September 2005
IMF Country Report No. 05/320

Cape Verde: 2005 Article IV Consultation, Sixth Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criterion—Staff Report; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Cape Verde

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2005 Article IV consultation with Cape Verde, sixth review under the Poverty Reduction and Growth Facility and request for waiver of a performance criterion, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, Sixth Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criterion, prepared by a staff team of the IMF, following discussions that ended on March 23, 2005, with the officials of Cape Verde on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 11, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) and Press Release summarizing the views of the Executive Board as expressed during its May 25, 2005 discussion of the staff report that concluded the Article IV consultation and the IMF arrangement, respectively.

- a statement by the Executive Director for Cape Verde.

The document listed below has been or will be separately released.

Selected Issues Paper and Statistical Appendix

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

CAPE VERDE

Staff Report for the 2005 Article IV Consultation, Sixth Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criterion

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

Approved by David Nellor and Mark Plant

May 11, 2005

- **The 2005 Article IV Consultations and Sixth Review under the PRGF arrangement were held in Praia on March 8–23, 2005.** Staff representatives were Mr. MacFarlan (head), Ms. Loukoianova, Ms. Karpowicz, Mr. Segura, and Ms. Carvalho (all AFR). The mission met with Prime Minister José Maria Neves, Minister of Finance and Planning João Serra, Bank of Cape Verde Governor Carlos Augusto de Burgo, officials, parliamentarians, representatives of the business and diplomatic communities, and trade unions.
- In concluding the last Article IV consultations on December 6, 2002, Directors commended the authorities for stabilizing the macroeconomic policy framework. They noted in particular the substantial reduction of the fiscal deficit, increase in international reserves, and maintenance of exchange rate stability and low inflation. In addition to ensuring ongoing macroeconomic stability, Directors encouraged the authorities to implement structural reforms that would help diversify the economy, remove barriers to economic growth, and enhance the competitiveness of exports.
- **Economic and policy performance over recent years has remained strong.** In 2004, the fiscal deficit was smaller than expected and all end-year quantitative performance criteria, including the accumulation of international reserves, were met with a substantial margin.
- Upon completion of the sixth review, the final disbursement of SDR 1.26 million from the PRGF arrangement would become available. Directors approved this arrangement on April 10, 2002, in the amount of SDR 8.64 million (90 percent of quota). The fifth review was completed on January 31, 2005, at which time the arrangement was extended to July 31, 2005.

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Cape Verde: Basic Data

Social and demographic indicators	
Area	4,033 sq. km.
Population (2003)	470,000
Rate of population growth (2003)	2.6 percent
Life expectancy at birth (2003)	69.1 years
Male	66.3 years
Female	72.0 years
Mortality rate of children under five years of age (2003)	38 per thousand
Net primary school enrollment (2001)	99.4

Source: World Bank: World Development Indicators.

EXECUTIVE SUMMARY

- **Cape Verde's economic and policy performance has been strong during the current PRGF arrangement,** helping the country correct the macroeconomic imbalances that followed the 2000 elections. Growth appears robust, inflation is low, the exchange rate peg—backed by a substantial level of international reserves—is credible, and the public debt burden has declined.

- **Macroeconomic developments remained sound in 2004.** The fiscal deficit was lower than expected, and reserve accumulation exceeded the programmed level. All end-year quantitative performance criteria under the PRGF-supported program were met with a substantial margin, and most structural objectives were also met. A structural performance criterion on finalizing a mechanism for adjusting electricity and water tariffs was missed, however. The staff supports the authorities' request for a waiver for nonobservance of this criterion, in view of the corrective actions taken to prepare the mechanism.

- **The economic outlook for 2005 and beyond is promising.** With continued sound macroeconomic policies and further structural reforms, the growth rates of 6 to 7 percent envisaged in the recently-completed PRSP appear achievable. Driving this outlook is increasing private investment in the tourism sector and public investment in infrastructure. Noting, however, the vulnerabilities posed by the country's narrow export base, capacity constraints, and exogenous shocks, the staff emphasized the need for ongoing macroeconomic stability and reforms to support diversification of the economy. Settling the long-standing dispute with Electra, the electricity and water company, remains a priority to reduce fiscal risks and meet growing energy demands.

- Cape Verde appears well-positioned to attract increasing external support, and there is also scope to mobilize greater domestic resources. In this regard, improvements in tax administration and rationalization of exemptions would enhance improvements to the revenue base that have come about with the new VAT. Strengthening the prioritization of spending, including through a medium-term expenditure framework, would allow the authorities to address PRSP priorities while restraining overall recurrent spending.

- **The staff agreed with the authorities that the exchange rate peg has served the country well**, and that price stability and accumulation of international reserves should remain the primary objectives of monetary policy. To support stability in and development of the relatively shallow financial sector, the staff supported the authorities' plans to strengthen bank supervision and introduce new indirect monetary policy instruments to improve liquidity management.

- The staff shares the authorities' assessment that results under the PRGF-supported program have been substantially better than initially expected. The government has requested that negotiations begin shortly on a new program under the PRGF; this would be a low-access arrangement.

I. Recent Economic Developments

1. **Cape Verde faced severe macroeconomic imbalances in the wake of the 2000 parliamentary elections.** The fiscal deficit including grants reached 20 percent of GDP in 2000 (and 27 percent of GDP excluding grants); the government had accumulated external and domestic arrears; international capital flows, including donor support, fell sharply; and international reserves declined to about one month of import coverage. While the exchange rate peg to the euro was maintained, despite this loss of reserves, the sustainability of the peg and of economic performance more generally was at risk.

2. **After an initially inadequate response, macroeconomic policies have improved significantly from 2001 to the present.** In particular, the marked strengthening of the fiscal position over this period has supported a buildup in international reserves together with reductions in external and domestic debt as a share of GDP. Since 2002, the current PRGF arrangement has added further support to the authorities' efforts to pursue disciplined economic policies. In particular, program ownership and policymaking capacity have strengthened, as reflected in the timely and satisfactory completion of all program reviews so far. The lynchpin of the economic strategy under the PRGF arrangement has been the recognition that disorder of public finances and debt overhang fundamentally constrained policies and required a multiyear fiscal consolidation.[1] This has been achieved principally by strengthening tax collection, including through the introduction of the VAT in 2004, and streamlining the externally financed public investment program (PIP). Monetary policy has focused on strengthening the sustainability of the exchange rate peg by building reserves and ensuring that inflation remained low, hence helping to foster an environment conducive to increased private investment, inflows of remittances, and accumulation of emigrant deposits.

3. **In key areas, economic outcomes have been better than envisaged when the PRGF-supported program began**. The discussion in subsequent sections covers the period from 2002 to 2004, with particular attention given to the most recent developments as part of this final review of the PRGF arrangement. In this regard, program performance remained strong in 2004: all end-year quantitative performance criteria were met with a substantial margin, as were most structural objectives (see Tables 9 and 10).

A. Growth and Inflation

4. **Real GDP has grown at a robust pace over recent years (see Table A), supported by strong public and private investment.** Reflecting this development and Cape Verde's overall move toward middle income status, economic activity is dominated by secondary and tertiary activities. For example, the GDP shares of such sectors as energy, construction, commerce, and transport and communication have grown substantially since 2002. The primary sector, in contrast, accounts for only around 8 percent of GDP, although a much higher share of employment. Growth of GDP per capita in Cape Verde, around 3 percent on average over 1999–2002, is among the highest in the group of small island economies in Africa, the Pacific, and the Caribbean shown in Table B. As discussed in the recently

[1] See, for example, IMF Staff Report (IMF Country Report No. 03/152).

released PRSP, this growth has supported poverty reduction and improvements in other human development indicators. In this regard, Cape Verde's development indicators are generally comparable to and, in some cases, better than those of the other economies shown in Table B, and substantially stronger than the average for sub-Saharan Africa.

Table A. Cape Verde: Selected Economic Indicators, 2000–04

(Annual percentage change unless indicated otherwise)

	2000	2001	2002	2003	2004
Real GDP growth	7.3	6.1	5.5	6.2	4.5
Inflation (p. a.)	-2.4	3.8	1.8	1.2	-1.9
Real effective exchange rate	-7.4	0.2	2.6	3.6	-2.9
Broad money growth	12.9	9.8	14.3	8.6	10.5
Overall fiscal balance incl. grants (percent of GDP)	-19.5	-4.7	-2.6	-3.5	-1.5
Government revenue (percent of GDP)	20.5	21.4	22.8	21.9	22.9
Current account balance (including grants)	-11.2	-10.1	-11.4	-9.4	-6.2
External debt (millions of U.S. dollars)	324.1	352.1	390.5	475.7	501.1
Debt service ratio (percent of exports)	10.8	29.2	15.6	10.6	10.7
Gross official reserves (euro millions)	30.4	47.5	76.1	74.1	102.4
Gross official reserves (months of imports)	1.0	1.5	2.0	1.9	2.6
Exchange rate (CV escudo/U.S. dollar)	119.7	123.2	117.2	97.7	88.8

Sources: Cape Verde authorities; and staff estimates.

5. **In 2004, growth remained strong at an estimated 4.5 percent, although this was somewhat slower than in previous years.** Activity was supported by the continuing strength of the construction sector, including private investment in tourism facilities and public investment in infrastructure. Agricultural production, however, was adversely affected by lower than average precipitation and a locust infestation in some areas. In addition, the implementation of public investment projects was somewhat lower than expected, a result in part of changes in budget administration (see below).

Table B. Human Development Indicators for Cape Verde and Comparator Countries, 1999-2002

	HDI Rank 1/	GDP per capita PPP US$, 2002	Real GDP per capita annual growth, avg. 1999-2002	Life expectancy at birth (years), 2002	Adult literacy rate, 2002 2/	School enrollment ratio, 2001/02 3/
Cape Verde	105	5000	3.5	70	75.7	73
Caribbean average 4/	73	7837	0.9	71	89	74
Comoros	136	1690	1.4	60.6	56.2	45
Madagascar	150	740	0.9	53.4	67.3	45
Maldives	84	4798	3.6	67.2	97.2	78
Mauritius	64	10810	4.1	71.9	84.3	69
São Tomé & Príncipe	123	1317	1.1	69.7	83.1	62
Seychelles	35	18232	0.9	72.7	91.9	85
Vanuatu	129	2890	-2.5	68.6	34	59
Sub-Saharan Africa, avg.	...	1790	...	46.3	63.2	44

Sources: UN Human Development Report, 2004; and IMF.

1/ Rank out of 177 countries
2/ Percent ages 15 and above.
3/ Combined gross enrollment ratio for primary, secondary, and tertiary schools (percent).
4/ Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and Grenadines.

6. **Consumer inflation has been consistently below 2 percent a year since 2002, underpinned by the firm monetary policy and the exchange rate peg to the euro.** Prices fell 1.9 percent in the year to December 2004, with lower food, beverage, and clothing prices helping to offset the impact of higher prices of oil imports. A key reason for the deflation in 2004 appears to have been the reductions in customs tariffs at the beginning of the year, which have allowed importers to draw on cheaper and more diversified sources of supplies. However, the current consumer price index (CPI), which uses a 1989 basket, may not provide a fully accurate representation of actual inflation. This problem should be rectified later this year with the expected release of the new CPI methodology, including an updated basket. Current indications are that, while the revised methodology would not lead to a major change in overall inflation trends, the extent of deflation in 2004 could be somewhat reduced because of the lower weight on food (whose prices have been falling) in the new basket.

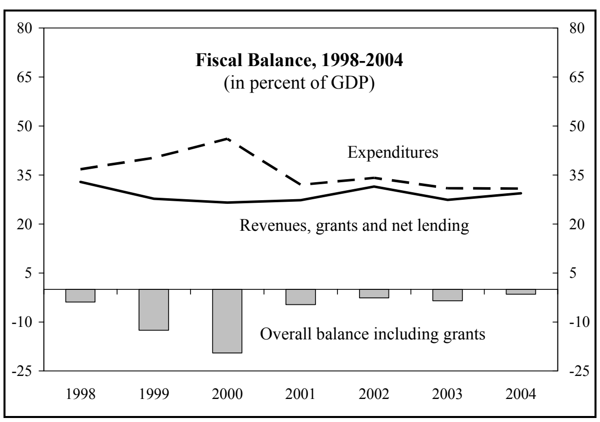
B. Fiscal Policy

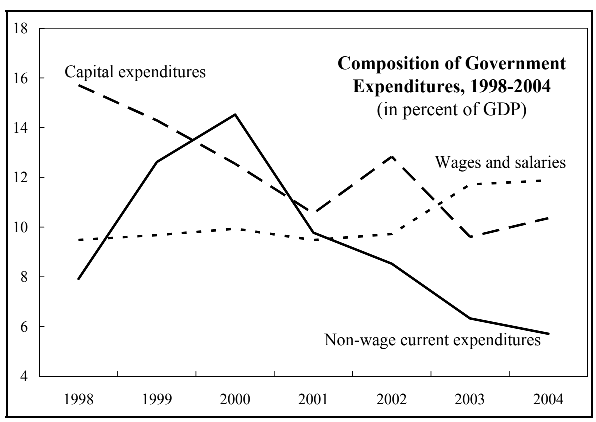
7. **Substantial fiscal consolidation has been achieved over recent years.** From a fiscal deficit (including grants) of 20 percent of GDP in 2000, the deficit was reduced to under 5 percent of GDP in 2001 and has averaged 2.5 percent of GDP over 2002–04. Progress in strengthening fiscal institutions has supported this consolidation effort, with the multiyear fiscal framework of the program under the PRGF arrangement helping to improve tax administration and expenditure planning. Tax revenue performance has improved significantly over this period, rising by over 2 percent of GDP since 2000 and backed by

comprehensive tax reform.[2] The new VAT was successfully implemented in January 2004, replacing a multiplicity of specific consumption taxes and thereby leading to a more efficient and broader-based tax regime. Recent reforms have also streamlined and rationalized taxes on imports, accompanied by a general reduction of customs duties and excises.

8. **Public expenditure policy has concentrated on containing total expenditures as a share of GDP, along with improving the composition of spending.** A key development has been the substantial reduction in transfers and subsidies since 2001 (see the text figure), notably subsidies to large public enterprises. This trend has allowed more resources to be committed to education, health, and other priority areas identified in the government's poverty reduction strategy, as indicated by the rise in the public sector wage bill. Public capital spending has been sustained at around 10 to 12 percent of GDP over recent years, largely reflecting the availability of and drawings from foreign financing.

9. **In 2004, the fiscal deficit including grants fell to 1.5 percent of GDP, much smaller than had been projected.** There were two main reasons for the fall of expenditures as a share of GDP. The wage bill grew less than expected, mainly because of difficulties in hiring teachers in rural areas. The execution rate of public investment was also lower than anticipated, in part due to teething problems in the application of new administrative procedures to support the move of some donor assistance from project to budget support. In addition, public sector wages were firmly contained, as were expenditures on goods and services. As reflected in variations in the stock of arrears, the government has made progress, first, in acknowledging domestic arrears incurred in earlier years, and then in clearing these arrears. It also made a lump sum payment to Electra to cover outstanding obligations arising from public sector consumption of electricity and water.





10. **The 2005 budget maintains a prudent fiscal stance, with the primary recurrent surplus expected to reach 3.7 percent of GDP.** Domestic revenues (including domestic capital participation and net lending) are expected to stabilize at about 21.7 percent of GDP, with growth of VAT revenues reflecting efficiency gains in administration. Processing of

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[2] Technical assistance from the IMF and World Bank has supported these recent tax reforms. A mission from the Fiscal Affairs Department in November 2004 has provided advice to the authorities on priorities for consolidating fiscal reforms and modernizing tax administration.

VAT refunds is running behind schedule, however, mainly because of weaknesses in administration and control systems. The staff has taken a cautious approach in its revenue projections for 2005, partly due to uncertainties about how quickly revenues from the new VAT will grow. The projections also allow for the fact that some other consumption tax revenues collected in 2004 will not recur.[3] Recurrent spending, notably the wage bill, continues to be restrained, although the budget provides for a small increase in transfers to those whose employment and incomes may be affected by the restructuring of public enterprises. With total expenditures projected to remain stable at the 2004 level, the fiscal deficit (including grants) would be around 2.8 percent of GDP. All external financing would be on concessional terms and recourse to domestic bank financing would be limited, in support of the monetary program targets and the accumulation of reserves.[4] Furthermore, the budget incorporates the clearance of arrears to oil companies and to the social security fund.

C. Monetary and External Developments

11. **Monetary policy has remained consistent with sustained low inflation and the accumulation of international reserves throughout the PRGF arrangement.** Broad money and credit to the economy grew by around 11 to 12 percent on average over 2002–04, supporting the overall increase in economic activity. Responding to the strong balance of payments position and low inflation rate, the Bank of Cape Verde (BCV) lowered the required reserve ratio from 19 to 18 percent in December 2004, and reduced the standing lending facility rate from 8.5 to 7.5 percent in February 2005. Following these developments, and facing high levels of excess liquidity, commercial banks have reduced lending rates by 1 percent. Banks have also pushed ahead with efforts to differentiate lending rates across clients to better reflect credit risks.

12. **The external current account deficit has narrowed substantially over recent years, falling from over 11 percent of GDP in 2002 to about 6 percent of GDP in 2004.** While the latter outturn partly reflects the mild slowdown in growth in 2004, other factors—including improving revenues from tourism, sustained remittance flows, and the more diversified import sources noted earlier—have also supported the favorable external performance of the economy. International reserve accumulation of the BCV exceeded the program floor in 2004, with gross official reserves standing at Euro 102 million (2.6 months of imports) at the end of the year. The appreciation of the euro (and hence Cape Verde escudo) against the dollar does not appear to have damaged Cape Verde's external competitiveness, reflecting the country's relatively strong links to Europe with respect to trade, tourism, and remittance flows. The real effective exchange rate has been depreciating since early 2003, mainly on account of low domestic inflation.[5] As discussed below,

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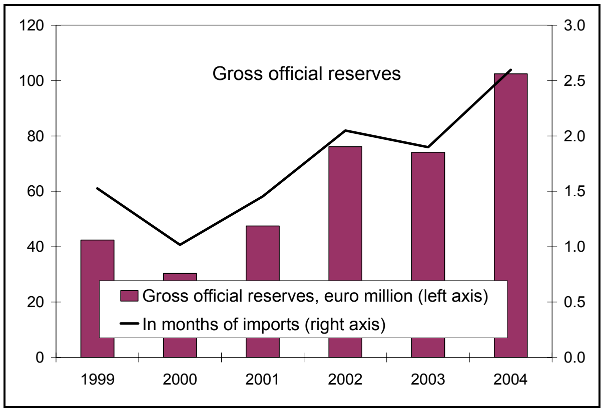
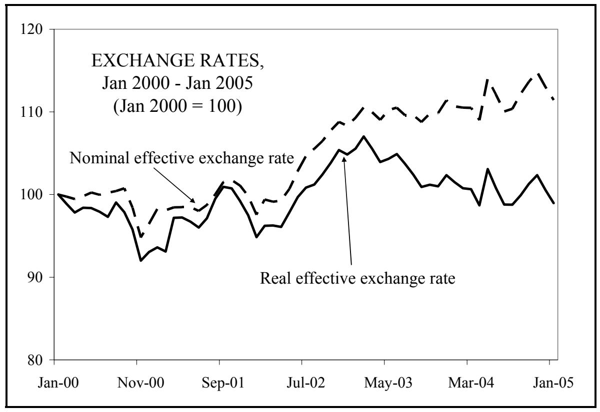
[3] The VAT replaced other taxes on goods and services; however, some revenues from the latter were still collected in 2004.

[4] The government expects to receive US$30 million in grants and loans as budget support, of which US$8 million will be used for project financing.

[5] The anticipated CPI revisions noted earlier may change the degree of real exchange rate depreciation over recent years, but the downward trend is expected to be maintained.

however, Cape Verde's narrow export base continues to be a key source of vulnerability and, in their discussions with the authorities, the staff emphasized the need for further structural reforms to improve competitiveness and hence support export diversification.





D. Financial Sector Developments

13. **The highly concentrated banking sector continues to dominate financial intermediation.** Although there are four commercial banks, the two largest banks shared 89 percent of total assets and total deposits at end-2004, with the larger of these two (Banco Comercial de Atlântico) having a share of over 65 percent of assets and deposits. One of the small commercial banks (Banco Totta de Cabo Verde), which has had a high share of nonperforming loans in total loans and a negative return on equity for a number of years, has recently been acquired by a group of private domestic investors, becoming the first domestically owned private bank.

14. **While financial markets remain shallow, financial soundness indicators suggest that the banking system is strengthening.** As discussed in the accompanying Selected Issues Paper on the Cape Verde financial system, these improvements have been supported by stronger banking regulation and supervision, and by the stable macroeconomic environment. In aggregate, banks are highly profitable and liquid, with the ratio of nonperforming loans to total loans (7.2 percent at end-2004) gradually decreasing. Commercial banks fully comply with prudential regulations. However, potential concerns of the BCV include the high concentration of credit, the duopolistic behavior of the two largest banks in setting interest rates, and weak risk assessment capacity in the commercial banking sector. As discussed below, the authorities have emphasized the need to develop alternative sources of financing, including through leasing companies, and are considering policy measures that could support such development.[6]

[6] There is currently only one registered leasing company, which is not yet operating.

Table C. Cape Verde: Financial Soundness Indicators, 2001–04

	2001	2002	2003	2004 1/
Regulatory capital to risk-weighted assets	16.0	15.0	13.8	13.3
Regulatory Tier I capital to risk weighted assets	17.8	16.5	15.2	14.6
Nonperforming loans to total gross loans	9.3	7.4	7.4	7.2
Nonperforming loans net of provisioning to capital	-8.2	-7.9	-3.6	1.9
Returns on assets (ROA), percent	1.0	1.1	1.1	0.9
Returns on equity (ROE), percent	15.5	18.7	19.8	16.7
Interest margin to gross income	66.5	66.7	68.5	66.0
Noninterest expenses to gross income	63.2	67.6	66.6	65.6
Liquid assets to total assets	93.2	93.9	93.9	94.1
Liquid assets to short-term liabilities	112.9	112.1	111.7	111.4

Source: Bank of Cape Verde.
1/ Provisional data.

E. Structural Developments

15. **Important progress has been made with structural reforms in the course of the PRGF arrangement** (see Box 1). In addition to measures to strengthen the implementation of fiscal and monetary policies, a major focus of structural reform has been to regularize the public sector's relationship with large state-owned and/or public service enterprises. Key steps have included:

- Eliminating direct budget subsidies to TACV (the national airline) and Electra.
- Preparing the remaining enterprises on the government's privatization agenda for sale, for tender under concession contracts, or for liquidation (see Box 2). While there have been delays in some areas, this program is moving ahead and is expected to be largely completed over 2005–06.
- Implementation of an automatic mechanism to adjust fuel prices in response to changes in import prices of oil products, and development of a price adjustment mechanism for electricity and water. The former is now operational, but an end-December 2004 performance criterion for published the latter mechanism was missed. The authorities have requested a waiver for noncompliance with this performance criterion (see Appendix II), which the staff supports. In their request, the authorities note that the process of developing the mechanism is well advanced: the underlying economic and financial model of Electra is now completed, and a consultant is to translate this model into the desired price adjustment mechanism. The economic regulatory agency expects to publish the mechanism by end-June, 2005.

16. **The long-standing difficulties between the government and Electra still appear some way from settlement, however.**[7] In particular, Electra's private shareholders and the government still need to reach agreement on the amount of the so-called "tariff deficit" to the company, which stems from the nonadjustment of electricity and water tariffs during

[7] For details of this dispute, see Box 1 of the Staff Report for the Fifth Review of the PRGF Arrangement (IMF Country Report No. 05/46).

2000–02. An encouraging step toward settlement is a recent agreement, reached with World Bank support, to appoint an independent mediator to help resolve the wide differences between the parties concerned. Resolving this dispute is vital to reduce fiscal risks arising in this area, to support Electra's recapitalization, and to enable the company to expand its electricity and water capacities to meet growth of demand. Urgent action is required, as electricity blackouts and water cutoffs are increasing in areas where supply capacities have not kept pace with the growth of demand. A further concern is that some municipalities are running significant arrears to Electra, a problem compounded by the fact that most municipalities, while autonomous, do not appear to have budget resources to meet their growing consumption. Also important is the implementation of the price adjustment mechanism for electricity and water noted above, which would help prevent a recurrence of the current difficulties and put Electra on a more sustainable financial footing.

Box 1. Overview of Structural Conditionality Under the PRGF

Structural conditionality set out when the PRGF arrangement was requested in March 2002 aimed at deepening fiscal consolidation, strengthening monetary policy, improving the efficiency of the tax and tariff structures, building external debt-management capacities, and implementing a pricing mechanism for oil products.

During the course of the arrangement, additional conditionality was introduced—mainly aimed at improving the efficiency of the fiscal structure and the regulation of public services. It included (i) setting up the regulatory framework and creation of associated agencies; (ii) eliminating budgetary subsidies to the national airline (TACV) and water and electricity company (Electra); (iii) approving an automatic and transparent mechanism for adjusting electricity and water tariffs; (iv) calculating the government's liabilities to Electra; (v) assessing the cost of tax exemptions and incentives, with some reduction in these included in the 2005 budget; and (vi) strengthening VAT collection.

Compliance with structural conditionality has been commendable, with only two waivers requested throughout the arrangement. The first covered the pricing mechanism for oil products, which was successfully introduced after the first review with only a few months delay. The second waiver, requested in this review, involves the approval of an automatic and transparent pricing mechanism for electricity and water. As the arrangement comes to an end, only two structural benchmarks are yet to be concluded: the introduction of new rules for tax collections through commercial banks, which is significantly advanced; and the conclusion of an assessment of the government's financial liabilities to Electra. As noted in the main text, this issue is still some way from resolution although, with the support of the World Bank, progress is expected through the appointment of an independent mediator.

Structural Areas covered by World Bank lending and conditionality

Other structural areas, notably including the privatization agenda and the completion of a public expenditure review, have been mostly pursued as part of World Bank lending facilities operating under successive Country Assistance Strategies (CAS). Assistance was also provided in such areas as macroeconomic management and debt reduction, private sector development, human resource development, and poverty reduction. Most projects have been rated satisfactory or better; during 2004, however, projects in the areas of Privatization and Regulatory Capacity Building, Energy and Water, and Social Sector Development were rated unsatisfactory. Except for the Energy and Water Project, which was extended for two additional years, the other areas demonstrated significant turnaround through the end of 2004, and were expected to finally meet their goals. The current CAS, approved in February 2005, is aligned with the PRSP and is based on three pillars: ensuring macroeconomic stability, supporting private-sector-led growth, and alleviating poverty.

Box 2. The Privatization Agenda

A cornerstone of the authorities' economic strategy to support private-sector-led growth and diversification has been to improve efficiency in the provision of key services. This goal has helped motivate the privatization program, which has seen large numbers of state-owned enterprises either liquidated or sold since the early 1990s—driving the number down from approximately 40 to just 6 by end-2004 (plus minority shareholdings in a few other enterprises). Results have not always been as successful as had been hoped, largely due to inadequate regulatory frameworks at the time of privatization. With a gradual strengthening of the regulatory environment now under way, however, the government is pushing forward with the remaining agenda. This covers the following companies.

- **Arca Verde,** the interisland maritime transport company, is in the process of being liquidated, with final decisions regarding disposal of remaining vessels, including sales and leases, expected within 2005.
- **TACV**, the freight and passenger air service, is to be restructured and then privatized. This process is behind schedule, however. The appointment of new management charged with restructuring the company has been held up due to procurement issues raised by the World Bank in the awarding of the management contract. Solving this problem could take up to a year, with privatization to take place afterwards.
- **CABNAVE,** the shipyard is technically bankrupt. Options are being explored to avoid liquidation.
- **Interbase,** the fishing storage company, is expected to be transferred to a consortium of Spanish and Cape Verdean interests during the first semester of the year. The contract would include investment undertakings to meet health standards for exporting to the European Union.
- **ENAPOR,** the port authority, would see concession contracts covering operations of port facilities transferred to the private sector. A technical study on privatization options is almost finished, and the privatization process is expected to be concluded by early 2006.
- **EMPROFAC**, in charge of imports and distribution of pharmaceuticals, has already started the privatization process. The government will decide on the privatization strategy when a technical report on transfer options is completed, and the process is expected to conclude within 2005.

II. Report on the Discussions

17. **In addition to assessing recent economic developments as part of the final review of the PRGF arrangement, the staff held discussions with the authorities on a range of economic and policy issues in the context of the Article IV consultations.** The focus was on medium-term economic prospects, including potential vulnerabilities surrounding the outlook, and the accompanying stance of fiscal, monetary, external, and structural policies to reduce risks and support ongoing growth and development. Attention was also given to the authorities' views on the overall results of the PRGF arrangement which is about to end, including lessons that could be applied to a successor arrangement. Finally, the staff assessed the quality of statistics and prospects for improvements in this area.

A. Economic Outlook

18. **The staff shares the authorities' view that the medium-term outlook for Cape Verde is promising and that GDP growth of 6 to 7 percent over 2005–08, as envisaged in the PRSP, appears achievable.** Underpinning this baseline scenario would be continued pursuit of sound macroeconomic policies—directed in particular at expenditure restraint, debt reduction, and exchange rate stability—and ongoing implementation of structural reforms. Growth is projected to be led by private investment in the tourism sector and, in support of this development, public investment in infrastructure. While the former would increase the capacity of the country to absorb the expected increase in tourist numbers, the latter would allow for improved and cheaper communications by land, sea, and air. In addition to supporting tourism growth, this public investment would also facilitate the diversification of the economy and development of other export-oriented activities. For example, the anticipated improvements in international air links and expansion of port capacities, combined with the strategic geographic location of the islands, point to the potential for Cape Verde to increase its service exports in the shipping and airline sectors.

Table D. Cape Verde: Key Projections, 2005–08

	2005	2006	2007	2008
Real GDP (percent change)	6.0	7.0	6.5	6.5
Inflation (p.a.)	0.8	2.0	2.0	2.0
Current account balance (percent of GDP) 1/	-14.2	-13.8	-13.4	-13.2
Central gov't fiscal balance (percent of GDP) 2/	-2.8	-3.0	-3.3	-3.6
Broad money growth (percent, eop)	8.7	9.3	9.5	9.2
Investment ratio	23.3	24.2	25.0	25.8
Saving ratio	14.9	15.8	16.8	17.6

Sources: Cape Verde authorities; and staff estimates.
1/ Excluding official transfers.
2/ Including grants.

19. **Supporting this favorable outlook for growth, Cape Verde's relatively strong policy record and high institutional quality have enabled it to continue attracting**

substantial inflows of private investment and official grants and loans. Significant support, starting in 2005, is expected from the Millennium Challenge Account, and commitments from other bilateral donors, including the European Union and Portugal, have also increased. As discussed in one of the Selected Issues papers, inflows of remittances and deposits from the Cape Verde diaspora also appear robust.

20. **Notwithstanding this bright outlook, Cape Verde faces a number of challenges in the way of sustaining a strong pace of economic growth over the longer term.** As a small island economy with a relatively narrow export base, Cape Verde is vulnerable to a range of external and domestic shocks. For example, growth prospects appear to hinge on further development of tourism services—a sector that is susceptible to changes in the global security situation, to economic conditions in Europe, and to international oil prices. In addition, this sector faces a relatively high cost structure compared with other tourism destinations, reflecting in part Cape Verde's high import requirements for food and energy, and high internal and external transportation costs. Cape Verde also remains heavily dependent on foreign support from loans, grants, and remittances to support domestic investment and the balance of payments position.

21. **The staff noted that, while some sources of vulnerability would be unavoidable, maintaining sound macroeconomic policies and pushing ahead with market-oriented structural reforms would offer Cape Verde the best prospect for securing ongoing growth and development.** Economic and regulatory policies that supported improvements in the flexibility and competitiveness of the economy would enhance its capacity to adjust to shocks. The staff also pointed out that the authorities should maintain their efforts to attract increased foreign private investment and improve the mobilization of domestic resources (see below). In addition, external vulnerabilities would be reduced through ongoing efforts directed at trade liberalization and export diversification. In this regard, the staff emphasized to the authorities the importance of moving rapidly toward complying with the requirements for WTO membership within Cape Verde's current opportunity for accession as a low-income country.

B. Fiscal Policy

22. **In assessing the medium-term fiscal outlook, the staff urged the authorities to maintain the prudent policy stance that has been in place over recent years.** The staff noted in particular the substantial increase in commitments of external grants and debt financing covering the next few years and, associated with that, the strong outlook for public investment spending. In addition, implementation of the PRSP may lead to increased pressures on current spending. The mission emphasized the need for expenditure growth to remain consistent with macroeconomic stability and with debt sustainability. In this context, the staff's current medium-term fiscal framework maintains a clear surplus in the primary recurrent domestic balance and a small deficit (around 1 percent of GDP or less) in the overall primary balance including grants. With the support of measures to increase domestic revenues (see below), the staff believes that this fiscal stance would allow a modest increase in spending on PRSP priorities, while helping ensure that aggregate demand and public debt remain at manageable levels. The debt sustainability analysis discussed below and in Appendix I elaborates these points and also takes into account the possibility that

Cape Verde's access to highly concessional financing may at some point diminish as the country's income level rises.

23. **The projected growth of real GDP should generate substantial increases in direct and indirect tax revenues, and there is also scope for mobilizing domestic resources by improving tax administration and reining in tax exemptions.** Recent technical assistance from the Fiscal Affairs Department (FAD) has recommended some urgent measures to improve VAT administration, including in the checking and timeliness of data entries, together with broader measures to strengthen the monitoring and collection of tax payments. Furthermore, the mission strongly supported the objectives recently set out by the Minister of Finance to rationalize tax exemptions through a number of constitutional and legislative reforms (see Box 3).[8]

24. **On the expenditure side, the staff recognized that implementation of the PRSP would continue to put upward pressure on some areas of personnel spending**—including increased hiring in education, health care, and security. To contain spending growth, including on the public wage bill, and ensure that the recurrent domestic balance remained in surplus, the staff urged the authorities to strengthen prioritization of PRSP-related spending and to continue to restrain nonpriority spending.

25. **The staff's assessment of public financing conditions and prospects has been supported by a full debt sustainability analysis (DSA) on external and total public debt** (see Appendix I). The staff's simulations suggest that under long-term economic scenarios that are in line with or more cautious than recent historical averages, Cape Verde's debt would appear to be sustainable. Nevertheless, the staff emphasizes that, in view of its vulnerabilities to shocks as noted above, Cape Verde should maintain a prudent approach to borrowing together with consolidation of fiscal reforms to improve domestic resource mobilization. The staff also supports the authorities' request for technical assistance from the Fund to improve the management of external public debt.

[8]The Minister addressed these issues at a March 2005 seminar in Praia, in which FAD presented its assessment of the incidence and costs of tax incentives and recommendations for reform.

Box 3. Fiscal Incentives and Exemptions

While recent reforms has strengthened Cape Verde's tax system, a key challenge ahead is to revise the outdated system of incentives and exemptions.1/ Tax incentives in Cape Verde are complex, pervasive, and generous. In particular:

- they are covered by scattered and outdated legislation;
- multiple agencies and departments are involved in their administration;
- they have a high cost in terms of revenue loss. Revenue forgone from import duties and income taxes alone is estimated at 27 percent of total tax revenue between 1997 and 2003 (see the table);
- revenue losses are volatile and difficult to predict, given the absence of an upper limit on the value of benefits.

The authorities are committed to rationalizing tax incentives, emphasizing the principles of exceptionality, stability, predictability, and moderation. As a first step, they have indicated their support for a single law on exemptions. Furthermore, with an amendment to the constitution, granting incentives and exemptions would be brought under the same legislative process as used to reform taxes, rather than taking effect through use of decrees. They have also indicated their intention to rationalize exemptions to import duties, eliminating exemptions on consumption goods and keeping only those on capital goods.

Beneficiaries of tax incentives in 2003	Income Tax	Import Duties	Total
	(percent shares)		
Industry	64.0	11.7	21.3
Tourism	18.2	12.6	13.6
Development projects	-	17.7	14.4
Import of vehicles	-	12.6	10.3
Other	17.8	45.4	40.4
Total	100	100	100
Revenue forgone in percent of total revenues	20.9	28.9	27.0

1/ A technical assistance mission from the Fiscal Affairs Department visited Praia in November 2004 to evaluate the fiscal cost of incentives and advise authorities on their rationalization.

C. Monetary and Exchange Rate Policies

26. **Key support for macroeconomic stability has come from the maintenance of sound monetary and exchange rate policies.** The staff agreed with the authorities that, in the context of the fixed exchange rate peg to the euro, monetary policy should continue to be directed toward price stability and the accumulation of international reserves. With the latter, the staff concurred that the benchmark of around 3 months of import cover would be an appropriate medium-term objective, and noted that, given the country's vulnerabilities, increases beyond that level could be sought over the longer term. Furthermore, the staff supported the authorities' assessment that there was no compelling need to consider a change

the current exchange rate regime. The peg has served Cape Verde well, anchoring the overall macroeconomic framework and contributing to a stable economic environment for inflows of remittances and emigrant deposits. In view of the economic and policy progress that has been made under the current exchange rate arrangement, moving to a more flexible regime would not appear warranted. The alternative of hardening the peg—for example, though a currency board or euroization—could well be kept under consideration as a longer-term policy option. However, moving in this direction would require the financial and technical support of Cape Verde's international partners, and would best be considered in the context of broader growth of economic integration with the euro area. The staff also noted that, to reduce risks arising under the fixed exchange rate, attention would need to be paid to improving productivity and competitiveness in the economy, including through real wage restraint.

27. **The staff observed that financial intermediation remained relatively shallow, making it difficult for the BCV to manage banking system liquidity.** With a view to improving monetary management, the staff supported the authorities' intentions to explore means of deepening financial markets through introducing new indirect monetary policy instruments and through the revival of secondary markets and the stock exchange. These improvements would help to reduce the costs of financing, supporting further increases in credit to the economy. The staff also agreed with the authorities that there is a growing need to develop the nonbanking financial sector—such as credit institutions and leasing companies—to promote competition in financial services, lower lending rates, and foster credit growth to the private sector.

28. **The BCV has made progress in building its capacities for management and supervision.** In particular, the mission supported the BCV's ongoing plans to improve liquidity and reserve management,[9] and to strengthen banking and financial sector supervision. In addition, the mission welcomed the BCV's commitment to adopt international Financial Reporting Standards and supported its request for technical assistance from the Fund for this reform.

D. External Sector Policies

29. **Cape Verde has a liberal trade regime, recently enhanced by the introduction of simplified and lower customs tariffs in early 2004.**[10] Tariffs are still above international standards, however, and the government has indicated it would consider further reforms over the next few years. Cape Verde does not have substantial nontariff barriers to trade. Recent trade policies have focused on diversification of exports to developed countries through improving the quality of export-oriented production. This would allow Cape Verde to make use of existing initiatives with the EU and the US (under AGOA). As noted earlier, however, there have been some slippages in current negotiations for WTO membership, and the staff emphasized the need for clear progress on this front. The authorities' efforts to provide a

[9] The BCV recently reached agreement with the central bank of Luxemburg to manage part of the BCV's foreign reserves.

[10] There are now seven tariff bands ranging from 0 to 50 percent.

supportive climate for tourism growth and trade diversification should be boosted by the plans to open international airports in at least three islands, which would decrease transportation costs and ease capacity constraints in inter-island connections.

E. Structural Policies and PRSP Implementation

30. **Discussions on structural policies focused on measures to improve conditions for private-sector-led growth and to reduce poverty.** The staff supported the authorities' efforts to complete their privatization agenda; as discussed earlier, this should see a number of large and strategically important public enterprises, including the national airline and the port operator, transferred to private ownership or management over the next two years. While acknowledging the complexities of the Electra issue, the staff emphasized that a full and equitable settlement of the dispute between the government and the majority shareholders was essential to restore Electra to sustainable financial health and enable it to invest in additional capacity to meet demand growth.

31. **As illustrated by the difficulties that have followed Electra's privatization, such reforms need to be backed by an adequate regulatory framework.** The recent creation of several new regulatory agencies should strengthen capacities in this regard. The main tasks of the regulatory agencies are monitoring privatization contracts and the associated provision of public services. The staff emphasized the need to ensure that the legal framework for these agencies guarantees the regulators' financial and legal autonomy. The staff also noted that some remaining functional overlaps among these agencies' responsibilities had to be addressed, specialized human capital developed, and the overall regulatory culture strengthened.

32. **Following approval of the PRSP in September 2004, the authorities have focused on developing the institutions needed to implement, monitor, and evaluate the strategy.** In accordance with the institutional framework envisaged in the PRSP, the authorities have drafted a bill to create the National Council for Poverty Reduction and the Technical Secretariat. The bill is expected to be approved in the first half of 2005. The strong mobilization of external resources projected for 2005 and subsequent years will also support implementation of the strategy.

33. **A draft new labor code is in its final stages of preparation,** following extensive discussions at the level of government, employers, and employees. After some delays in 2004, a proposal is to be submitted to the National Assembly in the second quarter of 2005. The code would unify and update the dispersed labor legislation currently in place and provide a stronger framework for enforcing labor regulations. This would represent an important step forward, especially given the apparently high degree of informality in labor contracts at present, and reported tensions between some groups of workers on formal contracts and some on informal contracts.

F. Perspectives on the Current PRGF Arrangement and on a Successor Arrangement

34. **The Cape Verde authorities assessed positively the cooperation with the Fund under the current PRGF arrangement.** They emphasized that the country's performance

under the program was substantially better than they anticipated in 2002. For example, GDP growth, the reduction of external debt, and the buildup of international reserves have all been much stronger than expected.[11] They commented favorably on the following:

- The authorities have found the policy dialogue with the Fund to be useful and productive. In particular, close cooperation with the Fund has helped them to view macroeconomic policies within a consistent framework and promoted associated discussions among key policymakers.
- The Fund's role in building policymaking and technical capacities has also been important, including through technical assistance from FAD and other departments.
- Program conditionality has provided an important discipline on policy direction and incentive for reform efforts. For example, the program ceiling on nonconcessional debt has supported the authorities' efforts to prioritize capital spending.

35. **The authorities recognized that a challenging structural reform agenda remains in front of them to support growth and development.** Drawing on the positive results from the first PRGF arrangement, the authorities have requested the staff to commence negotiations on a successor program under the PRGF; it would be a low-access arrangement. The staff agrees that such an arrangement would appear appropriate: while Cape Verde does not face a large balance of payments need, as a small island economy it will continue to be exposed to the range of vulnerabilities noted earlier. In this context, close engagement with the Fund would provide guidance for policy implementation, help address potential risks, and signal to donors and creditors the authorities' intentions to maintain policies directed at macroeconomic stability and structural reforms.

G. Statistical Issues

36. **Cape Verde's statistical system remains weak, although significant improvements are underway.** The mission urged the National Statistics Institute (INE) to push forward with revamping the national accounts statistics in order to implement the 1993 System of National Accounts (SNA), with technical assistance from AFRISTAT. The Statistics Department is also supporting this reform, which would include a substantial improvement in source data collection programs, and has scheduled technical assistance [for 2005]. A significant commitment will be required of INE to coordinate this assistance and implement the resulting recommendations. INE is expected to release final GDP numbers for 2002–03 in May 2005. With assistance from the National Statistics Institute of Portugal, INE is now completing a new consumer price index, based on an updated commodity basket, and this is to become operational by end-2005. Fund technical assistance is also scheduled on this matter. Finally, in collaboration with the Employment Institute, labor market surveys would be undertaken twice a year, starting from the second half of

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[11] For example, external public debt at end-2004 stood at 53 percent of GDP, compared with 57 percent of GDP envisaged when the program began; and gross international reserves reached 2.6 months of imports at end-2004, compared with the 2.2 months originally projected.

2005. The staff recommended that INE receive the funding necessary to ensure that it collects the relevant information and generates accurate and reliable data in a timely manner.

37. **These weaknesses and reform plans notwithstanding, there have been improvements in the compilation and dissemination of statistics.** The authorities are committed to use the GDSS as a framework for the development of statistical system. Furthermore, the BCV publishes a wide variety of monetary, external, real sector, and fiscal data on the worldwide web, and has strengthened its balance of payments statistics with technical assistance from the Fund.

III. Staff Appraisal

38. **Cape Verde's economic and policy performance remains strong.** Economic growth has been robust over recent years, contributing to a decline in absolute poverty. Moreover, with the backing of continued prudent macroeconomic policies and further structural reforms, the medium-term economic outlook is positive. Key driving forces for growth are coming from private investment in tourism facilities and public investment in infrastructure, financed through increasing levels of external support. Inflation has recently been negative, a result in part of tariff reforms in early 2004. With the support of the fixed exchange rate peg, inflation is expected to remain low in the years ahead.

39. **Economic policymaking has strengthened under the current three-year PRGF arrangement.** As reflected in the decline in public debt, fiscal performance and debt sustainability has improved substantially. Key reforms have occurred in the tax system, notably the introduction of the VAT. To draw the full potential from these reforms, the authorities need to maintain their efforts to strengthen tax administration and push forward with plans to rationalize tax incentives. Pressures to grant additional exemptions, including from import tariffs, should be resisted. Expenditure performance and administration have strengthened, with recurrent spending contained and increasingly focused on social priorities set out in the PRSP. These improvements will receive further backing from the planned introduction of a full medium-term expenditure framework.

40. **A further key element behind Cape Verde's macroeconomic stability has been the firm monetary policy of the Bank of Cape Verde (BCV).** In particular, the credibility and robustness of the exchange rate peg has grown, both supported by and contributing to sustained price stability and accumulation of international reserves. The fixed exchange rate regime remains appropriate, providing a major anchor for macroeconomic policies and contributing to a stable environment for inflows of remittances and emigrant deposits.

41. **Financial soundness indicators do not indicate any imminent banking sector vulnerabilities**. Nevertheless, the BCV must be prepared to act quickly should pressures emerge. Important steps to help ward off such pressures include the further strengthening of banking supervision, introduction of new indirect monetary policy instruments, and improvements in the effectiveness of banking and other financial intermediation services.

42. **Helped by the tariff reforms in early 2004, Cape Verde has a liberal trade regime.** There have been some slippages, however, in the current negotiations for WTO

membership, and rapid progress is needed on this front within the current window of opportunity for accession.

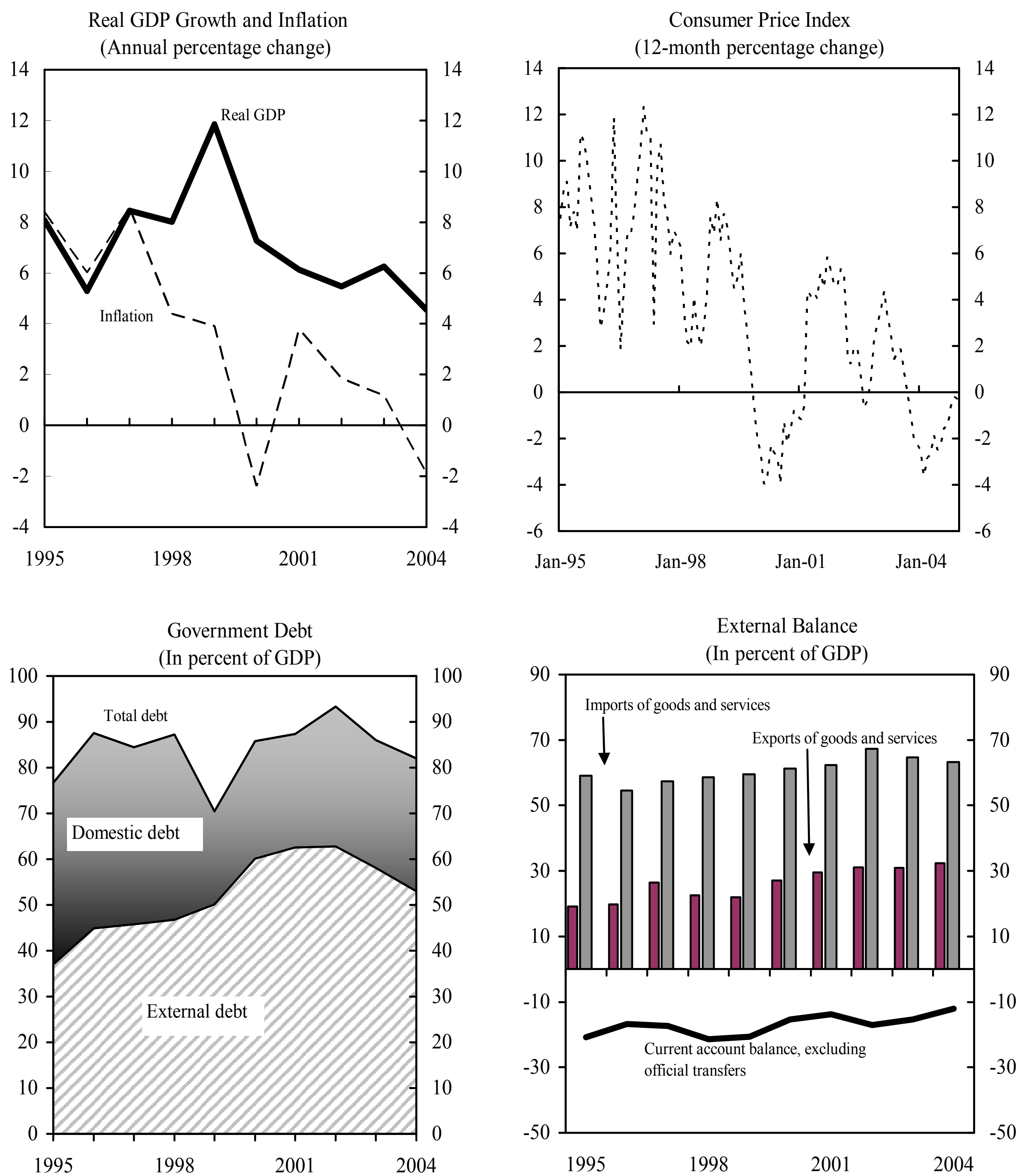
43. **The momentum of structural reforms needs to be maintained.** A key goal for 2005–06 should be to complete the restructuring and privatization of the remaining enterprises on the government's reform agenda. These efforts need to be backed by the ongoing development of a sound and efficient regulatory framework, including through the authorities' plans to create specialized regulatory agencies. Also essential is settlement of the long-standing dispute between the government and the majority shareholders of Electra. In addition to reducing fiscal risks, such a settlement is urgently required to restore Electra to financial health and enable it to meet growing demands for electricity and water.

44. **While Cape Verde's data quality has been generally adequate for program monitoring, statistical systems remain weak.** The staff urges the authorities to make full use of the technical assistance that is underway or planned, in order to strengthen national accounts data and implement the new methodology for measuring consumer prices.

45. **The staff agrees with the authorities that the results achieved under the current PRGF arrangement, which ends in July, have exceeded initial expectations.** Noting the government's interest in a successor arrangement with the Fund, the staff shares the authorities' assessment that the arrangement best suited to their needs would be a low-access PRGF. A mission to negotiate a new program under this arrangement is scheduled for June 2005.

46. **The staff recommends completion of the sixth review under the PRGF arrangement.** The staff also supports the authorities' request for a waiver for nonobservance of an end-December 2004 structural performance criterion relating to the publication of an automatic mechanism to adjust electricity and water tariffs. Preparation of this mechanism has taken longer than the staff and the authorities originally envisaged, mainly as a result of capacity constraints faced by the newly established economic regulatory agency. However, the authorities have taken corrective actions to address these constraints—notably the appointment of consultants to complete the underlying economic model and to translate this into the tariff adjustment mechanism by the new target date of end-June, 2005. It is recommended that the next Article IV consultation with Cape Verde be held in accordance with the July 2002 decision on consultation cycles. The authorities have consented to publish this Article IV staff report and related documents.

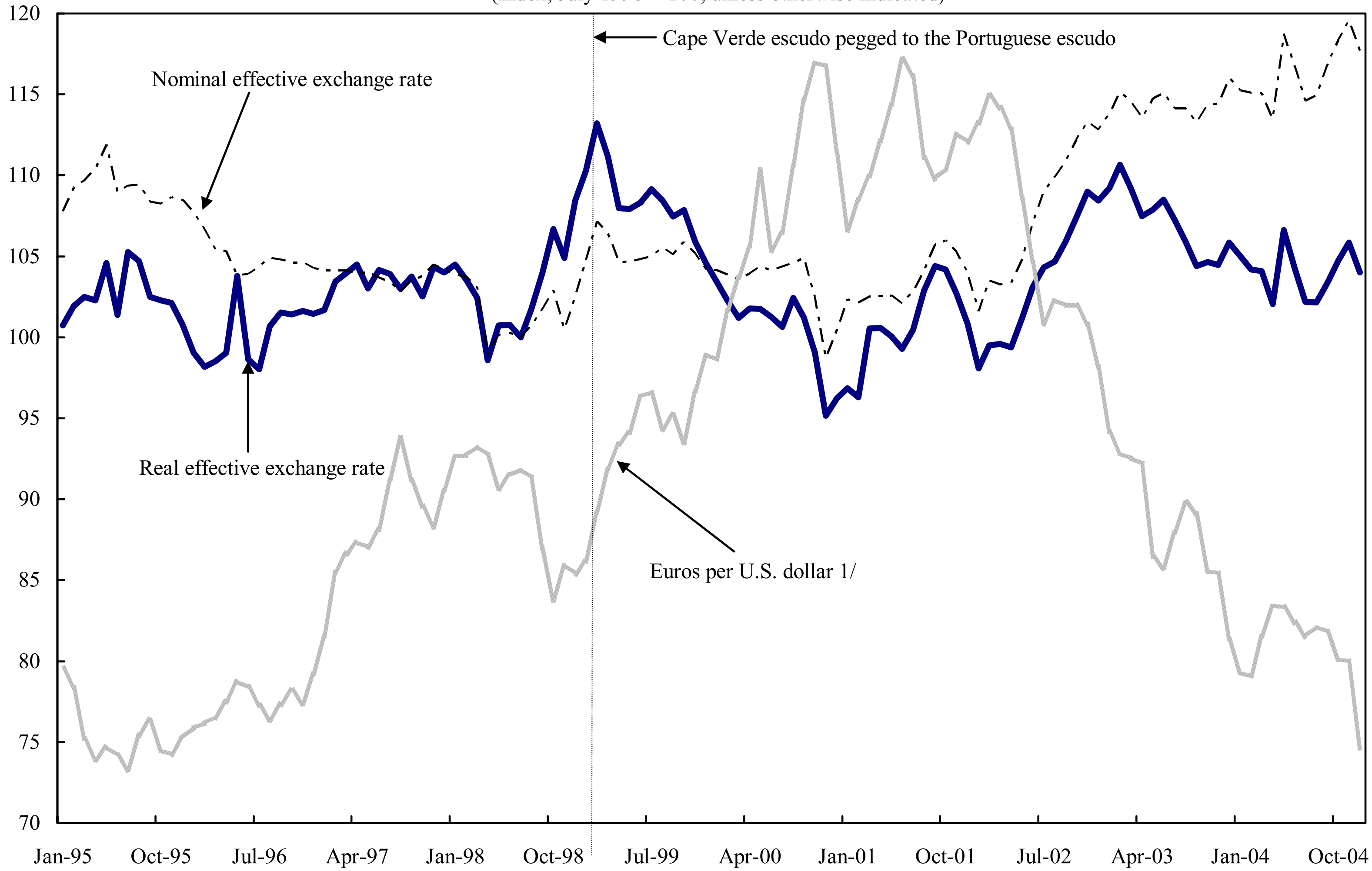
Figure 1. Cape Verde: Selected Economic Indicators, 1995–2004



Sources: Cape Verdean authorities; and Fund staff estimates and projections.

Figure 2. Cape Verde: Real and Nominal Effective Exchange Rates, January 1995–December 2004

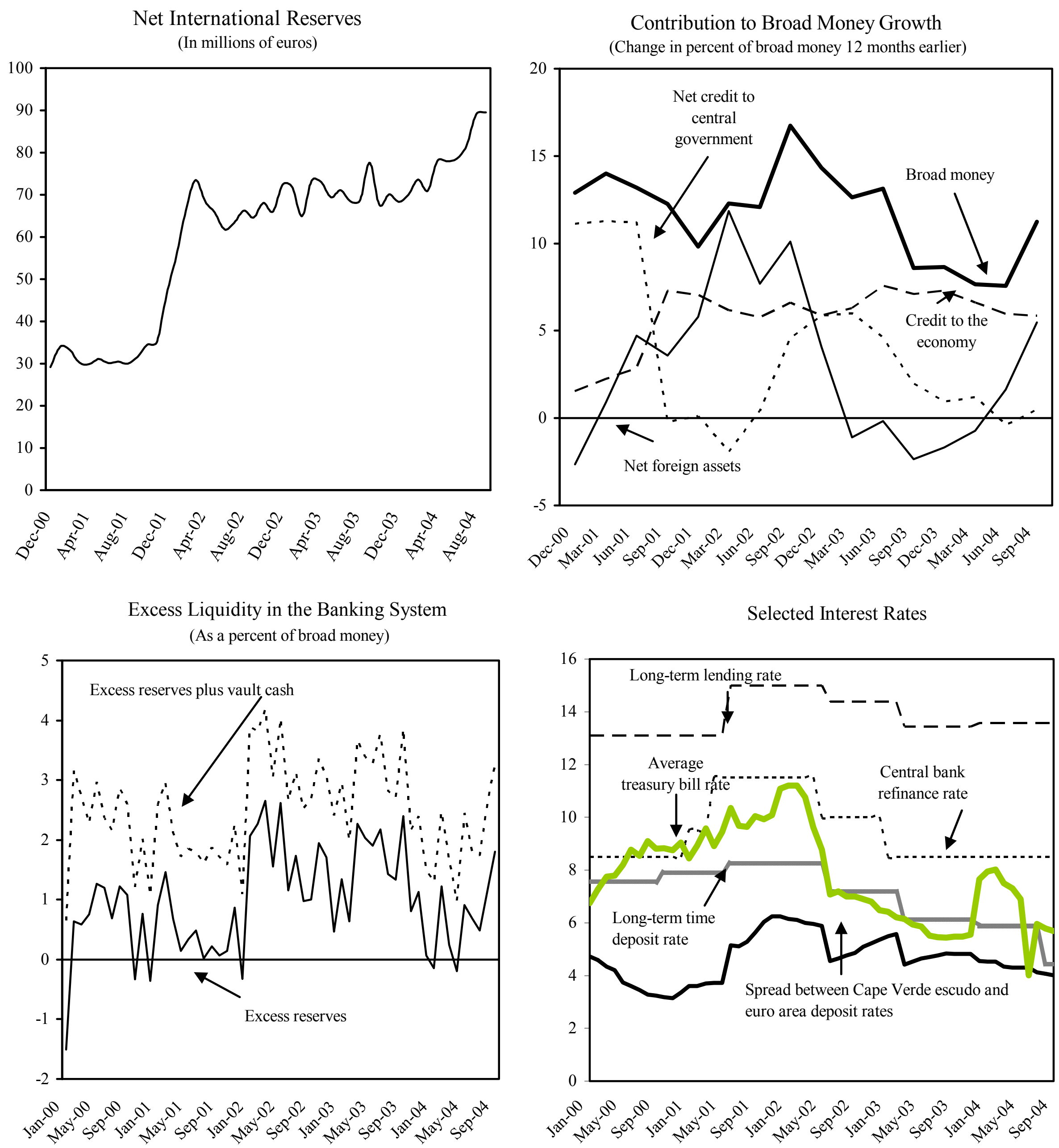
(Index, July 1998 = 100, unless otherwise indicated)



Source: International Monetary Fund, Information Notice System (INS).

1/ Prior to January 1999, based on the Portuguese escudo multiplied by the December 1998 euro-escudo conversion rate.

Figure 3. Cape Verde: Monetary Indicators, January 2000–November 2004
(In percent, unless otherwise indicated)



Sources: Bank of Cape Verde; IMF, *International Financial Statistics;* and Fund staff estimates.

Table 1. Cape Verde: Selected Economic and Financial Indicators, 2002–08

	2002	2003	2004		2005	2006	2007	2008
		Actual	Program 1/	Prel.	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change)							
National income and prices								
Real GDP	5.5	6.2	4.0	4.5	6.0	7.0	6.5	6.5
Real GDP (per capita)	3.6	4.3	2.1	2.7	4.5	5.0	4.5	4.5
Consumer price index (annual average)	1.8	1.2	-1.6	-1.9	0.8	2.0	2.0	2.0
Consumer price index (end of period)	3.0	-2.3	1.5	-0.3	2.0	2.0	2.0	2.0
External sector								
Exports (in euros) 2/	10.5	8.9	6.1	7.8	7.9	9.4	9.6	9.4
Imports (in euros) 2/	13.8	5.1	3.3	1.1	8.9	7.8	7.1	7.2
Real effective exchange rate (annual average)	2.6	3.6	...	-2.9	...	...	...	...
Terms of trade (minus = deterioration)	-0.4	1.2	-3.2	-2.9	1.1	1.8	1.2	0.7
Government budget								
Total revenue (excluding grants)	12.3	5.1	17.1	8.2	4.3	12.0	11.6	10.1
Total expenditure	12.2	-0.7	13.5	3.1	11.0	11.2	10.9	10.1
Recurrent and extraordinary expenditure	3.0	7.2	13.4	1.0	11.8	9.8	12.2	11.2
Capital expenditure	27.8	-18.0	17.9	11.4	14.1	13.7	8.4	8.1
	(Annual change in percent of beginning-of-period broad money, unless otherwise indicated)							
Money and credit								
Net domestic assets	10.5	10.3	5.5	4.7	6.6	...	...	...
Of which: net claims on the central government	5.9	0.9	0.7	0.4	0.2	...	...	...
credit to the economy	5.9	7.3	5.3	4.7	5.5	...	...	...
Broad money (M2)	14.3	8.6	8.2	10.5	8.7	9.3	9.5	9.2
Domestic broad money (M2X)	10.3	4.2	6.7	8.8	9.5	...	...	...
Income velocity (GDP/M2)	1.49	1.46	1.46	1.38	1.39	...	...	...
	(In percent of GDP)							
Saving-investment balance								
Gross domestic investment	21.8	18.7	17.4	20.4	23.3	24.2	25.0	25.8
Public	6.4	4.8	5.2	5.2	5.4	5.5	5.5	5.4
Private	15.3	13.9	12.2	15.2	17.9	18.7	19.5	20.3
Gross national savings	10.4	9.2	9.6	14.2	14.9	15.8	16.8	17.6
Of which: public sector	9.9	5.4	7.2	8.6	7.4	7.6	7.2	6.8
External current account (including official transfers)	-11.4	-9.4	-7.8	-6.2	-8.4	-8.3	-8.2	-8.1
Government budget								
Total revenue	22.8	21.9	23.7	22.9	21.7	22.1	22.5	22.7
Total grants	8.7	5.5	5.6	6.5	6.6	6.1	5.8	5.6
Total expenditure	34.1	30.9	32.3	30.9	31.1	31.3	31.7	32.0
Overall balance (including grants)	-2.6	-3.5	-2.9	-1.5	-2.8	-3.1	-3.4	-3.7
Domestic bank financing	3.7	1.2	0.6	0.3	0.2	0.2	0.1	0.0
Total public debt 3/	87.3	82.9	74.7	80.9	76.8	73.3	70.5	68.4
External public debt 4/	56.3	52.0	47.6	49.1	48.3	47.4	46.9	46.8
Domestic public debt 5/	31.0	30.9	27.1	31.8	28.5	25.8	23.6	21.7
External current account (excluding official transfers)	-17.1	-15.4	-13.4	-12.0	-14.2	-13.8	-13.4	-13.2
Overall balance of payments	3.7	-0.6	1.3	3.0	0.7	0.5	1.2	0.7
	(In units specified)							
External current account (million euros, including official transfers)	-75.4	-68.3	-61.2	-46.2	-69.3	-76.0	-81.4	-88.9
Gross international reserves (million euros, end of period)	76.1	74.1	87.4	102.4	115.8	129.5	143.6	159.2
Gross international reserves (in months of import of goods and nonfactor services	2.0	1.9	2.2	2.6	2.7	2.8	2.9	3.0
External debt service (in percent of exports of goods and nonfactor services)	15.6	10.6	11.2	10.7	10.4	9.4	9.4	10.8
Memorandum items:								
Nominal GDP (in billions of Cape Verde escudos)	73.0	79.9	86.5	82.5	91.0	100.4	109.9	119.9
Exchange rate (Cape Verde escudos per U.S. dollar)								
Period average	117.2	97.7	...	88.8	...	...	...	...
End period	105.1	87.3	...	81.0	...	...	...	...

Sources: Cape Verdean authorities; and staff estimates and projections.

1/ As contained in the January 14, 2005 staff report (IMF Country Report No. 05/46).
2/ Exports and imports of goods and nonfactor services.
3/ Including verified stock of domestic and external arrears.
4/ Projection numbers include financing gap.
5/ Excluding the claims on the offshore Trust Fund.

Table 2. Cape Verde: Annual Fiscal Operations of the Central Government, 2002–05

(In billions of escudos)

	2002	2003	2004		2005
			Program 1/	Act.	Proj.
Revenue, grants, and net lending	23.0	21.9	25.4	24.3	25.7
Domestic revenue	16.7	17.5	20.5	18.9	19.8
Tax revenue 2/	14.7	15.5	18.2	16.6	17.5
Income and profit taxes	5.1	5.3	6.7	5.4	6.0
Consumption taxes	2.5	2.5	6.9	6.3	6.3
Taxes on goods and services	2.5	2.5	1.2	0.8	0.0
Of which: petroleum taxes	0.3	0.2	0.4	0.0	0.0
Value-added tax	0.0	0.0	5.7	5.6	6.3
International trade taxes 2/	6.1	6.8	3.7	3.9	4.2
Other taxes	0.9	0.9	0.9	1.0	1.1
Nontax revenue	1.8	1.5	2.0	1.9	1.8
Domestic capital participation	0.0	0.0	0.0	0.2	0.2
Net lending	0.2	0.5	0.3	0.2	0.2
External grants	6.3	4.4	4.9	5.3	6.0
Capital grants	5.2	3.6	3.7	5.3	4.7
Budget support	1.2	0.8	1.1	0.0	1.3
Total expenditure	24.9	24.7	27.9	25.5	28.3
Recurrent expenditure	15.3	16.4	18.5	16.6	18.5
Primary recurrent expenditure	13.3	14.4	16.6	14.5	16.2
Wages and salaries	7.1	9.4	10.8	9.8	10.4
Goods and services	0.6	1.3	1.7	1.0	1.0
Transfers and subsidies	4.9	3.0	3.2	3.0	3.8
Other expenditures	0.7	0.8	1.0	0.7	1.0
Domestic interest payments	1.4	1.5	1.3	1.5	1.6
External interest payments	0.6	0.5	0.6	0.5	0.7
Extraordinary expenditures	0.2	0.6	0.4	0.4	0.0
Other extraordinary expenditures	0.0	0.0	0.0	0.0	0.0
Capital expenditure	9.4	7.7	9.0	8.5	9.7
Foreign financed	8.6	6.9	8.0	7.7	8.3
Domestically financed	0.7	0.8	1.0	0.8	1.4
Overall balance, including grants 3/	-1.9	-2.8	-2.5	-1.2	-2.5
Financing	1.4	3.0	2.6	1.4	2.6
Foreign (net)	1.1	2.0	2.8	0.8	2.9
Total drawings	4.1	4.1	5.2	3.1	5.2
Balance of payments, budget	1.3	1.3	0.9	0.7	1.6
Project loans	2.8	2.8	4.3	2.4	3.6
Amortization	-3.0	-2.1	-2.4	-2.3	-2.3
Domestic (net)	0.2	1.0	-0.2	0.6	-0.3
Banking system	2.7	0.9	0.6	0.2	0.2
Nonbanks	1.5	0.7	0.3	1.0	0.7
Domestic arrears 2/	-3.9	-0.6	-1.1	-0.6	-1.1
Net errors and omissions	0.5	-0.2	-0.1	-0.2	-0.1
Financing gap	0.0	0.0	0.0	0.0	-0.1
Memorandum items:					
Domestic expenditures 4/	15.7	17.3	19.3	17.0	19.0
Domestic balance 5/	1.0	0.2	1.2	1.8	0.5
Primary domestic balance 6/	2.4	1.7	2.5	3.3	2.1
Primary recurrent domestic balance 7/	3.3	3.1	3.9	4.3	3.3
Overall balance, excluding grants 8/	-8.2	-7.2	-7.4	-6.5	-8.5
Net external flows 9/	7.5	6.4	7.7	6.1	8.8
External debt service (in percent of domestic revenue)	21.3	14.9	14.3	15.0	15.1
Tax and nontax arrears 10/	...	0.5	0.8	1.9	0.8

Table 2. Cape Verde: Annual Fiscal Operations of the Central Government, 2002–05 (concluded)

(In percent of GDP, unless otherwise indicated)

	2002	2003	2004		2005
			Program 1/	Act.	Proj.
Revenue, grants, and net lending	31.5	27.4	29.3	29.4	28.3
Domestic revenue	22.8	21.9	23.7	22.9	21.7
Tax revenue 2/	20.1	19.3	21.1	20.2	19.3
Income and profit taxes	7.0	6.6	7.7	6.5	6.6
Consumption taxes	3.4	3.1	8.0	7.7	6.9
Taxes on goods and services	3.4	3.1	1.4	0.9	...
Value-added tax	0.0	0.0	6.6	6.8	6.9
International trade taxes 2/	8.4	8.5	4.3	4.7	4.6
Other taxes	1.3	1.1	1.1	1.2	1.2
Nontax revenue	2.4	1.9	2.3	2.3	1.9
Net lending	0.3	0.7	0.3	0.2	0.3
External grants	8.7	5.5	5.6	6.5	6.6
Capital grants	7.1	4.5	4.3	6.5	5.2
Budget support	1.6	1.0	1.3	0.0	1.4
Total expenditure	34.1	30.9	32.3	30.9	31.1
Recurrent expenditure	21.0	20.5	21.4	20.1	20.4
Primary recurrent expenditure	18.2	18.0	19.2	17.6	17.8
Wages and salaries	9.7	11.7	12.5	11.9	11.4
Goods and services	0.8	1.7	1.9	1.2	1.2
Transfers and subsidies	6.7	3.7	3.7	3.6	4.1
Other expenditures	1.0	1.0	1.1	0.9	1.1
Domestic interest payments	2.0	1.9	1.5	1.8	1.7
External interest payments	0.8	0.6	0.6	0.7	0.8
Extraordinary expenditures	0.3	0.8	0.5	0.4	0.0
Capital expenditure	12.8	9.6	10.5	10.4	10.7
Foreign financed	11.8	8.6	9.3	9.4	9.2
Domestically financed	1.0	1.0	1.2	1.0	1.6
Overall balance, including grants 3/	-2.6	-3.5	-2.9	-1.5	-2.8
Financing	1.9	3.8	3.0	1.7	2.9
Foreign (net)	1.6	2.5	3.2	0.9	3.2
Total drawings	5.7	5.1	6.0	3.7	5.7
Amortization	-4.1	-2.6	-2.7	-2.8	-2.5
Domestic (net)	0.3	1.3	-0.2	0.8	-0.3
Banking system	3.7	1.2	0.6	0.3	0.2
Nonbanks	2.0	0.9	0.3	1.2	0.7
Domestic arrears 2/	-5.4	-0.7	-1.2	-0.7	-1.2
Net errors and omissions	0.8	-0.3	-0.1	-0.2	-0.1
Financing gap	0.0	0.0	0.0	0.0	-0.1
Memorandum items:					
Domestic expenditures 4/	21.5	21.6	22.4	20.6	20.9
Domestic balance 5/	1.3	0.3	1.4	2.1	0.6
Primary domestic balance 6/	3.3	2.1	2.9	4.0	2.3
Primary recurrent domestic balance 7/	4.6	3.9	4.5	5.2	3.7
Overall balance, excluding grants 8/	-11.3	-9.0	-8.6	-7.9	-9.4
Net external flows 9/	10.2	8.0	8.9	7.4	9.7
External debt service (in percent of domestic revenue)	21.3	14.9	14.3	15.0	15.1
Tax and nontax arrears 10/	...	0.6	0.9	2.3	0.8

Sources: Ministry of Finance and Planning; Bank of Cape Verde; and staff estimates and projections.

1/ As contained in the January 14, 2005 staff report (IMF Country Report No. 05/46). Pensions in the program are classified as transfers, while in the budget and projections are classified as wages.
2/ 2003 includes exceptional revenues of CVEsc 455 million from old tax debt that were used to clear arrears of the same amount with a domestic oil company.
3/ "Overall balance, including grants" = revenue including grants - total expenditure.
4/ "Domestic expenditure" = total expenditure - external interest - foreign financed capital expenditure - capital expenditure financed by domestic capital participatic
5/ "Domestic balance" = domestic revenue - domestic expenditure.
6/ "Primary domestic balance"= domestic revenue - domestic expenditure + domestic interest payments.
7/ "Primary recurrent domestic balance"= domestic revenue - primary current expenditure.
8/ "Overall balance, excluding grants" = revenue excluding grants - total expenditure.
9/ Excluding external interest payments, and including financing gap.
10/ 2005 includes tax and nontax arrears to the BCA and construction companies.

Table 3. Cape Verde: Monetary Survey, 2002–05

	2002	2003	2004	2005	
	Dec.	Dec.	Dec.	March	Dec.
				Prel.	Proj.
	(In millions of Cape Verde escudos, unless otherwise specified)				
Net foreign assets	11,331	10,456	13,787	14,904	15,090
Foreign assets	13,841	13,434	16,912	19,119	18,531
Of which: foreign reserves	8,391	8,173	11,296	12,070	12,774
Foreign liabilities	-2,511	-2,978	-3,125	-4,215	-3,441
Net domestic assets	41,027	46,428	49,083	49,003	53,257
Net domestic credit	49,916	54,503	57,323	57,633	60,939
Net claims on general government	24,790	25,561	25,688	25,436	25,845
Claims on the Trust Fund (TCMFs)	10,600	11,038	11,038	11,038	11,038
Net claims on the central government	14,368	14,858	15,070	14,878	15,227
Credit to central government	16,546	17,097	17,485	18,014	17,641
Deposits of central government	-2,178	-2,239	-2,415	-3,136	-2,415
Of which: project deposits	-397	-393	-277	-678	-277
Net claims on local government	8	67	75	39	75
Net claims on other government agencies (INPS)	-186	-402	-495	-519	-495
Credit to the economy	25,126	28,943	31,635	32,197	35,094
Credit to public enterprises	230	180	161	381	163
Credit to private sector	24,890	28,726	31,430	31,784	34,888
Claims on nonbank financial institutions	6	37	44	33	44
Other items (net)	-8,889	-8,075	-8,241	-8,630	-7,682
Broad money (M2)	52,358	56,884	62,870	63,907	68,347
Narrow money (M1)	22,621	22,989	24,426	23,958	26,554
Currency outside banks	6,459	6,516	6,765	6,183	7,149
Demand deposits	16,162	16,474	17,661	17,775	19,405
Quasi money	27,636	31,662	35,762	37,190	38,877
Time deposits	25,857	29,983	34,313	35,648	37,303
Other quasi-monetary deposits	1,779	1,679	1,449	1,542	1,575
Foreign currency deposits	2,101	2,232	2,682	2,759	2,915
	(Change in percent of broad money 12 months earlier)				
Net foreign assets	3.9	-1.7	5.9	6.4	2.1
Net domestic assets	10.5	10.3	4.7	3.8	6.6
Net domestic credit	12.7	8.8	5.0	4.7	5.8
Net claims on the central government	5.9	0.9	0.4	0.1	0.2
Credit to the economy	5.9	7.3	4.7	4.8	5.5
Credit to public enterprises	0.0	-0.1	0.0	0.4	0.0
Credit to private sector	5.9	7.3	4.8	4.5	5.5
Valuation	0.0	0.0	0.5	0.0	0.2
Other items (net)	-2.3	1.6	-0.3	-0.9	0.9
Selected monetary indicators					
Income velocity of money	1.49	1.46	1.38	...	1.39
Emigrant deposits	19,042	22,153	25,091	25,713	26,935
Excess reserves /total deposits (in percent)	0.5	0.1	0.4	2.3	0.4
Money multilplier (M2 / M0)	3.22	3.29	3.38	3.30	3.44
Credit to the economy (percentage change)	12.0	15.2	9.3	9.5	10.9

Table 3. Cape Verde: Monetary Survey, 2002–05 (continued)

	2002	2003	2004	2005	
	Dec.	Dec.	Dec.	March	Dec.
				Prel.	Proj.
	(In millions of Cape Verde escudos, unless otherwise specified)				
Bank of Cape Verde					
Net foreign assets	8,632	8,088	10,698	11,303	11,860
Of which: net international reserves	7,984	7,528	10,524	11,120	11,686
Foreign assets	9,135	8,818	11,526	12,312	13,005
Foreign liabilities	-503	-730	-828	-1,009	-1,144
Net domestic assets	7,605	9,201	7,790	8,069	8,015
Net domestic credit	9,728	10,651	9,439	9,667	9,607
Trust Fund claims	4,167	4,605	4,605	4,605	4,605
Net claims on central government	4,103	4,424	3,594	3,847	3,642
Credit to central government	5,302	5,373	4,779	5,106	4,826
Deposits of central government	-1,199	-948	-1,184	-1,259	-1,184
Of which: project accounts	-397	-393	-277	-678	-277
Of which: foreign currency deposits	-330	-456	-426	-503	-376
Claims on local government	0	0	0	0	0
Credit to the economy	1,184	1,212	1,196	1,179	1,317
Credit to public enterprises	72	72	61	61	61
Credit to private sector	1,112	1,107	1,106	1,100	1,227
Claims on nonbank financial institutions	0	33	30	19	30
Credit to commercial banks	275	410	44	36	43
Valuation	0	0	0	0	0
Other items (net)	-2,123	-1,451	-1,649	-1,598	-1,593
Assets	2,345	2,396	1,460	2,082	1,827
Liabilities	4,468	3,847	3,108	3,680	3,419
Reserve money (M0)	16,237	17,289	18,489	19,372	19,875
Currency outside banks	6,459	6,516	6,765	6,183	7,149
Cash in vaults	1,013	808	1,072	994	1,106
Deposits of commercial banks	8,764	9,964	10,630	12,183	11,598
Deposits of private sector	0.0	0.0	0	0	0
Deposits of other financial institutions	1	0	21	12	21
Gross international reserves (mn. Euros)	76.1	74.1	102.4	109.5	115.8
Net international reserves (mn. Euros)	72.4	68.2	95.4	100.8	106.0
Reserve money (12-month change in percent)	11.4	6.5	6.9	12.9	7.5

Table 3. Cape Verde: Monetary Survey, 2002–05 (concluded)

	2002	2003	2004	2005	
	Dec.	Dec.	Dec.	March	Dec.
				Prel.	Proj.
	(In millions of Cape Verde escudos, unless otherwise specified)				
Commercial banks					
Net foreign assets	2,699	2,368	3,089	3,602	3,229
Foreign assets	4,706	4,616	5,386	6,807	5,526
Foreign liabilities	-2,007	-2,248	-2,297	-3,206	-2,297
Of which: nonresident deposits	-1,650	-1,847	-2,022	-2,346	-2,022
Net domestic assets	43,199	48,000	52,994	54,111	57,968
Net domestic credit	49,964	54,625	59,587	61,144	64,036
Net claims on general government	16,521	16,531	17,489	16,984	17,598
Trust Fund claims	6,433	6,433	6,433	6,433	6,433
Other government deposits (INPS)	-186	-402	-495	-519	-495
Net claims on central government	10,265	10,433	11,476	11,032	11,585
Loans and overdrafts	6,704	7,302	7,872	8,091	8,265
Holding of government securities	4,540	4,423	4,835	4,817	4,550
Deposits of central government	-979	-1,291	-1,230	-1,877	-1,230
Net claims on local government	8	67	75	39	75
Claims on local government	266	239	209	204	209
Deposits of local government	-259	-172	-134	-166	-134
Credit to the economy	23,941	27,731	30,439	31,018	33,777
Credit to public enterprises	158	108	101	321	103
Credit to private sector	23,778	27,619	30,325	30,684	33,660
Claims on nonbank financial institutions	6	4	14	13	14
Net claims on the Bank of Cape Verde	9,502	10,363	11,658	13,141	12,661
Total reserves	9,777	10,772	11,702	13,177	12,704
Vault cash	1,013	808	1,072	994	1,106
Deposits with central bank	8,764	9,964	10,630	12,183	11,598
Required reserves	8,518	9,924	10,430	10,849	11,379
Excess reserves	246	40	200	1,334	219
Credit from the Bank of Cape Verde	-275	-410	-44	-36	-43
Other items (net)	-6,765	-6,625	-6,592	-7,033	-6,068
Deposit liabilities to nonbank residents	45,898	50,368	56,083	57,713	61,197
Local currency deposits	43,796	48,135	53,402	54,954	58,282
Demand deposits	16,161	16,473	17,640	17,763	19,405
Of which: emigrant deposits	2,133	2,202	2,591	2,584	2,781
Quasi money	27,636	31,662	35,762	37,190	38,877
Time deposits	25,857	29,983	34,313	35,648	37,303
Of which: emigrant deposits	15,817	18,918	21,521	22,118	23,103
Other quasi-monetary deposits	1,779	1,679	1,449	1,542	1,575
Foreign currency deposits	2,101	2,232	2,682	2,759	2,915
Of which: emigrant deposits	1,092	1,033	979	1,012	1,051
Memorandum items:					
Emigrant deposits (as ratio to total deposits)	0.36	0.39	0.40	0.40	0.39
Other deposits (as ratio to total deposits)	0.64	0.61	0.60	0.60	0.61
Composition of emigrant deposits	1.00	1.00	1.00	1.00	1.00
Local currency	0.94	0.95	0.96	0.96	0.96
Demand	0.11	0.10	0.10	0.10	0.10
Time	0.83	0.85	0.86	0.86	0.86
Foreign currency	0.06	0.05	0.04	0.04	0.04

Sources: Bank of Cape Verde; and staff estimates and projections.

Table 4. Cape Verde: Balance of Payments, 2002–05
(In millions of Cape Verde escudos, unless otherwise indicated)

	2002	2003	2004		2005
			Program 1/	Prel.	Proj.
Current account balance (including official transfers)	-8,314	-7,539	-6,746	-5,093	-7,436
Trade balance	-27,673	-28,253	-29,412	-29,371	-31,510
Exports, f.o.b.	4,909	5,150	5,044	5,170	5,239
Imports, f.o.b.	-32,583	-33,403	-34,456	-34,540	-36,749
Services (net)	1,242	1,342	2,311	3,820	3,377
Credit	17,808	19,578	21,193	21,478	23,493
Of which: tourism	7,509	8,152	9,242	9,478	10,918
Debit	-16,565	-18,236	-18,883	-17,659	-20,117
Factor income (net)	-1,364	-1,134	-943	-1,338	-1,560
Credit	787	1,516	1,455	1,702	1,721
Debit	-2,151	-2,650	-2,398	-3,040	-3,281
Government interest	-557	-514	-556	-549	-477
Interest by other sectors	-896	-1,874	-1,366	-2,145	-2,205
Income on direct investment and other income	-699	-261	-475	-346	-599
Current transfers (net)	19,482	20,507	21,297	21,795	22,258
Government	4,159	4,776	4,874	4,852	5,273
Other	15,323	15,730	16,423	16,943	16,985
Capital and financial account (net)	11,329	6,278	7,833	7,847	8,052
Capital transfers	1,058	2,071	2,050	1,629	1,727
Government	244	2,071	2,050	1,629	1,727
Direct investment (net)	1,718	1,350	1,510	1,812	1,985
Portfolio investment	0	0	0	0	0
Government	1,150	1,006	2,806	627	2,808
Trust Fund	0	0	0	0	0
Net official flows	1,150	1,998	2,806	774	2,808
Disbursements	4,144	4,099	5,180	3,068	5,185
Amortization	-2,995	-2,101	-2,374	-2,293	-2,377
Other capital	7,404	-147	1,467	3,004	1,532
Commercial banks	1,082	3,261	-416	3,425	-128
Emigrant deposit flows	3,457	3,111	2,323	2,938	1,660
Commercial credit (net)	2,577	-171	0	112	0
Other	288	-6,348	-440	-3,471	0
Net errors and omissions	-328	760	0	-243	0
Overall balance	2,687	-500	1,087	2,511	616
Financing	-2,687	500	-1,087	-2,511	-1,168
Flow in NFA of central bank (– =accumulation)	-2,687	68	-1,142	-2,622	-1,168
Change in stocks (– = increase)		544		-2,610	-1,168
Valuation change (– = increase in stocks due valuation)		476		11	0
Of which: change in net international reserves	-2,884	456	-1,296	-2,996	-1,168
Of which: IMF (net)	354	291	172	127	316
Exceptional financing	0	432	55	110	0
Change in government arrears (+=increase)	0	0	0	0	0
Rescheduling/cancellation of arrears	0	0	0	0	0
Financing gap	0	0	0	0	552
Memorandum items:					
Current account (including official transfers) 2/	-11.4	-9.4	-7.8	-6.1	-8.2
Current account (excluding official transfers) 2/	-17.1	-15.4	-13.4	-12.0	-14.0
Overall balance 2/	3.7	-0.6	1.3	3.0	0.7
Gross international reserves	8,391	8,173	9,641	11,296	12,780
In months of imports of goods and nonfactor services	2.0	1.9	2.2	2.6	2.7
External public debt	41,064	41,536	39,364	40,569	43,921

1/ As contained in the January 14, 2005 staff report (IMF Country Report No. 05/46).

2/ In percent of GDP.

Table 5. Cape Verde: External Public Debt Outstanding, 2001–04

(In millions of U.S. dollars, unless otherwise indicated; end of period)

	2001	2002	2003	2004 Proj.
Multilateral	252.2	288.4	351.0	373.0
AfDF 1/	86.2	85.5	108.4	109.5
IDA	110.1	143.4	176.3	195.5
IMF	0.0	3.3	7.6	9.6
BADEA 1/	20.6	20.6	22.1	22.3
AfDB 1/	1.3	0.6	0.0	0.0
EIB 1/	8.1	7.0	9.4	8.0
OPEC 1/	7.7	10.7	6.6	5.7
IFAD 1/	8.9	9.1	10.9	13.1
Saudi Fund 1/	0.3	0.0	0.0	0.0
NDF 1/	2.9	2.7	3.3	3.3
NTF 1/	6.2	5.4	6.5	6.1
Bilateral	77.2	82.2	120.8	116.5
Government	56.0	67.7	87.5	84.7
China	0.0	0.0	7.6	10.1
Kuwait	4.4	2.9	2.8	3.5
Portugal	41.3	44.1	48.3	43.8
South Africa	0.0	0.0	...	...
Abu Dhabi	0.2	0.1	0.0	0.0
Germany	10.1	20.6	11.0	9.6
Russia	n.a.	n.a.	17.8	17.8
Export credit agencies	21.2	14.5	33.3	31.8
Caisse Général des Dépôts	4.7	7.0	16.6	14.3
ICO (Spain)	7.9	1.2	12.7	11.8
CACEX (Brazil)	2.4	2.4	0.0	3.1
SOMEC (Portugal)	6.3	3.9	4.0	2.6
Private companies	8.2	12.4	3.9	3.8
Banco Espirito Santo	7.5	11.8	3.9	3.8
MSF (Portugal)	0.7	0.7	...	...
Total (excluding arrears) 2/	337.6	383.0	475.7	493.3
As percent of GDP	60.9	55.2	52.0	49.1
Stock of external debt arrears	14.5	7.5	0.0	0.0
Total (including arrears)	352.1	390.5	475.7	493.3
As percent of GDP	63.5	56.3	52.0	49.1
Total (including arrears and financing gap)	352.1	390.5	475.7	493.3
As percent of GDP	63.5	56.3	52.0	49.1
In millions of Cape Verde escudos	44,052	41,064	41,536	40,569

Source: Cape Verdean authorities.

1/ AfDF = African Development Fund; BADEA = Arab Bank for Economic Development for Africa; AfDB = African Development Bank; EIB = European Investment Bank; OPEC = Organization of Petroleum Exporting Countries; IFAD = International Fund for Agricultural Development; Saudi Fund = Saudi Fund for Development; NDF = Nordic Development Fund; and NTF = Nigeria Trust Fund.

2/ Total debt (excluding arrears) for 2003 now includes rescheduled debt to ICO, which was formerly included in debt arrears.

Table 6. Cape Verde: Vulnerability Indicators, 1998–2004

(In units as indicated)

	1998	1999	2000	2001	2002	2003	2004
Real effective exchange rate (annual percentage change) 1/	-0.5	5.3	-7.4	0.2	2.6	3.6	-2.9
Nominal effective exchange rate (annual percentage change) 1/	-2.2	3.7	-1.9	0.2	4.0	6.3	1.3
Nominal Cape Verde escudos-U.S. dollar rate (annual percentage change) 2/	5.3	5.4	15.6	3.0	-4.9	-16.6	-9.1
Domestic credit growth (annual percentage change)	5.6	11.3	25.2	7.1	13.2	9.2	5.2
Overall fiscal balance, including grants (in percent of GDP)	-3.9	-12.5	-19.5	-4.7	-2.6	-3.5	-1.5
Public debt (in percent of GDP)	103.5	93.2	108.4	108.9	102.7	96.9	94.5
Domestic debt, including claims on the offshore Trust Fund (in percent of GDP)	58.5	40.0	48.9	45.5	46.4	44.9	45.4
Domestic debt, excluding claims on the offshore Trust Fund (in percent of GDP)	36.9	21.9	31.6	29.3	31.0	30.9	31.8
External debt (in percent of GDP)	44.9	53.2	59.5	63.5	56.3	52.0	49.1
Scheduled external debt service relative to gross international reserves (in percent)	167.7	87.8	56.2	114.8	42.3	32.0	25.2
Scheduled external debt service relative to fiscal domestic revenues (in percent)	13.0	32.1	14.2	40.5	21.3	14.9	15.0
Gross international reserves (in months of imports of goods and nonfactor services)	0.3	1.5	1.0	1.5	2.0	1.9	2.6
Broad money relative to official reserves (in percent)	4,081.0	789.7	1,245.3	874.3	624.0	696.0	556.6
Broad money relative to net foreign assets (in percent)	572.0	455.5	584.1	479.2	462.1	544.0	456.0
Central bank lending rate	10.0	8.5	9.5	11.5	10.0	8.5	8.5
Nonperforming loans (in percent of total loans)	21.6	10.4	10.1	9.3	7.4	7.4	7.2
Provisioning of nonperforming loans (in percent)	48.6	104.9	109.7	113.5	114.9	106.3	96.7
Private transfers (in percent of GDP)	15.7	18.4	21.0	19.9	21.0	19.7	20.5
Current account, excluding official current transfers (in percent of GDP)	-21.4	-20.6	-15.3	-13.9	-17.1	-15.4	-12.0
Exports of goods and nonfactor services relative to imports of goods and nonfactor services (in percent)	38.6	37.0	44.3	47.6	46.2	47.9	51.1
Tourism receipts and foreign direct investment (in percent of GDP)	5.5	13.5	13.5	10.8	12.6	11.9	13.7
Tourism receipts (annual percentage change)	41.7	46.3	66.2	35.6	14.8	8.6	16.3

Sources: Cape Verdean authorities; and staff estimates and projections.

1/ A minus sign symbolizes a depreciation.
2/ A minus sign symbolizes an appreciation.

Table 7. Cape Verde: Schedule of Disbursement Under the PRGF Arrangement, 2002–05

Amount	Available Date	Conditions Necessary for Disbursement 1/
SDR 1.23 million	April 4, 2002	Executive Board approval of the three-year annual arrangement.
SDR 1.23 million	December 16, 2002	Observance of the performance criteria for June 30, 2002 and completion of the first review under the arrangement.
SDR 1.23 million	June 25, 2003	Observance of the performance criteria for December 31, 2002 and completion of the second review under the arrangement.
SDR 1.23 million	December 19, 2003	Observance of the performance criteria for June 30, 2002 and completion of the third review under the arrangement.
SDR 1.23 million	August 27, 2004	Observance of the performance criteria for December 31, 2003 and completion of the fourth review under the arrangement.
SDR 1.23 million	January 31, 2005	Observance of the performance criteria for June 30, 2004 and completion of the fifth review under the arrangement.
SDR 1.26 million	May 25, 2005	Observance of the performance criteria for December 31, 2004 and completion of the sixth review under the arrangement.

Source: International Monetary Fund.
1/ Other than the generally applicable conditions under the Poverty Reduction and Growth Facility (PRGF) arrangement.

Table 8. Cape Verde: Millennium Development Goals

	1990	1995	2001	2002	2015 Target
Goal 1. Eradicate extreme poverty and hunger					
Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.					
1. Population below US$ 1 a day (percent)	...	...	...	...	...
2. Poverty gap ratio at US$ 1 a day (percent)	...	...	...	...	...
3. Share of income or consumption held by poorest 20 percent (percent)	...	...	...	...	...
3a. Percentage of poor, 2001-2002	...	...	30.0	...	...
3b. Incidence of absolute poverty 1/	49.0 2/	...	...	37.0	25.0
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger					
4. Prevalence of child malnutrition (percent of children under 5)	...	13.5	...	...	6.8
5. Population below minimum level of dietary energy consumption (percent)	...	...	...	...	...
Goal 2. Achieve universal primary education					
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling					
6. Net primary enrollment ratio (percent of relevant age group)	...	...	...	...	...
7. Percentage of cohort reaching grade 5	...	...	...	...	...
8. Youth literacy rate (percent age 15-24)	81.5	85.0	88.6	89.1	...
Goal 3. Promote gender equality and empower women					
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015					
9. Ratio of girls to boys in primary and secondary education (percent)	...	96.1	...	...	100.0
10. Ratio of young literate females to males (percent ages 15-24)	87.5	90.4	93.3	93.8	100.0
11. Share of women employed in the nonagricultural sector (percent)	...	...	...	...	...
12. Proportion of seats held by women in the national parliament (percent)	12.0	11.0	11.0	11.0	...
Goal 4. Reduce child mortality					
Target 5: reduce by two-thirds between 1990 and 2015, the under-five mortality rate					
13. Under-five mortality rate (per 1,000)	60.0	50.0	38.0	36.0	20.0
14. Infant mortality rate (per 1,000 live births)	45.0	37.0	29.0	30.0	...
15. Immunization against measles (percent of children under 12-months)	79.0	66.0	72.0	...	...
Goal 5. Improve maternal health					
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	190.0	...	...	...
17. Proportion of births attended by skilled health personnel	...	54.0	...	...	...
Goal 6. Combat HIV/AIDS, malaria and other diseases					
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS					
18. HIV prevalence among females (percent ages 15-24)	...	...	...	...	...
19. Contraceptive prevalence rate (percent of women ages 15-49)	...	...	...	...	...
20. Number of children orphaned by HIV/AIDS	...	...	...	...	...
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases					
23. Incidence of tuberculosis (per 100,000 people)	...	...	182.0	...	...
24. Tuberculosis cases detected under DOTS (percent)	...	...	...	...	...

Table 8. Cape Verde: Millennium Development Goals (concluded)

	1990	1995	2001	2002	2015 Target
Goal 7. Ensure environmental sustainability					
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources					
25. Forest area (percent of total land area)	8.7	...	21.1	...	...
26. Nationally protected areas (percent of total land area)	...	0.0	0.0	...	
27. GDP per unit of energy use (PPP $ per kg oil equivalent)	...	...	...	...	...
28. CO2 emissions (metric tons per capita)	0.2	0.3	0.3	...	...
Target 10: Halve by 2015 proportion of people without access to safe drinking water					
30. Access to improved water source (percent of population)	...	...	74.0	...	...
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers					
31. Access to improved sanitation (percent of population)	...	...	71.0	...	...
32. Access to secure tenure (percent of population)	...	...	...	...	...
Goal 8. Develop a Global Partnership for Development 3/					
Target 16: Develop and implement strategies for productive work for youth.					
45. Unemployment rate of population ages 15-24 (total)	...	...	...	...	...
Target 18: Make available new technologies, especially information and communications					
47. Fixed line and mobile telephones (per 1,000 people)	...	...	21.5	...	...
48. Personal computers (per 1,000 people)	...	81.7	68.6	...	...

Sources: World Bank; and Fund staff estimates.

1/ Absolute poverty measures the number of people in 1988 and 2002 whose income is below the 1988 national poverty line, indexed for inflation.

2/ Data for 1988.

3/ Targets 12-15 and indicators 29, 33-44 are excluded because they can not be measured on a country specific basis. These are related to official development, assistance, amrket access, and the HIPC initiative. Indicators 21 and 22 are not relevant for Cape Verde.

Table 9. Cape Verde: Quantitative Performance Criteria and Benchmarks for 2003–05 Under the PRGF Arrangement 1/ 2/

	2003	Cumulative flows from End-December 2003 2004											2005
	Dec.	March			June			Sep.		Dec.			
	Level	Indicative target			Performance criteria			Indicative		Performance			Indicative
	Actual	(unadjusted)	(adjusted)	Prel.	(unadjusted)	(adjusted)	Prel.	target	Prel.	criteria	(adjusted)	Prel.	target
Quantitative targets	(In billions of Cape Verde escudos)												
Ceiling on net domestic credit to the central government from the banking system 3/ 4/	14.9	1.1	0.9	-0.03	0.8	1.2	-0.5	0.7	-0.2	0.3	1.6	0.2	0.4
Ceiling on net domestic assets of the central bank 3/	9.2	-0.6	-0.8	-0.4	0.0	0.4	-1.0	-0.1	-0.8	-0.1	1.2	-1.4	-1.2
Ceiling on the accumulation of new domestic payment arrears by the central government	...	0	...	0	0	...	0	0	0	0	...	0	0
	(In millions of U.S. dollars)												
Ceiling on the accumulation of new external debt arrears by the central government 5/	0.0	0	...	0.0	0	...	0	0	0	0	...	0	0
Ceiling on the contracting or guaranteeing of non-concessional external debt with original maturity of more than one year by the central government 5/ 6/	...	10	...	5.0	10	...	10	...	...	20	...	20	20
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one one year by the central government 5/ 7/	0.0	0	...	0.0	0	...	0	...	...	0	...	0	0
	(In millions of euros)												
Floor on net international reserves of the Bank of Cape Verde (BCV) 8/	68.3	5.5	4.3	2.8	8.5	5.2	10.3	7	21.2	11	-1.0	27.2	37.7
Memorandum item:													
	(In billions of Cape Verde escudos)												
Floor on the primary current fiscal balance (indicative target)	...	0.0	...	...	0.3	...	...	-0.9	...	3.2	...	3.3	2.1
Program assumptions													
Nonproject external financial assistance, including credit line (program assumption)	...	0.4	...	0.4	0.8	...	0.4	1.0	0.4	2.5	1.2	1.2	4.0
External debt service 9/	...	0.6	...	0.4	1	...	1.0	1.4	1.5	2.4	...	2.4	4.8
Cash payments of domestic arrears	...	0	...	0	0	...	0.0	0.4	0.4	0.4	...	0.4	0.9

1/ Quantitative performance criteria and benchmarks are described in the technical memorandum of understanding.
2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.
3/ The ceiling will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject exernal financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.
4/ The ceiling on net domestic credit to the central government from the banking system will be adjusted downward by the shortfall in cash payments of domestic arrears relative to program assumptions.
5/ This performance criterion is on a continuous basis. The $20 million ceiling on nonconcessional external debt with original maturity of more than one year takes effect as of completion of the Fourth review.
6/ This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), but also commitments contracted or guaranteed for which value has not been received. Excluded from this performace criterion are rescheduling arrangements, the Portuguese credit line, and borrowings from the Fund.
7/ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt. Excluded from this performance criterion are rescheduling arrangments, the Portuguese credit line, borrowings from the Fund, and normal import-related credits.
8/ The floor on net international reserves of the Bank of Cape Verde will be adjusted upward (downward) by exchange valuation gains (losses), by the cumulative downward (upward) deviations in external debt service, and downward (upward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rate.
9/ Beginning end-December 2003, external debt service projections have been corrected downwards by CVEsc 550 million to eliminate the double counting of projected repayments of the Portuguese credit line, which are already captured in projected non-project external financial assistance.

Table 10. Cape Verde: Supplementary Structural Performance Criteria and Benchmarks Under the Third Annual Progran Supported by the PRGF Arrangement

Measures	Test Dates	Status or Amended Test Dates
Structural Performance criteria		
Refrain from providing budgetary subsidy to Electra for current operating expenses.	Continuous	Observed
Refrain from providing budgetary subsidy to TACV for current operating expenses.	Continuous	Observed
Approval by the Board of the ARE of an automatic and transparent mechanism for adjusting electricity and water tariffs on the basis of costs, and publication of such mechanism in the official gazette.	December 2004	Delayed: expected end-June, 2005
Structural benchmarks		
Present budget incorporating reduction of tax exemptions to the National Assembly.	December 2004	Observed
Conclude report of government's financial liabilities to Electra.	December 2004	Delayed
Introduction of all VAT returns into the VAT computer system.	December 2004	Observed
Implementation of new rules for tax collections through commercial banks.	February 2005	Delayed: Protocol issued to banks

Cape Verde: External and Public Debt Sustainability Analysis[12]

Background

1. This note assesses the sustainability of Cape Verde's external and total public debt. It measures the sensitivity of debt dynamics under the staff's baseline scenario when this outlook is subjected to a number of standardized shocks in the low-income countries (LIC's) debt sustainability framework. The previous debt sustainability analysis (DSA) was carried out during the third review of the PRGF (Appendix III of IMF Country Report No. 03/402, 12/03/03) based on the outstanding stock of external debt at end-2002 and projections for 2003. The analysis concluded that, under reasonable assumptions regarding new borrowing and export growth, the external debt burden would continue to ease over time, including in the face of moderate shocks.

2. The analysis is undertaken using loan-by-loan data. Data on bilateral external debt at end-2004 were provided by the authorities while multilateral debt data were obtained from the creditors.[13] The stock of Cape Verde's external debt, public and publicly guaranteed, amounted to US$493 million (53 percent of GDP) at end-2004. Of this debt, 76 percent was owed to multilateral creditors, 23 percent to bilateral creditors and less than 1 percent to commercial creditors. The World Bank was the largest multilateral creditor, followed by the African Development Fund and BADEA. Portugal, Russia and Germany accounted for 60 percent of the bilateral debt.

3. Cape Verde remains current on its external debt service obligations and has cleared all arrears with multilateral creditors. Discussions are currently under way with Brazil, Russia and China on loans contracted with these countries.

4. Central government domestic debt amounted to 24 million Cape Verde escudos (CVEsc) in 2004 (29 percent of GDP), of which 30 percent was short term debt. 70 percent of domestic debt was held by banks, while the largest share of nonbank debt was held by the public pension fund INPS.

[12] This DSA has been conducted in coordination with the World Bank.

[13] Cape Verde's external debt is public and publicly guaranteed debt to nonresidents. The analysis excludes private sector debt, which is believed to be negligible.

Table 1. Cape Verde: Net Present Value of Disbursed Debt Outstanding, 2004-10
(In millions of U.S. dollars)

	2004	2005	2006	2007	2008	2009	2010
	Actual	Projected					
Multilaterals	217.5	215.3	213.1	210.5	206.6	201.5	196.2
IDA	103.0	104.6	106.1	107.6	108.4	108.7	108.6
IMF	7.3	7.5	7.8	8.0	7.7	6.7	5.3
Others	107.3	103.2	99.1	94.9	90.4	86.1	82.3
Official bilaterals	100.1	89.5	78.7	69.3	56.5	43.3	32.0
Paris Club	60.3	54.7	49.0	43.2	34.7	26.0	19.2
Non-Paris Club	10.9	10.3	9.7	9.0	7.8	6.6	5.3
Export credit agencies	28.9	24.5	20.0	17.1	14.0	10.8	7.5
Commercial	3.5	2.8	2.2	1.5	0.9	0.4	0.3

Sources: Cape Verde authorities; and staff estimates and projections.

5. The assumptions underlying the DSA are based on the staff's medium-term macroeconomic framework until 2010 and the March 2005 *World Economic Outlook* forecast (Table 2). Beyond 2010, the baseline scenario projects constant GDP growth of 5 percent, inflation of 2 percent, export growth around 9 percent, and fiscal revenues remaining close to 26 percent of GDP. The medium and long-term assumptions imply stable current account and fiscal deficits. The baseline accounts for future disbursements under existing loans and disbursements under loans not yet contracted. Projected domestic borrowing is limited and external borrowing reflects the graduation of Cape Verde to middle income status and thus decreasing reliance on grants and nonconcessional borrowing.[14]

Table 2. Cape Verde: Macroeconomic Baseline Assumptions, 2005–10
(In percent, unless otherwise indicated)

	Historical Average (1995-2004)	2005	2006	2007	2008	2009	2010
Real GDP growth	7.1	6.0	7.0	6.5	6.5	6.5	6.5
Inflation	3.4	2.0	2.0	2.0	2.0	2.0	2.0
Exports of G&S (in U.S. dollars terms)	16.6	16.0	9.3	9.6	9.4	9.8	10.3
Imports of G&S (in U.S. dollars terms)	10.6	17.9	7.8	7.1	7.2	7.9	8.5
Current Account Balance (in percent of GDP)	-9.6	-8.4	-8.3	-8.2	-8.2	-7.9	-8.4
Foreign direct investment (in percent of GDP)	3.7	2.1	2.1	2.0	1.9	1.8	1.7
Grant element of new external borrowing	...	17.5	20.8	20.3	22.2	21.2	20.8
Exchange rate, national currency per U.S. dollar, p.a.	100.1	82.1	82.1	82.0	82.0	82.0	81.9
Public sector revenue and grants (in percent of GDP)	28.9	-2.6	-3.2	-3.2	-3.1	-2.5	-2.5

[14] Cape Verde is an IDA-only country. The projections assume that Cape Verde will continue receiving concessional IDA resources for the present decade and much of the next.

6. The DSA has three components: (1) the medium term baseline scenario described above, (2) an historical scenario, in which key variables in 2006–25 are at their historical averages (based on 1995–2004), and (3) a set of stress tests that explore the robustness of debt sustainability to alternative macroeconomic assumptions. The stress tests assume that key macroeconomic variables are at their recent historical averages or below them by a factor reflecting their historical volatility.

External Sustainability

7. In both the baseline and the historical scenarios, debt sustainability indicators remain comfortably below the indicative policy-dependent thresholds for a strong policy performing country (see Figure 1 and Table 3). The NPV of debt to exports is 100 percent at the beginning and end of the projection period, with the ratio peaking at around 125 percent under the baseline scenario. The NPV of debt to GDP increases from 32 to 39 percent of GDP over 2005–25, peaking at 47 percent in 2018 before declining. The ratio of debt service to exports remains at around 9 to 11 percent over the projection period. While the latter implies a growing commitment of domestic resources to servicing external debt, the simulations indicates that, under prudent assumptions on export growth and the terms of new borrowing in the next twenty years, the overall external debt position of Cape Verde would not deteriorate significantly.

Table 3. Policy Dependent External Debt Thresholds 1/
(In percent)

Indicator	Threshold	Initial ratio (2005)	Final ratio (2025)
Debt service-to-exports	25	9	11
Debt service-to-revenue	35	10	18
NPV of debt-to-GDP	50	32	39
NPV of debt-to-exports	200	100	92
NPV of debt-to-revenue	300	114	148

1/ Outcomes are reported as appear in the baseline scenario.

8. External debt sustainability remains sensitive to exogenous shocks, however. As shown in Figure 1, which includes results from the most extreme stress tests, a one time 30 percent nominal devaluation relative to the baseline pushes the NPV of debt to GDP above 45 percent in 2005 compared to 30 percent in the baseline, and keeps it permanently at a higher level—above the sustainability threshold. In addition to exchange rate fluctuations, the external debt outlook is vulnerable to declining exports and a worsening of lending terms. A decline in exports in 2005–06 by one standard deviation from historical levels results in the debt service to exports ratio reaching nearly 13 percent in the early 2020s. The debt outlook deteriorates, albeit less sharply, as a result of a worsening of the balance of payments financing pattern throughout the projection period, with the NPV of debt to exports ratio increasing by almost 50 percent. While the baseline scenario already builds in some deterioration in lending terms, this result highlights the need for continued vigilance regarding external financing conditions.

Figure 1. Cape Verde: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2005–25
(In percent)

Chart 1. NPV of debt-to-GDP ratio

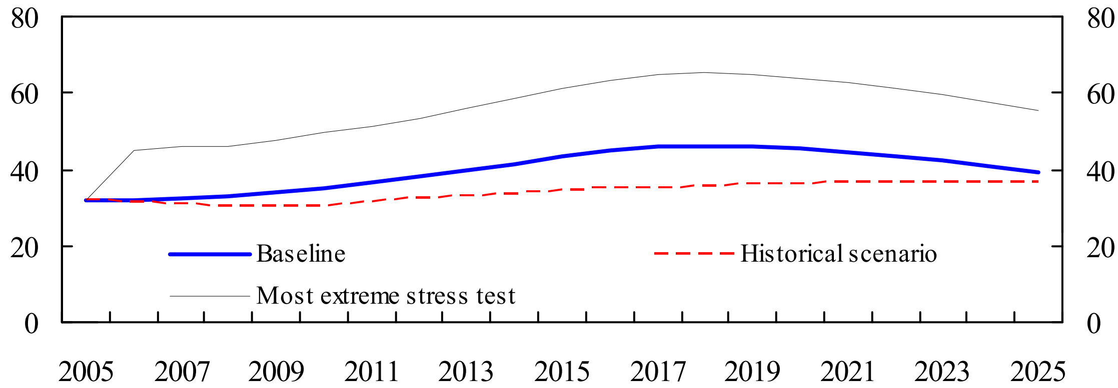


Chart 2. NPV of debt-to-exports ratio

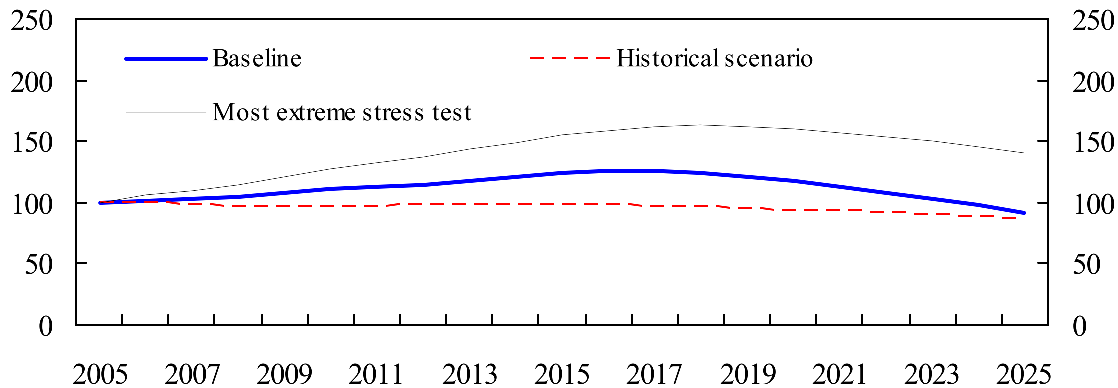
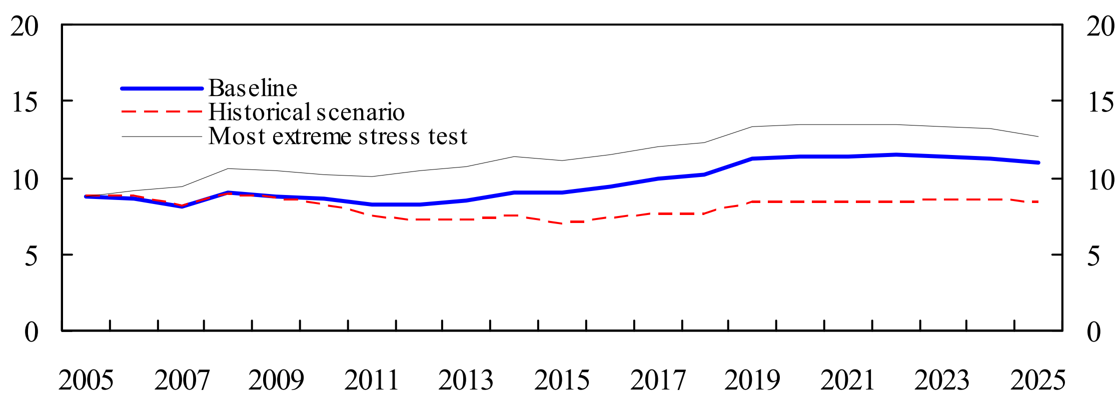


Chart 3. Debt service-to-exports ratio



Sources: Staff projections; and simulations.

Fiscal sustainability

9. Under a scenario with the primary balance held at the 2004 level, all indicators of public debt sustainability (external and domestic) show a decline of the debt service and debt burden in the projection period (Figure 2). The NPV of debt to GDP ratio declines to 15 percent by 2025, compared with 50 percent in the baseline.[15] The baseline scenario points to stable levels of the ratios of NPV of debt to GDP and NPV of debt service to revenue, and an increasing but low ratio of debt service to revenue.

10. The need for a prudent approach to borrowing is highlighted by the results of the stress test on public debt. In particular, in the most extreme test in which the primary balance is at historical averages minus one standard deviation in 2006–07, the NPV of public debt in percent of GDP and in percent of revenues increases sharply and stays permanently at a higher level, declining only after 2017.[16] Debt service to revenues would increase to nearly 30 percent after 2017.

11. In conclusion, the sensitivity analysis suggests that, under long-term economic scenarios which are in line with or more cautious than recent historical averages, Cape Verde's public debt would appear to be sustainable. Nevertheless, as a small island economy with a narrow export base, Cape Verde will remain vulnerable to shocks. In this light, a prudent approach to borrowing, consolidation of fiscal reforms to improve domestic resource mobilization, and strengthened debt management remain crucial. Such efforts are also warranted given Cape Verde's prospective graduation to middle income status and the possibility that, over time, it may be less able to borrow on highly concessional terms.

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[15] As the primary balance was much higher than expected in 2004, the baseline reflects a more conservative assumption on this balance over the projection period.

[16] It should be noted, however, that the historical scenario includes two episodes of fiscal expansion associated with pre-election periods.

Figure 2. Cape Verde: Indicators of Public Debt Under Alternative Scenarios, 2005–25

Chart 1. NPV of debt-to-GDP ratio

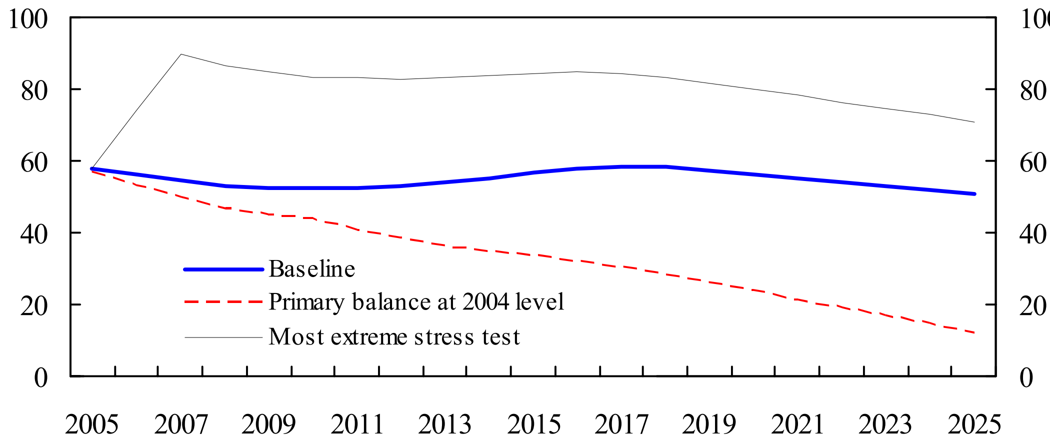

Chart 2. NPV of Debt-to-Revenue Ratio 2/

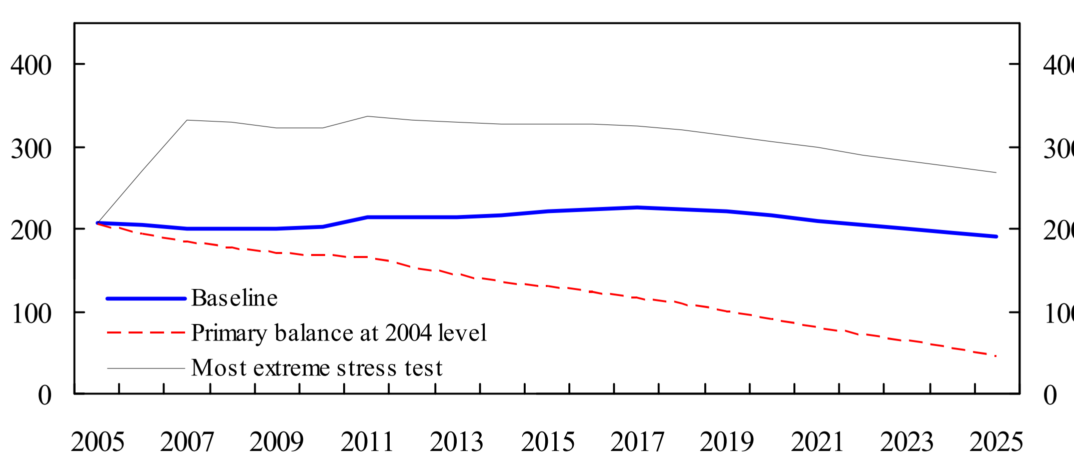

Chart 3. Debt Service-to-Revenue Ratio 2/

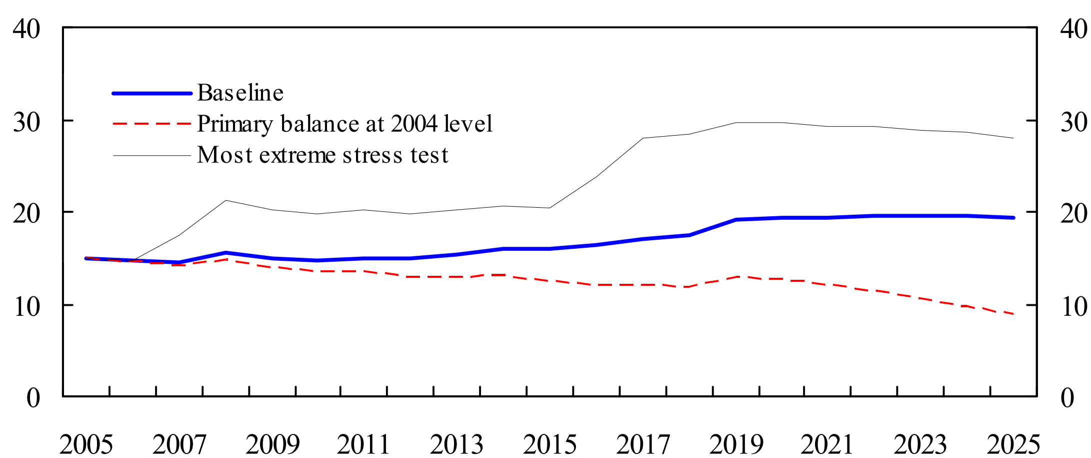

Table 4a. Cape Verde: External Debt Sustainability Framework, Baseline Scenario, 2002–25 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Estimate	Projections								
	2002	2003	2004			2005	2006	2007	2008	2009	2010	2005-10 Average	2015	2025	2011-25 Average
External debt (nominal) 1/	**62.7**	**58.2**	**53.0**			**48.2**	**47.2**	**46.6**	**46.4**	**47.0**	**48.2**		**55.4**	**49.0**	
o/w public and publicly guaranteed (PPG)	62.7	58.2	53.0			48.2	47.2	46.6	46.4	47.0	48.2		55.4	49.0	
Change in external debt	0.2	-4.6	-5.2			-4.8	-0.9	-0.6	-0.2	0.6	1.2		1.7	-1.9	
Identified net debt-creating flows	3.1	-7.2	-3.1			3.3	2.9	3.2	3.1	3.4	3.9		4.2	1.1	
Non-interest current account deficit	**9.0**	**6.4**	**5.0**	**8.0**	**2.7**	**7.3**	**7.3**	**7.2**	**7.1**	**7.2**	**7.6**		**7.2**	**3.6**	5.5
Deficit in balance of goods and services	36.2	33.7	31.0			30.3	28.9	27.6	26.3	26.7	26.0		24.2	15.2	
Exports	31.1	30.9	32.3			31.4	31.6	31.8	32.0	31.4	31.8		35.1	42.6	
Imports	67.4	64.6	63.2			61.7	60.5	59.5	58.3	58.1	57.9		59.2	57.8	
Net current transfers (negative = inflow)	-26.7	-25.7	-26.4	-26.4	2.0	-24.2	-22.9	-21.9	-21.0	-20.7	-19.8		-15.9	-10.2	-14.1
Other current account flows (negative = net inflow)	-0.5	-1.6	0.5			1.2	1.4	1.5	1.7	1.2	1.4		-1.1	-1.4	
Net FDI (negative = inflow)	**-2.4**	**-1.7**	**-2.2**	**-3.7**	**2.6**	**-2.1**	**-2.0**	**-1.9**	**-1.9**	**-1.8**	**-1.7**		**-1.6**	**-1.5**	-1.6
Endogenous debt dynamics 2/	**-3.6**	**-12.0**	**-5.9**			**-1.9**	**-2.4**	**-2.1**	**-2.1**	**-2.0**	**-2.0**		**-1.4**	**-1.0**	
Contribution from nominal interest rate	2.4	3.0	1.2			0.7	0.6	0.7	0.7	0.7	0.8		1.1	1.4	
Contribution from real GDP growth	-3.1	-3.0	-2.3			-2.7	-3.1	-2.8	-2.8	-2.8	-2.8		-2.5	-2.4	
Contribution from price and exchange rate changes	-2.9	-12.0	-4.7			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**-2.9**	**2.7**	**-2.1**			**-8.1**	**-3.8**	**-3.8**	**-3.4**	**-2.8**	**-2.7**		**-2.4**	**-3.0**	
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt 4/	...	...	33.5			31.7	31.9	32.3	32.8	33.9	35.5		44.1	39.7	
In percent of exports	...	...	103.8			100.8	100.9	101.5	102.4	107.9	111.7		125.8	93.2	
NPV of PPG external debt	**...**	**...**	**33.5**			**31.7**	**31.9**	**32.3**	**32.8**	**33.9**	**35.5**		**44.1**	**39.7**	
In percent of exports	...	...	103.8			100.8	100.9	101.5	102.4	107.9	111.7		125.8	93.2	
Debt service-to-exports ratio (in percent)	23.1	18.2	10.3			8.8	8.6	8.0	8.8	8.9	8.6		9.1	11.1	
PPG debt service-to-exports ratio (in percent)	23.1	18.2	10.3			8.8	8.6	8.0	8.8	8.9	8.6		9.1	11.1	
Total gross financing need (billions of U.S. dollars)	0.1	0.1	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.2	0.3	
Non-interest current account deficit that stabilizes debt ratio	8.9	11.0	10.2			12.1	8.3	7.8	7.3	6.6	6.4		5.5	5.5	
Key macroeconomic assumptions															
Real GDP growth (in percent)	5.5	6.2	4.5	7.1	2.1	6.0	7.0	6.5	6.5	6.5	6.5	6.5	5.0	5.0	5.0
GDP deflator in US dollar terms (change in percent)	4.8	23.6	8.9	1.9	11.1	12.4	3.1	2.9	2.6	2.4	2.4	4.3	2.0	2.0	2.0
Effective interest rate (percent) 5/	4.2	6.3	2.3	3.2	2.1	1.7	1.4	1.5	1.6	1.7	1.8	1.6	2.2	3.0	2.5
Growth of exports of G&S (US dollar terms, in percent)	16.2	30.5	18.7	16.6	13.5	15.9	11.0	10.3	9.9	7.0	10.3	10.7	9.2	9.2	9.2
Growth of imports of G&S (US dollar terms, in percent)	19.6	26.0	11.4	10.6	11.9	16.2	8.1	7.7	7.2	8.7	8.5	9.4	7.3	7.2	7.1
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	17.5	20.9	20.4	22.0	21.1	20.7	20.4	19.8	19.7	19.9
Memorandum item:															
Nominal GDP (billions of US dollars)	0.6	0.8	0.9			1.1	1.2	1.3	1.5	1.6	1.7		2.4	4.9	

Source: Staff simulations.
1/ Includes both public and private sector external debt.
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 NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments devided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4b. Cape Verde: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2005–25
(In percent)

	Estimate	Projections						
	2005	2006	2007	2008	2009	2010	**2015**	2025
NPV of debt-to-GDP ratio								
Baseline	32	32	32	33	34	36	**44**	40
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	32	31	31	31	31	31	**35**	37
A2. New public sector loans on less favorable terms in 2006-25 2/	32	33	34	36	38	41	**55**	61
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	32	33	33	34	35	37	**46**	41
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	32	34	38	38	39	40	**47**	40
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	32	36	42	42	44	46	**57**	51
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07	32	31	30	30	32	33	**43**	40
B5. Combination of B1-B4 using one-half standard deviation shocks	32	34	37	38	39	41	**51**	46
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	32	45	46	46	48	50	**62**	56
NPV of debt-to-exports ratio								
Baseline	101	101	102	102	108	112	**126**	93
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	101	99	97	96	99	99	**101**	87
A2. New public sector loans on less favorable terms in 2006-25 2/	101	104	108	112	121	129	**157**	143
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	101	101	102	102	108	112	**126**	93
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	101	115	136	136	142	145	**154**	108
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	101	101	102	102	108	112	**126**	93
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07	101	98	94	95	101	105	**122**	93
B5. Combination of B1-B4 using one-half standard deviation shocks	101	101	102	103	109	113	**127**	95
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	101	101	102	102	108	112	**126**	93
Debt service ratio								
Baseline	9	9	8	9	9	9	**9**	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2006-25 1/	9	9	8	9	9	8	**7**	9
A2. New public sector loans on less favorable terms in 2006-25 2/	9	9	7	8	8	8	**9**	15
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	9	9	8	9	9	9	**9**	11
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	9	9	9	11	11	11	**12**	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	9	9	8	9	9	9	**9**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07	9	9	8	9	9	8	**9**	11
B5. Combination of B1-B4 using one-half standard deviation shocks	9	9	8	9	9	9	**9**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	9	9	8	9	9	9	**9**	11
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	16	16	16	16	16	16	**16**	16

Source: Staff projections and simulations.
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 5a. Cape Verde: Public Sector Debt Sustainability Framework, Baseline Scenario, 2002–25
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate		Projections					
	2002	2003	2004	Historical Average 5/	Standard Deviation 5/	2005	2006	2007	2008	2009	2010	2005-10 Average	2015
Public sector debt 1/	86.9	79.8	78.1			74.6	71.5	68.9	66.6	65.4	64.9		68.1
Of which: foreign-currency denominated	62.7	58.2	53.0			48.2	47.4	46.8	46.4	46.8	47.9		54.7
Change in public sector debt	-1.4	-7.1	-1.7			-3.6	-3.0	-2.6	-2.3	-1.3	-0.5		1.4
Identified debt-creating flows	-11.3	-13.9	-4.4			-4.7	-3.3	-2.5	-2.3	-3.0	-2.9		0.3
Primary deficit	-0.1	1.0	-1.0	8.9	12.3	0.2	1.0	1.1	1.0	0.6	0.6	0.8	2.8
Revenue and grants	31.2	26.7	29.1			27.8	27.4	27.2	26.3	26.3	25.9		25.7
Of which : grants	8.7	5.5	6.5			6.6	6.1	5.8	5.0	4.8	4.2		3.5
Primary (noninterest) expenditure	31.1	27.8	28.1			28.1	28.4	28.3	27.4	26.8	26.5		28.6
Automatic debt dynamics	-11.2	-14.9	-3.4			-5.0	-4.8	-4.1	-3.8	-3.6	-3.5		-2.5
Contribution from interest rate/growth differential	-2.8	-4.4	-1.9			-4.0	-4.3	-3.7	-3.5	-3.4	-3.3		-2.5
Of which : contribution from average real interest rate	1.8	0.8	1.6			0.4	0.5	0.6	0.7	0.7	0.6		0.6
Of which : contribution from real GDP growth	-4.6	-5.1	-3.5			-4.4	-4.9	-4.3	-4.2	-4.1	-4.0		-3.2
Contribution from real exchange rate depreciation	-8.5	-10.5	-1.5			-0.9	-0.5	-0.4	-0.3	-0.2	-0.2		...
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.5	0.4	0.4	0.0	0.0		0.0
Privatization receipts (negative)	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	0.5	0.4	0.4	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
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
Residual, including asset changes	10.0	6.8	2.7			1.2	0.3	-0.1	0.0	1.7	2.4		1.1
NPV of public sector debt	...	...	...			58.0	56.1	54.5	53.0	52.3	52.3		56.9
Of which: foreign-currency denominated	...	...	...			31.7	32.0	32.5	32.8	33.8	35.3		43.5
Of which: external	...	...	...			31.7	32.0	32.5	32.8	33.8	35.3		43.5
NPV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...
Gross financing need 2/	30.6	33.8	30.4			31.0	29.1	27.2	25.4	23.1	21.5		19.7
NPV of public sector debt-to-revenue ratio (in percent) 3/	...	...	...			208.7	204.9	200.8	201.3	199.3	202.0		221.0
Of which: external	...	...	...			114.1	116.8	119.6	124.6	128.7	136.3		169.0
Debt service-to-revenue ratio (in percent) 3/ 4/	22.7	18.1	15.4			15.8	15.6	14.8	15.8	15.4	15.0		15.4
Primary deficit that stabilizes the debt-to-GDP ratio	1.2	8.1	0.6			3.8	4.0	3.7	3.3	1.8	1.1		1.4
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	5.5	6.2	4.5	7.1	2.1	6.0	7.0	6.5	6.5	6.5	6.5	6.5	5.0
Average nominal interest rate on forex debt (in percent)	1.3	1.1	1.2	1.6	0.4	1.5	1.4	1.5	1.6	1.7	1.8	1.6	2.2
Average real interest rate on domestic currency debt (in percent)	8.4	5.1	10.0	5.1	4.1	3.0	3.3	3.7	4.0	4.2	4.3	3.8	4.2
Real exchange rate depreciation (in percent, + indicates depreciation)	-14.3	-18.0	-2.7	0.4	11.3	-1.9	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	-0.3	3.1	-1.2	2.2	3.0	4.0	3.1	2.8	2.6	2.4	2.3	2.9	2.0
Growth of real primary spending (deflated by GDP deflator, in percent)	11.6	-5.1	5.9	-1.3	21.8	5.7	8.3	6.0	3.1	4.3	5.1	5.4	5.9
Grant element of new external borrowing (in percent)	...	...	...	...	...	17.5	20.8	20.3	22.2	21.2	20.8	20.5	19.8

Sources: Cape Verde authorities; and Fund staff estimates and projections.
1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
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 including 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 5b. Cape Verde: Sensitivity Analysis for Key Indicators of Public Debt, 2005–25

	Estimate	Projections						
	2005	2006	2007	2008	2009	2010	2015	2025
NPV of Debt-to-GDP Ratio								
Baseline	58	56	55	53	52	52	57	51
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	58	63	68	73	78	84	103	126
A2. Primary balance is unchanged from 2004	57	53	50	47	45	44	33	11
A3. Permanently lower GDP growth 1/	58	56	55	54	54	55	64	73
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006–07	58	58	57	56	56	57	64	62
B2. Primary balance is at historical average minus one standard deviations in 2006–07	58	75	90	87	85	84	85	71
B3. Combination of B1-B2 using one half standard deviation shocks	58	69	80	77	76	75	76	65
B4. One-time 30 percent real depreciation in 2006	58	69	66	64	62	61	64	58
B5. 10 percent of GDP increase in other debt-creating flows in 2006	58	65	63	61	60	60	64	56
NPV of Debt-to-Revenue Ratio 2/								
Baseline	209	205	201	201	199	202	221	191
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	209	231	251	277	299	327	407	497
A2. Primary balance is unchanged from 2004	205	194	183	177	170	168	127	40
A3. Permanently lower GDP growth 1/	209	206	203	205	205	211	248	271
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006-2007	209	209	210	213	213	218	249	234
B2. Primary balance is at historical average minus one standard deviations in 2006-2007	209	272	333	331	324	323	329	268
B3. Combination of B1-B2 using one half standard deviation shocks	209	253	294	293	287	288	297	243
B4. One-time 30 percent real depreciation in 2006	209	251	244	242	237	237	250	220
B5. 10 percent of GDP increase in other debt-creating flows in 2006	209	238	233	233	229	231	247	209
Debt Service-to-Revenue Ratio 2/								
Baseline	16	16	15	16	15	15	15	19
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	16	16	16	18	18	19	22	37
A2. Primary balance is unchanged from 2004	16	15	14	15	14	14	12	8
A3. Permanently lower GDP growth 1/	16	16	15	16	16	15	17	24
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006–07	16	16	15	16	16	16	17	22
B2. Primary balance is at historical average minus one standard deviations in 2006–07	16	16	18	22	21	20	20	28
B3. Combination of B1-B2 using one half standard deviation shocks	16	16	17	20	19	19	19	25
B4. One-time 30 percent real depreciation in 2006	16	16	16	17	17	16	18	23
B5. 10 percent of GDP increase in other debt-creating flows in 2006	16	16	16	17	17	16	16	21

Sources: Cape Verde authorities; and Fund staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

2/ Revenues are defined inclusive of grants.

REQUEST FOR WAIVER

Praia, March 12, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431
U.S.A.

Dear Mr. de Rato,

As the recent mission from the African Department of the Fund concluded, Cape Verde has maintained its sound economic and policy performance during 2004 and into 2005. All end-2004 quantitative performance criteria under the PRGF arrangement were met, as were two out of three structural performance criteria.

The government requests a waiver for nonobservance of one structural performance criterion, which concerns the approval by the Board of ARE (the independent economic regulatory agency) of an automatic and transparent mechanism for adjusting electricity and water tariffs on the basis of costs, and publication of such mechanism in the official gazette. Important progress has been made toward meeting this objective. After some delays earlier in 2004, reflecting in part capacity constraints faced by the newly established regulatory agency, an economic and financial model of the electricity and water sector has recently been completed with the help of the World Bank. Drawing on further Bank support, ARE has agreed to the appointment of a consultant to translate this model into the desired tariff adjustment mechanism. As a result, the government expects that ARE will be able to finalize and publish the mechanism by the end of June 2005.

The government looks forward to maintaining the excellent spirit of cooperation that has prevailed between the IMF and Cape Verde over the past three years during implementation of the PRGF arrangement.

Sincerely yours,

/s/

João Serra
Minister of Finance and Planning

Cape Verde: Relations with the Fund

(As of March 31, 2005)

I. **Membership Status**: Joined 11/20/1978; Article VIII

II. **General Resources Account**:	SDR million	%Quota
Quota	9.60	100.0
Fund holdings of currency	9.60	99.96
Reserve position in Fund	0.00	0.05

III. **SDR Department**:	SDR million	%Allocation
Net cumulative allocation	0.62	100.0
Holdings	0.02	3.12

IV. **Outstanding Purchases and Loans**:	SDR million	% Quota
Poverty Reduction and Growth Facility (PRGF) Arrangement	7.38	76.88

V. **Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	4/10/2002	7/31/2005	8.64	7.38
Stand-By Arrangement	02/20/1998	03/15/2000	2.50	0.00

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	0.00	0.00	0.12	0.49	0.98
Charges/interest	0.05	0.05	0.05	0.05	0.05
Total	0.05	0.05	0.17	0.54	1.03

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the Bank of Cape Verde (BCV) is subject to an assessment with respect to the PRGF arrangement approved on April 10, 2002. A safeguards assessment of the BCV was completed on December 9, 2002. The assessment identified certain vulnerabilities in the reporting, internal control, and audit areas, and made appropriate recommendations, as reported in IMF Country Report No. 03/152

(06/23/03). The BCV has implemented all but one of the safeguard assessment recommendations. The one outstanding recommendation, regarding clear separation of front and back office functions in the Operations Division, is expected to be implemented in 2005.

VIII. **Exchange Arrangements**:

The currency of Cape Verde, the Cape Verde escudo, has been pegged to the euro at a rate of CVEsc 110.3 per EUR 1 since January 4, 1999. Cape Verde accepted the obligations under Article VIII of the Articles of Agreement effective July 1, 2004.

IX. **Article IV Consultation**:

Discussions of the 2002 Article IV consultation and the first review under the PRGF arrangement were held in Praia during October 13-27, 2002. The Executive Board concluded the discussions of the Article IV consultations and completed the first review under the PRGF on December 16, 2002 (IMF Country Report No. 03/152 (06/23/03); and www.imf.org. It is expected that the next Article IV consultations with Cape Verde will be held on the 24-month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

X. **Technical Assistance**:

Since 1985, the Fund has provided technical assistance to the Bank of Cape Verde, the Ministry of Finance, and, more recently, the National Institute of Statistics in several areas: (i) The Bank of Cape Verde has received technical assistance from MFD in organization and methods, management of external debt, monetary and banking statistics, accounting, credit, and foreign exchange operations, management of public debt, and the separation of the functions of the Bank of Cape Verde, as well as on the choice of exchange rate regime. It has also received technical assistance from STA in monetary and balance of payments statistics. (ii) The Ministry of Finance has received technical assistance from FAD in organization and budgetary procedures, budgeting, tax policy, and tax administration; and (iii) the National Institute of Statistics has received technical assistance in national accounts and is now starting to receive assistance in price statistics. Cape Verde is a participant in STA's GDDS Regional Project for Lusophone Africa, and has recently posted its metadata on the web. It is receiving technical assistance to implement the GDDS plan for improvement in the context of this project.

Most recently, technical assistance has been provided in the following areas:

- An FAD follow-up visit in June 2004 was the most recent mission to help the authorities move to a VAT, including the rationalization of the import tariff and the overhaul of the domestic indirect tax system. Many visits and a two-year resident advisor have gone into this effort.

- In October 2004, two FAD missions visited Cape Verde—one to review tax administration, including VAT implementation, the other to assist the assessment of tax exemptions and incentives.

- STA missions have recently taken place on national accounts (November 2003), balance of payments statistics (February 2004), government finance statistics (March 2004), and price statistics (June 2004).

- In July 2003, an MFD expert visited the Bank of Cape Verde to advise on safeguards issues. In April 2004, MFD provided technical assistance on accounting for the BCV. In May 2004, MFD experts visited the BCV to advise on financial systems regulations and on monetary operations and liquidity management.

XI. **Resident Representative:** None.

Cape Verde: IMF-World Bank Relations

(April 15, 2005)

Partnership in Cape Verde's development strategy

1. The Joint staff advisory note (JSAN) of the Government's full Poverty Reduction Strategy Paper (PRSP) was discussed in the Board in January 2005. Cape Verde's strategy focuses on five key pillars for public intervention: (i) promoting good governance; (ii) improving competitiveness and private-sector-led growth; (iii) fostering human capital development; (iv) strengthening social security and solidarity; and (v) improving infrastructure and land use management. The main development challenges for the country revolve around: (i) maintaining macroeconomic stability given external vulnerabilities and uncertainties surrounding resources flows; (ii) achieving further improvements in governance, especially in a decentralized context; (iii) reforming social expenditure programs to reflect the changing nature of demand; and (iv) promoting stronger growth and poverty reduction through improvements in the business climate.

World Bank Group strategy

2. The Bank's FY05-08 Country Assistance Strategy (CAS) was discussed by the Board in February 2005. It is fully aligned with the PRSP, and supports efforts in the areas of (i) macroeconomic stability and sound finance and budget systems; (ii) private-led growth through an enhanced investment climate and increased competitiveness through public-private partnerships in infrastructure; and (iii) social programs aimed at alleviating poverty and inequity.

World Bank Group activities and assessment of country policies

IDA portfolio

3. The Bank's strategy aims at supporting the implementation of the Government's poverty reduction strategy by focusing in areas where the Bank has a comparative advantage. The CAS calls for a significant shift towards programmatic lending, complemented by a multi-sectoral investment operation, to the extent possible every two years. Contributing to the harmonization agenda, Bank group support aims to catalyze other donors and build partnerships.

4. With regard to programmatic lending, a first Poverty Reduction Support Credit (PRSC-1, US$15 million equivalent) was approved by the Board in February 2005. It focuses on three main objectives: (i) promote good governance, reinforcing effectiveness and guaranteeing equity; (ii) develop and upgrade human resources; (iii) improve the effectiveness and sustainability of the social protection system. PRSC-1 is a one-tranche operation and will be the first in a series o f three annual operations (PRSC-2 currently planned for FY06).

5. With regard to investment lending, the current World Bank investment portfolio gives a priority to stabilizing the macroeconomic framework, strengthening competitiveness (infrastructure and private sector) and building capacity in the social sector (HIV/AIDS).

6. IDA's assistance in terms of strengthening the country's physical infrastructure and competitiveness, is covered as follows:

> The Energy/Water Project aims to improve the supply of power, water, and sanitation systems, to increase operational and end-use efficiency in the power and water, sectors, to lower the barriers to the development of renewable energy sources, and to foster the sound management of water resources.
>
> The Growth and Competitiveness Project aims to broaden the base of private participation in Cape Verde's economic growth, enhance private sector competitiveness and further develop its financial sector. This would be achieved through a series of actions supported by the project, notably: (a) financial sector reform, including pension reform; (b) investment climate reform, which includes, but is not limited to: (i) tax reform, (ii) alleviation of administrative barriers, (iii) improved supply chains, and (iv) legal reform; (c) post privatization and divestiture reforms; and (d) private sector and institutional capacity building. The project thus helps to sustain the Government's poverty alleviation efforts by generating increased employment opportunities through improved international competitiveness.
>
> The Road Sector Support Project (currently under preparation) would aim to support critical road transport infrastructure needs through all, or a combination of the following approaches: (i) improving access roads linking villages and rural areas to main roads; (ii) filling critical gaps to establish a minimum continuous network within an island with the construction of a short section of new road (8–10 km. on St. Nicolau Island); and (iii) filling a major gap in an island network, through the construction of bridges or providing access to a chronically poor access zone.

7. In the social sectors, an HIV/AIDS Project supports (i) mitigation of the health and socioeconomic impact of HIV/AIDS at individual, household, and community levels, thus sustaining an economically productive population, and (ii) establishment of a strong and sustainable national capacity to respond to the epidemic.

8. The World Bank, IFC, and MIGA will continue to coordinate their respective roles to support development activities in Cape Verde.

Assessment of country policies

9. The authorities of Cape Verde and development partners, including the Bank, have undertaken a substantial body of analytic work to assess key social, structural, and sectoral development policies and identify policy and institutional reform priorities for poverty reduction. It allowed *inter alia* the adoption in April 2003 of a Statement of development policies for private sector development, which was one of the basic framework to the preparation of the Growth and competitiveness project.

10. In FY05 and beyond, advisory services are expected to be in large part related to infrastructure, fisheries and economic management (public service reform). Proposed economic and sector work (ESW) includes core diagnostics, annual public expenditures reviews (PER) updates, and general economic work to sustain macroeconomic and sectoral dialogue. The following studies are planned: Infrastructure regulation and competitiveness diagnostic report (FY05), investment climate assessment (ICA and pension study (FY06), Review of human development (FY07), Rural development assessment (FY07), Integrated CFAA/CPAR (FY07).

11. As of April 11th, 2005, IDA had extended 22 credits to Cape Verde, amounting to about US$213 million equivalent, of which about US$178 million has been disbursed. 18 credits have closed. The current portfolio includes four credits, with associated credit amounts of about US$53 million equivalent and an undisbursed balance of about US$35 million. The involvement of the International Finance Corporation (IFC) in Cape Verde remains limited.

World Bank-Fund collaboration in specific areas

12. The Fund and the Bank continue to collaborate in many areas, including fiscal operations and tax reform; public enterprise reform and privatization; utility regulation and private sector development; and the strengthening of human resource development and the poverty reduction strategy. In close collaboration with the World Bank, the Fund staff has discussed and reached understandings on a structural reform program with the government of Cape Verde in the context of the PRGF arrangement. The Fund and the Bank have collaborated in the areas of the privatization program, utility regulation, public expenditure management, and civil service and pension system reform.

13. Questions may be referred to Mr. Madani M. Tall (tel.: 1-221-849-5011), Ms. Francoise Perrot (tel: 1-202-473-4465), Isabelle Huynh-Segni (tel: 1-202-473-4373) or Mr. Jean van Houtte (tel.: 1-202-473-0156).

Relations with the World Bank Group

Statement of IDA Operations

(As of April, 2005; in millions of U.S. dollars)

Credit No.	Projects	Principal Amount	Disbursed	Undisbur-sed	Approved Date	Closing Date
	18 credits closed	*159.9*	*156.5*	*1.7*		
40370	PRSC-1	15.0	0	14.8	22-Feb-05	31-Mar-06
37550	Growth & Competitiveness	11.5	2.8	10.1	13-May-03	28-Feb-08
36290	HIV/AIDS	9.0	8.0	2.3	28-Mar-02	31-Dec-06
32050	Energy/Water	17.5	10.4	7.3	11-May-99	30-Jun-04
	Total active projects	53.0	21.2	34.5		
	Active and closed projects	212.9	177.8	36.2		

Note: Disbursed amount may be higher than commitment (approved amount) due to exchange rate vis-à-vis SDR.

Statement of IFC Investments

(In millions of U.S. dollars)

			Original Gross Commitments				Disbursed			
FY Approv.	Company	Type of Business	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic.
1992	Growela 1/	Shoe manu-facturing	0.15	0.00	0.00	0.00	0.15	0.00	0.00	0.00
2004	CECV 2/	Finance and insurances	6.63	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total portfolio			6.78	0.00	0.00	0.00	0.15	0.00	0.00	0.00

1/ Growela = shoe manufacturing.
2/ CECV = Caixa Economica de Cabo Verde.

CAPE VERDE: STATISTICAL ISSUES

1. The data compilation and reporting system in Cape Verde has improved significantly in recent years, although the development of the country's statistical system still suffers from a shortage of financial and human resources. The authorities decided to participate in the Fund's General Data Dissemination System (GDDS) and during 2003–04, benefited from the technical assistance provided by STA under the GDDS project for Lusophone Africa. The GDDS metadata for Cape Verde are posted on the IMF Data Standards Dissemination Board.

2. Under the GDDS project for Lusophone Africa, technical assistance was provided in national accounts statistics (two missions), consumer price, government finance, and balance of payments statistics (one mission each).

Real sector

3. Some improvements have been made for a more timely presentation of national accounts statistics. The National Statistical Institute (INE) plans to release the final GDP numbers for 2002–03, with 1980 as base year, in May 2005. The INE intends to use the results of the 2001–02 household income and expenditure survey in updating the national accounts benchmark and base year estimates from 1980 to 2002. The final objective is to adopt the *1993 SNA*, for which technical assistance from AFRISTAT and the Fund has been requested. STA conducted two technical assistance missions in 2003, which provided INE with extensive and detailed recommendations. A follow-up mission has been scheduled for mid-2005 in order to assist INE in designing the strategy for implementing the *1993 SNA*, including substantial improvement in the source data collections programs. This will require a significant commitment from INE to implement STA's previous recommendations while coordinating this assistance with that provided by AFRISTAT. In addition, labor market surveys will be undertaken twice a year, starting from the second half of 2005, in collaboration with the Employment Institute.

4. The official consumer price index (CPI) is obsolete, as the weights date back to 1989, four years before the liberalization of imports that considerably changed the composition of consumption. The introduction of a re-weighted CPI, after some delay, is now planned before the end of 2005, with the assistance from the National Statistics Institute of Portugal which provided the new CPI software installed at INE. The new CPI index will use an updated commodity basket, based on the 2001–02 household budget survey, with geographical coverage being re-examined. A STA technical assistance mission is tentatively scheduled for 2005, to follow up on a previous mission during the first half of 2004.

Government finance

5. The management of government expenditures has been improved with the consolidation of most accounts previously held with commercial banks at the central bank level. In addition, government agencies' reporting, as well as the coordination among the treasury, the budget directorates, and the central bank, has also been improved, with the Ministry of Finance and Planning being the single point of commitment, execution, and monitoring of public expenditure. As noted in the appendix on Fund Relations, the Ministry of Finance and Planning has received technical assistance from FAD in organization and

budgetary procedures, budgeting, tax policy, and tax administration during the course of the successive Fund programs.

6. The government finance statistics (GFS) compilation system is being substantially improved as part of the ongoing reforms of the government's management and information systems. The main recommendations of the STA technical assistance mission that took place in March 2004 were to assign the responsibility for compiling GFS within the Ministry of Finance, and to revise the budget classifiers to ensure full consistency with the recommendations of the *Government Finance Statistics Manual 2001.* The mission prepared derivation tables to compile GFS from the existing budget execution data more aligned with these recommendations.

7. The 2004 mission recommended that the derivation table prepared be used to start reporting government finance statistics to STA for publication. However, no government finance data are yet reported for publication in *International Financial Statistics (IFS)* or *Government Finance Statistics (GFS) Yearbooks*. A GFS mission by STA in March 2004 reviewed the current status of compilation of fiscal statistics and provided the authorities with recommendations to further improve the usefulness of the data. Further improvements of the institutional coverage of general government and the classification of transactions were recommended. Reviewing the chart of accounts and developing bridge tables to the *GFSM 2001* assisted the authorities with their plans to work towards disseminating GFS in accordance with the framework of *GFSM 2001*.

Money and banking

8. The central bank (BCV) compiles and reports monthly monetary statistics to STA on a timely basis. Balance sheet data for the central bank and other depository corporations are provided with a lag of approximately four weeks. Significant progress has been made in the area of monetary and financial statistics, both in terms of the accuracy and timeliness of the data.

9. As a result of extensive "hands-on" training and courses provided by STA to the BCV staff the institutional capacity of the BCV to compile monetary statistics has improved considerably. However, there is still a need to improve the timeliness of the monetary data reported to the Fund, particularly the consolidated analytical accounts for the commercial banks. As noted in the Fund Relations appendix, the BCV has received technical assistance from MFD in monetary and banking statistics and a range of other areas.

Balance of payments

10. With technical assistance from STA, the accuracy, periodicity and timeliness of balance of payments statistics compiled by BCV have continued to improve. A greater use of surveys, combined with the international transactions reporting system (ITRS) implemented by BCV, has permitted a significant expansion of data sources and statistical coverage, which, to a large extent, follow the recommendations of the fifth edition of the *Balance of Payments Manual* (*BPM5).*

11. The STA balance of payments mission that visited Cape Verde in 2004 provided advice to improve data sharing and coordination among data-producing agencies, namely the customs administration for the international merchandise trade statistics and Ministry of Finance with regard to external debt data, and to further improve the data collection program, including revisions to the quarterly surveys to increase the coverage of the transactions reported. The mission also provided recommendations for the BCV to start compiling Cape Verde's international investments position.

12. The timeliness of reporting BOP quarterly statistics to STA needs to be improved. The latest quarterly data published in *IFS* refers to December 2003. However, quarterly BOP statistics for 2004 are already disseminated in the BCV website. Reporting of annual data to STA is timely, and the latest annual data published in the 2004 edition of the *Balance of Payments Statistics Yearbook (BOPSY)* is 2003. The Cape Verdean authorities also provided STA with technical notes describing the methodologies and compilation procedures used for balance of payments statistics.

External debt

13. An adequate database on debt appears to be in place, although further improvements would facilitate the preparation of regular and reliable debt sustainability analyses. The treasury department of the Ministry of Finance and Planning is able to provide a breakdown by creditors for debt, including debts currently under negotiation.

CAPE VERDE: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF APRIL 15, 2005

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	Mar. 2005	Apr. 2005	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Feb. 2005	Apr. 2005	M	M	M
Reserve/Base Money	Mar. 2005	Apr. 2005	M	M	M
Broad Money	Mar. 2005	Apr. 2005	M	M	M
Central Bank Balance Sheet	Mar. 2005	Apr. 2005	M	M	M
Consolidated Balance Sheet of the Banking System	Mar. 2005	Apr. 2005	M	M	M
Interest Rates[2]	Mar. 2005	Apr. 2005	M	M	M
Consumer Price Index	Mar. 2005	Apr. 2005	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Dec. 2004	Mar. 2005	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Dec. 2004	Mar. 2005	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec. 2004	Mar. 2005	Q	Q	I
External Current Account Balance	Dec. 2004	Mar. 2005	Q	I	Q
Exports and Imports of Goods and Services	Dec. 2004	Mar. 2005	Q	I	Q
GDP/GNP	Dec. 2003	Mar. 2005	A	I	A
Gross External Debt	Dec. 2004	Mar. 2005	A	A	I

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[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).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 05/111
FOR IMMEDIATE RELEASE
August 11, 2005

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2005 Article IV Consultation with Cape Verde

On May 25, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Cape Verde together with the sixth review of Cape Verde's arrangement with the IMF under the Poverty Reduction and Growth Facility (PRGF) (see Press Release No. 05/124).[17]

Background

Macroeconomic policies in Cape Verde have strengthened significantly over recent years, enabling the country to correct the severe macroeconomic imbalances that emerged in 2000 in the run-up to parliamentary and presidential elections. In particular, the fiscal position is now markedly stronger than in 2000; external and domestic public debt have declined as a share of GDP; and international reserves have been built up, supporting the credibility of the exchange rate peg to the euro. Important progress has also been made on a range of structural reforms to increase efficiency, improve the business climate, and support investment. Underpinned by this sound policy environment, GDP growth has been robust—averaging nearly 6 percent since 2000—and inflation has remained low.

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[17] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Following a Fund staff-monitored program in the second half of 2001, the authorities' economic program has been supported by an arrangement with the IMF under the PRGF. This arrangement was approved in April 2002 and ended in July 2005. The government's medium-term development strategy is set out in the Poverty Reduction Strategy Paper (PRSP), which focuses on combating poverty and promoting private-sector-led growth by strengthening education, training, and health care, developing economic infrastructure, and improving governance. The PRSP was discussed by the Boards of the IMF and World Bank in January 2005.

Considering recent developments, GDP growth is estimated to have been 4.5 percent in 2004, held down in part by short-term difficulties in the agricultural sector, and is projected to reach around 6 percent in 2005. The construction sector continues to provide key support to economic activity, notably through private investment in tourism facilities and public investment in infrastructure. These trends have been backed by increasing foreign direct investment and concessional assistance from Cape Verde's bilateral and multilateral partners.

The fiscal deficit (including grants) fell to 1.5 percent of GDP in 2004, a stronger performance than expected. Revenues from the new value-added tax—introduced in January 2004—exceeded expectations and, within effective restraints on overall public spending, more resources were directed toward education, health, and other priority areas. The fiscal deficit in 2005 is projected to be 2.8 percent of GDP, fully financed through higher external assistance.

International reserves increased at a faster pace than anticipated in 2004, reaching 2.6 months of imports of goods and services at the end of the year—up from 1.9 months at end-2003. Further accumulation of reserves is expected in 2005. In view of continuing low inflation, the strong balance of payments position, and stable money and credit growth, the Bank of Cape Verde was able to lower the required reserve ratio in December 2004 and the standing lending facility rate in February 2005. These moves have been followed by a reduction in commercial banks' lending rates.

The remaining enterprises on the government's privatization agenda are being prepared for sale, tender under concession contracts, or liquidation. While progress in some areas is behind schedule, the program is expected to be largely completed over 2005-06. With the help of an independent mediator, negotiations are underway between the government and the majority shareholders of Electra, the electricity and water company, to reach agreement on the amount of the "tariff deficit" owed to this company. This deficit stems from the non-adjustment of electricity and water tariffs during 2000-02. Following some delays, the authorities are finalizing an automatic mechanism to adjust electricity and water tariffs in response to changes in import prices of oil products.

Executive Board Assessment

They commended the Cape Verde authorities' strong record in implementing their economic program, particularly the progress that has been made with fiscal consolidation, strengthening the credibility of the exchange rate peg, and structural reform. This has contributed to strong economic performance in recent years. The macroeconomic imbalances that emerged during the pre-election period in 2000 have disappeared. Real GDP growth has been robust, supported by private and public investment in tourism and infrastructure; inflation has been consistently low; international reserves have increased; and the external debt is relatively small. These achievements have supported poverty reduction and paved the way for Cape Verde's graduation to middle-income status in the near future.

While the public debt profile of Cape Verde at end-2004 appears sustainable under long term scenarios, Directors observed that the economy remains vulnerable to external shocks, due to the heavy dependence on external concessional financing and the narrow export base. Directors therefore urged the authorities to maintain prudent macroeconomic policies and a cautious approach to borrowing, and to sustain the reform momentum. Domestic resource mobilization, to reduce the reliance on external financing, and export diversification should remain high priorities.

Directors welcomed the decline in the fiscal deficit in 2004, which reflected the strong performance of the new value added tax and restraint on overall public spending, but also delayed wage and capital expenditures. They stressed the importance of continuing a prudent fiscal policy, especially in the run-up to elections in early 2006. They saw scope for further improvement in revenue performance, including through measures to strengthen tax administration and rationalize tax exemptions. They welcomed the authorities' commitment to keep expenditures within budgeted levels, and underscored the importance of prioritizing spending according to the objectives set out in the Poverty Reduction Strategy Paper.

Directors noted the key role monetary policy has played in supporting overall macroeconomic stability and growth, particularly by ensuring sustained low inflation and the credibility of the exchange rate peg. They supported the recent easing of the monetary policy stance, which has led to a much-needed reduction in commercial banks' lending rates. Directors considered that the current exchange rate regime remains appropriate for Cape Verde. They welcomed the further sizeable accumulation of international reserves in 2004, and noted the important role that remittances have played in strengthening the balance of payments.

Directors considered that the banking system is generally sound, but highly concentrated. They urged the authorities to push ahead with reforms to improve competition and efficiency in financial services, including through the introduction of new indirect monetary policy instruments to promote financial deepening. It was also noted that continued improvements in financial sector supervision will contribute to macroeconomic stability and private sector development. Directors welcomed the intention to adopt international financial reporting standards with technical assistance from the Fund.

Directors encouraged the authorities to continue with structural reforms focused on improving the conditions for private-sector-led growth. They welcomed the commitment to complete the restructuring and privatization of the remaining companies on the reform agenda during 2005 and 2006, but stressed the importance of parallel measures to strengthen the underlying regulatory framework. They considered that implementation of the automatic mechanism to adjust electricity and water tariffs in response to changes in input costs is important to reduce fiscal risks, restore the electricity and water company to financial health, and ensure a more efficient supply of utility services. Directors welcomed Cape Verde's move toward a more liberal trade regime, and called for faster progress in WTO membership negotiations. They encouraged efforts to enhance labour market flexibility and improve the business environment.

Directors welcomed the efforts being made to tackle poverty and achieve the Millennium Development Goals. They supported the creation of the National Council for Poverty Reduction, and commended the authorities for approving a PRSP after consultation with key stakeholders.

Directors observed that, while Cape Verde's statistical systems are generally adequate for program monitoring, there is substantial scope for improvement in this area. They urged the authorities to make full use of available technical assistance to strengthen national accounts data, implement the improved methodology for measuring consumer prices, and undertake labour market surveys.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Cape Verde: Selected Economic Indicators, 2001-05

	2001	2002	2003	2004	2005
Domestic economy					
Real GDP	4.0	5.5	6.2	4.5	6.0
Real GDP (per capita)	1.8	3.6	4.3	2.7	4.5
Consumer price index (annual average)	3.7	1.8	1.2	-1.9	0.8
Gross domestic investment (in percent of GDP)	17.4	21.8	18.7	20.4	23.3
Gross national savings (in percent of GDP)	6.6	10.4	9.2	14.2	14.9
External economy					
Exports f.o.b. (in local currency, annual percentage change)	-0.5	7.3	4.9	0.4	1.4
Imports f.o.b. (in local currency, annual percentage change)	3.6	14.2	2.5	3.4	6.4
Current account balance, excl. grants (in millions of U.S. dollars)	-189.9	-237.2	-287.0	-303.2	-361.7
Current account balance, excl. grants (in percent of GDP)	-13.9	-17.1	-15.4	-12.0	-14.2
Capital and financial account (in millions of U.S. dollars)	62.1	73.8	65.0	58.9	90.6
Debt service (in percent of exports of goods and nonfactor services)	19.2	15.6	10.6	10.7	10.4
External debt (in percent of GDP)	63.5	56.3	52.0	49.1	48.3
Real effective exchange rate (end of period, percentage change)	-2.7	2.6	3.6	-2.9	...
Financial variables					
Government revenues (in percent of GDP)	27.3	22.8	21.9	22.9	21.7
Total grants (in percent of GDP)	4.9	8.7	5.5	6.5	6.6
Current expenditure (in percent of GDP)	22.1	21.0	20.5	20.1	20.4
Overall fiscal deficit (incl. grants, in percent of GDP)	-4.6	-2.6	-3.5	-1.5	-2.8
Broad money (annual percentage change)	9.8	14.3	8.6	10.5	8.7

Sources: Cape Verde authorities; and IMF staff estimates and projections.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

Press Release No. 05/124
FOR IMMEDIATE RELEASE
May 26, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Sixth and Final Review Under Cape Verde's PRGF Arrangement and Approves US$1.9 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the sixth and final review of Cape Verde's economic performance under an SDR 8.64 million (about US$12.8 million) Poverty Reduction and Growth Facility (PRGF) arrangement (see Press Release No. 02/18). The completion of this review makes available the final disbursement of SDR 1.26 million (about US$1.9 million).

The Executive Board also granted Cape Verde's request for a waiver for nonobservance of an end-December 2004 structural performance criterion related to the publication of an automatic mechanism to adjust electricity and water tariffs, as the authorities have taken corrective actions to address this.

Following the Executive Board's discussion of Cape Verde, on May 25, 2005, Mr. Agustín Carstens, Deputy Managing Director and Acting Chair, stated:

"Cape Verde's economic performance under the PRGF-supported program has been commendable. Real GDP growth has been strong, supported by private and public investment in tourism and infrastructure, and inflation has been consistently low. The authorities have appropriately focused on maintaining macroeconomic stability, consolidating the fiscal position, and strengthening the credibility of the exchange rate peg to the euro.

"The fiscal deficit in 2004 was substantially smaller than expected, reflecting the positive performance of the new value added tax and effective restraint of overall public spending. The authorities will need to ensure that expenditure is kept within budgeted levels in 2005, especially in the lead-up to elections in early 2006. Looking ahead, effective prioritization of public spending according to the objectives set out in the Poverty Reduction Strategy Paper, and improved revenue performance through measures to strengthen tax administration and rationalize tax exemptions, will further strengthen the macroeconomic framework.

"The authorities have achieved substantial progress with structural reforms in recent years. It is important that this momentum be maintained, including through the restructuring and privatization of the remaining companies on the reform agenda and through accompanying measures to strengthen the underlying regulatory framework. The implementation of an automatic mechanism to adjust electricity and water tariffs in response to changes in input costs will help reduce fiscal risks, restore the electricity and water company to financial health, and ensure a more efficient supply of utility services. Other key reforms being pursued by the authorities include development of the financial sector to increase competition and efficiency; implementation of a more liberal trade regime; and measures to improve the functioning of the labor market and the business environment.

"The authorities are taking important steps to tackle poverty and achieve the Millennium Development Goals. To this end, a National Council for Poverty Reduction will be created, and a poverty reduction strategy paper has been approved after consultation with key stakeholders," Mr. Carstens said.

Statement by Mr. Ondo Mañe, Executive Director for Cape Verde
May 25, 2005

I would like to thank Management and staff for their continuous support to my Cape Verdean authorities' efforts under the three-year PRGF arrangement and for the constructive policy advice that has accompanied their macroeconomic policies and structural reforms throughout the program implementation. My authorities are appreciative of this assistance which has proved instrumental in maintaining sound macroeconomic policies and reforms, putting the economy on the path of sustainable growth and development. In the recent years, the growth rate of the Cape Verdean economy has been robust. The country's per capita GNP is improving, and progress has been made in reducing poverty. Amid positive prospects, my authorities are cognizant of the risks and challenges the country's economy faces for the period ahead. These challenges make it all the more necessary to stay the course as regards the reform efforts, and the authorities would like the support of the Fund in these efforts. Thus, the authorities of Cape Verde are requesting the opening of discussions towards a successor PRGF program which is best suited to sustain the country's current efforts and momentum.

Cape Verde has continued to perform well under the current PRGF arrangement. The pursuance of sound macroeconomic policies, which are based on a prudent fiscal policy stance, the enhancement of revenue collection efforts through fiscal and tax administration reforms, restrained current expenditures, prudent monetary policy geared towards price stability and reserves accumulation, have helped stabilize the economic environment and make it conducive to external budgetary support, increased private investment and sustained robust real GDP growth. The latter has averaged more than 5.4% in the last three years and is expected to increase further in the years ahead. Skillful monetary management, supported by an exchange rate regime that has served the Cape Verdean economy well, has helped to maintain inflation at or below the 2% mark. The authorities expect the inflation rate to stay around that figure for the foreseeable future. While the external current account continues to register deficits, owing to the continued high imports of capital goods, the overall balance of payments is in surplus and is expected to remain so in the period ahead, thanks to the significant capital inflows from emigrant remittances. These have provided a sizeable source of foreign exchange to the economy of Cape Verde and have been instrumental in supporting the fixed exchange rate policy.

As regards the current review of the medium-term program, all quantitative performance criteria at end-2004 were met with a substantial margin, and most structural objectives were observed. For the structural performance criterion that was missed, that is the finalization of the mechanism for adjusting electricity and water tariffs, for which discussions are underway with relevant partners, my authorities are requesting a waiver, on the ground of corrective actions taken to prepare the mechanism. Indeed, the authorities have completed the financial model of the electricity and water company, Electra; the translation of the model into the price adjustment mechanism is to be made by a consultant; and the publication of the mechanism is now expected by end-June 2005.

As noted above, my authorities are fully aware of the many challenges the country faces in the road to sustained robust economic growth and development over the longer term. These include the relatively narrow export base and the resulting vulnerability to exogenous shocks, especially the tourism sector which is susceptible to global security developments, economic conditions in Europe and world oil prices. The high transportation costs, in particular among the 9 islands of the archipelago add to the risks. To address these issues, my authorities share the view that improving the flexibility and competitiveness of the economy including through reduced transportation costs, attracting more foreign private investment, continuing to improve the mobilization of domestic resources, and pursuing trade liberalization and diversification are appropriate responses. The promotion of the tourism sector remains a cornerstone of the development strategy, in light of the geographic specificities of the archipelago. In this regard, recent public investment projects include the new international airport in the capital city, Praia, and in the island of Boa Vista; and major private investment comprises hotels in the islands of Sal and Boa Vista. The authorities intend to pursue and enhance this long-term development strategy centered on the tourism sector, while seeking economic diversification.

In a shorter time horizon, prospects for 2005 and for the medium term continue to be bright, in light of the solid foundations already put in place by the authorities. The latter are committed to maintaining prudent and sound macroeconomic policies and pursuing structural reforms to: (i) boost the competitiveness of the Cape Verdean economy, especially in the tourism sector through reduction of transportation costs; (ii) ensure economic diversification; and (iii) maintain the current pace of economic growth. They fully share the view of a private sector-led growth, putting private capital inflows and the privatization of state-owned enterprises at the center of their policy and reform agenda. The companies still to be transferred to the private sector include strategically important enterprises such as the freight and passenger air service, TACV; the fishing storage company, INTERBASE, which will be acquired by a consortium of Spanish and Cape Verdean investors; the operations of port facilities, which are expected to be transferred from the port authority, ENAPOR, to the private sector; and EMPROFAC, the enterprise in charge of imports and distribution of pharmaceuticals, which privatization process has already started. However, my authorities are strongly convinced that such private sector-led growth cannot be sustained without development of reliable infrastructure. Accordingly, they have designated public investment as a cornerstone of their economic strategy to support the development of a diversified private sector.

Fiscal Policy

My authorities would like to point out the significant fiscal consolidation achieved by Cape Verde over recent years, resulting in a reduction of fiscal deficit (including grants) to 1.5 percent of GDP in 2004 and to 2.5 percent on average over 2002-04, from 20 percent in 2000. A broad range of measures have contributed to this impressive outcome. They include the strengthening of fiscal institutions and the introduction of a multiyear fiscal framework in the context of the PRGF program, geared at improving tax administration and expenditure planning. The quest for a broader-based and more efficient revenue mobilization, the new VAT, reforms to streamline and rationalize taxes on imports, and reduction of customs duties and excises have allowed to strengthen revenues. On the expenditure side, policy has focused on restraining total expenditures as a share of GDP, including a reduction of transfers and subsidies to large public enterprises, and on improving the composition of spending, shifting the balance towards more resources committed to education, health and other priority sectors identified in the PRSP. The stock of domestic arrears has been acknowledged and is being cleared, including the payment of obligations due to the electricity and water company, ELECTRA.

For 2005 and beyond, my authorities intend to maintain a prudent fiscal stance. This year, the primary recurrent surplus is expected to reach 3.7 percent of GDP and the fiscal deficit (including grants) will be kept below the 3 percent mark. Recurrent spending, notably the wage bill, continues to be contained, albeit increments for the PRSP implementation and for mitigating the adverse social impact of public enterprise restructuring. The needed capital expenditures mentioned earlier will come from external concessional financing. To improve the management of external public debt and help maintain the current debt sustainability, my authorities are requesting technical assistance from the Fund in this area.

Monetary and External Sector Policies

My authorities intend to pursue a *monetary policy* that is consistent with sustained low inflation and the accumulation of international reserves. In efforts to build and improve its capacities for management and supervision, the BCV has reached an agreement with the central bank of Luxembourg to manage part of its foreign reserves. Furthermore, the BCV is elaborating plans to improve liquidity management and is committed to adopting the International Financial Reporting Standards. For the latter, my authorities request the technical assistance of the Fund. As stated above, the exchange rate regime has served the economy well. The strong links of the Cape Verdean economy to Europe in terms of trade, tourism and remittance flows have prevented an adverse effect of the euro appreciation on the country’s external competitiveness. However, the vulnerability embodied in Cape Verde’s narrow export base is a source of concern, and my authorities stand ready to improve competitiveness through the reduction of production and transportation costs, and agree on the need to advance export diversification.

On the *financial sector*, my authorities recognize the potential concerns stemming from the high credit concentration, the duopolistic behavior of the two dominant banks, and the still relatively weak capacity of commercial banks in risk assessment. They have stressed the need to develop alternative sources of financing, comprising the registration of credit institutions and leasing companies, in order to deepen financial intermediation. They are currently considering policy measures in this direction. It is also their intention to explore ways of deepening financial markets through the introduction of new indirect monetary policy instruments and the revival of secondary markets and the stock exchange.

On *trade issues*, Cape Verde will consider further reforms over the next few years to bring down tariffs. The country intends to take full advantage of the existing initiatives of the EU and US under AGOA by continuing to improve the quality of export-oriented production, and, my authorities remain committed to successful negotiations for WTO membership.

Structural Reforms

I would like to stress that significant achievements have been obtained by Cape Verde with structural reforms in the fiscal, monetary, domestic resource mobilization, external debt management capacities, and public enterprise restructuring areas during the current PRGF arrangement. The issue of the government disagreements with ELECTRA is a complex one deriving from the non-adjustment of energy tariffs to international oil prices and the unobserved investment in new power capacities by the privatized electricity company. My authorities recognize the need to settle the long-standing dispute promptly, so as to reduce fiscal risks to the budget and allow the company to restore its financial health, meet the growing demands for electricity and water and thus, help the country meet its developmental goals. As stated above, the government has already cleared its arrears to ELECTRA on its consumption of water and electricity. A recent agreement, reached with World Bank support, will lead to the appointment of an independent mediator to help resolve these issues.

Some results in the structural front have been more mixed, especially as regards to the implementation of the privatization agenda, mostly due to inadequate regulatory frameworks. My authorities are taking corrective actions to strengthen the regulatory environment, with the recent creation of several regulatory agencies.

PRSP Implementation

The implementation of the PRSP, which was approved in September 2004, will require increased personnel spending in the areas of education, health and security, among others. Since the approval, the authorities have focused on putting in place the institutions that are needed to implement, monitor and assess the poverty reduction strategy, including the creation, in the first half of this year, of the National Council for Poverty Reduction and the Technical Secretariat.

Conclusion

My authorities intend to request a successor PRGF arrangement following the completion of the current program at end-July 2005. This request is warranted by the continued economic and social needs of the country and the remaining challenging reform agenda. The Fund and other multilateral and bilateral partners have been instrumental in the economic and social achievements of Cape Verde. My authorities are very appreciative of this support and would like to see the continuation of this important assistance. They are also requesting technical assistance in areas of weak capacities highlighted above. They also hope that the international community will continue to provide them with much needed financial assistance. My authorities are determined to continue to work closely with the Fund to help the country sustain the achievements made thus far and meet the challenges in the period ahead.