INTERNATIONAL MONETARY FUND

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CABO VERDE

July 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND REQUEST FOR AN EIGHTEEN-MONTH POLICY COORDINATION INSTRUMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CABO VERDE

In the context of the 2019 Article IV Consultation and Request for an Eighteen-Month Policy Coordination Instrument, the following documents have been released and are included in this package:

- **Press Releases** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its July 15, 2019 consideration of the staff report for the Article IV consultation and the Request for an Eighteen-Month Policy Coordination Instrument with Cabo Verde.

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 15, 2019, following discussions that ended on March 25, 2019, 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 July 2, 2019.

- A **Debt Sustainability Analysis** 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:

Program Statement sent to the IMF by the authorities of Cabo Verde*
Technical Memorandum of Understanding*
*Also included in the Staff Report

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.

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FOR IMMEDIATE RELEASE
July 15, 2019

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

IMF Executive Board Approves a new Policy Coordination Instrument for Cabo Verde

- A newly-approved eighteen-month Policy Coordination Instrument will build on Cabo Verde's reform program under the Strategic Plan for Sustainable Development.
- It aims to bolster macroeconomic stability and encourage structural reforms.
- Cabo Verde's macroeconomic situation has improved significantly in recent years and the medium-term outlook is positive.

On July 15, 2019, the Executive Board of the International Monetary Fund (IMF) approved a new Eighteen-Month Policy Coordination Instrument (PCI) with Cabo Verde.

Cabo Verde's macroeconomic situation has improved significantly in recent years, and the outlook is positive despite downside risks. Economic growth has been robust and is projected at 5 percent for 2019, while inflation is expected to remain low. The fiscal deficit has declined from 4.6 percent of GDP in 2015 to 2.8 percent of GDP in 2018 and is projected at 2.2 percent of GDP for 2019. Fiscal risks generated by loss-making State-Owned Enterprises (SOEs) are expected to subside, reflecting the impact of reforms put in place in 2018 and early 2019, notably the privatization of the national airline company, as well as additional SOEs restructuring measures planned for 2019-20. The external position is projected to strengthen further, with gross international reserves remaining above 5 months of prospective imports of goods and services. Cabo Verde's risk of external and overall debt distress is assessed as high, unchanged compared with the 2018 Debt Sustainability Analysis carried out by the staffs of the IMF and the World Bank.

The newly-approved PCI will build on the authorities' reform program under the Strategic Plan for Sustainable Development (PEDS). It aims at bolstering macroeconomic stability through fiscal consolidation and growth-enhancing reforms to support medium-term fiscal and debt sustainability. The fiscal program will be anchored by improvement in the primary balance and the elimination, over time, of support from the budget to loss-making SOEs as reforms in the sector advance. Program reviews will take place on a semi-annual fixed schedule. While the PCI does not involve the use of IMF financial resources, successful completion of program reviews will help signal Cabo Verde's commitment to continued strong macroeconomic policies and structural reforms that are needed to address the country's economic challenges.

Following the Executive Board's discussion on Cabo Verde, Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, issued the following statement:

"Economic recovery has gained momentum in the last three years with output growth rising from 1 percent in 2015 to above 5 percent in 2018, supported by industry and services sectors, as well as strong domestic demand. Inflation has been subdued despite a spike in 2018 due to higher food and fuel prices. The external current account deficit narrowed in 2018, mostly reflecting strong export performance and higher remittances.

"Revenue-enhancing measures and expenditure controls have helped put public finances on a stronger footing and reduce the public debt-to-GDP ratio in the last three years. These efforts need to be sustained to support medium-term fiscal and debt sustainability. In this context, decisive progress in public enterprise reform is needed.

"The risk of external and overall debt distress is assessed as high, calling for continued fiscal consolidation, reliance on concessional borrowing, and decisive progress in growth-enhancing reforms.

"The monetary policy stance is appropriate and consistent with the objective of protecting the exchange rate peg and price stability. The recent decision by the Banco de Cabo Verde (BCV) to reduce the overnight interest rate corridor is expected to improve the monetary policy transmission mechanism. The BCV should continue these efforts, notably by increasing communication on its policy direction. It should also continue strengthening banking supervision and take appropriate actions for a continued reduction in non-performing loans.

"The new PCI will support the authorities' efforts to enhance macroeconomic stability as they implement their Strategic Plan for Sustainable Development (PEDS). Reforms and quantitative targets under the PCI focus on strengthening fiscal and debt sustainability, enhancing the monetary policy framework, fostering the financial system stability, and increasing inclusive growth.''

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 19/289
FOR IMMEDIATE RELEASE
July 17, 2019

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

IMF Executive Board Concludes 2019 Article IV Consultation with Cabo Verde

On July 15, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation[1] with Cabo Verde.

Cabo Verde's macroeconomic situation has improved significantly in recent years, and the outlook is positive despite downside risks. Economic growth has been robust and is projected at 5 percent for 2019, while inflation is expected to remain low. The fiscal deficit has declined from 4.6 percent of GDP in 2015 to 2.8 percent of GDP in 2018 and is projected at 2.2 percent of GDP for 2019. Fiscal risks generated by loss-making State-Owned Enterprises (SOEs) are expected to subside, reflecting the impact of reforms put in place in 2018 and early 2019, notably the privatization of the national airline company, as well as additional SOEs restructuring measures planned for 2019-20. The external position is projected to strengthen further, with gross international reserves remaining above 5 months of prospective imports of goods and services. Cabo Verde's risk of external and overall debt distress is assessed as high, unchanged compared with the 2018 Debt Sustainability Analysis carried out by the staffs of the IMF and the World Bank.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the economic reform agenda and sound policies that have underpinned a significant improvement in the macroeconomic situation in recent years, as evidenced by higher growth, continued low inflation, and improved fiscal and external positions. The outlook is favorable though there are risks, and Directors underscored the need for continued sustained structural reforms and prudent macroeconomic policies to address the significant challenges stemming from high public debt, lack of economic diversification, and vulnerability to natural disasters.

Directors welcomed the request for a Policy Coordination Instrument (PCI) and considered that the

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

authorities' economic and financial policy program would enhance macroeconomic stability and help sustain inclusive growth. They stressed that good performance under the PCI would play an important signaling role for the authorities' commitment to sound policies and reforms to address the country's developmental challenges.

Considering the high level of debt and high risk of debt distress, Directors stressed the need for sustained fiscal consolidation efforts. In this context, Directors underlined that sustained improvement in revenue mobilization—by combating tax evasion, broadening the tax base, and streamlining exemptions—and continued expenditure restraint are essential to preserve the significant gains made in the last three years and create fiscal space for priority spending. In particular, Directors emphasized that the elimination of budget transfers to and further reform of state-owned enterprises (SOEs) was necessary to reduce fiscal risks and safeguard debt sustainability.

Directors noted that the peg to the euro has served the country well. They observed that in the current environment of low inflation and adequate level of international reserves, the currently accommodative monetary policy stance remains appropriate. Directors noted, however, that the central bank should continue to monitor developments in the global economy and stand ready for any corrective action if necessary. Directors welcomed the measures taken recently by the central bank to improve the monetary policy transmission mechanism and welcomed efforts to further enhance communications on policy direction.

Directors underscored the improvement of Cabo Verde's external position and noted that the change of staff's External Stability Assessment compared with last year, stemmed from the use of an additional methodological approach.

Directors welcomed the improvement in financial stability indicators and called for measures to reduce the high level of non-performing loans. They encouraged the central bank to continue enhancing banking supervision, advance the preparation of a credit information system to facilitate banks' assessment of creditworthiness, and work with banks on the recovery of collaterals, particularly for legacy loans. Directors welcomed further efforts to improve the AML/CFT framework.

Directors stressed the importance of continued progress in the implementation of reforms to improve the business environment. In particular, they highlighted the need for further progress in SOEs' reforms, enhanced monitoring of their financial situation and performance, and implementation of measures to support small-and-medium sized enterprises' development. They called for actions to facilitate access to finance, notably by setting up a central registry for mobile collateral, to increase financial literacy through training, and to build skills through the expansion of access to vocational schools.

Table 1. Cabo Verde: Selected Economic Indicators, 2015–24

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.			Proj.			
				(Annual percent change)						
National accounts and prices 1/										
Real GDP	1.0	4.7	4.0	5.5	5.0	5.0	5.0	5.0	5.0	5.0
GDP deflator	1.7	-0.2	0.5	1.4	1.5	1.6	1.6	1.8	1.8	1.8
Consumer price index (annual average)	0.1	-1.4	0.8	1.3	1.2	1.6	1.6	1.8	1.8	1.8
Consumer price index (end of period)	-0.5	-0.3	0.3	1.0	1.0	1.6	1.6	1.8	1.8	1.8
External sector										
Exports of goods and services	-11.6	9.5	11.5	13.3	8.9	10.0	11.2	11.2	11.2	11.2
Of which: tourism	2.0	6.9	14.5	3.5	8.1	9.8	11.2	11.4	11.4	11.4
Imports of goods and services	-12.3	10.3	17.2	8.0	8.7	8.7	8.7	8.7	8.7	8.7
				(Change in percent of broad money, 12 months earlier)						
Money and credit										
Net foreign assets	4.0	6.1	1.3	-2.1	2.0	2.8	2.4	2.6	3.3	3.1
Net domestic assets	2.3	2.3	5.2	3.5	5.0	3.5	3.6	3.8	3.1	3.3
Net claims on the central government	-0.2	2.5	1.5	4.3	0.6	0.2	0.2	0.4	0.1	0.2
Credit to the economy	1.8	2.4	4.4	1.9	3.0	3.3	3.4	3.5	3.6	3.6
Broad money (M2)	6.2	8.4	6.5	1.4	7.0	6.3	6.0	6.4	6.4	6.4
				(Percent of GDP, unless otherwise indicated)						
Savings and investment										
Domestic savings	35.6	33.2	31.7	32.3	32.7	32.8	33.4	34.2	34.7	35.4
Government	0.7	-0.7	0.8	1.8	2.3	2.3	2.7	3.2	3.6	3.7
Private	34.9	34.0	30.9	30.4	30.5	30.6	30.6	31.0	31.1	31.7
National investment	38.7	37.1	38.3	36.7	36.9	36.9	37.4	38.1	38.3	39.0
Government	5.6	3.4	5.7	4.4	5.1	4.3	3.4	3.7	3.9	4.0
Private	33.2	33.8	32.6	32.3	31.8	32.6	34.0	34.3	34.4	35.0
Savings-investment balance	-3.2	-3.9	-6.6	-4.5	-4.2	-4.1	-4.1	-3.9	-3.6	-3.6
Government	-4.9	-4.1	-4.9	-2.6	-2.8	-2.0	-0.7	-0.5	-0.4	-0.3
Private	1.7	0.2	-1.7	-1.9	-1.3	-2.0	-3.4	-3.3	-3.3	-3.3
External sector										
External current account (including official transfers)	-3.2	-3.9	-6.6	-4.5	-4.2	-4.1	-4.1	-3.9	-3.6	-3.6
External current account (excluding official transfers)	-6.6	-6.6	-10.3	-7.2	-7.5	-7.1	-6.0	-5.6	-5.2	-5.1
Overall balance of payments	2.2	5.5	-0.9	0.5	3.6	2.6	2.8	2.9	3.1	2.9
Gross international reserves (months of prospective imports of goods and services)	6.0	6.1	5.5	5.1	5.3	5.3	5.3	5.3	5.4	5.4
Government finance										
Revenue	26.9	26.6	28.6	28.1	31.7	30.4	28.9	28.8	28.8	28.8
Tax and nontax revenue	24.4	23.9	24.9	26.7	28.9	28.5	28.0	27.9	28.0	28.0
Grants	2.5	2.7	3.7	1.4	2.8	1.9	0.9	0.8	0.8	0.8
Expenditure	31.4	29.6	31.5	30.9	33.9	31.8	30.1	29.8	29.7	29.6
Primary balance	-2.0	-0.5	-0.4	-0.3	0.7	1.0	1.2	1.2	1.2	1.2
Overall balance (incl. grants)	-4.6	-3.0	-3.0	-2.8	-2.2	-1.5	-1.2	-1.0	-0.9	-0.8
Net other liabilities (incl. onlending)	-3.2	-3.4	-0.4	-1.0	-4.3	-2.2	-0.9	-0.2	-0.2	-0.2
Total financing (incl. onlending and capitalization)	7.8	5.6	4.0	3.8	6.5	3.7	2.1	1.3	1.1	1.0
Net domestic credit	1.2	2.9	0.2	1.4	1.0	0.4	0.4	0.7	0.1	0.4
Net external financing	6.7	2.7	4.0	1.5	5.5	3.3	1.7	0.6	1.0	0.6
Public debt stock and service										
Total nominal government debt	126.6	128.4	127.0	123.9	121.4	116.8	111.0	104.6	98.5	92.7
External government debt	97.7	96.7	94.9	91.0	89.3	86.3	82.1	77.0	72.7	68.2
Domestic government debt	29.0	31.7	32.1	32.9	32.1	30.5	28.9	27.6	25.9	24.6
External debt service (percent of exports of goods and services)	6.4	6.0	6.3	5.8	7.6	6.8	7.4	7.9	7.4	6.8
Present value of PPG external debt										
Percent of GDP (risk threshold: 55%)	...	...	...	61.9	64.0	62.4	60.1	56.8	54.0	51.0
Percent of exports (risk threshold: 240%)	...	...	...	126.6	128.2	121.4	112.2	101.9	93.2	84.6
Present value of total debt										
Percent of GDP (benchmark: 70%)	...	...	...	97.2	95.8	92.7	88.8	84.3	79.7	75.4
Memorandum items:										
Nominal GDP (billions of Cabo Verde escudos)	158.7	165.8	173.4	185.6	197.8	211.1	225.3	240.9	257.5	275.2
Gross international reserves (€ millions, end of period)	453.3	536.2	522.7	531.1	596.6	645.8	704.1	767.2	838.7	911.3

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

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

CABO VERDE

July 2, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND REQUEST FOR AN EIGHTEEN-MONTH POLICY COORDINATION INSTRUMENT

KEYS ISSUES

Context. Following a long period of high growth, improved living standards and poverty reduction that lasted through the 2008 global financial crisis, Cabo Verde has been facing the challenge of low growth until recently and high public debt, also driven by key State-Owned Enterprises' (SOEs) losses. To consolidate recent gains and address remaining challenges, the authorities are implementing an ambitious reform agenda under their Strategic Plan for Sustainable Development (PEDS). In this context, they are requesting IMF support through a program under the Policy Coordination Instrument (PCI) for 18 months.

Outlook and Risks. The medium-term outlook is positive although risks are tilted to the downside. Economic growth is projected to remain robust while the fiscal and external positions are expected to improve further, underpinned by growth and programmed structural reforms. Key downside risks to this outlook are related to a slowdown in the Euro area and Cabo Verde' high vulnerability to weather-related shocks. Stronger tourism performance as well as increased foreign direct investment related to the PEDS implementation are the main upside risks.

Focus of the Consultation. Policy discussions for the 2019 Article IV Consultation and the PCI-supported program focused on achieving medium-term fiscal and debt sustainability; modernizing the monetary policy framework and continuing to build precautionary reserves; bolstering the financial system resilience; restructuring loss-making SOEs; and advancing structural reforms to support private sector-led growth.

Main Recommendations. Improve the fiscal position further to lower public debt and increase fiscal space for priority spending; improve the monetary policy transmission mechanism; build external buffers; bolster banking supervision; address the loss of correspondent banking relationships; reinvigorate growth-enhancing reforms.

The Policy Coordination Instrument. The PCI is the appropriate instrument for IMF support to Cabo Verde since the country does not face present, potential, or prospective balance of payments needs, and is not seeking IMF financial support. The program is fully financed for the next 12 months, with reasonable financing assurances for the second year. The main objective of the program is to enhance macroeconomic stability and underpin the authorities' reform program.

Approved By
Annalisa Fedelino (AFR) and Maria Gonzalez (SPR)

Discussions took place in Sal island (March 11–12), Praia (March 12–25), and in Washington, DC (April 10–14), 2019. The staff team comprised Ms. Kabedi-Mbuyi (Head), Mr. Amo-Yartey, Ms. Parulian, Ms. Mensah, and Ms. Woldemichael (All AFR), Ms. Quartey and Mr. Treilly provided support from Headquarters; Messrs. Saraiva and Fachada (OED) participated in some meetings in Praia and in Washington, DC. The team met with Prime Minister Ulisses Correia e Silva, Deputy Prime Minister and Minister of Finance Olavo Correia, Central Bank Governor João Serra, other Cabinet members and senior officials, the President of the Municipal Chamber of Sal island Julio Lopes, representatives of labor unions, non-government organizations, development partners, and the private sector.

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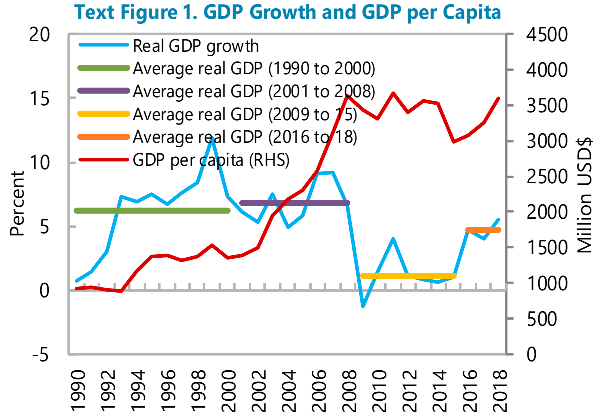
CONTEXT

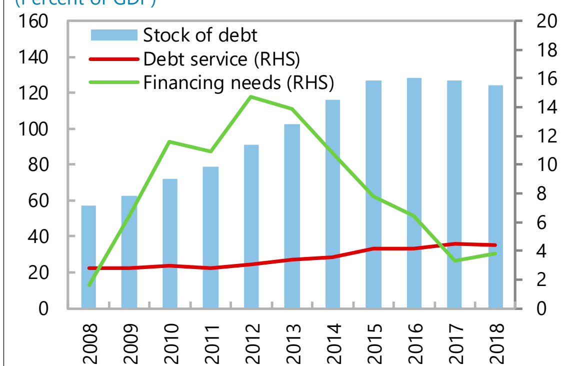
1. Cabo Verde made impressive strides in macroeconomic stability through 2008, when the global financial crisis started to unfold. Thanks to high growth in tourism, public investment scaling up, sustained private investment financed with foreign direct investment (FDI), and structural reforms, real GDP growth rose rapidly, averaging 6.2 percent between 1990-2000; and close to 6.8 percent during 2001-2008. This performance allowed the country to more than double its per capita income and to graduate to middle-income status in 2007 (Text Figure 1). Living standards improved and poverty declined. The macroeconomic situation deteriorated during 2009-15, partly due to a decline in tourism and FDI flows. During that period, real GDP growth averaged 1.1 percent; budget financing needs rose from 1.6 percent of GDP in 2008 to 7.8 percent of GDP in 2015; and public debt more than doubled, exceeding 120 percent of GDP in 2015 (Text Figure 2).

Text Figure 1. GDP Growth and GDP per Capita



Source: Cabo Verdean authorities.

Text Figure 2. Debt Stock, Debt Service and Financing Needs
(Percent of GDP)



Source: Cabo Verdean authorities.

2. There has been an improvement in the last three years, though significant vulnerabilities remain. Growth has recovered, and there has been a steady improvement in the fiscal and external positions (Figures 1 and 2). However, high and inclusive growth has remained constrained by the lack of diversification, low connectivity between the islands, high transaction costs, limited economies of scale, vulnerability to natural disasters and other exogenous shocks, and limited access to finance. In addition, weak financial situation in key State-Owned Enterprises (SOEs) have led to a build-up of liabilities, weighing heavily of budgetary resources and public debt.

3. The authorities have requested an eighteen-month PCI to enhance macroeconomic stability and underpin their reform agenda. The PCI will support their efforts to address the above-mentioned challenges as they implement reforms planned in their Strategic Plan for Sustainable Development (PEDS) for 2017-21.

4. There has been progress in the implementation of past IMF policy recommendations (Box 1). In addition, some measures recommended during the 2018 Article IV Consultation and the 2009 Financial Sector Assessment Program (FSAP) are part of reform targets under the PCI.

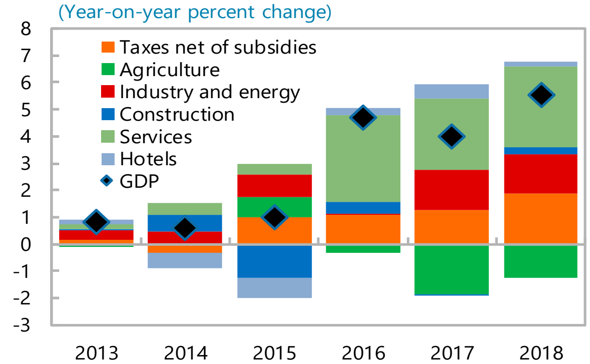
5. The political and social situation is stable. The ruling party (Movimento para a Democracia – MpD) won the parliamentary and presidential elections in 2016. The next elections will take place in 2020 at the municipal level, while legislative and presidential elections are scheduled for 2021.

Box 1. Status of the 2018 Article IV Consultation Main Recommendations

Policy Area	Key Recommendations	Status
Fiscal Policy and Debt Sustainability	Increase the VAT rate from 15 percent to 17 percent and restrain expenditures.	The authorities continued to focus on tax administration measures and expenditures restraint.
	Limit issuance of debt guarantees to contain fiscal risks.	The law on public debt adopted in November 2018 includes an article requiring parliamentary approval for the issuance of loan guarantees.
Monetary Policy	Tighten monetary policy in case of pressures on reserves.	The monetary policy stance remained unchanged in 2018 as price pressures were low and reserves were assessed as adequate.
	Narrow the overnight interest rate corridor to a maximum of 150-200 basis points and establish a symmetrical interest rate corridor to strengthen the monetary policy transmission mechanism.	In June 2019, the Central bank (Banco de Cabo Verde-BCV) reduced the corridor to 150 basis points.
Financial Sector	Give priority to the resolution of legacy non- performing loans (NPLs). Avoid further forbearance of requirements to write off irrecoverable loans. Provide guidance on loans restructuring, collateral valuation and asset classification. Create a central registry of movable collateral.	The BCV has been working with banks on the resolution of legacy NPLs. The creation of a central registry for movable collateral is a reform target under the PCI.
Correspondent Banking Relationships	Improve the AML/CFT framework. Implement the FATCA and the tax good governance standards agreed with the EU.	The authorities increased the corporate tax rate on off-shore banks.
Structural Reforms	Restructure the three loss-making State-Owned Enterprises (SOEs): the airline (TACV), housing (IFH), and power (Electra) companies. Integrate SOEs into the budget preparation processes. Create mechanisms to detect deviations from planned performance to inform timely corrective actions.	The social housing program managed by IFH was restructured at end-2018; TACV was privatized in March 2019; and ELECTRA is slated for privatization in 2020. The authorities plan to take measures in 2019-20 to strengthen the monitoring of SOEs' financial situation, while accelerating the privatization program. Enhanced monitoring of SOEs' performance is part of reform targets under the PCI.

RECENT ECONOMIC DEVELOPMENTS

Text Figure 3. Contributions to growth
(Year-on-year percent change)



Source: Cabo Verdean authorities.

6. **Growth momentum continues, and inflation remains low** (Figure 1, Table 1). Real GDP expanded from 4 percent in 2017 to 5.5 percent in 2018, driven by strong domestic demand, notably private investment. On the supply side, the main contributors to growth were the industry and services sectors. Inflation rose from 0.3 percent at end-December 2017 to 1 percent at end-December 2018 (y/y) reflecting higher fuel prices, and the impact of the drought that affected Cabo Verde for a second consecutive year, as shown by the contraction in the agriculture sector (Text Figure 3).

7. **The external position improved thanks to strong export performance** (Figure 2, Table 2). The current account deficit narrowed to 4.5 percent of GDP in 2018 (6.6 percent of GDP in 2017) on the back of increased export receipts in the tourism and fishery sectors; higher remittances, and a deceleration in imports demand. Although in decline compared with 2017, FDI remained important, covering the largest share of the current account deficit. Gross international reserves rose to €531 million at end-2018, equivalent to 5.1 months of prospective imports of goods and services.

8. **The external stability assessment shows that Cabo Verde's external position has strengthened, though remaining weaker than suggested by medium-term fundamentals and desirable policy settings**, while reserve adequacy remains strong (Annex I). Given the large negative net international investment position (NIIP), Staff puts special emphasis on the external sustainability approach which points to a large overvaluation, suggesting that in 2018 Cabo Verde's external position was weaker than implied by medium-term fundamentals and desirable policy settings. At the same time, the current account (CA) and the Real Effective Exchange Rate (REER)–based approaches suggest moderate to large undervaluation. Regarding gross international reserves, Staff's assessment using the Fund LIC/MIC framework suggests an optimal level of reserves of 3.6 months of prospective imports of goods and services—compared to actual and prospective levels slightly higher than 5 months (Table 2).

9. **The fiscal position improved slightly in 2018 and financial support to SOEs increased** (Figure 3; Tables 1,3a, 3b). The overall budget deficit declined from 3 percent of GDP in 2017 to 2.8 percent of GDP as revenue (excluding grants) rose by almost 2 percentage points of GDP, to 26.7 percent of GDP reflecting strong economic activity, continued tax administration reforms and enhanced collection of tax arrears. Expenditures stood at 30.9 percent of GDP, slightly below the 2017 level because capital outlays were under-executed. Support from the budget to SOEs rose to 2.1 percent of GDP (0.7 percent of GDP in 2017) reflecting increased transfers to the airline company (TACV) for restructuring and preparation for its privatization. The latter took place in March 2019, when 51 percent of TACV's shares was sold to a private investor.

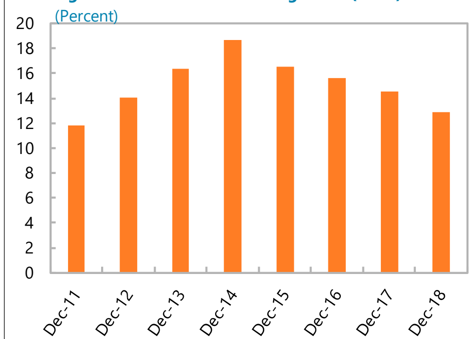
10. Credit growth decelerated (Figure 4, Table 4). Following a strong expansion in 2017 (7 percent y/y) credit to the economy grew by 3.1 percent in 2018, in line with historical trends. The deceleration was mostly due to the repayment of an important loan by a hotel operator. Trade and tourism-related activities received the largest share of bank financing. The relatively low level of credit to the private sector reflects both tight lending standards and banks' risk aversion in view of the high level of non-performing loans (Box 2). The central bank's prime rate was kept unchanged at 1.5 percent for the second consecutive year, while banks' lending rates rose, and deposits rates declined, by less than 50 basis points. In June 2019, the BCV reduced the interest rate of the overnight lending facility from 4.5 percent to 3 percent to improve the effectiveness of the monetary policy transmission mechanism, in line with understandings under the PCI.

Box 2. Non-Performing Loans (NPLs) Issues

The 2008 global financial crisis led to a significant increase in NPLs in the Cabo Verdean banking system. Following the crisis, the ratio of NPLs to total loans increased significantly, reaching 18.7 percent at end-December 2014 (Figure 1). The corporate sector accounts for about 70 percent of the stock, mostly in tourism, transport, commerce and construction. The household sector accounts for the remainder, notably for mortgages.

NPLs have declined somewhat in the last two years. They stood at 12.8 percent of total loans at end-December 2018 (14.5 percent of total loans at end-2017). Roughly 60 percent of the stock of NPLS is from legacy loans related to real estate development projects during 2006-08. The pace of resolution of these loans has been slow so far, mostly because of lengthy foreclosure processes and underdeveloped markets for distressed real estate assets. Banks have recently enhanced their recovery efforts and worked with the judicial system to recover some collaterals.

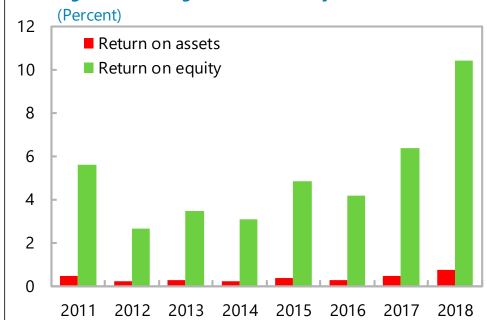
Figure 1. Total Non Performing Loans (NPLs)
(Percent)



Source: Cabo Verdean authorities.

The banking system's capacity to absorb losses has strengthened. Profitability, as measured by return on equity improved in recent years (Figure 2); the level of provisioning as well as the capital adequacy ratio are high. Consequently, with variations across the system, banks can absorb losses stemming from legacy NPLs without significantly harming their balance sheets. An analysis conducted by Fund staff and BCV shows that write-offs of all legacy loans would reduce the capital adequacy ratio of the banking system by 1.1 percentage points, to around 15.1 percent.

Figure 2. Earnings and Profitability of Banks
(Percent)



Source: Cabo Verdean authorities.

The BCV has taken an active role in addressing the resolution of NPLs. It conducted an asset quality review of the largest banks, with the aim of assessing their provisioning and NPLs disclosure practices. The BCV also standardized procedures across banks, mandated banks to adopt stringent International Financial Reporting Standards (IFRS) compliant definitions and developed a credit impairment index to encourage transparency on NPLs. To enforce provisioning standards, the BCV also carries out post-balance sheet submission adjustments.

11. Financial stability indicators have improved (Table 5). They point to an adequately capitalized financial sector; and despite still weak asset quality, banks' profitability has improved. NPLs have declined, reflecting concerted efforts to tackle them, though they remained high at 12.2 percent of total loans at end-December 2018.

12. Cabo Verde's risk of external and overall debt distress is assessed as high. The stock of public debt has been trending downwards in the last three years, partly reflecting improvement in the fiscal position and robust growth (Table 1). At end-2018, it stood at 123.9 percent of GDP. The joint IMF/World Bank debt sustainability analysis (DSA) assesses Cabo Verde's risk of external and overall debt distress as "high", unchanged from the 2018 DSA.

13. Cabo Verde's economic performance compared with peers Small Middle-Income Countries (SMICs), varies across sectors (Figure 5). In 2018, Cabo Verde recorded stronger growth, lower inflation and a better external position than comparator SMICs. However, the fiscal position was weaker and public debt much higher than peers.

OUTLOOK AND RISKS

14. The medium-term outlook is positive, contingent upon implementation of far-reaching structural reforms and favorable external environment. Real GDP growth is projected at 5 percent in 2019 and over the medium term, driven by sustained growth in the tourism and industry sectors, as well as increased activity in the transportation sector. The latter would be supported by the privatization of the airline company and the granting of a concession to a private operator for maritime transportation in early 2019, which are expected to improve connectivity between the islands and boost tourism. Economic activity would also benefit from the projected increase in private investments, planned infrastructure projects, notably the construction of the Maio island port, and enhanced investor confidence resulting from the implementation of structural reforms. These factors would overcompensate the potential adverse impact of fiscal consolidation on growth. Inflation is projected at 1 percent for 2019, and below 2 percent in the medium term, consistent with the average in the Euro area.

15. The external position is projected to strengthen. Continued good performance in tourism receipts and in remittances is expected to more than offset strong imports demand and help reduce the current account deficit from 4.5 percent of GDP in 2018 to 3.6 percent of GDP by 2024. With continued high inflows of FDI and remittances, gross international reserves would average 5.3 months of prospective imports of goods and services during 2019-24.

16. There are important risks to the outlook, with the balance tilted to the downside because of Cabo Verde's vulnerability to exogenous shocks (Box 3). On the downside, worse than expected external conditions, particularly economic slowdown in the Euro area and Brexit would impact tourism flows, and a sharp tightening of global financial conditions would affect growth and the external position. Downside risks also emanate from potential weather-related shocks. Domestically, weakening of fiscal consolidation efforts and delays in structural reforms implementation, particularly for SOEs restructuring would adversely affect the outlook. The main upside risks relate to stronger performance in tourism (Box 4), increased FDI-driven investments in relation with the implementation of the PEDS, continued successful restructuring of SOEs, and faster progress in other growth-enhancing structural reforms.

Authorities' Views

17. The authorities agreed with Staff's assessment of Cabo Verde's medium-term outlook and risks. While stressing that the economy's growth potential is high as illustrated by the estimated output expansion in the last quarter of 2018 (7.6 percent, y/y), they agreed with Staff's cautious projections for 2019 and the medium term. On the external position, the BCV viewed the projected gross international reserves in months of prospective imports of goods and services as an upper limit in view of external downside risks, notably the potential impact of Brexit on tourism receipts, and the weakening global economic growth.

Box 3. 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** In the near term, weak foreign demand makes euro area businesses delay investment, while faltering confidence reduces private consumption. Adverse financial market reaction to debt sustainability concerns further dampens growth. A disorderly Brexit could cause market disruption with negative spillovers.	**Medium/High** Prolonged stagnation in Europe would depress exports (especially tourism), 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 and enhance resilience to shocks.
Large swings in energy prices	**Medium** In the near term, uncertainty surrounding the shocks translates into elevated price volatility, complicating economic management and adversely affecting investment in the energy sector.	**Medium/High** Higher oil prices would harm growth and contribute to higher inflation. Household and corporate incomes may also be affected by shocks to oil prices.	Implement a credible fiscal consolidation plan to build fiscal buffers. Accelerate structural reforms to increase growth potential.

[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 ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects Staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. Short term and medium term are meant to indicate that the risk could materialize within 1 year and 3 years, respectively."

[2] In case the baseline does not materialize.

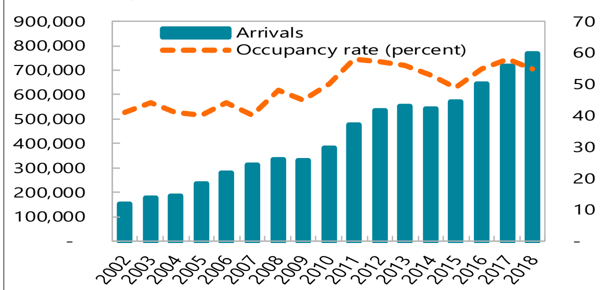
Box 3. Risk Assessment Matrix (concluded)			
Sharp tightening of global financial conditions	**Low/Medium** Sharp tightening of global financial conditions causes higher debt service and refinancing risks, stress on leveraged firms, households, and vulnerable sovereigns, capital account pressures and a broad-based downturn. This could be caused by sustained rise in risk premium in reaction to concerns about debt levels in some euro area countries; a disorderly Brexit; or idiosyncratic policy missteps in large emerging markets.	**Medium** Higher interest rate in the US and Europe may reduce the flow of migrant deposits to Cabo Verde. Cabo Verde's tourism and real estate sectors depend on FDI. Financial market volatility would hamper investment in Cabo Verde.	Stand ready to tighten monetary policy. Accelerate reforms to increase productivity and improve the business environment.
Rising protectionism and retreat from multilateralism	**High** Rising protectionism threatens the global trade system, regional integration, labor mobility, global and regional policy and regulatory collaboration. In the short run, increased uncertainty about growth triggered by escalating trade tension leads to increased financial market volatility.	**Medium** Financial market volatility would affect the predictability of financial flows and deter investment.	Accelerate structural reforms to increase productivity and improve the business environment.
Flickering fiscal consolidation and SOEs restructuring efforts	**Medium/High** Political pressures lead to less ambitious fiscal consolidation efforts and delayed implementation of SOEs reforms.	**High** Slower fiscal consolidation would undermine perception of macroeconomic stability, reduce capital inflows and weaken confidence in the peg. Higher public sector financing needs that may result from this would 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.	**Medium** Delays in advancing the structural reform agenda would hinder competitiveness, potential GDP growth and employment.	Accelerate structural reforms to improve growth potential.
Weather related shocks	**Medium** Weather related shocks such as drought and hurricanes could translate into higher food prices and lower activity in the agricultural and tourism sectors.	**Medium/High** Prolonged drought would undermine agricultural production with negative impact on GDP growth.	Diversify the economy and accelerate structural reforms to improve growth potential.

Box 4. The Tourism Sector – Background and Growth Prospects

Background

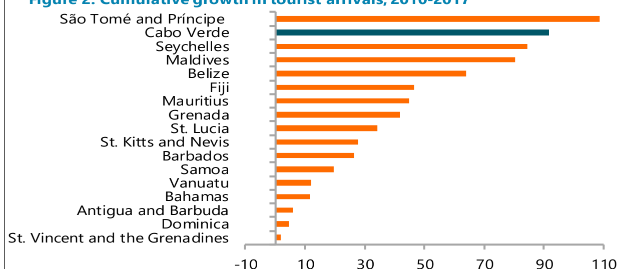
Cabo Verde is a tourism-based economy. The sector has witnessed impressive and sustained growth for more than a decade (Figure 1). Between 2000 and 2017, the number of tourist arrivals grew, on average, by 11 percent a year. The market is dominated by tourists from Europe, and therefore, was negatively affected by the 2008 financial crisis and its repercussions. It has since recovered, performing better than most peers (Figure 2). The accommodation capacity is about 12,000 rooms; and the average stay per tourist is about a week.

Figure 1. Tourism Arrivals and Occupancy Rate



Source: Cabo Verdean authorities.

Figure 2. Cumulative growth in tourist arrivals, 2010-2017

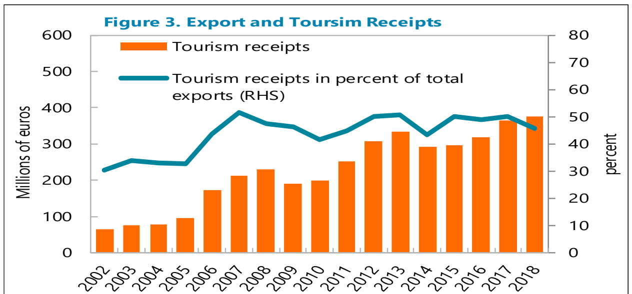


Sources: World Tourism Organization, Compendium of Tourism Statistics dataset; and IMF staff calculations.

Economic Impact

Tourism-related activities are estimated to account for about 25 percent of GDP, and some 50 percent of exports of goods and services (Figure 3). The direct contribution of the tourism industry to employment is concentrated in the hotel sector because of the "All-inclusive" model that dominates tourism in Cabo Verde. Spillovers on services typically associated with tourism for travel, restaurants, and transportation with local content; and linkages with non-tourism activities have remained limited.

Figure 3. Export and Toursim Receipts



Sources: Cabo Verdean authorities.

Constraints

The tourism sector is highly undiversified, making it vulnerable to exogenous shocks. Key impediments to growth and diversification include: (i) the industry's dependence on big hotel chains; (ii) concentration: although there is potential in all ten islands, tourism activities are concentrated in Sal and Boa Vista; (iii) lack of diversification: most tourists are from Europe —and 25 percent from the United Kingdom; (iv) about 70 percent of tourism activities, in terms of travel, are organized by two Tour operators in Europe and; (v) Cabo Verde offers predominantly a single tourism product ("sun, sea, and sand"), which may impact attractiveness.

Growth Potential

There is significant growth potential in the tourism industry. Despite the constraints mentioned above, demand is higher than supply for existing accommodations. There is an important pipeline of FDI in the sector, and the recent privatization of TACV is expected to boost tourism activities as the new company will be operating out of a hub in Sal island. The authorities are also planning to develop the cruise ship market with a terminal in São Vicente island. Their decision to waive visa requirements for travelers from the EU staying in Cabo Verde for up to 30 days, as well as the expected improvement in inter-island connections are important upside risks for the outlook in the tourism industry.

POLICY DISCUSSIONS

Cabo Verde is facing the twin challenge of raising sustainable and inclusive growth and reducing high public debt in an environment of high vulnerability to natural disasters and other exogenous shocks. Consequently, Article IV Consultation and program discussions focused on: (i) restoring fiscal and debt sustainability; (ii) restructuring SOEs; (iii) enhancing the monetary policy framework and continuing to build reserves; (iv) fostering the financial system stability; and (v) advancing growth-enhancing structural reforms.

A. Restoring Fiscal and Debt Sustainability

18. The medium-term fiscal framework supports the decline in debt-to-GDP ratio needed to restore debt sustainability. The revised budget projections for 2019 target a primary surplus of 0.7 percent of GDP mostly predicated on strong improvement in tax and non-tax revenue, as well as increased grants, creating fiscal space for spending and SOEs restructuring costs. The fiscal strategy is built on improvement in the primary balance (fiscal anchor) that would reduce public debt below 100 percent of GDP over the medium term (Text Table 1).

- The expected revenue performance reflects permanent and one-off measures introduced in the 2019 budget with an estimated impact of 3.6 percent of GDP. Key permanent measures – with 1.6 percent of GDP revenue impact – include the introduction of an airport and maritime security fees and the increase in the corporate income tax rate for off-shore banks from 2.5 percent to 10 percent. One-off measures (2 percent of GDP) comprise the sale of nonfinancial assets and the recovery of tax arrears (PS ¶15; Text Table 2).

- Expenditures are projected to increase by 3 percentage points of GDP compared with 2018, due to: (i) budgeted adjustments in the salary scale resulting from the implementation of re-grading and career adjustment in the civil service, as well as recruitments in the education, health, and security sectors; (ii) higher spending in goods and services; and (iii) a catch-up in capital outlays. In keeping with prudent expenditure management, the 2019 budget identified contingency spending to the tune of 1.8 percent of GDP. This, together with the legal instrument allowing expenditure freeze in case of a shortfall in budgetary resources will help in achieving fiscal targets (PS ¶15).

- Financing needs are expected to increase from 3.8 percent of GDP in 2018 to 6.5 percent of GDP in 2019 driven by net other liabilities (NOL) which are projected to grow from 1 percent of GDP in 2018 to 4.3 percent of GDP in 2019 due to higher outflows covering: onlending to SOEs for investment (1.5 percent of GDP), short-term financing to municipalities (1 percent of GDP), and TACV restructuring cost (1.9 percent of GDP). The increase in NOL also reflects the base effect compared with 2018 inflows that capture one-off repayments of previous onlending operations related to the social housing program, totaling 1.8 percent of GDP. Correcting for this amount brings financing needs in 2018 to 5.6 percent of GDP.[1]

[1] The restructuring in 2018 of the social housing program managed by IFH translated into a second partial repayment of 1.8 percent of GDP, of the loan that financed the program. The first partial repayment took place in 2017 for 2.4 percent of GDP. These repayments contributed to the reduction in budget financing needs for 2017–18.

Text Table 1: Medium Term Fiscal Indicators, 2018–24

(Percent of GDP)

	2018	2019	2020	2021	2022	2023	2024
Total revenue	28.1	31.7	30.4	28.9	28.8	28.8	28.8
Tax Revenue	21.9	21.8	21.9	22.5	22.8	23.0	23.3
of which: Income taxes	6.6	6.7	6.5	6.7	6.7	6.8	7.0
VAT	10.7	10.4	10.7	11.0	11.1	11.2	11.3
Other revenue	4.8	7.1	6.5	5.5	5.2	4.9	4.7
Grants	1.4	2.8	1.9	0.9	0.8	0.8	0.8
Total expenditure	30.9	33.9	31.8	30.1	29.8	29.7	29.6
Current expenditure	26.5	28.8	27.5	26.6	26.1	25.7	25.6
of which: Compensation of employees	10.6	11.7	11.2	10.7	10.4	10.2	10.2
Interest	2.5	2.8	2.4	2.3	2.2	2.1	2.0
Net acquisition of nonfinancial assets	4.4	5.1	4.3	3.4	3.7	3.9	4.0
Overall balance	-2.8	-2.2	-1.5	-1.2	-1.0	-0.9	-0.8
Primary balance	-0.3	0.7	1.0	1.2	1.2	1.2	1.2
Net other liabilities	-1.0	-4.3	-2.2	-0.9	-0.2	-0.2	-0.2
Of which: Onlending	1.1	-2.5	-1.6	-0.5	-0.2	-0.2	-0.2
Capitalization	-2.1	-1.9	-0.6	-0.5	0.0	0.0	0.0
Financing needs [1]	3.8	6.5	3.7	2.1	1.3	1.1	1.0
Total financing	2.8	6.5	3.7	2.1	1.3	1.1	1.0
Public debt	123.9	121.4	116.8	111.0	104.6	98.5	92.7
PV of PPG external debt (risk threshold: 55%)	61.9	64.0	62.4	60.1	56.8	54.0	51.0
PV of total debt (benchmark: 70%)	97.2	95.8	92.7	88.8	84.3	79.7	75.4

Sources: Cabo Verdean authorities and IMF staff projections.

[1] Defined as overall balance plus net other liabilities.

Text Table 2: The 2019 Budget Revenue Measures

2019 Budget Measures	Estimated Revenue Impact (Percent of GDP)
Permanent measures:	
Airport security fee	1.0
Maritime security fee	0.2
Contribution from operators to the Innovation Fund	0.1
Registration fees and notary fees	0.2
Special consumption excise tax	0.1
One-off measures:	
Sale of non-financial assets	0.8
Arrears collection	1.2
Total	3.6

Source: Cabo Verdean authorities.

- Over the medium term, tax and nontax revenue are conservatively projected to stabilize around 28 percent of GDP reflecting full-year impact of permanent measures introduced in 2019, continued tax administration reforms, notably enhanced monitoring of taxpayers' accounts and increased computerization of tax and customs services (PS ¶17).

- The medium-term expenditure framework will continue to be built on prudent expenditure management, backed by the continued budgeting of contingency outlays (PS ¶18–22). Expenditures are projected to decline below 30 percent of GDP in 2022 and going forward, mostly thanks to a prudent wage policy aimed at containing and limiting new recruitments as well as salary increases; tighter control of non-priority current spending, including through the setting up of performing Information Technology and improved procurement systems; and more efficient management of capital spending. This would help increase the primary surplus to 1 percent of GDP in 2020, and 1.2 percent of GDP during 2021-24, contributing to a decline in financing needs from 3.7 percent of GDP in 2020 to 1 percent of GDP in 2024. The medium term expenditure framework will continue to be built on identification of contingency spending. Reduced financing needs would also be supported by declining net other liabilities, in line with the expected progress in SOEs reforms that would significantly curtail onlending operations and eliminate transfers to SOEs for capitalization by 2022.

- On this basis, by 2023, public debt would be below 100 percent of GDP as targeted by the authorities. Furthermore, DSA results show that while the risk of external and total debt distress is high, the present value (PV) of public and publicly-guaranteed (PPG) external debt-to-GDP ratio would fall below the 55 percent threshold from 2023 onwards; and the PV of total PPG debt-to-GDP ratio would decline to 75.4 percent by 2024, and below the 70 percent benchmark by 2026. Consequently, the risk of external and overall debt distress would improve from high to moderate as these debt indicators fall below their respective thresholds.

- The budget is fully financed through the medium term. Domestic financing is projected well-below the annual ceiling of 3 percent of GDP per year set by Cabo Verde legislation thanks to external financing from the African Development Bank and the World Bank, as well as loans and grants from other external sources. The authorities' plan to lengthen the maturity of government securities will help improve domestic debt profile and reduce its cost.

19. The authorities' commitment to advancing fiscal reforms to put public finances on a stronger footing is commendable (PS Box 1). Staff welcomed the improvement in revenue mobilization envisioned in the medium-term fiscal framework and stressed the need for effective implementation of measures aimed at improving tax compliance and enhancing efficiency gains in tax administration. Building on technical assistance (TA) from the IMF Fiscal Affairs Department (FAD), Staff called for a revamping of exemptions on the value-added tax, customs duties and excises (**Reform Target**), estimated to generate revenue losses of about 2 percent of GDP. On expenditures, Staff recommended a prudent wage policy following the adjustments made in 2019, and enhanced management and prioritization of capital outlays to safeguard the projected decline in total expenditures as share of GDP. Staff stressed that these actions will help achieve the fiscal targets under the PCI while providing fiscal space for increased priority spending.

Authorities' Views

20. The authorities agreed with Staff's assessment and recommendations. On the revenue side, they indicated that efforts will focus on enhancing revenue administration, modernizing tax payments processes to combat tax evasion and broaden the tax base, and selling government properties. While agreeing to review and revamp tax exemptions, the authorities called for caution because of potential impact on activities in the tourism sector, which is the main beneficiary of exemptions and still largely undiversified. They reaffirmed commitment to bring the stock of public debt below 100 percent of GDP over the medium term, as reflected in the medium-term macroeconomic framework through continued fiscal consolidation efforts, prudent borrowing policies and growth-enhancing reforms.

B. Monetary Policy

21. The current fiscal and monetary policy mix is appropriate for safeguarding the peg to the euro and building foreign reserves. Given low inflation and adequate international reserves, a change in the monetary policy stance is not warranted at this stage. As in the past, Staff advised that the BCV remains vigilant for any sign of increasing inflationary pressures, monitors closely interest rates developments in the Euro area, and adapts the monetary policy stance as warranted. Staff also called for continued accumulation of international reserves over and above the level determined as adequate through the IMF External Sector Assessment Tool to preserve external buffers and guard against vulnerabilities. Staff noted that the projected fiscal consolidation and improvement in the external position would help preserve the peg and achieve the minimum reserve accumulation targeted under the PCI.

22. Monetary policy reforms should focus on improving liquidity management and strengthening the monetary policy transmission mechanism. The latter is hampered by very low turnover in the interbank market, excess liquidity in the banking system, and the limited development of the government securities market. Measures taken by the BCV in 2017 to improve the monetary policy transmission mechanism included: the re-linking of the rate of the Monetary Regularization Securities (TRM)—the BCV's main long-term sterilization instrument—to the policy rate by issuing the TRMs through fixed rate tenders instead of variable rate tenders; and improved communication to provide clearer guidance on the monetary policy orientation (PS ¶26). Staff argued that additional measures are needed in this area and recommended a reduction in the overnight interest rate corridor to a maximum of 150-200 basis points (**Reform Target, met in June 2019 ahead of schedule)**, the setting up of a symmetric interest rate corridor with overnight rates linked directly to the policy rate, and the publication of minutes of the Monetary Policy Committee meetings (**Reform Target**). Staff also urged the BCV to strengthen near-term forecasting capacity, and to improve monetary policy analysis through the introduction of new economic indicators.

C. Financial Sector Issues

23. The financial system is stable and adequately capitalized but profitability and asset quality remain weak (Figure 4; Table 5; Box 2). Regulatory capital is comfortable at more than 18 percent of risk-weighted assets, and there are no weak banks posing systemic risks. However, the system is overly liquid, partly due to the high level of emigrants' deposits (about 37 percent of total deposits at end-2018). This, together with still high NPLs and low credit growth negatively impact banks' profitability despite high lending interest rates. Staff welcomed steps taken to reduce NPLs, including enhanced recovery by banks and sale of assets held as collateral.

24. The BCV needs to continue strengthening financial regulation and supervision. There has been progress in implementing the recommendations of the 2009 FSAP, notably on banking supervision and the legal and regulatory framework (Table 6). Staff stressed that the few remaining recommendations were still relevant and called for their implementation. The enactment of basic banking and financial institutions laws is a crucial step in enhancing the BCV's ability to strengthen supervision and implement important regulatory reforms. Staff advised that the BCV strengthens banks' lending standards and risk management practices through enhanced surveillance; and accelerates ongoing work on a Credit Information System that will facilitate banks' assessment of risks and customer's creditworthiness (**Reform Target**). Staff urged the BCV to expedite the setting up of a central registry of mobile collateral (**Reform Target**) that will contribute to facilitating access to finance (PS ¶29-30).

25. Preserving correspondent banking relationships (CBRs) remains a challenge. Cabo Verde has been able to maintain CBRs, although the situation varies across banks. Given the country's dependence on migrant remittances and deposits, Staff called for improved compliance with international transparency requirements to prevent further loss of CBRs. In the event, priority should be given to the implementation of Foreign Account Tax Compliance Act (FATCA) and Financial Action Task Force (FATF) compliance requirements (PS ¶30).

Authorities' Views

26. The BCV concurred with Staff's assessment and policy recommendations. Regarding the monetary policy transmission mechanism and excess liquidity in the banking system, the BCV expects some improvement through measures introduced in 2018 and 2019, and training provided to its staff. The authorities also remain concerned about the possible loss of CBRs and its adverse impact on the transfer of remittances and deposit inflows, especially those denominated in US dollars. They were of the view that their strong AML/CFT framework and commitments under the PCI would help strengthen their credibility and mitigate risks of CBRs loss.

D. Public Enterprises Reforms

27. Public enterprises' financial difficulties are weighing heavily on public finances. Support to loss-making SOEs has been a major contributor to budget's financing needs and to the accumulation of public and publicly-guaranteed debt. Fiscal risks have remained concentrated in three SOEs: the airline (former TACV), the housing and real estate (IFH), and the electricity and water (ELECTRA) companies, which account for the largest share of SOEs' liabilities (PS ¶31; Box 5). At end-2018, six key SOEs received about 0.8 percent of GDP to finance their investment projects, and TACV was granted 2.1 percent of GDP for capitalization. The privatization of TACV in March 2019, and the authorities' plan to sell the remaining 49 percent of shares to employees and other private investors by end-2019 will help reduce fiscal risks.

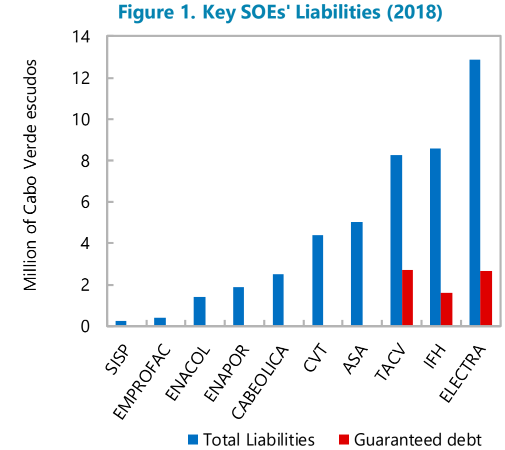
28. The authorities intend to accelerate SOEs reforms to support growth as well as fiscal and debt sustainability. Following the restructuring of the social housing program managed by IFH in late 2018 and the privatization of TACV, the authorities plan to privatize five additional SOEs, including the power company in 2020 (PS ¶33; PS Box 1). On this basis, financial support to SOEs will be eliminated by 2022 as indicated above—an important building-block of the PCI. Staff took the view that in the interim, it was critical to enhance fiscal reporting for the six largest SOEs by compiling financial information on their cash flow performance for fiscal year 2019 (**Reform Target**), and to carry out quarterly monitoring of their performance against their approved budgets, starting at end-December 2019 (**Reform Target**). To enhance the oversight of SOEs and improve the management of government properties, the authorities plan to set up an asset management company by the end-2019.

Box 5. Public Enterprises Sector – Issues and Reforms

Background

Cabo Verde has 23 State-Owned Enterprises (SOEs) in operation in various areas, including transportation (air and maritime), utilities, housing and pharmaceutical. Many SOEs have been facing important performance challenges over many years, and therefore, budget support to their operations has been a major contributor to the rapid accumulation of public and publicly-guaranteed debt. Through 2018, fiscal risks were concentrated in the airline (TACV), the real estate and housing (IFH), and the electricity and water (ELECTRA) companies, which account for the largest share of SOEs' total liabilities (Figure 1). Support from the budget covered onlending, notably for investment projects, capitalization for the airline company, and various subsidies and transfers (Table 1).

Figure 1. Key SOEs' Liabilities (2018)



Source: Cabo Verdean authorities.

Table 1. Government Support to Key SOEs 1/

(Millions of Cabo Verde escudos)

			On-Lending 2/					Capitalization					Subsidies/Transfers/Other expenditure from Budget				
Name of SOE	**Sector**	**Share**	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
ASA	Airport	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
ENAPOR	Port	100%	3,436	3,271	2,998	2,708	2,466	0	0	0	0	0	0	0	0	0	0
ELECTRA	Energy/Water	78%	3,759	9,378	9,378	12,339	13,212	0	0	0	0	0	0	0	0	120	0
TACV	Air Transport	100%	0	0	0	0	0	0	1,563	1,471	1,078	3,943	0	0	0	497	0
IFH	Real Estate	100%	12,096	14,427	16,066	13,072	9,800	0	0	0	0	0	0	0	0	300	0
EMPROFAC	Pharmaceutical	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total			19,291	27,076	28,442	28,119	25,478	0	1,563	1,471	1,078	3,943	0	0	0	917	0
In percent of GDP			13.9	19.3	19.4	18.4	15.8	0.0	1.1	1.0	0.7	2.4	0.0	0.0	0.0	0.6	0.0

Source: Cabo Verdean authorities.
1/ Only representing the big 6 SOEs in Cabo Verde.
2/ Onlending to SOEs are mostly for public investment execution (gross disbursement).

Structural Reforms

The authorities' efforts to restructure SOEs were accelerated in 2017 through the implementation of a reform program covering 23 companies. The program aimed to eliminate support from the budget to loss-making SOEs over time. Key steps included: (i) the sale of majority shares in TACV to a strategic partner; this operation was concluded in March 2019 with the sale of 51 percent of the company's shares to a subsidiary of Icelandair, with costs for the government budget in terms of equity (1.3 percent of GDP), and debt service obligations; (ii) the introduction of greater private sector participation in maritime inter-island transportation; (iii) the restructuring of ELECTRA to reduce its high commercial losses and prepare the company for privatization; and (iv) the restructuring of the housing program managed by the IFH to minimize losses and increase transparency. This operation was completed at end-2018. The World Bank is supporting SOEs reforms with a Development Policy Credit of US$40 million under the First State-Owned Enterprises Reform and Fiscal Management Development Policy Financing Operation approved by the World Bank Executive Board on June 5, 2019.

Authorities' Views

29. The authorities indicated that they will continue to give high priority to eliminating fiscal risks generated by loss-making SOEs. They stated that the planned acceleration of the restructuring and privatization during 2019-21 will help achieve this objective. However, they caution that these reforms are complex, dependent on market conditions beyond their control, and thus might take longer than expected. Consequently, while agreeing with the objective that capitalization funding to loss-making SOEs be eliminated by 2022, they stressed that this might prove overly ambitious. They agreed with Staff, however, that PCI reviews and collaboration with the World Bank will provide an opportunity to assess progress and make the needed adjustments.

E. Other Structural Reforms

30. Addressing impediments to private sector-led growth should remain at the center of structural reforms. Staff called for measures to improve the business environment and to ease access to finance, notably through the implementation of financial education program for Small-and-Medium Sized Enterprises (SMEs), and by expanding vocational training and certification. In the event, Staff welcomed the authorities' plan to implement reforms in vocational schools with support from donors; the study underway at the national statistics institute to assess the integration of students in the labor market and other measures planned by the authorities for 2019-21 to create a business-friendly environment (PS ¶34-35; PS Box 1).

Authorities' Views

31. The authorities indicated that reforms to improve the business environment and attract more private sector investment will be accelerated through the implementation of the PEDS, as these are the cornerstone of sustained and inclusive growth that creates opportunities for all, across all the islands.

PROGRAM OBJECTIVES AND MODALITIES

The eighteen-month PCI program seeks to enhance macroeconomic stability. Fiscal consolidation combined with decisive SOEs reforms will support medium-term fiscal and debt sustainability as well as a stronger external position. The fiscal adjustment will be anchored by improvement in the primary balance that would reduce public debt below 100 percent of GDP in the medium term. The authorities' policy commitments under the PCI for 2019-21 are detailed in the Program Statement (Appendices I-III).

32. Policies and reforms discussed above and detailed in the authorities' Program Statement (PS) will underpin the PCI. During the first year, the program targets a fiscal adjustment of 1.3 percent of GDP and sets a ceiling on net other liabilities (NOL) that cover onlending and capitalization operations (see ¶17). Targeting NOL provides some flexibility on the allocation of resources between the cost of SOEs restructuring, onlending to municipalities and to

SOEs to finance investment. The program also targets a stock of net international reserve of €566 million at end-September 2020 (PS Table 1). Programmed reform targets are focused on enhancing revenue mobilization and expenditure management, improving monitoring of SOEs performance to secure the elimination of the financial support from the budget over the medium term, enhancing monetary policy transmission mechanism, and improving access to finance (PS Table 2). Other structural reforms envisioned by the authorities for 2019-21 are presented in Box 1 in the PS.

33. The program will be monitored through semi-annual reviews, with quantitative targets on tax revenue, the primary balance of the central government, net other liabilities of the central government, non-accumulation of domestic payments arrears (continuous), non-accumulation of external arrears (continuous), new concessional external debt of the central government, zero ceiling on new non-concessional external debt, and net international reserves; and non-quantitative continuous targets (Table 7; PS Table 1).

34. Financing assurances. The program is fully financed for the first year through government securities and net external financing from the World Bank and the African Development Bank; and there are reasonable financing assurances for the second year (Text Table 3). Financial support from the World Bank and the African Development Bank is projected at US$240 million for 2019-2024.

Text Table 3: Cabo Verde: External Borrowing, 2019–20

(Millions of Cabo Verde Escudos)

Creditors	2019	2020
Multilateral:	10,878	8,039
World Bank	7,124	3,463
African Development Bank	3,754	3,514
Other	-	1,062
Bilateral:	4,257	4,241
Paris Club	3,916	3,097
Non-Paris Club	341	1,144
Total	15,135	12,280

Source: Cabo Verdean authorities.

35. Cabo Verde has a good track record of implementing IMF policy advice (see Box 1). The authorities have shown good traction with IMF policy advice in the context of Surveillance, and under the most recent Fund-supported program. The latter was a Policy Support Instrument (PSI, 2010–12) that helped advance structural reforms in the fiscal and monetary policy areas.

36. Risks to program implementation largely stem from exposure to various shocks. As discussed above (¶16, Box 3), the medium-term outlook is subject to risks that are also relevant for performance under the PCI.

STAFF APPRAISAL

37. Economic performance continues to improve with strong growth and low inflation, and the outlook is favorable despite risks. The economic recovery that started in 2016 is taking hold, with growth increasing from 1 percent in 2015 to an average of 4.7 percent during 2016–18.

The recovery has benefitted from continued good performance in tourism-related activities, strong growth in the industry sector, and private investment. Inflation has remained benign despite an increase in 2018, and the external position has improved, with gross international reserves remaining comfortably above 5 months of prospective imports of goods and services. Key downside risks related to, among others, economic slowdown in the Euro area, Brexit, potential weather-related shocks, weakening in fiscal consolidation efforts and delays in structural reforms, can be mitigated by a robust PCI implementation. Stronger performance in tourism and higher FDI-driven investments in relation with the implementation of the PEDS are the main upside risks.

38. The fiscal position has strengthened, with lingering vulnerabilities. Tax administration measures implemented in the last three years, as well as expenditure control, have been instrumental in putting public finances on a stronger footing, and securing a declining trend in public debt as a share of GDP. To shore up these gains and build fiscal buffers, it is essential to improve revenue mobilization further through measures to combat tax evasion and broaden the tax base, enhance audits to contain the accumulation of tax arrears, and streamline exemptions, notably on the VAT, customs duties and excises. Continued expenditure restraint will remain necessary to safeguard the achievement of medium-term fiscal targets. In addition, and consistent with programmed public enterprises reforms, a sustained reduction, and elimination over time, of transfers from the budget to loss-making SOEs is needed to reduce financing needs and support medium-term fiscal and debt sustainability. This is also essential to eliminate fiscal risks generated by SOEs and increase fiscal space for priority spending.

39. The risk of external and overall debt distress is assessed as high. Although on a declining trend, the debt-to-GDP ratio is elevated, and the risk of external and overall debt distress remains high, unchanged compared with the 2018 DSA. However, the medium-to-long-term outlook has improved compared with the macroeconomic framework underlying the 2018 DSA, mainly on the back of higher growth, and lower fiscal and current account deficits, improving prospects for better debt dynamics. To this effect, Staff encourages the authorities to sustain fiscal consolidation efforts to achieve the projected reduction in the debt-to-GDP ratio below 100 percent by 2023. Staff also stresses that prudent borrowing policies, relying on concessional financing as well as enhanced debt management strategy, are essential to bringing public debt to sustainable levels.

40. The monetary policy stance has been appropriate and consistent with the objective of protecting the peg and price stability. Staff agrees with the authorities that in the current environment of low inflation and adequate level of reserves, a change in the monetary policy stance is not warranted. Nonetheless, Staff encourages the BCV to remain vigilant and monitor developments in the global economy, particularly in the Euro area, and stand ready to change the monetary policy stance if warranted. The BCV will also need to take further actions to strengthen the monetary policy transmission mechanism, notably by enhancing communication on its policy direction through the publication of the minutes of the Monetary Policy Committee. The external sector is weaker than suggested by medium-term fundamentals and desirable policy settings while reserve buffers exceed the optimal level of 3.6 months of prospective imports of goods and services.

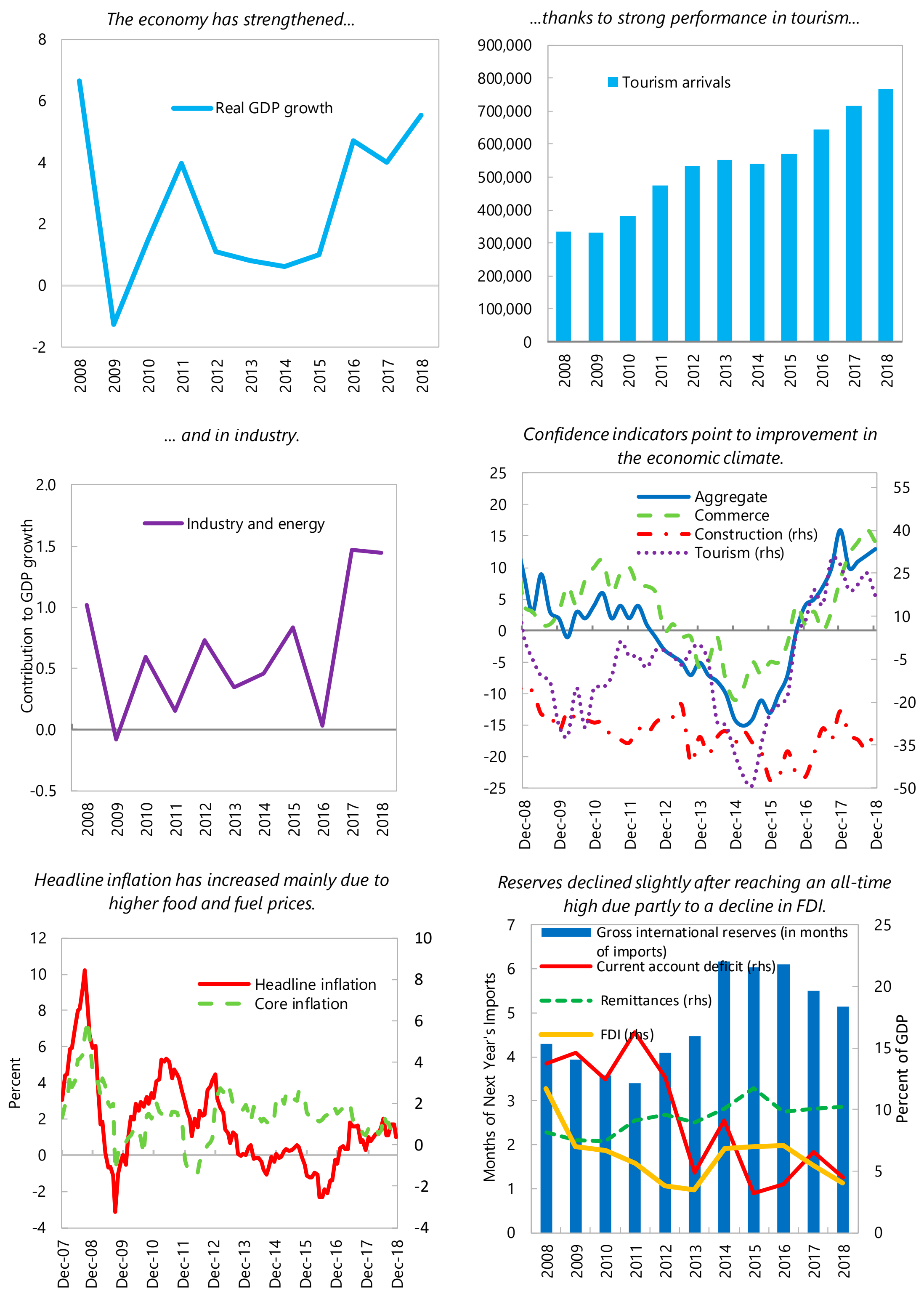
41. **Staff welcomes the improvement in financial stability indicators**. The financial sector remains stable and banks' profitability increased, although asset quality continues to be weak, calling for decisive measures to reduce the high level of NPLs. Staff encourages the BCV to continue enhancing banking supervision, to advance the preparation of a credit information system to facilitate bank's assessment of creditworthiness, and to work with banks on the recovery of collaterals, particularly in the case of legacy loans that make up the largest share of NPLs.

42. **Progress in the implementation of reforms to sustain high and inclusive growth remains critical**. In this context, it is essential to advance reforms in the public enterprises sector, particularly in the key sectors of energy and transportation to reduce transaction costs and improve the business environment. Recognizing that these reforms, including privatization of SOEs, require time to be brought to fruition, Staff recommends enhanced monitoring of the financial situation of key SOEs through the compilation of information on their cash flow and quarterly review of their performance. Staff also encourages the authorities to support the development of SMEs by facilitating access to finance, notably by setting up a central registry for mobile collateral, increasing financial literacy through training, and building skills through the expansion of access to vocational schools, as targeted under the PEDS.

43. **Staff supports the authorities' request for a PCI**. The PCI represents the appropriate instrument for IMF support to Cabo Verde's reform efforts under the PEDS given that the country does not face present, potential, or prospective balance of payments needs, and is not seeking IMF financial support. In addition, good performance under the PCI would play an important signaling role for the authorities' commitment to sound policies and reforms and help anchor confidence.

44. **Staff proposes that the next Article IV consultation be held on a 24-month cycle**.

Figure 1. Cabo Verde: Recent Economic Developments



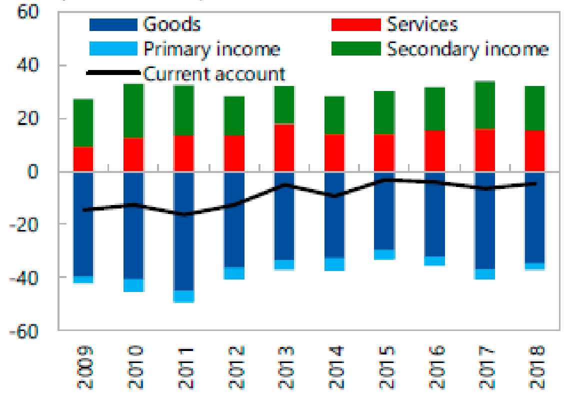
Sources: Cabo Verdean authorities; and IMF staff estimates.

Figure 2. Cabo Verde: External Sector Developments

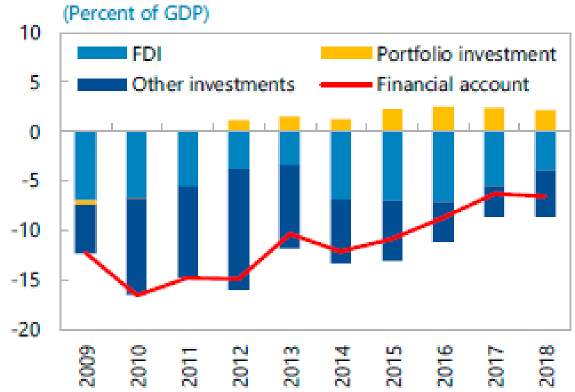
Current account deficit slightly narrowed in 2018 owing to an increase in exports and a deceleration in imports.

... the deficit has been financed mainly by foreign direct investment and other investments.

Current Account Balance
(Percent of GDP)



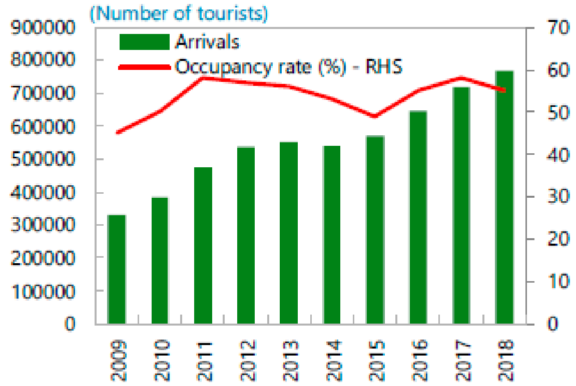
Financial Account Composition
(Percent of GDP)



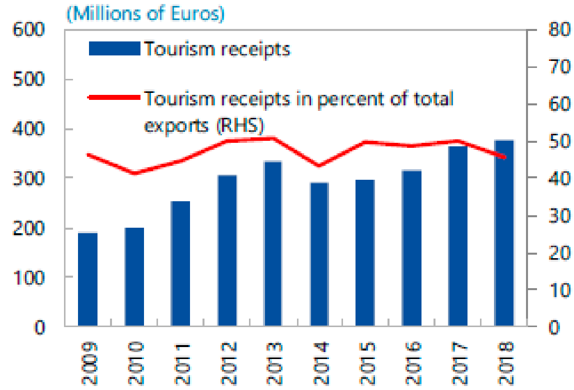
Tourism arrivals steadily improved in recent years ...

... as a result tourism receipts continue to be a significant contributor to export performance.

Tourism Arrivals and Occupancy Rate
(Number of tourists)



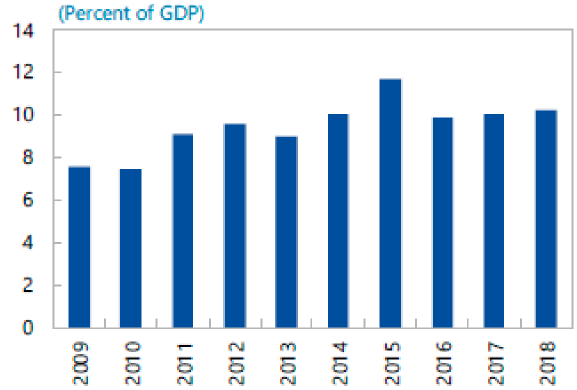
Tourism Receipts
(Millions of Euros)



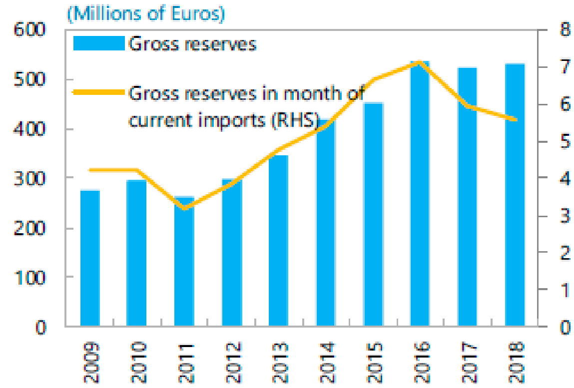
Remittances remain an important source of foreign currency ...

... supporting the country's strong reserve position.

Remittances
(Percent of GDP)



Reserves
(Millions of Euros)



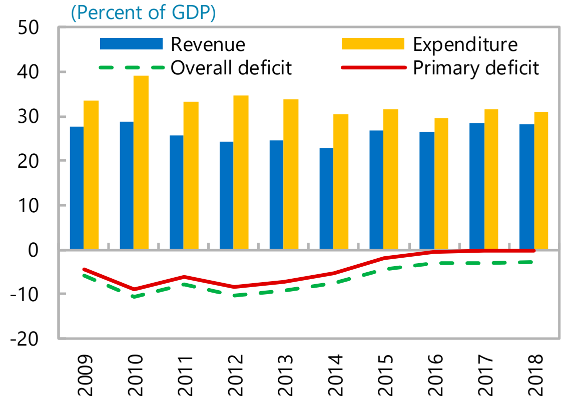
Source: Cabo Verdean authorities; and IMF estimates.

Figure 3. Cabo Verde: Fiscal Sector Developments

Fiscal perfomance has continously improved in recent years....

Fiscal Performance

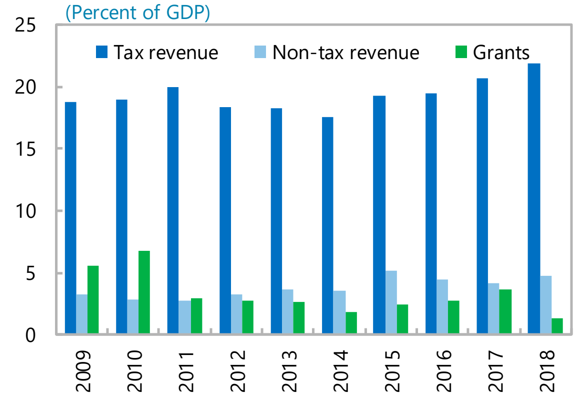
(Percent of GDP)



... owing to strong performance in tax revenue that compensated for the decline in grants...

Revenue Composition

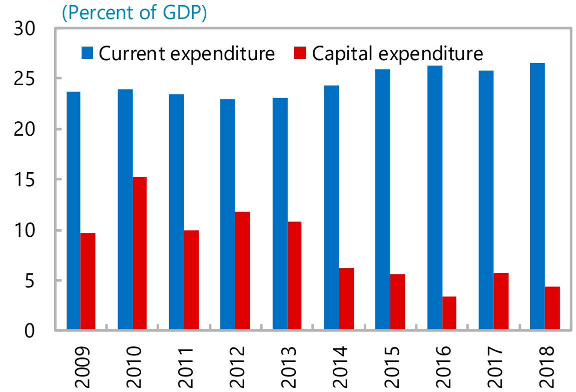
(Percent of GDP)



... and a decline in capital expenditure.

Expenditure

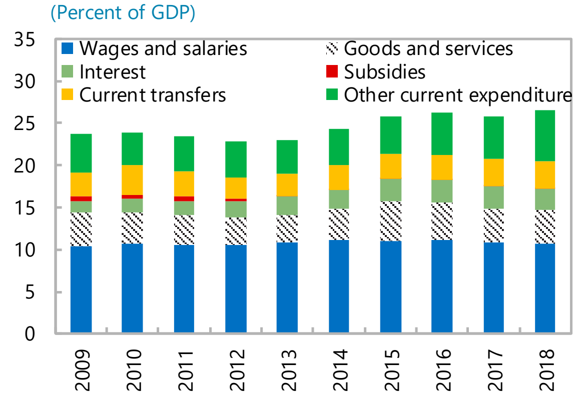
(Percent of GDP)



Current expenditure has been broadly stable with the wage bill being the largest component.

Current Expenditure Composition

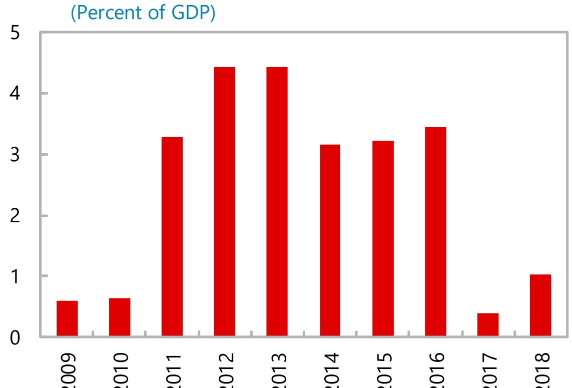
(Percent of GDP)



Support from the budget to SOEs has been trending downward...

Support from the Budget to SOEs[1/]

(Percent of GDP)

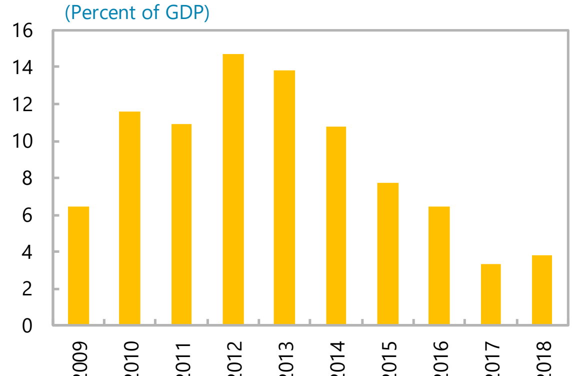


[1/]Includes onlending and capitalization.

... contributing to a reduction in financing needs.

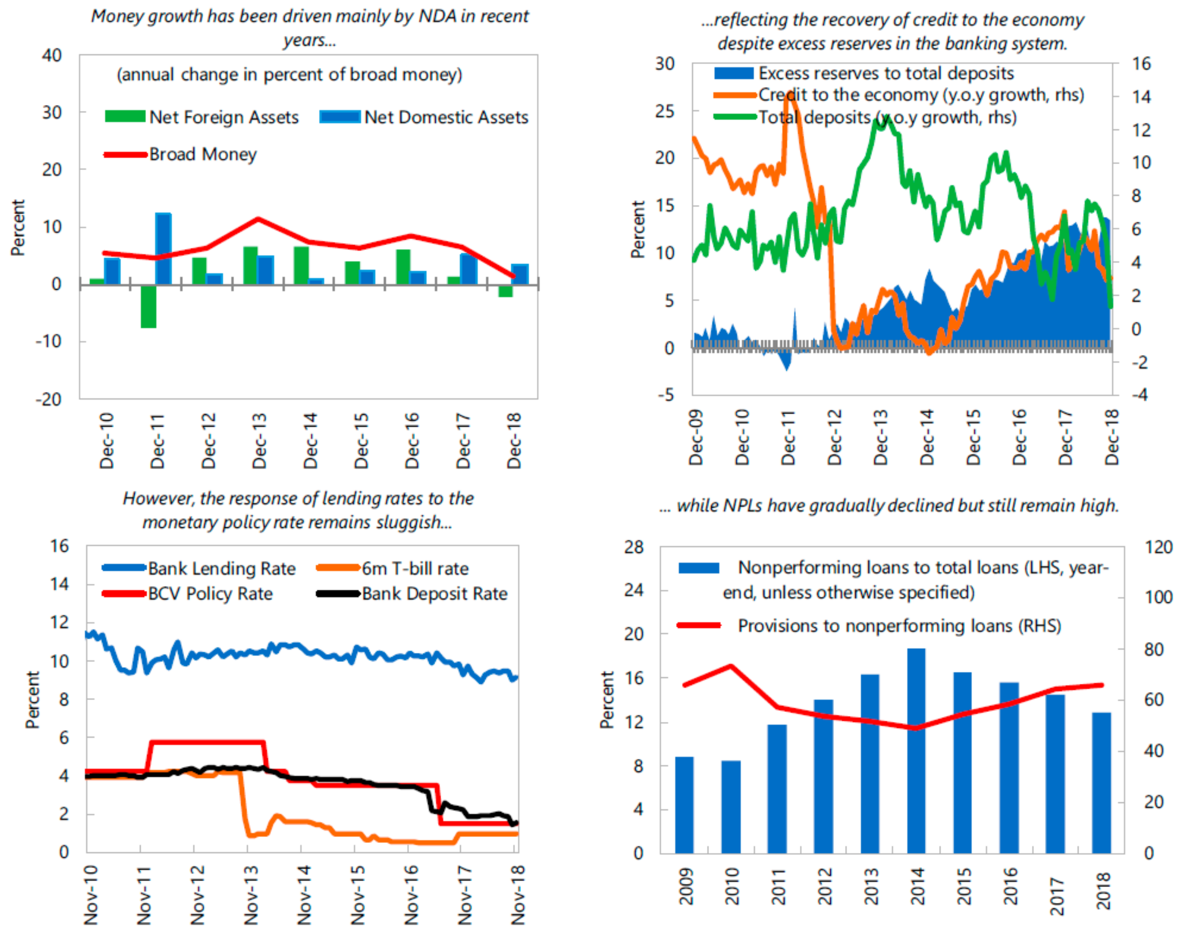
Financing Needs

(Percent of GDP)



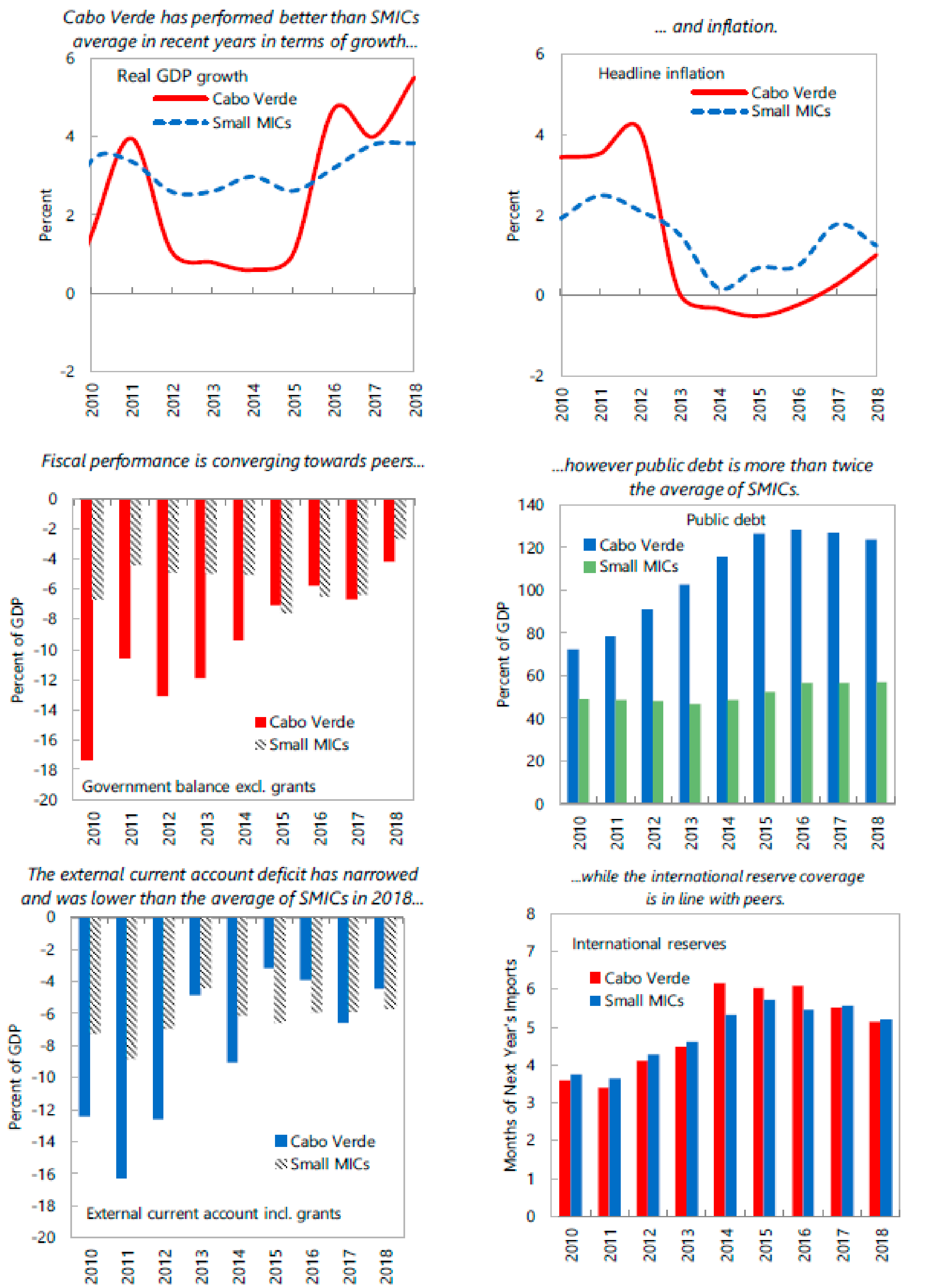
Source: Cabo Verdean authorities; and IMF staff estimates.

Figure 4. Cabo Verde: Monetary Developments



Sources: Cabo Verdean authorities; IMF staff estimates.

Figure 5. Cabo Verde's Performance Compared to Small Middle-Income Countries[1]



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

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

Table 1. Cabo Verde: Selected Economic Indicators, 2015–24

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.			Proj.			
				(Annual percent change)						
National accounts and prices 1/										
Real GDP	1.0	4.7	4.0	5.5	5.0	5.0	5.0	5.0	5.0	5.0
GDP deflator	1.7	-0.2	0.5	1.4	1.5	1.6	1.6	1.8	1.8	1.8
Consumer price index (annual average)	0.1	-1.4	0.8	1.3	1.2	1.6	1.6	1.8	1.8	1.8
Consumer price index (end of period)	-0.5	-0.3	0.3	1.0	1.0	1.6	1.6	1.8	1.8	1.8
External sector										
Exports of goods and services	-11.6	9.5	11.5	13.3	8.9	10.0	11.2	11.2	11.2	11.2
Of which: tourism	2.0	6.9	14.5	3.5	8.1	9.8	11.2	11.4	11.4	11.4
Imports of goods and services	-12.3	10.3	17.2	8.0	8.7	8.7	8.7	8.7	8.7	8.7
				(Change in percent of broad money, 12 months earlier)						
Money and credit										
Net foreign assets	4.0	6.1	1.3	-2.1	2.0	2.8	2.4	2.6	3.3	3.1
Net domestic assets	2.3	2.3	5.2	3.5	5.0	3.5	3.6	3.8	3.1	3.3
Net claims on the central government	-0.2	2.5	1.5	4.3	0.6	0.2	0.2	0.4	0.1	0.2
Credit to the economy	1.8	2.4	4.4	1.9	3.0	3.3	3.4	3.5	3.6	3.6
Broad money (M2)	6.2	8.4	6.5	1.4	7.0	6.3	6.0	6.4	6.4	6.4
				(Percent of GDP, unless otherwise indicated)						
Savings and investment										
Domestic savings	35.6	33.2	31.7	32.3	32.7	32.8	33.4	34.2	34.7	35.4
Government	0.7	-0.7	0.8	1.8	2.3	2.3	2.7	3.2	3.6	3.7
Private	34.9	34.0	30.9	30.4	30.5	30.6	30.6	31.0	31.1	31.7
National investment	38.7	37.1	38.3	36.7	36.9	36.9	37.4	38.1	38.3	39.0
Government	5.6	3.4	5.7	4.4	5.1	4.3	3.4	3.7	3.9	4.0
Private	33.2	33.8	32.6	32.3	31.8	32.6	34.0	34.3	34.4	35.0
Savings-investment balance	-3.2	-3.9	-6.6	-4.5	-4.2	-4.1	-4.1	-3.9	-3.6	-3.6
Government	-4.9	-4.1	-4.9	-2.6	-2.8	-2.0	-0.7	-0.5	-0.4	-0.3
Private	1.7	0.2	-1.7	-1.9	-1.3	-2.0	-3.4	-3.3	-3.3	-3.3
External sector										
External current account (including official transfers)	-3.2	-3.9	-6.6	-4.5	-4.2	-4.1	-4.1	-3.9	-3.6	-3.6
External current account (excluding official transfers)	-6.6	-6.6	-10.3	-7.2	-7.5	-7.1	-6.0	-5.6	-5.2	-5.1
Overall balance of payments	2.2	5.5	-0.9	0.5	3.6	2.6	2.8	2.9	3.1	2.9
Gross international reserves (months of prospective imports of goods and services)	6.0	6.1	5.5	5.1	5.3	5.3	5.3	5.3	5.4	5.4
Government finance										
Revenue	26.9	26.6	28.6	28.1	31.7	30.4	28.9	28.8	28.8	28.8
Tax and nontax revenue	24.4	23.9	24.9	26.7	28.9	28.5	28.0	27.9	28.0	28.0
Grants	2.5	2.7	3.7	1.4	2.8	1.9	0.9	0.8	0.8	0.8
Expenditure	31.4	29.6	31.5	30.9	33.9	31.8	30.1	29.8	29.7	29.6
Primary balance	-2.0	-0.5	-0.4	-0.3	0.7	1.0	1.2	1.2	1.2	1.2
Overall balance (incl. grants)	-4.6	-3.0	-3.0	-2.8	-2.2	-1.5	-1.2	-1.0	-0.9	-0.8
Net other liabilities (incl. onlending)	-3.2	-3.4	-0.4	-1.0	-4.3	-2.2	-0.9	-0.2	-0.2	-0.2
Total financing (incl. onlending and capitalization)	7.8	5.6	4.0	3.8	6.5	3.7	2.1	1.3	1.1	1.0
Net domestic credit	1.2	2.9	0.2	1.4	1.0	0.4	0.4	0.7	0.1	0.4
Net external financing	6.7	2.7	4.0	1.5	5.5	3.3	1.7	0.6	1.0	0.6
Public debt stock and service										
Total nominal government debt	126.6	128.4	127.0	123.9	121.4	116.8	111.0	104.6	98.5	92.7
External government debt	97.7	96.7	94.9	91.0	89.3	86.3	82.1	77.0	72.7	68.2
Domestic government debt	29.0	31.7	32.1	32.9	32.1	30.5	28.9	27.6	25.9	24.6
External debt service (percent of exports of goods and services)	6.4	6.0	6.3	5.8	7.6	6.8	7.4	7.9	7.4	6.8
Present value of PPG external debt										
Percent of GDP (risk threshold: 55%)	…	…	…	61.9	64.0	62.4	60.1	56.8	54.0	51.0
Percent of exports (risk threshold: 240%)	…	…	…	126.6	128.2	121.4	112.2	101.9	93.2	84.6
Present value of total debt										
Percent of GDP (benchmark: 70%)	…	…	…	97.2	95.8	92.7	88.8	84.3	79.7	75.4
Memorandum items:										
Nominal GDP (billions of Cabo Verde escudos)	158.7	165.8	173.4	185.6	197.8	211.1	225.3	240.9	257.5	275.2
Gross international reserves (€ millions, end of period)	453.3	536.2	522.7	531.1	596.6	645.8	704.1	767.2	838.7	911.3

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

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

Table 2. Cabo Verde: Balance of Payments, 2015–24

(Millions of Euros; unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.			Proj.			
Current account	-46	-59	-104	-75	-75	-78	-83	-84	-85	-90
Trade balance	-427	-481	-583	-582	-636	-696	-761	-832	-909	-993
Exports, f.o.b.	135	141	167	232	253	276	301	328	358	391
Imports, f.o.b.	561	622	750	814	889	972	1062	1160	1267	1383
Consumer goods	216	244	270	278	303	327	357	389	426	471
Intermediate goods	128	151	156	158	176	192	210	228	250	275
Capital goods	77	86	131	99	111	123	132	142	156	168
Others (including fuel)	141	141	192	279	299	329	363	401	434	470
Fuel	69	52	69	82	77	80	83	86	90	94
Services (net)	205	232	253	265	293	335	393	459	534	620
Receipt	460	510	559	591	642	709	794	889	996	1115
Of which: tourism	297	318	364	376	407	447	497	553	616	687
Payment	255	279	306	326	349	374	401	430	461	495
Primary Income (net)	-53	-54	-54	-37	-54	-65	-67	-76	-83	-102
Of which: interest on public debt	-16	-15	-16	-17	-18	-18	-19	-20	-20	-21
Secondary Income (net)	229	244	280	279	322	348	351	365	373	385
General Government	49	40	59	46	60	58	38	37	36	37
Other Sectors	180	204	221	233	262	290	313	328	337	349
Of which: remittances	169	148	158	172	187	212	236	250	266	278
Capital account	17	11	14	13	22	9	9	11	12	11
Of which: Grants	16	10	12	11	20	7	8	9	10	11
Financial account 1/	-125	-48	-112	-101	-53	-69	-74	-74	-73	-79
Foreign direct investment	-101	-107	-87	-68	-72	-105	-136	-147	-156	-173
Portfolio investment	32	38	37	36	39	37	34	19	19	19
Other investment	-88	-62	-49	-79	-86	-51	-30	-9	-7	3
Net acquisition of financial assets	-3	-26	53	-57	-27	-9	-13	-14	-3	-3
Net incurrence of liabilities	85	36	102	21	58	43	17	-5	4	-5
Monetary authority	0	0	2	0	0	0	0	0	0	0
Central government	96	40	63	24	87	62	35	13	23	15
Disbursements	119	64	92	56	137	111	97	90	103	96
Amortization	-23	-24	-29	-32	-51	-49	-62	-77	-80	-81
Exceptional financing	0	0	0	0	0	0	0	0	0	0
Commercial banks	-25	0	-4	4	5	4	5	5	5	5
Non-bank flows	-22	-5	41	-7	-34	-23	-23	-23	-23	-25
Reserve assets (+ accumulation)	32	83	-13	8	65	49	58	63	72	73
Errors and omissions 2/	-96	0	-23	-39	0	0	0	0	0	0
Overall balance	32	83	-13	8	65	49	58	63	72	73
Memorandum items:										
Current account (incl. official transfers, percent of GDP)	-3.2	-3.9	-6.6	-4.5	-4.2	-4.1	-4.1	-3.9	-3.6	-3.6
Current account (excl. official transfers, percent of GDP)	-6.6	-6.6	-10.3	-7.2	-7.5	-7.1	-6.0	-5.6	-5.2	-5.1
Overall balance (percent of GDP)	2.2	5.5	-0.9	0.5	3.6	2.6	2.8	2.9	3.1	2.9
Gross international reserves	453	536	523	531	597	646	704	767	839	911
Months of current year's imports of goods and services	6.7	7.1	5.9	5.6	5.8	5.8	5.8	5.8	5.8	5.8
Months of next year's imports of goods and services	6.0	6.1	5.5	5.1	5.3	5.3	5.3	5.3	5.4	5.4
External public debt	1406	1453	1492	1531	1602	1653	1677	1683	1697	1701
External aid (grants and loans, percent of GDP)	12.7	7.6	10.4	6.7	12.1	9.2	7.0	6.2	6.4	5.8
Nominal GDP	1439	1503	1572	1683	1794	1914	2043	2185	2335	2495

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

1/ Including international reserves and exceptional financing.

2/ Including banks' delays on trade credit reporting.

Table 3a. Cabo Verde: Statement of Operations of the Central Government, 2015–24[1]

(Millions of Cabo Verde Escudos)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.			Proj.			
Revenue	42,678	44,107	49,505	52,097	62,650	64,133	65,122	69,325	74,050	79,275
Tax	30,516	32,275	35,842	40,657	43,126	46,298	50,779	54,912	59,326	64,182
Taxes on income and profit	9,669	10,050	11,292	12,253	13,169	13,656	15,091	16,187	17,617	19,139
Taxes on goods and services	14,047	14,925	16,777	19,887	20,660	22,576	24,745	26,851	28,826	31,061
Taxes on international trade	6,082	6,813	7,224	7,733	8,466	9,199	9,998	10,872	11,815	12,842
Other taxes	719	488	549	784	830	867	945	1,001	1,067	1,140
Grants	3,958	4,507	6,389	2,575	5,479	4,070	1,988	1,988	1,988	2,125
Of which: Project Grants	1,884	1,074	1,906	385	1,967	803	868	1,008	1,122	1,216
Other revenue	8,203	7,325	7,273	8,865	14,045	13,765	12,355	12,425	12,735	12,968
Fees and penalties	404	679	498	433	297	295	314	322	329	335
Property Income	1,022	1,083	976	1,828	4,808	4,508	2,606	2,577	2,657	2,705
Sale of Goods and Services	4,652	5,042	5,189	5,732	7,896	7,956	8,448	8,529	8,743	8,901
Other (inc. social contributions)	2,125	522	610	873	1,045	1,005	987	997	1,007	1,028
Expenditure	49,907	49,139	54,650	57,301	66,972	67,197	67,770	71,849	76,388	81,502
Current expenditure	41,068	43,567	44,760	49,162	56,874	58,083	60,027	62,818	66,272	70,496
Compensation of employees	17,530	18,365	18,891	19,741	23,207	23,680	24,206	25,058	26,189	27,988
Use of goods and services	7,433	7,563	6,961	7,415	9,217	9,775	10,720	10,935	11,665	12,466
Interest	4,134	4,223	4,523	4,726	5,637	5,158	5,262	5,345	5,423	5,499
Domestic	2,374	2,455	2,684	2,811	3,406	3,025	3,021	3,035	3,076	3,103
External	1,724	1,748	1,790	1,822	2,128	2,036	2,144	2,205	2,242	2,291
Other Charges	37	20	50	93	102	97	97	105	105	105
Subsidies	161	167	124	153	579	588	588	598	619	630
Current transfers	4,755	4,895	6,001	6,283	5,682	6,964	6,672	7,175	7,628	8,152
Social benefits	4,735	5,165	5,541	6,237	6,963	7,429	8,050	8,869	9,421	10,068
Other expense (incl. capital transfer)	2,320	3,189	2,718	4,606	5,589	4,488	4,529	4,837	5,327	5,693
Net acquisition of nonfinancial assets	8,839	5,572	9,890	8,140	10,098	9,114	7,743	9,031	10,116	11,006
Purchase of assets	9,122	5,610	10,059	8,194	11,094	10,066	8,194	9,470	10,587	11,477
Foreign financed	6,016	3,285	7,782	5,689	7,785	6,951	5,422	6,301	7,013	7,598
Domestically financed	3,106	2,325	2,277	2,505	3,309	3,115	2,772	3,169	3,574	3,880
Sales of assets (-)	-284	-38	-168	-54	-996	-952	-451	-439	-471	-471
Primary balance	-3,095	-808	-622	-478	1,315	2,093	2,614	2,821	3,085	3,272
Overall balance	-7,229	-5,031	-5,145	-5,204	-4,322	-3,065	-2,648	-2,524	-2,338	-2,227
Net other liabilities	-5,092	-5,694	-615	-1,903	-8,511	-4,674	-2,137	-500	-430	-474
Onlending to SOEs for investment purpose	-3,928	-4,526	-4,098	-1,541	-2,992	-2,152	-1,226	-644	-643	-687
Other onlending (net)	273	313	4,565	3,606	-1,872	-1,293	145	144	212	212
Disbursement	0	0	0	0	-2,057	-1,437	0	0	0	0
Repayment	273	313	4,565	3,606	185	145	145	144	212	212
Capitalization	-1,457	-1,508	-1,157	-3,968	-3,667	-1,229	-1,056	0	0	0
Other	21	28	75	0	20	0	0	0	0	0
Financing needs	12,321	10,725	5,760	7,107	12,833	7,738	4,785	3,024	2,768	2,701
Total financing	12,451	9,224	7,197	5,239	12,833	7,738	4,785	3,024	2,768	2,701
Net domestic financing	1,872	4,770	273	2,517	2,029	851	878	1,567	283	1,096
Banking system (net)	-374	4,386	2,765	2,535	1,014	425	439	783	141	548
Non Bank (net)	3,303	2,237	292	685	1,014	425	439	783	141	548
Other	-1,057	-1,853	-2,783	-703	0	0	0	0	0	0
Net external financing	10,579	4,454	6,924	2,723	10,804	6,888	3,907	1,457	2,486	1,605
Disbursement	13,011	7,068	10,137	6,202	15,135	12,280	10,730	9,910	11,326	10,588
Budget Loans	2,652	0	2,205	2,205	6,085	3,116	3,345	3,146	3,146	3,519
Project and Program Loans	6,430	2,542	3,834	2,456	6,058	7,012	6,160	6,120	7,537	6,382
Loans to on lend to SOEs 2/	3,928	4,526	4,098	1,541	2,992	2,152	1,226	644	643	687
Amortization	2,432	2,614	3,213	3,479	4,331	5,392	6,823	8,453	8,840	8,983
Net errors and omissions (+ overfinancing)	130	-1,501	1,437	-1,868	0	0	0	0	0	0
Memorandum items:										
Social Spending 3/	10,295	9,205	14,151	14,008	14,423	15,391	16,427	17,566	18,772	20,061
Total Public Investment	13,051	10,136	14,156	9,735	14,086	12,218	9,420	10,114	11,230	12,164
of which: public investment done by SOEs	3,928	4,526	4,098	1,541	2,992	2,152	1,226	644	643	687

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

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

2/ On lend to SOEs for public investment execution.

3/ Covering health, education, and social protection sectors, excluding compensation of employees.

Table 3b. Cabo Verde: Statement of Operations of the Central Government, 2015–24[1]

(Percent of GDP)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.			Proj.			
Revenue	26.9	26.6	28.6	28.1	31.7	30.4	28.9	28.8	28.8	28.8
Taxes	19.2	19.5	20.7	21.9	21.8	21.9	22.5	22.8	23.0	23.3
Taxes on income and profit	6.1	6.1	6.5	6.6	6.7	6.5	6.7	6.7	6.8	7.0
Taxes on goods and services	8.9	9.0	9.7	10.7	10.4	10.7	11.0	11.1	11.2	11.3
Taxes on international trade	3.8	4.1	4.2	4.2	4.3	4.4	4.4	4.5	4.6	4.7
Other taxes	0.5	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Grants	2.5	2.7	3.7	1.4	2.8	1.9	0.9	0.8	0.8	0.8
Other revenue	5.2	4.4	4.2	4.8	7.1	6.5	5.5	5.2	4.9	4.7
Fees and penalties	0.3	0.4	0.3	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Property Income	0.6	0.7	0.6	1.0	2.4	2.1	1.2	1.1	1.0	1.0
Sale of Goods and Services	2.9	3.0	3.0	3.1	4.0	3.8	3.7	3.5	3.4	3.2
Other (inc. social contributions)	1.3	0.3	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4
Expenditure	31.4	29.6	31.5	30.9	33.9	31.8	30.1	29.8	29.7	29.6
Current expenditure	25.9	26.3	25.8	26.5	28.8	27.5	26.6	26.1	25.7	25.6
Compensation of employees	11.0	11.1	10.9	10.6	11.7	11.2	10.7	10.4	10.2	10.2
Use of goods and services	4.7	4.6	4.0	4.0	4.7	4.6	4.8	4.5	4.5	4.5
Interest	2.6	2.5	2.6	2.5	2.8	2.4	2.3	2.2	2.1	2.0
Domestic	1.5	1.5	1.5	1.5	1.7	1.4	1.3	1.3	1.2	1.1
External	1.1	1.1	1.0	1.0	1.1	1.0	1.0	0.9	0.9	0.8
Other Charges	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Subsidies	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.2	0.2	0.2
Current transfers	3.0	3.0	3.5	3.4	2.9	3.3	3.0	3.0	3.0	3.0
Social benefits	3.0	3.1	3.2	3.4	3.5	3.5	3.6	3.7	3.7	3.7
Other expense (incl. capital transfer)	1.5	1.9	1.6	2.5	2.8	2.1	2.0	2.0	2.1	2.1
Net acquisition of nonfinancial assets	5.6	3.4	5.7	4.4	5.1	4.3	3.4	3.7	3.9	4.0
Purchase of assets	5.7	3.4	5.8	4.4	5.6	4.8	3.6	3.9	4.1	4.2
Foreign financed	3.8	2.0	4.5	3.1	3.9	3.3	2.4	2.6	2.7	2.8
Domestically financed	2.0	1.4	1.3	1.3	1.7	1.5	1.2	1.3	1.4	1.4
Sales of assets (-)	-0.2	0.0	-0.1	0.0	-0.5	-0.5	-0.2	-0.2	-0.2	-0.2
Primary balance	-2.0	-0.5	-0.4	-0.3	0.7	1.0	1.2	1.2	1.2	1.2
Overall balance	-4.6	-3.0	-3.0	-2.8	-2.2	-1.5	-1.2	-1.0	-0.9	-0.8
Net other liabilities	-3.2	-3.4	-0.4	-1.0	-4.3	-2.2	-0.9	-0.2	-0.2	-0.2
Onlending to SOEs for investment purpose	-2.5	-2.7	-2.4	-0.8	-1.5	-1.0	-0.5	-0.3	-0.2	-0.2
Other onlending (net)	0.2	0.2	2.6	1.9	-0.9	-0.6	0.1	0.1	0.1	0.1
Disbursement	0.0	0.0	0.0	0.0	-1.0	-0.7	0.0	0.0	0.0	0.0
Repayment	0.2	0.2	2.6	1.9	0.1	0.1	0.1	0.1	0.1	0.1
Capitalization	-0.9	-0.9	-0.7	-2.1	-1.9	-0.6	-0.5	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing Needs	7.8	6.5	3.3	3.8	6.5	3.7	2.1	1.3	1.1	1.0
Total financing	7.8	5.6	4.2	2.8	6.5	3.7	2.1	1.3	1.1	1.0
Net domestic financing	1.2	2.9	0.2	1.4	1.0	0.4	0.4	0.7	0.1	0.4
Banking system (net)	-0.2	2.6	1.6	1.4	0.5	0.2	0.2	0.3	0.1	0.2
Non Bank (net)	2.1	1.3	0.2	0.4	0.5	0.2	0.2	0.3	0.1	0.2
Other	-0.7	-1.1	-1.6	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	6.7	2.7	4.0	1.5	5.5	3.3	1.7	0.6	1.0	0.6
Disbursement	8.2	4.3	5.8	3.3	7.7	5.8	4.8	4.1	4.4	3.8
Budget Loans	1.7	0.0	1.3	1.2	3.1	1.5	1.5	1.3	1.2	1.3
Project and Program Loans	4.1	1.5	2.2	1.3	3.1	3.3	2.7	2.5	2.9	2.3
Loans to on lend to SOEs 2/	2.5	2.7	2.4	0.8	1.5	1.0	0.5	0.3	0.2	0.2
Amortization	1.5	1.6	1.9	1.9	2.2	2.6	3.0	3.5	3.4	3.3
Net errors and omissions (+ overfinancing)	0.1	-0.9	0.8	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Social Spending 3/	6.5	5.6	8.2	7.5	7.3	7.3	7.3	7.3	7.3	7.3
Total Public Investment	8.2	6.1	8.2	5.2	7.1	5.8	4.2	4.2	4.4	4.4
of which: public investment done by SOEs	2.5	2.7	2.4	0.8	1.5	1.0	0.5	0.3	0.2	0.2
GDP at current market prices (billions of CVEsc)	158.7	165.8	173.4	185.6	197.8	211.1	225.3	240.9	257.5	275.2

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

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

2/ On lend to SOEs for public investment execution.

3/ Covering health, education, and social protection sectors, excluding compensation of employees.

Table 4. Cabo Verde: Monetary Survey, 2015–24
(Millions of Cabo Verde escudos, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
				Prel.	Proj.					
Net foreign assets	48,463	58,018	60,227	56,396	60,076	65,536	70,530	76,203	83,950	91,806
Foreign assets	75,880	85,390	86,730	83,533	87,678	93,531	99,056	105,272	113,571	121,993
Of which: gross international reserves	49,979	59,658	57,330	58,649	65,780	71,214	77,632	84,598	92,484	100,484
Foreign liabilities	-27,417	-27,371	-26,519	-27,233	-27,698	-28,091	-28,623	-29,165	-29,718	-30,283
Net domestic assets	108,466	112,024	120,878	127,234	136,456	143,291	150,789	159,174	166,455	174,724
Net domestic credit	133,196	137,724	145,938	156,614	162,715	169,682	177,366	186,039	194,748	204,550
Net claims on general government (net)	31,502	32,262	33,068	40,284	40,832	41,400	41,997	42,960	43,295	44,055
Investment in TCMFs 1/	11,636	11,143	11,053	11,070	11,070	11,070	11,070	11,070	11,070	11,070
Net claims on the central government	18,343	22,334	24,818	32,659	33,674	34,099	34,538	35,322	35,463	36,011
Credit to central government	29,299	33,268	35,920	46,866	47,881	48,306	48,745	49,529	49,670	50,218
Deposits of central government	-10,956	-10,934	-11,102	-14,207	-14,207	-14,207	-14,207	-14,207	-14,207	-14,207
Of which: project deposits	-47	-47	-47	-56	-56	-56	-56	-56	-56	-56
Net claims on local government and other agencies 2/	1,524	-1,216	-1,938	-3,446	-3,913	-3,769	-3,612	-3,432	-3,238	-3,027
Credit to the economy	101,694	105,463	112,869	116,330	121,884	128,281	135,370	143,079	151,453	160,495
Other items (net)	-24,730	-25,700	-25,060	-29,380	-26,259	-26,391	-26,577	-26,865	-28,293	-29,826
Broad money (M2)	156,929	170,043	181,105	183,630	196,532	208,827	221,319	235,377	250,404	266,530
Narrow money (M1)	62,413	70,275	81,953	86,806	92,905	98,717	104,622	111,268	118,371	125,994
Currency outside banks	8,967	9,207	9,342	9,571	10,243	10,884	11,535	12,268	13,051	13,891
Demand deposits	53,446	61,067	72,612	77,235	82,662	87,833	93,087	99,000	105,320	112,103
Quasi-money	90,484	93,394	93,394	91,862	98,316	104,466	110,715	117,748	125,265	133,332
Foreign currency deposits	4,032	4,701	5,758	4,963	5,312	5,644	5,982	6,362	6,768	7,203
(Change in percent of broad money, 12 months earlier)										
Net foreign assets	4.0	6.1	1.3	-2.1	2.0	2.8	2.4	2.6	3.3	3.1
Net domestic assets	2.3	2.3	5.2	3.5	5.0	3.5	3.6	3.8	3.1	3.3
Net domestic credit	1.8	2.9	4.8	5.9	3.3	3.5	3.7	3.9	3.7	3.9
Net claims on the central government	-0.2	2.5	1.5	4.3	0.6	0.2	0.2	0.4	0.1	0.2
Credit to the economy	1.8	2.4	4.4	1.9	3.0	3.3	3.4	3.5	3.6	3.6
Other items (net)	0.5	-0.6	0.4	-2.4	1.7	-0.1	-0.1	-0.1	-0.6	-0.6
Broad money (M2)	6.2	8.4	6.5	1.4	7.0	6.3	6.0	6.4	6.4	6.4
Memorandum items:										
Emigrant deposits	56,943	60,711	63,251	63,869	68,154	72,418	76,750	81,625	86,836	92,428
Emigrant deposits/total deposits (percent)	38.5	37.7	36.8	36.7	36.6	36.6	36.6	36.6	36.6	36.6
Excess reserves/total deposits (percent)	6.1	9.9	11.1	13.4	…	…	…	…	…	…
Money multiplier (M2/M0)	3.4	3.0	3.2	3.2	3.3	3.3	3.3	3.3	3.3	3.3
Money velocity (Nominal GDP/M2)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Credit to the economy (percent change) 3/	2.7	3.7	7.0	3.1	4.8	5.2	5.5	5.7	5.9	6.0
Broad money (M2 in percent of GDP)	98.9	102.6	104.5	99.0	99.4	98.9	98.2	97.7	97.3	96.9

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

1/ TCMFs (Titulos 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 5. Cabo Verde: Financial Soundness Indicators of the Banking Sector, 2010–18

(End-year; percent unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Capital adequacy									
Regulatory capital to risk-weighted assets	12.8	15.2	14.2	15.1	15.6	16.2	17.1	17.3	18.0
Regulatory Tier 1 capital to risk-weighted assets	13.0	15.9	13.9	13.7	14.4	15.0	15.9	16.4	17.8
Asset quality 1/									
Nonperforming loans to total loans	8.4	11.8	14.1	16.4	18.7	16.5	15.6	14.5	12.8
Nonperforming loans net of provisions to capital	17.1	40.2	47.9	53.5	62.8	49.4	42.5	35.0	27.8
Provisions to nonperforming loans	73.1	57.0	53.7	51.6	48.8	54.4	58.5	64.1	71.0
Earnings and profitability									
Return on assets	0.7	0.4	0.2	0.3	0.2	0.4	0.3	0.4	1.0
Return on equity	9.1	5.6	2.7	3.5	3.1	4.8	4.2	6.4	13.2
Interest margin to gross income	76.1	76.2	75.5	75.3	71.8	73.1	76.7	77.0	80.4
Noninterest expenses to gross income	67.0	68.5	76.5	78.1	72.5	75.8	66.4	60.2	56.0
Liquidity 2/									
Liquid assets to total assets	8.1	7.1	15.0	22.1	30.3	30.3	23.7	22.1	21.4
Liquid assets to short-term liabilities	10.5	9.7	21.1	29.0	37.3	37.0	28.6	26.6	25.5
Additional indicators									
Government deposits over total deposits	9.5	7.6	9.7	11.4	13.5	12.6	14.6	15.8	18.3
Emigrant deposits over total deposits	37.4	38.9	39.3	37.9	38.0	38.5	37.7	36.8	36.7
Emigrant deposits over total assets	27.2	27.0	26.5	25.4	26.7	27.3	26.8	26.2	25.6
Demand deposits over total deposits	43.8	43.4	42.0	45.5	43.2	42.8	44.0	48.3	50.5
Total credit over total deposits	79.1	85.9	79.0	67.4	61.5	59.5	55.6	55.8	55.3
Personnel cost over cost of operations	49.0	49.9	50.1	48.4	54.8	56.6	58.8	58.3	58.4

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.

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

Recommendation	Timeframe	Status
Financial Sector Soundness, Supervision and Regulation		
Reducing vulnerabilities in domestic banks		
• Encourage banks to raise capital above the regulatory minimum and strictly avoid forbearance in case of even temporary shortfalls	Short term	**Done**
• Further enhance the framework for financial soundness analysis	Short term	**Done**
• Enhance credit risk assessment framework	Short term	**Done**
Mitigating risks in the offshore sector		
• Determine whether to wind down IFI sector or reform it to conform to international standards of regulation, supervision and integrity	Short term	**Done**
• If reform is chosen, implement international standards of regulation, strengthen supervisory powers, and adopt stricter licensing standards	Short term	**Done**
Enhancing banking supervision		
• Improve supervision of onshore and offshore banks	Short term	**Done**
• Improve the legislative and regulatory framework for supervision	Short term	**Done**
Establishing a crisis management framework		
• Create well-defined guidelines for the management of problem financial institutions and financial crises	Short term	**Done**
• Review law and develop implementing regulations outlining lender of last resort arrangements	Short to medium term	**Done**
• Assess desirability of instituting system of deposit insurance, taking into account costs, benefits, and structure of the financial system	medium term	**Done**
Issues in Systemic Liquidity and Monetary Management		
Enhancing the framework for monetary operations		
• Streamline monetary operations decision making process	Medium term	**Done**
• Use predetermined long-term intervention program to implement program targets and short-term operations to manage daily liquidity conditions at banks.	Short term	**Done**
• Release Board monetary meeting minutes with a lag	Medium term	In process
• Use t-bills for monetary operations as much as possible	Medium term	In process
• Improve coordination of monetary and fiscal operations between BCV and the Treasury	Short term.	**Done**
• Harmonize tax treatment of BCV securities and treasuries	Short term	In process
Developing the money market		
• More actively manage bank liquidity through daily auctions	Short term	In process
• Apply less punitive and symmetric rates to standing facilities	Medium term	**Done**
• Allow wider secondary market trading in BCV securities	Short term	In process
• Use repos to implement all of BCV's short-term interventions (standing facilities and auctions)	Medium term	In process
Challenges for the Development of the Financial Sector		
Access to Finance		
• Promote technical assistance to SME's to implement proper accounting systems to facilitate lending decisions	Short term	In process
• Implement a more comprehensive credit reporting system	Short term	In process
• Do not allow deposit-taking by microfinance institutions	Short term	In process
Pension and insurance		
• Strengthen the governance and transparency of the INPS	Short term	**Done**
• Evaluate additional parametric reforms to the INPS to ensure long-term viability	Medium term	**Done**
• Evaluate the costs, benefits, and risks of allowing INPS to place part of its assets abroad	Short term	In process
• Consider tax deferral of contributions and investment gains in occupational and employer contributions as expenses for purposes of corporate and personal income tax	Medium term	Not initiated
• Modernize the legal and regulatory framework for insurance	Medium term	**Done**
Legal and judicial issues		
• Finish the process of replacing the Code of Civil Procedure	Short term	In process
• Implement further steps to promote mediation	Short term	In process
• Promote improved corporate governance practices that impact firms' ability to obtain credit	Short to medium term	In process
• Draw lessons from experience of other countries in replacing the bankruptcy code	Medium term	In process

Source: IMF Article IV, March 2014. Updated by IMF staff in March 2019.

Table 7. Cabo Verde—Schedule of Reviews Under the PCI, 2019–21		
Program Review	**Test Date**	**Review Date**
Board discussion of the PCI request		July 15, 2019
First Review	September 30, 2019	March 1, 2020
Second Review	March 31, 2020	September 2, 2020
Third Review	September 30, 2020	January 15, 2021

Annex I. External Stability Assessment

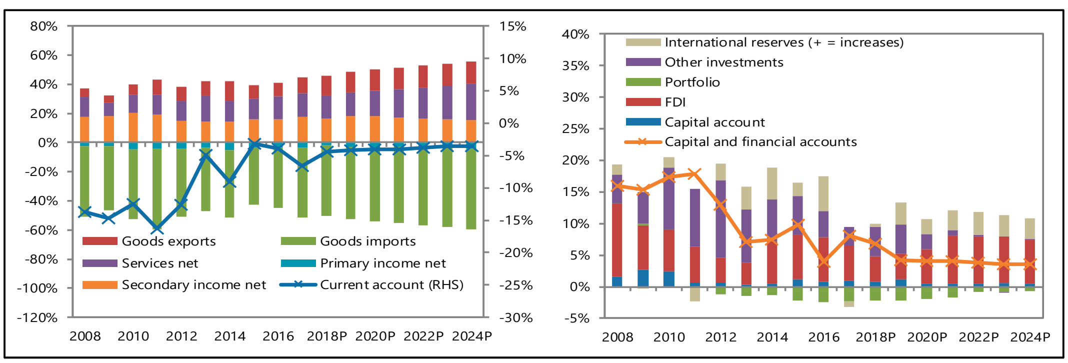
Cabo Verde's external position in 2018 was assessed to be weaker than suggested by fundamentals and desirable policy settings based on the external sustainability approach, which points to a large overvaluation. The net international investment position remains a vulnerability. However, its risks are mitigated by the nature of Cabo Verde's external liabilities, which are mainly composed of FDI and long-term maturity debt. Reserve adequacy is satisfactory—the assessment using the LIC/MIC framework suggests an optimal level of reserves of 3.6 months of prospective imports of goods and services—compared to an actual and prospective level exceeding 5 months. Although the business environment has improved in recent years, continued structural reforms remain critical to address non-price competitiveness factors.

CURRENT ACCOUNT

1. Background. The current account deficit narrowed to 4.5 percent of GDP in 2018, after averaging 9.4 percent of GDP in 2003-17, mostly reflecting strong export performance, increased remittances, and a deceleration in imports demand (Text Figure 1). Financial inflows remained important, covering the largest share of the current account deficit. Projections for 2019 and the medium term point to continued increase in exports of goods, tourism receipts and remittances that would outpace the projected growth in imports. As a result, the current account deficit would narrow to 4.2 percent of GDP in 2019, and 3.6 percent of GDP over the medium term.

Text Figure 1. Cabo Verde: Balance of Payments, 2008–24

(Percent of GDP)



Sources: Cabo Verdean authorities; and IMF Staff calculations.

2. Assessment. The EBA-lite methodology based on the current account (CA) model is based on a panel regression of the current account which generates an estimated "norm" consistent with medium-term fundamentals and desirable policies. Using the CA model shows that the cyclically-adjusted current account balance is estimated at -6.4 percent of GDP in 2018, while the multilaterally consistent cyclically-adjusted current account norm is -9.0 percent of GDP (Text Table 1). This suggests a current account gap of 2.6 percent of GDP. Using the estimated current account elasticities, this implies an undervaluation of the Real Effective Exchange Rate (REER) of about 6 percent. However, the CA model has limitations in analyzing tourism-based economies and does not fully capture Cabo Verde's need to save externally to guard against the country's exposure to natural disasters. As such, Staff finds that the EBA-lite estimated CA norm assumes a wider CA deficit than is appropriate for Cabo Verde's circumstances.

REAL EFFECTIVE EXCHANGE RATE

3. Background. The REER has been relatively stable over the past decade. In 2018, it appreciated by about 0.9 percent relative to 2017 while remaining broadly in line with the average for the past five years.

4. Assessment. The EBA-lite methodology based on the REER model is based on a panel regression of the real effective exchange rate which generates an estimated "norm" consistent with medium-term fundamentals and desirable policies. The REER model suggests an undervaluation of the REER, of about 19 percent, much higher than suggested under the current account model-based assessment (Text Table 1).

Text Table 1. Cabo Verde: Results of EBA-lite Assessment

CA Approach		REER Approach	
CA-Actual	-4.5%	Ln(REER) Actual	4.58
Cyclical Contributions (from model)	1.9%	Ln(REER) Fitted	4.80
Cyclically adjusted CA	-6.4%	Ln(REER) Norm	4.77
CA-Norm	-7.6%	Residual	-0.22
Cyclically adjusted CA Norm	-9.6%	REER Gap	-18.8%
Multilaterally Consistent Cyclically adjusted CA Norm	-9.0%	Policy Gap	3.6%
CA-Gap	2.6%	Natural Disasters and Conflicts	-0.1%
of/which Policy gap	-2.3%		
Elasticity	-0.4		
REER Gap	-6.4%		
CA-Fitted	-9.9%		
Residual	0.1		
Natural Disasters and Conflicts	0.0%		

Source: IMF Staff estimates.

CAPITAL AND FINANCIAL FLOWS

5. Background. Although declining in 2018, capital flows remain high, driven by foreign direct investment. The net capital and financial account balance stood at 5.2 percent of GDP in 2018, following a sharp increase in 2017 to 6.2 percent of GDP (2.5 percent of GDP in 2016).

6. Assessment. Net capital and financial flows are expected to be sustained over the medium term, which, combined with the projected improvement in the external current account would result in sustained overall balance of payments surpluses.

RESERVE ADEQUACY

7. Background. Following a sharp increase in 2016 (€83 million), gross international reserves dropped in 2017, and grew by €8 million in 2018, bringing the stock to €531 million at end-December 2018, equivalent to 5.1 months of prospective imports of goods and services.

8. Assessment. Results from the Fund's LIC/MIC framework suggests that the optimal level of reserves for Cabo Verde is about 3.6 months of prospective imports of goods and services. However, as noted in the previous assessment (Country Report No. 18/104), fragilities arising from the economy's small size, lack of export diversification, and vulnerability to exogenous shocks call for a higher level of reserves of about five months of imports in line with Staff's medium-term projections.

EXTERNAL BALANCE SHEET

9. Background. Cabo Verde's net international investment position (NIIP, excluding short-term migrants' deposits) improved from -150 percent of GDP in 2017 to -131 percent of GDP in 2018. Nonetheless, this large negative position is an important source of external vulnerability. In 2018, gross foreign assets and liabilities stood at 71 percent of GDP and 201 percent of GDP, respectively.

10. Assessment. The external sustainability approach (ES) calculates the REER adjustment required to satisfy the inter-temporal budget constraint as a measure of the external adjustment required to restore external sustainability. The ES approach suggests that the projected current account is weaker than the level required to stabilize the NIIP at its end-2018 level, implying a REER overvaluation of about 17 percent. This is due to the large stock of liabilities, and a smaller rate of return on assets compared to the cost of liabilities, which results in a net drain of income via the primary income balance.

NON-PRICE COMPETITIVENESS

11. Background. While Cabo Verde's business environment has improved in recent years, competitiveness could be strengthened further in several areas relative to peers. According to the World Economic Forum (WEF)[1], Cabo Verde's overall score for global competitiveness in 2018 was 50.2 compared with an average of 52.8 for Sub-Saharan Africa Small Middle-Income Countries (SSA SMICs). Cabo Verde does better in adoption of Information and Communication Technology (ICT) and health. However, there is considerable room for improvement in macroeconomic stability, business dynamism and innovation capacity (Text Table 2). Similarly, the World Bank's Doing Business Indicators[2] show that compared to peers, Cabo Verde lags in relation with the ease of doing business indicators. In 2019, Cabo Verde scores better in the areas of starting a business, dealing with construction permits, registering property and enforcing contracts, in comparison to SSA and SSA SMICs averages.

12. Assessment. Despite the abovementioned strides, decisive structural reforms aimed at improving the business environment and attracting private investors remain critical to bolster competitiveness. Key areas in need of improvement include power supply, access to finance, protecting minority investors, paying taxes and trading across borders (Text Figure 3). In terms of tourism competitiveness, Cabo Verde is a top performer in sub-Sharan Africa (Box 1).

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[1] The World Economic Forum's Global Competitiveness Index combines both official data and survey responses from business executives on several dimensions of competitiveness.

[2] Survey-based indicators reflect investor's perceptions on the business environment. Care should be taken when comparing scores across years since methodology changes can affect the scores.

Text Table 2. Cabo Verde: Global Competitiveness Index by Subcategories, 2018

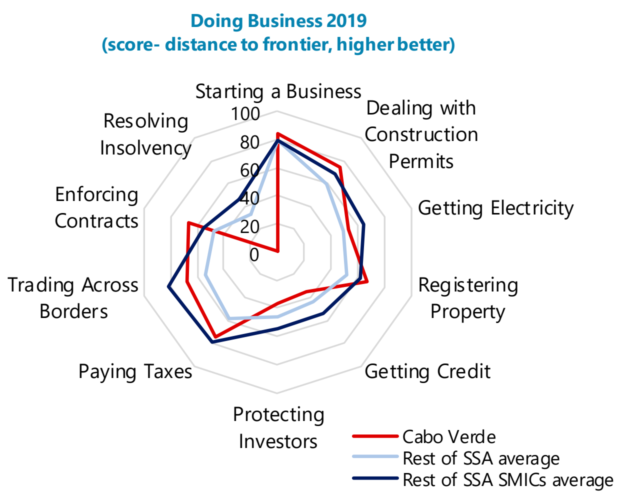
(Score 0 to 100)

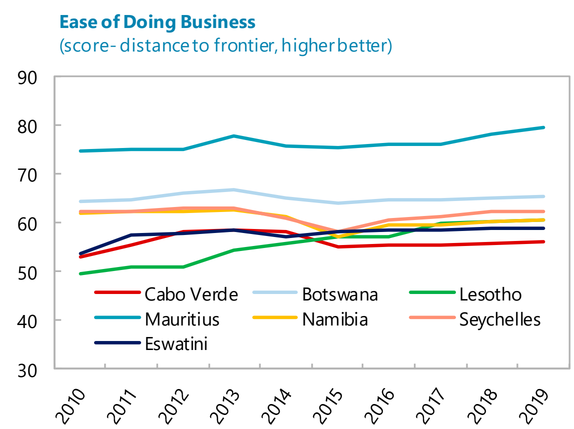
	Cabo Verde	SSA SMICs [1]
Overall score	50.2	52.8
Enabling environment component	55.8	58.4
Institutions	51.5	54.5
Infrastructure	54.7	57.2
ICT adoption	48.1	42.7
Macroeconomic stability	68.9	79.2
Human capital component	62.8	50.0
Health	75.6	50.2
Skills	53.3	56.6
Markets components	46.2	51.8
Product market	52.8	56.3
Labour market	57.6	61.3
Financial system	57.3	59.5
Market size	17.1	30.0
Innovation ecosystem component	32.7	43.4
Business dynamism	44.0	54.6
Innovation capability	21.4	32.2

Sources: World Economic Forum; and IMF staff estimates.

Note: [1] List of SSA SMICs include Botswana, Eswatini, Lesotho, Mauritius, Namibia, Seychelles.

Text Figure 3. Cabo Verde: Ease of Doing Business, 2019





Sources: World Bank, Doing Business Database; and World Economic Forum.

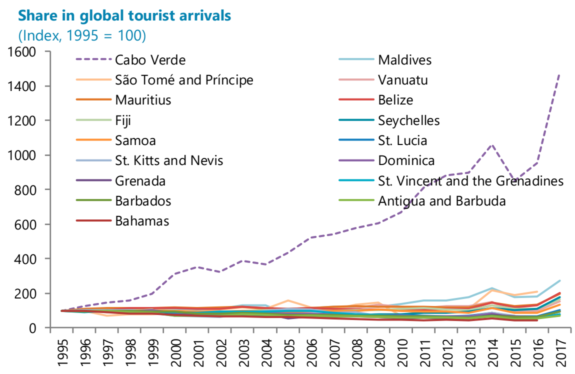
Note: Score is between 0 and 100.

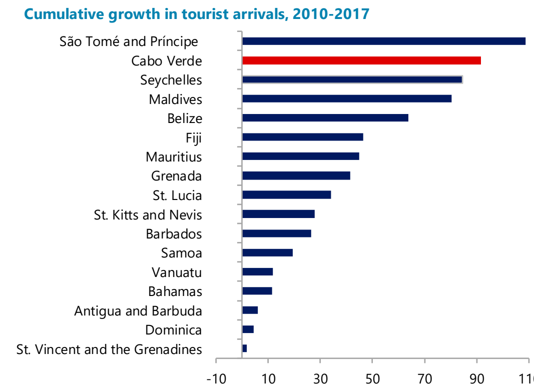
SSA SMICs include Botswana, Eswatini, Lesotho, Mauritius, Namibia and Seychelles.

Box 1. 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 2017, the annual average growth rate in the number of tourists entering the country was 11 percent. Most tourists originate from Europe; hence, the industry was negatively affected by the 2008 financial crisis. It has since recovered, 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 needs to improve on cultural and business travel, international openness and ground and transport infrastructure to fully compete with other destinations outside SSA. The recent privatization of the airline company (March 2019) is expected to enhance growth prospects in the sector.





Note: There is no data for 2016 and 2017 for St. Kitts and Nevis.
There is no data for 2017 for São Tomé and Príncipe, Dominica and Bahamas.
Source: World Tourism Organization , Compendium of Tourism Statistics dataset.

OVERALL ASSESSMENT AND RECOMMENDATIONS

13. **Staff assessment of the external position in 2018 found mixed results**. The external sustainability approach points to an overvaluation of about 17 percent to stabilize the NIIP at its end-2018 level. On the other hand, the EBA-lite methodology based on the current account model and the REER model point to an undervaluation of the real effective exchange rate in the range of 6 to 19 percent. Given the existing large external liabilities for Cabo Verde, Staff's policy recommendations are underpinned by the results derived from the external sustainability approach.

14. **Sustained fiscal consolidation and structural reforms are needed to improve the external position**. The fiscal adjustment envisioned under the PCI (discussed in the main report) is expected to help reduce external liabilities and thereby support medium-term external sustainability. Continued implementation of structural reforms is also needed to reduce transaction costs, increase labor market flexibility, boost productivity, and support private sector development. Although the current level of reserves is adequate in relation with estimates derived from the IMF LIC/MIC framework, building strong external buffers is critical in view of existing vulnerabilities and the need to protect the peg.

Policy Coordination Instrument

Attached hereto is a Program Statement dated June 21, 2019 from the Vice-Prime-Minister and Minister of Finance of Cabo Verde and the Governor of the Banco de Cabo Verde (the "Program Statement") with its attached Technical Memorandum of Understanding ("TMU") requesting from the International Monetary Fund (the "Fund") a Policy Coordination Instrument (the "Instrument"), and setting forth:

a. The objectives and economic and financial policies (the "Program") that the authorities of Cabo Verde intend to pursue during the period of the Instrument;

b. The policies and measures that the authorities of Cabo Verde intend to pursue during the first year of the Instrument, including a quantified macroeconomic framework for the first 12 months under the Instrument; and

c. Understandings of Cabo Verde with the Fund regarding reviews that will be made of progress in realizing the objectives of the Program.

To support these objectives and policies, the Fund approves this Instrument for a period of 18 months starting from the date of approval of the Instrument, in accordance with the following provisions, and subject to the requirements of Decision No. 16230-(17/62), adopted July 14, 2017, on Policy Coordination Instruments ("PCI Decision"):

1. Review Schedule. Cabo Verde's implementation of the Program will be assessed by the Fund through reviews, which are scheduled to be conducted by March 1, 2020, September 2, 2020, and January 15, 2021, subject to paragraphs 7(b) and (c) of the PCI Decision.

2. Establishing Targets. Completion of each review will be subject to Quantitative Targets or Reform Targets, or both, where established, having been set for the shorter of (a) the next two scheduled reviews, or (b) the remaining period of the Instrument.

3. Completing Reviews. A review will be completed only if the Fund is satisfied that the Program is on track to achieve its objectives, based on relevant factors such as Cabo Verde's observance of Quantitative Targets, Standard Continuous Targets, and Reform Targets as set forth in Tables 1

and 2 attached to the Program Statement and as further specified in the TMU, and its policy understandings for the future.

4. Provision of Information. In accordance with the Program Statement, Cabo Verde will provide the Fund with such information as the Fund requests in connection with the progress of Cabo Verde in implementing the policies and reaching the objectives of the Program.

5. Consultation. In accordance with the Program Statement, during the period of this Instrument, Cabo Verde will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of Cabo Verde or whenever the Managing Director of the Fund requests such a consultation. These consultations may include correspondence and visits of officials of the Fund to Cabo Verde, or representatives of Cabo Verde to the Fund.

Appendix I. Program Statement

Praia, June 21, 2019

Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C., 20431
U.S.A

Dear Ms. Lagarde,

The government of the Republic of Cabo Verde embarked in 2016 on an ambitious reform program to reduce the country's vulnerabilities and improve prospects for sustainable inclusive and private sector-led growth. The progress achieved thus far has been considerable, as evidenced by the substantial acceleration in economic growth recorded since 2016. To consolidate these results, the government requests the International Monetary Fund's (IMF) approval and support for the implementation of a macroeconomic and structural reforms program supported by the Policy Coordination Instrument (PCI) for the period July 2019–January 2021. The attached Program Statement (PS) outlines the program's objectives and presents the economic and financial policies that the government and the central bank of Cabo Verde intend to implement to reach those objectives.

The program will provide a sound framework for the implementation of reforms set forth in the government's Sustainable Development Strategy 2017–2021 (PEDS), which seeks to develop inclusive tourism, benefitting all the islands; transform Cabo Verde into an air transport hub and an international business center; create an international finance platform; develop a digital platform for technological innovation; expand maritime services; and support investment opportunities developed locally or by the diaspora. The PEDS has received support from Cabo Verde's development partners through financial pledges.

The program will focus on strengthening fiscal and public debt sustainability; continuously modernizing the monetary policy framework, strengthening the resilience of the financial system, improving the business environment, advancing public enterprises sector reforms, setting up mechanisms to protect the most vulnerable portions of the population, and broadening the foundation for improved resilience to climate change, natural disasters and other exogenous shocks.

The implementation of the program will be monitored through quantitative targets, standard continuous targets, and reform targets, as described in this PS and in the attached Technical Memorandum of Understanding (TMU). There will be semi-annual reviews of the program by the IMF to assess progress in reforms implementation.

We believe that the policies set forth in this PS are adequate to achieve the objectives of the PCI-supported program. Nonetheless, we stand ready to take any additional measures that may prove necessary to reach the expected results. We will provide the IMF with all information requested to assess progress in the implementation of the program.

Given the needed program ownership, we wish to make this letter available to the public, along with the Program Statement and the Technical Memorandum of Understanding, as well as the Staff Report for the 2019 Article IV Consultation and the Request for a program under the Policy Coordination Instrument. Therefore, we authorize the publication of these documents and their posting on the IMF's official webpage, subject to approval by the IMF Executive Board. We will also post these documents, including the Portuguese versions, on the government official webpage.

Sincerely,

/s/ Olavo Correia Vice-Prime-Minister and Minister of Finance	/s/ João Serra Governor of the Banco de Cabo Verde

Attachment: Technical Memorandum of Understanding

Appendix II. Program Statement for the Period July 2019–January 2021

BACKGROUND

1. **Cabo Verde made significant strides in economic development in the past few decades, despite constraints caused by the 2008 global financial crisis**. Real GDP rose by about 6 percent on average during 1990–2000, and by close to 4.2 percent during the period 2001-2015. After growth softened during the first half of the decade, the economy improved its growth performance during the period 2016-2018, when the GDP grew by 4.7 percent on average. Economic activity in Cabo Verde in recent years has been driven by a significant increase in tourism activities, the scaling-up of public investment to address infrastructure gaps, high private investment financed with Foreign Direct Investment (FDI), and structural reforms aimed at increasing the private sector's role in productive activities. It allowed the country to more than double its per capita income and to graduate to middle-income status in 2007 and helped improve living standards and reduce poverty.

2. **Economic performance improved in recent years thanks to the implementation of sound policies, a better external environment, and progress in some reforms**. However, important challenges and vulnerabilities remain. Despite the considerable improvement over the period 2016-18, economic growth remains far below potential, and constrained by structural factors, particularly: lack of diversification in the economy and regional equity; weak business environment; poor connectivity between the islands, lack of skilled labor and the attendant constraints to factor productivity; high transaction costs; and limited access to finance.

3. **While the fiscal position has improved in recent years there are important risks**. Vulnerabilities generated by the narrow tax base, financial support to loss-making State-Owned Enterprises (SOEs), and low efficiency in capital expenditure management have been constraining fiscal space and making it difficult to lock in recent gains in fiscal consolidation and put public debt on a downward trend at a desirable pace.

4. **Public debt increased significantly in the last decade**. The rapid growth in debt reflects the scaling-up of investment in infrastructure, support from the budget to SOEs under onlending, capitalization and guarantees to their external borrowing. The stock of public and publicly-guaranteed debt rose from 57 percent of GDP in 2008 to 128.4 percent of GDP at end-2016. Over the past two years, however, public debt declined, standing at 123.9 percent at end-2018. Despite this progress, the most recent debt sustainability analysis carried out by the IMF and World Bank Staff indicates that Cabo Verde is at high risk of external and overall debt distress.

A. Recent Economic Developments and Outlook

5. **Economic activity remained strong in 2018 and inflation subdued.** The real GDP growth is estimated at 5.5 percent, up from 4 percent in 2017. In the last quarter of 2018, GDP grew by 7.6 percent compared with the same period of the previous year. Sustained activity in the industry

and tourism sectors more than compensated for the impact of the drought on agricultural output. Although on the rise compared with previous years, inflation remained low. It rose to 1 percent at end-December 2018 (0.3 percent at end-2017), due to higher food and fuel prices.

6. **Developments in the monetary and financial sector were also positive**. Credit to the economy grew by 3.1 percent in 2018. The deceleration compared with 2017 was mostly due to a repayment of loans by a major operator in the tourism sector. The sectoral distribution shows that the largest share of credit was extended to trade, restaurant and hotel sectors. In 2018, migrant deposits rose compared with 2017, reflecting continued interest rate premia with the European Union and the United States. They stood at 36.7 percent of total deposits, equivalent to 35 percent of GDP. Migrants deposits remain an important contributor to the excess liquidity in the banking system.

7. **There were changes in some interest rates**. After a 200-basis points reduction in 2017, the central bank (Banco de Cabo Verde - BCV) maintained the prime rate at 1.5 percent. Interest rates on deposits, including emigrants' deposits declined to 1.6 percent at end-December (1.9 percent at end-2017), while lending rates increased from 9.3 percent in 2017 to 9.6 percent in 2018. In June 2019, the BCV reduced the interest rate of the overnight lending facility to 3.0 percent from 4.5 percent to improve the effectiveness of the monetary policy transmission mechanism.

8. **Government efforts to strengthen public finances continued in 2018**. Administrative measures put in place to strengthen revenue mobilization included: strengthening of the administrative and decision-making capacity of the tax administration; enhanced auditing to combat tax avoidance and evasion; promotion of the formalization of the economy and; improved collection of new revenues. These actions, combined with strong economic activity helped raise tax and nontax revenue to 26.7 percent of GDP, up from 24.9 percent of GDP in 2017. On the expenditure side, wages and salaries increased by 4.4 percent because of the updating of salary and career plans (PCCS) for specialized personnel in the civil service. Spending on goods and services rose by 6.5 percent, partly due to the purchase of medications for hospitals and security equipment. As for spending on transfers and subsidies, there was an increase of 4.7 percent and 23.4 percent, respectively because of a rise in transfers to municipalities resulting from the increase in financial fund for municipalities (FFM), payment of quota subscriptions to international organizations, and an increase in subsidies for Small-and-Medium Sized Enterprises. The increase also reflects the financing of the program to mitigate the effects of the drought that affected the country over the past two years. On capital expenditure, the execution was lower-than-budgeted, due to delays in disbursements for externally-financed projects, leading to a modest nominal increase in total expenditure. As a result, the primary deficit went from about CVE 0.6 billion (0.4 percent of GDP), to CVE 0.48 billion (0.3 percent of GDP). However, net other liabilities, including onlending as well as capitalization in favor of public enterprises facing financial difficulties which include net onlending, capitalization, and other net liabilities rose from CVE 0.6 billion in 2017 (0.4 percent of GDP) to CVE 1.9 billion (1 percent of GDP) because of support to SOEs as explained below. Consequently, financing needs reached CVE 7.1 billion (3.8 percent of GDP). They were covered with domestic and external borrowing in about the same proportion.

9. The government extended further financial support to SOEs in 2018. Total budget support to loss-making SOEs amounted to about CVE 4 billion, equivalent to 2.1 percent of GDP, a substantial increase compared with 2017, partly related to the cost of disruption in TACV's activities and the need to complete the restructuring of the enterprise and its consequent privatization.

10. The external position strengthened. The current account deficit improved from 6.6 percent of GDP in 2017 to 4.5 percent of GDP in 2018 reflecting continued strong exports performance, notably for tourism receipts and fish exports following the signing of the agreement granting Cabo Verde access to the EU market. Increased remittances and a deceleration in imports also contributed to the narrowing of the current account in 2018. The deficit was financed mainly by FDI flows. Gross international reserves rose from €523 million in 2017 (5.5 months of next year's imports of goods and services) to €531 million in 2018 (5.1 months of next year's imports).

11. Structural reforms advanced in various areas in 2018 as presented below.

- Introduction of corporate income tax rate of 2.5 percent for off-shore banks (January)
- Enactment of the law on the liberalization of capital flows (July).
- Preparation of a report to reform the insurance sector (May).
- Enactment of three legislative instruments on the legal regime of the new payment system, payment institutions, and electronic currency (November).

B. Economic Policies and Structural Reforms under the Program

12. The government expects that policies and reforms under its economic program, which are set out in the PEDS, and supported by the PCI, will help improve Cabo Verde's medium-term prospects (Box 1). Building on recent progress, real GDP growth is projected to move from an average of 3.8 percent during 2015-18 to about 5 percent on average in the medium term. It is expected that a successful implementation of key programs under the PEDS, and structural reforms, particularly in the public enterprises sector, would raise growth potential for Cabo Verde. Inflation is projected at 1.7 percent on average; and the external current account deficit is projected to improve to 4.2 percent in 2019, and 3.9 percent on average over the medium term. The expected improvement will be supported by the anticipated fiscal consolidation, continued dynamism in tourism activities, higher remittances, and higher transport services. The later are projected to contribute favorably to the improvement in the current account as measures under the PEDS materialize, notably the plan to turn Cabo Verde into an air transport hub in the Atlantic. The anticipated improvement in inter-island maritime connectivity will also help boost transport and tourism receipts. The external current account deficit will continue to be financed with FDI. Under these assumptions, gross international reserves are forecast to average about 5.3 months of prospective imports over the medium-term.

Box 1. Key Reforms Planned by the Government, 2019–21

The reform targets under the PCI are part of the broader reform agenda being implemented by the government to enhance macroeconomic stability and improve medium-term growth prospects. Key reforms planned for 2019 – 2021 (excluding reform targets under the PCI, presented in Table 2) are presented below.

Budgetary Reform:

- Roll out the tax arbitration center (2nd half of 2019)
- Introduce electronic billing (June 2020)
- Introduce the SAF-T (Standard Audit File for Tax Purposes) to complement the electronic billing system (December 2020)
- Set up a One-Stop Facility for foreign trade (December 2021)
- Expand the Integrated System for Tax Security and Efficiency to include other taxes apart from VAT and income tax withholding at source (2nd half of 2019)
- Introduce a VAT monitoring plan (2nd half of 2019)
- Introduce the second stage of the registered taxpayer base (2nd half of 2019)
- Submission of fiscal policy reform agenda and action plan to combat tax avoidance and evasion (December 2019)
- Approval of the new customs tariff by the government (December 2020)
- Adoption of the plan for public acquisitions, E-procurement and public purchasing (December 2019)
- Integrated debt management system (December 2020)
- Introduction and launch of PAYLOG System (December 2019)
- Approval of law on budget principles (2nd half of 2019)
- Creation of national council on government finance (December 2019)
- Creation of enterprise to manage State real estate holdings (December 2019)

Reform of Digital Governance and Dematerialization

- Action plan for digital governance (December 2019)
- Plan to strengthen regulatory capacity (continuous)

SOEs Reforms

- Design and implementation of platform for monitoring the public enterprise sector, generating larger amounts of more accurate data on enterprises in the public enterprise sector, to facilitate access by portfolio managers and the various stakeholders that interact with the sector (December 2020)
- Accelerate SOEs privatization process. The government has a clear agenda for privatizing enterprises in the transportation sector (TACV and maritime transportation), the pharmaceutical sector (Inpharma and Emprofac), energy and water (Electra), and for establishing concession arrangements for enterprises operating in the ports sector (Enapor) and airports sector (ASA and CV Handling). The government is committed to finalizing all the measures related to the SOEs reforms that are under its direct purview. The timeline related to the privatization process are as follows: TACV – completion of the sale of 49 percent shares by end-2019, establishment of concession arrangement

Box 1. Key Reforms Planned by the Government, 2019–21 (concluded)

for maritime transportation (completed), privatization of Electra (March 2020), privatization of EMPROFAC (December 2019), sale of INPHARMA (December 2019), licensing of port services (May 2020), establishment of concession arrangement for airport services (December 2019), privatization of CV Handling (December 2019).

- Creation of PARPública – Enterprise for the Management of State Investments (December 2019)

Monetary and Foreign Exchange reforms

- Promote effective regulation and supervision of financial transactions with the rest of the world, to derive greater benefit from foreign exchange liberalization (continuous).

Financial Sector Reforms

- Action Plan for Development of the Financial System (December 2019)
- Approval of the BCV Organic Law (December 2019)

Improving the Business Climate and Diversifying the Economy

- Approval of agenda for promoting MSMEs and diversifying the economy (December 2019)
- Publication of the agenda for improving the business climate (continuous)

13. This medium-term outlook is subject to risks. On the downside, worse than expected external conditions, including weak global growth, sharp tightening of global financial conditions, and the potential impact of Brexit are important risks with impact on growth prospects and on the external position. Domestically, downside risks are related to high vulnerability to natural disasters particularly drought, which has affected agriculture production over the last two years. Upside risks relate to tourism performance, implementation of growth enhancing structural reforms, and increased FDI-driven investments in relation with programs under the PEDS. Growth in the tourism sector could be above forecast due to a successful restructuring of the domestic airline as well as interisland maritime transport and improved domestic infrastructure.

14. The PEDS presents the government's vision for Cabo Verde's sustainable development. As such, it will underpin policies and reform implementation for the medium-term. Its main objectives are: (1) transforming the country into a hub for the delivery of air and maritime transportation services; (2) ensuring social inclusion and reducing poverty and regional and social asymmetries; and (3) strengthening sovereignty, valuing democracy and focusing diplomacy on the country's development challenges. External dependence, unemployment, poverty, and inequality; as well as natural vulnerabilities, lack of mineral resources, small dimension, geographic dispersion, and reduced population are key structural vulnerabilities for Cabo Verde.

C. Fiscal Policy and Reforms

15. Further improvement in the fiscal position is expected in 2019. Total revenue is expected to reach CVE 62.7 billion (31.7 percent of GDP), up from CVE 52 billion in 2018 (28.1 percent of GDP). The increase reflects the impact of the expected continued strong economic growth, further efforts to collect tax arrears, administrative efficiency gains through greater reinforcement of inspection, increased technological, human and material resources, the setting up of a tax return alert system to taxpayers; and revenue from: airport security fee; maritime security fee; innovation Fund fee; registration and notary services fees; special consumption excise tax; increase in the corporate income tax rate for off-shore banks from 2.5 percent to 10 percent; and sale of nonfinancial assets. The improvement in tax revenue is expected to come from the good performance of income taxes and from VAT. On the expenditure side, wages and salaries are projected to increase by 17.6 percent compared with 2018, reflecting the continued implementation of the re-grading and career adjustment program for teachers and nurses. Non-interest current expenditures are budgeted to increase by 15.3 percent, while capital outlays increased, partly reflecting the low execution rate in 2018, compared with 2017. Taking into account potential risks to revenue mobilization, the budget identified expenditure contingency measures for both current and capital expenditure totaling some CVE 3.6 billion. Based on the above, the primary balance will move from a deficit of CVE 0.48 billion in 2018 to a surplus of CVE 1.3 billion in 2019. With the budgeted transfers to SOEs and municipalities amounting to CVE 8.5 billion for onlending and capitalization, financing needs are projected at CVE 12.8 billion, equivalent to 6.5 percent of GDP; of which 5 ½ percent would be financed externally. Measures will be taken to enhance the monitoring of budget execution; and if the midyear outturn points to a shortfall in budgetary resources, expenditures commitments will be curtailed in line with Cabo Verde legislation, to safeguard the achievement of fiscal objectives, by reducing by 20 percent expenditure on non-financial assets.

16. For 2020 and beyond, fiscal consolidation efforts will aim to preserve gains made in recent years, and to bring the debt-to-GDP ratio below 100 percent in the medium-term. The primary balance is projected to improve from a deficit of 0.3 percent of GDP in 2018 to a surplus of 1.2 percent of GDP in 2024. Financing needs would decline from 3.8 percent of GDP in 2018 to 1 percent of GDP in 2024, thus reducing the stock of nominal public debt from 123.9 percent of GDP in 2018 to 92.7 percent of GDP in 2024. To reach this objective, measures will be taken to enhance the budget's financing capacity and improve expenditure management.

D. Revenue Mobilization

17. On the revenue side, **reform measures will aim to broaden the tax base and enhance efficiency gains in tax administration**. Hence, steps will be taken to streamline exemptions on the value-added tax, on import duties and on excises by end-June 2020 to broaden the tax base and improve revenue mobilization, building on recommendations from the technical assistance provided by the IMF Fiscal Affairs Department (**Reform Target**). In this context, a review report of exemptions will be completed by end-December 2019 (**Reform Target**) with the aim of identifying their potential revenue impact and defining streamlining actions. Measures will also be taken to strengthen the collection of tax arrears to reduce the current stock and prevent further accumulation. They notably include: automating the administrative processes related to the collection, tax credit management and enforced collection. For this purpose, steps will be taken to allow the consolidation of the integrated system for fiscal management (SISEF) and its broadening to include other categories of tax; and the entry onstream of the automated supervision of contributors' account. The goal of these measures will be to act efficiently in sectors and segments that tend to be beyond the control and remit of the Treasury, which will therefore help broaden the base and scope for tax collection. The following specific measures will also be taken in 2020-21:

- Clarify fiscal rules, review and simplify the reporting templates for accounting and tax-related report forms.
- Promotion of early review of accounts, and timely refunding of VAT credit.
- Roll out the Tax Arbitration Center as an alternative option for resolving disputes between the tax administration and the taxpayer, which will result in faster turnaround processing of cases.
- Expand the network of the Double Taxation Convention.
- Strengthen environmental and health-related taxation.
- Reform and computerization of customs services and taxes and duties, with the introduction of electronic billing and the restructuring and upgrade of the revenue administration.

E. Expenditures Management and Reforms

18. On the expenditure side, priority will be given to increasing efficiency in capital expenditure management and restraining nonpriority current spending. Consequently, for the period 2020-24, expenditure on goods and services will be reduced to about 4.5 percent of GDP compared with 2019; capital expenditure will be kept at about 4 percent of GDP on average; and the wage bill will be contained at about 10.5 percent of GDP. Expenditure appropriations in the budget will continue to take into account risks related to resources mobilization, and therefore, identify contingent expenditure.

19. Increasing efficiency in public investment management requires the adoption of systems that would help improve the allocation of public resources and enhance the quality of public investment projects. This would be based on; (i) standardized criteria for the evaluation, and the use of procedure manuals for key sectors to benchmark capital projects and guide the ex-ante selection of projects and programming of public investment expenditures; (ii) incorporation of Information Technology (IT) tools to monitor and evaluate investments throughout the project cycle. Progress will be achieved through the effective and permanent implementation of the National Investment System (SNI), aimed at improving the quality of public investment.

20. To restrain expenditure, the authorities will develop an IT system that will facilitate the monitoring and control of public expenditure at the time of execution, or even at the tendering stage. Furthermore, steps will be taken to re-evaluate the autonomous agencies of the government with a view to proposing mergers, closings, or downsizing. Other expenditure control measures will cover the rationalization of the fleet of government vehicles, the effective limiting of recruitment in the central public administration, and the implementation of the Annual Plan for Purchasing/Contracting and E-Procurement. In addition, after settling outstanding items with the specialized career streams in the civil service (general government), which resulted in the increase in the wage bill during the last two years, the wage bill policy will focus on containment, limiting recruitment and salary adjustments. These measures reflect the need for a structural reduction in expenditure, which, together with the efficient delivery of high-quality services to the public, are key objectives of the government. This requires a civil service administration of high calibre and well prepared. Reforms actions in this area will focus on resizing, reforming, and restructuring of the civil service to put in place a public administration that is competitive and skilled, in line with private sector performance. Other expenditure reform measures will include: (i) the restructuring of the integrated system of budget and financial management (SIGOF), designed to enhance the transparency of public expenditure, by bringing the system in line with new technologies, improving the system's security and interoperability, while optimizing it by enabling greater transparency, quality, and controls; and (ii) the computerization and modernization of services provided by embassies and Consular posts.

21. Support from the budget to SOEs (capitalization) will be kept down thanks to progress in public sector reforms (see below), and the privatization process for public enterprises, currently underway. This support is expected to be eliminated by 2022, as the restructuring process for SOEs is scheduled to the completed by 2021.

22. To enhance expenditure execution further and avoid domestic payment arrears accumulation, the PAYLOG system will be implemented. The new system will help ensure compliance with the new requirement that suppliers are paid within a maximum period of 45 days. This will also improve business confidence.

F. Financing

23. Net domestic financing will be maintained below the annual limit of 3 percent of GDP. Consistent with programmed fiscal objectives, it will decline from 1.4 percent of GDP in 2018 to 0.4 percent of GDP in 2024.

24. Consistent with its debt management strategy, the government will adhere to the zero limit of non-concessional borrowing under the PCI program to cover the budget's financing needs; and will continue to lengthen the maturity of securities. Debt management policy will aim to support medium term debt sustainability, guided by the following objectives:

- Set the annual limit as well as the type of debt to be contracted.
- Identify and analyse debt limits and debt sustainability indicators to guide borrowing policies.
- Minimize the cost of the portfolio as well as of new loans to be contracted.
- Minimize the portfolio risk associated with public debt.
- Establish rules to govern the contracting of new loans.

- Establish institutional coordination mechanisms for the management of public debt.

- Harmonize debt management procedures and mechanisms.

G. Monetary Policy

25. Monetary policy will aim to support price stability and to protect the peg. Current projections indicate that inflationary pressures will be low in 2019, and that international reserves will remain at an adequate level. Under the circumstances, the BCV intends to maintain the current monetary policy stance, while remaining vigilant, and continuing to monitor relevant economic and financial developments domestically and in the Euro area to take any corrective measures as warranted. To protect the credibility of the exchange rate regime, the BCV will target a level of net international reserves that would cover 30 percent of broad money.

26. The BCV will continue to enhance liquidity management and improve the monetary policy transmission mechanism. To this end, it will continue to implement the set of measures introduced in late 2017, including the linking of the Monetary Regularization Securities (TRM) rate to the policy rate by issuing the TRMs through fixed rate tenders instead of variable rate tenders, and improve communication on monetary policy orientation. In June 2019, the BCV reduced the overnight interest rate corridor to a maximum of 150 basis points as committed under the program and well ahead of the originally scheduled date. In addition, the BCV will take the following actions:

- Release the minutes of the Monetary Policy Committee Meetings to help improve the communication on monetary policy direction (**Reform Target**). The minutes will be released at least one month after each meeting, starting at end-July 2019.

- Improve monetary policy analysis through the introduction of new economic indicators, such as composite index of economic activity, and enhance near-term forecasting capacity.

- Establish a symmetric interest rate corridor with overnight rates linked directly to the policy rate.

27. The government will implement measures to strengthen the independence of the central bank. In this direction, a new BCV organic law was drafted with the aim of strengthening the operational independence of the central bank. The government intends to submit the draft law to parliament in December 2019.

28. The BCV attaches great importance to the development and modernization of the payment system, in all aspects, including technological innovation, regulatory, best practices and supervision, given its importance for the economy, financial inclusion and competitiveness. Consequently, in November 2018, three legal regimes were adopted, providing the basis for the functioning of the payment system, aimed at covering electronic currency, and paving the way for new business opportunities. It is expected to enhance efficiency for the market and may reduce the costs of domestic and international payment services. The laws include: (i) legal framework of the Cabo Verdean payment system, which consists of developing rules and principles applied to all components of the payment system, governing the mains aspects of the functioning of the system; (ii) legal framework of the payment system and electronic currency issue, governing the payment, distribution and reimbursement in electronic currency by the legally authorized entities; and (iii) the framework for payment and electronic currency institutions. Additional actions in areas mentioned above will be taken 2019-2020 to ensure that the payment system is fully modernized.

H. Financial Sector Reforms

29. The financial system is sound, although the high level of nonperforming loans (NPLs) remain a source of concern. Financial stability indicators show that the financial system is stable and adequately capitalized, and that banks are profitable. NPLs declined in 2018, standing at 12.8 percent of total loans at end-year, down from 14.5 percent of total loans at end-2017. This notwithstanding, they remain elevated, and efforts to address legacy loans, that account for about 60 percent of NPLs will be intensified.

30. Financial sector reforms will be accelerated in 2019-20. They will aim to deepen financial intermediation, support financial inclusion, and enhance banking supervision. In this context, the BCV will advance the implementation of recommendations from the 2013 and 2015 asset quality review as well as pending recommendations from the 2009 Financial Sector Assessment Program (FSAP). The government and BCV will also take the following actions:

- Revamp the credit information system by end-December 2020 (**Reform Target**). Key measures under this reform will cover the completion of the procurement and the development of the relevant software system.
- Create a functional central registry of mobile collateral by end-December 2020 (**Reform Target**).
- Strengthen bank's lending standards and risk management practices through enhanced supervision.
- Adopt centralized official balance sheets to support risk-based supervision.
- Improve the AML/CFT framework and bring it in line with FATCA standards to limit further loss of correspondent banking relationships.
- Ensure the proper functioning of the Financial Stability Committee. This includes the appointment of the Committee's participants and the establishment of an operating regulation and quarterly meetings.
- Ensure the functioning of the National Commission for Development of the Financial System. For the effective operation of the Commission, the following actions will be taken: the appointment of the Commission's members, the holding of periodic meetings, the definition of operating regulations, the adoption by the Council of Ministers, of the Action Plan for the development of the financial system.

- Implement the main recommendations of the report on access to financing for SMEs, dated February 2015. Priority actions will include: strengthening the public credit information systems, Continued training efforts to increase staffing and capacity of the banking supervision department, strengthening BCV's capacity to carry out effective bank supervision by hiring additional staff with relevant expertise.

- Continue negotiations to secure new correspondent banks.

- Implement the measures specified by the EU, to keep the country off the gray list, in the sense of reducing the risk associated with the country. Key measures will include: becoming a member of the Global Forum and/or to have a satisfactory rating; signing and ratifying the OECD Multilateral Convention on Mutual Administrative Assistance (MAC) or putting in place a network of agreements covering all EU Member States, amending or abolishing the harmful tax regimes, becoming member of the Inclusive Framework or implementing the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) minimum standard.

- Establish a national commission as recommended by the National Plan for Evaluation of AML/CFT Risk.

- Implement the recommendations made in the assessment by the EU in the Global Action on Cybercrime Extended about combatting cybercrimes.

I. Public Enterprises Reforms

31. Cabo Verde's SOEs deliver services in key economic areas. There are 23 SOEs operating in air and maritime transportation, energy and water, real estate, pharmaceutical and management of ports and airports. Although performance varies, some SOEs have been making losses in the last several years, thus accumulating liabilities and requiring continuous financial support from the budget for borrowing, debt service, and capitalization. At end-2018, SOEs' stock of debt stood at CVE 98.7 billion, equivalent to 53.2 percent of GDP, with government guaranteed debt totaling CVE 13.2 billion (7 percent of GDP); and their domestic liabilities amounted to 49 percent of GDP. Over the four year period (2014-17), cumulative support from the budget to SOEs, covering transfers, on-lending, capitalization, and subsidies amounted to CVE 108.2 billion, equivalent to 62.4 percent of GDP. Over half of this amount is related to the loan contracted by the government, and on-lent to the real estate company (IFH), to finance social the housing program (see below).

32. In recent years, the government implemented reform measures in the public enterprises sector. For three SOEs facing financial difficulties, the following actions were put in place:

- *The airline company*, *Transportes Aéreos de Cabo Verde* (TACV), in August 2017, all domestic routes were transferred to a new airline company, Binter Cabo Verde, with 30 percent State's participation. For international routes, a one-year management contract was signed with Icelandair (October 2017) to operate and prepare TACV for privatization. The company was privatized in March 2019 with the sale of 51 percent of TACV capital to a subsidiary of Icelandair, and the creation of a new company: Cabo Verde Airline (CVA).

- *The housing company*, *Imobiliária, Fundiária e Habitat, S.A* (IFH). In 2011, the government contracted an external loan to build social housing units to be sold below market prices and/or rented. The management of this program *Casa Para Todos* ("Housing for All") was carried out by IFH. Given the program's underperformance, it was restructured in 2017 into three groups: class A units (low income) were transferred to municipal governments and the central government; class B and C units (middle to high income) were to be sold at market price. The program's performance improved in 2018 with units' sales above expectations.

- *The power and water company* (Electra). The company's Board of Directors was given mandate to improve its efficiency levels and prepare it for privatization. A revenue protection program was put in place to reduce high commercial losses. In 2016, the company recorded distribution and transmission losses of 27 percent of GDP, which, although in decline from 29 percent in 2015 was still high. In addition, a restructuring process was initiated to unbundle water and energy operations. In 2017/18 the financial situation of Electra improved, eliminating the risk to the government budget.

33. The government remains committed to reducing the size of the public enterprise sector. The reform agenda for 2019-20 focuses on the measures below, aimed at eliminating financial support from the budget to loss-making SOEs.

- The completion of the concession for maritime transportation to the private sector, with 51 percent stake in the capital held by a foreign investor, and with 49 percent held by domestic investors.

- The sale of the remaining 49 percent of the State's stake in CVA, mostly through the Stock Exchange.

- Further privatization of enterprises in the pharmaceutical sector (Inpharma and Emprofac) and power and water (Electra).

- Establishment of concession arrangements for companies operating in the ports sector (Enapor) and airports sector (ASA and CV Handling), with separate treatment of the management of the air space (*FIR Oceânica*), which will continue under state control.

- Further restructuring of the housing program managed by IFH.

J. Other Structural Reforms

34. The government intends to accelerate other reforms aimed at improving the business environment to support growth. Consistent with the PEDS, priority will be given to measures that help to continue attracting FDI and to reduce transaction costs. Therefore, actions will be taken to increase efficiency in public administration, notably by decentralizing the decision-making process and cutting red tape, to improve telecommunications, transport, to reform the health sector and to adapt the education system to labor market needs. Cabo Verde is facing important challenges, including the need to create jobs and income for the population, which will only be feasible through higher and inclusive economic growth. Making the economy grow in a robust and sustained way and creating quality jobs call for efforts to reinvigorate the private sector and attract FDI. Improvement in the business climate and economic freedom of the country, including focus on an efficient and business-friendly government, as well as ready access to credit by the private sector, stand out as prerequisites for meeting these objectives.

35. Domestic economic performance should be viewed from the perspective of showcasing Cabo Verde's strategic location. In promoting private sector dynamism and growth, the main challenges facing the country should be taken into account, namely, (i) the need for Cabo Verde to take its place within the global economy to strengthen its own economy; and (ii) the need to overcome regional asymmetries and foster sustainable growth. Cabo Verde's geo-economic location requires efforts to build a country that can be counted on, with minimal transaction costs, so that it can become more attractive to investors. To improve the business climate, measures will be put in place to:

- Facilitate access to finance, notably through a sharing of risks with the private sector.
- Expedite procedures for setting up businesses, particularly with respect to digital entry and indexing in the Commercial Register.
- Improve the process for getting construction licenses and electricity and water to reduce the numbers of procedures and lower the associated costs.
- Protect minority investors, based on a new Code of Commercial Companies and regulations needed to expedite the Competitiveness Agenda.
- Improve the payment of taxes by rolling out the One-Stop Facility for Payment (online payment of taxes).
- Expedite procedures for resolution of insolvency, through more effective practices.
- Operationalize the Service Center Platform.
- Upgrade the "Portal Di Nos Ilha" Platform and the "Participa" Platform.
- Implement the One-Stop Shop in all municipalities.
- Institutionalize the One-stop shop for government services.
- Improve and modernize the quality of public services.

K. Digital Governance and Dematerialization

36. The government will focus on implementing an electronic procurement system to enhance the transparency and reliability of the Domestic Public Contracting System. The new system will be equipped with legal and operating instruments and will benefit from investment in personnel training. In addition, the government will rely on the enhanced availability of information in public procurement. The expected improvement will reflect efforts by the regulatory body (the Regulatory Authority for Public Procurement) and will benefit participants in the system at all levels – the planning of purchases, the conduct of procedures organized by the entities awarding contracts, and the evaluation of tenders submitted by businesses. The key objectives are to ensure the proper management of public resources, ethical behavior as well as sound market competition, to prevent and combat corruption. The Public e-Procurement System is a technological tool that will enable the government to execute procurement operations electronically, with an immediate and significant reduction in costs while reinvigorating the local and national economy. The implementation of the new system will set a more rational and transparent approach to the management of government finances, integrating public procurement needs of centralized and decentralized services, and therefore allowing a higher degree of planning and control of budget execution.

L. Program Monitoring

37. Program targets. Progress in the implementation of policies and reforms under the program will be monitored through quantitative targets and standard continuous targets (Table 1), as well as reform targets (Table 2). The latter are defined in the Technical Memorandum of Understanding attached to this Program Statement. Other structural reform measures planned by the government for 2019-21 are detailed in Box 1. The first review is scheduled to be completed by March 1, 2020; the second review by September 2, 2020; and the third and final review by January 15, 2021.

Table 1. Cabo Verde: Quantitative Targets Under the PCI[1] (2019–20)

	2019 end-June	2019 end-September	2019 end-December	2020 end-March	2020 end-June	2020 end-September	2020 end-December
	Proj.	Quantitative targets	Proj.	Quantitative targets	Proj.	Quantitative targets	Proj.
	Cumulative Flows from end-Dec, 2018						
Quantitative targets	(Millions of Cabo Verde escudos)						
Primary balance[2]	456	841	1,315	644	419	1,388	2,093
Tax revenue, floor	19,965	31,362	43,126	10,471	21,961	33,648	46,298
Net other liabilities, ceiling [3]	3,575	6,345	8,511	872	2,344	3,611	4,674
Nonaccumulation of domestic arrears[4]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-accumulation of external payment arrears[4]	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nominal level of new concessional external debt of central government, ceiling	3,784	9,563	15,135	1,122	4,210	8,330	12,280
	(Millions of U.S. dollars)						
Nominal level of new nonconcessional external debt of central government, ceiling	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(Millions of euros)						
Net international reserves, floor[2]	526	528	597	572	542	566	646
Non-quantitative continuous targets							
Non-imposition or intensification of restrictions on the making of payments and transfers for current international transactions							
Non-introduction or modification of multiple currency practices							
Not concluding bilateral payments agreement which are inconsistent with Article VIII							
Non-imposition or intensification of import restrictions for balance of payments reasons							
Memorandum items:	(Millions of Cabo Verde escudos)						
Social spending	5,550	8,685	14,423	3,252	6,534	11,543	15,391
Net onlending	1,877	3,647	4,864	672	1,832	2,638	3,444
Capitalization	1,698	2,698	3,667	200	512	973	1,229
Program assumptions							
Project and budget support grants	1,326	2,401	5,479	444	985	1,783	4,070
External debt service	3,765	5,648	6,459	1,857	3,714	5,571	7,428
Sales of assets	2	2	996	0	0	0	952
Project and budget support loans	2,591	7,231	12,143	451	2,883	6,553	10,128

[1] Foreign currency amounts will be converted at current exchange rates.

[2] The ceiling or floor will be adjusted as specified in the TMU.

[3] Net other liabilites includes net onlending, capitalization, and other assets.

[4] Continuous.

Table 2. Cabo Verde: Reform Targets for 2019–20 Under the PCI		
Actions	**Target Date**	**Objective**
Fiscal reforms		
• Complete a review report on exemptions identifying their potential impact and streamlining actions.	End-December 2019.	• Improve tax collection.
• Streamline exemptions for: (i) the VAT; (ii) import duties, and (iii) excises.	End-June 2020.	• Improve tax collection.
• Submit to Parliament the budget for 2020 that is in line with commitments under the PCI.	End-October 2019.	• Support fiscal and debt sustainability.
SOEs reforms		
• Implement quarterly monitoring of actual performance of 6 key SOEs against their approved budgets, starting at end-December 2019.	Continuous.	• Improve fiscal reporting and reduce fiscal risk.
• Compile financial information on cash flow performance of the 6 largest SOEs for FY2019.	End-July 2019.	• Improve fiscal reporting and reduce fiscal risk.
Monetary reforms		
• Release the minutes of the Monetary Policy Committee meetings at least one month after each meeting, starting at end-July 2019.	Continuous.	• Improve the communication of monetary policy.
• Reduce the excessively wide overnight interest rate corridor to a maximum of 150-200 basis points.	End-December 2019; implemented in June 2019.	• Improve monetary policy transmission mechanism.
Financial sector reforms		
• Create a functional central registry of mobile collateral.	End- December 2020.	• Improve access to finance.
• Revamp the credit information system by developing the relevant software system.	End-December 2020.	• Improve access to finance.

Attachment I. Technical Memorandum of Understanding

1. **This memorandum sets out the understandings between the Cabo Verdean authorities and the IMF** staff regarding the definitions of variables included in the quantitative targets and continuous targets set out in the Program Statements (PS), the key assumptions, and the reporting requirement of the Government and the Central Bank of Cabo Verde for the 18 months Policy Coordination Instrument (PCI).

QUANTITATIVE AND CONTINUOUS TARGETS

A. Floor on the Primary Balance of the Central Government

2. **The central government includes all units of budgetary central government**. It does not include local government (municipalities), extra-budgetary units, social security funds and public corporations.

3. **The central government primary balance is defined as total tax and non-tax revenues and grants minus primary expenditure** and covers non-interest government activities as specified in the budget. The central government primary balance will be measured as cumulative flow over the calendar year.

- Revenues are recorded when the funds are transferred to a government revenue account. Tax revenues are recorded as net of tax refunds.

- Central government primary expenditure is recorded on a cash basis covers recurrent expenditures and capital expenditure.

4. **The floor of primary balance will be adjusted upward adjusted upward** (downward) by the surplus (shortfall) in disbursements of grants relative to the baseline projection.

5. **For program monitoring, data will be provided to the Fund by the Directorate National of Planning (DNP) of Ministry of Finance** monthly with a lag of no more than four weeks from the end of-period.

B. Cumulative Floor on Central Government Tax Revenue

6. **Tax revenues refer to revenues from tax collection. It excludes all revenues from asset sales,** grants, and non-tax revenues. To gauge the impact of tax policy reforms and improvements in tax administration, the program will have a floor on central government tax revenues. The revenue target is calculated as the cumulative flow from the beginning of the calendar year.

7. **For program monitoring, data will be provided to the Fund by the DNP** monthly with a lag of no more than four weeks from the end of-period.

C. Ceiling on Net Other Liabilities

8. **Net Other Liabilities is defined as the sum of central government deposits, loans to state-owned enterprises (SOEs) and municipalities (onlending), capitalization, and other assets.** The ceiling of central government net other liabilities will be measured as cumulative over the calendar year. Deposits are all claims, represented by evidence of deposit, on the deposit-taking corporations (including the central bank). Onlending is defined as domestic and external loans contracted by the central government from another institution and then onlending the proceeds to SOEs. Net onlending is defined as disbursement of these loans minus repayment of previous loans by SOEs to the central government. Capitalization is defined as capital injection or equity participation made by the central government into corporations when some financial support is provided to capitalize or recapitalize these corporations. Other assets comprise of other accounts receivable/payable such as of trade credit and advances and miscellaneous other items due to be paid or received.

9. **For program monitoring, data will be provided to the Fund by the DNP of Ministry of Finance** monthly with a lag of no more than four weeks from the end of-period.

D. Non-accumulation of Domestic Payments Arrears

10. **As part of the program, the government will not accumulate any new domestic payments arrears.** This will be monitored through the monthly execution of the cash-flow plan and the corresponding release of budget appropriations. For programming purposes, a domestic payment obligation to suppliers is deemed to be in arrears if it has not been paid within the normal grace period of 60 days (30 days for government salaries and debt service) or such other period either specified by the budget law or contractually agreed with the supplier after the verified delivery of the concerned goods and services, unless the amount or the timing of the payment is subject to good faith negotiations between the government and the creditor.

11. **Reporting requirements.** The DNP of Ministry of Finance will submit on a quarterly basis a detailed table of the stock of domestic payments arrears, including the accumulation, payment, rescheduling and write-off of domestic payments arrears during the quarter. The data are to be provided within six weeks after the end of the quarter.

E. Ceiling on Nominal Level of New Concessional External Debt of the Central Government

12. **External public debt (long-term, medium-term, and short-term) is defined as debt to nonresidents contracted or guaranteed by the central government.** The external public debt comprises the external debt of the central government and the external debt of the official sector entities and SOEs guaranteed by the central government.

13. The definition of debt is set out in Point 8(a) of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 15688-(14/107), adopted December 5, 2014.

(a) The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows;

(i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

(ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

(iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

(b) Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

14. Under the program, ceilings on medium and long-term, as well as on short-term, concessional external debt constitute quantitative targets. The coverage of the ceiling on concessional external debt includes budget loans, projects and program loans, and on-lending loans to SOEs in line with the fiscal program. For program purpose, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.[1] For debts with a grant element equal or below zero, the PV will be set equal to the nominal value of the debt. The discount rate used for this purpose is the unified discount rate of 5 percent set forth in Executive Board Decision No. 15248-(13/97). Debt rescheduling, and debt reorganization are excluded from the limits on concessional external debt. New concessional external debt excludes normal short-term (less than one year) import-related financing.

15. Reporting requirements. The government of Cabo Verde will consult with Fund staff before assuming any liabilities in circumstances where they are uncertain whether the instrument in question falls under the quantitative target. Details of all new external debt (including government guarantees), indicating terms of debt and creditors, will be provided on a quarterly basis within six weeks of the end of each quarter.

F. Non-Concessional External Debt Contracted or Guaranteed by the Central Government

16. Under the program, ceilings on medium- and long-term, as well as on short-term, non-concessional external debt constitute quantitative target. The zero ceiling on non-concessional external debt is on a continuous basis. For program purpose, a debt is non-concessional if it includes a grant element of less than 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.[1] For debts with a grant element equal or below zero, the PV will be set equal to the nominal value of the debt. The discount rate used for this purpose is the unified discount rate of 5 percent set forth in Executive Board Decision No. 15248-(13/97). Debt rescheduling, and debt reorganization are excluded from the limits on non-concessional external debt. The quantitative target on new non-concessional external debt contracted or guaranteed by the central government, excluding borrowing from the Fund. Non-concessional external debt excludes normal short-term (less than one year) import-related financing. The Portuguese government's precautionary credit line (the "Portuguese credit line") in support of the exchange rate peg is also excluded from the definition of non-concessional external debt.

17. Reporting requirements. The government of Cabo Verde will consult with Fund staff before assuming any liabilities in circumstances where they are uncertain whether the instrument in question falls under the quantitative targets. Details of all new external debt (including government guarantees), indicating terms of debt and creditors, will be provided on a quarterly basis within six weeks of the end of each quarter.

[1] The calculation of concessionality take into account all aspects of the debt agreement, including maturity, grace period, payment schedule, upfront commissions, and management fees.

G. Net International Reserves of the Central Bank

18. The floor on the stock of net international reserves (NIR) of the BCV constitutes a quantitative target under the program. The NIR of the BCV are defined as gross international reserves of the BCV net of its short-term external reserve liabilities, calculated at the current exchange rates. Gross reserves of the BCV are those that are readily available (i.e., liquid and marketable and free of any pledges or encumbrances), controlled by the BCV and held for the purposes of meeting balance of payments needs and intervening in foreign exchange markets. They include gold, holdings of SDRs, the reserve position at the IMF, holdings of foreign exchange and traveler's checks, demand and short-term deposits at foreign banks abroad, fixed-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade securities. Short term external liabilities of the BCV comprise liabilities to nonresidents contracted by the BCV with an original maturity of less than a year, any net off-balance-sheet position of the BCV (futures, forwards, swaps, or options) with either residents and nonresidents, any arrears on principal and interest to external creditors and suppliers, and purchases from the IMF. The program floors for the NIR will be adjusted downward by:

- the cumulative upward deviations in external debt service relative to program assumptions.
- the cumulative downward deviations in external financial assistance, and project and budget loans relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.

19. Reporting requirements. A table on the NIR prepared by the BCV will be transmitted on weekly basis, with a maximum delay of two weeks.

H. Non-accumulation of External Payments Arrears

20. As part of the program, the government will not accumulate any new external payments arrears. This will be a continuous target under the program. This will be monitored through the monthly execution of the cash-flow plan and the corresponding release of budget appropriations.

21. External payments arrears for program monitoring purposes are defined as the amount of external debt service due and not paid within the contractually agreed period, subject to any applicable grace period, including contractual and late interests. Arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is sought are excluded from this definition.

22. Reporting requirements. Data on (i) debt-service payments; and (ii) external arrears accumulation and payments will be transmitted on a quarterly basis by the DNP of Ministry of Finance, within six weeks of the end of each quarter. In addition, the government will inform the Fund staff immediately of any accumulation of external arrears.

I. Memorandum Item: Floor on Central Government Social Spending

23. The indicative floor on social spending of the central government will apply only to expenditures incurred by the central government on the following plans and programs that are intended to have a positive impact on education, health, and social protection, excluding the wages and salaries component.

24. For program monitoring, the data will be measured as cumulative over the fiscal year and it will be reported by the DNP on a quarterly basis, with a lag of no more than six weeks from the end-of-period.

OTHER DATA REQUIREMENTS

25. Data on exports and imports, including volume and prices and compiled by the Director of Customs and the BCV, will be transmitted on a quarterly basis within five weeks after the end of each quarter. A preliminary quarterly balance of payments, compiled by the BCV, will be forwarded within six weeks after the end of each quarter.

26. The Statement of Other Economic Flows as defined in the IMF Manual GFSM2001 or GFSM2014 relative to holding gains/losses of the previous year with ASA, CVA, Electra, EMPROFAC, ENAPOR, and IFH will be transmitted on an annual basis within three months after the end of the following year (15 months after the closing date).

27. The consolidated balance sheet of ASA, CVA, Electra, EMPROFAC, ENAPOR, and IFH relative to the previous year will be transmitted on an annual basis within three months after the end of the following year (15 months after the closing date).

INTERNATIONAL MONETARY FUND

CABO VERDE

July 2, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND PCI REQUEST—INFORMATIONAL ANNEX

Prepared By

African Department
(In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

As of May 31, 2019

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	20.16	85.06
Reserve tranche position	3.54	14.94

SDR Department	SDR (million)	Percent of Quota
Net cumulative allocation	9.17	100.00
Holdings	0.09	0.94

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				
	2019	2020	2021	2022	2023
Principal					
Charges/interest	0.05	0.10	0.10	0.10	0.10
Total	0.05	0.10	0.10	0.10	0.10

[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

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 multiple currency practices as well as restrictions on the making of payments and transfers for current international transactions.

Previous Article IV Consultation

The Executive Board concluded the 2018 Article IV consultation on March 28, 2018 (Country Report No. 18/104).

Technical Assistance

Since 1985, Cabo Verde has received substantial technical assistance. Technical assistance activities since 2016 are listed below:

Department	Dates	Purpose
FAD		
	January 2016	AW2: Review the risk management action plan and opening of the management training for the DNRE
	February 2016	Tax policy administration
	February, March 2016	Tax policy administration
	February, March 2016	AW2: A customs post clearance audit manual for the DNRE
	April 2016	AW2: Follow up assistance in implementing the risk management action plan for the DNR
	April 2016	Delivery RA-GAP
	April 2016	AW2: Develop a communication strategy for the DNRE
	June 2016	Module 4 - Institutionalize strategic planning
	July, August 2016	Tax administration
	July, August 2016	Module 6 - VAT enforcement
	October 2016	Module 8 - Institutionalize strategic management
	October 2016	Module 4 - Institutionalize strategic planning
	October 2016	AW: Scoping mission
	December 2016	Module 6 -VAT enforcement
	December 2016	AW2: Customs reform program & project management framework
	January, February 2017	Module 8 - Institutionalize strategic management
	February 2017	Tax administration
	February 2017	AW2: Training on post clearance audit
	February 2017	AW2: Training on valuation of petroleum products

Department	Dates	Purpose
	February 2017	AW2: Post clearance audit
	February 2017	AW2: Strengthening the strategic planning and budget preparation functions [WFH]
	March 2017	Module 8 - IT system
	March 2017	Analysis of the MTFF and the annual budget
	March 2017	AW2: Budget credibility
	March 2017	AW2: Review ASYCUDA and deliver integrity workshop
	March 2017	Module 8 - HR and management development
	April, May 2017	Module 6 - VAT enforcement
	May, June 2017	AW2: Data matching project exchange program
	May, June 2017	AW2: Development of integrity strategy & risk management
	June 2017	Desk review of organic budget law
	July 2017	AW2: Treasury single account and cash management
	July 2017	AW2: Developing the Medium-Term Fiscal Framework (MTFF)
	September 2017	Strengthening arrears management
	September, October 2017	AW2: Oversight of State-Owned Enterprises
	October 2017	AW2: Audit training
	October, November 2017	Strengthening tax payer audit
	October, November 2017	RMTF Follow-up on tax administration
	November, December 2017	AW2: Control of exemptions from custom duties and taxes
	November, December 2017	Enhancing tax compliance
	December 2017	AW2: Establishment of valuation team to collect & analyze price data
	January, February 2018	Developing taxpayer service and communication strategy
	January, February 2018	Development of internal governance framework – customs division
	February, March 2018	AW2: ASYCUDA training, PCA mentoring & implementation of SOPs for exemptions & waiver
	March 2018	Strengthening reporting: electronic invoices
	April 2018	Audit and other verification programs
	April 2018	Strengthening debt monitoring and management
	May, June 2018	Strengthen core tax admin. procedures & processes
	June 2018	AW2: Development and implementation of DNRE integrity strategy
	July 2018	Reform strategy, core and support functions

Department	Dates	Purpose
	July, August 2018	Strengthen support functions
	November 2018	Strengthen core tax admin. procedures & processes
	November 2018	MTFF
	November 2018	AW2: Mentoring support on risk management, intelligence and investigation
	January, February 2019	General assessment of the tax system
	February 2019	AW2: Audit training
	March 2019	Strengthen core tax admin. procedures & processes
	March, April 2019	AW2: Completion of business process mapping and development of customs SOPs
	March, April 2019	Revenue administration governance arrangements
	April 2019	AW2: Audit training follow up
	April, May 2019	TADAT pre-assessment
	May 2019	TADAT assessment of tax system
MCM		
	April 2016	AW2: Scoping and follow-up mission
	January 2017	AW2: Improving monetary analysis and review of monetary operations
	January, February 2017	AW2: Forward looking monetary analysis and the review of the monetary operations
	January, February 2018	Medium-Term Debt Strategy (MTDS)
	March 2018	MTDS Follow up- debt recording, institutional and market development issues
	April 2018	FOREX reserves management
STA		
	October 2016	AW2: National accounts
	October, November 2016	AW2: Quarterly national accounts
	April 2017	AW2: Consumer Prices/Producer Price
	April, May 2017	AW2: National accounts
	November 2017	AW2: National accounts
	April 2018	Balance of payments statistics
	April 2018	AW2: National accounts
	April, May 2018	Governance finance statistics
	July 2018	AW2: Consumer Price index

Department	Dates	Purpose
	November 2018	AW2: National accounts
	February 2019	AW2: Consumer Price Index
	March 2019	AW2: National accounts
LEG		
	September 2017	Payments system, payments services, and electronic money

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 2019 IMF Article IV mission. This facilitated the discussions and provided valuable input, particularly in the areas of mutual interest such as debt management, 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, education, social protection, transport and management of state-owned enterprises. The Bank's 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 in 2018 completed the A Systematic Country Diagnostic for Cabo Verde which is being used to inform the new strategy due in 2019. A public expenditure review focused on debt management, and issues of efficiency in the education and health sectors was also completed in 2019. The two teams have also engaged very closely on discussions on public financial management and debt sustainability.

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

The teams agreed to continue the close cooperation going forward. The table below describes specific activities planned by the two country teams over the fiscal years 2019/2020. The Fund will continue to lead on macroeconomic analysis, and the Bank will continue to lead on SOE reforms and investment planning. The two teams will continue to closely cooperate in preparing a joint DSA.

Table 1. Cabo Verde: Joint World Bank and IMF Work Program (as of April 30, 2019)			
Title	Products	Timing of Mission	Expected Delivery Date
A. Mutual information on relevant work programs			
Bank work program in the next 12 months	1. Public Expenditure Review dissemination. 2. Fiscal Risk Management Operation. 3. Fiscal risk follow-up operation.	June 2019 January 2019 July 2019	Spring 2019 Spring/Summer 2019 Spring/Summer 2020
IMF work program in the next 12 months	1. Staff Visit. 2. First review mission. 3. Second review mission.	September 2019 January 2020 June 2020	
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 2019/20
Bank request to Fund	Macroeconomic framework updates.		FY 2019/20

STATISTICAL ISSUES

(As of May 31, 2019)

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.
National Accounts: Significant improvements have been made to the national accounts—with technical assistance from IMF STA and AFRITAC West 2—including the timely release of quarterly and yearly GDP data. The most recent annual GDP data released are for 2018 (released in March 2019). In the past few years, INE has worked on a complete overhaul of the national accounts. More specifically, INE has implemented the estimation of GDP at chained prices—as recommended by the 1993 System of National Accounts (1993 SNA)—as well as changing the base year from 1980 to 2007. The annual national accounts based on the new methodology were presented for the first time in July 2013, for 2011 and the backward projections of the old series of 2002–10. The quarterly national accounts by the production approach were published for the first time in April 2015. Future technical assistance missions will work on a GDP rebasing 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 has an ambitious target to continue building its statistics series—ranging from business, household, and labor force surveys to governance and security surveys and satellite accounts. In addition, INE assesses in detail and corrects individual source data entries on a regular basis—something not generally undertaken in most countries by national account compilers. 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, particularly 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 currently received, from the National Statistics Institute of Portugal and AFRITAC West 2 missions to support the rebasing, reweighting and dissemination of a revised CPI. A revised CPI index with new weights and an updated commodity basket was published in February 2019. 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. 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 particularly to include SOEs and municipalities. 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. An STA mission undertaken in March 2007 helped the Banco de
Cabo Verde (BCV) to finalize the standardized report forms (SRFs) for reporting monetary statistics to STA. SRF-based monetary data for the central bank and other depository corporations have been published in *International Financial Statistics* since June 2007 on a regular monthly basis. These data are fully aligned with the recommendations of the *Monetary and Financial Statistics Manual and Compilation Guide*. The integrated monetary database that meets STA, AFR, and BCV statistical needs is in place. Cabo Verde reports some data and indicators of the Financial Access Survey (FAS), including the two indicators adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).
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 data to STA following the sixth edition of the *Balance of Payments and International Investment Position Manual*. The BCV also reports inward Coordinated Direct Investment Survey data starting with 2012 data. Recent enhancements include better use of source data from the financial sector and the use of available stock data from the Ministry of Finance to compile government external debt stocks (replacing previous estimates by accumulation of transactions). However, further improvements are needed in data sources particularly in the new context of total liberalization of capital transactions. Data coverage needs to be strengthened for foreign trade in goods and the nonbank private sector, including for direct investment. Offshore banks data are not covered. Authorities should set a roadmap for including offshore banks in external sector statistics in coordination with other statistical domains and in consultation with the IMF.
II. Data Standards and Quality
Cabo Verde participates in e-GDDS since 2004. However, it has not implemented a National Summary Data Page centralizing the dissemination of key macroeconomic statistics. Its metadata were last updated in 2003.

Table 2. Cabo Verde: Common Indicators Required for Surveillance
(As of May 31, 2019)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange rates	04/30/19	5/25/19	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[2]	04/30/19	5/25/19	D	W	M
Reserve/base money	04/30/19	5/25/19	D	W	M
Broad money	04/30/19	5/25/19	M	W	M
Central bank balance sheet	04/30/19	5/25/19	D	W	M
Consolidated balance sheet of the banking system	04/30/19	5/25/19	M	M	M
Interest rates[3]	04/30/19	5/25/19	M	M	M
Consumer price index	04/30/19	5/25/19	M	M	M
Revenue, expenditure, balance, and composition of financing[4]—central government	12/31/18	3/25/19	M	Q	A
Stocks of central government and central government-guaranteed debt[5]	12/31/18	3/25/19	A	A	A
External current account balance	12/31/18	3/25/19	Q	Q	Q
Exports and imports of goods	12/31/18	3/25/19	Q	Q	Q
GDP/GNP	12/31/18	3/25/19	Q	Q	Q
Gross external debt	12/31/18	3/25/19	Q	A	A
International Investment Position[6]	12/31/18	3/25/19	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

July 2, 2019

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION AND REQUEST FOR A POLICY COORDINATION INSTRUMENT—DEBT SUSTAINABILITY ANALYSIS

Approved By
Annalisa Fedelino (AFR), Maria Gonzalez (SPR), and Marcello Estevão (IDA)

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

Joint Bank-Fund Debt Sustainability Analysis

Cabo Verde Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	*High*
Overall risk of debt distress	*High*
Granularity in the risk rating	*Sustainable*
Application of judgment	*No*

Cabo Verde's risk of external and overall debt distress is rated "high" as in the previous DSA. The present value (PV) of public and publicly-guaranteed (PPG) external debt-to-GDP ratio breaches its threshold in 2019-22 under the baseline and protractedly under stress test scenarios. The PV of total public debt-to-GDP ratio is projected to recede below its threshold from 2026 under the baseline and breaches its prescribed limit under stress test scenarios. The debt sustainability assessment is predicated on sustained fiscal consolidation and successful restructuring of State-Owned Enterprises (SOEs). Prudent borrowing policies and a strengthened debt management strategy are critical to containing debt accumulation. In view of Cabo Verde's vulnerability to exogenous shocks, growth-enhancing structural reforms remain critical to bringing public debt to sustainable levels.

PUBLIC DEBT COVERAGE

1. **The coverage of the public sector is in line with the previous DSA** (Text Table 1). Consistent with fiscal accounts, social security funds and local governments are excluded from the DSA, while the coverage of extra budgetary funds (EBFs) is focused on government support to State-Owned Enterprises (SOEs) through onlending and capitalization. Government guarantee to SOEs' external borrowing is included in the baseline stock of debt, while publicly-guaranteed domestic debt and non-guaranteed debt by SOEs are excluded because of limited information on the repayment schedule. However, efforts to broaden the coverage of public sector debt are ongoing, including under a World Bank project focused on SOEs. External debt is defined on a residency basis.

Text Table 1. Cabo Verde: Coverage of Public-Sector Debt and Design of Contingent Liability Stress Test

	Subsectors of the public sector	Sub-sectors covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	X
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

		Default		Used for the analysis	Reasons for deviations from the default settings
1	The country's coverage of public debt	The central government plus extra budgetary funds, central bank, government-guaranteed debt			
2	Other elements of the general government not captured in 1.	0	percent of GDP	0.4	
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	23.4	To reflect vulnerabilities associated with guaranteed domestic debt and non-guaranteed SOE debt.
4	PPP	35	percent of PPP stock	1.1	
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5.0	
	Total (2+3+4+5) (in percent of GDP)			29.9	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

2. **The contingent liability tailored stress test is calibrated to account for the debt coverage gaps highlighted above** (see Text Table 1). First, the default shock of 0 percent of GDP for other elements of the general government not captured in the baseline stock of debt is raised to 0.4 percent of GDP to account for the size of publicly-guaranteed domestic debt of local governments.[1] The strong financial position of the social security fund (INPS) rules out concerns of fiscal risks and obviates the need to adjust the contingent liability stress test for its exclusion. Second, the default shock of 2 percent of GDP for SOEs' debt is raised to 23.4 percent of GDP to reflect vulnerabilities associated with: (i) publicly-guaranteed domestic borrowing by ELECTRA, TACV, IFH, ENAPOR and CERMI amounting to CVE 11.4 billion (6.1 percent of GDP) at end-2018 and; (ii) non-guaranteed domestic debt of loss-making SOEs totaling CVE 32.1 billion (17.3 percent of GDP) at end-2018.[2] Third, the default shock of 1.1 percent of GDP is kept for public private partnerships (PPPs). Fourth, given that most banks are foreign-owned and well-capitalized, Cabo Verde's financial sector does not exhibit significant vulnerabilities that warrant an upward adjustment of the default minimum value of 5 percent of GDP for the financial market shock.

[1] Government-guaranteed domestic borrowing of municipalities from the banking system stood at CVE 682 million (0.4 percent of GDP) at end-December 2018 (see Text Table 3 for more details).

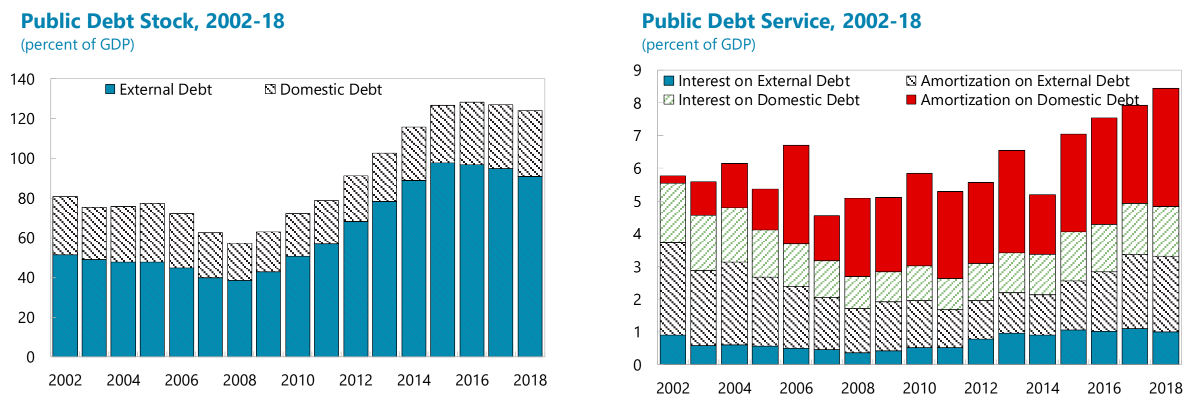
[2] The total stock of non-guaranteed domestic debt stood at CVE 79.2 billion at end-2018, of which CVE 32.1 billion represented borrowing by the following SOEs which recorded negative net income in 2018: ELECTRA, TACV, CVFF, APN, the Cabo Verdean News Agency, CABNAVE, CERMI, SCS, FIC and EHTCV.

BACKGROUND

A. Evolution and Composition of Debt

3. The stock of public debt stood at 123.9 percent of GDP at end-2018 (Text Figure 1). It declined compared with 2017 (127 percent of GDP), reflecting the downward trend in external debt, which accounts for almost 75 percent of the total stock of public debt. Domestic debt rose slightly to 32.9 percent of GDP. Interest and principal payments on domestic debt accounted for 61 percent of total public debt service burden in 2018.

Text Figure 1. Cabo Verde: Profile of Public Debt and Debt Service, 2002-18



Source: Cabo Verdean authorities and IMF staff estimates.

Note: Publicly-guaranteed external debt stock and debt service of SOEs included from 2015.

4. Cabo Verde's public external debt is highly concessional (Text Table 2). Multilateral institutions, notably the World Bank and the African Development Bank are the main creditors; and Portugal is the main bilateral creditor. Average maturity is about 30.5 years, and average interest is below 1 percent.[3] More than two third of the external debt portfolio is euro-denominated, and therefore, exchange risk is low given that the Cabo Verdean escudo (CVE) is pegged to the euro.

Text Table 2. Cabo Verde: External Debt Profile by Type of Creditors, 2018

	Percent of external debt	Average maturity	Average interest rate
Multilateral	46.2	33.0	0.94%
Bilateral	24.2	18.9	1.01%
Commercial	29.6	20.0	1.59%

Source: Cabo Verdean authorities and IMF staff estimates.

[3] Commercial loans mainly consist of debt owed to Caixa Geral de Depósitos (CGD) under favorable terms, with an average maturity of 20 years and an average interest rate of 1.55 percent.

5. Domestic debt consists mostly of medium and long-term Treasury securities. At end-2018, it accounted for 33 percent of total public debt (Text Table 3), comprising mainly Treasury bonds (97 percent); with average maturity and interest rate of about 7 years, and 5 percent respectively. Securities holders are: the banking sector (62 percent), the national social security fund (36 percent) and households (2 percent).

6. Publicly-guaranteed debt stood at CVE 13.8 billion (7.4 percent of GDP) at end-2018 (Text Table 3)**.** The State guarantee is mainly issued for SOEs' domestic debt. For 2018, the stock of publicly-guaranteed external debt covers TACV debt contracted with a consortium of foreign banks, while guaranteed domestic debt consists primarily of liabilities of ELECTRA, ENAPOR, IFH, TACV and CERMI to the domestic banking system and stock exchange; and borrowing by a few municipalities.[4] The issuance and management of State guarantee is regulated by Decree-Law 42 of June 29, 2018 which clarified the entities that could benefit from guarantees and under which conditions. It also cut red tape by empowering the Ministry of Finance and Planning in authorizing up to CVE 50 million of guarantees per project. Additionally, the recently approved public debt law includes an article requiring parliamentary approval for the issuance of loan guarantees.

Text Table 3. Cabo Verde: Publicly-Guaranteed Debt, 2016-18

	2016			2017			2018		
	CVE million	Percent of GDP	Percent of debt	CVE million	Percent of GDP	Percent of debt	CVE million	Percent of GDP	Percent of debt
External Debt (A)	**882**	**0.5**	**100.0**	**2,117**	**1.2**	**100.0**	**1,674**	**0.9**	**100.0**
contracted by SOEs	599	0.4	67.9	1,834	1.1	86.6	1,674	0.9	100.0
contracted by private entities	283	0.2	32.1	283	0.2	13.4	0	0.0	0.0
Domestic Debt (B)	**10,516**	**6.3**	**100.0**	**11,778**	**6.8**	**100.0**	**12,079**	**6.5**	**100.0**
contracted by local governments	381	0.2	3.6	677	0.4	5.7	682	0.4	5.6
contracted by SOEs	10,135	6.1	96.4	11,102	6.4	94.3	11,388	6.1	94.3
contracted by private entities	0	0.0	0.0	0	0.0	0.0	9	0.0	0.1
Total Publicly-Guaranteed Debt (A+B)	**11,398**	**6.9**		**13,895**	**8.0**		**13,753**	**7.4**	

Source: Cabo Verdean authorities and IMF staff calculations.

7. Historical series of private external debt derived from international investment position (IIP) data indicate a relatively low stock of about 10 percent of GDP at end-2018. Private debt includes both bank and non-bank external debt. The central bank (BCV) compiles and publishes non-financial corporations' private debt stock statistics, and a recent external sector statistics (ESS) technical assistance (TA) mission welcomed the significant progress achieved by the BCV in ESS compilation since 2012, including the migration of BOP and IIP statistics to BPM6 and the reporting of quarterly IIP.

B. Outlook and Key Macroeconomic Assumptions

8. The baseline scenario is predicated on a strong medium-term outlook. Medium and long-term real GDP growth is expected to be higher relative to the 2018 Article IV Consultation DSA. GDP

[4] These are Porto Novo, Santa Catarina, Sao Vicente and Paul. The 2018 stock also includes the domestic debt of Santiago island's water company, owned by the island's municipality.

growth reached 5.5 percent in 2018 and is projected to stabilize at 5 percent from 2019 onward (Text Table 4). The momentum in economic activity is expected to be supported by strong performance in the tourism, fishery, and industry sectors. Structural reforms aimed at enhancing the business environment, including through improved inter-island connectivity and strengthened linkages between tourism and non-tourism sectors, as well as the implementation of projects under the authorities' Strategic Plan for Sustainable Development (PEDS) 2017-21, should also support growth going forward. Inflation is expected to remain below 2 percent in the medium term, lower than the level projected under the previous DSA.

Text Table 4. Cabo Verde: Assumptions for Key Economic Indicators, 2017–24

(Percent of GDP)

	2017	2018	2019	2020	2021	2022	2023	2024	2025-29	2030-39
Real GDP growth										
Current DSA	4.0	5.5	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
2018 Article IV DSA	4.0	4.3	4.0	4.0	4.0	4.0	4.0	5.5	4.7	4.5
GDP Deflator										
Current DSA	0.5	1.4	1.5	1.6	1.6	1.8	1.8	1.8	2.0	2.1
2018 Article IV DSA	0.1	1.4	1.6	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Fiscal balance (including grants)										
Current DSA	-3.0	-2.8	-2.2	-1.5	-1.2	-1.0	-0.9	-0.8	0.1	0.0
2018 Article IV DSA	-3.0	-3.2	-5.9	-5.2	-4.6	-4.1	-4.1	-2.9	-2.8	-2.3
Overall financing needs (including onlending)										
Current DSA	-3.3	-3.8	-6.5	-3.7	-2.1	-1.3	-1.1	-1.0	0.1	0.0
2018 Article IV DSA	-4.2	-8.9	-8.6	-6.3	-5.3	-4.7	-4.7	-2.9	-2.8	-2.3
Current account balance (including grants)										
Current DSA	-6.6	-4.5	-4.2	-4.1	-4.1	-3.9	-3.6	-3.6	-2.8	-2.0
2018 Article IV DSA	-8.8	-9.5	-10.0	-10.0	-9.9	-9.9	-9.9	-4.3	-3.6	-6.3
Cv$/USD exchange rate (e-o-y)										
Current DSA	93.2	96.9	95.9	95.2	94.5	94.1	93.6	93.0	93.0	93.0
2018 Article IV DSA	91.9	90.7	90.3	90.3	90.4	90.6	90.8	90.8	90.8	90.8

Sources: Cabo Verdean authorities; and IMF staff estimates and projections.
Note: Averages for 2018 Article IV DSA are from 2030-37. Overall financing needs refer to the overall balance adjusted for below-the-line net liabilities capturing government support to SOEs through onlending and capitalization.

9. **The current framework assumes a more ambitious and steadfast fiscal consolidation path** (Text Table 4), with the fiscal deficit projected to fall from 2.8 percent of GDP in 2018 to 0.8 percent of GDP in 2024, before turning into a surplus in the long term. Fiscal efforts are assumed to be underpinned by strengthened domestic revenue mobilization and expenditure restraint. The projected improvement in the primary balance, combined with a steady reduction in government financial support to SOEs would bring total financing needs down to 1 percent of GDP by 2024 (3.8 percent of GDP in 2018). Compared with the previous DSA, the external current account deficit is projected to be lower and to further narrow in the medium term owing to robust export performance and increased remittances. Together with higher FDI inflows, it should contribute to a gradual accumulation of reserves.

10. **The DSA assumes that financing needs would be covered by identified external sources and by domestic borrowing up to the authorities' annual ceiling of 3 percent of GDP**. Multilateral sources comprise budget support from the World Bank and the African Development amounting to US$240 million during 2019-24. While projecting continued foreign support in the short and medium term, the DSA assumes in the long term a gradual shift of external financing from concessional loans toward less concessional financing, and toward commercial borrowing from 2025 onward, consistent with Cabo Verde's middle-income status. In line with the profile of domestic debt portfolio at end-2018, bonds with maturities of at least 4 years are assumed to account for 97 percent of the stock in the medium term. The

average interest rate is set to 1 percent for T-bills, and 4 and 5 percent for short-term and medium to longer-term bonds respectively.

11. Tools for assessing the realism of the baseline scenario do not flag significant and systematic deviations from historical experience.

- **Drivers of debt dynamics** (Figure 3). The contributions of past and projected debt-creating flows for PPG external debt remain broadly unchanged, although prices and exchange rates are expected to negatively contribute to PPG external debt accumulation relative to historical experience. For total public debt, the projected contribution of real GDP growth to public debt reduction is higher than what the past five years would suggest, owing to an upward revision of medium- and long-run growth. Although significant support to loss-making public enterprises in recent years is expected to increase public debt more than in the past as captured by "other debt creating flows",[5] continued fiscal consolidation efforts and restructuring of SOEs should significantly limit the contribution of the primary deficit to public debt accumulation relative to what the past five years would suggest. Unexpected changes in prices and exchange rates were the main drivers of past forecast errors of debt dynamics.

- **Realism of planned fiscal adjustment** (Figure 4). The projected three-year fiscal adjustment in the primary balance stands at 1.5 percentage points of GDP between 2018 and 2021 and lies beneath the top quartile of the distribution of past adjustments of the primary fiscal deficit derived from the sample of LICs.

- **Consistency between fiscal adjustment and growth** (Figure 4). The projected growth path for 2019 and 2020 is in line with the multiplier-based projections. The realism of the expected adjustment is predicated on the authorities' commitment to further fiscal consolidation and restructuring of SOEs. It is also underpinned by robust real GDP growth at 5 percent on the back of strong activity in the industry, tourism and transportation sectors and positive contribution from expected reforms aimed at transforming Cabo Verde into an air and maritime transportation hub in the medium term, under the PEDS.

- **Consistency between public investment and growth** (Figure 4). The realism tool shows that like historical figures, the contribution of public investment to real GDP growth remains marginal across the previous and current DSA, mainly reflecting low multiplier for public investment, consistent with the high import content of capital spending. While public investment is expected to hover around 4 percent of GDP in the medium term as in the previous DSA, private investment should remain at 34 percent of GDP on average over 2020-24.

[5] "Other debt creating flows" capture below-the-line liabilities from the fiscal accounts, including government support to SOEs through onlending and capitalization.

C. Country Classification and Determination of Stress Test Scenarios

12. Cabo Verde's debt-carrying capacity is assessed as "strong" as in the 2018 Article IV DSA (Text Table 5). In the previous framework, the debt-carrying capacity was solely informed by the World Bank Country Policy and Institutional Assessment (CPIA) score. The new methodology relies on a composite indicator (CI) combining the CPIA score, external conditions captured by world economic growth and country-specific factors. Based on data from the April 2019 World Economic Outlook (WEO) vintage and the 2017 CPIA, the CI score for Cabo Verde stands at 3.28, which is above the threshold of 3.05 applicable for a "strong" rating. The CI score reflects positive contributions from the CPIA (44 percent), international reserves (31 percent), world growth (15 percent), remittances (6 percent) and country real growth rate (3 percent). Debt burden thresholds implied by the strong debt-carrying capacity under the previous and new frameworks are summarized in Text Table 6.

Text Table 5. Cabo Verde: CI Score Summary Table

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.783	1.45	44%
Real growth rate (in percent)	2.719	4.010	0.11	3%
Import coverage of reserves (in percent)	4.052	48.773	1.98	60%
Import coverage of reserves^2 (in percent)	-3.990	23.788	-0.95	-29%
Remittances (in percent)	2.022	10.179	0.21	6%
World economic growth (in percent)	13.520	3.559	0.48	15%
CI Score			3.28	100%
CI rating			Strong	

Source: IMF staff calculations. The CI cutoff for strong debt-carrying capacity is CI > 3.05.

Text Table 6. Cabo Verde: Debt Thresholds under Strong Debt-Carrying Capacity

EXTERNAL debt burden thresholds	Old DSA	New DSA
PV of PPG external debt in % of		
Exports	200	240
GDP	50	55
PPG external debt service in % of		
Exports	25	21
Revenue	22	23
TOTAL public debt benchmark		
PV of total public debt in % of GDP	74	70

Source: IMF staff calculations.

13. The debt sustainability analysis relies on the six standardized stress tests and the contingent liability stress test. While the former uses the default settings, the latter is customized to address potential vulnerabilities stemming from the incomplete coverage of public sector debt as explained in paragraph 2. None of the tailored stress tests is triggered for Cabo Verde.

DEBT SUSTAINABILITY ANALYSIS

D. External Public Debt

14. **Under the baseline scenario, the PV of PPG external debt-to-GDP ratio breaches its applicable threshold in 2019-22, thereby signaling a high risk of external debt distress** (Figure 1, Tables 1 and 3). However, the other debt burden indicators remain comfortably below their prescribed thresholds throughout the DSA horizon. The PV of PPG external debt ratios to GDP and exports are expected to steadily decrease over time. Both debt service-to-exports and debt service-to-revenue ratios display similar patterns, declining through 2020 with the full amortization of TACV's publicly-guaranteed external debt, picking up in 2021 when Cabo Verde starts repaying the principal on loans from the Portuguese bank Caixa Geral de Depósitos (CGD), and decreasing gradually from 2022 onward.

15. **The PV of PPG external debt-to-GDP ratio also breaches its threshold protractedly under the stress test scenarios** (Figure 1, Tables 1 and 3). Under the most extreme shock which is a one-time 30 percent nominal depreciation, it rises to 88.2 percent in 2020 before gradually decreasing and receding below the threshold of 55 percent of GDP from 2028 only. The threshold is also breached under the remaining five standardized bound tests, albeit to different extents, and under the tailored combined contingent liabilities test over 2019-28. While the PV of PPG external debt-to-exports ratio exhibits a similar trend, it remains below its applicable threshold throughout the projection period, despite being close to its limit in 2021. Likewise, none of Cabo Verde's debt service-related indicators breaches their respective thresholds under the stress test scenario. However, the projected trajectories of PPG external debt burden indicators appear vulnerable to export growth shocks and to a one-time depreciation shock, thus highlighting the country's exposure to adverse shocks due to the lack of diversification.

E. Total Public Debt

16. **The PV of total public debt-to-GDP ratio exceeds the 70 percent benchmark through 2025 under the baseline scenario** (Figure 2, Tables 2 and 4). The prescribed benchmark is also breached throughout the projection period under the six standardized bound tests and the tailored combined contingent liabilities test, with the one-time depreciation being the most severe shock. Furthermore, the debt outlook, as shown by the other public DSA indicators, is particularly vulnerable to depreciation shocks and to contingent liabilities associated with SOEs' debt which emerge as the most extreme shock.

F. Debt Distress Ratings

17. **Cabo Verde's DSA finds a "high" risk of external and overall debt distress, with risks tilted to the downside**. The PV of PPG external debt-to-GDP ratio breaches its threshold over the medium-term projection period under the baseline scenario, thereby signaling a high risk of external debt distress, and is particularly sensitive to export and growth shocks. However, it is projected to gradually decline as the forecast horizon advances, falling below the 55 percent threshold from 2023 onward. Similarly, the PV of

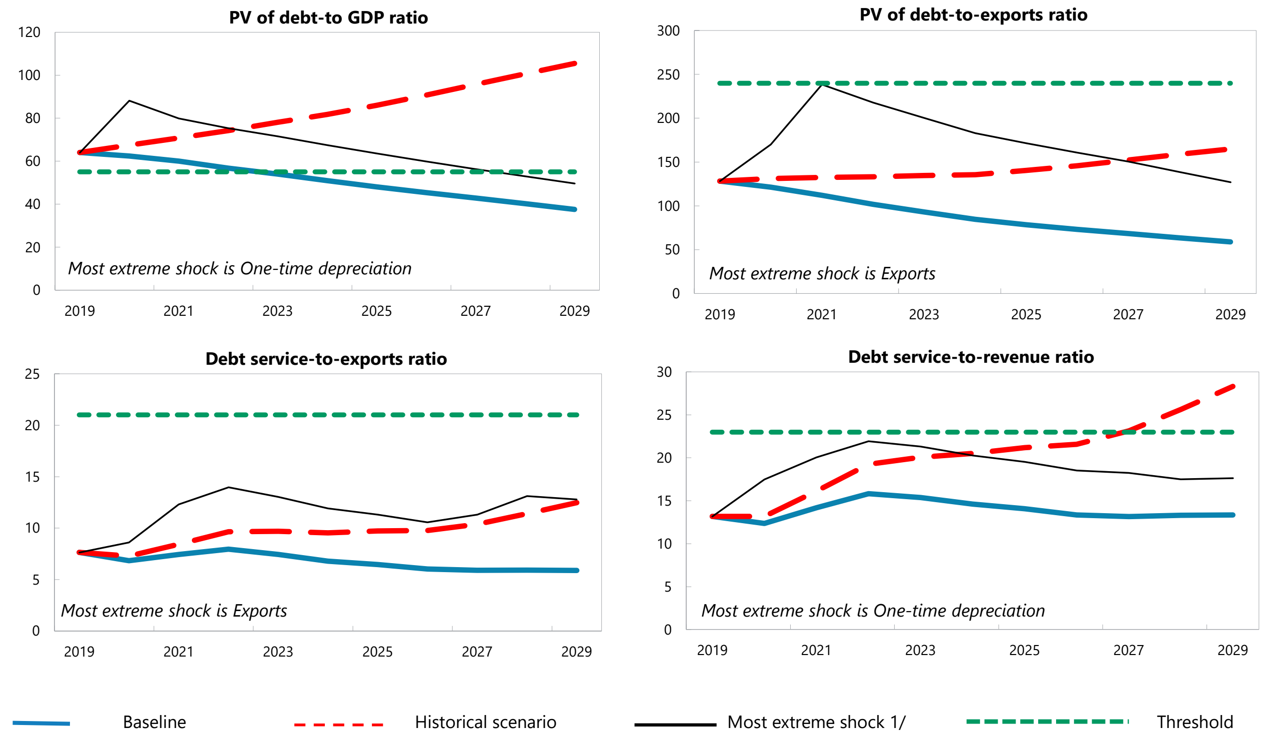
PPG external debt-to-exports ratio exhibits a continuous downward trend over the projection period. In addition, debt service indicators are projected to remain comfortably below their respective thresholds throughout the DSA projection horizon. The "high" risk of overall debt distress is the outcome of the breach of the PV of PPG external debt-to-GDP ratio (which also resulted in a "high" risk of external debt distress), combined with the breach by the PV of total public debt-to-GDP ratio. However, although the latter ratio stays above the 70 percent benchmark, it is expected to gradually decline, with the breach ending in 2026. Based on these dynamics, external and public debt are deemed sustainable going forward.

18. Cabo Verde could graduate to "moderate" external and overall public debt distress ratings by 2023 and 2026 respectively if the assumptions built into the DSA materialize. The projected fiscal adjustment, notably under the PCI, combined with successful implementation of SOEs reforms are expected to help contain debt accumulation. Prudent borrowing policies, adhering to the zero limit on non-concessional borrowing, as well as strengthened debt management strategy remain critical to keeping public debt at sustainable levels. Ensuring debt sustainability will also require implementation of growth-enhancing structural reforms with a focus on actions needed to diversify the productive base and to address the infrastructure gap. Effective implementation of the PEDS could play an important role in this respect.

G. Authorities' Views

19. The authorities broadly agreed with the assumptions and results of the DSA and made a few observations. While agreeing that the interest rate on the end-December 2018 stock of medium and long-term bonds averaged 5 percent, they emphasized the more favorable terms on new issuances in 2018 and 2019, with an average interest rate below 4 percent. They also ruled out any uncertainty about the repayment of TACV's publicly-guaranteed external debt by highlighting that the largest share of the debt corresponds to a EUR 13.5 million loan to finance the workforce retrenchment cost, and that financing was already secured. On the borrowing strategy assumptions, the authorities insisted they will refrain from contracting non-concessional debt and reiterated commitment to reducing the stock of public debt, including by enhancing revenue administration and spending quality, containing expenditures, increasing private sector participation through concessions and privatizations, selling government properties, and supporting the development of domestic debt markets. They also underscored that the recently adopted pieces of legislation regulating the issuance and management of public debt and State guarantees are a welcome step in the right direction.

Figure 1. Cabo Verde: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2019–2029



Customization of Default Settings		
	Size	Interactions
Standardized Tests		Yes
Tailored Tests		
Combined CLs	Yes	
Natural Disasters	n.a.	n.a.
Commodity Prices [2/]	n.a.	n.a.
Market Financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing Assumptions for Stress Tests*		
	Default	**User defined**
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.7%	1.7%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	22	22
Avg. grace period	6	6

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

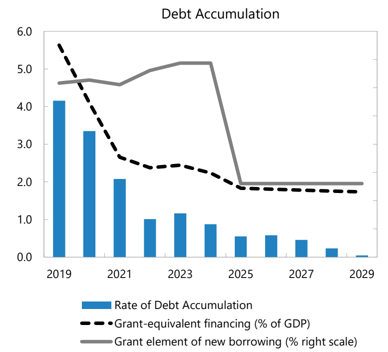
2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

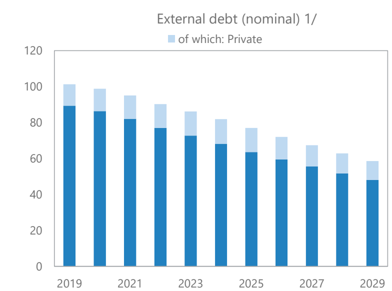
Table 1. Cabo Verde: External Debt Sustainability Framework, Baseline Scenario, 2016–2039

(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
External debt (nominal) 1/	**105.6**	**107.4**	**101.3**	**101.3**	**98.8**	**95.1**	**90.3**	**86.1**	**81.8**	**58.6**	**29.3**	**88.7**	**81.0**
of which: public and publicly guaranteed (PPG)	**96.7**	**94.9**	**91.0**	**89.3**	**86.3**	**82.1**	**77.0**	**72.7**	**68.2**	**48.1**	**24.0**	**76.6**	**68.5**
Change in external debt	-2.4	1.8	-6.1	0.1	-2.5	-3.8	-4.8	-4.1	-4.3	-4.3	-2.9		
Identified net debt-creating flows	**-7.2**	**-6.7**	**-11.9**	**-4.7**	**-4.3**	**-5.6**	**-6.8**	**-6.9**	**-6.6**	**-7.0**	**-6.7**	**1.4**	**-6.4**
Non-interest current account deficit	**1.1**	**3.8**	**2.3**	**1.7**	**1.7**	**1.8**	**1.6**	**1.4**	**1.4**	**0.4**	**-0.6**	**6.2**	**1.2**
Deficit in balance of goods and services	16.6	21.0	18.9	19.1	18.8	18.0	17.1	16.1	14.9	13.7	11.9	**21.9**	**16.0**
Exports	43.3	46.2	48.9	49.9	51.4	53.6	55.7	58.0	60.3	64.0	72.3		
Imports	59.9	67.1	67.7	69.0	70.3	71.6	72.8	74.0	75.3	77.7	84.1		
Net current transfers (negative = inflow)	-16.3	-17.8	-16.6	-18.0	-18.2	-17.2	-16.7	-16.0	-15.4	-14.8	-13.5	**-16.8**	**-16.2**
of which: official	-2.7	-3.7	-2.7	-3.4	-3.0	-1.9	-1.7	-1.5	-1.5	-0.8	-0.4		
Other current account flows (negative = net inflow)	0.8	0.7	0.0	0.6	1.1	1.0	1.2	1.3	1.9	1.5	1.0	**1.1**	**1.4**
Net FDI (negative = inflow)	**-6.7**	**-6.7**	**-4.9**	**-3.9**	**-3.7**	**-5.1**	**-6.2**	**-6.3**	**-6.2**	**-6.6**	**-6.5**	**-6.5**	**-5.8**
Endogenous debt dynamics 2/	**-1.6**	**-3.9**	**-9.3**	**-2.5**	**-2.4**	**-2.3**	**-2.2**	**-2.0**	**-1.8**	**-0.8**	**0.4**		
Contribution from nominal interest rate	2.8	2.7	2.2	2.4	2.3	2.3	2.3	2.2	2.2	2.1	1.9		
Contribution from real GDP growth	-4.9	-4.0	-5.3	-4.9	-4.7	-4.6	-4.4	-4.2	-4.0	-2.9	-1.5		
Contribution from price and exchange rate changes	0.5	-2.7	-6.2	...	...	...	...	...	...	...	...		
Residual 3/	**4.7**	**8.5**	**5.8**	**4.7**	**1.8**	**1.8**	**2.0**	**2.7**	**2.3**	**2.7**	**3.8**	**3.8**	**2.5**
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		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	**...**	**...**	**61.9**	**64.0**	**62.4**	**60.1**	**56.8**	**54.0**	**51.0**	**37.6**	**19.2**		
PV of PPG external debt-to-exports ratio	**...**	**...**	**126.6**	**128.2**	**121.4**	**112.2**	**101.9**	**93.2**	**84.6**	**58.8**	**26.5**		
PPG debt service-to-exports ratio	**6.5**	**7.3**	**6.8**	**7.6**	**6.8**	**7.4**	**7.9**	**7.4**	**6.8**	**5.9**	**3.4**		
PPG debt service-to-revenue ratio	**11.9**	**13.6**	**12.4**	**13.2**	**12.4**	**14.2**	**15.8**	**15.4**	**14.6**	**13.4**	**9.0**		
Gross external financing need (Million of U.S. dollars)	-16.8	39.2	37.4	63.5	65.0	48.1	30.5	22.0	19.6	-42.5	-265.9		
Key macroeconomic assumptions													
Real GDP growth (in percent)	4.7	4.0	5.5	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	**2.2**	**5.0**
GDP deflator in US dollar terms (change in percent)	-0.5	2.6	6.1	-1.8	2.7	2.2	2.5	2.2	2.4	2.0	2.3	**-0.9**	**1.9**
Effective interest rate (percent) 4/	2.7	2.8	2.3	2.5	2.5	2.5	2.6	2.7	2.8	3.6	6.4	**3.4**	**2.9**
Growth of exports of G&S (US dollar terms, in percent)	9.2	13.8	18.5	5.4	11.2	11.8	11.9	11.6	11.9	8.2	9.0	**4.5**	**9.6**
Growth of imports of G&S (US dollar terms, in percent)	10.0	19.6	13.0	5.2	9.8	9.3	9.4	9.1	9.4	7.6	8.5	**2.1**	**8.3**
Grant element of new public sector borrowing (in percent)	...	...	...	37.2	37.3	37.1	37.6	37.9	37.9	33.6	30.0	**...**	**35.7**
Government revenues (excluding grants, in percent of GDP)	23.9	24.9	26.7	28.9	28.5	28.0	27.9	28.0	28.0	28.2	27.3	**23.1**	**28.2**
Aid flows (in Million of US dollars) 5/	116.2	169.5	93.5	214.7	171.7	134.5	126.4	142.2	136.6	139.3	234.1		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	5.6	4.1	2.7	2.4	2.4	2.2	1.7	1.5	**...**	**2.6**
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	53.8	52.9	46.9	48.0	47.1	48.2	47.7	46.3	**...**	**48.5**
Nominal GDP (Million of US dollars)	1,664	1,776	1,988	2,052	2,213	2,375	2,556	2,743	2,950	4,163	8,336		
Nominal dollar GDP growth	4.2	6.7	12.0	3.2	7.9	7.3	7.6	7.3	7.6	7.1	7.5	**1.4**	**7.0**
Memorandum items:													
PV of external debt 7/	...	...	72.2	76.0	75.0	73.1	70.0	67.5	64.7	48.1	24.5		
In percent of exports	...	...	147.7	152.4	145.7	136.4	125.7	116.4	107.2	75.2	33.8		
Total external debt service-to-exports ratio	10.6	10.9	9.2	10.5	9.5	10.0	10.4	9.8	9.1	8.1	5.4		
PV of PPG external debt (in Million of US dollars)			1230.3	1312.9	1381.6	1427.5	1451.5	1481.2	1505.1	1565.3	1599.1		
(PVt-PVt-1)/GDPt-1 (in percent)				4.2	3.3	2.1	1.0	1.2	0.9	0.0	-0.6		
Non-interest current account deficit that stabilizes debt ratio	3.6	2.1	8.4	1.7	4.2	5.6	6.4	5.5	5.7	4.7	2.3		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	No





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) + Ɛα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

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

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

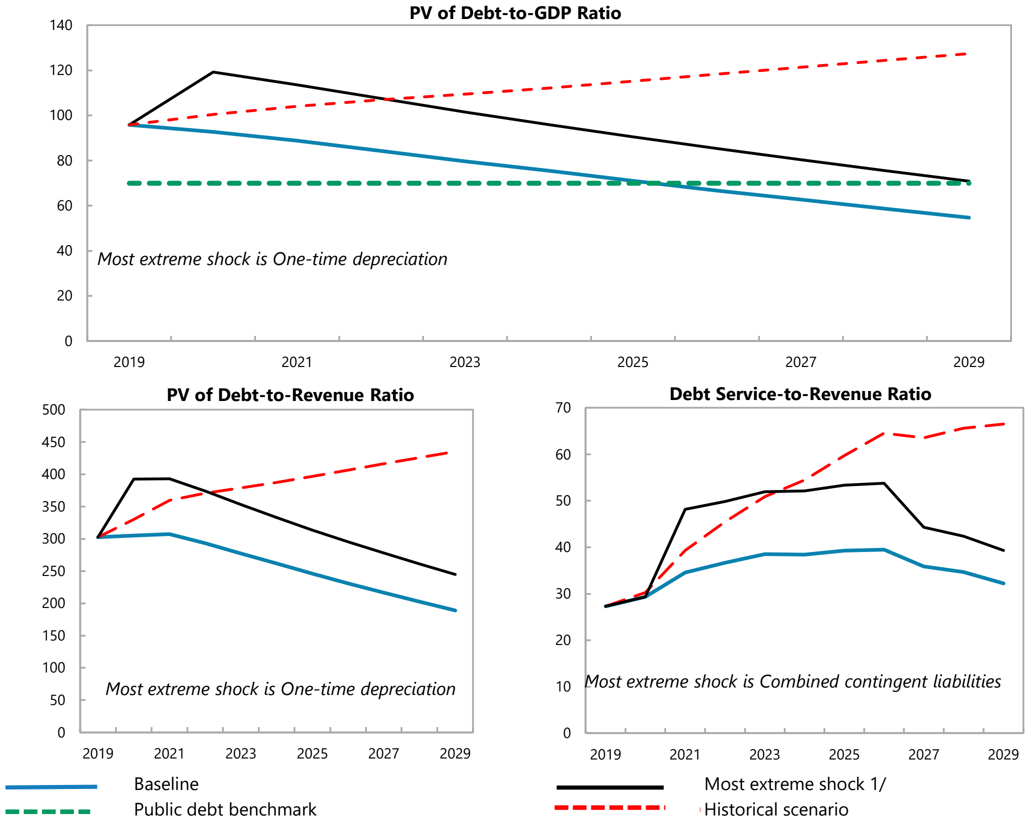
5/ Defined as grants, concessional loans, and debt relief.

6/ 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).

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

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Figure 2. Cabo Verde: Indicators of Public Debt Under Alternative Scenarios, 2019–2029



Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	43%	43%
Domestic medium and long-term	56%	56%
Domestic short-term	1%	1%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.7%	1.7%
Avg. maturity (incl. grace period)	22	22
Avg. grace period	6	6
Domestic MLT debt		
Avg. real interest rate on new borrowing	3.3%	3.3%
Avg. maturity (incl. grace period)	6	6
Avg. grace period	0	0
Domestic short-term debt		
Avg. real interest rate	0%	0.0%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2029. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

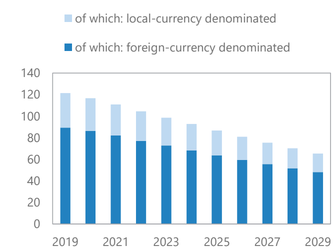
Table 2. Cabo Verde: Public Sector Debt Sustainability Framework, Baseline Scenario, 2016–2039

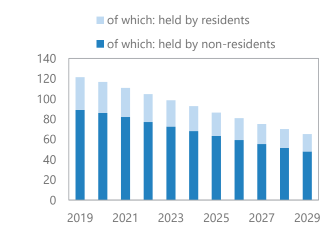
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029	2039	Historical	Projections
Public sector debt 1/	**128.4**	**127.0**	**123.9**	**121.4**	**116.8**	**111.0**	**104.6**	**98.5**	**92.7**	**65.3**	**29.9**	**102.9**	**93.0**
of which: external debt	**96.7**	**94.9**	**91.0**	**89.3**	**86.3**	**82.1**	**77.0**	**72.7**	**68.2**	**48.1**	**24.0**	**76.6**	**68.5**
Change in public sector debt	1.7	-1.4	-3.1	-2.5	-4.7	-5.8	-6.4	-6.1	-5.8	-5.0	-2.7		
Identified debt-creating flows	**4.0**	**-12.4**	**-1.0**	**-2.4**	**-4.7**	**-5.8**	**-6.4**	**-6.1**	**-5.8**	**-5.0**	**-1.5**	**7.4**	**-5.3**
Primary deficit	**0.5**	**0.4**	**0.3**	**-0.7**	**-1.0**	**-1.2**	**-1.2**	**-1.2**	**-1.2**	**-1.9**	**0.0**	**4.3**	**-1.4**
Revenue and grants	26.6	28.6	28.1	31.7	30.4	28.9	28.8	28.8	28.8	29.0	28.1	**26.4**	**29.3**
of which: grants	2.7	3.7	1.4	2.8	1.9	0.9	0.8	0.8	0.8	0.8	0.8		
Primary (noninterest) expenditure	27.1	28.9	28.3	31.0	29.4	27.7	27.6	27.6	27.6	27.1	28.1	**30.7**	**27.9**
Automatic debt dynamics	**0.1**	**-13.1**	**-2.3**	**-6.1**	**-5.9**	**-5.6**	**-5.4**	**-5.0**	**-4.8**	**-3.1**	**-1.5**		
Contribution from interest rate/growth differential	-4.2	-4.1	-6.6	-5.5	-5.6	-5.6	-5.4	-5.0	-4.7	-3.2	-1.5		
of which: contribution from average real interest rate	1.5	0.8	0.1	0.5	0.2	-0.1	-0.1	0.0	0.0	0.2	0.1		
of which: contribution from real GDP growth	-5.7	-5.0	-6.6	-5.9	-5.8	-5.6	-5.3	-5.0	-4.7	-3.3	-1.6		
Contribution from real exchange rate depreciation	4.2	-9.0	4.3	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**3.4**	**0.4**	**1.0**	**4.3**	**2.2**	**0.9**	**0.2**	**0.2**	**0.2**	**0.0**	**0.0**	**2.5**	**0.7**
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 contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
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 debt creating or reducing flow (please specify)	3.4	0.4	1.0	4.3	2.2	0.9	0.2	0.2	0.2	0.0	0.0		
Residual	**-2.3**	**11.1**	**-2.1**	**-0.6**	**-0.3**	**0.0**	**0.1**	**0.0**	**-0.1**	**0.1**	**-1.3**	**-0.7**	**0.0**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**97.2**	**95.8**	**92.7**	**88.8**	**84.3**	**79.7**	**75.4**	**54.7**	**25.0**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**346.1**	**302.4**	**305.2**	**307.1**	**292.9**	**277.2**	**261.8**	**188.9**	**89.0**		
Debt service-to-revenue and grants ratio 3/	**28.3**	**27.7**	**30.1**	**27.3**	**29.4**	**34.6**	**36.7**	**38.5**	**38.4**	**32.2**	**15.8**		
Gross financing need 4/	5.5	5.6	8.7	12.3	10.1	9.8	9.6	10.0	10.1	7.5	4.5		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	4.7	4.0	5.5	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	**2.2**	**5.0**
Average nominal interest rate on external debt (in percent)	1.1	1.3	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.4	1.9	**1.2**	**1.3**
Average real interest rate on domestic debt (in percent)	5.5	4.5	3.6	3.2	3.1	3.0	2.8	2.8	2.8	3.2	2.9	**4.1**	**2.9**
Real exchange rate depreciation (in percent, + indicates depreciation)	4.5	-9.7	4.8	...	...	...	...	...	...	...	...	**2.8**	**...**
Inflation rate (GDP deflator, in percent)	-0.2	0.5	1.4	1.5	1.6	1.6	1.8	1.8	1.8	2.0	2.3	**1.1**	**1.8**
Growth of real primary spending (deflated by GDP deflator, in percent)	-1.6	11.0	3.4	14.9	-0.5	-0.9	4.5	4.9	5.2	5.0	5.0	**2.4**	**4.6**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-1.2	1.7	3.4	1.8	3.7	4.7	5.2	4.9	4.6	3.1	2.7	**1.3**	**3.9**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**No**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government plus extra budgetary funds, central bank, government-guaranteed debt. Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

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

4/ 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 and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Cabo Verde: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2019–2029

(Percent)

	Projections										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of debt-to GDP ratio											
Baseline	64	62	60	57	54	51	48	45	43	40	38
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	64	68	71	74	78	82	86	91	96	101	106
B. Bound Tests											
B1. Real GDP growth	64	66	66	63	60	56	53	50	47	44	41
B2. Primary balance	64	65	65	62	60	57	55	53	50	48	45
B3. Exports	64	70	80	76	73	69	66	63	59	55	51
B4. Other flows 2/	64	66	67	64	61	58	55	52	49	46	42
B6. One-time 30 percent nominal depreciation	64	88	80	75	72	67	64	60	56	53	50
B6. Combination of B1-B5	64	73	75	71	68	64	61	58	54	51	47
C. Tailored Tests											
C1. Combined contingent liabilities	64	71	69	67	65	62	60	58	56	53	51
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	55	55	55	55	55	55	55	55	55	55	55
PV of debt-to-exports ratio											
Baseline	128	121	112	102	93	85	79	73	68	64	59
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	128	131	132	133	135	136	140	146	152	159	165
B. Bound Tests											
B1. Real GDP growth	128	121	112	102	93	85	79	73	68	64	59
B2. Primary balance	128	126	122	112	104	95	90	85	80	75	70
B3. Exports	128	170	238	218	200	183	171	161	151	139	127
B4. Other flows 2/	128	129	126	115	105	96	89	83	78	72	66
B6. One-time 30 percent nominal depreciation	128	121	106	96	87	79	73	68	64	59	55
B6. Combination of B1-B5	128	157	129	158	144	132	123	115	107	99	91
C. Tailored Tests											
C1. Combined contingent liabilities	128	138	130	120	112	103	98	93	89	84	79
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	240	240	240	240	240	240	240	240	240	240	240
Debt service-to-exports ratio											
Baseline	8	7	7	8	7	7	6	6	6	6	6
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	8	7	8	10	10	10	10	10	10	11	12
B. Bound Tests											
B1. Real GDP growth	8	7	7	8	7	7	6	6	6	6	6
B2. Primary balance	8	7	8	8	8	7	7	6	6	7	7
B3. Exports	8	9	12	14	13	12	11	11	11	13	13
B4. Other flows 2/	8	7	8	8	8	7	7	6	6	7	7
B6. One-time 30 percent nominal depreciation	8	7	7	8	7	7	6	6	6	6	5
B6. Combination of B1-B5	8	8	10	11	10	9	9	8	9	9	9
C. Tailored Tests											
C1. Combined contingent liabilities	8	7	8	8	8	7	7	6	6	6	6
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	21	21	21	21	21	21	21	21	21	21	21
Debt service-to-revenue ratio											
Baseline	13	12	14	16	15	15	14	13	13	13	13
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	13	13	16	19	20	21	21	22	23	26	28
B. Bound Tests											
B1. Real GDP growth	13	13	16	17	17	16	16	15	15	15	15
B2. Primary balance	13	12	14	16	16	15	15	14	14	15	15
B3. Exports	13	12	15	18	17	16	16	15	16	19	18
B4. Other flows 2/	13	12	15	16	16	15	15	14	14	15	15
B6. One-time 30 percent nominal depreciation	13	17	20	22	21	20	20	19	18	17	18
B6. Combination of B1-B5	13	13	16	18	17	16	16	15	16	17	17
C. Tailored Tests											
C1. Combined contingent liabilities	13	12	15	17	16	15	15	14	14	14	14
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	23	23	23	23	23	23	23	23	23	23	23

Sources: Country authorities; and staff estimates and projections.

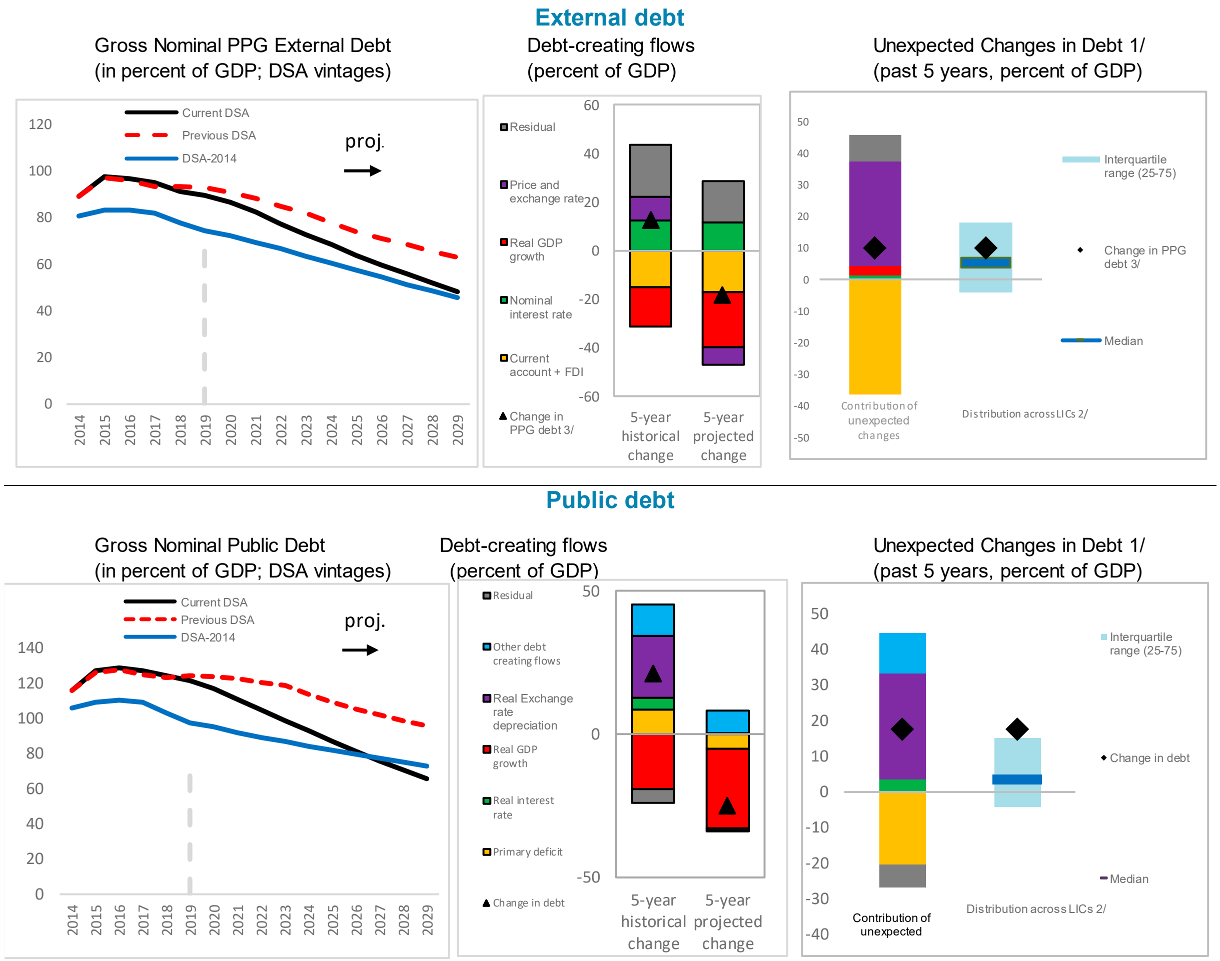
1/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Includes official and private transfers and FDI.

Table 4. Cabo Verde: Sensitivity Analysis for Key Indicators of Public Debt, 2019–2029
(Percent)

	Projections										
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
PV of Debt-to-GDP Ratio											
Baseline	96	93	89	84	80	75	71	67	63	59	55
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	96	100	104	107	109	112	115	118	121	124	127
B. Bound Tests											
B1. Real GDP growth	96	99	102	99	96	94	91	88	85	83	80
B2. Primary balance	96	100	104	99	93	89	84	79	74	70	65
B3. Exports	96	100	109	104	99	94	89	84	79	74	68
B4. Other flows 2/	96	97	96	91	87	82	77	73	69	64	59
B6. One-time 30 percent nominal depreciation	96	119	114	108	102	96	91	85	80	76	71
B6. Combination of B1-B5	96	103	103	97	93	89	85	81	77	73	69
C. Tailored Tests											
C1. Combined contingent liabilities	96	119	113	108	102	97	92	87	82	77	72
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Public debt benchmark	70	70	70	70	70	70	70	70	70	70	70
PV of Debt-to-Revenue Ratio											
Baseline	302	305	307	293	277	262	246	231	217	203	189
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	302	330	359	371	379	387	397	406	416	426	435
B. Bound Tests											
B1. Real GDP growth	302	323	350	343	333	324	314	304	295	285	276
B2. Primary balance	302	330	358	342	325	307	289	272	256	241	225
B3. Exports	302	329	377	361	343	326	308	291	274	254	236
B4. Other flows 2/	302	318	332	317	301	285	268	253	237	221	205
B6. One-time 30 percent nominal depreciation	302	392	393	374	353	333	314	295	278	261	245
B6. Combination of B1-B5	302	339	356	337	323	309	294	279	265	250	236
C. Tailored Tests											
C1. Combined contingent liabilities	302	390	393	375	356	337	318	300	283	266	250
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	27	29	35	37	39	38	39	40	36	35	32
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2019-2039 1/	27	30	39	45	51	54	60	65	64	66	67
B. Bound Tests											
B1. Real GDP growth	27	31	39	42	46	47	49	51	48	47	46
B2. Primary balance	27	29	39	45	46	46	47	48	43	40	38
B3. Exports	27	29	35	38	40	40	41	41	39	40	37
B4. Other flows 2/	27	29	35	37	39	39	40	40	37	36	34
B6. One-time 30 percent nominal depreciation	27	32	41	45	47	48	49	50	47	46	44
B6. Combination of B1-B5	27	30	37	43	45	46	48	49	46	45	42
C. Tailored Tests											
C1. Combined contingent liabilities	27	29	48	50	52	52	53	54	44	42	39
C2. Natural disaster	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities; and staff estimates and projections.
1/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
2/ Includes official and private transfers and FDI.

Figure 3. Cabo Verde: Drivers of Debt Dynamics - Baseline Scenario



Sources: Country authorities; and staff estimates and projections.

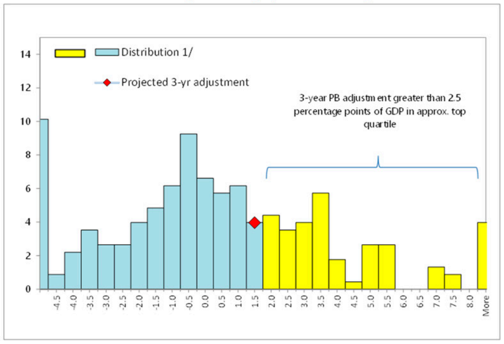
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

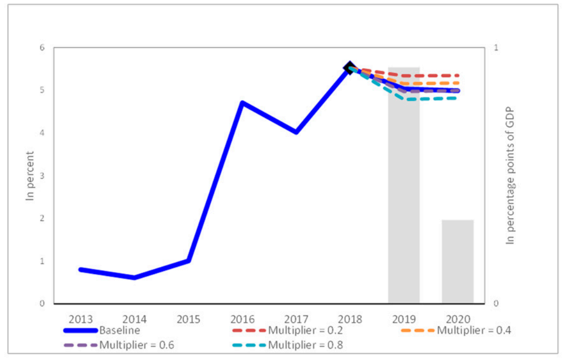
Figure 4. Cabo Verde: Realism tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



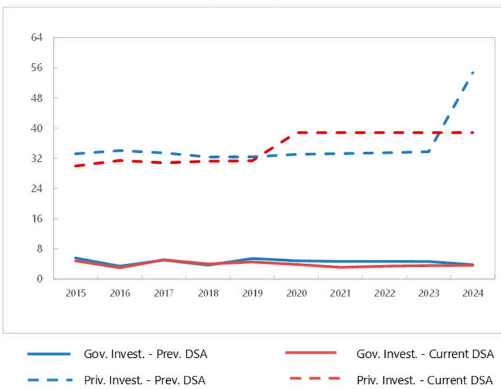
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(% of GDP)



Contribution to Real GDP growth
(percent, 5-year average)

Sources: Country authorities; and staff estimates and projections.

Statement by Alexandre Tombini, Executive Director for Cabo Verde, and Pedro Fachada, Alternate Executive Director, July 15, 2019

1. On behalf of the Cabo Verdean authorities, we thank the mission team for the report and policy advice. We also thank management for the support to Cabo Verde, and specifically Deputy Managing Director Tao Zhang for his visit to Praia in May, the first ever visit of a member of the management team to the country.

2. The Cabo Verdean authorities initiated in 2016 an ambitious transformation of the country's economy, aimed at increasing private sector participation, facilitating job creation, restructuring public companies, and eliminating fiscal risks. The results speak for themselves. Growth has increased markedly, unemployment has fallen, fiscal outturns have improved, and public debt has inverted its previous upward trend. To consolidate the recent progress, the authorities are requesting the Executive Board to approve an 18-month Policy Coordination Instrument (PCI). Cabo Verde does not have present or prospective balance of payments needs and does not require IMF financing. The authorities consider the PCI the ideal instrument to strengthen their current policy framework, signal their commitment to prudent policies and structural reforms, and catalyze external financing from bilateral and multilateral development partners.

3. Cabo Verde's political and social outlook is broadly positive, particularly when compared to the region. The country has robust institutions, well-consolidated democratic representation and solid governance structures. Cabo Verde is consistently ranked among top African countries in safety and rule of law, and has comparable rankings to many advanced economies in areas such as freedom of speech and the press, democratic rule and good governance. With that in mind, some references to third-party indicators in the staff report tend to understate the progress achieved by Cabo Verdeans since independence in 1975, giving a narrow view of the overall political, economic and institutional context of the country. Taking into account the specificities of Cabo Verde, its location and its historical development, comparisons with so-called "peer" countries may be misleading, particularly when no clear criteria is presented for the selection of "peers".

Recent Economic Developments and Outlook

4. Cabo Verde's economy strengthened substantially in 2018, with real GDP estimated to have expanded at the highest rate since 2008. GDP growth in the last three years marks a radical shift when compared to the performance of the economy in the aftermath of the global financial crisis, and especially during the period of the euro area crisis, given its strong economic links to the region (and Portugal in particular). As noted by staff, the positive performance of Cabo Verde in the last years has been achieved despite a severe drought that affected agriculture output in 2017-2018. In the first quarter of 2019, GDP grew by 5.2 percent year-on-year.

5. Recent economic growth partly reflects favorable external headwinds, but also shows early dividends from the authorities' reforms agenda. The expansion is relatively broad-based, with perhaps the exception of construction and, as already mentioned, agriculture. Tourism remains the most dynamic sector of the economy. As documented by staff, the activity has registered nearly exponential growth, with the number of visitors increasing from around 150,000 in 2002 to 765,000 last year. The authorities expect that Cabo Verde will receive more than 1 million tourists a year by 2020/2021. Although the country remains mostly a destination for "sun, sea, and sand", there is increasing diversification to other activities such as ecotourism, cultural travel, and convention and meetings. Political stability, security and an improved business environment have been encouraging foreign investment in new hotels, tourism infrastructure and travel-related services.

6. Given the recent expansion in economic activity, strong confidence, ongoing structural reforms and the increasing role of the private sector in the economy, the authorities are relatively optimistic about the medium-term growth outlook. They acknowledge that, compared to the last Article IV consultation in March 2018, staff's medium-term growth projections have been revised upwards by 1 percentage point, to 5 percent. Nevertheless, in their view, this figure is still on the cautious side. While agreeing with staff's conservative macro framework, they believe that the reforms being implemented set the economy in the right path to grow at an even faster pace. They also consider that risks to the outlook are broadly balanced, with potential downside risks associated mainly to the external environment (a no-deal Brexit and deceleration in the euro area) largely compensated by domestic upside risks related to progress with structural reforms and the restructuring of public companies, increased foreign investment in Cabo Verde, and stronger performance of the tourism sector.

Fiscal Policy

7. Fiscal consolidation continued to advance in 2018, with the overall fiscal deficit lowered to 2.8 percent of GDP from 3 percent of GDP in 2017. Seen in perspective, this represents a major fiscal adjustment effort, since Cabo Verde ran average fiscal deficits above 8 percent of GDP in the period between 2010 to 2015. As a result of the fiscal consolidation effort and faster GDP growth, the public debt as a share of GDP declined in 2018 to 123.9 from 127 percent in 2017, and is projected to decline further going forward.

8. Fiscal consolidation continues to be supported by strong revenue mobilization and expenditure restraint. The authorities managed to increase domestic revenue by nearly 2 percent of GDP in 2018 through strengthening the administrative capacity of the tax agency, combating tax evasion and informality, and collecting tax arrears. This successful strategy was achieved without the need to increase tax rates. Spending remained under control, despite some specific pressures related to the update of wage and career plans of some categories of civil servants and moderate increases in spending with health, security, transfers to municipalities and assistance to rural households affected by the drought. These pressures were compensated by some modest

delays in capital spending.

9. For 2019, the authorities are committed to maintain fiscal discipline, targeting a primary surplus of around 0.7 percent of GDP (quantitative target under the PCI). The authorities continue to see space for additional tax revenue mobilization (also a quantitative target under the program) by combating tax evasion and recovering tax arrears. Complementary revenue-raising measures include the introduction of airport and maritime security fees and the increase in corporate income tax for offshore banks. Spending will remain strictly under control, helped by the provision in Cabo Verde's budget legislation that authorizes the Minister of Finance to cut certain approved spending to ensure that fiscal targets are met.

10. Efforts to address the vulnerabilities of public companies, which represented a significant drag on the budget in the recent past, have picked up steam in 2018 and early 2019. The national airline had its majority stake sold in March to a subsidiary of Icelandair. The new controller had been managing the company since 2017, in preparation for its privatization. The authorities plan to sell the remaining 49 percent stake of the company to employees and domestic investors. The strategy of the new shareholder envisages using Cabo Verde's location in the South Atlantic as a hub for intercontinental air traffic, linking Africa, Europe, North and South America. Under the new management, the company has already announced flights to new destinations in Europe, Africa and Brazil. The electricity and water utility company Electra continued the internal process to minimize commercial losses, increase operational efficiency and prepare for privatization, which is planned for 2020. The housing company IFH had its social housing program restructured in 2018, mitigating potential risks to the budget.

11. Despite the decline in the public debt ratio in 2017-2018, the authorities are aware that the risk of debt distress remains high, as assessed in the joint IMF-World Bank Debt Sustainability Analysis (DSA). Although they remain fully committed to accelerate the reduction of the public debt ratio over the medium-term, they underscore once again that debt service is manageable and there is no medium-term sustainability concern, given the long maturity and highly concessional terms of public external debt. The authorities also reiterate that they will continue to refrain from contracting non-concessional external debt.

Monetary Policy and External Sector

12. Cabo Verde's inflation developments remains favorable, reflecting benign external inflation and the effectiveness of the peg to the euro as an anchor for price stability. In the 12 months to May 2019 (last available data), consumer prices rose 1.3 percent, while core inflation stood at 0.8 percent.

13. External stability has strengthened in recent years. The current account deficit was 4.5 percent of GDP in 2018, significantly lower than 2017 (6.6 percent of GDP). The 2018 outturn compares well with the historic series, with Cabo Verde having experienced two-digit current account deficits relative to GDP for most of the last two decades. The current account

deficit has been mostly financed by stable foreign direct investment, and international reserves remain comfortable under all metrics.

14. The currency peg continues to serve Cabo Verde well. As a small open economy, with high import content and a dominant trading partner (the euro area), the peg provides a firm anchor to macroeconomic stability and enhances the credibility of monetary policy. The peg is supported by a well-established Exchange Rate Cooperation Agreement between Cabo Verde and Portugal that celebrated its 20th anniversary in September last year. The Agreement includes a short-term credit facility provided by the Portuguese Treasury that supplements international reserves and effectively acts as a second line of defense in case of an adverse external shock. Notwithstanding their current comfortable level and the additional buffer represented by the credit facility with Portugal, the authorities are committed to continue to buildup international reserves.

15. In the absence of inflation or international reserves pressures, monetary policy in 2019 remained accommodative. At the same time, the Banco de Cabo Verde (BCV) continued to work to improve its communication and the effectiveness of the monetary transmission mechanism. With this objective in mind, the BCV announced in June 2019 the reduction of the interest rate of the marginal lending facility from 4.5 percent to 3.0 percent, while maintaining the policy rate unchanged at 1.5 percent. The narrowing of the interest rate corridor was recommended by staff in last year's Article IV consultation and incorporated as a reform target under the PCI. The authorities met this reform target even before the start of the PCI, attesting to their strong commitment to the program.

16. Given the strengthening of Cabo Verde's external position and staff's past assessments, we are somewhat surprised by this year's External Stability Assessment. According to staff, Cabo Verde's external position in 2018 was assessed as "weaker than suggested by fundamentals and desired policy settings." In the last consultation in March 2018, the external position was only "moderately weaker"; and in the previous one, in November 2016, it was assessed as "broadly consistent with medium-term fundamentals and desirable policy settings". In both years, external risks appeared low, according to staff. We appreciate the external stability methodology and agree that there is room for staff's judgement, but consistency throughout the years is fundamental to maintain the quality and trustworthiness of the analysis. In the case of Cabo Verde, we do not see a clear rationale for the gradual worsening, in a period when the external outlook is improving or, at least, broadly stable.

Financial Sector

17. Cabo Verde's banking sector remains relatively well-capitalized and liquid, with improving profitability amid declining non-performing loans (NPLs). Confidence in the soundness of the banking system is large, as attested by the significant share of deposits of non-residents in total deposits. The BCV continues to work with banks to resolve the stock of legacy NPLs and foster credit supply. Against this background, the PCI includes as reform targets two

measures aimed at facilitating financial intermediation, namely a revamp of the credit information system and the creation of a functional registry of mobile collateral.

18. The authorities continue to work to prevent withdrawals of correspondent banking relationships. Like in many other small economies, low scale relative to increasing due diligence costs have reduced the attractiveness of correspondent banking operations, especially denominated in US dollars. The preservation of correspondent banks is critical for Cabo Verde, given the significance of remittances and bank deposits of its diaspora. The authorities reaffirm that their anti-money laundering/combating the financing of terrorism (AML/CFT) framework is comprehensive and rigorous. In parallel, the BCV continues to cooperate with foreign supervisors and intergovernmental bodies to address the issue.

Structural Reforms

19. The authorities believe that the implementation of structural reforms is fundamental to increase potential growth, create job opportunities, and improve living standards of the Cabo Verdean population. They believe that private sector participation is critical to ensure long-term, inclusive economic growth. Reforms to the ease of doing business, better inter-island connectivity, improved education and vocational training, better access to financing, and privatization of public companies will help attract private sector investment and foster entrepreneurship, innovation and diversification.

20. The 2017-2021 Strategic Plan for Sustainable Development (PEDS) describes the authorities' medium-term growth vision. Together with tourism as the main driver of growth, the PEDS envisages establishing Cabo Verde as a hub for air and maritime transportation and regional business center.

21. Natural disasters and climate change represent a permanent concern to Cabo Verde. The country is exposed to a broad range of natural phenomena including droughts, volcanic eruptions, hurricanes, earthquakes, flash floods and landslides. The authorities appreciate recent IMF work aimed at incorporating natural disasters and climate change in the macroeconomic framework and are committed to increase structural, financial, and post-disaster resilience.

Conclusion

22. The Cabo Verdean authorities thank again staff, management and the Executive Board for their positive engagement with the country. They want to reassure the Executive Board and the international community that they will continue to follow prudent economic policies, with a view to deliver prosperity to Cabo Verdeans in all islands of the archipelago. They reaffirm the ownership of their economic transformation plan and their commitment to the PCI targets. They appreciate the opportunity to have a new non-financial program that offers slightly more flexibility in the review process, after two successful Policy Support Instruments (PSI) in the period 2006-2012. More flexibility does not necessarily mean less commitment, but rather more realism, especially in the context of a small country with relatively limited capacity.