International Monetary Fund

Democratic Republic of São Tomé and Príncipe and the IMF

Press Release:
IMF Executive Board Completes the Fifth Review under the Extended Credit Facility Arrangement, Approves US$0.9 Million Disbursement, and Concludes the 2018 Article IV Consultation with the Democratic Republic of São Tomé and Príncipe

July 23, 2018

Country's Policy Intentions Documents

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

July 9, 2018

Appendix I. Letter of Intent

São Tomé, July 9, 2018

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington, D.C. 20431
USA

Dear Ms. Lagarde:

The government of the Democratic Republic of São Tomé and Príncipe requests the IMF Executive Board to complete the fifth review of the Extended Credit Facility (ECF) arrangement and to approve the disbursement of the sixth tranche of the loan based on partial implementation of end-December 2017 performance criteria (PC) and satisfactory implementation of the prior actions.

As documented in the attached Memorandum of Economic and Financial Policies (MEFP), economic conditions remained challenging in 2017 and program performance was uneven under an unfavorable external environment. Both reduced and delayed financial support from our partners led to less dynamism in the economy, presenting a difficult challenge for striking the right balance between adjustment and growth and for achieving the program targets. Therefore, we would like to request the IMF Executive Board to approve waivers for the nonobservance of the program targets in 2017, including the domestic primary balance and bank financing of the central government (both missed by ½ percent of GDP), as well as net international reserves and the continuous PC on not introducing or intensifying any exchange restrictions. Additionally, as a sign of our commitment to the program, we have completed the prior actions for the fifth review.

The MEFP updates the government's policies and objectives for 2018 and beyond, which are anchored by our development strategies as outlined in the National Development Plan (NDP) 2017-2021 and the Vision 2030: Transformation Agenda. Specifically, the MEFP lays out policies for strengthening program implementation to meet program objectives for the remainder of the current arrangement and continue to safeguard macroeconomic stability and promote growth. We will implement fiscal measures to mobilize domestic revenue (including preparing the groundwork for the implementation of a value-added tax (VAT) in 2019), collect tax arrears owed to the government, keep the arrears clearance strategy on track, and reduce the public debt burden. We will also expedite the reform of a state-owned utility company (EMAE) to cut losses and contain fiscal risks.

The Central Bank of São Tomé and Príncipe (BCSTP) also remains committed to safeguarding financial sector stability and supporting sustainable credit growth. Our focus will be to deal proactively with problem banks and move ahead with the implementation of several key monetary reforms and strategic plans, such as the Non-Performing Loans (NPL) Reduction Strategy and the Financial Sector Development Implementation Plan (FSDIP).

Our country continues to face tremendous challenges and the support of the IMF is necessary to address our development issues. The government believes that measures and policies described in the July 2015 MEFP and its subsequent supplements, together with the attached supplementary MEFP, provide an adequate basis for attaining our economic policy objectives. However, we stand ready to take any additional measures, if necessary, including addressing any revenue shortfall. We will consult with the IMF, in advance, on the adoption of these measures and on any revisions to the policies contained in this supplementary MEFP, in accordance with the Fund policies on such consultation. We will hold timely discussions with the IMF staff on the terms of large external borrowing to ensure that such borrowing meets the concessionality requirement under the program, does not jeopardize debt sustainability, and is in line with the Fund's debt limit policy.

The government will also provide the IMF staff with all the relevant information required to complete program reviews and monitor performance on a timely manner as outlined in the TMU. During the remaining program period, the government will not introduce or intensify any exchange restrictions and multiple currency practices, or import restrictions for balance of payments purposes, nor conclude any bilateral payment agreements in violation of Article VIII of the Fund's Articles of Agreement.

The government agrees to make public this Letter of Intent, along with the attached supplementary MEFP and TMU, and the entire IMF staff report on the 2018 Article IV consultation and the fifth ECF review. We hereby authorize their publication and posting on the IMF website, once the IMF Executive Board approves the completion of the 2018 Article IV consultation and the fifth review under the three-year ECF arrangement.

Sincerely yours,

/s/ Mr. Américo d'Oliveira Ramos, Minister of Finance, Commerce and the Blue Economy	/s/ Mr. Hélio Silva Almeida, Governor of the Central Bank of São Tomé and Príncipe

Attachments:
/1 Memorandum of Economic and Financial Policies.
/2 Technical Memorandum of Understanding.

Attachment I. Supplementary Memorandum of Economic and Financial Policies for 2018

INTRODUCTION

1. **The Executive Board of the International Monetary Fund approved on July 13, 2015 a three-year arrangement under the Extended Credit Facility (ECF) in support of São Tomé and Príncipe's economic reform program to promote sustainable growth and reduce poverty.** The program aims to lay the foundation for stronger, more inclusive growth, and to catalyze financial support from bilateral and multilateral partners. Key aspects of the program include actions to strengthen public finances, reduce balance-of-payments vulnerabilities, and clear large domestic arrears.

2. **This supplementary Memorandum of Economic and Financial Policies (MEFP) reviews recent economic developments and performance under the ECF-supported program and updates the supplementary MEFP for the combined third and fourth review approved by the IMF Executive Board on December 11, 2017**. It provides an assessment of recent macroeconomic developments, implementation of the ECF-supported program, the economic outlook and risks, and macroeconomic policies for 2018 and beyond.

RECENT ECONOMIC DEVELOPMENTS

3. **Economic activity in 2017 decelerated somewhat, as the public spending impetus was constrained by reduced external inflows.** Real GDP growth slowed to 3.9 percent in 2017 from 4.2 percent in 2016. Wholesale and retail trade sectors grew, while indications are that tourist receipts also increased. Increased activity in the agricultural sector (mostly for cocoa), however, is moderated by lower international prices, and construction activity is estimated to have fallen, evidenced by a reduction in the imports of construction material.

4. **Inflation increased, mainly driven by higher prices for locally-produced food, despite economic slack and fiscal consolidation.** Unseasonal rain impeded fishing and damaged vegetable crops, leading to an acceleration of year-on-year inflation from a low of 3.5 percent during May 2017 to 7.7 percent at end-2017. One-off factors, such as the introduction of new import taxes and charges, also contributed to this development. However, seasonally-adjusted monthly inflation shows that inflation decelerated during the first four months of 2018. The January 2018 dobra redenomination did not come with any price gouging effects.

5. **Given strong headwinds, the fiscal deficit targets for 2017 were missed.** New tax measures, including a higher tax on imported alcoholic beverages, higher duties on selected imported commodities, and collection of tax arrears from large enterprises, raised revenue by less than 0.1 percent of GDP in 2017. The higher taxes on alcoholic beverages also reduced consumption, promoting good health among the population. However, the reduced imports, along

with cash flow problems and operational difficulties among some of the firms, lowered the yields from import taxes and arrears collection, leading to a shortfall of about 0.9 percent of GDP than expected. While the revenue shortfall was largely offset by under-executing the budget on transfers and personnel costs, it was necessary to increase investment in health and education by about ½ percent of GDP more than anticipated, partly to address a virus outbreak of "necrotizing cellulite". As a result, the domestic primary deficit (DPD) exceeded the program target of 1.8 percent of GDP by ½ percent of GDP, which was mirrored by a similar miss of the target on the change in net bank credit to the central government.

6. **Preliminary data suggest broadly similar trends in the first quarter of 2018**. The hike in import duties and delayed tax payments from large firms (notably ½ percent of GDP in import taxes due by ENCO as of May) continued to dampen tax revenue. This was mitigated by higher oil import tax revenue from higher international oil prices and budget under-execution. As a result, the end-March DPD indicative target was missed by 0.3 percent of GDP. However, the indicative target on the change in net bank financing of the central government was met.

7. **While accelerating the debt payment to ENCO, the government fell behind in arrears clearance with other domestic suppliers.** It accumulated a small amount of domestic arrears (6 million new dobras) and was unable to clear arrears as assumed in the revised budget (36 million new dobras), partly because budget support from the World Bank did not materialize and that from the EU was reduced by €1 million due to slow progress in public financial management (PFM) reform. In addition, the EU disbursement was used for investment projects that are needed to meet the requirements associated with the grant. Nonetheless, total public and publicly guaranteed debt fell from 67.6 percent of GDP in 2016 to 56.6 percent of GDP in 2017 on account of an appreciation of the euro-dollar exchange rate, accelerated debt payment to ENCO from gains through the higher domestic relative to import prices of oil, low external disbursements, and nominal GDP growth.

8. **Credit growth stalled in 2017 amid banks' efforts to de-risk their portfolios to become profitable.** While lending to the economy was stagnant, banks increased their holdings of Treasury Bills (T-bills), reducing excess liquidity at the BCSTP and deposits abroad. The T-bill stock held by banks now accounts for 9 percent of total assets, up from 2 percent in 2016. After breaking even on average in 2016, banks' return on assets (ROA) turned negative (-0.7 percent) again, with two-thirds of the banks posting losses as in 2016. As net interest income is flat, banks resolved to increase their fee income by 20 percent in 2017. This notwithstanding, banks' operating costs remain relatively high, with the cost-to-income ratio (before loan loss provisioning) at 75 percent.

9. **The NPLs remained high while provisions improved further.** Write-offs and loan recoveries—including out of court settlement—improved the NPL ratio by 2 percentage points to 25 percent, offsetting a spike in the default rate to 6.7 percent among loans contracted or restructured since end-2016. The rebound in this default rate may be temporary but vigilance is still required to ensure that NPLs stay on a declining path. At the same time, provisions coverage of NPLs rose to 88 percent, pointing to more stringent classification of NPLs. The still-elevated NPL ratio is also owed to banks' slow write-off practices, despite the slim chance of recovering collateral because of the bottleneck at the judicial system. To mitigate the high credit risk, the BCSTP has recently upgraded

its credit registry (CRC) along several dimensions, providing a wealth of real-time borrower information for banks to make well-informed lending decisions.

10. In line with banks' portfolio shift, liquidity indicators in the banking system fell somewhat while capitalization increased and monetary aggregates contracted slightly. The liquidity ratio (liquid assets to total assets) dropped from 54 to 50 percent, while the average capital adequacy ratio increased from 28 to 33 percent, as the decrease in risk-weighted assets more than offset negative profits that have been weighing on banks. One bank with a capital shortage injected additional capital in accordance with current regulations. Broad money (M3) fell marginally (0.4 percent) in 2017, reflecting lower net foreign assets from reduced external inflows.

11. The BCSTP intervened in a small bank in early 2018, while the liquidation of Banco Equador is waiting for court approval of the relevant procedures. Banco Privado (BPSTP)—the smallest bank in the system—was intervened on the grounds of several governance problems that led to sharply-higher NPLs, consecutive losses, and inadequate equity with own funds below the statutory minimum. After carefully considering various resolution options, the central bank announced in mid-June its decision to close the bank and transfer its portfolio to other financial institutions. Regarding Banco Equador, the liquidation process will be advanced as soon as the court approves the relevant procedures.

12. The current account worsened in 2017 after an improvement in 2016, mainly due to a contraction in grants and an increase in oil and investment imports. Imports of goods and non-factor services increased by almost 3 percent in 2017, after remaining broadly constant in 2016. Capital goods imports were up by 18 percent, and increased volume and rising international prices led to a 27 percent expansion in the value of oil imports. These factors more than offset the growth in exports of goods and non-factor services of 9.6 percent, given its low base. Tourist receipts are estimated to have grown by 8.8 percent while lower international prices offset the rising cocoa production. The lower external inflows and uptick in imports caused the gross international reserves at the market value to decline by $4.6 million to $51 million (4.2 months of imports).

PROGRAM PERFORMANCE

13. Program performance at end-2017 was uneven (Table 1). Three out of five performance criteria (PCs) are missed. The PC on the domestic primary balance and net bank financing of the central government (NCG) were missed by ½ percent of GDP. The PC on NIR was missed mainly because of lower external support, which was only partly accommodated by program adjusters. Two other PCs on external payment arrears and borrowing on non-concessional terms were met. The continuous PC which prohibits introducing or intensifying exchange restrictions was inadvertently missed. Fiscal indicative targets (IT) on tax revenue and new domestic arrears were missed, marginally for the latter. The pro-poor spending target was met.

14. The end-2017 structural reform agenda progressed according to plans (Table 2). A draft Public-Private Partnership (PPP) law was submitted to the National Assembly in October 2017 and promulgated in March 2018, and immediate measures to contain the financial losses of EMAE mostly through improving collection have been implemented.

15. Progress was also made on preparing for the end-June 2018 structural benchmarks (Table 4). A VAT law, drafted with the support of the IMF, was submitted to parliament on May 24, meeting an end-June structural benchmark. The strategy for tourism development was launched in January 2018 with the support of the World Bank. In light of the crucial role of tourism in the country's export diversification, this document forms the core of the planned export diversification strategy. On the other hand, the further delays in both the adoption of the financial management plan and least cost energy-production plan for EMAE and the commencement of an asset quality review (AQR) were attributable to needed steps for procurement. We wish to propose that the associated benchmark on the AQR be revised to require the delivery of an inception report from the external consultant in lieu of the completion of the AQR and that both benchmarks be rephased to end-September 2018.

16. In addition, we have also implemented other structural reforms. To prepare for VAT implementation, a law was promulgated to require companies to issue fiscal invoices. With the World Bank's support, a draft law on microfinance was submitted to parliament to address the legal and regulatory void for providers of microfinance, and a new National Payment Systems Law was submitted to parliament for regulation of modern payment methods, including agent banking, mobile money, and electronic payments.

ECONOMIC OUTLOOK AND RISKS

17. Economic growth is expected to remain stable in 2018 and accelerate gradually in the medium term. Real GDP growth is expected to stay at around 4 percent in 2018 and average around 5 percent in the medium term, supported by externally-financed projects in the construction, agriculture, and tourism sectors. Key infrastructure projects—such as a grant financed airport expansion and road rehabilitation, part of the latter started in early 2018. These projects will not only increase construction activity, but also lay the foundation for growth in the tourism and agro-processing industries. Faster growth, accompanied by appropriate structural reforms, will support plans for job creation and poverty reduction. Annual inflation is expected to recede to only 6 percent in 2018 as forecasts for rising oil prices could slow down its deceleration. Medium-term inflation is likely to average below 5 percent.

18. The economy also faces downside risks. The upcoming legislative elections in October 2018 could disrupt policy implementation as pressures to overspend heighten in the run-up to the elections; they may also hold back investment if investors take a wait-and-see approach. Furthermore, there are other uncertainties, concerning external financing, and infrastructure and service constraints that may restrict necessary investments and tourism growth. Limited implementation capacity also challenges the implementation of structural reforms and associated external financing. Continued high NPLs could further stall private sector lending and impede economic growth. On the upside, heightened interest from oil prospectors in acquiring exploration rights from the country is likely to boost external inflows through signing bonus, exploration activities, and social projects as components of the contracts.

POLICY OBJECTIVES FOR 2018

The main priorities for 2018 will be to consolidate macroeconomic stability, strengthen the financial sector, advance monetary reforms, and remove structural bottlenecks to higher, sustained, and inclusive growth.

A. Fiscal Policy

19. The government has reduced the deficit in 2017 and is committed to meet its fiscal targets in 2018. As noted above, the higher duty on selected products that took effect in July 2017 substantially reduced the import volume of these items. The government recognizes that this effect will also dampen revenues by about 1.4 percent of GDP this year relative to the initial budget. To avoid an unfair burden on families, the government has also rescinded its initial decision to suspend the deductible of the PIT in the tax law, lowering revenue by an additional 0.2 percent of GDP. The preliminary fiscal data for the first quarter of 2018 broadly confirmed this assessment. In addition, tax performance was also weakened by delayed tax payments from large firms.

20. The government will forcefully collect taxes due from large taxpayers. In particular, as a prior action, it will collect tax liabilities accumulated in 2018, amounting to over 60 million new dobras, from large taxpayers such as ENAPORT, BCSTP, INAC, and ENCO. To facilitate this ongoing assessment, we will put in place a system to closely monitor tax collections from large taxpayers, and will share with the IMF staff two weeks after each month monitoring tables of tax payments by top ten taxpayers against their projected taxes due during June-October 2018 *(newly proposed end-November 2018 structural benchmark),* and are prepared to launch administrative and legal procedures, including penalties, promptly if large taxpayers fail to comply.

21. The government has also identified revenue measures to offset the projected lower tax revenues (Table below). Taxpayers owe over 300 million new dobras in tax arrears to the state. As a first step, the state will target companies with large tax arrears such as Rosema (a beer maker) and ENASA (the airport authority). Rosema owes the state about 42 million new dobras, mostly in revenues it collected on behalf of the state for consumption tax on sales and income tax on its employees' salaries. ENASA owes 62 million new dobras mostly in legacy arrears prior to 2014. These tax arrears have not only deprived the state much needed revenue for social programs, such as education and health, but have also damaged the credibility of our tax system. For these reasons, the government has initiated fiscal and legal procedures to collect tax arrears owed by Rosema plus applicable penalties and has already collected 12 million new dobras. As a prior action for the completion of the fifth review (Table 4), the government will collect an additional 29 million new dobras of tax arrears from Rosema and 9 million new dobras from other large tax payers. The government has already reached agreements with other large taxpayers, including ENAPORT and ENASA, to collect tax arrears, and will take prompt legal actions if necessary to enforce these agreements. At the same time, it will help ENASA recover payment arrears from its clients for airport services and airport tax withheld amounting to about 38 million new dobras, including from an SOE in Ghana and various airlines. In return, ENASA's arrears clearance will be accelerated by the amount recovered which is expected to be at least 10 million new dobras. The government will pursue similar plans to collect tax arrears from other large taxpayers. It is committed to keep the arrears collection plan on track, which is essential for completing the program review, catalyzing the financing of projects and reform programs supported by other development partners.

22. The revenue measures will be complemented with spending restraint. The cuts in transfers and personnel costs that were introduced in 2017 will be maintained, and strict limits will be applied with the help of EMAE on the consumption of electricity and water as well as on fuel by public agencies, while domestically-financed capital expenditure will be reduced in light of expected higher externally-financed spending. Furthermore, in view of the uncertainty of revenue, the government will hold back expenditure to match available resources and meet the DPD target.

Impact of New Fiscal Measures
(Millions of new dobras)

Total revenue gain	43
Collection of tax arrears	43
Total domestic expenditure cuts	130
Of which: Cuts in transfers and personnel costs	79
Savings on goods and services	36
Cuts in capex	15
Total savings	173

23. Fiscal consolidation will continue in 2018 and over the medium term. Consistent with the budget law, the Minister of Finance has issued a resolution to limit budgetary expenditure in line with the program, meeting another prior action for the fifth review. Specifically:

- The DPD target is set at 1.3 percent of GDP for end-September and end-December. This assumes budget support grants in 2018 of $6 million from the World Bank and €3 million from the EU, and no privatization proceeds. As previously programmed, the nominal public wage bill will grow below GDP growth through keeping wages largely unchanged to free resources for new hiring for priority needs in the education, health, and security services, costing about 0.2 percent of GDP, while at the same time seeking savings through rationalization and higher efficiency in these sectors.

- The government is also committed to make up for delayed domestic arrears payments to suppliers to bring the arrears clearance plan back on track by 2020. To this end, a portion of budget grants and domestic borrowing (65 million new dobras) will be used to pay down arrears. In addition, a surcharge will be introduced in 2019 over the price of oil products to pay the debt to ENCO even after the differential between the current domestic and import prices fades. The surcharge will be set to raise about $2.7 to 3 million per year. The government will also prioritize arrears clearance if additional resources, including tax revenue, budget grants, delayed planned investment using budget support or privatization proceeds materialize. In addition, the Treasury has begun to prepare monthly liquidity projection to guide liquidity management and the issuance of T-bills.

Domestic Payables/Arrears 2016-18, Stocks

	2016 Actual	2017 Actual	2018 Plan
Treasury to EMAE (STD m)	55.1	54.2	0.0
Treasury to CST (STD m)	98.6	119.6	107.5
Treasury to other suppliers (STD m)	288.9	276.5	263.5
Treasury to ENCO (USD m)	43.9	38.5	35.5
EMAE to ENCO (USD m)	60.4	77.0	...

24. Reducing fiscal risks posed by the state-owned enterprises (SOEs), particularly the utility company, EMAE, remains high on the government's agenda. EMAE's arrears to ENCO increased by $16.6 million (4¼ percent of GDP) in 2017 to reach $77 million, like last year, despite immediate measures taken. To contain costs, retired staff are not replaced; customers missing three payments are disconnected; arrears payment plans are being developed with large debtors; a communication campaign was launched to change the non-payment culture; and customer services were improved, including shortened installation time and ease of bill payment. At the same time, we are advancing several medium-term efficiency-enhancing reform projects, notably the Financial Management Improvement Plan (FMIP) and the Least Cost Development Plan (LCDP), supported by our development partners. Other important steps encompass the pre-audit of all SOEs by an international firm under the auspices of the World Bank, and preparations for rehabilitation of the energy grid and large-scale installation of meters.

25. Ongoing work to introduce the VAT in 2019 will be accelerated. Focus will be placed on the finalization of the VAT law and its approval by Parliament, and: (i) hiring and training of 25 new employees; (ii) drafting regulations for the implementation of VAT, including the harmonization of other laws with the new VAT Law; (iii) providing adequate space, including furniture and computers to all staff by June 2018; (iv) adopting a clear organizational structure along functional lines and/or taxpayer segments for the tax administration by June 2018; (v) adopting a modern computer information system with key functionalities, such as automatic notification of taxpayers in default, extraction of statistical data, surveillance, and oversight support by July 2018; and (vi) implementing a customer services area and continued taxpayers education. To improve domestic revenue mobilization in the medium term, and in line with the recommendations of IMF TA on tax administration, the government will implement a more systematic inspection of large taxpayers and a wider surveillance coverage of taxpayers through a computer-based selection process, and improved risk management.

26. The government will continue to strengthen public financial management. The government, with the support of African Development Bank (AfDB), is further improving the electronic information management system (SAFEe), and has extended access to the general inspection finance entity and to the Court of Public Accounts. In this context, it has already submitted the state's accounts for 2015 and will accelerate the submission of those for 2016 to the Court of Auditors by July 2018. The government will also move to a centralized framework for monitoring and evaluating projects to ensure value for money. This will be done through the prioritization of capital projects and the adoption of public investment management assessment framework, and medium-term fiscal and expenditure frameworks. Additional TA will be needed in this regard. The government will implement the recommendations of a recent IMF TA mission on public financial management, including strengthening revenue forecasting and ensuring the coherence of the financial programming and macroeconomic framework in budget preparation and management, and limit the accumulation of arrears.

27. In addition to the VAT mentioned above, structural reforms will be accelerated to strengthen the fiscal position. The government is committed to effectively apply the automatic fuel price adjustment mechanism as international oil prices increase. The government has taken steps to control spending and rein in arrears. In particular, instructions have been sent to EMAE to control unbudgeted spending on electricity and water following recommendations by a working group that assessed the appropriate limits for different government units.

B. Financial Sector Policy

28. The BCSTP will continue to reduce banking sector vulnerabilities through frequent monitoring and enhanced supervision. In line with the NPL reduction strategy, the BCSTP is addressing the elevated level of NPLs through encouraging more concerted efforts to step up recoveries and write-offs by banks, enforcing collateral guidelines, and strictly overseeing banks' credit risk management frameworks and lending policies. To safeguard depositor interests and minimize fiscal cost, the central bank will continue to monitor the resolution of Banco Equador and spearhead the transfer of BPSTP's bank book to viable commercial banks.

29. Preparations for the AQR of the banking system with the support of the World Bank (structural benchmark, end-June 2018) are advancing though delayed. The external consultant is expected to sign the contract in July 2018 after a lengthy procurement process and contract negotiation period, and is required to prepare an inception report by end-September 2018 *(revised structural benchmark)* and a draft report by end-October 2018. The central bank has already communicated the plans and expectations to banks, and reviewed credit files to ensure that all documentation is in order to facilitate the work of the consultant. The BCSTP intends to leverage the AQR findings—the full report is expected by mid-2019—to update its loan classification system and the set of prudential regulations more broadly, with support from the Central Africa Regional Technical Assistance Center (AFC).

30. There has been an implementation delay for some of the recommendations of the last safeguards assessment. To ensure consistency, the revision to the Central Bank (Organic) law has been put on hold after some work was carried out in 2016 while the financial institutions law is being revised to align it with the proposed changes to the organic law regarding areas of oversight and resolution. The government hopes to have both laws approved by end-2018. The BCSTP Audit Board Regulations were revised in line with advice from the IMF Finance Department and approved in March 2017. However, staffing and physical space constraints have led to difficulties in adding staff to the Internal Audit Department. The completion of a new central bank headquarters, expected by end-2018, will allow for the eventual recruitment of more staff. An international auditing company, BDO, has already done field work on a central bank audit and submitted its draft report. BCSTP signed a cooperation agreement with the Central Bank of Brazil in November 2017 to support IFRS implementation over a three-year period. Banks will provision according to their calculations of expected loss, which may be higher than what the BCSTP requires as per its provisioning table. However, the CRC tool will help to validate whether the rates are in line with default history. A Brazilian team visited São Tomé in April 2018 on a scoping mission to begin working on the different modules of IFRS implementation. Another technical assistance mission from the Central Bank of Brazil in May supported the modernization of the CRC in collaboration with the World Bank.

31. The central bank is also working on other medium-term financial sector reform initiatives, such as developing a movable collateral registry (with support from the World Bank in line with our Financial Sector Development Implementation Plan (FSDIP)) and a corporate balance sheet repository (under a cooperation agreement with the Bank of Portugal and with financial support from the World Bank). An upgrade to the payment systems infrastructure is also underway with World Bank and AfDB support. BCSTP benefitted from AFC TA in May 2018 to modernize the prudential regulations on internal control (11/2007) and align it with the recently-issued regulation on corporate governance (17/2017).

C. Monetary Policy

32. The government will implement a set of measures to rebuild the reserves buffer. Continued fiscal consolidation will help control inflation and build a higher reserves buffer. The central bank, in an environment in which policy transmission depends on various structural factors of the national financial system (including the high credit risk index and bottlenecks in enforcing guarantees), will continue to monitor changes to inflation and develop the monetary policy tools available to support reserves accumulation. In addition, the Ministry of Finance will require the Treasury to act as project coordinator, working with various ministries, departments and external agencies to improve the implementation rate of externally-funded projects to avoid disbursement delays. The Treasury will publish quarterly reports on the progress of externally financed projects and revise the projected external disbursements in cooperation with the central bank, including both project and budgetary grants and loans. Among medium-term initiatives, ongoing plans to diversify the economy (centered around tourism, agriculture and fisheries) and efforts to reduce reliance on oil imports via electricity sector reform will both generate and save reserves. The future sale of exploration rights within the administrative areas will also generate needed foreign exchange for the country through attendant social programs, even though the associated signing bonuses are not considered for the calculation of the program target on reserves. The recent sale of two exploration blocks will add US$10 million oil signature bonus to the National Oil Account.

33. The government is making good efforts to develop monetary instruments. Recent amendments to the regulations (16/2017) allow the government to issue Treasury Bills, for which the maturity can bridge years. Based on this legislative amendment, the government successfully issued new bills in the second half of 2017 to manage the non-disbursement of World Bank funds as well as the shortfall and delay in EU assistance. Plans are also underway to further develop the securities market to allow for longer-term instruments, for which legislation is already drafted, and a secondary market overtime.

34. Interest in the domestic debt market remains strong, supporting the government's effort to issue securities as part of its cash management strategy. Each of the three issuances in 2017 were oversubscribed by an average of 60 percent; however, commercial banks continue to submit bids only at the ceiling of the variable rate, so allocations are done on a proportional basis.

35. The BCSTP, in coordination with the Treasury, has made some improvement in liquidity forecasting. Furthermore, thanks to better coordination and information sharing with economic agents—namely, commercial banks, the Treasury, as well as departments within the central bank, liquidity forecasting is more reliable. The BCSTP Markets Department now generally receives better and timely information. The main problem in the past with liquidity management was due to asymmetric information and reporting delays. Reporting today is more reliable, which helps to minimize forecasting errors that still occur, partially due to one-off unexpected operations.

36. The central bank successfully redenominated the domestic currency, effective January 1, 2018. The BCSTP kept the exchange peg unchanged and eliminated three zeros from the dobra and issued new notes and coins for use. The new bills include innovative features that secure against counterfeiting and the redenominated exchange rate is 24.50 new dobras for 1 euro. In large part due to the rollout of an extensive awareness campaign, involving all sectors, the public at large has welcomed the monetary reform plan and the risk of a negative impact on inflation did not materialize as post-redenomination inflation is in line with year-on-year figures.

D. External Sector Policies

Exchange Restrictions

37. As a microstate and a fragile economy, São Tomé and Príncipe faces wide fluctuations in foreign inflows and has experienced frequent foreign exchange shortages, which intensified in recent years from the delayed external support and the impact of lower oil

prices on our neighbors. With a population of less than 200,000 and an economy based mainly on subsistence agriculture and fisheries, the country relies heavily on imports for basic needs, requiring a large amount of foreign currency. Relative to these needs, sources of foreign currency (mainly official transfers and tourism receipts) are limited and volatile. For example, net official transfers fell from 13.7 percent of GDP in 2016 to 10.6 percent of GDP in 2017. The lower oil prices since 2014 put the economies and the foreign exchange markets of neighboring oil exporters under stress. In response, residents of those countries obtained foreign currency from São Tomé and Príncipe, including through external trade contracts that did not result in actual imports of goods to the country. There has been an intensification of such transactions since 2016. Because of the FX shortage and volatility, international reserves have been managed carefully.

38. Against this backdrop, a foreign exchange regulation (NAP 05/2017) was introduced on March 1, 2017 to ensure that import transactions of a bona fide nature are covered by the central bank while avoiding pressure on international reserves. The new regulation intensified an existing exchange restriction by limiting further the BCSTP's foreign exchange coverage to payments of imported goods that have already been delivered and excluding from such coverage payments for imports of services, invisible transactions, advance payments for goods, and import payments for goods based on invoices dated later than 6 months from the date of the foreign exchange coverage request. It also makes clear that foreign exchange from the BCSTP would not be provided for the banks' own proprietary current international transactions. While these measures were needed to meet the balance of payment needs, they also caused private external payment arrears for current international transactions.

39. The authorities are committed to eventually remove the exchange measures that limit the availability of foreign exchange for payments and transfer for current international transactions, and has been taking steps to improve its balance of payments to support such removal over time. In particular, the authorities are (i) implementing structural reforms to promote private-sector led growth, particularly in tourism and agro-business, to foster exports, (ii) reducing energy imports by revamping the electricity sector with World Bank and European Investment Bank support, and (iii) pursuing fiscal consolidation to address domestic demand. These measures are expected to improve the balance of payments over the medium term. This strengthening of the balance of payments should eventually allow an easing of exchange restrictions.

External Debt

40. Given the prolonged negotiations on rescheduling external arrears, the country is classified as being in debt distress, although the Debt Sustainability Analysis (DSA) shows that the outlook has improved. Under the baseline scenario, the ratio of the present value of public and publicly-guaranteed external debt to GDP no longer exceeds its threshold compared with the previous DSA, and the ratios to exports and to revenue still exceed their respective thresholds early in the projection period but decline over time with prudent policies. The government will continue its fiscal consolidation program and work to diversify the economy and expand the export base. In addition, the government will limit concessional borrowing to about 4 percent of GDP in the medium term and eschew non-concessional loans to help reduce the high risk of debt distress to ensure debt sustainability.

41. Despite the government's best efforts, the outstanding arrears with external creditors are yet to be resolved. The government has actively sought debt rescheduling agreements with Angola, Brazil, and Equatorial Guinea, through correspondence and high-level meetings. An agreement with the Brazilian government was reached, pending the ratification by the Brazilian Senate. The government is still waiting for responses from the other two countries on scheduling negotiation sessions, as well as from Nigeria on discussing the disputed loan.

42. The government is implementing measures to strengthen debt management, improve the management of its current loans portfolio, and manage the acquisition of new loans. The government is in the process of implementing some of the main recommendations of the Debt Management Performance Assessment (DeMPA), which was completed with the support of the World Bank in November 2016. In particular, a draft medium-term debt management strategy has been prepared and is being discussed within the government. With the help of the World Bank, a debt database is being established, which is critical for improving debt service projections, conducting risk analyses, and reporting more detailed information on the debt stock. Training of officials on debt management, including T-Bill issuance, is planned to start in 2018 with the help of the World Bank and the AfDB. The government will develop and publish an annual schedule of T-Bill issuance that aligns with cash flow forecasts and borrowing plans.

Borrowing Plan 2018–20
(Millions of U.S. dollars)

	2018	
New public debt contracted or guaranteed	Volume 1/	Present value 1/
Sources of debt financing	17.9	11.6
Concessional debt of which 2/	17.9	11.6
Non-concessional debt of which 2/	0.0	0.0
Semi-concessional debt 3/	0.0	0.0
Commercial terms 4/	0.0	0.0
Uses of debt financing	17.9	11.6
Memorandum items		
Indicative projections		
2019	19.9	12.9
2020	21.8	14.2

1/ Contracting and guaranteeing of new debt. The present value of debt is calculated using the terms of individual loans and applying the 5 percent program discount rate.
2/ Debt with a grant element that exceeds a minimum threshold of 35 percent.
3/ Debt with a positive grant element below the minimum grant element.
4/ Debt without a positive grant element. For commercial debt, the present value would be defined as the nominal/face value.

43. The government has secured a grant from China to complement a Kuwaiti loan in financing the Dr. Ayres Menezes Hospital. The financing package will have a grant element of well above the 35 percent threshold required under the program, although the Kuwaiti loan itself has a grant element of 34 percent. This project will bring significant benefits to our people by improving health services.

E. The Implementation of Other Structural Reforms

Development Planning

44. São Tomé and Príncipe has made considerable progress in promoting inclusive growth and tackling environmental issues, although significant challenges remain. The government passed the National Development Plan (NDP) for 2017-2021, in which some of the development priorities include quality education and a functioning judicial system accessible to all. On gender equality, the legal system provides equal rights to men and women; however, in practice, there is room for improvement in some social norms and outcomes. For example, the estimated gross national income per capita for women was less than half of that for men in 2015. On environmental issues, the government (particularly the Ministry of Agriculture) has been working with NGOs to implement the national sanitation plan and promote sustainable biodiversity (with the latter focusing on Príncipe), among other initiatives. Challenges include limited capacity in sectoral ministries; not-well-organized associations and cooperatives; and low environmental awareness among local residents.

Business Climate

45. The government is committed to create a conducive environment for private sector development. To this end, our structural reforms agenda prioritizes export diversification and cost competitiveness to support growth and external stability. The government adopted a tourism development strategy as a core element of an export diversification strategy (*end-June 2018 structural benchmark*). In addition, the government will pursue strategies to address the unreliable supply and high cost of electricity, including the development of cheaper energy sources. As discussed previously, the government will follow through on plans to reform the state electricity company (EMAE), eliminate cross-subsidies, and move to full cost recovery of electricity tariffs. The authorities are also committed to revise the Investment Code (12/2016) and its regulations on foreign exchange cover (05/2017) to remove the remaining exchange restrictions and multiple currency practice over time, while addressing balance of payment needs through implementing the policies under the program.

Capacity Development

46. Capacity development remains key and continued IMF support will be needed. The priority areas for capacity development include domestic revenue mobilization, public financial management, public investment management, public debt management, and financial sector regulation and supervision. However, weak domestic capacity has slowed the implementation of TA recommendations and delayed external project-related disbursements, requiring more hands-on support from our partners. The government will continue working with the IMF and other development partners to achieve its capacity development goals. The government will particularly welcome increased hands-on follow-up support on the implementation of TA recommendations to improve the impact of TA.

F. Statistics

47. Efforts to address data shortcomings in economic statistics for surveillance will continue. Having received TA from the IMF to improve balance of payments statistics and extend the coverage of the international investment position, the BCSTP is working on implementing the recommended actions to ensure better quality and broader coverage. Following the rebasing of the national accounts to 2008 and a new CPI, using a broader basket of goods and services and 2014 as the base year, and reweighting the sub-indices, the national statistics institute (INE) is planning to publish the analytical back series. It also expects to improve the real-sector statistics by developing data on the components of GDP on the demand side and quarterly GDP, including leading indicators of economic activity.

PROGRAM MONITORING

48. The performance criteria (PCs), indicative targets (ITs), prior actions, and structural benchmarks for end-June 2018 are presented in Tables 3 and 4. The definitions of quantitative PCs and ITs are provided in the attached TMU, which also defines the scope and frequency of data reporting for program monitoring purposes. The sixth review is expected to be completed on or after October 15, 2018.

Table 1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2017, Preliminary

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

	2017					
	September		December			
	Indicative Target 4th Review	Preliminary	Performance Criteria [1] 4th Review	Performance Criteria [1] w/adjustments	Preliminary	Status
Performance Criteria:						
Floor on domestic primary balance (as defined in the TMU) [2]	-173	-145	-152	…	-192	Not met
Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	0	142	66	184	229	Not met
Floor on net international reserves of the central bank (US$ millions) [2, 4]	50	46	51	48	44	Not met
Ceiling on the accumulation of central government's new external payment arrears (US$ millions) [5, 6, 7, 8]	0	0	0	…	0	Met
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the central government or the BCSTP (US$ millions) [5, 6, 7, 8, 9]	0	0	0	…	0	Met
Indicative Targets:						
Ceiling on change of central government's new domestic arrears	0	41	0	…	6	Not met
Floor on pro-poor expenditures	417	395	501	…	551	Met
Floor on tax revenue	817	738	1,066	…	1,036	Not met
Memorandum items:						
Ceiling on dobra base money (stock) [10]	1,290	1,388	1,504		1,337	
New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the BCSTP (US$ millions) [5, 7, 8, 11]	22		22		2	
Transfer from NOA to the budget (US$ millions)	2.3		2.3		2.3	
Net external debt service payments [12]	57.7		55.0		68.3	
Official external program support [12]	8		147		37.1	
Budget support grants	…		110		0.0	
Treasury-funded capital expenditure	25		27		23	

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

[1] Performance at the December 2017 test date is assessed on the fifth review.

[2] The floor will be adjusted upward or downward according to definitions in the TMU.

[3] The ceiling will be adjusted downward or upward according to definitions in the TMU.

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

[5] The term "central government" is defined as in ¶ 5 of the TMU, which excludes the operations of state-owned enterprises.

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

[7] The term "external" is defined on the basis of the residency of the creditor per paragraph 5 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014).

[8] This performance criterion or memorandum item applies not only to debt as defined in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014), but also to commitments contracted or guaranteed for which value has not been received. For further details on the definition of debt and external arrears refer to the TMU, ¶¶ 6 and 13.

[9] Only applies to debt with a grant element of less than 35 percent. For further details refer to the TMU, ¶ 17.

[10] Changed to a memorandum item.

[11] Only applies to debt with a grant element of at least 35 percent.

[12] As defined in the TMU, valued at the program exchange rate, excludes HIPC-related amortization.

Table 2. São Tomé and Príncipe: Structural Benchmarks Under ECF Program, December 2017

Policy Objectives and Measures	Timing	Macro Rationale	TA involved	Status
Strengthening Public Finances				
Adopt a 2018 budget that is consistent with the program parameters *(prior action for the 3rd and 4th reviews).*	End-November 2017	To demonstrate commitment to fiscal consolidation	No TA involved	Met.
Adopt measures to contain EMAE's loss in the near term.	End-December 2017	To contain fiscal risk	No TA involved	Met.
Submit the draft public private partnership (PPP) law to the National Assembly.	End-December 2017	To enhance capacity for efficient public investment decision-making	No TA involved	Met.

Table 3. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2018, Preliminary

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

	2018					
	March		June	September	December	
	Indicative Target		Performance Criteria [1]	Indicative Target	Indicative Target	
	4th review	Prel.	4th review	Proposed	4th review	Revised
Performance Criteria:						
Floor on domestic primary balance (as defined in the TMU) [2]	-48	-78	-90	-122	-97	-124
Ceiling on changes in net bank financing of the central government (at program exchange rate) [3, 4, 5]	50	8	75	70	65	70
Floor on net international reserves of the central bank (US$ millions) [2, 4]	52	46	52	49	54	50
Ceiling on the accumulation of central government's new external payment arrears (US$ millions) [5, 6, 7, 8]	0	0	0	0	0	0
Ceiling on the contracting or guaranteeing of new nonconcessional external debt by the central government or the BCSTP (US$ millions) [5, 6, 7, 8, 9]	0	0	0	0	0	0
Indicative Targets:						
Ceiling on change of central government's new domestic arrears	0	15	0	0	0	0
Floor on pro-poor expenditures	188	n.a.	289	413	551	551
Floor on tax revenue	238	193	535	745	1,211	1,084
Memorandum items:						
Ceiling on dobra base money (stock) [10]	1,553	1,336	1,578	1,574	1,574	1,499
New concessional external debt contracted or guaranteed with original maturity of more than one year by the central government or the BCSTP (US$ millions) [5, 7, 8, 11]	17	n.a.	17	17	17	17
Transfer from NOA to the budget (US$ millions)	1.5	0.0	1.5	2.2	1.5	2.2
Net external debt service payments [12]	34	n.a.	68	59	136	79
Official external program support [12]	45	0	85	120	218	179
Budget support grants [13]	45	0	66	101	181	142
Treasury-funded capital expenditure	6	3	13	10	28	12

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

[1] Performance at the June 2018 test date is assessed on the sixth review.

[2] The floor will be adjusted upward or downward according to definitions in the TMU.

[3] The ceiling will be adjusted downward or upward according to definitions in the TMU.

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

[5] The term "central government" is defined as in ¶ 5 of the TMU, which excludes the operations of state-owned enterprises.

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

[7] The term "external" is defined on the basis of the residency of the creditor per paragraph 5 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014).

[8] This performance criterion or memorandum item applies not only to debt as defined in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014), but also to commitments contracted or guaranteed for which value has not been received. For further details on the definition of debt and external arrears refer to the TMU, ¶¶ 6 and 13.

[9] Only applies to debt with a grant element of less than 35 percent. For further details refer to the TMU, ¶ 17.

[10] Changed to a memorandum item.

[11] Only applies to debt with a grant element of at least 35 percent.

[12] As defined in the TMU, valued at the program exchange rate, excludes HIPC-related amortization.

[13] The expected WB budget support in 2018 is $6 million of which $1 million will be treated as project grants and excluded from the DPD if it is spent on facilities for the tax administration.

Table 4. São Tomé and Príncipe: Structural Benchmarks Under ECF Program, 2018

Policy Objectives and Measures	Timing	Macro Rationale	TA involved	Status
Prior actions				
Issue a resolution to incorporate expenditure measures in the 2018 budget in line with the program.	End-May 2018	To demonstrate commitment to fiscal consolidation	No TA involved	Met.
Collect tax arrears owed by Rosema and other large taxpayers (38 million new dobras).	End-June 2018	To mobilize domestic revenue	No TA involved	Met.
Collect tax liabilities accumulated in 2018 from large taxpayers (60 million new dobras).	End-June 2018	To mobilize domestic revenue	No TA involved	Met.
Strengthening Public Finances				
Submit to the National Assembly a new VAT law.	End-June 2018	To support the introduction of VAT	FAD/LEG	Met.
Adopt financial management plan and least cost energy-production plan for EMAE *(proposed to be rephased to end-September 2018 as shown below).*	End-June 2018	To contain fiscal risk	With World Bank support	Not met.
Adopt financial management plan and least cost energy-production plan for EMAE *(newly rephased).*	End-September 2018	To contain fiscal risk	With World Bank support	-
Submit monthly monitoring table of tax payments by top 10 taxpayers during June-October 2018 *(newly proposed).*	End-November 2018	To mobilize domestic revenue	No TA involved	-
Enhancing Monetary Policy and Financial Stability				
Complete an independent detailed asset quality review of banks *(proposed to be rephased and replaced by "require the external consultant to complete an inception report" as shown below).*	End-June 2018	To support financial sector stability and growth	With World Bank support	Not met.
Require the external consultant to complete an inception report for asset quality review of banks *(newly proposed).*	End-September 2018	To support financial sector stability and growth	With World Bank support	-
Facilitating Business Activities				
Develop and submit to the National Assembly a National Export Diversification Strategy document.	End-June 2018	To promote economic diversification and employment opportunities	With World Bank support	Met.

Attachment II. Technical Memorandum of Understanding, July 2018

1. This Technical Memorandum of Understanding (TMU) contains definitions and adjuster mechanisms that clarify the measurement of quantitative performance criteria and indicative targets in Table 3, which are attached to the Memorandum of Economic and Financial Policies for 2018. Unless otherwise specified, all quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from the beginning of each calendar year.

2. The program exchange rate for the purposes of this TMU[1] will be 20.299 new dobras per U.S. dollar, 24.5 new dobras per euro, and 29.236 new dobras per SDR for 2018.

PROVISION OF DATA TO THE FUND

3. Data with respect to all variables subject to performance criteria and indicative targets will be provided to Fund staff on the frequency described below (paragraph 24) with a lag of no more than four weeks for data on net international reserves of the Central Bank of São Tomé and Príncipe (BCSTP) and six weeks for other data. The authorities will transmit promptly to Fund staff any data revisions. For variables that are relevant for assessing performance against program objectives but are not specifically defined in this memorandum, the authorities will consult with Fund staff as needed on the appropriate way of measuring and reporting. Performance criteria included in the program are defined below, specifically (i) the floor on domestic primary balance; (ii) the ceiling on changes in net bank financing of the central government; (iii) the floor on net international reserves of the central bank; (iv) the ceiling on central government's outstanding external payments arrears; and (v) the ceiling on the contracting or guaranteeing of new non-concessional external debt by the central government or the BCSTP.

DEFINITIONS

4. For the purposes of this TMU, **external** and **domestic** shall be defined on a residency basis.

5. Central government is defined for the purposes of this TMU to comprise 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.

6. Debt is defined as in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by Decision No. 15688 of the Executive Board (Dec. 5, 2014). "Debt will be understood to mean a current, i.e., not contingent, liability, created under a contractual agreement through the provision of value in the form of assets (including currency) or services, and

[1] Data refer to the mid-point exchange rates published on the BCSTP's webpage for the last day of 2014.

which requires the obligor to make one or more payments in the form of assets (including currency) or services at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract."

7. Government domestic revenue (excluding oil revenue) comprises all tax and non-tax revenue of the government (in domestic and foreign currencies), excluding: (1) foreign grants, (2) the receipts from the local sale of in-kind grants (e.g., crude oil received from Nigeria, food aid, etc.), and (3) any gross inflows to the government on account of oil signature bonus receipts and accrued interest on the National Oil Account (NOA). Revenue will be measured on a cash basis as reported in the table of government financial operations prepared by the Directorate of Budget and the Directorate of Treasury in the Ministry of Finance, Commerce and the Blue Economy (MOF).

8. Domestic primary expenditure comprises all government spending assessed on a commitment basis (*base compromisso*), excluding (1) capital expenditure financed with external concessional loans and project grants and (2) scheduled interest payments. Reporting of government domestic expenditure will be based on the state budget execution prepared every month by the Directorate of Budget and the Directorate of Treasury in the MOF. The portion of EU budget support grants that is used to finance capital expenditures in the areas linked to the conditionality of the grants, specifically on improving water supply and sanitation, is treated as project grants. The World Bank disbursement of up to $1 million spent on facilities for the tax administration is treated as project grant for September and December 2018 indicative targets.

Official External Program Support

	2017	2018 H1	2018	Currency Unit
Projected budgetary support grants				
World Bank	0.0	3.0	6.0	million US dollars
European Union	4.5	1.5	3.3	million euros
IMF ECF program	1.3	0.6	1.3	million SDR

PERFORMANCE CRITERIA

9. Performance criterion on the floor on domestic primary balance. This performance criterion refers to the difference between government domestic revenue (excluding oil revenue) and domestic primary expenditure. For reference, this balance for end 2016 was -314 million new dobras, broken down as follows:

Domestic Primary Balance
(2016, millions of new dobras)

I	Total revenue (=1+2)	1130
I.A	***of Which: Government Domestic Revenue (=I-2.1)***	***1056***
1	Tax revenue	949
2	Nontax revenue	181
2.1	*of which: oil revenue*	74
II	Total Domestic expenditure (=4+5+6)	1403
II.A	***Of which: Domestic primary expenditure (=I-4.2)***	***1370***
4	Current expenditure	1334
4.1	Personnel costs	684
4.2	Interest due	34
4.3	Goods and services	249
4.4	Transfers	282
4.5	Other current expenditure	84
5	Domestic capital expenditure	50
5.1	Financed by the Treasury	50
5.2	Financed by privatization proceeds	0
6	HIPC Initiative-related social expenditure	19
III	**Domestic primary balance (= I.A - II.A)**	**-314**

10. **Performance criterion on the ceiling on changes in net bank financing of the central government (NCG).** This performance criterion refers to the increase (decrease) of net bank financing of the central government, which equals the stock of all outstanding claims on the central government held by the BCSTP and by other depository corporations (ODCs), less the stock of all deposits held by the central government with the BCSTP and with ODCs. The balance of the National Oil Account (NOA), deposits from project grants and loans, contingent liabilities, and social security operations are not included in NCG. All foreign exchange-denominated accounts will be converted to new dobras at the program exchange rate. The relevant data are reported monthly by the BCSTP to the IMF staff. For reference, at end-2016, outstanding net bank financing of the central government (excluding NOA) was 224 million new dobras, as follows:

Net Banking Financing
(millions of new dobras)

		2015	2016
I	***Net credit to government by the BCSTP (=I.1-I.2)***	...	***221***
I.1	BCSTP credit, including use of IMF resources:	...	446
I.2	Government deposits with the BCSTP (excluding NOA)	...	225
	Treasury dobra-denominated accounts	...	14
	Treasury foreign currency-denominated accounts	...	129
	Counterpart deposits	...	82
II	***Net credit to government by ODCs***	...	***4***
II.1	ODC's credit to the government	...	4
II.2	Government deposits with ODCs (including counterpart funds)	...	0
III	***Net bank financing of the government (excluding NOA) (=I-II)***	***117***	***224***
IV	**Changes during 2016 in net bank financing of the central government (NCG)**		**107**

11. Performance criterion on the floor on net international reserves (NIR) of the BCSTP. The NIR of the BCSTP are defined for program-monitoring purposes as short-term (i.e., original maturities of one year or less), tradable foreign assets of the BCSTP minus short-term external liabilities, including liabilities to the IMF. All short-term foreign assets that are not fully convertible external assets nor readily available to and controlled by the BCSTP (i.e., they are pledged or otherwise encumbered external assets, including but not limited to the HIPC umbrella SDR account and assets used as collateral or guarantees for third-party liabilities) will be excluded from the definition of NIR. Securities whose market value on the last day of the year differs by over 20 percent from their original nominal issue price will be assessed at their market value as reported by the BCSTP's Markets Department. The balance of (1) NOA at the BCSTP, (2) banks' deposits related to capital or licensing requirements, and (3) banks' reserves denominated in foreign currency are excluded from the program definition of NIR. All values are to be converted to U.S. dollars at the actual mid-point market exchange rates prevailing at the test date. For reference, at end 2016 NIR was 1,188 million new dobras (or $50.7 million, using the exchange rate of 23.438 new dobras per U.S. dollar), calculated as follows:

International Reserves
(End-2016, millions of new dobras)

I	***Gross international reserves***	***1481***
	Cash	16
	Demand deposits	407
	Term deposits (incl. banks' deposits in foreign currency)	188
	Securities other than shares	840
	Portuguese Treasury Bond I	234
	Portuguese Treasury Bond II	248
	Rede Ferroviaria Nacional bonds	126
	US Treasury Bill I	116
	US Treasury Bill II	117
	Accrued interest on securities	15
	Reserve position in the Fund	0
	SDR holdings	15
II	***Foreign exchange liability***	***293***
	Short-term bilateral liabilities	23
	Liabilities to the IMF	121
	Banks' reserves denominated in foreign currency	149
	Banks' guaranteed deposits denominated in foreign currency	0
III	**Net international reserves (NIR) (=I - II)**	**1188**
IV	***Net other foreign assets***	***169***
	Other foreign assets	392
	Medium and long-term liabilities (including SDR allocation)	223
IV	***Net foreign assets (III+IV)***	***1357***
	Memorandum item: National Oil Account (NOA)	271

12. Performance criterion on the ceiling on the contracting or guaranteeing of new nonconcessional external debt by the central government or the BCSTP. This is a continuous performance criterion that refers to the contracting or guaranteeing of new external debt of any maturity (including overdraft positions but excluding normal import and supplier credits) by the government and/or the BCSTP. Debt is considered nonconcessional if it includes a grant element less than 35 percent. The grant element is the difference between the nominal value of the loan and its net present value, expressed as a percentage of the nominal value. The net present value of the debt at the date on which it is contracted is calculated by discounting the stream of debt service payments at the time of the contracting. The discount rate used for this purpose is 5 percent. A loan comes into effect on the signature date of the contract, unless it is specified in the contract that it becomes effective upon ratification by the parliament. For the program monitoring purpose, a loan contract is treated to be in effect on the date of the first disbursement if that is earlier than the date of signature or ratification of the contract. With respect to the precautionary line of credit from Portugal to support the pegging of the new dobra to the euro, unpaid balances outstanding during the first three quarters of a given calendar year will be excluded from this ceiling. However, outstanding balances at the end of a given calendar year will be included in the assessment of compliance with this performance criterion. This performance criterion does not apply to IMF facilities. Debt being rescheduled or restructured is excluded from this ceiling. Medium- and long-term debt will be reported by the Debt Management Department of the MOF (as appropriate), measured in U.S. dollars at the prevailing exchange rates published by the BCSTP. The government should consult with IMF staff before contracting or guaranteeing new medium– or long–term debt obligations.

13. Performance criterion on the ceiling on the accumulation of central government's new external payment arrears. This is a continuous performance criterion. New central government external payment arrears **consist of external debt service obligations (principal and interest) that have not been paid at the time they are** due**, as specified in the contractual agreement, subject to any applicable grace period**. This performance criterion does not apply to **arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or for which the government is actively seeking a rescheduling agreement.**

INDICATIVE TARGETS

14. Ceiling on change of central government's new domestic arrears is set on the difference between **expenditure** on a commitment basis and cash payments (amounts past due after 40 days and unpaid).

15. Within domestic primary expenditure, the floor on pro-poor expenditure refers to the floor on government outlays recorded in the budget that have a direct effect on reducing poverty, as agreed with the **IMF** and World Bank staffs. These expenditures, which include both current and capital outlays, are defined as follows:

a. **Pro-poor current spending:** These cover the following functional classifications and expenditure categories (by budget code) as described in the matrix below:

Pro-Poor Current Spending

Code	Economic classification of current expenditure	Education	Health	Social Security and Assistance	Housing and Community Services	Culture and Sport	Fuel and Energy	Agriculture and Fisheries
310000	Personnel Expenses	x	x					
331210	Specialty Durable Goods	x	x					
331290	Other Durable Goods	x	x					
331120	Fuels and Lubricants[1]	x	x					
331130	Foodstuffs, Food[1] and Accommodation	x	x					
331140	Specialized Current Consumable Materials (Specific to Each Sector)	x	x					
331190	Other Consumer Non Durable Goods	x	x					
332110	Water and Energy Services	x	x					
332120	Communication Services	x	x					
332130	Health services	x	x					
332220	Maintenance and Conservation Services	x	x					
353900	Other Miscellaneous Current Expenses	x	x	x				
352200	Transfers to non-profit institutions (private)		x	x				
352310	Retirement Pension and Veterans		x	x				
352320	Family Benefit		x	x				
352330	Scholarships	x						
352390	Other Current Transfers to Families		x	x				
353100	Unemployment Fund		x	x				
Code	**Economic classification of capital expenditure**							
411110	Feasibility Study and Technical Assistance	x	x	x	x	x	x	x
411120	Procurement and Construction of Real Estate	x	x	x	x	x	x	x
411200	Rehabilitation Works and Facilities	x	x	x	x	x	x	x
411300	Means and Equipments of Transportation	x	x	x	x	x	x	x
411400	Machinery and Equipment	x	x	x	x	x	x	x
411900	Other Fixed Capital Goods	x	x	x	x	x	x	x
412000	Stocks	x	x	x	x	x	x	x

Source: Diário da Republica de São Tome e Príncipe No. 21 - May 7, 2008, pages 12-13.

[1] Expenditures on fuels and lubricants (*combustíveis e lubrificantes*) that are affected 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.

16. Floor on tax revenue is set on tax revenue that includes direct and indirect taxes as well as recovery of tax arrears and additional collection efforts.

MEMORANDUM ITEMS

17. New concessional external debt contracted or guaranteed by the central government or the BCSTP measures such debt with a grant element of at least 35 percent.

18. Net external debt service payments by the central government are defined as debt service due less the accumulation of any new external payment arrears, as defined under the performance criterion on the ceiling on central government's outstanding external payment arrears.

19. Official external program support is defined as budget support grants and loans, including disbursements from the IMF under the ECF arrangement and in-kind aid when the products are sold by the government and the receipts are earmarked for a budgeted spending item, and other exceptional financing provided by foreign official entities and incorporated into the budget.

20. Treasury-funded capital expenditure is classified as part of domestic primary expenditure and covers public investment projects that are not directly financed by project grants and concessional loans or that have to be partially co-financed with government resources. It includes spending on new construction, rehabilitation, and maintenance. Expenditure on wages and salaries and the purchase of goods and services related to the projects will not be classified as capital expenditure.

21. Ceiling on base money is set on the sum of currency issued—which consists of currency outside depository corporations and cash in vaults—and banks reserves denominated in new dobras. Bank reserves refer to reserves of commercial banks (in new dobras) held with the central bank and include reserves in excess of the reserve requirements.

USE OF ADJUSTERS

22. The performance criterion on the domestic primary balance will have one adjuster. The floor on the domestic primary balance will be adjusted downward if the government receives more than projected budget support grants (excluding any portion of the additional EU grant used to finance capital expenditure on water and sanitation, which will be included in project grant financed capital expenditure) and privatization receipts in 2017 and 2018; this adjuster will be capped at 77.7 million dobras (about 1 percent of 2016 GDP) for 2017 and 38.8 million new dobras for the first semester of 2018.[2] For program purpose, the projected privatization proceeds are 0 in 2017 and 2018. For end 2018, if the collection of tax arrears from Rosema does not materialize, the floor on the domestic primary balance will be adjusted downward (in absolute value) by the market value of Rosema's assets that the government seizes.

23. The performance criteria on net bank financing of the central government and net international reserves of the central bank will be subject to the following adjusters based on deviations calculated cumulatively from end-December 2016 or end-December 2017, as appropriate (MEFP Attachment I, Table 3):

- ***Adjusters on ceilings on changes in net bank financing of the central government (NCG)***: Quarterly differences between actual and projected receipts of budget transfers from the NOA, budgetary support grant, net external debt service payments, and domestic arrears will be converted to new dobras at the program exchange rate and aggregated from end-December 2016 or end-December 2017, as appropriate, to the test date. The ceilings will be adjusted:
    - (i) downward (upward) by cumulative deviations downward (upward) of actual from projected net external debt service payments (exclude HPIC),
    - (ii) downward (upward) by deviation upward (downward) in budget transfers from the NOA,
    - (iii) downward by deviation upward of budgetary support grants in excess of 77.7 million new dobras and upward for the full deviation downward of budgetary support grants.
    - (iv) downward by deviation upward of domestic arrears.

The combined application of all adjusters at any test date is capped at the equivalent of US$3 million at the program exchange rate.

- ***Adjusters for the floor on net international reserves (NIR) of the BCSTP***: Quarterly differences between actual and projected receipts of budget transfers from the NOA, official external program support, net external debt service payments, and domestic arrears in new dobras, will be converted to U.S. dollars at the program exchange rate and aggregated from end-December 2016 or end-December 2017, as appropriate, to the test date. The floor will be adjusted upward (downward):
    - (i) by the cumulative deviation downward (upward) of actual from projected net external debt service payments of the central government;

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

- (ii) by deviations upward (downward) for budget transfers from the NOA, and
- (iii) by deviations upward (downward) of official external program support. Budget support loans in 2017 and 2018 are projected to be 0.

The combined application of all adjusters at any test date is capped at the equivalent of US$3 million at the program exchange rate.

DATA REPORTING

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

1) **Fiscal Data:** The Directorate of Treasury and Directorate of Budget at the MOF will provide the following information to IMF staff, within six weeks after the end of each month or quarter, except for the public investment program (PIP), which will be provided three months after each quarter:

   - Monthly data on central government operations for revenues, expenditure, and financing, including detailed description of net earmarked resources (*recursos consignados*), on commitment (*compromisso*) and cash payments (*caixa*);
   - Monthly data on net credit to the government by the BCSTP, recorded account by account in a format fully compatible with the monetary accounts of the BCSTP;
   - Monthly detailed data on tax and nontax revenues;
   - Monthly detailed data on domestically financed capital expenditure on commitment (*compromisso*) and cash payments (*caixa*);
   - Monthly data on domestic arrears by type and by creditor;
   - Quarterly data on implicit arrears to ENCO on account of fuel retail prices eventually not covering import costs, distribution margins and applicable taxes;
   - Quarterly data on EMAE's arrears to ENCO;
   - Monthly data on official external program support (non-project);
   - Quarterly data on the execution of the public investment program (PIP) by project and sources of financing;
   - Quarterly data on the execution of Treasury-funded capital expenditure by project type, amount, timetable of execution, and progress of execution;
   - Quarterly data on project grant and loan disbursement (HIPC and non-HIPC);

- Quarterly data on bilateral HIPC debt relief;
- Quarterly information on the latest outstanding petroleum price structures and submission of new pricing structures (within a week of becoming available).
- Quarterly pro-poor expenditure.

2) **Monetary Data:** The BCSTP will provide the IMF staff, within three weeks from the end of each month, the monetary accounts of the BCSTP. Other monetary data will be provided within six weeks after the end of each month for monthly data, within two months after the end of each quarter for quarterly data, and within two months after the end of the year for annual data. 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 (in new dobras) and currency in circulation, to be posted on the central bank's web site;
- Daily net international reserve position, to be posted on the central bank's web site;
- Monthly balance sheet data of BCSTP (in IMF report form 1SR, with requested memorandum items);
- Monthly consolidated balance sheet data of other depository corporations (in IMF report form 2SR);
- Monthly consolidated depository corporations survey (in IMF survey 3SG);
- Monthly central bank foreign exchange balance (*Orçamento cambial*);
- Quarterly table on bank prudential ratios and financial soundness indicators;
- Quarterly data on the BCSTP's financial position (profit and loss statement, deficit, budget execution, etc.).

3) **External Debt Data:** The Directorate of Treasury at the MOF 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, in arrears, and subject to debt relief or rescheduled;
- Quarterly data on disbursements for foreign-financed projects and program support loans;

- Annual data on future borrowing plans.

4) **National Accounts and Trade Statistics:** The following data will be provided to the IMF staff:

- Monthly consumer price index data, provided by the National Institute of Statistics within one month after the end of each month;

- Monthly data on imports (value of imports, import taxes collected, and arrears) and commodity export values, provided by the Customs Directorate at the MOF, 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.