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CABO VERDE

September 2014

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CABO 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 the 2014 Article IV consultation with Cabo Verde, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 28, 2014, following discussions that ended on January 28, 2014, with the officials of Cabo Verde on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 14, 2014.
- A **Debt Sustainability Analysis** prepared by the Staff of the IMF and the World Bank.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its May 28, 2014 consideration of the staff report that concluded the Article IV consultation with Cabo Verde.
- A **Statement by the Executive Director, the Alternate Executive Director, and the Government-Provided Advisor** for Cabo Verde.

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

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CABO VERDE

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

May 14, 2014

KEY ISSUES

Context: Over the last two decades, good governance and sound macroeconomic management have delivered remarkable economic and social progress to Cabo Verde. More recently, however, growth has slowed due to the prolonged downturn in Europe and a sharp deterioration in domestic confidence. A longer-term decline in the contribution of total factor productivity to growth may also have played a role. Financial stability risks have increased with the rise in non-performing loans and fall in bank profitability. The country remains vulnerable to external shocks, given its dependence on tourism, remittances, and concessional financing. Over the longer term, Cabo Verde's challenge as a new middle-income country is to bolster productivity and diversify the sources of growth.

Fiscal consolidation remains critical to safeguard macroeconomic and debt sustainability. Budgetary plans for 2014 and the medium term entail rising public debt, and are subject to downside risks to revenue. The authorities have already decided on a package of expenditure containment measures for 2014–17. However, given the high albeit sustainable level of public debt, further measures are needed to put public debt on a more robust downward path. Bolstering domestic revenue mobilization, increasing the efficiency of public investment, and managing existing infrastructure better are also central to sound public finances.

International reserves have recovered, which provided room to ease monetary policy in support of the recovery. In the absence of imminent pressures on the balance of payments or on prices, and with private sector credit growth having stalled, the central bank has cut the policy rate. At the same time, given pressures on the banking system, continued vigilance regarding risks to financial stability is warranted.

Structural reforms hold the key to bolstering competitiveness, creating jobs, and delivering inclusive growth. Increasing labor market efficiency and reducing skill mismatches would be particularly beneficial in this regard. Enhancing the efficiency of state-owned enterprises is also essential to improve delivery of infrastructure services.

Data are adequate for surveillance purposes, though some key shortcomings remain. In particular, national accounts data are released with a long delay. This complicates the formulation of macroeconomic policies.

Approved By
Mr. David Owen (AFR) and Mr. Chris Lane (SPR)

The mission comprised Ms. Richter Hume (head), Ms. Jirasavetakul, and Messrs. Chawani and Hitaj (all AFR). Mr. Santarosa (OED) participated in the discussions, which took place in Praia during January 13–28, 2014. The mission met with Minister of Finance Cristina Duarte, Governor of the Banco de Cabo Verde Carlos de Burgo, and with other senior officials, members of the National Assembly, and representatives of labor unions, the private sector, and the donor community. The second and final review of the 15-month policy support instrument (PSI) was completed on January 30, 2012, and the PSI expired on February 21, 2012. The last Article IV Consultation was concluded on March 8, 2013. Cabo Verde is an Article VIII country and has no exchange rate restriction subject to IMF jurisdiction. It has a conventional peg to the euro.

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DEVELOPMENTS AND CHALLENGES AHEAD

A. The Long-Term Setting

1. Over the last two decades, Cabo Verde has made impressive strides in economic and social development. Rapid economic growth, driven in large part by an expansion in tourism and public investment, helped the country graduate to middle-income country status in 2007. It has also dramatically reduced poverty—from 49 percent in 1989 to 25 percent in 2011—and raised living standards, such that achievement of all Millennium Development Goals by 2015 is within reach.

2. Now, to sustain its progress over the medium term, Cabo Verde must identify new drivers of growth. The large-scale Public Investment Program (PIP) is beginning to wind down, and tourism may grow less rapidly as limits to market share are reached. In addition, with total factor productivity in Cabo Verde having fallen over the last decade, structural reforms that boost competitiveness are critical to support job-creating and inclusive growth (Appendix).[1]

3. At the same time, fiscal consolidation remains essential to ensure debt sustainability. During the last few years, the combination of weaker revenue performance and higher capital expenditure has driven up public debt to 98 percent of GDP at end-2013—a rise of 40 percentage points since 2008. Even though debt financing has been highly concessional, there are risks to debt sustainability if progress on fiscal consolidation stalls.[2]

B. Current Conditions

4. During 2013, the economy continued to face significant headwinds from the anemic recovery in Europe and weak domestic confidence (Table 1 and Figure 1).

- *Real GDP growth* is estimated at 0.5 percent for 2013, a further slowdown from the 1.2 percent growth registered in 2012 and 4 percent in 2011. While tourism—which accounts for about a fifth of the economy—continued to do well, private consumption and investment remained very weak, and credit to the economy grew by only 1 percent. Unemployment was 16½ percent at end-2013 (about the same as in 2012, and up from 12 percent in 2011), with youth unemployment double that rate. Average inflation fell to 1½ percent, reflecting weak economic conditions and contained global price developments.

- *The balance of payments* was once again in small surplus (Table 2). The current account deficit narrowed considerably, to about 4½ percent of GDP, reflecting in particular a sharp decline in capital goods imports as investment declined. In the capital account, private flows continued to

[1] Cabo Verde was part of a recent IMF study of total factor productivity in small Middle Income Countries in Sub-Saharan Africa (Country Report No. 14/41). Results from this analytical work were presented during the mission.

[2] Concessional financing is typically available to a country for an additional five years after graduating to Middle-Income Country (MIC) status. However, due to the global downturn and to Cabo Verde's status as a small island country, donors decided to extend access to concessional financing for a few additional years.

decline, reflecting a further contraction in FDI and in particular a reversal of capital flows to commercial banks and of other private debt-related flows. International reserves recovered to about 4½ months of prospective imports.

5. As a result of the authorities' budget reprogramming exercise, fiscal performance in 2013 was less expansionary than originally budgeted (Text Table 1, page 12; and Table 3b). This was in line with the Fund's policy advice.

- *Total revenue* increased by about ¾ percentage point of GDP, considerably less than originally budgeted. While tax revenue edged down about ¼ percentage point, grants increased by ½ percentage point. Other non-tax revenue increased by the same amount, bolstered by additional resources from other state agencies that have been brought into the central budget through the creation of the Single Treasury Account.
- *Current expenditure and public investment* were reduced significantly during the mid-year budget reprogramming exercise, in light of revenue shortfalls and delays in some external financing.[3] Current expenditure is estimated as 1½ percentage points of GDP lower than budgeted, while public investment (including onlending) was 4 percentage points of GDP lower. The authorities were able to safeguard social spending from these containment measures.
- *The fiscal deficit fell by about 2 percentage points of GDP, to 7¾ percent.* Including onlending, total financing was 13.2 percent of GDP—about ½ percentage point less than in 2012.

6. Monetary conditions eased over the course of the year, as reflected in the build-up of excess liquidity in banks (Table 4a and Figure 2). Since May 2013, when the BCV adopted a market-based process for placing central bank bills, rates on these instruments (and also on short-term government securities) have fallen below 1 percent—significantly below the 5.75 percent policy rate. Other interest rates have been relatively sticky at higher levels. For deposits, higher rates partly reflect ongoing competition between banks to secure emigrant funds. And for loans, higher rates are related to continued risk aversion by banks, against the backdrop of high NPLs. Looking at liquidity conditions, while banks overall are in a situation of excess, this has not yet translated into credit growth. In the absence of a functioning interbank market and given the relatively high cost of BCV overdraft facilities, banks do not want to risk getting caught short. In addition, given the sharp rise in NPLs, banks have become more risk averse in the extension of new credit.

7. Financial stability has been weakened by the slowdown in growth (Table 5). The NPL ratio peaked at 20 percent in September 2013, though fell back to 16 percent by year-end.[4]

[3] In recent years, the procedure for approving the operating budget has included "freezing" 30 percent of expenditure on goods and services (except for medication, food, security, and a few other items), which can only be spent if revenue performs as budgeted. The "freezing" also affects nonfinancial assets, namely the purchase of administrative equipment and cargo transport equipment (except purchases of sovereign entities). For the investment budget, a minimum of 30 percent (and in some cases up to 50 percent) of expenditure is similarly frozen.

[4] The BCV noted that based on their NPL definitions (Circular 150, rather than IAS/IFRS), Cabo Verde's financial stability indicators are stronger. Their NPL ratio (which includes only installments that are 90 days or more past due, except where the cumulative past due installments exceed 25 percent of the loan balance) was only 13 percent in December 2013, and the ratio of provisions to NPLs was 60 percent (rather than 48 percent).

Capital adequacy appears to remain solid for the banking system as a whole, with the ratio of capital to risk-weighted assets (CAR) reaching 13 percent at end-2013, comfortably above the 10 percent regulatory minimum. However, in one bank the CAR has fallen just below the regulatory minimum. In addition, given that provisioning has not kept up with the rise in NPLs (the coverage ratio is 48 percent, down from 52 percent a year ago), there is a risk that actual capital (if impaired loans are properly provisioned) could be lower.

8. Policy implementation in 2013 was broadly in line with the Fund's policy advice. As recommended in the last Article IV, capital and current spending was curtailed compared to the original budget. However, the Fund's recommendation to adopt an ambitious medium-term fiscal consolidation plan was not adopted. The Fund had also recommended a neutral monetary policy stance to support a rebuilding of reserves. The BCV kept rates on hold through 2013. There has also been further progress in strengthening supervision, as called for by the Fund in order to enhance Cabo Verde's financial stability framework.

9. On the political front, the next parliamentary and presidential elections are expected in 2016. Prime Minister Jose Maria Neves, who began his third consecutive term in February 2011, represents the PAICV (*Partido Africano da Independência de Cabo Verde*). President Jorge Carlos Fonseca, in power since August 2011, is from the main opposition party, the MpD (*Movimento para a Democracia*). These two parties have been central in Cabo Verdean politics since independence in 1975, with each party having ruled for about a decade and now alternating power regularly.

C. External Assessment

10. While the external position has improved somewhat, Cabo Verde remains vulnerable due to its increasing external debt and challenges to competitiveness (Box 1). International reserves have recovered to about 4½ months of prospective imports, and are projected to remain around this level over the medium term. This reflects a healthy outlook for goods and services exports, and significant official financing flows (already committed). The exchange rate is assessed as broadly in line with fundamentals, as found in the last assessment (undertaken in March 2013). However, Cabo Verde's high dependence on tourism and remittances points to significant external vulnerabilities. In addition, business sector surveys indicate that competitiveness remains a challenge. Cabo Verde is ranked 122nd out of 148 countries on global competitiveness by the World Economic Forum, with labor market efficiency, financial market development, and macroeconomic environment found to be particular challenges.

Box 1. External Stability Assessment[1]

An external stability analysis suggests that the real effective exchange rate (REER) is broadly in line with medium-term fundamentals. However, competitiveness remains weak, on account of inefficiencies in the labor market and access to financing. Improving the business environment and increasing the productivity of human and physical capital remain critical for bolstering medium-term growth.

Over the last decade, Cabo Verde's **balance of payments** has been characterized by a relatively stable current account deficit (of about 16 percent of GDP), mostly used to finance investment. As grants and FDI have declined, the deficit has been financed increasingly by government borrowing, leading to a rise in external public debt from 39 percent of GDP in 2008 to 74 percent of GDP in 2013. After decreasing to 3.4 months of imports in 2011, at end-2013 international reserves had recovered to 4.4 months of imports—within the estimated optimal range of 3.7–5 months[2]—where they are projected to remain in the medium term. Exports of goods and services have increased steadily over 2003–12 (from about 30 to 45 percent of GDP), but remain heavily dependent on tourism and related travel, which represent about two thirds of the total.

Cabo Verde: Global Competitiveness Indicators, 2013–14

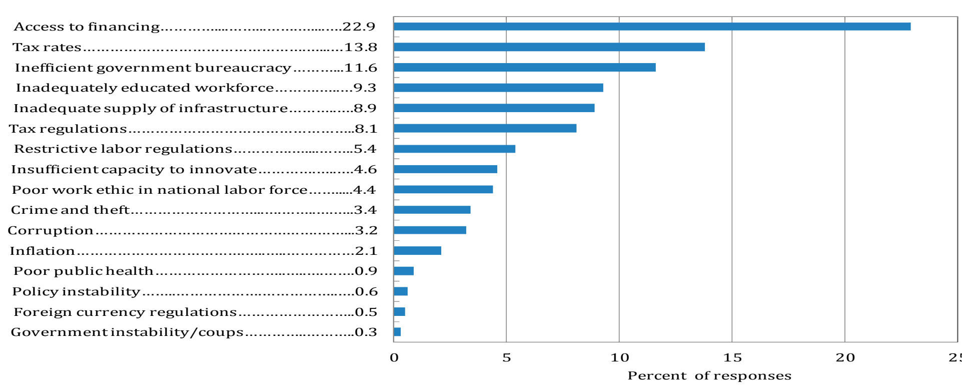
	2012–13 (Out of 144)	2013–14 (Out of 148)	Change [1]
Overall Rank	122	122	No change
Basic requirements (40%)	100	103	-3
Institutions	57	69	-12
Infrastructure	114	116	-2
Macroeconomic environment	121	128	-7
Health and primary education	71	75	-4
Efficiency enhancers (50%)	128	130	-2
Higher education and training	99	94	5
Goods market efficiency	105	112	-7
Labor market efficiency	126	129	-3
Financial market development	121	127	-6
Technological readiness	90	91	-1
Market size	143	148	-5
Innovation and sophistication factors (10%)	119	118	1
Business sophistication	118	121	-3
Innovation	120	116	4

Source: World Economic Forum.

[1] Negative sign indicates worsening score; otherwise indicates improvement.

Cabo Verde still does relatively poorly on **competitiveness**. Based on the World Economic Forum (WEF), Cabo Verde ranks 122nd out of 148 countries on global competitiveness, with market size, labor market efficiency, macroeconomic environment, and financial market development found to be particularly weak (see Table). In WEF business surveys, access to financing, labor market issues (cited under several factors), and inadequate supply of infrastructure feature among the most problematic factors for doing business (see Chart). Structural reforms aimed at improving the business climate therefore remain critical for bolstering competitiveness and attracting private investment.

Cabo Verde: The Most Problematic Factors for Doing Business



Source: World Economic Forum.

[1]A more detailed assessment of Cabo Verde's external balance was presented in Appendix 1 of the 2012 Article IV Staff Report.

[2]Marcio Ronci, "Cape Verde: Assessing International Reserve Adequacy" (2012 Article IV Staff Report).

Box 1. Cabo Verde: External Stability Assessment (concluded)

Turning to the **exchange rate**, all three approaches based on Consultative Group on Exchange Rates (CGER)-type methodologies indicate that Cabo Verde's real exchange rate is broadly in line with its fundamentals. Even though all three measures indicate possible undervaluation, the results are below the 10 percent threshold required for the assessment to be deemed statistically significant. The assessment has changed little since the 2012 Article IV assessment.

Cabo Verde: Quantitative Exchange Rate Assessment Results

	Current Account (Percent of GDP)		CA Elasticity[1, 2]	REER misalignment[3]
	Norm	Underlying		
Equilibrium Real Effective Exchange Rate	…	…		-7.9
Macroeconomic Balance	-9.2	-6.7	-0.385	-6.5
External Sustainability	-9.7	-6.7	-0.385	-7.8

Source: IMF staff estimates.

[1] CA elasticity = [Export elasticity * Share of exports in GDP]-[(Import elasticity-1) * Share of imports in GDP].

[2] Tokarick (2010) estimates Cape Verde's export and import elasticities of 0.36 and 1.41, respectively.

[3] In percentage, "+" = overvaluation.

D. Outlook and Risks

11. Staff forecasts a modest economic recovery in 2014, with GDP growth of 3 percent. The improving outlook for the euro area bodes well for remittances, FDI, and tourism (although competition from destinations in North Africa could increase in 2014). Better external conditions and continued strength in tourism are expected to help consumer and business sentiment recover. There are also encouraging signs that a number of stalled FDI projects in tourism will resume in 2014. As monetary conditions have eased and NPLs are gradually being resolved, banks should also be in a stronger position to increase credit to the private sector. Over the medium term, and drawing on the experience of other small middle-income countries, staff sees growth of about 4 percent as consistent with a lower middle-income economy that still faces challenges on the competitiveness front (Appendix Table 1). The balance of payments is forecast to again reach a small surplus in 2014. While imports are expected to rebound, reflecting a recovery in consumer sentiment and investment, strong remittances and public capital flows (as well as an uptick in FDI) should allow international reserves to cover about 4½ months of prospective imports.

12. The outlook remains subject to both upside and downside risks (Table 7).

- *On the upside,* a more rapid resumption of FDI in both stalled and new projects could bolster growth. And over the longer term, the public investment program and the successful implementation of the government's wide-ranging structural reform program could increase productivity and raise potential growth.

- *On the downside,* Cabo Verde faces both external and domestic risks. Externally, its high dependence on tourism and remittances makes it vulnerable to a further delay in the European recovery. In addition, its strong financial ties to Portugal—three of the four largest banks in Cabo Verde are owned by Portuguese groups—make it vulnerable to a resurfacing of financial stress in the euro area. Domestic risks are primarily fiscal in nature, given high public debt. Risks in the financial sector have increased with the economic downturn, and NPLs could aggravate the cycle through their adverse effect on growth (Box 2).

Box 2. NPLs and Economic Growth

The economic downturn in Cabo Verde has led to a significant increase in non-performing loans (NPLs). The experience of other countries shows that high NPLs can exert a drag on economic growth. To mitigate this impact, the central bank should take action to help arrest the rise in NPLs, and ideally also resolve them.

Since the onset of the global financial crisis, Cabo Verde has experienced a sharp increase in NPLs. Since 2009, the ratio of NPLs to total loans has increased significantly, peaking at 20 percent in September 2013 (though easing to 16 percent by December 2013). Corporates account for about two-thirds of the NPL stock, with NPLs concentrated in tourism, transport, business and construction. Households account for the remaining third of the NPL stock, with the impaired portfolio concentrated in mortgages.

Economic studies have found a link between high NPLs and economic growth, with intermediation declining as impaired assets rein in bank profitability. A number of empirical studies have established a strong, albeit short-lived feedback effect from bank losses on economic activity. To cite a few results, Espinoza and Prasad (2010) found an elasticity of 0.4 for NPLs on non-oil growth in the Gulf Cooperation Council (1995–2008). Nkusu (2011) found an elasticity of 0.6 over three years looking at the experience of 26 advanced countries (1999–2009). And Klein (2013) found an elasticity of 0.6 over two years in a group of Central Eastern and South Eastern Europe (1998–2011). While caution is warranted in applying these results to Cabo Verde, they do suggest that the recent increase in NPLs entails risks for growth.

The BCV has taken an active role in addressing the NPL situation in Cabo Verde. Following the sharp run-up in NPLs in 2012, the BCV conducted a detailed review of the quality of assets for the top clients of the largest banks, with the aim of assessing their provisioning and NPL disclosure practices. The BCV established that procedures were not standard across the banks and asked all banks to adopt stringent IFRS compliant definitions. They developed a credit impairment index to encourage transparency on NPLs and asked banks to cease dividend payments in 2013. The BCV also undertakes post-balance sheet submission adjustments to enforce provisioning standards.

The pace of write-offs has been slow so far, reflecting the weak economic situation, lengthy foreclosure processes, and underdeveloped markets for distressed real estate assets. While speeding up the reduction of NPLs is desirable, the capacity of banks to absorb further losses is limited. High NPLs are exerting pressure on banks' balance sheets, with profitability, as proxied by return on equity, declining to 2.3 percent in 2013 from 9.1 percent in 2010. Capital adequacy dropped from a comfortable cushion of 15.6 percent in 2010 to 12.1 percent in 2012, before recovering to 13.3 percent in 2013.

The BCV is encouraged to take the following steps to support the resolution of the NPL overhang:

- continue to monitor banks closely, and intervene preemptively to reinforce resilience of their positions;
- encourage banks to strengthen and enforce loss recognition and provisioning standards;
- provide proper guidance on loan restructuring, collateral valuation and asset classification;
- align current accounting and disclosure practices on loan quality and provisioning to best practices; and
- study backlogged cases and develop an action plan to tackle delays in judicial processes.

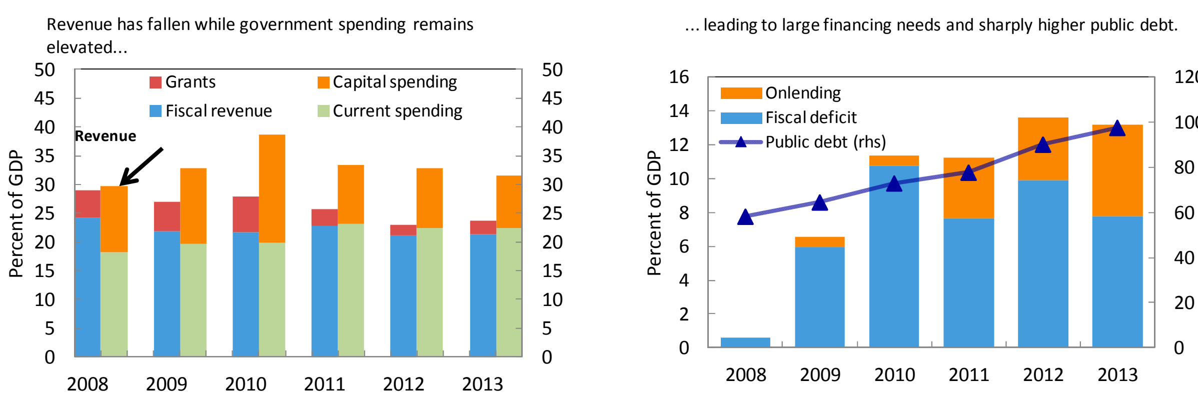
POLICY DISCUSSIONS

Policy discussions focused on four key challenges facing Cabo Verde today. First, with public debt already at high levels, can fiscal policy still play a major role in supporting long-term growth? Second, given monetary policy's primary objective of safeguarding the peg, is there scope to loosen the monetary policy stance in support of the recovery? Third, how has the downturn affected financial stability? And fourth, what can be done to increase competitiveness and improve the long-term outlook for growth? These issues are central to ensuring macroeconomic and debt sustainability in the near term, and for helping Cabo Verde shift to a productivity-led growth strategy over the medium term.

A. Balancing Fiscal Consolidation with Support for Long-Term Growth

13. The challenge for fiscal policy is to strike the right balance between supporting growth and preserving macroeconomic stability and debt sustainability. The IMF has supported Cabo Verde's strategy to use concessional resources to finance public investment that boosts the country's long-term growth potential. It has also seen a role for public investment to cushion the impact of the global downturn. However, as noted in the 2012 Article IV consultation, ambitious medium-term fiscal consolidation is essential to secure debt sustainability and rebuild fiscal positions. With public debt now approaching 100 percent of GDP, ambitious fiscal adjustment has become even more urgent (Text Figure 1). This view is shared by the World Bank and other members of the Budget Support Group.[5] It is also shared by rating agencies. In March 2014, Fitch downgraded Cabo Verde's long-term foreign and local currency ratings from B+ to B, citing a significant deterioration in the fiscal outlook and a weaker outlook for economic growth.

Text Figure 1. Cabo Verde: Revenue, Expenditure and Public Debt



Sources: Cabo Verdean authorities and IMF staff.

[5] The other members of the Budget Support Group are the African Development Bank, the EU, the Luxembourg Agency for Development Cooperation, Portugal, and the Spanish Agency for International Development Cooperation.

14. The authorities' 2014 budget entails an increase in the deficit and total financing needs, while their medium-term fiscal plans set out a relatively small consolidation effort.[6] For 2014, the budget entails a deficit of about 9 percent of GDP, over 1 percentage point higher than in 2013 (Text Table 1).[7] [8] Including onlending, total financing needs would reach 13½ percent of GDP. For 2015–17, the MTFF's expenditure plans (including onlending) would cause public debt to exceed 110 percent of GDP by 2017.

15. Staff recommended more ambitious fiscal consolidation to reduce the risk of debt distress, support investor confidence, and bolster international reserves. By reducing the need for domestic financing, there would be more room for credit to the economy, which would support the shift to private-sector led growth. In addition, by winding down the public investment program more quickly, external debt would grow less rapidly, thereby reducing external vulnerabilities and bolstering investor confidence. The impact on the balance of payments would likely be positive, with private capital flows picking up as external risk declines.

16. Staff's recommendations would deliver steady deficit reduction over the coming years, thereby demonstrating the authorities' commitment to fiscal consolidation. For 2014, staff recommended expenditure cuts of about 1 percentage point of GDP, and a similar reduction in public investment financed by onlending. Staff also recommended that major new public investment projects meet stringent tests of value-for-money. With current expenditure budgeted to increase by 4 percentage points of GDP, staff saw scope to contain spending, especially in the area of goods and services. For 2015–17, staff recommended a more cautious public investment plan and slower growth in some current expenditure items (while protecting social spending). Staff's proposed path would reduce the fiscal deficit by over 5 percentage points of GDP between 2013 and 2017, and total financing by 9½ percentage points—about 4½ percentage points more than envisaged in the authorities' plans. Public debt would be considerably lower in the adjustment scenario, falling below 100 percent of GDP by 2017. In light of the weaker growth outlook, the consolidation path recommended by staff is more gradual than had been proposed in the last Article IV Consultation.

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[6] The authorities' fiscal plans are set out in the Medium-Term Fiscal Framework (MTFF), which covers 2014–17.

[7] Staff's projection for 2014 is based on the MTFF's expenditure plans, with the exception of debt service, for which staff use the projections agreed by the World Bank and the Ministry of Finance's Debt Directorate, in the context of the Medium-Term Debt Strategy exercise (MTDS). The latter exclude an "exchange rate buffer", included in the budget to cover unexpected exchange rate swings, which averages about 0.4 percent of GDP for 2014–16.

[8] The budget deficit target is 8 percent of GDP. However, staff sees downside revenue risks of over 1 percent of GDP.

Text Table 1. Cabo Verde: Medium-Term Fiscal Adjustment
(Percent of GDP)

	2013		2014		2017		Fiscal Adj: 2013–17	
	Budget[1]	Est.	MTFF [2]	Staff Adj.	MTFF	Staff Adj.	MTFF	Staff Adj.
Revenue (incl. grants)	**26.8**	**23.7**	**25.5**	**25.5**	**25.4**	**25.4**	**1.7**	**1.7**
Of which: tax revenue	20.1	17.8	18.8	18.8	20.3	20.3	2.5	2.5
Total expenditure	**34.2**	**31.5**	**34.5**	**33.6**	**31.3**	**27.7**	**-0.2**	**-3.7**
Current	24.0	22.4	26.0	25.3	24.2	24.2	**1.8**	**1.8**
Capital	10.2	9.1	8.5	8.4	7.1	3.5	-2.0	-5.5
Overall balance	**-7.5**	**-7.8**	**-9.0**	**-8.1**	**-5.9**	**-2.3**	**1.9**	**5.4**
Onlending	**-8.0**	**-5.4**	**-4.4**	**-3.2**	**-2.3**	**-1.4**	**3.1**	**4.0**
Total financing (incl. onlending)	**-15.5**	**-13.2**	**-13.4**	**-11.3**	**-8.2**	**-3.7**	**4.9**	**9.5**
Total nominal public debt	…	97.6	104.6	101.9	112.1	98.6	14.5	1.0
PV of external public debt	…	42.6	45.6	44.3	49.3	43.6	6.7	1.0
Memorandum item:								
Public investment (incl. onlending)	18.3	14.5	12.9	11.6	9.5	4.9	-5.0	-9.6

Sources: Cabo Verdean authorities and IMF staff estimates and projections.

[1] Budget projections as presented in the 2012 Article IV Staff Report.

[2] Uses staff projections for revenue, and the authorities' MTFF projections for spending, with the exception of interest payments on debt.

17. **Further efforts to enhance domestic resource mobilization will be critical to support consolidation, and also to prepare Cabo Verde for the phasing out of concessional financing.** Staff welcomed the many important achievements during 2013, including the harmonization and streamlining of VAT rates, the passage of three new tax codes, and the launch of a large taxpayer office. The authorities have also focused on enhancing the efficiency of tax administration, by reforming the Directorate of Contributions and Taxes (DCI). Further improvements in taxpayer services and a smooth merger of customs and revenue administration remain important priorities. Staff welcomed plans to resolve sizeable tax arrears (about 4 percent of GDP), as well as outstanding claims for tax refunds (about 1½ percent of GDP).[9]

18. **With regards to public financial management, the authorities have also made considerable progress.** They have developed sound fiscal forecasting tools, introduced a medium-term fiscal framework, aligned their budget and planning processes, and introduced program-based budgeting. As recommended by FAD, more prioritization amongst the ongoing reforms, as well as detailed implementation arrangements, would contribute towards their success. Strengthening the coordination unit at the Ministry of Finance and Planning would also help. FAD has noted that under current procurement practices, which devolve such responsibilities to line ministries, there is a risk of unmonitored arrears. For this reason, they have recommended introducing robust commitment controls and improving the monitoring of arrears.

[9] To encourage payment of tax arrears, the Ministry of Finance has offered to waive overdue interest on amounts due. With regard to claims for tax refunds, the 2014 budget allocates 0.6 percent of GDP towards settling such claims and other refunds. The authorities are also preparing a full database of tax refunds due.

19. The performance of state-owned enterprises (SOEs) is improving, but further reforms are needed to increase efficiency and reduce contingent financial liabilities for the government. In 2012, the six largest SOEs registered total losses of 0.7 percent of GDP and debt of 27 percent of GDP. Preliminary estimates indicate that performance in 2013 was better. The national electricity and water provider (ELECTRA) has adopted a cost-based pricing mechanism and a results-based management contract—the first amongst the SOEs. The national airline (TACV) aims to complete the sale of its baggage handling branch by end-2014, but needs further urgent reforms to reduce losses and resolve sizeable domestic arrears. At the housing agency IFH, potential contingent fiscal liabilities arising from the social housing program "Casa Para Todos" (with a total program cost of €170 million over 2011–17, or 11 percent of 2014 GDP) require careful monitoring.[10] In light of the potential financial risks of the program, the authorities should take a careful, phased approach to its development.

Authorities' views and recent measures

20. The authorities underscored their commitment to preserving macroeconomic stability. As noted in their Growth and Poverty Reduction Strategy Paper III (GPRSP-III), Cabo Verde would not have been so successful if it had not prioritized macroeconomic stability as the core factor of good governance. Now, in the face of the country's reduced capacity to borrow, it has become critical to bolster domestic revenue mobilization in order to ensure macroeconomic stability. A broad set of reforms has already been implemented to streamline and rationalize tax policies in line with international best practice, and efforts are underway to increase the efficiency of tax administration.

21. The authorities emphasized that as in previous years, expenditure containment measures would be taken if revenue underperformed. A budget re-programming exercise—covering 2014 and the medium term—will take place in the second quarter of this year, once revenue performance in the first quarter is known. After the mission, the authorities informed staff that they had already decided on preliminary expenditure containment measures for 2014–17 that will lower expenditure by about 1½ percentage points of GDP per year. About half of the reduction would be in goods and services, with the rest split evenly between other current expenditure and capital expenditure. The authorities also noted that further cuts could be taken, if needed.[11]

22. With regards to capital expenditure, the authorities highlighted the window of opportunity Cabo Verde still had to draw on concessional resources to finance critical infrastructure projects. By addressing key bottlenecks, the PIP is boosting the country's long-term growth potential and has helped protect the economy from the global downturn. The authorities

[10] The program entails building affordable housing units financed by external funds, which will be sold by the government to private individuals. The program is subject to financial risks, given that purchasers will need to be able to obtain a mortgage to purchase a property.

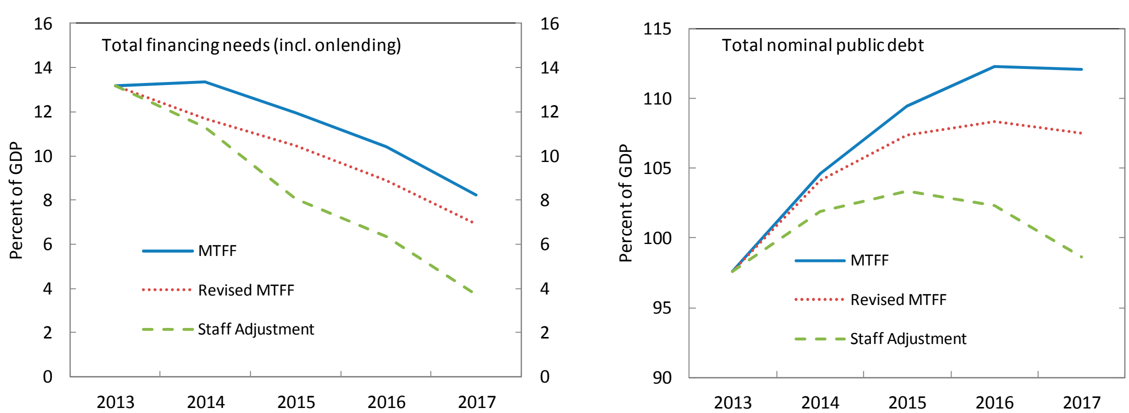
[11] Following parliamentary approval of the budget, the government can cut expenditure without obtaining additional parliamentary approval, since the original budget already entailed freezing certain amounts of expenditure pending satisfactory revenue performance.

underscored that they are working closely with the World Bank to adopt a national investment review board, to ensure that approved projects meet stringent rate-of-return criteria.

Staff evaluation and debt sustainability analysis

23. While staff welcomes the authorities' initial package of expenditure containment measures, a considerably greater consolidation effort will be needed to put public debt on a faster downward trajectory and reduce significant external vulnerabilities (Text Figure 2). The revised MTFF projections are based on the authorities' revised nominal expenditure projections, including the containment measures, but using the Medium-Term Debt Strategy (MTDS) projections for debt service (Tables 3a and 3b). The baseline projections for GDP growth and revenue are those of staff; both are somewhat below those of the authorities. While this revised spending path does bring down financing needs, public debt would still peak at 108 percent of GDP in 2016–17. In staff's recommended adjustment scenario, public debt would peak at 103 percent of GDP, and fall below 100 percent of GDP by 2017.

Text Figure 2. Cabo Verde: Financing Needs and Public Debt Under Different Consolidation Scenarios



Sources: Cabo Verdean authorities and IMF staff.

24. Based on the authorities' revised expenditure projections, Cabo Verde's external debt risk rating is assessed as "moderate" (Debt Sustainability Analysis Annex). While no threshold is breached under the baseline, both debt-to-GDP and debt service-to-revenue thresholds are breached in the one-time depreciation shock scenario. However, risks to overall debt sustainability remain high. The fact that the NPV of external debt peaks at 49 percent—just shy of the 50 percent threshold in the baseline—points to significant vulnerabilities. Cabo Verde is also vulnerable to contingent liabilities from the debt of SOEs. As discussed in the DSA Annex, having to take on even part of these liabilities through external loans (given legal constraints on domestic financing) would cause Cabo Verde's risk rating to increase to "high". Reducing the risk of debt distress will therefore depend critically on accelerating fiscal consolidation and advancing structural reforms to boost growth and enhance the efficiency of the public sector.

B. Balancing a Strong Peg with Support for the Recovery

25. Cabo Verde's monetary policy is geared towards maintaining a level of foreign exchange reserves that is consistent with safeguarding the peg. Following a 150 basis points policy rate increase in January 2012, international reserves recovered from minimally adequate levels in 2012, to about 4¼ months of prospective imports at end-2013—within the range estimated as adequate by staff research. They also cover 70 percent of emigrant deposits (which account for 40 percent of total deposits) and 25 percent of M2. The peg has served the economy well, given Cabo Verde's strong trade and financial ties to the euro area. An assessment using CGER-type methodologies indicates that the real exchange rate is broadly in line with fundamentals (Box 1).

26. Given weak economic growth, low inflation, and the stabilization of international reserves, staff saw scope for a cautious loosening of the monetary policy stance. A cut in the policy rate would send an important signal about the direction of monetary policy, even if weaknesses in the transmission mechanism would limit its impact on market rates. With regards to a possible negative impact on capital flows, staff noted that the very high spread between rates in Cabo Verde and in advanced economy markets made this unlikely. On the contrary, if a rate cut was seen as supporting a recovery in credit and growth, it could actually lead to higher inflows.[12]

27. Staff also recommended reducing the 18 percent minimum reserve requirement, which is relatively high compared to peers. This would free up liquidity and could support credit creation. Having said this, staff stressed the importance of close monitoring of liquidity conditions, and advised readiness to step up sterilization if international reserves came under pressure.

28. Strengthening the transmission mechanism remains an important objective to enhance the effectiveness of monetary policy. The policy rate is currently not playing the role of a reference rate. Strengthening the BCV's liquidity management could help to align the policy rate with market rates. Reforms to develop the government securities market, with the aim of developing a (non-segmented) market-based term structure of interest rates, are also needed. In this regard, particular care should be taken so that large public institutions do not distort pricing when investing in this market. More broadly, reforms that enhance the framework for monetary operations would also contribute to enhancing the effectiveness of monetary policy (Table 6)**.**

29. With regards to international reserves, the BCV sought to explore options to shore up Cabo Verde's resilience to capital outflows. While emigrant deposits have shown welcome stability over many years, a confidence shock could result in significant emigrant capital flight and present risks to the financial system. One possible mechanism to shore up international reserves would be to make the foreign assets held by the "International Support for Cape Verde Trust Fund" accessible to the BCV, when needed. This is an avenue worth exploring further, and on which MCM stands ready to provide guidance.

[12] Remittances have been found to be positively correlated with Cabo Verde's GDP growth (A. Shanghavi, Country Report No. 08/243). The impact of interest rate differentials was weaker.

Authorities' views and recent measures

30. The BCV agreed with the staff's recommendation to lower the policy rate, given less favorable economic conditions, and in the absence of imminent pressures on the balance of payments or consumer prices. The policy rate was cut by 150 basis points—to 4.25 percent—on March 1, 2014. The rediscount rate and the BCV's lending facility rate were cut by the same amount, to 8.25 percent and 7.25 percent, respectively. The aim of these measures is to help stimulate financing for viable investment projects, and thereby support the recovery. The BCV emphasized that the impact of these measures will be enhanced if they are combined with structural measures that help reduce risks and bolster potential growth.

31. The BCV noted that the impact of a rate cut on lending rates was unlikely to be significant, given weaknesses in the transmission mechanism. In discussing the recent disappointing performance of the interbank market (with no trades since 2012), the BCV explained that this was due to the fact that all banks have excess liquidity. The BCV requested further TA on liquidity management, in particular for retaining control over the monetary base (and international reserves) when the BCV intervenes to help banks facing a short-term liquidity need.[13]

32. With regards to the minimum reserve requirement (MRR), the BCV was of the view that it should be maintained at 18 percent. The BCV considers the MRR an important prudential tool, whose level should be determined by the stage of development and potential fragilities of the financial sector. They also noted that it was not a good idea to change the MRR too frequently (and it had only just been increased 2 years ago). Viewed from a historical context, the BCV considers the current level of the MRR—at 18 percent—as not very high (though the BCV acknowledged that it is high compared to peers). Furthermore, the BCV noted the constraints that the fixed exchange rate regime places on monetary policy, in particular given that about 40 percent of the funding of banks consists of emigrant deposits.

Staff evaluation

33. With the recent cut in the policy rate, staff assesses the stance of monetary policy as appropriate. Over time, this lower policy rate should help bring down market rates, which in turn would catalyze credit creation and support growth. In addition, if banks are successful in reducing the NPL overhang and with improving growth prospects, risk aversion may come down, which could reduce the need for precautionary excess liquidity. Given the weak transmission of monetary policy (either through changes in the policy rate or by releasing required reserves) and existing excess liquidity, financial sector reforms that address this weakness remain urgent.

[13] An MCM TA mission on liquidity management took place in April 2014.

C. Reinforcing Financial Stability through the Economic Downturn

34. While financial stability risks have increased with the economic downturn, the BCV has acted on various fronts to address these risks. The central bank has adopted a more stringent definition of NPLs (using IAS/IFRS standards), has undertaken an asset impairment review for the top 100 clients of systemic banks, and has issued guidance to banks to suspend dividend payments (which was done for 2012, and may also be done for 2013) . The BCV also issued new regulations that harmonize asset quality classification and provisioning standards, which are in effect as of December 2013. Cabo Verde is supported by MCM TA aimed at strengthening the financial stability framework (including bank supervision, crisis management and contingency planning; see Informational Annex). Progress continues to be made in implementing the recommendations of the 2009 Financial Sector Assessment Program (FSAP), especially in the areas of bank supervision and the legal and regulatory framework (Table 6). An important achievement was the recent enactment of the Basic Banking Law and the Financial Institutions Law, which will enhance the BCV's powers to strengthen oversight (including of the offshore sector) and implement regulatory reforms. The new financial laws will also strengthen the framework for insolvency, by enabling the use of progressive enforcement measures, early intervention and a broad range of resolution and liquidation tools. The next step is to draw up implementing regulations, which will also provide the opportunity to address some recommendations provided by MCM on the new laws.[14]

35. Staff encouraged the BCV to press ahead with efforts to address remaining priorities from the FSAP agenda. Amongst these, staff considers enhancing banking supervision and putting in place robust policies for crisis management as particularly important. The BCV should step up further its supervision of banks (to ensure proper classification of NPLs and proper provisioning), and reach understandings with bank owners on how to deal with possible liquidity and/or solvency threats. In particular, it should work closely with the bank whose CAR has fallen just below the 10 percent minimum, to ensure that it rebuilds its capital quickly. Strengthening collaboration between the BCV and the Ministry of Finance—in particular by making the Financial Stability Committee fully operational—remains essential to enhance crisis preparedness at the institutional level. The BCV's *Financial Stability Report,* which compares favorably with its peers, could be strengthened further by linking assessments over time (to clarify where the principal changes have taken place), strengthening the forward-looking orientation of the report by using early warning tools and qualitative surveys, and including more analytical topics (Box 3).

[14] LEG had provided extensive TA to the BCV when the financial laws were drafted, and stands ready to provide further support as implementing regulations are drawn up.

Box 3. Cabo Verde's Financial Stability Report

The Banco de Cabo Verde (BCV) began publishing a Financial Stability Report (FSR) in 2008. The BCV's FSR compares well with FSRs issued by peer countries, in particular with regards to the consistency of covering key stability risks, and also its increasing use of more sophisticated assessment tools like stress tests. Some suggestions for further enhancements are provided below, drawing on international best practices.

Over the last 20 years, Financial Stability Reports (FSRs) have come to play a key role as a financial sector surveillance tool. Since they are published on a regular basis, FSRs provide a good perspective on emerging risks and adverse trends that might threaten the financial system. By alerting financial institutions and market participants to the possible collective impact of their actions, FSRs can help prepare the ground for a collaborative and informed approach when confronted with a crisis. Publishing FSRs subjects the analysis of central banks to public scrutiny, which improves accountability and transparency. FSRs can also help encourage greater cooperation between central banks and ministries of finance, in particular if they are a regular agenda item of joint committees that focus on stability, crisis preparedness and management.

Most central banks are publishing FSRs. The first FSRs were issued in Europe in 1995; the first FSR in sub-Saharan Africa (SSA) was issued in 2004, by the South African Reserve Bank (SARB). The BCV launched its FSR in 2008 with the goal of identifying, analyzing and monitoring current and potential risks to the financial system. Like most central banks, the BCV publishes its FSR on a semi-annual basis, to capture in a timely manner emerging risks to financial stability. To assess the risks, most FSRs utilizes indicators related to macroeconomic aggregates, financial soundness, early warning, and market based and qualitative indicators.

The BCV's FSR compares well to FSRs issued by peers in SSA. The BCV started publishing its FSR relatively early (about four years after the SARB), and in the absence of a financial crisis (unlike most peers). Using an approach based on the "CCC" framework (assessing the report's clarity, consistency and coverage)[1] FSRs published by the BCV (2008–13) were compared with those published by peer central banks of Ghana, Mauritius, Namibia and South Africa. As the BCV has gained more experience, the content of the report has been strengthened, and more data is being provided. Over time, there has been good consistency in covering key stability risks, as well as sectors like the insurance markets, payment systems and the regulatory framework. The use of more sophisticated tools like stress tests (adopted in 2009 after Cabo Verde's FSAP) has increased over time, and has enhanced the forward-looking orientation of the report.

Drawing on international best practices, the BCV's FSR could be strengthened further as follows:

- improving the linkages between assessments over time, to clarify main changes in the assessment;
- strengthening forward orientation, by using early warning tools and surveys (e.g., Bank Lending Survey);
- focusing more on the interconnectedness of banks, to avoid missing risks to financial stability;
- exploring the introduction of a non-core part of the report where issues for follow up, selected articles, collaborative studies or papers on topical issues are discussed; and
- including the BCV's definition of financial stability and the aims of the FSR in each report, to improve users' understanding of the purpose of the report.

[1] Martin Čihák (2006) "How Do Central Banks Write on Financial Stability?" IMF Working Paper WP/06/163

Authorities' views

36. The BCV explained the recent steps they have taken to shore up financial stability. Banks have been required to strengthen their provisions and, in cases of insufficiency, they must register these insufficiencies immediately in their financial statements. The BCV is also monitoring write-offs of fully provisioned NPLs very closely, and explained that a new BCV regulation requires banks to regularly report all impaired loans to the BCV.

37. The BCV noted that the coverage ratio of provisions is actually higher than indicated by headline measures. All banks were asked to harmonize their accounting provisions by end-December 2013. Where relevant, the BCV identified underprovisioning in banks' financial reports and deducted the estimated underprovisioning from bank capital, reporting this as "adjusted" capital. Based on the harmonization exercise, if the value of the provisions recorded in the financial statements is included, the coverage ratio of provisions improves to 55 percent for credits more than 30 days overdue, and 70 percent for credits more than 90 days overdue.

D. Bolstering Competitiveness to Sustain Inclusive Growth

38. To sustain robust and inclusive growth over the medium term, Cabo Verde needs to make further progress in addressing shortcomings in competitiveness. The country made significant strides in recent years, moving up in the World Economic Forum's (WEF) Global Competitiveness rankings from 146th in 2010 to 122nd in 2012. And as noted in Box 1, the exchange rate is assessed as broadly in line with long-term fundamentals. However, compared to its peers in the region, Cabo Verde still lags behind in a number of areas that matter for global competitiveness. It has also demonstrated greater macroeconomic vulnerabilities than its peers (Figure 3).

39. Improving the performance of the labor market is particularly important to increase productivity, raise employment, and reduce inequality. The WEF ranks Cabo Verde 129th out of 148 countries for labor market efficiency. A new Labor Code—which is being finalized through broad-based consultation with stakeholders—should help reduce inflexibility with regards to working hours, disciplinary measures, and redundancy regulations. In addition to making labor regulations more employment-friendly, the authorities should explore providing more funding for vocational training and other skills enhancement. This would help address the skill mismatch, which has been found to be an important factor in explaining the decline in total factor productivity (Appendix I).

40. Cabo Verde has continued to do exceptionally well in the area of social development, putting achievement of all MDGs by 2015 within reach. Staff took note of the ambitious and comprehensive strategy set out in the GPRSP-III to promote economic growth, create jobs, and reduce poverty. Even as the country overall has done well, poverty and unemployment remain troublesome in rural and agricultural areas—and among women overall—where the incidence is higher. This calls for policies that focus in particular on increasing opportunities for groups that are doing less well. Given constraints on financial resources and capacity, further prioritization of the objectives of the GPRSP-III would help achieve goals with the highest social and economic return.

Authorities' views

41. Improving the business climate is a key feature of the government's medium-term growth and development plan (GPRSP-III). Enhancing labor market flexibility, bolstering productivity, and improving the quality and relevance of education and training are central to the authorities' reform agenda. The authorities also noted that while some indices may rank Cabo Verde low on competitiveness, others rank them much higher—for example, they noted that the country is now ranked 60th out of 160 countries in the Heritage Foundation's Economic Freedom Index.

42. With regards to social development, the authorities expressed their strong commitment to reducing inequality in income and increasing employment opportunities. The GPRSP-III seeks to reduce these inequalities through policies that promote pro-poor growth, for example by targeting training resources for workers in the farming and informal sectors, investing in infrastructure in less-advantaged areas, and strengthening linkages between tourism and other parts of the economy (especially agriculture).

STAFF APPRAISAL

43. Cabo Verde finds itself at an important juncture in its economic development, with capital investment waning as a driver of growth. For the transition to a productivity-led economy to be successful, an ambitious structural reform agenda is needed to address challenges to competitiveness. Maintaining robust growth over the medium term is certainly achievable, but far from given, with the historical experience of micro and small economies indicating an average long term growth rate of 3–4 percent. At the same time, given Cabo Verde's high public debt, a strong commitment to fiscal consolidation is critical to support macroeconomic stability.

44. In the near term, the outlook for economic growth is improving, though subject to some downside risks. With demand from major trading partners expected to pick up, tourism should continue to do well, and FDI to recover. And as banks work through the NPL overhang, a modest increase in credit growth could help fuel an incipient recovery in domestic demand.

45. For 2014, the macroeconomic policy stance is now broadly appropriate, though it required a shift in the policy mix and a reduction in the fiscal deficit. In the face of sharply lower investment and depressed private consumption, there has been a need for policies to support economic activity. And with the outlook for growth still moderate and uncertain, staff sees a continued role for accommodative policies. However, given the high level of public debt, staff recommended a more ambitious fiscal consolidation path than envisioned by the authorities. In addition, while the expenditure containment measures agreed after the mission are welcome, it would have been preferable for the original budget to set out a more realistic expenditure path, given likely risks to revenue. With regards to monetary policy, in the absence of pressures on the external position or on prices, staff welcomed the decision to loosen the monetary policy stance in support of the recovery.

46. Looking farther ahead, ambitious fiscal consolidation holds the key to ensuring macroeconomic stability and providing a sound basis for private sector-led growth. The large-scale public investment program has helped close infrastructure gaps and cushion the economy from the impact of the global financial crisis. However, with debt now approaching 100 percent of GDP, a strong commitment to bringing down debt is needed to reinforce Cabo Verde's reputation of sound macroeconomic management, and also to create room for financing private sector growth. Staff therefore welcomes the authorities' decision to adopt expenditure containment measures (for 2014 and beyond), though recommends that further containment measures be taken to put Cabo Verde on a faster downward trajectory for public debt.

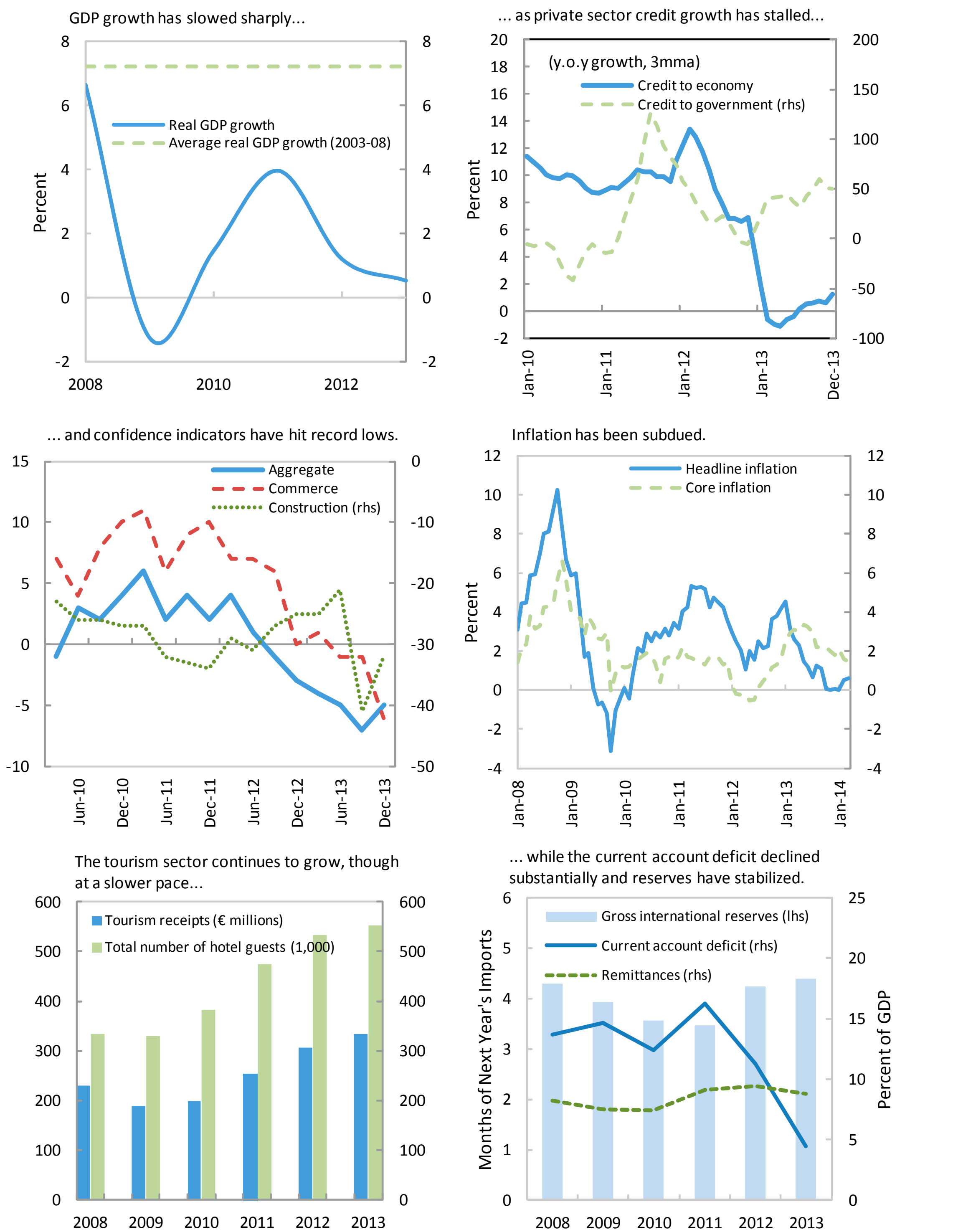
47. The fixed exchange rate regime has anchored macroeconomic stability in Cabo Verde, and external stability does not appear to be at risk. However, with its high dependence on tourism and remittances, Cabo Verde remains vulnerable to changes in external conditions. This underscores the importance of adopting reforms that enhance competitiveness and support economic diversification. At the same time, cautious macroeconomic management remains essential to safeguard the peg and macroeconomic stability more generally.

48. Cabo Verde's Third Growth and Poverty Reduction Strategy Paper (GPRSP-III) provides the country with a sound blueprint for achieving these aims. The GPRSP-III presents an ambitious and comprehensive strategy to promote economic growth, create jobs, and reduce poverty. Given constraints on resources—both financial and in terms of capacity—staff recommends further prioritization amongst the goals set out in the strategy, focusing efforts on those where the economic and social returns are expected to be highest.

49. While data are adequate for surveillance purposes, some key shortcomings remain. National accounts data are released with a significant lag and only on an annual basis. This represents a serious obstacle to macroeconomic policy formulation. STA has provided technical assistance in this area, focusing most recently on quarterly national accounts data. The authorities are taking steps to improve the provision of statistics, but still face both financial and human resource constraints.

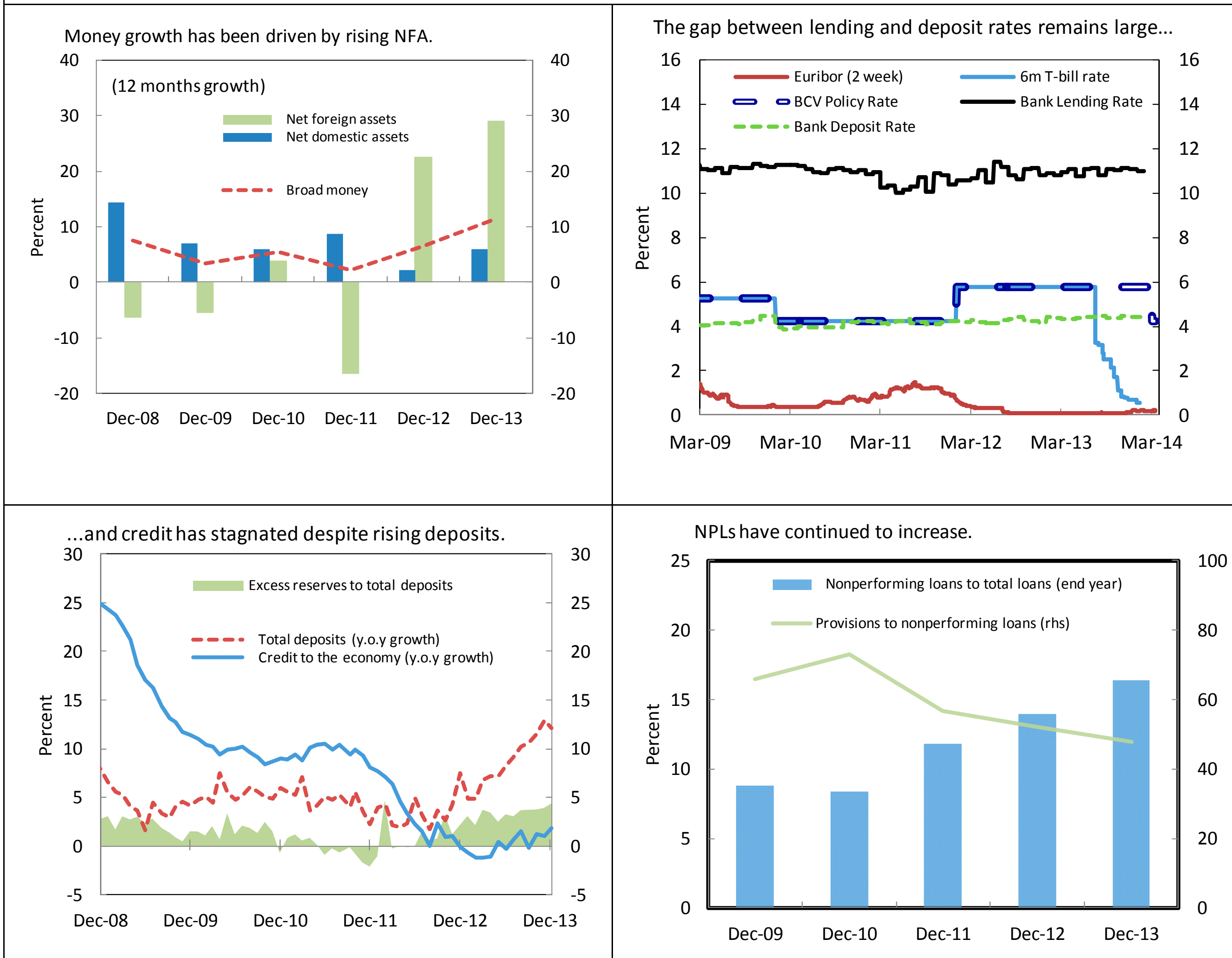
50. Staff urges the authorities to consent to the 2010 IMF Quota and Voice reforms. Staff recommends that the next Article IV consultation take place on the standard 12 month cycle.

Figure 1. Cabo Verde: Recent Economic Developments



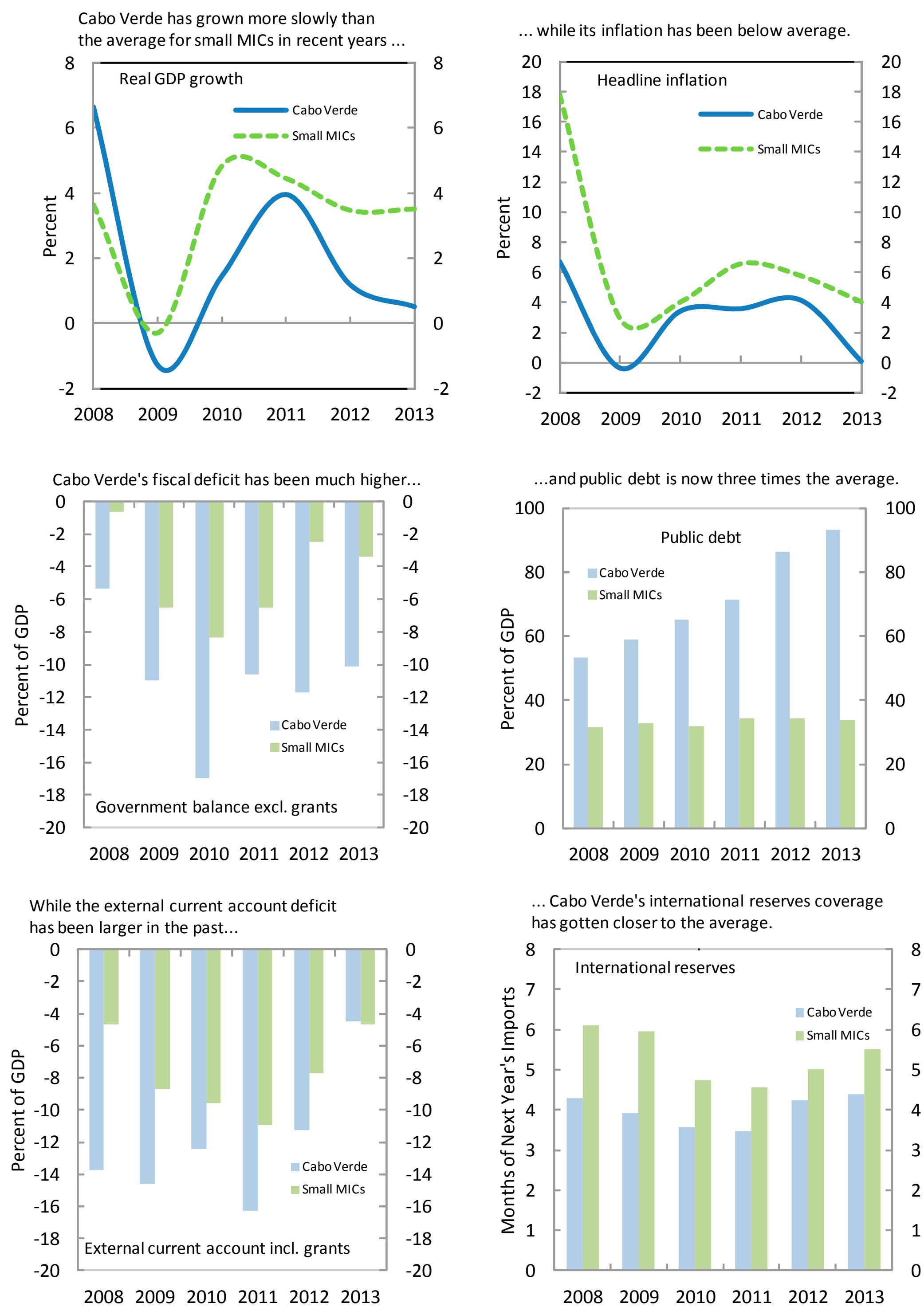
Sources: Cabo Verdean authorities and IMF staff.

Figure 2. Cabo Verde: Monetary Developments and Credit Growth



Sources: Cabo Verdean authorities and IMF staff.

Figure 3. Cabo Verde's Performance Compared to Small Middle-Income SSA Peers[1]



Sources: IMF, World Economic Outlook 2013; Cabo Verdean authorities; and IMF staff.

[1] Botswana, Cabo Verde, Lesotho, Mauritius, Namibia, Seychelles, and Swaziland.

Table 1. Cabo Verde: Selected Economic Indicators, 2011–17

	2011	2012	2013	2014	2015	2016	2017
			Est.		Proj.		
	(Annual percent change)						
National accounts and prices [1]							
Real GDP	4.0	1.2	0.5	3.0	3.5	4.0	4.0
GDP deflator	2.7	1.9	2.5	2.5	2.5	2.5	2.5
Consumer price index (annual average)	4.5	2.5	1.5	2.0	2.5	2.5	2.5
Consumer price index (end of period)	3.6	4.1	0.1	2.5	2.5	2.5	2.5
External sector							
Exports of goods and services	17.3	7.2	5.1	6.8	8.9	9.3	9.3
Of which: tourism	26.5	21.4	8.6	9.5	10.3	10.3	10.3
Imports of goods and services	17.9	-8.1	-6.9	11.9	9.9	7.2	5.0
	(Change in percent of broad money, 12 months earlier)						
Money and credit [2]							
Net foreign assets	-7.7	4.6	6.9	3.5	2.2	0.2	0.5
Net domestic assets	12.2	1.7	4.4	3.1	8.1	9.0	7.5
Net claims on the central government	4.0	3.3	1.8	1.4	1.1	1.3	1.1
Credit to the economy	10.8	0.0	1.3	5.1	6.0	6.2	5.8
Broad money (M2)	4.6	6.3	11.3	6.6	10.3	9.2	8.0
	(Percent of GDP, unless otherwise indicated)						
External sector							
External current account (including official transfers)	-16.3	-11.3	-4.5	-9.1	-10.8	-10.9	-9.2
External current account (excluding official transfers)	-20.0	-14.6	-7.5	-10.7	-12.4	-12.2	-10.5
Overall balance of payments	-2.7	2.7	3.5	3.2	2.2	0.6	0.8
Gross international reserves (months of prospective imports of goods and services)	3.5	4.2	4.4	4.6	4.6	4.5	4.4
Government finance							
Revenue	25.6	23.0	23.7	25.5	24.7	25.1	25.4
Tax and nontax revenue	22.7	21.2	21.3	22.6	22.9	23.5	24.1
Grants	2.9	1.8	2.4	2.9	1.8	1.6	1.3
Expenditure	33.3	32.9	31.5	32.9	31.2	30.8	30.0
Overall balance (incl. grants)	-7.7	-9.9	-7.8	-7.4	-6.5	-5.7	-4.6
External financing	6.0	7.5	6.2	5.7	4.7	3.5	2.6
Domestic financing	1.6	2.3	1.6	1.7	1.8	2.2	2.0
Onlending	-3.6	-3.7	-5.4	-4.3	-4.0	-3.2	-2.3
Total financing (incl. onlending)	11.2	13.6	13.2	11.7	10.4	8.9	6.9
Public debt stock and service [3]							
Total nominal government debt	77.8	90.2	97.6	104.1	107.4	108.4	107.5
External government debt	56.1	67.5	74.0	79.2	81.9	82.0	80.5
Domestic government debt	21.6	22.6	23.6	24.9	25.5	26.4	27.0
External debt service (percent of exports of goods and services)	4.1	4.3	4.6	4.5	4.5	4.4	4.1
Present value of external debt							
Percent of GDP (risk threshold: 50%)	…	…	42.6	45.8	47.8	48.5	48.2
Percent of revenue (risk threshold: 300%)	…	…	199.5	203.0	208.7	205.9	199.9
Percent of exports (risk threshold: 200%)	…	…	95.0	101.2	102.9	101.8	98.8
Memorandum items:							
Nominal GDP (billions of Cabo Verde escudos)	147.9	152.6	157.2	166.0	176.2	187.9	200.3
Gross international reserves (€ millions, end of period)	263.3	299.3	347.5	395.9	431.2	440.6	454.9

Sources: Cabo Verdean authorities; and IMF staff estimates and projections.

[1] Last data available for national accounts is for 2012.

[2] Adjusted for data inconsistency in December 2011.

[3] Public debt data for 2013 are preliminary estimates.

Table 2. Cabo Verde: Balance of Payments, 2011–17

(Millions of euros, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017
			Est.		Proj.		
Current account balance (including official transfers)	**-218**	**-156**	**-64**	**-137**	**-173**	**-185**	**-167**
Trade balance	-609	-557	-470	-552	-623	-665	-687
Exports, f.o.b.	152	143	149	160	170	183	197
Imports, f.o.b.	-761	-700	-619	-712	-793	-848	-883
Consumer goods	-222	-211	-209	-234	-261	-280	-293
Intermediate goods	-145	-122	-112	-139	-155	-166	-174
Capital goods	-128	-124	-59	-73	-82	-88	-92
Services (net)	185	254	261	285	323	359	400
Receipt	415	465	489	522	573	629	690
Of which: tourism	253	307	333	365	402	443	489
Payment	-229	-211	-228	-237	-249	-270	-289
Income (net)	-53	-55	-47	-55	-62	-70	-77
Credit	10	10	10	11	11	12	12
Debit	-63	-64	-57	-65	-73	-82	-89
Government interest	-7	-10	-13	-13	-14	-15	-16
Interest by other sectors	-24	-27	-32	-35	-39	-42	-47
Income on direct investment and other income	-32	-27	-12	-18	-21	-25	-26
Current transfers (net)	258	202	192	185	189	191	195
Government	50	46	43	25	25	23	23
Private	208	156	148	160	164	168	172
Capital and financial account (net)	**201**	**218**	**139**	**185**	**209**	**195**	**182**
Capital account	9	10	5	4	5	5	5
Of which: Grants	8	10	4	4	5	5	5
Financial account	192	208	134	181	204	190	176
Direct investment	75	45	27	40	50	55	60
Portfolio investment	0	-1	0	0	0	0	0
Other investment	116	163	107	141	154	135	116
Central government	129	156	145	151	138	114	90
Disbursements	145	172	161	169	158	134	111
Amortization	-16	-16	-16	-18	-19	-20	-21
Other investments, noncentral government	-13	7	-38	-10	15	21	26
Monetary authority	-1	-6	-2	-1	-1	0	0
Commercial banks	-47	-7	-21	6	6	6	6
Nonbank flows	36	20	-15	-15	10	15	20
Errors and omissions[1]	**-21**	**-25**	**-25**	**0**	**0**	**0**	**0**
Overall balance	**-38**	**37**	**50**	**48**	**35**	**9**	**14**
Financing	38	-37	-50	-48	-35	-9	-14
Gross international reserves (– = accumulation)	32	-37	-50	-48	-35	-9	-14
Exceptional financing	7	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0
Memorandum items:							
Current account (incl. official transfers, percent of GDP)	-16.3	-11.3	-4.5	-9.1	-10.8	-10.9	-9.2
Current account (excl. official transfers, percent of GDP)	-20.0	-14.6	-7.5	-10.7	-12.4	-12.2	-10.5
Overall balance (percent of GDP)	-2.9	2.7	3.5	3.2	2.2	0.6	0.8
Gross international reserves	263	299	347	396	431	441	455
Months of current year's imports of goods and services	3.2	3.9	4.9	5.0	5.0	4.7	4.7
Months of next year's imports of goods and services	3.5	4.2	4.4	4.6	4.6	4.5	4.4
External public debt	753	934	1,055	1,192	1,309	1,397	1,462
External aid (grants and loans; percent of GDP)	15.2	16.4	14.7	13.2	11.7	9.5	7.7

Sources: Bank of Cabo Verde; and IMF staff estimates and projections.

[1] Including banks' delays on trade credit reporting.

Table 3a. Cabo Verde: Statement of Operations of the Central Government, 2011–17 [1]
(Millions of Cabo Verde escudos)

	2011	2012	2013	2014	2015	2016	2017
			Est.	Proj.			
Revenue	**37,916**	**35,050**	**37,259**	**42,380**	**43,526**	**47,180**	**50,921**
Taxes	29,581	27,515	28,031	31,191	33,660	37,060	40,677
Taxes on income and profit	8,678	8,626	8,541	8,998	9,590	10,273	11,000
Taxes on goods and services	13,840	12,443	13,123	15,232	17,113	19,329	21,832
Taxes on international trade	6,228	5,778	5,700	6,129	6,071	6,506	6,829
Other taxes	835	667	668	832	887	950	1,017
Grants	4,342	2,768	3,708	4,889	3,159	2,949	2,579
Other revenue	3,993	4,768	5,520	6,300	6,707	7,171	7,665
Of which: Fees and penalties	280	365	430	1,105	1,194	1,292	1,398
Expenditure	**49,650**	**50,118**	**49,469**	**54,673**	**54,901**	**57,885**	**60,114**
Current expenditure	**34,738**	**34,166**	**35,200**	**41,164**	**42,450**	**44,794**	**46,523**
Compensation of employees	15,679	15,801	16,110	18,159	18,963	19,777	20,627
Use of goods and services	5,248	4,498	4,396	7,149	6,800	6,964	6,763
Interest	2,277	2,866	3,404	3,601	4,086	4,848	5,593
Subsidies	994	274	101	170	449	451	451
Current transfers	4,309	4,054	4,079	5,371	5,249	5,548	5,632
Social benefits	3,716	3,916	4,141	3,986	4,155	4,375	4,560
Other expense	2,515	2,756	2,968	2,729	2,748	2,832	2,897
Net acquisition of nonfinancial assets	**14,912**	**15,952**	**14,269**	**13,509**	**12,450**	**13,091**	**13,590**
Overall balance	**-11,734**	**-15,067**	**-12,210**	**-12,294**	**-11,374**	**-10,705**	**-9,193**
Net financing	**11,734**	**15,067**	**12,210**	**12,294**	**11,374**	**10,705**	**9,193**
Net foreign borrowing for the budget	**8,933**	**11,511**	**9,723**	**9,461**	**8,221**	**6,540**	**5,205**
Net domestic credit [2]	**2,111**	**2,835**	**1,880**	**2,832**	**3,153**	**4,165**	**3,987**
Of which: Capitalization of SOEs	**-46**	**-1,044**	**-600**	**-947**	**0**	**0**	**0**
Net errors and omissions	**282**	**722**	**2,435**	**0**	**0**	**0**	***0***
Net other liabilities	**-5,304**	**-5,714**	**-10,322**	**-7,112**	**-7,032**	**-6,000**	**-4,700**
Of which: Onlending	**-5,304**	**-5,714**	**-8,495**	**-7,112**	**-7,032**	**-6,000**	**-4,700**
Total financing (incl. onlending)	**17,038**	**20,782**	**22,532**	**19,406**	**18,406**	**16,705**	**13,893**
Memorandum items:							
Net foreign borrowing (incl. onlending)	14,237	17,225	18,218	16,574	15,253	12,540	9,906
Net acquisition of nonfinancial assets (incl. onlending)	20,216	21,666	22,764	20,622	19,482	19,092	18,291

Sources: Cabo Verdean authorities and IMF staff estimates and projections.

[1] Includes budgetary central government (BCG) and extrabudgetary central government (ECG), but excludes social security funds.

[2] Includes capitalization of state owned enterprises.

Table 3b. Cabo Verde: Statement of Operations of the Central Government, 2011–17 [1]

(Percentage of GDP)

	2011	2012	2013	2014	2015	2016	2017
			Est.	Proj.			
Revenue	**25.6**	**23.0**	**23.7**	**25.5**	**24.7**	**25.1**	**25.4**
Taxes	20.0	18.0	17.8	18.8	19.1	19.7	20.3
Taxes on income and profit	5.9	5.7	5.4	5.4	5.4	5.5	5.5
Taxes on goods and services	9.4	8.2	8.3	9.2	9.7	10.3	10.9
Taxes on international trade	4.2	3.8	3.6	3.7	3.4	3.5	3.4
Other taxes	0.6	0.4	0.4	0.5	0.5	0.5	0.5
Grants	2.9	1.8	2.4	2.9	1.8	1.6	1.3
Other revenue	2.7	3.1	3.5	3.8	3.8	3.8	3.8
Of which: Fees and penalties	0.2	0.2	0.3	0.7	0.7	0.7	0.7
Expenditure	**33.6**	**32.9**	**31.5**	**32.9**	**31.2**	**30.8**	**30.0**
Expense	23.5	22.4	22.4	24.8	24.1	23.8	23.2
Compensation of employees	10.6	10.4	10.2	10.9	10.8	10.5	10.3
Use of goods and services	3.5	2.9	2.8	4.3	3.9	3.7	3.4
Interest	1.5	1.9	2.2	2.2	2.3	2.6	2.8
Subsidies	0.7	0.2	0.1	0.1	0.3	0.2	0.2
Current transfers	2.9	2.7	2.6	3.2	3.0	3.0	2.8
Social benefits	2.5	2.6	2.6	2.4	2.4	2.3	2.3
Other expense	1.7	1.8	1.9	1.6	1.6	1.5	1.4
Net acquisition of nonfinancial assets	10.1	10.5	9.1	8.1	7.1	7.0	6.8
Overall balance	**-7.9**	**-9.9**	**-7.8**	**-7.4**	**-6.5**	**-5.7**	**-4.6**
Net financing	**7.9**	**9.9**	**7.8**	**7.4**	**6.5**	**5.7**	**4.6**
Net foreign borrowing for budget	**6.0**	**7.5**	**6.2**	**5.7**	**4.7**	**3.5**	**2.6**
Net domestic credit [2]	**1.4**	**1.9**	**1.2**	**1.7**	**1.8**	**2.2**	**2.0**
Of which: Capitalization of SOEs	**0.0**	**-0.7**	**-0.4**	**-0.6**	**0.0**	**0.0**	**0.0**
Net errors and omissions	**0.2**	**0.5**	**1.5**	**0.0**	**0.0**	**0.0**	**0.0**
Net other liabilities	**-3.6**	**-3.7**	**-6.6**	**-4.3**	**-4.0**	**-3.2**	**-2.3**
Of which: Onlending	**-3.6**	**-3.7**	**-5.4**	**-4.3**	**-4.0**	**-3.2**	**-2.3**
Total financing (incl. onlending)	**-11.5**	**-13.6**	**-13.2**	**-11.7**	**-10.4**	**-8.9**	**-6.9**
Memorandum items:							
Net foreign borrowing (incl. onlending)	9.6	11.3	11.6	10.0	8.7	6.7	4.9
Net acquisition of nonfinancial assets (incl. onlending)	13.7	14.2	14.5	12.4	11.1	10.2	9.1
GDP at current market prices (billions of CVEsc) [3]	147.9	152.6	157.2	166.0	176.2	187.9	200.3

Sources: Cabo Verdean authorities and IMF staff estimates and projections.

[1] Includes budgetary central government (BCG) and extrabudgetary central government (ECG), but excludes social security funds.

[2] Includes capitalization of state owned enterprises.

[3] Uses staff projections for nominal GDP. The Ministry of Finance's GDP projections are higher (by about 8 percent by 2017).

Table 4a. Cabo Verde: Monetary Survey, 2011–17

(Millions of Cabo Verde escudos, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017
					Proj.		
Net foreign assets	19,986	25,375	33,854	38,619	41,907	42,296	43,172
Foreign assets	40,466	52,725	68,041	73,381	77,276	78,314	79,884
Of which: gross international reserves	29,034	33,007	38,312	43,652	47,546	48,585	50,155
Foreign liabilities	-20,481	-27,350	-34,187	-34,763	-35,369	-36,019	-36,713
Net domestic assets	96,102	98,034	103,450	107,773	119,569	134,048	147,316
Net domestic credit	120,308	124,093	128,159	137,204	147,689	159,911	172,252
Net claims on general government (net)	21,954	25,694	28,138	30,131	31,830	34,057	36,203
Investment in TCMFs [1]	10,802	11,499	11,499	11,499	11,499	11,499	11,499
Net claims on the central government	9,993	13,769	15,983	17,872	19,449	21,532	23,525
Credit to central government	19,407	19,837	22,944	25,221	27,249	29,851	32,394
Deposits of central government	-9,414	-6,069	-6,961	-7,348	-7,800	-8,320	-8,869
Of which: project deposits	-14	-21	-29	-277	-277	-277	-277
Net claims on local government and other agencies [2]	1,159	426	656	759	882	1,026	1,179
Credit to the economy	98,354	98,400	100,021	107,073	115,858	125,854	136,049
Other items (net)	-24,205	-26,059	-24,708	-29,431	-28,119	-25,863	-24,937
Broad money (M2)	116,088	123,410	137,305	146,391	161,476	176,343	190,488
Narrow money (M1)	43,728	45,648	52,564	54,149	59,729	65,228	70,460
Currency outside banks	8,376	7,895	8,096	9,125	9,966	10,830	11,649
Demand deposits	35,352	37,754	44,468	45,024	49,762	54,398	58,811
Quasi-money	67,862	73,070	80,189	86,677	95,609	104,411	112,786
Foreign currency deposits	4,498	4,692	4,552	5,566	6,139	6,704	7,242
(Change in percent of broad money, 12 months earlier)							
Net foreign assets	-4.2	4.6	6.9	3.5	2.2	0.2	0.5
Net domestic assets	6.5	1.7	4.4	3.1	8.1	9.0	7.5
Net domestic credit	8.2	3.3	3.3	6.6	7.2	7.6	7.0
Net claims on the central government	3.0	3.3	1.8	1.4	1.1	1.3	1.1
Credit to the economy [3]	6.3	0.0	1.3	5.1	6.0	6.2	5.8
Other items (net)	-1.8	-1.6	1.1	-3.4	0.9	1.4	0.5
Broad money (M2)	2.2	6.3	11.3	6.6	10.3	9.2	8.0
Memorandum items:							
Emigrant deposits	41,853	45,454	49,070	56,587	62,434	68,191	73,668
Emigrant deposits/total deposits (percent)	38.9	39.3	38.0	41.2	41.2	41.2	41.2
Excess reserves/total deposits (percent)	-2.5	1.7	4.7	…	…	…	…
Money multiplier (M2/M0)	4.8	3.8	3.6	3.4	3.4	3.6	3.8
Credit to the economy (percent change) [3]	8.0	0.0	1.6	7.1	8.2	8.6	8.1
Broad money (M2 in percent of GDP)	78.5	80.9	87.3	88.2	91.6	93.8	95.1

Sources: Bank of Cabo Verde; and IMF staff estimates and projections.

[1] TCMFs (*Títulos Consolidados de Mobilização Financeira)* are government bonds in escudos maturing in 2018 and backed by a trust fund managed by the Banco de Portugal.

[2] Includes Cabo Verde's National Pension Institute (INPS).

[3] Staff adjusted variables presented in annual change, reflecting data discontinuity in December 2011.

Table 4b. Cabo Verde: Central Bank Survey, 2011–17

(Millions of Cabo Verde escudos, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017
				Staff	Proj.	Proj.	Proj.
Net foreign assets	26,644	31,224	36,819	42,237	46,193	47,262	48,832
Of which: net international reserves	28,480	32,641	38,141	43,559	47,515	48,584	50,154
Foreign assets	29,034	33,007	38,312	43,652	47,546	48,585	50,155
Of which: gross international reserves	29,034	33,007	38,312	43,652	47,546	48,585	50,155
Foreign liabilities	-2,391	-1,782	-1,492	-1,414	-1,354	-1,323	-1,323
Net domestic assets	-2,205	1,355	1,608	964	1,042	1,470	1,848
Net domestic credit	271	3,402	3,045	3,010	3,088	3,517	3,895
Investment in TCMFs [1]	4,739	4,872	4,873	4,873	4,873	4,873	4,873
Credit to central government (net)	-3,414	-200	-611	-645	-685	-730	-778
Credit to commercial banks (net)	-1,740	-1,989	-1,997	-1,998	-1,884	-1,413	-991
Credit to the economy	686	719	780	780	784	788	792
Other items (net)	-2,475	-2,047	-1,437	-2,047	-2,047	-2,047	-2,047
Reserve money (M0)	24,439	32,580	38,427	43,201	47,234	48,732	50,680
Currency issued	9,846	9,829	10,096	11,330	13,807	14,865	15,778
Deposits of commercial banks	14,593	22,751	28,331	28,963	34,049	37,455	40,720
Memorandum items:							
Gross international reserves (millions of euros)	263.3	299.3	347.5	395.9	431.2	440.6	454.9
Net international reserves (millions of euros)	258.3	296.0	345.9	395.0	430.9	440.6	454.8
(months of next year's imports)	3.5	4.2	4.4	4.6	4.6	4.5	4.4
Reserve money (12-month change in percent)	-5.7	33.3	17.9	12.4	9.3	3.2	4.0

Sources: Bank of Cabo Verde; and IMF staff estimates and projections.

[1] TCMFs (*Títulos Consolidados de Mobilização Financeira)* are government bonds in escudos maturing in 2018 and backed by a trust fund managed by the Banco de Portugal.

Table 4c. Cabo Verde: Deposit Money Bank Survey, 2011–17
(Millions of Cabo Verde escudos, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017
				Staff	Proj.	Proj.	Proj.
Net foreign assets	-6,658	-5,849	-2,965	-3,619	-4,286	-4,966	-5,660
Foreign assets	11,432	19,718	29,729	29,729	29,729	29,729	29,729
Foreign liabilities [1]	-18,090	-25,567	-32,694	-33,348	-34,015	-34,695	-35,389
Net domestic assets	114,365	121,352	132,168	140,885	155,795	170,479	184,499
Net domestic credit	134,984	144,435	155,259	165,362	181,374	196,825	212,294
Net claims on general government	20,630	21,021	23,876	25,903	27,642	29,914	32,109
Investment in TCMFs [2]	6,064	6,626	6,626	6,626	6,626	6,626	6,626
Net claims on central government	13,407	13,968	16,594	18,517	20,133	22,262	24,304
Net claims on local government	2,402	1,665	2,125	2,243	2,381	2,540	2,708
Credit to the economy	97,667	97,681	99,241	106,293	115,074	125,066	135,257
Net claims on the Bank of Cape Verde	16,687	25,733	32,142	33,166	38,658	41,845	44,927
Other items (net)	-20,619	-23,084	-23,092	-24,477	-25,578	-26,346	-27,795
Deposit liabilities to nonbank residents	107,707	115,502	129,203	137,266	151,510	165,514	178,839
Local currency deposits	103,209	110,811	124,651	131,701	145,371	158,809	171,597
Demand deposits	35,347	37,741	44,462	45,024	49,762	54,398	58,811
Time deposits	67,862	73,070	80,189	86,677	95,609	104,411	112,786
Foreign currency deposits	4,498	4,692	4,552	5,566	6,139	6,704	7,242
Memorandum items:							
Emigrant deposits (ratio to total deposits)	0.39	0.39	0.38	0.41	0.41	0.41	0.41
Other deposits (ratio to broad money)	0.64	0.63	0.63	0.63	0.63	0.63	0.63
Composition of emigrant deposits							
Local currency	0.97	0.97	0.97	0.97	0.97	0.97	0.97
Foreign currency	0.03	0.03	0.03	0.03	0.03	0.03	0.03

Sources: Bank of Cabo Verde; and IMF staff estimates and projections.

[1] The large increase in foreign liabilities in 2012 and 2013 reflects the inclusion of three new banks in the monetary survey statistics.

[2] TCMFs (*Títulos Consolidados de Mobilização Financeira)* are government bonds in escudos maturing in 2018 and backed by a trust fund managed by the Banco de Portugal.

Table 5. Cabo Verde: Financial Soundness of the Banking Sector, 2009–13
(End-year; percent unless otherwise indicated)

	2009	2010	2011	2012	2013
Capital adequacy					
Regulatory capital to risk-weighted assets	11.4	15.6	15.2	12.1	13.3
Regulatory Tier 1 capital to risk-weighted assets	11.2	14.4	15.9	11.8	11.5
Asset quality					
Nonperforming loans to total loans (end year)	8.8	8.4	11.8	14.0	16.4
Nonperforming loans net of provisions	3.0	2.3	5.1	6.7	8.5
Provisions to nonperforming loans	65.8	73.0	56.6	52.0	47.9
Earnings and profitability					
Return on assets	0.7	0.7	0.4	0.3	0.2
Return on equity	9.8	9.1	5.6	3.9	2.3
Interest margin to gross income	72.0	77.7	76.2	75.5	75.9
Noninterest expenses to gross income	65.4	67.0	68.5	76.5	76.5
Liquidity[1]					
Liquid assets to total assets	16.4	12.5	13.2	8.2	21.2
Liquid assets to short-term liabilities	49.2	37.4	43.1	28.2	27.9
Additional indicators					
Government deposits over total deposits	3.6	9.5	7.6	9.7	-5.4
Emigrant deposits over total deposits	35.2	35.0	37.1	37.1	39.8
Emigrant deposits over total assets	27.8	27.3	27.0	26.5	25.4
Demand deposits over total deposits	42.2	42.6	43.4	42.0	45.4
Credit to private sector over total deposits	76.3	79.2	85.9	78.9	80.2
Personnel cost over cost of operations	47.3	49.0	49.9	50.1	47.3
Spread (90 day lending - time deposit rate)	9.1	7.5	5.2	7.9	7.1
Spread (emigrant deposits - euro area deposit rate)	2.5	2.2	1.8	1.4	2.6

Source: Bank of Cabo Verde.

[1] Liquid assets include cash in vault and marketable securities. Short-term liabilities include demand deposits.

Table 6. Cabo Verde: Implementation Status for the Recommendations of the 2009 FSAP

Recommendation	Timeframe	Status
Financial Sector Soundness, Supervision and Regulation		
Reducing vulnerabilities in domestic banks		
• Encourage banks to raise capital above the regulatory minimum and strictly avoid forbearance in case of even temporary shortfalls	Short term	**Done**
• Further enhance the framework for financial soundness analysis	Short term	In process
• Enhance credit risk assessment framework	Short term	In process
Mitigating risks in the offshore sector		
• Determine whether to wind down IFI sector or reform it to conform to international standards of regulation, supervision and integrity	Short term	**Done**
• If reform is chosen, implement international standards of regulation, strengthen supervisory powers, and adopt stricter licensing standards	Short term	In process
Enhancing banking supervision		
• Improve supervision of onshore and offshore banks	Short term	In process
• Improve the legislative and regulatory framework for supervision	Short term	In process
Establishing a crisis management framework		
• Create well-defined guidelines for the management of problem financial institutions and financial crises	Short term	**Done**
• Review law and develop implementing regulations outlining lender of last resort arrangements	Short to medium term	In process
• Assess desirability of instituting system of deposit insurance, taking into account costs, benefits, and structure of the financial system	Short term	**Done**
Issues in Systemic Liquidity and Monetary Management		
Enhancing the framework for monetary operations		
• Streamline monetary operations decision making process	Medium term	**Done**
• Use predetermined long-term intervention program to implement program targets and short-term operations to manage daily liquidity conditions at banks.	Short term	In process
• Release Board monetary meeting minutes with a lag	Medium term	Not initiated
• Use t-bills for monetary operations as much as possible	Medium term	In process
• Improve coordination of monetary and fiscal operations between BCV and the Treasury	Short term.	**Done**
• Harmonize tax treatment of BCV securities and treasuries	Short term	Not initiated
Developing the money market		
• More actively manage bank liquidity through daily auctions	Short term	In process
• Apply less punitive and symmetric rates to standing facilities	Medium term	Not initiated
• Allow wider secondary market trading in BCV securities	Short term	Not initiated
• Use repos to implement all of BCV's short-term interventions (standing facilities and auctions)	Medium term	In process
Challenges for the Development of the Financial Sector		
Access to Finance		
• Promote technical assistance to SME's to implement proper accounting systems to facilitate lending decisions	Short term	Not initiated
• Implement a more comprehensive credit reporting system	Short term	In process
• Do not allow deposit-taking by microfinance institutions	Short term	In process

Table 6. Cabo Verde: Implementation status for the recommendations of the 2009 FSAP (concluded)

Pension and insurance		
• Strengthen the governance and transparency of the INPS	Short term	In process
• Evaluate additional parametric reforms to the INPS to ensure long-term viability	Medium term	In process
• Evaluate the costs, benefits, and risks of allowing INPS to place part of its assets abroad	Short term	Not initiated
• Consider tax deferral of contributions and investment gains in employer contributions as expenses for purposes of corporate and personal income tax	Medium term	Not initiated
• Modernize the legal and regulatory framework for insurance	Medium term	Not initiated
Legal and judicial issues		
• Finish the process of replacing the Code of Civil Procedure	Short term	In process
• Implement further steps to promote mediation	Short term	In process
• Promote improved corporate governance practices that impact firms' ability to obtain credit	Short to medium term	In process
• Draw lessons from experience of other countries in replacing the bankruptcy code	Medium term	In process

Source: IMF Article IV, March 2014. Updated by IMF staff in March 2014.

Table 7. Risks Assessment Matrix[1]

Sources of risks	Likelihood of realization in next 1-3 years	Impact if realized
	External (exogenous) risks	
Protracted period of slower growth in euro area economies	**High** The outlook for the euro area is for a modest recovery. However, the area remains subject to downside risks of prolonged stagnation.	**High** Prolonged stagnation would depress exports, remittances, and FDI, and consequently domestic demand. It could also lower grants and other donor financing. These would have a significant impact on economic growth and foreign reserves.
Surges in global financial market volatility	**High** Bouts of market volatility and higher-than-expected increases in long-term rates could occur as a result of advanced countries exiting from UMP.	**Medium** Although Cabo Verde is relatively insulated from global financial markets, higher interest rates in the US and the euro area could depress remittances and put pressure on international reserves.
Financial stress in Euro area (and in particular Portugal) re-emerges	**Medium** Financial stress could re-emerge as a result of stalled or incomplete delivery of national and euro policy commitments.	**Medium** A sharp deterioration in the Portuguese banking system could have a serious impact on Cabo Verde, given the dependence of the latter's banks on Portuguese capital (three of the four largest banks are Portuguese subsidiaries).
	Internal (endogenous) risks	
Delays in fiscal consolidation	**High** While the authorities have committed to medium-term fiscal consolidation, the 2014 budget is expansionary and 2015 is a pre-election year.	**High** A perceived lack of commitment to fiscal consolidation could seriously undermine investor perceptions of macroeconomic stability, reducing capital inflows and weakening confidence in the peg. It could also reduce concessional support from development partners, who have underscored the importance of fiscal consolidation.
Surge in imports or shortfall in capital inflows	**Medium** The outlook is for reserves coverage to remain at about 4½ months of imports over the medium term. However, a sharper-than-expected increase in imports or shortfall in capital inflows could weaken the balance of payments.	**High** A decline in the reserves coverage could undermine confidence in the peg, which could lead to a further decline in private inflows and remittances. A policy response of tightening monetary policy would weaken the recovery, while an imposition of capital controls would undermine investor confidence.
Financial instability	**Medium** NPLs have risen significantly in the last two years, reflecting the decline in economic activity but also intensified supervision. With the economy still weak, NPLs could rise further. Associated bank losses could result in capital shortfalls.	**Medium** The banking system as a whole is fairly well capitalized, which reduces the potential cost of a bank failure. In addition, with most banks having majority foreign ownership, outside capital would likely be available to recapitalize a failed bank. However, there is little fiscal space to finance any public bail-out.
Delays in state-owned enterprise reforms	**Medium** The authorities have adopted a detailed agenda to reform SOEs. However, implementation could be delayed due to political economy challenges.	**Medium** Financial weaknesses in some of the largest SOEs represent contingent liabilities for the government. As of end-2012, the debt of SOEs amounted to 27 percent of GDP. Persistent weak financial performance of SOEs could crowd out public investment and threaten fiscal sustainability.
Failure to increase productivity	**Medium** Implementation of needed structural reforms could be delayed due to political economy concerns, especially in the labor market (where Cabo Verde is particularly uncompetitive, and which matters greatly for service sector productivity).	**Medium** Cabo Verde's long-term growth depends critically on bolstering productivity. Delays in advancing the structural reform agenda hinder external competitiveness, potential GDP growth and employment.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline scenario path discussed in this policy note, which is the scenario most likely to materialize in the view of IMF staff. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline.

Table 8. Cabo Verde: Millennium Development Goals

	Cabo Verde			SSA
	2000	2005	2010	2010
Goal 1: Eradicate extreme poverty and hunger				
Employment to population ratio, 15+, total (%)	59	60	61	64
Employment to population ratio, ages 15–24, total (%)	53	52	52	46
GDP per person employed (constant 1990 PPP $)	..	..	..	3,549
Income share held by lowest 20%	*5*	..	..	..
Malnutrition prevalence, weight for age (% of children under 5)	..	..	..	22
Poverty gap at $1.25 a day (PPP) (%)	*6*	..	..	*21*
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	*21*	..	..	*48*
Vulnerable employment, total (% of total employment)	40	..	..	..
Goal 2: Achieve universal primary education				
Literacy rate, youth female (% of females ages 15–24)	..	*98*	*99*	69
Literacy rate, youth male (% of males ages 15–24)	..	*96*	*97*	*77*
Persistence to last grade of primary, total (% of cohort)	*88*	88	..	*60*
Primary completion rate, total (% of relevant age group)	107	87	99	70
Total enrollment, primary (% net)	99	97	93	*76*
Goal 3: Promote gender equality and empower women				
Proportion of seats held by women in national parliaments (%)	11	11	18	20
Ratio of female to male primary enrollment (%)	96	95	92	93
Ratio of female to male secondary enrollment (%)	*104*	109	120	82
Ratio of female to male tertiary enrollment (%)	103	108	129	63
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	38.9	..	..	..
Goal 4: Reduce child mortality				
Immunization, measles (% of children ages 12–23 months)	86	92	96	75
Mortality rate, infant (per 1,000 live births)	32	25	19	71
Mortality rate, under 5 (per 1,000 live births)	39	29	23	113
Goal 5: Improve maternal health				
Adolescent fertility rate (births per 1,000 women ages 15–19)	99	87	74	108
Births attended by skilled health staff (% of total)	*89*	78	..	46
Contraceptive prevalence (% of women ages 15–49)	*53*	61	..	22
Maternal mortality ratio (modeled estimate, per 100,000 live births)	170	110	79	500
Pregnant women receiving prenatal care (%)	*99*	98	..	73
Unmet need for contraception (% of married women ages 15–49)	..	..	..	25
Goal 6: Combat HIV/AIDS, malaria, and other diseases				
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	..	..	..	38
Condom use, population ages 15–24, female (% of females ages 15–24)	..	..	..	..
Condom use, population ages 15–24, male (% of males ages 15–24)	..	..	..	..
Incidence of tuberculosis (per 100,000 people)	160	153	147	271
Prevalence of HIV, female (% ages 15–24)	..	..	..	*3.9*
Prevalence of HIV, male (% ages 15–24)	..	..	..	*1.6*
Prevalence of HIV, total (% of population ages 15–49)	...	...	...	*5.5*
Tuberculosis case detection rate (%, all forms)	*41*	40	49	60
Goal 7: Ensure environmental sustainability				
CO2 emissions (kg per PPP $ of GDP)	0	0	*0*	*0*
CO2 emissions (metric tons per capita)	0	1	*1*	*1*
Forest area (% of land area)	20.3	20.8	21.1	28.0
Improved sanitation facilities (% of population with access)	44	53	61	31
Improved water source (% of population with access)	83	85	88	61
Marine protected areas (% of territorial waters)	0	0	0	6
Net ODA received per capita (current US$)	214	343	661	52
Goal 8: Develop a global partnership for development				
Debt service (PPG and IMF only, % of exports, excluding workers' remittances)	11	9	5	3
Internet users (per 100 people)	1.8	6.1	30.0	10.0
Mobile cellular subscriptions (per 100 people)	5	17	75	45
Telephone lines (per 100 people)	12	15	15	1
Fertility rate, total (births per woman)	4	3	2	5
Other				
GNI per capita, Atlas method (current US$)	1,330	2,080	3,280	1,178
GNI, Atlas method (current US$) (billions)	0.6	1.0	1.6	1,005.5
Gross capital formation (% of GDP)	30.7	36.0	37.8	20.5
Life expectancy at birth, total (years)	69	72	74	54
Literacy rate, adult total (% of people ages 15 and above)	..	*81*	*85*	63
Population, total (billions)	0.0	0.0	0.0	0.9
Trade (% of GDP)	87.5	104.3	105.7	65.2

Source: World Development Indicators, World Bank.

Figures in italics refer to periods other than those specified.

Appendix I. Raising Potential Growth in Cabo Verde[1]

Over the last two decades, Cabo Verde's rapid economic growth has allowed it to graduate to middle-income country status. In recent years, growth has been driven primarily by factor inputs, with productivity playing a fairly small (and declining) role. For Cabo Verde to remain on the path towards upper-middle income status, reforms that boost productivity will be essential. These include easing the regulatory burden in the labor market, reducing the skills mismatch, improving the business environment for local entrepreneurs and SMEs, and enhancing the efficiency of key public services.

Cabo Verde's Economic Development and Recent Challenges

1. Cabo Verde has achieved impressive gains in social and economic development over the past two decades. Good governance, sound macroeconomic policies, and structural reforms have attracted foreign direct investment and significant donor financing. Annual real GDP growth average over 6 percent during 2000–07, faster than most small island economies and the average for sub-Saharan Africa. As a result, Cabo Verde reached middle income country (MIC) status in December 2007.

2. To continue along its transition towards upper middle income level, Cabo Verde must now address new challenges. First, the crucial growth engines of the Cabo Verdean economy have been tourism, tourism-related foreign investment, and construction, all of which are greatly dependent upon the global economy. Second, the large-scale public investment program launched in 2008—which has contributed significantly to growth—is expected to wind down soon, as Cabo Verde's access to grants and concessional financing ends. Third, Cabo Verde faces considerable structural limits to sustaining high growth over the medium term. The growth experience of micro and small middle income countries shows that long-term growth has averaged around 3 to 4 percent (Table 1).

[1] This annex draws on the Selected Issues Paper "Policies that can raise potential growth in small Middle Income Countries of SSA" (Country Report No. 14/41).

Table 1. Average Real GDP Growth Rates of Small and Micro Countries
(Percent)

	1980–2013	1980s	1990s	2000–12	2000–07	2008–12	2008–13
All small and micro countries	3.14	3.66	2.96	3.00	3.55	2.11	2.18
Upper middle income countries	3.27	4.74	3.44	2.59	3.68	0.86	1.03
Lower middle income countries	3.06	2.35	2.59	3.52	3.49	3.52	3.48
Small and micro countries in SSA	3.35	3.77	3.08	3.47	3.67	3.13	3.12
Cabo Verde	5.68	5.74	6.15	5.28	6.91	2.67	2.47

Source: IMF World Economic Outlook.

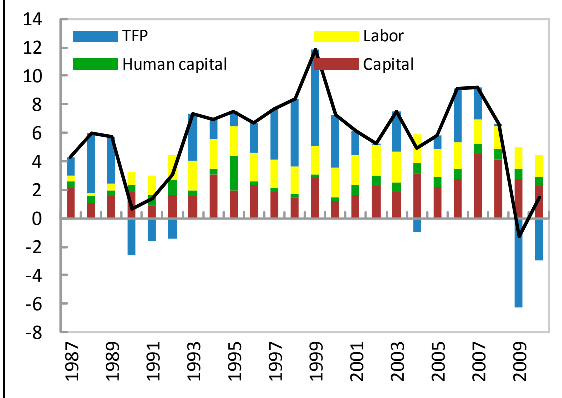
Note: Small states refer to small developing countries with populations of under 1.5 million.

3. A growth accounting framework can help explain the dynamics of economic growth in Cabo Verde. The framework decomposes output growth into (i) the contributions from increases in the amount of factor inputs—namely physical capital, and human capital-augmented labor—and (ii) the growth residual which cannot be accounted for by observed increases in factor inputs (Solow, 1957).[2] The contribution of capital input is calculated from the estimated capital stock—using the standard perpetual inventory model with geometric depreciation—weighted by the income share of capital. Meanwhile, the contribution of human capital-augmented labor input is derived from the estimated human capital stock—using the average educational attainment of the employed labor and the estimated returns to education—weighted by the income share of labor. With this growth decomposition, the growth residual indicates a change in technological progress and is known as total factor productivity (TFP). TFP affects economic growth through improvement in resource allocation, innovation, and productivity of each of the factor inputs. Therefore, rising TFP provides an economy with the opportunity to grow more efficiently, and thus, more sustainably in the long run.

[2] That is, $Y_t = A_t \cdot (K_t)^{\alpha} \cdot (HL_t)^{1-\alpha}$, where Y_t represents domestic output in period t, K_t is the physical capital stock, HL_t is human capital augmented labor, A_t is the total factor productivity (TFP), and α is the partial elasticity of output with respect to capital (which is often proxied by the income share of capital).

4. A decomposition of Cabo Verde's growth since the mid-1980s indicates that TFP's contribution to economic growth has been relatively small and declining in recent years. TFP has fluctuated in line with economic growth, and its decline in the late 2000s coincided with the economic downturn. While the contribution of capital accumulation to output growth has increased, the contribution of human capital has been small and steady over time. However, one should analyze the growth decomposition results with caution. As being a residual, TFP could also reflect the quality of data and estimates on the other components.

Cabo Verde's Growth Accounting with Human Capital



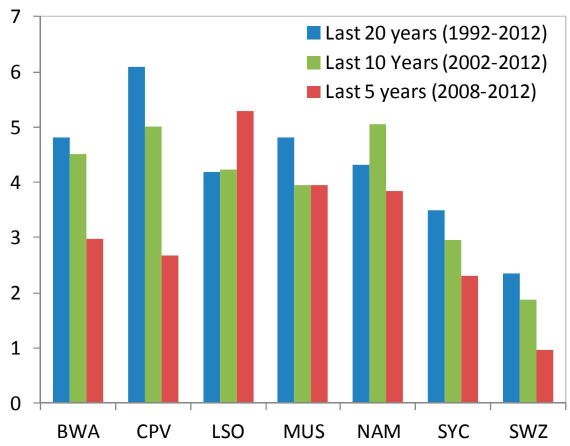
Sources: Penn World Tables and IMF staff calculations.

Raising Potential Growth in Small Middle Income Countries of Sub-Saharan Africa

5. The growth experience of Cabo Verde—with a period of rapid growth and high resource accumulation followed by a period of slow growth and falling TFP—is also found in other small middle income countries in sub-Saharan Africa (SSA SMICs). The growth slowdown prevents countries from reaching upper middle income and high income status—a phenomenon known as the "middle income trap".[3] To overcome this challenge, SSA SMICS—including Cabo Verde—need to revisit their growth model and identify new, higher-productivity drivers of growth.

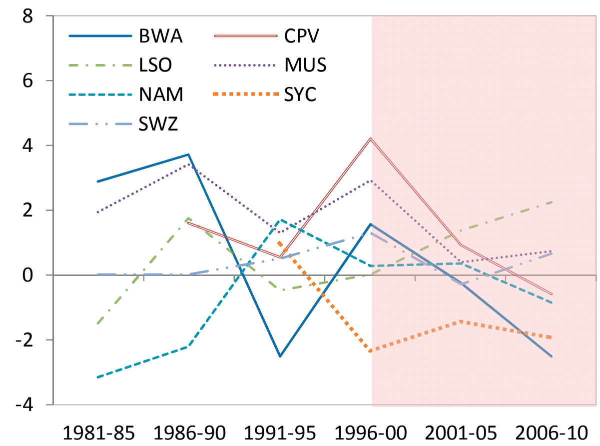
[3] For more detail see Felipe (2012), "Tracking the Middle-Income Trap: What Is It? Who Is In It? And Why? Part 1&2" Asian Development Bank.

Real GDP Growth (%) in SSA SMICs



Source: IMF World Economic Outlook.

TFP Contribution to Growth (%) in SSA SMICs



Sources: Penn World Tables and IMF staff calculations.

6. The experience of SSA SMICs suggests a two-stage trend in TFP and thus economic growth: capital deepening during the high growth period, and economic concentration and regulatory constraints in the slower growth period (Table 2). In the earlier decades, when global economic conditions where relatively supportive, SSA SMICs undertook capital deepening in the form of infrastructure investment and higher FDI to bolster productivity and growth. However, in the last few years, as the external environment deteriorated, the growth momentum in SSA SMICs weakened. The structural reforms that would have sustained the growth of TFP—such as those that encouraged economic diversification, and helped create a business friendly environment—were not fully implemented. In addition, their highly restrictive regulatory systems, albeit in different markets, and large public sector hinder productivity gains by raising production costs, and thus, reducing investment efficiency.

7. Cross-country empirical analysis can help shed light on the role of macroeconomic, structural, and institutional factors in TFP growth. Three econometric methodologies are applied to an (unbalanced) panel dataset of 33 middle-income countries (MICs) during the 1981–2010 period. First, the dynamic panel regressions are estimated to control for time-invariant country fixed effects, using the generalized method of moments.[4] Second, the co-integration analysis is used to identify and estimate the long-run relationship between TFP and its determinants. And third, a panel Probit analysis is conducted to identify the factors that contribute to TFP growth. The cross-country panel

[4] The dynamic panel estimates do not represent long-run effects.

dataset is obtained from five primary sources: the Penn World Tables, the IMF's World Economic Outlook (WEO), the World Bank's World Development indicators (WDI), the Economic of Freedom of the World (EFW) project, and the Barro-Lee database.

8. The empirical results suggest that macroeconomic stability and trade openness are necessary but not sufficient conditions for productivity growth (Table 3). MICs need to improve the quality of human capital to minimize the skills mismatch, reduce the regulatory burden on firms, and be aware of limits up to which infrastructure gap could be closed by public borrowing. First, the panel estimation results point to a negative impact of skill-mismatches on the contribution of TFP to growth.[5] They also suggest a concave impact of government debt on TFP contribution. Although public investment could enhance overall productivity and play an important counter-cyclical role, it carries risks of inefficient crowding-out similar private sector initiatives.[6] Second, turning to the co-integration analysis, most findings are consistent with those of the dynamic panel regressions, with foreign direct investment (FDI), trade openness, and market capitalization as additional positive factors for TFP. High inflation is found to reduce TFP growth. In addition to these results, the panel Probit analysis shows that restrictive labor and credit market regulations have a negative impact on TFP growth, while the impact of access to credit for small and medium enterprises (SMEs) is positive.

[5] In the empirical analysis, skill mismatch is measured (as set out by Estevao and Tsounta, 2011) by the $Skill\ Mismatch\ Index_{it} = \sum_j \left(S_{ijt} - M_{ijt}\right)^2$ where j denotes skill level; S_{ijt} denotes percent of labor force with skill level j at time t in country i; and M_{ijt} denotes percent of employment with skill level j at time t in country i. For more information, see Leigh and Flores (2011).

[6] See, for instance, Ranis (1989), Barro (1991), Ghali (1999), and Sala-i-Martin et al (2004).

Table 2: Structural Impediments to Productivity Enhancement in Selected SMICs

	Macroeconomic Environment	Labor Markret	Financial Sector	Public Sector	Environment
Resource Rich SMICs					
Botswana	Lack of economic diversification	High reservation wage and skill mismatch	High concentration of bank loans to households	Effectiveness of tax system; quality of public spending	
Namibia	Lack of economic diversification	Lack of competitiveness; large and persistent structural unemployment	High concentration of bank loans to households, in particular mortgages	Quality of public spending (not getting value for money) and large public sector	
Non Resource Rich and Non Island SMICs					
Lesotho	Lack of economic diversification	High and persistent structural unemployment; HIV prevalence among labor force	Small and inefficient; high lending rates; large risk premium	Large and ineffective public sector distorts labor market incentives and creates unfavorable business environment	Drought; soil degradation
Swaziland	Lack of economic diversification; depress capital accumulation; uncompetitive business environment	High and persistent structural unemployment; HIV prevalence among labor force		Large expansion with no clear evidence of high fiscal multiplier	
Non Resource Rich and Island SMICs					
Cabo Verde	Lack of economic diversification; reliance on imports for food, fuel, manufacturing items and capital goods	Low labor market efficiency owing to restrictive labor market regulations and shortage of technical skills	Predominantly bank-based; high concentration (four systematic banks account for more than 80 percent); sizeable exposure to the real sector	Large public investment in infrastructure financed by borrowing, leading to deteriorating fiscal balance and high public debt	
Mauritius	Although economy is relatively diversified, there is still reliance on European markets for trade and tourism	Structural labor market problems, including youth unemployment			Environmental degration and weather-related disasters
Seychelles	Lack of economic diversification; reliance on imports for food, fuel, manufacturing items and capital goods	Structural problems including shortage of adequate skills and expertise; complex procedures for hiring qualified foreign workers	Lack of financial deepening	Inefficient public investment; presence of large parastatals operating in quasi-monopoly environment	Environmental degration and weather-related disasters

Sources IMF staff.

Table 3: Summary of the Empirical Results

	Short-run	Long-run	
	Dynamic Panel	Cointegration	Panel Probit
Government debt to GDP	(-) or Concave *	(-) or Concave *	(-)/(+) or Concave *
Trade to GDP	(+)	(+)*	(-)
FDI to GDP	(+)	(+)/(-)*	
Credit to GDP		(+)/(-)[2]*	(+)
Share of agricultural sector in GDP		(-)*	
Share of manufacturing sector in GDP			(+)*
Female labor force participation	(+)/(-)	(+)/(-)[3]*	
Inflation	(+)/(-)	(-) *	(-) *
Years of education	(+)	(+)*	
Skill mismatch	(-) *	(-) *	(-) *
Credit market regulation index[1]	(+)		(+)*
Labor market regulation index[1]			(+)*
Goods market efficiency index[1]	(+)/(-)		
SMEs with credit line			(+)*

(+)/(-) indicates ambiguous results; * indicates statistical significance at least at the 10 percent level.

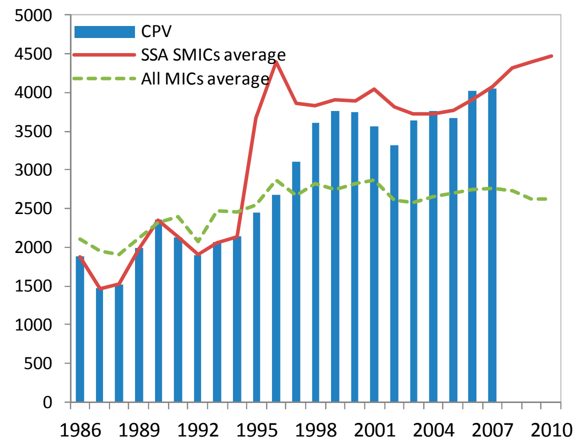
[1] A high value of the index implies a less restrictive regulatory system and/or a more competitive market.
[2] This probably reflects the high number of countries in our sample that have experienced financial crisis.
[3] The impact of female participation becomes positive after controlling for the share of agriculture in GDP.

Relevance of the SSA SMICs' Productivity Analysis for Cabo Verde

9. The results of the cross-country analysis could help identify factors that are inhibiting TFP in Cabo Verde. The following factors may be of particular relevance: skill mismatch, labor market regulations, access to finance by SMEs, and the size of public debt.

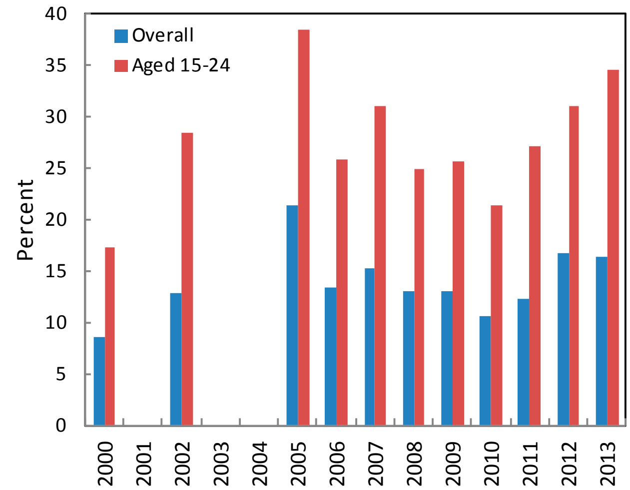
10. Improving the quality and relevance of education and training is crucial to reduce skill mismatch and generate employment. Skill mismatch has been relatively high in Cabo Verde and contributed to high unemployment, especially among young people. The unemployment rate was over 16 percent at end-2013, with youth unemployment more than double that rate. While the country has significantly improved access to higher education and professional training, it is still not able to create enough jobs for all new graduates. In 2012, there were around 9,300 formal job offers for graduates, compared to around 23,000 young people looking for jobs. Cabo Verde's medium-term development plan for 2012–16—the Growth and Poverty Reduction Strategy Paper-III (GPRSP-III)—seeks to address skill mismatch and unemployment by focusing resources on technical and vocational training, especially in tourism, agri-business and the creative economy. As funding is one of the challenges for expanding the education and training development plan, the government should also encourage more private sector participation in human capital development.

Skill-Mismatch Index



Sources: Penn World Tables, WDI, INE, and IMF staff calculations.

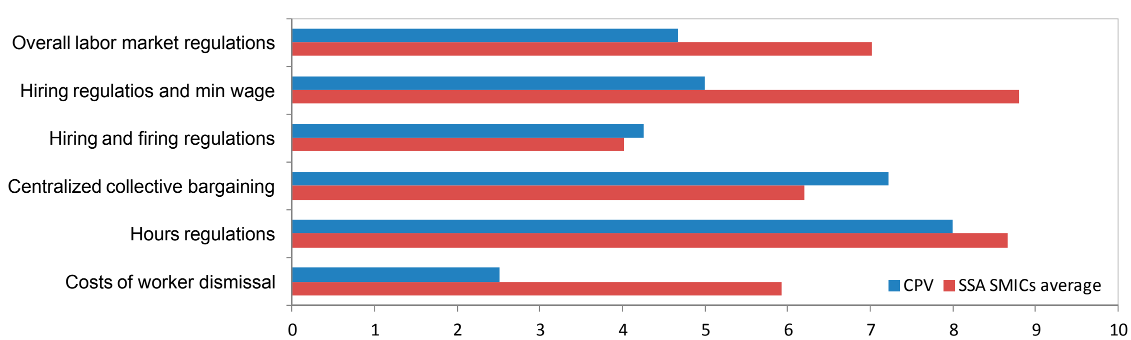
Unemployment Rates in Cabo Verde
(Percent)



Source: INE.

11. Enhancing labor market efficiency would also bolster competitiveness. Available business surveys reflect investors' concerns with heavy labor market regulations. The World Economic Forum (WEF) ranked Cabo Verde 129th out of 148 countries on labor market efficiency in its 2013/14 Competitiveness Report. In addition, the labor regulation indicators from the Economic Freedom of the World indices suggest that Cabo Verde's labor market is more restrictive than other SSA SMICs, particularly in hiring and wage-setting regulations, hour regulations and dismissal costs. Cabo Verde is already taking steps to address these inefficiencies. A new labor code is expected to enable a business climate and job creation by providing more flexibility in terms of working hours, disciplinary measures and redundancy costs.

Economic Freedom of the World's Labor Market Regulation Indicators



Source: Economic Freedom of the World (2011).
Note: Increases in the indices indicate a less restrictive labor market.

12. Creating a business climate that better supports local entrepreneurs and SMEs would also play an important role in boosting growth. Given the large informal sector, another effective way to promote sustainable employment and increase productivity is to support entrepreneurship and self-employment. As set out in the GPRSP-III, the government aims to develop entrepreneurship by both expanding training programs in entrepreneurial skills and innovation, and fostering an enabling business environment. The WEF had also identified access to financing as one of the most serious obstacles to doing business in Cabo Verde. The GPRSP-III addresses this issue, by setting out plans to strengthen access to financing by local entrepreneurs and SMEs, encouraging cooperative behavior, and providing business support infrastructure.

13. It is also worth considering whether the size of public debt could potentially slow productivity growth. Since 2008, Cabo Verde's public debt has increased by nearly 40 percentage points of GDP, reaching an estimated at 95 percent of GDP at end-2013. The significant increase in public debt reflects in good part a large-scale public investment program, which focuses in particular on reducing bottlenecks in energy and transportation, which are expected to play a positive role in boosting productivity. With many of Cabo Verde's infrastructure gaps now having been addressed (and access to concessional financing likely to end), it is possible that the public sector could make greater contributions to productivity by focusing more on the efficiency of public investments rather than by further increasing it. In addition, as the government reduces its draw on domestic financing, it will create more financing room for the private sector to investment in innovation and growth.

Conclusion

14. The cross-country analysis has shown the importance of boosting productivity to achieve sustainable economic growth in Cabo Verde. Reforms in the following areas look particularly relevant: reducing skill mismatch and the regulatory burden in the labor market, creating an enabling business environment for local entrepreneurs and SMEs, and enhancing the efficiency of public investment. The GPRSP-III sets out many important initiatives in these areas. Steady progress in implementing these reforms would play a key role in raising TFP in Cabo Verde, and moving towards upper MIC status.

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INTERNATIONAL MONETARY FUND

CABO VERDE

May 14, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION — JOINT IDA/IMF DEBT SUSTAINABILITY ANALYSIS

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Prepared by
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While Cabo Verde's debt remains sustainable, it is subject to significant vulnerabilities. Based on the authorities' budgetary projections ("baseline"), Cabo Verde's external debt risk distress rating is "moderate". However, total public debt is expected to reach considerably higher levels over the medium term than projected in the previous Debt Sustainability Analysis (DSA). This is a dangerous trend, particularly in light of a weaker macroeconomic outlook and contingent financial liabilities related to state-owned enterprises. Reducing the risk of debt distress depends critically on accelerating fiscal consolidation and advancing structural reforms to boost growth and enhance the efficiency of the public sector.

BACKGROUND

Over the last five years, Cabo Verde's public debt has increased significantly, reflecting a sharp decline in revenue and grants, as well as the ramping up of public investment. While public and publicly guaranteed debt remains sustainable, it is expected to reach considerably higher levels over the medium term than projected in the previous DSA, and is subject to significant vulnerabilities. This is a dangerous trend, particularly in light of a weaker macroeconomic outlook and contingent financial liabilities related to the debt of state-owned enterprises. Given these risks, efforts to significantly accelerate fiscal consolidation, combined with structural reforms that boost productivity and growth, are essential to improve the debt outlook.

1. **This DSA reflects official debt stock data for end-2012, and additional information available as of April 2014.** The fiscal outturn of 2013 and staff's fiscal projections for 2014–17 (Table 3a in the Staff Report) are used to project debt-creating flows. The debt data include central government external and domestic debt, and external debt contracted by the central government on behalf of state-owned enterprises (also referred to as "onlending"). The data do not include debt contracted directly by state-owned enterprises and local governments that carry a central-government guarantee; at end-2012, this debt was estimated at about 4 percent of GDP. Estimates for such publicly-guaranteed debt for 2013, and projections for 2014 and beyond, were not available at the time of this assessment.

2. **There is little reliable data on external private debt.** To estimate this debt, information from the balance of payments on bank and non-bank liabilities to non-residents is used. On this basis, private external debt was estimated around 36 percent of GDP at end-2013. The authorities are compiling information about private sector external debt, but there is a need for a more systematic monitoring of actual disbursements and repayment flows.

3. **Total public debt in Cabo Verde continued to increase in 2013 as a result of the Public Investment Program (PIP).** The stock of public debt reached 90 percent of GDP in 2012, and is estimated to have reached 98 percent of GDP at end-2013. The increase in public debt reflects the still-high financing needs owing to increases in capital spending, and falling tax revenue as a share of GDP.

Text Table 1. Cabo Verde: Stock of Total Public Debt at End-Year, 2004–13 [1]

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 2/
					(Percent of GDP)					
External debt	50.1	49.6	46.0	40.3	39.2	43.3	51.3	56.1	67.5	74.0
Domestic debt	33.7	35.7	31.7	24.7	19.1	21.3	21.7	21.6	22.6	23.6
Total public debt	83.7	85.3	77.7	65.0	58.2	64.6	73.0	77.8	90.2	97.6

Sources: Cabo Verdean authorities and IMF staff calculations.

1/ GDP data for 2013 are IMF staff estimates.
2/ The public debt level in 2013 is an estimate based on end-2012 debt stock and debt-creating flows in 2013.

4. While external public debt is high, it is overwhelmingly concessional. Multilateral institutions, in particular the World Bank Group and the African Development Bank, are the main external creditors. Cabo Verde's external public debt has a long maturity profile and low average interest rates (Text Table 2).

Text Table 2. Cabo Verde: External Debt Profile by Type of Creditor, 2012

	Percent of total external debt	Average grace period	Average amortization period	Average interest rate
Multilateral	52	9	34	1.0%
Bilateral	24	7	17	1.2%
Commercial	24	10	20	1.7%

Sources: Cabo Verdean authorities and IMF staff estimates.

5. Cabo Verde's domestic public debt remains at relatively low levels. The government's ability to finance the PIP through concessional external loans has helped keep domestic debt low (24 percent of GDP at end-2013). Moreover, there is a legal limit of 3 percent of GDP on domestic financing of the deficit per year.[1] At end-2012 the National Pension Fund held about 44 percent of domestic debt, and the rest was held by the banking system. Treasury bonds make up about 94 percent of domestic debt. The average maturity of domestic debt at end-2013 was six years and the average interest rate was 5.4 percent.

6. Cabo Verde is a strong policy performer for the purpose of determining the debt burden thresholds under the Debt Sustainability Framework (DSF). Cabo Verde's rating on the World Bank's Country Policy and Institutional Assessment (CPIA) averaged 4 (on a scale of 1 to 6) during 2010–12, making it a strong policy performer. Based on its 2012 CPIA score, Cabo Verde ranks first among IDA-recipient countries in the sub-Saharan African (SSA) region, and third among all IDA countries. The corresponding external public debt burden thresholds are shown in Text Table 3.

[1] In addition to the legal limit on domestic deficit financing, the government has also set the policy objective of keeping domestic debt below 25 percent of GDP.

Text Table 3. External Public Debt Thresholds for Strong Policy Performers under the Debt Sustainability Framework

Present value of external debt, percent of:	
GDP	50
Exports	200
Revenue	300
External debt service in percent of:	
Exports	25
Revenue	22

BASELINE SCENARIO UNDERLYING THE DEBT SUSTAINABILITY ANALYSIS

7. **The assumptions underlying the current DSA differ in a number of ways from those used in the 2012 Article IV Consultation** (Text Table 4 and Box 1). While the current baseline scenario assumes a rebound of economic activity, growth projections in the medium and long term are about one percentage point lower than in the previous DSA. Growth is also estimated to have been considerably weaker in 2012 and 2013. The baseline scenario assumes a slower path of fiscal consolidation, given the delayed economic recovery and higher current account deficit, reflecting higher imports owing to a slower phasing out of the PIP.

Text Table 4. Cabo Verde: Assumptions for Key Economic Indicators, 2012–17 1/
(Percent of GDP)

	2012	2013	2014	2015	2016	2017
Real GDP growth						
Current DSA	1.2	0.5	3.0	3.5	4.0	4.0
2012 Article IV DSA	4.3	4.1	4.5	4.7	5.0	5.0
Fiscal balance (including grants)						
Current DSA	-9.9	-7.8	-7.4	-6.5	-5.7	-4.5
2012 Article IV DSA	-7.5	-7.6	-5.8	-2.2	0.2	2.7
Fiscal balance (including onlending)						
Current DSA	-13.6	-12.9	-11.8	-10.5	-9.4	-6.6
2012 Article IV DSA	-11.2	-12.2	-10.1	-5.7	-0.2	2.3
Current account deficit (including grants)						
Current DSA	-11.3	-4.5	-9.8	-10.7	-11.3	-10.8
2012 Article IV DSA	-11.1	-13.2	-11.4	-8.3	-6.1	-4.3

Sources: Cabo Verdean authorities and IMF staff estimates.

1/ GDP data for 2013 are IMF staff estimates. All data for 2014–17 are IMF staff projections.

Box 1. Cabo Verde: Macroeconomic Assumptions of the Baseline Scenario, 2013–33

Real GDP growth is expected to pick up after the slowdown in 2012-13, and settle at 4 percent per year in the long term. Growth assumptions are based on continued good performance in the tourism sector, better conditions in the euro area, resumption of private credit growth, some product diversification into areas like agriculture and fisheries, and an increase in productivity owing to payoffs from the Public Investment Program and from structural reforms.

Fiscal policy. In the medium term (2013–17), the fiscal deficit and overall financing needs are expected to decline by 2.8 and 6.3 percentage points of GDP, respectively, corresponding to the fiscal consolidation outlined in the baseline scenario, as set out in paragraph 23 in the Staff Report. Fiscal consolidation is expected to continue in the long run, with the government continuing to reduce its financing needs as the concessional borrowing window closes. In the long run (2018-33), with fiscal consolidation complete and onlending coming to an end, financing needs are projected to stay below 2.5 percent of GDP per year.

The non-interest current account deficit is projected to widen in 2014 owing to the expected increase in economic activity, public investment and FDI (which will drive up imports) and decline gradually afterwards, as the Public Investment Program winds down.

Consumer price inflation is projected to remain below 3 percent.

Financing. The concessionality of new external loans will decline significantly starting from 2019, and the baseline assumes a slightly more accelerated move towards non-concessional financing than the previous DSA. In addition, the baseline assumes that domestic financing will remain below 3 percent of GDP, in compliance with the limit set in the Budget Law.

DEBT SUSTAINABILITY ANALYSIS

E. External Public Debt

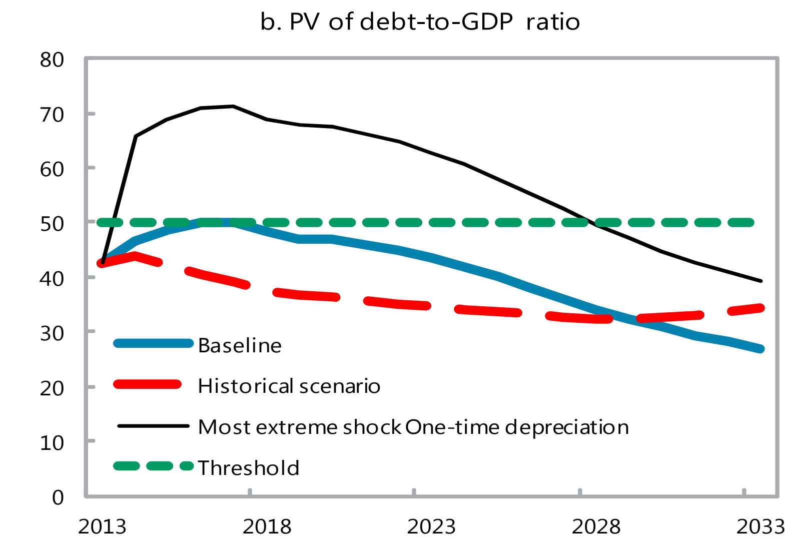
8. **Under the baseline assumptions, all external debt and debt-service ratios remain below the policy-dependent thresholds throughout the projection period** (Figure 1). The present value (PV) of public and publicly guaranteed (PPG) external debt is expected to peak at 49 percent of GDP in 2016, and then gradually decrease to 28 percent of GDP in 2033 (Figure 1b, Table 1a). The large increase in the PV of PPG external debt in 2013-14 is due to high public investment in these years.

9. **Cabo Verde's external debt sustainability is most sensitive to a one-time depreciation shock.** Under a bound test that entails a 30 percent nominal depreciation shock in 2014, the PV of the debt-to-GDP ratio would exceed the threshold in the year 2014 and remain above it for more than a decade (Figure 1b; Table 1b, Scenario B6). The PV of the debt-to-exports ratio would also breach the threshold under a hardening of financial terms, an export shock, and a GDP deflator shock (Table 1b, scenario A2, B2, and B3, respectively).

10. **External debt sustainability is also vulnerable to contingent liabilities associated with the debt of state-owned enterprises (SOEs).** At end-2012 (the latest information available), SOEs' debt that did *not* carry a government guarantee amounted to 12 percent of GDP. In a shock scenario where the financial situation of SOEs deteriorates to such an extent that the central government

must take on all of this debt, and respecting legal limits on domestic debt financing, the PV of PPG external debt reaches the 50 percent threshold under the baseline (Text Figure 1).[2]

Text Figure 1. Cabo Verde: Public and publicly guaranteed external debt in SOE debt scenario, 2013–33



Sources: Country authorities; and staff estimates and projections.

F. Total Public Debt

11. Total public debt in the baseline scenario peaks at 108 percent of GDP in 2016, and declines gradually over the projection period (Table 2a). The debt outlook is vulnerable to a prolonged economic slowdown; a delay of the Euro zone recovery, which would affect growth by depressing remittances and tourism income; and realization of losses on contingent liabilities associated with SOEs. With regards to remittances, which accounted for roughly 10 percent of GDP in 2013, there are also vulnerabilities related to financial stability. While these flows have remained fairly stable over many years, problems in a systemic bank could cause emigrants to re-assess their financial investment in Cabo Verde and withdraw their funds. Regarding SOEs, while the financial situation of ELECTRA has improved during 2013, TACV continues to be in difficult financial circumstances.

[2] The scenario assumes that (i) the stock of non-guaranteed SOE debt held steady in 2013 at the level recorded for end-2012 (CV$ 18.2 billion) and (ii) the entire stock of this debt is transferred to the central government in 2014. Assuming that the SOE debt at end-2012 had an average original maturity of 7 years, the government would need to refinance this debt over 2014–19. The financing to cover this would come from domestic borrowing (up to the legally binding limit on domestic deficit financing of 3 percent of GDP) and the remainder from external borrowing.

12. Public debt sustainability is sensitive to various alternative scenarios and stress tests (Table 2b). The expansion of public debt is most pronounced under the scenario which keeps the primary balance the same as in 2013. However, this scenario appears rather unlikely, given that the primary balance in 2013 reflected a temporarily high level of public investment. Significantly lower growth (for a prolonged period or the whole projection horizon) would also cause public debt to reach unsustainable levels.

G. Comparison with the Previous Debt Sustainability Analysis

13. While the PV of external debt does not breach the threshold under the baseline scenario—as was the case in the previous DSA—public debt peaks at a higher level. The improved assessment under the baseline is due to the increase in the discount rate from 3 to 5 percent.[3] However, while in the previous DSA public debt peaked at 92 percent of GDP (in 2015), in the current DSA it reaches 108 percent in 2016. This is a significant deterioration in the outlook for public debt, reflecting a combination of weaker economic growth and a slower path of fiscal consolidation.

H. The Authorities' Views

14. The authorities broadly concurred with the results of the DSA, though they saw upside risks to the assessment. In particular, they noted that by improving Cabo Verde's infrastructure, the large-scale public investment program was addressing critical bottlenecks to growth, which would deliver a more favorable economic performance over the medium term. This would bolster domestic revenue (which would reduce the deficit) and also raise growth (which would reduce the debt-to-GDP ratio).

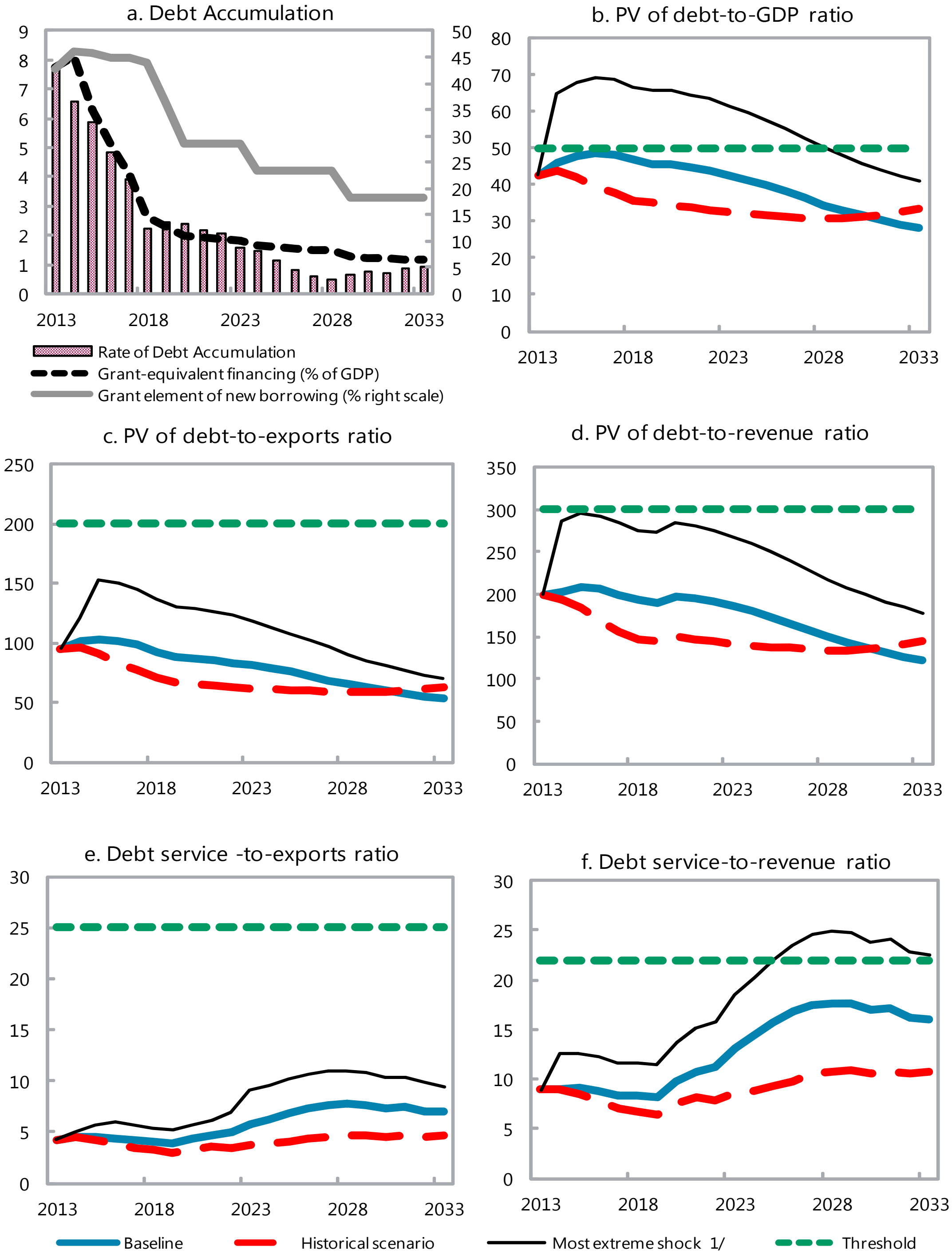
DEBT DISTRESS CLASSIFICATION AND CONCLUSIONS

15. Based on the external debt burden indicators, the current DSA finds that Cabo Verde's debt is sustainable, and that the risk of debt distress is moderate. None of the debt burden thresholds is breached over the 20-year projection period under the baseline scenario. A depreciation shock is the one to which debt sustainability is most sensitive.

16. However, the rapid accumulation of public debt has increased risks to the baseline, and points to elevated vulnerabilities. The degree (and timing) of the impact of the public investment program on growth remains uncertain, prospects for export diversification are challenging, and SOEs remain in financial difficulties. Given these downside risks, further efforts should be made to accelerate fiscal consolidation and reduce public debt faster. In addition, the government should aim to limit its external borrowing to concessional loans.

[3] The discount rate for the IMF's Debt Sustainability Analysis was increased from 3 to 5 percent in 2013 because globally low interest rates were making it difficult to obtain financing terms that met concessionality requirements.

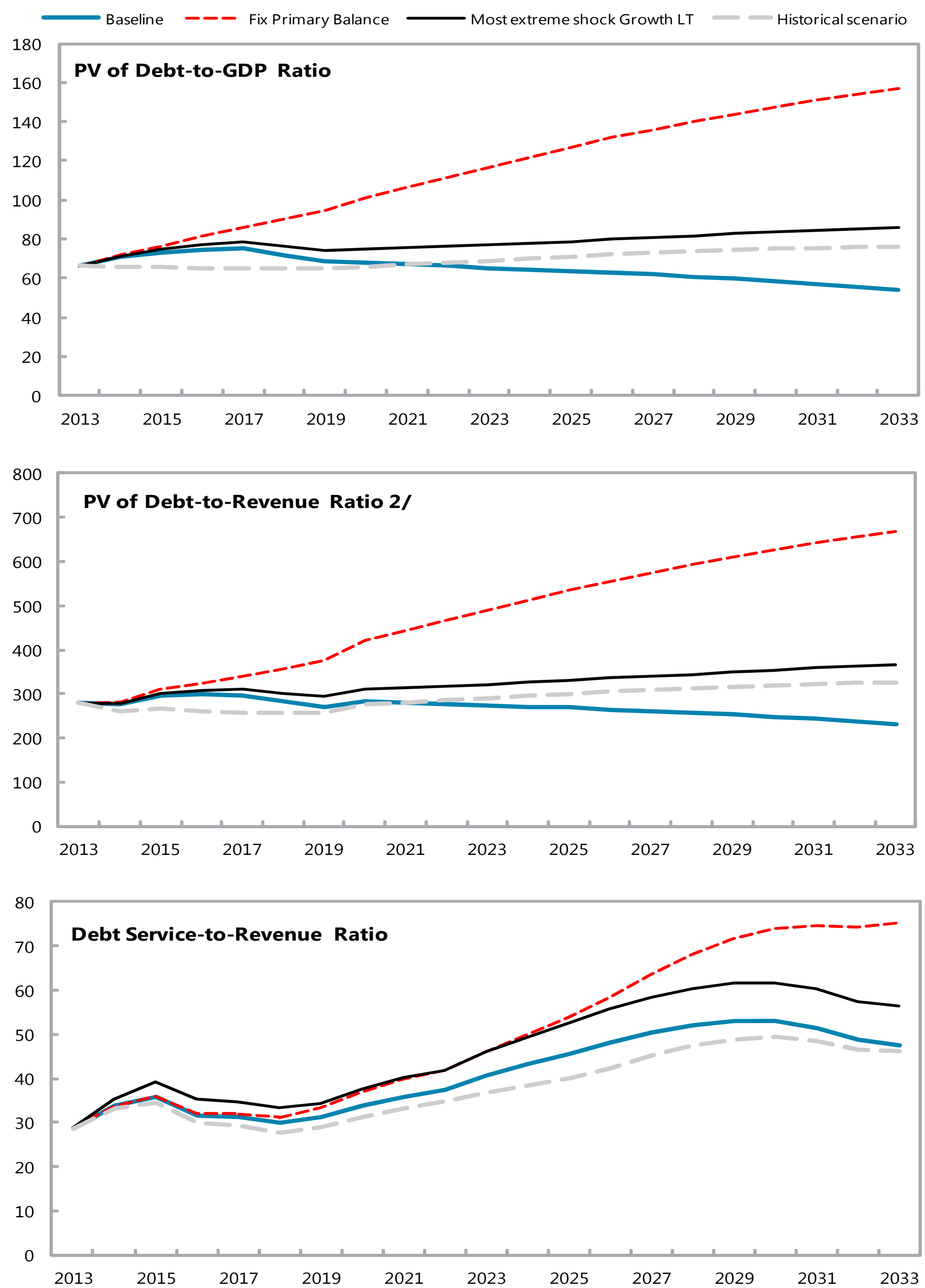
Figure 1. Cabo Verde: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2013–33 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2023. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Cabo Verde: Indicators of Public Debt Under Alternative Scenarios, 2013–33 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2023.

2/ Revenues are defined inclusive of grants.

Table 1a. Cabo Verde: External Debt Sustainability Framework, Baseline Scenario, 2010–33 1/

(Percent of GDP, unless otherwise indicated)

	Actual			Historical 6/	Standard 6/	Projections									
				Average	Deviation							2013-2018			2019-2033
	2010	2011	2012			2013	2014	2015	2016	2017	2018	Average	2023	2033	Average
External debt (nominal) 1/	**70.7**	**81.4**	**99.8**			**110.1**	**110.8**	**111.3**	**109.2**	**105.8**	**100.0**		**80.2**	**48.8**	
of which: public and publicly guaranteed (PPG)	51.3	56.1	67.5			74.0	79.2	81.9	82.0	80.5	76.5		62.5	37.7	
Change in external debt	6.8	10.7	18.4			10.3	0.7	0.4	-2.0	-3.4	-5.8		-4.0	-1.9	
Identified net debt-creating flows	7.5	3.1	12.1			2.0	3.3	4.1	3.5	1.9	0.1		-1.4	-3.2	
Non-interest current account deficit	**8.5**	**13.3**	**8.6**	**8.9**	**4.1**	**2.8**	**7.1**	**8.7**	**8.5**	**6.9**	**5.0**		**2.7**	**-0.1**	1.8
Deficit in balance of goods and services	28.4	31.6	21.9			14.7	17.7	18.8	18.0	15.7	13.3		8.1	0.5	
Exports	38.4	42.3	43.9			44.8	45.3	46.5	47.6	48.8	50.4		52.6	53.0	
Imports	66.9	73.9	65.8			59.4	63.0	65.3	65.6	64.6	63.7		60.7	53.5	
Net current transfers (negative = inflow)	-20.4	-19.2	-14.6	-20.6	3.4	-13.5	-12.3	-11.8	-11.2	-10.8	-10.3		-7.9	-4.4	-6.8
of which: official	-6.3	-3.7	-3.3			-3.1	-1.6	-1.5	-1.4	-1.3	-1.2		-0.9	-0.5	
Other current account flows (negative = net inflow)	0.5	1.0	1.2			1.6	1.6	1.7	1.8	1.9	2.0		2.5	3.8	
Net FDI (negative = inflow)	**-6.7**	**-5.6**	**-3.3**	**-7.3**	**3.0**	**-1.9**	**-2.6**	**-3.1**	**-3.2**	**-3.3**	**-3.2**		**-3.1**	**-3.1**	-3.1
Endogenous debt dynamics 2/	**5.6**	**-4.6**	**6.8**			**1.1**	**-1.1**	**-1.5**	**-1.8**	**-1.7**	**-1.6**		**-1.1**	**0.0**	
Contribution from nominal interest rate	3.8	3.0	2.8			1.6	2.0	2.1	2.3	2.3	2.2		2.1	1.9	
Contribution from real GDP growth	-1.0	-2.5	-1.0			-0.5	-3.1	-3.6	-4.1	-4.0	-3.9		-3.2	-1.9	
Contribution from price and exchange rate changes	2.8	-5.0	5.1			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-0.7**	**7.5**	**6.3**			**8.3**	**-2.6**	**-3.6**	**-5.5**	**-5.3**	**-5.9**		**-2.6**	**1.2**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	70.5			78.7	77.5	77.2	75.7	73.6	70.2		60.2	39.3	
In percent of exports	...	...	160.5			175.7	171.0	166.0	159.0	150.7	139.3		114.6	74.1	
PV of PPG external debt	**...**	**...**	**38.2**			**42.6**	**45.8**	**47.8**	**48.5**	**48.2**	**46.7**		**42.6**	**28.2**	
In percent of exports	**...**	**...**	**87.0**			**95.0**	**101.2**	**102.9**	**101.8**	**98.8**	**92.7**		**80.9**	**53.1**	
In percent of government revenues	**...**	**...**	**180.6**			**199.5**	**203.0**	**208.7**	**205.9**	**199.9**	**193.7**		**185.4**	**122.4**	
Debt service-to-exports ratio (in percent)	**13.5**	**9.8**	**8.8**			**6.1**	**7.1**	**7.2**	**7.4**	**7.1**	**6.8**		**8.3**	**9.1**	
PPG debt service-to-exports ratio (in percent)	**4.7**	**4.2**	**4.3**			**4.2**	**4.5**	**4.5**	**4.4**	**4.1**	**4.0**		**5.8**	**7.0**	
PPG debt service-to-revenue ratio (in percent)	**8.4**	**7.8**	**8.9**			**8.9**	**9.0**	**9.1**	**8.8**	**8.4**	**8.3**		**13.2**	**16.0**	
Total gross financing need (Billions of U.S. dollars)	0.1	0.2	0.2			0.1	0.2	0.2	0.2	0.2	0.1		0.2	0.1	
Non-interest current account deficit that stabilizes debt ratio	1.8	2.7	-9.8			-7.5	6.3	8.3	10.6	10.3	10.8		6.8	1.8	
Key macroeconomic assumptions															
Real GDP growth (in percent)	1.5	4.0	1.2	4.9	3.5	0.5	3.0	3.5	4.0	4.0	4.0	3.2	4.0	4.0	3.9
GDP deflator in US dollar terms (change in percent)	-4.3	7.7	-5.8	5.4	8.8	5.9	5.6	4.4	3.8	4.1	4.0	4.6	2.5	2.5	2.5
Effective interest rate (percent) 5/	5.7	4.7	3.3	3.7	1.4	1.7	1.9	2.1	2.2	2.3	2.3	2.1	2.6	4.1	3.0
Growth of exports of G&S (US dollar terms, in percent)	12.2	23.0	-1.0	15.6	15.9	8.6	10.1	10.8	10.6	11.0	11.6	10.4	6.6	6.7	6.9
Growth of imports of G&S (US dollar terms, in percent)	2.3	23.6	-15.1	11.8	16.4	-3.8	15.4	11.9	8.5	6.6	6.6	7.5	5.2	5.3	5.3
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	42.6	46.0	45.7	45.0	44.9	43.9	44.7	28.4	18.2	23.8
Government revenues (excluding grants, in percent of GDP)	21.7	22.7	21.2			21.3	22.6	22.9	23.5	24.1	24.1		22.9	23.0	23.0
Aid flows (in Billions of US dollars) 7/	0.3	0.3	0.3			0.3	0.3	0.3	0.2	0.2	0.1		0.1	0.0	
of which: Grants	0.1	0.1	0.0			0.0	0.1	0.0	0.0	0.0	0.0		0.0	0.0	
of which: Concessional loans	0.2	0.2	0.2			0.2	0.2	0.2	0.2	0.2	0.1		0.1	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			7.8	8.1	6.3	5.1	4.0	2.6		1.8	1.2	1.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			51.6	57.2	54.0	54.1	54.5	59.3		43.4	27.1	37.2
Memorandum items:															
Nominal GDP (Billions of US dollars)	1.7	1.9	1.8			1.9	2.1	2.2	2.4	2.6	2.8		3.8	7.2	
Nominal dollar GDP growth	-2.8	11.9	-4.7			6.5	8.8	8.0	8.0	8.3	8.1	7.9	6.6	6.6	6.5
PV of PPG external debt (in Billions of US dollars)			0.7			0.8	1.0	1.1	1.2	1.3	1.3		1.7	2.1	
(PVt-PVt-1)/GDPt-1 (in percent)						**7.8**	**6.6**	**5.9**	4.9	3.9	2.2	**5.2**	1.6	0.9	1.3
Gross workers' remittances (Billions of US dollars)	0.1	0.2	0.2			0.2	0.2	0.2	0.2	0.2	0.2		0.2	0.2	
PV of PPG external debt (in percent of GDP + remittances)	...	...	34.9			39.1	42.3	44.2	44.9	44.8	43.5		40.3	27.3	
PV of PPG external debt (in percent of exports + remittances)	...	...	71.6			79.5	85.3	87.5	87.3	85.5	80.9		73.0	50.2	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	3.5			3.5	3.8	3.8	3.7	3.6	3.5		5.2	6.6	

Sources: Country authorities; and staff estimates and projections.

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 PV of private sector debt is equivalent to its face value.

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

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

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

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

Table 1b. Cabo Verde: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–33

(Percent)

	Projections							
	2013	2014	2015	2016	2017	2018	**2023**	2033
PV of debt-to GDP ratio								
Baseline	43	46	48	48	48	47	**43**	28
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	43	44	42	40	38	35	**32**	33
A2. New public sector loans on less favorable terms in 2013-2033 2	43	49	54	56	57	56	**54**	43
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	43	47	50	51	51	49	**46**	31
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	43	50	58	58	58	56	**51**	30
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	43	51	57	58	58	56	**52**	35
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	43	42	39	40	41	39	**38**	29
B5. Combination of B1-B4 using one-half standard deviation shocks	43	43	43	44	44	43	**41**	31
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	43	65	68	69	69	67	**61**	41
PV of debt-to-exports ratio								
Baseline	95	101	103	102	99	93	**81**	53
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	95	97	91	83	77	70	**62**	63
A2. New public sector loans on less favorable terms in 2013-2033 2	95	109	115	118	117	111	**103**	82
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	95	102	104	104	101	95	**84**	55
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	95	121	152	150	145	136	**118**	70
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	95	102	104	104	101	95	**84**	55
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	95	92	84	85	83	78	**71**	54
B5. Combination of B1-B4 using one-half standard deviation shocks	95	92	89	89	88	82	**75**	57
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	95	102	104	104	101	95	**84**	55
PV of debt-to-revenue ratio								
Baseline	199	203	209	206	200	194	**185**	122
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	199	194	184	168	156	147	**141**	145
A2. New public sector loans on less favorable terms in 2013-2033 2	199	219	234	238	237	232	**236**	189
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	199	209	220	218	212	205	**199**	133
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	199	219	251	247	239	232	**220**	130
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	199	225	250	248	241	233	**227**	151
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	199	185	171	172	169	163	**164**	125
B5. Combination of B1-B4 using one-half standard deviation shocks	199	189	186	186	183	177	**178**	135
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	199	287	295	293	285	276	**268**	178

Table 1b. Cabo Verde: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2013–33 (continued)

(Percent)

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
Debt service-to-exports ratio								
Baseline	4	5	4	4	4	4	**6**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	4	4	4	4	3	3	**4**	5
A2. New public sector loans on less favorable terms in 2013-2033 2	4	5	5	5	5	5	**7**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	4	5	4	4	4	4	**6**	7
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	4	5	6	6	6	5	**9**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	4	5	4	4	4	4	**6**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	4	5	4	4	4	4	**4**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	4	5	4	4	4	4	**4**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	4	5	4	4	4	4	**6**	7
Debt service-to-revenue ratio								
Baseline	9	9	9	9	8	8	**13**	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2013-2033 1/	9	9	9	8	7	7	**9**	11
A2. New public sector loans on less favorable terms in 2013-2033 2	9	9	9	10	10	10	**16**	23
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2014-2015	9	9	9	9	9	9	**14**	17
B2. Export value growth at historical average minus one standard deviation in 2014-2015 3/	9	9	9	10	9	9	**17**	18
B3. US dollar GDP deflator at historical average minus one standard deviation in 2014-2015	9	10	11	10	10	10	**16**	19
B4. Net non-debt creating flows at historical average minus one standard deviation in 2014-2015 4/	9	9	9	8	7	7	**10**	15
B5. Combination of B1-B4 using one-half standard deviation shocks	9	9	9	9	8	8	**10**	16
B6. One-time 30 percent nominal depreciation relative to the baseline in 2014 5/	9	13	13	12	12	12	**18**	23
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	29	29	29	29	29	29	**29**	29

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2a. Cabo Verde: Public Sector Debt Sustainability Framework, Baseline Scenario, 2010–33

(Percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2010	2011	2012	Average 5/	Standard Deviation 5/	2013	2014	2015	2016	2017	2018	2013-18 Average	2023	2033	2019-33 Average
Public sector debt 1/	73.0	77.8	90.2			97.6	104.1	107.4	108.4	107.5	101.4		85.2	63.5	
of which: foreign-currency denominated	51.3	56.1	67.5			74.0	79.2	81.9	82.0	80.5	76.5		62.5	37.7	
Change in public sector debt	8.4	4.8	12.4			7.4	6.5	3.3	1.0	-0.9	-6.1		-2.6	-2.1	
Identified debt-creating flows	14.4	6.8	11.5			7.7	5.8	3.1	0.8	-1.1	-6.4		-2.9	-2.4	
Primary deficit	9.8	9.7	11.7	4.4	4.6	11.2	9.5	8.2	6.6	4.6	-0.4	6.6	1.0	-0.1	0.6
Revenue and grants	27.9	25.6	23.0			23.7	25.5	24.7	25.1	25.4	25.3		23.8	23.5	
of which: grants	6.3	2.9	1.8			2.4	2.9	1.8	1.6	1.3	1.2		0.9	0.5	
Primary (noninterest) expenditure	37.7	35.3	34.7			34.9	35.0	32.9	31.7	30.1	24.9		24.8	23.4	
Automatic debt dynamics	4.8	-2.9	-0.3			-3.5	-3.7	-5.0	-5.8	-5.7	-6.0		-3.9	-2.3	
Contribution from interest rate/growth differential	0.0	-2.7	-0.4			0.0	-2.3	-3.2	-3.9	-4.0	-4.6		-3.6	-2.2	
of which: contribution from average real interest rate	0.9	0.1	0.5			0.5	0.6	0.3	0.2	0.1	-0.6		-0.2	0.4	
of which: contribution from real GDP growth	-0.9	-2.8	-0.9			-0.5	-2.9	-3.6	-4.1	-4.1	-4.1		-3.4	-2.5	
Contribution from real exchange rate depreciation	4.8	-0.2	0.2			-3.5	-1.4	-1.8	-1.9	-1.7	-1.3		...	...	
Other identified debt-creating flows	-0.2	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.2	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-6.0	-2.0	0.9			-0.2	0.7	0.2	0.2	0.2	0.3		0.3	0.3	
Other Sustainability Indicators															
PV of public sector debt	...	...	60.9			66.2	70.7	73.3	74.8	75.3	71.6		65.2	54.0	
of which: foreign-currency denominated	...	...	38.2			42.6	45.8	47.8	48.5	48.2	46.7		42.6	28.2	
of which: external	...	...	38.2			42.6	45.8	47.8	48.5	48.2	46.7		42.6	28.2	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	15.0	15.0	17.8			18.0	18.1	17.0	14.5	12.6	7.2		10.7	11.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	264.9			279.3	277.0	296.8	298.1	296.1	282.8		273.6	229.9	
PV of public sector debt-to-revenue ratio (in percent)	...	...	287.6			310.2	313.2	320.0	318.0	311.9	297.0		284.2	234.6	
of which: external 3/	...	...	180.6			199.5	203.0	208.7	205.9	199.9	193.7		185.4	122.4	
Debt service-to-revenue and grants ratio (in percent) 4/	18.6	20.5	26.5			28.6	33.7	35.7	31.7	31.3	29.8		40.6	47.5	
Debt service-to-revenue ratio (in percent) 4/	23.9	23.2	28.8			31.8	38.1	38.5	33.8	32.9	31.3		42.2	48.4	
Primary deficit that stabilizes the debt-to-GDP ratio	1.4	4.9	-0.7			3.8	3.0	4.9	5.6	5.5	5.7		3.6	2.0	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	1.5	4.0	1.2	4.9	3.5	0.5	3.0	3.5	4.0	4.0	4.0	3.2	4.0	4.0	3.9
Average nominal interest rate on forex debt (in percent)	1.1	1.3	1.4	1.2	0.1	1.2	1.2	1.2	1.1	1.1	1.1	1.2	1.2	2.2	1.5
Average real interest rate on domestic debt (in percent)	4.6	2.0	3.4	3.1	1.9	2.8	3.6	3.4	3.5	3.2	0.7	2.8	1.3	1.3	1.3
Real exchange rate depreciation (in percent, + indicates depreciatior	11.2	-0.4	0.3	-1.4	10.8	-5.2	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	0.5	2.7	1.9	1.8	1.3	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Growth of real primary spending (deflated by GDP deflator, in percer	0.2	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	42.6	46.0	45.7	45.0	44.9	43.9	44.7	28.4	18.2	...

Sources: Country authorities; and 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 excluding grants.

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

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

Table 2b. Cabo Verde: Sensitivity Analysis for Key Indicators of Public Debt, 2013–33

	Projections							
	2013	2014	2015	2016	2017	2018	2023	2033
PV of Debt-to-GDP Ratio								
Baseline	66	71	73	75	75	72	65	54
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	66	66	65	65	65	65	69	76
A2. Primary balance is unchanged from 2013	66	72	77	81	86	90	117	157
A3. Permanently lower GDP growth 1/	66	71	75	77	79	76	77	86
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-20	66	72	77	79	80	77	73	65
B2. Primary balance is at historical average minus one standard deviations in 2014-201	66	70	74	75	75	72	65	54
B3. Combination of B1-B2 using one half standard deviation shocks	66	69	71	72	73	69	64	54
B4. One-time 30 percent real depreciation in 2014	66	86	86	86	85	81	73	60
B5. 10 percent of GDP increase in other debt-creating flows in 2014	66	78	80	81	81	78	70	57
PV of Debt-to-Revenue Ratio 2/								
Baseline	279	277	297	298	296	283	274	230
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	279	259	265	261	258	257	290	325
A2. Primary balance is unchanged from 2013	279	282	310	324	338	356	491	669
A3. Permanently lower GDP growth 1/	279	279	302	307	309	300	321	365
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-20	279	282	311	315	315	304	306	278
B2. Primary balance is at historical average minus one standard deviations in 2014-201	279	276	298	299	297	284	274	230
B3. Combination of B1-B2 using one half standard deviation shocks	279	269	286	288	287	274	267	228
B4. One-time 30 percent real depreciation in 2014	279	338	350	343	335	319	307	254
B5. 10 percent of GDP increase in other debt-creating flows in 2014	279	305	324	324	321	307	296	243
Debt Service-to-Revenue Ratio 2/								
Baseline	29	34	36	32	31	30	41	47
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	29	33	34	30	29	28	37	46
A2. Primary balance is unchanged from 2013	29	34	36	32	32	31	46	75
A3. Permanently lower GDP growth 1/	29	34	36	32	32	31	44	60
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2014-20	29	34	37	33	33	31	43	52
B2. Primary balance is at historical average minus one standard deviations in 2014-201	29	34	36	32	31	30	41	48
B3. Combination of B1-B2 using one half standard deviation shocks	29	34	36	31	31	30	40	47
B4. One-time 30 percent real depreciation in 2014	29	35	39	35	35	33	46	57
B5. 10 percent of GDP increase in other debt-creating flows in 2014	29	34	36	33	32	30	43	49

Sources: Country authorities; and staff estimates and projections.

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

CABO VERDE

May 14, 2014

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The African Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of March 31, 2014)

Membership Status
Joined November 20, 1978

General Resources Account	SDR (million)	Percent of Quota
Quota	11.20	100.00
Fund holdings of currency	10.79	96.37
Reserve tranche position	0.42	3.72

SDR Department	SDR (million)	Percent of Quota
Net cumulative allocation	9.17	100.00
Holdings	1.58	17.18

Outstanding Purchases and Loans	SDR (million)	Percent of Quota
ECF arrangements	0.75	6.67

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF[1]	Apr 10, 2002	Jul 31, 2005	8.64	8.64
Stand-By	Feb 20, 1998	Mar 15, 2000	2.50	0.00

[1] Formerly PRGF.

Projected Obligations to Fund [2]
(SDR Million: based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2014	2015	2016	2017	2018
Principal	0.50	0.25			
Charges/interest	0.01	0.01	0.01	0.01	0.01
Total	0.51	0.26	0.01	0.01	0.01

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

Implementation of HIPC Initiative	Not Applicable
Implementation of Multilateral Debt Relief Initiative (MDRI)	Not Applicable
Implementation of Post-Catastrophe Debt Relief (PCDR)	Not Applicable

Safeguards Assessments

Two safeguards assessments of the Bank of Cabo Verde (BCV) have been completed, in 2002 and 2008. The 2008 assessment was conducted at the request of the authorities regarding the Policy Support Instrument (PSI). It concluded that the BCV had adopted some of the measures recommended in 2002, but also made recommendations to address further safeguards vulnerabilities notably in the internal audit mechanism, system of internal controls, and transparency practices. Although the implementation of certain safeguards recommendations remains work in progress, the BCV has since improved the completion of the audits and the publication of audited financial statements on its website.

Exchange Rate Arrangements

The *de facto* and *de jure* exchange rate arrangement of Cabo Verde is a conventional fixed peg. The escudo has been pegged to the euro at a rate of CVE 110.265 per euro since January 4, 1999. Cabo Verde accepted the obligations of Article VIII of the Articles of Agreement effective July 1, 2004. It maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

Previous Article IV Consultation and PSI Reviews

The final review under the 15-month PSI for Cabo Verde was completed on January 30, 2012 (Country Report No. 12/29). The Executive Board concluded the 2012 Article IV consultation on March 8, 2013 (Country Report No. 13/52).

Technical Assistance

Since 1985, Cabo Verde has received substantial technical assistance from the IMF. Technical assistance activities since 2004 are listed below:

Department	Dates	Purpose
FAD	June 2004	Help the authorities move to a VAT, rationalize the import tariff, and overhaul the domestic indirect tax system
	October 2004	Review tax administration, including VAT implementation, and help assess tax exemptions and incentives
	September 2005	Assess tax exemptions and incentives
	June 2008	Review and rationalize tax exemptions
	March 2009	Rationalization of fiscal benefits
	July 2012	Review tax policy and exemptions
	September 2012	Diagnostic evaluation of tax administration
	November 2012	Tax administration: annual planning

Department	Dates	Purpose
	February 2013, and July 2013	Tax administration and policy
	April 2013, June 2013, September 2013, January 2014, and February 2014	Tax administration: large taxpayer office organization, human resources, organization, strategic planning, and information technology
	October 2013	Program budgeting and other public financial management reforms
	November 2013	Medium term debt management strategy
	January 2014	Tax policy: small taxpayers
LEG	October 2006 and March 2008	Tax legislation
	March 2008	AML/CFT initial assessment, and legal drafting
	March 2012 and October 2012	Draft the financial and banking system laws
MCM	April 2004	Accounting, financial sector regulation, monetary operations, and liquidity management
	November 2005, March 2006, June 2006, November 2006, and July 2007	Banking supervision, liquidity management, exchange regime, and reserves management
	March 2008	Macro-prudential indicators
	November 2008, January 2009, and March 2009	Financial Sector Assessment Program (FSAP), and various follow-up missions on banking supervision
	February 2009, September 2009, and October 2013	Joint IMF-World Bank on debt management (DeMPA) and on Medium-Term Debt Strategy (MTDS)
	December 2010	Liquidity management and monetary policy operations
	June 2011	Medium-Term Debt Strategy Development follow-up
	October 2011	Enhancing banking supervision and crisis resolution
	September 2012	Enhancing liquidity management and development of the government securities market
	March 2013	Enhancing banking supervision and crisis resolution
	November 2013	Crisis management and contingency planning

Department	Dates	Purpose
STA	November 2003, January 2006, March 2012, July 2013, and April 2014	National accounts
	February 2004, and February 2012	Balance of payment statistics
	March 2004, April 2006, February 2007, August 2008, and April 2012	Government finance statistics
	June 2004, May 2006, and October 2007	Price statistics
	March 2007	Monetary statistics and reporting

WORLD BANK AND IMF COLLABORATION

(As of March 31, 2014)

The IMF and the World Bank Cabo Verde teams maintain an ongoing exchange of views on macroeconomic and structural issues. The cooperation and the coordination include the following:

- **Article IV Consultations**. World Bank representatives attended the Policy Consultation Meeting for the 2014 Article IV mission brief, and meetings during the 2014 IMF Article IV mission in Cabo Verde. This facilitated the discussions and provided valuable input, in particular in the areas of mutual interest such as public financial management and state-owned enterprise reform.

- **Joint managerial action plan.** The IMF and World Bank teams meet regularly to discuss and exchange views on relevant issues. The Fund provides macroeconomic framework updates requested by the Bank for their sectoral work. The Bank's work program comprises projects in the following areas: poverty reduction, public sector efficiency, competitiveness and private sector development, and management of state-owned enterprises (SOEs). The Bank's tourism development study was completed in July 2013, while the Country Economic Memorandum was completed in December 2013, covering the key challenges and structural reforms that could support productivity-driven growth and broad-based poverty reduction. The Bank's work in the coming years will be guided by a Country Partnership Strategy (FY2014–FY2017). The two teams have also worked closely on issues related to public financial management and a joint debt sustainability analysis (DSA).

- **Joint Staff Advisory Note on the Poverty Reduction Strategy Paper.** The staffs have prepared a JSAN on the Third Growth and Poverty Reduction Strategy Paper (GPRSP-III) 2012–16.

The teams plan to continue the close cooperation going forward. The table below describes specific activities planned by the two country teams over the fiscal years 2014/2015. The Fund will continue to lead on macroeconomic analysis, and the Bank will continue to lead on developments in competitiveness and innovation in the private sector (including agriculture) and SOEs. The teams will cooperate closely in preparing a joint DSA.

Table 1. Cabo Verde: Joint World Bank and IMF Work Program (as of March 31, 2014)			
Title	**Products**	**Timing of Mission**	**Expected Delivery Date**
A. Mutual information on relevant work programs			
Bank work program in the next 12 months	1. Country Partnership Strategy (CPS) 2014–17	January 2014	May 2014
	2. Eighth Poverty Reduction Support Credit (PRSC – 8) for US$15 million	November 2013	April 2014
	3. Financial Sector Development Strategy	March, May 2014	June 2014
	4. National Investment System	May 2014	TBD
	5. Ninth Poverty Reduction Support Credit (PRSC – 9) for US$10 million	May 2014	TBD
	6. TA Projects for SOEs	May 2014	January 2015
	7. Innovation and Competitiveness	May 2014, TBD	June 2015
IMF work program in the next 12 months	1. Article IV Consultation	January 2014	May 2014
	2. Staff Visit	September 2014	
	3. Article IV Consultation	February 2015	May 2015
B. Requests for work program inputs			
Fund request to Bank	Updates on SOE reforms and financial situation Updates on real sector developments		FY2014 and FY 2015
Bank request to Fund	Macroeconomic framework updates		FY2014 and FY 2015
C. Agreement on joint products and missions			
Joint products in the next 12 months	1. Joint Debt Sustainability Analysis (DSA)		May 2014
	2. Joint Medium-Term Debt Management Strategy (MTDS) report		May 2014

STATISTICAL ISSUES

General: Cabo Verde is assessed as "Category A" with regards to data adequacy for surveillance purposes. While substantial improvements are needed in national accounts, on the whole data are adequate for surveillance purposes. The country has participated in the General Data Dissemination System (GDDS) since February 2004. Cabo Verde's plans for improvements of its statistical system are posted on the Fund's Dissemination Standards Bulletin Board (DSBB); the metadata of the monetary and financial sector were updated in August 2007. The country has benefited from IMF Statistics Department (STA) technical assistance under the GDDS project for Lusophone Africa.

The authorities are taking steps to strengthen statistics, but the statistical system still suffers from a shortage of financial and human resources. A comprehensive master plan has been developed under the direction of the National Statistical Institute (INE), which assesses the need for upgrading the agencies that constitute the statistical system and outlines steps to broaden and improve all areas of statistics.

National Accounts: Although some improvements have been made to the national accounts, significant weakness remains — including a lack of timely and accurate GDP numbers. The most recent annual GDP data are for 2012 (released in March 2014). In the past few years, INE has worked on a complete overhaul of the national accounts. More specifically, INE has implemented the estimation of GDP at chained prices—as recommended by the 1993 System of National Accounts (1993 SNA)—as well as changing the base year from 1980 to 2007. The national accounts based on the new methodology were presented for the first time in July 2013, for 2011 and the backward projections of the old series for 2002-2010.

With technical assistance from IMF STA National Accounts missions since 2012, INE has also been working towards the publication of quarterly national accounts. INE plans to publish quarterly GDP data by 2015.

Full implementation of the 1993 SNA and quarterly national accounts publication require substantial improvement in source data collection, for which capacity is currently limited. While capacity of INE staff is found to be overstretched, INE has an ambitious target to continue building its statistics series—ranging from business, household, and labor force surveys to governance and security surveys. In addition, INE assesses in detail and corrects individual source data entries—something not generally undertaken in most countries by national accounts compilers. Given capacity constraints, a greater prioritization amongst data collection is encouraged. Further technical assistance on how to preliminarily estimate or extrapolate economic activity from random sampling surveys in various sectors could lead to crucial improvement in national accounts estimates and the timeliness of the release.

Price Statistics: A revamped Consumer Price Index (CPI) with new methodology was launched in February 2008. The previous official CPI was based on weights dating back to 1989, four years before imports were liberalized. Import liberalization considerably changed consumption patterns. INE has received assistance, from the National Statistics Institute of Portugal and IMF STA CPI missions during 2006-2007, to support the introduction and dissemination of the revised

CPI. The new index has new weights and an updated commodity basket. Price statistics are published on a monthly basis and in a timely manner.
Labor market statistics: INE publishes labor market statistics only on an annual basis with long delays. The annual unemployment data for 2012 were released in the second quarter of 2013. In addition, there are no published data on wages and employment in different sectors. The labor force survey is relatively extensive and has a large coverage of around 10,000 households which are representative at the municipality level.
Government Finance Statistics: The fiscal data have improved. Benefiting from technical assistance (TA) under the GDDS project for Lusophone Africa, the Government Finance Statistics (GFS) compilation system is being upgraded. Most deposits previously held with commercial banks have been consolidated at the central bank. SIGOF, the Integrated Online Budget Management System, was expanded to cover all semiautonomous institutes and most municipalities by the end of 2007, and recent TA helped the authorities compile GFS data in line with GFSM 2001. The authorities have started reporting GFS for publication in the GFS Yearbook. However, quality is a concern. The fiscal accounts are subject to statistical discrepancies, and flows and stocks are not always consistent. Tax arrears and overdue tax credits and refunds need to be better measured and integrated into the budget. Also, institutional coverage of fiscal data needs to be extended. A significant delay in donor reporting of project financing also affects the accuracy of fiscal data. Despite the recent revision of external debt data, weaknesses regarding the public and publically guaranteed debt of state-owned enterprises persist.
Monetary and Financial Statistics: The monetary and financial statistics are adequate and the quality of the monetary survey has been improved. An STA mission undertaken in March 2007 helped the Banco de Cabo Verde (BCV) to finalize the standardized report forms (SRFs) for reporting monetary statistics to STA. SRF-based monetary data have been published in the IFS Supplement since June 2007. These data are fully aligned with the recommendations of the Monetary and Financial Statistics Manual. An integrated monetary database that meets STA, AFR, and BCV statistical needs is now in place.
External statistics: The accuracy, periodicity, and timeliness of Balance of Payments (BOP) statistics compiled by BCV have continued to improve. A greater use of surveys, combined with the International Transactions Reporting System implemented by the 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). However, problems and limitations in data sources and compilation techniques remain and need to be addressed. Data coverage needs to be strengthened, particularly for foreign trade in goods, direct investment, portfolio investment liabilities, and the nonbank sector's external transactions conducted via accounts held abroad. Dissemination of quarterly BOP data on the BCV website has been regular. Since 2007, the BCV has resumed regular and timely transmission of these data to STA for publication in IFS and in the Balance of Payments Statistics Yearbook.

Table 2. Cabo Verde: Common Indicators Required for Surveillance
(As of March 31, 2014)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange rates	03/30/14	03/31/14	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[2]	02/28/14	03/31/14	D	W	W
Reserve/base money	02/28/14	03/31/14	D	W	M
Broad money	02/28/14	03/31/14	M	M	M
Central bank balance sheet	02/28/14	03/31/14	D	W	M
Consolidated balance sheet of the banking system	02/28/14	03/31/14	M	M	M
Interest rates[3]	02/28/14	03/31/14	M	M	M
Consumer price index	02/28/14	03/18/14	M	M	M
Revenue, expenditure, balance, and composition of financing[4]—central government	12/31/13	01/20/14	A	A	A
Stocks of central government and central government-guaranteed debt[5]	12/31/12	09/30/13	A	A	A
External current account balance	12/31/13	02/28/14	Q	Q	Q
Exports and imports of goods	12/31/13	02/28/14	Q	Q	Q
GDP/GNP	2012	March 2014	A	A	A
Gross external debt	12/31/12	09/30/13	Q	Q	A
International Investment Position[6]	2007	Aug 2008	A	A	A

[1] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA).
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[3] Both market-based and officially determined, including discount, money market, treasury bill, note, and bond rates.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

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

IMF Executive Board Concludes 2014 Article IV Consultation[1] with Cabo Verde

On May 28, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the 2014 Article IV consultation with Cabo Verde.[1]

The economy of Cabo Verde has continued to face significant headwinds due to the prolonged downturn in key trading partners in Europe and weak domestic demand. Output growth slowed from 4 percent in 2011 to 1.2 percent in 2012. Staff estimates that growth moderated further in 2013, to about 0.5 percent. While tourism performed well, remittances and private capital flows continued to decline, and domestic confidence declined further. The unemployment rate was 16 percent at end-2013, with the rate for youth twice as high. Consumer price inflation has fallen sharply, reaching 0.6 percent in March 2014. On the external front, the current account deficit is estimated to have narrowed sharply, contributing to a positive overall balance of payments and allowing international reserves to increase to roughly 4½ months of prospective imports.

Given weak economic conditions, and in the absence of imminent pressures on the balance of payments or consumer prices, the Banco de Cabo Verde (BCV) reduced its policy rate by 150 basis points in March 2014. While banks remain well-capitalized, financial stability has been weakened by the slowdown in economic growth. Non-performing loans have continued to rise, and by end-2013 accounted for 16 percent of total loans. This has contributed to a decline in bank profitability.

On the budgetary front, the fiscal deficit fell to 7¾ percent in GDP in 2013, about 2 percentage points less than the year before. However, total financing needs (including onlending to state-

[1] 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.

owned enterprises) remained very large, at 13 percent of GDP, causing total public debt to reach an estimated 98 percent of GDP by December 2013. The budget imbalance reflects the combination of weaker revenue performance and higher capital expenditure.

Staff projects Cabo Verde's real GDP growth to pick up to 3 percent in 2014. Improving economic conditions in the euro area bode well for tourism, remittances, and FDI. Domestically, consumer and investor confidence is expected to begin recovering, boosted by a more accommodative monetary policy stance. Inflation is expected to increase as activity picks up, but remain below 3 percent. The current account deficit should widen in 2014 as the demand for imports recovers, and is likely to remain high for a few more years, as the large-scale public investment program is gradually phased out. The principal near-term risks relate to a further delay in the European recovery, and to a resurfacing of financial stress in the euro area. Domestic risks are primarily fiscal in nature, given high public debt, though these risks are mitigated by the high concessionality and long maturity of this debt. Over the longer term, staff project growth of about 4 percent. The main risk to this outlook relates to Cabo Verde's ability to implement the structural reforms needed to boost competitiveness and potential growth.

Executive Board Assessment[2]

Executive Directors commended Cabo Verde's economic and social progress in the past decade, as well as the authorities' skillful macroeconomic management amid a difficult external environment, which has helped strengthen foreign reserves and safeguard the exchange rate peg. At the same time, Directors noted that Cabo Verde is vulnerable to external shocks, and that its public debt, while mainly on concessional terms, is elevated. They encouraged fiscal consolidation to rebuild buffers, and structural reforms to bolster productivity and long-term growth and enhance resilience.

Directors welcomed the fiscal consolidation achieved in 2013 and the authorities' plans to restrain spending in 2014 and beyond. At the same time, most Directors saw merit in faster deficit reduction, balanced with the need to protect growth, to help bring public debt on a downward path. Directors recommended safeguarding priority social spending and prioritizing strategic public investment projects while focusing on enhancing their efficiency.
They welcomed efforts to bolster domestic revenue mobilization, and noted the role of Fund technical assistance in supporting the reform efforts. Directors also commended recent actions to strengthen the governance and financial performance of state-owned enterprises, and encouraged continued efforts to improve their efficiency.

Directors agreed that the recent loosening of monetary policy is appropriate, given the slowdown in private sector credit growth and absence of pressures on international reserves or prices.

[2] 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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

However, the weak monetary transmission mechanism undermines the effectiveness of monetary policy, and Directors called on the authorities to strengthen their liquidity management capacity, improve interbank market efficiency, and continue developing the government securities market. It will also be important to maintain a sufficient level of international reserve buffers.

Directors supported the efforts to safeguard financial stability and address non-performing loans, including more intense bank supervision and new laws that strengthen the supervisory and regulatory framework. They encouraged the authorities to implement the remaining recommendations of the 2009 Financial Sector Assessment Program.

Directors noted staff's assessment that the escudo remains broadly aligned with fundamentals. In order to enhance the economy's resilience to external shocks and diversify its sources of growth, they called for further progress on reforms to bolster competitiveness, create jobs, and deliver inclusive growth. Improving the business climate and increasing labor market efficiency and reducing skill mismatches will be particularly important. Directors also encouraged the authorities to prioritize the goals of the medium-term development plan with the highest potential economic and social returns.

Cabo Verde: Selected Economic Indicators, 2011–17

	2011	2012	2013	2014	2015	2016	2017
			Est.		Proj.		
			(Annual percent change)				
National accounts and prices [1]							
Real GDP	4.0	1.2	0.5	3.0	3.5	4.0	4.0
GDP deflator	2.7	1.9	2.5	2.5	2.5	2.5	2.5
Consumer price index (annual average)	4.5	2.5	1.5	2.0	2.5	2.5	2.5
Consumer price index (end of period)	3.6	4.1	0.1	2.5	2.5	2.5	2.5
External sector							
Exports of goods and services	17.3	7.2	5.1	6.8	8.9	9.3	9.3
Of which: tourism	26.5	21.4	8.6	9.5	10.3	10.3	10.3
Imports of goods and services	17.9	-8.1	-6.9	11.9	9.9	7.2	5.0
			(Change in percent of broad money, 12 months earlier)				
Money and credit [2]							
Net foreign assets	-7.7	4.6	6.9	3.5	2.2	0.2	0.5
Net domestic assets	12.2	1.7	4.4	3.1	8.1	9.0	7.5
Net claims on the central government	4.0	3.3	1.8	1.4	1.1	1.3	1.1
Credit to the economy	10.8	0.0	1.3	5.1	6.0	6.2	5.8
Broad money (M2)	4.6	6.3	11.3	6.6	10.3	9.2	8.0
			(Percent of GDP, unless otherwise indicated)				
External sector							
External current account (including official transfers)	-16.3	-11.3	-4.5	-9.1	-10.8	-10.9	-9.2
External current account (excluding official transfers)	-20.0	-14.6	-7.5	-10.7	-12.4	-12.2	-10.5
Overall balance of payments	-2.7	2.7	3.5	3.2	2.2	0.6	0.8
Gross international reserves (months of prospective imports of goods and services)	3.5	4.2	4.4	4.6	4.6	4.5	4.4
Government finance							
Revenue	25.6	23.0	23.7	25.5	24.7	25.1	25.4
Tax and nontax revenue	22.7	21.2	21.3	22.6	22.9	23.5	24.1
Grants	2.9	1.8	2.4	2.9	1.8	1.6	1.3
Expenditure	33.3	32.9	31.5	32.9	31.2	30.8	30.0
Overall balance (incl. grants)	-7.7	-9.9	-7.8	-7.4	-6.5	-5.7	-4.6
External financing	6.0	7.5	6.2	5.7	4.7	3.5	2.6
Domestic financing	1.6	2.3	1.6	1.7	1.8	2.2	2.0
Onlending	-3.6	-3.7	-5.4	-4.3	-4.0	-3.2	-2.3
Total financing (incl. onlending)	11.2	13.6	13.2	11.7	10.4	8.9	6.9
Public debt stock and service [3]							
Total nominal government debt	77.8	90.2	97.6	104.1	107.4	108.4	107.5
External government debt	56.1	67.5	74.0	79.2	81.9	82.0	80.5
Domestic government debt	21.6	22.6	23.6	24.9	25.5	26.4	27.0
External debt service (percent of exports of goods and services)	4.1	4.3	4.6	4.5	4.5	4.4	4.1
Present value of external debt							
Percent of GDP (risk threshold: 50%)	…	…	42.6	45.8	47.8	48.5	48.2
Percent of revenue (risk threshold: 300%)	…	…	199.5	203.0	208.7	205.9	199.9
Percent of exports (risk threshold: 200%)	…	…	95.0	101.2	102.9	101.8	98.8
Memorandum items:							
Nominal GDP (billions of Cabo Verde escudos)	147.9	152.6	157.2	166.0	176.2	187.9	200.3
Gross international reserves (€ millions, end of period)	263.3	299.3	347.5	395.9	431.2	440.6	454.9

Sources: Cabo Verdean authorities; and IMF staff estimates and projections.

[1] Last data available for national accounts is for 2012.

[2] Adjusted for data inconsistency in December 2011.

[3] Public debt data for 2013 are preliminary estimates.

Statement by Mr. Nogueira Batista, Executive Director for Cabo Verde; Mr. Oliveira Lima, Alternate Executive Director; and Mr. Felipe Santarosa, Government-Provided Advisor

May 28, 2014

1. The Cabo Verdean authorities are thankful to staff for their constructive cooperation and dialogue during the Article IV mission. The process has provided an opportunity for an exchange of views on a broad range of topics that will contribute to a refinement of the authorities' macroeconomic objectives in the current transition of Cabo Verde from low to middle-income status.

2. Cabo Verde is pursuing a pathway of reforms that, together with the successful conclusion of the public investment program (PIP), are expected to accelerate growth by increasing productivity and competitiveness, as well as to foster economic diversification and develop human capital. The authorities also attribute a high priority to enhancing financial supervision, improving debt management and strengthening tax administration, areas in which Fund's technical assistance (TA) has been instrumental.

Economic developments and outlook

3. Exposed to a difficult external environment, the Cabo Verdean economy decelerated in the last two years. The country has been particularly affected by a decline in remittances and foreign direct investment (FDI) originating from Europe. In 2013, according to staff, GDP is estimated to have grown by 0.5 percent. If confirmed, this growth rate would be the lowest since 1990. Against this background, support to domestic demand by the PIP seems to have been of crucial importance. An outright recession could have been the outcome in 2013 had the government followed staff's advice in the last Article IV consultation and pursued fiscal consolidation at a faster pace.

4. The continued decline in the current account deficit (from 16.3 percent of GDP in 2011 to an estimated 4.5 percent of GDP last year) has been linked most of all to the good performance of the services sector, especially tourism, and to the reduction of imports in the context of a carefully-managed re-phasing of the PIP. Thanks to infrastructure investments and consistent policies for the sector, tourism has continued to expand in 2013, albeit at a slower pace, and remained a key driver for growth and exports. The overall balance of payments moved into surplus in 2012 and 2013 and is expected by staff to remain in positive territory until 2017. As a result, at end-2013, gross international reserves held by the central bank (*Banco de Cabo Verde* – BCV) reached the equivalent of 4.4 months of prospective imports, the midpoint of the Fund's estimated optimal range for Cabo Verde. We note that, in the last Article IV report, staff projected reserve coverage for 2013 at 3.3 months of prospective imports, below the floor of the optimal range.

5. For 2014 and beyond, GDP growth is expected to accelerate as remittances and FDI gradually recover and the impact of the PIP on productivity and competitiveness starts to be more clearly felt. Cabo Verde is an archipelago with its economic activity concentrated in three of the nine inhabited islands: Santiago, the administrative center, and Sal and Boa Vista, the main tourist destinations. One of the main objectives of the PIP is to overcome infrastructural bottlenecks and enhance integration between the islands. As the infrastructural transformation takes place, synergies are being created between the most dynamic sectors and the rest of the economy, allowing each island to fully develop its potential, according to its comparative advantages.

Fiscal policy

6. Cabo Verde has a long record of sound macroeconomic management, and the authorities are aware of the need to pursue fiscal consolidation. As highlighted in our last Buff statement, the fiscal deficit has been closely associated with the PIP and the country is a good example of why it may be relevant to separate the capital from the current budget. The ordinary or current budget balance — proxied by the overall balance excluding public investment — was in surplus last year to the amount of 1.3 percent of GDP, as can be seen from Table 3b of the staff report. Public investment (net acquisition of non-financial assets) corresponded to 9.1 percent of GDP while the central government's overall deficit was 7.8 percent of GDP. Current expenditures (including wages, goods and services, subsidies, transfers, social benefits and interest) have decreased as a share of GDP, from 28.3 percent in 2000 to 22.4 percent in 2012 and 2013. We are surprised to see that staff once again fails to make this fundamental distinction, thus providing a misleading presentation of Cabo Verde's public finances.

7. Even when including public investment, a trend towards medium-term fiscal consolidation can be observed since the PIP peaked in 2012. The overall deficit of the central government dropped from 9.9 percent of GDP that year to 7.8 percent in 2013. It is expected to fall to 7.4 percent in 2014 and to gradually decline to 4.6 percent in 2017. Moreover, the pace of fiscal consolidation is likely to be more pronounced in the years to come than portrayed under staff's baseline projections. Staff's forecasts are based on expenditure plans contained in the original 2014 budget and in the current Medium-Term Fiscal Framework (MTFF). However, given Cabo Verde's budgetary rules, actual fiscal performance is often less expansionary than originally envisaged.[1] This has been the case in recent years, and the authorities are currently reviewing this year's budget execution in order to reduce expenses according to the weaker revenue performance observed in the first quarter. Expenditures projected in the MTFF for years 2015–17 are also being reduced accordingly.

8. Raising fiscal revenues is another important component of the middle-term consolidation strategy. In 2013, measures continued to be taken by the Ministry of Finance and Planning (MFP), with the help of Fund TA, to broaden the tax base, enhance tax collection, and strengthen the institutional and administrative capacities of the General Directorate for Contributions and Taxes (*Direção Geral de Contribuições e Impostos* – DGCI). The authorities believe that the full impact of these measures will materialize in the course of the current year. The same can be said of the harmonization of the value-added tax (VAT) rates, approved in 2012. In this case, a loophole in the

[1] The approved budget includes a provision stipulating that as much as 30 percent of several classes of expenditures can only be executed if revenues perform as expected.

original law was seized by the biggest tourism operators allowing them to pay old rates on tourist packages during 2013, provided that contracts had been signed in 2012.[2]

9. The performance of state-owned enterprises (SOEs) is improving, as noted by staff. Of the six largest SOEs, only two remain under distress — the energy company Electra and the airline company TACV *(Transportes Aéreos de Cabo Verde*) — but reforms on both companies are starting to show positive results. Preliminary data for 2013 indicate that Electra's operational losses decreased by half when compared to 2012. Insofar as TACV is concerned, with the sale of its baggage handling branch, streamlining of routes and fleet, as well as ongoing managerial improvements, losses have been similarly contained and the company is expected to break even in 2015.

Debt sustainability

10. While maintaining Cabo Verde's commitment to sound public finances, the authorities intend to finalize in the next few years their strategy of harnessing the concessional financing still available to the country for ramping up public investment in infrastructure and social projects. This has resulted in a rapid increase in public external debt, but under very favorable conditions.[3] Interest rates are very low (averaging 1.1 percent), mostly fixed (over 92 percent of the total), and the amortization and grace periods are very long. As can be seen in Text Table 2 of the Debt Sustainability Analysis (DSA), multilateral debt, which represents over 50 percent of total external debt, has an average grace period of 9 years and an average amortization period of 34 years. As a result, external public debt does not breach any indicative threshold under the DSA baseline.

11. Financing infrastructure projects through concessional rather than non-concessional resources has entirely different implications. Staff continues to ignore or downplay this elementary point, and focuses excessively on the debt to GDP ratio. Had Cabo Verde not stepped up its investment during the current window of opportunity after graduation to middle-income status, it would have been required to pay much more to finance the same infrastructure. The completion of the PIP will lay the ground for higher future growth and enhance the country's capacity to pay its debt.

12. Staff continues to consider Cabo Verde's public and publicly guaranteed debt to be sustainable but seems unwilling to say so. The important conclusion that Cabo Verde's debt is sustainable is only stated in the DSA, and not in the main report, let alone in the staff appraisal. The report concentrates on emphasizing debt-related risks to such an extent that a different impression is conveyed to the reader. While references to high or very high overall debt levels abound (for example, three times in the seven paragraphs of the staff appraisal), there are very few reminders of the overwhelmingly concessional nature of Cabo Verde's debt.

[2] This was possible because the VAT law used the date contracts were signed as the basis for determining the rate to be applied. Taking advantage of that, tourism operators anticipated to 2012 the signature of contracts for a sizeable number of tourist packages sold for 2013.

[3] External public debt accounts for 76 percent of Cabo Verde's total public debt.

Monetary policy and financial sector

13. Monetary policy in 2013 was successful in keeping inflation low and supporting the exchange rate peg with the euro. With the increase in international reserves to a comfortable level and inflation under control, the BCV was able to ease monetary policy to support the economic recovery, in line with staff's advice. It cut the policy rate by 150 basis points — to 4.25 percent — last March, and reduced the rates of rediscount and of the lending facility by the same amount, to 8.25 and 7.25 percent, respectively.

14. Staff had also recommended the BCV to lower the 18 percent minimum reserve requirement (MRR), stating that it is high compared to peers and that a decrease would free up liquidity and support credit creation. The BCV, however, considers the current level of the MRR as adequate, given its dual role as a monetary and prudential tool, and also argued that reserve requirements should not be changed frequently. Staff's arguments for lowering the MRR are indeed unconvincing. It is doubtful that a central bank would make a decision on reserve requirements based on a simple comparison with its peers. Moreover, with already high excess liquidity, freeing up more bank reserves would hardly have any effect on credit, and would make liquidity management an even greater challenge.

15. BCV's measures to address non-performing loans (NPLs) in the banking system, on the other hand, could bring about an increase in credit to the private sector. As indicated in Box 2 of the staff report, among other initiatives, the BCV conducted a detailed review of banks' practices for NPL provisioning and disclosure, and requested banks to follow strictly International Financial Reporting Standards (IFRS) definitions. The level of NPLs has started to fall, but, at 16 percent, is still high.

16. Cabo Verde's banking sector remains well capitalized and liquid. Foreign banks do not depend on parent institutions as they are fully funded by domestic deposits. The BCV is committed to completing the implementation of the 2009 FSAP recommendations. Future priorities of the BCV include refining its operational framework so as to raise the efficiency of the transmission mechanism and promote the development of the interbank market.