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CABO VERDE

November 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; 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 2016 Article IV consultation with Cabo Verde the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 18, 2016 consideration of the staff report that concluded the Article IV consultation with Cabo Verde.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 18, 2016, following discussions that ended on October 8, 2016, 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 November 3, 2016.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Cabo Verde.

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

Selected Issues

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IMF Executive Board Concludes 2016 Article IV Consultation with Cabo Verde

On November 18, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the 2016 Article IV consultation[1] with Cabo Verde.

In 2015, economic growth stagnated at 1.5 percent, slightly below the 1.9 percent registered in 2014. Tourism recovered and remittances remained robust, but FDI and public investment slowed. The unemployment rate declined to 12.4 percent, as did youth unemployment, which nevertheless remained high at 28.6 percent. Consumer price inflation remained muted owing to lower food and energy prices, averaging 0.1 percent for 2015. On the external front, the current account deficit shrank markedly to an estimated 4.25 percent of GDP, reflecting lower imports due to the slowdown in public and foreign direct investment, the recovery in tourism and continued strong remittances. International reserves increased to about 5.75 months of prospective imports. In the first half of 2016, tourism continued its strong growth and FDI accelerated, reflecting a large increase in the pipeline of projects.

In the absence of imminent pressures on the balance of payments or consumer prices and to support the economic recovery, the Banco de Cabo Verde (BCV) reduced its policy rate by 25 basis points to 3.5 percent in February 2015, and lowered the minimum reserve requirement ratio from 18 to 15 percent. Lending rates have so far been slow to respond, reflecting the corporate debt overhang, and banks' risk aversion. Asset quality and bank profitability remain a concern, but capital buffers appear adequate, and non-performing loans (NPLs) have continued to decline from their August 2014 peak of 22.4 percent, reaching 16.9 percent in June 2016.

With the authorities embarking on fiscal consolidation, the fiscal deficit fell to 4.1 percent of GDP in 2015, about 3.4 percentage points less than the year before, on account of a strong revenue performance. Total financing needs (including onlending to state-owned enterprises) also declined by 2.3 percentage points to 8.3 percent of GDP as the investment program was

[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.

lowered to slow the buildup of public debt. Total public debt reached an estimated 125.8 percent of GDP by end-2015, reflecting the scaling up of externally financed public investment since 2008 coupled with low growth, falling prices and the recent strong appreciation of the U.S. dollar.

In 2016, growth is forecast to recover to 3.2 percent supported by FDI, domestic demand, agriculture, and tourism, which should benefit from the mild upswing in Europe. Domestically, consumer and investor confidence has started to recover, supported by continued strong remittances and the accommodative monetary policy stance. Inflation is expected to remain benign. The current account deficit should widen in 2016 reflecting strong FDI inflows and related imports, while the large-scale public investment program is gradually phased out over the medium term.

Executive Board Assessment[2]

Executive Directors commended the authorities' macroeconomic management amid the difficult external environment of recent years due to spillovers from the global financial and euro area crises. Directors welcomed Cabo Verde's long-term economic and social progress and that the economy appears to be at the onset of a recovery with prospects for a marked acceleration of growth in 2016. At the same time, Directors noted that the country is vulnerable to external shocks, and that its public debt, while mainly on concessional terms, is high. They encouraged fiscal consolidation to rebuild buffers, as well as structural reforms to promote the private sector as the main engine of growth, bolster productivity, and facilitate long-term growth.

Directors welcomed the fiscal consolidation achieved in 2015 and the authorities' plans to restrain spending in 2016 and beyond. They recommended safeguarding critical social spending and prioritizing strategic public investment projects while enhancing their efficiency. Directors saw merit in efforts to bolster domestic revenue mobilization, and noted the role of Fund technical assistance in supporting reforms in this area. They welcomed continued efforts to improve the efficiency of state-owned enterprises and noted that acceleration of the privatization program would help bolster private sector growth. Directors emphasized that the financial difficulties of two state-owned enterprises require swift resolution and welcomed the authorities' determination in that regard.

Directors agreed that the recent loosening of monetary policy and continued accommodative stance is appropriate, given the slow private sector credit growth and provided there are no pressures on international reserves or prices. However, Directors encouraged the authorities to continue strengthening their liquidity management capacity to strengthen the monetary

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[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.

transmission mechanism and thus the effectiveness of monetary policy, improve interbank market efficiency, and continue developing the government securities market.

Directors supported continued efforts to safeguard financial stability and address non-performing loans, including new regulations that facilitate their recognition and heightened bank supervision. They welcomed the progress in following up on the recommendations of the 2009 Financial Sector Assessment Program and encouraged the authorities to implement the remaining recommendations.

Directors emphasized the importance of stepping up the structural reform agenda 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, including improving the business climate, increasing labor market efficiency, and supporting education and vocational training to reduce skill mismatches.

Cabo Verde: Selected Economic Indicators, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Prel.				Proj.	
				(Annual percent change)					
National accounts and prices [1]									
Real GDP	1.1	0.8	1.9	1.5	3.2	3.7	4.1	4.1	4.1
GDP deflator	0.6	1.4	-0.1	0.5	0.1	1.2	1.8	2.0	2.0
Consumer price index (annual average)	2.5	1.5	-0.2	0.1	-1.6	0.8	1.6	2.0	2.0
Consumer price index (end of period)	4.1	0.1	-0.4	-0.5	-1.8	1.2	2.0	2.0	2.0
External sector									
Exports of goods and services	8.4	6.9	2.7	-9.8	4.8	7.5	7.5	7.5	7.5
Of which: tourism	21.4	8.6	-12.5	3.3	9.3	7.5	7.5	7.5	7.5
Imports of goods and services	-6.2	-5.7	6.3	-8.6	9.7	6.8	6.8	6.8	6.8
				(Change in percent of broad money, 12 months earlier)					
Money and credit [2]									
Net foreign assets	4.6	6.6	6.7	3.9	2.2	1.4	0.7	0.5	-0.2
Net domestic assets	1.7	4.8	0.7	2.4	3.6	4.6	5.3	5.6	6.3
Net claims on the central government	3.3	1.8	2.1	0.4	1.5	1.0	1.0	0.9	0.6
Credit to the economy	-0.1	1.5	-0.7	1.8	2.0	3.5	4.1	4.5	5.6
Broad money (M2)	6.3	11.4	7.4	6.3	5.8	6.0	6.0	6.1	6.1
				(Percent of GDP, unless otherwise indicated)					
External sector									
External current account (including official transfers)	-12.6	-4.9	-9.0	-4.3	-7.2	-8.8	-8.4	-7.9	-7.1
External current account (excluding official transfers)	-16.0	-7.9	-12.0	-8.0	-11.1	-10.6	-9.9	-9.2	-8.4
Overall balance of payments	2.7	3.6	5.0	2.2	2.1	1.4	0.7	0.5	-0.2
Gross international reserves (months of prospective imports of goods and services)	4.1	4.5	5.9	5.8	5.8	5.7	5.5	5.2	5.2
Government finance									
Revenue	24.4	24.5	22.6	26.2	27.4	26.0	26.0	26.1	26.0
Tax and nontax revenue	21.6	22.0	20.8	23.8	23.5	24.2	24.5	24.7	24.7
Grants	2.8	2.5	1.8	2.4	3.8	1.8	1.5	1.3	1.3
Expenditure	34.7	33.4	30.1	30.4	30.7	29.0	27.9	28.1	26.0
Overall balance (incl. grants)	-10.3	-8.9	-7.5	-4.1	-3.3	-3.0	-1.9	-2.0	0.0
Net other liabilities (incl. onlending) [3]	-4.1	-5.1	-3.1	-4.1	-4.5	-4.1	-3.7	-1.9	-1.0
Total financing (incl. onlending and capitalization)	14.4	14.0	10.6	8.3	7.8	7.0	5.6	3.9	1.0
Net domestic credit	2.6	1.1	0.7	1.6	2.9	1.9	2.0	1.8	1.2
Net external financing	11.8	12.8	10.0	6.7	4.9	5.1	3.6	2.1	-0.3
Public debt stock and service									
Total nominal government debt	91.1	102.5	114.5	125.8	129.1	130.2	128.5	124.7	118.6
External government debt	68.1	78.3	87.9	96.9	98.1	98.4	96.2	92.1	86.3
Domestic government debt	23.0	24.2	26.6	28.9	31.0	31.8	32.3	32.5	32.3
External debt service (percent of exports of goods and services)	4.3	4.5	4.8	6.3	6.5	6.6	6.8	6.8	7.6
Present value of external debt									
Percent of GDP (risk threshold: 50%)	...	...	...	61.8	63.3	64.4	63.8	62.0	59.0
Percent of revenue (risk threshold: 300%)	...	...	...	259.5	268.9	265.9	260.0	250.5	238.5
Percent of exports (risk threshold: 200%)	...	...	...	147.2	145.1	143.4	140.4	135.0	127.7
Memorandum items:									
Nominal GDP (billions of Cabo Verde escudos)	150.4	153.7	156.4	159.4	164.7	172.8	183.2	194.7	206.8
Gross international reserves (€ millions, end of period)	299.1	347.5	419.7	453.3	484.2	505.8	517.3	526.4	522.4

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

[1] Last data available for national accounts is for 2015.

[2] Adjusted for data inconsistency in December 2011

[3] Includes errors and omissions.

CABO VERDE

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

November 3, 2016

KEY ISSUES

Context: Cabo Verde appears to be at the onset of a recovery from the growth slowdown of 2012–15. However, the economy remains vulnerable to external shocks notably from Europe, the main source of tourism revenue, FDI and remittances. The Public Investment Program, while addressing key infrastructure gaps, has contributed to a marked rise in public debt (125.8 percent of GDP in 2015). The Debt Sustainability Analysis indicates that debt risks are high on account of the elevated stock of debt, while debt service indicators remain comfortable.

Challenges: Policies should focus on sustaining the growth momentum while curbing public debt. This would include reevaluating the public investment pipeline with a view on reducing externally financed capital spending, and encouraging the private sector to take on a larger role in investment and growth. Over the medium term, continued implementation of the ambitious structural reform agenda is critical to help the country reap the benefits of the infrastructure investment scaling up.

Key policy recommendations:

- Fiscal consolidation remains key to macroeconomic and debt sustainability. Addressing financial difficulties in state owned enterprises and improving investment efficiency are central to healthy public finances.

- In line with staff advice, the authorities revisited the scope and timeline of externally financed public investment with a view to put external debt on a downward path and lower the risk of debt distress in the medium term.

- Monetary policy should remain accommodative while carefully monitoring international reserves for any signs of pressure.

- The authorities should remain vigilant regarding risks to financial stability, and continue heightened supervision of the banking sector.

- Structural reforms should continue, especially toward improving the business environment and enhancing revenue performance. Reforms should be prioritized based on expected returns and in line with reform implementation capacity.

Approved By **David Owen (AFR) and Hans Weisfeld (SPR)**	Discussions were held in Praia and Mindelo during September 8–21, 2016 and concluded in Washington during October 6–8. The mission team comprised Mr. Ulrich Jacoby (head), Mmes. Sin and Parulian, Messrs. Hitaj and Almeida (all AFR). Messrs. Fachada (Alternate Executive Director, OED) and Leigh (AFRITAC West2 coordinator) joined for part of the discussions. Ms. Adjahouinou provided assistance at headquarters. Discussions were held with Prime Minister Correia e Silva, Minister of Finance Correia, Minister of Economy and Employment Gonçalves, Minister of Justice and Labor Lélis, Banco de Cabo Verde Governor Serra, other government officials, parliamentarians, civil society representatives, development partners, and the private sector. The mission coordinated closely with an overlapping World Bank mission.

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CONTEXT: STALLING GROWTH, HIGH PUBLIC DEBT

A. The Long-Term Setting

1. Cabo Verde has a robust democracy and has enjoyed prolonged political stability. After 15 years in opposition, the center-right Movimento para Democracia (MpD) won an absolute majority in the parliamentary elections of March 2016 and landslide victories in subsequent municipal and presidential elections. The transfer of power was smooth, testifying to the country's institutional strength and maturity.

2. Cabo Verde has made impressive progress in economic development and poverty reduction over the last two decades. Cabo Verde's rapid economic growth has allowed the country to triple per capita GDP and graduate to middle-income country status. Living standards have risen, and great strides have been made in reducing poverty.

3. However, growth stalled in the aftermath of the global financial and the euro crises, despite a substantial scaling up of public infrastructure investment (Figure 1). Starting in 2008, the previous government scaled up public investment to build much needed infrastructure while concessional resources were still available, providing a boost to the stuttering economy. Despite this, growth over 2009–15 averaged only about 1.3 percent. Furthermore, over 2009–15 Cabo Verde's growth trailed that of peer Small Middle Income Countries (SMICs), owing to higher exposure to Europe (Figure 3).

4. The public investment scaling up combined with lower than expected growth, declining inflation and a strengthening U.S. dollar has pushed up public debt to GDP ratios. Public debt reached 125.8 percent of GDP at end-2015. However, debt service remains manageable owing to the high concessionality of external debt.

5. With fiscal consolidation key to ensuring debt sustainability, the focus should be on enabling the private sector to take on a stronger role in sustaining growth. As the authorities wind down public investment and reduce financing needs, it is important to crowd in the private sector to take advantage of the improved infrastructure. Policies should aim at devolving the activities of public companies, ensuring a strong and competitive business environment, and improving private access to finance.

6. The new government which came into office in April 2016 has a comprehensive agenda. Policy priorities include (i) fiscal consolidation to reduce public debt, in particular external debt; (ii) containing or resolving contingent liabilities related to SOEs, in particular the national housing company and airline; (iii) crowding in the private sector through improving the business environment, increasing access to financing for SMEs, attracting FDI and promoting exports, accelerating the privatization of SOEs, and connecting the local economy with the tourism sector; and (iv) encouraging formalization of the informal sector.

B. Recent Developments

7. Growth remained low in 2015 as the external environment remained challenging and domestic demand lackluster. Real GDP growth stagnated at 1.5 percent in 2015, slightly below the 1.9 percent experienced in 2014. Solid performance in fisheries and agriculture contributed to growth, as did tourism, but construction and services contracted, and private sector credit stagnated due to weak demand and the corporate debt hangover from the real estate boom of previous years which ended abruptly with the growth slowdown. Headline inflation remained muted owing to lower food and energy prices, averaging 0.1 percent for 2015.

8. The current account deficit contracted in 2015, and international reserve cover improved. The current account deficit shrank markedly to an estimated 4¼ percent of GDP, reflecting lower imports due to the slowdown in public and foreign direct investment, the recovery in tourism and continued strong remittances, with reserve coverage of 5.8 months of prospective imports. Tourism receipts increased by 3.3 percent and the number of tourists by 5½ percent in 2015, reflecting price competition and gains from the decline in tourism in North Africa.[1]

9. The recovery showed signs of taking off in the first six months of 2016. Real GDP grew by 5.9 and 3.6 percent respectively in the first and second quarter on account of tourism, agriculture, and public services. Tourist arrivals grew by 16 percent. Domestic demand showed signs of recovery as remittances remained strong and private sector credit inched up, reflecting the gradual reduction of corporate non-performing loans (NPLs).

10. Policy implementation was broadly in line with Fund staff advice (Text Table 1). The authorities agreed that external debt should be curbed by reducing public investment while being mindful of growth. Staff encouraged the authorities to continue their structural reform program but advised a slightly more gradual approach, especially in the fiscal area where capacity constraints could be a significant challenge. In line with Fund advice, the BCV reduced the minimum reserve requirement to encourage credit growth and embarked on an accommodative monetary policy stance. Furthermore, a new labor code increasing labor market flexibility and lowering the cost of staff layoffs was submitted to parliament in late 2015 and entered into force in October 2016.

[1] Growth in tourism in 2015 was 4.4 percent globally, led by Europe with 5 percent, while SSA saw zero growth, and tourism in North Africa declined by 8 percent (World Tourism Organization, 2015).

Text Table 1. Cabo Verde: Traction of IMF Staff Advice, 2014-16

	Staff advice	Implemented
Fiscal policy	Start fiscal consolidation and reduce fiscal deficit	Yes, reduced from 8.9 of GDP in 2013 to 4.1 percent of GDP in 2015
	Reduce capital spending	Yes, reduced from 10.2 percent of GDP in 2013 to 4.6 percent of GDP in 2015
	Reduce financing needs to below 10 percent of GDP	Yes
Monetary policy	Reduce minimum reserve requirement	Yes, reduced from 18 to 15 percent
	Cautious loosening of monetary policy	Yes, policy rate reduced by 225 basis points
Financial stability	Ensure proper classification and provisioning of NPLs	Yes, heightened supervision and stronger provisioning
Competiveness	Improving performance of labor market	Yes, new labor code in effect in October 2016

Source: IMF staff.

OUTLOOK AND RISKS: THE RECOVERY CONTINUES, BUT VULNERABILITIES REMAIN

A. Medium-Term Outlook and Risks

11. With spillovers from the global financial and euro crises having subsided, Cabo Verde's economy is expected to resume its higher growth trajectory driven mainly by tourism and FDI. In 2016, growth is forecast to recover to 3.2 percent supported by FDI, domestic demand, agriculture, and tourism, which should benefit from the mild upswing in Europe. Tourism-related FDI worth €625 million (42 percent of 2016 GDP) from signed projects is expected over the medium term, and further projects worth some €700 million are under discussion. Domestic demand is expected to improve, reflecting the reversal of the long-term decline in confidence indicators, the resumption of growth in private sector credit, and robust remittances. Average inflation is projected to remain negative at about -1.6 percent in 2016.

12. While growth prior to the recent slowdown averaged 6.8 percent during 2001–08, recent experience and the global low-growth environment suggest that such a growth pace may be difficult to attain. Over the medium term, trend growth of about 4 percent seems achievable, drawing on peer experience and expected returns on large-scale public investment in past years.[2] Inflation is expected to return to positive territory but remain benign over the medium term. Tourism should continue growing at a strong pace, reflecting ongoing FDI and the resulting

[2] The IMF Country Report 14/296 estimates potential growth at 3.5–4 percent.

increase in capacity, and goods exports are also projected to grow robustly. [3] Domestic demand is projected to pick up, supported by rising credit growth and continued strong remittances. Gross international reserves are forecast to remain above 5 months of prospective imports, supported by tourism, FDI and remittances.

13. The outlook remains subject to external and domestic downside risks (Table 6). Externally, Cabo Verde's high dependence on tourism and remittances makes it vulnerable to adverse developments in Europe, including risks related to Brexit—about 20 percent of the country's tourists come from the UK. Global financial market volatility and sovereign stress could impede FDI and be transmitted via the banking sector linkages to Portugal. Domestic risks are primarily fiscal, as public debt has risen to uncomfortably high levels. The elevated level of NPLs indicates risks in the financial sector, and continued weakness in credit creation could depress consumption and investment.

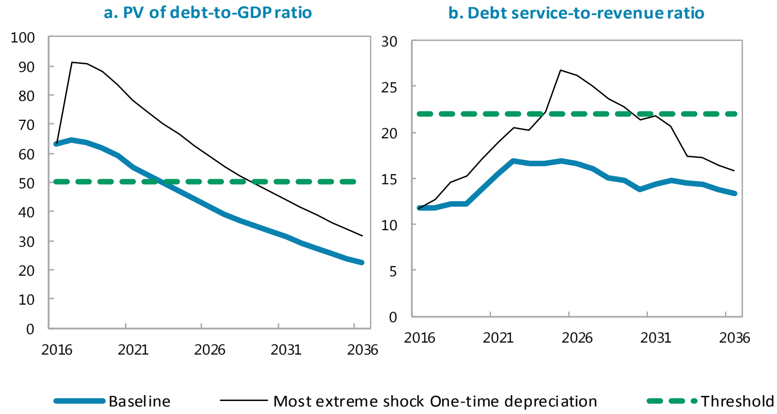
14. Over the longer term, economic growth will depend critically on increasing productivity and strengthening the private sector. The implementation of productivity-enhancing structural reforms—in particular in the areas of access to financing, labor market efficiency, and human capital development—is crucial for increasing Cabo Verde's long-term growth potential. With the public investment program winding down, it will be important to crowd in the private sector to take over as the engine of growth and reap the returns from improved infrastructure.

B. Debt Sustainability Analysis (DSA)

15. The risk of debt distress is high, though baseline debt service indicators remain at comfortable levels (Debt Sustainability Analysis). Mainly reflecting the recent dollar appreciation and lower GDP growth and inflation, total nominal debt reached 125.8 percent of GDP. The present value (PV) of external debt to GDP reached 61.8 percent in 2015, exceeding the 50 percent threshold, and is projected to gradually decline to below 50 percent in the medium term (Figure 1). Debt sustainability remains highly sensitive to a depreciation shock.

[3] Tourism in Cabo Verde is mainly supply constrained and the growth projection reflects the expected expansion of capacity related to the very large pipeline of tourism related FDI as well as the expansion of airport capacities. Growth in goods exports reflects mainly an expansion of fish processing as the industry is currently operating well below capacity and seeking to increase the supply of fish.

Text Figure 1. Cabo Verde: External Debt Sustainability and Service Indicators [1]



1/ The depreciation shock consists of a nominal one-time depreciation of 30 percent vis-a-vis the US$ in 2017.

C. External Stability Assessment

16. The external position in 2015 was broadly consistent with medium-term fundamentals and desirable policy settings, and short-term risks appear low. The External Stability Assessment (ESA) finds that the exchange rate is broadly in line with fundamentals, but underscores the importance of enhancing the business environment (Appendix I). The two complementary assessment models based on the extended External Balance Assessment (EBA-lite) methodology do not indicate significant misalignments of Cabo Verde's real exchange rate. [4] Cabo Verde's current account has been characterized by deficits mainly reflecting FDI and, more recently, government borrowing. While the international investment position reached minus $235 million in 2015, it is not considered a threat to external stability as it reflects continued net FDI inflows. International reserves are projected to be broadly adequate at over 5 months of prospective imports over the medium term (Appendix). However, the country's high dependence on tourism and remittances represents a significant external vulnerability in the longer run. Further improving the business environment—particularly in the area of access to financing and labor market efficiency as well as by enhancing the productivity of human and physical capital—will play an important role in diversifying production and exports and increasing resilience to external shocks.

THE POLICY AGENDA

A. Fiscal Policy: Ensuring Debt Sustainability and Safeguarding Growth

17. In 2015, budget execution was managed carefully and fiscal consolidation was achieved on account of higher than expected revenue. Tax revenue increased strongly by about

[4] See IMF Policy Paper "Methodological Note on EBA-Lite", February 2016.

12 percent in 2015. While this reflects the revenue administration reforms of recent years, it also includes one-off effects which should not be carried over into the revenue projections for the outer years.[5] Capital spending was reprogrammed downward during the year, and the fiscal deficit decreased to 4.1 percent of GDP, about 3.4 percent of GDP lower than in 2014. Overall financing needs including onlending to state-owned enterprises (SOEs) declined from 10.6 percent of GDP in 2014 to 8.3 percent of GDP in 2015.

18. The main challenge for fiscal policy is to contain public debt and secure debt sustainability without stifling the emerging growth recovery. Tax revenue is expected to increase by about 1 percent of GDP over 2015–19, reflecting the economic recovery and recent FAD-supported tax administration reforms, compensating for the decline in grants. Current spending is predominantly funded by tax revenue and domestic financing, which is capped at 3 percent of GDP annually. In contrast, the public investment program (PIP) that the new government inherited is predominantly externally financed. To rein in debt without unduly endangering the prospects for economic recovery, fiscal consolidation should focus on reducing externally financed capital spending (which has a much lower multiplier of about 0.15 than current spending due to high import content), while rationalizing current expenditure in line with past practice.

19. The 2016 budget and mid-2016 medium-term fiscal framework (MTFF) envisioned an expansionary fiscal policy stance for 2016–17 before embarking on a fiscal consolidation in the outer years (Text Table 2, *Authorities' mid-2016 MTFF and PIP*). Broadly in line with previous Fund advice, the MTFF envisioned reducing total financing needs to about 4 percent of GDP by 2019 by rationalizing current spending and curtailing onlending. However, the consolidation path was back-loaded and financing needs for 2016–17 were high.

20. In light of the discussions, the authorities revised their 2016 budget, the MTFF, and the associated externally financed PIP broadly in line with IMF staff advice (Text Table 2, *Authorities' Current MTFF and PIP*). In line with their commitment to fiscal consolidation, the authorities agreed with staff advice that a stronger and more frontloaded fiscal consolidation charting out a clear path toward debt reduction would send a strong signal of fiscal responsibility to donors and investors. They implemented contingent containment measures already included in the budget. The MTFF and PIP were revised by cutting domestically financed capital spending, including to make space for sudden financial demands on the budget for a recapitalization of the loss-making national airline TACV (*Text Table 2*); and by postponing several externally financed projects to 2018–19, thus reducing the external debt build-up in 2016. These measures are quite significant, especially in light of the abrupt need of TACV for financial support, and taking into

[5] One-off effects result from the switch to intra-year collection of corporate income tax for 2015 in parallel to ex-post collection for 2014, and collection of tax arrears. Tax arrears amounted to about 5 percent of GDP at end-2015, with offsets due to pending VAT and income tax refunds of about 0.6 percent of GDP. The authorities are receiving technical assistance from the Fund and bilateral donors in estimating the outstanding amounts and expedite the clearing process.

account that the country operated on a pro-rated budget for the first half of the year.[6] Growth projections were revised down in line with the fiscal consolidation path.

Text Table 2. Cabo Verde: Medium-Term Fiscal Adjustment Scenarios, 2015–19
(Percent of GDP)

		Authorities' mid-2016 MTFF and PIP				Authorities' current MTFF and PIP			
	2015	2016	2017	2018	2019	2016	2017	2018	2019
Revenue	**26.2**	**26.0**	**26.0**	**26.4**	**26.5**	**27.4**	**26.0**	**26.1**	**26.1**
Of which: Tax revenue	19.0	19.0	19.5	19.9	20.0	18.9	19.5	19.8	20.0
Expenditure	**30.4**	**30.9**	**30.4**	**29.9**	**29.7**	**30.7**	**29.0**	**27.9**	**28.1**
Current spending	25.7	25.1	24.8	24.5	23.8	26.4	25.0	24.7	24.1
Net acquisition of nonfinancial assets	4.6	5.8	5.6	5.4	5.9	4.3	4.0	3.2	4.0
Overall balance	**-4.1**	**-4.9**	**-4.3**	**-3.5**	**-3.3**	**-3.3**	**-3.0**	**-1.9**	**-2.0**
Net other liabilities (incl. onlending)	**-4.5**	**-4.8**	**-3.9**	**-1.9**	**-0.8**	**-4.5**	**-4.1**	**-3.7**	**-1.9**
Onlending	-4.5	-4.8	-3.9	-1.9	-0.8	-4.5	-4.1	-3.7	-1.9
Capitalization [1]	-3.6	0.0	0.0	0.0	0.0	-3.3	-3.4	-3.1	-1.3
Errors and emissions	**0.3**								
Total financing (incl. onlending)	**8.3**	**9.7**	**8.2**	**5.4**	**4.0**	**7.8**	**7.0**	**5.6**	**3.9**
Net domestic credit	**1.6**	**2.9**	**3.1**	**3.1**	**3.1**	**2.9**	**1.9**	**2.0**	**1.8**
Net external borrowing	**6.7**	**6.8**	**5.1**	**2.4**	**0.9**	**4.9**	**5.1**	**3.6**	**2.1**
Memorandum items:									
Total financing excluding capitalization	4.7	9.7	8.2	5.4	4.0	4.5	3.6	2.5	2.5
Real GDP growth	1.5	3.6	4.1	4.3	4.3	3.2	3.7	4.1	4.1

Sources: Cape Verdean authorities and IMF staff estimates.

[1] Includes anticipated capitalization needs for SOEs.

21. Budget execution is sufficiently flexible to reach the fiscal targets. Rather than a commitment, current spending as approved by parliament represents a maximum amount of authorized spending and can be cut by up to 30 percent in case revenue underperforms. Similarly, the government can reduce capital spending.

22. Efforts to enhance domestic revenue mobilization continued in 2014–15. In 2014 Cabo Verde completed an overhaul of the tax administration system by restructuring the revenue administration, which became operational in September 2014. Staff welcomes the accelerated efforts to collect the considerable VAT and corporate income tax arrears of about 5 percent of GDP. In addition, tax declaration is now fully digitalized and conducted by the taxpayers themselves. While this should help expedite tax payments and free human resources, its success will require careful monitoring and the capacity to conduct targeted audits. Strengthening the capacity, technical skills and IT of the national revenue administration (DNRI) remains a key priority.

23. Structural fiscal reforms remain important to strengthen public finances. In the medium term as concessional financing phases out, revenue mobilization efforts should continue. Furthermore, the authorities will eventually also need to think about alternative domestic and external financing options (see Selected Issues paper). Good management and maintenance of infrastructure remains important. With reduced public investment, strengthening project evaluation

[6] In an election year budget execution is based on the pro-rated budget of the previous year until the new government approves a budget.

and implementation capacity is even more critical as is the selection of those projects that will deliver the highest return on growth within the next few years. Staff welcomes the authorities' ongoing efforts to strengthen the investment cycle by building a National Investment System and enhancing the results based management of budget programs and projects, encompassing the entire cycle from project formulation to selection, implementation and ex post evaluation.

24. Swift and decisive action is needed with regard to two loss-making public enterprises (SOEs) The situation of the national airline TACV—a longstanding problem which had already worsened in 2015—continued to deteriorate in 2016 with operating losses requiring capital increases from the budget to allow continuation of service. The financial situation of the housing company (IFH) also deteriorated related to risks from its largest social housing project (€187 million), requiring intervention and close monitoring. For these and other obligations for SOEs the authorities have set aside CVE 2.5 billion (1.5 percent of GDP) in 2016 and CVE 1.1 billion annually through 2020. [7] Without urgent intervention, capital needs for TACV alone could rise to around 3.0 percent of GDP in 2017, diverting much needed resources from growth enhancing expenditure.

25. Further reform of other SOEs remains crucial to increase efficiency and reduce contingent liabilities. SOEs account for about one third of the country's GDP. According to preliminary data for 2015, the aggregate result of all SOEs amounted to a loss of CVE 1.1 billion (0.7 percent of GDP) on account of TACV, whereas contingent liabilities increased to CVE 41.4 billion or 25.8 percent of GDP, from about 9 percent of GDP in 2014, primarily on account of loans contracted by the IFH and the water and electricity (ELECTRA) company. Structural reforms, recapitalization, and performance-based management contracts have generated encouraging results at ELECTRA. Staff welcomes that mandatory performance contracts were extended in 2014 to the remaining four SOEs which the authorities consider strategic. However, staff notes with concern that customers have accumulated arrears to ELECTRA in the amount of CVE9.1 billion (5.5 percent of GDP) and urges the authorities to step up collection efforts.

Authorities' views

26. The authorities pointed out that they are more optimistic for growth than staff. Their growth forecast for 2016 is 3.5–4.5 percent, with a further acceleration in the following years.

27. The authorities added that despite the high debt-to–GDP ratio, the debt is almost exclusively concessional and debt service indicators continue to be comfortable.
This highlights Cabo Verde's ability to service its debt.

28. The authorities emphasized that they are fully committed to fiscal consolidation to reduce debt risks, as evidenced by the adjustments in their MTFF. In tandem with this, the authorities are stepping up their efforts to crowd in the private sector by accelerating privatization (Section D).

[7] Actual recapitalization payments for TACV from January to early September 2016 amounted to CVE 1.3 billion.

29. The authorities noted that further reducing the externally financed PIP would be very costly. All loans in the PIP pipeline had been contracted by the previous government. While the authorities had made best efforts to stretch out and postpone projects to the extent possible, cancellation of ongoing projects would be costly in terms of penalties and counterproductive.

B. Monetary Policy: Bolstering Private Credit and Protecting the Peg

30. With muted inflation and robust international reserves, the BCV has taken an appropriately accommodative monetary policy stance and measures to facilitate the resolution of NPLs. In 2014, the BCV policy rate was cut by 200 basis points to 3.75 percent by August 2014. In February 2015, the BCV further reduced the policy rate by 25 basis points to 3.5 percent, lowered the minimum reserve requirement ratio (MRR) from 18 percent to 15 percent, and cut the remuneration rate of excess reserves from 0.5 to 0.25 percent.

31. Lending rates did not respond much, reflecting the corporate debt overhang and banks' risk aversion, but private sector credit started to grow again. Credit to the private sector remained shy in 2015, with much of the 2.8 percent increase on account of SOEs. The BCV absorbed excess liquidity to stabilize the monetary transmission mechanism, encourage the development of the interbank market and discourage excessive risk-taking. However, with excess liquidity hovering around 5 percent of deposits, the transmission mechanism remains weak and activity in the interbank market is rare. The BCV pointed out that the cost of absorbing the full amount of excess liquidity would be prohibitive.

32. Credit growth is expected to accelerate. Confidence indicators suggest a gradual improvement in the business climate and anecdotal evidence suggests that banks are cautiously optimistic. Strong capital buffers combined with the NPL-resolution measures, low government yields and the improved prospects of a sustained economic recovery should help credit extension pick up in 2016.

Box 1. Cabo Verde: Financial Sector — Challenges and Opportunities

The financial benchmarking exercise in the attached Special Issues Paper shows that financial sector performance is broadly in line with the estimated benchmarks, but a few issues deserve attention. There is little financial sector activity outside of banking. Furthermore, asset concentration is high, and lending activity is firmly concentrated in the top three banks (out of 8). While access to the banking sector —measured by the number of branches per 100,000 adults— is high relative to expectations, profitability is rather low, with returns from assets and equity significantly below the expected median. Viewed together with the high asset concentration, this could suggest that the banking sector is overcrowded.

Box 1. Cabo Verde: Financial Sector — Challenges and Opportunities (concluded)

Furthermore, the paper examines whether the recent slowdown in private sector credit growth is demand or supply driven. Using a disequilibrium model (Maddala and Nelson, 1974), staff estimates show that, while demand factors have been the main drivers in Cabo Verde's credit market in the late 2000s, supply factors' role has increased in recent years. Accordingly, for Cabo Verde to promote more sustainable private-sector led growth, reforms aiming at strengthening both credit demand and supply will be essential.

Policies that aim at tackling demand-side obstacles could include increasing productivity by improving the business environment for the private sector, and providing financial and business literacy training to small businesses. Supply-side policies, on the other hand, could focus on: (i) strengthening the financial sector through continued prudent banking supervision, (ii) reducing credit risks by resolving the non-performing loan (NPL) overhang, and (iii) facilitating the reallocation of liquidity across banks by developing the interbank market.

Authorities' views

33. The authorities were in broad agreement with staff's views and analysis on the monetary sector. They noted that credit growth in 2016 has shown signs of recovery, and agreed that the monetary policy stance needs to remain accommodating provided that international reserves remain strong.

C. Financial Supervision: Increasing Resilience

34. Asset quality and bank profitability remain a concern, but capital buffers appear adequate (Table 5). Despite high lending rates, profitability is depressed by low credit extension and high NPLs. Short-term commercial bank spreads dropped sharply in early 2016, but longer-term spreads increased, maintaining the average spread at 7.3 percent. NPLs which peaked at 22.3 percent in August 2014 continued to decline to 16.5 percent at end-2015, but inched up to 16.9 percent in June 2016. Capital adequacy has slightly declined to 14.8 percent in June 2016, yet provisions to NPLs remain quite strong at about 53 percent.

35. The authorities have taken regulatory measures to facilitate the resolution of NPLs and thus encourage credit growth. In February 2015, the BCV extended the time period to liquidate repossessed assets from NPLs from 2 to 5 years. In tandem, the finance ministry has postponed tax collection to the time of sale of repossessed assets. Meanwhile, the BCV has continued its heightened supervision and is in the process of making it even more pro-active by reinforcing its supervision team and stepping up on-site audits. At the same time, it continues to encourage banks and corporates to recognize and address NPLs.

36. However, Cabo Verde continues to lag in financial market development. Although Cabo Verde's ranking in the WEF financial market development index has improved, it still trails the country's institutional development. The interbank money market only recently resumed activity after a couple of years of hiatus, suggesting that the reputational stigma attached to borrowing in the interbank market may have eased. However, a secondary market for BCV and government bills still needs to be established and activated. This would also help in preparing alternative financing options beyond concessional borrowing in the medium to longer term (see Selected Issues paper).

D. Structural Reforms: Passing the Baton to the Private Sector for Long-Term Growth

37. Further improvements in the business climate remain crucial to job creation and private sector growth. There has been progress in recent years, for example in Cabo Verde's move from 122nd place in 2013/14 to 110th place in 2016/17 in the World Economic Forum global competitiveness rankings. Importantly, a new labor code increasing labor market flexibility and lowering the cost of staff layoffs came into effect on October 1, 2016. In late 2014, *Cabo Verde Investimentos* (CI) launched an online one-stop-platform to ease the investment process for foreign investors. Earlier in 2016, CI was transformed into *Cabo Verde Trade-Invest* to enhance the synergies between FDI and export promotion, in particular in the tourism sector. In September 2016, the authorities entered into a collaboration agreement to establish an African Growth and Opportunity Act (AGOA) Trade Resource Center to promote exports. Also earlier in 2016, a credit guarantee scheme (CV Garante) to facilitate financing for small and micro businesses became operational. In 2015, the government provided for the establishment of credit bureaus to improve credit information and ultimately access to financing—establishment of these bureaus should be accelerated. Analytical work indicates that lack of know-how in accessing financing is a major factor holding back credit extension—relevant training should be expanded.

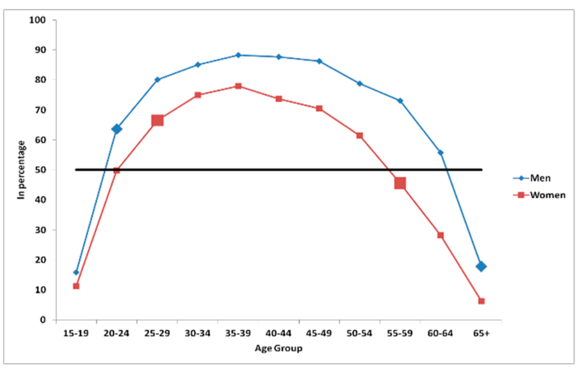
38. Despite a downward trend, unemployment remains high, in particular among youths and women, pointing to structural reform needs to further reduce labor market rigidities and in particular skill mismatches. The average unemployment rate declined from 15.8 percent (2014) to 12.4 percent (2015), with higher unemployment observed in less connected islands. Youth unemployment is particularly high, although it decreased from 35.8 percent in 2014 to 28.6 percent in 2015. While unemployment is overall higher among men than women, the highest rates of unemployment are observed among young women between the ages of 15–19 and 20–24 who reside in rural areas. Analytical work also indicates that closing the gender gap in labor force participation could increase per capita income by as much as 12 percent, depending on the absorption capacity of the economy and the labor productivity of new entrants (Box 2). Vocational training should be expanded and better aligned with the current and future needs of the economy.

Box 2. Cabo Verde: Closing the Gender Gap

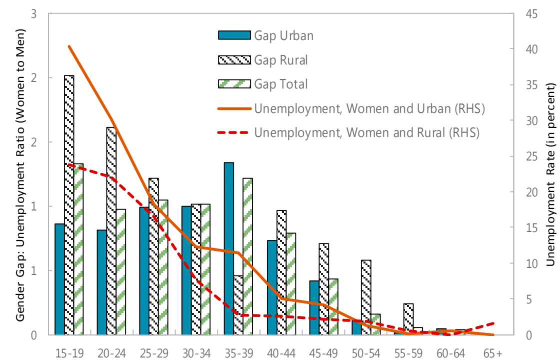
Demographic transition. Cabo Verde is currently undergoing a demographic transition with social and economic implications for its development path going forward. As Cabo Verde's demographic transition slows, the size and potential of demographic dividends post-2015 will drop due to the slowdown of the proportion of working-age population.

The gender gap. In this context, efforts towards closing the gender gap and making growth more inclusive will become increasingly important. In 2014, the labor force participation rate of women was 51.2 percent of the total female working-age population; for men, it was 65 percent. The gap in labor force participation is large, especially for young women and women in rural areas. Women tend to enter the labor force later (age of 25–29) and leave it earlier (age of 55–59). A gender gap exists in the labor market participation rate, employment conditions, and use of time dedicated to unpaid work.

Labor Force Participation by Age Group and Gender (2015)



Gender Gaps in Unemployment Rate and Unemployment Rates for Women, Urban and Rural (2015)



Source: National Statistics Institute.

Underlying labor market characteristics. According to the 2010 census, informality in the labor market is high in Cabo Verde, with 59 percent of the workforce reporting working with no contract (INE, 2015). The majority of these informal workers are women who mostly work in retail, family homes, and agriculture. More women report being engaged in unpaid work (90%) compared to men (73%); and women spend on average about 3.5 hours more than men on unpaid work each day. These gaps increase with decreasing standards of living and levels of education, and with larger numbers of dependents. The 2010 census also indicated that family tasks are a limiting factor for female access to the labor force.

Impact on growth. Marone[1] (2016), specifically on the Cabo Verde case, estimates that closing the gender gap in labor force participation would increase the total labor force participation rate by 12.2 percent (26,428 workers) and could have a direct impact on the level of GDP between 7.4 to 12.2 percent. The actual impact of closing the gender gap on GDP would depend on several factors such as the absorption capacity of the economy and the labor productivity of new entrants. These results underline the fact that women tend to be one of the most "underutilized assets" in the economy.

Box 2. Cabo Verde: Closing the Gender Gap (concluded)

Policy options. Improving women's effective participation in the labor market requires well-designed and integrated policies. In the Cabo Verde context, two main sets of policies could be effective: a focus on decreasing time spent by women for unpaid work and a focus on increasing the employability and hiring of women. The first policy set includes expanding the capacity and affordability of care services, promoting shared responsibility in the care of dependents, more targeted cash transfer policies, and other development initiatives such as increased access to water and electricity. The second set of policies includes policies to promote flexible work arrangements, female entrepreneurship, specific training that is integrated with economic diversification initiatives, access to financing, and awareness campaigns to increase gender diversity in business.

[1] Marone, Heloisa, 2016. "*Demographic Dividends, Gender Equality, and Economic Growth: The Case of Cabo Verde,*" IMF Working Papers 16/169, International Monetary Fund.

39. **The privatization program has been accelerated.** In 2014, the ministry of finance established a unit to encourage and plan private-public partnerships and privatization, and oversee the privatization of SOEs. Privatization of minority holdings in companies was accelerated starting in 2014. A modernized privatization law and a new Public-Private Partnership (PPP) law laying the legal foundation for PPPs came into effect late in 2015. The authorities are currently reassessing the entire privatization program to align it with the new government's priorities.

STAFF APPRAISAL

40. **Cabo Verde is at a crucial stage in its economic development where the private sector will need to take over as driver of growth as public investment will gradually decline.** Given the high public debt and several major investment projects at or near completion, the authorities have decided to gradually phase out the PIP. Private investment needs to take over as the main growth engine in order to take advantage of the improved infrastructure and ensure sustained long-term growth. To that end, accelerating the privatization program is an important step in the right direction. In addition, the authorities need to continue improving the business climate, enhance the efficiency of the financial sector, and ensure private sector compliance with the new labor code.

41. **Staff forecast an acceleration of the recovery, but vulnerabilities remain.** Staff expect growth to continue to pick up speed and reach about 4 percent in the medium term, powered by tourism and trade, and supported by FDI, remittances and private sector credit growth. Accelerated progress on structural reforms could help growth reach an even higher trajectory. However, vulnerabilities remain. Remittances and tourism growth could be thwarted by the implications of Brexit on both the UK and the euro area, and credit to the private sector could be held back by a slow resolution of NPLs.

42. Staff welcomes the authorities' commitment to fiscal consolidation to address debt risks. The revised PIP essentially foresees a gradual phasing out, as decided by the authorities. These measures should help Cabo Verde regain a moderate risk of debt distress over the medium term. Staff initially advised an even deeper and more frontloaded consolidation, but understands the limits to consolidation as changes to ongoing investment projects need to be agreed with creditors and contractors. The authorities' medium-term fiscal consolidation path is necessary and realistic as budget execution is flexible. The authorities will need to stay the course on fiscal consolidation and should be ready to implement in-year expenditure containment if revenue falls short.
Staff welcomes the reforms taken to bolster tax revenue. The priority should now be on bringing these reforms to fruition, including by strengthening the human resource and IT capacity.

43. The financial situation of TACV and IFH requires urgent action and careful monitoring. Staff welcomes the authorities' determination to swiftly tackle the problems at TACV and reduce and then eliminate recapitalizations, in close cooperation with the World Bank. Regarding IFH**,** staff welcomes the government's intention to quickly appoint a commission to review and salvage the project with assistance from the World Bank.

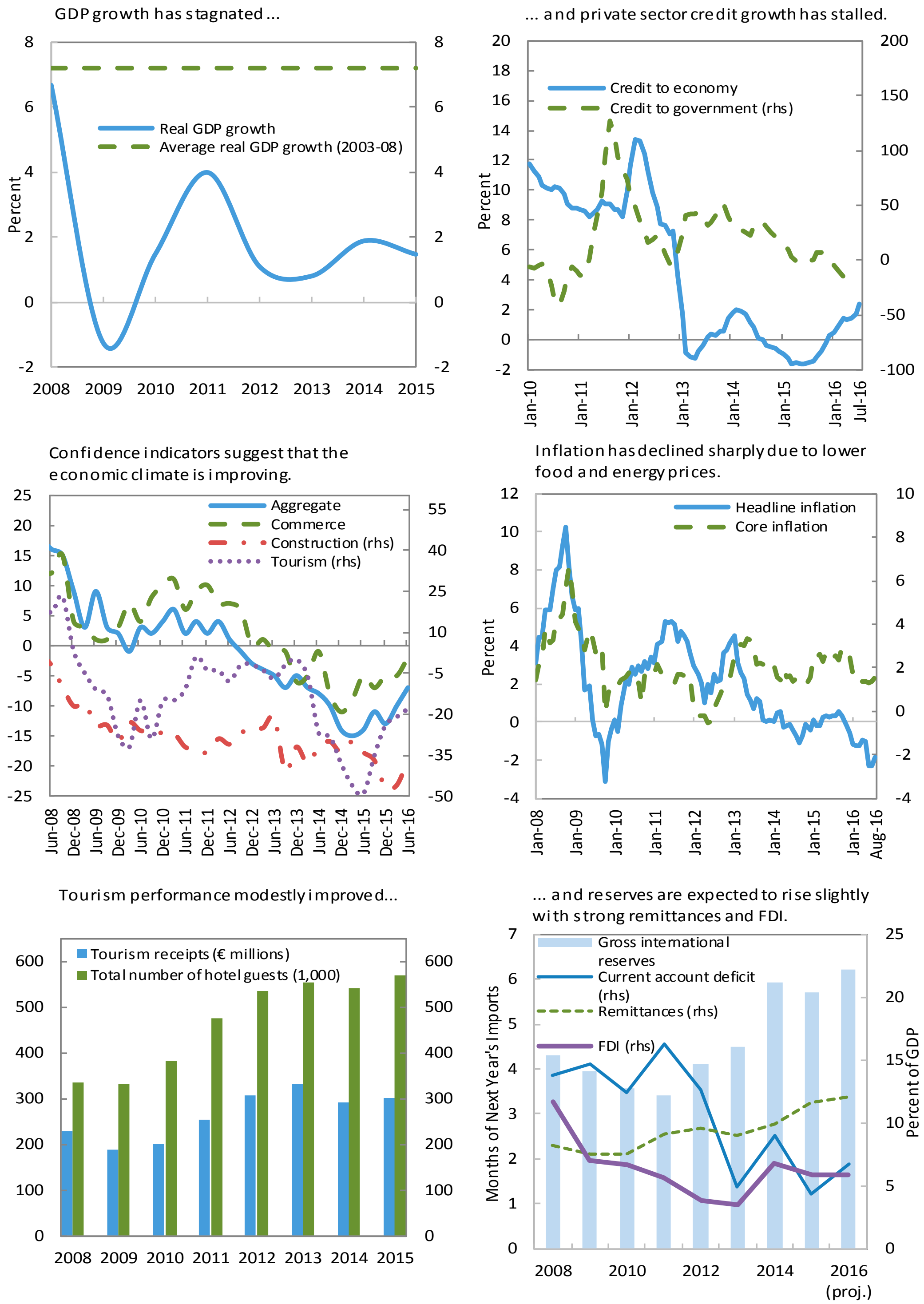
44. Staff commends the BCV for the timely decision to ease monetary conditions and measures to facilitate the resolution of NPLs. Continued benign inflation and strong international reserves should allow monetary policy to remain accommodative for the foreseeable future, while monitoring euro interest rates, domestic liquidity conditions and international reserves for any signs of pressure. In the medium term, strengthening the monetary transmission mechanism (with MCM support) remains a key objective. Staff also considers that it is important to expedite the resolution of NPLs to strengthen the banking sector and facilitate private sector credit growth.

45. Staff welcomes the steps taken by the BCV to ensure financial stability, and supports measures to improve financial market efficiency. The BCV should continue its heightened supervision (including the provisioning for NPLs), implementing the regulations of the new banking laws and, together with the finance ministry, making the Financial Stability Committee fully operational to enhance crisis preparedness

46. The macroeconomic policy mix is broadly appropriate. Fiscal consolidation is expected to continue in 2016 and the medium term, supported by higher tax revenue and careful rationing of current and capital spending. The fixed exchange rate regime has anchored macroeconomic stability in Cabo Verde, and external stability does not appear to be at risk. However, the rapid development of tourism has increased dependence on the sector, and Cabo Verde remains vulnerable to exogenous shocks in particular from Europe. This reinforces the importance of structural reforms to support economic diversification and enhance competitiveness to set growth on a broader footing. At the same time, careful macroeconomic management remains crucial to safeguard the peg and macroeconomic stability.

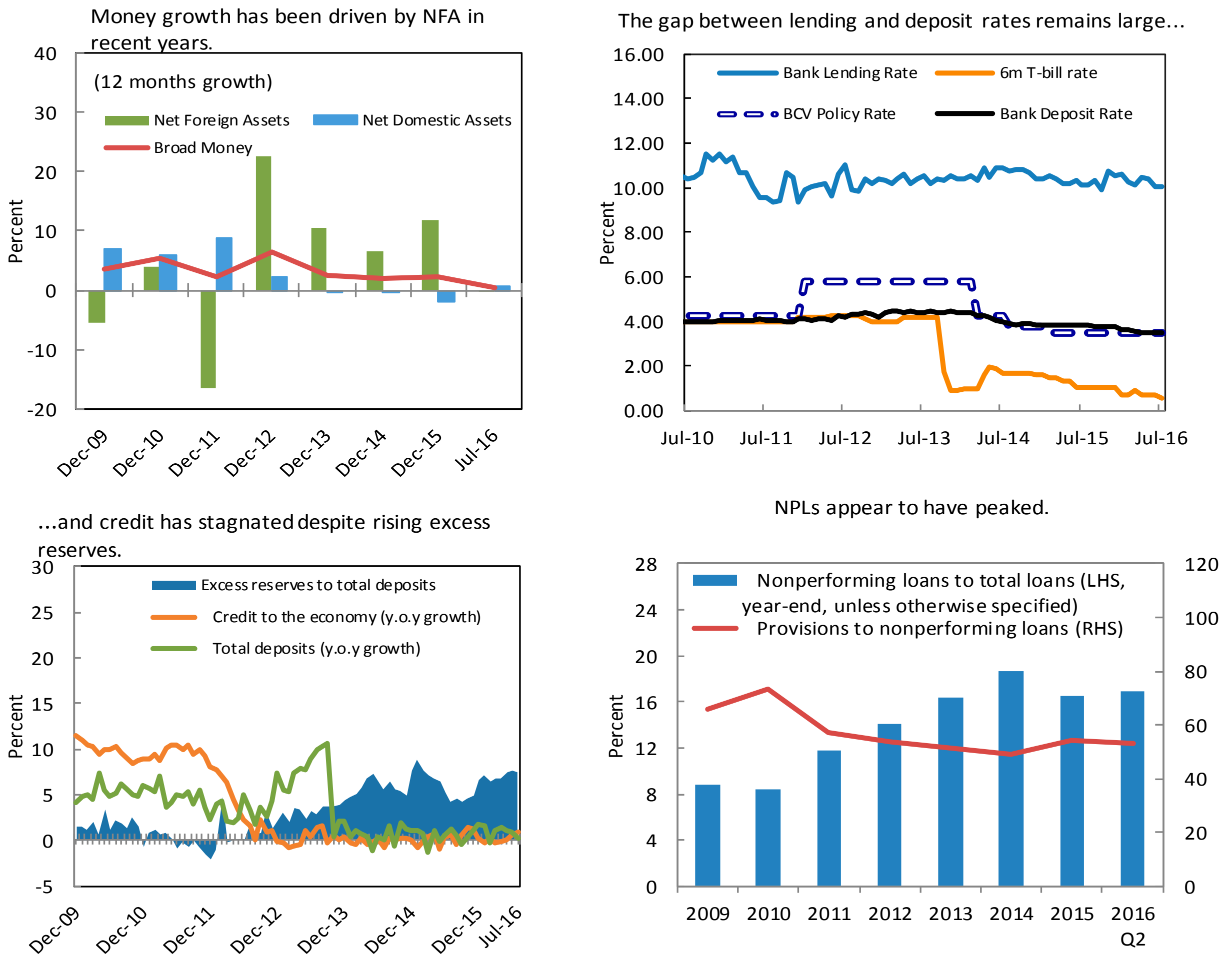
47. Staff recommends that the next Article IV consultation take place on the standard 12 month cycle.

Figure 1. Cabo Verde: Recent Economic Developments



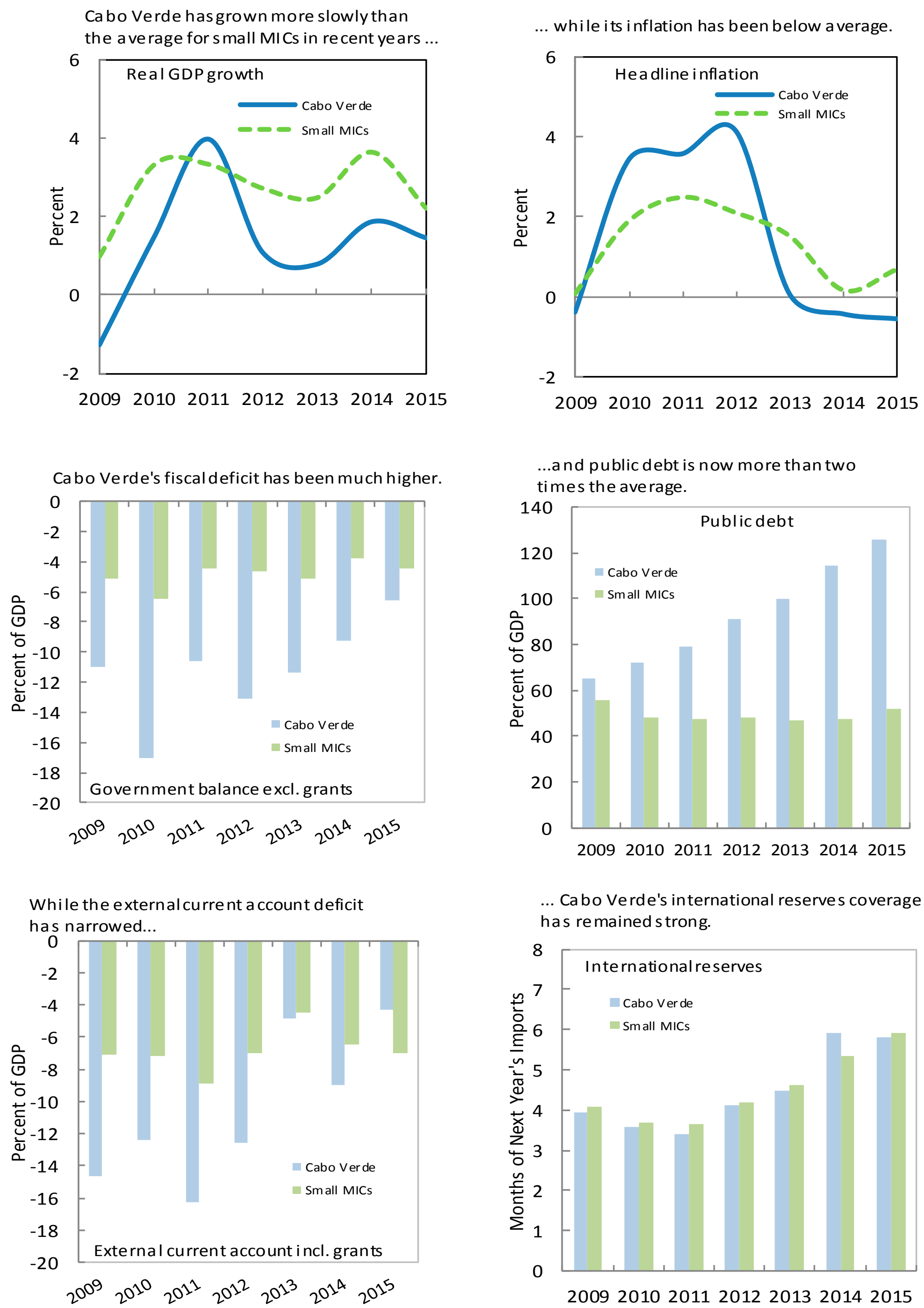
Sources: Cabo Verdean authorities and IMF staff.

Figure 2. Cabo Verde: Monetary Developments and Credit Growth



Sources: Cabo Verdean authorities and IMF staff.

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



Sources: IMF, World Economic Outlook 2016; Cabo Verdean authorities; and IMF staff.

[1] Belize, Cabo Verde, Lesotho, Mauritius, Seychelles, Swaziland, and Vanuatu.

Table 1. Cabo Verde: Selected Economic Indicators, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Prel.		Proj.			
				(Annual percent change)					
National accounts and prices [1]									
Real GDP	1.1	0.8	1.9	1.5	3.2	3.7	4.1	4.1	4.1
GDP deflator	0.6	1.4	-0.1	0.5	0.1	1.2	1.8	2.0	2.0
Consumer price index (annual average)	2.5	1.5	-0.2	0.1	-1.6	0.8	1.6	2.0	2.0
Consumer price index (end of period)	4.1	0.1	-0.4	-0.5	-1.8	1.2	2.0	2.0	2.0
External sector									
Exports of goods and services	8.4	6.9	2.7	-9.8	4.8	7.5	7.5	7.5	7.5
Of which: tourism	21.4	8.6	-12.5	3.3	9.3	7.5	7.5	7.5	7.5
Imports of goods and services	-6.2	-5.7	6.3	-8.6	9.7	6.8	6.8	6.8	6.8
				(Change in percent of broad money, 12 months earlier)					
Money and credit [2]									
Net foreign assets	4.6	6.6	6.7	3.9	2.2	1.4	0.7	0.5	-0.2
Net domestic assets	1.7	4.8	0.7	2.4	3.6	4.6	5.3	5.6	6.3
Net claims on the central government	3.3	1.8	2.1	0.4	1.5	1.0	1.0	0.9	0.6
Credit to the economy	-0.1	1.5	-0.7	1.8	2.0	3.5	4.1	4.5	5.6
Broad money (M2)	6.3	11.4	7.4	6.3	5.8	6.0	6.0	6.1	6.1
				(Percent of GDP, unless otherwise indicated)					
External sector									
External current account (including official transfers)	-12.6	-4.9	-9.0	-4.3	-7.2	-8.8	-8.4	-7.9	-7.1
External current account (excluding official transfers)	-16.0	-7.9	-12.0	-8.0	-11.1	-10.6	-9.9	-9.2	-8.4
Overall balance of payments	2.7	3.6	5.0	2.2	2.1	1.4	0.7	0.5	-0.2
Gross international reserves (months of prospective imports of goods and services)	4.1	4.5	5.9	5.8	5.8	5.7	5.5	5.2	5.2
Government finance									
Revenue	24.4	24.5	22.6	26.2	27.4	26.0	26.0	26.1	26.0
Tax and nontax revenue	21.6	22.0	20.8	23.8	23.5	24.2	24.5	24.7	24.7
Grants	2.8	2.5	1.8	2.4	3.8	1.8	1.5	1.3	1.3
Expenditure	34.7	33.4	30.1	30.4	30.7	29.0	27.9	28.1	26.0
Overall balance (incl. grants)	-10.3	-8.9	-7.5	-4.1	-3.3	-3.0	-1.9	-2.0	0.0
Net other liabilities (incl. onlending) [3]	-4.1	-5.1	-3.1	-4.1	-4.5	-4.1	-3.7	-1.9	-1.0
Total financing (incl. onlending and capitalization)	14.4	14.0	10.6	8.3	7.8	7.0	5.6	3.9	1.0
Net domestic credit	2.6	1.1	0.7	1.6	2.9	1.9	2.0	1.8	1.2
Net external financing	11.8	12.8	10.0	6.7	4.9	5.1	3.6	2.1	-0.3
Public debt stock and service									
Total nominal government debt	91.1	102.5	114.5	125.8	129.1	130.2	128.5	124.7	118.6
External government debt	68.1	78.3	87.9	96.9	98.1	98.4	96.2	92.1	86.3
Domestic government debt	23.0	24.2	26.6	28.9	31.0	31.8	32.3	32.5	32.3
External debt service (percent of exports of goods and services)	4.3	4.5	4.8	6.3	6.5	6.6	6.8	6.8	7.6
Present value of external debt									
Percent of GDP (risk threshold: 50%)	...	...	...	61.8	63.3	64.4	63.8	62.0	59.0
Percent of revenue (risk threshold: 300%)	...	...	...	259.5	268.9	265.9	260.0	250.5	238.5
Percent of exports (risk threshold: 200%)	...	...	...	147.2	145.1	143.4	140.4	135.0	127.7
Memorandum items:									
Nominal GDP (billions of Cabo Verde escudos)	150.4	153.7	156.4	159.4	164.7	172.8	183.2	194.7	206.8
Gross international reserves (€ millions, end of period)	299.1	347.5	419.7	453.3	484.2	505.8	517.3	526.4	522.4

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

[1] Last data available for national accounts is for 2015.

[2] Adjusted for data inconsistency in December 2011.

[3] Includes errors and omissions.

Table 2. Cabo Verde: Balance of Payments, 2012–20

(Scale: Millions of Euros; unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Est.			Proj.		
Current account	**-172**	**-68**	**-127**	**-62**	**-108**	**-138**	**-140**	**-139**	**-134**
Trade balance	-500	-468	-455	-434	-501	-534	-567	-602	-638
Exports, f.o.b.	136	140	192	135	127	141	155	171	185
Imports, f.o.b.	636	608	647	569	628	674	722	773	823
Consumer goods	211	209	211	216	221	233	247	262	278
Intermediate goods	122	112	128	128	131	138	146	155	164
Capital goods	124	59	101	77	79	85	90	97	105
Others (including fuel)	179	228	206	148	174	200	221	241	263
Fuel	85	114	89	69	90	108	120	131	142
Services (net)	185	248	198	191	204	222	238	256	274
Receipt	477	515	482	473	509	543	580	619	665
Of which: tourism	307	333	291	301	329	354	380	409	440
Payment	292	267	284	282	305	322	342	363	390
Primary Income (net)	-58	-49	-70	-52	-61	-64	-66	-68	-70
Of which: interest on public debt	-10	-13	-14	-16	-16	-17	-17	-18	-18
Secondary Income (net)	202	201	200	233	249	238	254	275	299
General Government	46	43	42	53	57	28	25	24	24
Other Sectors	156	158	158	180	192	210	230	252	276
Capital account	**10**	**5**	**6**	**17**	**4**	**5**	**5**	**5**	**5**
Of which: Grants	10	4	5	16	4	5	5	5	5
Financial account[1]	**-167**	**-94**	**-98**	**-87**	**-104**	**-133**	**-135**	**-134**	**-129**
Foreign direct investment	-52	-49	-95	-85	-88	-94	-103	-118	-134
Portfolio investment	15	20	18	3	0	0	0	0	0
Other investment	-167	-117	-92	-37	-46	-60	-44	-24	9
Net acquisition of financial assets	60	102	-63	48	18	13	10	7	4
Net incurrence of liabilities	227	219	29	85	64	74	54	31	-5
Monetary authority	-6	-2	-2	0	-1	0	0	0	0
Central government	156	155	143	96	74	80	60	37	-6
Disbursements	172	171	162	100	99	108	92	73	41
Amortization	-16	-16	-18	-23	-25	-28	-32	-36	-47
Exceptional financing	0	0	0	18	0	0	0	0	0
Commercial banks	65	69	-75	4	5	5	5	5	5
Non-bank flows	11	-3	-37	-15	-13	-11	-11	-11	-4
Central government	-156	-155	-143	-96	-74	-80	-60	-37	6
Disbursements	-172	-171	-162	-100	-99	-108	-92	-73	-41
Amortization	16	16	18	23	25	28	32	36	47
Other investment, non-central government	-11	38	51	59	27	20	16	13	3
Monetary authority	6	2	2	0	1	0	0	0	0
Commercial banks	3	29	-6	21	-9	-10	-10	-10	-10
Non-bank flows	-20	7	55	38	36	29	26	23	13
Reserve assets (+ accumulation)	37	51	71	32	31	22	12	9	-4
Errors and omissions[2]	**-5**	**-31**	**23**	**-41**	**0**	**0**	**0**	**0**	**0**
Overall balance	**37**	**51**	**71**	**32**	**31**	**22**	**12**	**9**	**-4**
Memorandum items:									
Current account (incl. official transfers, percent of GDP)	-12.6	-4.9	-9.0	-4.3	-7.2	-8.8	-8.4	-7.9	-7.1
Current account (excl. official transfers, percent of GDP)	-16.0	-7.9	-12.0	-8.0	-11.1	-10.6	-9.9	-9.2	-8.4
Overall balance (percent of GDP)	2.7	3.6	5.0	2.2	2.1	1.4	0.7	0.5	-0.2
Gross international reserves	299	347	420	453	484	506	517	526	522
Months of current year's imports of goods and services	3.9	4.8	5.4	6.4	6.2	6.1	5.8	5.6	5.2
Months of next year's imports of goods and services	4.1	4.5	5.9	5.8	5.8	5.7	5.5	5.2	5.2
External public debt	929	1,092	1,247	1,401	1,465	1,542	1,599	1,626	1,619
External aid (grants and loans, percent of GDP)	16.7	15.6	14.7	11.7	10.8	9.0	7.3	5.8	3.7

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

[1] Including international reserves and exceptional financing.

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

Table 3a. Cabo Verde: Statement of Operations of the Central Government, 2012–20[1]

(Millions of Cabo Verde Escudos)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Est.			Proj.		
Revenue	**36,688**	**37,646**	**35,327**	**41,827**	**45,108**	**44,947**	**47,725**	**50,767**	**53,794**
Taxes	27,573	28,089	27,061	30,252	31,179	33,655	36,322	38,972	41,440
Taxes on income and profit	8,616	8,551	7,747	9,561	10,263	11,188	12,100	12,985	13,796
Taxes on goods and services	12,446	13,171	12,833	14,038	14,865	15,987	17,291	18,555	19,714
Taxes on international trade	5,778	5,700	5,754	6,082	5,431	5,798	6,192	6,639	7,088
Other taxes	734	668	726	572	620	683	739	793	842
Grants	4,203	3,791	2,787	3,841	6,332	3,125	2,747	2,600	2,636
Other revenue	4,913	5,766	5,480	7,733	7,596	8,166	8,657	9,195	9,718
Of which: Fees and penalties	332	550	706	404	432	467	495	526	559
Expenditure	**52,151**	**51,332**	**47,083**	**48,415**	**50,492**	**50,044**	**51,127**	**54,619**	**53,785**
Current expenditure	**34,409**	**35,669**	**37,542**	**41,040**	**43,457**	**43,117**	**45,192**	**46,807**	**49,713**
Compensation of employees	15,886	16,479	17,172	17,814	19,880	18,460	19,450	20,219	21,482
Use of goods and services	4,995	4,737	5,744	7,128	7,283	7,176	7,249	7,393	7,900
Interest	2,858	3,426	3,444	4,134	4,261	4,701	4,945	5,151	5,287
Subsidies	274	101	107	161	246	207	207	207	219
Current transfers	4,057	4,072	4,389	4,753	4,586	4,877	5,176	5,512	5,827
Social benefits	3,918	4,136	4,348	4,729	4,764	5,055	5,362	5,629	6,057
Other expense	2,421	2,719	2,339	2,321	2,438	2,642	2,804	2,697	2,940
Net acquisition of nonfinancial assets	**17,742**	**15,663**	**9,541**	**7,375**	**7,035**	**6,926**	**5,935**	**7,812**	**4,072**
Primary balance	**-12,605**	**-10,260**	**-8,312**	**-2,454**	**-1,123**	**-396**	**1,543**	**1,299**	**5,297**
Overall balance	**-15,463**	**-13,687**	**-11,756**	**-6,588**	**-5,384**	**-5,097**	**-3,402**	**-3,852**	**9**
Net other liabilities	**-6,645**	**-7,718**	**-5,036**	**-7,113**	**-7,472**	**-7,050**	**-6,823**	**-3,657**	**-2,025**
Of which: Onlending	-5,601	-7,171	-4,908	-5,670	-5,378	-5,960	-5,731	-2,574	-952
Of which: Capitalization	-1,044	-546	-128	-1,443	-2,502	-1,108	-1,091	-1,082	-1,072
Net errors and omissions	**-473**	**135**	**-150**	**-532**	**0**	**0**	**0**	**0**	**0**
Total financing (incl. onlending and capitalization)	**21,636**	**21,539**	**16,642**	**13,170**	**12,856**	**12,147**	**10,224**	**7,509**	**2,015**
Net domestic credit	**3,908**	**1,710**	**1,037**	**2,528**	**4,743**	**3,335**	**3,640**	**3,409**	**2,677**
Net external financing	**17,728**	**19,722**	**15,605**	**10,642**	**8,113**	**8,812**	**6,584**	**4,099**	**-661**
Memorandum items:									
Net foreign borrowing (incl. onlending)	17,728	19,722	15,605	10,642	8,113	8,812	6,584	4,099	-661
Net acquisition of nonfinancial assets (incl. onlending)	23,343	22,834	14,448	13,045	12,413	12,886	11,666	10,386	5,025
Of which: externally financed	13,517	18,339	12,743	8,323	7,032	7,614	5,731	2,574	952

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.

Table 3b. Cabo Verde: Statement of Operations of the Central Government, 2012–20[1]

(Percentage of GDP)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Est.			Proj.		
Revenue	**24.4**	**24.5**	**22.6**	**26.2**	**27.4**	**26.0**	**26.0**	**26.1**	**26.0**
Taxes	18.3	18.3	17.3	19.0	18.9	19.5	19.8	20.0	20.0
Taxes on income and profit	5.7	5.6	5.0	6.0	6.2	6.5	6.6	6.7	6.7
Taxes on goods and services	8.3	8.6	8.2	8.8	9.0	9.3	9.4	9.5	9.5
Taxes on international trade	3.8	3.7	3.7	3.8	3.3	3.4	3.4	3.4	3.4
Other taxes	0.5	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Grants	2.8	2.5	1.8	2.4	3.8	1.8	1.5	1.3	1.3
Other revenue	3.3	3.8	3.5	4.9	4.6	4.7	4.7	4.7	4.7
Of which: Fees and penalties	0.2	0.4	0.5	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	**34.7**	**33.4**	**30.1**	**30.4**	**30.7**	**29.0**	**27.9**	**28.1**	**26.0**
Expense	22.9	23.2	24.0	25.7	26.4	25.0	24.7	24.0	24.0
Compensation of employees	10.6	10.7	11.0	11.2	12.1	10.7	10.6	10.4	10.4
Use of goods and services	3.3	3.1	3.7	4.5	4.4	4.2	4.0	3.8	3.8
Interest	1.9	2.2	2.2	2.6	2.6	2.7	2.7	2.6	2.6
Subsidies	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Current transfers	2.7	2.6	2.8	3.0	2.8	2.8	2.8	2.8	2.8
Social benefits	2.6	2.7	2.8	3.0	2.9	2.9	2.9	2.9	2.9
Other expense	1.6	1.8	1.5	1.5	1.5	1.5	1.5	1.4	1.4
Net acquisition of nonfinancial assets	11.8	10.2	6.1	4.6	4.3	4.0	3.2	4.0	2.0
Primary balance	**-8.4**	**-6.7**	**-5.3**	**-1.5**	**-0.7**	**-0.2**	**0.8**	**0.7**	**2.6**
Overall balance	**-10.3**	**-8.9**	**-7.5**	**-4.1**	**-3.3**	**-3.0**	**-1.9**	**-2.0**	**0.0**
Net other liabilities	**-4.4**	**-5.0**	**-3.2**	**-4.5**	**-4.5**	**-4.1**	**-3.7**	**-1.9**	**-1.0**
Of which: Onlending	**-3.7**	**-4.7**	**-3.1**	**-3.6**	**-3.3**	**-3.4**	**-3.1**	**-1.3**	**-0.5**
Of which: Capitalization	**-0.7**	**-0.4**	**-0.1**	**-0.9**	**-1.5**	**-0.6**	**-0.6**	**-0.6**	**-0.5**
Net errors and omissions	**-0.3**	**0.1**	**-0.1**	**-0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Total financing (incl. onlending and capitalization)	**14.4**	**14.0**	**10.6**	**8.3**	**7.8**	**7.0**	**5.6**	**3.9**	**1.0**
Net domestic credit	2.6	1.1	0.7	1.6	2.9	1.9	2.0	1.8	1.3
Net external financing	11.8	12.8	10.0	6.7	4.9	5.1	3.6	2.1	-0.3
Memorandum items:									
Net foreign borrowing (incl. onlending)	11.8	12.8	10.0	6.7	4.9	5.1	3.6	2.1	-0.3
Net acquisition of nonfinancial assets (incl. onlending)	15.5	14.9	9.2	8.2	7.5	7.5	6.4	5.3	2.4
Of which: externally financed	9.0	11.9	8.1	5.2	4.3	4.4	3.1	1.3	0.5
GDP at current market prices (billions of CVEsc)	150.4	153.7	156.4	159.4	164.7	172.8	183.2	194.7	206.8

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.

Table 4. Cabo Verde: Monetary Survey, 2012–20

(Millions of Cabo Verde Escudos, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Est.			Proj.		
Net foreign assets	25,375	33,541	42,698	48,463	51,927	54,304	55,573	56,576	56,134
Foreign assets	52,696	67,769	68,917	75,880	79,806	82,715	84,526	86,080	86,202
Of which: gross international reserves	32,976	38,312	46,277	49,979	53,386	55,767	57,039	58,044	57,604
Foreign liabilities	-27,320	-34,228	-26,219	-27,417	-27,879	-28,410	-28,952	-29,504	-30,068
Net domestic assets	98,031	103,950	104,970	108,466	114,121	121,766	131,088	141,489	153,982
Net domestic credit	123,976	128,399	130,745	133,196	138,787	146,401	155,637	165,982	178,502
Net claims on general government (net)	25,705	28,328	31,706	31,502	33,949	35,744	37,736	39,632	41,121
Investment in TCMFs [1]	11,499	11,691	11,772	11,636	11,636	11,636	11,636	11,636	11,636
Net claims on the central government	13,779	15,981	18,828	19,353	21,724	23,392	25,212	26,917	28,202
Credit to central government	19,848	22,944	27,838	29,299	31,999	34,173	36,643	39,063	41,106
Deposits of central government	-6,069	-6,962	-9,010	-9,946	-10,275	-10,781	-11,432	-12,146	-12,905
Of which: project deposits	-21	-29	-41	-47	-277	-277	-277	-277	-277
Net claims on local government and other agencies [2]	426	656	1,106	514	589	717	889	1,080	1,284
Credit to the economy	98,271	100,070	99,040	101,694	104,838	110,657	117,900	126,350	137,381
Other items (net)	-25,944	-24,449	-25,775	-24,730	-24,666	-24,635	-24,548	-24,493	-24,520
Broad money (M2)	123,407	137,491	147,668	156,929	166,048	176,070	186,661	198,065	210,116
Narrow money (M1)	45,648	52,763	59,595	62,413	66,040	70,026	74,238	78,774	83,567
Currency outside banks	7,895	8,005	8,658	8,967	9,365	9,818	10,303	10,831	11,490
Demand deposits	37,753	44,758	50,938	53,446	56,675	60,208	63,936	67,943	72,077
Quasi-money	73,067	80,175	84,918	90,484	95,741	101,520	107,627	114,202	121,150
Foreign currency deposits	4,692	4,552	3,154	4,032	4,266	4,524	4,796	5,089	5,399
(Change in percent of broad money, 12 months earlier)									
Net foreign assets	4.6	6.6	6.7	3.9	2.2	1.4	0.7	0.5	-0.2
Net domestic assets	1.7	4.8	0.7	2.4	3.6	4.6	5.3	5.6	6.3
Net domestic credit	3.2	3.6	1.7	1.7	3.6	4.6	5.2	5.5	6.3
Net claims on the central government	3.3	1.8	2.1	0.4	1.5	1.0	1.0	0.9	0.6
Credit to the economy [3]	-0.1	1.5	-0.7	1.8	2.0	3.5	4.1	4.5	5.6
Other items (net)	-1.5	1.2	-1.0	0.7	0.0	0.0	0.0	0.0	0.0
Broad money (M2)	6.3	11.4	7.4	6.3	5.8	6.0	6.0	6.1	6.1
Memorandum items:									
Emigrant deposits	45,454	49,070	52,779	56,943	60,272	63,930	67,793	71,952	76,330
Emigrant deposits/total deposits (percent)	39.3	37.9	38.0	38.5	38.5	38.5	38.4	38.4	38.4
Excess reserves/total deposits (percent)	1.7	3.9	7.2	…	…	…	…	…	…
Money multiplier (M2/M0)	3.8	3.6	3.2	3.4	3.5	3.6	3.7	3.8	3.8
Credit to the economy (percent change) [3]	-0.1	1.8	-1.0	2.7	3.1	5.5	6.5	7.2	8.7
Broad money (M2 in percent of GDP)	82.1	89.4	94.4	98.4	100.8	101.9	101.9	101.7	101.6

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 5. Cabo Verde: Financial Soundness of the Banking Sector

(End-year, percent unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	Jun-16
Capital adequacy							
Regulatory capital to risk-weighted assets	15.3	13.9	14.2	15.1	15.6	16.1	14.8
Regulatory Tier 1 capital to risk-weighted assets	14.0	13.3	13.9	13.7	14.4	14.8	15.4
Asset quality							
Nonperforming loans to total loans (end year)	8.4	11.8	14.1	16.4	18.7	16.5	16.9
Nonperforming loans net of provisions	2.3	5.1	6.5	7.9	9.6	7.5	7.9
Provisions to nonperforming loans	73.1	57.0	53.7	51.6	48.8	54.4	53.1
Earnings and profitability							
Return on assets	0.7	0.4	0.2	0.3	0.2	0.4	0.1
Return on equity	9.1	5.6	2.7	3.5	3.1	4.8	2.0
Interest margin to gross income	76.1	76.2	75.5	75.3	71.8	73.1	74.8
Noninterest expenses to gross income	59.7	61.3	68.3	68.4	72.5	66.9	70.0
Liquidity[1]							
Liquid assets to total assets	8.1	7.1	15.0	22.1	19.9	21.9	23.4
Liquid assets to short-term liabilities	10.5	9.7	21.1	29.0	24.4	26.8	28.4
Additional indicators							
Government deposits over total deposits	9.5	7.6	9.7	11.4	13.5	12.6	13.5
Emigrant deposits over total deposits	35.0	37.1	37.1	33.4	32.9	33.3	32.9
Emigrant deposits over total assets	27.3	27.0	26.5	25.4	26.7	27.3	27.1
Demand deposits over total deposits	42.6	43.4	42.0	45.5	43.2	42.8	44.2
Total credit over total deposits	79.2	85.9	79.0	67.4	61.5	59.5	56.7
Personnel cost over cost of operations	55.0	55.8	56.1	55.3	54.8	56.6	59.0
Spread (90 day lending - time deposit rate)	7.5	5.2	7.9	7.1	7.1	8.3	3.9
Spread (average lending - time deposit rate)	7.2	5.2	6.7	6.5	6.9	7.6	7.3
Spread (emigrant deposits - euro area deposit rate)	2.2	1.8	1.4	2.6	3.0	3.4	3.3

Source: Bank of Cabo Verde.

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

* based on IFRS definition

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	**Done**
• Enhance credit risk assessment framework	Short term	**Done**
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	**Done**
Enhancing banking supervision		
• Improve supervision of onshore and offshore banks	Short term	**Done**
• Improve the legislative and regulatory framework for supervision	Short term	**Done**
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	**Done**
• Assess desirability of instituting system of deposit insurance, taking into account costs, benefits, and structure of the financial system	medium 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	**Done**
• 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	**Done**
• Allow wider secondary market trading in BCV securities	Short term	In process
• 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
Pension and insurance		
• Strengthen the governance and transparency of the INPS	Short term	**Done**
• Evaluate additional parametric reforms to the INPS to ensure long-term viability	Medium term	**Done**
• Evaluate the costs, benefits, and risks of allowing INPS to place part of its assets abroad	Short term	In process
• Consider tax deferral of contributions and investment gains in occupational 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 October 2016.

Table 7. Cabo Verde: Millennium Development Goals

	Cabo Verde								SSA
	1990	**1995**	**2000**	**2005**	**2010**	**2011**	**2012**	**2013**	**2013**
Goal 1: Eradicate extreme poverty and hunger									
Employment to population ratio, 15+, total (%)	*57*	58	59	60	62	62	63	63	65
Employment to population ratio, ages 15–24, total (%)	*55*	54	53	52	53	53	54	54	47
GDP per person employed (constant 1990 PPP $)	..	..	..	..	..	..	..	..	4,035
Income share held by lowest 20%	..	..	*5*	..	..	..	..	..	..
Malnutrition prevalence, weight for age (% of children under 5)	..	*12*	..	..	..	..	..	..	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)	86	..	..	*98*	*99*	..	98	98	*64*
Literacy rate, youth male (% of males ages 15–24)	90	..	..	*96*	*97*	..	98	98	*76*
Persistence to last grade of primary, total (% of cohort)	*33*	*51*	*88*	88	89	..	..	..	*60*
Primary completion rate, total (% of relevant age group)	57	*74*	100	86	100	97	99	95	70
Total enrollment, primary (% net)	99	*99*	99	95	94	95	97	98	*77*
Goal 3: Promote gender equality and empower women									
Proportion of seats held by women in national parliaments (%)	12	*11*	11	11	18	21	21	21	22
Ratio of female to male primary enrollment (%)	97	*97*	96	95	93	92	91	92	93
Ratio of female to male secondary enrollment (%)	107	*97*	*104*	112	120	118	119	116	86
Ratio of female to male tertiary enrollment (%)	..	..	103	108	129	137	139	146	73
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	..	..	39	..	..	..	..	..	..
Goal 4: Reduce child mortality									
Immunization, measles (% of children ages 12–23 months)	79	85	86	92	97	96	91	91	73
Mortality rate, infant (per 1,000 live births)	45	39	32	23	23	23	22	22	60
Mortality rate, under 5 (per 1,000 live births)	58	49	39	28	28	27	27	26	89
Goal 5: Improve maternal health									
Adolescent fertility rate (births per 1,000 women ages 15–19)	..	*106*	99	87	75	73	75	74	106
Births attended by skilled health staff (% of total)	..	54	*89*	78	..	..	..	..	*46*
Contraceptive prevalence (% of women ages 15–49)	*24*	..	*53*	61	..	..	..	..	*22*
Maternal mortality ratio (modeled estimate, per 100,000 live births)	200	200	170	63	58	..	..	..	*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)	175	168	160	153	147	145	144	143	282
Prevalence of HIV, female (% ages 15–24)	..	..	..	0.4	0.3	0.3	0.3	0.3	1.8
Prevalence of HIV, male (% ages 15–24)	..	..	..	0.6	0.7	0.8	0.8	0.8	1.1
Prevalence of HIV, total (% of population ages 15–49)	..	..	...	0.9	1.0	1.0	1.0	1.1	4.6
Tuberculosis case detection rate (%, all forms)	36	46	*41*	40	50	53	59	43	51
Goal 7: Ensure environmental sustainability									
CO2 emissions (kg per PPP $ of GDP)	0	0	0	0	*0*	..	..	..	0
CO2 emissions (metric tons per capita)	0	0	0	1	1	..	..	..	*1*
Forest area (% of land area)	14.4	..	20.3	21.0	21.0	21.0	21.0	21.0	28.0
Improved sanitation facilities (% of population with access)	*35*	37	44	53	62	63	68	70	29
Improved water source (% of population with access)	*80*	80	83	85	88	89	89	91	66
Marine protected areas (% of territorial waters)	0	0	0	0	1	1	1	1	12
Net ODA received per capita (current US$)	302	293	214	339	672	514	498	488	50
Goal 8: Develop a global partnership for development									
Debt service (PPG and IMF only, % of exports, excluding workers' remittances)	9	10	11	10	6	5	5	5	5
Internet users (per 100 people)	0.0	*0.2*	1.8	6.0	30.0	32.0	35.0	38.0	17.0
Mobile cellular subscriptions (per 100 people)	0	0	5	17	76	81	86	100	66
Telephone lines (per 100 people)	2	5	12	15	15	15	14	13	1
Fertility rate, total (births per woman)	5	5	4	3	2	2	2	2	5
Other									
GNI per capita, Atlas method (current US$)	870	1,290	1,330	2,090	3,430	3,570	3,470	3,530	1,674
GNI, Atlas method (current US$) (billions)	0.3	0.5	0.6	1.0	1.7	1.8	1.7	1.8	1,575.1
Gross capital formation (% of GDP)	43.8	41.1	30.7	*36*	48	48	36	36	21
Life expectancy at birth, total (years)	65	67	69	72	74	74	75	75	57
Literacy rate, adult total (% of people ages 15 and above)	63	..	..	*81*	*85*	..	85	*85*	*59*
Population, total (millions)	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5	948
Trade (% of GDP)	86.0	77.5	87.5	104	87	92	87	87	62

Source: World Development Indicators, World Bank.

Figures in italics refer to periods other than those specified.

Table 8. Cabo Verde: Risk Assessment Matrix

Sources of risks	Likelihood of realization in the short to medium term	Impact if realized	Policy response
External (exogenous) risks			
Tighter or more volatile global financial conditions	Medium Sharp rise in risk premia with flight to safety: Investors withdraw from specific risk asset classes as they reassess underlying economic and financial risks in large economies, or respond to unanticipated Fed tightening, and increases in U.S. term premia, with poor market liquidity amplifying volatility. Safe haven currencies—especially the US dollar—surge creates balance sheet strains for FX debtors.	Medium Cabo Verde's tourism real estate sector depends on FDI. Financial market volatility could hamper investment in Cabo Verde and contribute to a delayed recovery.	Strengthen focus on accelerating private sector balance sheet rebuilding to jump-start domestic investment.
Economic fallout from political fragmentation	Medium Protracted uncertainty associated with negotiating post-Brexit arrangements could weigh on confidence and investment more than expected—most prominently in the UK and the rest of Europe with possible knock-on effects elsewhere. Increased barriers could also dampen the longer-run economic performance of affected countries more than expected.	Medium The negative impact of Brexit to the UK and EU economies could reduce the number of tourists visiting Cabo Verde from these countries, hurting tourism and other service industries.	Diversify the tourism base by attracting tourists from countries outside the EU.
Weaker-than-expected global growth	High Structurally weak growth in key advanced and emerging economies: Weak demand, low productivity growth, and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms, leading to lower medium-term path of potential growth (the euro area, Japan, and the United States) and exacerbating legacy financial imbalances especially among banks (the euro area).	Medium/High Prolonged stagnation in Europe 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.	Improve fiscal space to bolster domestic demand through current government spending when it is needed.
Internal (endogenous) risks			
Delays in fiscal consolidation relative to staff advice	Medium While the authorities have committed to contain domestic debt through medium-term fiscal consolidation, there is likely to be some political resistance to a tighter fiscal stance.	Medium Slower than recommended fiscal consolidation under the staff advice scenario could 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 need for fiscal consolidation.	Consider reducing current spending and postponing or canceling select infrastructure projects.

Table 8. Cabo Verde: Risk Assessment Matrix (concluded)

Financial instability	Medium NPLs have risen significantly in the recent years, reflecting the slow economic activity and intensified supervision. Although NPLs as a share of total loans have stabilized in 2015, with the economy still being weak, NPLs could rise further.	Medium The banking system as a whole is fairly well capitalized. Most banks have majority foreign ownership and outside capital would likely be available for recapitalization. However, there is little fiscal space for any public bail-out.	Work with banks to accelerate NPL resolution and increase fiscal space to widen policy options.
Delays in state-owned enterprise reforms relative to staff advice	Medium The authorities have adopted a detailed agenda to reform SOEs. However, implementation could be delayed due to political challenges.	Medium/High Financial weaknesses in some of the largest SOEs represent contingent liabilities for the government. As of end-2015, the debt of SOEs amounted to 38 percent of GDP. Persistent weak financial performance of SOEs could crowd out public investment and threaten fiscal sustainability.	Proceed with structural reforms following the example of Electra, and consider privatization when possible.
Failure to increase productivity	Medium Implementation of needed structural reforms could be delayed due to political concerns, especially in the labor market (where Cabo Verde is particularly uncompetitive)	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.	To crowd-in the private sector, accelerate structural reforms, improve the banking sector's intermediation ability, and improve access to financing.

[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.

Appendix I. External Stability Assessment

The external position in 2015 was broadly consistent with medium-term fundamentals and desirable policy settings, and risks appear low. The real effective exchange rate is broadly aligned with macroeconomic fundamentals. Competitiveness has improved but substantially more progress is needed. Improving the business environment—such as access to financing, inefficient bureaucracy, and labor flexibility—and increasing the productivity of human and physical capital remain critical for bolstering medium- and long-term growth.

A. External Sector Developments

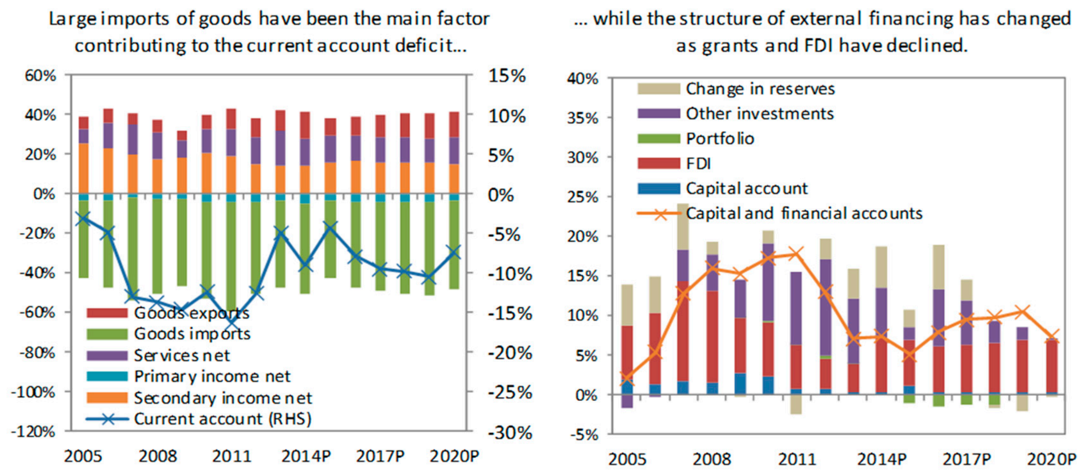
1. **Cabo Verde's balance of payment has been characterised by a current account deficit (about 10 percent over the period 2003–15) fuelled primarily by FDI and government borrowing.** FDI was the main driver of imports until 2008. However, FDI and grants have since declined owing to the euro crisis, and the current account deficit has been increasingly driven by government borrowing to finance investment, leading to a rise in external public debt. Cabo Verde's net international investment position reached minus $235 million in 2015, reflecting the long-term trend of net inward flows of FDI, and thus suggesting that it does not pose a threat to external stability.

2. **The current account deficit fell in 2015 to 4.3 percent of GDP (from 9 percent of GDP in 2014), in part due to a fall in imports and a strong increase in emigrant remittances.** Over the medium term, staff forecasts the current account deficit to widen to about 8 percent of GDP in 2017 owing to strong FDI and recovering growth, and then to gradually improve to around 7 percent of GDP as goods exports continue to grow and the tourism sector recovers.

3. **International reserve coverage is broadly adequate at over 5 months of prospective imports.** The optimal reserve level has previously been estimated in the interval of 3.7–5 months of prospective imports, and an updated assessment using the Fund's LIC/MIC framework estimates it at about 4 months of imports. [1] However, a higher level could be preferable taking into account vulnerabilities stemming from the country's size and lack of export diversification.

[1] IMF Country Report No. 12/29.

Figure 1. Cabo Verde: Balance of Payments Characteristics

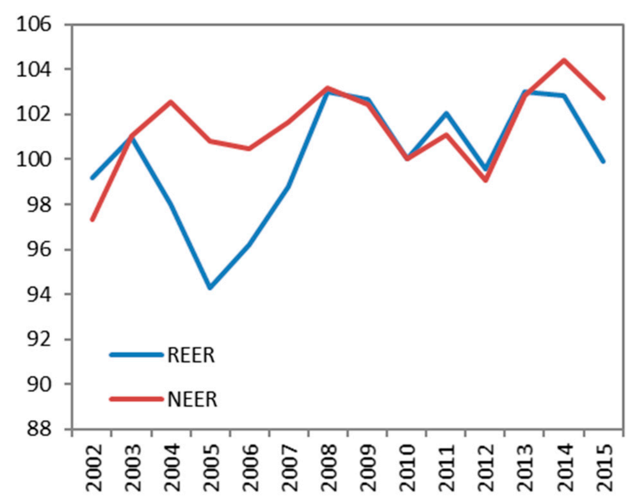


Sources: Cabo Verdean authorities and IMF staff calculations.

B. Model-Based Assessment

4. **Cabo Verde's real exchange rate has been relatively stable over the past decade.** In 2015, the real effective exchange rate (REER) remained in line with the average over the past five years (Figure 2). However, the observed moderate cumulative appreciation over the last decade may signal some erosion in external competitiveness.

Figure 2. Cabo Verde: Real Exchange Rate



5. **Model-based assessments indicate that Cabo Verde's real exchange rate is broadly in line with its fundamentals.** The two complementary assessment models based on the extended External Balance Assessment (EBA-lite) methodology do not indicate significant misalignments of Cabo Verde's real exchange rate. [2] The current account (CA) model of the EBA-lite methodology estimates a CA norm of -7.4 percent of GDP for 2015 against the actual CA balance of -4.3 percent of GDP, implying that Cabo Verde's REER may be undervalued by 8 percent (Table 1). Out of the CA gap of 3.1 percent of GDP, only 0.2 percent of GDP is estimated to be due to policy. The REER index model of the EBA-lite

[2] See IMF Policy Paper "Methodological Note on EBA-Lite", February 2016.

methodology, on the other hand, suggests that Cabo Verde's REER for 2015 may be overvalued by about 4 percent, out of which about -2½ percent is estimated to be related to policy. Although the two assessment models point to opposite directions of REER misalignment, the results are below the 10-percent threshold for the misalignments to be deemed statistically significant.

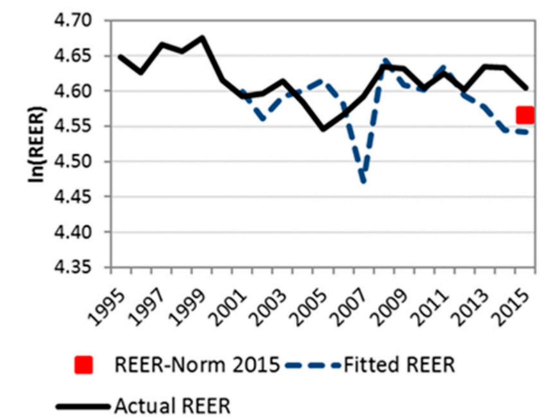
Table 1. Cabo Verde: Results of EBA-Lite Assessment based on the CA Model

(1)	Current account-actual (2015)	-4.3%
(2)	Current account-norm	-7.4%
(3)=(1)-(2)	Current account-gap	3.1%
(4)	Current account-fitted	-7.2%
(5)=(4)-(2)	Policy gap	0.2%
(6)=(1)-(4)	Residual	2.9%
(7)	Elasticity of CA to REER	-0.39
(8)=(3)/(6)	REER misalignment for 2015[1]	-8.0%

Percentage, "+" = overvaluation.

Source: IMF staff estimates.

Figure 3. Cabo Verde: Results of EBA-Lite Assessment based on the REER Index Model



C. Broader Competitiveness Indicators

6. **Cabo Verde's competitiveness has improved, but it still lags behind the middle-income country average**. According to the World Economic Forum (WEF), Cabo Verde ranks 110th out of 138 countries in 2016–17 on global competitiveness, with considerable room for improvement in labour market efficiency, financial market development, business sophistication and innovation. (Table 2) The most problematic factors for doing business in Cabo Verde were suggested to be access to financing, government bureaucracy, tax rates and complexity of the tax system, and restrictive labor regulations. (Figure 4) Structural reforms aimed at improving the business climate therefore remain critical for enhancing competitiveness and attracting private investment.

Table 2. Cabo Verde: Global Competitive Indicators, 2016–17

	2015–16 (Out of 140)	2016–17 (Out of 138)	Change [1]
Overall Rank	112	110	2
Basic requirements (40%)	92	89	3
Institutions	66	71	-5
Infrastructure	94	94	0
Macroeconomic environment	124	107	17
Health and primary education	51	58	-7
Efficiency enhancers (50%)	122	121	1
Higher education and training	81	79	2
Goods and market efficiency	99	97	2
Labor market efficiency	125	116	9
Financial market development	111	112	-1
Technological readiness	77	78	-1
Market size	138	137	1
Innovation and sophistication factors (10%)	104	105	-1
Business sophistication	106	108	-2
Innovation	100	98	2

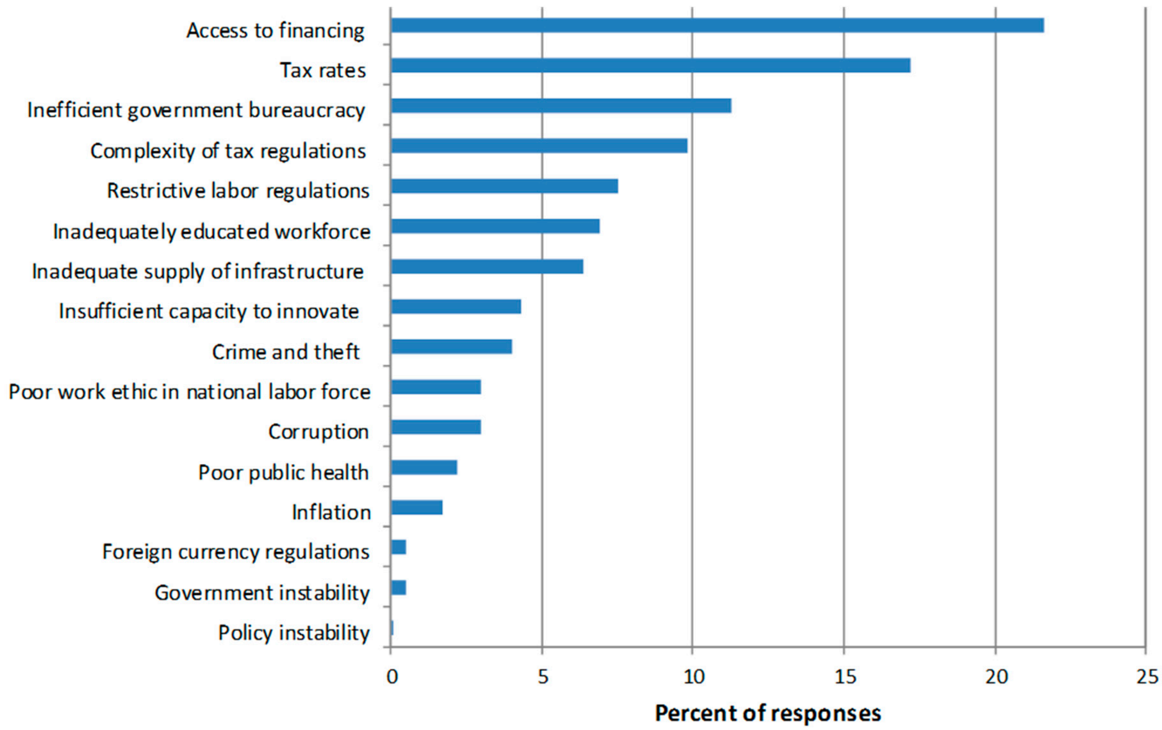
Source: World Economic Forum.

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

D. Conclusion

7. **An assessment of the real effective exchange rate suggests that there is no indication of significant misalignment, but broader indicators show that structural competitiveness issues remain.** Cabo Verde's external competitiveness in the medium and long term will depend crucially on increasing competitiveness and productivity of both human and physical capital. To this end, the government has carried out a large investment program in infrastructure, initiated labour market reforms and is committed to reform weak SOEs. However, more progress is required—particularly in improving the business environment.

Figure 4. Cabo Verde: The Most Problematic Factors for Doing Business, 2016



Source: World Economic Forum.

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INTERNATIONAL MONETARY FUND

CABO VERDE

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

November 3, 2016

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Prepared by
The International Monetary Fund and International Development Association

CONTENTS

Based on the Staff baseline scenario, Cabo Verde's risk of external debt distress rating is assessed as high, up from the moderate rating in the previous DSA. [1] *Total public debt is expected to reach considerably higher levels over the medium term than projected in the previous Debt Sustainability Analysis (DSA). While public debt is high, it is overwhelmingly on highly concessional terms. The assessment of high risk is reinforced by risks stemming from a slower-than-expected growth in the Euro area, rising domestic debt, and contingent financial liabilities related to state-owned enterprises. The authorities have taken important steps to contain the risk of debt distress, including faster fiscal consolidation than envisaged in the Medium-Term Fiscal Framework underlying the 2014 Article IV report, with a particular focus on shifting the execution of some public investment projects to beyond 2018. The debt situation bears careful monitoring in light of growth and exchange rate vulnerabilities.*

BACKGROUND

1. **This DSA reflects official debt stock data for end-2015, and additional information available as of October 2016.** The staff's fiscal projections for 2016–19 (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 the domestic debt contracted directly by state-owned enterprises and local governments that carry a central-government guarantee; at end-2015, this debt was estimated at about 6.1 percent of GDP (preliminary data). Projections for such publicly-guaranteed debt for 2016 and beyond were not available at the time of this assessment.

2. **Private external debt is relatively low.** Private external debt is estimated using non-bank private sector debt data, and balance of payments data on bank liabilities to non-residents. On this basis, private external debt was estimated at around 13 percent of GDP at end-2015. The authorities compile non-bank private sector debt, but there is need for a more systematic monitoring of the repayment flows.

3. **Total public debt in Cabo Verde continued to increase in 2015 as a result of the Public Investment Program (PIP).** The stock of public debt increased markedly from about 114.5 percent of GDP in 2014 to an estimated 125.8 percent of GDP at end-2015, driven primarily by external debt accumulation to finance the scaling-up of infrastructure. However, low growth, declining prices and the appreciation of the U.S. dollar have also contributed significantly to the increase in the debt ratio.

Text Table 1. Cabo Verde: Stock of Total Public Debt at End-Year, 2005–15

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
	(Percent of GDP)										
External debt	49.6	46.2	39.9	38.4	43.9	50.7	57.2	68.1	78.3	87.9	96.9
Domestic debt	35.7	31.7	24.7	19.1	21.3	21.7	21.6	23.0	24.2	26.6	28.9
Total public deb	85.3	77.9	64.6	57.4	65.2	72.4	78.8	91.1	102.5	114.5	125.8

Sources: Cabo Verdean authorities and IMF staff calculations.

[1] Cabo Verde's three-year average CPIA score is 3.9, making the country a strong policy performer.

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—including commercial debt, which is subsidized by Portugal—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, 2015

	Percent of Total External Debt	Average Grace Period	Average Amortization Period	Average Interest Rate
Multilateral	47	9	32	0.9%
Bilateral	23	8	19	1.1%
Commercial	30	9	20	1.6%

Sources: Cabo Verdean authorities and IMF staff estimates.

5. Cabo Verde's domestic public debt has risen lately, but its structure and maturity remain favorable. The government's ability to finance the PIP through concessional external loans has helped keep domestic debt at about 29 percent of GDP at end-2015. Moreover, the authorities strive to limit domestic financing of the deficit to 3 percent of GDP per year. At end-2015 the National Pension Fund held about 43 percent of domestic debt, and the rest was held by the banking system. Treasury bonds make up about 96 percent of domestic debt. The average maturity of domestic debt at end-2014 was about 7 years and the average interest rate was 5.7 percent. Domestic debt is projected to increase gradually, peaking at about 38 percent in 2029 before declining to 35 percent in 2036, while external debt is repaid and net foreign borrowing remains low.

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 3.9 (on a scale of 1 to 6) during 2013–15. Based on its 2015 CPIA score, Cabo Verde ranks second among IDA-recipient countries in the sub-Saharan African (SSA) region. The corresponding external public debt burden thresholds for high risk are shown in Text Table 3.

Text Table 3. External Public Debt Thresholds for High Risk 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

Sources: Cabo Verdean authorities and IMF staff estimates.

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 2014 Article IV Consultation** (Text Table 4 and Box 1). While the current baseline scenario still assumes a rebound of economic activity in the medium term, the growth forecast for 2016–20 is overall lower than in the previous DSA owing to the shifting of some public investment projects into later years. The GDP deflator is projected slightly lower, reflecting the low inflation in the country and in the Euro area. The baseline scenario also assumes a different profile of fiscal consolidation, reflecting the most recent MTFF. The current account deficit is also projected slightly higher, reflecting the large pipeline of FDI for the next few years. Most importantly, the exchange rate depreciation versus the dollar of about 30 percent at end-2015 is carried forward in the projections, contributing significantly to the increase in the PV of debt.

Text Table 4. Cabo Verde: Assumptions for Key Economic Indicators, 2015–20

(Percent of GDP)

	2015	2016	2017	2018	2019	2020
Real GDP growth						
Current DSA	1.5	3.2	3.7	4.1	4.1	4.1
2014 Article IV DSA	3.5	4.0	4.0	4.0	4.0	4.0
GDP Deflator						
Current DSA	0.5	0.1	1.2	1.8	2.0	2.0
2014 Article IV DSA	2.5	2.5	2.5	2.5	2.5	2.5
Fiscal balance (including grants)						
Current DSA	-4.1	-3.3	-3.0	-1.9	-2.0	0.0
2014 Article IV DSA	-6.5	-5.7	-4.6	-0.5	-1.3	-2.5
Overall financing needs (including onlending)						
Current DSA	8.3	7.8	7.0	5.6	3.9	1.0
2014 Article IV DSA	10.4	8.9	6.9	1.5	1.3	2.5
Current account deficit (including grants)						
Current DSA	-4.3	-7.2	-8.8	-8.4	-7.9	-7.1
2014 Article IV DSA	-10.8	-10.9	-9.2	-7.2	-5.2	-5.2
Cv$/USD exchange rate (e-o-y)						
Current DSA	101.4	100.7	100.5	100.3	99.7	99.6
2014 Article IV DSA	78.2	76.8	75.5	74.5	73.8	73.8

Sources: Cabo Verdean authorities and IMF staff estimates.

Box 1. Cabo Verde: Macroeconomic Assumptions of the Baseline Scenario, 2016–36

Real GDP growth is expected to pick up after the slowdown in 2012–15, and settle at about 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 PIP and from structural reforms. In addition, medium-term growth projections take into account the impact of PIP containment on the economy over 2015–17, as well as the postponement of several projects to 2018–20 and beyond.

Fiscal policy. In the medium term (2015–20), the fiscal deficit and overall financing needs are expected to decline by 4.1 and 5.9 percent of GDP, respectively, in line with the latest MTFF. 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 (2019–36), with fiscal consolidation complete and onlending coming to an end, net financing needs are projected to stay below 2 percent of GDP per year.

The non-interest current account deficit is projected to widen in 2016–19 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 and the GDP deflator are projected not to exceed 2 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.

DEBT SUSTAINABILITY ANALYSIS

E. External Public Debt

8. **Under the staff baseline scenario, the PV of external debt to GDP breaches the 50 percent threshold significantly.** The PV of public and publicly guaranteed (PPG) external debt is expected to peak at 64.4 percent of GDP in 2017, gradually decreasing to below 50 percent by 2023 (Figure 1). The debt service indicators remain safely below the threshold throughout 2036.

9. **Cabo Verde's ability to service its debt is most sensitive to a growth slowdown (embedded in the historical scenario) and a one-time depreciation shock.** The PV of the debt-to-exports and debt-to-revenue ratio, and the debt service to revenue ratio would breach the threshold under the historical growth scenario. The PV of the debt-to-revenue ratio would breach the threshold under a bound test that entails a 30 percent nominal depreciation shock in 2016, and so would the debt-service-to-revenue ratio (Table 1b, scenario B6). Debt service rises over the medium term owing to the grace period ending for several loans, but remains sustainable and considerably below the threshold in the baseline scenario throughout the projection period.

F. Total Public Debt

10. Total public debt peaks at about 130 percent, and its present value at 96.1 percent of GDP in 2017, and declines gradually over the projection period (Table 2a, Figure 2). The PV of total public debt exceeds the 74 percent benchmark and remains above it until 2028. Furthermore, the debt outlook is vulnerable to a prolonged economic slowdown; developments in the Euro zone, 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 12 percent of GDP in 2015, 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 2013–15, TACV's financial circumstances and the situation at IFH have deteriorated sharply.

11. 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 real growth and the primary balance at historical averages. However, a primary balance as high as that over the past decade seems unlikely, given that the primary balance over 2005–14 reflects a temporarily high level of public investment.

12. Public debt sustainability is also vulnerable to contingent liabilities associated with the debt of state-owned enterprises (SOEs). At end-2015 (preliminary data), SOE-related contingent liabilities amounted to 25 percent of GDP, up from 9 percent of GDP in 2014. If the financial situation of SOEs were to deteriorate to such an extent that the central government had to take on all of this debt (and respect the 3 percent limit on domestic financing), debt sustainability would be further jeopardized, the serviceability of public debt would be put under significant strain.

G. Comparison with the Previous Debt Sustainability Analysis

13. The PV of external debt does breach the threshold under the staff baseline scenario—which was not the case in the previous DSA—and public debt peaks at a higher level. In the previous DSA, the PV of external debt to GDP in 2015 was 48.5, and in the current DSA it increases to 61.8, breaching the 50 percent threshold. While the debt profile has deteriorated owing to lower than expected nominal GDP and a strong appreciation of the U.S. Dollar, the authorities PIP containment measures were crucial in curbing the PV of external debt to GDP. In addition, while in the previous DSA public debt peaked at 108 percent of GDP (in 2016), in the current DSA it reaches 130 percent in 2017.

H. The Authorities' Views

14. The authorities broadly concurred with the results of the DSA. They noted, however, that although the external debt level is high, the public investment scaling up that contributed to it should help increase potential growth and boost revenue in the long term. In addition, the authorities remarked that while the PV of external debt is high, the debt service indicators remain comfortably below the threshold in the baseline scenario.

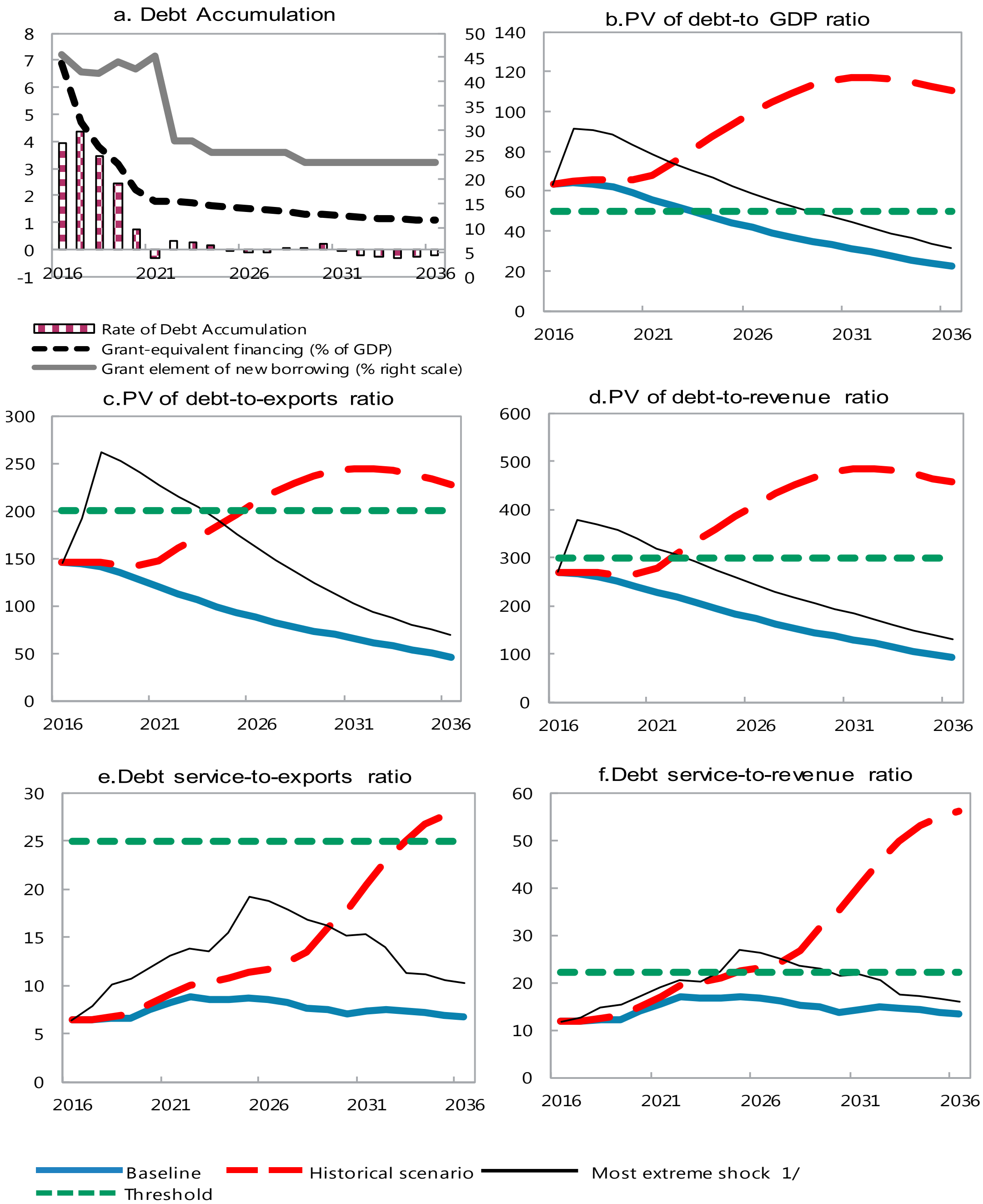
DEBT DISTRESS CLASSIFICATION

15. Based on the external debt burden indicators, the current DSA finds that the risk of debt distress is high but Cabo Verde retains its capability to service its debt. The PV of external debt to GDP threshold is breached over the 20-year projection period under the baseline scenario, and the breach is significant. [2] Furthermore, debt sustainability remains sensitive to a depreciation shock. However, the debt service indicators are comfortably below their respective thresholds.

16. The authorities should stay the course on their fiscal consolidation which should help set the country on the path to moderate risk of debt distress by 2023. Broadly in line with staff advice, the authorities have embarked on a fiscal consolidation driven in large part by a reduction in externally financed capital spending. The fiscal adjustment envisioned is realistic, and necessary to give a strong message of fiscal responsibility to development partners and investors.,

[2] Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries, International Monetary Fund, November 2013.

Figure 1. Cabo Verde: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2016–36 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. 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 Combination shock

Table 1a. Cabo Verde: External Debt Sustainability Framework, Baseline Scenario, 2013–36 1/

(Percent of GDP, unless otherwise indicated)

	Actual			Historical [6/] Average	Standard [6/] Deviation	Projections									
	2013	2014	2015			2016	2017	2018	2019	2020	2021	2016-2021 Average	2026	2036	2022-2036 Average
External debt (nominal) 1/	**99.8**	**101.3**	**109.8**			**110.2**	**109.3**	**105.9**	**101.1**	**94.6**	**87.2**		**60.7**	**28.4**	
of which: public and publicly guaranteed (PPG)	78.3	87.9	96.9			98.1	98.4	96.2	92.1	86.3	79.7		55.6	26.9	
Change in external debt	6.4	1.4	8.5			0.4	-0.9	-3.4	-4.8	-6.5	-7.4		-4.6	-3.5	
Identified net debt-creating flows	-3.7	0.4	16.4			-1.4	-0.4	-0.7	-0.3	-3.1	-6.7		-10.3	-6.8	
Non-interest current account deficit	**2.8**	**6.1**	**2.2**	**7.9**	**4.4**	**4.9**	**6.5**	**6.8**	**7.5**	**4.5**	**0.3**		**-4.2**	**-3.7**	-4.1
Deficit in balance of goods and services	15.8	18.1	16.8			20.2	21.0	21.8	22.4	18.8	14.2		7.9	5.8	
Exports	47.0	47.5	42.0			43.6	44.9	45.5	45.9	46.2	46.2		47.6	48.4	
Imports	62.8	65.6	58.8			63.8	65.9	67.2	68.3	65.0	60.4		55.5	54.1	
Net current transfers (negative = inflow)	-14.4	-14.1	-16.1	-17.8	3.0	-16.4	-15.7	-16.0	-15.8	-15.1	-14.6		-12.4	-9.0	-11.4
of which: official	-3.1	-3.0	-3.7			-2.1	-1.4	-1.3	-1.2	-1.2	-1.1		-0.8	-0.4	
Other current account flows (negative = net inflow)	1.4	2.0	1.5			1.2	1.1	1.0	0.9	0.8	0.7		0.3	-0.4	
Net FDI (negative = inflow)	**-3.5**	**-6.7**	**-5.7**	**-7.2**	**3.0**	**-5.9**	**-6.0**	**-6.1**	**-6.7**	**-6.6**	**-6.2**		**-6.2**	**-4.1**	-5.0
Endogenous debt dynamics 2/	**-2.9**	**1.0**	**19.9**			**-0.5**	**-0.9**	**-1.3**	**-1.2**	**-1.0**	**-0.8**		**0.2**	**0.9**	
Contribution from nominal interest rate	2.1	2.8	2.2			3.0	3.0	3.0	2.9	2.9	2.8		2.6	2.1	
Contribution from real GDP growth	-0.7	-1.8	-1.7			-3.5	-3.9	-4.3	-4.1	-3.9	-3.6		-2.5	-1.2	
Contribution from price and exchange rate changes	-4.3	0.0	19.4			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**10.1**	**1.1**	**-7.9**			**1.9**	**-0.5**	**-2.7**	**-4.5**	**-3.4**	**-0.6**		**5.6**	**3.3**	
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/	...	...	74.7			75.4	75.2	73.5	71.0	67.3	62.8		46.7	23.7	
In percent of exports	...	...	177.9			172.9	167.6	161.7	154.6	145.6	136.1		98.2	49.1	
PV of PPG external debt	**...**	**...**	**61.8**			**63.3**	**64.4**	**63.8**	**62.0**	**59.0**	**55.2**		**41.6**	**22.3**	
In percent of exports	**...**	**...**	**147.2**			**145.1**	**143.4**	**140.4**	**135.0**	**127.7**	**119.7**		**87.5**	**46.0**	
In percent of government revenues	**...**	**...**	**259.5**			**268.9**	**265.9**	**260.0**	**250.5**	**238.5**	**225.4**		**171.7**	**92.0**	
Debt service-to-exports ratio (in percent)	**7.0**	**8.8**	**8.7**			**10.5**	**10.6**	**10.8**	**10.8**	**11.7**	**12.5**		**12.7**	**10.3**	
PPG debt service-to-exports ratio (in percent)	**5.1**	**4.8**	**6.3**			**6.3**	**6.4**	**6.6**	**6.6**	**7.4**	**8.2**		**8.5**	**6.7**	
PPG debt service-to-revenue ratio (in percent)	**10.9**	**10.9**	**11.1**			**11.8**	**11.8**	**12.2**	**12.2**	**13.9**	**15.4**		**16.7**	**13.3**	
Total gross financing need (Billions of U.S. dollars)	0.0	0.1	0.0			0.1	0.1	0.1	0.1	0.1	0.0		-0.1	-0.1	
Non-interest current account deficit that stabilizes debt ratio	-3.7	4.7	-6.3			4.5	7.4	10.2	12.3	11.0	7.7		0.4	-0.2	
Key macroeconomic assumptions															
Real GDP growth (in percent)	0.8	1.9	1.5	3.4	3.7	3.2	3.7	4.1	4.1	4.1	4.1	3.9	4.0	4.0	4.0
GDP deflator in US dollar terms (change in percent)	4.8	0.0	-16.1	0.9	8.8	-1.6	1.8	1.9	2.4	2.6	2.0	1.5	2.0	2.0	2.0
Effective interest rate (percent) 5/	2.3	2.8	1.9	3.8	1.2	2.7	2.8	2.9	3.0	3.1	3.2	2.9	4.3	7.1	5.1
Growth of exports of G&S (US dollar terms, in percent)	10.5	2.8	-24.7	8.1	19.4	5.4	8.6	7.4	7.8	7.5	6.1	7.1	6.2	6.3	6.4
Growth of imports of G&S (US dollar terms, in percent)	-2.5	6.4	-23.7	5.4	18.2	10.1	9.1	8.2	8.3	1.6	-1.3	6.0	5.6	6.0	5.3
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	45.5	41.9	41.8	44.2	42.6	45.3	43.6	25.6	23.5	24.8
Government revenues (excluding grants, in percent of GDP)	22.0	20.8	23.8			23.5	24.2	24.5	24.7	24.7	24.5		24.2	24.2	24.2
Aid flows (in Billions of US dollars) 7/	0.3	0.2	0.1			0.2	0.1	0.1	0.1	0.1	0.1		0.0	0.0	
of which: Grants	0.0	0.0	0.0			0.1	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
of which: Concessional loans	0.2	0.2	0.1			0.1	0.1	0.1	0.1	0.0	0.0		0.0	0.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			6.9	4.7	3.8	3.2	2.2	1.8		1.5	1.1	1.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			65.5	54.0	54.2	57.8	63.9	71.3		45.0	36.1	42.1
Memorandum items:															
Nominal GDP (Billions of US dollars)	1.9	1.9	1.6			1.6	1.7	1.8	1.9	2.1	2.2		3.0	5.4	
Nominal dollar GDP growth	5.7	1.8	-14.9			1.5	5.6	6.1	6.7	6.8	6.2	5.5	6.1	6.1	6.1
PV of PPG external debt (in Billions of US dollars)			1.0			1.0	1.1	1.2	1.2	1.2	1.2		1.2	1.2	
(PVt-PVt-1)/GDPt-1 (in percent)						3.9	4.4	3.5	2.4	0.8	-0.3	2.4	-0.1	-0.2	0.0
Gross workers' remittances (Billions of US dollars)	13.8	15.5	18.6			19.9	21.9	24.1	26.5	29.1	30.0		34.8	46.7	
PV of PPG external debt (in percent of GDP + remittances)	...	...	4.9			4.8	4.7	4.5	4.2	3.9	3.8		3.3	2.3	
PV of PPG external debt (in percent of exports + remittances)	...	...	5.1			5.0	4.9	4.7	4.4	4.1	3.9		3.4	2.4	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	0.2			0.2	0.2	0.2	0.2	0.2	0.3		0.3	0.4	

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, 2016–36

(Percent)

	Projections							
	2016	2017	2018	2019	2020	2021	**2026**	2036
PV of debt-to GDP ratio								
Baseline	63	64	64	62	59	55	**42**	22
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	63	65	66	65	66	68	**99**	110
A2. New public sector loans on less favorable terms in 2016-2036 2	63	66	67	66	63	59	**47**	31
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	63	67	69	67	64	60	**45**	24
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	63	70	80	78	75	71	**52**	23
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	63	71	78	76	72	67	**51**	27
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	63	66	68	66	63	59	**44**	22
B5. Combination of B1-B4 using one-half standard deviation shocks	63	73	88	86	82	77	**57**	26
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	63	91	91	88	84	78	**59**	32
PV of debt-to-exports ratio								
Baseline	145	143	140	135	128	120	**87**	46
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	145	145	145	142	142	147	**209**	228
A2. New public sector loans on less favorable terms in 2016-2036 2	145	147	147	143	136	129	**100**	63
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	145	143	141	135	128	120	**87**	46
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	145	192	262	253	239	227	**161**	69
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	145	143	141	135	128	120	**87**	46
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	145	148	150	144	136	128	**93**	46
B5. Combination of B1-B4 using one-half standard deviation shocks	145	168	200	193	183	173	**124**	56
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	145	143	141	135	128	120	**87**	46
PV of debt-to-revenue ratio								
Baseline	269	266	260	251	239	225	**172**	92
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	269	270	268	264	266	277	**410**	456
A2. New public sector loans on less favorable terms in 2016-2036 2	269	272	272	266	254	242	**196**	126
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	269	276	283	273	259	244	**186**	100
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	269	290	327	316	302	288	**213**	93
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	269	294	318	307	291	275	**210**	112
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	269	274	277	268	254	241	**182**	92
B5. Combination of B1-B4 using one-half standard deviation shocks	269	303	359	347	330	315	**235**	108
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	269	377	369	356	338	319	**243**	130

Table 1b. Cabo Verde: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2016–36 (continued)

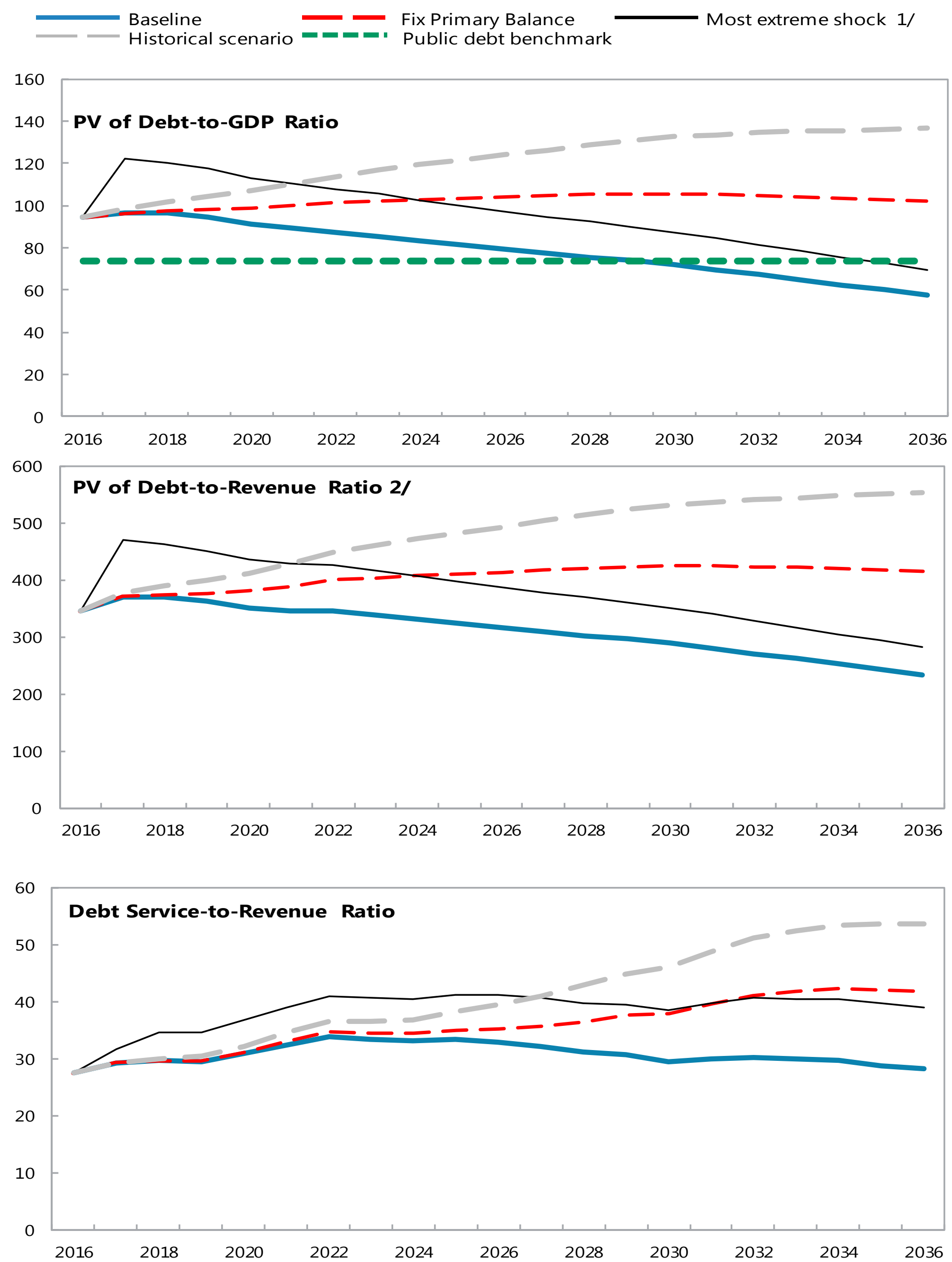
(Percent)

				Debt service-to-exports ratio				
Baseline	6	6	7	7	7	8	**8**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	6	6	7	7	8	9	**12**	28
A2. New public sector loans on less favorable terms in 2016-2036 2	6	6	7	7	8	9	**9**	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	6	6	7	7	7	8	**8**	7
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	6	8	10	11	12	13	**19**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	6	6	7	7	7	8	**8**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	6	6	7	7	8	8	**10**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	6	7	8	9	9	10	**14**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	6	6	7	7	7	8	**8**	7
				Debt service-to-revenue ratio				
Baseline	12	12	12	12	14	15	**17**	13
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2016-2036 1/	12	12	13	13	15	17	**23**	56
A2. New public sector loans on less favorable terms in 2016-2036 2	12	12	12	13	15	17	**17**	19
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2017-2018	12	12	13	13	15	17	**18**	14
B2. Export value growth at historical average minus one standard deviation in 2017-2018 3/	12	12	13	13	15	17	**25**	14
B3. US dollar GDP deflator at historical average minus one standard deviation in 2017-2018	12	13	15	15	17	19	**20**	16
B4. Net non-debt creating flows at historical average minus one standard deviation in 2017-2018 4/	12	12	12	13	14	16	**19**	13
B5. Combination of B1-B4 using one-half standard deviation shocks	12	13	15	15	17	19	**26**	16
B6. One-time 30 percent nominal depreciation relative to the baseline in 2017 5/	12	17	17	17	20	22	**24**	19
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
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 t
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.

Figure 2. Cabo Verde: Indicators of Public Debt Under Alternatives Scenarios, 2016–36 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2026. It correponds to a one-time depreciation shock.
2/ Revenues are defined inclusive of grants.

Table 2a. Cabo Verde: Public Sector Debt Sustainability Framework, Baseline Scenario, 2013–36

(Percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2013	2014	2015	Average 5/	Standard Deviation 5/	2016	2017	2018	2019	2020	2021	2016-21 Average	2026	2036	2022-36 Average
Public sector debt 1/	102.5	114.5	125.8			129.1	130.2	128.5	124.7	118.5	113.4		93.2	62.3	
of which: foreign-currency denominated	78.3	87.9	96.9			98.1	98.4	96.2	92.1	86.3	79.7		55.6	26.9	
Change in public sector debt	11.4	12.0	11.3			3.4	1.1	-1.7	-3.9	-6.1	-5.2		-3.8	-2.8	
Identified debt-creating flows	8.6	18.1	17.1			1.9	0.1	-2.6	-4.8	-7.0	-5.5		-3.7	-2.3	
Primary deficit	11.4	8.5	5.1	6.3	4.7	4.0	3.8	2.4	0.8	-2.1	-1.0	1.3	-0.4	-0.5	-0.4
Revenue and grants	24.5	22.6	26.2			27.4	26.0	26.0	26.1	26.0	25.7		25.1	24.7	
of which: grants	2.5	1.8	2.4			3.8	1.8	1.5	1.3	1.3	1.2		0.9	0.5	
Primary (noninterest) expenditure	35.9	31.1	31.4			31.4	29.8	28.5	26.8	23.9	24.7		24.8	24.2	
Automatic debt dynamics	-2.7	9.6	11.9			-2.1	-3.7	-5.0	-5.6	-4.9	-4.5		-3.4	-1.8	
Contribution from interest rate/growth differential	0.1	-0.9	-0.2			-2.7	-4.1	-5.1	-5.1	-5.0	-4.6		-3.5	-1.9	
of which: contribution from average real interest rate	0.8	0.9	1.5			1.3	0.5	0.1	0.0	0.0	0.0		0.2	0.6	
of which: contribution from real GDP growth	-0.7	-1.9	-1.6			-3.9	-4.6	-5.2	-5.1	-4.9	-4.7		-3.7	-2.5	
Contribution from real exchange rate depreciation	-2.8	10.6	12.1			0.6	0.5	0.0	-0.4	0.0	0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	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	2.7	-6.1	-5.8			1.5	0.9	1.0	0.9	0.9	0.4		-0.1	-0.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	90.7			94.3	96.1	96.1	94.5	91.2	88.9		79.2	57.6	
of which: foreign-currency denominated	...	...	61.8			63.3	64.4	63.8	62.0	59.0	55.2		41.6	22.3	
of which: external	...	...	61.8			63.3	64.4	63.8	62.0	59.0	55.2		41.6	22.3	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	18.5	13.9	12.5			11.5	11.4	10.1	8.4	5.9	7.3		7.9	6.5	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	345.6			344.3	369.6	369.1	362.4	350.7	346.2		315.3	233.4	
PV of public sector debt-to-revenue ratio (in percent)	...	...	380.6			400.6	397.2	391.6	382.0	368.8	362.9		326.8	238.1	
of which: external 3/	...	...	259.5			268.9	265.9	260.0	250.5	238.5	225.4		171.7	92.0	
Debt service-to-revenue and grants ratio (in percent) 4/	29.2	24.2	28.3			27.5	29.2	29.6	29.5	30.8	32.3		32.9	28.2	
Debt service-to-revenue ratio (in percent) 4/	32.4	26.3	31.1			31.9	31.4	31.4	31.0	32.4	33.9		34.1	28.8	
Primary deficit that stabilizes the debt-to-GDP ratio	0.0	-3.5	-6.2			0.6	2.8	4.1	4.6	4.1	4.2		3.5	2.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	0.8	1.9	1.5	3.4	3.7	3.2	3.7	4.1	4.1	4.1	4.1	3.9	4.0	4.0	4.0
Average nominal interest rate on forex debt (in percent)	1.8	1.2	1.1	1.3	0.3	1.2	1.1	1.1	1.1	1.1	1.1	1.1	1.2	1.4	1.2
Average real interest rate on domestic debt (in percent)	2.8	5.3	5.2	2.9	1.7	5.2	3.9	3.2	2.9	2.9	2.9	3.5	2.3	2.4	2.3
Real exchange rate depreciation (in percent, + indicates depreciation	-4.2	13.8	14.0	1.3	9.0	0.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	1.4	-0.1	0.5	1.7	1.3	0.1	1.2	1.8	2.0	2.0	2.0	1.5	2.0	2.0	2.0
Growth of real primary spending (deflated by GDP deflator, in percer	-1.0	-11.8	2.4	-1.0	3.9	3.3	-1.4	-0.7	-1.8	-7.1	7.3	-0.1	3.7	3.8	3.9
Grant element of new external borrowing (in percent)	...	...	...	...	...	45.5	41.9	41.8	44.2	42.6	45.3	43.6	25.6	23.5	...

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, 2016–36

	Projections							
	2016	2017	2018	2019	2020	2021	2026	2036
PV of Debt-to-GDP Ratio								
Baseline	94	96	96	95	91	89	79	58
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	94	98	101	104	107	110	124	137
A2. Primary balance is unchanged from 2016	94	96	97	98	99	100	104	102
A3. Permanently lower GDP growth 1/	94	97	98	98	95	94	93	93
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-20	94	101	106	106	104	103	99	84
B2. Primary balance is at historical average minus one standard deviations in 2017-201	94	101	107	105	102	99	88	63
B3. Combination of B1-B2 using one half standard deviation shocks	94	101	108	107	104	103	95	75
B4. One-time 30 percent real depreciation in 2017	94	122	120	117	113	110	97	70
B5. 10 percent of GDP increase in other debt-creating flows in 2017	94	103	103	101	98	95	85	61
PV of Debt-to-Revenue Ratio 2/								
Baseline	344	370	369	362	351	346	315	233
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	344	377	389	399	412	429	492	553
A2. Primary balance is unchanged from 2016	344	370	374	376	380	389	413	415
A3. Permanently lower GDP growth 1/	344	373	376	374	366	367	368	376
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-20	344	386	407	405	398	399	392	340
B2. Primary balance is at historical average minus one standard deviations in 2017-201	344	389	411	403	391	386	351	256
B3. Combination of B1-B2 using one half standard deviation shocks	344	389	414	410	400	398	378	305
B4. One-time 30 percent real depreciation in 2017	344	469	462	450	435	429	386	282
B5. 10 percent of GDP increase in other debt-creating flows in 2017	344	396	395	388	376	371	337	247
Debt Service-to-Revenue Ratio 2/								
Baseline	27	29	30	29	31	32	33	28
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	27	29	30	30	32	34	40	54
A2. Primary balance is unchanged from 2016	27	29	30	30	31	33	35	42
A3. Permanently lower GDP growth 1/	27	29	30	30	32	34	36	39
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2017-20	27	30	32	32	34	35	37	37
B2. Primary balance is at historical average minus one standard deviations in 2017-201	27	29	30	31	32	33	38	30
B3. Combination of B1-B2 using one half standard deviation shocks	27	30	31	31	33	34	38	34
B4. One-time 30 percent real depreciation in 2017	27	32	35	35	37	39	41	39
B5. 10 percent of GDP increase in other debt-creating flows in 2017	27	29	30	30	31	33	36	30

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.

INTERNATIONAL MONETARY FUND

CABO VERDE

November 3, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

African Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

As of September 30, 2016

Membership Status
Joined November 20, 1978, Article VIII

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	0.82	8.95

Outstanding Purchases and Loans None

Latest Financial Arrangements

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF[1]	April 10, 2002	July 31, 2005	8.64	8.64
Stand-By	February 20, 1998	March 15, 2000	2.50	0.00

[1] Formerly PRGF.

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

	Forthcoming				
	2016	2017	2018	2019	2020
Principal					
Charges/interest	0.00	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00	0.00

[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) were completed in 2002 and 2008. The 2008 assessment was conducted voluntarily 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 new 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 jure and de facto 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, Sections 2, 3 and 4 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 Executive Board concluded the 2010 Article IV consultation and approved a 15-month PSI arrangement in November 2010 (Country Report No. 10/349). The Executive Board concluded the first review under the PSI on a lapse-of-time basis on July 22, 2011 (Country Report No. 11/254); and the second and final review on January 30, 2012 (Country Report No. 12/29). The Executive Board concluded the 2012 Article IV consultation in April 2013 (Country Report No. 13/52). The Executive Board concluded the 2014 Article IV consultation on May 28, 2014 (Country Report No. 14/296).

Technical Assistance

Since 1985, Cabo Verde has received substantial technical assistance. 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

Department	Dates	Purpose
	September 2012	Diagnostic evaluation of tax administration
	November 2012	Tax administration: Annual planning
	February 2013, and July 2013	Tax administration and policy
	April 2013, June 2013, September 2013, January 2014, February 2014, September 2014, January 2014, July 2015, August 2015, October 2015, April 2016, June 2016, July 2016, and October 2016	Tax administration: Large taxpayer office organization, human resources, organization, strategic planning, and information technology, revenue administration gap analysis
	October 2013, and January 2015	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 2007	AML/CFT initial assessment, and legal drafting on March 2008
	March 2012 and October 2012	Draft the financial and banking system laws
STA	November 2003, January 2006, March 2012, July 2013, April 2014, April 2015, and October 2016.	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

Department	Dates	Purpose
	June 2004, May 2006, and October 2007	Price statistics
	March 2007	Monetary statistics and reporting
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 and September 2009	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	Mid-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
	April 2014	Liquidity management

WORLD BANK AND IMF COLLABORATION

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

- **Article IV consultations**. The World Bank representatives met with the country team before and during the 2016 IMF Article IV mission. This facilitated the discussions and provided valuable input, in particular in the areas of mutual interest such as public financial management, performance of state-owned enterprises, and investment planning.

- **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 crucial for the Bank's sectoral work. The Bank's work programs comprise work in the following areas: poverty reduction, public sector efficiency, competitiveness and private sector development, and management of state-owned enterprises. 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 potentially increase productivity-driven growth and broad-based poverty reduction. The Bank has commenced the preparation of a Systematic Country Diagnostic which will inform the next strategy due in 2017. The two teams have also engaged very closely on discussions on public financial management and debt sustainability.

- **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 agreed to continue the close cooperation going forward. The following table describes specific activities planned by the two country teams over the fiscal years 2016/2017. The Fund will continue to lead on macroeconomic analysis, and the Bank will continue to lead on SOE reform and investment planning. The two teams will closely cooperate in preparing a joint DSA.

Table 1. Cabo Verde: Joint World Bank and IMF Work Program (as of November 18, 2016)			
Title	Products	Timing of Mission	Expected Delivery Date
A. Mutual information on relevant work programs			
Bank work program in the next 12 months	1. Systematic Country Diagnostic 2. Program for Results – SOEs Operation 3. TA on Debt Management	November 2016 November 2016 December 2016	Summer 2017 June 2017 June 2017
IMF work program in the next 12 months	1. Staff Visit 2. Article IV Consultation	February 2017 September 2017	
B. Requests for work program inputs			
Fund request to Bank	1. Updates on SOE reforms and financial situation 2. Updates on real sector developments		FY 2017
Bank request to Fund	Macroeconomic framework updates		FY 2017

STATISTICAL ISSUES

(As of November 18, 2016)

I. Assessment of Data Adequacy for Surveillance

General: Data provision has some shortcomings but is broadly adequate for surveillance. At the same time improvements are needed in national accounts, government finance, and external sector statistics. 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: Significant improvements have been made to the national accounts—with technical assistance from IMF STA—including the timely release of quarterly and yearly GDP data. The most recent annual GDP data released are for 2015 (released in March 2016). 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 annual 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 of 2002–10. The quarterly national accounts by the production approach were published for the first time in April 2015. Future technical assistance missions will work on a GDP rebasing and developing estimates for expenditure-side GDP components.

Full implementation of the 2008 SNA and quarterly national accounts 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 account 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 2006–07, 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.

Government Finance Statistics: The fiscal data have improved. Benefiting from technical assistance (TA) the Government Finance Statistics (GFS) compilation system is being upgraded. Recent TA helped the authorities compile GFS data in line with GFSM 2001. The authorities have started reporting GFS for publication in the IFS and 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 for the central bank and other depository corporations have been published in *International Financial Statistics* since June 2007 on a regular monthly basis. These data are fully aligned with the recommendations of the *Monetary and Financial Statistics Manual* and the *MFS Compilation Guide*. The integrated monetary database that meets STA, AFR, and BCV statistical needs is now in place.
Financial Sector Surveillance: Cabo Verde does not report financial soundness indicators for dissemination on the IMF's website.
External statistics: The BCV compiles Balance of Payments (BOP) and International Investment Position (IIP) statistics on a BPM5 basis. Dissemination of quarterly BOP data on the BCV website has been regular. The BCV reports quarterly BOP and annual IIP data to the STA and commenced participation in the Coordinated Direct Investment Survey starting with 2012 data. A greater use of surveys, combined with the International Transactions Reporting System implemented by the BCV, has permitted an expansion of data sources and statistical coverage, which to a large extent follow the recommendations of the BPM6. However, problems and limitations in data sources and compilation techniques remain and need to be addressed. Data coverage needs to be increased, particularly for foreign trade in goods, direct investment, portfolio investment liabilities, and nonbank sectors' external transactions conducted via account abroad.

II. Data Standards and Quality	
Cabo Verde has participated in the General Data Dissemination System (GDDS) since February 2004.	No data ROSC has been done in Cabo Verde.

Table 2. Cabo Verde: Common Indicators Required for Surveillance
(As of October 26, 2016)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange rates	10/30/16	10/30/16	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[2]	7/31/16	09/08/16	D	W	M
Reserve/base money	7/31/16	9/10/16	D	W	M
Broad money	7/31/16	9/10/16	M	W	M
Central bank balance sheet	7/31/16	9/10/16	D	W	M
Consolidated balance sheet of the banking system	7/31/16	9/10/16	M	M	M
Interest rates[3]	7/31/16	9/10/16	M	M	M
Consumer price index	7/31/16	9/10/16	M	M	M
Revenue, expenditure, balance, and composition of financing[4]—central government	7/31/16	9/10/16	M	Q	A
Stocks of central government and central government-guaranteed debt[5]	12/31/15	9/10/16	A	A	A
External current account balance	6/30/16	9/10/16	Q	Q	Q
Exports and imports of goods	6/30/16	9/10/16	Q	Q	Q
GDP/GNP	6/30/16	9/10/16	Q	Q	Q
Gross external debt	12/31/15	9/10/16	Q	A	A
International Investment Position[6]	6/30/16	9/10/16	Q	Q	Q

1 Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA).
2 Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
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.

Statement by Alexandre Tombini, Executive Director for Cabo Verde, and Pedro Fachada, Alternate Executive Director
November 18, 2016

1. On behalf of our Cabo Verdean authorities, we thank the mission team that visited Praia and São Vicente in September for the candid dialogue and policy recommendations. Our authorities reiterate their appreciation of staff's excellent work during this year's Article IV consultation, as well as the valuable support received from headquarters, particularly on capacity building.

2. In 2016, Cabo Verde held presidential, legislative, and local elections. After obtaining a clear majority in March's parliamentary election, the largest then-opposition party formed a new government that took office in April. The smooth political transition is a testimony to the maturity of Cabo Verde's political process and institutions. The country enjoys comparable rankings to many advanced economies in areas such as freedom of press, and governance and transparency.

3. The economic priorities of the new government include promoting a larger role for the private sector and advancing fiscal consolidation. These priorities mark a shift from the strategy pursue by the previous administration, which sought to scale up public infrastructure investment in a period when access to concessional financing was coming to an end as Cabo Verde graduated to middle-income status. Although the previous strategy played an important role in reducing energy and transportation bottlenecks, boosting productivity, and enhancing competitiveness, it also led to a substantial increase in public sector indebtedness. The new authorities are now committed to put public debt on a firm downward path and to crowd-in private investment.

Recent Economic Developments

4. After growing by 7.4 percent on average during the period 1993–2008, the Cabo Verdean economy decelerated significantly in the aftermath of the global financial crisis. Given its links to Europe and particularly Portugal, Cabo Verde was severely hit by the euro area crisis. Between 2009 and 2015, real GDP growth averaged a mere 1.3 percent annually.

5. Buoyed by the tourism sector, economic activity seems to have rebounded this year from the low growth cycle of the 2009-2015 period. According to the most recent data released by the National Institute of Statistics (INE), GDP grew by 4.7 percent in the first half of 2016 relative to the same period of last year. Tourism activities grew by 15.2 percent, helped by political and security instability in some Mediterranean destinations that compete directly with Cabo Verde in the *"sun, sand and sea"* market. Agriculture and public utilities also grew at double-digit rates.

6. Confidence indicators support the case that the recovery is taking hold. In the third quarter of 2016, the INE's Economic Situation Indicator reached its highest level since mid-2012, due to the rebound in confidence in the retail and tourism activities. Confidence within the

tourism sector was at its highest level since the end of 2008, while there was also considerable improvement in consumer sentiment to date in 2016.

7. With the rebound in business and consumer confidence, credit growth gained some momentum after remaining stagnant between 2013 and 2015. In the first eight months of 2016, credit to the private sector grew by 4.1 percent, with banks reporting less restrictive credit conditions and slightly lower lending rates.

8. On the inflation front, Cabo Verde has benefited from imported deflation, especially from the euro area – a result of the currency peg. After ending 2015 with annual deflation of 0.5 percent, consumer prices continued to decline, falling by 2.0 percent in the 12 months through September. Public transportation, utilities and food items contributed to the fall in consumer prices, the latter reflecting favorable domestic weather conditions and the consequent increase in agriculture output this year.

9. Cabo Verde continued to make progress towards strengthening its external buffers. The improvement in the current account deficit (4.3 percent of GDP in 2015 compared to 9.0 percent of GDP in 2014 and 16.3 percent of GDP at the peak in 2011) can be attributed to the good performance of tourism receipts, remittances and more recently, the reduction of imports in the context of the phasing out of the public investment pipeline. As a result of favorable balance of payment conditions, gross international reserves accumulated and are expected by staff to end the year close to six months of prospective imports of goods and services.

Fiscal Policy

10. The new Cabo Verdean authorities are well aware of the need to improve the fiscal outlook. As a clear signal of their commitment to fiscal prudence, they have decided to accelerate the pace of consolidation relative to what was previously envisaged. As highlighted by staff in the reports, large fiscal deficits in recent years have been mainly driven by capital spending. As the public investment program phases out, fiscal outcomes will improve substantially.

11. The size of the public investment program has already been significantly scaled down. At its 2012 peak—when it was entirely justified to adopt counter-cyclical policies—capital spending represented 11.8 percent of GDP. It declined to 4.6 percent of GDP in 2015 and is currently expected to continue its downward trajectory until it reaches around 2 percent of GDP by 2020. As a consequence, the overall deficit of the central government, which reached 10.3 percent of GDP in 2012, is estimated to converge to a balanced position by the end of the decade.

12. Raising fiscal revenues is an important component of the consolidation strategy. The authorities continue to make progress in broadening the tax base, enhancing collection, recovering tax arrears and strengthening the capacity of the tax agency (DNRE– *Direção Nacional de Receitas do Estado).* These efforts are being supported by technical assistance provided by the Fund.

13. The performance of some state-owned enterprises (SOEs) remains a source of fiscal risk. The financial situation of the energy company Electra, one of the vulnerable SOEs at the time of the last Article IV consultation, has improved substantially. However, the financial difficulties of the national airline TACV (*Transportes Aéreos de Cabo Verde*) remains unresolved. Any solution to its challenges needs to take into account that Cabo Verde is an archipelago of nine dispersed inhabited islands and inter-island air transportation is a public good. That said, the authorities are conscious that the fragility of TACV not only represents a fiscal risk but also constrains tourism development. An additional source of concern is the housing company IFH (*Imobiliária, Fundiária e Habitat*) due to weaknesses in an externally-financed project, which is currently being reevaluated.

14. The authorities note that, although the public debt ratio is high, there is no major sustainability concern. Most public debt is external, and was contracted under concessional conditions, including long grace and repayment periods and low interest rates. As recognized by staff in the Debt Sustainability Analysis (DSA), the external "debt service indicators remain safely below the threshold throughout 2036" (page 5, emphasis added).

Monetary Policy and Financial Stability

15. The authorities have been successful in supporting the exchange rate peg with the euro, which continues to serve Cabo Verde well. We draw attention to staff's assessment that the exchange rate is broadly in line with fundamentals and that international reserves coverage is strong.

16. Since 2013, the *Banco de Cabo Verde* (BCV) has adopted an accommodative monetary policy stance. In light of deflation pressures, the policy rate was lowered to 3.5 percent in February 2015 and has remained unchanged since then. In the same month, reserve requirements were reduced to 15 percent from 18 percent. It should be noted that, in the case of Cabo Verde, deflation does not seem to have adverse impacts on the economy, increasing real incomes and supporting consumption.

17. Cabo Verde's banking sector remains relatively well capitalized and liquid. Non-performing loans (NPLs) have declined from the mid-2014 peak (22.3 percent), but remain relatively high. The BCV took additional measures to stimulate credit growth, including the extension from two to five years of banks' liquidation period for repossessed assets from NPLs. The BCV also continues to deepen its institutional and administrative capacities to monitor and mitigate stability risks, including through improvements in regulation, supervision and crisis resolution frameworks. Cabo Verde has a comprehensive AML/CFT framework and, contrary to many other small states and economies that rely on remittances, the country has not been affected by the loss of correspondent banking relationships.

Structural Agenda

18. Cabo Verde is a country poor in terms of natural resources, geographically dispersed, with relatively scarce arable land and low rain levels, and prone to natural disasters. In the last decades,

tourism and tourism-related foreign direct investment (FDI) have been the main engines of growth. The upward trend in tourism arrivals and FDI was interrupted by the global financial crisis in 2008-2009 and the euro crisis in 2011–13. More recently, however, Cabo Verde's political stability and improved infrastructure have led to a surge in FDI directed to tourism activities.

19. As noted by staff in the report, tourism-related FDI from already signed projects is estimated to represent 42 percent of GDP, with additional projects in the pipeline amounting to around 50 percent of GDP. As these projects mature, they will contribute to radically transform the Cabo Verdean economy and improve the living standards of its population. In this regards, the government is aware that structural reforms are needed for the dynamism in the tourism sector to disseminate into economic benefits for all.

20. Among the growth-friendly reform initiatives, a new labor code entered into effect last October. The new code increases labor market flexibility, extending the conditions and time period under which temporary work contracts are allowed and facilitating dismissal due to redundancy or performance at the job. At the same time, the government is committed to continue to prepare and improve the skills of the labor force, in line with the needs of a more diversified economy.

21. With the phasing out of the public investment program, the authorities are aiming at attracting the private sector, including but not limited to public private partnerships (PPPs) and privatizations. The authorities are also exploring mechanisms to catalyze investment into the country from the large Cabo Verdean diaspora. The private sector is expected to bring innovation and diversification to the economy and boost overall productivity and competitiveness.

Final Remarks

22. In light of the ongoing recovery of the economy, the Cabo Verdean authorities consider staff's short-term growth forecast to be on the low side. They also view the completion of the public investment program and the crowding-in of private investment as providing the foundations for higher potential growth comparatively to recent economic performance, a fact that does not seem to have been fully captured in staff's long-term growth projections.

23. This year's consultation offered both the new authorities and staff an opportunity for a frank exchange of views on a range of topics that will certainly contribute to reshape Cabo Verde's macroeconomic policies. The authorities attribute high importance to the engagement with the Fund and underline, once again, that technical assistance in areas such as strengthening tax administration, debt management and macroeconomic statistics are fundamental to Cabo Verde's development aspirations.