IMF Country Report No. 18/104

CABO VERDE

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CABO VERDE

March 2018

In the context of the 2018 Article IV Consultation, 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 March 26, 2018 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 March 26, 2018, following discussions that ended on January 26, 2018, 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 March 13, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis Update** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for Cabo Verde.

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

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 18/135
FOR IMMEDIATE RELEASE
April 18, 2018

International Monetary Fund
Washington, D.C. 20431 USA

Executive Board Concludes 2018 Article IV Discussions with Cabo Verde

On March 26, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the 2018 Article IV consultation[1] with Cabo Verde.

The economic recovery is gaining momentum, reflecting a more favorable external environment and the payoff of ongoing economic reforms. In 2017, the economy is estimated to have expanded by 4 percent supported by the double digit-growth in tourist arrivals, the recovery in credit to the private sector, and stronger consumer and business confidence. These factors are expected to boost growth further to 4.3 percent in 2018. Over the medium term, real GDP growth is projected to stabilize at around 4 percent. Average inflation turned positive (0.8 percent) in 2017, reflecting the increase in energy prices. The current account deficit is estimated to have widened to 8.8 percent of GDP as the higher tourism receipts were more than offset by the rapid increase of imports, partly owing to higher oil prices, and a decline in remittances; and was mostly financed by FDI.

Cabo Verde achieved an impressive fiscal consolidation in recent years. In 2017, the budget deficit is estimated to have narrowed to 3 percent of GDP from 3.1 percent in 2016, and public debt to have declined to 126 percent of GDP from 129.5 percent, the first decline in a decade. The 2018 budget targets a deficit target of 3.1 percent of GDP.

Citing the absence of price pressures and adequate reserve levels, the Banco de Cabo Verde's (BCV) cut its policy rate by 200 basis points to 1.5 percent in June, 2017. The response of credit to the economy to the monetary stimulus has been sluggish but it is now recovering, reaching 5.3 percent annual growth in November, 2017. Financial stability indicators have improved but the level of non-performing loans (NPLs) remains elevated.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Cabo

[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.

[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 summing ups can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm

Verde's ongoing economic recovery, reflecting a more favorable external environment and the payoff of recent economic reforms. They agreed that the medium-term outlook is broadly stable, conditional on a decisive implementation of the authorities' reform agenda. They stressed that the current favorable external conditions present an opportunity to accelerate reforms to address vulnerabilities and make progress toward the goal of promoting higher and inclusive growth.

Directors commended the substantial fiscal consolidation of recent years. They encouraged the authorities to sustain and deepen the adjustment efforts through a combination of revenue and expenditure measures to reduce the high level of public debt. This will help lower the risk of external debt distress, safeguard macroeconomic and financial stability, and support economic growth in the medium term. Directors also called for accelerating the restructuring of loss-making state-owned enterprises to eliminate their need for government support, and for strengthening fiscal institutions.

Directors agreed that the monetary policy stance of the Banco de Cabo Verde (BCV) has been appropriate in the absence of pressures on inflation or reserves, and consistent with the objective of protecting the currency peg. Nonetheless, they urged the BCV to remain vigilant as economic conditions evolve. They welcomed the measures adopted to strengthen the monetary policy transmission mechanism, and encouraged the BCV to step up efforts to enhance its liquidity management capacity and reduce the high level of excess liquidity in the banking system.

Directors welcomed the improvement in financial stability indicators. Nonetheless, they urged the authorities to give priority to the resolution of the high level of legacy nonperforming loans. Directors agreed that fostering financial intermediation is important to strengthen the role of the private sector as the engine of growth. They recommended focusing reforms on strengthening collateral repossession and improving the credit information system.

Director agreed that the loss of correspondent banking relationships represents a vulnerability, given Cabo Verde's reliance on migrant remittances and deposits. They urged the authorities to continue to strengthen the AML/CFT framework in line with international standards and to cooperate effectively with other jurisdictions on tax issues.
Directors welcomed the authorities' Strategic Plan for Sustainable Development to improve the business environment and build on the progress in improving governance and fighting corruption. They underscored that steady implementation of structural reforms is critical to boost potential output growth and reduce poverty. To increase productivity and address the high levels of youth and female unemployment, priority should be given to improving the efficiency and flexibility of the labor market, as well as the quality and relevance of education. Strengthening and better targeting social protection programs would also be important.

It is expected that the next Article IV consultation with Cabo Verde will be held on the standard 12-month cycle.

Cabo Verde: Selected Economic Indicators, 2014–23

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Prel.			Proj.			
	(Annual percent change)									
National accounts and prices [1,2]										
Real GDP	0.6	1.0	3.8	4.0	4.3	4.0	4.0	4.0	4.0	4.0
GDP deflator	-0.1	1.7	-0.8	0.1	1.4	1.6	2.0	2.0	2.0	2.0
Consumer price index (annual average)	-0.2	0.1	-1.4	0.8	1.0	1.5	2.0	2.0	2.0	2.0
Consumer price index (end of period)	-0.4	-0.5	-0.3	0.3	1.0	1.5	2.0	2.0	2.0	2.0
External sector										
Exports of goods and services	2.7	-11.6	11.8	11.3	10.9	7.0	7.1	7.1	7.1	7.1
Of which: tourism	-12.5	2.0	7.0	10.0	13.7	6.5	6.5	6.5	6.5	6.5
Imports of goods and services	6.3	-12.3	11.8	15.2	8.1	7.4	7.0	7.0	7.0	7.0
	(Change in percent of broad money, 12 months earlier)									
Money and credit										
Net foreign assets	6.7	3.9	6.1	-1.5	1.7	0.5	-1.4	-2.4	-2.2	-2.1
Net domestic assets	0.7	2.4	2.3	4.5	4.1	4.5	4.7	4.8	4.9	4.6
Net claims on the central government	2.1	0.4	1.9	-1.4	3.0	1.5	1.6	1.6	1.7	1.7
Credit to the economy	-0.7	1.8	2.4	3.2	3.3	2.8	2.8	2.8	2.9	3.0
Broad money (M2)	7.4	6.3	8.4	3.0	5.8	5.0	3.3	2.4	2.7	2.5
	(Percent of GDP, unless otherwise indicated)									
Savings and investment										
Domestic savings	27.9	35.6	34.7	29.6	26.5	27.8	27.9	28.0	28.3	28.5
Government	-1.9	0.7	-0.7	1.5	0.6	0.0	0.1	0.5	1.6	1.6
Private	29.8	34.9	35.4	28.1	25.9	27.8	27.8	27.5	26.7	26.9
National investment	34.5	38.8	37.4	38.4	36.0	37.8	37.9	37.9	38.1	38.4
Government	6.2	5.6	3.4	5.0	3.7	5.5	4.8	4.7	4.7	4.7
Private	28.3	33.2	34.0	33.4	32.3	32.4	33.1	33.2	33.5	33.7
Savings-investment balance	-6.6	-3.2	-2.8	-8.8	-9.5	-10.0	-10.0	-9.9	-9.9	-9.9
Government	-8.1	-4.9	-4.1	-3.5	-3.1	-5.5	-4.7	-4.2	-3.1	-3.1
Private	1.5	1.7	1.4	-5.3	-6.4	-4.6	-5.3	-5.8	-6.8	-6.8
External sector										
External current account (including official transfers)	-9.1	-3.2	-2.8	-8.8	-9.5	-10.0	-10.0	-9.9	-9.9	-9.9
External current account (excluding official transfers)	-12.1	-6.6	-5.8	-11.0	-10.7	-11.3	-11.2	-11.2	-11.1	-11.1
Overall balance of payments	5.1	2.2	5.9	-0.5	1.3	0.8	-1.7	-2.6	-2.7	-1.8
Gross international reserves (months of prospective imports of goods and services)	6.2	6.0	6.2	5.6	5.4	5.2	4.6	3.9	3.2	3.0
Government finance										
Revenue	22.9	26.9	27.0	28.4	29.8	28.1	27.5	27.2	27.7	27.6
Tax and nontax revenue	21.1	24.4	24.2	24.9	27.9	26.8	26.5	26.3	26.7	26.8
Grants	1.8	2.5	2.8	3.5	1.9	1.3	1.0	0.9	0.9	0.9
Expenditure	30.5	31.4	30.1	31.4	33.0	34.0	32.7	31.8	31.7	31.7
Overall balance (incl. grants)	-7.6	-4.6	-3.1	-3.0	-3.2	-5.9	-5.2	-4.6	-4.1	-4.1
Net other liabilities (incl. onlending) [3]	-3.2	-3.0	-3.5	-1.2	-5.7	-2.7	-1.1	-0.7	-0.6	-0.6
Total financing (incl. onlending and capitalization)	10.7	7.7	5.6	4.2	8.9	8.6	6.3	5.3	4.7	4.7
Net domestic credit	0.6	1.0	2.9	0.9	2.3	3.0	3.0	3.0	3.0	3.0
Net external financing	10.1	6.7	2.7	3.5	6.6	5.6	3.3	2.3	1.7	1.7
Public debt stock and service										
Total nominal government debt	115.9	126.0	129.5	126.0	124.7	126.7	126.1	124.6	122.7	120.9
External government debt	89.0	97.0	97.3	94.1	94.5	94.7	92.6	89.7	86.4	83.3
Domestic government debt	26.9	29.0	32.2	31.9	30.2	32.0	33.5	35.0	36.4	37.7
External debt service (percent of exports of goods and services)	4.8	6.4	5.7	6.5	6.5	7.3	8.4	9.0	9.6	9.1
Present value of external debt										
Percent of GDP (risk threshold: 50%)	...	65.0	73.3	66.9	67.4	67.3	65.9	64.0	61.7	60.5
Percent of revenue (risk threshold: 300%)	...	266.3	302.5	269.2	241.6	250.8	248.5	243.0	231.0	226.2
Percent of exports (risk threshold: 200%)	...	155.0	163.4	139.5	133.9	132.1	128.1	123.1	117.8	114.5
Memorandum items:										
Nominal GDP (billions of Cabo Verde escudos)	154.4	158.7	163.4	170.1	179.8	189.9	201.3	213.6	226.6	240.4
Gross international reserves (€ millions, end of period)	419.7	453.3	541.0	532.8	553.5	566.8	534.8	483.8	429.0	389.0

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

[1] Last data available for national accounts is for 2016.

[2] The Cabo Verdean exchange rate has been pegged to the Euro since 1999, at a rate of 110.265 CVE/€.

[3] Includes errors and omissions.

INTERNATIONAL MONETARY FUND

CABO VERDE

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

March 13, 2018

KEY ISSUES

Context: Cabo Verde has made significant progress over the last few decades in economic and social development. During 2012-15, low economic growth as a consequence of the crisis in Europe, a significant scaling-up of public investment, and the support of loss-making state-owned enterprises (SOEs) led to a rapid accumulation of public debt. The government has embarked on an ambitious reform program to promote the development of the private sector and rein in the high public debt, including by restructuring SOEs.

Main issues. Cabo Verde achieved an impressive fiscal consolidation in recent years but the public debt burden remains high, owing in part to the depreciation of the escudo vis-à-vis the US dollar but also reflecting the continued support to SOEs. Further fiscal adjustment is needed to offset the projected decline in grants, put public debt on a declining path, and safeguard macroeconomic and financial stability over the medium term. Structural reforms are required to foster private sector development and boost potential output.

Key policy recommendations.

- *Fiscal policy.* Safeguard debt sustainability and address fiscal risks by stepping up fiscal consolidation efforts and accelerating the restructuring of SOEs with a view to reducing the risk of external debt distress to moderate by 2023.

- *Monetary and exchange rate policies.* Preserve price stability and protect the peg. Maintain an accommodative monetary policy stance provided there are no pressures on reserves and prices.

- *Financial sector.* Bolster financial sector resilience by strengthening bank regulation and supervision, adopting measures to facilitate the resolution of legacy NPLs, and improving the AML/CFT framework to help address the loss of correspondent banking relationships (CBRs).

- *Structural reforms.* Implement reforms outlined in the Sustainable Development Strategic Plan 2017–21 to boost potential output growth and reduce poverty and inequality. Improve the efficiency and flexibility of the labor market, as well as the quality and relevance of education. Promote financial intermediation by strengthening collateral repossession and improving the credit information system.

Approved By
Roger Nord and Gavin Gray

Discussions were held in Praia during January 15-26, 2018. The mission team comprised Max Alier (head), Charles Amo-Yartey, Friska Parulian, Luiz Almeida (all AFR), and Haimanot Teferra (SPR). Messrs. Tombini and Fachada (Executive Director and Alternate Executive Director, OED) attended the final meetings.
The mission met with Prime Minister Correia e Silva, Deputy Prime Minister and Minister of Finance Correia, Minister of Tourism, Transport, and Maritime Economy Gonçalves, Banco de Cabo Verde Governor Serra, other government officials of the executive branch and state-owned enterprises, members of the Finance Committee of the National Assembly, representatives of labor unions, development partners, and the private sector.

CONTENTS

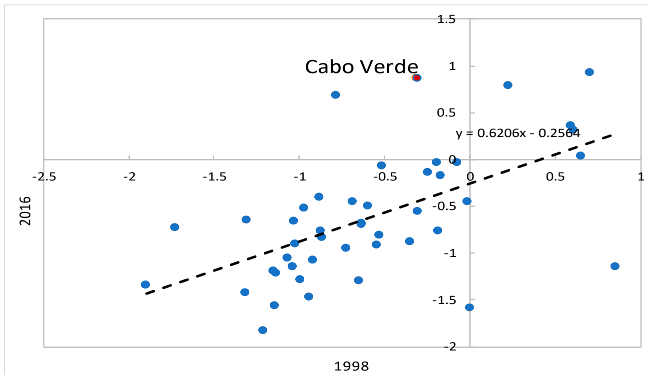
TABLES

ANNEXES

CONTEXT

1. **Cabo Verde has made significant progress over the last few decades in economic and social development.** Strong economic growth buoyed by a rapid expansion in tourism catapulted the country to middle income status. In the process, the incidence of poverty and extreme poverty, as well as inequality declined.[1] Cabo Verde has also made significant progress over the last two decades in improving governance and fighting corruption. However, during the global financial crisis, economic growth fell sharply as tourism receipts declined. Meanwhile, a significant scaling-up of public investment since 2009, and the support of loss-making SOEs brought public debt to 129.5 percent of GDP in 2016, twice the level at end-2009.

Text Figure 1. Cabo Verde: WGI – Control of Corruption Index for SSA[1/]



1/ The index captures perceptions of the extent to which public power is exercised for private gain. The rankings used are subject to uncertainty around the point estimate. Rankings reflect the relative, not the absolute performance of the country.

Source: Worldwide Governance Indicators (WGI) is dataset summarizing the views on the quality of governance provided by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries

2. **Cabo Verde experienced a smooth political transition in 2016.** The center-right Movimento para Democracia (MpD) party won an absolute majority in the March 2016 parliamentary elections and landslide victories in the municipal and presidential elections. The government's priorities are boosting growth and employment, promoting economic diversification, and reining in the high public debt.

3. **Cabo Verde has established a good track record of implementing Fund advice in the context of Fund programs and surveillance notwithstanding the mixed performance under the second PSI (Annex I).** Two Policy Support Instrument (PSI) supported the authorities' policies during 2006–12. A sizable fiscal consolidation aimed at restoring sustainability was achieved under the first PSI (2006-10) along with low inflation, and considerable progress in structural reforms particularly in the areas of revenue administration and public financial management, while performance against quantitative targets was weak under the second PSI. The record has been weaker regarding implementation of advice on mitigating fiscal risks from SOEs. Cabo Verde benefits from a comprehensive capacity development program (Annex II). Data provision is broadly adequate for surveillance (Informational Annex).

[1] According to the National Statistics Institute, the incidence of poverty fell to 35 percent in 2015 from 57 percent in 2001 and extreme poverty to 11 percent from 30 percent, using the national extreme poverty line of €1.2 per person per day in 2015. Inequality also declined, the consumption based Gini index fell to 0.42 in 2015 from 0.53 in 2001.

RECENT ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

A. Recent Developments

4. The economic recovery is gaining momentum reflecting a more favorable external environment and the payoff of recent economic reforms (Figures 1–3).

- In 2017, the economy is estimated to have expanded by 4 percent compared to 3.8 percent in 2016 and an average of 0.9 percent during 2012–15. The recovery has been supported by the double digit-growth in tourist arrivals, the recovery in credit to the economy, and stronger consumer and business confidence. Average inflation turned positive (0.8 percent) in 2017 reflecting the increase in energy prices.

- In 2017, the current account deficit is estimated to have widened to 8.8 percent of GDP as the higher tourism receipts were more than offset by the rapid increase of imports, partly owing to higher oil prices, and a decline in remittances; and was mostly financed by FDI. International reserves slightly fell to €533 million (5½ months of prospective imports). In May 2017, S&P affirmed their "B" rating and removed the negative outlook, citing favorable growth prospects and significant tourism-related FDI inflows.

5. Sustained fiscal consolidation efforts resulted in the first decline in the stock of public debt in a decade. In 2017, the budget deficit is estimated to have narrowed to 3 percent of GDP (from 3.1 percent in 2016), total financing needs (including, recapitalization and onlending) to 4.2 percent of GDP (from 5.6 percent in 2016) and public debt to have fallen to 126 percent of GDP, after peaking at 129.5 percent in 2016.[2] The adjustment was achieved through a combination of efforts to strengthen revenue administration, resulting in an increase in tax collections in excess of 10 percent in real terms; higher grants, reflecting the final disbursements under the Millennium Challenge Corporation (MCC) compact and extraordinary grants from development partners in response to weather related disasters; under execution of the budget for goods and services consistent with the partial freeze decreed early in the year; and the containment of capital spending.[3] The appreciation of the escudo vis-à-vis the US dollar contributed to the decline in public debt.

[2] In 2013, the budget deficit reached 9.3 percent of GDP and total financing needs 13.9 percent. Despite the fiscal consolidation efforts in 2014-16 public debt continued to increase owing in part to the depreciation of the escudo vis-à-vis the US dollar but also reflecting the support to loss-making SOEs.

[3] In 2017, data on the acquisition of non-financial assets reflect the transfer of part of the stock of social housing from the housing SOE (IFH) equivalent to 2.5 percent of GDP. In the absence of this operation the budget deficit would have been 0.5 percent of GDP. This transfer did not generate a financing need given that the construction of these houses had been financed by loan from the Portuguese Caixa Geral de Depositos to the government that was onlent to IFH.

B. Medium-Term Outlook and Risks

6. The short-term outlook is positive and the medium-term outlook broadly stable if the government decisively implements its reform agenda, although fiscal risks will remain high for the foreseeable future. In 2018, output growth is expected to accelerate to 4.3 percent, supported by the same factors underpinning the ongoing recovery and reflecting the lagged impact of last year's monetary policy easing, before stabilizing at around 4 percent over the medium term. Average inflation is projected to remain stable at about 1 percent and to increase gradually to stabilize at about 2 percent over the medium term. In 2018, the current account deficit is projected to widen to 9.5 percent of GDP, reflecting import growth partly driven by the appreciation of the euro vis-à-vis other currencies, and remain at about 10 percent of GDP over the medium term. Public debt levels would fall only modestly over the medium term. International reserves coverage would remain at about 5½ months of prospective imports in 2018 and then gradually decline over the medium term, below the level considered adequate by staff. This outcome reflects, in part, the projected decline in net external financing to the central government envisaged in the Medium Term Fiscal Framework (MTFF).

7. External and domestic risks have become more balanced as the recovery in Europe gathers pace. Weaker-than-expected global growth, tighter global financial conditions, and the loss of correspondent banking relations (CBRs) represent downside risks to the economic and financial outlook. The impact of these risks in the short- and medium-term would be exacerbated by domestic risks related to wavering fiscal consolidation and SOEs restructuring efforts, and delays in implementing structural reforms to increase productivity (see Risk Assessment Matrix). On the upside, tourism could grow faster buoyed by improved infrastructure and a more dynamic recovery in Europe. Success in strengthening the linkages between the tourism sector and domestic economy could result in faster growth of the non-tourism sector.

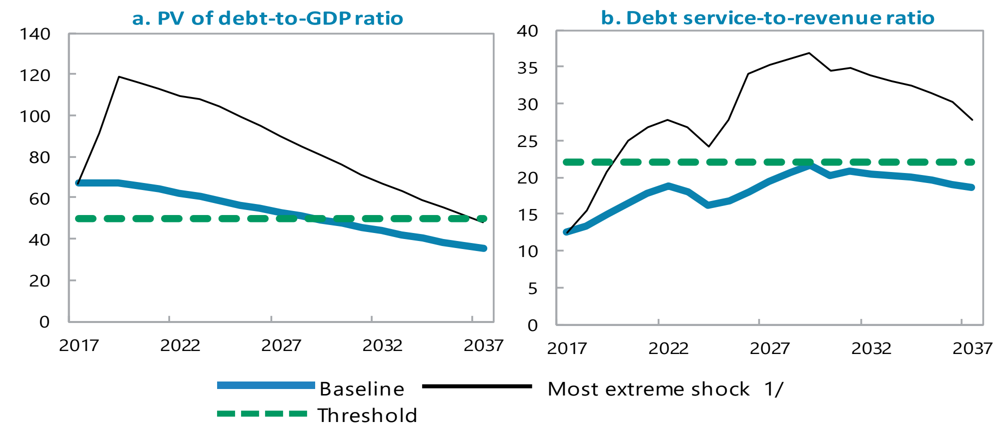
Authorities' Views

8. The authorities argued that ongoing reforms would result in higher potential output growth and that the projected increase in the budget deficit and decline in reserves coverage would prompt a policy response. The authorities agreed that the short-term outlook was positive and benefitted from a more favorable external environment. They expected their reform agenda to have a stronger impact on potential output growth. The Ministry of Finance expected output to expand by more than 5 percent in 2018, as envisaged in the budget, and further accelerate over the medium term.

C. Debt Sustainability Analysis

9. Cabo Verde's risk of external debt distress rating is assessed as high, unchanged from the rating in the previous Debt Sustainability Analysis (DSA). Despite the high stock of public debt, debt service remains manageable due to the highly concessional terms of external debt, which accounts for 75 percent of total public debt. Under the baseline scenario the debt-service-to revenue ratio would remain below the threshold throughout 2037, but growth and exchange rate vulnerabilities remain elevated (Text Figure 2).

Text Figure 2. Cabo Verde: External Debt Sustainability and Service Indicators



1/ The most extreme stress test is the test that yields the highest ratio on or before 2027. It corresponds to a Combination shock in both figures.

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

D. External Stability Assessment

10. The external position is moderately weaker than implied by fundamentals and desirable policy settings, but risks appear low (Annex III). The real effective exchange rate is broadly in line with macroeconomic fundamentals and reserves remain adequate but broader issues of non-price competitiveness remain. Increasing the productivity of human and physical capital and improving the business environment by facilitating access to financing, reducing the inefficiencies in the bureaucracy, and improving education remain critical for bolstering medium and long-term growth.

POLICY DISCUSSIONS

11. Cabo Verde's development priorities are to promote inclusive economic growth and reduce vulnerabilities by implementing an ambitious structural reform agenda. The current favorable external conditions present the authorities with an opportunity to accelerate progress towards this aim. Policy discussions focused on the need to significantly reduce public debt; the importance of implementing policies consistent with protecting the peg and strengthening the financial system; and the role of structural reforms in promoting the development of the private sector and fostering investment, while protecting the most vulnerable.

A. Fiscal Policy

12. The authorities' MTFF appropriately aims at fiscal consolidation over the medium term to offset the projected decline in grants and keep public debt on a downward trend. However, the projected adjustment in the MTFF is predicated on optimistic growth assumptions and revenue administration gains, expectations about a speedy restructuring of SOEs, and on imprecise expenditure rationalization plans. In 2018, staff projections indicate that the deficit target in the budget is reachable but will require continuous efforts to strengthen the revenue administration directorate, ensuring that the public asset sales delayed last year materialize in 2018, and keeping a tight control of expenditures. The deficit is projected to widen to 3.2 percent of GDP, total financing needs to 8.9 percent, and public debt to decline to 124.7 percent of GDP. Under more prudent assumptions than those in the MTFF, over the medium term the budget deficit would widen and public debt remain at about 125 percent of GDP by 2021, instead of falling to 113 percent as projected in the MTFF.

13. A key element of the authorities' fiscal strategy is the restructuring of SOEs (Annex IV). Loss-making SOEs have been a significant burden on public finances and one of the underlying causes for the rapid debt accumulation due to their recapitalization needs and onlending operations. In addition, the government has provided sovereign guarantees to loans obtained by SOEs.[4] At end-September 2017, the outstanding stock of sovereign guarantees was estimated at 7.6 percent of GDP, most of which are guarantees on domestic borrowing (DSA Text Table 2). The government intends to restructure all SOEs but priority is being given to the restructuring of the three largest loss-making ones: the airline (TACV), the housing company (IFH), and the power and water company (Electra). The restructuring process will involve some costs for the government. In the case of TACV the government will need to assume up to 6 percent of GDP in debt obligations. However, the amounts are being renegotiated and the government expect to reduce this amount by at least half. In addition, the 2018 budget envisages the issuance of sovereign guarantees to SOEs equivalent to 5.3 percent of GDP, a third of which would be to TACV, IFH, and Electra. Government support to SOEs is expected to decline significantly by 2020 following the successful restructuring of TACV, IFH, and Electra.

Staff's Views

14. Cabo Verde's main fiscal challenge is addressing the high level of public indebtedness and reducing fiscal risks. Given the authorities' strong commitment to the peg and the highly concessional nature of the debt, the best strategy to achieve this objective is through an ambitious and sustained fiscal adjustment. Taking advantage of the more favorable economic conditions, fiscal policy should aim at keeping public gross financing needs below 14 percent of GDP, and reducing the risk of external debt distress to moderate by 2023; the latter would involve bringing external

[4] At end-2016, the six largest SOEs had total liabilities equivalent to 38.2 percent of GDP. Of these, 17.6 percent of GDP were onlending operations and external debt guarantees, thus these liabilities are reflected in the DSA; 6 percent were domestic debt guarantees; 2.7 percent other non-guaranteed debt; and 11.9 percent were other liabilities, including past due taxes, social security contributions, and payments to suppliers.

public debt below the LIC DSF threshold (the applicable threshold for the PV of external public debt for high capacity countries would be 55 percent of GDP from July 1, 2018). [5] The adjustment could be achieved through a combination of revenue and expenditure measures including the following: increasing the VAT rate to 17 percent, similar to the level in other highly-indebted small island economies; capping expenditure on goods and services at 4 percent of GDP, the average in 2013-17; capping the net acquisition of non-financial assets at 3 percent of GDP, the average in 2016-17; and containing the growth in public employment. The issuance of debt guarantees should be limited to contain fiscal risks.

15. The proposed adjustment will help strengthen the country's medium-term outlook and mitigate fiscal and external risks. The proposed fiscal consolidation, a successful restructuring of SOEs that eliminates the need for government support (in particular for TACV, IFH, and Electra), and stepped up structural reforms is expected to open room for faster growth in credit and crowd-in the private sector, boost investor's confidence, accelerate medium-term growth to 5 percent, put public debt on a downward path, reduce the risk of external debt distress to moderate by 2023, facilitate external adjustment, and keep reserve adequacy at about 5½ months of prospective imports (Text Table 1 and Figure 4). [6]

16. The success of the fiscal strategy hinges on rapidly restructuring SOEs and strengthening fiscal institutions to contain fiscal risks. Restructuring the largest loss-making SOEs at the least possible cost to the budget is the priority. Going forward, preventing SOEs from becoming again a burden on the budget requires developing mechanisms to oversee their financial performance, including their borrowing plans. The Ministry of Finance should integrate SOEs into the budget preparation processes, and create mechanisms to detect deviations from planned performance to inform timely corrective action. A new organic budget law aimed at strengthening budget execution, broadening the coverage to the non-financial public sector, and introducing a debt ceiling is a positive step. Revenue administration reforms of recent years have been successful in mobilizing domestic resources. These efforts could be complemented by revisiting existing tax expenditures and resisting pressures to grant additional tax exemptions that erode the tax base.

---

[5] The applicable debt service indicators would also need to remain below the corresponding thresholds.

[6] Medium-term projections under the adjustment scenario are subject to uncertainty, given the difficulties of assessing the persistence of fiscal multiplier effects and the pay-offs from structural reforms.

Text Table 1. Cabo Verde: Fiscal Indicators Under Alternative Scenarios, 2014-2023
(Percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Baseline Scenario										
Revenues	22.9	26.9	27.0	28.4	29.8	28.1	27.5	27.2	27.7	27.6
of which: Grants	1.8	2.5	2.8	3.5	1.9	1.3	1.0	0.9	0.9	0.9
Expenditure	30.5	31.4	30.1	31.4	33.0	34.0	32.7	31.8	31.7	31.7
of Which: Capital expenditure	6.2	5.6	3.4	5.0	3.7	5.5	4.8	4.7	4.7	4.7
Overall balance	-7.6	-4.6	-3.1	-3.0	-3.2	-5.9	-5.2	-4.6	-4.1	-4.1
Primary balance	-5.4	-2.0	-0.5	-0.4	-0.2	-2.9	-2.1	-1.5	-1.0	-1.0
Total Financing Needs 1/	-10.8	-7.6	-6.6	-4.2	-8.9	-8.6	-6.3	-5.3	-4.7	-4.7
Public debt	115.9	126.0	129.5	126.0	124.7	126.7	126.1	124.6	122.7	120.9
PV of public debt	...	...	105.5	98.8	97.6	99.3	99.5	98.9	98.1	98.2
PV of external public debt	61.4	65.0	73.3	66.9	67.4	67.3	65.9	64.0	61.7	60.5
Memorandum items:										
Real GDP growth 2/	0.6	1.0	3.8	4.0	4.3	4.0	4.0	4.0	4.0	4.0
Current accound balance	-9.1	-3.2	-2.8	-8.8	-9.5	-10.0	-10.0	-9.9	-9.9	-9.9
Gross international reserves 3/	6.2	6.0	6.2	5.6	5.4	5.2	4.6	3.9	3.2	3.0
Credit to the economy 4/	-1.0	2.7	3.7	5.1	5.2	4.5	4.5	4.5	4.5	4.5
Active Scenario										
Revenues					29.7	29.2	28.6	28.3	28.7	28.6
of which: Grants					1.9	1.3	1.0	0.9	0.9	0.8
Expenditure					31.8	31.1	30.3	29.4	29.3	29.2
of Which: Capital expenditure					3.0	3.0	3.0	3.0	3.0	3.0
Overall balance					-2.1	-1.9	-1.7	-1.2	-0.6	-0.5
Primary balance					1.0	1.0	1.2	1.6	2.0	1.9
Total Financing Needs 1/					-7.7	-4.6	-2.8	-1.8	-1.2	-1.2
Public debt					124.1	122.0	117.2	111.8	106.1	100.8
PV of public debt					96.9	95.5	92.3	88.4	84.2	81.0
PV of external public debt					67.7	66.4	63.4	60.2	57.0	54.7
Memorandum items:										
Real GDP growth 2/					3.8	4.0	5.0	5.0	5.0	5.0
Current accound balance					-8.3	-7.5	-6.9	-7.0	-6.6	-6.4
Gross international reserves 3/					5.8	5.8	5.6	5.6	5.6	5.6
Credit to the economy 4/					5.0	5.3	6.0	6.0	6.0	6.0

Sources: Cabo Verdean authorities and IMF staff estimates and projections.
1/ Includes errors and omissions.
2/ In percent
3/ In months of prospective imports
4/ Percent change, year-over-year

Authorities' Views

17. The authorities agreed that reducing public debt is a priority and saw merits in the fiscal anchors recommended by the mission. They reiterated their commitment to fiscal consolidation and putting debt on a downward path, and to cut expenditures as needed to keep the deficit in line with the budget. However, they expressed a strong preference for revenue administration and expenditure containment measures as opposed to raising taxes. In the area of revenue administration, they pointed to the payoff of their efforts that resulted in an increase in tax revenues to 21.1 percent of GDP in 2017 from 17.5 percent in 2014. The authorities argued that there is still ample room to increase revenues by fighting tax evasion and collecting the remaining outstanding tax arrears. In 2018, they are allocating additional human and IT resources to the revenue administration directorate. They have also engaged an international consultant firm to help them streamline existing tax incentives. The authorities noted that the successful restrain on expenditure to compensate revenue shortfalls in 2016-17 attests to their ability and willingness to keep spending under control and achieve their fiscal deficit objectives. They reported their intention to decree a partial freeze of 10 percent in the goods and services budget for 2018.

18. SOE reform is at the top of the authority's agenda and the ultimate goal is to eliminate the SOEs' need for government support. The restructuring of TACV has advanced somewhat slower than initially planned but the transfer of the domestic operations to a new airline, in which government participation is 30 percent, has been very successful. The authorities reported progress in renegotiating TACV's debts but acknowledged that some obligations will still need to be assumed by the government. The authorities expect to finalize the privatization of the international operations by April 2018. IFH's transfer of social housing to municipalities is ongoing and the sales of larger houses is moving forward. Progress in restructuring Electra has been slower than anticipated but they expect it to gather momentum this year.

19. The authorities shared staff's views on the importance of strengthening fiscal institutions. They expect the new organic budget law to be approved in the coming months. They agreed that closely monitoring the performance of SOEs is a necessary step to reduce fiscal risks.

B. Monetary and Exchange Rate Policy

20. The BCV has maintained an accommodative monetary policy stance citing the absence of price pressures and adequate reserve levels. In June 2017, the BCV cut its policy rate by 200 bp to 1.5 percent bringing the cumulative cuts to 425 bp since August 2014. The BCV also adopted measures to strengthen the monetary policy transmission mechanism, in line with IMF technical assistance advice, with the objective of shortening the current transmission lag of about six months. The response of credit to the economy to the monetary policy stimulus has been sluggish but is now recovering, reaching 5.3 percent annual growth in November 2017. Excess liquidity in the banking system has continued to accumulate reaching the equivalent of 10.8 percent of GDP in November 2017. The flow of migrant deposits has started to slow down reflecting the narrower interest rate differential between the Cabo Verde and the US but remains sizable. In 2017, the annual flow of migrant deposits was equivalent to 2.3 percent of GDP, and the stock represented 38 percent of total deposits (37 percent of GDP).

Staff's Views

21. The BCV's monetary policy stance has been appropriate in the absence of pressures on reserves and consistent with the objective of protecting the peg. However, a reversal in fiscal consolidation efforts could lead to pressures on reserves, in which case the BCV will need to tighten monetary policy. The BCV should monitor the evolution of migrant deposits as monetary policy conditions normalize in the US and the Euro zone. Measures adopted to strengthen the monetary transmission mechanism are welcome and can be complemented by narrowing the overnight interest rate corridor to a maximum 150–200 basis points and establishing a symmetrical interest rate corridor with rates linked to the key policy rate. The BCV should step up efforts to strengthen its liquidity management capacity and develop a plan to address the high level of excess liquidity in the banking system.

22. The BCV should aim at maintaining international reserves coverage above five months of prospective imports to guard against vulnerabilities. A reserve adequacy assessment using the Fund's LIC/MIC framework under the fixed exchange rate assumption estimated the optimal reserve level at about four months of prospective imports. However, given the economy's small size, the high external debt level, the significant level of migrant deposits, and the lack of export diversification, a higher level is desirable.

23. Plans to adopt a new foreign exchange law and a new BCV organic law are welcome. By consolidating the existing foreign exchange legislation and liberalizing the already de facto open capital and financial accounts this law will support efforts to advance Cabo Verde's integration in the global economy. However, this liberalization will further limit the BCV's freedom to conduct monetary policy. In the near term, the BCV should develop contingency plans in case there is a surge in capital outflows following the enactment of the law. Regarding the proposed BCV organic law, the draft under consideration needs to be strengthened to achieve the objectives of buttressing the operational independence of BCV and limiting budget financing.

Authorities' Views

24. The authorities agreed with staff's views on monetary policy and reserve adequacy. The BCV agreed on the need to continue strengthening the monetary transmission mechanism to shorten the current transmission lag of about six months. They reiterated their commitment to the two-decades long peg and noted that preserving the peg's credibility required a significant cushion of reserves.[7] The BCV stated their readiness to tighten monetary policy to ensure maintaining international reserves equivalent to at least a third of broad money. They concurred that the enactment of the new foreign exchange law could prompt capital outflows but noted that there are provisions in the law that would allow the BCV to act if that were the case.

C. Financial Sector Policies

25. Financial stability indicators have improved but NPLs remain high (Table 5). Non-performing loans are high representing about 17.3 percent of total loans with legacy loans relating to real estate development projects during 2006-08 contributing to about 70 percent of the stock of NPLs. Excluding these loans, NPLs represent 6.3 percent of total loans (Text Table 2). In February 2015, the BCV extended the period to liquidate repossessed assets in 2013-16 from 2 to 5 years.

[7] In mid-1998 an agreement with Portugal established a pegged rate of 1 Portuguese escudo = 0.55 Cabo Verdean escudo. Since the replacement of the Portuguese escudo with the euro, the Cabo Verdean escudo has been pegged to the euro at a rate of 1 EUR = 110.265 CVE. This peg is supported by a credit facility from the Portuguese Treasury.

These assets will need to start being liquidated or written off banks' balance sheets in 2018. The high non-performing loans continue to weigh on credit to the economy and growth. The authorities are considering initiatives to promote bank lending, including providing partial guarantees on loans to SMEs.

Text Table 2. Cabo Verde: Impact of Legacy Loans Write-off on Bank Capital[1]
(millions of Escudos)

Non-performing loans to total loans (percent)	17.3
Capital	16,522
Risk weighted assets	97,201
Capital adequacy ratio without write-off (percent)	**17.0**
Provision	9,943
Legacy NPLS	12,799
Non-performing loans less of legacy NPLS to total loans (percent)	**6.3**
Additional provisioning required to write-off	2,856
Capital after write-off of legacy loans	13,666
Risk weighted assets without legacy loans	84,402
Capital adequacy ratio with write-off of legacy loans (percent)	**16.2**

1/ Data as of end-September 2017

Source: Central Bank of Cabo Verde

26. Commercial banks and the BCV have lost some of their CBRs with global banks. The number of active correspondent banks declined to 33 in 2017 from in 38 in 2015 and the value of payment flows declined by 27 percent between 2014 and 2016. The loss of CBRs represents a major vulnerability given Cabo Verde's reliance on migrant remittances and deposits. Cabo Verde has agreed with the EU to adopt a number of tax good governance standards to avoid being listed as a non-cooperative jurisdiction for tax purposes.

27. Stress tests indicate that the banking system is becoming more resilient but still vulnerable to credit shocks. According to the BCV's latest stress test of the banking system, in the event of the materialization of credit risk (shocks in credit to sectors such as housing, consumption, tourism, and construction and public works), most banks would experience significant losses but would continue to operate comfortably under the minimum capital ratio of 10 percent. The average capital adequacy ratio (CAR) would decline by 1.7 percentage points but no bank would be undercapitalized under any of the sectoral shocks. The risk exposure to a small number of counterparties is high. In the event of default by the three largest debtors, banks would experience significant losses in their portfolio with a reduction in capital of 12.8 percent (1.4 percent of GDP). In this case, the capital adequacy ratio would decline by 6.2 percentage points and 2 banks would not meet the minimum regulatory capital requirements.

Staff's Views

28. Efforts to strengthen banking sector regulation and supervision are important to safeguard financial stability. Resolving the high level of legacy NPLs should be a priority and further forbearance of requirements to write off irrecoverable loans should be avoided. Strict implementation of the recommendations of the 2013 and 2015 asset quality reviews is important to strengthen the banking system. Improving the quality of the models used by banks to assess the quality of their loan portfolio should be priority and the recommendations of the 2017 BCV study in this regard should be implemented, including providing guidance on loan restructuring, collateral valuation and asset classification. The results from the stress test reinforces the need to remain vigilant about the credit worthiness of large debtors. Increasing bank capital to more comfortable levels in view of the underlying risks is advisable.

29. Fostering financial intermediation through structural reforms is important to facilitate the private sector's role as the engine of growth. Reforms should focus on improving access to finance by strengthening collateral repossession, creating a central registry of movable collateral, improving the credit information system, and developing and implementing a financial education program for SMEs. Given the high level of public debt, initiatives to encourage bank lending that would generate potential fiscal liabilities should be avoided.

30. The loss of CBRs represents a vulnerability given Cabo Verde's reliance on migrant remittances and deposits. The BCV is encouraged to work closely with commercial banks to assess the consequences of the loss of CBRs and to develop contingency plans in case more CBRs are lost. Establishing contacts with correspondent banks and their supervisors would help better understand the specific reasons for the loss of CBRs by banks in Cabo Verde. Preventing and possibly reversing the loss of CBRs over time would be facilitated by improving the AML/CFT framework and bringing it in line with the FATF standard, and by effectively cooperating with other jurisdictions on tax issues, including by implementing FATCA and the tax good governance standards agreed with the EU. Cabo Verde is currently undergoing an AML/CFT assessment by GIABA (The Inter-Governmental Action Group against Money Laundering in West Africa), which assesses AML/CFT compliance with international standards set by FATF.

Authorities' Views

31. The authorities shared staff's views on the importance of addressing the high level of NPLs and fostering financial intermediation through structural reforms. They reported that non-legacy NPLs are trending downwards reflecting the dynamism of the economy. Resolving the legacy NPLs is the real challenge and a solution will need to be found in consultation with the banks. They agreed that a lasting increase in financial intermediation can only be achieved through structural reforms. However, in the near term partial loan guarantees could play an important role in facilitating access to credit by SMEs. Regarding the potential fiscal cost, they noted it would be small; the 2018 budget limits the issuance of loan guarantees for the private sector to 0.7 percent of GDP.

32. The authorities expressed concern about the loss of CBRs and assign a high priority to preserving existing ones. In their view, the loss of CBRs in Cabo Verde is related to the economy's scale that does not generate enough business to compensate for the due diligence costs that correspondent banks need to incur. They argued that Cabo Verde's AML/CFT framework is by and large aligned with international standards. The authorities reported to be working on improving the cooperation with other jurisdictions on tax issues.

D. Structural Reforms

33. The reorientation of development model presented in the *Strategic Plan for Sustainable Development* (PEDS) 2017–21 aims at exploiting Cabo Verde's privileged geographical position to further its integration into the world economy, and to diversify its economic activities and export markets (Annex V).

Staff's Views

34. Steady implementation of structural reforms is critical to boost potential growth and reduce poverty. The protracted economic slowdown observed in 2012-15 made evident the vulnerabilities faced by a poorly diversified small economy. Going forward the high indebtedness of the public sector limits the role it can play in promoting economic growth through active demand management policies.

35. Cabo Verde ranks well on social indicators compared with Sub-Saharan Africa but poverty, inequality and unemployment remain high. Improving the efficiency and flexibility of the labor market is important to increase productivity, raise employment, and tackle informality. To these aims, efforts to improve the quality and relevance of education and training are central, particularly to address the high levels of youth and female unemployment. In contrast, large increases in the minimum wage unrelated to productivity gains, like the recently decreed 18 percent increase to private sector workers, do not bode well for the competitiveness and efforts to reduce informality. The PEDS rightly envisages policies to promote inclusive growth, including investing in transport infrastructure to integrate the islands, and strengthening the linkages between tourism and the agricultural sector. However, it will take time for these structural policies to pay off. In the near term adequately protecting the poor requires strengthening and improving the targeting of social programs, and protecting social spending from the fiscal consolidation efforts. It also requires to have in place a safety net to protect the most vulnerable groups in society from the consequences of natural disasters that are common in Cabo Verde.

Authorities' views

36. The authorities noted that the shift to a private sector-led development model aims at improving efficiency and competitiveness. In their view, the public sector has demonstrated to be highly inefficient and incapable of generating the economic dynamism required to foster inclusive growth and sustained improvements in living standards. They expect a significant pay-off in terms of increasing productivity and potential output growth from reforms to improve the business environment, the privatization of inefficient SOEs, and bringing in the private sector to address infrastructure bottlenecks, including inter-island transportation. They are also optimistic about the prospects of making Cabo Verde a tourism and logistics hub. The authorities concurred that sustainable increases in wages can only be achieved by increasing productivity and investing in human capital. In this connection, they reported their plans to reform the education sector to make it more efficient and well-tailored to the needs of the country. They agreed on the importance of providing well-targeted support to the most vulnerable groups in society. The ongoing work on the single social registry (*Cadastro Social Unico*) will help them to better target social expenditure. The authorities reported ongoing work in developing a strategic mitigation and response plan to national disasters.

STAFF APPRAISAL

37. Cabo Verde's economic recovery is gaining momentum reflecting a more favorable external environment and the pay-off of recent economic reforms. The economy is estimated to have expanded by 4 percent in 2017 supported by the double digit-growth in tourist arrivals, the recovery in credit to the economy, and stronger consumer and business confidence. In 2018, output growth is projected to accelerate to 4.3 percent, supported by those same factors. The current account deficit is projected to widen to 9.5 percent of GDP and remain mostly financed by FDI. International reserves coverage is projected to remain at about 5½ months of prospective imports in 2018; an adequate level given the economy's size, the high external debt level, significant level of migrant deposits, and lack of export diversification.

38. The favorable external conditions present an opportunity to accelerate progress towards the goal of promoting inclusive economic growth and addressing vulnerabilities. The medium-term outlook is broadly stable conditional on a decisive implementation of the government's reform agenda. The projected decline in international reserves coverage over the medium term calls for a more decisive fiscal consolidation. External and domestic risks have become more balanced as the recovery in Europe gathers pace but vulnerabilities remain. Weaker-than-expected global growth, tighter global financial conditions, and the loss of correspondent banking relations (CBRs) represent downside risks to the economic and financial outlook.

39. Fiscal policy should be geared towards reducing the risk of external debt distress to moderate. The decline in the stock of public debt in 2017 is welcome and reflects the authorities' determination to mobilize domestic revenues and contain expenditures. However, the risk of external debt distress currently remains high. Significantly reducing the high public debt is necessary to support higher growth in the medium term, and to safeguard macroeconomic and financial stability. Decisive fiscal consolidation through a combination of revenue and expenditure measures can lower the risk of external debt distress to moderate by 2023. Successful adjustment will require accelerating the restructuring of SOEs to eliminate their need for government support, in particular for the three largest loss-making SOEs (TACV, IFH, and Electra). Fiscal consolidation would also support the external position, which is currently moderately weaker than implied by fundamentals and desirable policy settings.

40. The BCV's monetary policy stance has been appropriate in the absence of pressures on reserves and consistent with the objective of protecting the peg. The BCV needs to remain vigilant as monetary policy conditions normalize in the US and the Euro zone, which may affect the evolution of migrant deposits. Measures adopted in June, 2017 to strengthen the monetary transmission mechanism are welcome. The BCV should step up efforts to strengthen its liquidity management capacity and develop a plan to address the high level of excess liquidity in the banking system.

41. Financial stability indicators have improved but the high level of NPLs needs to be addressed. The BCV's efforts to strengthen banking sector regulation and supervision are important to safeguard financial stability. Resolving the high level of legacy NPLs should be a priority and further forbearance of requirements to write off irrecoverable loans should be avoided.

42. Fostering financial intermediation is important to strengthen the private sector's role as the engine of growth. Reforms should focus on strengthening collateral repossession, improving the credit information system, and developing and implementing a financial education program for SMEs. Given the high level of public debt, initiatives to encourage bank lending that generate contingent fiscal liabilities should be avoided.

43. The loss of CBRs represents a vulnerability given Cabo Verde's reliance on migrant remittances and deposits. The BCV should work closely with commercial banks to assess the consequences of the loss of CBRs and to develop contingency plans in case additional CBRs are lost. Preventing and possibly reversing the loss of CBRs over time would be facilitated by strengthening the AML/CFT framework in line with international standards, by addressing any deficiencies that may be identified in the ongoing AML/CFT assessment, and by effectively cooperating with other jurisdictions on tax issues.

44. Plans to adopt a new foreign exchange law and a new BCV organic law are welcome. By consolidating the existing foreign exchange legislation and liberalizing the already de facto open capital and financial accounts this law will support efforts to further integrate Cabo Verde in the global economy. The draft BCV organic law under consideration should be strengthened to achieve the objectives of reinforcing the BCV operational independence and limiting budget financing.

45. Steady implementation of structural reforms is critical to boost potential growth and reduce poverty. Improving the efficiency and flexibility of the labor market, as well as the quality and relevance of education, are particularly important to increase productivity, and address the high levels of youth and female unemployment. Staff welcomes the PEDS focus on reforms to promote inclusive growth but notes that these reforms are likely to take time to bear fruit. In the near term, adequately protecting the poor requires strengthening and improving the targeting of social programs, and protecting social spending from the fiscal consolidation efforts.

46. It is proposed that the next Article IV consultation with Cabo Verde be held on the standard 12-month cycle.

Table 1. Cabo Verde: Risk Assessment Matrix[1]

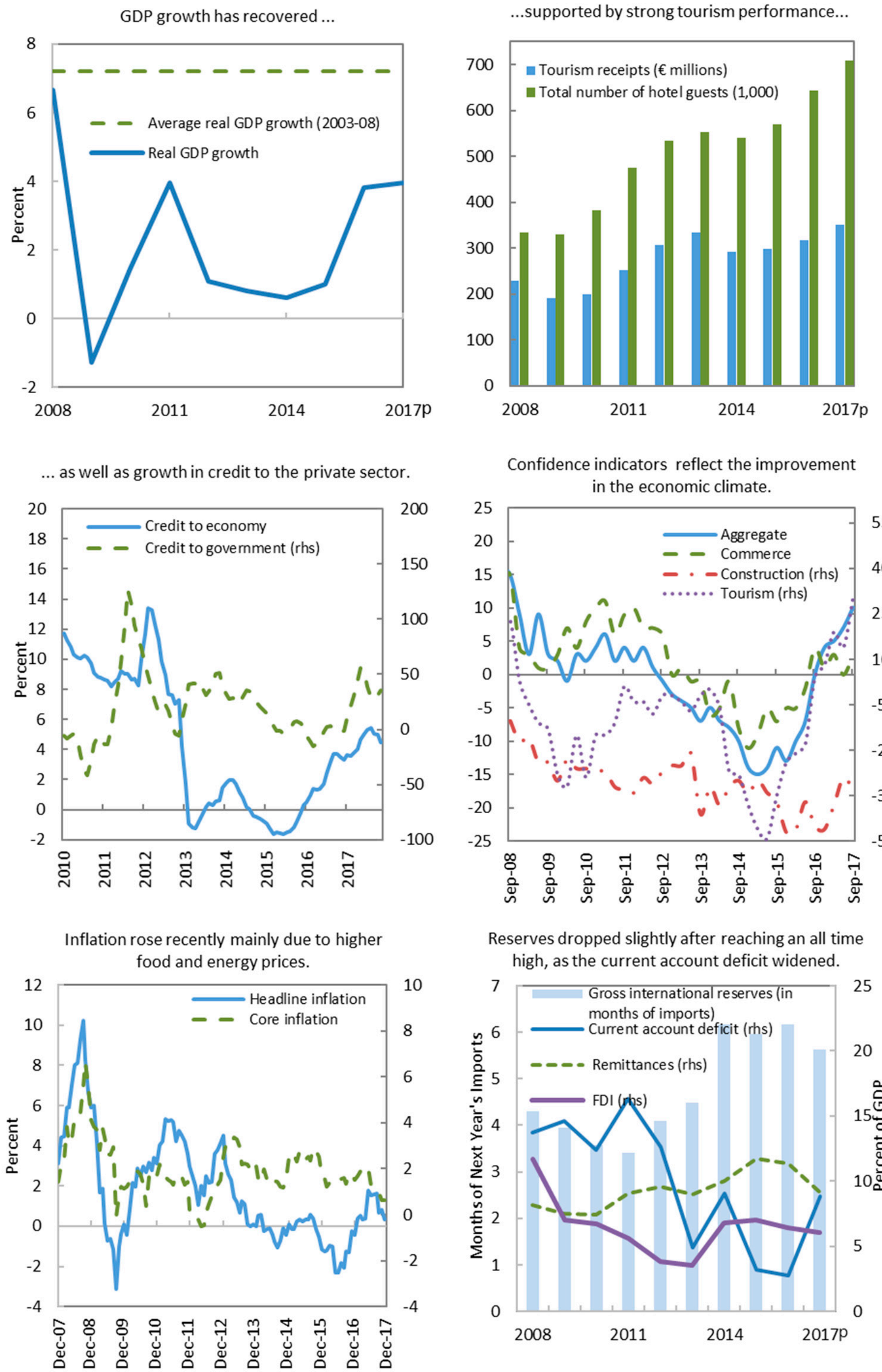
(Scale—high, medium, or low)

Source of Risks	Relative Likelihood[2]	Impact if Realized	Policy Response
Weaker-than-expected global growth	**High** Structurally weak growth in key advanced economies: low productivity growth, high debt, a failure to fully address crisis legacies by undertaking structural reforms amidst persistently low inflation undermine medium term growth in advanced economies.	**Medium/High** Prolonged stagnation in Europe would depress exports, remittances, and FDI. This would have a significant impact on economic growth, external sustainability, and foreign reserves.	Accelerate structural reforms to increase productivity and improve the business environment.
Tighter or more volatile global financial conditions	**High** Against the backdrop of continued monetary policy normalization and increasingly stretched valuations across asset classes, an abrupt change in global risk appetite could lead to sudden, sharp increases in interest rates and associated tightening of financial conditions. Higher debt service and refinancing risks could stress leveraged firms, households, and vulnerable sovereigns, including capital account pressures in some cases.	**Medium** Higher interest rate in the US and Europe may reduce the flow of migrant deposits to Cabo Verde. Cabo Verde's tourism real estate sector depends on FDI. Financial market volatility could hamper investment in Cabo Verde.	Tighten monetary policy. Accelerate reforms to increase productivity and improve the business environment.
Reduced financial services by correspondent banks	**Medium** Significant curtailment of cross border financial services in emerging and developing economies	**High** BCV and commercial banks have lost some CBRs. Further loss of CBRs could reduce capital flows and threaten the stability of the banking system given the country's dependence on migrant remittances and deposits.	Develop contingency plans to limit the loss of CBRs. Further strengthen the AML/CFT framework.
Wavering fiscal consolidation and SOEs restructuring efforts	**Medium** Political pressures lead to less ambitious fiscal consolidation efforts and the restructuring of SOEs is delayed.	**High** Slower fiscal consolidation undermines perception of macroeconomic stability, reduces capital inflows and weakens confidence in the peg. Higher public sector financing needs crowd out private investment resulting in lower growth	Reduce current spending and postpone or cancel non-priority infrastructure projects. Reinvigorate the SOEs reform plans.
Delays in implementing measures to increase productivity	**Medium** Political pressures delay implementation of needed structural reforms is delayed.	**Medium** Delays in advancing the structural reform agenda hinder competitiveness, potential GDP growth and theesmining the stability of the exchange peg. This would propt the central bank to tighten ce the employment creation.	Accelerate structural reforms.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path—the scenario most likely to materialize in the view of the staff. The RAM reflects staff's views on the source of risks and overall level of concerns as of the time of the discussion with the authorities. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline.

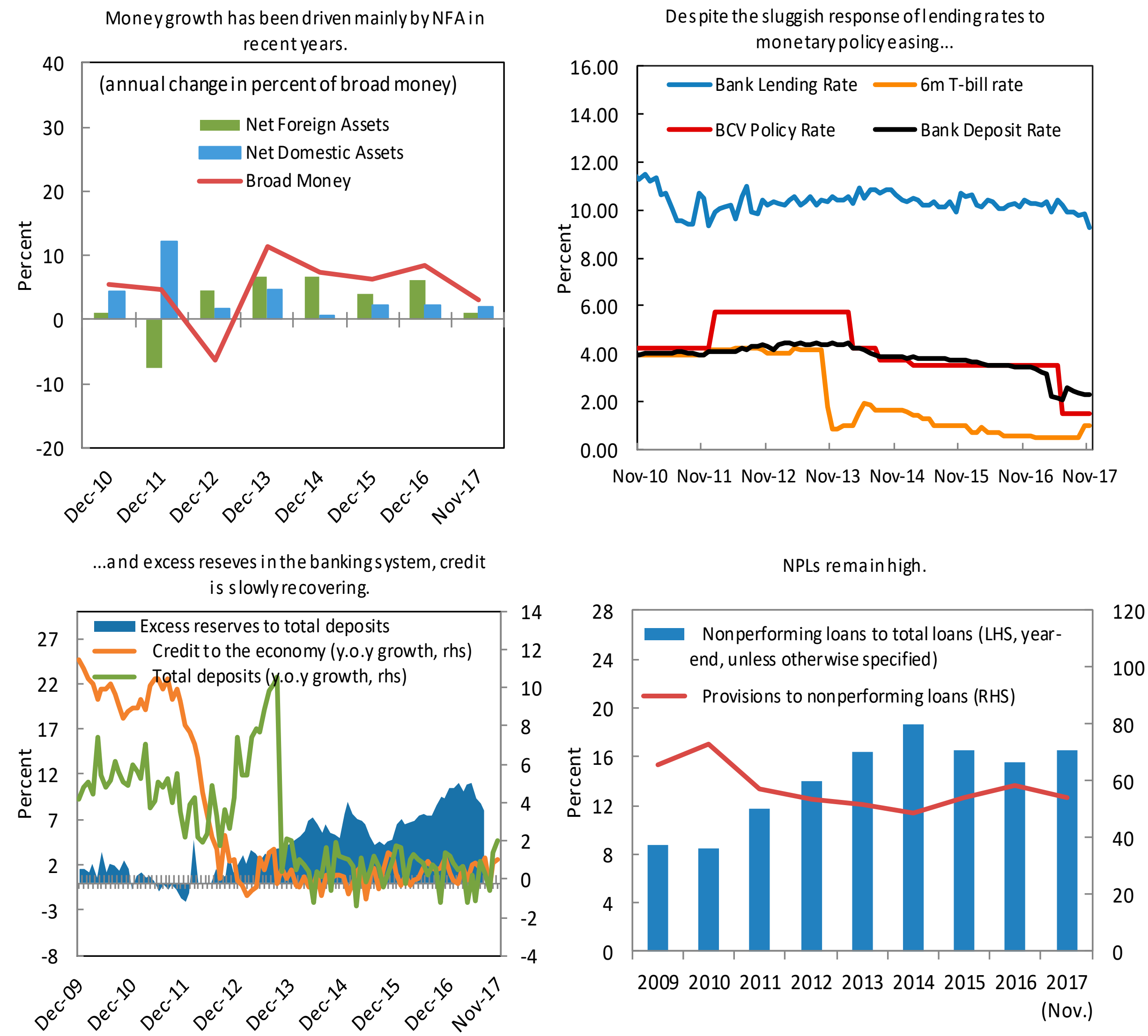
[2] In case the baseline does not materialize.

Figure 1. Cabo Verde: Recent Economic Developments



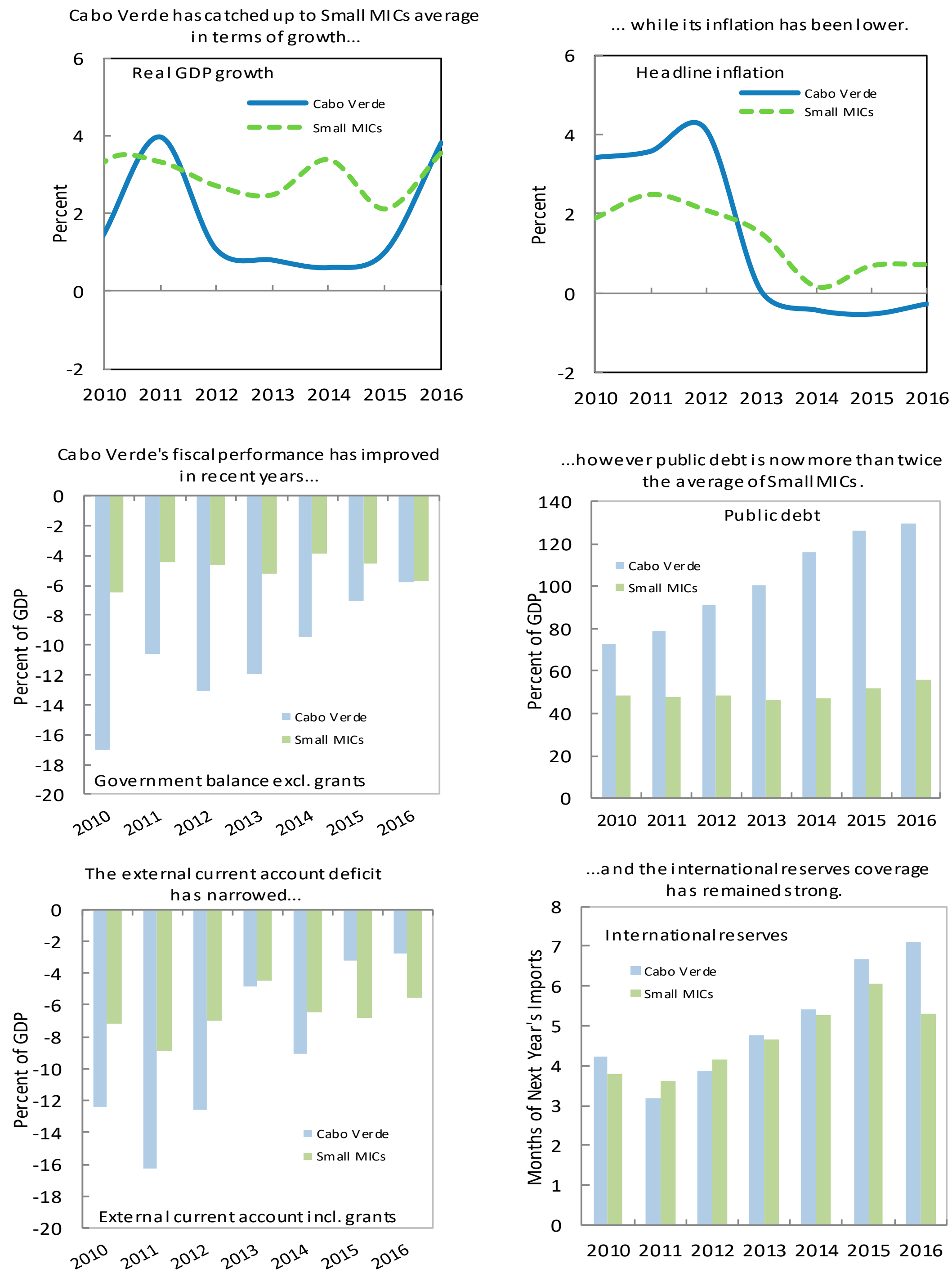
Sources: Cabo Verdean authorities and IMF staff.

Figure 2. Cabo Verde: Monetary Developments and Credit Growth



Sources: Cabo Verdean authorities and IMF staff.

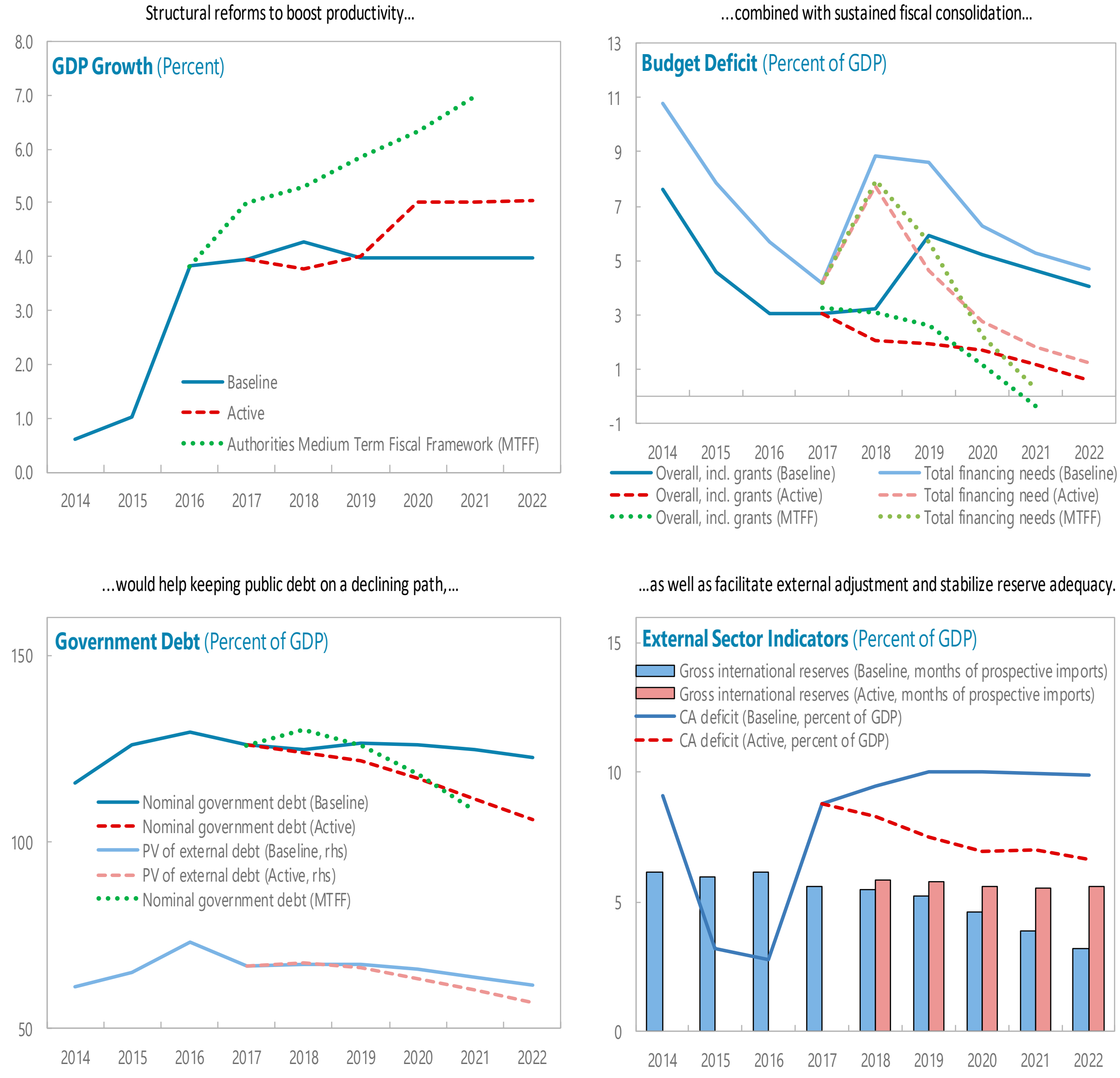
Figure 3. Cabo Verde: Performance Compared to Small Middle-Income Peers[1]



Sources: IMF, World Economic Outlook 2017; Cabo Verdean authorities; and IMF staff.

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

Figure 4. Cabo Verde: Selected Economic Indicators Under the Baseline and Active Scenarios, 2014-22



Sources: Cabo Verdean authorities and IMF staff.

Table 2. Cabo Verde: Selected Economic Indicators, 2014–23

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Prel.			Proj.			
				(Annual percent change)						
National accounts and prices [1,2]										
Real GDP	0.6	1.0	3.8	4.0	4.3	4.0	4.0	4.0	4.0	4.0
GDP deflator	-0.1	1.7	-0.8	0.1	1.4	1.6	2.0	2.0	2.0	2.0
Consumer price index (annual average)	-0.2	0.1	-1.4	0.8	1.0	1.5	2.0	2.0	2.0	2.0
Consumer price index (end of period)	-0.4	-0.5	-0.3	0.3	1.0	1.5	2.0	2.0	2.0	2.0
External sector										
Exports of goods and services	2.7	-11.6	11.8	11.3	10.9	7.0	7.1	7.1	7.1	7.1
Of which: tourism	-12.5	2.0	7.0	10.0	13.7	6.5	6.5	6.5	6.5	6.5
Imports of goods and services	6.3	-12.3	11.8	15.2	8.1	7.4	7.0	7.0	7.0	7.0
				(Change in percent of broad money, 12 months earlier)						
Money and credit										
Net foreign assets	6.7	3.9	6.1	-1.5	1.7	0.5	-1.4	-2.4	-2.2	-2.1
Net domestic assets	0.7	2.4	2.3	4.5	4.1	4.5	4.7	4.8	4.9	4.6
Net claims on the central government	2.1	0.4	1.9	-1.4	3.0	1.5	1.6	1.6	1.7	1.7
Credit to the economy	-0.7	1.8	2.4	3.2	3.3	2.8	2.8	2.8	2.9	3.0
Broad money (M2)	7.4	6.3	8.4	3.0	5.8	5.0	3.3	2.4	2.7	2.5
				(Percent of GDP, unless otherwise indicated)						
Savings and investment										
Domestic savings	27.9	35.6	34.7	29.6	26.5	27.8	27.9	28.0	28.3	28.5
Government	-1.9	0.7	-0.7	1.5	0.6	0.0	0.1	0.5	1.6	1.6
Private	29.8	34.9	35.4	28.1	25.9	27.8	27.8	27.5	26.7	26.9
National investment	34.5	38.8	37.4	38.4	36.0	37.8	37.9	37.9	38.1	38.4
Government	6.2	5.6	3.4	5.0	3.7	5.5	4.8	4.7	4.7	4.7
Private	28.3	33.2	34.0	33.4	32.3	32.4	33.1	33.2	33.5	33.7
Savings-investment balance	-6.6	-3.2	-2.8	-8.8	-9.5	-10.0	-10.0	-9.9	-9.9	-9.9
Government	-8.1	-4.9	-4.1	-3.5	-3.1	-5.5	-4.7	-4.2	-3.1	-3.1
Private	1.5	1.7	1.4	-5.3	-6.4	-4.6	-5.3	-5.8	-6.8	-6.8
External sector										
External current account (including official transfers)	-9.1	-3.2	-2.8	-8.8	-9.5	-10.0	-10.0	-9.9	-9.9	-9.9
External current account (excluding official transfers)	-12.1	-6.6	-5.8	-11.0	-10.7	-11.3	-11.2	-11.2	-11.1	-11.1
Overall balance of payments	5.1	2.2	5.9	-0.5	1.3	0.8	-1.7	-2.6	-2.7	-1.8
Gross international reserves (months of prospective imports of goods and services)	6.2	6.0	6.2	5.6	5.4	5.2	4.6	3.9	3.2	3.0
Government finance										
Revenue	22.9	26.9	27.0	28.4	29.8	28.1	27.5	27.2	27.7	27.6
Tax and nontax revenue	21.1	24.4	24.2	24.9	27.9	26.8	26.5	26.3	26.7	26.8
Grants	1.8	2.5	2.8	3.5	1.9	1.3	1.0	0.9	0.9	0.9
Expenditure	30.5	31.4	30.1	31.4	33.0	34.0	32.7	31.8	31.7	31.7
Overall balance (incl. grants)	-7.6	-4.6	-3.1	-3.0	-3.2	-5.9	-5.2	-4.6	-4.1	-4.1
Net other liabilities (incl. onlending) [3]	-3.2	-3.0	-3.5	-1.2	-5.7	-2.7	-1.1	-0.7	-0.6	-0.6
Total financing (incl. onlending and capitalization)	10.7	7.7	5.6	4.2	8.9	8.6	6.3	5.3	4.7	4.7
Net domestic credit	0.6	1.0	2.9	0.9	2.3	3.0	3.0	3.0	3.0	3.0
Net external financing	10.1	6.7	2.7	3.5	6.6	5.6	3.3	2.3	1.7	1.7
Public debt stock and service										
Total nominal government debt	115.9	126.0	129.5	126.0	124.7	126.7	126.1	124.6	122.7	120.9
External government debt	89.0	97.0	97.3	94.1	94.5	94.7	92.6	89.7	86.4	83.3
Domestic government debt	26.9	29.0	32.2	31.9	30.2	32.0	33.5	35.0	36.4	37.7
External debt service (percent of exports of goods and services)	4.8	6.4	5.7	6.5	6.5	7.3	8.4	9.0	9.6	9.1
Present value of external debt										
Percent of GDP (risk threshold: 50%)	…	65.0	73.3	66.9	67.4	67.3	65.9	64.0	61.7	60.5
Percent of revenue (risk threshold: 300%)	…	266.3	302.5	269.2	241.6	250.8	248.5	243.0	231.0	226.2
Percent of exports (risk threshold: 200%)	…	155.0	163.4	139.5	133.9	132.1	128.1	123.1	117.8	114.5
Memorandum items:										
Nominal GDP (billions of Cabo Verde escudos)	154.4	158.7	163.4	170.1	179.8	189.9	201.3	213.6	226.6	240.4
Gross international reserves (€ millions, end of period)	419.7	453.3	541.0	532.8	553.5	566.8	534.8	483.8	429.0	389.0

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

[1] Last data available for national accounts is for 2016.

[2] The Cabo Verdean exchange rate has been pegged to the Euro since 1999, at a rate of 110.265 CVE/€.

[3] Includes errors and omissions.

Table 3. Cabo Verde: Balance of Payments, 2014–23
(Millions of Euros; unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
			Prel.				Proj.			
Current account	**-127**	**-46**	**-41**	**-136**	**-155**	**-173**	**-183**	**-193**	**-203**	**-215**
Trade balance	-455	-427	-483	-579	-636	-694	-751	-794	-854	-903
Exports, f.o.b.	192	135	135	152	159	164	169	193	205	233
Imports, f.o.b.	647	561	618	731	795	858	920	987	1,059	1,135
Consumer goods	211	216	244	275	301	326	349	373	399	429
Intermediate goods	128	128	151	170	186	201	215	230	246	264
Capital goods	101	77	86	96	106	114	122	131	140	150
Others (including fuel)	206	141	138	189	203	217	233	253	275	292
Fuel	89	69	52	65	62	61	60	61	63	65
Services (net)	198	205	236	268	321	352	386	405	438	459
Receipt	482	460	530	588	662	714	771	813	872	921
Of which: tourism	291	297	318	350	398	424	451	481	512	545
Payment	284	255	295	321	341	362	384	409	434	462
Primary Income (net)	-70	-53	-54	-66	-63	-71	-78	-84	-89	-96
Of which: interest on public debt	-14	-16	-15	-18	-20	-22	-22	-22	-22	-23
Secondary Income (net)	200	229	261	241	223	240	260	281	302	324
General Government	42	49	45	33	20	21	22	24	25	27
Other Sectors	158	180	216	208	203	219	237	257	277	297
Of which: remittances	140	169	162	154	149	164	182	201	221	240
Capital account	**6**	**17**	**12**	**29**	**13**	**8**	**4**	**4**	**18**	**19**
Of which: Grants	5	16	10	29	13	8	4	4	18	19
Financial account[1]	**-98**	**-74**	**-31**	**-62**	**-142**	**-165**	**-179**	**-188**	**-185**	**-197**
Foreign direct investment	-95	-101	-95	-93	-133	-147	-151	-157	-162	-181
Portfolio investment	18	32	36	37	37	37	37	37	37	37
Other investment	-92	-37	-60	3	-66	-68	-32	-17	-5	-13
Net acquisition of financial assets	-63	48	-31	23	23	22	22	22	17	19
Net incurrence of liabilities	29	85	28	20	88	90	54	39	22	32
Monetary authority	-2	0	0	0	0	0	0	0	0	0
Central government	143	96	33	53	109	97	60	44	35	37
Disbursements	162	119	53	83	142	139	117	113	116	120
Amortization	-18	-23	-23	-30	-33	-42	-57	-69	-81	-82
Exceptional financing	0	0	3	0	0	0	0	0	0	0
Commercial banks	-75	-25	-2	5	5	5	-2	-1	-9	0
Non-bank flows	-37	-22	-10	-38	-25	-11	-4	-4	-5	-5
Reserve assets (+ accumulation)	71	32	88	-8	21	13	-32	-51	-55	-40
Errors and omissions[2]	**23**	**-45**	**-1**	**45**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance	**71**	**32**	**88**	**-8**	**21**	**13**	**-32**	**-51**	**-55**	**-40**
Memorandum items:										
Current account (incl. official transfers, percent of GDP)	-9.1	-3.2	-2.8	-8.8	-9.5	-10.0	-10.0	-9.9	-9.9	-9.9
Current account (excl. official transfers, percent of GDP)	-12.1	-6.6	-5.8	-11.0	-10.7	-11.3	-11.2	-11.2	-11.1	-11.1
Overall balance (percent of GDP)	5.1	2.2	5.9	-0.5	1.3	0.8	-1.7	-2.6	-2.7	-1.8
Gross international reserves	420	453	541	533	553	567	535	484	429	389
Months of current year's imports of goods and services	5.4	6.7	7.1	6.1	5.8	5.6	4.9	4.2	3.4	2.9
Months of next year's imports of goods and services	6.2	6.0	6.2	5.6	5.4	5.2	4.6	3.9	3.2	3.0
External public debt	1,247	1,397	1,442	1,451	1,541	1,631	1,690	1,737	1,775	1,816
External aid (grants and loans, percent of GDP)	14.9	12.7	7.2	9.4	10.7	9.8	7.9	7.3	7.7	7.6

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 4a. Cabo Verde: Statement of Operations of the Central Government, 2014–23[1]
(Millions of Cabo Verde Escudos)

	2014	2015	2016	2017		2018		2019		2020		2021		2022	2023
			Prel.	Rev. Budget	Est.	MTFF[2]	Proj.	MTFF[2]	Proj.	MTFF[2]	Proj.	MTFF[2]	Proj.	Proj.	Proj.
Revenue	**35,327**	**42,678**	**44,107**	**50,222**	**48,233**	**54,561**	**53,565**	**57,684**	**53,361**	**60,367**	**55,345**	**65,712**	**58,138**	**62,694**	**66,480**
Taxes	27,060	30,516	32,274	36,006	35,908	42,328	40,520	44,535	42,065	48,212	45,385	52,552	49,001	52,907	56,229
Taxes on income and profit	7,747	9,669	10,049	11,162	11,297	13,196	12,180	14,525	13,123	15,866	14,191	17,302	15,358	16,620	17,635
Taxes on goods and services	12,870	14,047	14,940	16,877	16,845	20,207	19,611	20,418	19,568	21,992	21,161	24,006	22,901	24,782	26,296
Taxes on international trade	5,754	6,082	6,813	7,357	7,224	8,269	8,143	8,885	8,741	9,578	9,351	10,356	10,003	10,705	11,449
Other taxes	688	719	472	610	544	655	586	708	631	776	683	888	739	800	849
Grants	2,787	3,958	4,507	5,507	5,948	3,415	3,415	2,381	2,381	1,926	1,926	1,926	1,926	2,112	2,112
Other revenue	5,480	8,203	7,325	8,709	6,376	8,818	9,630	10,767	8,915	10,229	8,034	11,234	7,211	7,675	8,139
Of which: Fees and penalties	706	404	679	795	463	717	489	742	517	768	548	797	581	617	655
Expenditure	**47,082**	**49,907**	**49,139**	**55,582**	**53,408**	**60,258**	**59,332**	**62,483**	**64,647**	**63,498**	**65,834**	**64,511**	**67,998**	**71,934**	**76,291**
Current expenditure	**37,542**	**41,068**	**43,567**	**49,539**	**44,853**	**53,644**	**52,717**	**52,092**	**54,256**	**53,757**	**56,093**	**54,515**	**58,002**	**61,319**	**65,108**
Compensation of employees	17,172	17,530	18,365	20,331	19,016	21,672	21,672	21,785	22,197	22,066	22,641	22,334	23,094	24,501	25,998
Use of goods and services	5,744	7,433	7,563	8,048	7,095	9,265	8,339	7,920	8,464	8,621	8,633	8,683	8,806	9,128	9,685
Interest	3,444	4,134	4,223	4,769	4,522	5,496	5,496	5,794	5,767	5,956	6,195	6,024	6,613	7,013	7,483
Subsidies	107	161	167	233	120	253	253	253	253	253	253	253	253	268	284
Current transfers	4,389	4,755	4,895	5,398	5,845	6,106	6,106	6,251	6,251	6,738	6,738	7,143	7,143	7,578	8,041
Social benefits	4,348	4,735	5,165	5,476	5,542	5,660	5,660	5,841	5,841	5,819	5,819	5,925	5,925	6,286	6,670
Other expense (incl. capital transfer)	2,339	2,320	3,189	5,285	2,712	5,192	5,192	4,249	5,484	4,305	5,814	4,153	6,169	6,545	6,945
Net acquisition of nonfinancial assets	**9,540**	**8,839**	**5,572**	**6,043**	**8,555**	**6,614**	**6,614**	**10,391**	**10,391**	**9,741**	**9,741**	**9,996**	**9,996**	**10,615**	**11,183**
of which: IFH housing transfer transaction					4,200										
Primary balance	**-8,312**	**-3,095**	**-809**	**-591**	**-652**	**-201**	**-270**	**995**	**-5,520**	**2,826**	**-4,293**	**7,225**	**-3,247**	**-2,228**	**-2,327**
Overall balance	**-11,756**	**-7,229**	**-5,032**	**-5,360**	**-5,174**	**-5,697**	**-5,766**	**-4,799**	**-11,287**	**-3,130**	**-10,489**	**1,201**	**-9,860**	**-9,240**	**-9,810**
Net other liabilities	**-4,907**	**-4,819**	**-5,694**	**-7,683**	**-1,961**	**-10,175**	**-10,175**	**-5,067**	**-5,067**	**-2,180**	**-2,180**	**-1,425**	**-1,425**	**-1,433**	**-1,521**
Of which: Onlending	-4,908	-3,656	-4,526	-6,155	-1,179	-7,238	-7,238	-1,986	-1,986	-829	-829	-74	-74	0	0
Of which: Capitalization	-101	-1,457	-1,508	-1,610	-782	-4,015	-4,015	-3,082	-3,082	-1,351	-1,351	-1,351	-1,351	-1,433	-1,521
Net errors and omissions	**-150**	**130**	**-1,501**	**112**	**316**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Total financing (incl. onlending and capitalization)	**16,513**	**12,178**	**9,225**	**13,156**	**7,451**	**15,872**	**15,941**	**9,867**	**16,354**	**5,310**	**12,668**	**224**	**11,285**	**10,673**	**11,331**
Net domestic credit	**908**	**1,599**	**4,771**	**4,112**	**1,493**	**4,076**	**4,146**	**3,334**	**5,696**	**2,227**	**6,039**	**1,658**	**6,408**	**6,798**	**7,213**
Net external financing	**15,605**	**10,579**	**4,454**	**9,043**	**5,958**	**11,795**	**11,795**	**6,533**	**10,658**	**3,083**	**6,629**	**-1,434**	**4,877**	**3,875**	**4,118**

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

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

2/ Authorities' Medium Term Fiscal Framework.

Table 4b. Cabo Verde: Statement of Operations of the Central Government, 2014–23[1]

(Percent of GDP)

	2014	2015	2016	2017		2018		2019		2020		2021		2022	2023
			Prel.	Rev. Budget	Est.	MTFF[2]	Proj.	MTFF[2]	Proj.	MTFF[2]	Proj.	MTFF[2]	Proj.	Proj.	Proj.
Revenue	**22.9**	**26.9**	**27.0**	**29.5**	**28.4**	**30.0**	**29.8**	**29.7**	**28.1**	**29.0**	**27.5**	**29.1**	**27.2**	**27.7**	**27.6**
Taxes	17.5	19.2	19.8	21.2	21.1	23.3	22.5	22.9	22.2	23.1	22.5	23.3	22.9	23.3	23.4
Taxes on income and profit	5.0	6.1	6.2	6.6	6.6	7.3	6.8	7.5	6.9	7.6	7.0	7.7	7.2	7.3	7.3
Taxes on goods and services	8.3	8.9	9.1	9.9	9.9	11.1	10.9	10.5	10.3	10.5	10.5	10.6	10.7	10.9	10.9
Taxes on international trade	3.7	3.8	4.2	4.3	4.2	4.6	4.5	4.6	4.6	4.6	4.6	4.6	4.7	4.7	4.8
Other taxes	0.4	0.5	0.3	0.4	0.3	0.4	0.3	0.4	0.3	0.4	0.3	0.4	0.3	0.4	0.4
Grants	1.8	2.5	2.8	3.2	3.5	1.9	1.9	1.2	1.3	0.9	1.0	0.9	0.9	0.9	0.9
Other revenue	3.5	5.2	4.5	5.1	3.7	4.9	5.4	5.5	4.7	4.9	4.0	5.0	3.4	3.4	3.4
Of which: Fees and penalties	0.5	0.3	0.4	0.5	0.3	0.4	0.3	0.4	0.3	0.4	0.3	0.4	0.3	0.3	0.3
Expenditure	**30.5**	**31.4**	**30.1**	**32.7**	**31.4**	**33.2**	**33.0**	**32.2**	**34.0**	**30.5**	**32.7**	**28.6**	**31.8**	**31.7**	**31.7**
Expense	24.3	25.9	26.7	29.1	26.4	29.5	29.3	26.8	28.6	25.8	27.9	24.1	27.2	27.1	27.1
Compensation of employees	11.1	11.0	11.2	12.0	11.2	11.9	12.1	11.2	11.7	10.6	11.2	9.9	10.8	10.8	10.8
Use of goods and services	3.7	4.7	4.6	4.7	4.2	5.1	4.6	4.1	4.5	4.1	4.3	3.8	4.1	4.0	4.0
Interest	2.2	2.6	2.6	2.8	2.7	3.0	3.1	3.0	3.0	2.9	3.1	2.7	3.1	3.1	3.1
Subsidies	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Current transfers	2.8	3.0	3.0	3.2	3.4	3.4	3.4	3.2	3.3	3.2	3.3	3.2	3.3	3.3	3.3
Social benefits	2.8	3.0	3.2	3.2	3.3	3.1	3.1	3.0	3.1	2.8	2.9	2.6	2.8	2.8	2.8
Other expense (incl. capital transfer)	1.5	1.5	2.0	3.1	1.6	2.9	2.9	2.2	2.9	2.1	2.9	1.8	2.9	2.9	2.9
Net acquisition of nonfinancial assets	6.2	5.6	3.4	3.6	5.0	3.6	3.7	5.4	5.5	4.7	4.8	4.4	4.7	4.7	4.7
of which: IFH housing transfer transaction					2.5										
Primary balance	**-5.4**	**-2.0**	**-0.5**	**-0.3**	**-0.4**	**-0.1**	**-0.2**	**0.5**	**-2.9**	**1.4**	**-2.1**	**3.2**	**-1.5**	**-1.0**	**-1.0**
Overall balance	**-7.6**	**-4.6**	**-3.1**	**-3.2**	**-3.0**	**-3.1**	**-3.2**	**-2.5**	**-5.9**	**-1.5**	**-5.2**	**0.5**	**-4.6**	**-4.1**	**-4.1**
Net other liabilities	**-3.2**	**-3.0**	**-3.5**	**-4.5**	**-1.2**	**-5.6**	**-5.7**	**-2.6**	**-2.7**	**-1.0**	**-1.1**	**-0.6**	**-0.7**	**-0.6**	**-0.6**
Of which: Onlending	-3.2	-2.3	-2.8	-3.6	-0.7	-4.0	-4.0	-1.0	-1.0	-0.4	-0.4	0.0	0.0	0.0	0.0
Of which: Capitalization	-0.1	-0.9	-0.9	-0.9	-0.5	-2.2	-2.2	-1.6	-1.6	-0.6	-0.7	-0.6	-0.6	-0.6	-0.6
Net errors and omissions	**-0.1**	**0.1**	**-0.9**	**0.1**	**0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Total financing (incl. onlending and capitalization)	**10.7**	**7.7**	**5.6**	**7.7**	**4.4**	**8.7**	**8.9**	**5.1**	**8.6**	**2.5**	**6.3**	**0.1**	**5.3**	**4.7**	**4.7**
Net domestic credit	0.6	1.0	2.9	2.4	0.9	2.2	2.3	1.7	3.0	1.1	3.0	0.7	3.0	3.0	3.0
Net external financing	10.1	6.7	2.7	5.3	3.5	6.5	6.6	3.4	5.6	1.5	3.3	-0.6	2.3	1.7	1.7
Memorandum items:															
GDP at current market prices (billions of CVEsc)	154.4	158.7	163.4	170.1	170.1	181.7	179.8	194.1	189.9	208.5	201.3	225.9	213.6	226.6	240.4

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

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

2/ Authorities' Medium Term Fiscal Framework.

Table 5. Cabo Verde: Monetary Survey, 2014–23
(Millions of Cabo Verde Escudos, unless otherwise indicated)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Prel.	Proj.					
Net foreign assets	42,698	48,463	58,018	55,492	58,390	59,313	56,577	51,751	47,195	42,783
Foreign assets	68,917	75,880	85,390	80,837	86,763	88,225	85,289	80,326	74,817	70,406
Of which: gross international reserves	46,277	49,979	59,658	58,822	61,032	62,493	58,971	53,351	47,302	42,891
Foreign liabilities	-26,219	-27,417	-27,371	-25,345	-28,373	-28,912	-28,712	-28,576	-27,623	-27,623
Net domestic assets	104,970	108,466	112,024	119,652	126,878	135,240	144,399	154,006	164,144	173,911
Net domestic credit	130,745	133,196	137,724	139,026	151,893	160,090	168,791	177,867	187,485	197,588
Net claims on general government (net)	31,706	31,502	32,262	28,185	35,311	38,311	41,507	44,903	48,509	52,338
Investment in TCMFs [1]	11,772	11,636	11,143	11,143	11,143	11,143	11,143	11,143	11,143	11,143
Net claims on the central government	18,828	19,353	22,334	19,910	25,153	28,002	31,021	34,225	37,624	41,231
Credit to central government	27,838	29,299	33,268	36,050	37,183	40,709	44,493	48,518	52,789	57,322
Deposits of central government	-9,010	-9,946	-10,934	-16,139	-12,029	-12,707	-13,472	-14,294	-15,165	-16,091
Of which: project deposits	-41	-47	-47	-277	-277	-277	-277	-277	-277	-277
Net claims on local government and other agencies [2]	1,106	514	-1,216	-2,869	-986	-834	-658	-465	-258	-36
Credit to the economy	99,040	101,694	105,463	110,842	116,583	121,779	127,284	132,964	138,976	145,250
Other items (net)	-25,775	-24,730	-25,700	-19,375	-25,016	-24,849	-24,392	-23,861	-23,341	-23,677
Broad money (M2)	147,668	156,929	170,043	175,144	185,268	194,553	200,976	205,757	211,339	216,694
Narrow money (M1)	59,595	62,413	70,275	64,930	76,567	80,404	83,059	85,034	87,341	89,555
Currency outside banks	8,658	8,967	9,207	9,412	9,136	9,193	9,497	9,723	9,986	10,239
Demand deposits	50,938	53,446	61,067	55,517	67,431	71,211	73,562	75,312	77,355	79,315
Quasi-money	84,918	90,484	95,067	106,307	103,579	108,770	112,361	115,034	118,154	121,148
Foreign currency deposits	3,154	4,032	4,701	3,873	5,122	5,379	5,557	5,689	5,843	5,991
(Change in percent of broad money, 12 months earlier)										
Net foreign assets	6.7	3.9	6.1	-1.5	1.7	0.5	-1.4	-2.4	-2.2	-2.1
Net domestic assets	0.7	2.4	2.3	4.5	4.1	4.5	4.7	4.8	4.9	4.6
Net domestic credit	1.7	1.7	2.9	0.8	7.3	4.4	4.5	4.5	4.7	4.8
Net claims on the central government	2.1	0.4	1.9	-1.4	3.0	1.5	1.6	1.6	1.7	1.7
Credit to the economy	-0.7	1.8	2.4	3.2	3.3	2.8	2.8	2.8	2.9	3.0
Other items (net)	-1.0	0.7	-0.6	3.7	-3.2	0.1	0.2	0.3	0.3	-0.2
Broad money (M2)	7.4	6.3	8.4	3.0	5.8	5.0	3.3	2.4	2.7	2.5
Memorandum items:										
Emigrant deposits	52,779	56,943	60,711	63,563	68,343	71,831	74,203	75,968	78,029	80,006
Emigrant deposits/total deposits (percent)	38.0	38.5	37.7	38.4	38.8	38.8	38.8	38.8	38.8	38.8
Excess reserves/total deposits (percent)	7.2	...	...	...	...	...	...	...	...	...
Money multiplier (M2/M0)	3.2	3.4	3.0	3.1	3.3	3.4	3.4	3.4	3.4	3.4
Money velocity (Nominal GDP/M2)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.1	1.1
Credit to the economy (percent change) [3]	-1.0	2.7	3.7	5.1	5.2	4.5	4.5	4.5	4.5	4.5
Broad money (M2 in percent of GDP)	95.6	98.9	104.1	103.0	103.1	102.5	99.8	96.3	93.3	90.1

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

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

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

[3] Percent change, year over year.

Table 6. Cabo Verde: Financial Soundness Indicators of the Banking Sector

(End-year; percent unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	Mar-17	Jun-17	Sep-17	Nov-17
Capital adequacy											
Regulatory capital to risk-weighted assets	12.8	15.2	14.2	15.1	15.6	16.2	15.5	17.6	17.1	17.0	16.9
Regulatory Tier 1 capital to risk-weighted assets	13.0	15.9	13.9	13.7	14.4	15.0	15.5	16.4	15.9	15.8	15.7
Asset quality[1]											
Nonperforming loans to total loans	8.4	11.8	14.1	16.4	18.7	16.5	15.5	17.1	17.4	17.3	16.6
Nonperforming loans net of provisions to capital	17.1	40.2	47.9	53.5	62.8	49.4	43.5	50.8	56.3	55.9	50.8
Provisions to nonperforming loans	73.1	57.0	53.7	51.6	48.8	54.4	58.3	54.2	51.8	51.7	54.5
Earnings and profitability											
Return on assets	0.7	0.4	0.2	0.3	0.2	0.4	0.3	0.1	0.3	0.5	0.6
Return on equity	9.1	5.6	2.7	3.5	3.1	4.8	4.0	1.7	4.1	6.7	8.1
Interest margin to gross income	76.1	76.2	75.5	75.3	71.8	73.1	76.7	77.2	78.0	78.4	78.9
Noninterest expenses to gross income	67.0	68.5	76.5	78.1	72.5	75.8	67.7	66.7	65.9	64.5	62.9
Liquidity[2]											
Liquid assets to total assets	8.1	7.1	15.0	22.1	30.3	30.3	32.6	32.2	30.2	30.8	30.8
Liquid assets to short-term liabilities	10.5	9.7	21.1	29.0	37.3	37.0	39.2	38.4	36.1	37.4	36.9
Additional indicators											
Government deposits over total deposits	9.5	7.6	9.7	11.4	13.5	12.6	14.5	15.3	16.2	16.8	16.5
Emigrant deposits over total deposits	34.9	37.1	37.1	33.4	32.9	33.3	32.1	32.1	32.7	32.6	31.9
Emigrant deposits over total assets	27.2	27.0	26.5	25.4	26.7	27.3	26.7	26.9	27.3	26.9	26.7
Demand deposits over total deposits	43.8	43.4	42.0	45.5	43.2	42.8	44.0	45.3	45.9	46.8	47.4
Total credit over total deposits	79.1	85.9	79.0	67.4	61.5	59.5	55.6	54.3	56.6	57.2	56.5
Personnel cost over cost of operations	49.0	49.9	50.1	48.4	54.8	56.6	58.8	61.6	59.9	59.0	58.6
Spread (90 day lending - time deposit rate)	7.5	5.2	7.9	7.1	7.1	8.3	6.6	6.4	7.6	8.2	5.0

Source: Bank of Cabo Verde.

[1]Based on IFRS definition.

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

Annex I. Implementation of Past IMF Policy Advice

Policy Support Instrument, 2006–10 and 2010–12

The objective of the first PSI (2006–10) was to reduce vulnerabilities, including from the prospect of a longer-term decline in concessional financing resulting from the country's graduation to middle income status in 2008. Macroeconomic performance under the PSI was particularly strong, helping to lay the foundation for the countercyclical fiscal response to the global financial crisis. All eight program reviews were completed through 2010, with robust growth performance and structural reforms progressed in the tax and PFM areas. The authorities also completed an FSAP in 2009. Overall, strong ownership of policies by the authorities contributed to its success and the PSI was instrumental in supporting the authorities' poverty reduction strategy.

The second PSI was implemented in a more difficult environment of weak global demand, especially from the euro zone, and shocks to fuel and food prices. Staff supported the authorities' focus on reducing infrastructure bottlenecks but cautioned against the rising macroeconomic vulnerabilities, including low reserves, high fiscal and current account deficits and rapid growth in external debt. The PSI concentrated on reforming public enterprises, broadening the tax base, and enacting a new banking law that covered both onshore and offshore banks. Overall performance under the PSI was mixed with weak performance against the quantitative targets but progress on structural reforms.

2016 Article IV Consultation

2016 Article IV consultation recommended initiating fiscal consolidation with emphasis on addressing financial difficulties in the SOE sector and improving investment efficiency to help strengthen macroeconomic and debt sustainability. Staff also recommended maintaining accommodative monetary policies and continue heightened supervision of the financial sector. Since the last Article IV consultation, monetary and fiscal policies have been well coordinated and broadly in line with Fund recommendations. The overall fiscal deficit has remained on a declining trend mostly because of the under-execution of investment projects but reforming the SOE sector and reducing the high debt levels remains a challenge. The central bank's monetary policy stance has remained appropriate, which has helped bolster international reserves and kept inflation stable. Financial stability has been preserved but addressing the high level of legacy non-performing loans remains a challenge

Annex II. Summary of Capacity Development Strategy

Main Macroeconomic Challenges

The overarching priorities for Cabo Verde are accelerating economic growth and reducing vulnerabilities. Central to achieving these objectives are reining in the high stock of public debt and eliminating vulnerabilities stemming from struggling SOEs. The authorities have started fiscal consolidation efforts, cut more than half the fiscal deficit in recent years, mainly through delays in the execution of externally financed projects. Given the high risk of external debt distress, further policy actions will be needed to curb the high level of public debt over the long term. The authorities recognize the need for additional measures, by pushing ahead with their SOE reforms and revenue mobilizations efforts, and laying down policies to support economic growth. Staff encouraged the authorities to continue their structural reform program, but advised a more gradual and sequenced approach, especially in the fiscal area where implementation capacity constraints have been a significant challenge.

CD assessment

CD activities in Cabo Verde have reflected the authorities' preferences and reform priorities identified in the context of Article IV consultations. The level of technical assistance support has been in line with the authorities' significant appetite for reform. CD activities would benefit in some areas from better prioritization and sequencing, as well as from adequately taking into consideration absorption capacity constraints. Traction of CD activities would benefit from an increased emphasis on hands-on training to implement technical assistance recommendations.

CD priorities

CD priorities going forward are: (i) Revenue Administration and Tax policy Reforms to increase domestic revenue mobilization and open fiscal space; (ii) PFM reform to reduce the costs and risks stemming from SOEs, improve the budget process credibility, and raise efficiency of public investment; (iii) strengthening Central Bank Operations to improve the monetary policy transmission mechanism, liquidity management, and reserves management, and (iv) further improve statistics, notably national accounts and price statistics.

Authorities' Views

The Ministry of Finance requested to add technical assistance on preparing the MTFF and on developing a debt strategy. The National Statistics Institute concurred with the priorities identified in the CD strategy and underscored the importance they attach to receiving support to their efforts to rebase the national accounts and to improve their quarterly activity indicators. The authorities requested TA with more emphasis on "how, not only what" and fewer diagnostic missions.

Priorities	Objectives
Revenue Administration and Tax Policy	Increasing domestic revenue mobilization through improvement in taxpayer registration, management of tax arrears, customs control, and improvement on staff performance; improving tax compliance levels; and reviewing the tax code to see the opportunities to increase revenue and eliminate inconsistencies.
PFM	Reducing fiscal costs and risks stemming from the SOEs; improving the budget credibility by strengthening budget preparation; advancing program-based budgeting; strengthening debt management.
National Accounts and Price Statistics	Improving the quality quarterly GDP estimates; developing quarterly GDP estimates by expenditure; rebasing of GDP and CPI; and developing a PPI.
External Sector Statistics	Improving the coverage and quality of source data, in particular regarding non-bank sector, direct investment and portfolio investment stocks.
Government Financial Statistics	Improving the coverage and quality of data; addressing delays in donor reporting; and enhancing staff capacity through GFS training (in Portuguese).
Central Bank Operations	Improving the monetary policy transmission mechanism; developing the payment system oversight function; and improving foreign reserve management.
Other (Training)	Strengthening capacity, particularly at the Ministry of Finance's Planning Department, through training in financial programming and macroeconomic forecasting.

Annex III. External Stability Assessment

The external position is moderately weaker than implied by fundamentals and desirable policy settings, but risks appear low. The real effective exchange rate is broadly in line with macroeconomic fundamentals and reserves remain adequate but broader issues of non-price competitiveness remain. Increasing the productivity of human and physical capital and improving the business environment by facilitating access to financing, reducing the inefficiencies in the bureaucracy, and improving education remain critical for bolstering medium and long-term growth.

A. External Sector Developments

Cabo Verde's balance of payments has been characterized by a wide current account deficit (about 10 percent of GDP in 2003–16) financed primarily by FDI and government borrowing. Imports linked to the increase in investment were financed by FDI flows until 2008. However, FDI and grants have since declined, and the current account deficit has been increasingly financed by government borrowing for its investment program, leading to a rise in external public debt. However, Cabo Verde's net international investment position at end 2016 remains stable but large at a negative $2.37 billion (146 percent of GDP).

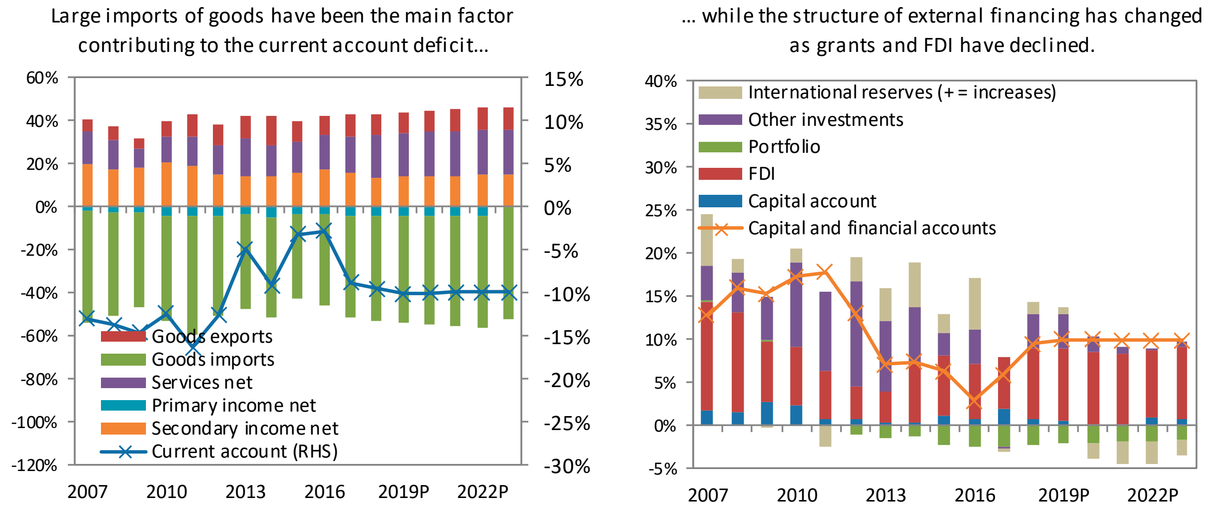
The current account deficit narrowed in 2016 to 2.8 percent of GDP (after having strongly contracted to 3.2 percent of GDP in 2015), mainly due to strong performances in tourism receipts and remittances. The Fogo island volcano eruption in 2014 led to an increase in remittances in the following years, which combined with the improvement in the tourism sector affected the current account substantially. In 2017, the current account is estimated to have widened to 8.8 percent of GDP reflecting a higher demand for imports and oil prices. Over the medium term, staff forecast the current account to return close to the historical level of 10 percent of GDP owing to strong FDI, recovering growth, and high import levels.

International reserve coverage is adequate at over 5.6 months of prospective imports. An updated assessment made using the Fund's LIC/MIC framework estimated the optimal reserve level of about 4 months of prospective imports. However, a higher level would be preferable considering vulnerabilities stemming from the country's small size and lack of export diversification.

B. Model-Based Assessment

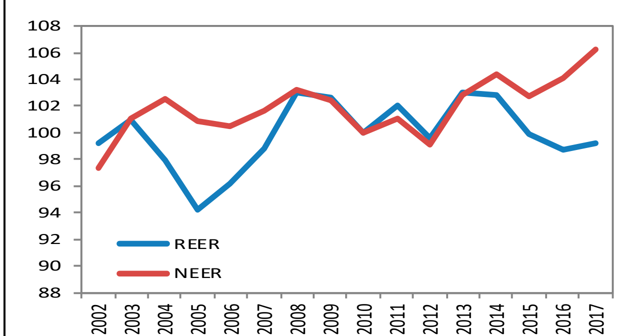
Cabo Verde's real exchange rate has been relatively stable over the past decade. In 2017, the real effective exchange rate (REER) remained in line with the average over the past five years (Figure 2).

Figure 1. Cabo Verde: Balance of Payments Characteristics (in percent of GDP)



Sources: Cabo Verdean authorities and IMF staff calculations.

Figure 2. Cabo Verde: Real Exchange Rate



Source: IMF staff calculations.

In 2017, Cabo Verde' external position was moderately weaker than the level consistent with fundamentals and desirable policy settings. Based on the extended External Balance Assessment (EBA-lite) methodology, the current account gap amounted to -1.8 percent of GDP[1].12Nevertheless, the estimates are subject to a degree of uncertainty, as indicated by a residual of -0.8 percent of GDP, which suggests structural weaknesses and/or factors not captured by the model, like tourism receipts. The current account gap of -1.8 percent of GDP suggests that the REER is overvalued by about 4.4 percent (Table 1)[2]. The EBA-lite REER model confirms this, suggesting a slight overvaluation, of about 2.4 percent.

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

[2] Cross-country elasticities based on EBA-lite sample of 150 economies from 1995 to 2014 are estimated at 0.71 for exports and 0.92 for imports.

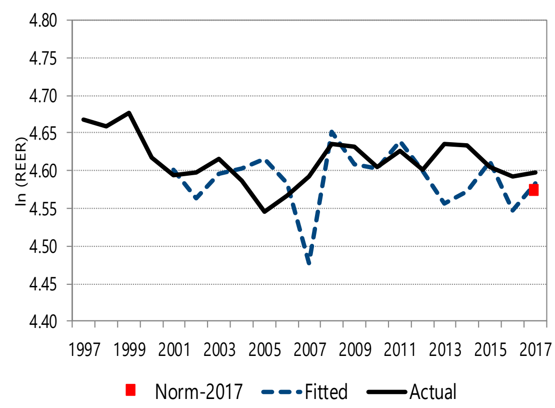
Table 1. Cabo Verde: Results of EBA-Lite Assessment based on the CA Model

(1)	Current account-actual (2017)	-8.8%
(2)	Current account-norm	-7.0%
(3)=(1)-(2)	Current account-gap	-1.8%
(4)	Current account-fitted	-8.0%
(5)=(4)-(2)	Policy gap	-1.0%
(6)=(1)-(4)	Residual	-0.8%
(7)	Elasticity of CA to REER	-0.4
(8)=(3)/(6)	REER misalignment for 2017	4.4%

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

Cabo Verde's competitiveness has improved, but still lags behind the middle-income country average. According to the World Economic Forum (WEF), Cabo Verde ranks 110th out of 137 countries in 2017–18 on global competitiveness, with considerable room for improvement in labor market efficiency, financial market development, business sophistication and innovation (Table 2). While Cabo Verde does generally well on the World Bank's Doing Business indicators related to protecting minority investors, resolving insolvency and access to electricity, important weaknesses are identified. The most problematic factors for doing business in Cabo Verde were found to be access to financing, government bureaucracy, tax rates, workforce education, and infrastructure supply (Figure 5). Similarly, based on the World Bank Doing Business survey, the business environment is hampered by poor regulations for enforcing contracts, registering property and dealing with construction permits; as well as the burden on paying taxes. Structural reforms aimed at improving the business climate therefore remain critical for enhancing competitiveness and attracting private investment.

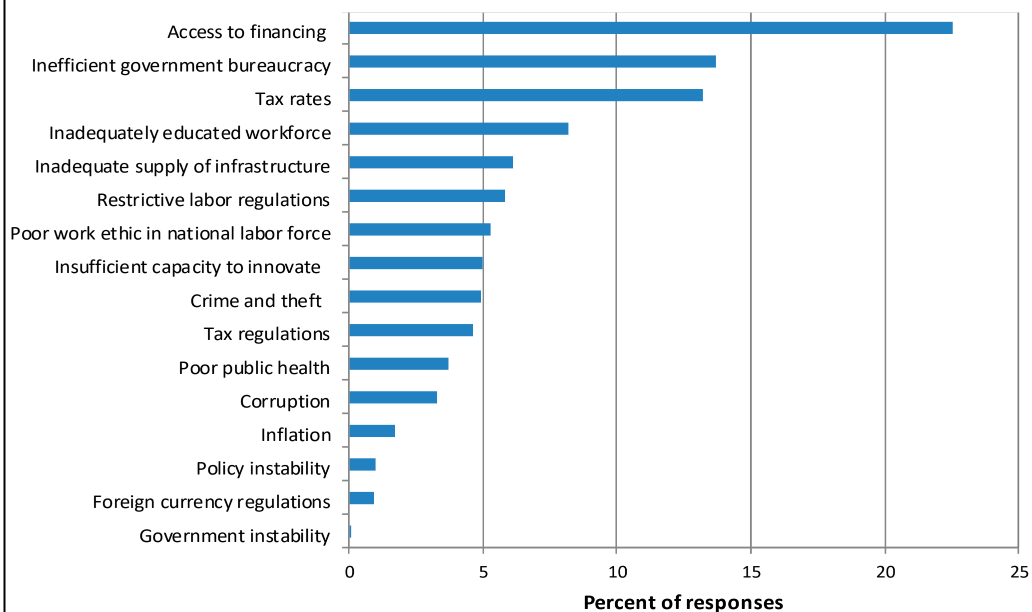
Table 2. Cabo Verde: Global Competitive Indicators, 2017–18

	2016–17 (Out of 138)	2017–18 (Out of 137)	Change [1]
Overall Rank	110	110	0
Basic requirements (40%)	89	88	1
Institutions	71	65	6
Infrastructure	94	95	-1
Macroeconomic environment	107	100	7
Health and primary education	58	65	-7
Efficiency enhancers (50%)	121	121	0
Higher education and training	79	86	-7
Goods and market efficiency	97	105	-8
Labor market efficiency	116	115	1
Financial market development	112	117	-5
Technological readiness	78	84	-6
Market size	137	134	3
Innovation and sophistication factors (10%)	105	109	-4
Business sophistication	108	118	-10
Innovation	98	98	0

Source: World Economic Forum.

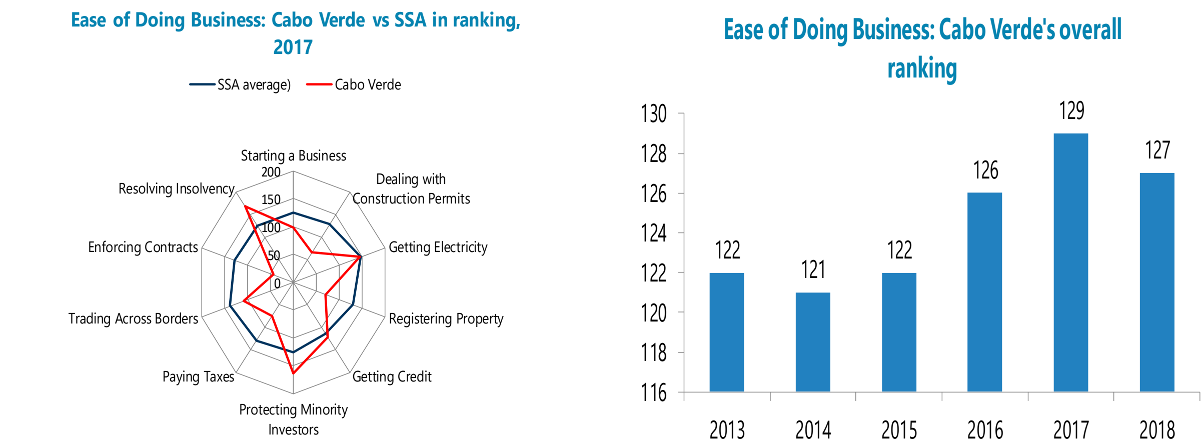
[1] Negative sign indicates worsening score; otherwise indicates improvement.

Figure 4. Cabo Verde: The Most Problematic Factors for Doing Business, 2017



Source: World Economic Forum.

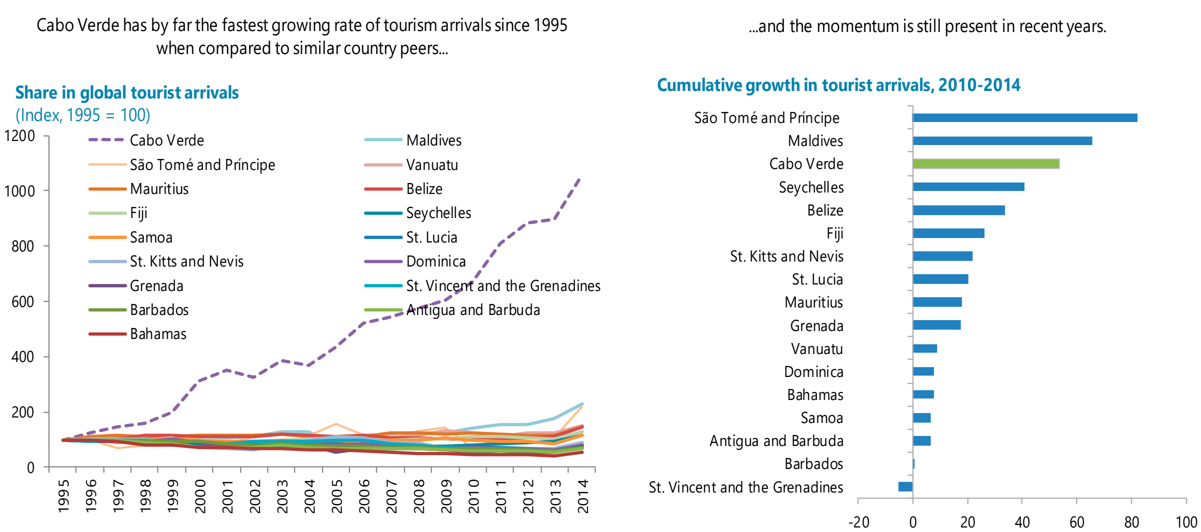
Figure 5. World Bank Ease of Doing Business, 2017



Source: World Bank's Doing Business Indicators.

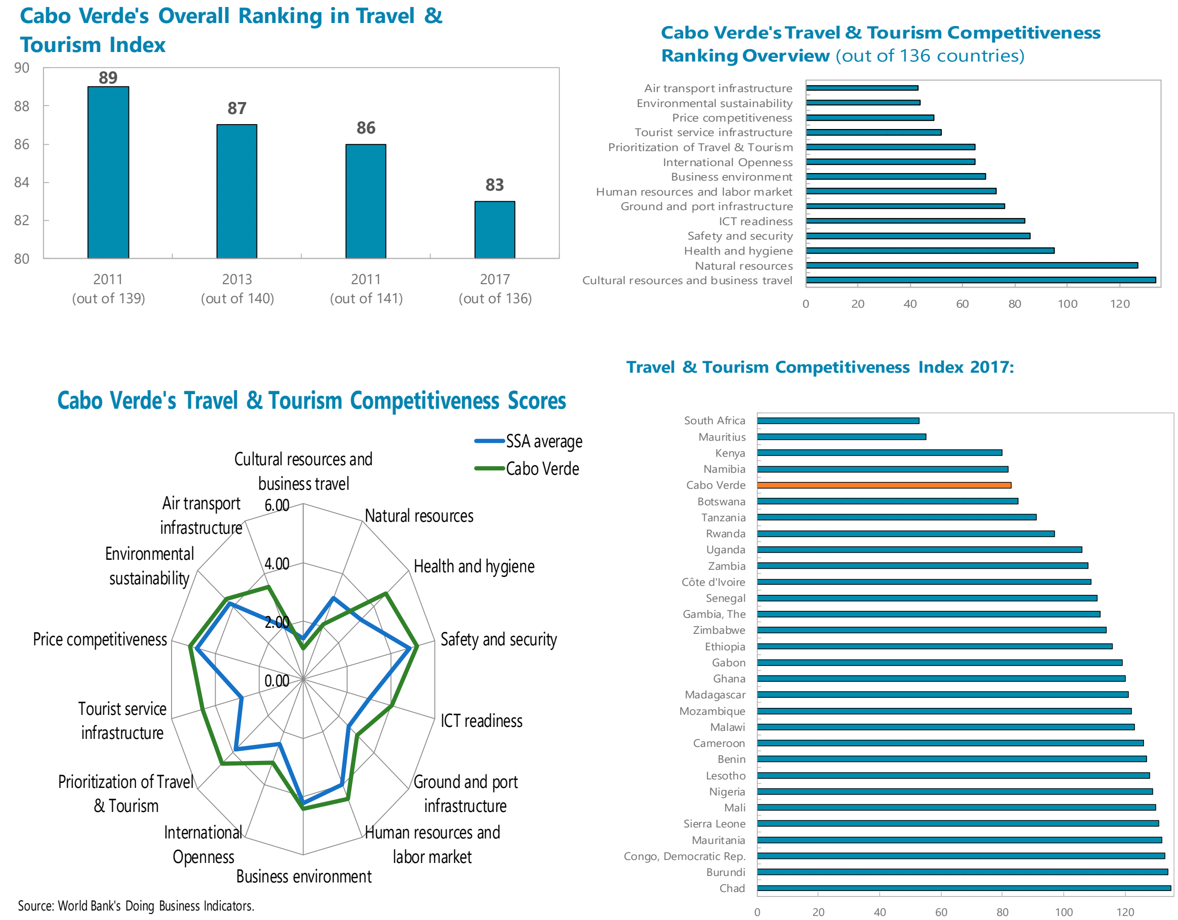
Figure 6. Tourism Sector Competitiveness

Cabo Verde is a tourism-based economy. The sector has witnessed impressive, sustained growth for more than a decade. Between 2000 and 2014, the annual average growth rate was 11 percent in the number of tourists entering the country. The Cabo Verde tourism market, which is dominated by Europeans, was negatively affected by the crisis in Europe, but is seeing a rebound, particularly compared to other tourism-dependent small states.



Cabo Verde is a top performer in SSA on indicators of travel and tourism competitiveness. Nevertheless, the country could improve on cultural and business travel, international openness and ground and transport infrastructure to fully compete with other destinations outside SSA.

Figure 7. Tourism Sector Competitiveness (cont.)



Sources: World Tourism Organization, Compendium of Tourism Statistics dataset, Travel & Tourism Competitiveness Index 2017 edition.

D. Conclusion

An assessment of the external position suggests that it is moderately weaker than implied by fundamentals and that broader issues of structural competitiveness remain. The identified policy gap is largely explained by fiscal policy and could be addressed by the planned fiscal adjustment. 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 labor market reforms and is committed to reform weak state-owned enterprises (SOEs).

References

IMF Country Report No. 16/366, November 2016. *Cabo Verde 2016 Article IV Consultation.* Available online at: https://www.imf.org/external/pubs/ft/scr/2016/cr16366.pdf.

IMF Policy Paper, February 2016. *Methodological Note on EBA-Lite*. Available online at: https://www.imf.org/external/np/pp/eng/2016/020516.pdf.

Phillips, Steven, Luis Catao, Luca Ricci, Rudolfs Bems, Mitali Das, Julian Di Giovanni, D. Filiz Unsal, Marola Castillo, Jungjin Lee, Jair Rodriguez, and Mauricio Vargas, 2013, *The External Balance Assessment (EBA) Methodology*, IMF Working Paper No. 13/272.

Ronci, Marcio, 2012, *Cape Verde: Assessing International Reserve Adequacy*, background paper.

Tokarick, Stephen, *A Method for Calculating Export Supply and Import Demand Elasticities*, IMF Working Paper No. 10/180.

Annex IV. State-Owned Enterprises

The government's fiscal consolidation strategy critically depends on successfully restructuring state-owned enterprises (SOEs). Support to SOEs is one on the main reasons underlying the rapid accumulation of public and publicly-guaranteed debt in recent years. Reform of the three largest loss-making enterprises is a government priority.

SOEs act in a wide range of sectors and are large relative to the economy's size. The 23 active SOEs participate in sectors as diverse as transport (air and maritime), real estate, energy and water, pharmaceutical, and infrastructure management (ports and airports). The 16 largest SOEs had total liabilities equivalent to 46 percent of GDP, of which 6.6 percent of GDP is guaranteed by the central government. Domestic liabilities are about 12 percent of GDP and include tax and social security contribution arrears (1.6 percent), loans to the banking sector (4.2 percent), and the domestic capital market (6.2 percent).

Fiscal risks are concentrated in the three largest loss-making SOEs, the airline (TACV), the housing company (IFH), and the electricity and water company (Electra).[1] In 2014-16, government support to these SOEs in the form of onlending, recapitalization and other budget subsidies and transfers was about 3½ percent of GDP annually. In 2017, the support declined to 2.1 percent of GDP. These SOEs had total labilities in excess of 36 percent of GDP at end-2016 and had received sovereign guarantees equivalent to 6.3 percent of GDP. In 2016, their losses reached 1.6 percent of GDP. A Ministry of Finance study found that the risk of the central government having to take over the liabilities of these SOEs is high in the case of TACV and IFH, and moderate in the case of Electra.

Table 1. State Participation and Net Income in Key SOEs
(As of December 2016)

No.	Main SOE Portfolio	Sector	State Shareholding	Share Capital (in million Escudo)	Net Income (in million Escudo)
1	ASA	Airport	100%	5,201	469.4
2	ELECTRA	Energy/water	78%	1,585	-171.7
3	ENAPOR	Ports	100%	1,200	187.8
4	TACV	Transport/Airlines	100%	1,000	-2174.1
5	IFH	Housing	100%	750	-227.5
6	EMPROFAC	Pharmaceutical	100%	200	171.9

Source: 2016 Contingent Liabilities Report, Ministry of Finance

[1] The central government is the sole shareholder in TACV and IFH. In the case of Electra the central government holds 78 percent of shares, the remainder are held by the National Social Security Institute (16 percent) and municipalities (6 percent).

Text Table 2. Government Support to Key SOEs
(Million CVE)

Name of SOE	Sector	Share	On-lending 1/				Capitalization				Subsidies/Transfers/Other expenditure from budget			
			2014	2015	2016	2017	2014	2015	2016	2017	2014	2015	2016	2017
ASA	Airport	100%	-	-	-	-	-	-	-	-	-	-	-	-
ENAPOR	Port	100%	n.a.	n.a.	n.a.	n.a.	-	-	-	-	-	-	-	-
ELECTRA	Energy/water	78%	n.a.	n.a.	n.a.	n.a.	-	-	-	-	-	-	-	120
TACV	Air transport	100%	-	-	-	-	-	1,563	1,471	702	-	-	-	1,199
IFH	Real estate	100%	n.a.	n.a.	n.a.	n.a.	-	-	-	-	-	-	-	300
EMPROFAC	Pharmaceutical	100%	-	-	-	-	-	-	-	-	-	-	-	-
Total			4,908	3,656	4,526	1,179	-	1,563	1,471	702	-	-	-	1,619
(in Percent of GDP)			*3.2*	*2.3*	*2.8*	*0.7*	-	*1.0*	*0.9*	*0.4*	-	-	-	*1.0*

Source: Cabo Verdean authorities.
1/Total on-lending based on the fiscal accounts. Distribution by SOE is not available.

Text Table 3. SOE Liabilities at December 31, 2016

SOE Liabilites at Dec. 31, 2016 - Gov Ownership > 50% (in million CVE)

		State Ownership	Long-Term Liability	Short-Term Liability	Total Liability	% of Total SOE	State Guarantee	% State Guarantee
1	IFH – Imobiliária, Fundiária e Habitat, S.A	100%	19,581	1,475	21,056	27.9%	2,334	11%
2	ELECTRA – Empresa de Eletricidade e Águas, S.A	78%	12,796	5,188	17,984	23.8%	5,003	28%
3	TACV – Transportes Aéreos de Cabo Verde, S.A	100%	4,028	8,181	12,208	16.2%	2,628	22%
4	SDTIBM – Sociedade de Desenvolvimento de Turismo Integrado BV e Maio, S.A	51%	8,517	688	9,205	12.2%	-	
5	ASA – Empresa Nacional de Aeroportos e Segurança Aérea, S.A	100%	2,107	4,644	6,751	8.9%	-	
6	ENAPOR – Empresa Nacional de Administração dos Portos, S.A	100%	2,872	949	3,821	5.1%	171	4%
7	CVFF - Cabo Verde Fast Farry	53%	1,954	530	2,484	3.3%	200	8%
8	EMPROFAC – Empresa Nacional de Produtos Farmacêuticos, S.A	100%	108	495	603	0.8%		
9	CCV - Correios de Cabo Verde, S.A	100%	31	556	587	0.8%		
10	NOSI - Núcleo Operacional Sistema Informação, EPE	100%	108	290	398	0.5%		
11	INCV - Imprensa Nacional de Cabo Verde	100%	132	122	255	0.3%		
12	CABNAVE - Estaleiros Navais	99%	-	115	115	0.2%		
13	FIC – Feira Internacional de Cabo Verde, S.A	100%	18	30	48	0.1%		
14	SCS – Sociedade Caboverdiana de Sabões, S.A	69%	2	34	35	0.0%		
15	BVC - Bolsa de Valores de Cabo Verde	100%				0.0%		
16	EHTCV - ESCOLA DE HOTELARIA E TURISMO, EPE	100%	-	1	2	0.0%		
	Total SOE		**52,254**	**23,298**	**75,553**	**100%**	**10,335**	**14%**

SOE Liabilites at Dec. 31, 2016 - Gov Ownership < 50% (in million CVE)

		State Ownership	Long-Term Liability	Short-Term Liability	Total Liability	% of Total SOE	State Guarantee	% State Guarantee
17	CVTELECOM – Cabo Verde Telecom	3%	1,935	4,465	6,400	40.8%		
18	Cabeólica	2%	4,754	844	5,598	35.7%		
19	ENACOL – Empresa Nacional de Combustíveis, S.A	2%	143	2,739	2,882	18.4%		
20	SISP – Sociedade Interbancária de Sistemas de Pagamentos, S.A	27%	6	482	488	3.1%		
21	APN - Águas de Porto Novo, S.A	10%	197	43	239	1.5%		
22	PROMOTORA – Sociedade de Capital de Risco, S.A	27%	-	-	78	0.5%		
23	SGZ – Sociedade de Gestão de Lazareto, S.A	33%	-	13	13	0.1%		
	Total		**7,033**	**8,586**	**15,697**	**100%**		

Source: Cabo Verdean authorities.

Text Table 4. SOE Risk Analysis

Risk Assessment Change 2016-2015	Business Volume	EBITDA	Net Income	Assets	Social Capital	Liabilities	Risk
ASA	↑	↓	↓	↑	↓	↑	Low
ENAPOR	↑	↑	↓	↓	↑	↓	Low
ELECTRA	↓	↓	↓	↓	↓	↓	Moderate
TACV	↓	↑	↑	↓	↓	↓	High
IFH	↓	↓	↓	↑	↓	↑	High
EMPROFAC	↑	↓	↓	↓	↑	↓	Low

Source: Cabo Verde authorities.

The following is the state of progress in the restructuring of the three largest loss-making SOEs:

- **Transportes Aéreos de Cabo Verde (TACV).** In August 2017, all domestic routes were transferred to Binter Cabo Verde, a new airline in which the government received a 30 percent participation. In October 2017, a one-year management contract was signed with Icelandair to operate the international routes and prepare TACV for privatization in 2018, after a valuation is completed. A loan of €13.5 million has been contracted with Bank BNI Europa to finance the workforce retrenchment cost. TACV current liabilities are €100 million (6 percent of GDP). The government expects to reduce them by at least 50 percent through a renegotiation with creditors. The fiscal cost for 2017-18 is estimated at about 2.2 percent of GDP.

- **Imobiliária, Fundiária e Habitat, S.A (IFH).** During 2017, the *Casa Para Todos* ("House for All") housing program managed by IFH was restructured. Class A (low income units) houses started to be transferred to municipal governments and the central government. Class B and C developments (more expensive houses) started to be commercialized. The fiscal cost for 2017-18 is estimated at 0.6 percent of GDP.

- **Electra.** The company's Board of Directors was given a mandate to improve the company's efficiency levels and prepare it for privatization. A revenue protection program is being implemented to reduce high commercial losses. In 2016, the company recorded distribution and transmission losses of 27 percent, which despite declining from 29 percent in 2015 is still very high. A restructuring process is underway to unbundle water and energy operations. The government is to move forward with the privatization of ELECTRA in 2018/2019. The fiscal cost for 2017-18 is estimated at 0.3 percent of GDP.

Other reform measures are also in progress to strengthen the operations of the SOE sector. These include (i) the creation of SOE oversight unit at the Ministry of Finance in July 2016, (ii) follow up and monitoring platform of the SOEs, (iii) revision of the legal framework and management contracts (giving public managers goals and metrics for performance evaluation) of major SOEs, (iv) review of the PPP law, (v) development of instruments to monitor concession contracts, and (vi) technical training by the World Bank on SOEs reforms.

Annex V. Cabo Verde's Strategic Plan for Sustainable Development 2017-21

The Strategic Plan for Sustainable Development (PEDS) 2017-2021 was submitted to Parliament in December, 2017.

The PEDS presents the government's vision on how to address Cabo Verde's economic and social challenges. The plan main objectives are: (1) transforming the country into an air and maritime transportation hub; (2) guaranteeing economic sustainability; (3) ensuring social inclusion and reducing poverty and asymmetries, and (4) strengthening sovereignty, valuing democracy and focusing diplomacy on the country's development challenges. The PEDS identifies structural vulnerabilities, including external dependence, unemployment, poverty, and inequality; as well as natural vulnerabilities, including volcanic origin, lack of mineral resources, small dimension, geographic dispersion, reduced population and isolation from the rest of Africa.

The PEDS points to the need of shifting to a new development model to promote inclusive economic growth and address vulnerabilities. The current model is highly dependent on external transfers, development aid and remittances, and as a result Cabo Verde is highly vulnerable to external shocks. The plan stresses the need to promote FDI as the main driver to change the economic structure and to reduce external dependence. It identifies the following priority sectors to promote economic diversification and generate employment:

- *Economic hub*. Take advantage of the country's strategic geographical location to develop a commercial (logistics) and a financial hub. Increase efficiency and capacity of the airports and ports.

- *Tourism*. Consolidate the gains of recent years and increase the supply and quality of services by attracting new operators.

- *Agriculture*. Through investment in infrastructure, training and finance, shift agriculture from a subsistence activity to a productive activity. Currently, 80 percent of food is imported.

- *Light industry*. Reactivate and develop the sector aiming to promote export diversification;

- *Infrastructure*. Reduce the high dependence on fuel imports for energy generation (currently accounts for 75 percent) by promoting investment in renewable energies**.**

Measures to improve the business environment are aimed at attracting FDI. These include public administration reform (aiming at decentralizing the decision-making process and cutting red tape), lowering energy prices, improving telecommunications, transport, and reforming the health and education systems (adapting the latter to the labor market needs). The plan intends to improve the country position in international indexes such as Doing Business, Economic Freedom and Good Governance.

The PEDS puts social inclusion in the center of public policies. This includes guaranteeing a minimum income for families with precarious links to the labor market, and for the elderly and children with special needs. It emphasizes the need to improve the quality and access to education, promote professional training, and attract investments in light and creative industries. It aims at a continuous decrease in absolute and relative poverty, in line with the Sustainable Development Goals.

INTERNATIONAL MONETARY FUND

CABO VERDE

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

March 13, 2018

Prepared By

African Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

As of February 28, 2018

Membership Status
Joined November 20, 1978, Article VIII

General Resources Account	SDR (million)	Percent of Quota
Quota	23.70	100.00
Fund holdings of currency	20.17	85.10
Reserve tranche position	3.54	14.94

SDR Department	SDR (million)	Percent of Quota
Net cumulative allocation	9.17	100.00
Holdings	0.03	0.28

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				
	2018	2019	2020	2021	2022
Principal					
Charges/interest	0.06	0.08	0.08	0.08	0.08
Total	0.06	0.08	0.08	0.08	0.08

[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

The Executive Board concluded the 2016 Article IV consultation on November 18, 2016 (Country Report No. 16/366).

Technical Assistance

Since 1985, Cabo Verde has received substantial technical assistance. Technical assistance activities since 2012 are listed below:

Department	Dates	Purpose
FAD	July 2012	Review tax policy and exemptions
	September 2012	Diagnostic evaluation of tax administration
	November 2012, and October 2017	Tax administration: Annual planning
	February. July 2013, and September 2017	Tax administration and policy
	April, June, September 2013, January, February, September 2014, July, August, October 2015, April, June, July, October 2016, and March, June, October 2017	Tax administration: Large taxpayer office organization, human resources, organization, strategic planning, and information technology, revenue administration gap analysis

Department	Dates	Purpose
	October 2013, and January, November 2015	Program budgeting and other public financial management reforms
	November 2013, and January, 2018	Medium-term debt management strategy
	January 2014	Tax policy: Small taxpayers
	June, September 2014, April 2015, and March, July 2017	Budget execution, medium term budgetary framework and budget credibility
	October 2017	Oversight of State Owned Enterprises
	May, June 2017	Cash management and Single Treasury Account
	October, and December 2017	Revenue administration: risk management strategy; and data matching projects and audit trainings
	June 2017	Review of Draft Organic Budget Law
LEG	March 2012 and October 2012	Draft the financial and banking system laws
	September 2017 and January 2018	Payment systems, payment services, and electronic money
STA	March 2012, July 2013, April 2014, April 2015, October 2016, and April, November 2017	National accounts
	February 2012	Balance of payment statistics
	April 2012	Government finance statistics
	April 2017	Price statistics
	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
	January 2017	Improving monetary policy analysis

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 after the 2018 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, social protection 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 2018. A public expenditure review focused on debt management, and the education and health sectors is expected to be completed by summer 2018. The two teams have also engaged very closely on discussions on public financial management and debt sustainability.

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 2018/2019. 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.

Cabo Verde: Joint World Bank and IMF Work Program (as of March 8, 2018)			
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. Investment Loan and Fiscal Risk Management Operation 3. TA on Debt Management	October 2017 February 2018 February 2018	Spring 2018 Spring/Summer 2018 June 2018
IMF work program in the next 12 months	1. Staff Visit 2. Article IV Consultation	May 2018 January 2019	
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 2018/19
Bank request to Fund	Macroeconomic framework updates		FY 2018/19

STATISTICAL ISSUES

(As of March 8, 2018)

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 2016 (released in March 2017). In the past few years, INE has implemented the chained linked time series of GDP—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. However, due to limitations in quarterly data sources, the quarterly GDP estimates for 2014 were revised significantly during the annual revision. Future technical assistance missions will work on a GDP rebasing with a base year of 2015 and developing estimates for quarterly 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 and overstretched. INE continues building its statistics series—ranging from business, household, and labor force surveys to governance and security surveys and satellite accounts. Given capacity constraints, a greater prioritization amongst data collection is encouraged with an emphasis on improved use of administrative data. 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 as well as using more administrative data, in particular tax data.
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 is currently receiving, from the National Statistics Institute of Portugal and AFRITAC West 2 missions to support the rebasing, reweighting and dissemination of a revised CPI in 2020. The revised index will have new weights and an updated commodity basket. CPI statistics are

published on a monthly basis and in a timely manner. INE CV are also developing a Producer Price Index which should be released in the near future.
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, but the last year submitted was 2012. 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 broadened. 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 publicly 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 improved. Standardized report forms (SRFs)-based monetary statistics 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*. An integrated monetary database that meets STA, AFR, and BCV statistical needs is in place.
Financial Sector Surveillance: Cabo Verde does not report financial soundness indicators for dissemination on the IMF's website.
External statistics: The BCV reports quarterly balance of payments and international investment position (IIP) data to the STA. These data, to a large extent, follow the recommendations of the sixth edition of the *Balance of Payments and International Investment Position Manual*. The BCV also reports inward 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. However, further improvements are needed in data sources and compilation techniques particularly in the new context of total liberalization of capital transactions. Data coverage needs to be strengthened for foreign trade in goods, direct investment, portfolio investment liabilities, and nonbank sectors' external transactions conducted via account held 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.

Cabo Verde: Common Indicators Required for Surveillance
(As of March 8, 2018)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange rates	12/31/17	1/26/18	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[2]	12/31/17	1/26/18	D	W	M
Reserve/base money	11/30/17	1/26/18	D	W	M
Broad money	11/30/17	1/26/18	M	W	M
Central bank balance sheet	11/30/17	1/26/18	D	W	M
Consolidated balance sheet of the banking system	11/30/17	1/26/18	M	M	M
Interest rates[3]	12/31/17	1/26/18	M	M	M
Consumer price index	1/31/18	2/20/18	M	M	M
Revenue, expenditure, balance, and composition of financing[4]—central government	11/30/17	1/26/18	M	Q	A
Stocks of central government and central government-guaranteed debt[5]	12/31/17	1/26/18	A	A	A
External current account balance	6/30/17	1/26/18	Q	Q	Q
Exports and imports of goods	6/30/17	1/26/18	Q	Q	Q
GDP/GNP	9/30/17	1/26/18	Q	Q	Q
Gross external debt	12/31/17	1/26/18	Q	A	A
International Investment Position[6]	9/30/17	1/24/18	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.

INTERNATIONAL MONETARY FUND

CABO VERDE

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

March 13, 2018

Approved By
Roger Nord and Gavin Gray (IMF) and Paloma Anos Casero (IDA)

Prepared by the Staffs of the International Monetary Fund and International Development Association

Based on the Staff baseline scenario, Cabo Verde's risk of external debt distress rating is assessed as high, unchanged from the rating in the previous Debt Sustainability Analysis (DSA).[1] Total public and publicly guaranteed debt declined for the first time in a decade in 2017. However, it is expected to reach higher levels over the medium term than projected in the previous DSA, as a result of a more gradual fiscal consolidation than previously envisaged reflecting the spending plans in the authorities' latest Medium-Term Fiscal Framework (MTFF). While public debt is elevated, it remains on highly concessional terms. Contingent financial liabilities related to state-owned enterprises (SOEs) represent an additional source of risk. The authorities are taking important steps to reduce the risk of debt distress, including progress in restructuring SOEs and revenue mobilization efforts. These steps should be complemented with efforts to contain fiscal risks, including by strengthening public investment management and prudently managing SOE contingent liabilities.

[1] Cabo Verde's three-year average CPIA score is 3.8, placing the country in the category of a strong policy performers.

BACKGROUND

1. **This DSA reflects official debt stock data for end-2016, and additional information available at end December 2017.** Staff fiscal projections for 2018–22 (Table 4a in the Staff Report) are used to project debt-creating flows. Debt coverage of this DSA includes central government external and domestic debt, and external debt contracted by the central government on behalf of SOEs (also referred to as "onlending"), and external debt contracted directly by SOEs that carry a central government guarantee. The data do not include domestic debt contracted directly by SOEs and by local governments that carry a central-government guarantee; at end-2016, total publicly guaranteed debt (domestic and external) was estimated at about 7 percent of GDP. Non-guaranteed external debt contracted by SOEs is also not included. Information for 2017 is not yet fully reconciled, but outstanding guarantees at end-September 2017 were estimated at about 8.5 percent GDP (Text Table 2). The majority of the guarantees is for domestic debt (7.4 percent of GDP), with an average interest rate of 6.5 percent. The 2018 budget envisages issuance of guarantees as follows:

Text Table 1. Cabo Verde: Government Guarantees Issuance Plan, 2018 (in CVE billion)

Entities	Public	Private	Total 2018	Description
AEB	3.53	-	3.53	External
TACV	2.20	-	2.20	Domestic
INCV	0.13	-	0.13	Domestic
TRANSPORTES MARÍTIMOS	0.77	-	0.77	N.A
ENAPOR	1.10	-	1.10	Mixed
ELECTRA	0.50	-	0.50	Mixed
IFH	0.80	-	0.80	N.A
START UP	-	0.18	0.18	Domestic
MICRO FINANÇAS	-	0.05	0.05	Domestic
MEDIAS EMPRESAS	-	0.56	0.56	Domestic
GRANDES EMPRESAS	-	0.63	0.63	N.A
INTERNACIONALIZAÇÃO	-	0.06	0.06	N.A
LINHA SUPLEMENTAR	0.50	-	0.50	N.A
TOTAL	**9.53**	**1.48**	**11.01**	
In percent of GDP	**5.3%**	**0.8%**	**6.1%**	

Source: Cabo Verdean authorities.

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 about 9.5 percent of GDP at end-2016. The authorities compile non-bank private sector debt, but there is a need for a more systematic monitoring of the repayment flows.

Text Table 2. Cabo Verde: External Debt Profile by Type of Creditor (2015-2017)

	2015		2016		2017 1/	
	In USD million	Percent of GDP	In USD million	Percent of GDP	In USD million	Percent of GDP
Total Public Debt and Publicly-Guarantee External Debt		**126.5**		**129.9**		**123.5**
Public and Publicly-Guarantee External Debt	**1,525.6**	**97.5**	**1,525.9**	**97.7**	**1,694.9**	**91.6**
Public External Debt--General Government	**1,519.3**	**97.0**	**1,520.2**	**97.3**	**1,675.1**	**90.5**
Multilaterals	716.8	45.8	716.2	45.8	754.2	40.8
0f which to: World Bank	342.5	21.9	332.8	21.3	345.8	18.7
African Development Bank	39.9	2.5	39.9	2.6	41.1	2.2
Bilaterals 1/	342.2	21.9	342.4	21.9	389.4	21.0
Paris Club	139.1	8.9	140.2	9.0	169.2	9.1
Non-Paris Club	203.1	13.0	202.2	12.9	220.2	11.9
0f which to: Portugal	156.8	10.0	152.0	9.7	168.0	9.1
China	25.8	1.6	24.0	1.5	22.8	1.2
Commercial	460.3	29.4	461.6	29.5	531.5	28.7
Publicly-Guarantee External Debt	**6.3**	**0.4**	**5.7**	**0.4**	**19.8**	**1.1**
TACV	3.9	0.3	3.8	0.2	18.1	1.0
Cabo Verde Fast Ferry	2.4	0.2	1.9	0.1	1.7	0.1
	In CVE billion	Percent of GDP	In CVE billion	Percent of GDP	In CVE billion	Percent of GDP
Public Domestic Debt	**46.0**	**29.0**	**52.6**	**32.2**	**54.2**	**31.9**
Domestic Debt Guarantees	**10.1**	**6.3**	**10.8**	**6.6**	**24.6**	**14.5**
Memo item:						
Other Contingent Liabilities	24.5	15.4	23.8	14.6	25.7	15.1
Nominal GDP (billions of Escudos)	158.7		163.4		170.1	
Exchange rate (Avg. CPV/USD)	99.4		99.6		97.7	
Exchange rate (end period CPV/USD)	101.4		104.6		91.9	

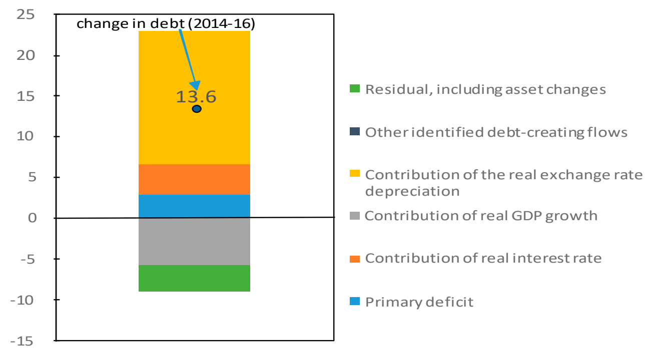
1/ For 2017, data on public and publicly-guarateed external debt is as of end September.

3. **Total public debt in Cabo Verde declined for the first time in a decade in 2017, after having doubled over that period.** During 2012-15, low economic growth as a consequence of the crisis in Europe, a significant scaling-up of public investment, and the support of loss-making state-owned enterprises (SOEs) led to a rapid accumulation of public debt (Text Table 3). Despite the impressive fiscal consolidation in recent years reducing public debt proved difficult, owing in part to the depreciation of the escudo vis-à-vis the US dollar but also reflecting the continued support to SOEs. Between 2014-16 the increase in the stock of debt is largely explained by the depreciation of the escudo. The debt stock is estimated to have declined to 126 percent of GDP at end-2017 from 129.5 percent owing to fiscal consolidation and favorable exchange rate developments.

4. **While external public debt is high, its terms are highly concessional.** Multilateral institutions, in particular the World Bank Group and the African Development Bank, are the main external creditors. Portugal is by far the largest bilateral creditor and also subsidizes the largest commercial loan. Cabo Verde's external public debt—including commercial debt—has a long maturity profile and low average interest rate (Text Table 4).

Text Figure 1. Cabo Verde: Decomposition of Debt Accumulated

(2014-2016, in percent of GDP)



Source: Cabo Verdean authorities and IMF staff estimates.

Text Table 3. Cabo Verde: Stock of Total Public Debt at End-Year, 2005–17

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017 (prel.)
						(Percent of GDP)							
External debt	49.6	46.2	39.9	38.4	43.9	50.7	57.2	68.1	78.3	89.0	97.0	97.3	94.1
Domestic debt	35.7	31.7	24.7	19.1	21.3	21.7	21.6	23.0	24.2	26.9	29.0	32.2	31.9
Total public debt	85.3	77.9	64.6	57.4	65.2	72.4	78.8	91.1	102.5	115.9	126.0	129.5	126.0

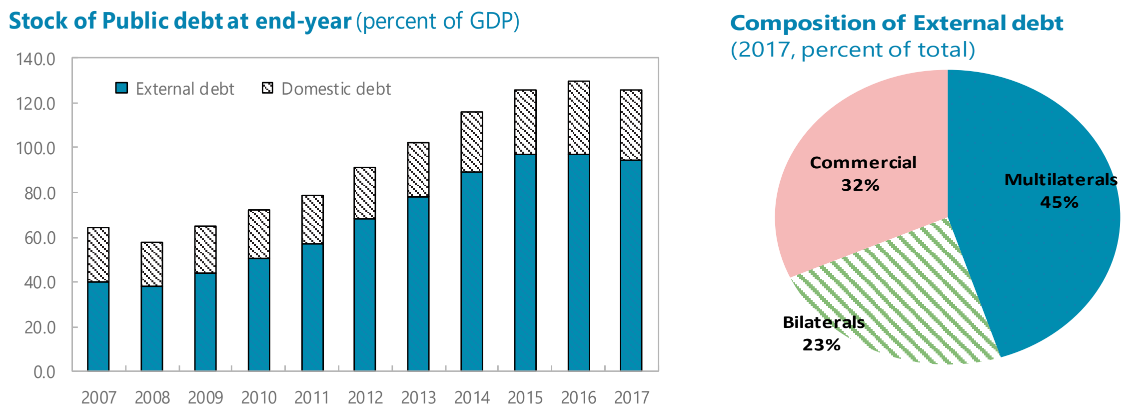
Sources: Cabo Verdean authorities and IMF staff calculations.

Text Table 4. Cabo Verde: External Debt Profile by Type of Creditor, 2017

	Percent of Total External Debt	Average Grace Period	Average Amortization Period	Average Interest Rate
Multilateral	45	9	32	0.9%
Bilateral	23	8	19	1.1%
Commercial	32	9	20	1.6%

Source: Cabo Verdean authorities and IMF staff estimates.

Text Figure 2. Cabo Verde: Public Debt and its Composition



Source: Cabo Verdean authorities and IMF staff estimates.

5. **Cabo Verde's domestic public debt has risen in recent years, 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 32 percent of GDP at end-2017. The banking system holds the majority of domestic debt, at about 60 percent; the remainder is held by the National Social Security Institute (INPS). Treasury bonds make up about 94 percent of domestic debt. The average maturity of outstanding domestic debt at end-2017 was about 5 years and the average interest rate was 5.1 percent. According to the 2018 budget, the government's overall borrowing strategy for the medium and long-term is 60 percent external and 40 percent domestic borrowing. The large surpluses projected for the INPS over the medium term (the current surplus exceeds 4 percent of GDP) and the excess liquidity in the banking system (exceeding 10 percent of GDP) suggest that the projected domestic borrowing is feasible.

6. **Cabo Verde is a strong policy performer for the purpose of determining the thresholds under the Debt Sustainability Framework (DSF).** Cabo Verde's rating on the World Bank's Country Policy and Institutional Assessment (CPIA) averaged 3.8 (on a scale of 1 to 6) during 2014–16. Based on its 2016 CPIA score, Cabo Verde ranks third 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 5.

Text Table 5. Cabo Verde: 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: 2013 Staff Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries.

BASELINE SCENARIO UNDERLYING THE DEBT SUSTAINABILITY ANALYSIS

7. The assumptions underlying the current DSA differ from those used in the 2016 Article IV Consultation mainly in regards to the path of fiscal consolidation (Text Table 6 and Box 1). The current baseline scenario still assumes a rebound in economic activity in the medium term, with the growth forecast for 2018–22 in line with the previous DSA. The GDP deflator remains the same compared to the last DSA, reflecting low inflation in the country and in the Euro area. However, the baseline scenario assumes a different profile for the fiscal path, reflecting the authorities' most recent MTFF for expenditure plans, which includes a higher public investment, and staff's projections of revenue in line with current policies. At the end of the medium-term projection, the current account deficit is projected to be wider compared to the last DSA, reflecting the larger pipeline of FDI for the next few years and a less ambitious fiscal consolidation path.

Text Table 6. Cabo Verde: Assumptions for Key Economic Indicators, 2016–23
(Percent of GDP)

	2016	2017	2018	2019	2020	2021	2022	2023
Real GDP growth								
Current DSA	3.8	4.0	4.3	4.0	4.0	4.0	4.0	4.0
2016 Article IV DSA	3.2	3.7	4.1	4.1	4.1	4.1	4.0	n.a.
GDP Deflator								
Current DSA	-0.8	0.1	1.4	1.6	2.0	2.0	2.0	2.0
2016 Article IV DSA	0.1	1.2	1.8	2.0	2.0	2.0	2.0	n.a.
Fiscal balance (including grants)								
Current DSA	-3.1	-3.0	-3.2	-5.9	-5.2	-4.6	-4.1	-4.1
2016 Article IV DSA	-3.3	-3.0	-1.9	-2.0	0.0	-1.4	-2.1	n.a.
Overall financing needs (including onlending)								
Current DSA	-6.6	-4.2	-8.9	-8.6	-6.3	-5.3	-4.7	-4.7
2016 Article IV DSA	-7.8	-7.0	-5.6	-3.9	-1.0	-1.4	-2.1	n.a.
Current account balance (including grants)								
Current DSA	-2.8	-8.8	-9.5	-10.0	-10.0	-9.9	-9.9	-9.9
2016 Article IV DSA	-7.2	-8.8	-8.4	-7.9	-7.1	-3.0	2.6	n.a.
Cv$/USD exchange rate (e-o-y)								
Current DSA	104.6	91.9	90.7	90.3	90.3	90.4	90.6	90.8
2016 Article IV DSA	100.7	100.5	100.3	99.7	99.6	99.6	99.6	n.a.

Sources: Cabo Verdean authorities and IMF staff estimates.

1/ All data for 2017–23 are IMF staff projections.

Box 1. Macroeconomic Assumptions of the Baseline Scenario, 2017–37

Real GDP growth is expected to keep the momentum reflecting a more favorable external environment and the payoff of recent economic reforms, 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.

Fiscal policy. In the medium term (2018–22), the fiscal deficit is expected to widen to more than 4 percent of GDP under the baseline. Total financing needs are expected to increase initially to near 9 percent of GDP in 2018 and 2019, due to the upfront costs associated with the restructuring of loss-making SOEs; then decline to below 5 percent of GDP in the medium term in line with the fiscal deficit path. In the long run (2023–37), with gradual fiscal consolidation and on-lending coming to an end, total financing needs are projected to stay below 4 percent of GDP per year.

The non-interest current account deficit is projected to widen in the medium term 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. Total financing needs are assumed to be covered domestically up to the ceiling of domestic borrowing of 3 percent of GDP and the remainder with external financing. For the long term, financing is assumed with 40 percent domestic borrowing and 60 percent external. Within the external financing envelope, 65 percent is assumed coming from multilateral and bilateral new borrowing and 35 percent commercial borrowing for the rest of projection period.

DEBT SUSTAINABILITY ANALYSIS

A. External Public Debt

8. Under the staff baseline scenario, the PV of external debt to GDP breaches the 50 percent threshold significantly. In the baseline, the PV of public external debt is expected to decrease gradually, falling below 50 percent only by 2032 (Figure 1). The debt service indicators remain below the threshold throughout 2037.

9. Cabo Verde's ability to service its debt is sensitive to lower growth 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 2018, and so would the debt-service-to-revenue ratio in 2020 (Table 1b, scenario B6).

B. Total Public Debt

10. Total public debt also remains above the high-risk benchmark, but is projected to decline gradually over the period (Table 2a, Figure 2). The PV of total public debt exceeds the 74 percent benchmark and remains above it throughout most of the projection period. 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.

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 2007-16 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). Contingent liabilities of the six largest SOEs represented 38.1 percent of GDP at end-2016, of which onlending and guarantees on externally-contracted debt represent 23.5 percent of GDP and are included in the DSA numerical exercise. The remainder, consisting of guarantees on domestically-contracted debt and other liabilities, represents 14.6 percent of GDP. As part of the restructuring and in preparation for the privatization of the SOEs the government will need to assume a portion of this obligations. However, in cases like the national airline (TACV) the government has approached creditors to renegotiate these obligations.

C. The Authorities' Views

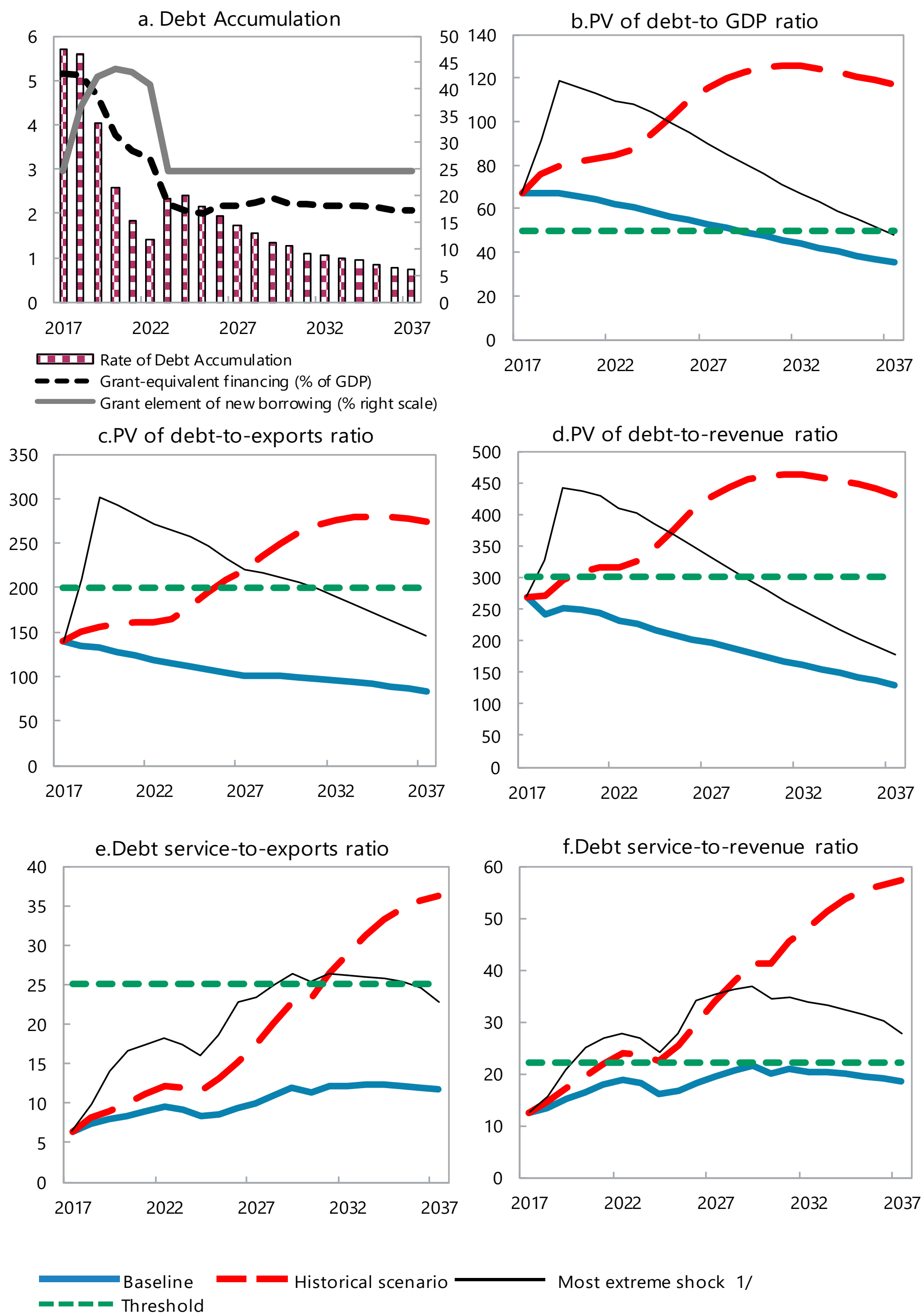
13. The authorities concurred with the results of the DSA based on the fiscal path assumed by staff. However, they expect to achieve a more ambitious fiscal consolidation path over the medium term as a result of their revenue mobilization and expenditure rationalization efforts. They stressed their commitment to such fiscal consolidation and their intention to cut expenditures as needed to achieve it. The authorities also expressed a different view with regard to the external commercial borrowing assumption and concessionality of the loans for the long-term projection. They reiterated that commercial borrowing will remain very low (below 10 percent of the envelope) and expressed confidence in being able to secure commercial external borrowing on highly-concessional terms. The current significantly-lower-than market commercial borrowing rate reflects a special credit facility with back up and subsidy from Portugal, which will not be unwound anytime soon.

DEBT DISTRESS CLASSIFICATION

14. Based on the external debt burden indicators, the current DSA finds that the risk of external debt distress remains high, but Cabo Verde retains its capability to service its debt. The PV of external debt to GDP threshold is breached over an 11-year period under the baseline scenario, and the breach is significant.[2] Debt service indicators remain below their respective thresholds in the baseline scenario, but are sensitive to growth or exchange rate shocks.

[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, 2017–37 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 2027. In figure b. it corresponds to a Combination shock; in c. to a Exports shock; in d. to a Combination 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, 2014–37 1/

(Percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2014	2015	2016			2017	2018	2019	2020	2021	2022	2017-2022 Average	2027	2037	2023-2037 Average
External debt (nominal) 1/	**102.1**	**109.8**	**106.8**			**103.6**	**102.0**	**101.3**	**98.5**	**94.9**	**91.0**		**72.4**	**48.7**	
of which: public and publicly guaranteed (PPG)	89.0	97.0	97.3			95.0	94.9	94.8	92.7	89.7	86.4		69.5	47.2	
Change in external debt	2.3	7.7	-3.0			-3.2	-1.6	-0.7	-2.8	-3.5	-3.9		-3.0	-1.5	
Identified net debt-creating flows	1.6	13.2	-6.5			-1.1	-2.8	-2.3	-2.1	-1.9	-1.6		-5.5	-0.1	
Non-interest current account deficit	**5.9**	**1.1**	**-0.2**	**7.6**	**4.9**	**5.7**	6.2	6.7	6.7	**6.7**	**6.6**		**-0.9**	**3.3**	2.4
Deficit in balance of goods and services	18.4	15.4	16.7			20.2	19.4	19.9	20.0	20.1	20.3		10.7	11.8	
Exports	48.1	41.3	44.9			48.0	50.3	51.0	51.5	51.9	52.4		52.9	42.6	
Imports	66.4	56.7	61.6			68.2	69.7	70.8	71.5	72.1	72.7		63.6	54.4	
Net current transfers (negative = inflow)	-14.3	-15.9	-17.6	-17.2	2.3	-15.6	-13.7	-13.9	-14.2	-14.5	-14.7		-12.7	-9.2	-11.7
of which: official	-3.0	-3.4	-3.0			-2.2	-1.2	-1.2	-1.2	-1.2	-1.2		-1.2	-1.4	
Other current account flows (negative = net inflow)	1.8	1.6	0.7			1.1	0.6	0.8	1.0	1.0	1.1		1.1	0.7	
Net FDI (negative = inflow)	**-6.8**	**-7.0**	**-6.4**	**-7.1**	**2.9**	**-6.1**	-8.2	-8.5	-8.3	**-8.1**	**-7.9**		**-4.8**	**-4.0**	-5.3
Endogenous debt dynamics 2/	**2.5**	**19.1**	**0.1**			**-0.7**	-0.8	-0.5	-0.5	**-0.4**	**-0.3**		**0.2**	**0.6**	
Contribution from nominal interest rate	3.1	2.2	3.0			3.3	3.1	3.3	3.3	3.3	3.2		3.4	2.8	
Contribution from real GDP growth	-0.6	-1.2	-4.1			-4.0	-3.9	-3.8	-3.8	-3.7	-3.6		-3.2	-2.1	
Contribution from price and exchange rate changes	0.1	18.1	1.2			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**0.6**	**-5.5**	**3.5**			**-2.2**	1.2	1.6	-0.8	**-1.6**	**-2.4**		**2.5**	**-1.5**	
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/	...	...	82.8			75.5	74.4	73.9	71.7	69.2	66.3		55.9	36.8	
In percent of exports	...	...	184.6			157.4	147.9	144.9	139.4	133.2	126.5		105.7	86.2	
PV of PPG external debt	**...**	**...**	**73.3**			**66.9**	**67.4**	**67.3**	**65.9**	**64.0**	**61.7**		**53.0**	**35.3**	
In percent of exports	**...**	**...**	**163.4**			**139.5**	**133.9**	**132.1**	**128.1**	**123.1**	**117.8**		**100.2**	**82.7**	
In percent of government revenues	**...**	**...**	**302.5**			**269.2**	**241.6**	**250.8**	**248.5**	**243.0**	**231.0**		**195.8**	**130.3**	
Debt service-to-exports ratio (in percent)	**9.3**	**8.9**	**10.0**			**10.6**	**11.3**	**11.9**	**12.5**	**13.1**	**13.7**		**14.1**	**16.0**	
PPG debt service-to-exports ratio (in percent)	**5.3**	**6.4**	**5.9**			**6.5**	**7.4**	**7.9**	**8.4**	**9.0**	**9.6**		**9.9**	**11.8**	
PPG debt service-to-revenue ratio (in percent)	**12.1**	**10.9**	**10.9**			**12.5**	**13.3**	**15.0**	**16.3**	**17.8**	**18.8**		**19.4**	**18.6**	
Total gross financing need (Billions of U.S. dollars)	0.1	0.0	0.0			0.1	0.1	0.1	0.1	0.1	0.1		0.1	0.4	
Non-interest current account deficit that stabilizes debt ratio	3.7	-6.6	2.8			8.9	7.9	7.4	9.5	10.2	10.6		2.1	4.8	
Key macroeconomic assumptions															
Real GDP growth (in percent)	0.6	1.0	3.8	2.7	3.2	4.0	4.3	4.0	4.0	4.0	4.0	4.0	4.5	4.5	4.6
GDP deflator in US dollar terms (change in percent)	-0.1	-15.0	-1.1	0.5	8.5	2.2	8.9	2.0	2.3	1.9	1.9	3.2	2.0	2.0	2.0
Effective interest rate (percent) 5/	3.1	1.9	2.8	3.7	1.2	3.2	3.4	3.4	3.5	3.5	3.6	3.4	4.8	5.8	5.0
Growth of exports of G&S (US dollar terms, in percent)	2.8	-26.2	11.5	5.3	16.8	13.6	19.2	7.4	7.4	6.9	6.9	10.2	6.9	5.9	5.2
Growth of imports of G&S (US dollar terms, in percent)	6.4	-26.7	11.5	3.7	17.6	17.5	16.1	7.8	7.3	6.8	6.9	10.4	4.9	5.0	4.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	24.6	36.7	42.2	43.8	43.2	40.8	38.6	24.6	24.6	24.6
Government revenues (excluding grants, in percent of GDP)	21.1	24.4	24.2			24.9	27.9	26.8	26.5	26.3	26.7		27.1	27.1	27.1
Aid flows (in Billions of US dollars) 7/	0.2	0.2	0.1			0.1	0.1	0.1	0.1	0.1	0.2		0.1	0.2	
of which: Grants	0.0	0.0	0.0			0.1	0.0	0.0	0.0	0.0	0.0		0.0	0.1	
of which: Concessional loans	0.2	0.1	0.1			0.0	0.1	0.1	0.1	0.1	0.1		0.1	0.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			5.1	5.1	4.7	3.8	3.4	3.2		2.2	2.1	2.2
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			50.4	48.0	50.0	51.1	50.9	49.2		33.7	34.1	33.8
Memorandum items:															
Nominal GDP (Billions of US dollars)	1.9	1.6	1.6			1.7	2.0	2.1	2.2	2.4	2.5		3.5	6.6	
Nominal dollar GDP growth	0.6	-14.2	2.7			6.2	13.6	6.1	6.3	5.9	6.0	7.4	6.6	6.6	6.7
PV of PPG external debt (in Billions of US dollars)			1.1			1.2	1.3	1.4	1.5	1.5	1.5		1.8	2.3	
(PVt-PVt-1)/GDPt-1 (in percent)						5.7	5.6	4.0	2.6	1.8	1.4	3.5	1.7	0.7	1.4
Gross workers' remittances (Billions of US dollars)	0.2	0.2	0.2			0.2	0.2	0.2	0.2	0.2	0.3		0.3	0.4	
PV of PPG external debt (in percent of GDP + remittances)	...	...	66.1			60.9	61.8	61.5	60.0	58.0	55.8		48.4	33.0	
PV of PPG external debt (in percent of exports + remittances)	...	...	131.4			115.5	113.4	111.4	107.4	102.7	97.8		85.0	71.5	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	4.7			5.3	6.2	6.7	7.1	7.5	7.9		8.4	10.2	

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. Large residuals for historical data is owing to differences in changes in the exchange rate of the euro-USD exchange rate (given the local currency is pegged to the Euro) compared to changes in the various currencies in which external debt is denominated vis-à-vis USD. About 60 percent of external debt is denominated in Euro.

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, 2017–37

(In percent)

	Projections							
	2017	2018	2019	2020	2021	2022	**2027**	2037
PV of debt-to GDP ratio								
Baseline	67	67	67	66	64	62	**53**	35
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	67	76	79	82	83	84	**116**	117
A2. New public sector loans on less favorable terms in 2017-2037 2	67	70	72	72	71	70	**68**	63
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	67	71	74	72	70	68	**58**	39
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	67	78	94	92	90	87	**71**	38
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	67	80	89	87	84	81	**70**	46
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	67	70	73	71	69	67	**56**	36
B5. Combination of B1-B4 using one-half standard deviation shocks	67	91	118	116	113	109	**90**	48
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	67	93	93	91	88	85	**73**	49
PV of debt-to-exports ratio								
Baseline	140	134	132	128	123	118	**100**	83
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	140	150	156	159	160	161	**219**	274
A2. New public sector loans on less favorable terms in 2017-2037 2	140	139	141	139	137	133	**128**	149
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	140	134	133	128	123	118	**100**	83
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	140	209	302	292	282	271	**220**	145
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	140	134	133	128	123	118	**100**	83
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	140	139	142	138	132	127	**107**	84
B5. Combination of B1-B4 using one-half standard deviation shocks	140	190	249	241	233	224	**182**	121
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	140	134	133	128	123	118	**100**	83
PV of debt-to-revenue ratio								
Baseline	269	242	251	249	243	231	**196**	130
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	269	271	296	308	316	315	**427**	432
A2. New public sector loans on less favorable terms in 2017-2037 2	269	250	267	270	270	261	**250**	234
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	269	254	276	272	266	253	**214**	142
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	269	280	350	347	340	325	**264**	140
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	269	287	331	327	320	304	**257**	171
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	269	251	270	267	261	249	**208**	132
B5. Combination of B1-B4 using one-half standard deviation shocks	269	326	441	436	429	410	**332**	178
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	269	335	348	344	336	319	**270**	180

Table 1b. Cabo Verde: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2017–37 (concluded)

(Percent)

	Projections							
	2017	2018	2019	2020	2021	2022	**2027**	2037
Debt service-to-exports ratio								
Baseline	6	7	8	8	9	10	**10**	12
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	6	8	9	10	11	12	**17**	36
A2. New public sector loans on less favorable terms in 2017-2037 2	6	7	7	8	9	10	**10**	17
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	6	7	8	8	9	10	**10**	12
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	6	10	14	17	17	18	**23**	23
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	6	7	8	8	9	10	**10**	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	6	7	8	9	9	10	**11**	12
B5. Combination of B1-B4 using one-half standard deviation shocks	6	9	12	14	14	15	**19**	19
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	6	7	8	8	9	10	**10**	12
Debt service-to-revenue ratio								
Baseline	12	13	15	16	18	19	**19**	19
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	12	15	17	19	22	24	**34**	57
A2. New public sector loans on less favorable terms in 2017-2037 2	12	13	14	15	17	19	**19**	27
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	12	14	16	18	20	21	**21**	20
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	12	13	16	20	21	22	**28**	22
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	12	16	20	21	23	25	**26**	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	12	13	15	17	18	19	**21**	19
B5. Combination of B1-B4 using one-half standard deviation shocks	12	16	21	25	27	28	**35**	28
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	12	18	21	23	25	26	**27**	26
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	19	19	19	19	19	19	**19**	19

Sources: Country authorities; and staff estimates and projections.

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

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

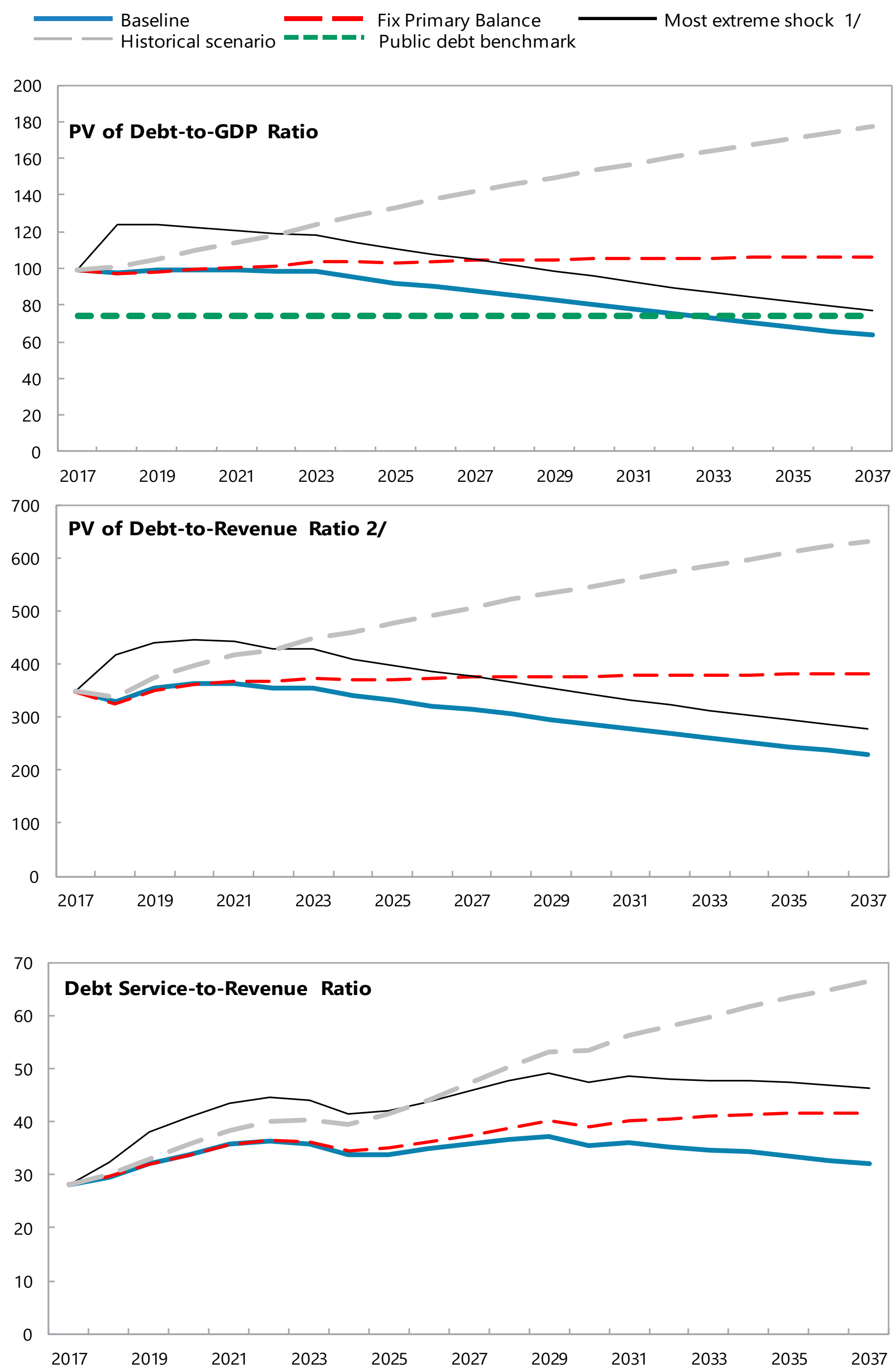
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming
an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

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

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

Figure 2. Cabo Verde: Indicators of Public Debt Under Alternatives Scenarios, 2017–37 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 2027.

2/ Revenues are defined inclusive of grants.

Table 2a. Cabo Verde: Public Sector Debt Sustainability Framework, Baseline Scenario, 2014–37

(Percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2014	2015	2016	Average 5/	Standard Deviation 5/	2017	2018	2019	2020	2021	2022	2017-22 Average	2027	2037	2023-37 Average
Public sector debt 1/	115.9	126.0	129.5			126.9	125.2	126.7	126.2	124.7	122.8		103.8	75.6	
of which: foreign-currency denominated	89.0	97.0	97.3			95.0	94.9	94.8	92.7	89.7	86.4		69.5	47.2	
Change in public sector debt	13.4	10.1	3.5			-2.5	-1.8	1.6	-0.5	-1.5	-1.9		-3.5	-2.4	
Identified debt-creating flows	19.7	16.3	6.2			-9.7	1.5	1.7	-0.8	-1.8	-2.3		-3.9	-2.8	
Primary deficit	8.6	4.3	3.3	6.3	4.6	3.6	4.3	4.1	2.7	1.7	1.0	2.9	-0.4	-0.6	-0.4
Revenue and grants	22.9	26.9	27.0			28.4	29.8	28.1	27.5	27.2	27.7		27.8	27.8	
of which: grants	1.8	2.5	2.8			3.5	1.9	1.3	1.0	0.9	0.9		0.8	0.8	
Primary (noninterest) expenditure	31.4	31.2	30.3			31.9	34.1	32.2	30.2	28.9	28.7		27.5	27.2	
Automatic debt dynamics	11.1	11.1	2.0			-13.7	-5.0	-4.1	-4.2	-4.1	-4.0		-3.5	-2.2	
Contribution from interest rate/growth differential	0.2	-0.1	-3.0			-3.8	-4.6	-4.4	-4.2	-4.2	-3.9		-3.3	-2.1	
of which: contribution from average real interest rate	0.8	1.1	1.6			1.1	0.6	0.4	0.6	0.7	0.9		1.3	1.2	
of which: contribution from real GDP growth	-0.6	-1.2	-4.6			-4.9	-5.2	-4.8	-4.9	-4.8	-4.8		-4.6	-3.4	
Contribution from real exchange rate depreciation	10.9	11.1	5.0			-9.9	-0.4	0.3	0.0	0.1	0.0		...	...	
Other identified debt-creating flows	0.1	0.9	0.9			0.5	2.2	1.6	0.7	0.6	0.6		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)	0.1	0.9	0.9			0.5	2.2	1.6	0.7	0.6	0.6		0.0	0.0	
Residual, including asset changes	-6.3	-6.2	-2.7			7.2	-3.3	-0.1	0.3	0.3	0.4		0.4	0.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	105.5			98.8	97.6	99.3	99.5	98.9	98.1		87.3	63.6	
of which: foreign-currency denominated	...	...	73.3			66.9	67.4	67.3	65.9	64.0	61.7		53.0	35.3	
of which: external	...	...	73.3			66.9	67.4	67.3	65.9	64.0	61.7		53.0	35.3	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	14.1	11.7	10.7			11.6	13.1	13.1	12.0	11.4	11.1		9.6	8.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	390.7			348.5	327.6	353.4	361.8	363.5	354.6		313.5	228.6	
PV of public sector debt-to-revenue ratio (in percent)	...	...	435.2			397.5	349.9	369.9	374.9	376.0	367.0		322.6	235.1	
of which: external 3/	...	...	302.5			269.2	241.6	250.8	248.5	243.0	231.0		195.8	130.3	
Debt service-to-revenue and grants ratio (in percent) 4/	24.2	27.7	27.6			28.2	29.6	32.0	33.9	35.6	36.3		35.9	32.0	
Debt service-to-revenue ratio (in percent) 4/	26.3	30.5	30.8			32.2	31.6	33.5	35.1	36.8	37.6		36.9	32.9	
Primary deficit that stabilizes the debt-to-GDP ratio	-4.9	-5.8	-0.2			6.1	6.1	2.5	3.3	3.2	2.9		3.1	1.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	0.6	1.0	3.8	2.7	3.2	4.0	4.3	4.0	4.0	4.0	4.0	4.0	4.5	4.5	4.6
Average nominal interest rate on forex debt (in percent)	1.5	1.1	1.2	1.3	0.4	1.3	1.4	1.4	1.4	1.3	1.3	1.3	1.7	2.1	1.8
Average real interest rate on domestic debt (in percent)	4.2	3.9	6.2	3.1	1.6	5.0	4.6	4.4	4.0	3.9	3.9	4.3	3.9	3.9	3.9
Real exchange rate depreciation (in percent, + indicates depreciation)	14.0	12.6	5.4	2.7	7.9	-10.7	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	-0.1	1.7	-0.8	1.4	1.4	0.1	1.4	1.6	2.0	2.0	2.0	1.5	2.0	2.0	2.0
Growth of real primary spending (deflated by GDP deflator, in percent)	-11.3	0.1	0.8	-1.0	3.6	9.7	11.4	-1.7	-2.6	-0.4	3.2	3.2	4.2	4.7	4.2
Grant element of new external borrowing (in percent)	...	...	...	...	...	24.6	36.7	42.2	43.8	43.2	40.8	38.6	24.6	24.6	...

Sources: Country authorities; and staff estimates and projections.

1/ Coverage is central government. Data refers to gross debt.

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, 2017–37

	Projections							
	2017	2018	2019	2020	2021	2022	2027	2037
PV of Debt-to-GDP Ratio								
Baseline	99	98	99	99	99	98	87	64
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	99	101	105	109	114	118	142	177
A2. Primary balance is unchanged from 2017	99	97	98	99	100	101	104	106
A3. Permanently lower GDP growth 1/	99	98	101	102	103	104	101	101
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	99	103	112	114	115	116	113	101
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	99	103	110	110	109	108	96	70
B3. Combination of B1-B2 using one half standard deviation shocks	99	104	112	113	114	114	108	90
B4. One-time 30 percent real depreciation in 2018	99	124	124	122	121	119	105	77
B5. 10 percent of GDP increase in other debt-creating flows in 2018	99	105	107	107	106	105	94	69
PV of Debt-to-Revenue Ratio 2/								
Baseline	349	328	353	362	364	355	314	229
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	349	337	374	398	417	427	506	631
A2. Primary balance is unchanged from 2017	349	326	350	361	368	366	374	381
A3. Permanently lower GDP growth 1/	349	330	360	372	378	374	362	362
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	349	346	396	413	422	419	405	362
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	349	345	391	400	401	391	345	250
B3. Combination of B1-B2 using one half standard deviation shocks	349	348	398	412	418	412	386	323
B4. One-time 30 percent real depreciation in 2018	349	416	441	445	443	429	376	276
B5. 10 percent of GDP increase in other debt-creating flows in 2018	349	353	379	388	389	380	338	248
Debt Service-to-Revenue Ratio 2/								
Baseline	28	30	32	34	36	36	36	32
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	28	30	33	36	38	40	47	66
A2. Primary balance is unchanged from 2017	28	30	32	34	36	36	37	42
A3. Permanently lower GDP growth 1/	28	30	32	35	37	38	39	42
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	28	31	35	37	40	41	42	43
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	28	30	33	35	37	38	39	35
B3. Combination of B1-B2 using one half standard deviation shocks	28	30	34	37	39	40	41	40
B4. One-time 30 percent real depreciation in 2018	28	32	38	41	43	45	46	46
B5. 10 percent of GDP increase in other debt-creating flows in 2018	28	30	33	36	37	38	40	35

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.

Statement by Alexandre Tombini, Executive Director for Cabo Verde and Pedro Fachada, Alternate Executive Director March 26, 2018

1. On behalf of our Cabo Verdean authorities, we thank the mission team for the constructive engagement during this year's Article IV consultation. Our authorities reiterate their appreciation for the Fund's support to Cabo Verde, both in terms of surveillance and capacity building.

2. Cabo Verde's economy continued to strengthen in 2017 and the medium-term outlook is positive. The recent economic recovery has undoubtedly a cyclical component, but also reflects early dividends from the authorities' reforms over the last two years, aimed at increasing private sector participation, reducing fiscal risks, and reorganizing public companies. In the authorities' view, the mission team captured well the strength of the ongoing recovery, but their medium-term projections underestimate the payoff from the reform momentum on growth.

Economic Developments and Outlook

3. Real GDP grew 4.9 percent on a year-on-year basis in the third quarter of 2017 (latest available data), the best performance since the first quarter of 2012. This performance was driven by double-digit expansions in the hotel and restaurant, utilities, and manufacturing sectors, which more than offset declines in agriculture and fisheries due to largely one-off factors. On a cumulative basis, GDP grew 3.9 percent in the first three quarters of 2017, compared to the same period in 2016.

4. In recent years, tourism has been the most dynamic sector in Cabo Verde's economy. Traffic of international passengers in Cabo Verde's airports increased by 18.5 percent last year. According to data released by the National Institute of Statistics (INE), the number of nights stayed by visitors increased by 12.3 percent in 2017. Although there is a cyclical component inherent within the tourism industry worldwide, in Cabo Verde's case there is also a structural element to the tourism boon. In addition to the marketing of Cabo Verde as a safe and "off the beaten track" alternative to Mediterranean destinations, new hotel

developments and the expansion in airlinks with the main European markets have increased the attractiveness of the islands.

5. Cabo Verde's inflation dynamics continued to be influenced by external price developments and the peg to the euro. Inflation returned to positive territory in 2017, and in the 12-months through February 2018 consumer prices increased by 0.8 percent. The benign inflationary environment has positively impacted consumer and business confidence.

6. Given the rebound in economic activity and their structural reform agenda, the authorities consider staff's medium-term growth outlook to be relatively pessimistic. Partly, this can be attributed to the backward-looking methodologies applied by staff to estimate the growth potential of the economy, which are affected by the weak growth environment that prevailed in Cabo Verde at the time of the euro area crisis between 2012-2015. The relevance of these backward-looking techniques diminishes when structural changes take place, making the use of historic data inadequate to project future GDP growth. High investment and capital accumulation in past years enable the country to grow now at higher rates. The Ministry of Finance estimates GDP to grow between 5.0 and 5.5 percent in 2018, with further strengthening expected in the following years.

Fiscal Policy

7. In 2017, public debt as a share of GDP declined for the first time in a decade. This was a result of the authorities' strong efforts to put the public debt ratio on a firm downward path and reduce fiscal sustainability risks. The overall fiscal deficit was in line with the authorities' target, standing at 3 percent of GDP in 2017 and compared favorably to the average fiscal deficit of around 9 percent of GDP in the 2010-2014 period. As recognized by staff (footnote 3), in the absence of a specific operation related to the public housing company IFH, the budget would be close to balance.

8. Fiscal consolidation has been supported by strong revenue mobilization efforts and expenditure restraint. The authorities have managed to increase tax revenues from 19.2 percent of GDP in 2015 to an estimated 21.1 percent of GDP in 2017 by fighting tax evasion, combating informality, collecting tax arrears and strengthening the capacity of the tax agency. To ensure that the budget target was met last year, the Ministry of Finance cut certain approved spending, in accordance with the budget legislation.

9. For 2018, the authorities are committed to sustain fiscal discipline, targeting a budget deficit of around 3.1 percent of GDP. They continue to see space for additional domestic revenue mobilization by combating tax evasion and recovering tax arrears. They take note of staff's recommendation to raise the VAT rate from 15 to 17 percent, similar to the level of other highly-indebted small island economies, but they are not planning any tax increase at this juncture. As was the case in 2017, the authorities have already announced cuts of certain spending categories to alleviate budget pressures.

10. Efforts to address vulnerabilities in important state-owned enterprises (SOEs) are ongoing. Significant progress has already been achieved regarding the national airline, TACV. The company withdrew last year from the domestic market and management was transferred to Icelandair Group, which is restructuring TACV's international operations and preparing for its privatization. The strategy of the new management envisages using Cabo Verde's central location in the South Atlantic as a hub for intercontinental air traffic. Regarding IFH, part of the stock of low-income houses was transferred to municipal governments, which are better prepared to manage local housing needs, while the sale of middle-income houses to the public was accelerated. Finally, the electricity and water utility company Electra advanced the internal process to increase operational efficiency, reduce commercial losses and prepare for privatization.

11. Despite the decline recorded in 2017, the authorities are aware that the public debt to GDP ratio remains very high. However, as recognized by staff, debt service is manageable and there is no medium-term sustainability concern, given the long maturity profile and highly concessional terms of external debt. Over the medium-term, the authorities intend to continue their gradual fiscal consolidation process and attain a balanced budget by 2021, significantly improving public debt sustainability. Further, they welcome staff's recommendation to anchor fiscal policy with the objective of reducing the present value of external public debt to below 55 percent of GDP by 2023 from 67 percent in 2017, as a way to diminish the risk of external debt distress.

Monetary Policy and Financial Stability

12. The Banco de Cabo Verde (BCV) has continued to successfully support the exchange rate peg with the euro. The authorities take note of staff's assessment that the real exchange rate is broadly in line with economic fundamentals, and that international reserves are adequate. Despite the widening in the current account deficit in 2017, international reserves stood at a comfortable level at 5.6 months of prospective imports of goods and services.

13. In the absence of inflation or international reserves pressures, monetary policy in 2017 remained accommodative. The BCV reduced the policy rate by 200 basis points to 1.5 percent in June 2017, while adopting measures to improve communication and the transmission mechanism of monetary policy.

14. The banking sector remains relatively well capitalized and liquid, despite high legacy non-performing loans (NPLs) and low profitability. The BCV continues to work with banks to resolve the stock of legacy NPLs and stimulate credit. More recently, Cabo Verde has been affected by the withdrawal of correspondent banking relationships due to the small size of the domestic market. Like in many other small economies, low scale relative to increasing costs of due diligence processes have reduced their attractiveness to correspondent banks, especially for operations in US dollars. Cabo Verde has a comprehensive anti-money

laundering/combating the financing of terrorism (AML/CFT) framework and the BCV is cooperating with foreign supervisors and intergovernmental bodies to address the issue.

Structural Reforms

15. The Cabo Verdean authorities are aware that the implementation of structural reforms is fundamental to increase potential growth, generate jobs, and improve the welfare of the population. Moving forward, they agree that private sector participation is critical to ensure long term economic growth and sustainability. Reforms to the business environment, better education and vocational training, improved access to financing, and privatization of inefficient SOEs are expected to crowd-in private investment and bring innovation and diversification, which will boost productivity and competitiveness.

16. The 2017-2021 Strategic Plan for Sustainable Development (PEDS) lays out the authorities' medium-term growth vision and redefines Cabo Verde's position in the regional and global economy. Alongside tourism as the main driver of growth, the PEDS envisages Cabo Verde as a viable and robust hub for air and maritime transportation, and regional business center. The authorities also plan to develop the digital economy. They are determined to push ahead with the diversification drive to ensure a socio-economic environment that is attractive to both domestic and foreign investment.