International Monetary Fund

Democratic Republic of São Tomé and Príncipe and the IMF

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

December 27, 2006

São Tomé, December 27, 2006

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

Dear Mr. de Rato:

1. The attached Memorandum of Economic and Financial Policies (MEFP) sets out the objectives and policies that the government of São Tomé and Príncipe intends to pursue during the remainder of 2006 and for 2007, consistent with the Government's Poverty Reduction Strategy (PRS) and the objectives of the three-year arrangement under the IMF's Poverty Reduction and Growth Facility (PRGF). Based on our efforts we sincerely hope the Saotomean population will benefit from the continued support of the international community, including through debt relief. We understand that São Tomé and Príncipe would reach the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative once the Board of the IMF completes the third review under the PRGF arrangement and the Boards of the IMF and World Bank determine that all completion point triggers laid out in the HIPC decision point document have been met.

2. The year 2006 has been crucial for our country as we held parliamentary, presidential and local elections which have strengthened our democratic institutions. While undertaking the elections, we have continued the progress since the beginning of our program in 2005, notably in fiscal consolidation while prioritizing social spending, in developing monetary instruments to control inflation, and in implementing structural reforms, with a focus on good governance. We have also expeditiously implemented all the HIPC completion point triggers, and we are putting in place transparent frameworks for the management of public expenditure and the use of oil resources, especially for poverty reduction. Our program through end-2007 envisages a continuation of fiscal consolidation combined with a prudent use of oil bonuses, a strengthening of monetary and exchange rate policies to lower inflation, and an acceleration of structural reforms. These are key conditions for sustained low-inflation growth which in turn is key for poverty reduction.

3. In support of our objectives and policies, the government hereby requests the completion of the third review and the disbursement of the fourth loan under the PRGF arrangement in an amount equivalent to SDR 0.423 million (5.7 percent of quota). The Government requests waivers for the nonobservance of the end-June 2006 performance criteria for domestic primary balance, domestic primary spending, and net domestic financing of the government. These deviations are mainly due to higher spending related to the elections, and the Government has since then taken revenue and expenditure measures as well as monetary policy measures to broadly safeguard the financial targets for end-2006. At end-November, these measures have allowed the domestic primary deficit in percent of GDP to return to the programmed path and 12-month inflation to slow to 24 percent from its peak

of 26 percent at end-August. The Government also requests waivers for the nonobservance of the end-June 2006 performance criteria on net international reserves and net domestic assets of the Central Bank of São Tomé and Príncipe which was mostly due to the delay in the receipt of oil signature bonuses. Given that the higher inflation and election spending needs have required a revision of our fiscal program for 2006, the Government requests modification of the targets for four quantitative performance criteria for end-December 2006; it also requests deletion of the performance criterion for domestic primary spending. Furthermore, the Government requests deletion of the structural performance criterion on the implementation of the public financial management system (SAFE) on the understanding that it will be established in due course as a structural performance criterion for end-December 2007 related to the sixth review.

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

5. The fourth and fifth reviews related to the fifth and sixth disbursements under the PRGF arrangement based on the end-December 2006 and end-June 2007 performance criteria are expected for May and November 2007, respectively.

6. The Government believes that the policies and measures set forth in the MEFP are adequate to achieve the objectives of the 2006–07 program supported by the PRGF arrangement, but will take further measures to that end if deemed necessary. During the implementation of the arrangement, the Government will consult with the Managing Director of the IMF on the adoption of any measures that may be appropriate, at the initiative of the Government or whenever the Managing Director requests such a consultation.

7. The Government intends to make the contents of this Letter of Intent and those of the attached MEFP and Technical Memorandum of Understanding (TMU), as well as the staff report on the third review under the PRGF arrangement, available to the public and authorizes the IMF to arrange for them to be posted on the IMF website, subsequent to Board completion of the third review.

Yours truly,

/s/

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

/s/

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

Attachments: Memorandum of Economic and Financial Policies

Technical Memorandum of Understanding

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

December 27, 2006

I. INTRODUCTION

1. This Memorandum of Economic and Financial Policies (MEFP) supplements that of July 2006, as well as our Letter of Intent dated July 14, 2006. It describes (i) performance under the PRGF arrangement through September 2006; (ii) economic developments in the first nine months of 2006, and (iii) the government's economic program for the remainder of this year and for 2007. The satisfactory performance under the PRGF-supported program since 2005, combined with our policies set forth in this Memorandum should help São Tomé and Príncipe attain the medium-term objectives set out in our PRSP and reach the completion point for the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. Our government remains committed to create the conditions for sustained low-inflationary growth, which is essential for reducing poverty.

II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM

2. **Economic activity so far in 2006 has exceeded expectations, with GDP growth projected at 8 percent**. The construction, commerce and services sectors have shown strong growth, while the agricultural and fishery sectors have shown lower growth due to structural problems.

3. **Inflation rose to 26 percent in the 12 months through August (from 17.2 at end-2005), as a result of a combination of temporary exogenous factors and fiscal and monetary expansion.** On the supply side, temporary food shortages and other bottlenecks and the significant increase in fuel prices to move closer to world prices in June have contributed to the surge in inflation. Large unexpected private capital inflows and related built up of foreign currency deposits (FCD), together with some unforeseen fiscal spending related to the electoral period, have boosted base money, credit to the economy, and broad money (M3).

4. **The Dobra depreciated by 10 percent against the U.S. dollar in the 12 months through November 2006**. The growth in FCD may have slowed the depreciation of the exchange rate so far in 2006.

5. **Fiscal performance deviated somewhat from the program path through June 2006 owing mainly to expenditure overruns related to the elections and the need to meet unforeseen needs, mainly in the period January–April.** Domestic primary spending was higher than programmed reflecting (i) higher-than-programmed spending for the elections (Dobras 9 billion); (ii) unbudgeted advances by the treasury for projects pending financing by donors (Dobras 10 billion); and (iii) extrabudgetary spending for the military for back risk

premia (Dobras 5 billion) committed by the previous government. Revenue collection was better than programmed thanks to more buoyant import and domestic indirect tax receipts. As a result, the performance criteria for domestic primary balance and spending were missed by the equivalent of 2 and 2½ percent of GDP, respectively. However, fiscal measures initiated in May 2006, notably the increase in import reference prices, the 28 percent increase in petroleum prices in June, and a stricter control of expenditure have started to reap benefits, bringing the domestic primary deficit close to the indicative ceiling envisaged for end-September. Our financial management was complicated by the delay in receipt of oil signature bonuses for Blocks 2–4 (a total of US$28.6 million) which led to the nonobservance of three end-June monetary performance criteria, even after adjustment for these delays.

6. **Monetary aggregates grew faster than programmed because of overperformance on net international reserves (NIR), unplanned increase in credit to government, and large increase in private foreign currency deposits (FCD) partly related to the electoral period.** The overperformance on NIR resulted from the Central Bank of São Tomé and Príncipe's (BCSTP) cautious approach to the sale of foreign exchange reserves for fear of missing NIR targets, when the receipt of oil bonuses did not materialize. Moreover, concern about an excessive depreciation of the exchange rate and its impact on inflation led to the suspension of the foreign exchange auctions and the reversion to direct sales to priority sectors, such as for oil and government needs. However, after the suspension, the BCSTP has continued to adjust its exchange rate daily to market conditions by calculating it as the sum of (i) 40 percent of the previous day's selling rate quoted by commercial banks for transactions with the public; and (ii) 60 percent of its previous day own selling rate. As a result, the emerging tensions on the foreign exchange market have remained limited and commercial bank selling rates have only relatively little deviated from that of the central bank.

7. **In response to the strong growth of monetary aggregates, the BCSTP raised its reference interest rate from 18.2 to 24 percent in May and to 28 percent in September and slightly raised reserve requirements**. However, although the program goal of keeping real interest rates positive was attained, these containment measures had only relatively little impact on the level of liquidity and monetary aggregates.

8. **Structural reforms under the program advanced considerably in 2006, compensating for the slow pace that had been registered, allowing five structural benchmarks for September to be met by December** (Table 4). The government strengthened the powers of the Inspectorate General of Finance (IGF) to oversee and audit government financial operations (presidential decree promulgated end-December); submitted two draft customs laws to the National Assembly and a related administrative text is ready for promulgation (November); and completed studies for the electricity sector (November) and for the restructuring of the port and airport (September). The government made significant progress in preparing the integrated public financial management system for budget execution (SAFE), with the submission to the National Assembly of the organic public finance law (November), the preparation of a new budget nomenclature and a ministerial circular for a new public accounting

system. However, the preparation of the SAFE and agreement on modalities with a key donor has taken longer than foreseen and its full implementation is expected for end-2007 (instead of end-2006 as planned).

9. **The government also made progress on other structural reforms to improve the business climate and enhance governance.** The remaining trigger for the HIPC Completion Point—the establishment of arbitration tribunals—was met with the promulgation of the arbitration law and the setting up of a **"center of arbitration"** at the Chamber of Commerce in mid-December. Furthermore, the government has submitted to the National Assembly the draft anti-money laundering law, ahead of schedule in October.

III. Economic Policies for the rest of 2006

10. **To reduce inflation, the authorities will vigorously implement the fiscal and monetary tightening agreed on in the second program review so as to stay close to the financial targets for end-2006, while protecting as much as possible propoor spending.** The authorities will continue to make every effort to speed up ongoing structural reforms, notably in the areas of public expenditure management and tax reform.

A. Fiscal Policy

11. **For the remainder of 2006, our government will continue to implement fiscal measures so as to contain the domestic primary deficit within the program target of 15½ percent.** The impact of the measures already implemented has allowed the domestic primary balance to be close to the indicative program targets for end-September. The revised program takes into account that the originally projected oil bonuses for blocks 2–4 (US$ 28.6 million) are unlikely to be disbursed before end-2006.

12. **On the revenue side, the government has stepped up its efforts to implement the measures agreed in May 2006** (Table 3):

- we have adopted and started implementing an action plan to recover corporate and personal income tax arrears (an estimated stock of Dobras 67 billion at end-October 2006), and the collection of ENCO indirect tax arrears on petroleum products;

- we will review the structure of the petroleum pricing mechanism as well as exemptions to eliminate existing anomalies (cross subsidies and ENCO's hidden losses) and at least safeguard petroleum revenue in percent of GDP. Based on this review and in consultation with IMF and World Bank staffs, it intends to introduce a revised structure with fewer exemptions by mid–March 2007, with a moderate increase in pump prices as needed, based on the simulations to be undertaken;

- we intend to effect the increase in excises on services (excluding water and electricity), from 5 percent to 7 percent, and raise the tax base by end-December 2006; and

- we have submitted a proposal to the National Assembly to increase excises on some imported goods, including alcoholic beverages and tobacco.

13. **On the expenditure side, we have implemented measures to correct the expenditure overruns registered in the first half of 2006**:

- the wage bill will be contained at Dobras 133 billion (equivalent to 13.5 percent of GDP, below the program figure of 13.8 percent) and wage drift due to payment of bonuses and other emoluments will be strictly monitored;

- non-wage expenditure will be vigorously contained by strict application of the May 19, 2006 budget circulars requiring prior authorization by the Minister of Planning and Finance of all expenditure commitments (*compromissos)* by budgetary units (except for spending within monthly budget allocations for wages, fuel, food, medicines, basic office supplies, and telecommunications); the payment of utilities (electricity and water) will closely follow consumption while continuing to avoid arrears; and all expenditure commitments have been stopped in early December 2006; and

- propoor spending is expected to increase to Dobras 230 billion (from Dobras 193 billion in 2005) thanks to the use of HIPC funds; however, due to the delay in the conclusion of interim debt relief agreements with bilateral creditors and the government's tight financial situation, propoor spending in 2006 will be somewhat below the program target (23.3 percent of GDP compared with 28.4 percent of GDP under the original program).

B. Monetary and Exchange Rate Policies

14. **The BCSTP's overriding objective is to reduce the rate of inflation in close coordination with fiscal policy, while maintaining a flexible exchange rate regime.** To this effect, the monetary authorities will adhere strictly to the target for base money and make a more active use of available monetary and foreign exchange instruments, consistent with the NIR target. Our monetary program envisages base money growth of 27.9 percent in 2006 and 21.5 percent in 2007. Given the high proportion of foreign currency in deposits, credit to the economy, and bank reserves (and the sensitivity of inflation to exchange rate volatility), the authorities will closely monitor the evolution of the Dobras component of base money to ensure an orderly evolution of the exchange rate. Furthermore, given the uncertainty about the relationship between base money, broad money (M3), and inflation under currency substitution, the authorities will respond flexibly to deviations from the base money target in consultation with IMF staff as needed.

15. **With a view to mopping up excess liquidity, the BCSTP will activate its instrument of Certificates of Deposits (CDs) and will introduce a complementary deposit facility depending on its financial position.** A first issuance of CDs is envisaged for December 2006 and should help pave the way for the development of an interbank market, and in due course,

open market operations. Subsequently, the BCSTP will start accepting fixed-term remunerated deposits from commercial banks in the second quarter of 2007.

16. **The BCSTP remains committed to maintaining a flexible exchange rate regime—while meeting the NIR target and avoiding excessive fluctuations of the exchange rate—through both auctions and direct sales of foreign exchange, taking into account the evolution of the foreign exchange market.** Although the daily adjustment of the BCSTP's exchange rate has avoided the emergence of significant parallel market premiums, the BCSTP aims to return before end-2006 to its single-price auctions, with a view to ensuring a fuller and faster market determination of the exchange rate, while avoiding excessive fluctuations in the exchange rate. To this effect, the BCSTP will conduct selling or buying auctions, at least bi-weekly, but it will meet banks demand for payments for petroleum imports and government needs (including scholarships and debt service) through direct sales outside the auction, at the current BCSTP exchange rate. Furthermore, the BCSTP will also strengthen its foreign exchange liquidity forecast, taking into account banks net open foreign currency positions in determining the amounts of its intervention.

17. **The BCSTP will continue to develop its communication strategy to inform the market on its monetary and exchange policies.** The BCSTP will meet at regular pre-announced intervals with the banking community and the media, to communicate the BCSTP's views on inflation and its monetary objectives. In addition, summary data on the monetary and macroeconomic aggregates will be made available to banks every month and posted on the BCSTP website.

18. **The BCSTP will further enhance the transparency of its operations and seek to improve its financial situation.** The BCSTP has posted the audited financial statements for 2005 on its website and will continue to do so every year. Its budget execution and profits and loss account on a cash basis will be reported at least quarterly as part of the program's monetary data. With regards to the construction of its new building, the BCSTP will seek to significantly reduce the total cost of the project, taking into consideration its contractual obligations and the impact on its current and future financial situation, in consultation with the government and IMF staff.

C. Structural Policies

19. **Following the submission of the main texts, the legal and institutional framework for the reform of public finance should be ready before the end of 2006.** This includes: putting in place the institutional and legal framework for the budget execution system (SAFE); the submission of six direct tax reform laws to the National Assembly; the start of implementation of the customs reform laws following their adoption by end-2006; and the adoption by the National Assembly of the new Investment Code—which provides equal treatment for domestic and foreign investors.

IV. Economic Policies and Structural Reforms for 2007

20. **Our macroeconomic framework for 2007 aims at significantly reducing inflation by continued fiscal consolidation and tighter and proactive monetary policy.** A significant reduction in inflation should be attainable given the actions we have already taken in recent months and the non-recurrence of one-off factors that contributed to inflation in 2006, such as the private capital inflows and spending related to the electoral period. MDRI relief (after HIPC completion point) should allow significantly higher propoor spending in line with the government's PRSP objectives. In this regard, we will step up our efforts to control HIPC/MDRI spending, while progressively putting in place the integrated public financial management system (SAFE) with technical assistance from Angola, the World Bank, and other external partners.

A. Fiscal Policy

21. **The government aims to reduce further the domestic primary deficit to about 12.9 percent of GDP in 2007 (compared with 15.3 percent in 2006), while increasing propoor spending**. Fiscal consolidation under the 2007 Budget (expected to be submitted to the National Assembly by end-December 2006) would come mainly from containment of nonessential spending and the wage bill, while the revenue-to-GDP is expected to decline slightly. The domestic primary deficit would be financed by the use of part of the oil bonuses (equivalent to 8.5 percent of GDP). The main elements of the fiscal program for 2007 are:

- **Receipt of oil signature bonuses from Blocks 2–4 (**delayed from 2006), projected at US$ 28.6 million (30.6 percent of GDP). Of this amount, US$8 million will be used for the budget and the remainder—after repayment of oil-related debt to Nigeria—will be deposited in the National Oil Account (NOA) to replenish the budgetary withdrawals in 2006. The NOA should reach US$14.5 million at end-2007, for future years. If further bonuses (possibly up to US$26 million) are received for blocks 5–6 in 2007, these funds will also be deposited in the NOA, consistent with Oil Revenue Management Law (ORML).

- **Full-year impact of measures taken in 2006 and early 2007** (see ¶12 above, and Table 3). The impact of the direct tax reform would be broadly neutral in 2007, reflecting the gradual adoption of the procedural codes that would strengthen the fight against tax evasion. The entry into force of the corporate and personal income tax codes is scheduled for 2008, with a potential slight loss of revenues for that year.

- **The contribution to the Joint Development Authority (JDA)** of US$3.6 million. This contribution would depend on clarification to be obtained from the Joint Ministerial Committee (JMC) on the disbursements of oil bonuses and the execution of the JDA budget.

- **A 20 percent increase in the wage bill to Dobras 160 billion, resulting in a decline in the wage bill-to-GDP ratio to 12.8 percent** (from 13.5 percent projected for 2006). This should leave room for further hiring in the social sectors, a slight widening of the salary range, and a general wage increase of about 18 percent to partly compensate for past inflation and the absence of a general wage increase in 2006. The authorities will closely monitor all the components of salaries and strictly limit the payments of emoluments, pending the outcome of the recently initiated study of salary structure and components. Based on this study, expected for end–April 2007, the government intends to adopt a revised salary structure with adequate incentives for public servants, as a first step of a civil service reform strategy.

- **A further increase in propoor spending** to 26.0 percent of GDP (from 23.3 percent in 2006). We aim to achieve this goal by containing nonessential primary spending by systematically applying the execution mechanisms contained in the draft Organic Budget Law. We will also strictly monitor the use of HIPC resources (about 8.5 percent of GDP in flow terms) and prospective MDRI resources (about 1 percent of GDP), while aligning allocations with PRSP priorities set out in the Priority Actions Plan for 2006–08.

22. **The proposed 2007 program is fully financed.** The fiscal plan assumes budget support from Taiwan-Province of China and the World Bank (consistent with its 2006–09 Country Assistance Strategy). To seek donor support for its Priority Actions Plan for 2006–08, the government has presented a revised list of needs in infrastructure, education, and good governance to the December 2006 Round Table in São Tomé.

B. Monetary and Exchange Rate Policies

23. **The monetary program for 2007 aims at reducing inflation through a stricter adherence to the base money target and active use of monetary and foreign exchange instruments, consistent with the NIR target (approximately 4 months of imports).** The monetary program aims to reduce the 12-month inflation to the 10–15 percent range by the end of 2007 through base money growth of 21.5 percent. Base money remains an indicative target, in light of the uncertainty about the relationships between monetary aggregates, on account of movements in bank reserves (related to new banks) and FCD. With technical assistance of the IMF's MCM, the BCSTP will seek to fine-tune its instruments so as to mop up liquidity while avoiding excessive fluctuations in the exchange rate. When liquidity conditions permit and our other monetary instruments become established, the BCSTP will seek to gradually lower the reserve requirements for banks, with due regard to other aspects of financial market development. The BCSTP will also take measures to develop the foreign exchange market, including providing information on banks' net open foreign currency positions and reducing the costs of making foreign transfers (Table 5).

C. Structural Reforms in 2007

24. **The government is committed to continue strengthening public financial management, increasing transparency of the management of prospective oil resources, and strengthening our financial system.**

25. **On public financial management (PFM), the government is implementing a pilot PFM program (SAFINHO)**, as a first step toward introducing the full system (SAFE) with the 2008 Budget. The pilot encompasses budget and treasury operations and enables the directorates of the Ministry of Planning and Finance to share a unified computerized system. We will adopt a new public accounting plan and the related manual of accounting procedures, consistent with the new organic public finance law and SAFE by end-March 2007 (structural PC, Table 2). Furthermore, we will continue our in-depth review and modernization of public finances.

26. **Transparency in the oil sector is guaranteed by the ORML.** We aim to publish the ORML handbook and submit legislation relating to the Petroleum Oversight Committee for auditing and supervision of petroleum receipts and expenditures under ORML by January 2007. Simultaneously, we intend to implement the EITI process, as expressed at the third EITI conference in Oslo in October 2006. Furthermore, we will seek to improve information sharing on the outcome of JMC meetings, on Production Sharing Contracts (PSC), and budget execution reports of the Joint Development Agency (JDA).

27. **In 2007, the government intends to conduct a study on indirect taxation.** The objective will be to review the current tax structure and expand the tax base (including by including the informal sector), with the support of international partners.

28. **Regarding the financial system, the BCSTP intends to further enhance banking supervision, strengthen its internal management in line with the IMF's safeguards assessment conducted in 2004, and implement the anti-money laundering law** (Tables 2 and 5).

- The BCSTP is strengthening its capacity to supervise licensing of new banks, devise on-site and off-site prudential indicators, and assess foreign currency positions and operating risks of banks. In this context, it will issue new prudential regulations on credit classification, liquidity, transactions with related parties, and limits on net open foreign currency positions by end-June 2007 (structural PC, Table 2). A regular system for reporting prudential ratios to IMF staff has now been established.

- Following the adoption by the National Assembly of the draft anti-money laundering law (expected for end-2006), the BCSTP intends to adopt regulations on the creation of a Central Risk Unit within the BCSTP and the "know-your-client" rules for banks in March 2007.

- Regarding the safeguards assessment, the BCSTP intends to publish the 2005 audited financial statements and adopt investment guidelines for international reserves by January 2007.

29. **The government remains committed to accept the obligations under Article VIII, Sections 2(a), 3, and 4 of the IMF's Articles of Agreement, in the near future, as foreign exchange market conditions normalize.** To this effect, the exchange restriction on transfers abroad of dividends will be eliminated with the new Investment Code (expected to be adopted by the National Assembly in December 2006). Furthermore, the BCSTP expects to progressively reduce the exchange restriction related to the mechanism for selling foreign exchange to banks with the implementation of a single-price auction system and the continued application of the formula for calculating the BCSTP rate.

D. HIPC Completion Point and MDRI

30. **Reaching the HIPC completion point in early 2007 is an overriding policy objective for our government.** We believe we have made significant progress in (i) implementing the required health and education measures; (ii) putting in place institutional mechanisms to ensure efficient and transparent use of HIPC interim debt relief; and (iii) increasing transparency and accountability in the management of public resources. The remaining outstanding trigger for the HIPC completion point—the establishment of arbitration tribunals—was promulgated and is expected to be operational by end-December 2006. Furthermore, in preparation for the HIPC completion point, the government has contacted the Paris Club creditors with a view to concluding bilateral agreements under the September 2005 Paris Club terms of reference. It has also signed agreements with Germany and France, and the signature process with Spain is advanced.

31. **The government intends to use potential MDRI resources in line with the Priority Actions Program (PAP) for 2006-08.** Savings on debt service from MDRI are estimated at about 1 percent of GDP in 2007 and 2 percent on average during 2008–10. On debt management, the government is conscious of the need to secure concessional external financing and ensure debt sustainability after HIPC and MDRI. To improve the government's capacity to manage external debt, we are putting in place a debt recording and management system obtained from the Commonwealth Secretariat (CS-DRMS).

E. External Sector Policies

32. **In the context of the Integrated Framework, the government continues implementing the 2005 Diagnostic Trade Integration Study (DTIS).** Our policy aims to facilitate and expand export-oriented production by the poor, improve the business environment, enhance infrastructure and public services, and reduce trading costs. The government has appointed a commission to prepare the Memorandum on Foreign Trade Regime to be submitted

to the WTO working party as part of the formal WTO's accession. Also, the Ministry of Trade will hire a consultant to study São Tomé and Príncipe's options for regional trade integration.

F. PRSP Issues

33. **As indicated in our first PRSP Annual Progress Report, the government will continue its reforms and seek to enhance propoor spending.** Based on current trends, many MDGs may be out of reach for 2015; therefore, we have stepped up our efforts to mobilize donor support, seek enhanced donor coordination, and improve the quality of poverty reduction spending. As noted above, we have hosted sectoral Round Tables in December 2006 on governance, education, and infrastructure. We will also reinforce the PRSP monitoring and evaluation process, strengthen the Poverty Observatory (with UNDP and AfDB assistance), and seek to involve more our civil society in the implementation of the PRSP and the oversight of the use of HIPC funds.

G. Statistical Issues and Capacity Building

34. **Despite progress in certain areas (especially in monetary statistics), the government is aware of remaining weaknesses in statistical data, in particular, in the area of government financial operations (TOFE), for which the government will seek further technical assistance from the IMF.** Furthermore, the government will request technical assistance from the IMF in the areas of tax reform (notably customs and indirect taxes) and public financial management.

H. Program Monitoring

35. **The revised Technical Memorandum of Understanding (TMU) sets out the modalities of program monitoring.** This includes the definitions of performance criteria and indicative targets, the application of adjustors for deviations from programmed amounts of oil signature bonuses, budget support, and net external debt service payments, and data sources and frequency of data reporting. To strengthen program monitoring and data reporting, the government will establish an interministerial technical committee.

36. **The attached Table 1 shows the proposed quantitative performance criteria for end-December 2006 (fourth review under the program) and proposed quantitative performance criteria for end-June 2007 (fifth review).** The government requests the modification of the targets for four quantitative performance criteria (domestic primary balance, net bank financing of the government, and net domestic assets and net international reserves of the BCSTP) and the deletion of one quantitative performance criterion (domestic primary spending, already covered under the domestic primary balance) for end-December 2006, for the fourth review.

37. **The attached Table 2 includes the proposed structural performance criteria and benchmarks for December 2006 and for 2007.** The Government requests the deletion of one structural performance criterion (implementation of SAFE) for end-December 2006, on the

understanding that it will be established as a structural performance criterion for end-December 2007, for the sixth review. In addition, the non accumulation of external payment arrears (as defined in the attached revised TMU) is a continuous performance criterion, as are the injunctions against imposing or intensifying restrictions on current payments, introducing or modifying multiple currency practices, concluding bilateral payments agreements that are inconsistent with Article VIII, or imposing or intensifying import restrictions for balance of payments reasons.

Table 1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2006–07

(Billions of dobras, unless otherwise specified)

	2006			2007			
	Sep. 30	Dec. 31		Mar. 31	Jun 30	Sep. 30	Dec. 31
	Base (in stocks)	*Perf. Criteria* [11] *CR/06/400*	Proposed revised Perf. Criteria	Ind.Target	Perf. Criteria	Ind.Target	Ind.Target
1. Floor on domestic primary balance (as defined in the TMU; cumulative from beginning of year)	…	*-143,8*	-150,0	-40,6	-97,0	-129,3	-163,2
2. Ceiling on changes in net bank financing of the government (cumulative from end–September 2006; billions of dobras at program exchange rate) [1,2,3]	-126,8	*-182,7*	62,1	-90,3	-32,4	-23,9	3,0
3. Ceiling on changes in net domestic assets of the central bank (cumulative from end–September 2006; billions of dobras at program exchange rate) [1,2,3]	-289,8	*-175,2*	73,1	-77,7	-19,6	-11,0	21,8
4. Floor on changes in the net international reserves of the central bank (cumulative from end–September 2006; millions of U.S. dollars) [3,4]	41,8	*14,2*	-6,4	4,6	1,9	2,5	0,7
5. Ceiling on central government's outstanding external payment arrears (stock, millions of U.S. dollars) [5]	…	*0,0*	0,0	0,0	0,0	0,0	0,0
6. Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the central government or the BCSTP (cumulative flows from January 2005, millions of euros) [6,7]	…	*1,6*	1,6	1,6	1,6	1,6	1,6
7. Ceiling on the outstanding stock of external debt with original maturity of less than one year owed or guaranteed by the central government or the BCSTP (stock, millions of U.S. dollars) [8]	…	*1,0*	1,0	1,0	1,0	1,0	1,0
Memorandum items:							
Base money (ceiling; billions of dobras)	273,2	…	269,5	282,0	302,5	322,3	327,6
Currency Issued (ceiling; billions of dobras)	94,4	*94,3*	103,6	99,0	105,0	110,6	123,7
Oil signature bonuses including accrued interest on NOA (millions of U.S. dollars, cumulative from beginning of year)	0,5	*28,6*	0,6	28,7	28,8	28,9	29,0
Net external debt service payments (cumulative from beginning of the year, billions of dobras at program exchange rate) [9]	-35,4	*-32,1*	-46,1	-205,8	-211,0	-216,6	-220,4
Official external program support (cumulative from beginning of the year, billions of dobras at program exchange rate) [10]	7,8	*27,3*	2,4	0,0	0,0	31,4	41,8

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

[1] The ceiling will be adjusted downward (upward) by the cumulative negative (positive) deviations of actual from projected net payments in external debt service and the cumulative positive (negative) deviation of actual from projected disbursements of external program support and oil bonuses including accrued interest on NOA. The downward adjustment of higher than programmed external program support will not take place to the extent that the additional support is used to accommodate higher capital outlays of the government, up to US$1 million.

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

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

[4] The floor on net international reserves will be adjusted upward (downward) by the cumulative negative (positive) deviation of actual from projected net payments in external debt service (including repayments to Nigeria), and the cumulative positive (negative) deviation of actual from projected disbursements of oil bonuses including accrued interest on NOA. The upward adjustment of higher than programmed external program support will not take place to the extent that the additional support is used to accommodate higher capital outlays of the government, up to US$1 million.

[5] This is a continuous performance criterion.

[6] This performance criterion applies not only to debt as defined in point No. 9 of the *Guidelines on Performance Criteria with Respect to Foreign Debt* adopted on August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received.

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

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

[9] Includes US$15 million repayment to Nigeria.

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

[11] Net domestic assets of the BCSTP and net bank financing of the government measured at previous program exchange rate of 10,104 dobras per US dollar and in flows with respect to end–December 2005.
In addition it assumed inflow of signature bonuses totaling US$28.6 million (reflected also in net international reserves target of BCSTP).

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

Action	**Date**
Prior Actions	
Submission to the National Assembly of the draft 2007 Budget agreed with IMF staff.	December 31, 2006
Adoption by the government of a budget nomenclature with functional, economic, and administrative classifications, based on the 2001 GFS, identifying propoor expenditure.	December 31, 2006
Issue a central bank regulation on banks' reporting of their net open foreign currency positions.	December 2006
Structural Benchmarks or Structural Performance Criteria (SPC)	
Public Expenditure Management	
Adopt decree establishing the new public accounting plan and the related manual of accounting procedures, consistent with the organic public finance law and the public financial management system (SAFE).	March 31, 2007, **SPC**
Implement the fully integrated computerized public financial management system (SAFE) with new nomenclature, unified current and investment budgets, and incorporating public accounting (including of patrimony/debt).	December 2007
Public Enterprises	
Finalize the installation of prepaid electricity metering systems (3,000).	June 2007
Oil Transparency	
Publish the Handbook of the Oil Resource Management Law (ORML) by posting it on the government website.	January 2007
Adopt Petroleum Sector Strategy for development of the Exclusive Exploitation Zone (EEZ).	December 2007
Banking Supervision	
Issue regulations to implement the law against money laundering and the financing of terrorism (AML/CFT), notably for the Central Risk Unit within the BCSTP and "know-your-client" rules for banks.	March 2007
Issue new prudential regulations on credit classification, liquidity, transactions with related parties, and limits on net open foreign currency positions.	June 30, 2007, **SPC**

Table 3. São Tomé and Príncipe: Tax Policy and Business Climate Measures November 2006–December 2007

Actions	**Dates**
Adopt and start implementing action plan to collect income tax arrears (Dobras 67 billion at end-October 2006), following adoption of new tax procedural law.	March 2007
Increase excise tax on services (excluding water and electricity) from 5 to 7 percent and enlarge tax base to include all sales except a list of exempted goods.	December 15, 2006
Domestic petroleum product pricing and tax collection:	
• Revise petroleum pricing structure, fixing distribution margins in U.S. dollar cents per liter (including for ENCO), reducing tax differentials between products, and partially moving to specific taxation, while at least safeguarding petroleum tax revenue in percent of GDP.	March 2007
• Apply revised petroleum pricing mechanism.	Continuous
• Eliminate import and consumption tax exemptions, except for EMAE and justified conventions, and eliminate Road Fund tax exemption for EMAE.	March 2007
• Adopt timetable to gradually phase out tax exemptions for EMAE.	June 2007
Submit draft direct tax reform laws to National Assembly:	December 2006
• New tax administrative and procedural codes and new inheritance tax code (for implementation in 2007).	
• New corporate tax code (for implementation in 2008).	
• New personal income tax code and new urban property tax code (for implementation in 2008).	
• Implement Investment Code (after adoption by National Assembly, expected for end-2006).	June 2007
• Draft revised Labor Code in consultation with IMF and World Bank staffs.	December 2007
• Promulgate legislation on arbitration tribunals in business and contract matters.	November 2006
• Adopt convention between Ministry of Justice and Chamber of Commerce to operationalize arbitration tribunals within Chamber of Commerce.	December 2006

Table 4. São Tomé and Príncipe: Structural Performance Criterion and Benchmarks Under the PRGF-Supported Program (March–December 2006)

Policy Measure	**Test Date**	**Status**
Structural Benchmarks		
Establish a database to record and monitor follow-up actions on problems identified by the Inspectorate General of Finance (IGF) in each inspected sector within its jurisprudence, including the applicable sanctions and penalties.	End of June 2006	Met.
Amend the laws defining internal control and administrative regulations governing the Inspectorate General of Finance (IGF) to increase IGF powers regarding the oversight and auditing of the financial operations of the central government, public enterprises, and local governments.	End of July 2006	Met in December 2006.
Submit to the National Assembly proposals to revise the Customs Law, the Customs' Organic Law (*Estatuto das Alfandegas*), and the General Code on Customs Infractions (*Regime Geral das Infrações Aduaneiras*); to update accounting practices and customs procedures; and to modernize the system to increase the efficiency of the customs service.	End of September 2006	Met in November 2006.
Complete the installation of EMAE's pre-paid electricity metering systems in designated urban locations to address the public utilities' financial weaknesses in the short run.	End of September 2006	Ongoing; installation of 3,000 meters is expected to be completed in second quarter of 2007.
Adopt a sectoral strategy to address the development of suitable infrastructure for electricity production, transportation, and distribution, as well as business modalities to secure dynamic private sector participation in the electricity sector.	End of September 2006	Met in November 2006.
Complete feasibility studies on the restructuring of ENASA and ENAPORT.	End of September 2006	Met.
Implement the Commonwealth Secretariat debt recording management system (CS-DRMS) to improve the government's capacity to manage external debt.	End of December 2006	Ongoing.
Submit to the National Assembly legislation criminalizing money laundering and the financing of terrorism.	End of December 2006	Met in October 2006.
Structural Performance Criterion		
Implement the fully integrated, computerized budget and public expenditure system ("SIGFE", renamed "SAFE").	End of December 2006	Ongoing. It is proposed to re-schedule the measure to end-December 2007.

Table 5. São Tomé and Príncipe: Monetary Policy and Banking Supervision Measures

Recommendation	Status	Date
Licensing		
• Establish contacts with Nigeria's and CEMAC's banking supervisors to cooperate and share information	Ongoing	NA
• Check background of proposed shareholders and administrators	Ongoing	NA
• Monitor implementation of business plan and performance of new bank in relation to plan	Ongoing	NA
• Increasing the minimum capital required initially	Pending	March 2007
• Qualification of administrators	Draft NAP elaborated	December 2006
Prudential Regulations		
• Revised capital adequacy minima	NAP considered	March 2007
• Liquidity	Update pending	March 2007
• Transactions with related parties	Update pending	March 2007
• Classification of Assets	Update pending	March 2007
• Credit to Employees	Update pending	March 2007
• Intervention in banks	Pending	March 2007
• Limits on banks' net open foreign currency positions	Drafted and pending	March 2007
Internal Control and Auditing		
• Implementing internal control and auditing	In progress	January 2007
• Chart of Accounts	Submitted to banks for comments	Adoption in January 2007
• Report on Financial Conditions	Pending	Adoption in January 2007
Banking Supervision		
• Timely reporting	Ongoing	NA
• Manual for on-site inspections	Manual completed and training	December 2006
• Further training with expert guidance on monitoring	Ongoing	November 2006
Monetary Policy Instruments		
• Restart the auctions of foreign exchange	Pending	December 2006
• Introduce BCSTP CDs	Pending	December 2006
• Require remunerated reserves	Pending	March 2007
• Institute a complementary deposit facility	Pending	March 2007
• Improve liquidity forecast and coordination with Treasury	Pending	June 2007
Measures for the Exchange Market		
• Implement mandatory weekly reporting to BCSTP on their net open foreign currency positions by banks	Draft of NAP	December 2006
• Implement a registry system for banks' exchange operations (including exports and imports) in order to modernize the information on trade balance and	Pending	March 2007

Recommendation	Status	Date
payments, as well as customs control (such a system is being developed at the BCSTP) • Review NAP 13/2006 to remove commission charges by BCSTP on withdrawal of foreign currency deposited by banks in the Central Bank	Done	December 2006
Communication Strategy for Monetary and Exchange Policy		
• Central bank will announce its policy objectives and framework to the public • Central bank board decisions will be explained through press notes • Regular meetings with market participants • Post BCSTP data on inflation and monetary base on website	Ongoing Ongoing Ongoing Done	NA NA NA November 2006
Anti-Money Laundering		
• Regulations for application of the law • Regulations on Credit Risk Unit and "Know your client"	Pending (draft elaborated, approval depends on passing legislation on money-laundering) Pending	March 2007 March 2007
Safeguards Assessment		
• Establish formal procedures to ensure that monetary data used to check the conformity with performance criteria within a future PRGF program follow the Technical Memorandum of Understanding of that program and are compatible with the accounting registry. The Internal Audit Department must review and certify these data. • Review the role of the Audit Board to fully align its responsibilities with those of an independent audit committee • Develop annual audit plans based on a risk analysis of operations • Introduce formal investment guidelines identifying the allowed investments, qualified counterparts, and controls of investment operations	In progress Pending Pending Pending	June 2007 June 2007 June 2007 January 2007

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE:
TECHNICAL MEMORANDUM OF UNDERSTANDING
December 27, 2006

1. This technical memorandum of understanding (TMU) contains definitions and adjuster mechanisms that are intended to clarify the measurement of variables in Table 1, Quantitative Performance Criteria, PRGF Arrangement, 2006–07, attached to the Memorandum of Economic and Financial Policies. Unless otherwise specified, all quantitative performance criteria and benchmarks will be evaluated in terms of cumulative flows from end-September, 2006.

Provision of data to the Fund

2. Data with respect to all variables subject to performance criteria and indicative targets will be provided to IMF staff on a monthly basis with a lag of no more than three weeks for data on the net domestic assets and net international reserves of the Central Bank of São Tomé and Príncipe (BCSTP), and six weeks for other data. The authorities will transmit promptly to IMF 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 IMF staff as needed on the appropriate way of measuring and reporting. Performance criteria included in the program, as defined below, refer to domestic primary balance of the central government, net bank financing of the central government, net domestic assets and net international reserves of the central bank, external payments arrears, nonconcessional medium and long-term external debt and short-term external debt.

Definitions

3. **Government** is defined for the purposes of this TMU to comprise the central government, which includes all governmental departments, offices, establishments, and other bodies which 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 (non-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 government on account of oil signature bonus receipts and accrued interest in the National Oil Account (NOA). Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and Directorate of Treasury in the Ministry of Planning and Finance.

5. **Domestic primary expenditure** comprises all government spending assessed on a commitment basis (*compromisso*), excluding: (i) foreign-financed capital expenditure;

(ii) foreign-financed expenditure under the overseas scholarship program that is externally-financed; and (iii) scheduled interest payments. Reporting of government domestic expenditure will be based on the government budget execution prepared every month by the Directorate of Budget and Directorate of Treasury in the Ministry of Planning and Finance.

6. Within the above total, **propoor expenditure** refers to government outlays recorded in the budget nomenclature that have a direct effect in reducing poverty, as agreed with the IMF and World Bank staffs. These expenditures, which include both current and capital outlays, are defined as follows:

a. **Propoor current spending**: These cover the following ministries and expenditure categories (by budget code) as described in the matrix below.

		EDUCATION OF EDUCATION AND CULTURE	MINISTRY OF HEALTH	MINISTRY OF LABOR AND SOLIDARITY
Code	**Description of current expenditure**			
01.00.00	Despesa com Pessoal	X	X	
02.01.05	Outros bens duradouros	X	X	
02.02.02	Combustíveis e lubrificantes	X	X	
02.02.04	Alimentação		X	
02.02.05	Medicamentos	X	X	
02.02.06	Roupas e calsados		X	
02.02.09	Outros bens não duradouros		X	
02.03.01.0	Agua e energia	X	X	
02.03.02	Conservação de bens		X	
02.03.06	Comunicações	X	X	
04.01.01	Orçamento do estado		X	
04.02.01	Instituições particulares		X	X
04.03.01	Particulares		X	X
04.04.02	Outras transferências para exterior			X
06.01.00	Ensino e formação	X		
06.04.01	Custos recorrentes de projectos	X	X	
06.04.04.0	Outros Diversos	X	X	

Expenditures on fuels and lubricants *(combustíveis e lubrificantes)* that are effected for administrative purposes are excluded. Likewise, food *(alimentacão)* and clothing and shoes *(roupas e calsados)* supplied to administrative staff are excluded.

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

b. **Propoor capital spending:** This covers selected projects, which are deemed to have a direct impact on alleviating poverty in the following sectors: education, health, social safety nets, agriculture and fisheries, rural development, planning and finance, youth and sports, provision of potable water, and electrification.

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

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

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

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

10. **Net bank financing of the central government (NCG)** is defined as the stock of all outstanding claims on the government held by the BCSTP, less all deposits held by the central government with the BCSTP, plus the stock of all outstanding claims on the government held by deposit money banks (DMBs)[1], less all deposits held by the central government with DMBs—as they are reported monthly by the BCSTP to the IMF staff. All foreign exchange denominated accounts will be converted to dobras at the program exchange rate. At end-September 2006, outstanding net bank financing of the government was assessed at dobras -126.8 billion, broken down as follows:

BCSTP credit, including use of IMF resources:		Db 105.8 billion
Less: government deposits with BCSTP:		Db 226.3 billion
Of which:	National Oil Account (NOA)	Db 106.0 billion
	Treasury foreign currency denominated accounts	Db 43.9 billion
	Treasury local currency denominated accounts	Db 28.7 billion
	Account for HIPC relief [2]	Db 20.3 billion
	Account for MDRI relief [3]	Db 0.0 billion

[1] Deposit money banks (DMBs) refers to Other Depository Corporations as stated in the Monetary and Financial Statistics Manual.

[2] Pending the use of HIPC debt relief for pro-poor spending.

[3] Pending the use of MDRI relief for pro-poor spending.

Counterpart deposits	Db 22.6 billion
PRGF disbursement account	Db 4.7 billion
Equals: Net credit to government by the BCSTP:	Db -120.5 billion
Plus: DMBs credit:	Db 0.0 billion
Less: government deposits with DMBs (including counterpart funds):	Db 6.3 billion
Equals: Net bank financing of the government:	Db -126.8 billion

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

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

12. **Net international reserves** (NIR) of the BCSTP are defined for program monitoring purposes as short-term foreign assets of the BCSTP minus short-term external liabilities. All short-term foreign assets that are not fully convertible external assets readily available to and controlled by the BCSTP (i.e., they are pledged or otherwise encumbered external assets, including, but not limited to, the HIPC umbrella SDR account, and assets used as collateral or guarantees for third party liabilities) will be excluded from the definition of NIR. All values are to be converted to U.S. dollars at actual market exchange rates prevailing at the test date. At end-September 2006, NIR was assessed at dobras 524.6 billion, calculated as follows:

Net international reserves:		Db 524.6 billion
Of which:	gross reserves:	Db 552.3 billion
	Of which: National Oil Account (NOA)	Db 106.0 billion
	short-term liabilities:	Db -27.6 billion
Plus: Other foreign assets:		Db 91.9 billion
Plus: Medium and long- term liabilities:		Db -53.6 billion
Equals: Net Foreign Assets:		Db 563.0 billion

Memorandum item:

Net international reserves minus National Oil Account (NOA) minus bank's foreign currency deposits with the central bank	Db 320.4 billion

13. **Net domestic assets** of the central bank of São Tomé and Príncipe are defined as the difference between base money and net foreign assets of the BCSTP, all at programmed exchange rates. All foreign denominated accounts will be converted to dobras at the program exchange rate. At end-September 2006, net domestic assets were assessed at dobras–289.8 billion, calculated as follows:

Base money:	Db 273.2 billion
Less: Net foreign assets:	Db 563.0 billion
Equals: Net domestic assets of the BCSTP:	Db -289.8 billion

14. **Treasury deficit** of the Central Bank of São Tomé and Príncipe is defined as revenue (excluding unrealized valuation changes) minus costs minus investment.

15. The performance criterion on **short-term external debt** refers to the outstanding stock of external debt with original maturity of one year or less, (including overdraft positions) and owed or guaranteed by the government or the BCSTP.[4] At end-September 2006, the stock of short-term external debt stood at US$16.0 million.[5]

16. The performance criterion on **nonconcessional medium- and long-term external debt** refers to the contracting or guaranteeing of external debt with original maturity of more than one year by the government or the BCSTP.[6] [7] Debt rescheduling and restructurings are excluded from the ceilings set on nonconcessional borrowing. Medium- and Long-term debt will be reported by the Debt Management Unit of the Ministry of Finance and Planning and

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

[5] This amount includes three nonconcessional loans from Nigeria totaling US$15 million, which were previously classified under nonconcessional medium term external debt. These loans have been reclassified as short-term debt, following a joint World Bank-IMF DSA mission in April 2006.

[6] This performance criterion applies not only to debt as defined in point No. 9 of the *Guidelines on Performance Criteria with Respect to Foreign Debt* adopted on August 24, 2000 but also to commitments contracted or guaranteed for which value has not been received.

[7] The concessionality of loans is assessed according to the reference interest rate by currency published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). For loans of terms of no less than 15 years, the ten-year average of commercial interest reference rates (CIRR) for the currency in which the loan is denominated will be used. For loans of shorter terms, the six-month average will apply. A loan is deemed to be on concessional terms if, on the initial date of 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.

(as appropriate) by the BCSTP, measured in U.S. dollars at current exchange rates. The government of São Tomé and Príncipe will consult with IMF staff before contracting obligations if it is uncertain as to whether those obligations are included in the performance criterion limits.

17. The nonaccumulation of new **external payment arrears** is a continuous performance criterion. Government external payment arrears are defined as all unpaid external public debt obligations, according to the data established by the Debt Management Unit of the Ministry of Planning and Finance and (as appropriate) by the BCSTP, with the exception of arrears pending rescheduling arrangements. The latter will be considered technical arrears. Debt would be deemed to be in arrears when it has not been paid by the time it is due, unless the definition of an arrear has been otherwise contractually defined. The performance criterion relating to external arrears does not apply to external 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 interim HIPC debt relief (including multilateral and bilateral relief) and the accumulation of any new external payment arrears, including technical arrears.

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

Use of adjusters

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

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

negative sum of deviations (i.e., an overall shortfall), these ceilings will be increased by 100 percent of any cumulative shortfall. In case of a positive sum (i.e., an overall surplus), the downward adjustment to NCG and NDA will not take place to the extent that additional external program support is used to accommodate higher capital outlays by the government, up to US$1 million, converted to dobras at program exchange rates.

22. **Floor on net international reserves (NIR) of the BCSTP.** The quarterly difference between actual and projected receipts of oil signature bonuses including accrued interest on NOA, official external program support, and net external debt service payments will be converted to dobras at the program exchange rate, and aggregated from end-September 2006 to the test date. The floor on NIR will be adjusted upward (downward) by the positive (negative) sum of the deviations of actual from projected receipts of oil signature bonuses including accrued interest on NOA, actual from projected official external program support, and projected from actual net external debt service payments. In the case of a negative sum of deviations (i.e., an overall shortfall), this floor will be decreased by 100 percent of any cumulative shortfall. In case of a positive sum (i.e., an overall surplus) the upward adjustment to NIR will not take place to the extent that additional external program support is used to accommodate higher capital outlays by the government, up to US$1 million, converted at program exchange rates. In addition, the NIR floor will be lowered by the amount that disbursements under the PRGF arrangement are lower than expected.

Data reporting

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

i. Fiscal data

The Directorate of Budget at the Ministry of Planning and Finance will provide to IMF staff, within two months after the end of each month or quarter, with the exception of the public investment program (PIP), which will be provided three months after each quarter:

- Monthly data on central government operations for revenues, expenditure and financing including detailed description of net earmarked resources (*recursos consignados*)
- Monthly data on net credit to the government by the BCSTP, recorded account by account in a format fully compatible with the monetary accounts of the BCSTP
- Monthly data detailed tax and non-tax revenues
- Monthly detailed data on current and domestically financed capital expenditure on commitment *(compromisso)* and cash payments *(caix”)*
- Monthly data on domestic arrears by type
- Quarterly data on official external program support (nonproject)

- Quarterly data on the execution of the public investment program (PIP) by project and source of financing
- Quarterly data on project grant and loan disbursements (HIPC and non-HIPC)
- Quarterly data on bilateral HIPC debt relief
- Latest petroleum price structures, and submission of any new pricing structures (within a week of 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. Daily data will be provided on a weekly basis no later than the Wednesday following the end of the week, and weekly data will be provided no later than two weeks after the end of such week. The BCSTP will provide:

- Daily data on exchange rates
- Daily data on interest rates
- Daily liquidity management table, including base money and currency in circulation, on a weekly basis
- Daily net international reserve position
- Weekly balance sheet data of BCSTP (in BCSTP and IMF formats)
- Monthly balance sheet data of BCSTP (in BCSTP and IMF formats)
- Monthly balance sheet data of individual deposit money banks (in BCSTP and IMF formats)
- Monthly consolidated balance sheet data of deposit money banks (in BCSTP and IMF formats)
- Monthly monetary survey (in BCSTP and IMF formats)
- Monthly central bank foreign exchange balance (*Orçamento cambial*)
- Quarterly table on banks' prudential ratios and financial soundness indicators
- Quarterly data on the BCSTP's financial position (profit and loss statement, treasury deficit, budget execution).

iii. External debt data

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

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

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

iv. National accounts and trade statistics

The following data will be provided to the IMF staff:

- Monthly consumer price index data, will be provided by the National Institute of Statistics within one month after the end of each month
- Monthly data on imports (value and import taxes collected and arrears) and commodity export values will be provided by Customs, within two months after the end of each month
- Monthly data on petroleum shipments and consumption (volumes, CIF prices; by product).