current implicit subsidy on utility payments and preventing the emergence of new arrears would help reduce rigidities in the budget structure and improve macroeconomic management.

40. **The central bank must continue using exchange rate auctions to control domestic liquidity, subject to the condition of keeping adequate reserve coverage.** The actions taken by the BCSTP to control liquidity in 2008 send a positive signal of the authorities' commitment to reduce inflation. Continued close coordination between the BCSTP and the Ministry of Finance is needed to ensure timely sterilization and effective liquidity control. However, to limit the associated impact on foreign reserves, ongoing fiscal discipline is essential. The government agreed to stand ready to reduce expenditure commitments, if necessary, to help meet the program's NIR target.

41. **The recent improvements in the central bank's regulatory and supervision functions are welcomed and should continue.** With the support of its development partners, the central bank should persevere in this area, both for the stability and development of the financial sector.

42. **The authorities intention to peg the dobra to the euro is well justified, but raises the stakes for macroeconomic management.** A peg to the euro can help deliver low inflation and deepen integration with the country's main economic partners. However, strict fiscal discipline will be necessary for the sustainability of a fixed exchange rate.

43. **Sustaining growth and reducing poverty in the medium term will require moving ahead with priority structural reforms.** These include developing the financial

sector and implementing regulatory reforms to remove the impediments to private sector development. Upgrading the country's infrastructure can help develop the supply side of the economy over the medium term, improve growth prospects, and reduce poverty.

44. **Medium term economic prospects are good, but important risks exist.** The main challenge facing the authorities in the next few years is to ensure macroeconomic stability by strengthening policy implementation. This becomes all the more important given the uncertain oil revenue prospects.

45. **Based on the authorities' policy commitments, staff recommends approval of the authorities' request for a new PRGF-supported arrangement.** The country continues to need close Fund engagement in formulating, implementing, and monitoring macroeconomic policies. As in the past, the new PRGF would also provide an important catalytic role for continued external donor financing and support.

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2006–13

	2006	2007	2008	2009	2010	2011	2012	2013
			Proj.	Prog.		Proj.		
	(Annual change in percent, unless indicated)							
National income and prices								
GDP at constant prices	6.7	6.0	5.8	5.5	6.5	7.0	7.5	8.0
Consumer prices								
End of period	24.6	27.6	24.8	16.0	10.0	7.0	5.0	5.0
Period average	23.1	18.5	26.0	20.1	12.8	8.4	6.0	5.0
External trade								
Exports of goods and non-factor services	7.8	-21.5	60.7	-8.5	13.2	13.5	10.6	10.4
Imports of goods and non-factor services	45.2	9.7	36.8	27.4	-5.4	1.0	3.1	7.2
Exchange rate (dobras per US$; end of period) [1]	12,945	14,220	15,077	…	…	…	…	…
Real effective exchange rate (depreciation = -)	4.3	1.3	20.0	…	…	…	…	…
Money and credit (end of period)								
Base money [2]	32.0	50.0	18.9	10.7	20.7	16.4	14.4	14.1
Broad money (M3)	39.3	36.4	9.5	13.5	20.7	16.4	14.4	14.1
Velocity (GDP to average broad money)	2.7	2.8	3.0	3.1	3.1	3.1	3.0	3.0
Central bank reference interest rate (percent)	28.0	28.0	28.0	…	…	…	…	…
Bank lending rate (percent)	29.3	32.4	32.4	…	…	…	…	…
Bank deposit rate (percent)	10.8	12.8	12.8	…	…	…	…	…
	(Percent of GDP, unless otherwise specified)							
Government finance								
Total revenue, grants, and oil signature bonuses [3]	36.8	160.3	47.6	70.7	50.2	34.4	31.7	29.6
Of which : tax revenue	17.2	16.3	14.7	16.7	15.9	16.0	16.1	16.3
Non-tax revenue	3.7	2.8	1.9	1.8	1.4	1.3	1.3	1.2
grants	15.9	120.1	31.0	52.2	20.7	17.0	14.3	12.1
oil signature bonuses	0.0	21.1	0.0	0.0	12.2	0.0	0.0	0.0
Total expenditure and net lending	50.5	39.8	31.0	62.9	53.2	47.0	42.2	38.4
Of which: personnel costs	8.6	8.9	8.6	8.6	8.4	8.2	8.0	7.8
non-wage noninterest current expenditure	16.3	15.6	12.5	10.1	9.0	8.5	8.1	8.0
treasury funded capital expenditures	3.3	1.1	0.5	2.8	2.4	2.4	2.5	2.5
donor funded capital expenditures	16.5	10.2	7.5	39.6	31.5	25.9	21.8	18.3
Domestic primary balance [4]	-10.7	-8.4	-6.6	-4.5	-3.9	-3.1	-2.4	-1.9
Overall balance (commitment basis)	-13.7	120.5	16.6	7.9	-2.9	-12.6	-10.5	-8.8
External sector								
Current account balance								
Including official transfers	-28.8	-29.9	-34.0	-43.0	-38.1	-35.1	-33.4	-33.3
Excluding official transfers	-53.5	-51.7	-58.8	-69.7	-59.5	-52.5	-47.7	-45.3
PV of external debt	159.7	11.8	10.9	19.0	25.9	30.6	33.8	35.4
External debt service (percent of exports) [5]	33.8	24.3	5.1	5.5	7.1	8.0	8.0	10.4
Export of goods and non-factor services (US$ millions)	17.2	13.5	21.7	19.8	22.4	25.5	28.2	31.1
Gross foreign reserves [6, 7]								
Months of imports of goods and nonfactor services [8]	4.8	3.4	6.6	5.0	4.0	4.0	4.0	4.0
Millions of U.S. dollar	24.7	26.3	46.5	38.6	32.6	34.8	37.7	40.9
National Oil Account (US$ millions) [9]	8.6	14.9	12.2	9.9	32.3	30.0	27.5	25.0
Memorandum Item								
GDP								
Billions of dobras	1,550	1,962	2,568	3,196	3,817	4,398	4,980	5,626
Millions of U.S. dollars	125	145	176	201	213	230	251	275
Privatisation account (million US dollars)	0	0	21	17	14	11	9	7

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

[1] Central bank (BCSTP) buying rate.

[2] 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.

[3] Includes HIPC and MDRI debt relief.

[4] A new definition is adopted from 2008, retroactively, to exclude oil revenue, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.

[5] In percent of exports of goods and nonfactor services. Includes HIPC and MDRI debt relief.

[6] Gross reserves exclude the National Oil Account and commercial banks' foreign currency deposit at the BCSTP in order to meet the reserve requirement for their foreign currency deposits or as application deposits for new licensing.

[7] For 2008, includes the proceeds from the privatization of the government's share in the fuel distribution company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the central bank to boost reserves.

[8] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

[9] For 2010, based on the assumption that dispute will be settled to allow disbursement of bonuses for Blocks 5 and 6 ($26 million).

Table 2. São Tomé and Príncipe: Financial Operations of the Central Government, 2006–09

(Billion dobra)

	2006	2007	2008 Proj.	2009 Prog.
		(billion dobra)		
Total revenue and grants	**570**	**3144**	**1223**	**2260**
Total revenue	324	374	427	593
Tax revenue	267	320	378	534
Nontax revenue, of which:	57	55	49	59
oil-related revenue [1]	18	7	8	9
Grants	247	2357	796	1667
Project grants	197	168	202	810
Nonproject grants	2	21	87	18
HIPC Initiative-related grants [2]	47	2168	507	839
Oil signature bonuses	0	413	0	0
Total expenditure	**783**	**780**	**797**	**2009**
Domestic primary expenditure	472	532	588	727
Current expenditure	441	506	557	616
Of which: personnel costs	133	174	220	274
interest on external debt due	52	26	16	17
goods and services	91	112	148	123
transfers, of which:	108	140	146	182
JDA	38	42	15	16
other	54	54	27	19
Capital expenditure	307	223	205	1355
Financed by the Treasury	51	22	12	91
Financed by external sources	256	200	193	1264
HIPC Initiative-related social expenditure	35	51	35	38
Domestic primary balance [3]	**-166**	**-166**	**-169**	**-143**
Overall fiscal balance (commitment basis)	**-213**	**2364**	**426**	**251**
Net change in arrears (reduction = -)	21	5	21	0
External arrears [4]	21	0	0	0
Domestic arrears	0	5	21	0
Overall fiscal balance (cash basis)	**-192**	**2370**	**442**	**230**
Financing	**192**	**-2370**	**-442**	**-230**
Net external	31	-2339	-469	-376
Net domestic	162	-31	27	146
Net bank credit to the government	162	-31	-285	125
Banking system credit (excluding National Oil Account)	-23	41	-328	86
of which Privatisation account [5]	0	0	-306	62
National Oil Account	184	-72	44	39
Nonbank financing [5]	0	0	312	21
Financing gap	0	0	0	0
Memorandum items:				
Overall balance (commitment basis, incl. grants, excl. oil bonuses)	-213	1951	426	251
MDRI debt relief (flow in US$ million)	0	2	1.8	0
Privatisation account balance (US$ million)	0	0	21	17
National Oil Account balance (US$ million, excl. transfers to budget)	9	15	12	10

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

[1] Includes revenue from Nigeria's oil program - Arcadia.

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

[3] A new definition is adopted from 2008, retroactively, to exclude oil revenue, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.

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

[5] For 2008, includes the proceeds from the privatization of the government's share in the fuel distribution company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the central bank to boost reserves.

Table 3. São Tomé and Príncipe: Financial Operations of the Central Government, 2006–13

(In percent of GDP)

	2006	2007	2008	2009	2010	2011	2012	2013
			Proj.	Prog.		Proj.		
				(Percent of GDP) [1]				
Total revenue and grants	**36.8**	**160.3**	**47.6**	**70.7**	**50.2**	**34.4**	**31.7**	**29.6**
Total revenue	20.9	19.1	16.6	18.6	17.4	17.3	17.4	17.5
Tax revenue	17.2	16.3	14.7	16.7	15.9	16.0	16.1	16.3
Nontax revenue, of which:	3.7	2.8	1.9	1.8	1.4	1.3	1.3	1.2
oil-related revenue [2]	1.1	0.4	0.3	0.3	0.3	0.3	0.2	0.2
Grants	15.9	120.1	31.0	52.2	20.7	17.0	14.3	12.1
Project grants	12.7	8.6	7.9	25.3	20.2	16.6	13.9	11.7
Nonproject grants	0.2	1.1	3.4	0.6	0.5	0.4	0.4	0.4
HIPC Initiative-related grants [3]	3.0	110.5	19.7	26.3	0.0	0.0	0.0	0.0
Oil signature bonuses	0.0	21.1	0.0	0.0	12.2	0.0	0.0	0.0
Total expenditure	**50.5**	**39.8**	**31.0**	**62.9**	**53.2**	**47.0**	**42.2**	**38.4**
Domestic primary expenditure	30.4	27.1	22.9	22.8	20.9	20.1	19.6	19.2
Current expenditure	28.4	25.8	21.7	19.3	18.2	17.6	17.0	16.8
Of which: personnel costs	8.6	8.9	8.6	8.6	8.4	8.2	8.0	7.8
interest on external debt due	3.4	1.3	0.6	0.5	0.7	0.9	0.9	1.0
goods and services	5.9	5.7	5.8	3.8	3.5	3.3	3.1	3.1
transfers, of which:	7.0	7.1	5.7	5.7	5.0	4.7	4.5	4.4
JDA	2.5	2.2	0.6	0.5	0.5	0.4	0.4	0.4
other	3.5	2.7	1.1	0.6	0.5	0.5	0.5	0.5
Capital expenditure	19.8	11.4	8.0	42.4	33.9	28.4	24.3	20.8
Financed by the Treasury	3.3	1.1	0.5	2.8	2.4	2.4	2.5	2.5
Financed by external sources	16.5	10.2	7.5	39.6	31.5	25.9	21.8	18.3
HIPC Initiative-related social expenditure	2.3	2.6	1.4	1.2	1.1	1.0	1.0	0.9
Domestic primary balance [4]	**-10.7**	**-8.4**	**-6.6**	**-4.5**	**-3.9**	**-3.1**	**-2.4**	**-1.9**
Overall fiscal balance (commitment basis)	**-13.7**	**120.5**	**16.6**	**7.9**	**-2.9**	**-12.6**	**-10.5**	**-8.8**
Net change in arrears (reduction = -)	1.3	0.3	0.8	0.0	0.0	0.0	0.0	0.0
External arrears [5]	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic arrears	0.0	0.3	0.8	0.0	0.0	0.0	0.0	0.0
Overall fiscal balance (cash basis)	**-12.4**	**120.8**	**17.2**	**7.2**	**-2.9**	**-12.6**	**-10.5**	**-8.8**
Financing	**12.4**	**-120.8**	**-17.2**	**-7.2**	**2.9**	**12.6**	**10.5**	**8.8**
Net external	2.0	-119.2	-18.3	-11.8	11.7	9.7	8.0	6.8
Net domestic	10.4	-1.6	1.1	4.6	-8.8	2.9	2.5	2.1
Net bank credit to the government	10.4	-1.6	-11.1	3.9	-8.8	2.9	2.5	2.1
Banking system credit (excluding National Oil Account)	-1.5	2.1	-12.8	2.7	1.6	1.2	0.9	0.6
of which Privatisation account [6]		0.0	-11.9	1.9	1.6	1.2	0.9	0.6
National Oil Account	11.9	-3.7	1.7	1.2	-10.4	1.7	1.6	1.5
Nonbank financing [6]	0.0	0.0	12.1	0.7	0.0	0.0	0.0	0.0
Financing gap	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)	-13.7	99.5	16.6	7.9	-15.1	-12.6	-10.5	-8.8
MDRI debt relief (flow in US$ million)	0	1.7	1.8	0.0	0.0	0.0	0	0
Privatisation account balance (US$ million)	0	0.0	21.0	17.0	13.6	10.9	8.7	7.0
National Oil Account balance (US$ million, excl. transfers to budget)	8.6	14.9	12.2	9.9	32.3	30.0	27.5	25.0

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

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

[2] Includes revenue from Nigeria's oil program - Arcadia.

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

[4] A new definition is adopted from 2008, retroactively, to exclude oil revenue, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.

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

[6] For 2008, includes the proceeds from the privatization of the government's share in the fuel distribution company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the central bank to boost reserves.

Table 4. São Tomé and Príncipe: Summary Accounts of the Central Bank, 2006–09

(million dobra)

	2006	2007	2008				2009			
	Dec.	Dec	Mar.	June	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
			Actual	Actual	Actual	Est.	Proj.			
Net foreign assets	**620**	**853**	**896**	**886**	**973**	**1,204**	**1,141**	**1,111**	**1,110**	**1,168**
Net international reserves	529	738	778	768	867	1,014	943	910	914	957
Gross reserves [1]	557	777	875	864	900	1,116	1,059	1,030	1,040	1,094
Of which: National Oil Account (NOA)	111	212	219	218	174	183	193	161	157	171
Of which: guarantee deposits	16	25	83	82	19	20	21	22	21	23
Short-term liabilities	-28	-39	-97	-96	-33	-103	-116	-121	-127	-137
Other foreign assets	143	171	178	177	172	190	198	201	196	210
Other liabilities [2]	-52	-56	-60	-59	-66	0	0	0	0	0
Net domestic assets	**-342**	**-436**	**-503**	**-508**	**-504**	**-708**	**-671**	**-659**	**-601**	**-619**
Net domestic credit	-121	-152	-190	-203	-221	-394	-355	-344	-286	-302
Net credit to government	-108	-163	-200	-212	-230	-406	-403	-357	-325	-334
Claims [2]	106	112	118	116	122	126	138	142	148	157
Of which : use of SDRs/PRGF Facility	65	69	75	73	80	82	95	99	105	114
Deposits	-214	-274	-318	-328	-353	-532	-541	-499	-474	-491
Ordinary	-34	-13	-22	-30	-45	-89	-85	-82	-73	-76
Of which : HIPC Initiative resources	-12	-8	-9	-7	-16	-5	-5	-5	-5	-5
Counterpart funds	-23	-8	-14	-14	-23	-22	-22	-22	-22	-22
Foreign currency	-157	-253	-282	-285	-284	-420	-433	-395	-378	-393
Of which: NOA	-111	-212	-219	-218	-174	-183	-193	-161	-157	-171
Rediscount to commercial banks	2	1	1	1	1	1	35	1	27	18
Other claims	10	9	9	9	9	12	13	13	13	14
Central Bank certificates of deposit	-25	0	0	0	0	0	0	0	0	0
Other items (net)	-220	-283	-313	-305	-284	-314	-315	-316	-315	-317
Base money	**278**	**417**	**393**	**378**	**469**	**496**	**470**	**451**	**509**	**549**
Currency issued	103	126	110	104	106	141	133	128	144	156
Bank reserves	175	291	284	274	363	355	337	323	364	393
Of which : domestic currency	65	126	82	91	116	143	136	130	147	158
Of which: foreign currency	110	165	202	182	247	212	201	193	218	235
Memorandum items:										
Gross international reserves (US$ millions) [1]	43.0	54.6	59.9	59.7	62.7	74.0	67.4	63.2	65.4	63.5
excluding NOA and guaranteed deposits	33.3	37.9	39.3	38.9	49.2	60.5	53.8	52.0	54.2	52.2
Net international reserves (US$ millions)	40.8	48.0	49.2	49.0	55.8	67.2	60.0	55.8	57.5	55.5
Of which: National Oil Account (US$ millions)	8.6	14.9	15.0	15.1	12.1	12.2	12.3	9.9	9.9	9.9
Net international reserves (US$ millions; excl. NOA)	32.3	33.1	34.2	33.9	43.7	55.1	47.8	45.9	47.6	45.6
Of which: Commercial banks reserves in foreign currency	8.5	11.6	13.5	12.6	17.2	14.1	12.8	11.8	13.7	13.6
Usable net international reserves										
in US$ millions [3]	23.7	21.5	20.7	21.3	26.5	41.0	34.9	34.1	33.9	32.0
in months of imports [4]	4.0	4.2	2.7	2.7	3.4	5.3	5.0	4.8	4.8	4.5
Base money (annual percent change)	32.0	50.0	27.1	18.7	15.4	18.9	19.5	19.5	8.5	10.7

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] Includes prospective disbursements under new PRGF arrangement.

[3] Excluding NOA and banks' reserves in foreign currencies.

[4] Imports of goods and nonfactor services excluding investment goods and technical assistance of the year.

Table 5. São Tomé and Príncipe: Monetary Survey, 2006–09
(million dobra)

	2006	2007	2008				2009			
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
			Actual	Actual	Actual	Proj.	Proj.			
Net foreign assets	**860**	**1,149**	**1,265**	**1,292**	**1,392**	**1,643**	**1,564**	**1,515**	**1,469**	**1,520**
Central bank	620	853	896	886	973	1,204	1,141	1,111	1,110	1,168
Commercial banks	240	296	369	407	419	439	424	404	360	352
Net domestic assets	**-257**	**-328**	**-434**	**-481**	**-563**	**-743**	**-547**	**-508**	**-427**	**-499**
Net domestic credit	238	426	409	387	341	158	313	378	404	422
Net credit to government	-115	-179	-228	-239	-264	-440	-436	-391	-359	-367
Claims	106	112	118	116	122	126	138	142	148	157
Deposits	-221	-291	-346	-355	-386	-566	-575	-533	-507	-525
Budgetary deposits	-41	-30	-50	-57	-79	-123	-119	-116	-107	-109
Counterpart funds	-23	-8	-14	-14	-23	-22	-22	-22	-22	-22
Foreign currency deposits	-157	-253	-282	-285	-284	-420	-433	-395	-378	-393
Of which: National Oil Account	-111	-212	-219	-218	-174	-183	-193	-161	-157	-171
Credit to the economy	354	606	637	626	605	598	750	769	763	790
Of which: credit in foreign currency	260	472	500	468	451	446	573	602	596	428
Other items (net)	-496	-754	-843	-867	-904	-901	-860	-886	-831	-921
Broad money (M3)	**603**	**822**	**831**	**812**	**829**	**900**	**1,018**	**1,007**	**1,043**	**1,022**
Local currency	253	313	290	283	289	341	376	369	391	393
Money	226	286	260	252	258	308	339	332	353	357
Currency outside banks	92	110	94	93	84	141	133	128	144	156
Demand deposits	133	176	166	159	173	168	206	205	209	201
Time deposits	28	27	30	31	31	33	37	37	37	36
Foreign currency deposits	349	509	542	529	540	559	642	638	652	628
Memorandum items:										
Velocity (ratio of GDP to average broad money)	3.0	2.8	2.8	2.8	2.9	3.0	3.1	3.1	3.1	3.1
Money multiplier (M3/M0)	2.2	2.0	2.1	2.1	1.8	1.9	2.2	2.2	2.0	1.9
Base money (12-month growth rate)	32.0	50.0	27.1	18.7	15.4	18.9	19.5	19.5	8.5	10.7
M3 (12-month growth rate)	39.3	36.4	27.3	15.5	5.5	9.5	22.4	24.1	25.7	13.5

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

Table 6. São Tomé and Príncipe: Balance of Payments, 2006–13

	2006	2007	2008	2009	2010	2011	2012	2013
			Proj.	Prog.		Proj.		
Trade balance	**-51.5**	**-60.1**	**-80.9**	**-103.2**	**-102.1**	**-102.7**	**-106.4**	**-115.5**
Exports, f.o.b.	7.7	6.8	11.6	8.7	10.1	11.7	12.7	13.7
Of which : cocoa	2.5	3.5	2.8	3.7	4.3	4.6	4.9	5.3
re-export	3.9	2.9	8.3	4.5	5.2	6.3	6.9	7.4
Imports, f.o.b.	-59.2	-66.9	-92.4	-111.9	-112.3	-114.3	-119.0	-129.2
Of which : food	-17.0	-17.6	-21.1	-18.2	-19.4	-20.8	-22.4	-24.2
petroleum products	-15.0	-14.6	-27.8	-15.1	-19.3	-21.0	-22.9	-24.8
Services and income (net)	-17.2	-17.1	-25.8	-40.8	-29.4	-24.4	-21.3	-19.5
Exports of nonfactor services	9.5	6.7	10.1	11.1	12.3	13.8	15.5	17.4
Of which : travel and tourism [1]	6.7	5.0	8.0	8.8	9.8	11.1	12.5	14.1
Imports of nonfactor services	-29.0	-30.0	-40.0	-56.7	-47.3	-46.9	-47.1	-49.0
Factor services (net)	2.4	6.1	4.0	4.8	5.6	8.6	10.4	12.1
Interest due	-3.8	-0.7	-0.2	-0.2	-0.7	-1.1	-1.5	-1.8
National Oil Account (NOA) interest earnings	0.6	3.0	0.4	0.1	0.3	1.7	1.6	1.4
Private transfers (net)	1.6	2.0	3.1	3.9	4.9	6.3	8.0	10.2
Official transfers (net)	31.0	31.8	43.6	53.7	45.5	39.9	36.0	33.3
Of which : project grants	25.5	28.4	35.9	50.9	42.8	38.2	35.0	32.3
HIPC Initiative-related grants	3.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current account balance								
Including official transfers	-36.1	-43.4	-60.0	-86.4	-81.1	-80.8	-83.7	-91.5
Excluding official transfers	-67.1	-75.2	-103.6	-140.1	-126.6	-120.8	-119.6	-124.8
Capital and financial account balance	**36.1**	**47.3**	**79.3**	**74.3**	**98.1**	**81.3**	**85.4**	**94.8**
Capital transfer [2]	0.0	162.7	34.8	52.8	0.0	0.0	0.0	0.0
Financial account	36.1	-86.8	44.5	21.5	124.1	81.3	85.4	94.8
Public sector (net)	-7.3	-148.4	-33.5	-38.9	35.6	6.9	5.3	4.9
Project loans	4.4	1.4	1.9	14.9	10.3	7.6	5.7	4.1
Program loans	0.0	2.1	2.0	2.0	2.4	2.4	2.0	2.0
Amortization	-7.4	-178.2	-35.7	-53.7	-0.9	-0.9	-0.8	-0.8
Other investment	-4.3	-2.3	-1.7	-2.1	-2.1	-2.1	-1.6	-0.4
Of which : transfers to JDA	-3.1	-3.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Private sector (net)	43.4	61.6	77.9	60.5	88.5	74.3	80.1	90.0
Direct foreign investment [3]	27.0	52.6	59.1	27.9	50.2	28.2	34.3	45.1
Of which: Oil signature bonuses	0.0	28.6	0.0	0.0	26.0	0.0	0.0	0.0
Commercial banks	0.8	-2.3	-5.5	8.7	13.8	13.9	13.9	14.0
Short-term private capital	15.7	11.2	24.3	23.9	24.5	32.3	31.9	30.8
Errors and omissions	**-6.1**	**8.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**-6.1**	**11.9**	**19.2**	**-12.0**	**17.0**	**0.4**	**1.8**	**3.3**
Financing	6.1	-11.9	-19.2	12.0	-17.0	-0.4	-1.8	-3.3
Change in official reserves, excl. NOA (increase= -)	-11.7	-4.7	-22.6	8.3	4.4	-3.9	-4.8	-5.3
Use of Fund resources (net)	1.2	-0.8	0.7	1.1	1.1	1.1	0.6	-0.6
Purchases	1.2	1.2	0.7	1.1	1.1	1.1	0.6	0.0
Repurchases (incl. MDRI repayment)	0.0	-2.1	0.0	0.0	0.0	0.0	0.0	-0.6
National Oil Account (increase = -)	14.9	-6.3	2.7	2.3	-22.3	2.3	2.4	2.6
Change in arrears (net; decrease = -)	1.7	-10.2	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Current account balance (percent of GDP)								
Before official transfers	-53.5	-51.7	-58.8	-69.7	-59.5	-52.5	-47.7	-45.3
After official transfers	-28.8	-29.9	-34.0	-43.0	-38.1	-35.1	-33.4	-33.3
Debt service ratio (percent of exports) [4]	33.8	24.3	5.1	5.5	7.1	8.0	8.0	10.4
Usable Gross reserves [5, 6]								
Millions of U.S. dollars	24.7	26.3	46.5	38.6	32.6	51.7	56.4	61.7
Months of imports of goods and nonfactor services [7]	4.8	3.4	6.6	5.0	4.0	4.0	4.0	4.0

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 in the hotel sector increases.

[4] In percent of exports of goods and nonfactor services.

[5] Gross reserves exclude the National Oil Account and commercial banks' foreign currency deposit at the BCSTP in order to meet the reserve requirement for their foreign currency deposits or as application deposits for new licensing.

[6] For 2008, includes the proceeds from the privatization of the government's share in the fuel distribution company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the central bank to boost reserves.

[7] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

Table 7. São Tomé and Príncipe: External Financing Requirements and Sources, 2006–13
(Millions of U.S. dollars)

	2006	2007	2008	2009	2010	2011	2012	2013
			Proj.	Prog.		Proj.		
Gross financing requirements	**-88.9**	**-272.6**	**-163.6**	**-187.6**	**-125.2**	**-127.7**	**-126.8**	**-131.9**
Current account, excluding official transfers	-67.1	-75.2	-103.6	-140.1	-126.6	-120.8	-119.6	-124.8
Exports, f.o.b.	7.7	6.8	11.6	8.7	10.1	11.7	12.7	13.7
Imports, f.o.b.	-59.2	-66.9	-92.4	-111.9	-112.3	-114.3	-119.0	-129.2
Services and income (net)	-17.2	-17.1	-25.8	-40.8	-29.4	-24.4	-21.3	-19.5
Private transfers	1.6	2.0	3.1	3.9	4.9	6.3	8.0	10.2
Financial account	-11.8	-182.6	-37.4	-55.8	-3.0	-3.1	-2.4	-1.8
Scheduled amortization [1]	-7.4	-178.2	-35.7	-53.7	-0.9	-0.9	-0.8	-0.8
IMF repayments [2]	0.0	-2.1	0.0	0.0	0.0	0.0	0.0	-0.6
Other public sector flows (net)	-4.3	-2.3	-1.7	-2.1	-2.1	-2.1	-1.6	-0.4
Change in external reserves (increase = -)	-11.7	-4.7	-22.6	8.3	4.4	-3.9	-4.8	-5.3
Change in arrears (net)	1.7	-10.2	0.0	0.0	0.0	0.0	0.0	0.0
Available funding	**88.9**	**272.6**	**163.6**	**187.6**	**125.2**	**127.7**	**126.8**	**131.9**
National Oil Fund (net)	14.9	22.3	2.7	2.3	3.7	2.3	2.4	2.6
Oil signature bonuses	0.0	28.6	0.0	0.0	26.0	0.0	0.0	0.0
Saving (accumulation of oil reserve fund = -)	14.9	-6.3	2.7	2.3	-22.3	2.3	2.4	2.6
Expected disbursements	35.5	198.0	82.3	123.4	58.2	49.9	43.7	39.3
Multilateral HIPC interim assistance	3.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital transfers [1, 2]	0.0	162.7	34.8	52.8	0.0	0.0	0.0	0.0
Grants [3]	27.2	31.8	43.6	53.7	45.5	39.9	36.0	33.3
Concessional loans	4.4	3.5	3.9	16.9	12.7	10.0	7.7	6.1
Project loans	4.4	1.4	1.9	14.9	10.3	7.6	5.7	4.1
Program loans	0.0	2.1	2.0	2.0	2.4	2.4	2.0	2.0
Private sector (net)	37.3	41.0	77.9	60.5	62.5	74.3	80.1	90.0
IMF [4]	1.2	1.2	0.7	1.1	1.1	1.1	0.6	0.0
Financing gap	0.0	10.2	0.0	0.3	-0.3	0.0	0.0	0.0
HIPC debt relief (bilateral creditors) [2]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reschedulable arrears (bilateral creditors)	0.0	10.2	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing (Fund MDRI)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	0.0	0.3	-0.3	0.0	0.0	0.0

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

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

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

[3] Include aid in kind received from Nigeria (Arcadia oil).

[4] Include projected disbursements under the new PRGF.

Table 8. São Tomé and Príncipe: Financial Soundness Indicators for the Banking Sector, 2005–08 [1/]

	2005	2006	2007	2008
		(in percent)		
Capital Adequacy				
Regulatory capital to risk-weighted assets [2/]	33.4	39.4	62.2	58.9
Capital (net worth) to assets	9.6	19.8	16.7	24.1
Asset quality				
Foreign exchange loans to total loans [2/]	68.9	79.5	77.9	74.9
Past-due loans to gross loans	37.6	44.3	26.6	15.7
Nonperforming loans (past-due more than 30 days)	. . .	. . .	. . .	7.9
Watch-listed loans (past-due less than 30 days)	. . .	. . .	. . .	7.8
Provision as percent of past-due loans [3/]	12.9	27.7	53.4	. . .
Earnings and profitability				
Net profit before tax/net income	. . .	-47.6	-24.2	4.5
Return on assets [2/]	-3.8	-3.5	-0.03	0.05
Return on equity [2/]	-18.6	-20.1	-0.18	0.33
Expense (including amortiz. & provisions)/ net income	. . .	126.6	122.2	95.2
Interest rate spread between lending and deposit rates	18.3	18.6	19.7	19.7
Liquidity				
Liquid assets/total assets	46.2	43.5	44.0	46.8
Liquid assets/short term liabilities	69.2	82.0	86.4	92.2
Loan/deposits	56.5	77.2	76.2	72.6
Foreign exchange liabilities/total liabilities	50.5	71.7	71.0	79.3
Sensitivity to market risk				
Foreign exchange liabilities to shareholders funds	. . .	227.0	349.2	287.0

Source: São Tomé and Príncipe authorities and MCM technical assistance report November 2008.

1/ Preliminary data as of June 2008. The BCSTP is still in the process of finalizing the financial soundness indicators.

2/ Updated from the data in the technical assistance report based on the information by the BCSTP. The latest data is as of September 2008.

3/ Not comparable across years due to the change of the definition of past-due loans. The BCSTP is currently in the process of making them comparable.

Table 9. São Tomé and Príncipe: Schedule of Disbursements Under the PRGF Arrangement, 2009–11

SDR Amount	Percent of Quota	Date	Disbursement conditions
370,000	5	03/02/09	Board approval of arrangement.
370,000	5	09/15/09	Observance of PCs for end-June 2009 and completion of the first review.
370,000	5	03/15/10	Observance of PCs for end-December 2009 and completion of the second review.
370,000	5	09/15/10	Observance of PCs for end-June 2010 and completion of the third review.
370,000	5	03/15/11	Observance of PCs for end-December 2010 and completion of the fourth review.
370,000	5	09/15/11	Observance of PCs for end-June 2011 and completion of the fifth review.
370,000	5	03/15/12	Observance of PCs for end-December 2011 and completion of the sixth review

Source: IMF

Table 10: Sao Tome and Principe: Indicators of Capacity to Repay the Fund, 2008–13

	Projections					
	2008	2009	2010	2011	2012	2013
Fund obligations based on existing credit (in millions of SDRs)						
Principal	0.00	0.00	0.00	0.00	0.00	0.40
Charges and interest	0.03	0.02	0.02	0.02	0.02	0.02
Fund obligations based on existing and prospective credit (in millions of SDRs) 1/						
Principal	0.00	0.00	0.00	0.00	0.00	0.40
Charges and interest	0.03	0.02	0.02	0.03	0.03	0.03
Total obligations based on existing and prospective credit 1/						
In millions of SDRs	0.03	0.02	0.02	0.03	0.03	0.43
In millions of U.S. dollars	0.05	0.03	0.03	0.05	0.05	0.67
In percent of exports of goods and services	0.21	0.16	0.14	0.18	0.17	2.15
In percent of debt service 2/	3.94	2.74	1.90	2.24	2.02	20.44
In percent of quota	0.40	0.27	0.27	0.41	0.41	5.81
In percent of gross international reserves	0.07	0.06	0.06	0.09	0.08	1.08
Outstanding Fund credit						
In millions of SDRs	2.5	3.2	4.0	4.7	5.1	4.7
In millions of U.S. dollars	3.8	4.9	6.1	7.3	7.9	7.3
In percent of exports of goods and services	17.4	24.9	27.1	28.5	27.9	23.3
In percent of debt service 2/	329.1	439.0	376.0	349.8	340.8	221.5
In percent of quota	33.4	43.4	53.4	63.4	68.4	63.0
In percent of gross international reserves	6.2	9.4	12.7	14.0	13.9	11.8
Memorandum items:						
Exports of goods and services (millions of U.S. dollars)	21.7	19.8	22.4	25.5	28.2	31.1
Debt service (millions of U.S. dollars) 2/	1.1	1.1	1.6	2.1	2.3	3.3
Quota (millions of SDRs)	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. dollars)	61	52	48	52	56	62
GDP (millions of U.S. dollars)	176	201	213	230	251	275

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

1/ Assumes disbursement of SDR 0.74 million in 2009 under new three-year PRGF arrangement.

2/ After HIPC and MDRI debt relief. Including IMF repurchases and repayments in total debt service.

APPENDIX I—LETTER OF INTENT

São Tomé, February 6, 2009

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

Dear Mr. Strauss-Kahn:

1. São Tomé and Príncipe reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in March 2007 and satisfactorily completed its last three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in June 2008. In 2007, São Tomé and Príncipe received debt relief from the IMF under the Multilateral Debt Relief Initiative (MDRI). São Tomé and Príncipe has also received considerable technical assistance from the IMF, which we have incorporated into our medium-term economic program.

2. The new government of the Democratic Republic of São Tomé and Príncipe has put forward a program of action with three main priorities:

- Promotion of food security through the implementation of programs that help increase domestic production of basic staples, reducing external dependence;
- Improving basic infrastructure and mitigating power supply problems;
- Promoting tourism as an engine of growth of economic activity

3. The choice of the first two of these areas reflects the fact that a large proportion of our population earn a living in small scale agriculture and fishing, and that enabling them to increase their productivity and to bring their products to market will not only help them, but will benefit the population at large, which has suffered as a result of the high prices and frequent scarcity of imported foodstuffs. Addressing these two areas will also improve the conditions for the development of our country's tourism potential while contributing to macroeconomic stability.

4. Our program is built on the premise that macroeconomic stability is a necessary condition for achieving durable gains in those three priority areas and for our broader objectives of development and poverty reduction. Our country has seen robust economic growth in the last few years, and the government strives to make progress in economic stability and structural reforms in a difficult external economic environment. Still, important

challenges persist, including reducing inflation, implementing a fiscal policy that takes into account the uncertainty that surrounds the oil sector, and further strengthening institutions.

5. Following discussions in São Tomé between the government and Fund staff in November 2008, understandings ad referendum were reached on targets for policies that could form the basis for a Fund-supported economic program for 2009-2011. The government has presented its strategy in a Memorandum of Economic and Financial Policies (MEFP), and committed itself to a set of structural and quantitative performance criteria for 2009 (Tables A and B). Two prior actions will be met before the new PRGF-agreement is discussed at the IMF's Executive Board (Table B).

6. The key components of the 2009–11 program are:

- A macroeconomic framework for price stabilization and sustained high growth;
- Steady, gradual fiscal adjustment, curbing the growth of current expenditure and strengthening tax collections, while allowing increases in pro-poor and priority capital spending;
- Gradual use of the balances in the government's National Oil Account and of the proceeds from privatization operations, and;
- Structural reform in the areas of public enterprises, public expenditure management, banking sector prudential regulation, labor regulations, and business climate.

7. To support these objectives and policies São Tomé and Príncipe hereby requests a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), covering the period March 2009-December 2011, in a total amount equivalent to SDR 2.59 million (35 percent of quota), to be provided in seven equal semi-annual disbursements.

8. The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take additional measures if needed. São Tomé and Príncipe will consult with the Fund on the adoption of these measures, and in advance of the revisions to the policies contained in the MEFP, following the Fund's policies on such consultation. São Tomé and Príncipe will provide the Fund with the necessary data for monitoring purposes on a timely basis. During the program period, the government will not introduce or intensify any exchange rate restrictions or multiple currency practice that are inconsistent with Article VIII of the Fund's Articles of Agreement, or introduce or intensify import restrictions for balance of payments purposes.

9. We propose that the Fund carry out the reviews under the 2009 program in July, 2009 and March, 2010, based, respectively, on the observance of end-June 2009 and end-December, 2009 quantitative performance criteria, and a structural performance criterion for end-September 2009, as established in Tables A, B, and C of the attached memorandum.

Subsequent reviews would be based on end-June and end-December targets that will be determined in due course.

10. The government intends to divulge the contents of this Letter of Intent, those of the attached MEFP and Technical Memorandum of Understanding (TMU), and the IMF staff report on the request for a three-year PRGF, and authorizes the IMF to arrange for them to be posted on the IMF website, subsequent to Executive Board approval of the arrangement.

Yours truly,

/s/	/s/
Ms. Ângela Maria da Graça Viegas Santiago 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

APPENDIX I—ATTACHMENT I

SÃO TOMÉ AND PRÍNCIPE: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES
February 6, 2009

I. INTRODUCTION

1. **The Government of São Tomé and Príncipe has embarked on a medium-term program for poverty reduction and growth that can be supported by the International Monetary Fund.** The program's three priority areas are increasing food security through programs that boost domestic food production, improving basic infrastructure, and promoting tourism as an engine of growth, as explained in the *Programa do XIII Governo*, while continuing to ensure macroeconomic stability, which is a necessary condition for the pursuit of our main priorities in a sustainable way. To achieve these objectives, the program will implement rigorous financial policies, an ambitious program of investment (part of which is set out in Table C – a prior action) in key infrastructure areas, and well targeted structural reforms, while safeguarding pro-poor and priority capital spending.

II. RECENT ECONOMIC DEVELOPMENTS

2. **Economic activity remained robust in 2007, with real GDP growth estimated at 6 percent**. Tourism-related construction, communication, commerce, 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. During 2008, we concluded debt reduction agreements with France, Portugal, and Spain, and with the International Fund for Agricultural Development and the European Investment Bank.

3. **Consumer price inflation reached 27.6 percent in 2007 and 37 percent (year-on-year) at the end of June 2008, declining to 30.2 percent in October 2008**. These high readings reflect in part high world prices for food and fuel. In fact, the government raised electricity and water tariffs (by 40-60 percent) and the domestic retail prices of petroleum products (by 14-25 percent) in September 2007; prices of fuels were raised again in July 2008 (by 9-18 percent). Occasional episodes of scarcity of certain goods due to failures in the commercialization chain have further complicated the evolution of prices. In addition, faster-than-programmed liquidity growth in 2007 contributed to the depreciation of the dobra, which fell 26 percent against the euro, the main import currency, in 2007, giving a further boost to inflation. In 2008, however, liquidity control improved, contributing to a more stable exchange rate, while import prices have moderated. As a result of the retreat of world oil prices, as of October 2008, most domestic fuel prices were broadly in line with international prices.

4. **Despite some slippages in the past few years, the government has made progress in fiscal consolidation.** The primary domestic deficit is programmed to fall from nearly 11 percent of GDP in 2005-2006 and 8.5 percent in 2007 to about 6.6 percent in 2008. In the first half of 2008, the deficit was on course to fall as planned on a *commitment* basis; but domestic expenditure arrears emerged due to a shortfall in domestic revenue, delays in the approval of the budget, and some reallocation of resources. Domestic revenues have been broadly stable as a ratio to GDP in the past few years, with an increasing weight of indirect taxes (excises and import duties); even so, tax arrears have accumulated. Meanwhile, government expenditure has gradually fallen as a percent of GDP, although spending on salaries and goods and services was nearly 3/4 of domestic revenue in 2008 and current spending continues to exceed domestic revenue.

5. **The stock of resources available to finance the domestic primary deficits is now lower than we had anticipated a year ago.** Large oil signature bonuses in 2005 and 2007 replenished the National Oil Account (NOA), and the World Bank provided a large budget grant in 2008; we have used the bulk of these resources in the last few years as planned. However, an expected payment of $26 million for blocks 5 and 6 of the Joint Development Zone (JDZ) did not materialize in 2008, and is not expected in the foreseeable future. Although we received $21 million in privatization proceeds in 2008, these are smaller than the shortfall in signature bonuses, and should not finance current expenditures. This leaves the government in a more difficult position at the end of 2008 than it had been anticipated a year ago, when it had been projected that the NOA would climb to $38 million this year; instead, the NOA stood at $12 million in October 2008. At the same time, future oil revenues remain as distant as ever: exploratory drilling in blocks 2 and 4 of the JDZ is now expected to take place in the second half of 2009, further pushing back the eventual date for initiation of production to 2015 or 2016, if the existence of commercially viable reserves were to be confirmed.

6. **In 2008 the Central Bank (BCSTP) has worked actively to control liquidity through the sale of foreign exchange, a task made possible by the close coordination between the Ministry of Planning and Finance and the bank.** While maintaining the usable net international reserves above 3 months of imports, the BCSTP sold $8.1 million in eleven foreign exchange auctions in the first ten months of 2008, helping reduce annual base money growth to 16.5 percent in October 2008. This has curbed the depreciation of the dobra against both the U.S. dollar and the euro in the second and third quarters of the year, which is expected to contribute to moderating inflation in the months ahead.

7. **The exchange rate of the dobra remains market-based, although the government is considering a reform of the exchange rate system**. The BCSTP intervenes in the exchange rate market with the objective of managing liquidity, while allowing the market to determine the exchange rate. The government has begun conversations with Portugal on a possible exchange rate agreement along the lines of that in force between Portugal and Cape Verde. Under such an agreement, São Tomé and Príncipe would peg its dobra to the euro,

and Portugal would provide support to that peg with a line of credit, within the context of a jointly agreed program of sustainable macroeconomic policies for São Tomé and Príncipe. The two governments have formed a bi-national commission to conduct technical discussions during the months ahead.

8. **Several important structural reforms were implemented recently, but the overall pace of reform needs to be accelerated.** In 2008, the National Assembly approved the AML/CFT law, a new investment code, and the direct tax reform package. In the banking sector, the BCSTP issued various prudential regulations and strengthened bank licensing requirements. In addition, the government sold a controlling stake in the national fuel distribution company, ENCO, in September 2008. However, our AML/CFT framework still needs improvement. Besides, frequent government changes have had adverse effects on the implementation of other reforms, and the remaining structural problems are significant.

9. **Public enterprise reform remains a challenge**. Under a reform strategy for the water and electricity company, EMAE, utility tariffs were increased and, for a small number of customers, prepaid electricity meters were installed to strengthen payment collection. Nevertheless, continued collection problems have resulted in the financial bankruptcy of the company. Also, the water and electricity infrastructure needs repair and investment, and EMAE's operational efficiency remains low. Meanwhile, large arrears in payments among EMAE, ENCO and the government have continued to accumulate. Similarly, ENASA, the airport operator, has difficulties in covering its operating costs, while ENAPORT, the seaport managing company, suffers from excessive costs and low efficiency.

III. Medium-Term Economic Policy Framework (2009-2011)

10. In order to pursue the development objectives outlined in the *Programa do XIII Governo*, the strategy to be followed will emphasize developing productive capacity in agriculture, with a special emphasis on the provision of material and technical support for small producers; rehabilitating and building key infrastructure, especially in electricity generation, transportation and communications; and creating conditions for the development of private business, especially in the tourism sector. The government is seeking support for this strategy from its development partners and engaging with reputable private firms to help implement it. To create a suitable environment for its overall strategy, the government is committed to implement policies that foster macroeconomic stability. Early in 2009, the government will present its strategy in fuller detail, in the form of a new Strategic Plan for National Development.

11. **The macroeconomic goals for the next three years are the following**: (i) an average rate of GDP growth of 6.3 percent over 2009-2011; (ii) gradually reducing inflation to single digits; (iii) increasing the tax base and strengthening domestic revenue collection; (iv) improving the management and effectiveness of public expenditure; (v) continuing the process of fiscal consolidation to ensure the sustainability of public finances even in an

adverse oil scenario; (vi) maintaining international reserves at a level sufficient to cover 4 months of imports; (vii) preserving banking system stability and strengthening the ability of the banking system to support the development of the real sector; and (viii) facilitating a smooth transition toward a new exchange rate regime.

12. **The acceleration of real economic growth is expected to come largely from construction, fueled by the public infrastructure program and foreign direct investment, in particular by the start of the work on the new deep seaport, which is expected for 2010.** We also expect to see improvements in production in the agricultural sector as a result of government interventions in support of small farmers. Tourism will continue to contribute to economic activity now that a major hotel chain has expanded its capacity in São Tomé and Príncipe and additional flights to the country are in operation, resulting in a reduction of ticket prices. In order to foster a sustained dynamic performance by the real economy, the government will strengthen its own investment program and implement reforms aimed at stimulating private investment, including by modernizing the labor and commercial regulatory frameworks.

13. **Fiscal consolidation will continue over the medium term.** We aim to reduce the primary domestic deficit from 6.6 percent of GDP in 2008 to about 3.3 percent by the end of the program period in 2011, with the goal of stabilizing it below 3.0 percent by 2013. We will redouble our efforts to mobilize domestic revenues by widening the tax base and increasing tax compliance in order to create fiscal space for necessary public expenditure. We will also follow through on the implantation of the SAFE, which will help the government improve the management of public resources. We will also prioritize spending that directly supports the attainment of the three strategic priorities of the government program; in particular, we will ensure that maintenance and other capital expenditures are not crowded out by current expenditure. Over the next three years we will put into effect law 5/97, which mandates full transparency in the reporting and budgeting of the compensation of public servants and a decompressed salary structure, by granting salary increases in line with the growth in real productivity. The government will also continue advancing in the restructuring of the public enterprise sector and the elimination of inter-enterprise arrears. In pursuing its fiscal goals, government policies will be guided by the principles of avoiding nonconcessional and monetary financing of fiscal deficits. In addition, the government will study the possibility of using an approach towards proceeds from privatization operations similar to the approach we use in the case of oil revenues, given the strong similarities between these two sources of financing and the proven worthiness of our Oil Revenue Management Law. Under such an approach, a dobra-denominated account could be created at the BCSTP where proceeds from the sale of ENCO shares, and other privatization operations that may take place in the future, would be deposited, and starting in 2010, one fifth of the starting balance of that account each year would be available to finance the domestic primary deficit.

14. **Monetary policy will target a reduction in inflation to low double digits early in the program period and to single digits by its end.** For as long as the current monetary and exchange rate framework remains in effect, the BCSTP will continue to use foreign exchange auctions to control liquidity and moderate currency depreciation. The central bank will also continue strengthening banking sector supervision and is committed to take the necessary steps to reduce the risk of distress in the banking system, which has been expanding rapidly. The framework for banking regulation will be further improved by 2010; other reforms, such as the establishment of a Bureau of Credit registry (structural benchmark for end-December) and the introduction of a network of automatic teller machines and debit cards, will tend to improve the productivity of the banking system and its ability to support the functioning of the real economy.

15. **The government is studying the possible modification of the country's exchange rate regime, for which it is discussing an agreement with Portugal.** It expects the joint technical work with the Portuguese authorities to be concluded during the course of 2009, and to make a final decision once this preliminary work is concluded. The government is aware of the need for the strictest discipline in the conduct of fiscal policy for the viability of a fixed exchange rate. The decision on a new regime will be made only after the most careful consideration has been given to these issues and to the design of a transition strategy. The timeline just outlined also allows the BCSTP to make headway in the current disinflation process in advance of the possible pegging of the exchange rate.

16. **External inflows (both private and official) are expected to continue to finance the current account deficits**, which are projected to remain sizable during 2009-11, reflecting still high import prices and strong demand for FDI-related imports. However, the macroeconomic outlook for São Tomé and Príncipe is not immune to the risks from the ongoing global crisis. Of particular note are risks to the financing available to foreign investors interested in São Tomé and Príncipe, risks to the flow of resources from development partners, and risks from the still high prices of food imports. The focused implementation of our program will help reduce the country's vulnerability to those risks.

IV. Macroeconomic Policies for 2009

17. **For 2009, our macroeconomic framework aims for a real GDP growth of at least 5.5 percent, reduce annual inflation to 16 percent by the end of the year, and keep international reserves at no less than 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, restore fiscal sustainability over the medium term, and mobilize support from the World Bank and other multilateral and bilateral development partners.

A. Fiscal Policy

18. **The Government plans to further reduce the domestic primary deficit to 4.5 percent of GDP in 2009, from 6.6 percent in 2008**. Fiscal consolidation in

the 2009 budget would come mainly from the containment of current expenditure growth, because the recently approved direct tax reforms would be largely neutral, while other revenues in 2009 are of moderate size and/or nonrecurring. The domestic primary deficit is expected to be financed by the remainder of the IDA Development Policy Operation (DPO) grant ($1.5 million), a draw-down of $2.4 million from the National Oil Account (NOA), and a drawdown of other government balances with origin in the privatization of ENCO for an amount of about $4 million. The government is seeking additional budget support from its development partners; if such support is obtained, the primary deficit may increase by the equivalent of up to 0.5 percent of GDP. To avoid financing consumption with the liquidation of assets, government capital expenditure will be no smaller than the drawdown of privatization related resources. If the execution of the priority treasury funded capital projects listed in Table C of this MEFP is faster (slower) than in our baseline projection, the primary deficit limit will be adjusted upward (downward) by up to 62 billion dobras, as explained in the attached Technical Memorandum of Understanding. The additional capital spending would be financed with resources from privatization operations. During the two reviews of the program in 2009, the Government and Fund staff, with help from the World Bank, will monitor the execution of capital spending under this provision, and will make adjustments if it is needed to ensure macroeconomic stability. There will be no recourse to domestic banking system credits.

19. **On the revenue side, the Government will focus on the following actions**:

- Strengthening tax and customs administration. 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, all with support from the Portuguese authorities and the U.S. Millennium Challenge Corporation (MCC). To facilitate tax arrears collections, the Government intends to set up a tribunal to settle tax disputes by 2011.

- The government will reform the tax legal framework to grant the tax authority power to accept limited debt deferrals—allowing tax obligations to be paid in installments (structural benchmark for end-September, 2009). This change will help prevent the accumulation of chronic, un-payable tax arrears. As an interim measure to deal with existing arrears, and for a limited time, the Government may introduce a temporary phased payment facility for taxpayers who come forward to regularize their tax debts. A regulation will establish the cases in which the taxpayer may benefit from a partial pardon of some overdue taxes, late interest and fines.

- In addition, the government will receive some one-time payments from oil firms, via the JDA, and from the new concessionaires in the seaport and airport projects. The government will be careful to ensure that the availability of these temporary resources does not lead to the creation of permanent expenditure obligations.

20. **In the period ahead, the Ministry of Planning and Finance will strengthen expenditure management in order to prevent the recurrence of expenditure overruns.** We will follow through on the implementation of the computerized public financial management system (SAFE/SAFINHO). Specifically, the Ministry of Planning and Finance will procure and install IT equipment and software (structural performance criterion for end-September, 2009) and establish a Directorate of Accounting and an IT office (structural benchmark for end-September, 2009). We intend to make progress in training users of the system at the level of spending entities in the following months.

21. **Other expenditure measures planned for 2009 include**:

- **Public wage reform**. As part of its civil service reform strategy and to increase transparency, the Government has the intention over the next three years to (i) integrate expenditures in goods and services that directly support civil servants into the fringe benefits account; (ii) incorporate into the salary some elements of the compensation package which have so far been excluded; and (iii) decompress the salary structure. The steps in this area aim to make fully effective law 5/97. A comprehensive wage study will be carried out in 2009, which will allow the introduction of a revised government salary structure with incentives for productivity in subsequent years.

- **Personnel costs**. The 2009 budget acknowledges the need to update the compensation package for public servants. The increases in salary and benefits will permit total real remunerations to rise broadly in line with productivity growth in 2009. This is sufficient to ensure the recovery of the purchasing power of civil servants' compensation packages, while maintaining the same level of the wage bill and fringe benefits in the central government as a percent of GDP relative to 2008 (8.6 percent of GDP).

- **Adjusting non-wage current spending**. Discretionary expenditures on goods, services, and other items, especially outside those priority areas, will be restrained as needed to stay within available resources.

- **Assisting the most vulnerable segments of the population**. We plan to achieve this goal by strengthening implementation of HIPC-related expenditure programs and selected targeted schemes, such as the school meals program. The latter is key to help the population cope with high import prices for food. Our work to improve our public financial management will also help monitor pro-poor spending more effectively.

- **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 Treasury funded investment projects and maintenance.

- **If the revenues and budget support which are still to be verified do materialize, the government will allow selected current expenditure to rise.**

22. **To strengthen the monitoring and execution of the 2009 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. The government will make every effort to avoid the emergence of payments arrears in 2009.

23. **The Government will review with the Fund the medium-term fiscal and financing strategy, including the use of NOA resources, after the information from the exploratory drilling in mid/late 2009 becomes available**. If prospects for oil production and exports were to deteriorate significantly relative to current expectations of a start of production by 2015/16, the fiscal program will be revised.

B. Monetary, Financial, and Exchange Rate Policies

24. **Under the current monetary and exchange rate framework, to keep inflation on a downward path, the BCSTP must sustain its effort to retire excessive liquidity, thus controlling dobra base money growth.** Our monetary program for 2009 aims to keep base money growth in line with the program's objective of reducing inflation to 16 percent by year end and with the projected increase in demand for real monetary balances. 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 primarily on fiscal restraint and foreign exchange sales to control liquidity. Therefore, the BCSTP will continue to use foreign exchange auctions actively, taking care of maintaining at all times a strong level of reserves. Nevertheless, at some points during the year, it may be necessary for the BCSTP to temporarily provide dobra liquidity to the banking system and to buy back foreign exchange; in those cases the BCSTP may conduct reverse foreign currency auctions and / or make credit available to banks.

25. **The BCSTP and the Treasury Department of the Ministry of Planning and Finance will continue their close cooperation, which in 2008 helped ensure that the BCSTP could take timely action to offset the monetary impact of budget-based operations**. 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. Public expenditure is a major determinant of base money creation and the BCSTP does not have instruments to conduct open market operations, other than foreign exchange auctions; therefore, the Government will stand ready to reduce its own spending if

this were to be necessary to meet the program's NIR target. This would in a first instance involve the selected expenditure items referred to in the last bullet of paragraph 21.

26. **The BCSTP is committed to deepening foreign exchange market reform**. Accepting the obligations under Article VIII, Sections 2(a), 3, and 4, of the IMF's Articles of Agreement remains our goal over the medium term. To eliminate the remaining multiple currency practice, the BCSTP will review possible measures to ensure that the various exchange rates in Sao Tome and Principe remain within the two percent for spot transactions, including a new mechanism for setting the daily official exchange rate, based on a careful review of domestic market conditions. During the program period, we intend to take measures, within our possibilities, to eliminate the exchange restriction, arising from the new investment law, regarding the transferability of net income from investment, and we also intend to discuss with staff measures to eliminate the multiple currency practice and put in place a time-table for its removal.

27. **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 without delay. 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.

28. **We intend promptly to implement the recently approved AML/CFT law and to improve it further with the help of our development partners, and to continue to strengthen supervision**. The BCSTP has introduced stricter requirements for issuing bank licenses, including a higher minimum capital requirement, has implemented various prudential regulations, and started off-site inspections. The BCSTP will complete the first round of off-site inspections and finalize the first Financial Conditions Quarterly Report in March 2009. The central bank will also start on-site bank inspections (structural benchmark for end-March 2009) and complete the first round for all banks by end-2009. 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 Bureau of Credit Registry (structural benchmark for end-December, 2009) to facilitate credit information sharing among banks. The BCSTP plans to prepare a framework to facilitate mergers and acquisitions among banks by 2010.

C. Structural Reforms

29. **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) enact and implement a revised labor

code (structural benchmark for end-June, 2009); (ii) submit draft legislation, prepared in consultation with the private sector, to create the "one-stop window" - "*guichet unico*"- (structural benchmark for end-September, 2009), reduce red tape and other regulatory impediments to start a business ; and (iii) with external technical assistance, complete the revision of the commercial codes (structural benchmark for end-December, 2009). Revisions to the labor code would aim more clearly to define hiring and firing rules, remove ambiguities in contractual employment arrangements, and increase labor market flexibility by eliminating regulatory impediments.

30. **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.

31. **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 our development partners to promote agricultural marketing, commercial fishing, and tourism-related services. The government will put into effect the automatic mechanism to update fuel prices on a monthly basis (structural benchmark for end-June) in line with the variation of world prices and the exchange rate of the dobra. We will also address EMAE's financial and technical weaknesses through tariff and other reforms, increase the productivity of ENASA and ENAPORT through outsourcing (e.g. cleaning, security guards), and continue our work to attract investment to upgrade our infrastructure, as we have done in the case of the seaport.

D. Debt Management

32. **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 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 the Arab Bank for Economic Development in Africa (BADEA) and will try to conclude these agreements as soon as possible. We plan to introduce the Framework Law for Public Debt; a first draft is expected by end-September 2009 (structural benchmark), and a definitive draft will be submitted to the National Assembly in December 2009.

E. Capacity Building

33. **São Tomé and Príncipe continues to need external support to build capacity for policy monitoring and implementation**. Our bilateral and multilateral development partners are providing support for our public financial management reform, as well as for strengthening tax and customs administration and macroeconomic analysis at the Ministry of Planning and Finance. We are also benefiting from advice on how to improve the business environment. We will welcome additional support from the IMF in the areas of banking supervision, public finances, and statistics. To facilitate the completion of the updated safeguards assessment before the first review under the arrangement, we will provide all the necessary information and will welcome a safeguards assessment mission as deemed necessary in 2009. We will also welcome a mission from the IMF's Legal Department for enhancing our AML/CFT framework.

34. **We will further improve our economic statistics**. With support from our development partners, we will revise our national income and product statistics. Further progress will also be made to improve budget classification and the consistency between monetary and fiscal data.

F. Program Monitoring

35. **To facilitate expenditure control and liquidity management, performance criteria and indicative targets for selected fiscal and monetary variables are set for 2009** (Table A). These include indicative ceilings for dobra base money. 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. A number of structural benchmarks and performance criterion are detailed in Table B.

36. **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 budget support, and net external debt service payments; and data sources and frequency of data reporting.

37. **We will update our PRSP in line with the new Strategic Plan for National Development now under preparation**, and also when new information on oil prospects becomes available, especially after information from further oil exploratory drilling in the JDZ.

Table A. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2009
(Billions of dobras, cumulative from beginning of year, unless otherwise specified)

	2009			
	end-March	end-June	end-September	end-December
	Indicative Target	Performance Criteria	Indicative Target	Performance Criteria
Performance criteria:				
1 Floor on domestic primary balance (as defined in the TMU) [1]	-26	-84	-110	-143
2 Ceiling on changes in net bank financing of the government (at program exchange rate) [1,2,3,4]	28	89	118	146
3 Ceiling on changes in net domestic assets of the central bank (at program exchange rate) [1,2,3,4]	62	88	144	162
4 Floor on changes in the net usable international reserves of the central bank (in US$ millions) [3, 4]	-7	-7	-8	-10
5 Ceiling on central government's outstanding external payment arrears (stock, in US$ millions) [5]	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 (in US$ millions) [5, 6]	0	0	0	0
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, in US$ millions) [5, 6, 7]	0	0	0	0
Indicative targets:				
Ceiling on dobra base money (stock, in billion dobras) [8]	269	258	291	314
Memorandum items:				
Privatisation account - stock (US $ million)	...	...	...	17
Transfer from NOA to the budget (in US$ millions)	0.0	2.4	2.4	2.4
Net external debt service payments (in US$ millions)	0.3	0.5	0.8	1.1
Official external program support (in US$ millions) [9]	8	15	23	31
Treasury -funded capital expenditure (in billion dobras)	23	46	68	91

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

[1] 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] Excluding the National Oil Account (NOA) at the Central Bank .

[4] The floor on net usable international reserves will be adjusted upward or downward according to definitions in the TMU.

[5] 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 receive

[6] Only applies to debt with a grant element of less than 50 percent (defined as non-concessional for least developed countries).

[7] Debt is defined as in point 9 of the *Guidelines on Performance Criteria with Respect to Foreign Debt* (August 24 2000).

[8] BCSTP targets the dobra component of base money, rather than total base money, since the latter includes a large, volatile foreign currency component.

[9] Official external program support, as defined in the TMU, valued at the program exchange rate .

Table B. São Tomé and Príncipe: Prior Actions and Structural Performance Criteria and Benchmarks for 2009

Action	Performance Criteria / Benchmark	Status
Prior actions		
• Prepare the 2009 budget in line with the organic law (SAFE) and submit to National Assembly.		Done
• Prepare a detailed list of priority treasury-funded capital projects for 2009, indicating their size in millions of dobras, a summary timetable, and the government agency responsible for execution (Table C of this MEFP).		Done
End-March 2009		
• Adopt the 2009 budget in line with the PRGF-supported program.	Benchmark for January, 2009	Done
• Start on-site banking supervision inspections.	Benchmark	
End-June 2009		
• Fully implement the automatic pricing mechanism for petroleum products.	Benchmark	
• Submit new labor law to the National Assembly	Benchmark	
End-September 2009		
• Establish a Directorate of Accounting and an IT office at the Ministry of Planning and Finance.	Benchmark	
• Purchase and install IT equipment related to the SAFINHO.	**Performance Criterion**	
• Prepare a draft Framework Law for the Public Debt.	Benchmark	
• Establish the "Guichet Unico" – one stop window.	Benchmark	
• Submit reform of the tax laws to grant the tax authority power to accept limited debt deferrals.	Benchmark	
By December 2009 or later		
• Prepare the 2010 budget in line with the organic law (SAFE) and submit to National Assembly.	Benchmark for end-November, 2009	
• Prepare an action plan to address prudential issues in the banking system.	Benchmark for end-December, 2009	
• Establish a bureau of credit registry.	Benchmark for end-December, 2009	
• Complete a draft new commercial code to reduce the cost and time of doing business.	Benchmark for end-March, 2010	
• Prepare regulations under the SAFE budget law.	Benchmark for end-June, 2010	
• Put in place intervention and closure processes for the banking system.	Benchmark for end-June, 2010	

Table C. São Tomé and Príncipe - Implementation Plan of the Government's Investment Program, 2009 [1, 2, 3]

Code	Agency	Sub-Program	Project	Amount [4]	Planned Dates (tentative)			Progress to Date
					Approval of Terms of Reference	Conclusion of Procurement	Conclusion of Project	
29.0.00	Ministry of Education	039-Construction and rehabilitation of Secondary Schools	Rehabilitation of the Patrice Lumumba Secondary School	1000	March	May	September	Terms of Reference and/or Procurement under preparation
			Rehabilitation and equipment of the Santana Secondary School	475	February	April	August	Terms of Reference and/or Procurement under preparation
			Rehabilitation of school infrastructures	400	March	May	September	Terms of Reference and/or Procurement under preparation
		041-Secondary Level Development	Construction/rehabilitation and equipment of the Lembá Delegation of Education	200	February	March	May	Terms of Reference and/or Procurement under preparation
		036-Construction and rehabilitation of Primary Schools	Construction of walls at the Conde Basic School	300	February	March	May	Terms of Reference and/or Procurement under preparation
31.0.00	Ministry of Natural Resources	108-Power distribution network: capacity expansion	Power network expansion to the Algés/Ototó/M.Angolares/A.Soares areas	3000	February	April	September	Terms of Reference and/or Procurement under preparation
		083-Water collection and distribution network: capacity expansion	Moreira I water project	5300	February	April	November	Terms of Reference and/or Procurement under preparation
32.0.00	Ministry of Public Works	112-Construction, modernization and rehabilitation of the road system	Capital and suburbs road network re-qualification	3000	March	April	September	Terms of Reference and/or Procurement under preparation
			Ribeira Afonso access rehabilitation	2903	February	March	July	Terms of Reference and/or Procurement under preparation
			S. Nicolau bridge rehabilitation	1688	March	May	November	Terms of Reference and/or Procurement under preparation
			Construction of the aqueduct accessing Água Arroz	2000	March	May	December	Terms of Reference and/or Procurement under preparation
			Reconstruction of a protection wall at Emília Beach	881	February	March	June	Terms of Reference and/or Procurement under preparation
			Rehabilitation of deteriorated road areas	50672	March	May	December	Terms of Reference and/or Procurement under preparation
			"Road Fund" -- road maintenance	11250	February	April	December	Terms of Reference and/or Procurement under preparation
33.0.00	Ministry of Health	057-Basic Health equipment	Laboratory equipment for the STP Hospital Center and Health Areas	3600	March	April	July	Terms of Reference and/or Procurement under preparation
			X-ray equipment	765	February	March	May	Terms of Reference and/or Procurement under preparation
			Equipment for Surgery facilities	2321	March	April	July	Terms of Reference and/or Procurement under preparation
		074-Health policy management	Emergency ambulance	490	March	April	June	Terms of Reference and/or Procurement under preparation
			Equipment for STP Health Areas	1080	February	March	May	Terms of Reference and/or Procurement under preparation
		146-Science, Technology and Innovation in the Health area -- research	Implementation of the Health Information System	500	February	March	June	Terms of Reference and/or Procurement under preparation
		056-Construction, rehabilitation and equipment of Health Infrastructures	Construction of the Cantagalo Health Center (conclusion)	2000	February	March	July	Terms of Reference and/or Procurement under preparation
			Construction of the morgue and other facilities related with the Cantagalo Health Center	600	February	March	June	Terms of Reference and/or Procurement under preparation
70.0.00	Autonomous Region of Principe [5]	083-Water collection and distribution network: capacity expansion	Water supply facilities	2000	March	May	October	Terms of Reference and/or Procurement under preparation
		112-Construction, modernization and rehabilitation of the road system	Construction of a section of the Airport-Santo António road	5000	April	June	December	Terms of Reference and/or Procurement under preparation
		082-Housing support to poor families	Construction of 40 social houses for poor families	7000	March	May	December	Terms of Reference and/or Procurement under preparation
			TOTAL:	**108,424**				

1. This matrix corresponds to the 2009 government plan for investment on roads, bridges, schools, water, and power, to be financed using 2008 privatization proceeds. It includes spending on new construction, rehabilitation, and maintenance.
2. This matrix is updated on a quarterly basis and will be reported to the IMF as part of the statistical requirements of the PRGF-supported program.
3. Normal ministerial expenditure on wages and salaries and the purchase of goods and services related to the projects will not be classified as capital expenditures.
4. These amounts (in millions of dobras) are indicative, since final figures will be contingent on the results of the procurement process (which follows international best practices, having been designed with World Bank and ADB support).
5. Due to the special political statute of Prínicipe, projects in the island (otherwise of the same nature as those in São Tomé island) are identified separately.

Appendix I—Attachment II

São Tomé and Príncipe: Technical Memorandum of Understanding

1. This technical memorandum of understanding (TMU) contains definitions and adjuster mechanisms that clarify the measurement of variables in Table A, Quantitative Performance Criteria, and Indicative Targets under the PRGF arrangement for 2009–11, 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 the beginning of each calendar year.

I. Provision of Data to the Fund

2. Data with respect to all variables subject to performance criteria and indicative targets will be provided to Fund staff monthly with a lag of no more than four weeks for data on 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 the primary balance and net bank financing of the central government, net domestic assets and net usable international reserves of the central bank, external payments arrears, new nonconcessional short-term and medium- and long-term external debt owed or guaranteed by the central government and/or the central bank.

II. Definitions

3. **Government** is defined for the purposes of this TMU to comprise the central government, which includes all governmental departments, offices, establishments, and other bodies that are agencies or instruments of the central authority of São Tomé and Príncipe. The central government does not include the operations of state-owned enterprises.

4. **Government domestic revenue (excluding oil revenue)** comprises all tax and non-tax revenue of the government (in domestic and foreign 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 the government on account of oil signature bonus receipts and accrued interest on the National Oil Account (NOA). Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and the Directorate of Treasury in the Ministry of Planning and Finance.

5. **Domestic primary expenditure** comprises all government spending assessed on a commitment basis (base *compromisso*), excluding capital expenditure financed with external concessional loans and grants and scheduled interest payments. Reporting of government

domestic expenditure will be based on the state budget execution prepared every month by the Directorate of Budget and the Directorate of Treasury in the Ministry of Planning and Finance.

6. Within domestic primary expenditure, **pro-poor expenditure** refers to government outlays recorded in the new 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. **Pro-poor current spending**: These cover the following ministries and expenditure categories (by budget code) as described in the matrix below:

Code	Description of expenditure	Ministry of Education	Ministry of Health	Ministry of Labour
01.00.00	Personnel expenses	x	x	x
02.01.05	Other durable goods	x	x	
02.02.02	Fuel and lubricants	x	x	x
02.02.04	Food	x		
02.02.05	Medicine	x	x	
02.02.06	Clothing and footwear	x	x	x
02.02.09	Other nondurable goods	x	x	
02.03.01.01	Water and energy	x	x	x
02.03.02	Custody of goods	x	x	
02.03.06	Communications	x	x	x
04.02.01	Private institutions	x		x
04.03.01	Individuals	x		x
04.04.02	Other outward transfers		x	
06.01.00	Education and training		x	
06.04.01	Project costs	x		
06.04.04.02	Miscellaneous	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.

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

7. **Treasury-funded capital expenditure:** This is classified as part of domestic primary expenditure and covers projects that are not directly financed by grants and concessional loans. For 2009, the projects that comprise total potential expenditure under this category fall in two groups: (i) a group of projects worth 29 billion dobras to be financed with traditional sources of funds, and (ii) a group worth up to 124 billion dobras to be financed by drawing down the proceeds from the privatization of ENCO. The privatization-financed projects comprising the second group are listed individually in Table C of the MEFP, which is exhaustive. The baseline projection in the program is that the projects in the second group will be executed by 50 percent in 2009. Treasury-funded capital spending will correspond to items of the type indicated in the following matrix, which was agreed with the IMF staff:

Sao Tome and Principe - Definition of Treasury Funded Capital Expenditure, 2009 [1, 2, 3]				
Description of expenditure	**Ministry of Public Works**	**Ministry of Education**	**Ministry of Health**	**Ministry of Natural Resources**
Expenditure on new roads	x	...	...	...
Machinery and equipment	x	...	...	...
Maintenance of roads	x	...	...	...
Maintenance	x	...	...	...
Machinery and equipment	x	...	...	...
Expenditure on new bridges	x	...	...	...
Machinery and equipment	x	...	...	...
Maintenance of bridges	x	...	...	...
Maintenance	x	...	...	...
Machinery and equipment	x	...	...	...
Building rehabilitation	x	x	x	x
Maintenance	x	x	x	x
Machinery and equipment	x	x	x	x
New buildings	x	x	x	...
Diagnostic clinics	x	...	x	...
New schools	x	x	...	...
Laboratories	x	x	x	...
IT equipment	...	x	x	...
New power plant	...	...	...	x
Machinery and equipment	...	...	...	x
Machinery	...	...	...	x
New location and building	...	...	...	x
Electric Grid	...	...	...	x
Maintenance	...	...	...	x
Machinery and equipment	...	...	...	x

1/ This matrix corresponds to the 2009 government plan for investment on roads, bridges, schools, water, and power. It includes spending on new construction, rehabilitation, and maintenance.
2/ This matrix will be updated on a yearly basis in line with the government's new investment plans.
3/ Expenditure on wages and salaries and the purchase of goods and services related to the projects will not be classified as capital expenditure.

8. The **domestic primary balance** is defined as the difference between government domestic revenue and domestic primary expenditure. For reference, this balance for end-December 2008 is projected at -169 billion dobra, broken down as follows:

Government domestic revenue:		419 billion
Less:	Government primary expenditure: (as defined in paragraph 5)	588 billion
Equals:	Domestic primary balance:	-169 billion

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

10. **The program exchange rate** for the purposes of this TMU will be 15,897 dobra per U.S. dollar. The exchange rate of the dobra against the euro will be 21,783 dobra per euro and against the SDR will be 24,411 dobra per SDR for 2009.

11. **Net bank financing of the central government (NCG)** is defined as the stock of all outstanding claims on the government held by the BCSTP and by deposit money banks

(DMBs),[18] less all deposits held by the central government with the BCSTP and with DMBs, as they are reported monthly by the BCSTP to the IMF staff. Although the balance of the National Oil Account (NOA) is not included in NCG, the annual flow from the balance of the NOA to the government's budget is included. All foreign exchange–denominated accounts will be converted to dobras at the program exchange rate. For reference, at end-December 2008, outstanding net bank financing of the government excluding NOA is projected to be at – 295 billion dobra, broken down as follows:

BCSTP credit, including use of IMF resources:			125 billion
Less:	Government deposits with BCSTP:		532 billion
	Of which:	Balance of the National Oil Account (NOA)	183 billion
		Treasury foreign currency–denominated accounts	237 billion
		Treasury dobra–denominated accounts	89 billion
		Counterpart deposits	22 billion
Equals:	Net credit to government by the BCSTP		– 406 billion
Plus:	DMBs credit		0 billion
Less:	Government deposits with DMBs (including counterpart funds)		33 billion
Equals:	Net bank financing of the government		– 440 billion
Less:	Balance of the National Oil Account (NOA)		–183 billion
Plus:	Annual flow from the NOA to the budget		– 39 billion
Equals:	Net bank financing of the government excluding NOA		– 295 billion

12. **Dobra base money** is defined as the sum of currency issued—which consists of currency outside banks and cash in vaults—and bank reserves denominated in dobra. Bank reserves refer to reserves of commercial banks - in dobra - held with the central bank and include reserves in excess of the reserve requirements. For reference, at end-December 2008 dobra base money is projected to be at 283 billion dobra, calculated as follows:

Currency issued:			141 billion
	Of which:	Cash in vaults	10 billion
		Currency outside banks	130 billion
Plus:	Bank reserves denominated in dobras		143 billion
	Bank reserves denominated in foreign currency		212 billion
Equals:	Base money		496 billion
Less:	Bank reserves denominated in foreign currency		212 billion
Equals:	Dobra base money		283 billion

13. **Net usable international reserves** (usable NIR) of the BCSTP are defined for program-monitoring purposes as short-term foreign assets of the BCSTP minus short-term external liabilities including liabilities to the IMF. All short-term foreign assets that are not

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

fully convertible external assets nor readily available to and controlled by the BCSTP (i.e., they are pledged or otherwise encumbered external assets, including but not limited to the HIPC umbrella SDR account and assets used as collateral or guarantees for third-party liabilities) will be excluded from the definition of usable NIR. The balance of the NOA at the BCSTP is also excluded but the annual flow from the NOA to the budget is included. Bank reserves denominated in foreign currency are also excluded. From this, usable NIR is reached. All values are to be converted to U.S. dollars at actual market exchange rates prevailing at the test date. For reference, at end-December 2008 usable NIR is projected to be at 617 billion dobra, calculated as follows:

Gross international reserves:		1,116	billion
Less:	Short-term liabilities (including guaranteed deposits by banks and liabilities to the IMF)	103	billion
Equals:	Net international reserves	1,013	billion
Plus:	Other foreign assets	190	billion
Less:	Medium and long-term liabilities	0	billion
Equal	Net foreign assets	1,204	billion
Net international reserves:		1,013	billion
Less:	NOA	183	billion
	Banks reserves denominated in foreign currency	212	billion
Equals:	Net usable international reserves	617	billion

14. **Net domestic assets (NDA)** 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 program exchange rates. The balance of the NOA at the BCSTP is also excluded but the annual flow from the NOA to the budget is included. All foreign-denominated accounts will be converted to dobras at the program exchange rate. For reference, at end-December 2008, net domestic assets are projected to be at 708 billion dobra, calculated as follows:

Base money:		496	billion
Less:	Net foreign assets:	1,204	billion
Equals:	Net domestic assets of the BCSTP:	708	billion

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) owed or guaranteed by the government and/or the BCSTP.[19] For reference, at end-December 2008 the stock of short-term external debt is projected to be zero.

[19] The term "debt" is defined in accordance with point 9 of the IMF *Guidelines on Performance Criteria with Respect to Foreign Debt* (IMF Decision No. 12274-(00/85), August 24, 2000).

16. The performance criterion on **nonconcessional medium- and long-term external debt** is a continuous performance criterion that refers to the contracting or guaranteeing of new external debt with original maturity of more than one year by the government and/or the BCSTP.[20] [21] Debt rescheduling and restructuring are excluded from the ceilings set on nonconcessional borrowing. Medium- and long-term debt will be reported by the Debt Management Department of the Ministry of Finance and Planning and (as appropriate) by the BCSTP, measured in US dollars at the prevailing exchange rates. The government should consult with IMF staff before contracting new debt obligations.

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 Department and (as appropriate) by the BCSTP, except for arrears pending rescheduling arrangements. The latter are considered as technical arrears. Debt would be deemed to be in arrears when it has not been paid by the time it is due, unless arrears have otherwise been contractually defined. The performance criterion relating to external arrears does not apply to those arrears 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 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 earmarked for a budgeted spending item, and other exceptional financing provided by foreign official entities and incorporated into the budget. Amounts assumed in the program consistent with this definition are shown in Table A of the MEFP as a memorandum item entitled "official external program support".

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[20] This performance criterion applies not only to debt as defined in point 9 of the IMF *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.

[21] 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. For least developed countries such as São Tomé and Príncipe, a loan is deemed to be on concessional terms if, on the date of initial disbursement, the ratio of the present value of the loan, calculated on the basis of the reference interest rate, to the nominal value of the loan is less than 50 percent (in other words, a grant element of at least 50 percent). For currencies with no available reference interest rates, the SDR rate will be used. This performance criterion does not apply to IMF resources.

III. Use of Adjusters

20. The Performance Criterion on the domestic primary deficit will have two adjusters. Firstly, the limit on the domestic primary deficit will be adjusted upward (downward) if the combined execution level of the programs comprising the privatization-financed part of Treasury-funded capital expenditure exceeds (underperforms) programmed baseline levels (see paragraph 7); this adjustment will be capped at 62 billion dobras for the year as a whole. Secondly, the limit on the domestic primary deficit will be adjusted upward if the government finds budget support for 2009 in addition to that described in paragraph 18 of the MEFP; this adjuster will be capped at 16 billion dobras for the year as a whole.

21. Adjustors for the Performance Criteria on net bank financing of the central government, net domestic assets of the BCSTP, and net usable international reserves will be set. Deviations from amounts projected in the program for budget transfer from the NOA, the privatization-financed component of Treasury-funded capital expenditure, official external program support, net external debt service payments, and domestic arrears will trigger adjustments on the above-mentioned performance criteria. These deviations will be calculated cumulatively from end-December 2008 (see Table A). The following is an explanation of these adjustments:

- **Adjustors on ceilings on changes in net bank financing of the central government (NCG) and net domestic assets (NDA) of the BCSTP:** Quarterly differences between actual and projected receipts of the budget transfer from the NOA, official external program support, net external debt service payments, and Fund's disbursements under the PRGF arrangement, in foreign exchange will be converted to dobras at the program exchange rate and aggregated from end-December 2008 to the test date. The ceilings will be adjusted downward by the amount of accumulated domestic arrears. The ceilings will be adjusted downward (upward) by cumulative deviations downward (upward) of actual from projected net payments in external debt service, and by deviations upward (downward) in the budget transfers from the NOA, external program support, and the Fund's disbursements under the PRGF arrangement. The ceilings will be adjusted upward (downward) by cumulative deviations upward (downward) relative to the baseline projection for execution of the privatization-financed component of Treasury-funded capital expenditure, by up to 62 billion dobras for the year as a whole.

- **Adjustors for the floor on changes in net usable international reserves (usable NIR) of the BCSTP:** Quarterly differences between actual and projected receipts of the budget transfer from the NOA, official external support, and net external debt service payments, will be converted to dobras at the program exchange rate and aggregated from end-December 2008 to the test date. The ceilings will be adjusted upward by the amount of accumulated domestic arrears. The floor will be adjusted upward (downward) by the cumulative deviation downward (upward) in external debt service and by deviations upward (downward) for the budget transfer from the NOA, and official external support. The ceilings will be adjusted downward (upward) by cumulative deviations upward (downward) relative to the baseline projection for execution of the privatization-financed component of Treasury-funded capital expenditure, by up to the equivalent of 62 billion dobras for the year as a whole. The combined application of all adjusters at the December test date is capped in such a way that the adjusted floor does not fall short of the equivalent of 4 months of imports in 2009.

IV. Data Reporting

22. 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 the following information 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*), on commitment (*compromisso*) and cash payments (*caixa*);
- Monthly data on net credit to the government by the BCSTP, recorded account by account in a format fully compatible with the monetary accounts of the BCSTP;
- Monthly detailed data on tax and nontax revenues;
- Monthly detailed data on domestically financed capital expenditure on commitment (*compromisso*) and cash payments (*caixa*);
- Monthly data on domestic arrears by type;
- Monthly data on official external program support (non-project);
- Quarterly data on the execution of the public investment program (PIP) by project and sources of financing;
- Quarterly data on the execution of Treasury-funded capital expenditure by project type, amount, timetable of execution, and progress of execution (see Table C);
- Quarterly data on project grant and loan disbursement (HIPC and non-HIPC);
- Quarterly data on bilateral HIPC debt relief;
- Latest outstanding petroleum price structures and submission of new pricing structures (within a week of any changes).

ii. Monetary Data: The BCSTP will provide the IMF staff, within three weeks from the end of each month, the monetary accounts of the BCSTP. Other monetary data will be provided within six weeks after the end of each month for monthly data, within two months after the end of each quarter for quarterly data, and within two months after the end of each year for annual data. Weekly data will be provided no later than two weeks after the end of the week. The BCSTP will provide the following information to IMF staff:

- Daily data on exchange rates, to be posted on the central bank's web site;
- Daily data on interest rates, to be posted on the central bank's web site;
- Daily liquidity management table, including base money and currency in circulation, to be posted on the central bank's web site;
- Daily net usable international reserve position, to be posted on the central bank's web site;
- 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 consolidated 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, deficit, budget execution, etc.).

iii. External Debt Data: The Debt Management Unit at the Ministry of Planning and Finance will provide the IMF staff, within two months after the end of each month the following information:

- Monthly data on amortization and interest on external debt by creditor: paid, scheduled, and subject to debt relief or rescheduled;
- Quarterly data on disbursements for foreign-financed projects and program support loans.

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 of imports, import taxes collected, and arrears) and commodity export values, provided by the Customs Directorate at the Ministry of Planning and Finance, within two months after the end of each month;
- Monthly data on petroleum shipments and consumption (volumes and c.i.f. prices, by product), provided by the Customs Directorate.

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 World Bank and
the International Monetary Fund

Approved by Sudhir Shetty and Carlos Braga (World Bank),
and Michael Atingi-Ego and David Marston (IMF)

February 12, 2009

Based on the Debt Sustainability Analysis (DSA) for Low-Income Countries (LIC), São Tomé and Príncipe (STP)'s risk of debt distress is high. [2] *Compared to the last DSA, the overall assessment of debt distress is unchanged, although the results show that the debt outlook is somewhat weaker in the baseline scenario before oil exports start because of new financing for investment. In fact, some debt indicators exceed the thresholds before the oil era starts. In addition, like in the previous DSA, in the absence of significant adjustment, the risk of debt distress dramatically increases in the scenario without oil production, which indicates that the country's debt outlook critically depends on the oil prospects.*

I. Background

1. **The country reached the completion point under the enhanced HIPC Initiative in March 2007, received topping-up assistance in December 2007, and benefited from HIPC/MDRI debt relief**.[3] Consequently, the debt service-to-exports ratio is projected to decline to 5.1 percent in 2008 from 24.3 percent in 2007. MDRI, in particular, brought substantial debt service savings, since 54 percent of total debt before the HIPC completion

[1] This report has been produced jointly by Bank and Fund staffs in consultation with the African Development Bank. This report updates the DSA prepared for the 2008 Article IV Consultation and Sixth Review under the Poverty Reduction and Growth Facility (IMF Country Report No. 08/307, September 19, 2008).

[2] São Tomé and Príncipe is classified as a "Weak Performer" according to the three-year average of IDA's Country Policy and Institutional Assessment (CPIA) index. Under the joint IDA/IMF debt sustainability framework, the thresholds for "Weak Performer" are: 30 percent for the present value of debt-to-GDP ratio, 100 percent for present value of debt-to-exports ratio, 15 percent for the debt service-to-exports ratio, 200 percent for present value of debt-to-revenue ratio, and 25 percent of debt service-to-revenue ratio excluding grants.

[3] The country benefited from MDRI on two occasions, one from the MDRI Trust and one from topping-up assistance.

point was with IDA, AfDF, and IMF. Debt relief from Paris Club members also helped improve the country's debt profile as it represented 14 percent of total debt before the completion point.

2. **STP's medium- and long-term external debt was estimated at $109 million in nominal terms at the end of October 2008, down from $150 million at the end of 2007 and $360 million at the end of 2006**. Debt composition was substantially changed after the HIPC completion point. The share of multilateral debt declined to 27 percent in late-2008 from around 60 percent before the completion point, while the share of bilateral debt rose to 73 percent from around 40 percent. At the end of October 2008, Angola was the country's main creditor, with 23 percent of total debt, followed by China with 16 percent. The main multilateral creditor is the IDA. STP has no domestic debt, no short-term debt, and no commercial loans.

3. **To implement the terms of the May 2007 Agreed Minute, the authorities signed bilateral agreements with all its Paris Club creditors, except Russia with whom discussions have started.** Meanwhile they have also expedited debt relief negotiations with non-Paris Club members. As a result, in July 2008, STP received debt relief from Portugal, which was the main non-Paris Club creditor at that time. Since then, they have concentrated their efforts on concluding negotiations with Angola, the main remaining creditor.

Table 1. Estimated outstanding external debt (as of October 2008) 1/

	Million USD	Share
Multilateral creditors	29.6	27%
IDA	9.7	9%
African Development Bank	2.2	2%
Arab Bank for Economic Development in Africa (BADEA)	2.5	2%
IMF	3.9	4%
OPEC	6.2	6%
Others	5.1	5%
Bilateral creditors	79.4	73%
Angola	25.4	23%
China	17.3	16%
Others	36.7	34%
Total	109.0	100%

Source: Country authorities and IMF staff estimates.
1/ Debt to other bilateral creditors includes debt in dispute.

II. MEDIUM-TERM MACROECONOMIC FRAMEWORK

4. **Macroeconomic assumptions were updated from the previous DSA, which was carried out in June 2008**. The revisions include, among others, the use of the latest oil price projections from the World Economic Outlook, which are lower than those used in June 2008; the new debt service and disbursement schedules including a new PRGF program; and new macroeconomic assumptions in line with the government's medium term objectives. Changes were also made to the oil production and investment assumptions reflecting lower expected production volume.

5. **Relative to the previous DSAs, significant revisions were made on the financing assumptions in line with the latest medium term government plan.** In the period 2009–2014, the government projects to contract concessional loans for $25–30 million a year from multilateral and bilateral creditors to finance an ambitious investment program, aimed at developing non-oil sectors and improving food security. The investment projects are expected to bring in growth dividends in the long term; in the near term, they will help offset

the negative impact of the global crisis. Implementing those projects will test the government's execution capacity. Once the country enters the oil era, it is expected to receive less concessional financing. The Fund is expected to provide a new PRGF loan of about US $4 million for the period of 2009–2011. No financing from privatization operations, no commercial loans, no domestic borrowing and no short-term loans are assumed throughout the period.[4]

6. **Real non-oil GDP growth is expected to reach 8 percent by 2013 led by foreign and domestic investment projects in the agriculture, services and construction sectors along with growing tourism industry prospects.** Once those sectors reach their expected steady state, real non-oil GDP growth should slow down gradually to a sustainable 5 percent per year. Meanwhile, total real GDP growth including oil export revenues is expected to jump by 20 percent in 2015 when oil exports start. It then gradually declines to a 4.5 percent and remains around that level for the rest of projection period.

7. **Oil production is expected to start in 2014 and oil exports to start in 2015 as assumed in the previous DSA**. It is assumed that the Joint Development Zone (JDZ) produces 12,697 barrels a day at an average price of $75 per barrel during the period analyzed in this paper (2015–2028). This is expected to yield $349 million in export earnings on average and to bring $197 million in budget revenues to the Joint Development Agency (JDA) per year. São Tomé and Príncipe will receive 40 percent of the JDA's take and is expected to accumulate it in the National Oil Account (NOA) from which resources flow to the budget in accordance with the Oil Revenue Management Law (ORML). The Exclusive Development Zone is assumed to produce no oil in the time horizon covered in this paper.

8. **Inflation is projected to decline to 5 percent by 2012 and remain at that level thereafter, reflecting our assumption of strong macroeconomic policies.** Macroeconomic policies will aim to achieve single-digit inflation rates by the end of the new PRGF program.

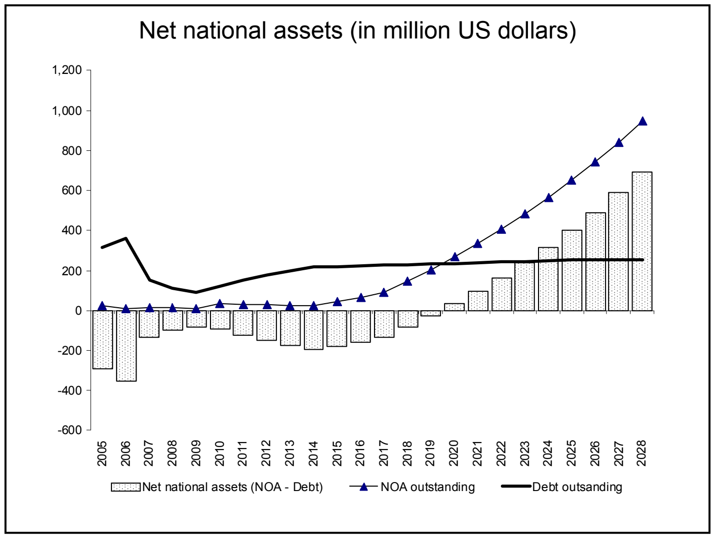
9. **Budget oil resources are projected to rise only gradually.** Budget transfers from the NOA are assumed first to be around 1.5 percent of GDP per year in 2008–2014, down from the average of about 10 percent in 2005–2007, reflecting the shrinking balance of the NOA. Once oil exports start, the transfer will rise to around 5 percent of GDP in line with the ORML. Even after oil exports start, the domestic primary deficit after budget transfers from the NOA is projected to remain around 0.5 percent of GDP, which will be financed mainly by concessional loans.

10. **The current account balance will improve once oil exports start in 2015**. The current account deficit including oil revenues is projected to decline to around 30 percent of

[4] It is assumed that all of the remaining bilateral creditors provide debt relief in 2010 on terms comparable to those of the Paris Club. Currently the country does not service bilateral debt under negotiation. Therefore even if the country does not receive debt relief from those bilateral creditors, its debt payment schedule remains unchanged on a cash flow basis.

GDP from around 35 percent before the oil era. Meanwhile, FDI and private capital inflows are projected to grow rapidly once the country enters into the oil era.[5, 6] As a result, the country is projected to record a surplus in the overall balance, and increases assets in the NOA by approximately 10 percent of GDP a year.

11. **Net national assets are projected to grow rapidly reflecting mounting oil wealth in the NOA.** In line with the ORML the oil revenues continue to be accumulated in the NOA from which annual budget transfers are allocated. As a result, net national assets including the NOA are projected to substantially increase during the oil era, reaching 68 percent of GDP at the end of 2028.



12. **The main risk to the macroeconomic framework arises from uncertain oil prospects**. Commercially viable oil reserves have not yet been found. The balance of the NOA has already declined to $12 million at the end 2008 from $49 million at the inception of NOA in 2005. Under the current assumptions of budget transfers from the NOA, and without additional oil signature bonuses and oil production revenues, the NOA would be depleted by 2013.[7] Then, the fiscal position would become significantly constrained by the lack of financing. Moreover, if commercially viable reserves are not identified and developed, resources will remain limited to those coming from the non-oil sectors and donors. Other financing, such as from privatization operations, could provide temporary relief, but would not change the nature of a non-oil scenario.

III. External Debt Sustainability Analysis [8]

13. **The baseline scenario indicates a vulnerable debt outlook before oil production starts** (Box 1)**.** Some debt burden indicators exceed the thresholds during 2009–2014. In particular, the PV of debt-to-exports ratio breaches the threshold by a wide margin in the next few years because of STP's small export base. These indicators fall sharply once oil exports

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[5] Oil signature bonuses are recoded as FDI in the balance of payment.

[6] It is assumed that oil-related projects are funded by FDI and do not accumulate public debt.

[7] Oil signature bonuses of US$26 million of Block 5 and 6 have not been disbursed due to disputes among stakeholders. The baseline scenario assumes that the bonuses will be released in 2010.

[8] See Figure 1 and Tables 1a and 1b for the external debt sustainability analysis.

start. The various debt ratios are somewhat higher than in the previous DSA because of higher concessional loans to finance investment projects.

Box 1. Baseline Macroeconomic Assumptions

Real non-oil GDP growth: Real non-oil GDP growth is expected to reach 8 percent by 2013 led by strong investment. It then slows down gradually to a sustainable 5 percent per year.

Inflation: Inflation is projected to decline to 5 percent by 2012 and remain at that level thereafter, reflecting our assumption of strong macroeconomic policies.

Current account balance: In the period 2009-2014, the current account deficit is projected to increase to around 35 percent of GDP due to large import demand for investment goods. Once oil exports start, the deficit will decline to around 30 percent of GDP.

Government balance: In the period of 2009-2014, the domestic primary deficit after budget transfers from the NOA is projected to improve gradually to around 2 percent of GDP, reflecting our assumption of strong macroeconomic policies. After oil exports start, the deficit will remain around 0.5 percent of GDP.

External assistance: In the period 2009-2014, the government projects to receive $30-50 million in grants a year and contract concessional loans for $25-30 million a year to finance investment. Once oil exports start, both grants and concessional loans are projected to decline substantially.

Domestic borrowing: No domestic borrowing is assumed.

14. **Historical scenarios would appear stronger.**[9] In the baseline scenario, due to the government's large planned investment projects, the fiscal balance and the external balance are projected to deteriorate substantially in the period 2009–2014. Applying instead the historical averages of key variables such as the primary balance and the non-interest current account balance improves debt sustainability, but would imply the cancellation of those projects currently planned.

15. **The stress tests show that debt indicators are vulnerable to various macroeconomic shocks**. In the most extreme stress tests, which assume exports shock or a combination of lower growth, weaker exports, and a lower US dollar GDP deflator, most of the debt ratios are projected to breach the thresholds during 2009–2014, and then fall sharply after oil exports start.[10]

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[9] Historical scenarios consider constant primary balance and external balance at their historical averages of the last ten years. Those scenarios are presented in A1, key variables at their historical averages in external debt analysis in Table 1b, and A1, real GDP growth and primary balance are at historical averages and A2, primary balance is unchanged from 2008 in public debt analysis in Table 2b.

[10] In the DSA template, US dollar GDP deflator is used to calculate endogenous debt dynamics. See footnote 2 of Table 1a.

16. **In the scenario with no oil production, debt dynamics becomes explosive**. In this scenario, all debt indicators are projected to continue increasing well above the thresholds. This will call for a significant tightening of policies.

17. **Different price projections do not alter significantly the conclusions of this Debt Sustainability Analysis.** The size of the oil sector implied by the assumptions made here is quite large relative to the non-oil sector. Thus, even with significantly different oil prices, the qualitative thrust of the conclusions from the scenarios with oil would stand—if the oil sector develops, debt ratios will remain low and assets will accumulate.

IV. Fiscal Debt Sustainability Analysis [11]

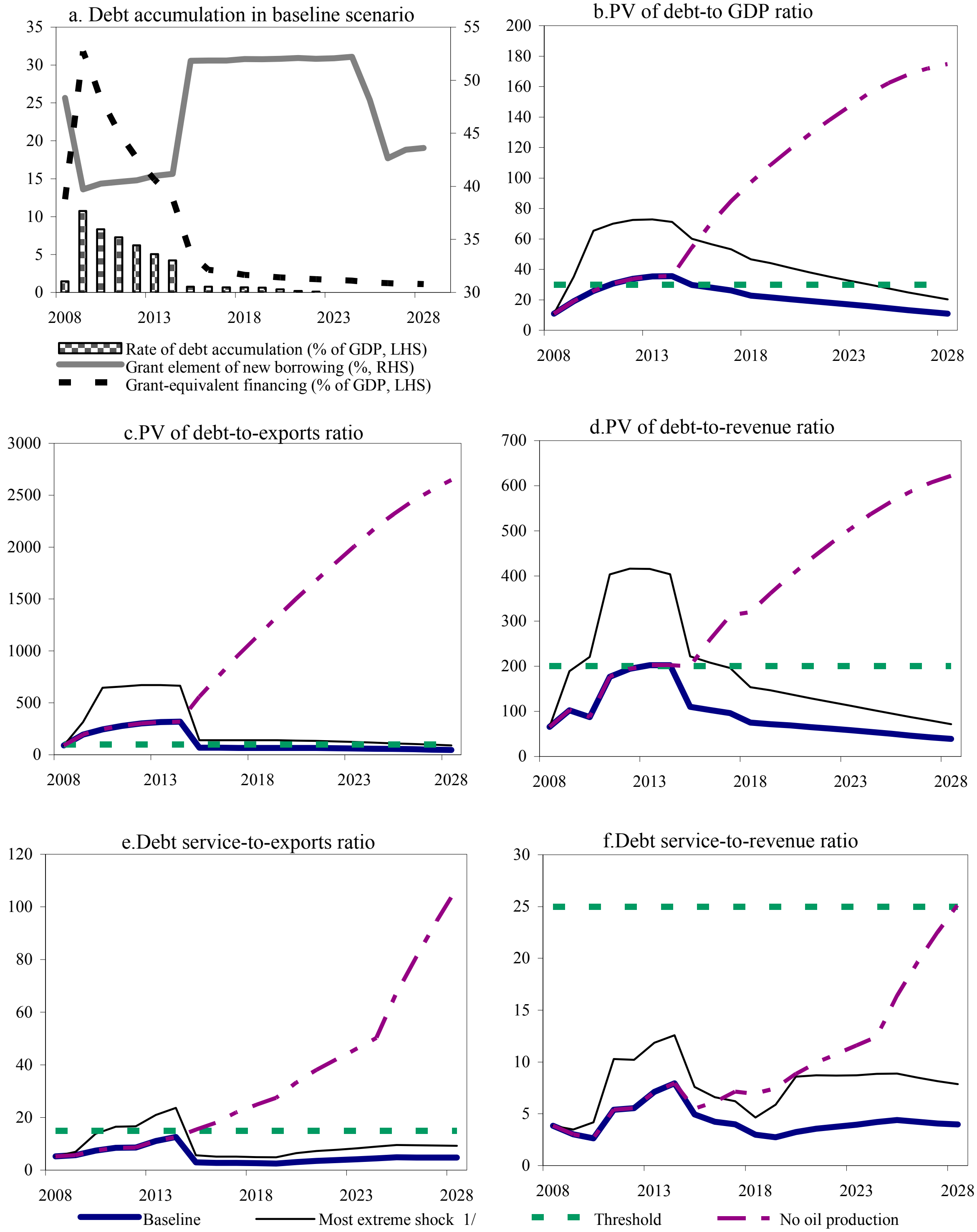
18. **The public sector debt sustainability analysis also reveals a vulnerable picture.** The fiscal stress tests show that the fiscal debt indicators are vulnerable to lower growth. The debt ratios under that scenario climb faster than the baseline scenario. São Tomé and Príncipe is not projected to issue domestic debt in the baseline scenario. Essentially, the fiscal and external DSA produce similar conclusions because the government is the main borrower among domestic residents.

V. Conclusion

19. **In staff's view, São Tomé and Príncipe should be considered at a high risk of debt distress even after debt relief under the HIPC Initiative and MDRI.** The country has a structurally high current account deficit that has been partly financed with signature bonuses. In the baseline scenario, oil revenues that are key for debt sustainability will flow from 2015. The DSA shows that, even in the baseline scenario, some debt ratios are projected to rise above the thresholds before oil production starts. In the scenario without oil production, debt distress becomes very acute on unchanged policies and clearly exhibits the dependence of the debt outlook on the development of the oil sector. The DSA also indicates that debt distress substantially intensifies in the face of various macroeconomic shocks. These results point out the need for fiscal consolidation with a continued prudent borrowing strategy. Moreover, broadening the country's export base will be necessary to mitigate the debt risk in the face of uncertain oil prospects.

[11] See Figure 2 and Tables 2a and 2b for the fiscal debt sustainability analysis.

Figure 1. São Tomé and Príncipe: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2008–28 [1/ 2/]

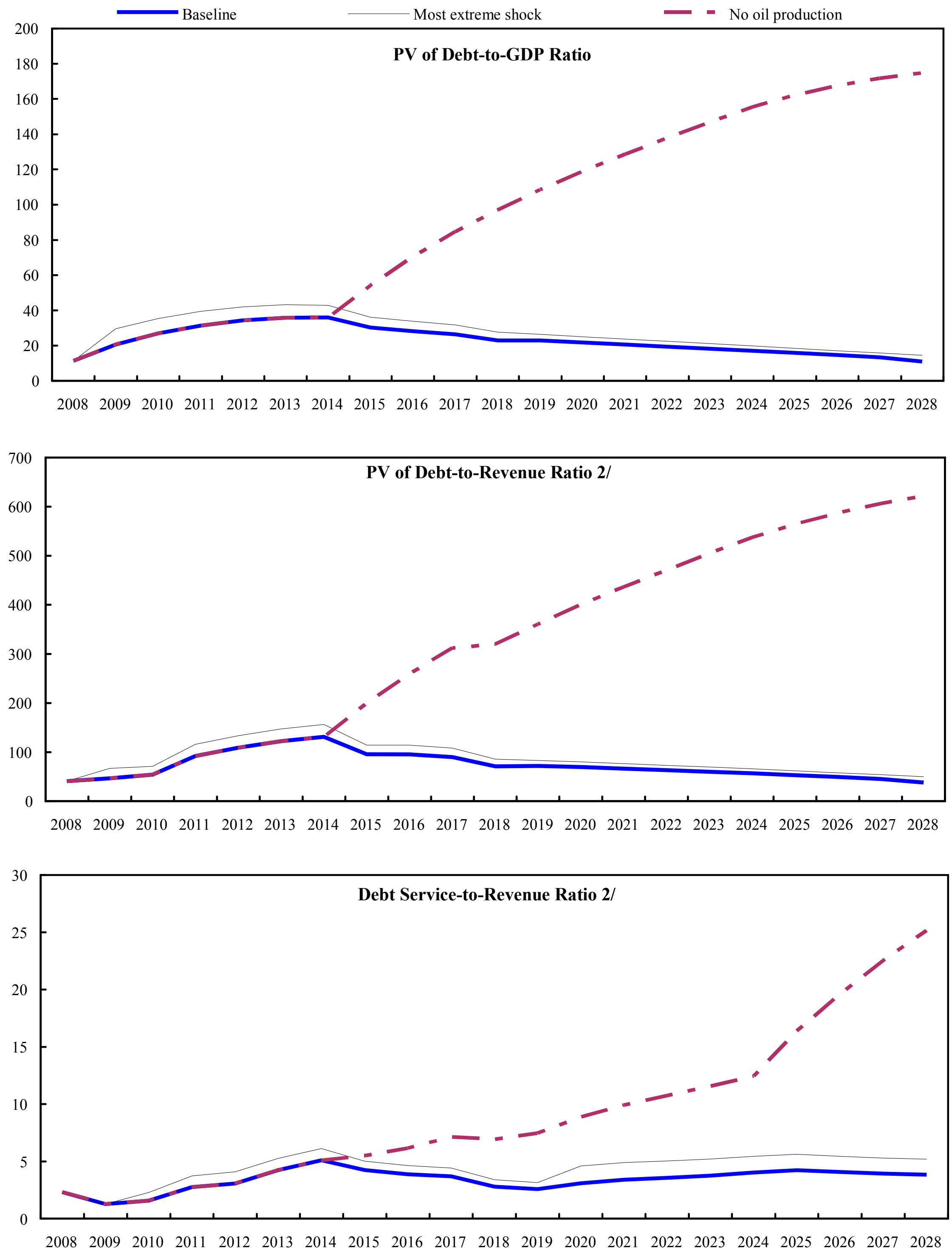


Source: Staff projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2018. In figure b. it corresponds to a Combination shock; in

2/ The grant element of new borrowing declines in the period of 2009-2014 because during this period the government contracts concessional loans whose grant elements are lower than that of the World Bank, the main creditor in the rest of the period.

Figure 2. São Tomé and Príncipe: Indicators of Public Debt under Alternative Scenarios, 2008–28 1/



Sources: Country authorities; and Fund staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2018.
2/ Revenues are defined inclusive of grants and oil signature bonuses.

Table 1a. São Tomé and Príncipe: External Debt Sustainability Framework, Baseline Scenario, 2005–28 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 9/	Standard Deviation 9/	Projections									
	2005	2006	2007			2008	2009	2010	2011	2012	2013	2008-2013 Average	2018	2028	2014-2028 Average
External debt (nominal) 1/	**309.2**	**300.2**	**108.5**			**69.7**	**52.2**	**60.3**	**65.6**	**68.3**	**69.1**		**40.5**	**18.2**	
o/w public and publicly guaranteed (PPG)	309.2	300.2	108.5			69.7	52.2	60.3	65.6	68.3	69.1		40.5	18.2	
Change in external debt	2.6	-9.0	-191.7			-38.9	-17.5	8.2	5.3	2.7	0.8		-6.9	-1.9	
Identified net debt-creating flows	-99.6	-18.6	-67.2			-4.7	25.7	-0.9	19.0	15.2	11.9		-9.7	1.7	
Non-interest current account deficit	**-35.3**	**25.7**	**9.7**	**9.3**	**17.4**	**33.9**	**42.8**	**25.5**	**34.6**	**32.7**	**32.5**	**33.7**	**28.1**	**31.6**	32.9
Deficit in balance of goods and services	39.1	56.7	57.3			62.8	74.0	64.5	59.0	55.0	53.5		23.8	33.5	
Exports 2/	13.9	13.7	9.3			12.3	9.9	10.6	11.1	11.2	11.3		34.3	23.6	
Imports	52.9	70.4	66.6			75.1	83.9	75.0	70.1	66.3	64.8		58.2	57.1	
Net current transfers (negative = inflow)	-30.5	-26.0	-23.3	-22.1	4.9	-26.5	-28.7	-23.7	-20.1	-17.5	-15.8		-4.9	-3.4	-5.3
o/w official	-29.2	-24.8	-21.9			-24.7	-26.7	-21.4	-17.4	-14.3	-12.1		-1.9	-0.9	
Other current account flows (negative = net inflow)	-43.9	-4.9	-24.4			-2.4	-2.5	-15.2	-4.3	-4.8	-5.1		9.1	1.5	
Net FDI (negative = inflow)	**-48.2**	**-21.5**	**-36.2**	**-13.7**	**16.2**	**-33.5**	**-13.9**	**-23.6**	**-12.3**	**-13.7**	**-16.4**		**-31.8**	**-29.2**	-32.2
Endogenous debt dynamics 3/	**-16.0**	**-22.7**	**-40.7**			**-5.0**	**-3.2**	**-2.8**	**-3.3**	**-3.9**	**-4.3**		**-5.9**	**-0.6**	
Contribution from nominal interest rate	2.8	3.4	0.5			0.1	0.1	0.4	0.6	0.7	0.7		0.5	0.2	
Contribution from real GDP growth	-16.3	-18.9	-15.5			-5.2	-3.4	-3.2	-3.9	-4.5	-5.0		-6.4	-0.9	
Contribution from price and exchange rate changes	-2.5	-7.3	-25.7			-13.9	-5.2	0.4	-0.7	-0.9	-1.1		-0.8	-0.3	
Residual (3-4) 4/	**102.2**	**9.5**	**-124.5**			**-34.2**	**-43.2**	**9.1**	**-13.7**	**-12.5**	**-11.1**		**2.8**	**-3.6**	
o/w exceptional financing (including debt relief)	-1.0	-1.3	-111.9			-19.7	-26.3	0.0	0.0	0.0	0.0		0.0	0.0	
o/w accumulation to NOA from oil revenue 5/	30.4	-12.4	14.2			-1.7	-1.2	10.4	-1.7	-1.6	-1.5		9.5	6.0	
PV of external debt 6/	...	...	11.8			10.9	19.0	25.9	30.6	33.8	35.4		22.7	10.9	
In percent of exports	...	...	127.1			89.0	193.0	245.1	276.8	301.2	313.5		66.1	46.1	
PV of PPG external debt	**...**	**...**	**11.8**			**10.9**	**19.0**	**25.9**	**30.6**	**33.8**	**35.4**		**22.7**	**10.9**	
In percent of exports	**...**	**...**	**127.1**			**89.0**	**193.0**	**245.1**	**276.8**	**301.2**	**313.5**		**66.1**	**46.1**	
In percent of government revenues	**...**	**...**	**29.4**			**65.8**	**102.5**	**87.4**	**176.7**	**194.3**	**202.1**		**74.8**	**38.7**	
Debt service-to-exports ratio (in percent)	**75.6**	**65.8**	**24.3**			**5.2**	**5.7**	**7.4**	**8.4**	**8.6**	**11.0**		**2.6**	**4.7**	
PPG debt service-to-exports ratio (in percent)	**75.6**	**65.8**	**24.3**			**5.2**	**5.7**	**7.4**	**8.4**	**8.6**	**11.0**		**2.6**	**4.7**	
PPG debt service-to-revenue ratio (in percent)	**16.4**	**43.1**	**5.6**			**3.9**	**3.0**	**2.6**	**5.4**	**5.5**	**7.1**		**3.0**	**4.0**	
Total gross financing need (Billions of U.S. dollars)	-0.1	0.0	0.0			0.0	0.1	0.0	0.1	0.1	0.0		0.0	0.0	
Non-interest current account deficit that stabilizes debt ratio 7/	-37.9	34.7	201.4			72.8	60.4	17.4	29.3	30.0	31.7		34.9	33.5	
Key macroeconomic assumptions															
Real GDP growth (in percent)	5.7	6.7	6.0	5.0	3.1	5.8	5.5	6.5	7.0	7.5	8.0	6.7	16.1	4.6	7.3
GDP deflator in US dollar terms (change in percent)	0.8	2.4	9.4	2.7	3.9	14.7	8.1	-0.7	1.1	1.4	1.6	4.4	1.7	1.6	1.7
Effective interest rate (percent) 8/	1.0	1.2	0.2	0.8	0.3	0.2	0.2	0.8	1.0	1.1	1.2	0.7	1.3	1.2	1.2
Growth of exports of G&S (US dollar terms, in percent)	5.1	7.8	-21.5	4.1	28.7	60.7	-8.5	13.2	13.5	10.6	10.4	16.6	2.8	2.9	29.1
Growth of imports of G&S (US dollar terms, in percent)	9.0	45.2	9.7	10.6	19.9	36.8	27.4	-5.4	1.0	3.1	7.2	11.7	-5.4	6.3	8.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	48.3	39.7	40.2	40.4	40.6	41.0	41.7	52.0	43.6	49.3
Government revenues (excluding grants, in percent of GDP)	64.0	20.9	40.1			16.6	18.6	29.6	17.3	17.4	17.5		30.3	28.1	28.0
Aid flows (in Billions of US dollars) 10/	0.016	0.017	0.015			0.023	0.082	0.070	0.062	0.057	0.053		0.014	0.012	
o/w Grants	0.015	0.012	0.012			0.019	0.051	0.043	0.038	0.035	0.033		0.010	0.010	
o/w Concessional loans	0.001	0.004	0.004			0.004	0.031	0.026	0.024	0.022	0.020		0.004	0.002	
Grant-equivalent financing (in percent of GDP) 11/	...	...	...			12.3	31.8	25.5	21.1	17.7	14.9		2.3	1.1	2.8
Grant-equivalent financing (in percent of external financing) 11/	...	...	...			90.1	77.0	76.7	76.5	77.0	77.5		86.3	90.4	87.0
Memorandum items:															
Nominal GDP (Billions of US dollars)	0.1	0.1	0.1			0.2	0.2	0.2	0.2	0.3	0.3		0.5	1.0	
Nominal dollar GDP growth	6.5	9.2	15.9			21.3	14.0	5.8	8.2	9.0	9.7	**11.3**	18.0	6.3	9.2
PV of PPG external debt (in Billions of US dollars)						0.0	0.0	0.1	0.1	0.1	0.1		0.1	0.1	
(PVt-PVt-1)/GDPt-1 (in percent)						1.5	**10.8**	**8.3**	**7.3**	**6.2**	**5.1**	**6.5**	0.7	-0.5	0.4

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Includes full amount of oil signature bonuses and oil export revenues.
3/ Derived as [r - g - ρ*(1+g)]/(1+g+ρ+g*ρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
4/ The difference between a change in external debt and identified net debt-creating flows. Includes exceptional financing (i.e., changes in arrears and debt relief); private capital inflows; changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes and accumulation to NOA from oil exports revenues. Due to the statistical weaknesses of the country, this item could include relatively large statistical errors.
5/ Savings and dissavings from the NOA. Negative numbers show withdrawals from the NOA.
6/ Assumes that PV of private sector debt is equivalent to its face value.

7/ Non-interest current account deficit that stabilizes debt ratio is non-interest current account deficit minus the change of external debt. The figures in 2007 and 2008 are large because of debt reductions owing to debt relief.
8/ Current-year interest payments divided by previous period debt stock.
9/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
10/ Defined as grants, concessional loans, and debt relief.
11/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 1b. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2008–28 (In percent)

	Projections							
	2008	2009	2010	2011	2012	2013	2018	2028
PV of Debt-to-GDP Ratio								
Baseline	11	21	27	31	34	36	23	11
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages 1/	11	10	20	20	20	21	64	183
A2. Primary balance is unchanged from 2008 1/	11	7	14	11	9	7	29	104
A3. Permanently lower GDP growth 2/	11	21	28	33	36	39	31	44
A4. No oil production	11	21	27	31	34	36	97	175
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	11	22	32	38	42	45	37	41
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	11	24	48	52	54	54	35	20
B3. Combination of B1-B2 using one half standard deviation shocks	11	17	35	40	43	46	34	31
B4. One-time 30 percent real depreciation in 2009	11	38	40	41	42	43	29	19
B5. 10 percent of GDP increase in other debt-creating flows in 2009	11	30	35	39	42	43	28	15
PV of Debt-to-Revenue Ratio 3/								
Baseline	41	47	54	92	109	122	71	38
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages 1/	41	22	40	56	62	68	191	619
A2. Primary balance is unchanged from 2008 1/	41	16	28	33	28	25	90	358
A3. Permanently lower GDP growth 2/	41	47	55	95	114	130	95	149
A4. No oil production	41	47	54	92	109	122	320	621
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	41	49	62	107	129	148	114	140
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	41	55	97	152	171	185	108	69
B3. Combination of B1-B2 using one half standard deviation shocks	41	38	68	114	135	152	105	107
B4. One-time 30 percent real depreciation in 2009	41	86	79	121	134	145	90	65
B5. 10 percent of GDP increase in other debt-creating flows in 2009	41	67	71	116	133	147	86	50
Debt Service-to-Revenue Ratio 3/								
Baseline	2	1	2	3	3	4	3	4
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages 1/	2	1	1	2	2	2	6	29
A2. Primary balance is unchanged from 2008 1/	2	1	0	1	1	1	2	15
A3. Permanently lower GDP growth 2/	2	1	2	3	3	4	4	9
A4. No oil production	2	1	2	3	3	4	7	25
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	2	1	2	3	4	5	4	10
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	2	1	2	5	6	7	4	7
B3. Combination of B1-B2 using one half standard deviation shocks	2	1	1	4	4	5	4	8
B4. One-time 30 percent real depreciation in 2009	2	2	2	4	5	7	5	7
B5. 10 percent of GDP increase in other debt-creating flows in 2009	2	1	2	4	4	5	3	5

Sources: Country authorities; and Fund staff estimates and projections.

1/ Those scenarios create a positive shock to debt sustainability compared to the baseline scenario in some years.

2/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the length of the projection period.

3/ Revenues are defined inclusive of grants and oil signature bonuses.

Table 2a. São Tomé and Príncipe: Public Sector Debt Sustainability Framework, Baseline Scenario, 2005–28
(in percent of GDP, unless otherwise indicated)

	Actual			Average 7/	Standard Deviation 7/	Projections									
	2005	2006	2007			2008	2009	2010	2011	2012	2013	2008-13 Average	2018	2028	2014-28 Average
Public sector debt 1/	309.2	300.2	108.5			69.7	52.2	60.3	65.6	68.3	69.1		40.5	18.2	
o/w foreign-currency denominated	309.2	300.2	108.5			69.7	52.2	60.3	65.6	68.3	69.1		40.5	18.2	
Change in public sector debt	2.6	-9.0	-191.7			-38.9	-17.5	8.2	5.3	2.7	0.8		-6.9	-1.9	
Identified debt-creating flows	-22.4	-26.7	-165.9			-50.0	-15.4	-1.6	7.5	4.8	3.0		-16.0	-7.2	
Primary deficit	-35.6	16.6	-8.8	6.4	16.5	3.3	18.7	2.9	12.4	10.1	8.3	9.3	-9.3	-6.2	-5.8
Revenue and grants 2/	76.9	30.8	48.1			27.6	44.1	49.9	34.1	31.5	29.4		32.3	29.1	
of which: grants	12.8	10.0	8.0			11.0	25.5	20.3	16.7	14.1	11.9		1.9	1.0	
Primary (noninterest) expenditure	41.2	47.4	39.3			30.9	62.7	52.8	46.4	41.6	37.7		23.0	22.9	
Automatic debt dynamics	14.3	-41.9	-39.1			-20.5	-5.5	-4.5	-4.9	-5.3	-5.3		-6.7	-1.0	
Contribution from interest rate/growth differential	-22.9	-25.0	-23.9			-8.1	-4.4	-3.6	-4.5	-5.1	-5.6		-7.0	-1.1	
of which: contribution from average real interest rate	-6.4	-5.6	-6.9			-2.1	-0.8	-0.4	-0.6	-0.5	-0.5		-0.4	-0.2	
of which: contribution from real GDP growth	-16.5	-19.3	-17.0			-5.9	-3.6	-3.2	-3.9	-4.6	-5.1		-6.6	-0.9	
Contribution from real exchange rate depreciation	37.2	-16.9	-15.2			-12.4	-1.1	-0.9	-0.4	-0.2	0.2		...	...	
Other identified debt-creating flows	-1.1	-1.4	-117.9			-32.8	-28.5	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			-12.3	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	0.0	
Debt relief (HIPC and other)	-1.1	-1.4	-117.9			-20.4	-28.5	0.0	0.0	0.0	0.0		0.0	0.0	
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	0.0	
Residual, including asset changes	25.0	17.7	-25.8			11.1	-2.1	9.8	-2.2	-2.1	-2.2		9.2	5.3	
o/w accumulation to NOA from oil revenue 3/	30.4	-12.4	14.2			-1.7	-1.2	10.4	-1.7	-1.6	-1.5		9.5	6.0	
Other Sustainability Indicators															
PV of public sector debt	0.0	0.0	12.4			11.3	20.6	26.9	31.4	34.3	35.9		23.0	11.0	
o/w foreign-currency denominated	0.0	0.0	12.4			11.3	20.6	26.9	31.4	34.3	35.9		23.0	11.0	
o/w external	...	...	12.4			11.3	20.6	26.9	31.4	34.3	35.9		23.0	11.0	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 4/	-25.1	25.6	-6.6			3.9	19.2	3.7	13.3	11.1	9.6		-8.4	-5.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	0.0	0.0	25.8			41.0	46.8	53.9	92.1	108.9	122.3		71.2	37.8	
PV of public sector debt-to-revenue ratio (in percent) 5/	0.0	0.0	31.0			68.1	111.2	90.9	180.9	197.1	205.1		75.7	39.2	
o/w external	…	…	31.0			68.1	111.2	90.9	180.9	197.1	205.1		75.7	39.2	
Debt service-to-revenue and grants ratio (in percent) 6/	13.6	29.2	4.7			2.3	1.3	1.6	2.7	3.1	4.2		2.8	3.8	
Debt service-to-revenue ratio (in percent) 6/	16.4	43.1	5.6			3.9	3.0	2.6	5.4	5.5	7.1		3.0	4.0	
Primary deficit that stabilizes the debt-to-GDP ratio	-38.2	25.6	182.8			42.1	36.2	-5.3	7.1	7.4	7.5		-2.5	-4.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	5.7	6.7	6.0	5.0	3.1	5.8	5.5	6.5	7.0	7.5	8.0	6.7	16.1	4.6	7.3
Average nominal interest rate on forex debt (in percent)	1.0	1.2	0.2	0.8	0.3	0.2	0.2	0.8	1.0	1.1	1.2	0.7	1.3	1.2	1.2
Average real interest rate on domestic debt (in percent)	...	...	...	…	…	...	...	...	...	...	...	...	...	...	...
Real exchange rate depreciation (in percent, + indicates depreciation)	13.1	-6.0	-5.5	0.8	7.1	-12.4	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	7.6	20.9	19.4	11.2	5.4	23.7	18.0	12.2	7.7	5.3	4.6	11.9	4.3	4.3	4.4
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.1	0.2	-0.1	0.1	0.2	-0.2	1.1	-0.1	-0.1	0.0	0.0	0.1	0.1	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	48.3	39.7	40.2	40.4	40.6	41.0	41.7	52.0	43.6	...

Sources: Country authorities; and Fund staff estimates and projections.

1/ Gross debt of the general government. The difference between the public sector debt table and the external debt table was created by applying the average exchange rate to the public sector debt and the end-of-period exchange rate to the external debt table.
2/ Includes full amount of oil signature bonuses and oil export revenues.
3/ Savings and dissavings from the NOA. Negative numbers show withdrawals to the NOA.
4/ 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.
5/ Revenues excluding grants.
6/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
7/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public Debt, 2008–28

	Projections							
	2008	2009	2010	2011	2012	2013	2018	2028
PV of Debt-to-GDP Ratio								
Baseline	11	21	27	31	34	36	23	11
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages 1/	11	10	20	20	20	21	64	183
A2. Primary balance is unchanged from 2008 1/	11	7	14	11	9	7	29	104
A3. Permanently lower GDP growth 2/	11	21	28	33	36	39	31	44
A4. No oil production	11	21	27	31	34	36	97	175
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	11	22	32	38	42	45	37	41
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	11	24	48	52	54	54	35	20
B3. Combination of B1-B2 using one half standard deviation shocks	11	17	35	40	43	46	34	31
B4. One-time 30 percent real depreciation in 2009	11	38	40	41	42	43	29	19
B5. 10 percent of GDP increase in other debt-creating flows in 2009	11	30	35	39	42	43	28	15
PV of Debt-to-Revenue Ratio 3/								
Baseline	41	47	54	92	109	122	71	38
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages 1/	41	22	40	56	62	68	191	619
A2. Primary balance is unchanged from 2008 1/	41	16	28	33	28	25	90	358
A3. Permanently lower GDP growth 2/	41	47	55	95	114	130	95	149
A4. No oil production	41	47	54	92	109	122	320	621
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	41	49	62	107	129	148	114	140
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	41	55	97	152	171	185	108	69
B3. Combination of B1-B2 using one half standard deviation shocks	41	38	68	114	135	152	105	107
B4. One-time 30 percent real depreciation in 2009	41	86	79	121	134	145	90	65
B5. 10 percent of GDP increase in other debt-creating flows in 2009	41	67	71	116	133	147	86	50
Debt Service-to-Revenue Ratio 3/								
Baseline	2	1	2	3	3	4	3	4
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages 1/	2	1	1	2	2	2	6	29
A2. Primary balance is unchanged from 2008 1/	2	1	0	1	1	1	2	15
A3. Permanently lower GDP growth 2/	2	1	2	3	3	4	4	9
A4. No oil production	2	1	2	3	3	4	7	25
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	2	1	2	3	4	5	4	10
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	2	1	2	5	6	7	4	7
B3. Combination of B1-B2 using one half standard deviation shocks	2	1	1	4	4	5	4	8
B4. One-time 30 percent real depreciation in 2009	2	2	2	4	5	7	5	7
B5. 10 percent of GDP increase in other debt-creating flows in 2009	2	1	2	4	4	5	3	5

Sources: Country authorities; and Fund staff estimates and projections.
1/ Those scenarios create a positive shock to debt sustainability compared to the baseline scenario in some years.
2/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the length of the projection period.
3/ Revenues are defined inclusive of grants and oil signature bonuses.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Informational Annex

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

February 12, 2009

- **Relations with the Fund**. Describes financial and technical assistance by the IMF and provides information on the safeguards assessment and exchange rate system.

- **Relations with the World Bank Group**. Describes 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 December 31, 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	3.06

IV. Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
PRGF Arrangements	2.47	33.37

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	2.96
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				
	2009	2010	2011	2012	2013
Principal	...	...	…	…	0.40
Charges/Interest	0.02	0.02	0.03	0.02	0.02
Total	0.02	0.02	0.03	0.02	0.41

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 forthcoming arrangement. 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. Implementation of the recommendations needs to be monitored by the staff.

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 as the sum of 40 percent of previous day’s selling rate quoted by commercial banks and 60 percent of the most recent auction 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 arising 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 arising from Article 3(i) and Article 10 b of the new investment code regarding limitations on the transferability of net income from investment resulting from the requirement that taxes and other obligations to the government have to be paid/fulfilled as a condition for transfer to the extent it includes the payment of taxes and the fulfillment of obligations unrelated to the net income to be transferred.

Under the PRGF-supported program, the BCSTP intends to revise, based on a careful review of the domestic market conditions, 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 authorities also intend within the PRGF to identify the measures needed to eliminate restrictions arising from the investment code. The intervention currency for the dobra is the U.S. dollar and the euro. The official selling exchange rate was Db. 15,077 per U.S. dollar on December 31, 2008.

XI. Article IV Consultation:

The Executive Board concluded the last Article IV consultation with São Tomé and Príncipe on June 18, 2008.

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

None.

XIII. Technical Assistance:

January 2009: STA mission on national accounts

November 2008: MCM mission on banking supervision

August 2008: MCM mission on banking supervision

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 has not had 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 December, 2008)

1. The IMF and World Bank São Tomé and Príncipe teams discussed a joint managerial action plan, under this initiative.

2. The World Bank's work program entails moving forward in FY09 with a CAS Progress Report. A Country Economic Memorandum is under consideration in FY10.

3. The IMF's work program entails moving forward with the following components: (i) a new Poverty Reduction and Growth Facility, and (ii) safeguards assessment.

4. Both institutions are working to prepare a joint Debt Sustainability Analysis, to be delivered the first semester of 2009.

Title	Products	Provisional timing of missions	Expected delivery date
	A. Mutual information on relevant work programs		
Bank work program in next 12 months	• Country Economic Memorandum. • CAS Progress Report.	April 2009. February 2008.	FY2010. December 2008.
IMF work program in next 12 months	• Conclude negotiation on new PRGF • The first review under the PRGF. • Safeguards Assessments • The second review of the PRGF.	January 2009. 3rd quarter of 2009. April 2009. 1st quarter of 2010.	March 2009. 3rd quarter of 2009. August 2009. 1st quarter of 2010.
	B. Requests for work program inputs		
Fund request to Bank (summary justification)	• Provide comments on selected government-financed projects in the Public Investment Program (PIP) for which the Fund has received sufficiently detailed information for a Bank review • PEFA	Date around new PRGF prior action, and at the time of reviews. June 2009.	January/February, April, and October 2009. September 2009.
Bank request to Fund (summary justification)	• Macroeconomic scenarios.	November 2008.	December 2008.
	C. Agreement on joint products and missions		
Joint products in next 12 months	• DSA.	November 2008.	March 2, 2009.

APPENDIX III—RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of January 20, 2009) [1]

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, 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 started in 2005 and 2006 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 second phase of the livestock development project, financed with ADF-X resources, was approved in May 2006 and signed in July 2006. The human resource development project, financed with ADF-IX resources 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 for STP (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 (2005–2007) was 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 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. The Country Allocation on ADF-XI (2008-2010) resource is UA 5.00 million in the form of grants. Under the ADF XI allocation, the AfDB will finance one project in agriculture sector and one BOP operation.

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[1] Provided by the African Development Bank.

[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.

Currently, a UA 1 million grant is under preparation as an AFDB response to STP food crisis. In 2009, the AfDB intends to finance two studies one on the insular cost study and another on the regional capacity building initiatives, within CEMAC, ECCAS, the African Portuguese-speaking countries and the small insular countries.

4. In addition, as STP reached decision and completion point respectively in 2000 and 2007, the AfDB could provide $43.43 million ($88.36 million in nominal value). In reaching the HIPC decision point, STP became eligible to MDRI and the debt service under the MDRI was estimated at $99.56 million. The AFDB total assistance under HIPC and MDRI amounted to $187.92. At the end of December 2008, the AfDB provided $13.33 million under HIPC and $99 million under MDRI.

Table 1. AfDB Ongoing Projects (Millions of UA)

Title of Projects	Window	Commitment	Disbursement Rate
Support for human resource development	ADF	3.50	9.93 percent
	ADF grant	0.50	43.63 percent
Livestock Development Project – Phase II	ADF grant	4.0	7.45 percent
Total		*8.0*	*10.79 percent*

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 2005, 2006 and 2008. 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. 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 January 15, 2009)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange rates	Jan 2009	Jan 2009	D	D	D
International reserve assets and reserve liabilities of the monetary authorities [1]	Dec 2008	Jan 2009	M	M	M
Reserve/base money	Jan 2009	Jan 2009	D	D	D
Broad money	Sep 2008	Nov 2008	M	M	M
Central bank balance sheet	Dec 2008	Jan 2009	M	M	M
Consolidated balance sheet of the banking system	Sep 2008	Nov 2008	M	M	M
Interest rates [2]	Jan 2009	Jan 2009	D	D	D
Consumer Price Index	Dec 2008	Jan 2009	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	Sep 2008	Nov 2008	M	M	NA
Stocks of central government and central government-guaranteed debt [5]	Oct 2008	Nov 2008	M	I	M
External current account balance	Dec 2007	Nov 2008	A	I	A
Exports and imports of goods	Sep 2008	Nov 2008	M	I	M
GDP/GNP	2007	Nov 2008	A	I	A
Gross external debt	Oct 2008	Nov 2008	M	I	M

[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).

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FOR IMMEDIATE RELEASE
March 3, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$3.8 Million PRGF Arrangement for São Tomé and Príncipe

The Executive Board of the International Monetary Fund (IMF) has approved a three-year, SDR 2.59 million (about US$3.8 million) arrangement under the Poverty Reduction and Growth Facility (PRGF) for São Tomé and Príncipe, to support the authorities' economic program. The decision will enable São Tomé and Príncipe to draw the equivalent of SDR 0.37 million (about US$0.54 million) from the IMF immediately.

At the conclusion of the Executive Board's decision, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, made the following statement:

"São Tomé and Príncipe's economic performance has improved in the last year. Real GDP growth has remained robust and international reserves are at a comfortable level. Recent efforts to combat high inflation are welcome.

"The country's prospects remain broadly positive. Prudent macroeconomic policies and continued implementation of structural reforms will be key to addressing downside risks to the outlook, and help achieve the policy objectives supported by the new PRGF program. The authorities' 2009 fiscal program is designed to reduce the domestic primary budget deficit, implement important direct tax reforms, and increase capital spending to support economic activity and the development of the non-oil sector.

"Monetary policy will continue to be proactive in curbing liquidity growth to reduce inflation. It will be important that the authorities coordinate their fiscal and monetary policies in order to safeguard international reserves, while bringing inflation down to single digits. The adoption of a fixed exchange rate regime, by pegging the dobra to the euro, would enhance the prospects for low inflation and deepen ties with key economic partners. The authorities are giving careful consideration to the challenges involved in the move to a new regime, which will require strong fiscal discipline to ensure its sustainability.

"Over the medium term, the authorities face the challenge of maintaining fiscal and debt sustainability. Given uncertain oil prospects, continued fiscal consolidation beyond 2009, strengthened debt management and relying on concessional external financing will be critical. Sustained structural reforms will help develop the economy's production potential and export base and reduce its vulnerability to shocks. Strengthening and deepening the financial sector and improving the investment climate should be given high priority," Mr. Portugal said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies. These strategies are adopted after an inclusive process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period on principal payments.

ANNEX

Recent Economic Developments

In 2008, the Democratic Republic of São Tomé and Príncipe experienced strong economic growth, driven by foreign direct investment in the construction, commerce, tourism, and services sectors. Real GDP growth is projected to reach about 5.5 percent in 2009 after averaging 6 percent in the previous two years. Higher food and energy costs pushed up consumer price inflation in 2008, reaching 37 percent in June 2008. Inflation has retreated in the second half of 2008, falling back to 24.5 percent in December, thanks to strengthened monetary policy.

Fiscal consolidation continued in 2008, albeit at a slower pace than planned due to the decision to cover part of households' utility bills, which were rising as a result of high oil prices in the last year. The primary fiscal deficit is estimated to reach 6.6 percent of GDP in 2008, down from 8.4 in 2007..

The external current account deficit in 2008 is estimated at 34 percent of GDP, and was more than fully financed by foreign direct investment and external aid. São Tomé and Príncipe's debt outlook remains vulnerable despite relief from the enhanced Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief Initiatives.

Program Summary

The government's medium-term macro-economic program is designed to support growth, significantly reduce inflation, and ensure fiscal and external sustainability.

The macroeconomic framework for 2009-11 aims to achieve:

• Annual real GDP growth of about 6.3 percent.

• Single-digit inflation by the end of the program.

• Sustainable public finances even in an adverse oil scenario.

• Preparing the ground for a possible decision to peg the dobra to the euro within a framework of macro-economic discipline.

To achieve these objectives, medium-term policies include:

• Gradual fiscal adjustment curbing the growth of current expenditure and strengthening tax collections.

• Central bank focus on reducing inflation to low double digits early in the period and to single-digits by the end of the three-year period.

• Structural reforms in the areas of public enterprises, public expenditure management, banking sector regulation, labor regulation and business climate.

São Tomé and Príncipe: Selected Economic Indicators, 2006–2011

	2006	2007	2008 Proj.	2009 Prog.	2010 Proj.	2011 Proj.
	(Annual change in percent, unless indicated)					
National income and prices						
GDP at constant prices	6.7	6.0	5.8	5.5	6.5	7.0
Consumer prices						
End of period	24.6	27.6	24.8	16.0	10.0	7.0
Period average	23.1	18.5	26.0	20.1	12.8	8.4
External trade						
Exports of goods and non-factor services	7.8	-21.5	60.7	-8.5	13.2	13.5
Imports of goods and non-factor services	45.2	9.7	36.8	27.4	-5.4	1.0
Exchange rate (dobras per US$; end of period) [1]	12,945	14,220	15,077	…	…	…
Real effective exchange rate (depreciation = -)	4.3	1.3	20.0	…	…	…
Money and credit (end of period)						
Base money [2]	32.0	50.0	18.9	10.7	20.7	16.4
Broad money (M3)	39.3	36.4	9.5	13.5	20.7	16.4
Velocity (GDP to average broad money)	2.7	2.8	3.0	3.1	3.1	3.1
Central bank reference interest rate (percent)	28.0	28.0	28.0	…	…	…
Bank lending rate (percent)	29.3	32.4	32.4	…	…	…
Bank deposit rate (percent)	10.8	12.8	12.8	…	…	…
	(Percent of GDP, unless otherwise specified)					
Government finance						
Total revenue, grants, and oil signature bonuses [3]	36.8	160.3	47.6	70.7	50.2	34.4
Of which: tax revenue	17.2	16.3	14.7	16.7	15.9	16.0
Non-tax revenue	3.7	2.8	1.9	1.8	1.4	1.3
grants	15.9	120.1	31.0	52.2	20.7	17.0
oil signature bonuses	0.0	21.1	0.0	0.0	12.2	0.0
Total expenditure and net lending	50.5	39.8	31.0	62.9	53.2	47.0
Of which: personnel costs	8.6	8.9	8.6	8.6	8.4	8.2
non-wage noninterest current expenditure	16.3	15.6	12.5	10.1	9.0	8.5
treasury funded capital expenditures	3.3	1.1	0.5	2.8	2.4	2.4
donor funded capital expenditures	16.5	10.2	7.5	39.6	31.5	25.9
Domestic primary balance [4]	-10.7	-8.4	-6.6	-4.5	-3.9	-3.1
Overall balance (commitment basis)	-13.7	120.5	16.6	7.9	-2.9	-12.6
External sector						
Current account balance						
Including official transfers	-28.8	-29.9	-34.0	-43.0	-38.1	-35.1
Excluding official transfers	-53.5	-51.7	-58.8	-69.7	-59.5	-52.5
PV of external debt	159.7	11.8	10.9	19.0	25.9	30.6
External debt service (percent of exports) [5]	33.8	24.3	5.1	5.5	7.1	8.0
Export of goods and non-factor services (US$ millions)	17.2	13.5	21.7	19.8	22.4	25.5
Gross foreign reserves [6, 7]						
Months of imports of goods and nonfactor services	4.8	3.4	6.6	5.0	4.0	4.0
Millions of U.S. dollar	24.7	26.3	46.5	38.6	32.6	34.8
National Oil Account (US$ millions) [9]	8.6	14.9	12.2	9.9	32.3	30.0
Memorandum Item						
GDP						
Billions of dobras	1,550	1,962	2,568	3,196	3,817	4,398
Millions of U.S. dollars	125	145	176	201	213	230
Privatization account (million US dollars)	0	0	21	17	14	11

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

[1] Central bank (BCSTP) buying rate.

[2] 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.

[3] Includes HIPC and MDRI debt relief.

[4] A new definition is adopted from 2008, retroactively, to exclude oil revenue, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.

[5] In percent of exports of goods and nonfactor services. Includes HIPC and MDRI debt relief.

[6] Gross reserves exclude the National Oil Account and commercial banks' foreign currency deposit at the BCSTP in order to meet the reserve requirement for their foreign currency deposits or as application deposits for new licensing.

[7] For 2008, includes the proceeds from the privatization of the government's share in the fuel distribution company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the central bank to boost reserves.

[8] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

[9] For 2010, based on the assumption that dispute will be settled to allow disbursement of bonuses for Blocks 5 and 6 ($26 million).

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

March 2, 2009

My authorities would like to thank Management and the staff for their continued support and useful advice to São Tomé and Príncipe (STP) over the past few years. My authorities are also very grateful to the international community for their financial and technical support during the previous Fund arrangement. Since the last review of that PRGF-supported program in June 2008, they followed through on their commitments with the completion of various reforms initiated during the arrangement and pursued an overall satisfactory program implementation through the end of 2008.

My authorities intend to maintain their growth and poverty-reducing efforts going forward with the implementation of a medium-term program of actions whose priorities are (i) increasing domestic food production, (ii) improving basic infrastructure and (iii) promoting tourism as an engine of economic growth. During the implementation of their program, my authorities will continue to pursue macroeconomic stability, which they believe is a necessary condition for the pursuit of their abovementioned priorities in a sustainable way.

In support to their program, my authorities are requesting a new three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), covering the period March 2009-December 2011, as they believe that such arrangement provides an appropriate framework to continue their macroeconomic stabilization efforts and the reforms initiated in the previous arrangement, and to secure international community support to their development program. In this regard, the National Assembly adopted a budget for 2009 in line with the organic law (SAFE) and the program to be implemented under the PRGF arrangement. In addition, they have prepared a set of priority projects that will be implemented in the context of the public investment program, and have established a monitoring framework to ensure the quality of related spending.

I. Recent developments

Economy activity remained buoyant in 2008. Output is estimated to have grown by 5.8 percent in 2008, thanks to continued tourism-related construction, commerce and services. The completion of new hotel in the archipelago as well as the increase in the number of international flights to the country and the resulting reduction in airplane tickets has resulted in a growing number of tourists visiting the country in 2008, which in turn contributed to a 61-percent growth in exports of goods and services. Despite this achievement, the current account balance deteriorated by 4 percentage points of GDP due to higher imports of food and fuel products and investment goods. This deficit was financed by sustained external grants and tourism-related FDI.

In the **fiscal sector**, my authorities managed to pursue their fiscal consolidation efforts with a greater control of expenditures. As a result, the primary fiscal deficit declined for the fifth consecutive year from 8.4 percent of GDP in 2007 to 6.6 percent in 2008. As regards fiscal reforms, the direct tax package, aimed at reducing the corporate income tax rate and replacing the current flat personal income tax rate with a progressive tax structure, was adopted in October 2008. Good progress was also made towards to a fully integrated computerized public financial management system (eSAFE) with the completion of the bidding process for the equipment. My authorities also initiated the bidding process for the eSAFE software. The IT and accounting offices are expected to start operations by end-September 2009, once the purchase and the installation of all IT equipment are completed.

The **monetary tightening** initiated in the second quarter of 2008 to mop up excessive liquidity has been maintained through the end of 2008, with a more extensive use of foreign exchange sales and an increased coordination with the Ministry of Planning and Finance. As a result, money growth declined from 50 percent at end-2007 down to 19 percent at end-2008, and the exchange rate stabilized in the course of the year. In addition, inflation receded from its peak of 37 percent in June to 25 percent at-end 2008, while usable international reserves remained high at 6.6 months, well above the 4-month target.

Given its limited external exposure, the **financial sector** has not been affected by the global financial turbulence. However, in light of the growing number of banks in the country, the BCSTP enhanced its banking supervisory capacity held by Fund assistance. After preliminary off-site inspections revealed some weaknesses in some banks, they intend to start on-site inspections beginning this month, with MCM assistance.

As regards **structural reforms**, the new investment code, which aims to reduce the time to approve investment projects and provides equal treatment to foreign and domestic investors, was approved in December 2008. In the public enterprise sector, my authorities sold a majority stake in ENCO, the national petroleum distribution company, to SONANGOL, the Angolan national oil company. Electricity tariffs have been revised upwards in 2008, in order to improve the financial viability of EMAE, the national electricity company. However, EMAE is still experiencing some collection problems and the continued degradation of its operating infrastructure is affecting the company’s efficiency. On the other hand, there has been little improvement in the financial situation of other state-owned enterprises, notably ENASA, the airport operator, and ENAPORT, the seaport managing company, as they continue to suffer from excessive costs and difficulties to cover them. My authorities have initiated efforts to redress these enterprises by involving the private sector.

Developments in the **oil sector** have not been encouraging as exploratory drilling so far has not confirmed the existence of commercially extractable oil reserves. In addition, long-term prospects are more and more uncertain as new drilling scheduled for late 2009 may be further delayed as a result of weak oil prices. The corollary of this uncertain outlook is the greater risk of debt distress in the absence of oil production, as indicated by the Debt Sustainability Analysis Update, which outlines the need for continued prudent macroeconomic policies and diversification of the sources of growth over the medium-term.

II. Medium term program, outlook and policies

The government's medium-term program[1]

As noted above, the government has put forward a medium-term action program, *Programa do XIII Governo*, aimed at taking full advantage of the country's natural resource potential and establishing the conditions for private sector development, consistent with the PRSP, while ensuring macroeconomic stability. This program focuses on three priority areas namely agriculture, infrastructure and tourism.

Specifically, given that a large proportion of the population earns a living in small-scale agriculture and fishing, my authorities believe that there is a huge potential to increase domestic food production if appropriate programs are in place and hence to reduce dependence on imported food stuffs, which are sometimes the source of high food prices and inflation. The strategy here is to develop this sector's productive capacity, with a special emphasis on the provision of material and technical support for small producers. They believe that a successful implementation of programs in this regard will contribute to poverty reduction and lead to food security over time.

My authorities also believe that the continued deterioration of its infrastructure or the lack thereof has been one of the main impediments to private sector development. The emphasis of the program going forward will be primarily on improving the basic infrastructure and mitigating power supply problems. They have already reached agreements with foreign investors on several large projects regarding notably the airport and a deep-water seaport.

My authorities strongly believe that succeeding in the two previous areas, together with continued regulatory reform and public enterprise sector reform, will significantly improve the conditions for private sector development, notably in the tourism sector, which they view as the main engine of growth over the medium-to-long term.

[1] The full program is available at this website: http://www.gov.st/content.php?intMenuID=39

Exchange rate arrangement

As indicated in the MEFP, the government is studying the possible modification of the country's exchange rate regime, for which it is discussing an agreement with Portugal. It expects the joint technical work with the Portuguese authorities to be concluded during the course of 2009, and to make a final decision once this preliminary work is concluded. The government is aware of the need for the strictest discipline in the conduct of fiscal policy for the viability of a fixed exchange rate. The decision on a new regime will be made only after the most careful consideration has been given to these issues and to the design of a transition strategy. The timeline just outlined also allows the BCSTP to make headway in the current disinflation process in advance of the possible pegging of the exchange rate.

Medium-term economic outlook and risks

My authorities foresee that economic growth will remain robust, on average above 5 percent over the next three years, as a result of continued buoyant construction activity fuelled by the public investment program and FDI. The current account deficit is expected to widen as a result of continued investment imports, although the current low levels of international oil prices might dampen this widening, if sustained over time. Macroeconomic policies for the medium-term will be geared towards achieving macroeconomic stability while supporting their development program and putting in place the foundations for reaching an agreement with Portugal on an exchange rate arrangement. My authorities are aware that their macroeconomic framework is subject to significant risks stemming from the effects of the current global economic slowdown and financial turmoil on external demand for STP exports, tourism, FDI and donor support. In the event significant changes in the external environment occur or if long-term oil prospects deteriorate further, they will revise their economic program accordingly.

Fiscal policy

Fiscal consolidation will continue over the medium term, with the objective of reaching a primary fiscal deficit of 3.3 percent by the end of the program in 2011. In particular, an emphasis will put on (i) pursuing the strengthening of the tax administration with the support of the Portuguese authorities and the US Millenium Challenge Corporation (MCC); (ii) completing the public financial management reform; and (iii) undertaking the public wage reform with a view to revising the salary structure, while rationalizing the compensation package and ensuring that all elements thereof are properly reported in the fiscal accounts.

For 2009, the goal is to achieve a primary fiscal deficit of 4.5 percent of GDP. This will be achieved through continued containment of expenditures –in particular the wage bill-related and nonessential current expenditures, while preserving pro-poor spending and increasing treasury-funded capital expenditures–, as the recently approved direct tax reforms would be largely neutral. The deficit will be financed by statutory withdrawals from the National Oil Account, the remainder of the IDA's Development Policy Operation (DPO) grant and part of the proceeds of the privatization of ENCO. The government will stand ready to adjust its spending if needed to meet the NIR target.

My authorities intend during the program to use the proceeds of the privatization of ENCO and any other non-oil one-off receipts in a way similar to that of the resources in the NOA. In this regard, they create a dobra-denominated account at the BCSTP where all above-mentioned receipts will be deposited. These resources will be financing the fiscal primary deficit up to one fifth of the starting balance each year starting in 2010. The government will ensure that the availability of these temporary resources does not lead to the creation of permanent expenditure obligations. They will also refrain from resorting to domestic banking system credits.

The 2009 fiscal reform program will focus on addressing the issue of protracted tax arrears. In this regard, my authorities intends to establish a temporary facility that will encourage taxpayers to regularize their tax situation by allowing them to settle their tax arrears in several installments, with the possibility in some cases to benefit a partial pardon of some overdue taxes, late interests and fines. My authorities also intend to take advantage of the current low oil prices to implement an automatic pricing mechanism for petroleum products. As indicated above, the public financial management reform will be pursued. They will also proceed with the reform of public enterprises to improve their financial situation.

Monetary, exchange rate and financial policies

The monetary tightening initiated last year will be pursued in 2009. In particular, the monetary program aims to keep base money growth in line with the program's objective of reducing inflation to 16 percent by end-2009 and to single digits by 2011. Given the limited effectiveness of interest rates and other monetary policy instruments, my authorities will continue to use foreign exchange sales to control liquidity, while preserving a strong level of reserves. The BCSTP will also continue their close cooperation with the Ministry of Planning and Finance, which has proven effective in improving the central bank's liquidity management and meeting international reserves target last year. The central bank will continue with its communication strategy of informing the market of its monetary and exchange policies.

The BCSTP will continue to enhance its banking supervision and further strengthen its capacity to enforce banking supervision regulations. In particular, the central bank plans to set up a Bureau of Credit registry to facilitate credit information sharing among banks. It also plans to prepare a framework to facilitate mergers and acquisitions among banks by 2010. My authorities will implement the recently approved AML/CFT law and improve it further with the help of development partners.

Other issues

Efforts to enhance the **investment climate**, notably by reducing the cost of investing and doing business in STP, will be sustained. In particular, my authorities will submit a new labor law to the National Assembly by end-June 2009 and establish one-stop window for business registration by end-September 2009.

My authorities will continue to strengthen transparency and accountability in the **oil sector**. In particular, they will submit to the National Assembly the legal framework for the Exclusive Economic Zone (EEZ) and conduct the licensing round for the EEZ transparently and consistent with the Oil Revenue Management Law (ORML) and the EITI.

As regards **debt management**, my authorities will continue to ensure debt sustainability by refraining from new non-concessional external borrowing, and redouble their efforts to seek full delivery of HIPC debt relief from the remaining official creditors. They plan to introduce a draft framework law for the public debt by end-September 2009.

III. Conclusion

In conclusion, cognizant of the increasing uncertainty surrounding oil prospects, my authorities have devised a development program, consistent with the PRSP, aimed at securing food security, improving infrastructure and power supply, and promoting tourism as an engine of growth, while ensuring macroeconomic stability. This is an ambitious program for which they are requesting Fund support through a PRGF arrangement. My authorities believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but stands ready to take additional measures if needed, in consultation with the Fund. I will appreciate Directors' support to my authorities' request.