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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

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SÃO TOMÉ AND PRÍNCIPE: 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/

Ms. Ângela Maria da Graça Viegas Santiago
Minister of Planning and Finance

/s/

Mr. Luis Fernando Moreira de Sousa
Governor of the Central Bank of São Tomé
and Príncipe

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

SÃO TOMÉ AND PRÍNCIPE: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES
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 B. São Tomé and Príncipe: Prior Actions and Structural Performance Criteria and Benchmarks for 2009

Action	Performance Criteria / Benchmark	Status
Prior actions		
<ul style="list-style-type: none"> • Prepare the 2009 budget in line with the organic law (SAFE) and submit to National Assembly. • 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
		Done
End-March 2009		
<ul style="list-style-type: none"> • Adopt the 2009 budget in line with the PRGF-supported program. • Start on-site banking supervision inspections. 	Benchmark for January, 2009	Done
	Benchmark	
End-June 2009		
<ul style="list-style-type: none"> • Fully implement the automatic pricing mechanism for petroleum products. • Submit new labor law to the National Assembly 	Benchmark	
	Benchmark	
End-September 2009		
<ul style="list-style-type: none"> • Establish a Directorate of Accounting and an IT office at the Ministry of Planning and Finance. • Purchase and install IT equipment related to the SAFINHO. • Prepare a draft Framework Law for the Public Debt. • Establish the “Guichet Unico” – one stop window. • Submit reform of the tax laws to grant the tax authority power to accept limited debt deferrals. 	Benchmark	
	Performance Criterion	
	Benchmark	
	Benchmark	
	Benchmark	
By December 2009 or later		
<ul style="list-style-type: none"> • Prepare the 2010 budget in line with the organic law (SAFE) and submit to National Assembly. • Prepare an action plan to address prudential issues in the banking system. • Establish a bureau of credit registry. • Complete a draft new commercial code to reduce the cost and time of doing business. • Prepare regulations under the SAFE budget law. • Put in place intervention and closure processes for the banking system. 	Benchmark for end-November, 2009	
	Benchmark for end-December, 2009	
	Benchmark for end-December, 2009	
	Benchmark for end-March, 2010	
	Benchmark for end-June, 2010	
	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 Emilia 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 Príncipe 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 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 Príncipe, projects in the island (otherwise of the same nature as those in São Tomé island) are identified separately.

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
<i>Less:</i> Government primary expenditure: (as defined in paragraph 5)	588 billion
<i>Equals:</i> 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),¹ 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 dobra 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
<i>Less:</i> Government deposits with BCSTP:	532 billion
<i>Of which:</i> 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
<i>Equals:</i> Net credit to government by the BCSTP	– 406 billion
<i>Plus:</i> DMBs credit	0 billion
<i>Less:</i> Government deposits with DMBs (including counterpart funds)	33 billion
<i>Equals:</i> Net bank financing of the government	– 440 billion
<i>Less:</i> Balance of the National Oil Account (NOA)	–183 billion
<i>Plus:</i> Annual flow from the NOA to the budget	– 39 billion
<i>Equals:</i> 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
<i>Of which:</i> Cash in vaults	10 billion
Currency outside banks	130 billion
<i>Plus:</i> Bank reserves denominated in dobras	143 billion
Bank reserves denominated in foreign currency	212 billion
<i>Equals:</i> Base money	496 billion
<i>Less:</i> Bank reserves denominated in foreign currency	212 billion
<i>Equals:</i> 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

¹ 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
Short-term liabilities (including guaranteed deposits by banks	
<i>Less:</i> and liabilities to the IMF)	103 billion
<i>Equals:</i> Net international reserves	1,013 billion
<i>Plus:</i> Other foreign assets	190 billion
<i>Less:</i> Medium and long-term liabilities	0 billion
<i>Equal</i> Net foreign assets	1,204 billion
Net international reserves:	1,013 billion
<i>Less:</i> NOA	183 billion
Banks reserves denominated in foreign currency	212 billion
<i>Equals:</i> 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
<i>Less:</i> Net foreign assets:	1,204 billion
<i>Equals:</i> 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.² For reference, at end-December 2008 the stock of short-term external debt is projected to be zero.

² 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.^{3 4} 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”.

³ 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.

⁴ 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.