INTERNATIONAL MONETARY FUND

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DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

August 2012

Request for a Three-Year Arrangement Under the Extended Credit Facility

In the context of the request for a three-year arrangement under the extended credit facility, the following documents have been released and are included in this package:

- **Staff Report** for the Request for a Three-Year Arrangement Under the Extended Credit Facility, prepared by a staff team of the IMF, following discussions that ended on May 17, 2012, with the officials of the Democratic Republic of São Tomé and Príncipe on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 6, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Informational Annex** prepared by the staff of the IMF.
- **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- **Press Release** summarizing the views of the Chair of the Executive Board meeting of July 20, 2012, that discussed the Extended Credit Facility arrangement request.
- **Statement by the Executive Director** for the Democratic Republic of São Tomé and Príncipe.

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

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

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

July 6, 2012

KEY ISSUES

Context. Economic performance has been good despite a challenging international environment. Real GDP growth accelerated slightly to 5 percent in 2011, and inflation has continued to trend downward, reaching 8.6 percent (year-on-year) in May 2012. Real GDP is projected to decelerate slightly to 4½ percent in 2012, reflecting persistent global uncertainties and a slowdown in foreign-financed investments in the first half of the year. In the medium-term, non-oil GDP growth is expected to reach 6 percent per year in line with an expansion in tourism, agriculture, and construction (total GDP growth is projected to be significantly higher as oil production is expected to start in 2015). Inflation is projected to decline to low single digits over the medium term, supported by the exchange rate peg to the euro and continued fiscal prudence.

Policy Framework. The authorities' medium-term economic program, anchored by the government's new National Poverty Reduction Strategy Paper, aims at maintaining macroeconomic stability and accelerating structural reforms as the economy gears up for the start of oil production in 2015. Given a high risk of debt distress and continued head winds from the world economy, the program envisages a cautious fiscal stance, including measures to keep the domestic primary deficit in line with available non-debt-creating financing, while mobilizing additional domestic revenue for priority infrastructure and pro-poor spending. It also includes an ambitious and realistic structural reform agenda to strengthen public finances as well as the frameworks for monetary policy, banking supervision, and anti-money laundering. Well-targeted IMF technical assistance will support program implementation.

Request for an Extended Credit Facility arrangement. In the attached letter of intent, the authorities request a new three-year Extended Credit Facility (ECF) arrangement in the amount of SDR 2.59 million (35 percent of quota) in support of their medium-term economic program. The ECF arrangement is expected to play mainly a catalytic role for São Tomé and Príncipe's major development partners to maintain or step up their assistance to the country, thus helping cover the country's balance of payment needs and maintain its international reserves at an adequate level. The accompanying memorandum of economic and financial policies spells out in more detail the objectives of the program and policy actions that the government of São Tomé and Príncipe envisages to undertake during 2012–15.

Approved By
David Owen and Dhaneshwar Ghura

Discussions were held in São Tomé during May 4–17, 2012. The team comprised Messrs. Ricardo Velloso (head), Wendell Daal, Justin Matz (all AFR), and Francesco Luna (ICD). Mr. Oumar Diakite (OED) accompanied the mission and attended all policy discussions. The mission met with Minister Américo d'Oliveira dos Ramos (Finance and International Cooperation), Central Bank Governor Maria do Carmo Silveira, Minister Carlos Vila Nova (Public Works and Natural Resources), other high level government officials, and representatives of São Tomé and Príncipe's private sector and main development partners.

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BACKGROUND

1. **São Tomé and Príncipe—the world's third smallest economy—has a narrow production and export base, and is highly vulnerable to external shocks and dependent on aid inflows.** The country's export base, consisting mostly of cocoa and a nascent tourism industry, while growing, is very small. The large external current account deficit has been financed by official transfers, FDI, and oil signature bonuses. Official foreign aid finances about 93 percent of the country's public investment program.

2. **The uncertainties related to the onset of oil production in the Joint Development Zone (JDZ) with Nigeria have diminished significantly.** The French oil company, Total, which has taken over the exploration license from Chevron since December last year, has an offshore oil platform in an adjacent Nigerian exclusive zone. This platform will be used to extract oil from the JDZ through horizontal drilling, making it easier for operations in the JDZ to start, since there is no need to setup a complete new offshore platform. As a result, there is now a high probability that commercial oil production will start in 2015, but there is still uncertainty related to the quantities that will be produced.

3. **The government that took office in August 2010 under the leadership of Prime Minister Patrice Trovoada is reform oriented**. The government is working toward making São Tomé and Príncipe more resilient to external shocks through stable macroeconomic policies and structural reforms aimed to strengthen institutions. The governing party does not enjoy a majority in parliament, but it has been able to rely on smaller parties for support.

4. **Performance under the recently expired ECF arrangement was mixed**. The first and only review was completed in February 2010. Completion of subsequent reviews was held up first by slippages against program targets, and then by delays in completing a new National Poverty Reduction Strategy Paper (NPRSP). The authorities, however, tightened fiscal policy in 2010 and 2011, and have brought the fiscal program back on track. There was good progress in implementing structural reforms under the program, although many measures, such as the establishment of a credit reference bureau, took longer than programmed to implement.

5. **The government has finalized its new NPRSP**. The new PRSP prioritizes actions around four pillars: institutional reform to promote good governance; policies for sustainable growth; development of human capital and improved basic social services; and social cohesion. In this context, the government has established several strategic objectives to be achieved by 2016: annual growth of at least 6 percent; reducing by 6 percentage points the share of the population living under the poverty line (currently about 65 percent); ensuring that the entire population has access to social services; reducing significantly social and gender differences; strengthening institutional capacity and the authority and credibility of the state; and guaranteeing environmental sustainability.

6. **An Ex-Post Assessment (EPA) was recently conducted** (Box 1). Directors welcomed the progress made by São Tomé and Príncipe, and emphasized that continued IMF engagement should be based on the recommendations in the EPA. They stressed that to enhance ownership and implementation, the program should be fully in line with the authorities' priorities and timetable, and supported by well-targeted technical assistance by the Fund.

7. **Notwithstanding substantial debt relief under the HIPC initiative and MDRI, São Tomé and Príncipe remains at high risk of debt distress.** The latest Joint Fund-Bank debt sustainability analysis stressed that the debt burden remains high especially in relation to exports at 292 percent. A narrow export base and a high dependence on imports render the country vulnerable to external shocks.

Box 1. Ex-Post Assessment (EPA) of Longer-term IMF Program Engagement

The EPA found that Fund-supported programs in the last decade played a useful role in helping São Tomé and Príncipe achieve macroeconomic stability and advance structural reforms. The EPA covered three PRGF/ECF-supported programs (2000–03, 2005–08, 2009–12) and one staff-monitored program (2002). During this period, São Tomé and Príncipe experienced substantial economic growth and no major macroeconomic crisis. However, controlling fiscal deficits and inflation was a challenge. Structural reforms were effectively implemented over the years, albeit from a low base and with some delays, in the areas of public finance and natural resource management, monetary operations and bank supervision, and, more recently, business environment. Considerable technical assistance was provided in support of structural reform, but there was a mismatch between TA delivery and program focus.

Although Fund-supported programs appropriately identified the key structural reform issues, excessive conditionality and limited ownership hampered program performance. Program design and conditionality supported policies that tried to address the main challenges of a small island state. However, program performance was encumbered by the high number of structural conditions per completed review given the country's small size and limited capacity. In addition, there seemed to be limited program ownership prior to 2005. Prospects for debt relief and financial support from Portugal to the exchange rate peg (external factors) and constitutional changes that led to more stable governments (domestic factor) have contributed to better program ownership and implementation since 2005.

The new ECF arrangement tries to address several key recommendations of the EPA by:

- Emphasizing policies that build appropriate buffers to deal with future shocks and risks, such as possible delays in the start of oil production;
- Streamlining quantitative performance criteria and structural conditionality;
- Aligning better the program's structural reform agenda to the authorities' priorities and timetable, to increase ownership; and
- Ensuring that IMF technical assistance supports program implementation.

RECENT ECONOMIC DEVELOPMENT

8. The economic performance of São Tomé and Príncipe remains good despite a challenging external environment. Real GDP growth reached 5 percent in 2011, reflecting a rebound in foreign direct investment and other private sector capital inflows (Table 1, Figure 1). Supported by the exchange rate peg to the euro and a prudent fiscal policy, (year-on-year) inflation has continued to trend downward, reaching 8.6 percent in May 2012.

9. The government has continued to make progress on fiscal consolidation, but eliminating intra-governmental arrears remains elusive. The domestic primary deficit narrowed to 3 percent of GDP in 2011 (Tables 2 and 3, Figure 2), on account of efforts to contain non-priority spending and improve revenue collections by strengthening the enforcement of tax laws and increasing the collection of tax arrears. Despite this progress, in 2011 the government accumulated new arrears to the state-owned water and electricity company (EMAE) of about ½ percent of GDP, related mainly to unpaid utility bills at the local government level. In turn, EMAE accumulated new arrears to the oil importing company (ENCO) which then accumulated new fuel tax arrears.

10. Money growth is decelerating, driven by a slowdown in private sector credit growth. After strong growth in 2009–10 (averaging around 40 percent annually) to finance consumption, private sector credit decelerated to about 15 percent in 2011 as new sources of credit began to dwindle and household debt levels rose (Tables 4 and 5, Figure 3). Credit growth was broadly flat in the first quarter of 2012 as banks increased provisions for non-performing loans (below) and became more selective in light of information on potential customers from the recently-established credit reference bureau.

11. The central bank continues to take steps to strengthen the financial sector. Banks profitability and capital-to-risk weighted assets ratio improved in 2011 (Table 6), the latter reflecting the central bank's requirement for unprofitable banks to raise capital and all banks to raise their capital-to-risk weighted assets ratio to above 10 percent. However, the ratio of non-performing loans in total increased from 15 percent in September 2011 to 21 percent in March 2012, which seems to be the result of (temporary) delays in payments to contractors for large-scale construction projects.

12. The external current account deficit improved slightly in 2011 (Tables 7, 8, and 9, Figure 4). The completion of some investment projects contributed to a slowdown in import growth, which partly mitigated the impact of rising international fuel prices on the trade balance. In addition, credit growth stagnation in the latter part of 2011 and, more broadly, a slowdown in activity translated into a decline of consumption goods imports. Private sector capital flows financed only part of the current account deficit and. The gross international reserves remained practically unchanged at about 4½ months of imports.

THE MEDIUM–TERM MACROECONOMIC PROGRAM

13. The authorities' 2012–15 economic program, anchored by the government's new NPRSP, aims at maintaining macroeconomic stability, ensuring fiscal and debt sustainability, and accelerating structural reform as the economy gears up for the start of oil production in 2015. The program contains measures to keep the domestic primary deficit in line with available non-debt-creating financing, while mobilizing additional domestic revenue for priority infrastructure and pro-poor spending. It also includes an ambitious and realistic structural reform agenda to strengthen public finances as well as the frameworks for monetary policy, banking supervision, and anti-money laundering. Key medium-term macroeconomic objectives of the program are to:

- Raise the annual rate of non-oil GDP real growth to about 6 percent;
- Reduce inflation to low single digits and keep it broadly in line with international inflation; and
- Maintain a gross international reserve cover of at least 3 months of imports in support of the exchange rate peg, which is viewed as adequate given the additional support provided by the credit line from Portugal.[1]

A. The 2012–15 Macroeconomic Framework

14. The medium-term macroeconomic framework assumes that oil production and exports will start in 2015. It envisages an acceleration of real growth in GDP to 6 percent in 2014, supported by an expansion in tourism, agriculture, and construction. Growth drivers will include drilling in the Joint Development Zone (JDZ) and in the Exclusive Economic Zone (EEZ), investment in infrastructure projects to support tourism development, and work on a deepwater port (expected to start in 2014). The projected onset of oil production and exports in 2015 will boost GDP growth considerably in that year and reduce significantly the external current account deficit.[2]

15. In 2012, however, economic growth is expected to decelerate to 4½ percent, reflecting the effects of lower project-related disbursements. After the completion of several large scale public investment projects in 2011, public investment slowed during the first half of 2012. Growth is expected to pick up in the second half of the year, boosted by construction projects to improve the airport, port, and roads, and to convert the fishing pier into a shopping center.

16. Inflation is projected to decline to low single digits over the medium term, anchored by the exchange rate peg. The onset of oil production is not expected to have a substantial impact on inflation because the

[1] The authorities have an agreement with Portugal according to which Portugal stands ready to provide support in the form of a credit line of up to € 25 million if international reserves fall below 3 months of import.

[2] The 2015 projection differs significantly from the one in the latest Article IV consultation staff report (Country Report No. 12/34). For details, see the technical note in Appendix II.

National Oil Account (NOA) will absorb most oil related inflows. Despite the favorable evolution of inflation so far in 2012, the authorities revised end-of-year projected inflation upwards, from 6 to 8 percent, in anticipation of the planned increase in domestic fuel prices in the second half of the year.

17. Risks to the medium-term outlook stem from potential delays in the start of oil production, or the possibility that the quantities produced in the initial years are not substantial. In this regard, staff and the authorities discussed an alternative (non-oil) scenario, consisting of projected GDP growth that is ½ percentage point lower than in the oil scenario during 2013–14, due to lower oil-related FDI inflows and lower public investment given the absence of oil-related revenues (Table 10). Over the medium term, annual growth is projected to be sustained at around the historical average of 5½ percent.

B. Strengthening Public Finances

Fiscal Policy Framework (MEFP ¶16)

18. The government's medium-term fiscal program is largely determined by the prospects of oil production and exports. While there may be more fiscal space when oil production starts, given the high risk of debt distress and continuing uncertainty, it is important to maintain a cautious fiscal stance over the program period**.**

19. In this regard, the government recognizes the need to continue relying primarily on non-debt creating financing, including withdrawals from NOA (up to 20 percent of the outstanding balance at the end of the previous year for 2012–14)[3] and budget support grants, while strengthening revenue collections and containing non-priority spending. Based on current projections, the fiscal space is expected to be larger starting in 2015, given oil revenue. Staff and the authorities agreed that this additional space should be used for higher infrastructure and pro-poor spending. In line with this, the government will target a domestic primary deficit of about 3 percent of GDP (equivalent to about 3.9 percent of non-oil GDP) by program-end. [4]

20. For 2012, the government is targeting a domestic primary deficit of about 3¼ percent of GDP,[5] consistent with available non-debt creating financing from the World Bank, Equatorial Guinea, and drawings from NOA. To achieve this target, staff and the authorities agreed on the need to continue with efforts to mobilize additional domestic

[3] The Oil Revenue Management Law (ORML) has been developed with assistance from Norway and the World Bank and meets international best practice standards. It contains strong governance and accountability provisions that ensure management of oil revenue is balanced and transparent. The guiding principle of the ORML is that, from the second year onward of production, all oil revenues are deposited in a permanent fund while a long-term real rate of return (capped at 5 percent) applied to the previous year's closing balance will be used to determine the amount annually transferred to the budget. For a detailed presentation on the management of oil wealth in São Tomé and Príncipe, see WP/06/183 and IMF Country Report No. 06/329.

[4] The additional fiscal space is limited in the first year of oil production, because the ORML envisages a transitional period for that year.

[5] In line with the approved budget and recommendations of the last Article IV consultation (IMF Country Report No.12/34).

resources and contain non-priority spending. Government plans to mobilize more revenue include (i) broadening the tax base by enforcing compliance with the tax laws and improving efficiency in the customs and tax administrations; and (ii) increasing (gradually) the domestic price of fuel products by 10 percent, which will enable ENCO to clear its fuel tax arrears and pay fuel taxes on time. The government agreed with staff that it is crucial to continue controlling spending by containing outlays on goods and services and enforcing a strict budget constraint on local and regional governments to avoid budget overruns and buildup in arrears, while protecting priority spending by raising treasury financed pro-poor and development investment.

21. The government's fiscal program is targeting a domestic primary deficit of about 3 percent of GDP in 2013 and 2014. Staff welcomed the authorities' commitment to continue with efforts to mobilize additional fiscal revenue, including measures to modernize the customs and tax administrations, making them more efficient and effective, and other measures to broaden the tax base, such as strengthening inspection actions through investigations, better analysis of tax returns, more judicious selection of taxpayers for inspections, and the use of modern inspection techniques. To achieve the government's objective of poverty reduction, it is critical that the government continue with efforts to contain non-priority discretionary spending, while protecting pro-poor spending. In addition to NOA financing, the government has already confirmed budget support from the World Bank and is expected to secure additional non-debt creating financing from regional bilateral partners, including Equatorial Guinea, Gabon, and Morocco.

22. In the case of significant delays in the start of oil production, or if the quantities produced in the initial years are not substantial, fiscal adjustment will need to continue over the medium term. The government expressed its commitment to take additional measures to safeguard fiscal stability, if there are indications that such a potential risk will materialize. Under those circumstances, the government stands ready for an additional fiscal adjustment of about one percentage point of GDP by 2015. This adjustment is adequate to lower the domestic primary deficit and bring it in line with available non-debt creating financing, which is projected to be 2 percent of GDP over the medium-term. In this case, the government is committed to introducing additional revenue measures to broaden the tax base and containing non-priority discretionary spending further.

Structural Reforms to Strengthen Public Finances

23. Staff and the authorities shared the view that the medium-term reform strategy to strengthen public finances should focus on mobilizing domestic revenue by improving tax and custom administration, and strengthening public financial management and transparency.

Improving tax and customs administration

24. Staff and authorities agreed that increasing revenue collection is a priority. Tax revenue (16½ percent of GDP in 2011) is low compared with peers in sub-Saharan Africa and other small island states. To help achieve the medium-term objective of raising the tax-to-GDP ratio to 18 percent of non-oil GDP, the government plans to develop a reform strategy for 2013–15 to modernize the tax administration (structural benchmark, December 2012) and prepare by year-end a reform strategy for customs administration, with technical assistance from the Fund and other developing partners (MEFP ¶18). To ensure a successful implementation of the reform strategy, the government will take the following steps to strengthen the tax administration: (i) restructuring of the Tax Directorate (DI) by enhancing the coordination between the regional tax administration and central office and segmenting taxpayers between large firms and other taxpayers; (ii) strengthening of fiscal operations by improving the taxpayer register, dossier management, monitoring of tax compliance, enforcement and management of tax arrears, computerization, and taxpayer education; and (iii) improving tax administration capacity (MEFP ¶19).

Strengthening Public Financial Management and transparency

25. As part of its medium-term reform strategy to continue strengthening public financial management and transparency, the government will take steps to (MEFP ¶21–¶23):

(i) Fully implement the 2007 Law on the Government Financial Administration, the SAFE Law, by introducing transparency rules in the SAFE Law, under which key fiscal data are published on a pre-announced schedule.

(ii) Strengthen public financial oversight, by using the newly introduced electronic system of the government's financial administration system (SAFE-e) to present—for the first time in two decades—general government accounts to the National Assembly and the Audit Court, starting in 2013 (structural benchmark, June 2013).

(iii) Resolve the issue of cross-arrears, by working closely with ENCO and EMAE to (a) reconcile and certify the stock of unpaid bills; and (b) agree on a strategy to address these arrears and prevent future accumulation of arrears between these entities (structural benchmark, December 2012).

C. Enhancing Monetary Management and Financial Stability

26. The monetary authorities and staff agreed that the central bank should focus on strengthening monetary management, maintaining financial stability, and improving the credibility of the financial system.

27. The central bank will continue to strengthen monetary management. The authorities noted in this regard that it is important for the central bank to improve its liquidity forecasting and foreign exchange operations (MEFP ¶25). For this purpose it will (a) continue to work closely with the finance ministry to facilitate the flow of information between the two institutions and coordinate fiscal and monetary policy operations, and (b) develop—with IMF technical assistance—a framework for forecasting liquidity, international reserves, and government accounts (structural benchmark, December 2012).

28. Strengthening banking supervision and reducing the risk of distress in the banking system will be critical for safeguarding financial stability and improving the credibility of the financial system. To safeguard financial stability, the central bank plans to (MEFP ¶27):

(i) Strengthen banking supervision by (a) conducting on-site supervision of two more banks in 2012 (structural benchmark, December 2012), (b) completing on-site supervisions of the remaining three banks by 2013 (structural benchmarks, June and December 2013), (c) hiring additional supervisors to help increase the frequency of on-site supervision, (d) and training staff on risk-based supervision;

(ii) Review the commercial banks' business plans and begin the analysis of restructuring solutions for banks that are unwilling or unable to restore profitability;

(iii) Take steps to ensure that a sound legal and regulatory framework to deal with problem banks will be in place by 2014.

29. Careful international reserve management is essential to São Tomé and Príncipe's monetary framework based on the exchange rate peg. Staff and the authorities agreed that the gross international reserve cover should be kept above three months of imports during the program period to enhance the credibility of the peg. The authorities noted that the agreement with Portugal, which guarantees emergency reserve support in case international reserves were to decrease below three months of imports, provides additional support for the exchange rate peg. In light of the international economic and financial crisis, staff highlighted the importance of asset portfolio diversification to hedge against counter-party, currency, and liquidity risks. In this regard, the central bank will seek to invest its international reserves in high quality financial assets and will emphasize liquidity over return in deciding the portfolio composition (MEFP ¶26).

30. The central bank will also continue to improve transparency (MEFP ¶28). To comply with international financial reporting standards, the authorities will introduce a new chart of accounts for the central bank in 2013. The central bank will maintain its website with current data on monetary and macroeconomic aggregates and will post on a timely basis its annually audited financial statements. As part of its ongoing efforts to improve disclosure and protect consumers, the central bank will request banks to publish their preliminary quarterly accounts.

D. Other Structural Reforms

Strengthening External Debt Management

31. In addition to the steps already taken, the authorities are planning to continue strengthening the institutional role of external debt management (MEFP ¶29–¶31). As part of the reforms in this area, the government has assigned to the External Debt Department a strategic role in debt monitoring and management. In this regard, the government has prepared a draft law, in cooperation with the Debt Relief International (DRI) and the World Bank DeMPA mission, which establishes the responsibility and governance structure of the External Debt Department and defines its strategic framework. Following the approval in April 2012 by the National Assembly of the general principles of a new debt management law, the specific articles of the law are now under discussion and the final text is expected to be approved and published in the second half of 2012.

Strengthening AML/CFT Framework

32. São Tomé and Príncipe has been recently placed on the Financial Action Task Force's (FATF) public list of high risk and non-cooperative jurisdictions. The FATF has called upon São Tomé and Príncipe to work on: (i) adequately criminalizing money laundering and terrorist financing; (ii) establishing a fully operational and effectively functioning Financial Intelligence Unit (FIU); (iii) ensuring that financial institutions and designated non-financial business and professions are subject to adequate ant-money laundering and combating the financing of terrorism (AML/CFT) regulation and supervision; and (iv) implementing effective, proportionate and dissuasive sanctions in order to deal with natural or legal persons that do not comply with the national AML/CFT requirements.

33. The government expressed its full commitment to address the deficiencies of the AML/CFT framework. In particular, with technical assistance from the IMF's Legal Department, the government will (MEFP ¶33):

(i) Prepare the necessary draft amendments to the AML/CFT Law, which was approved in 2008 and updated in 2010, with a view to sending those amendments to the National Assembly shortly thereafter and seeking their approval by end-2012 (structural benchmark, December 2012); and

(ii) Strengthen the operations of the FIU by providing it with additional staff and facilitating the training of its staff, to strengthen the core functions of the FIU, namely the receipt, analysis, and dissemination of suspicious transaction reports from financial and non-financial institutions and professions.

Improving the Business Environment

34. Staff and the authorities shared the view that further reforms are needed to support stronger growth and help reduce poverty (Table 11). The World Bank's 2012 Doing Business Survey ranked São Tomé and Príncipe among the top reformers last year. The government has identified in the new NPRSP key areas for reform to revitalize the energy sector and promote private sector participation (MEFP ¶34). With involvement of the World Bank, the authorities have started implementing a medium-term strategy for making the state-owned water and electricity corporation (EMAE) commercially viable.

STATISTICS, CAPACITY BUILDING, AND TECHNICAL ASSISTANCE

35. The government intends to continue working to improve the statistical system (MEFP ¶35). The authorities are taking steps to further improve the system of National Accounts and plan to use the household budget survey that was completed in 2011 as the basis for reweighting the CPI components and expanding its coverage over the entire country. The government is working with assistance from the IMF to improve balance of payments statistics.

36. Staff and the authorities recognize that capacity building and technical assistance is critical for the successful implementation of the medium term economic program (MEFP ¶36). The government will continue working closely with its traditional development partners in the priority areas of public financial management, customs and tax administration, monetary management, banking supervision, debt management, and AML/CFT. The government will seek to join the upcoming IMF Regional Technical Assistance Center in Accra, AFRITAC West 2, which will enhance access to technical assistance and training and facilitate follow up of technical assistant in critical reform areas.

PROGRAM ACCESS, CONDITIONALITY, AND RISKS

37. Access and phasing. The proposed ECF access level is equivalent to 35 percent of quota (SDR 2.59 million). If all disbursements are made under the arrangement, STP's debt outstanding to the Fund will reach 54.9 percent of quota. This relative low access level is sufficient to cover the projected balance of payment need and help maintain international reserves at an adequate level just above 3 months of imports during the program period. The agreement with Portugal provides the central bank with additional resources to support the peg if needed, in the form of a credit line of up to €25 million. The ECF arrangement, therefore, will play mainly a catalytic role and help secure funding from STP's major development partners, including Portugal, EU, AfDB, and the World Bank. ECF resources are programmed to be disbursed in equal tranches over the program period (Table 12).

38. Program conditionality. The program includes quantitative performance criteria and macro-critical structural measures relating to core areas of Fund expertise. In line with the recommendations of the EPA to enhance ownership and implementation, the program structural reform agenda is fully consistent with the authorities' priorities and timetable, and will be supported by well-targeted technical assistance from the Fund. In this regard, the authorities and staff agreed on quantitative indicators and performance criteria and on structural benchmarks that focus on strengthening public finances and the frameworks for monetary policy, banking supervision, and anti-money laundering (Tables 13 and 14). To monitor other key quantitative elements of the program, the authorities and staff also agreed indicative targets for domestic arrears, base money, and pro-poor spending. The program will encourage improvement in economic statistics, notably for the national accounts and BOP statistics.

39. **An update safeguards assessment of the BCSTP has been initiated and will be concluded before the first review**. The BCSTP is subject to external audits by a reputable firm and the financial statements are published, albeit with some delays. The 2011 audit has been completed and the results will be published.

40. **STP is highly vulnerable to external shocks, but risks to the Fund's resources are low**. Downside risks stems from a protracted recession in Europe, with potential dampening effect on aid, FDI, and remittances. STP's capacity to repay the Fund is sound (Table 15).

STAFF APPRAISAL

41. **The government's medium-term economic program is consistent with the growth and poverty reduction strategy set forth in the new PRSP.** The program also draws on the recommendations presented in the recent EPA. It aims at fiscal stability and includes an ambitious and realistic structural reform agenda to strengthen public finances and the frameworks for monetary policy, banking supervision, and anti-money laundering.

42. **While the government's medium-term fiscal framework is prudent, addressing inter-governmental arrears is crucial**. The fiscal program strikes the right balance between the government's efforts to mobilize additional revenue and contain non-priority spending in line with available non-debt creating financing. Staff strongly encourages the authorities to work with ENCO and EMAE to address the cross arrears problem.

43. **To mitigate the risk of debt distress, the government needs to maintain prudent external borrowing policies.** Although the underlying fiscal framework is consistent with available non-debt creating resources, staff strongly encourages the government to rely mainly on grant financing for execution of the public investment program. If the government must borrow to finance capital expenditure, new loans should be on highly concessional terms, to help mitigate the risk of debt distress.

44. **The government's continued commitment to fiscal prudence will be important for achieving lasting macroeconomic stability**. While the current level of international reserves provides sufficient backing for the peg, including the credit line from Portugal, the government should stand ready to tighten fiscal policy further as needed to maintain the viability of the peg.

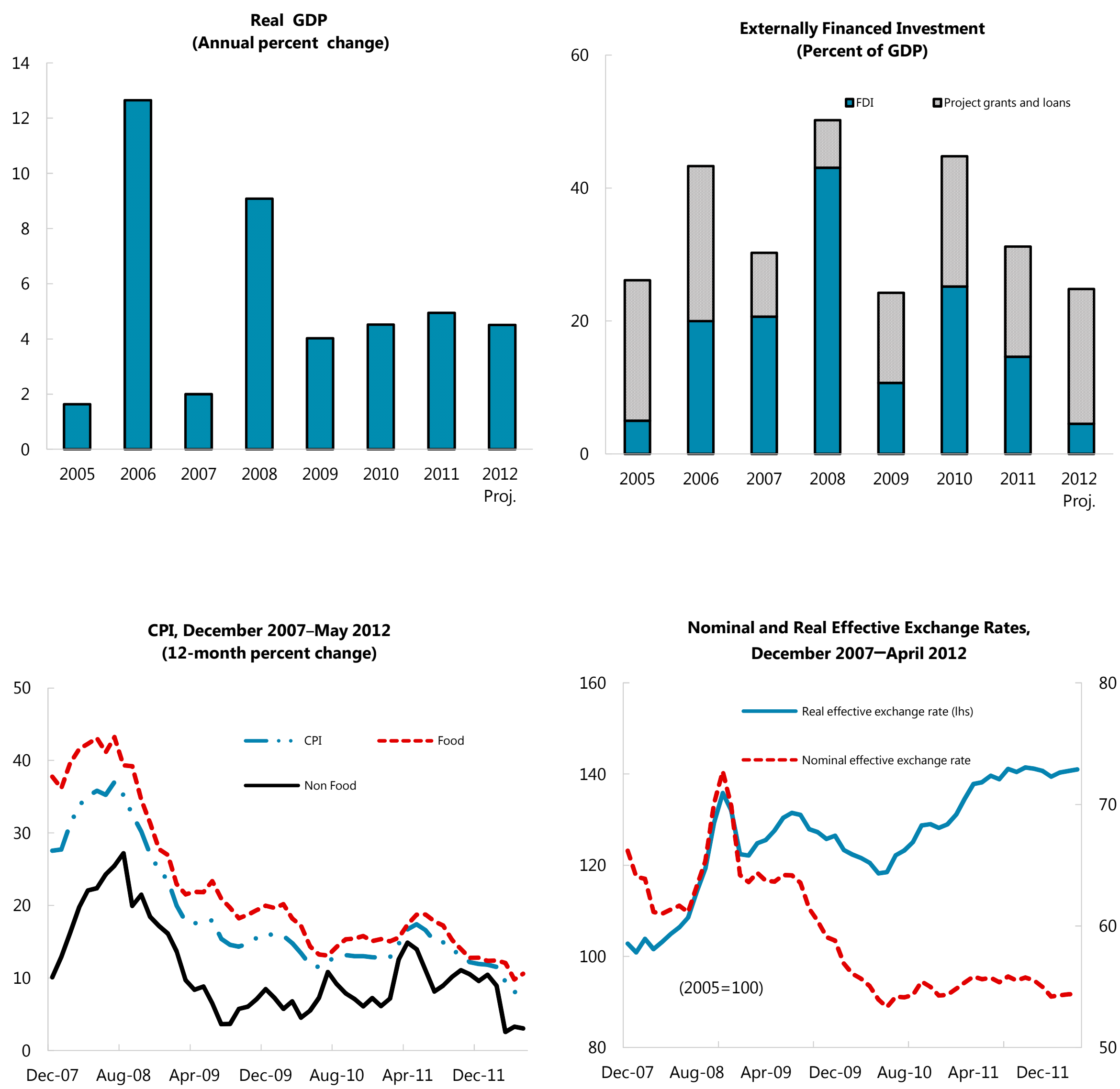
45. **Careful international reserve management is crucial for São Tomé and Príncipe's monetary framework based on the peg.** The authorities are committed to keeping the gross international reserve coverage above three months of imports. It

will be also important to invest international reserves in high quality assets, emphasizing liquidity over return in deciding the portfolio composition.

46. While banks have increased provisioning and become more selective in credit extension, the increase in non-performing loans is a concern for maintaining financial stability. Staff advises the central bank to monitor closely the effects on bank profitability and capital, to require additional provisioning should the increase in non-performing loans prove to be longer lasting, and to complete as planned the on-site inspections of all commercial banks.

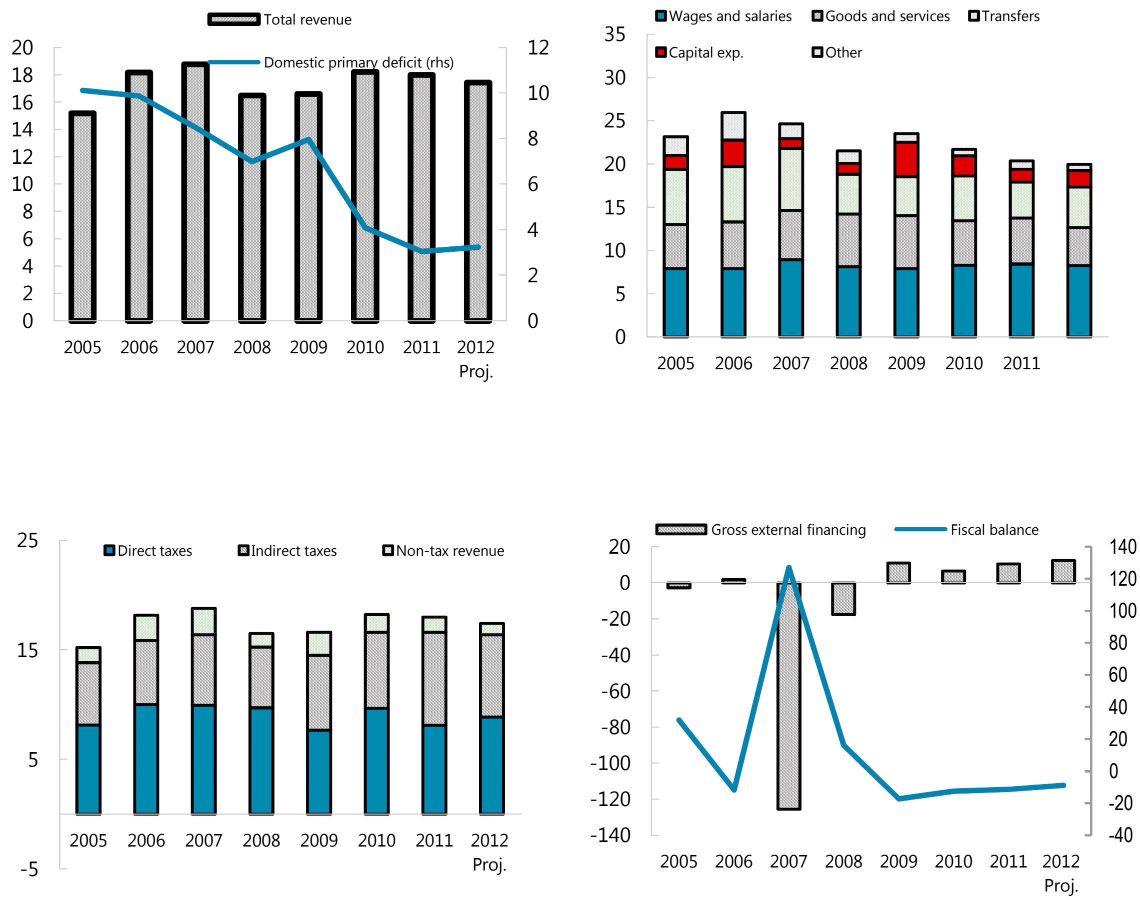
47. Staff supports the authorities request for a new three-year ECF arrangement, based on the strength of their medium-term macroeconomic program, and the authorities' strong commitment to the successful implementation of the program.

Figure 1. São Tomé and Príncipe: Recent Macroeconomic Developments



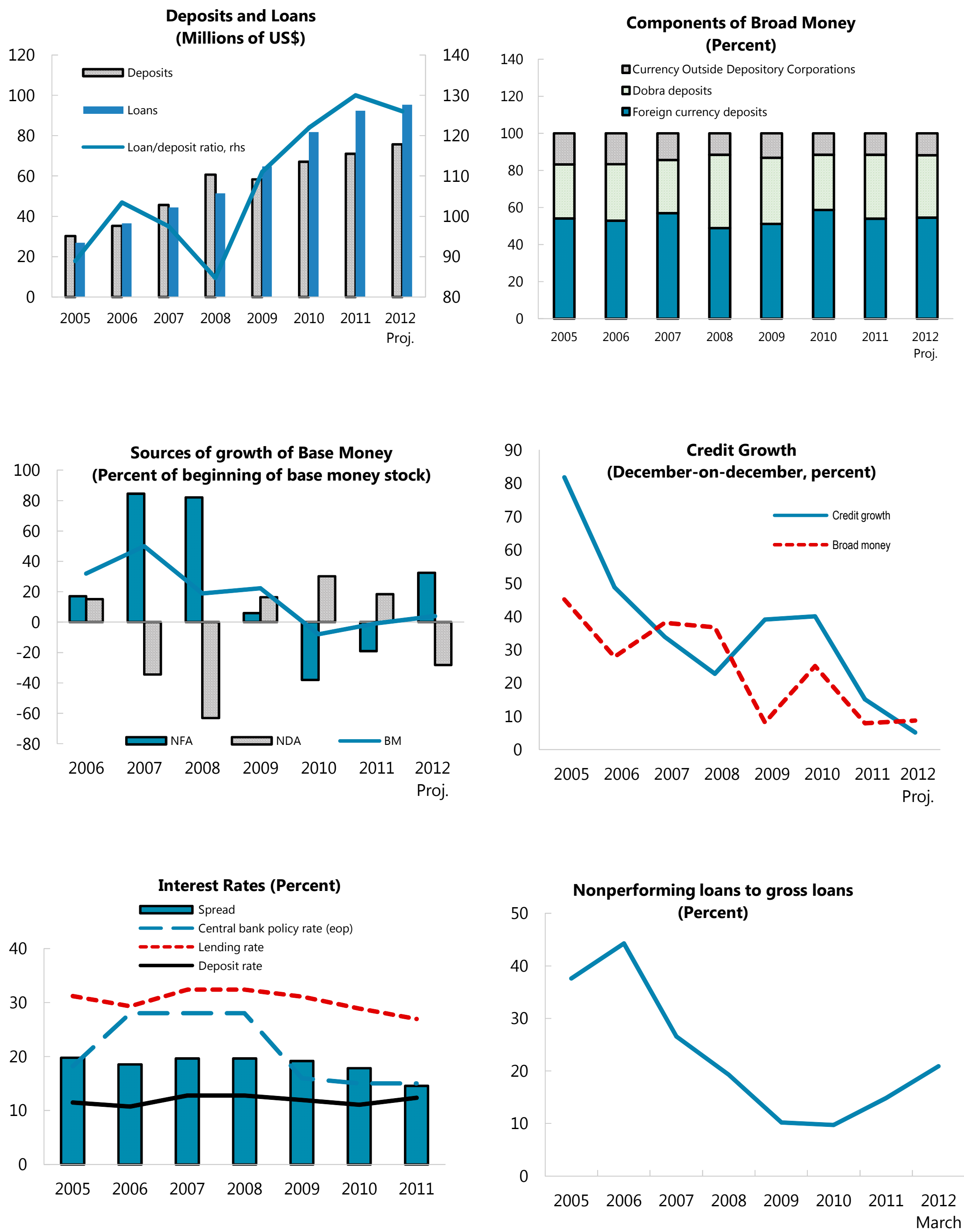
Sources: Data provided by the São Tomé and Príncipe authorities and IMF staff estimates.

Figure 2. São Tomé and Príncipe: Fiscal Indicators, 2005–12



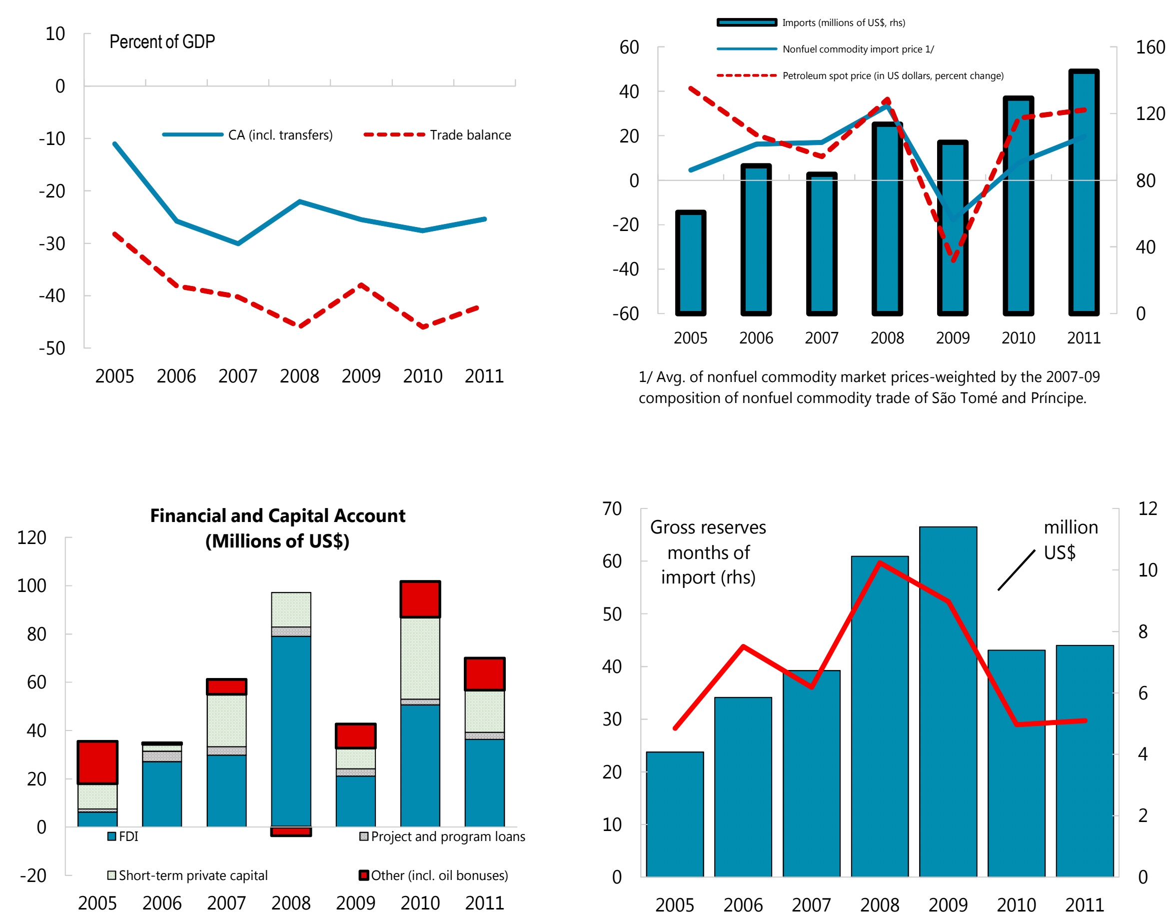
Sources: Data provided by the São Tomé and Príncipe authorities and IMF staff estimates.

Figure 3. São Tomé and Príncipe: Money and Credit Developments



Sources: Data provided by the São Tomé and Príncipe authorities and IMF staff estimates.

Figure 4. São Tomé and Príncipe: External Sector, 2005–11



Sources: Data provided by the São Tomé and Príncipe authorities and IMF staff estimates.

Table 1. São Tomé and Príncipe: Selected Economic Indicators, 2008–15

(Annual change in percent, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015
		Actual		Est.		Program		
National income and prices								
GDP at constant prices	9.1	4.0	4.5	4.9	4.5	5.5	6.0	37.7
Non-oil GDP at constant prices	9.1	4.0	4.5	4.9	4.5	5.5	6.0	6.0
Consumer prices								
End of period	24.8	16.1	12.9	11.9	8.3	6.0	4.0	3.0
Period average	32.0	17.0	13.3	14.3	9.6	7.1	5.0	3.5
External trade								
Exports of goods and nonfactor services	29.6	12.0	24.0	19.5	12.3	8.7	17.7	312.4
Imports of goods and nonfactor services	36.0	-9.5	25.8	12.5	8.8	-3.3	3.6	53.3
Exchange rate (dobras per US$; end of period) [1]	15,228	16,814	18,651	19,008	…	…	…	…
Real effective exchange rate (depreciation = -)	13.2	12.0	-2.8	11.7	…	…	…	…
Money and credit								
Base money	18.9	22.3	-7.9	-0.7	4.1	7.7	11.8	10.6
Broad money (M3)	36.8	8.2	25.1	8.0	8.8	15.2	9.6	41.7
Credit to the economy	22.8	39.1	40.0	15.1	5.2	7.3	7.6	35.5
Velocity (GDP to broad money; end of period)	2.6	2.8	2.6	2.9	3.0	3.0	3.1	3.1
Central bank reference interest rate (percent)	28.0	16.0	15.0	15.0	…	…	…	…
Bank lending rate (percent)	32.4	31.1	28.9	27.0	…	…	…	…
Bank deposit rate (percent)	12.8	11.9	11.0	12.4	…	…	…	…
Government finance								
Total revenue, grants, and oil signature bonuses [2]	45.4	31.2	38.1	37.1	44.8	32.7	29.2	27.1
Of which: tax revenue	15.2	14.5	16.6	16.6	16.4	17.1	17.6	15.1
Nontax revenue	1.2	2.1	1.6	1.4	1.1	1.3	1.4	1.1
Grants	28.9	14.6	19.9	18.3	23.5	14.3	10.2	3.9
Oil signature bonuses	0.0	0.0	0.0	0.8	4.0	0.0	0.0	0.0
Oil revenues	…	…	…	…	…	…	…	7.1
Total expenditure and net lending	31.2	49.6	49.1	49.0	53.6	45.0	40.2	29.2
Of which: personnel costs	8.1	7.9	8.3	8.4	8.3	8.3	8.3	6.5
Nonwage noninterest current expenditure	12.1	11.7	11.1	10.5	9.8	9.8	9.8	7.6
Treasury funded capital expenditures	1.3	4.0	2.3	1.5	1.9	2.7	3.2	4.6
Donor funded capital expenditures	6.9	24.4	26.3	27.5	32.4	23.0	17.8	9.7
Domestic primary balance [3]	-7.0	-8.0	-4.1	-3.0	-3.2	-3.1	-3.0	-3.0
Overall balance (commitment basis)	14.2	-18.4	-11.0	-12.0	-8.8	-12.3	-11.1	-2.1
External sector								
Current account balance								
Including official transfers	-22.0	-25.5	-27.6	-25.4	-21.8	-23.0	-23.1	-11.7
Excluding official transfers	-52.5	-42.9	-50.5	-45.6	-46.0	-38.0	-33.9	-16.0
PV of external debt	10.5	18.1	33.7	33.6	35.5	33.9	32.8	23.5
External debt service (percent of exports) [4]	56.3	19.9	10.6	18.4	10.6	11.7	11.3	3.1
Export of goods and non-factor services (US$ millions)	17.5	19.6	24.3	29.0	32.6	35.5	41.7	172.1
Gross international reserves [5, 6, 7]								
Millions of U.S. dollars	47.0	49.0	39.3	39.7	28.8	31.8	33.4	39.5
Months of imports of goods and nonfactor services [8]	7.9	6.6	4.5	4.6	3.3	3.5	3.6	3.8
National Oil Account (US$ millions)	12.0	9.7	7.8	8.3	17.6	14.2	11.5	35.4
Memorandum Item								
GDP								
Billions of dobras	2,696	3,185	3,719	4,376	5,063	5,801	6,488	9,183
Millions of U.S. dollars	183.5	196.5	201.0	248.3	264.8	298.8	333.0	469.5

Sources: São Tomé and Príncipe authorities and IMF staff estimates and projections.
[1] Central bank (BCSTP) mid-point rate.
[2] Includes HIPC and MDRI debt relief.
[3] Excludes oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.
[4] In percent of exports of goods and nonfactor services. Includes HIPC and MDRI debt relief.
[5] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital
[6] For 2008 and 2009, includes the proceeds from the privatization of the government's share in the fuel distribution company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the Central Bank to boost reserves.
[7] For 2009, includes new allocation of 6.5 million SDR.
[8] Imports of goods and nonfactor services excluding imports of investment goods and technical assistance.

Table 2. São Tomé and Príncipe: Financial Operations of the Central Government, 2008–15

(Billions of dobra)

	2008	2009	2010	2011	2012	2013	2014	2015
		Actual		Est.		Projections		
Total revenue and grants	1225	995	1417	1622	2270	1897	1893	2488
Total revenue	444	529	677	787	882	1065	1230	1481
Tax revenue	411	462	617	726	828	990	1140	1385
Nontax revenue	33	67	60	61	54	75	90	96
Of which: Nigeria Oil Program	0	0	0	0	0	0	0	0
Grants	780	466	739	799	1188	832	663	358
Project grants	165	387	686	674	962	640	442	145
Nonproject grants	99	13	25	83	182	151	172	146
HIPC Initiative-related grants	516	66	28	43	43	42	49	67
Oil signature bonuses	0	0	0	35	201	0	0	0
Oil revenue	…	…	…	…	…	…	…	649
Total expenditure	841	1581	1824	2145	2716	2610	2610	2682
Domestic primary expenditure	633	783	829	920	1046	1243	1422	1754
Current expenditure	569	646	737	851	946	1081	1207	1329
Of which: personnel costs	219	252	309	369	418	479	536	600
Interest due	23	23	16	24	32	33	34	33
Goods and services	164	195	191	234	223	255	285	312
Transfers	124	144	192	181	237	272	306	335
Other current expenditure	39	32	28	43	36	41	46	48
Capital expenditure	219	902	1066	1266	1735	1489	1362	1312
Of which: financed by the Treasury	34	126	87	65	96	155	208	418
Financed by external sources	185	776	979	1201	1638	1334	1153	895
HIPC Initiative-related social expenditure	53	33	21	29	35	41	41	41
Primary Balance	360	-609	-424	-547	-478	-747	-751	-227
Overall fiscal balance (commitment basis)	383	-586	-408	-524	-446	-713	-717	-194
Net change in arrears, float, and stat. discrepancies (reduction = -)	52	35	-58	25	0	0	0	0
External arrears	0	0	0	0	0	0	0	0
Domestic arrears	21	0	0	65	0	0	0	0
Float and statistical discrepancies	31	35	-58	-40	0	0	0	0
Overall fiscal balance (cash basis)	435	-552	-466	-499	-446	-713	-717	-194
Financing	-435	552	466	499	446	713	717	194
Net external	-473	348	246	461	629	645	662	673
Disbursements (projects)	20	388	293	528	676	694	711	750
Program financing (loans)	30	0	1	1	0	0	0	0
Net short-term loans	0	0	0	0	0	0	0	0
Scheduled amortization	-530	-75	-48	-68	-47	-49	-50	-76
Change in arrears (principal)	0	0	0	0	0	0	0	0
Bilateral rescheduling	7	2	0	0	0	0	0	0
HIPC flow savings	0	32	0	0	0	0	0	0
Net domestic	38	203	220	38	-183	68	55	-479
Net bank credit to the government	-272	170	220	38	-183	68	55	-479
Banking system credit (excluding National Oil Account)	-301	149	201	51	0	0	0	-13
Of which: Privatisation account [1]	-309	196	13	0	0	0	0	0
National Oil Account	29	21	18	-13	-183	68	55	-466
Nonbank financing	310	33	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Domestic primary balance [2]	-188	-254	-152	-133	-164	-178	-193	-273
MDRI debt relief (flow in US$ million)	1.8	1.8	0.0	0.0	0.0	0.0	0.0	0.0
Privatisation account balance (US$ million)	21.0	5.7	0.0	0.0	0.0	0.0	0.0	0.0
National Oil Account balance (US$ million, excl. transfers to budget)	12.0	9.7	7.8	8.3	17.6	14.2	11.5	35.4

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

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

[2] Exclude oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlays.

Table 3. São Tomé and Príncipe: Financial Operations of the Central Government, 2008–15

(Percent of GDP)

	2008	2009	2010	2011	2012	2013	2014	2015
		Actual		Est.		Projections		
Total revenue and grants	**45.4**	**31.2**	**38.1**	**37.1**	**44.8**	**32.7**	**29.2**	**27.1**
Total revenue	16.5	16.6	18.2	18.0	17.4	18.4	19.0	16.1
Tax revenue	15.2	14.5	16.6	16.6	16.4	17.1	17.6	15.1
Nontax revenue	1.2	2.1	1.6	1.4	1.1	1.3	1.4	1.1
Of which: Nigeria Oil Program	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	28.9	14.6	19.9	18.3	23.5	14.3	10.2	3.9
Project grants	6.1	12.2	18.5	15.4	19.0	11.0	6.8	1.6
Nonproject grants	3.7	0.4	0.7	1.9	3.6	2.6	2.7	1.6
HIPC Initiative-related grants	19.1	2.1	0.7	1.0	0.8	0.7	0.8	0.7
Oil signature bonuses	0.0	0.0	0.0	0.8	4.0	0.0	0.0	0.0
Oil revenue	...	...	...	...	...	...	...	7.1
Total expenditure	**31.2**	**49.6**	**49.1**	**49.0**	**53.6**	**45.0**	**40.2**	**29.2**
Domestic primary expenditure	23.5	24.6	22.3	21.0	20.7	21.4	21.9	19.1
Current expenditure	21.1	20.3	19.8	19.4	18.7	18.6	18.6	14.5
Of which: personnel costs	8.1	7.9	8.3	8.4	8.3	8.3	8.3	6.5
Interest due	0.9	0.7	0.4	0.5	0.6	0.6	0.5	0.4
Goods and services	6.1	6.1	5.1	5.3	4.4	4.4	4.4	3.4
Transfers	4.6	4.5	5.2	4.1	4.7	4.7	4.7	3.6
Other current expenditure	1.4	1.0	0.8	1.0	0.7	0.7	0.7	0.5
Capital expenditure	8.1	28.3	28.7	28.9	34.3	25.7	21.0	14.3
Of which: financed by the Treasury	1.3	4.0	2.3	1.5	1.9	2.7	3.2	4.6
Financed by external sources	6.9	24.4	26.3	27.5	32.4	23.0	17.8	9.7
HIPC Initiative-related social expenditure	2.0	1.0	0.6	0.7	0.7	0.7	0.6	0.4
Primary Balance	13.3	-19.1	-11.4	-12.5	-9.4	-12.9	-11.6	-2.5
Overall fiscal balance (commitment basis)	14.2	-18.4	-11.0	-12.0	-8.8	-12.3	-11.1	-2.1
Net change in arrears, float, and stat. discrepancies (reduction = -)	1.9	1.1	-1.6	0.6	0.0	0.0	0.0	0.0
External arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic arrears	0.8	0.0	0.0	1.5	0.0	0.0	0.0	0.0
Float and statistical discrepancies	1.1	1.1	-1.6	-0.9	0.0	0.0	0.0	0.0
Overall fiscal balance (cash basis)	**16.1**	**-17.3**	**-12.5**	**-11.4**	**-8.8**	**-12.3**	**-11.1**	**-2.1**
Financing	**-16.1**	**17.3**	**12.5**	**11.4**	**8.8**	**12.3**	**11.1**	**2.1**
Net external	-17.6	10.9	6.6	10.5	12.4	11.1	10.2	7.3
Disbursements (projects)	0.7	12.2	7.9	12.1	13.4	12.0	11.0	8.2
Program financing (loans)	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net short-term loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Scheduled amortization	-19.7	-2.3	-1.3	-1.6	-0.9	-0.8	-0.8	-0.8
Change in arrears (principal)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral rescheduling	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
HIPC flow savings	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Net domestic	1.4	6.4	5.9	0.9	-3.6	1.2	0.9	-5.2
Net bank credit to the government	-10.1	5.3	5.9	0.9	-3.6	1.2	0.9	-5.2
Banking system credit (excluding National Oil Account)	-11.2	4.7	5.4	1.2	0.0	0.0	0.0	-0.1
Of which: Privatisation account [1]	-11.5	6.2	0.4	0.0	0.0	0.0	0.0	0.0
National Oil Account	1.1	0.6	0.5	-0.3	-3.6	1.2	0.9	-5.1
Nonbank financing	11.5	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Domestic primary balance [2]	-7.0	-8.0	-4.1	-3.0	-3.2	-3.1	-3.0	-3.0
MDRI debt relief (flow in US$ million)	1.8	1.8	0.0	0.0	0.0	0.0	0.0	0.0
Privatisation account balance (US$ million)	21.0	5.7	0.0	0.0	0.0	0.0	0.0	0.0
National Oil Account balance (US$ million, excl. transfers to budget)	12.0	9.7	7.8	8.3	17.6	14.2	11.5	35.4
Nominal GDP (Billions of dobras)	2,696	3,185	3,719	4,376	5,063	5,801	6,488	9,183

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

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

[2] Exclude oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlays.

Table 4. São Tomé and Príncipe: Summary Accounts of the Central Bank, 2008–15
(Billions of dobra)

	2008	2009	2010	2011	2012	2013	2014	2015
	Actual					Projections		
Net foreign assets	**1,199**	**1,228**	**998**	**891**	**1,070**	**1,054**	**1,054**	**1,628**
Claims on nonresidents	1,306	1,668	1,311	1,385	1,410	1,417	1,410	1,985
Official foreign reserves [1]	1,111	1,284	1,052	1,148	1,160	1,164	1,156	1,730
Other foreign assets	195	385	259	237	250	253	254	255
Liabilities to nonresidents	-107	-440	-313	-494	-340	-363	-355	-358
Short-term liabilities to nonresidents	-93	-91	-110	-287	-129	-151	-143	-144
Other foreign liabilities [1]	-15	-348	-203	-207	-211	-212	-213	-214
Net domestic assets	**-703**	**-622**	**-439**	**-337**	**-494**	**-433**	**-360**	**-860**
Net domestic credit	-393	-211	14	70	-106	-38	72	-465
Claims on other depository corporations	1	1	9	1	1	1	1	1
Net claims on central government	-406	-232	-23	35	-145	-80	28	-510
Claims on central government	126	157	258	262	266	267	267	268
Of which: use of SDRs/PRGF Facility	*82*	*113*	*211*	*215*	*219*	*220*	*221*	*222*
Liabilities to central government	-532	-389	-281	-228	-411	-347	-239	-779
Ordinary deposits of central government	-89	-42	-33	-25	-25	-25	-25	-38
Counterpart funds	-22	-30	-43	-30	-30	-30	-30	-30
Foreign currency deposits	-420	-318	-205	-173	-356	-292	-184	-711
Of which: National oil account	*-183*	*-163*	*-145*	*-157*	*-340*	*-276*	*-224*	*-695*
Claims on other sectors	13	20	28	35	39	41	43	45
Other items (net)	-311	-411	-454	-407	-388	-395	-432	-395
Base money	**496**	**606**	**558**	**554**	**577**	**621**	**694**	**768**
Currency issued	141	167	191	204	171	185	206	228
Bank reserves	355	439	367	350	405	436	488	540
Of which: domestic currency	143	144	297	268	320	344	385	426
Of which: foreign currency	212	295	71	82	85	92	103	114
Memorandum items:								
Gross international reserves (US$ millions) [2]	47.0	49.0	39.3	39.7	28.8	31.8	33.4	39.5
Months of imports of goods and nonfactor services [3]	7.9	6.6	4.5	4.6	3.3	3.5	3.6	3.8
Net international reserves (US$ millions) [4]	40.9	43.5	33.3	24.6	22.1	24.0	26.1	32.2
Months of imports of goods and nonfactor services [3]	6.9	5.9	3.8	2.8	2.5	2.6	2.8	3.1
National Oil Account (US$ millions)	12.0	9.7	7.8	8.3	17.6	14.2	11.5	35.4
Commercial banks reserves in foreign currency (US$ millions)	13.9	17.5	3.8	4.3	4.4	4.7	5.3	5.8
Guaranteed deposits (US$ millions)	0.0	0.0	1.2	0.0	0.0	0.0	0.0	0.0
Base money (annual percent change)	18.9	22.3	-7.9	-0.7	4.1	7.7	11.8	10.6

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

[1] For 2009, includes new allocation of 6.5 million SDR.

[2] Gross international reserves exclude the National Oil Account and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.

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

[4] Net international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.

Table 5. São Tomé and Príncipe: Monetary Survey, 2008–15

(Billions of dobra)

	2008	2009	2010	2011	2012	2013	2014	2015
	Actual				Projections			
Net foreign assets	**1,418**	**1,279**	**1,364**	**1,214**	**1,365**	**1,328**	**1,640**	**2,213**
Net foreign assets of the BCSTP	1,199	1,228	998	891	1,070	1,054	1,054	1,628
Net foreign assets of other depository corporations	219	50	367	323	295	275	585	586
Net domestic assets	**-373**	**-148**	**50**	**313**	**296**	**584**	**457**	**759**
Net domestic credit	334	810	1,466	1,733	1,635	1,833	2,089	2,305
Net claims on central government	-450	-280	-60	-22	-212	-149	-44	-586
Claims on central government	127	158	261	267	267	268	269	270
Liabilities to central government	-577	-438	-321	-290	-479	-417	-313	-856
Budgetary deposits	-89	-42	-33	-25	-25	-25	-25	-38
Counterpart funds	-22	-30	-43	-30	-30	-30	-30	-30
Foreign currency deposits	-465	-366	-245	-235	-424	-363	-258	-788
Of which: National Oil Account	-183	-163	-145	-157	-340	-276	-224	-695
Claims on other sectors	784	1,090	1,526	1,756	1,847	1,982	2,133	2,891
Of which: claims in foreign currency	572	739	1,099	1,120	1,098	1,178	1,269	1,728
(In Millions of $US)	38	44	59	59	57	61	65	88
Other items (net)	-707	-958	-1,415	-1,420	-1,339	-1,249	-1,631	-1,546
Broad money (M3)	**1,045**	**1,130**	**1,415**	**1,527**	**1,661**	**1,913**	**2,099**	**2,975**
Local currency liabilities included in broad money (M2)	534	553	585	703	755	869	943	1,354
Money (M1)	429	437	562	654	719	828	898	1,290
Currency outside depository corporations	120	149	163	177	196	225	244	351
Transferable deposits in dobra	309	288	399	477	523	603	653	939
Other deposits in dobra	105	116	23	48	36	41	45	64
Foreign currency deposits	511	578	829	824	906	1,043	1,157	1,621
Memorandum items:								
Velocity (ratio of GDP to M3; end of period)	2.6	2.8	2.6	2.9	3.0	3.0	3.1	3.1
Money multiplier (M3/M0)	2.1	1.9	2.5	2.8	2.9	3.1	3.0	3.9
Base money (12-month growth rate)	18.9	22.3	-7.9	-0.7	4.1	7.7	11.8	10.6
Claims on other resident sectors (12-month growth rate)	22.8	39.1	40.0	15.1	5.2	7.3	7.6	35.5
M3 (12-month growth rate) [1]	36.8	8.2	25.1	8.0	8.8	15.2	9.6	41.7

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

[1] Revised commercial banks monetary data beginning in Jan. 2010 is not comparable with historical series.

Table 6. São Tomé and Príncipe: Financial Soundness Indicators, 2008–12

(Percent)

	2008	2009	2010	2011	2012
	December	December	December	December	March
Capital Adequacy					
Regulatory capital to risk-weighted assets					
Percentage of banks greater or equal to 10 percent	71.40	85.70	85.70	100.00	100.00
Percentage of banks below 10 and above 6 percent minimum			...	...	...
Percentage of banks below 6 percent minimum	28.60	14.30	14.30		
Capital (net worth) to assets	24.70	23.20	27.90	28.00	25.12
Deposits with banks below 6%			...	...	...
Asset quality					
Foreign exchange loans to total loans	74.20	73.00	77.50	67.08	64.16
Nonperforming loans	19.30	10.20	9.73	14.83	20.92
Provision as percent of past-due loans	10.90	24.00	42.20	46.05	37.04
Earnings and profitability					
Net profit (before tax)/net income	-13.10	-1.20			
Return on assets	-1.00	0.10	0.70	0.07	0.02
Return on equity	-3.70		1.80	0.23	0.09
Expense(w/amortization & provisions)/income	109.30	98.20	98.20	97.48	98.92
Liquidity					
Liquid assets/total assets	19.70	18.40	21.90	21.43	27.74
Liquid assets/short term liabilities			36.10	36.18	43.70
Loan/total liabilities			109.73	103.04	117.42
Foreign exchange liabilities/total liabilities	71.00	73.10	57.40	59.22	60.58
Loan/deposits			104.20	114.15	101.14
Sensitivity to market risk					
Foreign exchange liabilities to shareholders funds	215.70	274.00	203.80	101.78	118.67

Source: São Tomé and Príncipe authorities.

Table 7. São Tomé and Príncipe: Balance of Payments, 2008–15

(Millions of U.S. dollars)

	2008	2009	2010	2011	2012	2013	2014	2015
		Actual		Est.		Projections		
Trade balance	**-84.3**	**-74.6**	**-92.5**	**-103.7**	**-105.4**	**-105.0**	**-107.2**	**-57.3**
Exports, f.o.b.	7.8	9.2	10.9	10.6	11.5	10.0	10.9	118.9
Of which: oil	0.0	0.0	0.0	0.0	0.0	0.0	0.0	108.1
Cocoa	5.0	5.4	4.3	5.3	4.6	4.5	5.2	4.8
Re-export	2.2	3.0	5.2	5.1	6.4	5.0	5.2	5.4
Imports, f.o.b.	-92.2	-83.8	-103.4	-114.3	-116.8	-115.0	-118.1	-176.2
Of which: food	-24.2	-29.0	-31.9	-33.6	-32.6	-32.8	-33.6	-35.0
Petroleum products	-22.1	-14.7	-18.4	-25.2	-25.8	-25.2	-25.9	-27.1
Investment goods	-35.3	-30.0	-38.0	-40.2	-44.1	-40.9	-40.6	-26.6
Services and income (net)	**-11.8**	**-8.9**	**-11.8**	**-12.5**	**-19.4**	**-11.7**	**-8.7**	**-21.1**
Exports of nonfactor services	9.7	10.4	13.4	18.5	21.2	25.4	30.8	53.2
Of which: travel and tourism	7.7	8.3	11.1	15.1	17.7	21.8	26.7	35.8
Imports of nonfactor services	-21.4	-19.0	-25.9	-31.1	-41.3	-38.0	-40.4	-66.7
Factor services (net)	-0.1	-0.3	0.6	0.2	0.8	0.9	0.9	-7.6
Of which: oil related	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-8.6
Private transfers (net)	**-0.2**	**-0.9**	**2.8**	**2.9**	**2.9**	**3.0**	**3.0**	**3.1**
Official transfers (net)	**56.0**	**34.3**	**46.1**	**50.3**	**64.1**	**44.9**	**36.0**	**20.3**
Of which: project grants	11.2	23.9	37.1	38.2	50.3	32.9	22.7	7.4
HIPC Initiative-related grants	35.1	4.1	1.5	2.4	2.2	2.1	2.5	3.4
Current account balance								
Including official transfers	-40.4	-50.0	-55.5	-63.0	-57.7	-68.8	-76.8	-55.0
Excluding official transfers	-96.4	-84.4	-101.6	-113.3	-121.8	-113.7	-112.8	-75.3
Capital and financial account balance	**70.4**	**72.2**	**51.8**	**82.9**	**65.3**	**68.3**	**76.1**	**84.1**
Capital transfer [1]	34.8	79.4	0.0	3.2	0.0	0.0	0.0	0.0
Financial account	35.6	-7.2	51.8	79.7	65.3	68.3	76.1	84.1
Public sector (net)	1.1	26.5	18.0	26.9	15.7	4.6	8.4	1.5
Project loans	1.9	2.7	2.3	2.9	3.3	2.4	1.5	1.0
Program loans	2.0	0.3	0.1	0.0	0.0	0.0	4.6	4.6
Amortization	-2.0	-1.3	-1.2	-1.7	-2.6	-2.7	-2.9	-3.5
Other investment	-0.8	24.7	16.8	25.7	14.9	4.9	5.2	-0.7
Of which: transfers to JDA	-0.1	-0.2	-0.1	-0.3	-0.5	-0.6	-0.6	-0.6
Private sector (net)	34.4	-33.7	33.8	52.8	49.6	63.7	67.7	82.7
Direct foreign investment	79.0	21.0	50.7	38.3	22.5	25.0	27.9	30.3
Of which: Oil signature bonuses	0.0	0.0	0.0	1.9	10.4	0.0	0.0	0.0
Petroleum related investment	0.0	0.0	0.0	0.1	0.1	0.0	0.0	102.9
Recovery of oil capital expense	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	-102.9
Commercial banks	-2.3	11.4	16.7	-2.6	-1.8	-1.1	15.9	-0.1
Short-term private capital	-42.2	-66.1	-33.5	17.1	28.9	39.8	24.0	52.5
Errors and omissions	**-14.9**	**-12.1**	**-4.8**	**-24.3**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**15.1**	**10.1**	**-8.5**	**-4.5**	**7.6**	**-0.6**	**-0.7**	**29.1**
Financing	-15.1	-10.1	8.5	4.5	-7.6	0.6	0.7	-29.1
Change in official reserves, excl. NOA (increase= -)	-18.5	-2.8	6.0	4.9	1.2	-3.3	-2.2	-5.2
Use of Fund resources (net)	0.7	0.5	0.6	0.0	0.6	0.5	0.2	0.1
Purchases	0.7	0.5	0.6	0.0	0.6	1.1	1.1	1.1
Repurchases (incl. MDRI repayment)	0.0	0.0	0.0	0.0	0.0	-0.6	-1.0	-1.1
National Oil Account (increase = -)	2.7	2.4	1.9	-0.5	-9.3	3.4	2.7	-24.0
Exceptional financing [2]	0.0	-10.3	0.0	0.0	0.0	0.0	0.0	0.0
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Current account balance (percent of GDP)								
Before official transfers	-52.5	-42.9	-50.5	-45.6	-46.0	-38.0	-33.9	-16.0
After official transfers	-22.0	-25.5	-27.6	-25.4	-21.8	-23.0	-23.1	-11.7
Debt service ratio (percent of exports) [3]	56.3	19.9	10.6	18.4	10.6	11.7	11.3	3.1
Gross international reserves [4, 5]								
Millions of U.S. dollars	47.0	49.0	39.3	39.7	28.8	31.8	33.4	39.5
Months of imports of goods and nonfactor services [6]	7.9	6.6	4.5	4.6	3.3	3.5	3.6	3.8

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

[1] Includes MDRI debt relief.

[2] For 2009, includes new allocation of 6.5 million SDR.

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

[4] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.

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

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

Table 8. São Tomé and Príncipe: Balance of Payments, 2008–15

(Percent of GDP)

	2008	2009	2010	2011	2012	2013	2014	2015
		Actual		Est.		Projections		
Trade balance	**-46.0**	**-37.9**	**-46.0**	**-41.8**	**-39.8**	**-35.1**	**-32.2**	**-12.2**
Exports, f.o.b.	4.3	4.7	5.4	4.3	4.3	3.4	3.3	25.3
Of which: oil	0.0	0.0	0.0	0.0	0.0	0.0	0.0	23.0
Cocoa	2.7	2.8	2.2	2.1	1.7	1.5	1.5	1.0
Re-export	1.2	1.5	2.6	2.1	2.4	1.7	1.6	1.2
Imports, f.o.b.	-50.2	-42.6	-51.4	-46.0	-44.1	-38.5	-35.5	-37.5
Of which: food	-13.2	-14.8	-15.9	-13.5	-12.3	-11.0	-10.1	-7.5
Petroleum products	-12.1	-7.5	-9.1	-10.2	-9.7	-8.4	-7.8	-5.8
Investment goods	-19.2	-15.2	-18.9	-16.2	-16.7	-13.7	-12.2	-5.7
Services and income (net)	**-6.4**	**-4.5**	**-5.9**	**-5.0**	**-7.3**	**-3.9**	**-2.6**	**-4.5**
Exports of nonfactor services	5.3	5.3	6.7	7.4	8.0	8.5	9.2	11.3
Of which: travel and tourism	4.2	4.2	5.5	6.1	6.7	7.3	8.0	7.6
Imports of nonfactor services	-11.7	-9.7	-12.9	-12.5	-15.6	-12.7	-12.1	-14.2
Factor services (net)	0.0	-0.1	0.3	0.1	0.3	0.3	0.3	-1.6
Of which: oil related	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-1.8
Private transfers (net)	**-0.1**	**-0.5**	**1.4**	**1.2**	**1.1**	**1.0**	**0.9**	**0.7**
Official transfers (net)	**30.5**	**17.5**	**22.9**	**20.3**	**24.2**	**15.0**	**10.8**	**4.3**
Of which: project grants	6.1	12.2	18.5	15.4	19.0	11.0	6.8	1.6
HIPC Initiative-related grants	19.1	2.1	0.7	1.0	0.8	0.7	0.8	0.7
Current account balance								
Including official transfers	-22.0	-25.5	-27.6	-25.4	-21.8	-23.0	-23.1	-11.7
Excluding official transfers	-52.5	-42.9	-50.5	-45.6	-46.0	-38.0	-33.9	-16.0
Capital and financial account balance	**38.3**	**36.8**	**25.8**	**33.4**	**24.7**	**22.8**	**22.8**	**17.9**
Capital transfer [1]	19.0	40.4	0.0	1.3	0.0	0.0	0.0	0.0
Financial account	19.4	-3.6	25.8	32.1	24.7	22.8	22.8	17.9
Public sector (net)	0.6	13.5	8.9	10.8	5.9	1.5	2.5	0.3
Project loans	1.0	1.4	1.1	1.2	1.3	0.8	0.4	0.2
Program loans	1.1	0.2	0.0	0.0	0.0	0.0	1.4	1.0
Amortization	-1.1	-0.6	-0.6	-0.7	-1.0	-0.9	-0.9	-0.7
Other investment	-0.4	12.6	8.4	10.4	5.6	1.6	1.6	-0.1
Of which: transfers to JDA	-0.1	-0.1	0.0	-0.1	-0.2	-0.2	-0.2	-0.1
Private sector (net)	18.8	-17.1	16.8	21.3	18.7	21.3	20.3	17.6
Direct foreign investment	43.0	10.7	25.2	15.4	8.5	8.4	8.4	6.4
Of which: Oil signature bonuses	0.0	0.0	0.0	0.7	3.9	0.0	0.0	0.0
Petroleum related investment	0.0	0.0	0.0	0.1	0.1	0.0	0.0	21.9
Recovery of oil capital expense	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	-21.9
Commercial banks	-1.3	5.8	8.3	-1.1	-0.7	-0.4	4.8	0.0
Short-term private capital	-23.0	-33.6	-16.7	6.9	10.9	13.3	7.2	11.2
Errors and omissions	**-8.1**	**-6.1**	**-2.4**	**-9.8**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**8.2**	**5.2**	**-4.2**	**-1.8**	**2.9**	**-0.2**	**-0.2**	**6.2**
Financing	-8.2	-5.2	4.2	1.8	-2.9	0.2	0.2	-6.2
Change in official reserves, excl. NOA (increase= -)	-10.1	-1.4	3.0	2.0	0.4	-1.1	-0.7	-1.1
Use of Fund resources (net)	0.4	0.3	0.3	0.0	0.2	0.2	0.1	0.0
Purchases	0.4	0.3	0.3	0.0	0.2	0.4	0.3	0.2
Repurchases (incl. MDRI repayment)	0.0	0.0	0.0	0.0	0.0	-0.2	-0.3	-0.2
National Oil Account (increase = -)	1.5	1.2	0.9	-0.2	-3.5	1.1	0.8	-5.1
Exceptional financing [2]	0.0	-5.2	0.0	0.0	0.0	0.0	0.0	0.0
Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Debt service ratio (percent of exports) [3]	56.3	19.9	10.6	18.4	10.6	11.7	11.3	3.1
Gross international reserves [4, 5]								
Millions of U.S. dollars	47.0	49.0	39.3	39.7	28.8	31.8	33.4	39.5
Months of imports of goods and nonfactor services [6]	7.9	6.6	4.5	4.6	3.3	3.5	3.6	3.8

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

[1] Includes MDRI debt relief.

[2] For 2009, includes new allocation of 6.5 million SDR.

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

[4] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.

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

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

Table 9. São Tomé and Príncipe: External Financing Requirements and Sources, 2008–15
(Millions of U.S. dollars)

	2008	2009	2010	2011	2012	2013	2014	2015
		Actual			Est.		Projections	
Gross financing requirements	**-117.6**	**-63.6**	**-79.9**	**-84.3**	**-108.4**	**-115.5**	**-113.6**	**-85.7**
Current account, excluding official transfers	-96.4	-84.4	-101.6	-113.3	-121.8	-113.7	-112.8	-75.3
Exports, f.o.b.	7.8	9.2	10.9	10.6	11.5	10.0	10.9	118.9
Imports, f.o.b.	-92.2	-83.8	-103.4	-114.3	-116.8	-115.0	-118.1	-176.2
Services and income (net)	-11.8	-8.9	-11.8	-12.5	-19.4	-11.7	-8.7	-21.1
Private transfers	-0.2	-0.9	2.8	2.9	2.9	3.0	3.0	3.1
Financial account	-2.8	23.5	15.6	24.0	12.3	1.6	1.4	-5.2
Scheduled amortization [1]	-2.0	-1.3	-1.2	-1.7	-2.6	-2.7	-2.9	-3.5
IMF repayments [2]	0.0	0.0	0.0	0.0	0.0	-0.6	-1.0	-1.1
Other public sector flows (net)	-0.8	24.7	16.8	25.7	14.9	4.9	5.2	-0.7
Change in external reserves (-ve = increase) [3]	-18.5	-2.8	6.0	4.9	1.2	-3.3	-2.2	-5.2
Available funding	**117.6**	**63.6**	**79.9**	**84.3**	**108.4**	**115.5**	**113.6**	**85.7**
National Oil Fund (net)	2.7	2.4	1.9	1.4	1.1	3.4	2.7	-24.0
Oil signature bonuses	0.0	0.0	0.0	1.9	10.4	0.0	0.0	0.0
Saving (-ve = accumulation of oil reserve fund)	2.7	2.4	1.9	-0.5	-9.3	3.4	2.7	-24.0
Expected disbursements	94.7	116.8	48.4	56.4	67.5	47.2	42.1	25.9
Multilateral HIPC interim assistance	35.1	4.1	1.5	2.4	2.2	2.1	2.5	3.4
Capital transfers [1, 2]	34.8	79.4	0.0	3.2	0.0	0.0	0.0	0.0
Grants [4]	20.8	30.3	44.6	47.9	61.9	42.7	33.5	16.9
Concessional loans	3.9	3.0	2.3	2.9	3.3	2.4	6.1	5.6
Project loans	1.9	2.7	2.3	2.9	3.3	2.4	1.5	1.0
Program loans	2.0	0.3	0.1	0.0	0.0	0.0	4.6	4.6
Private sector (net)	19.5	-45.8	29.0	26.6	39.3	63.7	67.7	82.7
IMF [3]	0.7	0.5	0.6	0.0	0.6	1.1	1.1	1.1
Financing gap	0.0	-10.3	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing [3]	0.0	-10.3	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

[1] Includes MDRI debt relief.

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

[3] For 2009, includes new allocation of 6.5 million SDR.

[4] Includes revenue from Nigeria oil program.

Table 10. São Tomé & Príncipe: Selected Economic Indicators, 2008–15

(Non-oil scenario, Annual change in percent, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015
		Actual		Est.		Projections		
National income and prices								
GDP at constant prices	9.1	4.0	4.5	4.9	4.5	5.0	5.5	6.0
Consumer prices								
End of period	24.8	16.1	12.9	11.9	8.3	6.0	4.0	3.0
Period average	32.0	17.0	13.3	14.3	9.6	7.1	5.0	3.5
External trade								
Exports of goods and nonfactor services	29.6	12.0	24.0	19.5	12.3	10.4	21.4	15.1
Imports of goods and nonfactor services	36.0	-9.5	25.8	12.5	8.8	-13.8	2.6	7.2
Exchange rate (dobras per US$; end of period) [1]	15,228	16,814	18,651	19,008	...	...	...	...
Real effective exchange rate (depreciation = -)	13.2	12.0	-2.8	11.7	...	...	...	...
Money and credit								
Base money	18.9	22.3	-7.9	-0.7	4.1	7.7	2.3	-0.1
Broad money (M3)	36.8	8.2	25.1	8.0	8.8	15.2	8.6	9.1
Credit to the economy	22.8	39.1	40.0	15.1	5.2	6.8	7.1	5.7
Velocity (GDP to broad money; end of period)	2.6	2.8	2.6	2.9	3.0	3.0	3.1	3.1
Central bank reference interest rate (percent)	28.0	16.0	15.0	15.0	...	...	...	...
Bank lending rate (percent)	32.4	31.1	28.9	27.0	...	...	...	...
Bank deposit rate (percent)	12.8	11.9	11.0	12.4	...	...	...	...
Government finance								
Total revenue, grants, and oil signature bonuses [2]	45.4	31.2	38.1	37.1	44.8	32.9	29.6	29.6
Of which: tax revenue	15.2	14.5	16.6	16.6	16.4	17.1	18.1	18.1
Nontax revenue	1.2	2.1	1.6	1.4	1.1	1.3	1.4	1.4
Grants	28.9	14.6	19.9	18.3	23.5	14.4	10.0	10.2
Oil signature bonuses	0.0	0.0	0.0	0.8	4.0	0.0	0.0	0.0
Oil revenues	...	...	...	...	...	...	...	0.0
Total expenditure and net lending	31.2	49.6	49.1	49.0	53.6	45.2	40.5	39.6
Of which: personnel costs	8.1	7.9	8.3	8.4	8.3	8.3	8.3	8.5
Nonwage noninterest current expenditure	12.1	11.7	11.1	10.5	9.8	9.8	9.9	9.7
Treasury funded capital expenditures	1.3	4.0	2.3	1.5	1.9	2.7	3.1	2.8
Donor funded capital expenditures	6.9	24.4	26.3	27.5	32.4	23.1	17.9	17.6
Domestic primary balance [3]	-7.0	-8.0	-4.1	-3.0	-3.2	-3.1	-2.5	-2.0
Overall balance (commitment basis)	14.2	-18.4	-11.0	-12.0	-8.8	-12.4	-10.9	-10.0
External sector								
Current account balance								
Including official transfers	-22.0	-25.5	-27.6	-25.4	-21.8	-16.3	-16.4	-15.5
Excluding official transfers	-52.5	-42.9	-50.5	-45.6	-46.0	-32.4	-27.9	-26.7
PV of external debt	10.5	18.1	33.7	33.5	36.9	33.3	30.7	30.5
External debt service (percent of exports) [4]	56.3	19.9	10.6	18.4	10.6	11.5	10.8	10.7
Export of goods and non-factor services (US$ millions)	17.5	19.6	24.3	29.0	32.6	36.0	43.8	50.3
Gross international reserves [5, 6, 7]								
Millions of U.S. dollars	47.0	49.0	39.3	39.7	28.8	31.8	33.9	40.5
Months of imports of goods and nonfactor services [8]	7.9	6.6	4.5	4.6	3.8	4.1	4.2	4.8
National Oil Account (US$ millions)	12.0	9.7	7.8	8.3	17.6	14.2	11.5	9.3
Memorandum Item								
GDP								
Billions of dobras	2,696	3,185	3,719	4,376	5,063	5,774	6,427	7,003
Millions of U.S. dollars	183.5	196.5	201.0	248.3	264.8	297.4	329.9	358.0

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

[1] Central bank (BCSTP) mid-point rate.

[2] Includes HIPC and MDRI debt relief.

[3] Excludes oil related revenues, grants, interest earned, scheduled interest payments, and foreign-financed capital outlay.

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

[5] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital

[6] For 2008 and 2009, includes the proceeds from the privatization of the government's share in the fuel distribution company (ENCO) of $32 million. Of this, $10 million were used to pay back some of ENCO's debt to Sonangol, $0.96 million were used to audit the transaction and $21.4 million were put in the Central Bank to boost reserves.

[7] For 2009, includes new allocation of 6.5 million SDR.

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

Table 11. São Tomé & Príncipe: Millennium Development Goals

	1990	1995	2000	2005	2010
Goal 1: Eradicate extreme poverty and hunger					
Income share held by lowest 20%	--	--	5.23[5/]	--	--
Malnutrition prevalence, weight for age (% of children under 5)	--	--	10.1	--	13.1[10/]
Poverty gap at $1.25 a day (PPP) (%)	--	--	7.87[5/]	--	--
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	--	--	28.18[5/]	--	--
Poverty headcount ratio at national povertyline, total (%)	--	--	53.8[5/]	--	66.2[10/]
Prevalence of undernourishment (% of population)	14[2/]	15[3/]	8[5/]	--	5[9/]
Depth of hunger (kilocalories per person per day)	190[2/]	190[3/]	170[6/]	--	160[8/]
Vulnerable employment, total (% of total employment)	27[1/]	--	--	--	--
Unemployment rate, total	--	--	14.4	--	16.7[8/]
Goal 2: Achieve universal primary education					
Literacy rate, youth female (% of females ages 15-24)	92[1/]	--	94.85[5/]	--	95.81[10/]
Literacy rate, youth male (% of males ages 15-24)	96[1/]	--	95.97[5/]	--	94.86[10/]
Persistence to last grade of primary, total (% of cohort)	--	--	58.83	68.91[7/]	75.02[8/]
Primary completion rate, total (% of relevant age group)	78	--	46.28[4/]	74.34	85.31
Total enrollment, primary (% net)	97	--	87.59[4/]	99.33	98.63
Goal 3: Promote gender equality and empower women					
Proportion of seats held by women in national parliaments (%)	12	--	9	9	18
Ratio of female to male primary enrollment (%)	92	--	97[4/]	97	100
Ratio of female to male secondary enrollment (%)	--	--	--	107	103
Ratio of female to male tertiary enrollment (%)	--	--	--	--	98
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	32[1/]	--	--	--	--
Goal 4: Reduce child mortality					
Immunization, measles (% of children ages 12-23 months)	71	74	69	88	92
Mortality rate, infant (per 1,000 live births)	62	59	56	55	53
Mortality rate, under-5 (per 1,000)	95	90	86	83	80
Goal 5: Improve maternal health					
Adolescent fertility rate (births per 1,000 women ages 15-19)	--	--	87	72	62[10/]
Births attended by skilled health staff (% of total)	--	--	79	--	82[10/]
Contraceptive prevalence (% of women ages 15-49)	--	--	29	--	38[10/]
Pregnant women receiving prenatal care (%)	--	--	91	--	98[10/]
Goal 6: Combat HIV/AIDS, Malaria and other diseases					
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	--	--	61	--	8[10/]
Use of insecticide-treated bed nets (% of under-5 population)	--	--	23	--	56[10/]
Incidence of tuberculosis (per 100,000 people)	135	124	114	105	96
Tuberculosis case detection rate (all forms)	11	--	60	85	76
Goal 7: Ensure environmental sustainability					
CO2 emissions (kg per PPP $ of GDP)			.62[5/]	0.59	0.46[9/]
CO2 emissions (metric tons per capita)	0.57	0.60	0.62	0.84	0.80[9/]
Forest area (% of land area)	28	--	28	28	28
Improved sanitation facilities (% of population with access)	--	20	21	24	26[9/]
Improved water source (% of population with access)	--	75	79	85	89[9/]
Goal 8: Develop a global partnership for development					
Debt service (PPG and IMF only, % of exports, excluding workers' remittances)	29	27[3/]	22	61	3
Internet users (per 100 people)	0.0	--	4.6	14	19
Mobile cellular subscriptions (per 100 people)	0.0	0.0	0.0	8	62
Net ODA received per capita (current US$)	466	657	247	213	189[10/]
Telephone lines (per 100 people)	1.9	2.0	3.3	4.7	4.6
Other					
Fertility rate, total (births per woman)	5.4	5.0	4.6	4.1	3.7[10/]
GNI per capita, Atlas method (current US$)	--	--	--	770	1200
GNI, Atlas method (current US$, millions)	--	--	--	118	199
Life expectancy at birth, total (years)	62	63	62	63	64[10/]
Literacy rate, adult total (% of people ages 15 and above)	73[1/]	--	84[5/]	--	89[10/]
Literacy rate, youth total (% of people ages 15-24)	94[1/]	--	95[5/]	--	95[10/]
Population, total (thousands)	116	128	140	153	165
Trade (% of GDP)	--	--	--	--	--

Source: World Bank Development Indicators.

1/ Correspond to 1991 2/ Correspond to 1992 3/ Correspond to 1997 4/ Correspond to 1999 5/ Correspond to 2001

6/ Correspond to 2002 7/ Correspond to 2004 8/ Correspond to 2007 9/ Correspond to 2008 10/ Correspond to 2009

Table 12. São Tomé and Príncipe: Schedule of Disbursements Under the ECF Arrangement, 2012–15

Date	Disbursement conditions	SDR Amount	Percent of Quota
07/20/12	Board approval of arrangement.	370,000	5
04/15/13	Observance of PCs for end-December 2012 and completion of the first review.	370,000	5
10/15/13	Observance of PCs for end-June 2013 and completion of the second review.	370,000	5
04/15/14	Observance of PCs for end-December 2013 and completion of the third review.	370,000	5
10/15/14	Observance of PCs for end-June 2014 and completion of the fourth review.	370,000	5
04/15/15	Observance of PCs for end-December 2014 and completion of the fifth review.	370,000	5
06/15/15	Observance of PCs for end-March 2015 and completion of the sixth review	370,000	5
	Total	2,590,000	35

Source: IMF

Table 13. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2012–13

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

	2012		2013	
	September	December	March	June
	Indicative Target	Performance Criteria [1]	Indicative Target	Performance Criteria [1]
	30-Sep-12	31-Dec-12	31-Mar-13	30-Jun-13
Performance criteria:				
1 Floor on domestic primary balance (as defined in the TMU) [2]	-99	-164	-47	-105
2 Ceiling on changes in net bank financing of the central government (at program exchange rate) [2, 3, 4, 5, 9]	0	0	0	0
3 Floor on net international reserves of the central bank (US$ millions) [4, 5]	21.97	21.97	21.97	21.97
4 Ceiling on central government's outstanding external payment arrears (stock, US$ millions) [6, 9, 11, 12]	0	0	0	0
5 Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the central government or the BCSTP (US$ millions) [6, 7, 8, 9, 11, 12]	0	0	0	0
6 Ceiling on the outstanding stock of external debt with original maturity of up to and including one year owed or guaranteed by the central government or the BCSTP (stock, US$ millions) [6, 7, 8, 9, 12]	0	0	0	0
Indicative targets:				
Ceiling on central government's outstanding domestic arrears (stock, billion dobras)	0	0	0	0
Ceiling on dobra base money (stock, billion dobras)	515	551	551	560
Pro-poor expenditures (internally and externally financed)	213	285	73	146
Memorandum items:				
Transfer from NOA to the budget (US$ millions)	1.2	1.2	3.5	3.5
Net external debt service payments (US$ millions)	59	79	21	41
Official external program support (US$ millions) [10, 11]	102	160	28	81
Treasury-funded capital expenditure (billion dobras)	58	96	48	88

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

[1] Performance at the December and June test dates are assessed on the first and second reviews, respectively.

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

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

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

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

[6] This performance criterion applies not only to debt as defined in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009) 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, ¶ 14-16.

[7] Only applies to debt with a grant element of less than 50 percent as defined in point 8 g (i) of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009). For further details on the definition of concessionality refer to the TMU, Footnote 6.

[8] Debt is defined as in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009). For further details on the definition of debt refer to the TMU, ¶ 14-15.

[9] The term "government" is defined as in point 3 of the TMU, which excludes the operations of state-owned enterprises.

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

[11] This criterion will be assessed as a continuos performance criterion.

[12.] The term "external" is defined in accordance with the residency of the creditor as indicated in point 2 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009).

Table 14. São Tomé and Príncipe: Structural Benchmarks for 2012–13

Category		Structural Benchmarks	Economic rationale	Date
		Strengthening Public Finances		
Tax administration	i.	Develop a reform strategy plan to modernize tax administration in line with FAD recommendations	Strengthen revenue administration	End-Dec. 2012
Internal control	ii.	Strengthen internal control, by Reconciling and certifying the cross-arrears between ENCO, EMAE, and the Treasury, and agreeing on a strategy to address these and to prevent future accumulation of arrears between these entities	Strengthen PFM	End-Dec. 2012
External control	iii.	Strengthen external control, by Preparing the general government accounts for 2012 and sending them to the Court of Audit	Strengthen PFM	End-Jun. 2013
		Enhancing Monetary Management and Financial Stability		
Liquidity management	iv.	Improve liquidity management, by Setting up a framework for forecasting liquidity, international reserves, and government accounts to identify the level of excess or deficit in liquidity	Strengthen the monetary policy framework	End-Dec. 2012
Bank supervision	v.	Strengthen banking supervision and regulation, by	Ensure financial stability	
		– Completing the on-site supervision process for two commercial banks		End-Dec. 2012
		– Completing the on-site supervision process for the largest commercial bank		End-Jun. 2013
		– Completing the on-site supervision process for remaining two commercial banks		End-Dec. 2013
		Strengthening AML/CFT Framework		
AML/CFT	vi.	Strengthening AML/CFT, by Submitting to parliament appropriate draft amendments to the AML/CFT law	Bring the AML/CFT legislation in line with FATF standards and contribute to delisting from FATF blacklist	End-Dec. 2012

Table 15: São Tomé and Príncipe: Indicators of Capacity to Repay the Fund, 2010–17

	Obs.				Proj.			
	2010	2011	2012	2013	2014	2015	2016	2017
Fund obligations based on existing credit (millions of SDRs)								
Principal	0.00	0.00	0.00	0.40	0.63	0.70	0.61	0.44
Charges and interest	0.00	0.00	0.00	0.00	0.02	0.01	0.01	0.00
Fund obligations based on existing and prospective credit (millions of SDRs)								
Principal	0.00	0.00	0.00	0.40	0.63	0.70	0.61	0.44
Charges and interest	0.00	0.00	0.00	0.00	0.02	0.02	0.02	0.01
Total obligations based on existing and prospective credit								
Millions of SDRs	0.00	0.00	0.00	0.40	0.65	0.72	0.63	0.45
Millions of U.S. dollars	0.00	0.00	0.00	0.61	0.99	1.10	0.96	0.68
Percent of exports of goods and services	0.00	0.00	0.00	1.72	2.37	0.64	0.23	0.14
Percent of debt service [1]	0.02	0.00	0.00	14.69	20.99	20.38	22.22	12.10
Percent of quota	0.00	0.00	0.00	5.41	8.78	9.73	8.51	6.08
Percent of gross international reserves [2]	0.00	0.00	0.00	1.67	2.56	2.42	1.93	1.27
Outstanding Fund credit								
Millions of SDRs	3.2	3.2	3.6	3.9	4.0	4.1	3.5	3.0
Millions of U.S. dollars	4.9	5.1	5.5	6.0	6.1	6.2	5.2	4.6
Percent of exports of goods and services	20.1	17.4	16.8	16.8	14.7	3.6	1.3	0.9
Percent of debt service [1]	190.2	94.5	158.0	143.6	129.8	114.9	121.7	80.9
Percent of quota	43.2	43.2	48.2	52.8	54.3	54.9	46.6	40.7
Percent of gross international reserves [2]	11.3	11.5	16.5	16.3	15.8	13.6	10.6	8.5
Memorandum items:								
Exports of goods and services (millions of U.S. dollars)	24.3	29.0	32.6	35.5	41.7	172.1	411.0	489.4
Debt service (millions of U.S. dollars)	2.6	5.3	3.5	4.1	4.7	5.4	4.3	5.6
Quota (millions of SDRs)	7.4	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Gross international reserves [2]	43.0	44.0	33.2	36.5	38.7	45.3	49.5	53.8
GDP (millions of U.S. dollars)	201	248	265	299	333	470	706	802

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

[1] After HIPC and MDRI debt relief. Including IMF repurchases and repayments in total debt service.

[2] Gross international reserves exclude the National Oil Account and commercial banks' foreign currency deposits at the BCSTP in order to meet reserve requirements and foreign currency deposits of commercial banks used application deposits for new licensing or for meeting capital requirements.

APPENDIX I. LETTER OF INTENT

São Tomé, July 6, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

1. São Tomé and Príncipe continues to view close cooperation with its development partners as critical for the successful implementation of its economic policies and structural reforms. The Government has made substantial progress in recent years—despite a very challenging international environment—consolidating the fiscal position, supporting economic growth and reducing inflation. The Government is fully committed to build on these achievements.

2. Anchored by a new National Poverty Reduction Strategy Paper (NPRSP), which is now undergoing broad-based consultations in São Tomé and Príncipe, the Government's medium-term economic program, as formulated in the attached Memorandum of Economic and Financial Policies (MEFP), aims to strengthen public finances and the frameworks for monetary policy, banking supervision, and anti-money laundering. To support our policies described in the MEFP, the Government of the Democratic Republic of São Tomé and Príncipe requests assistance from the IMF under the Extended Credit Facility (ECF) in the amount of SDR 2.59 million (35 percent of quota), to be provided in seven equal disbursements over three years. The Government requests the first disbursement of SDR 0.37 million upon IMF Board approval of the ECF arrangement.

3. The key components of the 2012–15 program are:

- A macroeconomic framework for sustained high growth and low single-digit inflation;
- Continued, gradual fiscal consolidation centered around domestic primary deficit targets that are in line with available non-debt creating financing;
- Strengthening customs and tax administration to mobilize additional revenue for priority infrastructure and pro-poor spending;
- Improving public financial management, transparency and oversight and developing a medium-term fiscal framework;
- Strengthening monetary policy and operations as well as bank supervision; and
- Addressing the remaining challenges of the country's anti-money laundering framework.

4. The Government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but it will take additional measures, if needed, to safeguard those objectives. São Tomé and Príncipe will consult with the IMF on the adoption of these measures, and in advance of any revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. The Government will furnish the IMF 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 IMF's Articles of Agreement, or introduce or intensify import restrictions for balance of payments purposes.

5. We propose that the IMF monitor progress under the program by semi-annual reviews and quantitative performance criteria and structural benchmarks that are presented in Tables 1 and 2 of the attached MEFP. The definitions of quantitative indicative targets and performance criteria are provided in the attached Technical Memorandum of Understanding (TMU). The first review is expected to be completed by May 2013 and the second review by November 2013.

The Government authorizes the IMF to publish this Letter of Intent, the attached MEFP and TMU, and the IMF staff report and the Debt Sustainability Analysis (DSA) update that are related to this request.

Yours truly,

/s/

Mr. Américo d'Oliveira dos Ramos
Minister of Finance and International Cooperation

/s/

Ms. Maria do Carmo Silveira
Governor of the Central Bank of São Tomé and Príncipe

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

ATTACHMENT I. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2012–15

I. INTRODUCTION

1. **The government is determined to continue pursuing macroeconomic policies to support growth and reduce inflation and poverty**. In this regard, the government has reached agreement with the Fund on a medium-term economic program for 2012–15 that can be supported by an ECF arrangement. The medium-term economic program, anchored on the new National Poverty Reduction Strategy Paper (NPRSP), aims at fiscal, monetary, and financial stability. To achieve these objectives, the program contains measures to keep the domestic primary deficit in line with available non-debt creating financing, while mobilizing additional domestic revenue for infrastructure and pro-poor spending. The program also includes an ambitious and realistic structural reform agenda to strengthen public finances and the frameworks for monetary policy, banking supervision, and anti-money laundering.

2. **The medium-term program is largely determined by the prospects of oil production and exports**. There are many encouraging signs that oil production and exports will start in 2015. The French oil company, Total, has recently bought the rights from Chevron to explore oil in Block 1 of the Joint Development Zone (JDZ) with Nigeria. Total already has an oil platform in a neighboring block of Nigeria's exclusive zone and, thus, will not need to construct or bring a new platform—it can use horizontal drilling. The company has announced plans to invest about US$ 200 million. The size of this investment indicates a high probability of commercially extractable quantities of oil (significant enough to provide a good rate of return on the investment). Also, recent exploratory drilling in Block 1 yielded positive results and another test well is currently in development.

II. RECENT ECONOMIC DEVELOPMENTS

3. **The economic recovery has been resilient**. Despite an unfavorable external environment, the economic recovery that started in 2010 is continuing. Fueled mainly by growing construction activity, growth accelerated slightly from about 4½ percent in 2010 to about 5 percent in 2011. This pickup in economic activity is largely related to a rebound in private sector external financing, stemming from foreign direct investment and other private capital inflows.

4. **Inflation is declining sharply**. Supported by the exchange rate peg to the euro[1] and declining international food prices, annual average domestic inflation has declined substantially, from a peak of 32 percent in 2008 to about 14 percent in 2011. Year-on-year inflation reached 8 percent in April 2012, the lowest level recorded in ten years, driven by lower international food prices and stable domestic fuel and energy prices.

[1] The dobra (Dbs) has been pegged to the euro (€) at a rate of Dbs 24,500 per € since 2010.

5. The government has continued to make substantial progress on fiscal consolidation. The domestic primary deficit improved from 8 percent of GDP in 2009 to 4.1 and 3 percent of GDP in 2010 and 2011, respectively. These lower deficits largely reflect the government efforts to contain non-priority spending and improve tax collections by strengthening the enforcement of tax laws and increasing the collection of tax arrears. Government spending on goods and services and domestically-financed development projects has been carefully managed.

6. Despite this progress, eliminating cross-arrears between the government, the state-owned water and electricity company (EMAE), and the oil importing company (ENCO) remains a challenge. The government accumulated new arrears to EMAE of about ½ percent of GDP (Dbs 28 billion) in 2011, related mainly to unpaid utility bills at the level of regional and local governments, bringing the end-year stock of government arrears to EMAE to 1½ percent of GDP (Dbs. 72 billion). In turn, EMAE's stock of unpaid bills to ENCO reached about 6 percent of GDP (Dbs. 253.6 billion) at end-2011, while ENCO had fuel tax arrears of about ¾ percent of GDP (Dbs. 36 Billion).

7. The pace of money growth is declining, driven by private sector credit. After a substantial acceleration to 25 percent in 2010, growth in broad money declined to 8 percent in 2011, stemming from a sharp deceleration in private sector credit. Credit growth was quite strong in 2009 and 2010, averaging around 40 percent annually, with much of it financing personal consumption (spurred by the implementation of direct deposit for civil servant salaries in commercial banks and successive reductions in reserve requirements). As a result, the loan-to-deposit ratio steadily rose to over 100 percent. However, credit growth decelerated throughout 2011 (to about 15 percent) as new sources of credit began to dwindle and household debt levels rose. Month-on-month credit growth was flat in the first quarter of 2012 as banks began to increase provisions for non-performing loans (the ratio of non-performing loans in the total increased to around 21 percent in March 2012 from 14 percent in September 2011).

8. The central bank continues to take steps to ensure the soundness of the financial sector. The credit reference bureau has become operational, providing banks with information necessary to analyze and evaluate the credit worthiness of their customers. In addition, the central bank has successfully required unprofitable banks to raise capital and all banks to raise their capital-to-risk weighted assets ratio to above 10 percent, and it has been carefully monitoring the banks' net open foreign exchange position. As a result of central bank's efforts to de-dollarize the financial system, credit in dobra increased from around 30 percent of total credit in 2010 to almost 40 percent in March 2012. Most banks turned a profit in 2011. However, as noted above, non-performing loans have been increasing lately. On-site inspections of two banks were carried out in 2011, resulting in additional recommendations around good governance, implementation of internal auditing controls, and careful use of the credit reference bureau when making lending decisions.

9. The external current account deficit improved slightly in 2011. The completion of some investment projects contributed to a slowdown in import growth, which partly mitigated the impact of rising international fuel prices on the trade balance. In addition, credit growth stagnation in the latter part of 2011 and, more broadly, a slowdown in activity translated in a decline of consumption goods imports. Private sector capital flows financed only part of the current account deficit and, as a result, net international reserves declined.

III. THE NEW NATIONAL POVERTY REDUCTION STRATEGY

10. The government has finalized its new National Poverty Reduction Strategy Paper (NPRSP). The NPRSP prioritizes actions around four pillars: institutional reform to promote good governance; policies for sustainable growth; development of human capital and improved basic social services; and social cohesion. In this context, the government has established several strategic objectives: (i) annual growth of at least 6 percent over the medium term; (ii) reducing by 6 percentage points the share of the population living under the poverty line; (iii) ensuring that the entire population has access to social services by 2016; (iv) reducing significantly social and gender differences; (v) strengthening institutional capacity and the authority and credibility of the state; and (vi) guaranteeing environmental sustainability. To achieve these objectives, the government's economic reform program aims to strengthen public finances, create additional space for infrastructure and pro-poor spending, strengthen the planning and execution of public spending, and implement other structural reforms to improve the business climate further. The NPRSP, after broad-based consultations, will be submitted to the council of ministers for approval by end-July 2012 and subsequently sent to the National Assembly for information and discussions.

IV. MEDIUM-TERM MACROECONOMIC FRAMEWORK AND POLICIES FOR 2012–15

11. Anchored by the new NPRSP, the government's 2012–15 macroeconomic program aims at achieving fiscal, monetary, and financial stability, as well as sustainable economic growth to support poverty alleviation. Key macroeconomic objectives of this program are to (i) raise the annual rate of non-oil GDP real growth to about 6 percent over the medium term; (ii) reduce inflation to single digits and keep it broadly in line with international inflation over the medium term; and (iii) maintain a gross international reserve cover of at least 3 months of imports in support of the exchange rate peg.[2] Policies will focus on mobilizing domestic revenue to create additional fiscal space for infrastructure and pro-poor spending, while keeping the domestic primary deficit in line with non-debt creating financing, and on enhancing monetary policy management, banking supervision, and financial stability.

A. Medium-Term Macroeconomic Framework

12. The medium-term macroeconomic framework assumes that oil production and exports will start in 2015. It envisages an acceleration of real growth in GDP from 4½ percent in

[2] In support of the exchange rate peg, the authorities have an agreement with Portugal according to which Portugal stands ready to provide support in the form of a credit line of up to € 25 million, which would add another 3¼ months of imports cushion to international reserves.

2012 to 6 percent in 2014, supported by an expansion in tourism, agriculture, and construction. Growth drivers will include drilling in the JDZ and in the Exclusive Economic Zone (EEZ), [and work on a deepwater port (expected to start in 2014)]. Investments in infrastructure will help spur growth in general, and in tourism, transportation, and telecommunications in particular. That is the case of the planned new foreign investments in an oil terminal in the northern coast of São Tomé island, and improvements of its roads, the rehabilitation of the country's international airport and main port, and the construction of a new shopping mall. To further help spur growth, significant investments are also planned for the island of Príncipe, namely the expansion and modernization of its airport, which is fundamental to promote the sustainable tourism investment recently approved for the island. The projected onset of oil production and exports in 2015 will boost considerably GDP growth in that year and improve significantly the external current account deficit by end of the program period.

13. In 2012, however, economic growth is expected to decelerate to 4½ percent as foreign financed projects have taken longer than expected to begin. After the completion of several large scale public investment projects in 2011, public investment slowed during the first half of 2012. Growth is expected to pick up in the second half of the year, boosted by construction projects to improve the airport, port, and roads, and to convert the fishing pier into a shopping center. The government has been actively seeking aid and concessional loans to fund the public investment plan.

14. Inflation is projected to decline to lower single digits over the medium term, anchored by the exchange rate peg. The onset of oil production is not expected to have a substantial impact on inflation because the National Oil Account (NOA) will absorb most oil related inflows. Despite the favorable evolution of inflation so far in 2012, end-of-year inflation has been revised upward, from 6 to 8 percent, in anticipation of an increase in domestic fuel prices in the second half of the year (domestic fuel prices were last increased in March 2011).

B. Strengthening Public Finances

15. The government recognizes the need to continue strengthening fiscal performance to maintain macroeconomic stability and foster an environment conducive to sustainable growth and poverty reduction. In pursuing its fiscal goals, the government will avoid nonconcessional borrowing and central bank financing. The government understands fully the importance of a strong fiscal position to underpin the exchange rate peg. While the current level of international reserves provides sufficient backing for the peg, the government stands ready to tighten policies as needed to maintain the viability of the peg.

Fiscal policy

16. The government remains committed to fiscal prudence:

- **The medium-term fiscal program is largely determined by the prospects of oil production and exports**. The government will continue to rely primarily on non-debt creating financing, including withdrawals from NOA and budget support grants, and will focus on strengthening domestic revenue collections and containing non-priority spending. Starting in 2015, the fiscal space is expected to be larger given oil revenue. The government will continue to draw NOA resources according to the oil law's formula which, based on current projections, would enable the domestic primary deficit to be 3.0 percent of GDP (equivalent to about 3.9 percent of non-oil GDP) in 2015. The government will use this additional fiscal space for higher infrastructure and pro-poor spending.

- **For 2012, the government is targeting a domestic primary deficit of 3¼ percent of GDP, which is in line with the approved budget and available non-debt creating financing**. To achieve this target, the government will continue to mobilize additional domestic revenue and contain non-priority domestic primary spending. On the revenue side, the government plans to broaden the tax base by enforcing compliance with the tax laws and improving efficiency in the customs and tax administrations. In addition, the government will increase (gradually) the domestic price of fuel products by 10 percent in the second half of the year. This is expected to enable ENCO to clear its fuel tax arrears and pay fuel taxes on time. The government aims to control spending by containing outlays on goods and services and enforcing a strict budget constraint on local and regional governments to avoid budget overruns or a buildup in arrears, while protecting priority spending by increasing treasury financed pro-poor and development projects. Available non-debt creating financing is expected from the World Bank, Equatorial Guinea, and drawings from NOA.

- **The government will target a domestic primary deficit of 3.1 and 3.0 percent of GDP in 2013 and 2014, respectively**. Measures to modernize the customs and tax administrations, making them more efficient and effective, and other measures to broaden the tax base—strengthening inspection actions through investigations, better analysis of tax returns, more judicious selection of taxpayers for inspection, and the use of modern inspection techniques—will help mobilize additional revenue. While the government will continue to protect pro-poor spending, it will spare no efforts to contain and prioritize other spending. For example, the wage and hiring policies of the government will be consistent with maintaining the annual wage bill in both 2013 and 2014 at 8¼ percent of GDP (unchanged from 2012). In addition to NOA financing, the government has already confirmed budget support from the World Bank and is expected to secure additional non-debt creating financing from regional bilateral partners, including Equatorial Guinea, Gabon, and Morocco.

Structural measures to strengthen public finances

17. The government has made considerable progress implementing fiscal reforms, albeit from a low base. There is still a need for comprehensive reform to further strengthen public finances. In this regard, the government's reform program for the next three years focuses primarily on modernizing and strengthening the customs and tax administrations, and implementing an action plan for improving public financial management.

Improving tax administration

18. The government will continue to modernize the customs and tax administrations. Since 2008, the government has been implementing reform measures to modernize the tax system and customs. However, the tax intake (16½ percent of GDP in 2011) is low compared with peers in sub-Saharan Africa and other small island states. To help achieve the objective of raising the tax-to-GDP ratio to 18 percent of non-oil GDP by 2015, the government will:

- With technical assistance from development partners, develop a reform strategy plan for 2013–15 to modernize the tax administration. This plan will cover: (i) organizational reform of the tax administration to integrate its essential functions more effectively; (ii) modernization of tax legislation, particularly with regard to indirect taxation, and the rationalization of tax exemptions; (iii) strengthening of fiscal operations and increasing revenue; (iv) effective use of taxpayer segmentation in the functioning of the tax administration; (v) preparation of a plan with measures to improve the tax education of taxpayers and provide better services to them; and (vi) strengthening of the Tax Directorate's (DI) capacities and improvement of its working conditions.

- Develop by end-2012 a strategy for further modernization of the customs administration, based on the recommendations of a mission from the IMF's Fiscal Affairs Department (FAD) that is scheduled for November 2012.

19. To ensure a successful implementation of the reform strategy, the government will take specific steps to strengthen the tax administration. They will focus on (i) restructuring of the Tax Directorate (DI) by coordinating the regional tax administration with central office and segmenting taxpayers between large firms and other taxpayers; (ii) strengthening of fiscal operations by improving taxpayer register, dossier management, monitoring of tax compliance, enforcement and management of tax arrears, computerization, and taxpayer education; and (iii) tax administration capacity building.

Strengthening public financial management

20. The government has been implementing public financial management reforms since 2005. To fully implement the 2007 Law on the Government Financial Administration System, the SAFE Law, the government will continue with reforms that focus on strengthening transparency, financial management and supervision and, as capacity permits, moving to a medium-term fiscal framework.

21. In addition, the government plans to strengthen the legal framework for fiscal responsibility, and bring it closer to international standards. The public finance legislation already has some elements of responsibility and transparent system management, but further improvements are needed. Quarterly budget execution reports, the TOFE, the proposed budget, and the broad planning options (GOP) are publicly available. However, other relevant information, such as general government accounts, the main contingent liabilities, and tax expenses are not readily available. In this regard, the government will take steps to introduce transparency rules in the SAFE Law under which key fiscal data are published periodically on a pre-announced schedule.

22. The government will continue strengthening public financial management and oversight. The government has been testing, with technical assistance from the IMF, an electronic system of the government's financial administration system (SAFE-e) which, for the first time in two decades, will enable the government to present general government accounts to the National Assembly and to the Audit Court, starting in 2013. The next step will be to allow the Financial Inspector General (IGF) and Audit Court to have direct access to the system to monitor budget and financial execution in real time. The government is also planning to propose amendments to the organic law of the Audit Court to provide it with punitive and coercive instruments, such as fines and the authority to suspend contracts when irregularities are found.

23. The government will work closely with ENCO and EMAE to resolve the issue of cross-arrears. This will involve reconciling and certifying the stock of unpaid bills and unpaid fuel taxes; proposing a solution to clear those arrears that could be accepted by the government, ENCO and EMAE; and developing an action plan that, if implemented, would lead to permanent solution to this problem. This solution is likely to comprise the eventual adoption of an automatic pricing adjustment mechanism for domestic fuel products, a close review of ENCO's cost structure, and a careful review of EMAE's cost structure and its urgent investment needs to replace an old and wasteful power plant with a more efficient one.

C. Enhancing Monetary Management and Financial Stability

24. During the program period, the central bank will focus on achieving three main goals: strengthening monetary management, maintaining financial stability, and improving the credibility of the financial system.

25. To strengthen monetary management, the central bank will cooperate closely with the finance ministry. The central bank and finance ministry signed a memorandum of understanding in May 2012 to facilitate the flow of information between the two institutions. Regular information sharing will include data on the Treasury's cash outlays (in both domestic and foreign currency), which are important for the central bank's liquidity forecast and foreign exchange operations. With IMF technical assistance, the central bank is developing a liquidity forecasting model and an accompanying reference manual to guide domestic liquidity management. Liquidity forecasting will focus on money in circulation, government account expenditure and revenue, and net international reserves, with a view to identifying the level of excess demand for or supply of liquidity in the banking system.

26. São Tomé and Príncipe's monetary framework based on the exchange rate peg requires careful management of international reserves by the central bank. As noted above, the central bank intends to keep its gross international reserve cover above three months of imports during the program period. Moreover, the international economic and financial crisis has highlighted the importance of asset portfolio diversification to hedge against counter-party, currency, and liquidity risks. In this connection, the central bank will seek to invest its international reserves in high quality financial assets and will emphasize liquidity over return in deciding the portfolio composition.

27. The central bank will continue strengthening banking supervision and taking the necessary steps to reduce the risk of distress in the banking system. The central bank conducted on-site inspections of two commercial banks in 2011, plans to have on-site inspections of two more banks in 2012, and expects to complete on-site inspections of the remaining three banks in 2013. The central bank intends to hire additional supervisors to help increase the frequency of on-site inspections and to begin training staff on risk-based supervision. IMF technical assistance on risk-based supervision will be needed. The central bank is reviewing the commercial banks' business plans, and will begin analysis of restructuring solutions for banks which are unwilling or unable to restore profitability. It also plans to take steps to ensure that a sound legal and regulatory framework to deal with problem banks will be in place by 2014. In addition, the new chart of accounts of the central bank, which is expected to be introduced in 2013, will adopt international financial reporting standards. The central bank will further strengthen coordination with banking supervisors in neighboring countries.

28. The central bank will continue to strengthen its communication with banks and the general public. The central bank will maintain its website with current data on monetary and macroeconomic aggregates and will post on a timely basis its annually audited financial statements. In 2011, the bank created an Office of Customer Support to educate financial sector clients, monitor unfair business practices, and field complaints. As part of its ongoing efforts to improve disclosure and protect consumers, the central bank will request banks to publish their preliminary quarterly accounts.

D. Other Structural Reforms

Strengthening external debt management

29. Notwithstanding substantial debt relief under the HIPC initiative and MDRI, São Tomé and Príncipe is vulnerable to external debt distress. The latest Joint Fund-Bank debt sustainability analysis stressed the need for a careful debt management strategy to accompany a prudent fiscal policy stance especially in case the onset of profitable oil extraction shifts much beyond 2015. As part of the reforms to improve performance in this area, the government has assigned to the finance ministry's External Debt Department a strategic role in debt monitoring and management.

30. To establish a strong institutional role for external debt management, the National Assembly approved in April 2012 the general principles of a new debt management law. The specific articles of the law are now under discussion and the final text could be approved and published in the second semester of 2012. The draft law, prepared in cooperation with the Debt

Relief International (DRI) and the World Bank DeMPA mission, establishes the responsibility and governance structure of the External Debt Department and defines its strategic framework.

31. The External Debt Department will work to enhance transparency and best practices in debt management. The department will continue preparing summary reports on the country's debt situation and strategy and post them on the finance ministry's website. To improve the department's operational effectiveness, DRI has provided training in debt management and the finance ministry has endowed it with an Oracle-based debt management software (CSDRMS).

Strengthening AML/CFT framework

32. São Tomé and Príncipe has been recently placed on the Financial Action Task Force's (FATF) public list of high risk and non-cooperative jurisdictions. The list includes jurisdictions with strategic anti-money laundering and combating the financing of terrorism (AML/CFT) deficiencies that have not made sufficient progress in addressing them. The FATF has called upon São Tomé and Príncipe to work on: (i) adequately criminalizing money laundering and terrorist financing; (ii) establishing a fully operational and effectively functioning Financial Intelligence Unit (FIU); (iii) ensuring that financial institutions and designated non-financial business and professions are subject to adequate AML/CFT regulation and supervision; and (iv) implementing effective, proportionate and dissuasive sanctions in order to deal with natural or legal persons that do not comply with the national AML/CFT requirements.

33. The government is fully committed to addressing the deficiencies of the AML/CFT framework. In particular, with technical assistance from the IMF's Legal Department, the government will prepare the necessary draft amendments to the AML/CFT Law, which was approved in 2008 and updated in 2010, with a view to sending those amendments to the National Assembly shortly thereafter and seeking their approval by end-2012. Also, the government will strengthen the operations of the FIU by providing it with additional staff and facilitating the training of its staff. These actions are expected to strengthen the core functions of the FIU, namely the receipt, analysis, and dissemination of suspicious transaction reports from financial and non-financial institutions and professions.

Improving the business climate

34. São Tomé and Príncipe has made strides toward improving the business climate, but further reforms are needed. The World Bank's 2012 Doing Business Survey ranked São Tomé and Príncipe among the top reformers last year, with its overall ranking improving by 11 positions. The government has identified in the new NPRSP key areas for reform to revitalize the energy sector and promote private sector participation. With involvement of the World Bank, the government has started implementing a medium-term strategy for making the state-owned water and electricity corporation (EMAE) commercially viable. The government is also committed to continue simplifying the regulatory framework and strengthening institutional capacity to promote investment, alleviating critical infrastructure bottlenecks in the area of telecommunications, and implementing the country's tourism strategy with a focus on increasing accessibility.

E. Statistics

35. Although hampered by serious financial, human, and technological resource constraints, the government continues to work to strengthen the statistical system. The National Institute of Statistics (INE) is moving toward using a new system to better capture survey and market information and to include estimates of the informal sector. A household budget survey was completed in 2011 and can serve as the basis for reweighting the CPI components and expanding its coverage over the entire country. The finance ministry's Accounts Department is currently compiling the government's general accounts since 2010 for the first time in two decades. The central bank intends to implement a new chart of accounts for the central bank in 2013. An independent consulting firm is currently reviewing the proposed chart of accounts to ensure that it complies with international financial reporting standards. The government recently received technical assistance from the IMF to help improve balance of payments statistics, begin to adopt the methodology recommended in the *Balance of Payments Manual 6*, and investigate the possibility of producing International Investment Position (IIP) data.

F. Capacity Building and Technical Assistance

36. Capacity building and technical assistance is crucial for the successful implementation of the medium-term economic program. The government will continue working closely with its traditional development partners, including the IMF and the World Bank, in the priority areas of public financial management, customs and tax administration, monetary management, banking supervision, debt management, and AML/CFT. The government will seek to join the upcoming IMF Regional Technical Assistance Center in Accra, AFRITAC West 2, which will enhance access to technical assistance and training and facilitate follow up of technical assistant in critical reform areas.

G. Program Monitoring

37. The first year of the program covers the 12 months from July 20, 2012 through July 19, 2013. Progress under the program will be monitored by semi-annual reviews and by quarterly quantitative targets and structural benchmarks that are presented in Tables 1 and 2. A summary list of the main structural reform measures identified by the government is shown in Table 3. The definitions of quantitative indicative targets and performance criteria are provided in the attached Technical Memorandum of Understanding (TMU). The first review is expected to be completed by May 2013 and the second review by November 2013.

Table 1. São Tomé and Príncipe: Performance Criteria and Indicative Targets for 2012–13
(Billions of dobra, cumulative from beginning of year, unless otherwise specified)

	2012		2013	
	September Indicative Target	December Performance Criteria [1]	March Indicative Target	June Performance Criteria [1]
	30-Sep-12	31-Dec-12	31-Mar-13	30-Jun-13
Performance criteria:				
1 Floor on domestic primary balance (as defined in the TMU) [2]	-99	-164	-47	-105
2 Ceiling on changes in net bank financing of the central government (at program exchange rate) [2, 3, 4, 5, 9]	0	0	0	0
3 Floor on net international reserves of the central bank (US$ millions) [4, 5]	21.97	21.97	21.97	21.97
4 Ceiling on central government's outstanding external payment arrears (stock, US$ millions) [6, 9, 11, 12]	0	0	0	0
5 Ceiling on the contracting or guaranteeing of new nonconcessional external debt with original maturity of more than one year by the central government or the BCSTP (US$ millions) [6, 7, 8, 9, 11, 12]	0	0	0	0
6 Ceiling on the outstanding stock of external debt with original maturity of up to and including one year owed or guaranteed by the central government or the BCSTP (stock, US$ millions) [6, 7, 8, 9, 12]	0	0	0	0
Indicative targets:				
Ceiling on central government's outstanding domestic arrears (stock, billion dobras)	0	0	0	0
Ceiling on dobra base money (stock, billion dobras)	515	551	551	560
Pro-poor expenditures (internally and externally financed)	213	285	73	146
Memorandum items:				
Transfer from NOA to the budget (US$ millions)	1.2	1.2	3.5	3.5
Net external debt service payments (US$ millions)	59	79	21	41
Official external program support (US$ millions) [10, 11]	102	160	28	81
Treasury-funded capital expenditure (billion dobras)	58	96	48	88

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

[1] Performance at the December and June test dates are assessed on the first and second reviews, respectively.

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

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

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

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

[6] This performance criterion applies not only to debt as defined in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009) 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, ¶ 14-16.

[7] Only applies to debt with a grant element of less than 50 percent as defined in point 8 g (i) of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009). For further details on the definition of concessionality refer to the TMU, Footnote 6.

[8] Debt is defined as in point 9 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009). For further details on the definition of debt refer to the TMU, ¶ 14-15.

[9] The term "government" is defined as in point 3 of the TMU, which excludes the operations of state-owned enterprises.

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

[11] This criterion will be assessed as a continuos performance criterion.

[12.] The term "external" is defined in accordance with the residency of the creditor as indicated in point 2 of the IMF Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF (as amended effective December 1, 2009).

Table 2. São Tomé and Príncipe: Structural Benchmarks for 2012–13

Category		Structural Benchmarks	Economic rationale	Date
		Strengthening Public Finances		
Tax administration	i.	Develop a reform strategy plan to modernize tax administration in line with FAD recommendations	Strengthen revenue administration	End-Dec. 2012
Internal control	ii.	Strengthen internal control, by Reconciling and certifying the cross-arrears between ENCO, EMAE, and the Treasury, and agreeing on a strategy to address these and to prevent future accumulation of arrears between these entities	Strengthen PFM	End-Dec. 2012
External control	iii.	Strengthen external control, by Preparing the general government accounts for 2012 and sending them to the Court of Audit	Strengthen PFM	End-Jun. 2013
		Enhancing Monetary Management and Financial Stability		
Liquidity management	iv.	Improve liquidity management, by Setting up a framework for forecasting liquidity, international reserves, and government accounts to identify the level of excess or deficit in liquidity	Strengthen the monetary policy framework	End-Dec. 2012
Bank supervision	v.	Strengthen banking supervision and regulation, by	Ensure financial stability	
	-	Completing the on-site supervision process for two commercial banks		End-Dec. 2012
	-	Completing the on-site supervision process for the largest commercial bank		End-Jun. 2013
	-	Completing the on-site supervision process for remaining two commercial banks		End-Dec. 2013
		Strengthening AML/CFT Framework		
AML/CFT	vi.	Strengthening AML/CFT, by Submitting to parliament appropriate draft amendments to the AML/CFT law	Bring the AML/CFT legislation in line with FATF standards and contribute to delisting from FATF blacklist	End-Dec. 2012

Table 3. São Tomé and Príncipe: Other Planned Reform Measures

Category		Structural measures	Economic rationale	Indicative timeframe
		Strengthening Public Finances		
Tax administration	i.	Strengthen tax administration core business, by - Reorganizing DI services, creating an internal audit and a multidisciplinary central service - Creating a single dossier system for each taxpayer - Strengthening fiscal operations through (i) improving the security of the taxpayer register, (ii) strengthening of inspection actions, (iii) reorganizing of tax enforcement actions, (iv) developing of new computer functionalities, and (v) strengthening of relations with taxpayers - Introduce segmentation in the organization of services, working methods, and resource allocation, distinguishing between large firms and other taxpayers - Strengthen the capacities of the DI and improve working conditions for its officials	Strengthen revenue administration	2013–15
Customs administration	ii.	Prepare a reform plan to strengthen customs administration	Strengthen revenue administration	Dec. 2012
Medium-term fiscal framework	iii.	Develop a medium-term fiscal scenario by incorporating elements of the GOP to gradually arrive at an MTFF	Strengthen PFM	Dec. 2013
Fiscal responsibility framework	iv.	Introduce transparency rules under which key fiscal information, such as budget execution, public debt, [medium-term fiscal scenario], and general government accounts are published in quarterly reports in accordance with a pre-announced timetable	Strengthen PFM	Mar. 2013
Internal control	v.	Strengthening internal control, by - Giving the IGF auditors a password to enter SAFE-e - Improving the operational resources of the IGF	Strengthen PFM	 Dec. 2012 Jan. 2013
External control	vi.	Strengthening external control, by - Improve the operational resources of the Audit Court - Amending the organic law of the Audit Court to equip it with punitive and coercive instruments, such as fines and the authority to suspend contracts when irregularities are found - Giving the Audit Court access to the SAFE-e system so that it can monitor budget and financial execution in real time	Strengthen PFM	2013–14 Jan. 2013 2014 Dec. 2012
		Enhancing Monetary Management and Financial Stability		
Liquidity management	vii.	Improve liquidity management, by	Strengthen the monetary policy	2012–15

Category		Structural measures	Economic rationale	Indicative timeframe
	-	Defining a policy rate and introducing open market instruments with a view to neutralizing liquidity conditions	framework	2013–15
	-	Improving the payment system for interbank market operations based on international best practices		2013–15
Bank supervision	-	Strengthen banking supervision and regulation	Ensure financial stability	2012–15
	-	Require commercial banks to publish standardized preliminary quarterly accounts		2013–15
	-	Amend the legal and regulatory framework to deal with problem banks		2013–15
	-	Review business plans and begin analysis of restructuring solutions for banks which are unwilling or unable to restore bank profitability		2013–15
		Statistics		
Monetary Statistics	viii.	Introduction of new chart of accounts for the central bank and regular and timely provision of these data to the IMF in the Standardized Report Forms (SRFs)	Improve transparency	End-Dec. 2013
		Strengthening AML/CFT Framework		
AML/CFT	ix.	Strengthening AML/CFT, by	Bring the AML/CFT legislation in line with FATF standards and contribute to delisting from FATF blacklist	End-December 2012
	-	Increasing the FIU's financial and human resources, and providing it with a detailed and adequate budget effectively allocated to strengthen its core functions		

ATTACHMENT II. SÃO TOMÉ AND PRÍNCIPE: TECHNICAL MEMORANDUM OF UNDERSTANDING

May 23, 2012

1. This Technical Memorandum of Understanding (TMU) contains definitions and adjuster mechanisms that clarify the measurement of variables in Table 1, Quantitative Performance Criteria, and Indicative Targets under the ECF arrangement for 2012–15, which is attached to the Memorandum of Economic and Financial Policies. 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.

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 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, as defined below, refer to the domestic primary balance and net bank financing of the central government, net international reserves of the central bank, external payments arrears, and non-concessional 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 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 and International Cooperation.

5. **Domestic primary expenditure** comprises all government spending assessed on a commitment basis (*base compromisso*), excluding (1) capital expenditure financed with external concessional loans and 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 Ministry of Finance and International Cooperation.

6. Within domestic primary expenditure, **pro-poor expenditure** refers to 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 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[1]	x	x	x
02.02.04	Food[1]	x		
02.02.05	Medicine	x	x	
02.02.06	Clothing and footwear[1]	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 inward transfers		x	
06.01.00	Education and training		x	
06.04.01	Project costs	x		
06.04.04.02	Miscellaneous	x	x	

[1] 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 project grants and concessional loans. Treasury funded capital spending will correspond to the 2012 government plan for investment on roads, bridges, schools, water and power. It will include 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. The government investment program will be carried out by the Ministries of Public Works and Natural Resources, Education, and Health.

8. Domestic primary balance is defined as the difference between government domestic revenue and domestic primary expenditure. For reference, this balance for end-December 2011 is projected at 133 billion dobra, broken down as follows:

	Government domestic revenue:	787 billion
Less:	Government primary expenditure:	
	(as defined in paragraph 5)	920 billion
Equals:	Domestic primary balance:	-133 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[1] will be 19,008 dobra per U.S. dollar, 24,500 dobra per euro, and 28,987 dobra per Special Drawing Right (SDR).

11. Net bank financing of the central government (NCG) is defined as the stock of all outstanding claims on the central government held by the BCSTP and by other depository corporations (ODCs), less all deposits held by the central government with the BCSTP and with ODCs, as they are reported monthly by the BCSTP to the IMF staff. The balance of the National Oil Account (NOA) is not included in NCG. All foreign exchange-denominated accounts will be converted to dobra at the program exchange rate. For reference, at end-December 2011, outstanding net bank financing of the central government (excluding NOA) is projected at 135 billion dobra, broken down as follows:

	BCSTP credit, including use of IMF resources:		262 billion
Less:	Government deposits with the BCSTP (excluding NOA)		70 billion
	Of which:	Treasury dobra-denominated accounts	25 billion
		Treasury foreign currency-denominated accounts	16 billion
		Counterpart deposits	30 billion
Equals:	Net credit to government by the BCSTP		192 billion
Plus:	ODC's credit to the government		5 billion
Less:	Government deposits with ODCs (including counterpart funds)		62 billion
Equals:	Net bank financing of the government (excluding NOA)		135 billion

12. Dobra base money is defined as the sum of currency issued—which consists of currency outside depository corporations and cash in vaults—and banks 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 2011 dobra base money is projected at 472 billion dobra, calculated as follows:

[1] Data refer to the mid-point exchange rates published on the BCSTP's webpage for December 31, 2011.

	Currency issued:		204 billion
	Of which:	Cash in vaults	26 billion
		Currency outside depository corporations	177 billion
Plus:	Bank reserves denominated in dobra		268 billion
Equals:	Dobra base money		472 billion

13. Net international reserves (NIR) of the BCSTP are defined for program-monitoring purposes as short-term, 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 at end-December 2011 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-December 2011 NIR is projected at 421billion dobra, calculated as follows:

	Gross international reserves:			815 billion
	Of which:	Cash		33 billion
		Demand deposits		74 billion
		Term deposits (including banks' deposits in foreign currency)		346 billion
		Securities other than shares		236 billion
		Of which:	Portuguese Treasury bonds	95 billion
			Less: discount (69.65)	29 billion
			Rede Ferroviaria Nacional bonds	123 billion
			Less: discount (36.45)	78 billion
			Mortgage-backed securities of CDG	195 billion
			Less: discount (64.00)	70 billion
			Accrued interest on securities	16 billion
			Reserve position in the Fund	0 billion
			SDR holdings	110 billion
Less:	Short-term liabilities (including liabilities to the IMF)			312 billion
Less:	Banks' reserves denominated in foreign currency			82 billion
Equals:	Net international reserves			421 billion
Plus:	Other foreign assets			237 billion
Less:	Medium and long-term liabilities (including SDR allocation)			206 billion
Equals:	Net foreign assets			452 billion
Memorandum item:	National Oil Account (NOA)			157 billion

14. 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 but excluding normal import credits) owed or guaranteed by the government and/or the BCSTP.[2] With respect to the precautionary line of credit from Portugal to support the pegging of the dobra to the euro, unpaid balances outstanding during the first three quarters of a given year will be excluded from the short-term external debt limit. However, outstanding balances at the end of a given year will be included in the assessment of compliance with the short-term external debt performance criterion. For reference, at end-December 2011 the stock of short-term external debt is projected to be zero.

15. 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 being rescheduled or restructured is 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 International Cooperation and (as appropriate) by the BCSTP, measured in U.S. dollars at the prevailing exchange rates. The government should consult with IMF staff before contracting or guaranteeing new medium- or long-term debt obligations.

16. The non-accumulation of 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 of the Ministry of Finance and International Cooperation 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 relation to external arrears

[2] The term "debt" is defined as in point 9 of the IMF *Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF*, as amended effective December 1, 2009. 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 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.

[3] This performance criterion applies not only to debt as defined in point 9 of the IMF *Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements adopted by the Decision No. 6230-(79/140) of the Executive Board of the IMF*, as amended effective December 1, 2009, but also to commitments contracted or guaranteed for which value has not been received.

[4] The level of concessionality of loans is assessed according to the reference interest rate by currency published, by the Export Credit Division 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 facilities.

does not apply to those arrears pending the signing of bilateral agreements in the context of debt-rescheduling with the Paris Club, if any, and other bilateral creditors.

17. **Net external debt service payments** are defined as debt service due less the accumulation of any new external payment arrears, including technical arrears.

18. **Official external program support** is defined as grants and loans, including 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. Amounts assumed in the program consistent with the definition are shown in Table 1 of the MEFP as a memorandum item labeled "official external program support."

III. USE OF ADJUSTERS

19. **The performance criterion on the domestic primary deficit will have one adjuster**. The limit on the domestic primary deficit will be adjusted upward if the government finds budget support in 2012 and 2013 in addition to that described in the MEFP; this adjuster will be capped at 22 billion dobra (½ percent of 2011 GDP) for 2012 and at 16.5 billion dobra for the first half of 2013.[5]

20. **Adjusters for the performance criteria on net bank financing of the central government and net international reserves will be set**. Deviations from amounts projected in the program for budget transfers from the NOA, 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 2011 or end-December 2012, as appropriate (MEFP, Table 1). The following is an explanation of these adjustments:

- **Adjustors 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, official external program support, and net external debt service payments will be converted to dobra at the program exchange rate and aggregated from end-December 2011 or end-December 2012, as appropriate, to the test date. The ceilings will be adjusted downward (upward) by cumulative deviations downward (upward) of actual from projected net external debt service payments, and by deviations upward (downward) in budget transfers from the NOA and official external program support. The combined application of all adjusters at any test date is capped at 57 billion dobra (the equivalent to US$3 million at the program exchange rate).

- **Adjustors for the floor on net international reserves (NIR) of the BCSTP**: Quarterly differences between actual and projected receipts of budget transfers from the NOA,

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

official external program support, and net external debt service payments, in dobra, will be converted to U.S. dollars at the program exchange rate and aggregated from end-December 2011 or end-December 2012, as appropriate, to the test date. The floor will be adjusted upward (downward) by the cumulative deviation downward (upward) of actual from projected net external debt service payments of the central government, and by deviations upward (downward) for budget transfers from the NOA, and official external program support. The combined application of all adjusters at any test date is capped in such a way that the adjusted floor does not fall short of US$18.97 million.

IV. DATA REPORTING

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

1) **Fiscal Data**: The Directorate of Budget at the Ministry of Finance and International Cooperation 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;
- 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;

- Latest outstanding petroleum price structures and submission of new pricing structures (within a week of any changes).

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. 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 dobra base money 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 balance sheet data of individual other depository corporations (in IMF report form 2SR);
- 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 Debt Management Unit at the Ministry of Finance and International Cooperation 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.

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 Ministry of Finance and International Cooperation, 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.

APPENDIX II. TECHNICAL NOTE ON THE TREATMENT OF OIL PRODUCTION IN THE MACROECONOMIC FRAMEWORK

Treatment in the 2011 Article IV staff report

The macroeconomic framework of the latest Article IV staff report followed a simple model for calculating the impact of oil production on macroeconomic aggregates. From information provided by the authorities and available in the media, oil production is expected to commence in 2015 and last for twenty years. The key assumptions behind the framework are based primarily on the STP's Oil Revenue Management Law (ORML), the agreement between STP and Nigeria creating the Joint Development Zone (JDZ), and the production sharing agreement (PSA) with the oil company. The assumptions are limited to production in the JDZ as activities in STP's Exclusive Economic Zone (EEZ) are still in the early stages of development. The oil production assumptions do not include signature bonuses related to allocating exploration rights in other blocks of the JDZ or in the EEZ.

Annual oil production values are derived from staff estimates of volume and oil price projections presented in the *World Economic Outlook (WEO)*. The projection was for 4.634 million barrels per year to be produced in the JDZ Block 1 discounting the *WEO* price by 15 percent due to quality. Under those assumptions, the gross revenue from the project was to be $373 million in 2015. Based on the JDZ's rules and the PSA, the oil company is entitled to the first share of revenues (to recover its operational costs and capital investment). Operational costs were assumed to be $7 million per year and the recovery of capital investment was assumed to be $200 million per year through 2018 and $100 million per year thereafter.

The remainder, net production, is to be split between the governments of STP, Nigeria, and the oil company. Per the PSA, net production is split 70% to both governments and 30% to the oil company. The oil company's revenues from production in the JDZ are $50 million for 2015. Nigeria's and STP's revenue of $117 million is topped up with income derived from surface rent (10 percent of gross production) and royalties (12% of gross production).

The JDZ agreement allocates these revenues 60 percent to Nigeria and 40 percent to STP. For STP, fiscal revenue was projected to be $65 million in 2015. This value was placed into the National Oil Account (NOA), with a portion of the proceeds allocated to the budget according to the ORML. Total gross oil production ($149 million) entered the current account as exports. The oil company's remittances ($103 million) entered the current account under net factor services. Net oil production ($66 million) entered GDP.

Problems with the treatment in the 2011 Article IV staff report

The old approach suffered from three inconsistencies: methodological problems, misclassifications, and problems in the underlying assumptions. Adjusting the model to correct for these issues resulted in significant changes to STP's main macroeconomic aggregates from 2015 onward.

The treatment of oil production/export should be consistent between the national accounts and balance of payments. The old methodology used gross production as an input into the balance of payments and production net of capital recovery as an input into national accounts. The result was that the trade balance improved much more than the increase in GDP. Since expenditure-based GDP is calculated using known values for net exports and gross domestic investment, private consumption becomes the residual. Under the old assumptions, private consumption dropped by 28% in 2015 and did not reach pre-oil levels for another two years. International best practices laid out in the *Balance of Payments and International Investment Position Manual 6 (BPM6)* recommend that both sets of macroeconomic statistics be treated on a gross basis.

A key error in the older methodology was the treatment of oil investment and capital recovery. The investment will be taking place in the JDZ, primarily using imported materials and labor. Only São Tomé and Príncipe's direct contribution to the investment should be treated in the national accounts and balance of payments. São Tomé and Príncipe's projected current account balance did not improve with the production of oil in 2015 because of the inclusion of additional investment-related imports and the classification of capital investment recovery within factor services. The old framework did not make use of two provisions of the ORML. The government can charge taxes of 40 percent on net income arising from petroleum operations, but no such adjustment was made to the fiscal accounts or the balance of payments. The old framework also allocated revenue from oil production directly into the budget beginning in 2015 using the Permanent Income Hypothesis. This contradicts ORML legislation which calls for an average of the opening balance of the NOA account and the projected closing balance at the end of the year to be allocated to the budget the first year of production. The new framework is in line with the ORML requirements for allocating oil revenue to the budget. Twenty percent of the prior year's closing balance of the NOA is allocated to the budget every year through 2015. In 2015, twenty percent of the prior year's closing balance of the NOA plus twenty percent of the projected closing balance of the NOA for 2015 is allocated to the budget. Beginning in 2016, oil revenues are allocated to the budget using the permanent income hypothesis with a nominal discount rate of 8.8 percent and a ceiling on the real rate of return of 3 percent.

The assumptions surrounding oil production were not updated for at least four years. The assumptions, based on the October 1998 draft of the production profile for Equatorial Guinea's Block B, were used in the initial assessment for the production sharing arrangement between the JDZ and Mobil. This profile had an initial production of 42,322 barrels of oil per day which increased over time to achieve peak production at 153,300 barrels of oil per day in the third year of production before beginning to decline during the fifth year of production. The old oil production profile held production constant at 43,322 barrels per day (discounted by 70 percent in order to have a conservative estimate). Unfortunately, this profile did not account for increases in capacity and depletion of the reserves. The 1998 production profile has been restored to the framework and has been modified to account for new assumptions about the volume of oil reserves.

Impact of proposed corrections

Substantial revisions stemming from the changes detailed above lead to major changes in the macroeconomic aggregates for 2015 and beyond. Not only are there significant revisions to the oil production profile and estimated volume of reserves, but there are major methodological changes which feed into the calculations for GDP, balance of payments, and fiscal revenues. The impact of these changes is shown compared with the *2011 Article IV Staff Report* values below.

- GDP increases from $468 million (*2011 Article IV staff report*) to $489 million in 2015. Real GDP growth for 2015 is revised from 24.4 (*2011 Article IV staff report*) to 38 percent.

- The current account balance (excluding official transfers) changes from a deficit of 28.8 percent of old GDP (*2011 Article IV staff report*) to a deficit of 15.2 percent of new GDP for 2015. The capital and financial account balance declines from a surplus of 37.8 percent of old GDP (*2011 Article IV staff report*) to 17.1 percent of new GDP.

- Oil revenues are reduced from 14.3 percent of old GDP (*2011 Article IV staff report*) to 7.7 percent of new GDP in 2015. This, combined with the change in the way the budget allocation is calculated for 2015 lowers the amount of non-debt creating financing available to the government in 2015. The result is that the government will require additional grants and concessional financing through 2015.

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

July 6, 2012

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY —INFORMATIONAL ANNEX

Prepared By

African Department
(in consultation with other departments)

CONTENTS

RELATIONS WITH THE FUND

(As of May 31, 2012)

Membership Status

Joined: September 30, 1977; Article XIV

General Resources Account:	**SDR Million**	**%Quota**
Quota	7.40	100.00
Fund holdings of currency (exchange rate)	7.40	100.05
Reserve tranche position	0.00	0.00

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	7.10	100.00
Holdings	3.76	53.01

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ECF Arrangements	3.21	43.37

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF[a]	03/02/2009	03/01/2012	2.59	0.74
ECF[a]	08/01/2005	07/31/2008	2.96	2.96
ECF[a]	04/28/2000	04/27/2003	6.66	1.90

[a] Formerly PRGF.

Projected Payments to Fund [1]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2012	2013	2014	2015	2016
Principal		0.40	0.63	0.70	0.61
Charges/Interest	0.00	0.00	0.01	0.01	0.01
Total	0.00	0.40	0.64	0.71	0.62

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Implementation of HIPC Initiative:

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

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

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

Implementation of Multilateral Debt Relief Initiative (MDRI):

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

Debt Relief by Facility (SDR Million)

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

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

Safeguards Assessments:

An update safeguards assessment of the Central Bank of São Tomé and Príncipe (BCSTP) was finalized in November 2009. The assessment concluded that the overall governance structure and oversight of the BCSTP should be strengthened to mitigate the control risks associated with the capacity constraints at the bank. Since the assessment, some progress has been made to enhance the financial reporting framework and the BCSTP is working on a new chart of accounts. The BCSTP continues to be audited by reputable audit firms and the financial statements are published, albeit with delays. Fund staff has not yet received the 2010 and 2011 management letters on internal controls issued by the external auditors; provision of this information is required under the safeguards policy. An updated safeguards assessment of the BCSTP has been initiated and will be concluded before the first review. The 2011 audit of the BCSTP has been completed and the audited financial statements shared with Fund staff.

Exchange Arrangements:

Since January 2010 São Tomé and Príncipe has pegged the Dobra to the euro at a rate of Dobra 24, 500 per euro. Commercial banks buy foreign exchange directly from the central bank, which can charge up to 1.5 percent commission on all foreign exchange transactions. Any foreign exchange commission that banks may decide to charge cannot exceed two percent for transactions in Euro and 4 percent for transactions in other currencies. The new exchange rate system has eliminated the multiple currency practice related to the existence of numerous exchange rate markets with differing effective exchange rates for spot transactions that existed in previous years.

São Tomé and Príncipe continues to avail itself of the transitional arrangements under Article XIV, but does not maintain restrictions under Article XIV. However, it maintains one measure subject to Fund approval under Article VIII: an exchange restriction arising from Article 3(i) and Article 10.1(b) of the Investment Code (Law No. 7/2008) regarding limitations on the transferability of net income from investment. The restriction results from the requirement that taxes and other obligations to the government have to be paid/fulfilled as a condition for transfer, to the extent the requirement includes the payment of taxes and the fulfillment of obligations unrelated to the net income to be transferred.

Article IV Consultation:

The Executive Board concluded the last Article IV consultation with São Tomé and Príncipe on January 23, 2012.

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

None.

Technical Assistance:

Date of Delivery	Department/Purpose
April 2012	FAD mission on Revenue Administration
March 2012	FAD mission on public financial management
March 2012	STA mission on balance of payments
March 2012	FAD mission on public accounting
February 2012	FAD mission on public financial management
February 2012	LEG diagnostic mission on AML/CFT
January 2012	FAD mission on tax administration
November 2011	FAD mission on public accounting
October 2011	FAD mission on public financial management
August 2011	FAD mission on public accounting
June 2011	MCM mission on Liquidity Management under Fixed Exchange Arrangement (follow up)
June 2011	FAD mission on public accounting
February 2011	MCM mission on Bank Resolution Framework
January 2011	FAD mission on public accounting
September 2010	MCM mission on Liquidity Management under Fixed Exchange Arrangement
August/September 2010	STA mission on Monetary and Financial Statistics
December 2009	MCM mission on banking supervision
August 2009	MCM mission on banking supervision
June 2009	FIN mission on safeguards assessment
May 2009	FAD mission on public financial management
April 2009	MCM mission on banking supervision
March 2009	MCM mission on banking supervision
January 2009	STA mission on national accounts
November 2008	MCM mission on banking supervision
August 2008	MCM mission on banking supervision
March 2008	MCM mission on banking supervision
September 2007	STA mission on government finance statistics
July 2007	STA mission on monetary and financial statistics
July 2007	MCM mission on banking supervision
March 2007	FAD mission on public financial management
March 2007	MCM mission on the foreign exchange market
March 2007	STA mission on balance of payment statistics
February 2007	LEG mission on tax laws

Date of Delivery	Department/Purpose
November/December 2006	LEG mission on tax codes
November/December 2006	MCM mission on banking supervision
November/December 2006	MFD missions on foreign exchange market and monetary operations.
August 2006	MFD mission on banking supervision
June 2006	MFD mission to assess implementation of technical assistance

Resident Representative:

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

RELATIONS WITH THE WORLD BANK GROUP

Joint Managerial Action Plan (JMAP) for São Tomé and Príncipe
(As of June, 2012)

1. The IMF and World Bank São Tomé and Príncipe teams held meetings to discuss macro critical structural reforms for São Tomé and Príncipe and their respective work programs for the period 2012–13.

2. The World Bank's work program is guided by the 2011–2012 Interim Strategy Note that focuses on accelerating sustainable and broad-based economic growth and on strengthening governance, public institutions, and human capital. A new Country Assistance Strategy for 2013–2016 will be prepared next year, after a Joint Staff Assessment Note on the National Poverty Reduction Strategy has been completed. Analytical underpinnings for the new Country Assistance Strategy include a Country Economic Memorandum, "Success Beyond Petroleum," completed in 2011, and a Poverty Assessment, which is expected to be completed in early 2013. A First Governance and Competitiveness budget support operation was approved in March 2012. This is the first of a series of three annual programmatic budget support operations for 2012–14. A new Debt Management and Performance Assessment (DeMPA) report was completed in October 2011, and an accompanying reform plan to improve debt management was completed in March 2012.

3. The IMF's work program includes the Executive Board's discussion on the authorities' request for a new three-year ECF arrangement, a staff visit, a mission to conduct the first review under the ECF-supported program, and assistance with capacity building in the areas of PFM, liquidity management, banking supervision, AML/CFT, and statistics.

4. The Bank and the Fund are providing complementary support to help São Tomé and Príncipe strengthen public financial management and make progress toward debt sustainability. Regarding the latter, the teams prepared a Joint IMF-World Bank Debt Sustainability Analysis (DSA) update in 2012. The teams will prepare a Joint Staff Assessment Note (JSAN) on the government's new National Poverty Reduction Strategy (NPRS), which has been completed and is expected to be discussed by Cabinet by end-July 2012.

Title	*Products*	*Provisional timing of missions*	*Expected delivery date*
A. Mutual information on relevant work programs			
World Bank work program in the next 12 months	• Poverty Assessment • Budget support operation • Country Assistance Strategy	Oct 2012 Oct 2012, Nov 2012, and February 2013 Sept/Oct 2012 and February 2013	FY2013 FY2013 FY2013
IMF work program in the next 12 months	• ECF request • Staff visit • ECF first review • Technical Assistance from FAD: o PFM o Revenue Administration • Technical Assistance from MCM: o Liquidity Management o Banking Supervision • Technical Assistance from LEG: o AML/CFT • Technical Assistance from STA: o Money and banking statistics	May 2012 October 2012 March 2013	July 2012 June 2012 May 2013
B. Requests for work program inputs			
Fund request to Bank (with summary justification)	• Information on Bank budget support operations and disbursement schedule	To support the 2013 fiscal program	October 2012
Bank request to Fund (with summary justification)	• Safeguards Assessment • Macroeconomic framework		March 2013 October 2012
C. Agreement on joint products			
Joint products in next 12 months	• JSAN		December 2012

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of October 31, 2011)

1. São Tomé and Príncipe became a member of the African Development Bank Group (AfDB) in 1976. To date, the AfDB has financed 28 operations in the country. This includes 22 projects, including institutional support, and 5 studies, for total net commitments of UA 100 million under the African Development Fund (ADF) (98.9%), as well as one special support operation of UA 1 million under the Nigeria Trust Fund (NTF). Ninety-four percent (94%) of these funds were in the form of loans and only 6% were in grants. At October 1 2011, the total amounts disbursed for the entire portfolio stood at UA 84.29 million, or 84.6% of net commitments. Agriculture has been the most important sector, receiving (24%) of the total assistance followed by (23%) for infrastructure/transport; (22%) for multi-sector interventions; (20%) for social sector; (9%) for energy, water, and sanitation; and (2%) for telecommunications. These operations have helped build and rehabilitate basic economic and social infrastructure (roads, airport, electricity, water, schools, and health centers) and have strengthened São Tomé and Príncipe's economic and institutional capacities. The AfDB has a national program office since 1995.

2. The AfDB has only three active projects—which started in 2005, 2006 and 2011—in human resource development, agriculture (the second phase of the livestock development project) and Infrastructure Rehabilitation for Food Security (PRIASA). These projects, in accordance with the PRSP, focus on the main factors affecting poverty. The second phase of the livestock development project, financed with ADF-X resources (UA 4 million), was approved in May 2006 and signed in July 2006—the mid-term review of the project took place in September 2010, aiming at restructuring the project for improved achievements. The human resource development project, financed with ADF-IX resources (UA 4 million) was signed in June 2003 and began in March 2005. This project tackles cross-sectoral capacity-building by providing training in literacy, information, and community organization, as well as specialized vocational training adapted to specific demands, particularly in the oil and tourist sectors. While the PRISA project, approved in November 2010 and signed in February 2011, aims at addressing the food security challenges in the country.

3. The AfDB assistance for São Tomé and Príncipe (Country Strategy Paper 2005–09) rested on two pillars: Pillar I-Poverty Reduction in Rural area; and Pillar II- Promotion of Good Governance in Public Finance Management. The country allocation of ADF-X resources (2005–07) was UA 5.15 million in the form of grants. The first pillar helped promote and diversify the country's economic base, especially the agricultural and rural sector, and reinforce operations in the social sectors. The second pillar supported macroeconomic reforms and governance, through an institutional support project on governance and a technical assistance on the PRSP process, which helped improve public finance management and institutional capacity building to prepare the country for the forthcoming oil era. The UA 300.000 TA on PRSP process was approved in 2008 and proved very much effective in setting-up the PRSP follow-up mechanisms. The UA 1 million grant, as an AfDB response to São Tomé and Príncipe food crisis, was approved by the AfDB Board in April 2009, and disbursed in a single tranche in August 2009. The mission for the completion of the AfDB Country Assistance for 2005–09 took place in August 2009, together with the Country Portfolio Performance Review (CPPR).

4. In 2009 the AfDB updated a study on São Tomé and Príncipe's governance profile and has finalized the study on the costs of insularity in June 2010. Conclusions of this important report was presented and discussed with government officials, donors, and civil society, in São Tomé, November 10, 2010. The study on the regional capacity building initiatives, within CEMAC, ECCAS, the African Portuguese-speaking countries and the small insular countries, was postponed. Programming of other Economic and Sector Work studies is underway.

5. Decision has been made not to prepare an AfDB Country Assistance for 2010–14, as initially planned, but to finalize an Interim 2010–11 Strategy (approved by the AfDB Board on November 16, 2010) in the absence of a current PRSP, and in alignment with other development partners position. This interim strategy financed only one project (under the ADF XI allocation, UA 5 million) in the agriculture sector, i.e. a consolidated rural infrastructure project in support of food security (Pillar II)—the main objective of this Interim Strategy being on targeting capacity building activities in view of preparing the new PRSP (pillar I), by accessing the AfDB Fragile State Facility.

6. Since the I-CSP 2010–11 will expire at the end of 2011; based on the authorities information that the strategic thrust of the new PRSP II will remain as of the PRSP I, the Bank has started the preparation of its new strategy for São Tomé and Príncipe, CSP 2012–16. The overarching goal of the Bank's proposed CSP 2012–16 is to strengthening São Tomé and Príncipe's public sector capacity, notably in the area of PFM, consistent with pillar I of the I-CSP 2010–11. To that end, the proposed CSP 2012–16 is articulated around a single pillar, capacity building and institutional strengthening, to be financed under the ADF–XII.

7. In addition, as São Tomé and Príncipe reached decision and completion point respectively in 2000 and 2007. In reaching the HIPC decision point, São Tomé and Príncipe became eligible to MDRI and the debt service under the MDRI was estimated at $99.56 million. The AfDB total assistance under HIPC and MDRI amounted to $187.92 million. At the end of December 2008, the AfDB provided $13.33 million under HIPC and $99 million under MDRI.

Table 1. AfDB Ongoing Projects (Millions of UA)

Title of Projects	Window	Commitment	Disbursement Rate (percent)
Support for human resource development	ADF Loan ADF Grant	3.5 0.5	14.16 43.63
Livestock Development Project – Phase II	ADF Grant	4.0	21.25
PRIASA	ADF Grant	***5.0***	
Total		***13.0***	***19.54 t***

STATISTICAL ISSUES

Introduction

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

2. The country has participated in the Fund's General Data Dissemination System (GDDS) since April 20, 2004. The metadata and plans for improvement have not been updated since the original metadata were posted on the DSBB. Over the period 2003–09, the country has benefited from technical assistance from STA and other providers, largely under the GDDS project for Lusophone Africa.

National accounts

3. Statistics on GDP/GNP are compiled on a yearly basis and provided at the time of the Article IV consultation and program review missions. STA provided technical assistance in national accounts to the National Statistics Institute (INE) in 2005, 2006, 2008 and 2009. Low response rates and/or insufficient rigor of the responses to the business surveys, including those from important enterprises, continue to affect the quality of the business data compiled.

4. A new GDP series for the period 2007–10 with base year 2001 became available in mid–2011. The new estimates cover: (i) GDP by production approach at current and constant prices; and (ii) cross-classification tables by industry sectors. The revised series reflect more accurately recent economic developments. Based on the most recent population census, corporation census, and living conditions survey, higher weights are now attributed to the sectors that experienced faster growth, such as trade, transportation and communication, and services. While the revision of the GDP series is a significant improvement, a number of shortcomings remain. Further improvements would require input from a new household expenditure survey (rather than living conditions survey), using producer prices, and better estimates for agricultural production. INE is moving toward using a new system to better capture survey and market information and to include estimates of the informal sector and is currently compiling data from a household survey undertaken at the end of 2010.

Consumer prices

5. Since 1997 the CPI weights have been based on a three-month household survey conducted in 1995. Data from the recent household expenditure survey need to be compiled to update the weights. Current price surveys only cover the capital, although there are plans to use the results of the 2010 household survey to expand coverage nationwide.

Government finance statistics

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

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

Monetary and financial statistics

8. STA missions provided technical assistance on monetary statistics in December 2004, April/May 2006, June 2007 and September 2010. As a result, the accuracy and timeliness of the monetary data reported in the standardized report forms (SRF) for the central bank and the other depository corporations data have improved.

9. The previous missions found that the BCSTP monthly trial balance sheets were broadly adequate to compile monetary statistics in line with the *Monetary and Financial Statistics Manual (MFSM)*.

10. A New Plan of Accounts of other depository corporations (ODCs) was introduced in January 2010. The September mission reviewed the new plan of accounts for the financial system, and found it adequate for a proper classification, sectorization, and valuation of financial instruments, and in line with the methodology of the *MFSM*. However, the mission detected serious shortcomings in the information reported by some banks, an inconsistent approach in the way banks report to the BCSTP, and the fact that one bank is still reporting using the old plan of accounts. The mission developed the bridge table that links the ODCs' trial balances—based on the new plan of accounts—to the SRF for ODCs (form 2SR).

11. A September 2010 mission assisted the authorities in: (1) reconstructing the SRF for ODCs following the introduction of the new plan of accounts; (2) assessing the quality of the data reported by ODCs after the migration to the new plan of accounts; (3) advancing work on the generation of the SRF for the central bank, based on the new plan of account; and (4) establishing an integrated monetary database (IMD) that automatically generates the data required for publication in International Financial Statistics (IFS), by the African Department (AFR) of the IMF for surveillance purposes, and by the BCSTP for analytical and dissemination purposes. For the integrated monetary database that meets the data needs of STA, AFR, and BCSTP, STA reconstructed the historical data starting from December 2001.

External sector statistics

12. There are significant weaknesses in the collection of source data related to merchandise trade. Some transactions, including certain imports related to investment, are not fully captured in the balance of payments (BOP). Monthly data on the main exports and imports are reported to AFR regularly but with some lags in recent months, and unit prices and volumes of exports are only occasionally included. AFR does not receive any data on São Tomé and Príncipe's international investment position (IIP) as these data are not yet compiled by the BCSTP.

13. The GDDS Lusophone project has targeted a substantial improvement in the source data, including the response rate to the surveys, and in the methodology for compiling the BOP in line with the Sixth Edition of the *Balance of Payments Manual (BPM6)*.

14. A June 2004 mission found inconsistencies in the classification of BOP operations and that certain components continued to be largely estimated. Resource constraints, particularly with regard to qualified staff, contribute to the lack of improvement in the response rate to surveys. The mission recommended improving coordination and data sharing among data-producing agencies, intensifying contacts with survey respondents, and using alternative sources to improve source data. A March 2007 mission found that little progress had been achieved in implementing recommendations of previous missions, primarily due to resource constraints in the BCSTP. The mission assisted the authorities in reconciling balance of payments data and outlined a set of recommendations and detailed work plan to improve compilation capacity. Resource constraints at the BCSTP have also hampered the development of IIP data.

15. A March 2012 mission assisted the authorities to migrate to *BPM6* methodology. The mission recommended improving coordination and data sharing among data-producing agencies.

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

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF SÃO TOMÉ AND PRÍNCIPE

JOINT IMF/WORLD BANK DEBT SUSTAINABILITY ANALYSIS[1]

July 6, 2012

Approved By
David Owen and Dhaneshwar Ghura (IMF) and Marcelo Giugale and Jeffrey Lewis (IDA)

Prepared by:
International Monetary Fund and International Development Association staffs in collaboration with the authorities of São Tomé and Príncipe.

São Tomé and Príncipe is at a high risk of debt distress according to this update of the joint Bank-IMF low-income country debt sustainability analysis (DSA). The update reflects recent economic data and forecast, including for the oil sector. Despite the revised projections, the assessment of high risk of debt distress is unchanged from the DSA published in February 2012. Under the baseline scenario, the PV of debt-to-exports ratio remains above the country-specific indicative threshold for an extended period due to the country's narrow export base. Taking into account expected commercial oil production beginning in 2015 and associated foreign direct investment, the projected debt profile is consistent with manageable – if high risk – debt dynamics. Stress scenarios show that reduced availability of concessional financing could undermine debt sustainability. Under an alternative, non-oil scenario, all indicators deteriorate when compared to the baseline results, and reaching a sustainable debt level would require an additional fiscal adjustment of 1 percent of GDP by 2015 and further efforts to diversify the economy and expand the export base over the medium term.

[1] The DSA was prepared by IMF and World Bank staff in collaboration with the authorities of São Tomé and Príncipe. The analysis updates the previous Joint DSA dated February 8, 2012 (IMF Country Report No. 12/34). The DSA follows the IMF and World Bank Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries (January 22, 2010).

BACKGROUND

1. The previous DSA for São Tomé and Príncipe was undertaken as part of the 2011 Article IV consultation and published in February 2012.[2] It concluded that São Tomé and Príncipe was at a high risk of debt distress. At the same time, it showed a more favorable dynamics of debt indicators than those in earlier assessments, reflecting fiscal revenue improvements and more up-to-date information on future oil production.

2. São Tomé and Príncipe reached the completion point under the enhanced HIPC initiative in March 2007, received topping-up assistance in December 2007, and later on benefited from HIPC/MDRI debt relief. MDRI, in particular, brought substantial debt service savings, since 54 percent of total debt before the HIPC completion point was with IDA, AfDB, and IMF. Debt relief from Paris Club members also helped improve the country's debt profile.

3. São Tomé and Príncipe's medium- and long-term public and publicly guaranteed external debt was estimated at $200.9 million (81 percent of GDP) as of December 2011 (Table 1).[3] The debt burden increased from $157.1 million at end-2010 but remains significantly below the pre-debt relief high of $359.5 million at end-2006. Total public sector debt is composed solely of debt contracted or guaranteed by the central government, and there is currently no state-owned enterprise external debt. Debt composition has shifted after the HIPC completion point. The share of multilateral debt declined from nearly 60 percent before the completion point to around 20 percent. Portugal is now the country's main bilateral creditor, and IDA is its main multilateral creditor.

Table 1. São Tomé and Príncipe: External Debt Stock

(As of end-December 2011)

	Million USD	Share
Multilateral Creditors	42.1	21%
IDA	14.9	7%
FIDA	7.9	4%
BADEA	5.8	3%
OPEC	5.5	3%
IMF	4.9	2%
AfDB	2.2	1%
EIB	0.9	0%
Bilateral Creditors	158.8	79%
Portugal	45.6	23%
Angola [1]	35.4	18%
Italy [1]	25.8	13%
Nigeria	20.0	10%
China [1]	17.3	9%
Yugoslavia [1]	8.8	4%
Brazil[1]	5.0	2%
Belgium	0.9	0%
Total	200.9	100%

Sources: Country authorities and IMF staff estimates

[1] Includes debt in dispute.

4. To implement the terms of the May 2007 Agreed Minutes, the authorities have signed bilateral agreements with all its Paris Club creditors, except Russia, with whom agreement has been reached but not formally signed yet.[4] São Tomé and Príncipe received debt relief from Algeria in 2011. Efforts are underway to conclude additional debt relief with other non-Paris club creditors.

[2] IMF (2012), Country Report for São Tomé and Príncipe 12/34.

[3] $82.3 million of this debt consists of technical arrears (including accrued interest) to Angola ($25.4million), China ($17.3 million), Italy ($25.8 million), Yugoslavia ($8.8 million), and Brazil ($5 million).

[4] The signing of the agreement has been delayed due to the Russian authorities' request that an official signing ceremony take place in Moscow.

MACROECONOMIC ASSUMPTIONS

5. The assumptions in the baseline scenario for 2012–32 are as follows:

- A subdued recovery from the global economic crisis, with annual non-oil output averaging 5 percent through 2013, 6 percent from 2014–22, and 5½ percent thereafter. The main drivers of growth are expected to be construction, tourism, and agriculture. Oil production is expected to begin in 2015 in Block 1 of the Joint Development Zone (JDZ) shared with Nigeria, boosting GDP growth to 38 percent in that year and 48 percent in 2016 as oil production approaches its peak.

- A decline in average annual inflation from 14.3 percent in 2011 to 9.6 percent in 2012, and further to around 3.5 percent in 2015. Inflation is then assumed to remain around 3 percent over the longer term. This reflects continued fiscal prudence and the effects of the peg of the dobra to the euro, which has been in effect since January 2010.

- A domestic primary deficit that is in line with available non-debt creating financing. Any domestic financing needs are assumed to be met via a drawdown of government National Oil Account (NOA) deposits. No domestic borrowing is envisaged.

- A recovery in capital inflows, including in FDI to the oil sector. The authorities expect investment in infrastructure projects to support tourism development, and work on a deepwater port (expected to start in 2014). After the conclusion of these large projects, FDI is projected to return to about 6 percent of GDP.

- The non-interest current account deficit (including official grants) is expected to remain over 21 percent of GDP until oil exports start. The current account deficit is then projected to decline sharply to 12 percent of GDP in 2015, reaching a surplus of 14 percent in 2017 before gradually trending toward balance over the longer term. Non-oil export growth will be driven by increases in cocoa production and re-exports of fuel to airline and shipping companies as São Tomé and Príncipe rehabilitates its airport and expands its connectivity.

- A level of loan concessionality of 50 percent during the new IMF program period. In the baseline, concessional financing is phased out as the country becomes an oil producer: first moving from IDA grants to IDA loans, and then to seeking market financing as needed after oil production starts. No financing from future privatization operations, no commercial loans, no domestic borrowing, and no short-term loans are assumed throughout the DSA projection period.

- Total grants are projected to decline from their current level of 17 percent of GDP in 2011 to an average of 12 percent of GDP through 2015, and to virtually disappear after NOA transfers to the budget become more substantial from 2016 onward.

6. The baseline scenario includes revisions to the oil related assumptions applied under the previous DSA. Production and exports of oil are assumed to commence in 2015 in the JDZ. Production is assumed to be about 8,200 barrels per day in 2015 and peak at about 29,700 barrels per day in 2017–18. Production will average about 13,000 barrels per day over the 20-year life of the project. This is expected to yield, on average, $460 million of annual export earnings, of which $325 million would go to the JDZ partners, with 40 percent ($130 million) belonging to São Tomé and Príncipe.[5] In accordance with the Oil Revenue Management Law (ORML), oil signature bonuses will be accumulated in the NOA from which resources will be drawn up to a maximum of 20 percent of the balance per year to finance the annual budget. Once oil production starts, the bulk of current revenues are to be transferred into a sub-account of the NOA—the Permanent Fund of São Tomé and Príncipe. Resources in the Permanent Fund are to be invested with a view to generating a permanent income stream for the NOA. In steady state, all revenues are deposited in the Permanent Fund while a long-term real rate of return (capped at 5 percent) applied to the previous year's closing balance will be used to determine the amount annually transferred to the budget.

7. The main risk to the macroeconomic framework arises from the uncertainty about the prospects for oil. For illustrative purposes, the DSA expands the analysis under an alternative, non-oil scenario to assess the debt outlook in the event that the quantities produced are not substantial. The details of the alternative medium-to long-term assumptions are as follows:

- Real GDP growth is assumed to be lower than in the baseline by ½ percentage point in 2013–14 as the government slows its public investment program absent funding from oil revenues. Over the long term, growth is projected to be sustained at around 5½ percent per year, similar to the historical norm. However, stronger macroeconomic policies, further measures to enhance the business climate, and successful implementation of a tourism development strategy would be needed to achieve this potential. Investment would have to be supported by grant inflows in the absence of oil revenues.

- The domestic primary deficit is adjusted by an additional 1 percent of GDP by 2015 and ½ percent of GDP by the end of the projection period to keep it in line with projected non-debt creating financing. The fiscal adjustment would come through measures to enhance revenue mobilization (i.e., broaden the tax base by consolidating tax revenue reforms) and to reduce non-priority spending.

- The projected non-interest current account deficit (including grants) would decline from around 25 percent of GDP in 2011 to around 16 percent in 2015, reflecting a decline in imports while FDI flows will subside toward 5 percent of GDP, consistent with the average for Sub-Saharan countries.

- Concessional borrowing would decline from the unusually high levels of 2009–11, beginning with a reduction of planned

[5] The DSA assumes an oil price averaging $96 a barrel. The previous DSA prepared by Fund staff assumed that oil production volumes were fixed at about 12,700 barrels per day beginning in 2015 at a (discounted) price of $82 per barrel due to early concerns about the quality of the hydrocarbon reserves.

borrowing during 2013–15. All borrowing during the DSA projection period would occur on highly concessional terms. Capital investment of about US$12 million currently projected to be financed by concessional loans over 2013 and 2014 would have to be postponed to keep the PV of debt-to GDP ratio around the threshold. Grant financing is expected to remain around historical norms, but additional grant mobilization could mitigate the impact of lower borrowing for capital investment.

EXTERNAL DEBT SUSTAINABILITY

A. Baseline

8. Under the baseline scenario, some external debt indicators remain above their relevant indicative thresholds over the medium term (Figure 1, blue lines).[6] Reflecting São Tomé and Príncipe's narrow export base, the present value (PV) of public and publicly guaranteed external debt-to-exports ratio is almost three times the indicative threshold of 100 percent and is expected to remain above the threshold until 2015 when oil exports begin. External debt indicators improve dramatically once oil production begins and remain below all thresholds for the duration of the projection period.

9. São Tomé and Príncipe's net creditor position becomes positive in 2017. The DSA is conducted using gross debt indicators. However, when the assets deposited in the NOA are taken into account, the country is projected to become a net creditor 2 years after oil production starts. The accumulation of deposits in the Permanent Fund of the NOA is responsible for the large residuals appearing from 2016 onward (Table 1).

B. Sensitivity Analysis and Alternative Scenario

10. Stress tests show the highest vulnerability of debt sustainability to a shock to non-debt creating flows in which new borrowing is assumed to be 200 basis points more expensive (Figure 1, red lines).[7] In this case, the projected PV of debt-to-GDP, debt-to-revenue, and debt-to-exports ratios would exceed their respective thresholds for an extended period.

11. Under an alternative, non-oil scenario, São Tomé and Príncipe's projected debt indicators would remain close to their thresholds, with one exception (Figure 1, green lines). Significant breaches would occur throughout the projection period only for the PV of debt-to-exports ratio due to São Tomé and Príncipe's narrow export base. Redressing the breach of the PV of debt-to-GDP threshold over the longer term would require that the domestic primary deficit remain in line with available non-debt creating financing.

[6] São Tomé and Príncipe's quality of policies and institutions as measured by the average World Bank's Country Policy and Institutional Assessment (CPIA) for the period 2007–10 is 2.97 (weak performer). The corresponding indicative thresholds are 30 percent for the NPV of debt-to-GDP ratio, 100 percent for the debt-to-export ratio, 200 percent for NPV of debt-to-revenue ratio, 15 percent for the debt service-to-exports ratio, and 18 percent for the debt service-to-revenue ratio.

[7] The country was most vulnerable to an exports shock in the previous DSA.

12. There is essentially no difference between the external and public sector DSAs. This is because the government of São Tomé and Príncipe does not issue domestic debt and is not projected to issue debt in the baseline scenario. The dynamics of debt appear unsustainable when the primary balance is unchanged from 2012 (Figure 2, red lines). This highlights the importance of continued fiscal prudence to ensure debt sustainability, and in structural reforms to improve the business environment and thus support private investment and achieve rapid growth.

PUBLIC DEBT SUSTAINABILITY

13. There is essentially no difference between the external and public sector DSAs. This is because the government of São Tomé and Príncipe does not issue domestic debt and is not projected to issue debt in the baseline scenario. The dynamics of debt appear unsustainable when the primary balance is unchanged from 2012 (Figure 2, red lines). This highlights the importance of continued fiscal prudence to ensure debt sustainability, and in structural reforms to improve the business environment and thus support private investment and achieve rapid growth.

CONCLUSION AND THE AUTHORITIES' VIEW

14. São Tomé and Príncipe remains at a high risk of external debt distress. However, the country is able to service its current obligations and, while some external debt indicators are projected remain above their respective thresholds, they show a clear downward trend in the long term. The authorities will need to monitor the adequacy of the fiscal stance and be prepared to tighten it if the non-oil scenario were to materialize. In this context, the DSA underlines the need for measures to mitigate risks:

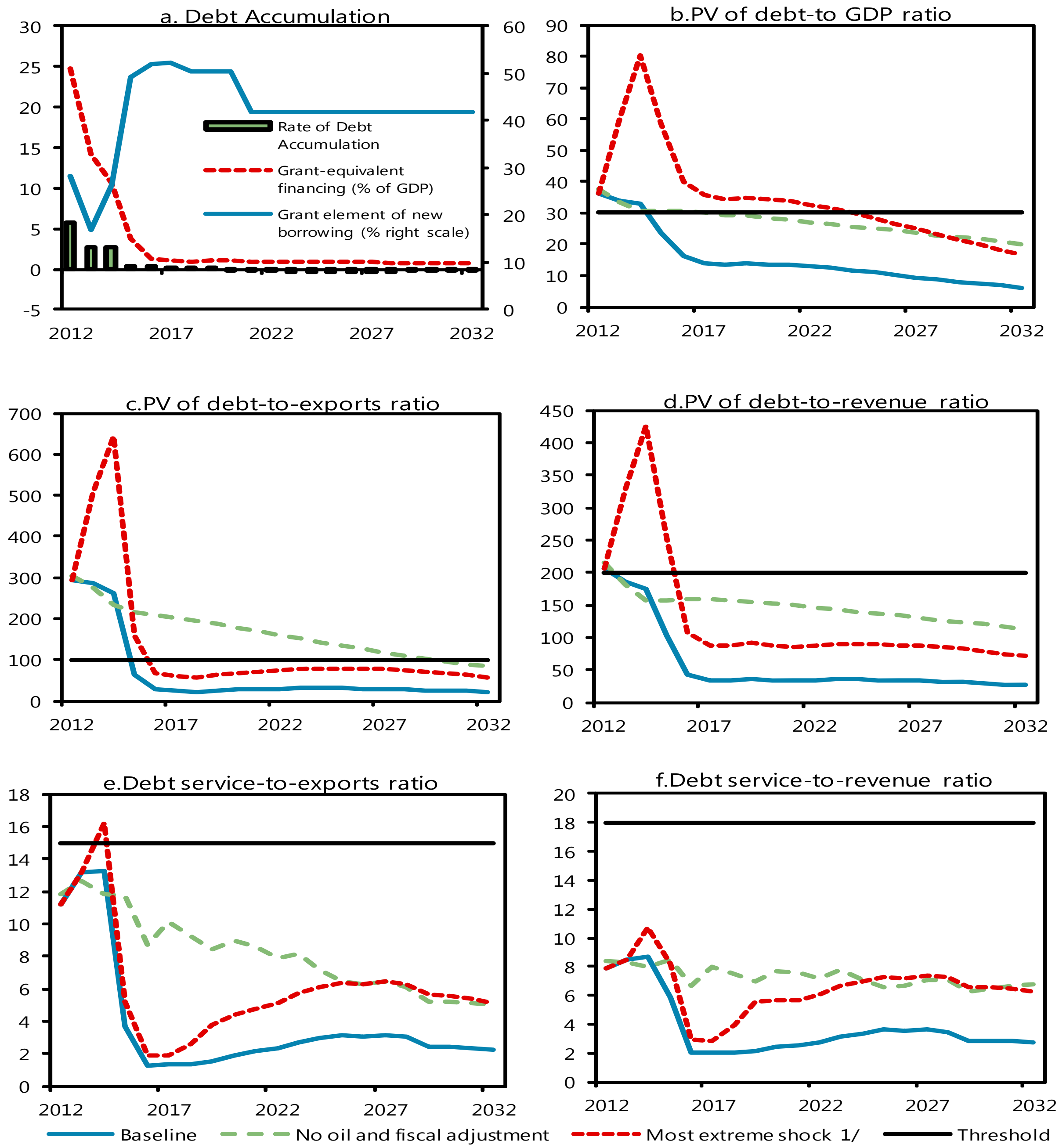
- Maintain fiscal prudence, particularly in the run-up to oil production;
- Accelerate reforms to improve policy and institutional performance to enhance the growth potential of the country;
- Ensure favorable financing terms in the form of grants or highly concessional borrowing; and
- Develop a comprehensive strategy to reduce the cost of doing business and attract investments that can broaden the export base.

15. Key medium-term vulnerabilities include lower GDP growth, external shocks, and borrowing on less concessional terms. These vulnerabilities underscore the importance of sound macroeconomic policies to improve the growth potential on a sustained basis. The development of sound public debt management, anchored in a medium-term debt management strategy and medium-term fiscal framework, will be essential to guide future development financing. Priority should be given to projects which would help generate high growth and employment as well as exports to help ensure debt service capacity in the future.

16. The authorities broadly agreed with the key macroeconomic assumptions and

analysis underpinning the joint DSA. The authorities carefully guarded their optimism about the prospects for future oil production and welcomed the discussion of a non-oil scenario. While acknowledging that São Tomé and Príncipe remains at high risk of falling back into debt distress, they highlighted that supporting growth and diversification requires mobilizing sufficient resources to implement the country's public investment program, which will continue to require highly-concessional borrowing to the extent that sufficient grant financing is not available. Finally, the authorities noted that additional borrowing did not pose an immediate concern as debt service levels are currently well below the thresholds.

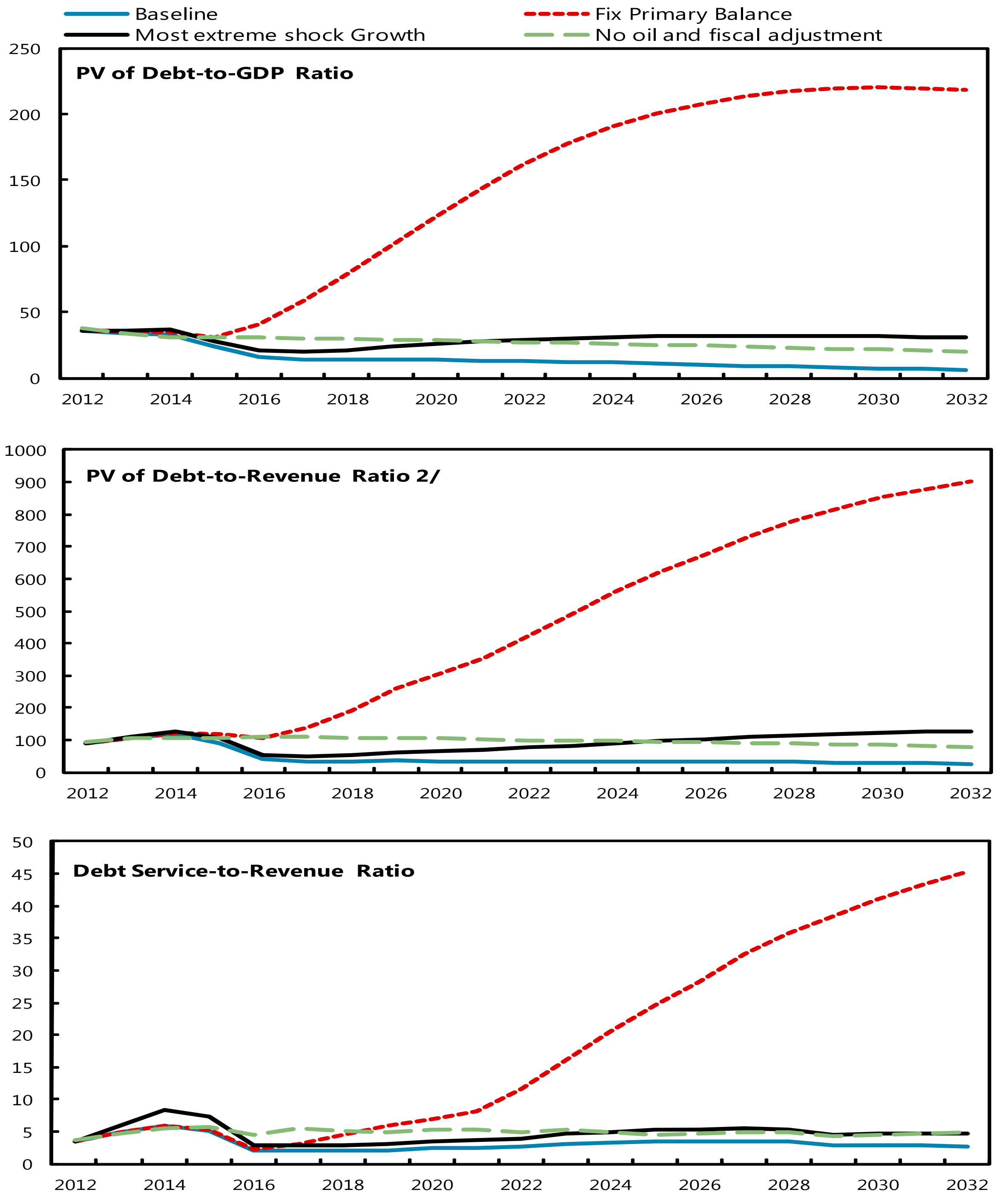
Figure 1. São Tomé and Príncipe: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2012–32[1/]



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a Non-debt flows shock; in c. to a Non-debt flows shock; in d. to a Non-debt flows shock; in e. to a Non-debt flows shock and in figure f. to a Non-debt flows shock

Figure 2. São Tomé and Príncipe: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2012-2032 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2022.
2/ Revenues are defined inclusive of grants.

Table 1. São Tomé and Príncipe: External Debt Sustainability Framework, Baseline Scenario, 2009–32 1/

(Percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-2017 Average	2022	2032	2018-203 Average
External debt (nominal) 1/	**30.4**	**38.3**	**53.7**			**54.1**	**49.6**	**47.3**	**34.1**	**22.9**	**20.1**		**18.3**	**9.4**	
o/w public and publicly guaranteed (PPG)	30.4	38.3	53.7			54.1	49.6	47.3	34.1	22.9	20.1		18.3	9.4	
Change in external debt	11.2	7.9	15.4			0.4	-4.5	-2.2	-13.3	-11.2	-2.8		-0.6	-0.8	
Identified net debt-creating flows	27.9	1.2	-14.0			-5.1	-2.4	-2.5	-18.8	-24.4	-21.6		-12.2	1.4	
Non-interest current account deficit	**25.0**	**27.3**	**24.9**	**19.9**	**7.1**	**21.4**	**22.6**	**22.6**	**11.3**	**-8.3**	**-14.5**		**-5.2**	**8.3**	0.2
Deficit in balance of goods and services	42.3	52.2	46.9			47.4	39.3	35.0	15.1	-15.1	-22.8		-8.5	11.7	
Exports	10.0	12.1	11.7			12.3	11.9	12.5	36.7	58.3	61.0		43.8	29.3	
Imports	52.3	64.3	58.6			59.7	51.2	47.6	51.7	43.1	38.3		35.3	41.0	
Net current transfers (negative = inflow)	-17.0	-24.3	-21.4	-22.6	4.5	-25.3	-16.0	-11.7	-5.0	-1.4	-1.5		-1.5	-1.1	-1.4
o/w official	-17.5	-22.9	-20.3			-24.2	-15.0	-10.8	-4.3	-1.0	-1.1		-1.1	-0.7	
Other current account flows (negative = net inflow)	-0.3	-0.6	-0.6			-0.7	-0.7	-0.8	1.2	8.2	9.7		4.8	-2.3	
Net FDI (negative = inflow)	**3.6**	**-25.8**	**-32.1**	**-7.4**	**30.0**	**-24.7**	**-22.8**	**-22.8**	**-17.9**	**-5.6**	**-5.0**		**-7.2**	**-6.6**	-7.3
Endogenous debt dynamics 2/	**-0.8**	**-0.4**	**-6.8**			**-1.8**	**-2.2**	**-2.2**	**-12.3**	**-10.5**	**-2.1**		**0.2**	**-0.3**	
Contribution from nominal interest rate	0.5	0.3	0.5			0.4	0.5	0.5	0.4	0.3	0.2		0.2	0.1	
Contribution from real GDP growth	-0.7	-1.3	-1.5			-2.3	-2.6	-2.7	-12.6	-10.8	-2.3		0.0	-0.4	
Contribution from price and exchange rate changes	-0.6	0.7	-5.8			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-16.6**	**6.7**	**29.4**			**5.5**	**-2.1**	**0.2**	**5.6**	**13.2**	**18.8**		**11.6**	**-2.2**	
o/w exceptional financing	5.2	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	34.7			36.0	34.0	33.0	23.7	16.0	14.1		12.9	6.3	
In percent of exports	...	...	296.2			292.1	286.1	263.3	64.7	27.5	23.1		29.5	21.3	
PV of PPG external debt	...	...	**34.7**			**36.0**	**34.0**	**33.0**	**23.7**	**16.0**	**14.1**		**12.9**	**6.3**	
In percent of exports	...	...	**296.2**			**292.1**	**286.1**	**263.3**	**64.7**	**27.5**	**23.1**		**29.5**	**21.3**	
In percent of government revenues	...	...	**192.6**			**206.6**	**185.1**	**174.1**	**102.3**	**42.7**	**34.1**		**34.6**	**26.3**	
Debt service-to-exports ratio (in percent)	**11.3**	**7.3**	**10.2**			**11.2**	**13.1**	**13.2**	**3.7**	**1.3**	**1.4**		**2.3**	**2.2**	
PPG debt service-to-exports ratio (in percent)	**11.3**	**7.3**	**10.2**			**11.2**	**13.1**	**13.2**	**3.7**	**1.3**	**1.4**		**2.3**	**2.2**	
PPG debt service-to-revenue ratio (in percent)	**6.8**	**4.8**	**6.6**			**7.9**	**8.5**	**8.7**	**5.8**	**2.0**	**2.0**		**2.7**	**2.8**	
Total gross financing need (Billions of U.S. dollars)	0.1	0.0	0.0			0.0	0.0	0.0	0.0	-0.1	-0.1		-0.1	0.0	
Non-interest current account deficit that stabilizes debt ratio	13.7	19.4	9.5			21.0	27.1	24.8	24.6	2.9	-11.8		-4.6	9.1	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.0	4.5	4.9	5.2	3.5	4.5	5.5	6.0	37.7	47.5	11.5	18.8	0.2	4.3	1.7
GDP deflator in US dollar terms (change in percent)	2.9	-2.1	17.7	7.2	7.0	2.1	7.0	5.2	2.4	1.9	1.9	3.4	1.5	1.5	1.5
Effective interest rate (percent) 5/	2.8	1.0	1.6	1.5	1.1	0.9	1.0	1.1	1.1	1.1	1.1	1.0	1.1	0.8	1.0
Growth of exports of G&S (US dollar terms, in percent)	12.0	24.0	19.5	11.5	17.6	12.3	8.7	17.7	312.4	138.8	19.1	84.8	-5.7	5.3	-1.6
Growth of imports of G&S (US dollar terms, in percent)	-9.5	25.8	12.5	13.6	17.9	8.8	-3.3	3.6	53.3	25.4	0.8	14.8	6.3	5.7	3.9
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	28.4	16.9	26.5	49.3	52.1	52.3	37.6	41.8	41.8	43.5
Government revenues (excluding grants, in percent of GDP)	16.6	18.2	18.0			17.4	18.4	19.0	23.2	37.5	41.4		37.4	23.8	32.0
Aid flows (in Billions of US dollars) 7/	0.1	0.1	0.1			0.1	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
o/w Grants	0.0	0.0	0.0			0.1	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
o/w Concessional loans	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			24.8	14.2	10.5	3.9	1.2	1.1		1.0	0.7	0.9
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			81.8	83.9	78.1	84.0	77.9	79.1		75.4	76.3	76.4
Memorandum items:															
Nominal GDP (Billions of US dollars)	0.2	0.2	0.2			0.3	0.3	0.3	0.5	0.7	0.8		0.9	1.3	
Nominal dollar GDP growth	7.1	2.3	23.5			6.6	12.8	11.5	41.0	50.3	13.6	22.6	1.7	5.8	3.2
PV of PPG external debt (in Billions of US dollars)			0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.1	
(PVt-PVt-1)/GDPt-1 (in percent)						5.8	2.7	2.8	0.5	0.3	0.0	2.0	-0.2	-0.2	-0.2
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	34.3			35.6	33.6	32.7	23.6	15.9	14.0		12.9	6.2	
PV of PPG external debt (in percent of exports + remittances)	...	...	269.5			268.1	264.1	245.6	63.6	27.3	23.0		29.3	21.1	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	9.3			10.3	12.1	12.3	3.6	1.3	1.4		2.3	2.2	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt. Technical arrears which are currently being renegotiated are excluded.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–32

(Percent)

		Projections						
	2012	2013	2014	2015	2016	2017	**2022**	2032
PV of debt-to GDP ratio								
Baseline	36	34	33	24	16	14	**13**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	36	42	47	54	65	78	**114**	88
A2. New public sector loans on less favorable terms in 2012-2032 2	36	34	35	26	18	16	**16**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	36	35	36	26	17	15	**14**	7
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	36	35	36	26	18	16	**14**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	36	36	37	27	18	16	**14**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	36	60	80	59	40	36	**33**	17
B5. Combination of B1-B4 using one-half standard deviation shocks	36	53	69	50	34	31	**28**	14
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	36	47	46	33	22	20	**18**	9
PV of debt-to-exports ratio								
Baseline	292	286	263	65	27	23	**30**	21
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	292	350	377	148	111	128	**261**	300
A2. New public sector loans on less favorable terms in 2012-2032 2	292	290	278	70	30	26	**36**	34
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	292	286	263	65	27	23	**29**	21
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	292	340	419	103	44	37	**47**	34
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	292	286	263	65	27	23	**29**	21
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	292	505	642	160	69	59	**75**	57
B5. Combination of B1-B4 using one-half standard deviation shocks	292	449	612	152	65	56	**71**	54
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	292	286	263	65	27	23	**29**	21
PV of debt-to-revenue ratio								
Baseline	207	185	174	102	43	34	**35**	26
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	207	226	249	233	173	188	**305**	371
A2. New public sector loans on less favorable terms in 2012-2032 2	207	188	184	111	47	38	**42**	42
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	207	192	188	110	46	37	**37**	28
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	207	190	191	112	47	38	**38**	29
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	207	197	195	114	48	38	**38**	29
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	207	326	425	252	106	87	**87**	71
B5. Combination of B1-B4 using one-half standard deviation shocks	207	289	365	216	91	74	**74**	60
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	207	257	242	142	59	47	**48**	36

Table 2. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–32 (concluded)
(Percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
Debt service-to-exports ratio								
Baseline	11	13	13	4	1	1	**2**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	11	13	14	5	3	3	**9**	14
A2. New public sector loans on less favorable terms in 2012-2032 2	11	13	12	4	1	1	**2**	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	11	13	13	4	1	1	**2**	2
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	11	15	19	5	2	2	**4**	4
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	11	13	13	4	1	1	**2**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	11	13	16	5	2	2	**5**	5
B5. Combination of B1-B4 using one-half standard deviation shocks	11	14	18	6	2	2	**5**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	11	13	13	4	1	1	**2**	2
Debt service-to-revenue ratio								
Baseline	8	9	9	6	2	2	**3**	3
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2012-2032 1/	8	9	9	8	4	5	**10**	18
A2. New public sector loans on less favorable terms in 2012-2032 2	8	9	8	6	2	2	**3**	3
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	8	9	9	6	2	2	**3**	3
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	8	9	9	6	2	2	**3**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	8	9	10	7	2	2	**3**	3
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	8	9	11	8	3	3	**6**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	8	9	11	8	3	3	**5**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	8	12	12	8	3	3	**4**	4
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	40	40	40	40	40	40	**40**	40

Sources: Country authorities; and staff estimates and projections.

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

Table 3. São Tomé and Príncipe: Public Sector Debt Sustainability Framework, Baseline Scenario, 2009–32

(Percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	30.4	38.3	53.7			54.1	49.6	47.3	34.1	22.9	20.1		18.3	9.4	
o/w foreign-currency denominated	30.4	38.3	53.7			54.1	49.6	47.3	34.1	22.9	20.1		18.3	9.4	
Change in public sector debt	11.2	7.9	15.4			0.4	-4.5	-2.2	-13.3	-11.2	-2.8		-0.6	-0.8	
Identified debt-creating flows	17.1	9.6	8.0			6.5	5.6	6.1	-11.3	-31.3	-27.6		-16.5	-0.4	
Primary deficit	18.9	10.8	12.6	9.8	4.7	12.5	11.9	10.7	2.0	-20.2	-25.1	-1.4	-16.4	0.0	-10.1
Revenue and grants	29.2	37.4	35.3			40.0	32.0	28.4	26.4	38.4	42.1		38.1	24.3	
of which: grants	12.6	19.1	17.3			22.6	13.6	9.5	3.2	0.8	0.7		0.7	0.5	
Primary (noninterest) expenditure	48.1	48.2	47.9			52.6	43.8	39.1	28.4	18.2	17.0		21.7	24.3	
Automatic debt dynamics	-0.7	-1.2	-4.6			-6.0	-6.2	-4.6	-13.4	-11.1	-2.5		-0.1	-0.5	
Contribution from interest rate/growth differential	-0.4	-1.4	-2.0			-2.5	-3.1	-3.0	-13.1	-11.1	-2.5		-0.2	-0.5	
of which: contribution from average real interest rate	0.3	0.0	-0.2			-0.2	-0.3	-0.2	-0.2	-0.1	-0.2		-0.2	-0.1	
of which: contribution from real GDP growth	-0.7	-1.3	-1.8			-2.3	-2.8	-2.8	-13.0	-11.0	-2.4		0.0	-0.4	
Contribution from real exchange rate depreciation	-0.3	0.1	-2.6			-3.5	-3.1	-1.6	-0.2	-0.1	0.0		...	...	
Other identified debt-creating flows	-1.1	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-1.1	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-5.9	-1.8	7.4			-6.2	-10.1	-8.3	-1.9	20.2	24.9		15.9	-0.3	
Other Sustainability Indicators															
PV of public sector debt	...	...	34.7			36.0	34.0	33.0	23.7	16.0	14.1		12.9	6.3	
o/w foreign-currency denominated	...	...	34.7			36.0	34.0	33.0	23.7	16.0	14.1		12.9	6.3	
o/w external	...	...	34.7			36.0	34.0	33.0	23.7	16.0	14.1		12.9	6.3	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	20.1	11.7	13.8			13.9	13.4	12.3	3.4	-19.4	-24.3		-15.4	0.7	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	98.3			89.9	106.2	116.1	90.0	41.8	33.5		33.9	25.8	
PV of public sector debt-to-revenue ratio (in percent)	…	…	192.6			206.6	185.1	174.1	102.3	42.7	34.1		34.6	26.3	
o/w external 3/	…	…	192.6			206.6	185.1	174.1	102.3	42.7	34.1		34.6	26.3	
Debt service-to-revenue and grants ratio (in percent) 4/	3.9	2.4	3.4			3.4	4.9	5.8	5.1	2.0	2.0		2.6	2.7	
Debt service-to-revenue ratio (in percent) 4/	6.8	4.8	6.6			7.9	8.5	8.7	5.8	2.0	2.0		2.7	2.8	
Primary deficit that stabilizes the debt-to-GDP ratio	7.7	3.0	-2.8			12.2	16.4	12.9	15.3	-9.0	-22.3		-15.8	0.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.0	4.5	4.9	5.2	3.5	4.5	5.5	6.0	37.7	47.5	11.5	18.8	0.2	4.3	1.7
Average nominal interest rate on forex debt (in percent)	2.8	1.0	1.6	1.5	1.1	0.9	1.0	1.1	1.1	1.1	1.1	1.0	1.1	0.8	1.0
Average real interest rate on domestic debt (in percent)	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Real exchange rate depreciation (in percent, + indicates depreciation)	-1.7	0.4	-7.2	-3.7	5.5	-6.8	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	13.6	11.7	12.1	14.7	4.6	10.7	8.6	5.5	2.8	2.3	2.4	5.4	2.9	2.9	2.9
Growth of real primary spending (deflated by GDP deflator, in percent)	0.8	0.0	0.0	0.1	0.3	0.1	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	28.4	16.9	26.5	49.3	52.1	52.3	37.6	41.8	41.8	...

Sources: Country authorities; and staff estimates and projections.

1/ Includes gross debt of the general government. Technical arrears which are currently being renegotiated are excluded.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public Debt, 2012–32

(Percent)

		Projections						
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	36	34	33	24	16	14	13	6
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	36	33	32	34	60	92	191	195
A2. Primary balance is unchanged from 2012	36	34	34	31	40	58	162	219
A3. Permanently lower GDP growth 1/	36	34	34	25	17	16	22	33
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	36	36	37	28	20	20	29	31
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	36	36	37	26	18	16	15	8
B3. Combination of B1-B2 using one half standard deviation shocks	36	35	35	26	18	17	22	20
B4. One-time 30 percent real depreciation in 2013	36	48	45	32	22	19	18	10
B5. 10 percent of GDP increase in other debt-creating flows in 2013	36	40	38	28	19	17	16	8
PV of Debt-to-Revenue Ratio 2/								
Baseline	90	106	116	90	42	33	34	26
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	90	102	111	124	153	214	498	800
A2. Primary balance is unchanged from 2012	90	107	121	117	105	138	424	900
A3. Permanently lower GDP growth 1/	90	107	118	93	45	38	59	135
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	90	110	127	104	53	48	76	127
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	90	111	129	100	47	37	39	31
B3. Combination of B1-B2 using one half standard deviation shocks	90	107	122	97	48	41	57	82
B4. One-time 30 percent real depreciation in 2013	90	150	159	122	57	45	47	40
B5. 10 percent of GDP increase in other debt-creating flows in 2013	90	125	135	105	49	39	41	34

Table 4. São Tomé and Príncipe: Sensitivity Analysis for Key Indicators of Public Debt, 2011–31 (concluded)

(Percent of Revenue)

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
Debt Service-to-Revenue Ratio 2/								
Baseline	3	5	6	5	2	2	3	3
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	3	5	6	6	4	5	14	41
A2. Primary balance is unchanged from 2012	3	5	6	5	2	3	12	45
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	3	5	6	6	2	2	4	7
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	3	5	6	5	2	2	3	3
B3. Combination of B1-B2 using one half standard deviation shocks	3	5	6	5	2	2	3	5
B4. One-time 30 percent real depreciation in 2013	3	6	8	7	3	3	4	5
B5. 10 percent of GDP increase in other debt-creating flows in 2013	3	5	6	6	2	2	3	3

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

Common Indicators Required for Surveillance

(As of June 15, 2012)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting	Frequency of publication
Exchange rates	May 2012	June 2012	D	D	D
International reserve assets and reserve liabilities of the monetary authorities [1]	April 2012	May 2012	D	D	D
Reserve/base money	April 2012	May2012	D	D	D
Broad money	March 2012	May 2012	M	M	M
Central bank balance sheet	April 2012	May 2012	M	M	M
Consolidated balance sheet of the banking system	April 2012	May 2012	M	M	M
Interest rates [2]	May 2012	May 2012	M	M	M
Consumer Price Index	May 2012	June 2012	M	M	M
Revenue, expenditure, balance and composition of financing [3] – general government [4]	March 2012	May 2012	Q	Q	Q
Revenue, expenditure, balance and composition of financing [3]– central government	March 2012	May 2012	Q	Q	Q
Stocks of central government and central government-guaranteed debt [5]	Dec. 2011	May 2012	Q	I	M
External current account balance	Dec. 2011	May 2012	A	I	A
Exports and imports of goods	March 2012	May 2012	M	M	A
GDP/GNP	2010	Aug 2011	A	I	A
Gross external debt	Dec. 2011	May 2012	Q	I	A

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

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FOR IMMEDIATE RELEASE
July 23, 2012

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves New US$ 3.9 Million Extended Credit Facility Arrangement for the Democratic Republic of São Tomé and Príncipe

On July 20, 2012, the Executive Board of the International Monetary Fund (IMF) approved a new three-year arrangement for the Democratic Republic of São Tomé and Príncipe under the Extended Credit Facility (ECF) in an amount equivalent to SDR 2.59 million (about US$ 3.9 million). The Board's decision will enable an immediate disbursement equivalent to SDR 0.37 million (about US$ 0.56 million).

The authorities' program is aimed at maintaining macroeconomic stability and accelerating structural reforms as the economy gears up for the start of oil production in 2015. The program, which builds on the government's new National Poverty Reduction Strategy Paper, includes a structural reform agenda to strengthen public finances and the frameworks for monetary policy, banking supervision, and anti-money laundering.

Following the Board's discussion of the Democratic Republic of São Tomé and Príncipe, Min Zhu, Deputy Managing Director and Acting Chair, issued the following statement:

"The authorities of São Tomé and Príncipe are to be commended for their prudent fiscal stance in support of the exchange rate peg, and for maintaining growth and reducing inflation against the backdrop of a challenging global environment.

"Building on these achievements, and anchored by the government's new National Poverty Reduction Strategy Paper, the ECF-supported program aims at maintaining macroeconomic stability and accelerating structural reforms as the economy gears up for the start of oil production in 2015. Well-targeted IMF technical assistance will support program implementation.

"The program envisages a cautious fiscal stance over the medium term, given continued head winds from the global economy and a high risk of debt distress due to São Tomé and Príncipe's narrow export base. In this connection, the program's domestic primary deficit targets are in line with available non-debt creating financing, while additional domestic revenue will be mobilized for priority infrastructure and pro-poor spending.

“The authorities’ structural reform agenda appropriately focuses on strengthening public finances as well as the frameworks for monetary policy, banking supervision, and anti-money laundering. As part of its fiscal reform strategy, the government will take steps to improve the tax and customs administrations and further strengthen public financial management and transparency. The central bank will continue to strengthen monetary management and banking supervision, including by ensuring the soundness of the financial sector’s legal and regulatory framework, and completing as planned the onsite inspection of all commercial banks. To address the deficiencies of the anti-money laundering framework, the authorities are fully committed to amend the anti-money laundering law and strengthen the operations of the ministry of finance’s financial intelligence unit,” M. Zhu added.

Annex

Recent economic developments

São Tomé and Príncipe's macroeconomic performance has been good despite a challenging international environment:

- Growth reached an estimated 5 percent in 2011.
- Supported by the exchange rate peg, inflation has continued to trend downward, reaching 8.6 percent (year-on-year) in May 2012 (from a peak of 37 percent in July 2008).
- The government has made further progress on fiscal consolidation. Efforts to contain non-priority spending and improve revenue collections contributed to a narrowing of the domestic primary deficit to about 3 percent of GDP in 2011.
- Gross international reserves in 2011 remained practically unchanged at about 4½ months of imports, and the external current account deficit improved slightly. The impact of rising international fuel prices on the trade balance was mitigated by a slowdown in import growth due the completion of some investment projects and a slowdown in credit growth.
- The central bank has continued to make progress on strengthening the financial sector. Banks' profitability and capital-to-risk weighted assets improved in 2011. However, the share of non-performing loans in total loans deteriorated in the first quarter of 2012 as a result of delays in payments to contractors for large-scale construction projects.

Program Summary

The government's medium-term economic program supported by the ECF is anchored by the new National Poverty Reduction Strategy Paper. It aims to raise economic growth and reduce poverty by maintaining macroeconomic stability and accelerating structural reforms.

The specific objectives of the government's program include:

- Raising the rate of non-oil GDP real growth to about 6 percent per year.
- Reducing inflation to low single digits and keeping it broadly in line with international inflation.
- Maintaining a gross international reserves cover of at least 3 months of imports in support of the exchange rate peg.

To help achieve these objectives, the program is based on four main pillars:

- Fiscal policy will target a domestic primary deficit of about 3 percent of GDP, which is in line with available non-debt creating financing.
- The structural reform program in the fiscal area will focus on mobilizing domestic revenue for priority infrastructure and pro-poor spending by improving tax and custom administration, and on strengthening public financial management and transparency.
- The central bank will continue to strengthen monetary management and maintain financial stability by improving liquidity forecasting and banking supervision.
- The anti-money laundering framework will be improved by strengthening its legal basis and the operations of the Ministry of Finance's Financial Intelligence Unit.

Statement by Ngueto Tiraina Yambaye, Alternate Executive Director for the Democratic Republic of São Tomé and Príncipe
July 20, 2012

Our São Toméan authorities are grateful to Fund Staff for the fruitful discussions held in São Tomé in May 2012. They greatly appreciate the valuable technical and financial assistance, as well as the policy advice they have received in the context of IMF-supported programs. In order to consolidate the progress achieved over the years towards stronger economic growth and macroeconomic stability, they are requesting a new arrangement under the Extended Credit Facility (ECF) to help them shape their policies to support growth and reduce inflation and poverty. The new ECF-supported program is expected to build on recent experience, as highlighted in the Ex-post assessment of longer term program engagement (EPA) in São Tomé and Príncipe. It is designed around the objectives of reducing poverty, promoting good governance, and achieving sustainable and inclusive growth as set forth in the country's new poverty reduction strategy.

1. Economic Developments and Performance under the recent ECF Arrangement

The economy of São Tomé and Príncipe continues to recover from the impact of an unfavorable global environment. Growth accelerated from 4½ percent in 2010 to 5 percent last year, driven by the growing construction activities and an increase in foreign direct investment and other private capital inflows.

The exchange rate peg to the euro as well as declining international food prices contributed to a declining trend in inflation from an annual average peak of 32 percent in 2008 to 14 percent in 2011. As of April 2012, year-on-year inflation is estimated at 8 percent notably as a result of stable fuel and energy prices.

My authorities persevered in fiscal prudence and continued to make substantial progress as regards fiscal consolidation. The domestic primary deficit improved from 8 percent of GDP in 2009 to 4.1 percent in 2010 and 3 percent in 2011, reflecting the authorities' efforts to contain non-priority spending and improve tax collections.

In the monetary sector, after accelerating to 25 percent in 2010, growth in broad money declined to 8 percent in 2011, as a result of the deceleration in private sector credit**.** The authorities continued to take measures to ensure the soundness of the financial sector as illustrated by the requirement for unprofitable banks to raise capital, and for all banks to raise their capital-to-risk ratio above 10 percent. In spite of an increase in non-performing loans, most banks were profitable in 2011.

The external current account deficit improved in 2011 when some investment projects reached their completion stage. This contributed to a slowdown in import growth and partly softened the impact of rising international fuel prices on the trade balance. However, the current account deficit was financed only partially by private sector capital flows, leading to a decrease in net international reserves.

Performance under the recently expired ECF-supported program (2009-2012) has been affected by significant capacity constraints and by the impacts of the global economic crisis. Nevertheless, my authorities consider that significant progress has been made in implementing structural reforms. The government has finalized its new National Poverty Reduction Strategy Paper (NPRSP) which, after broad-based consultations, will be approved by the Cabinet by end-July 2012 and discussed by the National Assembly thereafter. In the financial sector, the credit reference bureau has become operational, providing banks with information necessary to analyze and evaluate the creditworthiness of their customers. The authorities have also approved a new investment code providing equal treatment for domestic and foreign investors, as well as measures to substantially reduce administrative hurdles and the cost of starting a business.

2. Medium term Policy and Reform Agenda

The proposed new ECF-supported program is derived from the priorities of the new NPRSP and the recommendations of the recent EPA. It aims at achieving fiscal, monetary and financial stability, as well as sustainable economic growth and poverty reduction. More specifically, the program is directed at (i) raising annual non-oil real GDP growth to 6 percent over the medium term, (ii) reducing inflation to single digits and to the level of international inflation, and (iii) maintaining a gross international reserve cover of at least 3 months of imports in support of the exchange rate peg.

Fiscal policy

The strategy adopted by my São Toméan authorities remains prudent, and focus on mobilizing domestic revenue to create additional fiscal space for infrastructure and pro-poor spending, while keeping the domestic primary deficit in line with non-debt creating financing. For 2012, the authorities are targeting a domestic primary deficit of 3¼ percent of GDP, consistent with the approved budget and available non-debt creating financing. For 2013 and 2014, the government aims to attain a domestic primary deficit of 3.1 and 3.0 percent of GDP respectively.

To achieve these targets, the authorities will continue to mobilize additional domestic revenue and contain non-priority domestic primary spending. Among the measures envisaged, the government intends to gradually increase the domestic price of fuel products by the end of 2012. This is expected to enable the importing oil company (ENCO) to clear its fuel tax arrears and pay fuel taxes on time. This will also help to resolve the issue of cross-arrears when the government, ENCO, and the electricity and water company (EMAE) reconcile and certify the stock of unpaid bills and unpaid fuel taxes as intended by the authorities.

My authorities also aim to control spending by containing outlays on goods and services and enforcing a strict budget constraint on local and regional governments to avoid budget overruns or a buildup in arrears. They intend to continue protecting priority spending by increasing treasury financed pro-poor and development projects and by relying on available non-debt creating financing from donors as well as drawings from the national oil account (NOA).

On the revenue side, the authorities will pursue their efforts to strengthen public finances and plan to further modernize the customs and tax administrations, and improve public financial management. Regarding the tax administration, a strategy plan is being developed with technical assistance from development partners, to better integrate its essential functions, further modernizing the tax legislation and rationalizing tax exemptions. The plan will also focus on strengthening fiscal operations and increasing revenue, promote the effective use of taxpayer segmentation in the functioning of the tax administration, and improve the education of taxpayers and the working conditions of the tax Directorate. In addition, the government will continue to improve the public finance legislation and upgrade the legal framework for fiscal responsibility to the level of international standards. Regarding customs administration, further modernization measures will be carried by the authorities by end-2012 along the recommendations of the IMF technical assistance mission which is expected later this year.

Monetary and financial sector policies

The agenda of the authorities in the monetary and financial sector aims at achieving three main goals: strengthening monetary management, maintaining financial stability, and improving the credibility of the financial system. Strengthening monetary management will require greater cooperation between the central bank and the finance ministry. In this regard, the two institutions signed a memorandum of understanding in May 2012 to facilitate the flow of information between them. Also, the Central Bank will improve liquidity management by developing a liquidity forecasting model and an accompanying reference manual to guide domestic liquidity management, with technical assistance from the IMF.

Likewise, my authorities continue to give high importance to the effective supervision of the banking sector. The central bank conducted on-site inspections of two commercial banks in 2011, and five more banks are to be inspected during the period 2012-13. The Central Bank also envisages the introduction in 2013 of the new chart of accounts in line with international financial reporting standards, and is determined to have a sound legal and regulatory framework in place by 2014 to deal with problem banks.

Structural reforms

My authorities are aware that São Tomé and Príncipe is vulnerable to external debt distress despite substantial debt relief under the HIPC initiative and the MDRI. The authorities are committed to improve debt management and have assigned to the finance ministry's External Debt Department a strategic role in this area. An important step in improving the framework for debt management was the approval by the National Assembly in April 2012 of the general principles of a new debt management law which establishes the responsibility and governance structure of the External Debt Department.

The government is also committed to addressing the deficiencies of the AML/CFT framework. It is expected that the National Assembly will approve by end-2012 the necessary amendments to the AML/CFT Law which are being prepared by the authorities with technical assistance from the IMF.

Regarding the business climate, my authorities are determined to consolidate the recent progress made in this area, as indicated in the World Bank's 2012 Doing Business Survey which ranked the country among the top reformers in 2011. In this vein, the authorities will continue to simplify the regulatory framework and strengthen institutional capacity to promote investment and alleviate the infrastructure deficit in a number of sectors identified in the NPRSP. The authorities have started implementing a number of sectoral strategies in support of economic diversification, notably in the tourism sector, and in the energy sector where their efforts will aim at making the water and electricity company (EMAE) commercially viable.

3. Conclusion

My São Toméan authorities are committed to pursuing sound macroeconomic policies conducive to sustained growth, reduced inflation and poverty, and increased resilience to external shocks. My authorities believe that a new ECF-supported program is essential to help them achieve these objectives. With well-targeted technical assistance, they are determined to implement an ambitious but realistic structural reform agenda to strengthen public finances and the frameworks for monetary and financial policies. As noted in the recent EPA report, a new program would also provide an important signaling effect for donors, and help catalyze international assistance to the country. It is in this light that my São Toméan authorities are seeking Fund support and I would appreciate Directors' favorable consideration of their request for a new three-year ECF arrangement.