December 2009
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Cape Verde: Seventh Review Under the Policy Support Instrument—Staff Report; Staff; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Cape Verde

In the context of the seventh review under the policy support instrument, the following documents have been released and are included in this package:

- The staff report for the Seventh Review Under the Policy Support Instrument, prepared by a staff team of the IMF, following discussions that ended on October 1, 2009, with the officials of Cape Verde on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on November 18, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A supplement to the staff report.

- A Press Release summarizing the views of the Executive Board as expressed during its December 7, 2009 discussion of the staff report that completed the request and/or review.

- A statement by the Executive Director for Cape Verde.

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

Letter of Intent sent to the IMF by the authorities of Cape Verde*
Memorandum of Economic and Financial Policies by the authorities of Cape Verde*
Technical Memorandum of Understanding*
*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

CAPE VERDE

Seventh Review Under the Policy Support Instrument[1]

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

Approved by Sharmini Coorey and Aasim Husain

November 18, 2009

Executive Summary

Focus: The impact of the global financial crisis on Cape Verde and calibrating the pace of public investment to realize the country's long-term growth potential while keeping the risk of debt distress low.

Assessment: All assessment criteria were met with a margin and all but three structural benchmarks were met. Growth is holding up at 4 percent in 2009, and inflation is low. The authorities have responded to the global crisis by accelerating their largely externally financed investment program and tightening monetary policy. Staff recommends completing the seventh review and modifying year-end assessment criteria on NIR, nonconcessional external borrowing, and domestic borrowing.

Policy discussions:

- Staff and authorities agreed that the fiscal deficit should be reduced over the medium term. The authorities noted that their investments should promote long-term growth and debt service will remain low.

- Staff pointed out that there should be room to gradually lower interest rates. The Bank of Cape Verde responded that it plans to wait until the global recovery has become stronger and pressure on reserves has receded before lowering the policy rate.

- The BCV is exploring how to develop securities markets and is taking steps to safeguard financial sector stability.

Exchange rate regime: Conventional peg to the euro.

[1] Discussions took place September 23–October 1, 2009. The team comprised Nils Maehle (head), Eduardo Castro, and Jean Frederic Noah Ndela (all AFR). The mission met with Cristina Duarte, Minister of Finance; Carlos Burgo, Governor of the Bank of Cape Verde; other government officials; the Finance Committee of the National Assembly; and donors.

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I. Background and PSI Performance

A. Impact of the Global Economic Crisis and Outlook

1. **Cape Verde is weathering the global economic crisis well.** In recent years it has built sizeable buffers of international reserves and reduced domestic debt.

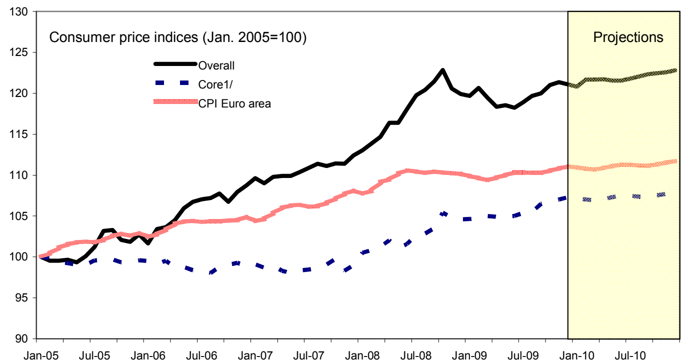
- **Growth in 2009 has been better than expected and there are signs of recovery.** Despite a steep decline in foreign direct investment (FDI) in the first half of 2009, real GDP growth for 2009 is projected at about 4 percent. An expansion of the public investment program is supporting economic activity, FDI has stabilized, construction on several private investment projects has resumed, and tourist arrivals are up.

- **Growth in the next few years could be lower than in recent past.** There are no large FDI projects in the pipeline and external demand may stay weak. Good harvests should contribute to growth and poverty reduction thanks to the exceptional good rain this season.

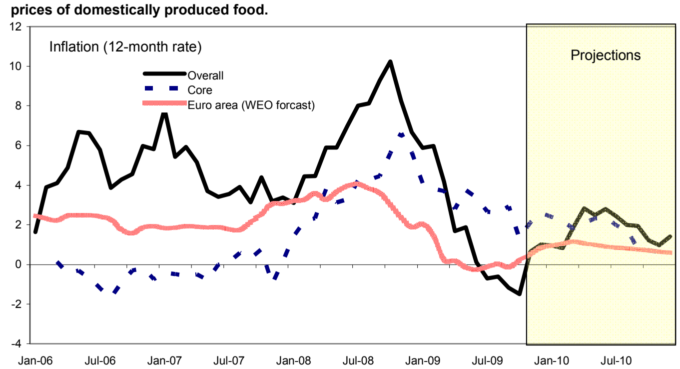
- **Inflation is low.** Consumer prices fell by 1.2 percent in the 12 months to September 2009 because prices for food and energy imports fell. Prices are projected to increase moderately going forward.

- **Gross international reserves remain adequate.** After declining to 3.8 months of imports (108 percent of base money) in July 2009, reserves have stabilized and are expected to remain at 3½–4 months through 2012, partly because of the SDR allocation and expected new external loans.[2] Remittances are holding steady, but in the first half of 2009 FDI declined by

Consumer prices fell between October 2008 and June 2009, largely because of the sharp decline in food and energy import prices. The same factors caused inflation in Cape Verde to rise more rapidly than in the Euro area during 2005-08.



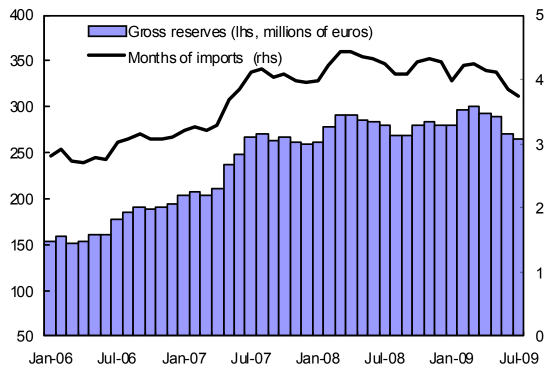
Recent increases in domestic petroleum prices are pushing prices up again. Inflation is projected to increase in 2010 in line with EU area inflation, and projected higher fuel prices and lower prices of domestically produced food.



1/ Excludes food and energy (proxied by electricity, water, and transportation prices).
Sources: BCV, Cape Verde's National Institute of Statistics (INE), and staff projections.

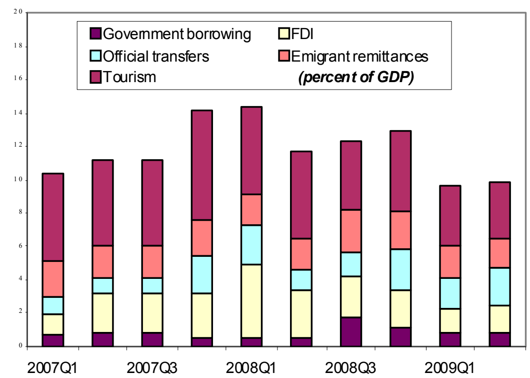
[2] The authorities intend to keep the resources from the SDR allocations as part of their SDR holdings.

International reserves fell during the first half of 2009, but are expected to recover to 4 months of imports by end year...



Source: BCV and Cape Verde's National Institute of Statistics.

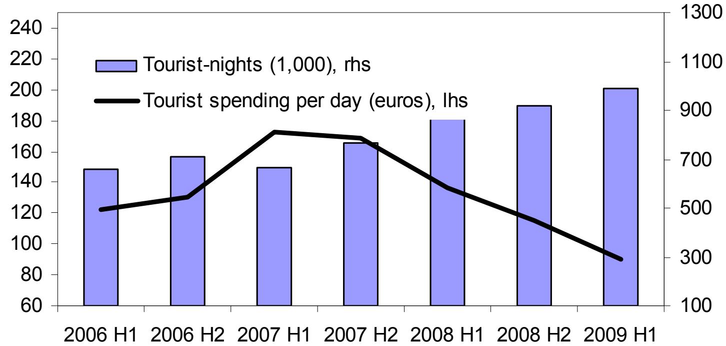
...as public inflows are partially offseting the decline in private inflows and remittances are holding steady.



Source: Bank of Cape Verde.

55 percent and tourism receipts by 28 percent. The impact on reserves has been moderated by a slowdown in imports. Internal and external balance considerations suggest that the real effective value of the escudo remains broadly consistent with fundamentals (¶12).

Tourist nights have increased, while tourism spending has declined since late 2007



Source: Cape Verde's National Institute of Statistics.

2. **The global financial crisis has had little impact on the financial sector.** Local banks have good liquidity and low loan-to-value ratios. Although some banks had low capital-asset ratios,[3] they have raised capital through the local stock exchange. Nonperforming loans have not increased as banks have responded to client payment problems by rescheduling loans. The provisions over NPL have been rising since the stricter new credit classification regulation was enacted in 2007 (Table 8). They have also become more restrictive in providing new loans, including mortgages and personal loans, which constitute 60 percent of their portfolios.

B. Policy Response

3. **The authorities have responded to the global crisis by easing fiscal policy and tightening monetary policy**. They have reduced income and corporate tax rates, accelerated public investments, and increased priority spending.[4] At the same time, to partly compensate for the impact on revenues from the tax cuts, lower import duties on fuel, and weaker

[3] Caused by the expansion of their balance sheets in recent years.

[4] Mainly social transfers and hiring for schools, police, justice, and public notaries.

activity, they improved tax collection. They have also reduced nonpriority current spending. Still, spending is projected to increase by 31 percent relative to 2008, and with an expected shortfall in tax revenues and land sales proceeds the deficit in 2009 is projected at 8.8 percent of GDP. The deficit will be fully financed by external borrowing, which limits the impact on reserves. With new budget loans (¶15), net domestic borrowing,[5] the program's fiscal anchor, is expected to be –0.8 percent of GDP in 2009, substantially below the program ceiling. The liquidity crunch in Europe and an increased country risk premium forced the Bank of Cape Verde (BCV) to raise its policy rate in October 2008 to 5¼ percent. This helped stabilize capital flows and stem reserve losses.

Cape Verde: Revised Macroframework

	6th PSI review					Current projections			
	2008	2009	2010	2011	2012	2009	2010	2011	2012
	(Percent change)								
Real GDP	5.9	3.5	4.0	6.6	6.6	4.1	5.0	5.5	7.0
Inflation (end period)	6.8	3.4	3.1	2.0	3.0	1.0	1.4	2.0	2.0
	(Percent of GDP or units indicated)								
External current account	-12.1	-17.6	-14.2	-13.9	-13.5	-19.4	-22.9	-22.3	-15.7
Gross reserves[1]	4.0	3.9	3.7	3.6	3.6	3.9	3.8	4.0	3.7
Net reserves (€ million)	268	250	265	294	338	270	285	300	315
Fiscal balance	-1.2	-9.0	-4.2	-3.8	-5.3	-8.8	-9.9	-10.0	-6.0
Net domest. borrowing[2]	-1.9	1.4	0.7	1.1	1.4	-0.8	1.0	0.8	-0.5
Domestic debt	15.8	16.0	15.7	15.4	15.3	13.9	14.2	14.1	12.3

[1] Months of prospective imports.
[2] Net of arrears clearance and accounts payable.

C. Program Performance

4. **All end-June 2009 Policy Support Instrument (PSI) assessment criteria were met by a wide margin, and most structural benchmarks were met, though many with delays due to capacity constraints**.

- Net domestic borrowing was below the ceiling by 2.6 percent of GDP and net international reserves were above the floor by €13 million.

- The authorities have completed all structural benchmarks, including those rescheduled at the 6th PSI review, except three. The draft income tax codes have been submitted to the Council of Ministers and is expected to be submitted to the National Assembly before the end of the year, the monetary coordination memorandum has been delayed because of administrative reasons but should be completed shortly, and the offshore sector strategy memorandum has been replaced by draft legislation, which should expedite the reform (¶14).

[5] Net of arrears clearance.

Table. Cape Verde: Structural Benchmarks for 2008–09 [1]

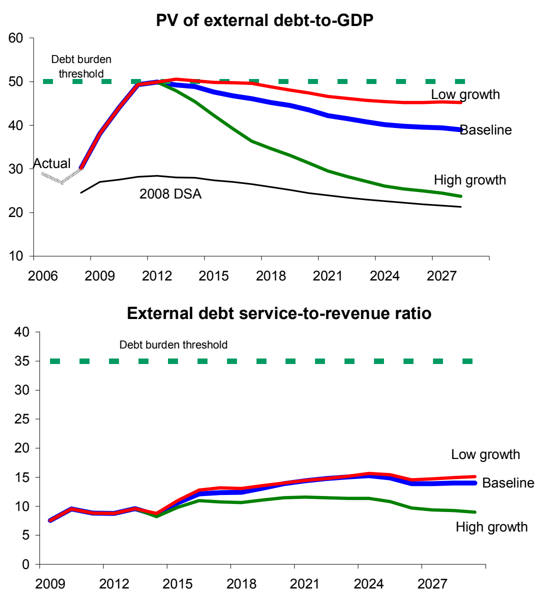
Objective	Structural Benchmark	Timing	Status
Strengthen tax base	Submit the draft individual and corporate income tax bills to the National Assembly.	End-Oct. 2008. Reset to be implemented in June 2009.	Not met.
Promote financial stability	Prepare a quarterly report on developments on balance of payments flows, including an assessment of interest sensitivity of non-resident flows into the banking system.	End-Dec. 2008 Reset to be implemented in June 2009.	Met with delay.
Strengthen public financial management	Place financial controllers in each line ministry to monitor the budget execution as specified in Regulatory Decree 2/2007 of 15 January.	End-Mar. 2009 Reset to be implemented in June 2009.	Met with delay.
Strengthen debt management	Submit to the Council of Ministers a report on contingent liabilities of the state assessing potential risks based on the 2007 or more recent data, including those risks arising from state-owned enterprises.	End-Mar. 2009 Reset to be implemented in June 2009.	Met with delay.
Strengthen debt management	Conduct a mid-year review of fiscal performance, including projections for end 2009, justifying that the envisaged borrowing is consistent with debt sustainability.	End-August 2009	Met.
Strengthen debt management	Include a medium-term fiscal framework (MTFF) for 2010-2012 in the 2010 budget's write up ("Enquadramento") describing the implied debt trajectory and justifying that the envisaged borrowing is consistent with debt sustainability.	End-October 2009	Met.
Strengthen fiscal-monetary policy coordination	BCV to prepare a short memorandum on strengthening monetary-fiscal policy coordination in managing liquidity to be discussed by PSI Monitoring Committee and endorsed by Ministry of Finance and BCV.	End-August 2009	Not met.
Strengthen the financial sector	Inform the Fund of measures taken in the event that the capital ratio of one (or more) banks falls below 10 percent.	Continuous effective June 2009	Met.
Strengthen the financial sector	Present a Policy Strategy Memorandum to the Council of Ministers on the offshore sector.	End-September 2009	Not met.

[1] Measures outstanding at the time of the 7th PSI review.

II. Policy Discussions: Maintaining a Low Risk of Debt Distress and Safeguarding Financial Stability

A. Fiscal Policy: Keeping a Low Risk of Debt Distress

5. **The fiscal deficit in both 2010 and 2011 is projected at 10 percent of GDP.** The deficit for 2012, as set out in the medium-term fiscal framework (MTFF), could be about 6 percent of GDP. The revenue forecast for 2010 is prudent, recurrent spending is restrained while social spending expands. Continued low revenues and rapid implementation of the largely externally financed investment program is driving the deficit. As a result, external debt will increase fast, albeit from a low level. Nevertheless, the risks of debt distress remains low because external debt is on long and highly concessional terms, domestic debt is low and falling, and debt service is projected to remain moderate (see Appendix II. Debt Sustainability Analysis).



6. **To dispel any market concerns about fiscal sustainability, staff urged the authorities to reduce the 2011 deficit and keep the fiscal deficit lo over the medium term.** While the risk of debt distress continues to be low, the fiscal space is rapidly being used and there are increasing risks to the debt outlook. Fiscal sustainability issues need to be carefully considered because they could affect market sentiment and threaten the exchange rate peg. Reducing the deficit will require careful project prioritization and use of private-public partnerships. Staff advised limiting borrowing to long-term financing on concessional terms to preserve the borrowing space, and highlighted that Cape Verde's ability to service its debt, and its borrowing capacity, could be enhanced by strengthening revenue collection and broadening the tax base, including through rationalizing tax exemptions (MEFP ¶12). Staff also recommended including a new external debt anchor in the envisaged successor PSI in line with the new Fund policies for debt limits.

7. **The authorities are committed to keeping the risk of debt distress low and want to make debt management central to a successor PSI.** They explained that it would be difficult and undesirable to reduce external borrowing in 2011. With Cape Verde's graduation from least-developed-country status, donors have provided a five-year transitional period for concessional funding. The authorities are using this window of opportunity to finance as much as possible of the infrastructure investment needs on favorable terms. The external borrowing for 2009–12 is the result of years of efforts to build and streamline their capacity to prepare and appraise projects and mobilize external resources. This resulted in a concentration of projects now underway. The pace should moderate after the current projects are completed. The authorities believe the risk of debt distress should remain low because:

- All projects have undergone feasibility and market studies and address critical growth-constraining bottlenecks in ports, roads, electricity, and water supply (DSA Supplement).

- As a result, growth and fiscal revenues would be stronger and the debt service-to-revenue ratio would be lower than in the baseline scenario of the DSA.

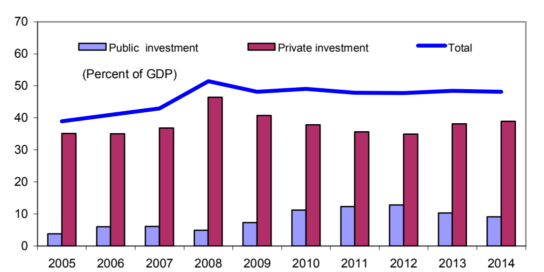
- The investments are reducing contingent liabilities (MEFP ¶13).

8. **The authorities noted, and staff concurred, that implementation capacity would not be a constraint in the near term (Box 1).** Execution rates rose from below 60 percent earlier in the decade to 94 percent because of improvements in budget procedures. A project monitoring and evaluation system is being set up to tighten financial control. Absorptive capacity should be sufficient because of (i) excess capacity in the construction sector; (ii) the high import content of most projects; (iii) use of donor-country contractors; and (iv) high unemployment and the ability to import labor as needed (use of foreign construction workers is common). The social housing component of the investment program should facilitate inter-island labor mobility and help reduce structural unemployment, thereby increasing labor supply and absorptive capacity further. Consequently, the impact on domestic prices and the real effective exchange rate should be low and the impact on competitiveness positive: the investments are benefiting the tourism sector.

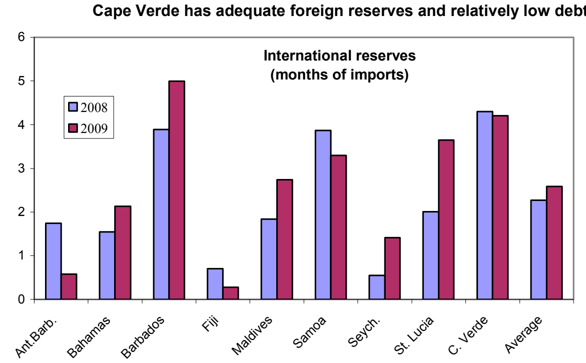
Box 1. Cape Verde: Accelerating Externally Financed Public Investments

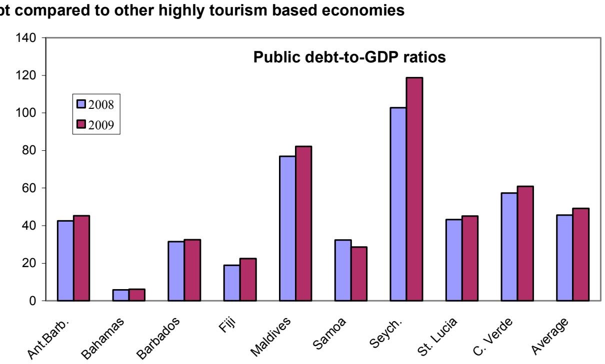
The impact on domestic prices and international reserves should be small because

- With an import-to-GDP ratio at 70 percent, import leakages are high and multipliers low.
- Increased public investments are only partly offsetting the decline in private investment.
- Import leakages are higher for public than for private investments: about 40 percent of the public investment program is directed to electricity and water generation, and port construction with a particularly low domestic component.
- A one percentage point shift from private to public investment is estimated to reduce GDP growth by about 0.3 percentage points and increase the current account deficit by 0.2 percent of GDP.



Cape Verde has adequate foreign reserves and relatively low debt compared to other highly tourism based economies

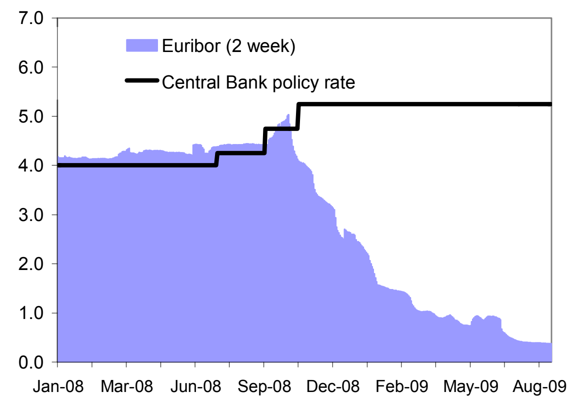




9. **Authorities and staff agreed that net domestic borrowing[6] should continue to be kept low to support international reserves and protect the peg.** The current policy has served Cape Verde well. With sustained sizable repayment of domestic debt in 2006–08 reserves increased faster than expected. Net domestic borrowing in 2010 will be about 1 percent of GDP, consistent with maintaining, but not increasing, the reserve coverage. Adequate reserves are critical because of Cape Verde's intrinsic vulnerabilities, including a narrow export base, dependence on remittances, increased external debt, substantial nonresident deposits with local banks, and contingent liabilities (MEFP ¶13). The authorities noted that domestic borrowing in the MTFF is low.

B. Monetary Policy: Setting Interest Rates Consistent with the Peg

10. **The monetary policy framework remains appropriate, but there are issues with the transmission mechanism (¶13).** Consistent with the peg and the largely open capital account, the framework is geared toward keeping cross-border capital flows low and stable. Monetary management is largely passive with the BCV policy rate set relative to the euribor adjusted for the perceived country risk premium. Structural excess liquidity is mopped up by auctioning 90-day BCV bills in variable-rate tenders to ensure price discovery. This approach has reduced the incentives for banks to place excess liquidity abroad.



Sources: Bank of Cape Verde and Thomson Datastream.

11. **Staff pointed out that there could be room to gradually lower interest rates.** The differential between the policy rate and the euribor is record-high while risk premiums are declining internationally. The BCV responded that it plans to wait until the global recovery has become stronger, risk premiums have narrowed further, and the pressure on reserves has receded (MEFP ¶14), arguing that lowering interest rates while there is downward pressure on reserves and the global recovery is fragile could be risky. They also argued that capital account frictions provide room for using monetary policy—both interest rates and the reserve requirement[7]—to contain demand and protect reserves through current account adjustments. They argued that the wide differential is not attracting speculative inflows because banks are not borrowing abroad to take advantage of the differential, portfolio flows are largely nonexistent, and emigrant deposits react slowly to the differential. Moreover, because bank credit is predominantly for mortgages and personal loans,

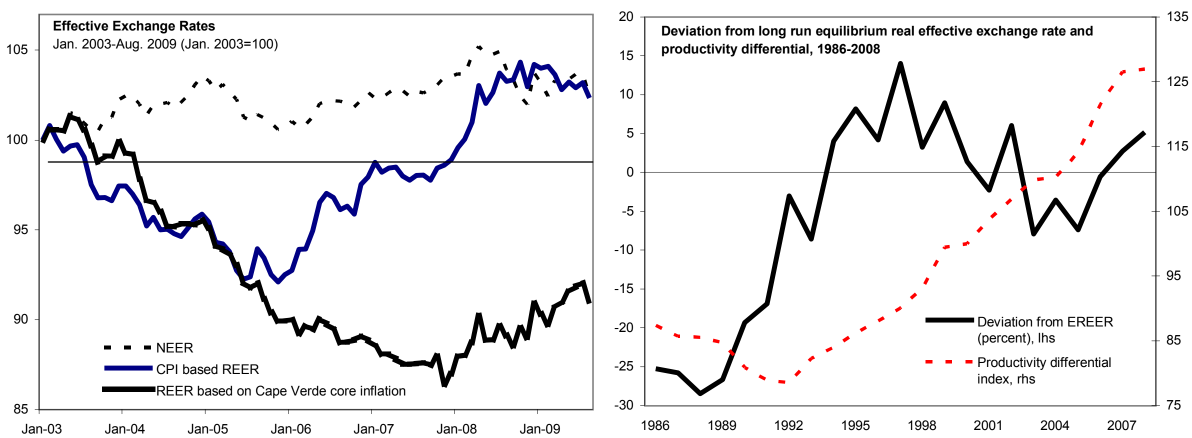
[6] Domestic borrowing net of deposits and arrears clearance is the PSI fiscal anchor.

[7] The reserve requirement was increased from 14 percent to 16 percent in February 2009 to reduce credit growth and protect reserves.

containing credit growth would have a large effect on import demand and little effect on working capital and investments. Staff pointed out that, under the exchange rate peg framework and consistent with the passive interest rate setting, net domestic borrowing, rather than the policy rate, should be the instrument for building reserves.

12. **Internal and external balance considerations suggest that the real effective value of the escudo continues to be broadly in line with fundamentals.** Recent developments in both goods and factor markets after the global shocks do not suggest any sign of over or undervaluation of the real effective exchange rate (REER). Inflation remains low and stable, and real wages in Cape Verde are not out of line with its competitor highly-tourism-based economies. Staff's updated reduced form REER equation shows no significant misalignment. As before, adjustment to larger or more lasting shocks will rely on the flexibility with which the real exchange rate in Cape Verde has adjusted to correct macroeconomic imbalances. Underlying this flexibility is their ability to adjust to external shocks through changes in wages, and asset and product prices—there is no minimum wage or wage indexation, the energy pricing mechanisms ensure pass through of world oil prices, and tourism prices adjust to changes in demand as demonstrated during the current global crisis.

Increased import energy and food prices caused the CPI-based REER to appreciate in 2005-2008 while the core-based REER continued to depreciate sharply. The CPI based REER has depreciated since, reflecting lower import prices, while lagged second round effects caused a moderate appreciation of the core-based REER.

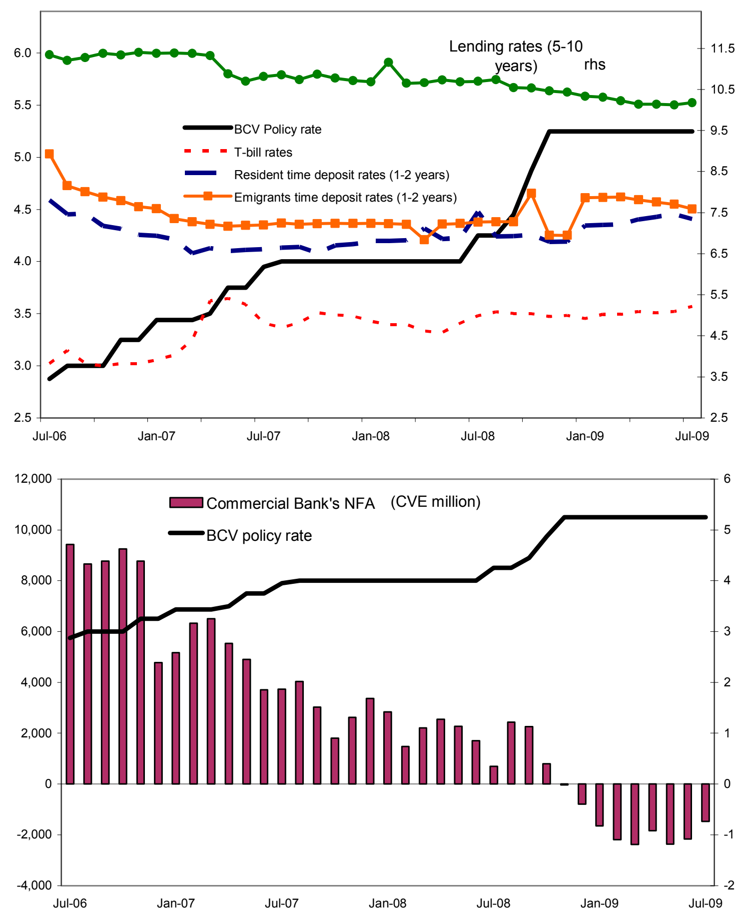


Sources: IMF Information Notice System, and IMF staff estimates.

C. Financial Sector Reform: Improving Markets and Reducing Risks

13. **The authorities are exploring improvements to the monetary transmission mechanism and the government securities market.** Currently the BCV's policy rate is not appropriately influencing lending, deposit, and t-bill rates. Moreover, with t-bill rates substantially below the policy rate only financial institutions that don't have access to BCV bills are buying t-bills. To rectify this, improve the depth and liquidity of the t-bill market, improve price discovery, and reduce its monetary policy costs, the BCV has been considering using outright sales of t-bills to mop up excess liquidity. Staff warned that without improving the issuance of government securities and addressing the market distortions created by large institutional investors with low price sensitivity that is hampering price discovery, banks will shift entirely to the 14-day BCV bill, which would worsen price discovery. Instead, it would be advisable first to

BCV policy rate is not leading other interest rates, but drives commercial banks' net foreign asset position.



Sources: BCV, IMF Information Notice System.

- Reform the primary t-bill and t-bond issuances as outlined in MEFP (¶15).

- Adjust the maturity of the longer-term BCV bill (and treasury securities) to avoid competing in the same segment of the market; calibrate the amounts offered to better balance the use of short- and longer-term instruments; and ensure that the amounts offered are sold by accepting market outcomes.

14. **The BCV is taking steps to safeguard financial sector stability.** The authorities indicated that the FSAP and the PSI are supporting their internal reforms to strengthen supervision and regulation. In 2009, the BCV doubled supervision staff and tightened supervision of offshore banks.

- Financial sector surveillance is being enhanced. Following the FSAP the BCV has updated the stress-tests and established an internal financial stability group.

- Legislation for the offshore-sector is being overhauled. A draft banking law, based on the EU banking law standard, will implement the new offshore strategy. The dual banking system will continue but with harmonized prudential ratios, tightened requirements to operate, and information sharing with foreign supervisors.

- Enforcement capacity is being strengthened. The BCV has ensured that the bank whose capital fell below the regulatory minimum in July was recapitalized. Also, the new banking law will protect supervision staff against legal action.

III. Program Monitoring and Modifying PSI Targets

15. **The authorities request, and staff support, that the December 2009 assessment criteria be modified.** Assessment criteria and indicative targets for the 8th and last review of the PSI are in Tables 1 and 2 of the MEFP. The review schedule is in Table 9. The authorities request that the floor for net international reserves be lowered by €5.7 million because of the larger-than-envisaged impact of the global crisis on the balance of payments, current pressure on reserves, and uncertainties regarding tourism inflows and the weak global economic recovery. They also request that the ceiling on nonconcessional external financing be raised by US$13 million, to US$48 million, and the ceiling on net domestic borrowing be lowered by the same amount to accommodate a €20 million budget support loan from the African Development Bank (AfDB). The AfDB loan will replace domestic borrowing, reinforce foreign reserves, and lengthen the maturity of government debt. Although nonconcessional, the AfDB loan carries a lower interest rate than domestic borrowing.

IV. Staff Appraisal

16. **Cape Verde is weathering the global economic crisis well**. All PSI performance assessment criteria were observed by a wide margin. Though slowing, growth remains solid and inflation has returned to low levels. Despite a moderate decline, gross reserves should remain robust, partly because of the SDR allocation and expected new external loans.

17. **The current fast pace of public investment is consistent with external stability**. The expansion is financed externally, thereby preserving reserves, and mainly on long and concessional terms. The impact on domestic prices and the REER should be low and the medium-term impact on competitiveness positive; the REER is broadly in line with fundamentals.

18. **While the investment-driven fiscal deficit in 2010 is justified, the borrowing space is being used rapidly.** The investments address critical growth-constraining infrastructure bottlenecks, and debt service should remain moderate. However, while the risk of debt distress in Cape Verde remains low, the more rapid increase of the debt ratios than earlier envisaged is reducing the comfort level. Staff welcomes the lower deficit in 2012 but recommends that the authorities also significantly reduce the 2011 deficit and keep the fiscal deficit low over the medium term to dispel any market concerns about fiscal sustainability and retain a low risk of debt distress. The authorities should strengthen their use of DSAs and set a borrowing ceiling before taking out new loans. The envisaged successor PSI should include a new external debt anchor.

19. **Domestic borrowing should continue to be low to support reserves and protect the peg.** Adequate reserves are critical because of Cape Verde's intrinsic vulnerabilities, including a narrow export base, dependence on remittances, increased external debt, the large volume of nonresident deposits with local banks, and the need to provision for contingent liabilities.

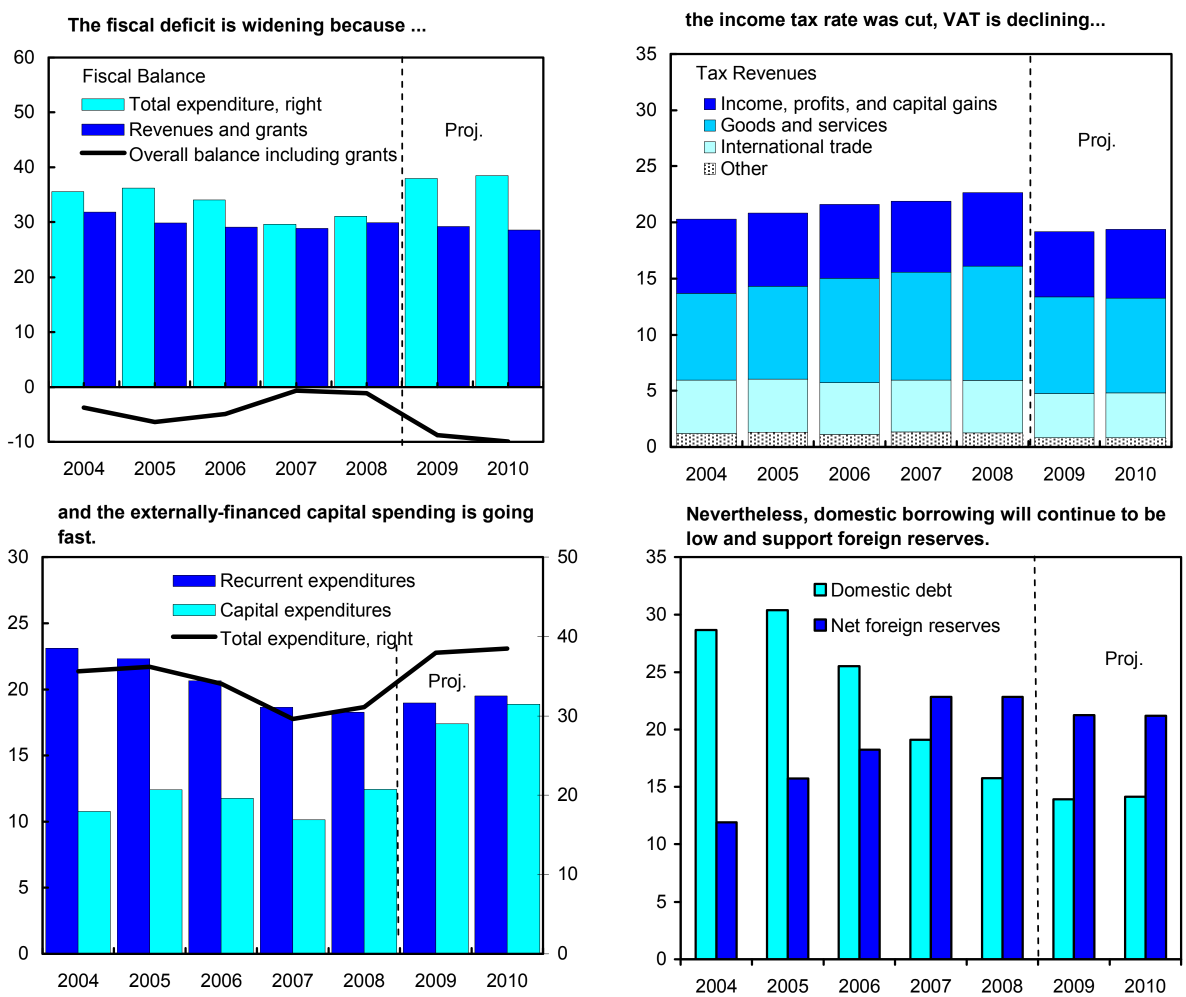
20. **There should be room to gradually lower interest rates in line with the decline in international country risk premiums.** The monetary framework continues to be appropriate, but the transmission mechanism needs to be improved. The BCV should keep monetary management passive and set the short-term policy rate in line with the euribor in order to anchor market expectations and keep capital flows low and stable. Given the pressure on international reserves, in the short term the increase in the reserve requirement is justified. Over the medium term, the authorities should develop the domestic financial market and rely more on market instruments, however.

21. **The progress in implementing FSAP recommendations to improve financial sector regulation and supervision is welcomed.** A new banking law will strengthen regulation of the offshore sector, supervision capacity was doubled, and enforcement of prudential regulations has been timely. Staff urges the BCV to continue its efforts to enact the new banking law in 2010.

22. **Staff recommends completion of the seventh PSI review.** Based on the strength of their policies, staff supports the authorities' request for modification of end-December 2009 assessment criteria (¶15).

Figure 1. Cape Verde: Fiscal Performance, 2004–10

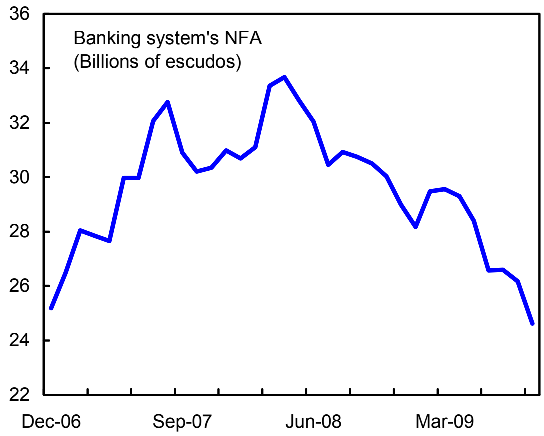
(Percent of GDP)



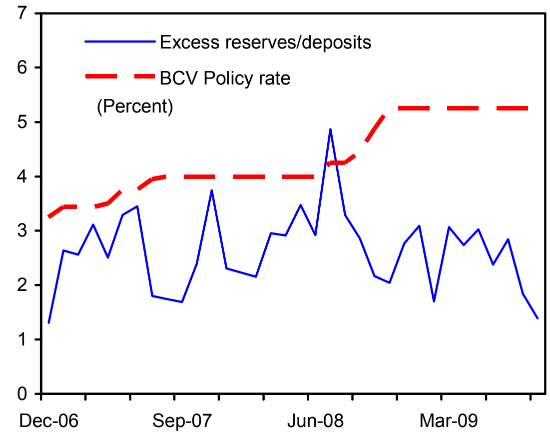
Sources: Cape Verdean authorities and IMF staff estimates.

Figure 2. Cape Verde: Monetary Developments, Dec. 2006–Sep. 2009

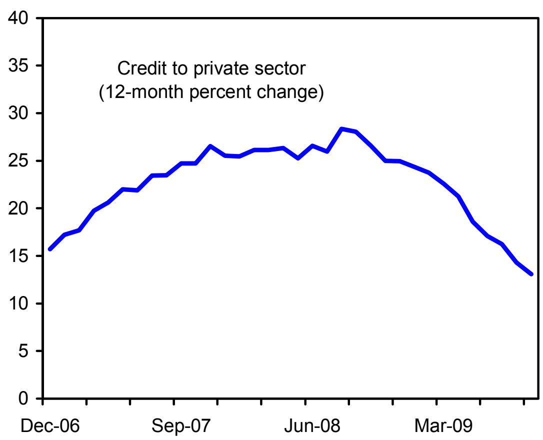
The external shock widened the external current account and reduced banking system reserves...



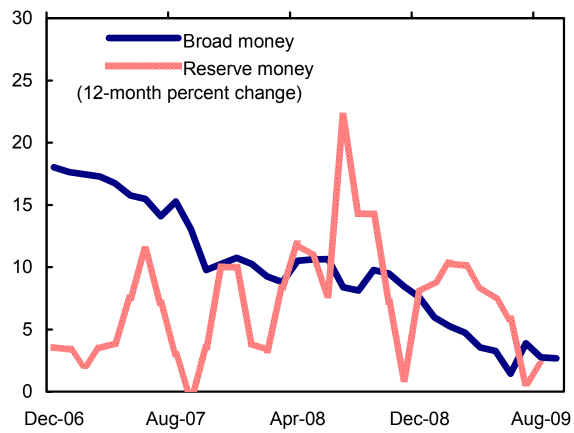
leading the central bank raised its policy rate and reserve requirements, thereby tightening liquidity...



...decelerating the growth of credit to the private sector...

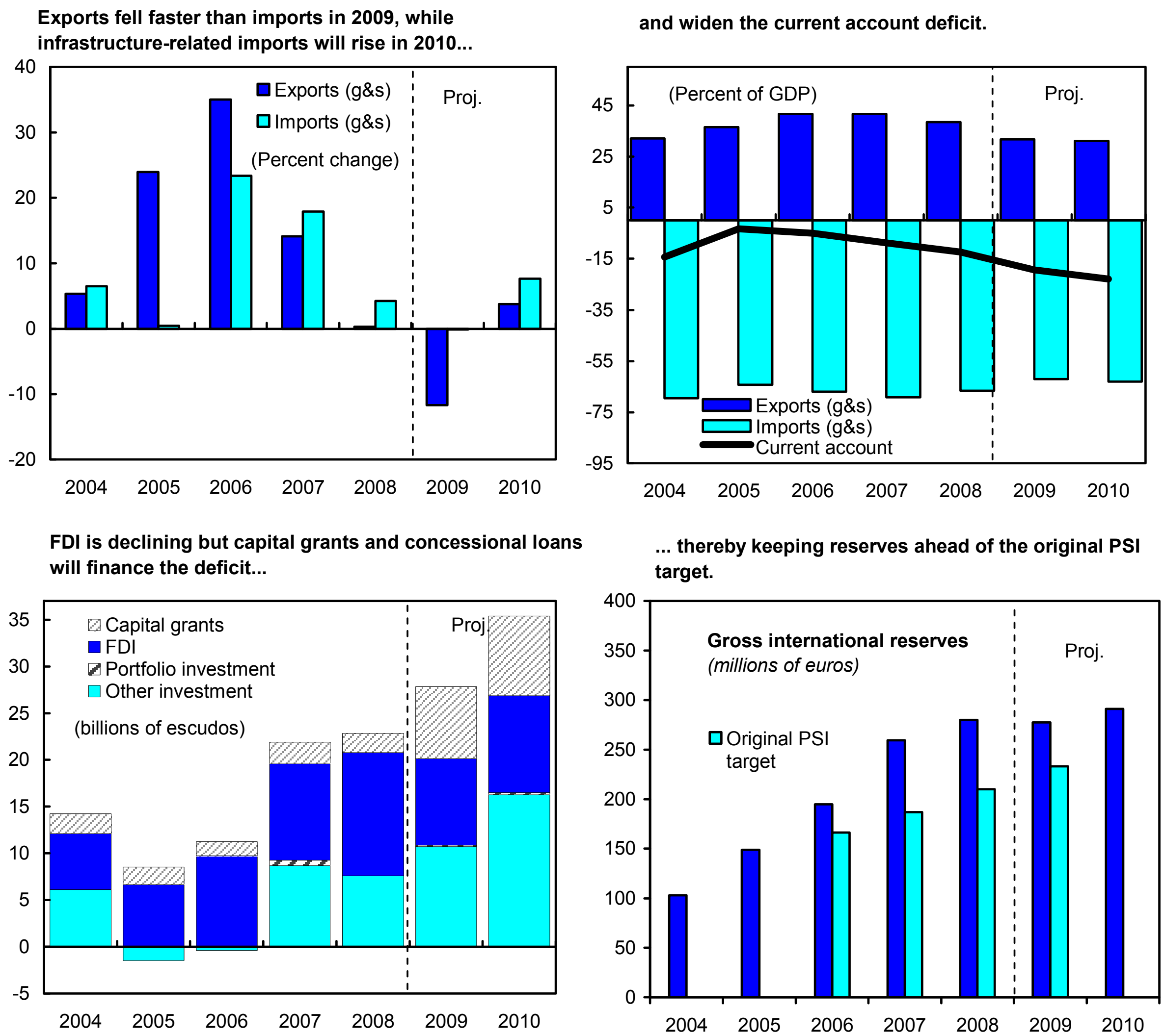


and slowing down the growth of broad money and base money.



Source: Bank of Cape Verde.

Figure 3. Cape Verde: External Sector 2004–10



Sources: Cape Verdean authorities and IMF staff estimates.

Table 1. Cape Verde: Selected Indicators, 2006–14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Actual		Estimates	Projections					
	(Annual percentage change)								
National accounts and prices									
Real GDP	10.8	7.8	5.9	4.1	5.0	5.5	7.0	7.1	6.9
Real GDP per capita	8.8	6.4	3.4	2.1	3.0	3.5	5.0	5.1	4.8
Consumer price index (annual average)	4.8	4.4	6.8	1.4	1.4	2.0	2.0	2.0	2.0
Consumer price index (end of period)	5.8	3.4	6.7	1.0	1.4	2.0	2.0	2.0	2.0
External sector									
Exports of goods and services	35.0	14.1	0.3	-11.7	3.8	11.0	15.6	17.5	17.7
Of which: tourism	82.5	40.6	-5.6	-26.5	2.0	11.5	17.9	20.4	20.4
Imports of goods and services	23.4	17.9	4.2	-0.2	7.6	8.2	0.3	12.1	10.0
Real effective exchange rate (annual average)	2.8	2.5	4.3	...	...	...	...	...	...
Terms of trade (minus = deterioration)	-4.4	-1.1	-5.2	6.2	-1.8	-0.2	-0.2	-0.2	-0.2
Government finance									
Total revenue (excluding grants)	19.6	17.0	10.8	-1.7	5.1	17.2	9.6	11.3	10.3
Total expenditure	11.8	-0.7	13.1	30.6	7.4	9.8	-2.7	6.3	8.7
Noncapital expenditure	11.6	-0.4	3.0	18.7	0.3	8.1	5.4	12.5	9.5
Capital expenditure	12.1	-1.4	32.9	48.5	15.9	11.5	-10.8	-1.0	7.7
Money and credit									
Net foreign assets	15.2	23.0	-6.4	-5.5	5.8	5.5	5.2	8.4	17.3
Net domestic assets	19.3	5.6	14.4	3.8	7.2	2.0	6.8	7.3	9.1
Of which: net claims on the central government	1.1	-61.6	31.4	-23.3	6.6	-11.4	5.4	-6.5	-10.2
credit to the economy[1]	30.0	25.5	24.9	6.0	8.7	4.8	8.2	9.4	11.1
Broad money (M2)	18.0	10.8	7.6	1.2	6.9	2.9	6.4	7.6	11.3
Domestic broad money (M2X)	22.6	13.8	9.2	3.5	6.9	2.9	6.4	7.6	11.3
Income velocity (GDP/M2)[2]	1.33	1.35	1.33	1.37	1.39	1.42	1.50	1.56	1.57
Reserve money (M0)	3.5	10.0	8.0	1.4	6.6	2.8	6.4	7.7	11.4
	(Percent of GDP)								
Saving-investment balance									
Gross capital formation	43.0	51.4	48.2	49.1	47.9	47.7	48.4	48.1	47.7
Government	6.1	4.9	7.4	11.2	12.3	12.8	10.3	9.2	8.9
Nongovernment	36.9	46.4	40.8	37.8	35.6	34.9	38.1	39.0	38.8
Gross national savings	38.3	42.2	35.7	29.6	25.0	25.5	32.7	33.8	35.5
Of which: government	9.4	9.5	12.8	5.9	3.3	5.3	6.0	5.7	5.7
External current account (including official current transfers)	-5.0	-8.7	-12.4	-19.4	-22.9	-22.3	-15.7	-14.3	-12.2
Government finance									
Total domestic revenue	24.1	24.3	25.1	23.0	22.8	25.0	24.8	24.8	24.7
Total external grants	5.5	4.6	4.9	6.2	5.7	4.6	4.1	2.6	2.5
Total expenditure	34.6	29.6	31.2	38.0	38.5	39.6	34.9	33.2	32.7
Overall balance before grants	-10.5	-5.3	-6.1	-15.0	-15.7	-14.5	-10.0	-8.5	-8.0
Overall balance (including grants)	-5.0	-0.7	-1.2	-8.8	-9.9	-10.0	-6.0	-5.8	-5.5
External financing (net)	3.0	1.9	2.7	9.4	11.0	10.6	6.5	4.4	4.4
Domestic financing (net)	2.9	-0.7	-0.9	-0.8	-1.1	-0.6	-0.6	1.4	1.1
Financing gap/ statistical discrepancy	-0.9	-0.5	-0.6	0.1	0.0	0.0	0.0	0.0	0.0
Total nominal government debt[3]	73.4	59.7	57.4	60.5	69.3	76.5	75.5	73.8	71.7
External government debt[4]	47.7	40.7	41.6	46.6	55.2	62.5	63.3	61.6	60.2
Domestic government debt, net of deposits	25.8	18.9	15.8	13.9	14.2	14.1	12.3	12.2	11.5
External current account (excluding official current transfers)	-9.1	-12.9	-18.4	-21.6	-23.6	-23.2	-16.7	-15.5	-13.3
Overall balance of payments	4.7	5.8	1.2	-0.2	1.0	0.9	0.8	1.3	2.8
External current account (€ millions, including official transfers)	-47.7	-96.4	-147.0	-246.7	-307.6	-320.2	-249.0	-253.6	-238.9
Gross international reserves (€ millions, end of period)	194.9	259.5	280.0	277.7	291.1	304.2	317.4	341.0	395.3
Gross international reserves to reserve money	1.0	1.2	1.2	1.2	1.1	1.1	1.2	1.2	1.2
Gross international reserves (months of prospective imports of goods and services)	3.1	4.0	4.3	3.9	3.8	4.0	3.7	3.6	3.7
External debt service (percent of exports of goods and services)	5.7	4.7	4.8	5.5	7.0	6.8	6.5	6.7	5.6
Memorandum items:									
Nominal GDP (billions of Cape Verde escudos)	104.6	121.8	130.7	140.0	148.2	158.5	174.9	195.2	215.3
Net domestic borrowing, net of arrears clearance	0.5	-4.7	-1.9	-0.8	1.0	0.8	-0.5	1.3	0.4
Exchange rate (Cape Verde escudos per US$)									
Period average	87.8	80.4	74.9	…	…	…	…	…	…
End period	83.5	75.6	80.9	…	…	…	…	…	…

Sources: Cape Verdean authorities, and IMF staff estimates and projections.

[1] Excluding a December 2006 purchase of a Portuguese credit to Electra and subsequent offloading on the domestic securities market.
[2] Velocity is nominal GDP devided by average end period broad money.
[3] Net of central government deposits; including verified stock of domestic and external arrears.
[4] Excluding claims on the offshore Trust Fund.

Table 2a. Cape Verde: Fiscal Operations of the Central Government, 2007–14

(Millions of Cape Verde escudos, unless otherwise indicated)

	2007	2008		2009			2010	2011	2012	2013	2014
	Actual	Jan-Jun	Prel.	Budget	Jan-Jun	Mid-yr review	Fiscal program			Projections	
Revenue, grants, and net lending	35,131	17,854	39,187	43,639	17,219	40,892	42,344	46,897	50,584	53,460	58,697
Domestic revenue (incl. net lending)	29,559	15,897	32,757	36,267	14,219	32,190	33,824	39,628	43,426	48,316	53,290
Tax revenue	26,423	14,388	29,585	30,302	12,555	26,838	28,737	32,128	34,858	40,556	44,612
Income and profit taxes	7,656	4,368	8,525	8,900	4,008	8,121	9,067	10,137	10,998	13,041	14,431
Consumption taxes	11,565	6,462	13,300	14,508	5,527	12,071	12,505	13,981	15,169	18,381	20,381
International trade taxes	5,592	2,739	6,110	5,917	2,502	5,478	5,917	6,615	7,177	7,755	8,279
Other taxes	1,611	819	1,650	978	519	1,168	1,248	1,395	1,513	1,379	1,522
Nontax revenue	2,843	1,473	3,102	5,944	1,651	5,331	5,087	7,500	8,568	7,760	8,678
Net lending	293	36	70	21	13	21	0	0	0	0	0
External grants	5,572	1,957	6,430	7,372	3,000	8,702	8,520	7,269	7,158	5,144	5,407
Capital grants	4,009	696	4,790	5,478	1,997	7,699	8,520	7,269	7,158	4,644	4,907
Budget support	1,563	1,261	1,640	1,894	1,003	1,003	0	0	0	500	500
Total expenditure	35,986	16,288	40,715	51,435	17,807	53,177	57,094	62,684	60,991	64,839	70,499
Recurrent expenditure	22,308	9,437	23,264	27,984	11,123	26,571	28,920	31,490	33,181	37,313	40,861
Primary recurrent expenditure	20,428	8,509	21,367	25,692	10,217	24,225	26,408	29,411	30,770	33,345	37,142
Wages and salaries	12,491	5,839	13,518	15,950	6,978	15,651	17,129	15,280	15,985	19,077	21,403
Goods and services	1,853	500	2,048	2,964	936	2,739	3,162	3,214	3,362	3,644	4,019
Transfers and subsidies	5,219	1,730	4,781	4,924	2,026	4,414	5,173	7,940	8,309	8,192	9,037
Transfers	3,309	1,669	3,910	4,667	1,953	4,066	4,800	7,172	7,503	7,132	7,867
Subsidies	1,910	61	871	258	73	348	372	768	806	1,061	1,170
Of which: energy subsidies	1,802	0	525	0	0	0	0	0	0	0	0
Other expenditures	864	440	1,020	1,854	277	1,422	944	2,977	3,115	2,432	2,683
Domestic interest payments	1,361	643	1,348	1,570	601	1,624	1,727	1,386	1,607	1,311	1,425
External interest payments	519	285	548	722	305	722	784	693	804	2,656	2,294
Extraordinary expenditures	0	0	0	0	0	200	0	0	0	0	0
Capital expenditure	12,237	5,062	16,264	20,990	5,850	24,146	27,974	31,194	27,810	27,526	29,638
Foreign financed	9,599	3,066	11,701	13,939	4,052	16,726	22,976	28,905	26,405	11,403	13,092
Domestically financed	2,638	1,996	4,562	7,052	1,798	7,420	4,998	2,290	1,405	16,123	16,546
Other expenditures (incl. arrears clearance)	1,440	1,790	1,188	2,460	834	2,260	200	0	0	0	0
Of which: energy subsidies	0	0	0	…	0	0	0	0	0	0	0
Overall balance, including grants (budget basis)	-855	1,566	-1,529	-7,796	-587	-12,285	-14,750	-15,787	-10,407	-11,379	-11,802
Financing	855	-1,566	1,529	7,796	587	12,285	14,750	15,787	10,407	11,379	11,802
Foreign, net	2,326	-219	3,495	6,756	1,294	13,195	16,342	16,784	11,430	8,600	9,436
Drawings	4,145	726	5,381	8,884	2,189	15,322	18,456	18,852	13,473	11,130	11,692
Amortization	-1,819	-945	-1,886	-2,127	-895	-2,127	-2,114	-2,068	-2,043	-2,530	-2,256
Domestic, net	-889	-2,056	-1,138	1,039	-899	-1,101	-1,593	-997	-1,023	2,779	2,366
Net domestic borrowing	-2,567	-2,593	-1,972	1,759	-252	1,165	1,667	1,290	-839	2,477	859
Banking system	-9,685	-1,374	-2,008	…	616	1,854	398	-736	313	-395	-575
Nonbanks	7,117	-1,219	36	…	-868	-689	1,268	2,026	-1,151	2,872	1,434
Privatization and other sales of assets	3,598	537	834	-720	-647	-2,266	-3,259	-2,287	-184	302	1,506
Accounts payable (*atrasados*), net	-1,919	0	0	…	0	0	0	0	0	0	0
Net errors and omissions	-582	709	-828	0	192	192	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:											
Overall balance, including grants (excluding clearance of arrears and accounts payable)	2,321	2,289	-955	-5,336	34	-10,025	-14,550	-15,787	-10,407	-11,379	-11,802
Arrears clearance	1,257	724	574	2,460	621	2,260	200	0	0	0	0
Net domestic borrowing, excluding clearance of arrears and net accounts payable	-5,743	-3,317	-2,546	-701	-873	-1,095	1,467	1,290	-839	2,477	859
Primary balance (including grants)[2]	1,025	2,493	368	-5,503	319	-9,939	-12,238	-13,708	-7,996	-7,412	-8,083
Recurrent domestic balance[3]	7,250	6,460	9,493	8,283	3,096	5,619	4,904	8,138	10,245	11,003	12,429
Net external flows[4]	7,898	1,738	9,925	14,128	4,294	21,897	24,862	24,053	18,588	13,744	14,844
External debt service (percent of domestic revenue)	7.9	7.7	7.4	7.9	8.4	8.9	8.6	7.0	6.6	10.7	8.5
Domestic debt (including arrears and accounts payable, net of deposits)	23,057	...	20,606	19,905	...	19,510	20,977	22,267	21,428	23,906	24,765

Sources: Ministry of Finance, Bank of Cape Verde, and IMF staff estimates and projections.

[1] The energy subsidies recorded in 2007 were incurred in previous periods.

[2] Overall balance (including grants) – total expenditure + domestic and external interest payments.

[3] Domestic revenue – recurrent expenditure.

[4] External grants + net foreign financing.

[5] Negative values reflect onlending operations.

Table 2b. Cape Verde: Fiscal Operations of the Central Government, 2007–14

(Percent of GDP)

	2007	2008		2009			2010	2011	2012	2013	2014
	Actual	Jan-Jun	Prel.	Budget	Jan-Jun	Mid-yr review	Fiscal program			Projections	
Revenue, grants, and net lending	28.9	13.7	30.0	31.2	12.3	29.2	28.6	29.6	28.9	27.4	27.3
Domestic revenue (incl. net lending)	24.3	12.2	25.1	25.9	10.2	23.0	22.8	25.0	24.8	24.8	24.7
Tax revenue	21.7	11.0	22.6	21.6	9.0	19.2	19.4	20.3	19.9	20.8	20.7
Income and profit taxes	6.3	3.3	6.5	6.4	2.9	5.8	6.1	6.4	6.3	6.7	6.7
Consumption taxes	9.5	4.9	10.2	10.4	3.9	8.6	8.4	8.8	8.7	9.4	9.5
International trade taxes	4.6	2.1	4.7	4.2	1.8	3.9	4.0	4.2	4.1	4.0	3.8
Other taxes	1.3	0.6	1.3	0.7	0.4	0.8	0.8	0.9	0.9	0.7	0.7
Nontax revenue	2.3	1.1	2.4	4.2	1.2	3.8	3.4	4.7	4.9	4.0	4.0
Net lending	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External grants	4.6	1.5	4.9	5.3	2.1	6.2	5.7	4.6	4.1	2.6	2.5
Capital grants	3.3	0.5	3.7	3.9	1.4	5.5	5.7	4.6	4.1	2.4	2.3
Budget support	1.3	1.0	1.3	1.4	0.7	0.7	0.0	0.0	0.0	0.3	0.2
Total expenditure	29.6	12.5	31.2	36.7	12.7	38.0	38.5	39.6	34.9	33.2	32.7
Recurrent expenditure	18.3	7.2	17.8	20.0	7.9	19.0	19.5	19.9	19.0	19.1	19.0
Primary recurrent expenditure	16.8	6.5	16.3	18.3	7.3	17.3	17.8	18.6	17.6	17.1	17.2
Wages and salaries	10.3	4.5	10.3	11.4	5.0	11.2	11.6	9.6	9.1	9.8	9.9
Goods and services	1.5	0.4	1.6	2.1	0.7	2.0	2.1	2.0	1.9	1.9	1.9
Transfers and subsidies	4.3	1.3	3.7	3.5	1.4	3.2	3.5	5.0	4.8	4.2	4.2
Transfers	2.7	1.3	3.0	3.3	1.4	2.9	3.2	4.5	4.3	3.7	3.7
Subsidies	1.6	0.0	0.7	0.2	0.1	0.2	0.3	0.5	0.5	0.5	0.5
Of which: energy subsidies	1.5	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other expenditures	0.7	0.3	0.8	1.3	0.2	1.0	0.6	1.9	1.8	1.2	1.2
Domestic interest payments	1.1	0.5	1.0	1.1	0.4	1.2	1.2	0.9	0.9	0.7	0.7
External interest payments	0.4	0.2	0.4	0.5	0.2	0.5	0.5	0.4	0.5	1.4	1.1
Extraordinary expenditures	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Capital expenditure	10.1	3.9	12.4	15.0	4.2	17.2	18.9	19.7	15.9	14.1	13.8
Foreign financed	7.9	2.3	9.0	10.0	2.9	11.9	15.5	18.2	15.1	5.8	6.1
Domestically financed	2.2	1.5	3.5	5.0	1.3	5.3	3.4	1.4	0.8	8.3	7.7
Other expenditures (incl. arrears clearance)	1.2	1.4	0.9	1.8	0.6	1.6	0.1	0.0	0.0	0.0	0.0
Of which: energy subsidies	0.0	0.0	0.0	…	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, including grants (budget basis)	-0.7	1.2	-1.2	-5.6	-0.4	-8.8	-9.9	-10.0	-6.0	-5.8	-5.5
Financing	0.7	-1.2	1.2	5.6	0.4	8.8	9.9	10.0	6.0	5.8	5.5
Foreign, net	1.9	-0.2	2.7	4.8	0.9	9.4	11.0	10.6	6.5	4.4	4.4
Drawings	3.4	0.6	4.1	6.3	1.6	10.9	12.5	11.9	7.7	5.7	5.4
Amortization	-1.5	-0.7	-1.4	-1.5	-0.6	-1.5	-1.4	-1.3	-1.2	-1.3	-1.0
Domestic, net	-0.7	-1.6	-0.9	0.7	-0.6	-0.8	-1.1	-0.6	-0.6	1.4	1.1
Net domestic borrowing	-2.1	-2.0	-1.5	1.3	-0.2	0.8	1.1	0.8	-0.5	1.3	0.4
Privatization and other sales of assets	3.0	0.4	0.6	-0.5	-0.5	-1.6	-2.2	-1.4	-0.1	0.2	0.7
Accounts payable (atrasados), net	-1.6	…	0.0	…	…	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-0.5	0.5	-0.6	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Overall balance, including grants (excluding clearance of arrears and accounts payable)	1.9	1.8	-0.7	-3.8	0.0	-7.2	-9.8	-10.0	-6.0	-5.8	-5.5
Arrears clearance	1.0	0.6	0.4	1.8	0.4	1.6	0.1	0.0	0.0	0.0	0.0
Net domestic borrowing, excluding clearance of arrears and net accounts payable	-4.7	-2.5	-1.9	-0.5	-0.6	-0.8	1.0	0.8	-0.5	1.3	0.4
Primary balance (including grants)[2]	0.8	1.9	0.3	-3.9	0.2	-7.1	-8.3	-8.6	-4.6	-3.8	-3.8
Recurrent domestic balance[3]	6.0	4.9	7.3	5.9	2.2	4.0	3.3	5.1	5.9	5.6	5.8
Net external flows[4]	6.5	1.3	7.6	10.1	3.1	15.6	16.8	15.2	10.6	7.0	6.9
Domestic debt (including arrears and accounts payable, net of deposits)	18.9	…	15.8	14.2	…	13.9	14.2	14.1	12.3	12.2	11.5
Nominal GDP (millions of CVEsc)	121,753	130,688	130,688	140,042	140,042	140,042	148,240	158,480	174,910	195,200	215,322

Sources: Ministry of Finance, Bank of Cape Verde, and IMF staff estimates and projections.

[1] The energy subsidies recorded in 2007 were incurred in previous periods.
[2] Overall balance (including grants) – total expenditure + domestic and external interest payments.
[3] Domestic revenue – recurrent expenditure.
[4] External grants + net foreign financing.
[5] Negative values reflect onlending operations.

Table 3. Cape Verde: Balance of Payments, 2007–14
(Millions of euros, unless otherwise indicated)

	2007	2008		2009		2010	2011	2012	2013	2014
		Jan-Jun	Est.	Jan-Jun	Proj.	Projections				
Current account balance (including official transfers)	-96	-54	-147	-76	-247	-308	-320	-249	-254	-239
Trade balance	-485	-212	-485	-237	-531	-589	-602	-580	-653	-718
Exports, f.o.b.	56	42	78	26	54	62	68	75	82	89
Imports, f.o.b.	-541	-255	-563	-263	-586	-651	-671	-655	-735	-807
Services (net)	183	80	152	70	147	160	149	196	252	325
Credit	399	190	378	179	349	356	396	461	548	652
Of which: tourism	244	124	230	89	169	172	192	226	273	328
Debit	-216	-110	-225	-109	-202	-196	-246	-265	-296	-326
Income (net)	-19	-20	-32	-27	-37	-46	-55	-62	-72	-79
Credit	18	11	19	1	9	10	7	8	9	10
Debit	-37	-32	-51	-28	-46	-56	-62	-70	-81	-88
Government interest	-5	-2	-5	-2	-2	-9	-11	-14	-19	-21
Interest by other sectors	-15	-9	-19	-5	-19	-20	-20	-21	-22	-23
Income on direct investment and other income	-17	-20	-27	-21	-25	-27	-31	-35	-39	-44
Current transfers (net)	225	98	218	118	175	168	188	197	219	233
Government	46	37	71	44	28	9	14	16	20	20
Others, incl. emigrant remittances[1]	179	62	147	74	148	158	174	181	198	212
	0	0	0	0	0	0	0	0	0	0
Capital and financial account (net)	198	119	230	82	252	321	333	262	277	293
Capital transfers	20	7	19	10	70	77	66	23	26	29
Government	20	6	18	10	70	77	66	23	26	29
Other	0	0	0	0	0	0	0	0	0	0
Direct investment (net)	94	86	142	39	84	94	122	141	161	174
Portfolio investment	5	0	0	2	2	2	2	2	2	2
Other investments, central government	18	5	29	13	119	147	151	102	78	86
Trust Fund	0	0	0	0	0	0	0	0	0	0
Net official flows	18	5	29	13	119	147	151	102	78	86
Disbursements	34	12	46	20	139	167	171	122	101	106
Amortization	-17	-8	-17	-7	-20	-20	-20	-20	-23	-20
Other	0	0	0	0	0	0	0	0	0	0
Other investments, non-central government	61	22	40	18	-22	1	-7	-6	10	4
Commercial banks (net)	13	17	38	18	6	1	1	1	1	1
Commercial credit (net)	4	3	6	2	0	0	0	0	0	0
Other	44	2	-4	-2	-28	0	-8	-6	10	3
	0	0	0	0	0	0	0	0	0	0
Net errors and omissions	-38	-43	-68	-16	-8	0	0	0	0	0
	0	0	0	0	0	0	0	0	0	0
Overall balance	65	22	14	-9	-2	13	13	13	24	54
Financing	-65	-22	-14	9	2	-13	-13	-13	-24	-54
Gross international reserves (– accumulation)	-65	-24	-14	9	2	-13	-13	-13	-24	-54
Exceptional financing	0	2	0	1	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0	0
Memorandum items:										
Current account (including official transfers; percent of GDP)	-8.7	-4.9	-12.4	-6.4	-19.4	-22.9	-22.3	-15.7	-14.3	-12.2
Current account (excluding official transfers; percent of GDP)	-12.9	-8.2	-18.4	-10.1	-21.6	-23.6	-23.2	-16.7	-15.5	-13.3
Overall balance (percent of GDP)	5.8	2.0	1.2	-0.8	-0.2	1.0	0.9	0.8	1.3	2.8
Gross international reserves	260	284	280	271	278	291	304	317	341	395
Months of current year's import of goods and services	4.1	4.3	4.3	4.1	4.2	4.1	4.0	4.1	4.0	4.2
Months of next year's import of goods and services	4.0	4.3	4.3	3.8	3.9	3.8	4.0	3.7	3.6	3.7
External public debt	450	…	493	…	592	742	898	1,003	1,090	1,176
External aid (grants and loans; percent of GDP)	9.1	5.0	11.5	6.2	18.6	18.9	17.4	10.2	8.3	7.9

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

Table 4. Cape Verde: Monetary Survey, 2006–14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Dec.		Dec.	December					
	Actual		Est.	Projections					
	(Millions of Cape Verde escudos, unless otherwise specified)								
Net foreign assets	25,189	30,976	28,991	27,377	28,971	30,565	32,156	34,850	40,870
Foreign assets	31,423	38,762	38,147	37,047	38,619	40,163	41,721	44,428	50,525
Of which: foreign reserves	0	0	30,880	30,627	32,104	33,549	35,008	37,613	43,606
Foreign liabilities	-6,235	-7,786	-9,161	-9,670	-9,648	-9,598	-9,564	-9,579	-9,655
Net domestic assets	60,252	63,652	72,793	75,584	81,047	82,653	88,270	94,729	103,362
Net domestic credit	71,248	68,534	89,754	92,234	99,174	102,401	109,796	118,206	128,982
Net claims on general government	25,923	11,639	18,675	16,881	17,298	16,586	16,943	16,603	16,083
Claims on the Trust Fund (TCMFs)	11,038	6,433	11,038	11,038	11,038	11,038	11,038	11,038	11,038
Net claims on the central government	15,714	6,029	7,925	6,102	6,500	5,764	6,077	5,682	5,108
Credit to central government	19,681	13,095	14,377	14,659	15,672	15,244	16,569	17,436	18,218
Deposits of central government	-3,967	-7,066	-6,453	-8,557	-9,172	-9,480	-10,492	-11,754	-13,111
Of which: project deposits	-1,398	. . .	0	0	0	0	0	0	0
Net claims on local government	-341	-310	403	431	457	488	539	601	663
Net claims on other government agencies (INPS)	-488	-514	-690	-690	-697	-704	-711	-718	-726
Credit to the economy	45,325	56,896	71,079	75,354	81,876	85,814	92,853	101,603	112,899
Of which: excluding purchase of a Portuguese credit to Electra and subsequent off-loading on the domestic securities market	40,461	…	…	…	…	…	…	…	…
Credit to public enterprises	6	3	0	0	0	0	0	0	0
Credit to private sector	2,714	2,496	70,443	74,717	81,240	85,178	92,217	100,967	112,262
Claims on nonbank financial institutions	42,604	54,397	636	636	636	636	636	636	636
Other items (net)	-10,996	-4,882	-16,962	-16,651	-18,127	-19,748	-21,526	-23,478	-25,620
Broad money (M2)	85,441	94,628	101,783	102,961	110,018	113,217	120,426	129,579	144,232
Narrow money (M1)	38,810	43,021	45,071	45,592	48,718	50,134	53,326	57,379	63,868
Currency outside banks	7,731	8,399	8,675	8,685	9,214	9,433	9,998	10,731	11,917
Demand deposits	31,079	34,622	36,396	36,907	39,504	40,701	43,328	46,648	51,951
Quasimoney	41,776	45,640	50,459	51,043	54,542	56,128	59,702	64,239	71,503
Foreign currency deposits	4,856	5,967	6,253	6,325	6,759	6,955	7,398	7,961	8,861
	(Change in percent of broad money 12 months earlier)								
Net foreign assets	4.6	6.8	-2.1	-1.6	1.5	1.4	1.4	2.2	4.6
Net domestic assets	13.4	4.0	9.7	2.7	5.3	1.5	5.0	5.4	6.7
Net domestic credit	14.3	-3.2	22.4	2.4	6.7	2.9	6.5	7.0	8.3
Net claims on the central government	0.2	-11.3	2.0	-1.8	0.4	-0.7	0.3	-0.3	-0.4
Credit to the economy	14.5	13.5	15.0	4.2	6.3	3.6	6.2	7.3	8.7
Credit to public enterprises	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to private sector	0.6	-0.3	15.7	4.2	6.3	3.6	6.2	7.3	8.7
Other items (net)	-0.9	7.2	-12.8	0.3	-1.4	-1.5	-1.6	-1.6	-1.7
Broad money (M2)	18.0	10.8	7.6	1.2	6.9	2.9	6.4	7.6	11.3
Memorandum items:									
Income velocity of money [1]	1.33	1.35	1.33	1.37	1.39	1.42	1.50	1.56	1.57
Emigrant deposits	27,250	28,424	28,159	26,017	27,800	28,609	30,430	32,743	36,446
(as percent total deposits)	61.0	37.9	30.2	27.6	27.6	27.6	27.6	27.6	27.5
Excess reserves/total deposits (percent)	1.3	2.3	2.8	1.3	1.3	1.3	1.3	1.3	1.3
Money multiplier (M2/M0)	3.9	3.9	3.9	3.9	4.0	4.0	4.0	4.0	4.0
Credit to the economy (percentage change)	30.0	25.5	24.9	6.0	8.7	4.8	8.2	9.4	11.1

Sources: Bank of Cape Verde, and IMF staff estimates and projections.

[1] Velocity is nominal GDP devided by average end period broad money.

Table 5. Cape Verde: Central Bank Survey, 2006–14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Dec.		Dec.	December					
	Actual		Est.	Projections					
	(Millions of Cape Verde escudos, unless otherwise specified)								
Net foreign assets	20,411	27,614	29,780	28,874	30,528	32,182	33,836	36,592	42,677
Of which: net international reserves	19,269	27,572	29,866	29,772	31,426	33,080	34,733	37,490	43,575
Foreign assets	21,644	28,760	31,013	30,760	32,237	33,682	35,141	37,746	43,739
Foreign liabilities	-1,233	-1,146	-1,239	-1,887	-1,709	-1,501	-1,305	-1,154	-1,062
Net domestic assets	1,451	-3,574	-3,821	-2,805	-2,738	-3,610	-3,441	-3,870	-6,211
Net domestic credit	3,596	-9,666	-1,105	-500	-386	-1,211	-995	-1,375	-3,666
Trust Fund claims	4,605	0	4,605	4,605	4,605	4,605	4,605	4,605	4,605
Net claims on central government	1,748	-4,346	79	-2,025	-2,640	-2,948	-3,961	-5,223	-6,579
Credit to central government	3,739	0	3,640	3,640	3,640	3,640	3,640	3,640	3,640
Deposits of central government	-1,991	-4,346	-3,561	-5,665	-6,280	-6,588	-7,601	-8,863	-10,219
Credit to the economy	1,225	1,162	1,106	1,111	1,117	1,123	1,128	1,134	1,140
Credit to public enterprises	0	0	0	0	0	0	0	0	0
Credit to private sector	1,216	1,159	1,106	1,111	1,117	1,122	1,128	1,134	1,139
Claims on nonbank financial institutions	9	3	0	0	0	0	0	0	0
Credit to commercial banks	-3,982	-6,483	-6,895	-4,191	-3,468	-3,991	-2,767	-1,891	-2,831
Other items (net)	-2,145	6,092	-2,715	-2,305	-2,351	-2,398	-2,446	-2,495	-2,545
Reserve money (M0)	21,861	24,041	25,959	26,069	27,790	28,572	30,395	32,722	36,466
Currency issued	9,188	9,983	10,350	11,013	11,286	11,969	12,852	14,279	15,918
Deposits of commercial banks	12,673	14,058	15,609	15,700	16,777	17,286	18,425	19,870	22,186
Memorandum items:									
Gross international reserves (€ millions)	194.9	259.6	280.1	277.8	291.2	304.3	317.5	341.1	395.5
Net international reserves (€ millions)	174.8	250.1	270.9	270.0	285.0	300.0	315.0	340.0	395.2
(months of imports)	3.1	4.0	4.3	3.9	3.8	4.0	3.7	3.6	3.7
Reserve money (12-month change in percent)	3.5	10.0	8.0	0.4	6.6	2.8	6.4	7.7	11.4

Sources: Bank of Cape Verde, and IMF staff estimates and projections.

Table 6. Cape Verde: Deposit Money Bank Survey, 2006–14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Dec.		Dec.	December					
	Actual		Est.	Projections					
	(Millions of Cape Verde escudos, unless otherwise specified)								
Net foreign assets	4,778	3,361	-789	-1,497	-1,556	-1,617	-1,679	-1,742	-1,807
Of which: excluding the effect of a purchase of a Portuguese credit to Electra	8,346	…	…	…	…	…	…	…	…
Foreign assets	9,780	10,001	7,134	6,286	6,382	6,480	6,580	6,682	6,786
Foreign liabilities	-5,002	-6,640	-7,922	-7,783	-7,939	-8,097	-8,259	-8,425	-8,593
Of which: nonresident deposits	-3,579	-5,198	-5,647	-4,800	-4,896	-4,994	-5,094	-5,196	-5,300
Net domestic assets	72,929	82,859	93,859	95,772	102,361	105,401	112,107	120,590	134,122
Net domestic credit	81,903	93,628	107,392	110,117	118,137	122,750	131,187	141,573	157,197
Net claims on general government	0	0	0	14,301	15,333	14,930	16,299	17,221	18,058
Trust Fund claims	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433
Other government deposits (INPS)	-488	-514	-690	-690	-697	-704	-711	-718	-726
Net claims on central government	13,966	10,375	7,846	8,127	9,141	8,713	10,038	10,905	11,687
Claims on central government	15,943	13,095	10,737	11,019	12,032	11,604	12,929	13,796	14,578
Deposits of central government	-1,977	-2,721	-2,891	-2,891	-2,891	-2,891	-2,891	-2,891	-2,891
Net claims on local government	-341	-310	403	431	457	488	539	601	663
Claims on local government	241	295	772	827	875	936	1,033	1,152	1,271
Deposits of local government	-582	-605	-369	-395	-419	-447	-494	-551	-608
Credit to the economy	44,099	55,733	69,973	74,242	80,759	84,692	91,725	100,469	111,759
Of which: excluding purchase of a Portuguese credit to Electra and subsequent off-loading on the domestic securities market	39,705	…	…	…	…	…	…	…	…
Credit to public enterprises	6	2	0	0	0	0	0	0	0
Credit to private sector	1,498	54,394	69,337	73,606	80,123	84,055	91,089	99,833	111,123
Claims on nonbank financial institutions	42,595	1,337	636	636	636	636	636	636	636
Net claims on the Bank of Cape Verde	18,233	21,911	23,428	21,574	22,044	23,129	23,163	23,882	27,380
Other items (net)	-8,973	-10,770	-13,533	-14,345	-15,776	-17,349	-19,080	-20,982	-23,075
Deposit liabilities to nonbank residents	77,707	86,220	93,070	94,275	100,804	103,784	110,428	118,848	132,315
Local currency deposits	72,852	80,253	88,286	87,950	94,046	96,829	103,030	110,887	123,454
Demand deposits	31,076	34,613	35,926	36,907	39,504	40,701	43,328	46,648	51,951
Time deposits	41,776	45,640	52,360	51,043	54,542	56,128	59,702	64,239	71,503
Of which: emigrant deposits	26,148	27,187	28,159	26,017	27,800	28,609	30,430	32,743	36,446
Foreign currency deposits	4,856	5,967	4,784	6,325	6,759	6,955	7,398	7,961	8,861
Of which: emigrant deposits	965	1,081	1,225	1,620	1,731	1,782	1,895	2,039	2,270
Memorandum items:									
Emigrant deposits (ratio to total deposits)	0.61	0.38	0.30	0.28	0.28	0.28	0.28	0.28	0.28
Other deposits (ratio to broad money)	0.35	0.57	0.65	0.65	0.65	0.65	0.65	0.65	0.65
Composition of emigrant deposits	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Local currency	0.98	0.96	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Demand	0.43	0.13	0.14	0.14	0.14	0.14	0.14	0.14	0.14
Time	0.55	0.83	0.86	0.86	0.86	0.86	0.86	0.86	0.86
Foreign currency	0.02	0.04	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Sources: Bank of Cape Verde, and IMF staff estimates and projections.

Table 7. Cape Verde: Financial Soundness of the Banking Sector, Dec 2005–Jul 2009

(End-year; percent unless otherwise indicated)

Indicator	2005	2006	2007	2008	Jul-09
Capital adequacy					
Regulatory capital to risk-weighted assets	12.1	11.1	11.4	10.7	12.0
Regulatory tier 1 capital to risk-weighted assets	13.4	11.3	11.8	10.3	11.1
Asset quality [1]					
Nonperforming loans to total loans	6.3	3.9	13.5	10.3	13.5
Nonperforming loans net of provisions to capital	-2.5	-1.7	91.1	52.3	66.4
Provisions to nonperforming loans	104.9	104.1	35.0	50.6	42.6
Earnings and profitability					
Return on assets	0.5	1.1	1.6	1.7	0.3
Return on equity	9.7	19.7	30.1	28.2	4.6
Interest margin to gross income	62.7	67.2	71.3	71.6	74.0
Noninterest expenses to gross income	61.2	54.5	46.1	45.3	26.0
Liquidity					
Liquid assets to total assets [2]	46.2	18.3	17.7	17.0	18.4
Liquid assets to short-term liabilities [2]	170.2	46.1	42.9	45.1	50.3

Sources: Bank of Cape Verde.

[1] The NPL ratio for the four onshore banks increased in 2007 because of new stricter loan classification criteria.

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

[3] Spreads between deposit and lending rates reflect largely limited competition of small banking system domintaed by two major banks.

Table 8. Cape Verde: Proposed Work Program 2009−10

Mission Date	Purpose	Board Review
March 2010	Eighth (last) PSI review against December 2009 assessment criteria.	May 2010

APPENDIX I—LETTER OF INTENT

November 13, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington DC 20431 USA

Dear Mr. Strauss-Kahn:

1. Discussions for the 7th review of the PSI were held in Praia during September 23–October 1, 2009. The attached Memorandum of Economic and Financial Policies (MEFP) reviews implementation to date of the Cape Verde government's macroeconomic and structural program as set out in the May 2009 Letter of Intent. It describes economic and policy developments since the sixth review under the PSI and presents the government's objectives and policy actions for the remainder of the PSI and the medium term.

2. The government of Cape Verde reaffirms its commitment to the policy priorities of the Policy Support Instrument (PSI). The PSI provides firm support for our policies for macroeconomic stability, economic growth, and poverty reduction. The PSI has served the country well and we intend to request a new three-year PSI in early 2010.

3. The government of Cape Verde requests a modification of the program's assessment criteria for end-2009 for net international reserves, nonconcessional external borrowing, and net domestic borrowing (Table 1). We request to lower the floor on net international reserves, raise the ceiling on nonconcessional external financing, and lower the ceiling on net domestic borrowing. Raising the ceiling on nonconcessional external financing would allow us to obtain an additional budget support loan to bolster our international reserves. This will help us weather the global economic crisis and reduce the interest costs and lengthen the maturity of government debt.

4. Under the PSI, the government will regularly update the IMF on economic and policy developments and will provide the data needed for adequate monitoring of the program. During the period of the PSI, Cape Verde will consult with the IMF on adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director of the IMF requests such a consultation. We authorize the IMF to publish this letter of intent, the attached MEFP, and the related staff report.

Sincerely yours,

/s/
Cristina Duarte
Minister of Finance

ATTACHMENT I. MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

RECENT DEVELOPMENTS AND PROGRAM PERFORMANCE

1. **Cape Verde is coming through the global economic crisis well.** Growth has weakened reflecting the slowdown in tourism and foreign direct investment, but it is still projected at about 4 percent in 2009. An expansion of our public investment program is supporting economic activity. There are signs that the growth decline has stopped. Foreign investment has recovered slightly, and construction on several private investment projects have resumed. Twelve month inflation dropped to -1.2 percent in September and is projected at 1 percent by end-2009 reflecting a good harvest, and lower oil and food prices in international markets. International reserves have declined moderately in the first part of 2009.

2. **The government is responding to the global crisis by implementing a fiscal stimulus as agreed during the last PSI review.** We are using the policy space created by our prudent fiscal policy in recent years, the availability of additional external financing, and the excess capacity in the construction sector to accelerate our investment program. We are also increasing social spending to protect the most vulnerable social groups. Although recurrent spending has been reduced, overall spending is projected to increase by 7.4 percent of GDP relative to 2008 and, with expected shortfalls in tax revenues and land sales, the deficit is projected to reach 8.8 percent of GDP in 2009. However, net domestic borrowing, the program's fiscal anchor, is expected to be less than -0.8 percent of GDP, substantially below the program ceiling agreed during the sixth review under the PSI.

3. **The June 2009 quantitative targets were observed by a solid margin (Table 1).**

- Domestic borrowing was below the ceiling by 2.6 percent of GDP, thereby further reducing the domestic debt. Our mid-year review of the budget execution conducted in August (a PSI benchmark) found that tax revenues in the first half of 2009 were lower than projected, but so were expenditures.

- Net international reserves (NIR) were above the floor by €13 million

4. **Despite some delays, all but three structural benchmarks have been met.**

- The draft income tax codes have been submitted to the Council of Ministers and is expected to be submitted to the National Assembly before the end of the year. We have undertaken an additional round of consultations with the main stakeholders to shore up political support for the tax codes and ensure their passage by the National Assembly.

- The BCV has prepared a report on developments of balance of payments flows, and an assessment of the interest rate sensitivity of non-resident flows into the banking system. The report found that the inflows currently recorded as remittances in the balance of payments were interest rate sensitive, implying that a part of these inflows would not be remittances to support local relatives but for portfolio investment. This is consistent with the exceptionally large stock of emigrant deposits in our banking system (about one third of total deposits) and the belief of our local commercial banks that these deposits are sensitive to external interest rate differentials.

- Financial controllers for each line ministry were appointed on October 14, 2009. The process has taken longer than originally envisaged because of the legal procedures to screen the candidates and nominate the selected.

- A report of contingent liabilities has been prepared and discussed by the Council of Ministers. The Cabinet welcomed the report, asked that the report be continuously updated to closely monitor contingent liabilities, and requested that the updated report be submitted on an annual basis.

- We have also prepared a medium term fiscal framework (MTFF) that was included in the budget write up and attached to the submission of the 2010 budget to the National Assembly. The MTFF documents the implied debt trajectory of the current pace of external borrowing for the investment program. Our associated DSA concluded that while the debt service will rise, it remains manageable.

- We are preparing a memorandum on the modalities for strengthening monetary and fiscal policy coordination, aimed at improving our liquidity management, limit the burden of monetary management on the BCV, and improve our ability to adjust monetary and fiscal policies in the event of external shocks. Finalization of the memorandum has been delayed because of administrative reasons but is expected before end-November.

- Work is well underway to harmonize prudential regulations for onshore and offshore banks, in line with the 2009 FSAP recommendations. We are preparing a new banking law to be submitted for approval for the Council of Ministers to implement our strategy for the sector (¶16).

I. Macroeconomic Outlook and Policies for 2010 and the Medium Term

5. **In 2010 and over the medium term, fiscal policy will remain anchored on preserving international reserves and ensuring debt sustainability, and monetary management will remain focused on keeping external capital flows stable.** The PSI's quantitative assessment criteria for end-2009 and indicative targets for 2010 are set out in Table 1.

A. Macroeconomic Outlook for 2010

6. **The outlook for 2010 is positive, helped by the incipient global recovery and strength of our policies**.

- **Real GDP growth** is expected recover moderately in 2010 as ongoing private construction projects are getting back up to full steam and tourism and FDI flows pick up. The pace of our largely externally-financed investment program will also continue to help sustain growth.

- **Inflation** will continue to be low, consistent with the peg to the euro and the high pass-through of international prices in our open economy, and the outlook for a good agriculture harvest following the recent unusually generous rainfall. We forecast CPI inflation to average about 1-2 percent in 2010.

- **International reserves** are expected to remain between 3½–4 months of imports. Imports are expected to slow further due to the weakened external inflows. While the current account deficit will widen, it will be financed by mostly concessional funds secured by the government.

B. Fiscal Policy for 2010 and the Medium Term

7. **Continued fiscal discipline remains key to our macroeconomic program.** Net domestic borrowing in 2010 will continue to be contained to protect international reserves. The 2010 budget authorizes a net domestic borrowing up to a maximum of CVEsc 4.0 billion (2.7 percent of GDP), but the budget includes a number of provisions that we do not expect to execute. Thus, we expect net domestic borrowing in 2010 (the PSI's fiscal anchor) to be around or less than 1 percent of GDP, consistent with a further reduction in domestic debt and maintaining a solid international reserve coverage. We are committed to maintaining a low level of net domestic borrowing over the medium term.

8. **The rapid implementation of our largely externally financed investment program will continue.** We are now reaping the rewards of our efforts over the last few years to strengthen and streamline our project preparation and appraisal capacity and capacity to mobilize concessional external financing for our investment program. These efforts have resulted in a substantial improvement in our project implementation ratio from below 60 percent earlier in the decade to around 90-95 percent currently. It has also resulted in a large number of projects prepared with our external partners over a number of years that are now ready for implementation. The pace of our investment program is expected to continue in 2011–12, but should return to more moderate levels after the completion of the current large infrastructure projects.

9. **The investment program is aimed at supporting long-term private sector-led growth based on services exports in line with the Cape Verde Poverty Reduction and Growth Strategy.** It addresses critical infrastructure bottlenecks in roads, airports, sea ports, and electricity and water supply. We are also investing in social housing to reduce illegal construction activities and address social challenges arising from increasing inter-island labor movements associated with the uneven employment opportunities, thereby further improving inter-island mobility and the flexibility of our domestic labor market. We are also investing in new sea vessels to patrol our waters and carry out our commitment to the international community to combat drug smuggling and human trafficking through our waters. Project appraisals carefully prepared with the help of our development partners confirm that the economic and social return from these projects should be high. Absorptive capacity is not expected to be a major constraint because of continued high unemployment (around 18 percent), the high import content of most projects, and the use of donor country contractors that will supply equipment, material, and some personnel. Implementation capacity has also been strengthen through improvements in our procurement system.

10. **Consistent with the above, for 2010 we expect an overall fiscal deficit of around 10 percent.** External borrowing in 2010 is budgeted at 12.2 percent of GDP, up from 9.4 percent of GDP in 2009, but because of normal implementation delays it will likely be around 11 percent of GDP. A part of our external borrowing (2.9 percent of GDP) will be on-lent to Enapor, a state owned company that operates the ports, to help them to obtain financing at more favorable terms for their infrastructure investments. Enapor is a profitable and financial sound company with a proven track-record of servicing their debt to the government. Thus, this amount in our fiscal accounts is recorded below the line as negative domestic financing consistent with the accounting practice and the 2001 IMF Government Finance Statistics Manual.

11. **The Government of Cape Verde remains firmly committed to keeping the risk of debt distress low.** The window for highly concessional financing will likely be reduced as our income level rises. Our borrowing strategy is designed with that in mind. We have taken measures to improve our debt management capacity and our capacity to conduct debt sustainability analyses (DSA), including through technical assistance from the World Bank and the Fund, and have reinforced the staffing of our Debt Management Unit. Going forward, we will use the DSA framework to ensure that the fiscal stance and the external borrowing embedded in the MTFF remains sustainable. We will present an updated MTFF for the period 2011–13 in the budget write-up for the 2011 budget. The DSA will show the projected debt trajectory and assess debt sustainability.

12. **To ensure continued low risk of debt distress, external borrowing will continue to be mostly on concessional terms, and scaled back to past trend after the completion of the current large infrastructure projects.** Our debt portfolio is mainly on long term and highly concessional, implying a low risk profile. We will maintain debt service-to-revenues at a manageable level. In that regard, we will accelerate our efforts to enhance revenue

collection and broaden the tax base to keep the debt service-to-revenue ratio low, including through a rationalization of tax exemptions. Fast implementation of the broad range of tax legislation prepared with IMF assistance and submitted to the National Assembly will be instrumental to achieve this. Expanding revenue collection while ensuring international attractiveness for businesses is critical for our development.

13. **The government will continue to take action to address contingent liabilities arising from state-owned enterprises (SOEs). The Council of Ministers decided to take a bold action to put both the electricity company Electra and the airline TACV on a viable restructuring plan.** Electra's finances should recover as the new investments are completed and a consolidated TACV is being prepared to be delivered to private partners as soon as global conditions permit. While TACV has balance sheet weaknesses, it is a functioning airline with unrecorded market value. In particular, TACV is nearing International Air Transportation Association (IATA) membership that will allow it to partner with other IATA members and further raise its market value. The first step in this process has been achieved in early 2009, when, for the first time ever, TACV was registered as an IOSA Operator, under the IATA Operational Safety Audit (IOSA) program, after meeting the world aviation's leading quality and safety standards. The government will continue to monitor state-owned enterprises and update the risk assessment continuously. To reinforce the control, the Council of Ministers has approved the Law of State Enterprises and a Public Managers Law will be approved by end of 2009. The approval and implementation of these reforms will create a new model for parastatals management based on performance and permit better control and monitoring of the sector, by establishing a set of rules and procedures which will serve as a framework for the regulation of sector, permitting a re-structuring of the public enterprises in order to become an instrument for economic policies. Moreover, they will allow a change of paradigm in the management of the parastatals, to become result/objective oriented

C. Monetary Management and Financial Sector Issues

14. **Consistent with the peg and largely open capital account, the BCV policy rate will continue to follow the euribor adjusted for the country risk premium to preserve the stability of external capital flows.** The liquidity crunch in Europe, an increased risk premium for peripheral economies, and the loss of reserves forced the BCV to raise the rate in October 2008 and hold it steady at 5¼ percent since. This rise helped stem the reserve loss in mid-2008 when the euribor spiked. As the global crisis recedes, risk premium narrows, and reserves firms, the BCV could have room to gradually lower the interest rate spread. The BCV will continue to monitor closely capital flows to adjust the policy rate to prevent potentially destabilizing capital flows from occurring.

15. **We are exploring how to improve monetary transmission mechanism, and in particular the functioning of the government security market, to ensure that the BCV's policy rate is appropriately influencing market interest rates.** A critical issue is how to

address the market distortions created by the existence of one large institutional investor with low price sensitivity that is hampering price discovery. As a first step, we intend to regularize public security issuance arrangements by (i) improving the predictability and regularity of issuance, (ii) start issuing benchmark series that would facilitate secondary market activity; (iii) encouraging active bidding by all participants, and (iv) clearly signaling a willingness to accept market outcomes. We are also considering the advantages of using treasury bills to mop up structural excess liquidity.

16. **The government is revisiting its strategy regarding the offshore sector.** In this regard, the ongoing overhaul of banking regulation will harmonize prudential norms for onshore and offshore banks. This law would also give more timely enforcement tools to the central bank to end forbearance in line with the 2009 FSAP's recommendations.

II. Poverty Reduction Strategy and the Next PSI

17. **We consider that the PSI has served the country well, helping to support growth and reduce poverty, and intend to request a new three-year PSI program in early 2010.** We are conducting an internal ex post assessment of the current PSI. Our preliminary conclusion is that the PSI program has helped to improve economic performance and leverage the government reform program, serving as a facilitator to introduce structural reforms. It has also a catalytic role for donor support and strengthens the credibility of the government policies. During the PSI, Cape Verde was invited to join the WTO, graduated from LDC status and was accepted as a special partner of the EU. As a facilitator of reforms, the PSI is helping to advance the objectives of our Poverty Reduction and Growth Strategy. Cape Verde is on track to achieve most of the MDGs by 2015, including halving the 1990 poverty level.

18. **On the other hand, it was with great dissatisfaction that the government received the news that countries must now participate on the financing of technical assistance missions.** We believe that that was one of the key strengths of the PSI program. As you know, there are no financial commitment under the program, thus we believe that countries under a program should benefit of the Fund's knowledge resources, especially when they are linked to structural benchmarks established under the program. In the case of Cape Verde, taking into account its vulnerabilities, we believe that without the Fund's support the rate of implementation and success of the program would be limited. Thus, we request the IMF to reconsider its decision or design a better way to channel technical assistance where is needed with the lowest burden possible for the countries. We should not jeopardize the successful milestone that together we have reached, especially given the present global environment.

Table 1. Cape Verde: Quantitative Assessment Criteria and Indicative Targets for 2009-10 under the PSI [1, 2]

	Stock 2008	Cumulative Flows from End-Dec, 2008 2009						Cumulative Flows from End-Dec, 2009 2010			
	Dec.	March	June			Sep.	Dec.	March	June	Sep.	Dec.
	Stock	Indicative Targets	Assessment Criteria	Assessment Criteria with adjusters	Flow Actual	Indicative Targets	Assessment Criteria	Indicative Targets	Indicative Targets	Indicative Targets	Indicative Targets
Quantitative targets						(Billions of Cape Verde escudos)					
Ceiling on net domestic borrowing of the central government [3]	...	-0.1	1.4	2.7	-0.9	1.7	-1.1	0.4	0.7	1.1	1.5
Ceiling on net domestic assets of the central bank [4]	-3.8 [11]	-0.9	4.9	5.1	1.3	4.9	4.9	0.0	0.1	0.1	0.1
Ceiling on the accumulation of new domestic payment arrears by the central government	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
						(Millions of U.S. dollars)					
Ceiling on the accumulation of new external payment arrears by the central government [5]	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on the contracting or guaranteeing of non-concessional external debt with original maturity of more than one year by the central government [6]	...	8.8	22.5	22.5	0.0	28.8	48.0	35.0	35.0	35.0	35.0
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one one year by the central government [5,7]	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
						(Millions of euros)					
Floor on net international reserves of the Bank of Cape Verde (BCV) [8]	270.9 [11]	13.1	-19.5	-22.0	-8.7	-19.5	-25.2 [10]	3.7	7.4	11.2	15.0
						(Percentage)					
Floor on the regulatory capital ratio of individual banks[9]	…	…	10.0	10.0	9.8 [9]	10.0 [9]	10.0 [9]	10.0	10.0 [9]	10.0 [9]	10.0
Memorandum item:						(Billions of Cape Verde escudos)					
Program assumptions											
Nonproject external financial assistance, including credit line (program assumption)	...	0.8	1.5	...	1.0	2.3	4.8	0.7	1.5	2.2	3.0
External debt service	...	0.5	1.4	...	1.2	2.1	2.8	0.7	1.4	2.2	2.9
Land sales	...	0.4	1.0	...	0.0	1.3	1.6	0.2	0.4	0.6	0.7
Clearance of end-2006 stock of domestic arrears	...	0.6	0.8	...	0.6	1.6	2.3	0.1	0.1	0.2	0.2

[1] Quantitative assessment criteria and benchmarks are described in the technical memorandum of understanding.

[2] For purposes of calculating program adjusters, foreign currency amounts will be converted at current exchange rates.

[3] Excluding borrowing for clearance of arrears and net late payments. The ceiling will be adjusted upward by the cumulative upward deviation in external debt service, and by the cumulative downward deviation in nonproject external financial assistance and land sales relative to program assumptions. The ceiling will be adjusted downward by the cumulative downward deviation in external debt service and by the cumulative upward deviation in land sales relative to program assumptions. The ceiling will be adjusted upward by the costs of restructuring state-owned enterprises up to a limit of CVE 1.5 billion.

[4] The ceiling will be adjusted upward by the cumulative upward deviation in external debt service and by the cumulative downward deviation in nonproject external financial assistance relative to program assumptions. The ceiling will be adjusted downward by the cumulative downward deviation in external debt service relative to program assumptions. The ceiling will be adjusted upward by the costs of restructuring state-owned enterprises up to a limit of CVE 1.5 billion.

[5] This assessment criterion is on a continuous basis.

[6] This assessment criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), but also commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are rescheduling arrangements, the Portuguese credit line, and borrowings from the Fund.

[7] The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt. Excluded from this performance criterion are rescheduling arrangements, the Portuguese credit line, borrowings from the Fund, and normal import-related credits.

[8] The floor on net international reserves of the Bank of Cape Verde will be adjusted downward by the cumulative upward deviation in external debt service, by the cumulative downward deviation in nonproject external financial assistance relative to program assumptions, and by the costs of restructuring state-owned enterprises up to a limit of 13.6 million euros. The floor will be adjusted upward by the cumulative downward deviation in external debt service relative to program assumptions. Additionaly, in the case Cape Verde participates in any SDR allocation(s) between June 30, 2009 and the test date, the floor on net international reserves will be adjusted upwards by the equivalent of the amount of the cumulative additional SDR allocation(s) up to the test date measured at program exchange rates.

[9] The floor on banks' regulatory capital ratios is an indicative floor for all test dates. This indicative target is continuous.

[10] Does not include the positive flow caused by the allocation of € 9.3 million SDRs to Cape Verde.

[11] Differs from IMF Country Report 09/198 because of a small upward revision of net international reserves by the Bank of Cape Verde.

Table 2. Cape Verde: Structural Benchmarks for 2008–09 [1]

Objectives	Structural Benchmark	Timing	Status
Strengthen tax base	Submit the draft individual and corporate income tax bills to the National Assembly.	End-Oct. 2008. Reset to be implemented in June 2009.	Not met.
Promote financial stability	Prepare a quarterly report on developments on balance of payments flows, including an assessment of interest sensitivity of non-resident flows into the banking system.	End-Dec. 2008 Reset to be implemented in June 2009.	Met with delay.
Strengthen public financial management	Place financial controllers in each line ministry to monitor the budget execution as specified in Regulatory Decree 2/2007 of 15 January.	End-Mar. 2009 Reset to be implemented in June 2009.	Met with delay.
Strengthen debt management	Submit to the Council of Ministers a report on contingent liabilities of the state assessing potential risks based on the 2007 or more recent data, including those risks arising from state-owned enterprises.	End-Mar. 2009 Reset to be implemented in June 2009.	Met with delay.
Strengthen debt management	Conduct a mid-year review of fiscal performance, including projections for end 2009, justifying that the envisaged borrowing is consistent with debt sustainability.	End-August 2009	Met.
Strengthen debt management	Include a medium-term fiscal framework (MTFF) for 2010-2012 in the 2010 budget's write up ("Enquadramento") describing the implied debt trajectory and justifying that the envisaged borrowing is consistent with debt sustainability.	End-October 2009	Met.
Strengthen fiscal-monetary policy coordination	BCV to prepare a short memorandum on strengthening monetary-fiscal policy coordination in managing liquidity to be discussed by PSI Monitoring Committee and endorsed by Ministry of Finance and BCV.	End-August 2009	Not met.
Strengthen the financial sector	Inform the Fund of measures taken in the event that the capital ratio of one (or more) banks falls below 10 percent.	Continuous effective June 2009	Met.
Strengthen the financial sector	Present a Policy Strategy Memorandum to the Council of Ministers on the offshore sector.	End-September 2009	Not met.

[1] Measures outstanding at the time of the 7th PSI review.

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets out the understandings between the Cape Verdean authorities and the IMF staff regarding the definition of assessment criteria and indicative targets and reporting requirements for the seventh and eighth reviews under the Policy Support Instrument.

I. QUANTITATIVE ASSESSMENT CRITERIA AND INDICATIVE TARGETS

A. Net Domestic Borrowing Excluding for Clearance of Arrears and Net Late Payments

2. **Net domestic borrowing excluding for clearance of arrears and net late payments** is defined as the cumulative change since the start of the calendar year of the net credit to the central government from the banking and nonbanking sectors less (1) the cumulative clearance during the calendar year of the stock of arrears as of the end of the previous year and (2) the cumulative payments during the first three months of the calendar year of expenses authorized by the previous year's budget, plus the expenses accrued during the current year that will be paid during the first three months of the next calendar year as provisioned for in the budget law (late payments or *atrasados*).

- The ceiling will be adjusted upward by
  - the cumulative upward deviations in external debt service, by
  - the cumulative downward deviations in nonproject external financial assistance and land sales relative to program assumptions, and by the costs of restructuring state-owned enterprises up to a limit of CVE 1.5 billion.
- The ceiling will be adjusted downward by
  - the cumulative downward deviation in external debt service and by
  - the cumulative upward deviation in land sales relative to program assumptions.

3. **Net credit to the central government from the banking and nonbanking system** is defined as the overall position of the main central government institutions vis-à-vis the banking and nonbanking system—that is, the stock of all outstanding claims on the central government (loans, advances), and all other government debt instruments, such as long-term government securities, held by the BCV, commercial banks, and nonbank institutions, less all deposits held by the central government with the BCV and with commercial banks. The INPS is not included in central government accounts. Net credit to the central government excludes claims on the Trust Fund (TCMFs).

4. **Reporting requirements.** Data on the implementation of the budget compiled by the Ministry of Finance and Public Administration will be provided on a quarterly basis, to be submitted no later than five weeks after the end of each quarter, including (i) government

domestic revenue by category; (ii) external budget support grants; (iii) government expenditure, including primary current expenditure, domestic and external interest payments, and capital expenditure, including domestically and budget support financed capital expenditure and estimates of externally project financed capital expenditure; (iv) the gross payment and gross accumulation of domestic accounts payable (*atrasados*); (v) the gross payment and gross accumulation of domestic payments arrears; (vi) external loan receipts and principal payments; (vii) external arrears payments and accumulation; (viii) bank and nonbank financing; (ix) privatization and land sale receipts; and (x) any other revenue, expenditure, or financing not included above.

5. For the purposes of this memorandum, privatization and land proceeds will be understood to mean all monies received by the government from the sale or concessioning of a public company, organization, or facility to a private company or companies, organization(s), or individual(s), as well as any proceeds generated from the sale of government land and the liquidation of a public company, less restructuring costs.

B. Net Domestic Assets of the Central Bank

6. The ceiling on the cumulative change, from the beginning of calendar-year 2009, in net domestic assets of the BCV constitutes an assessment criterion. **Net domestic assets (NDA) of the BCV** are defined as reserve money minus net foreign assets of the BCV, evaluated at the current end-of-period exchange rates.

- The program ceilings for NDA will be adjusted upward by
    - the cumulative upward deviations in external debt service, by
    - the cumulative downward deviations in nonproject external financial assistance relative to program assumptions, and by the costs of restructuring state-owned enterprises up to a limit of CVE 1.5 billion.
- The ceiling will be adjusted downward by the cumulative downward deviation in external debt service relative to program assumptions.

For purposes of calculating the adjusters, these flows will be valued at current exchange rates. Reserve money comprises bank reserves and deposits of the monetary institutions and private sector with the central bank, as well as cash in circulation.

7. **Reporting requirements.** The preliminary monthly balance sheets of the BCV and the consolidated commercial banks will be transmitted on a monthly basis, with a maximum delay of five weeks. The definitive version of the monthly balance sheet of the BCV will be provided as soon as available.

C. Ceiling on Nonconcessional External Debt Contracted or Guaranteed by the Central Government

8. Under the program, ceilings on medium- and long-term, as well as on short-term, nonconcessional external debt constitute assessment criteria. The ceiling on medium- and long-term nonconcessional external debt is on a quarterly basis while the one on short-term nonconcessional external debt is on a continuous basis. Nonconcessional external debt is defined as debt contracted or guaranteed by the central government with a grant element of less than 35 percent, calculated using currency-specific commercial interest reference rates (CIRRs) published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). Debt rescheduling and debt reorganization are excluded from the limits on nonconcessional external debt. The limits on new nonconcessional external debt contracted or guaranteed by the central government (excluding borrowing from the Fund) are specified in Table 1 of the Letter of Intent. The definition of short-term nonconcessional external debt excludes normal short-term (less than one year) import-related financing. The Portuguese government's precautionary credit line in support of the exchange rate peg is also excluded from the definition of nonconcessional external debt. The assessment criterion on medium- and long-term nonconcessional external indebtedness applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00) but also to commitments contracted or guaranteed for which value has not been received. With respect to the assessment criterion on short-term nonconcessional external indebtedness, the term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00).

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

D. Net International Reserves of the Central Bank

10. The floor on the cumulative change, from the beginning of calendar-year 2009, in net international reserves (NIR) of the BCV constitutes an assessment criterion under the program. **The NIR of the BCV** are defined as gross international reserves of the BCV net of its 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. 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, by
  - the cumulative downward deviations in nonproject external financial assistance relative to program assumptions, and by the costs of restructuring state owned enterprises up to a limit of € 13.6 million. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.
- The floor will be adjusted upward by the cumulative downward deviation in external debt service relative to program assumptions. Additionally, in the case Cape Verde participates in any SDR allocation(s) between June 30, 2009 and the test date, this floor will be adjusted upwards by the equivalent of the amount of the cumulative additional SDR allocation(s) up to the test date measured at program exchange rates.

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

E. Nonaccumulation of New Domestic Payments Arrears

12. 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.

13. **Reporting requirements.** The Ministry of Finance and Public Administration, through the D.G.T., 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 four weeks after the end of the quarter.

F. Nonaccumulation of External Payments Arrears

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

15. External arrears are defined as total external debt-service obligations of the government that have not been paid by the time they are due, except where agreements between the government and creditors explicitly provide for a grace period after such obligations falling due. External arrears exclude arrears on external debt, pending the conclusion of debt-rescheduling agreements.

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

II. Other Data Requirements

17. 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 five weeks after the end of each quarter.

18. The Statement of Other Economic Flows as defined in the IMF Manual GFSM2001 relative to holding gains/losses of the previous year with Enapor, Electra, ASA, TACV, 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).

19. The consolidated balance sheet of Electra, Enapor, ASA, TACV 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).

20. The table of Financial Soundness Indicators and the regulatory capital ratios of individual banks will be transmitted to the IMF on a monthly basis within six weeks after the end of each month. The nomination of individual banks is optional.

Appendix II. Joint IMF–World Bank Debt Sustainability Analysis

While the risk of debt distress in Cape Verde remains low, a more rapid increase of the debt ratios than earlier envisaged is reducing the comfort level*. A temporary acceleration of external borrowing for investments to address growth and export impeding infrastructure bottlenecks is causing the present value of the external debt-to-GDP ratio to rise faster than projected in the 2008 DSA. As a result, the PV of external debt-to-GDP ratio reaches the threshold in 2012 under the baseline and breaches it in several stress tests. Nevertheless, staff conclude that the risk of debt distress remains low primarily because inward remittances are large and, while not formally included in the DSA thresholds, they bolster the capacity to repay external liabilities. Still, to safely retain a low risk of debt distress in the future, Cape Verde will need to (i) reduce external borrowing from 2011 onwards, (ii) increase revenue mobilization, and (iii) keep domestic borrowing low to accumulate foreign reserves and reinforce the credibility of the currency peg.*

I. Background

1. The present DSA reviews the evolution of Cape Verde's public debt[1] since the 2008 DSA and projects the future debt trajectory to assess the risk of debt distress. Debt declined in 2008 but has risen substantially in 2009 owing mainly to the fiscal deficit. The risk of debt distress is assessed by comparing the projected external debt and external debt service trajectories with the debt burden thresholds for countries like Cape Verde that have sound policies and institutions (Table 1).[2] The total debt projections are based on Cape Verde's medium-term fiscal framework (MTFF) 2010–12,[3] which was discussed with the authorities during the 7th Policy Support Instrument (PSI) review mission in September 2009, and on their nascent medium-term debt strategy (MTDS) developed with technical assistance from the World Bank and the IMF. The DSA excludes the external debt of the private sector, municipalities, and state-owned enterprises, which is estimated to be small (projected to total 4 percent of GDP at end 2009).

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[1] Includes central government gross external debt and guarantees, central bank gross external debt, and central government net domestic debt. The SDR allocation is not included because the authorities do not plan to sell the SDR holdings and thus its present value is zero. It excludes the external debt of municipalities and state-owned enterprises. Central government external debt is gross of financial assets associated with on-lending of external loans to state-owned enterprises.

[2] Cape Verde's score on the World Bank's Country Policy and Institutional Assessment (CPIA) averaged 4.14 for 2006–08, substantially above the 3.75 floor for strong performers.

[3] The MTFF 2010–12 has been submitted to the National Assembly and is available in a document accompanying the 2010 State Budget.

2. **The risk profile of Cape Verde's central government debt is low as it has a long average maturity and is mostly on concessional terms.**

- Nominal external debt at the end of 2008 was 44 percent of GDP (30 percent of GDP in PV terms) with an average maturity of 25 years. Most of it is owed to multilateral agencies, such as IDA and the African Development Fund, and to bilateral donors. The share of commercial external debt is only 1 percent.

- Domestic debt represents 25 percent of total debt and is composed mostly of long-term bonds owed to domestic banks and the public pension fund. It has declined significantly in recent years as a result of the strong fiscal consolidation under the PSI, which is anchored on keeping domestic borrowing low to build external reserves.

- Public debt data does not include debt from high risk state owned enterprises (SOEs), which is entirely owed to domestic financial institutions. The authorities' report on contingent liabilities to the Council of Ministers in August 2009 estimates the total liabilities owed by the two loss making SOEs–the airline, TACV, and the water and electricity company, Electra–at 13 percent of GDP. While the amounts needed to recapitalize these firms would be less, it could reach as much as 5 percent of GDP.[4] Given the high risk, this amount can be considered a *de facto* liability and is factored in the overall sustainability assessment (section IV).

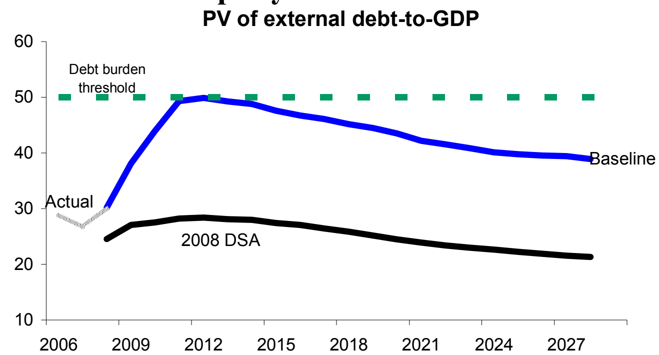
Cape Verde: Public Debt by residency and creditor, July 2009

	US$ million	Percent of GDP	Percentage of Total
Total	1,014	58.1	100
Domestic public debt, net	250	14.3	25
External debt	764	43.8	75
Multilateral	485	27.8	63
o/w IDA	*285*	16.3	*59*
ADF	*128*	7.3	*26*
Bilateral	256	14.7	33
o/w Portugal	*25*	1.4	*96*
Bilateral Export Agencies	18	1.0	2
o/w ICO Spain	*15*	0.9	*83*
Private	5	0.3	1

Source: Ministry of Finance and staff estimates.

[4] This is the estimated amount that would be needed to replenish the capital of these corporations to around 20 percent of their assets.

3. **Cape Verde's external government debt has risen rapidly since the last DSA**[5] **for three main reasons:** an acceleration of infrastructure spending, a decline in government revenues, and the temporary depreciation of the euro (and thus the escudo) against the dollar in late 2008 after the previous DSA was prepared. The fiscal deficit is expected to widen to 8.8 percent of GDP in 2009 from 1 percent in 2007–08 (on average).



- **Infrastructure spending is being accelerated to remove infrastructure bottlenecks and raise Cape Verde's growth potential.** The authorities' medium-term borrowing plans have been revised upward relative to the previous DSA because of new concessional funds secured from bilateral donors, notably Portugal. The concentration of these investments during 2009–12 has been dictated by the concessional financing windows that Cape Verde has secured from donors. Approximately one-third of the investments planned for 2009–12 is financed by external grants and the rest by external loans and current surpluses. The Millennium Challenge Corporation is providing grants to expand the port of Praia. Most loans are concessional from multilateral banks and Paris Club members, but one third is nonconcessional, notably from the European Investment Bank (EIB) to expand the port of Palmeira in Sal Island.[6] Other nonconcessional loans are in the pipeline, notably from the IBRD for energy infrastructure. However, because all new loans, including the nonconcessional ones, are long-term with long grace periods, debt service will increase only slowly.

- **Tax revenues declined as a result of the global crisis and reduced tax rates.** The 2009 budget law lowered income tax rates for individuals and firms for 2009 and retroactively for 2008. The decline in fuel import taxes caused by lower oil prices and the slowdown in tourism revenues and foreign direct investment (FDI) associated with the global crisis are reducing tax revenues and land sale proceeds in 2009 below budget. To cover the shortfall without borrowing domestically and draining foreign reserves, a nonconcessional budget support loan from the African Development Bank

[5] IMF Country Report 09/14 and World Bank report No. 47750-CV.

[6] The fiscal statistics do not treat the EIB loan as capital spending because it is on-lent to the port operator (recorded below the line).

has been requested. It is expected to be disbursed in two tranches of €20 million (1.6 percent of GDP) each in 2009 and 2010.[7]

- **The depreciation of the euro, and thus the Cape Verde escudo, against the US dollar in the second half of 2008 temporarily raised the external debt-to-GDP ratio by approximately 3 percentage points at the end of 2008, confirming the currency risk highlighted in the previous DSA.** Cape Verde's public sector is not fully hedged against currency risk because a portion of its external debt is denominated in US dollars without matching dollar-denominated assets in the central bank. As a result of this open position, the depreciation of the dollar relative to the euro (and thus the escudo) during 2009 was beneficial to Cape Verde's debt indicators. To better hedge the consolidated public sector against currency risk, the authorities have adopted a policy of seeking new loans in euros while keeping part of foreign reserves in dollars.

II. The Baseline Scenario

4. **The long term macroeconomic framework will continue to be driven by two main processes:** the economic transformation toward a service exports-based economy, and accumulation of international reserves at the BCV. The escudo will continue to be pegged to the euro. Because of the high import penetration, inflation in Cape Verde will continue to reflect mainly supply side developments, notably import prices and exogenous shocks.

5. **Growth is marked by a deceleration of economic activity in the near term due to the global crisis and a slow recovery toward trend over the medium term.** Despite the acceleration of infrastructure spending and the lower tax rates, the slowdown in FDI could keep growth below its historical trend for some time. The acceleration of public infrastructure spending is unlikely to boost contemporaneous growth because of the small fiscal multipliers caused by high import leakages and because it is not fully offsetting the demand effect of the decline in private investment. While the global shock worsened the near-term growth outlook, Cape Verde's medium-term growth prospects remain strong.

[7] In Cape Verde, spending in excess of budgeted amounts is allowed as long as the financing source is external and total debt remains below 60 percent of GDP.

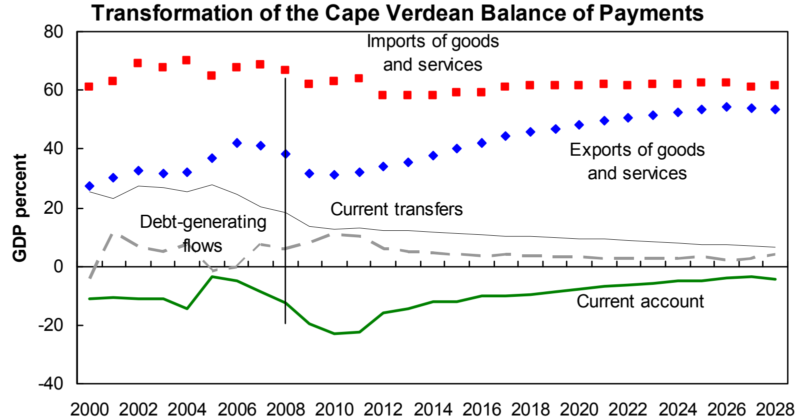
Cape Verde: Baseline Assumptions, 2009-29

	Average	Average 2009-13		Average 2014-29	
	1999-2008	2008 DSA	Current DSA	2008 DSA	Current DSA
	(Annual growth rate)				
Real GDP	7.1	6.7	5.7	5.0	5.2
CPI (end-of-period)	2.0	2.5	1.7	2.0	2.0
	(Percent of GDP)				
Exports of goods and services	33.3	48.3	32.9	65.5	48.6
Imports of goods and services	65.8	71.9	61.0	79.0	61.1
Private transfers, incl. remittances	19.4	11.5	11.6	9.1	8.7
Of which: remittances	12.3	5.9	7.0	6.2	6.2
Current account	-10.2	-10.6	-18.9	-5.2	-7.3
FDI	7.6	8.5	8.0	4.8	4.8
Government revenues and grants	29.3	27.7	28.7	26.8	26.9
Overall fiscal balance	-6.9	-4.8	-8.1	-2.4	-3.7

Source: National authorities and staff estimates and projections.

6. **After the global crisis abates, external demand and FDI should recover, supported by the new infrastructure.** Growth will be driven by tourism, FDI, and to a lesser extent, remittances. Under the baseline, growth is assumed to recover slowly and not fully catch up with the pre-crisis trend because there are no large FDI projects currently in the pipeline. Lower availability of real estate credit in Britain and Spain could restrain post-crisis FDI for, and construction of, vacation apartments in Cape Verde. However, the acceleration of infrastructure spending is likely to raise Cape Verde's long-run growth potential. Thus, growth could turn out to be higher than assumed under the baseline. Cape Verde is transforming its economy by harnessing its comparative advantage on tourism, and export of tourism services is undergoing a structural rise.

Transformation of the Cape Verdean Balance of Payments



7. **Imports are assumed to remain flat (as a share of GDP).** While the fast growing exports have a high import component (goods consumed by tourists), the associated import increase will be largely offset by a decline in other import-driving inflows. The deceleration of FDI is containing imports in the near term, and completion of the current large tourism projects will contain it in the long run; construction material, equipment, and labor are mostly imported. In addition, as Cape Verde climbs the income ladder, emigration will slow and the share of remittances and other current transfers in GDP should decline.

8. **The baseline assumes that the authorities will continue to keep domestic borrowing low to support accumulation of foreign reserves and protect the exchange rate peg.** Fiscal policy is geared toward accumulating reserves equivalent to 0.1 months of

imports of goods and services annually. At this pace, foreign reserves will increase from a comfortable 3.9 months of imports in 2009 to an expected 5.2 months in 2029 or, reflecting the high import-to-GDP ratio, from 21 percent of GDP in 2009 to 31 percent in 2029. To accumulate this volume of reserves, an enduring fiscal restraint will be required to keep net domestic borrowing below 1 percent of GDP on average throughout the period. Because reserves will remain at a comfortable level, the SDR holdings will not be exchanged for foreign currency, interest will not accrue, and thus the PV of the SDR allocation is zero.

9. **Cape Verde will progressively borrow on less concessional terms.** The baseline scenario assumes that the concessionality of new loans will decline in the medium term. With Cape Verde's graduation from least-developed-country status in 2008, it acquired "blend" status with multilateral development agencies and is now eligible to borrow from their nonconcessional windows, notably the EIB, ADB, and the IBRD and, after a transition period, with shrinking access to concessional funds. While these loans have market rates, their maturities are long, typically 20 years with 5–10 years of grace. During the disbursement of these nonconcessional loans, the average grant element will be around 25 percent. After the bulk of these nonconcessional loans has been disbursed, the average concessionality will rise to above 30 percent by 2014 and then concessionality will resume its gradual long term decline (Figure 1, top left chart).

III. External Debt Sustainability

A. Baseline Scenario: Debt Decline in the Medium Term

10. **The pace of external borrowing will slow sharply in 2012, putting the PV of the external debt-to-GDP ratio on a declining path thereafter (Table 1).** This policy commitment is embedded in the MTFF submitted to the National Assembly with the 2010 budget proposal (footnote 3). While the debt-to-GDP ratio will touch, but not breach, the debt burden threshold in 2012, all other debt ratios will remain well below their thresholds, including the debt service ratios. Further, the ratios relative to GDP and exports overstate the true debt burden indicator in the sense that they do not consider the large and steady flow of remittances as broadening the repayment capacity of the country. With an average of 12 percent of GDP over the past ten years and a conservative estimate of 6½ percent of GDP over the next 10 years, remittances should feature prominently in the debt sustainability analysis.

B. Stress Tests and Alternative Scenarios

11. **All debt burden indicators, but the ones associated with the PV of debt-to-GDP, remain well below the thresholds even under the extreme tests. (Table 2 and Figure 1).**[8] The breaches of the three stress tests relevant for Cape Verde are minor and last for two years at most. Under the growth shock (B1), the PV of the debt-to-GDP ratio, breaches the threshold during one year and the deviation only amounts to 0.6 percent of GDP; the export shock (B2) results in a one-year breach amounting to 0.1 percent of GDP, while the financing shock leads to a two-year breach totaling 0.2 and 0.5 percent of GDP. The other two stress tests–a depreciation (B6) and US deflation (B3)–are irrelevant for Cape Verde. The assumed 30 percent devaluation of the escudo is unlikely due to the strength of the peg supported by adequate reserves and policies geared toward a further steady reserve build-up. In addition, Cape Verde has access to a contingent balance of payments support facility from Portugal equivalent to 500 percent of its quota in the Fund. The stress test highlights, however, the importance of keeping reserves adequate to protect the peg. A continued low domestic borrowing and steady reserve accumulation is vital to comfort markets about the sustainability of the peg. The US deflation shock (B3) is irrelevant as the US is not a significant trading partner and only part of the debt is denominated in dollars.

12. **The other debt ratios provide assurances that Cape Verde's repayment capacity remains satisfactory.** Given the high export-to-GDP in this small open archipelago (over 40 percent) and the strong capacity to collect taxes, the debt-to-export and debt-to-revenue ratios remain below the thresholds even under extreme scenarios. Moreover, all of Cape Verde's external debt has maturities that are typically more than 10 years, which alleviates cash flow pressures and limits rollover difficulties. This lessens concerns about the country's ability to repay its debt, and provides additional support for the low risk classification.

C. Country-Specific Alternative Scenarios

13. **A high-growth and a low-growth scenario were constructed to test the sensitivity of debt ratios to growth assumptions (Table 5)**. Each scenario assumes that growth will deviate from the baseline by +/–2.5 percentage points (one standard deviation) in 2013–17. As in the baseline, the low-growth scenario implies that GDP will be permanently below its pre-crisis trend. Because the high-growth scenario assumes growth slightly above its pre-crisis trend, GDP will eventually surpass the trend.

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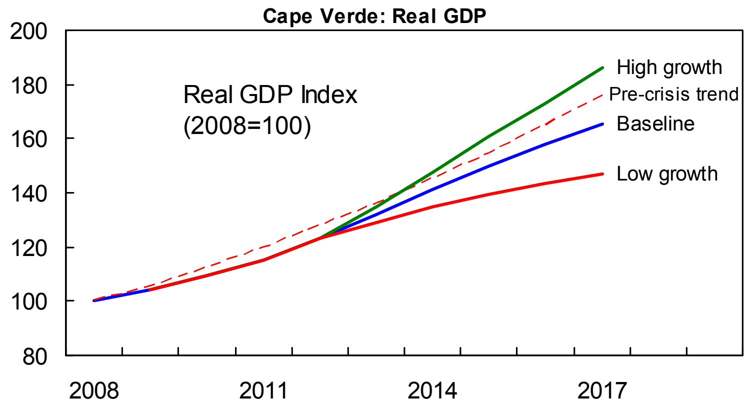
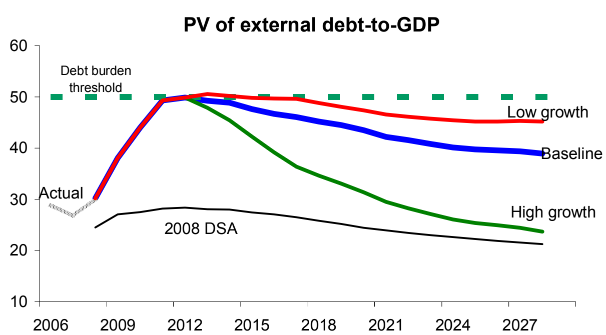
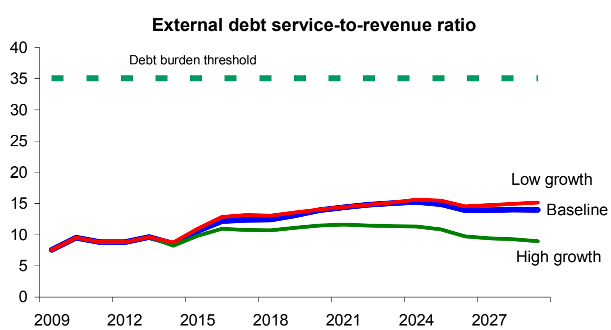
[8] The test B2 is applied for the years 2011–12, instead of 2010–11, to ensure that export growth under the stress test is below the baseline growth rate.



14. **Even under the low-growth scenario, the debt and debt service dynamics remain sustainable.** The PV of external debt-to-GDP breaches its threshold only for one year (2013) and by a slight deviation of less than 1 percentage point. The ratios decline thereafter, but very slowly (ending at 47 percent of GDP in 2029) unlike under the baseline scenario (38 percent). Under those circumstances, the borrowing space would be very limited and the country may face difficulties to borrow if necessary to smooth future shocks. Given that it is assumed that borrowing will continue with long maturities, the debt ratios will stay low even in the low-growth scenario. This should dispel any concerns about the country's ability to repay its debt.

15. **Under the high growth scenario, with a higher growth dividend than conservatively assumed under the baseline, the debt stock ratios would decline rapidly after 2012.** If the higher growth dividend materializes, the ensuing strong tax revenues will make it easier to contain the deficit and reduce debt faster while still further expanding public expenditures (Table 5).





IV. Total Public Debt Sustainability

A. Baseline Scenario: Continued Decline in Net Domestic Debt

16. **The trajectory of total public debt mirrors external debt and yields the same conclusion (Table 4).** The PV of total debt-to-GDP peaks at 63 percent of GDP (68 percent if adding the contingent liabilities) in 2010 and declines thereafter in line with the authorities' commitment in the MTFF to reduce external borrowing after 2011. External borrowing is determining the trajectory of total public debt because net domestic debt is projected to continue to decline: from 14 percent of GDP in 2009 to 7 percent by 2029. Net domestic borrowing is projected to remain below 1 percent of GDP on average. The debt-to-revenue and debt service-to-revenue ratios will remain broadly stable.

B. Alternative Scenarios and Stress Tests

17. **The alternative scenarios and stress tests reiterate the conclusion that external borrowing needs to be reduced from 2011 onward (Table 5).** If not, all debt ratios would evolve on an explosive path in the alternative scenarios (A1-3). In the scenario where the 2009 primary deficit of 7.4 percent[9] of GDP is maintained through 2029, debt ratios rise without bounds (Figure 2). A sharp real devaluation is the most extreme scenario for all ratios, which reinforces the message that domestic borrowing needs to be low to contain domestic demand and accumulate foreign reserves.

18. **Other risks to the debt outlook include a currency mismatch and the contingent liabilities of state-owned enterprises.**

- A depreciation of the dollar could raise debt relative to GDP. To mitigate the currency risk, the authorities are designing a two-pronged MTDS[10] using an asset-liability technique: while the BCV will seek to have foreign assets matching the currencies and maturities of debt service obligations, the Treasury will seek its new loans in euros.

- The amount needed today to recapitalize Electra and TACV can reach as much as 5 percent of GDP (footnote 4). While these two corporations continue to make losses and this amount could be considered *de facto* debt, the authorities are taking actions to minimize the budgetary impact. The new energy regulation and the government investments in energy promise to restore Electra's profitability. TACV is being prepared to be taken over by a private partner after the global shock abates in an

[9] Historical average deficit minus one standard deviation is 10.4 percent.

[10] During 2009 the World Bank and the IMF provided Cape Verde with technical assistance missions and seminars on debt management, such as how to perform the Debt Management Performance Assessment, build capacity to conduct DSAs, and apply the MTDS tool.

operation that may limit the impact on the budget through a renegotiation that could reduce TACV's debt with the state-owned airport operator.[11]

V. Conclusions: Low Risk Of Distress But Tighter Conditions

19. **While the risk of debt distress remains low, there are increased risks to the debt outlook that warrant vigilance.** This joint external and public-sector debt sustainability analysis reveals increased vulnerability as external debt ratios are higher than anticipated in the 2008 DSA, reflecting a large increase in external borrowing related to the acceleration of the investment program, the impact of the global downturn, and euro-dollar exchange rate changes.

20. **Mitigating factors, however, lead staffs to assess Cape Verde's debt distress rating as low.** Most important, large and steady remittances amounting to 6½ percent of GDP on average over the next ten years enhance the country's repayment capacity. Moreover, Cape Verde's strong policies and institutions should help ensure that the growth dividends from the accelerated public investments do materialize. Finally, the long maturities of the existing debt ensure that liquidity risks are absent.

21. **Nevertheless, the increased debt vulnerabilities warrant vigilance.** In particular

- The assessment of a continued low risk of distress is based on the authorities' commitment to decelerate external borrowing in 2012 and thereafter. Deviations from this commitment could jeopardize long-term external debt sustainability and the debt distress rating.

- New borrowing should continue to be mostly with long maturities and on concessional terms. The low risk of distress classification takes into account the fact that long maturities will ensure low debt service obligations relative to Cape Verde's export and revenue ratios. If maturities are shorter, and concessionality lower compared to the baseline, the risks to the debt outlook would be worse and the rating may have to be downgraded.

- Currency mismatch and contingent liabilities continue to be a risk, as illustrated in 2008 when the dollar appreciated. The authorities should seek to hedge the short dollar positions by rebalancing the currency composition of the BCV's portfolio toward dollar-denominated assets. Contingent liabilities should be addressed without delay.

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[11] See Memorandum of Economic and Financial Policies for the 7th PSI review.

Table 1. Cape Verde: External Debt Sustainability Framework, Baseline Scenario, 2006-2029 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-2014 Average	2019	2029	2015-2029 Average
External debt (nominal) 1/	62.8	49.6	54.0			59.3	64.6	71.5	71.2	68.5	67.1		59.2	48.5	
o/w public and publicly guaranteed (PPG)	47.7	40.7	41.6			46.6	55.2	62.5	63.3	61.6	60.2		53.2	44.2	
Change in external debt	-9.2	-13.2	4.5			5.3	5.2	6.9	-0.3	-2.6	-1.4		-1.3	0.5	
Identified net debt-creating flows	-15.9	-13.2	-6.2			10.7	13.1	10.5	2.2	0.7	-0.9		-0.1	2.0	
Non-interest current account deficit	2.2	6.9	10.4	7.6	4.0	17.7	20.7	20.1	13.5	12.0	10.0	15.7	6.8	3.1	5.0
Deficit in balance of goods and services	25.6	27.4	28.1			30.3	32.0	31.5	24.2	22.6	20.1		14.8	8.1	
Exports	42.0	41.2	38.5			31.7	31.1	32.3	33.8	35.6	37.9	33.7	46.9	53.2	49.3
Imports	67.6	68.5	66.5			62.0	63.1	63.8	58.0	58.2	58.1	60.5	61.6	61.2	61.3
Net current transfers (negative = inflow)	-24.4	-20.4	-18.4	-24.6	3.1	-13.8	-12.5	-13.1	-12.4	-12.4	-11.9	-12.7	-9.8	-6.2	-8.7
o/w official	-4.1	-4.2	-6.0			-2.2	-0.7	-1.0	-1.0	-1.2	-1.0		-0.4	0.6	
Other current account flows (negative = net inflow)	1.0	-0.1	0.7			1.2	1.3	1.6	1.7	1.7	1.8		1.9	1.2	
Net FDI (negative = inflow)	-9.3	-8.5	-12.0	-7.6	2.8	-6.6	-7.0	-8.5	-8.9	-9.1	-8.9	-8.2	-6.2	-0.7	-4.6
Endogenous debt dynamics 2/	-8.9	-11.6	-4.6			-0.4	-0.6	-1.1	-2.3	-2.2	-2.0		-0.7	-0.4	
Contribution from nominal interest rate	2.9	1.7	1.9			1.8	2.1	2.2	2.3	2.3	2.3		2.0	1.8	
Contribution from real GDP growth	-6.5	-3.9	-2.5			-2.2	-2.7	-3.3	-4.6	-4.5	-4.3		-2.8	-2.2	
Contribution from price and exchange rate changes	-5.3	-9.5	-4.0			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	6.7	0.0	10.7			-5.5	-7.9	-3.6	-2.5	-3.3	-0.5		-1.2	-1.5	
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	42.6			51	53	58	58	56	56		50	43	
In percent of exports	...	...	110.7			160	172	181	171	158	147		108	80	
PV of PPG external debt	...	...	30.2			38	44	49	50	49	49		44	38	
In percent of exports	...	...	78.4			120	141	153	148	138	129		95	72	
In percent of government revenues	...	...	120.4			166	193	197	201	199	197		176	150	
Debt service-to-exports ratio (in percent)	11.2	8.0	9.0			10.3	11.7	11.2	10.4	10.2	8.7		9.2	8.1	
PPG debt service-to-exports ratio (in percent)	5.6	4.7	4.9			5.5	7.0	6.8	6.5	6.7	5.6		7.1	6.7	
PPG debt service-to-revenue ratio (in percent)	9.8	7.9	7.5			7.5	9.5	8.8	8.8	9.6	8.5		13.1	14.0	
Total gross financing need (Billions of U.S. dollars)	0.0	0.0	0.0			0.251	0.329	0.306	0.178	0.159	0.118		0.206	0.605	
Non-interest current account deficit that stabilizes debt ratio	11.5	20.1	5.9			12.5	15.5	13.2	13.8	14.6	11.4		8.1	2.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	10.8	7.8	5.9	7.1	2.5	4.1	5.0	5.5	7.0	7.1	6.9	5.9	5.0	4.9	5.1
GDP deflator in US dollar terms (change in percent)	7.9	17.8	8.8	5.9	11.0	-3.9	3.4	0.9	2.4	3.3	3.2	1.6	3.4	2.8	3.2
Effective interest rate (percent) 5/	4.9	3.5	4.5	4.7	1.4	3.3	3.9	3.6	3.5	3.6	3.7	3.6	3.6	4.0	3.7
Growth of exports of G&S (US dollar terms, in percent)	36.3	24.5	7.7	19.2	9.3	-17.6	6.4	10.5	14.7	16.4	17.7	8.0	11.3	7.1	10.9
Growth of imports of G&S (US dollar terms, in percent)	24.6	28.7	11.9	14.8	12.1	-6.8	10.4	7.7	-0.5	11.1	10.0	5.3	8.8	7.8	8.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	24.3	22.4	28.3	31.9	17.6	16.5	23.5	16.4	11.1	15.5
Government revenues (excluding grants, in percent of GDP)	24.1	24.3	25.1			23.0	22.8	25.0	24.8	24.8	24.7		25.2	25.6	25.3
Aid flows (in Billions of US dollars) 7/	0.114	0.116	0.086			0.199	0.205	0.243	0.195	0.098	0.104		0.148	0.136	
o/w Grants	0.066	0.069	0.086			0.108	0.109	0.092	0.090	0.064	0.068		0.081	0.076	
o/w Concessional loans	0.048	0.047	0.000			0.091	0.096	0.151	0.105	0.034	0.037		0.068	0.059	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			8.9	8.5	8.0	6.5	3.6	3.4		2.8	1.4	2.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			51.7	46.9	48.2	55.5	43.7	42.9		38.4	23.8	34.6
Memorandum items:															
Nominal GDP (Billions of US dollars)	1.192	1.513	1.744			1.744	1.894	2.015	2.208	2.442	2.694		4.177	9.009	
Nominal dollar GDP growth	19.5	27.0	15.3			0.0	8.6	6.4	9.5	10.6	10.3	7.6	8.5	7.9	8.4
PV of PPG external debt (in Billions of US dollars)			0.5			0.7	0.8	1.0	1.1	1.2	1.3		1.9	3.5	
(PVt-PVt-1)/GDPt-1 (in percent)						7.9	9.7	8.5	5.3	4.6	4.6	6.8	3.1	2.6	2.9

Source: Staffs simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; valuation adjustments; and the capital account. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Cape Verde: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009-2029
(In percent)

	Projections							
	2009	2010	2011	2012	2013	2014	**2019**	2029
PV of debt-to GDP ratio								
Baseline	38	44	49	50	49	49	**44**	38
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	38	29	21	20	22	25	**29**	15
A2. New public sector loans on less favorable terms in 2009-2029 /2	38	44	50	50	49	49	**48**	48
A3. Low growth scenario 7/	38	44	49	50	51	50	**48**	47
A4. High growth scenario 7/	38	44	49	50	48	45	**33**	23
B. Bound Tests								
B1. Real GDP growth at historical level minus one standard deviation in 2010-2011	38	44	50	51	50	49	**45**	39
B2. Export value growth at historical level minus one standard deviation in 2011-12 3/	38	44	50	50	49	49	**44**	38
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	38	48	57	58	57	57	**52**	45
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	38	37	38	40	42	44	**44**	38
B5. Combination of B1-B4 using one-half standard deviation shocks	38	33	28	32	36	40	**45**	39
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	38	62	70	70	69	69	**63**	54
PV of debt-to-exports ratio								
Baseline	120	141	153	148	138	129	**95**	72
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	120	93	66	60	61	66	**61**	28
A2. New public sector loans on less favorable terms in 2009-2029 /2	120	141	155	149	137	130	**102**	90
A3. Low growth scenario 7/	120	141	153	148	142	133	**101**	87
A4. High growth scenario 7/	120	141	153	148	132	113	**65**	41
B. Bound Tests								
B1. Real GDP growth at historical level minus one standard deviation in 2010-2011	120	142	153	148	138	129	**95**	72
B2. Export value growth at historical level minus one standard deviation in 2011-12 3/	120	142	154	155	146	135	**100**	76
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	120	142	153	148	138	129	**95**	72
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	120	120	118	120	118	116	**95**	72
B5. Combination of B1-B4 using one-half standard deviation shocks	120	97	76	82	88	92	**84**	65
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	120	142	153	148	138	129	**95**	72
PV of debt-to-revenue ratio								
Baseline	166	193	197	201	199	197	**176**	150
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	166	126	86	82	87	101	**114**	59
A2. New public sector loans on less favorable terms in 2009-2029 /2	166	193	201	203	197	199	**190**	188
A3. Low growth scenario 7/	166	193	197	201	199	199	**187**	180
A4. High growth scenario 7/	166	193	197	201	199	199	**187**	180
B. Bound Tests								
B1. Real GDP growth at historical level minus one standard deviation in 2010-2011	166	194	200	204	202	200	**179**	152
B2. Export value growth at historical level minus one standard deviation in 2011-12 3/	166	193	198	202	199	198	**176**	150
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	166	210	229	233	231	229	**204**	174
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	166	163	152	163	170	177	**176**	150
B5. Combination of B1-B4 using one-half standard deviation shocks	166	146	112	128	145	161	**179**	154
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	166	272	278	283	280	278	**248**	212

Table 2. Cape Verde: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2009-2029 (continued)
(In percent)

	Projections							
	2009	2010	2011	2012	2013	2014	**2019**	2029
Debt service-to-exports ratio								
Baseline	5	7	7	6	7	6	**7**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	5	7	5	0	0	0	**7**	3
A2. New public sector loans on less favorable terms in 2009-2029 /2	5	7	7	7	7	6	**5**	4
A3. Low growth scenario 7/	5	7	7	6	7	6	**7**	7
A4. High growth scenario 7/	5	7	7	6	7	6	**7**	7
B. Bound Tests								
B1. Real GDP growth at historical level minus one standard deviation in 2010-2011	5	7	7	6	7	6	**7**	7
B2. Export value growth at historical level minus one standard deviation in 2011-12 3/	5	7	7	7	7	6	**7**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	5	7	7	6	7	6	**7**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	5	7	6	2	0	0	**7**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	5	6	5	0	0	0	**6**	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	5	7	7	6	7	6	**7**	7
Debt service-to-revenue ratio								
Baseline	8	10	9	9	10	9	**13**	14
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2009-2029 1/	8	9	6	0	0	0	**6**	7
A2. New public sector loans on less favorable terms in 2009-2029 /2	8	10	9	10	11	9	**9**	8
A3. Low growth scenario 7/	8	10	9	9	10	9	**14**	15
A4. High growth scenario 7/	8	10	9	9	10	8	**11**	9
B. Bound Tests								
B1. Real GDP growth at historical level minus one standard deviation in 2010-2011	8	10	9	9	10	9	**13**	14
B2. Export value growth at historical level minus one standard deviation in 2011-12 3/	8	10	9	9	10	9	**13**	14
B3. US dollar GDP deflator at historical average minus one standard deviation in 2010-2011	8	10	10	10	11	10	**15**	16
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010-2011 4/	8	10	8	3	1	0	**13**	14
B5. Combination of B1-B4 using one-half standard deviation shocks	8	10	7	0	0	0	**12**	14
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	8	13	12	12	14	12	**18**	20
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	0	0	0	0	0	0	**0**	0

Source: Staffs projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels). The test is applied on 2011-12, instead of 2010-11, so that export growth in the test is below baseline.
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.
7/ Assumes growth rates respectively 2.5 percentage points (one standard deviation) above and below the baseline in 2013-17.

Table 3. Cape Verde: Public Sector Debt Sustainability Framework, Baseline Scenario, 2006-2029
(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009-14 Average	2019	2029	2015-29 Average
Public sector debt 1/	73.4	59.7	57.4			60.5	69.3	76.5	75.5	73.8	71.7		62.0	51.3	
o/w foreign-currency denominated	47.7	40.7	41.6			46.6	55.2	62.5	63.3	61.6	60.2		53.2	44.2	
Change in public sector debt	-11.5	-13.7	-2.3			3.1	8.8	7.2	-1.0	-1.7	-2.1		-1.5	-0.9	
Identified debt-creating flows	-13.9	-14.9	-1.1			3.3	5.9	5.7	-1.2	-2.1	-1.9		-1.5	-1.2	
Primary deficit	**3.2**	**-0.8**	**-0.3**	**4.8**	**5.6**	**7.4**	**8.1**	**8.3**	**4.1**	**4.1**	**3.8**	**6.0**	**2.2**	**1.3**	**1.9**
Revenue and grants	29.7	28.9	30.0	**29.3**	**1.9**	**29.2**	**28.6**	**29.6**	**28.9**	**27.4**	**27.3**	**28.5**	**27.2**	**26.5**	**26.9**
of which: grants	5.5	4.6	4.9			6.2	5.7	4.6	4.1	2.6	2.5		1.9	0.8	
Primary (noninterest) expenditure	32.8	28.0	29.7	**34.1**	**5.0**	**36.6**	**36.7**	**37.9**	**33.0**	**31.5**	**31.0**	**34.5**	**29.4**	**27.8**	**28.9**
Automatic debt dynamics	-16.6	-12.9	-0.2			-4.2	-1.6	-2.8	-5.4	-5.8	-5.4		-3.6	-2.5	
Contribution from interest rate/growth differential	-10.0	-7.0	-3.2			-2.2	-2.2	-3.1	-4.9	-5.0	-4.7		-2.9	-2.1	
of which: contribution from average real interest rate	-1.7	-1.7	0.2			0.0	0.7	0.5	0.1	-0.1	0.1		0.1	0.3	
of which: contribution from real GDP growth	-8.3	-5.3	-3.3			-2.2	-2.9	-3.6	-5.0	-5.0	-4.7		-3.0	-2.5	
Contribution from real exchange rate depreciation	-6.6	-5.9	3.0			-1.9	0.5	0.3	-0.5	-0.8	-0.7		...	...	
Other identified debt-creating flows	-0.4	-1.2	-0.6			0.0	-0.5	0.1	0.1	-0.4	-0.3		-0.1	0.0	
Residual, including asset changes	2.3	1.2	-1.2			-0.1	2.9	1.5	0.1	0.4	-0.2		0.0	0.3	
Other Sustainability Indicators															
PV of public sector debt	**53.3**	**44.0**	**48.4**			**51.0**	**58.2**	**63.5**	**62.1**	**61.5**	**60.3**		**53.4**	**45.5**	
o/w foreign-currency denominated	27.5	25.0	32.6			37.1	44.1	49.5	49.9	49.2	48.8		44.5	38.5	
o/w external	27.5	25.0	32.6			37.1	44.1	49.5	49.9	49.2	48.8		44.5	38.5	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	9.1	4.1	4.2			13.3	14.7	13.7	9.6	9.6	9.9		9.7	10.2	
PV of public sector debt-to-revenue and grants ratio (in percent)	180	152	161			175	204	215	215	224	221		196	172	
PV of public sector debt-to-revenue ratio (in percent)	221	181	193			222	255	254	250	248	244		211	178	
o/w external 3/	114	103	130			161	193	198	201	199	197		176	150	
Debt service-to-revenue and grants ratio (in percent) 4/	19.9	17.0	14.8			20.0	23.0	18.3	18.9	20.3	22.6		27.5	33.3	
Debt service-to-revenue ratio (in percent) 4/	24.4	20.3	17.7			25.4	28.8	21.6	22.1	22.5	24.9		29.6	34.4	
Primary deficit that stabilizes the debt-to-GDP ratio	14.7	12.9	2.0	**9.9**	**6.9**	4.3	-0.7	1.1	5.1	5.8	5.9	**3.6**	3.7	2.2	**3.3**
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	10.8	7.8	5.9	7.1	2.5	4.1	5.0	5.5	7.0	7.1	6.9	**5.9**	5.0	4.9	**5.1**
Average nominal interest rate on forex debt (in percent)	1.1	1.1	1.1	1.3	0.3	0.5	1.6	1.5	1.6	1.9	1.9	1.5	2.1	2.5	2.2
Average real interest rate on domestic debt (in percent)	-2.6	-3.7	3.1	2.3	4.7	2.9	5.3	3.2	1.9	-0.1	0.7	2.3	0.5	1.1	0.9
Real exchange rate depreciation (in percent, + indicates depreciation)	-13.7	-13.6	7.8	-0.9	13.4	-4.8	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.9	7.9	1.4	2.7	3.7	3.0	0.9	1.4	3.1	4.2	3.2	2.6	3.4	2.8	3.2
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	-0.1	0.1	0.1	0.2	0.3	0.1	0.1	-0.1	0.0	0.1	0.1	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	24.3	22.4	28.3	31.9	17.6	16.5	23.5	16.4	11.1	...

Sources: Country authorities; and staffs estimates and projections.

1/ Includes central government and central bank. External liabilities on a gross basis except SDR allocation (not included in nominal debt because its present value is zero). Domestic liabilities net of Treasury deposits at the central bank.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

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

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

Table 4. Cape Verde: Sensitivity Analysis for Key Indicators of Public Debt 2009-2029

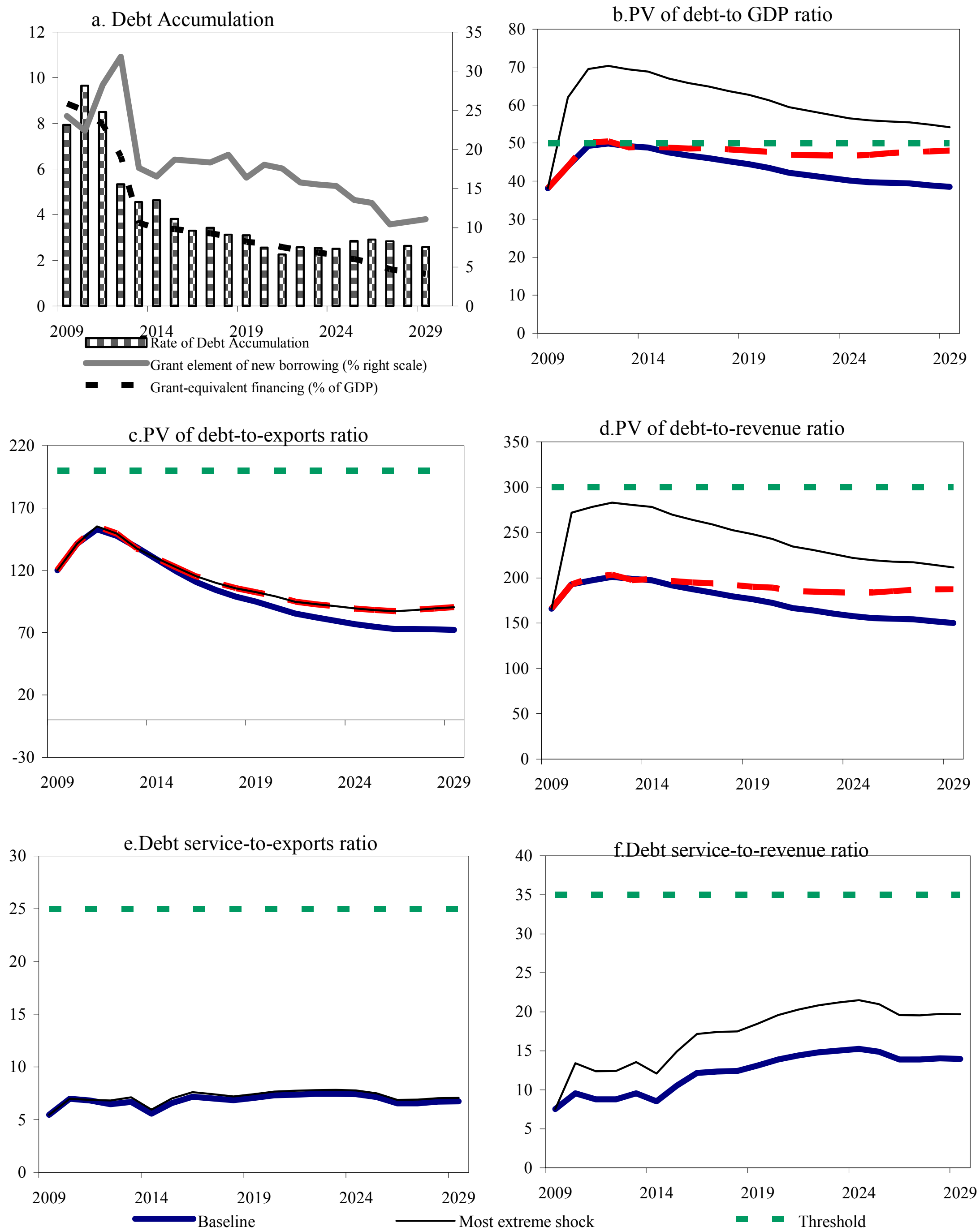
	Projections							
	2009	2010	2011	2012	2013	2014	**2019**	2029
PV of Debt-to-GDP Ratio								
Baseline	51	58	64	62	61	60	**53**	46
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	51	54	55	55	56	56	**58**	73
A2. Primary balance is unchanged from 2009	51	58	63	65	68	70	**87**	130
A3. Permanently lower GDP growth 1/	51	59	65	65	65	65	**65**	81
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	51	59	65	65	64	64	**58**	55
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	51	61	69	67	67	66	**59**	52
B3. Combination of B1-B2 using one half standard deviation shocks	51	58	62	61	60	59	**52**	43
B4. One-time 30 percent real depreciation in 2010	51	73	77	75	74	72	**65**	63
B5. 10 percent of GDP increase in other debt-creating flows in 2010	51	69	74	73	72	70	**63**	55
PV of Debt-to-Revenue Ratio 2/								
Baseline	175	204	215	215	224	221	**196**	172
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	175	190	188	193	205	207	**217**	277
A2. Primary balance is unchanged from 2009	175	203	211	224	247	258	**320**	492
A3. Permanently lower GDP growth 1/	175	206	220	223	237	238	**238**	306
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	175	206	220	223	234	233	**215**	207
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	175	214	232	233	243	240	**216**	196
B3. Combination of B1-B2 using one half standard deviation shocks	175	202	211	211	220	217	**190**	164
B4. One-time 30 percent real depreciation in 2010	175	257	262	259	270	265	**240**	239
B5. 10 percent of GDP increase in other debt-creating flows in 2010	175	241	251	252	262	259	**232**	209
Debt Service-to-Revenue Ratio 2/								
Baseline	20	23	18	19	20	23	**28**	33
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	20	23	17	17	16	15	**28**	54
A2. Primary balance is unchanged from 2009	20	23	18	19	20	22	**47**	102
A3. Permanently lower GDP growth 1/	20	23	18	19	21	24	**33**	58
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010-2011	20	23	18	19	21	23	**30**	38
B2. Primary balance is at historical average minus one standard deviations in 2010-2011	20	23	19	20	23	28	**31**	36
B3. Combination of B1-B2 using one half standard deviation shocks	20	23	18	19	19	21	**25**	29
B4. One-time 30 percent real depreciation in 2010	20	25	22	22	25	28	**40**	59
B5. 10 percent of GDP increase in other debt-creating flows in 2010	20	23	20	21	32	34	**35**	40

Sources: Country authorities; and staffs estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

Table 5. Cape Verde: Assumptions of the Alternative Macroframeworks, 2010-2028

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023	2028
Real GDP growth rate											
Low growth	5.0	5.5	7.0	4.6	4.4	3.7	2.8	2.5	5.0	4.9	4.9
Baseline	5.0	5.5	7.0	7.1	6.9	6.2	5.3	5.0	5.0	5.0	4.9
High growth	5.0	5.5	7.0	9.6	9.4	8.7	7.8	7.5	5.0	5.0	5.0
Export growth											
Low growth	3.8	11.0	15.6	14.7	14.8	13.6	13.6	13.7	12.6	9.9	7.1
Baseline	3.8	11.0	15.6	17.5	17.7	16.5	15.2	13.9	12.6	9.9	7.1
High growth	3.8	11.0	15.6	22.7	25.8	23.6	18.4	17.1	11.3	9.9	7.0
Overal fiscal balance (percent of baseline GDP)											
Low growth	-9.9	-10.0	-6.0	-5.8	-4.6	-4.2	-4.1	-4.1	-4.1	-4.1	-4.1
Baseline	-9.9	-10.0	-6.0	-5.8	-5.5	-4.4	-4.3	-4.3	-3.9	-3.4	-3.1
High growth	-9.9	-10.0	-6.0	-5.8	-4.5	-3.1	-2.5	-2.0	-1.9	-2.1	-2.0
Government revenues, excl. grants (billion CVE)											
Low growth	33.8	39.6	43.4	48.3	51.9	56.6	60.5	65.0	71.1	106.8	157.6
Baseline	33.8	39.6	43.4	48.3	53.3	59.2	64.7	70.9	77.4	115.8	170.7
High growth	33.8	39.6	43.4	48.3	55.3	63.3	71.2	80.2	87.5	130.6	192.1
Government revenues, excl. grants (percent of baseline GDP)											
Low growth	22.8	25.0	24.8	24.8	24.1	23.7	23.3	23.0	23.1	23.4	23.6
Baseline	22.8	25.0	24.8	24.8	24.7	24.8	24.9	25.1	25.2	25.4	25.6
High growth	22.8	25.0	24.8	24.8	25.7	26.6	27.4	28.4	28.5	28.6	28.8
Total expenditures (billion CVE)											
Low growth	57.1	62.7	61.0	64.7	67.0	72.0	76.7	82.0	89.3	131.4	190.5
Baseline	57.1	62.7	61.0	64.8	70.5	75.4	81.6	89.1	95.8	137.9	197.6
High growth	57.1	62.7	61.0	65.0	70.8	76.8	84.3	92.9	100.6	147.8	212.4
Total expenditures (percent of baseline GDP)											
Low growth	38.5	39.6	34.9	33.2	31.1	30.2	29.5	29.0	29.0	28.8	28.5
Baseline	38.5	39.6	34.9	33.2	32.7	31.6	31.4	31.5	31.1	30.2	29.6
High growth	38.5	39.6	34.9	33.3	32.9	32.2	32.5	32.9	32.7	32.4	31.8
Net external borrowing (percent of baseline GDP)											
Low growth	11.0	10.6	6.5	4.4	3.5	3.6	3.2	3.3	3.4	3.4	3.6
Baseline	11.0	10.6	6.5	4.4	4.4	3.8	3.3	3.5	3.3	2.7	2.6
High growth	11.0	10.6	6.5	4.4	3.4	2.5	1.6	1.3	1.3	1.4	1.5
Nominal GDP (billion CVE)											
Low growth	148.2	158.5	174.9	190.1	206.1	223.0	238.0	254.2	276.7	410.7	602.1
Baseline	148.2	158.5	174.9	195.2	215.3	238.3	259.6	282.5	307.6	455.8	667.6
High growth	148.2	158.5	174.9	200.8	227.7	258.9	289.7	323.3	351.6	519.9	760.3
GDP per capita (Euros, current prices)											
Low growth	2,570	2,696	2,919	3,114	3,311	3,515	3,681	3,858	4,119	5,559	7,412
Baseline	2,570	2,696	2,919	3,196	3,459	3,756	4,015	4,287	4,580	6,171	8,218
High growth	2,570	2,696	2,919	3,287	3,659	4,081	4,480	4,906	5,235	7,039	9,358

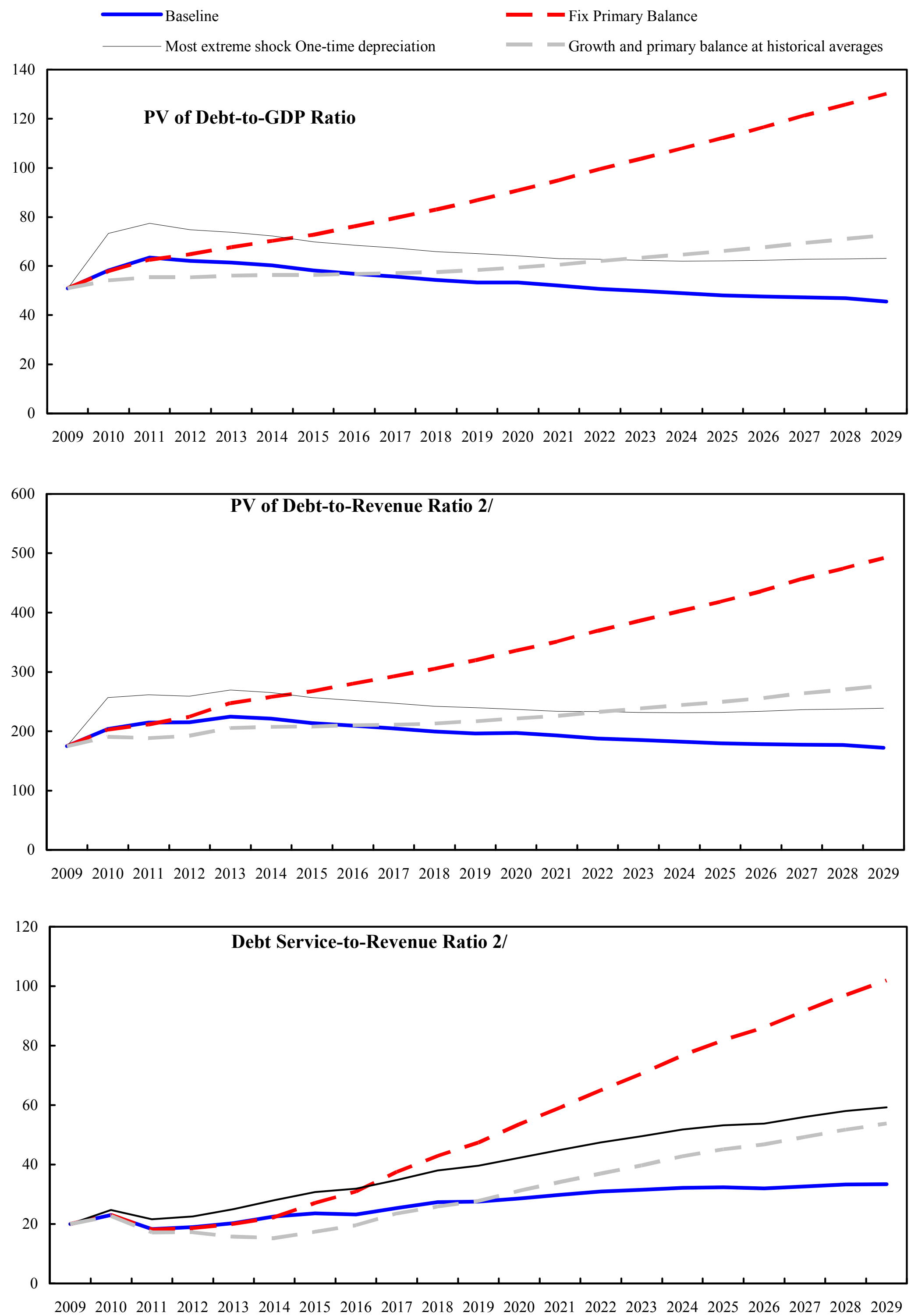
Figure 1. Cape Verde: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2009-2029 1/



Source: Staff projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2019. In figure b. it corresponds to a Most extreme shock One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in picture f. to a One-time depreciation shock

Figure 2. Cape Verde: Indicators of Public Debt Under Alternative Scenarios, 2009-2029 1/



Sources: Country authorities; and staffs estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2019.
2/ Revenues are defined inclusive of grants.

I. Cape Verde—Fund Relations
(as of October 31, 2009)

I. Membership Status: Joined: November 20, 1978; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	9.60	100.00
Fund holdings of currency	9.59	99.93
Reserve Position	0.02	0.17
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	9.17	100.00
Holdings	8.48	92.51

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
PRGF Arrangements	7.29	75.91

V. Latest Financial Arrangements:

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

VI. Projected Payments to Fund [1/]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	2010	2011	2012	2013
Principal	0.25	1.48	1.73	1.61	1.24
Charges/Interest	0.02	0.03	0.03	0.02	0.01
Total	0.269	1.51	1.75	1.62	1.25

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

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Safeguards Assessments

In response to a request from the Bank of Cape Verde's (BCV), a voluntary safeguards assessment with respect to the Policy Support Instrument (PSI) approved on July 31, 2006 is was completed in 2008. The previous safeguards assessment of the BCV, which was completed in December 2002, concluded that substantial risks may have existed at the time in the bank's financial reporting framework, its internal audit mechanism, and system of internal controls. The 2008 assessment concluded that, while the BCV has taken some measures recommended in the 2002 assessment, there are still significant outstanding vulnerabilities, notably in the system of internal control, internal audit, and transparency and publication of the financial statements.

X. Exchange Arrangements

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

XI. Previous Article IV Consultation and PSI Reviews

Discussions for the 2006 Article IV consultation and on a medium-term economic program that could be supported by a three-year PSI were held in Praia April 28–May 16, 2006. The Executive Board concluded the Article IV consultation and approved the request for a PSI on July 31, 2006 (Country Report No. 06/334); the first PSI review on January 19, 2007 (Country Report No. 07/44); the second PSI review on May 7, 2007 (Country Report No. 07/223); the third PSI review on December 21, 2007 (Country Report 08/37); the 2008 Article IV consultation and the fourth PSI review on June 30, 2008 (Country Report 08/248); the fifth PSI review on December 22, 2008 (Country Report 09/14); and the sixth PSI review on June 19, 2009 (Country Report 09/198).

XII. Technical Assistance

Since 1985 the Fund has provided technical assistance to the BCV, the Ministry of Finance, and more recently the National Institute of Statistics in several areas: (i) MCM provided technical assistance to the BCV on organization and methods, management of external debt, monetary and banking statistics, accounting, credit, foreign exchange operations, management of public debt, and the separation of the functions of the Bank, as well as on the choice of exchange rate regime. BCV has also received technical assistance from STA on monetary and balance of payments statistics. (ii) The Ministry of Finance has received technical assistance from FAD on organization and budgetary procedures, budgeting, tax policy, and tax administration; from STA on fiscal accounting; and from LEG on tax legislation. (iii) The National Institute of Statistics has received technical assistance in national accounts and price statistics. Cape Verde is a participant in STA's GDDS Regional Project for Lusophone Africa, and its metadata were posted on the DSBB in February 2004. It is now receiving technical assistance to implement the GDDS plan for improvement.

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

FAD

- June 2004, visit to help the authorities move to a VAT, rationalize the import tariff, and overhaul the domestic indirect tax system. Many visits and a two-year resident advisor have gone into this effort.
- October 2004, mission to review tax administration, including VAT implementation, and a mission to help assess tax exemptions and incentives.
- September 2005, mission to assess tax exemptions and incentives.
- June–July 2008, mission to review and rationalize tax exemptions.

STA

- National accounts (November 2003 and January–February 2006), balance of payments statistics (February 2004), government finance statistics (March 2004, April 2006, February–March 2007), price statistics (June 2004, May–June 2006, October 2007), and monetary statistics and reporting (March 2007), government finance statistics (August 2008).

MCM

- Accounting, financial sector regulation, monetary operations and liquidity management (April and May 2004); banking supervision, liquidity management, exchange regime and reserves management (November 2005, March–April 2006, June 2006, November 2006, July 2007).
- Macro-prudential indicators (March 2008).
- Financial Sector Assessment Program (FSAP) (November 2008) a various follow up missions on banking supervision (January, March and April 2009).
- Joint IMF-World Bank on debt management (DeMPA, February 2009) and on Medium-Term Debt Strategy (MTDS) (August–September 2009)

LEG

- Tax legislation (several missions October 2006–March 2008).
- AML/CFT initial assessment (March 2007), and legal drafting (March 2008).

XIII. Resident Representative: None.

Cape Verde: Joint Management Action Plan—Implementation Matrix

Title	Products	Provisional Timing of Missions	Expected Delivery Date
A. Mutual information on relevant work programs			
Bank work program in the next 12 months	**Lending**: - PRSC-5 (IDA)	October 2009	Q2 FY10 (Dec 2009)
	- Roads Project-2 (IDA)	Nov/Dec. 2009	Q4 FY10
	- SME Technical Assistance and Capacity Building Operation (IDA)	October 2009 (ongoing)	Q2 FY 10 (Dec 2009)
	- Energy Operation (IBRD)	November 2009	Q4 FY10
	- Energy Guarantee (IBRD – partial risk guarantee) for windmill farm	November 2009	Q4 FY10
	- Regional Fisheries Operation	August 2009	Delivered on October 20, 2009
	Analytical and advisory activities: - Poverty assessment	December 2008	Delivered Q4 FY09
	- Public-Private Infrastructure Advisory Facility (PPIAF)/TA proposal on road sector is under revision	Dec. 2009	Dec. 2010
	- PPIAF/TA on the energy sector (develop strategic/recovery plan for Electra; Electra management model)	Nov./Dec. 2009	April/May 2010
	- Skills Development/Labor market study	October 2009 (ongoing)	Q2 FY10
	- General economic monitoring	Next Budget Support Group joint mission	Throughout the year
	- Transport assessment	Nov./Dec. 2009	Q4FY10
	- FSAP update	To be defined	

Cape Verde: Joint Management Action Plan—Implementation Matrix (concluded)

Title	Products	Provisional Timing of Missions	Expected Delivery Date
A. Mutual information on relevant work programs			
IMF work program in next 12 months	PSI program, 8th review, and 2010 Article IV consultation	March 2010	Board meeting June-2010
	PSI program, 1st review	September– October 2010	Board meeting Dec-2010
B. Agreement on joint products and missions			
Joint products in next 12 months	Technical assistance on debt management	January-March 2010	End FY2010 (possible second phase of TA in FY11)

III. Cape Verde—Statistics Issues

1. **Data provision has some shortcomings, but is broadly adequate for surveillance.** There is a need for substantial improvements in the areas of government finances, national accounts, and balance of payments. The country has participated in the GDDS since February 2004. Cape Verde's plans for improvements of its statistical system are posted on the Fund's DSBB; the metadata of the monetary and financial sector were updated in August 2007. The country has benefited from STA technical assistance under the GDDS project for Lusophone Africa.

2. **The authorities are taking steps to strengthen statistics, but the statistical system still suffers from a shortage of financial and human resources.** A comprehensive master plan has been developed under the direction of the National Statistical Institute (INE), which assesses the need for upgrading the agencies that constitute the statistical system and outlines steps to broaden and improve all areas of statistics. The country's development partners have already committed a substantial part of the estimated US$15 million required to implement the plan through 2010.

Real sector statistics

3. **Although some improvements have been made to the national accounts, significant weaknesses remain**, including a lack of reliable demand-side GDP. The timeliness of the data has improved, with the INE releasing production and expenditure-based GDP data for 2002–03 in 2005 and providing production-based GDP estimates for 2004–06 to the AFR mission in October 2007. However, the lag is still lengthy by international standards. In addition, the base year for the constant price estimates is outdated.

4. **INE is currently working on a complete overhaul of the national accounts.** It is updating the national accounts benchmark and base years from 1980 to 2002 and adopting the *1993 SNA*. The objective is timely compilation of GDP by industry and expenditure categories at current and constant prices as well as institutional sector accounts.

5. **INE will also introduce Tourism Satellite Accounts**. These accounts will measure upstream linkages between the tourism sector and the rest of the economy and the import content of tourism exports.

6. **Full implementation of the *1993 SNA* would require a substantial improvement in source data collection, for which capacity is currently lacking.** The 2006 STA mission found a critical need to improve the timeliness and accuracy of national accounts source data, in particular the business survey. The capacity of INE staff working on national accounts was found to be overstretched; they assess in detail and correct individual source data entries—something not undertaken in most countries by national accounts compilers. The statistical master plan will address many of these challenges.

7. **A revamped CPI with new methodology was launched in February 2008.** The previous official CPI was based on weights dating back to 1989, four years before imports were liberalized. Import liberalization considerably changed consumption patterns. INE has had assistance from the National Statistics Institute of Portugal and benefited from STA CPI missions in May–June, 2006, October 2006, and October 2007, to support the introduction and dissemination of the revised CPI. The new index has new weights and an updated commodity basket.

8. **Labor market statistics are weak.** Data on unemployment are compiled with long delays and there are no wage data.

Government finance statistics

9. **Fiscal data have been improved.** Benefiting from TA under the GDDS project for Lusophone Africa, the Government Finance Statistics (GFS) compilation system is being upgraded. Most deposits previously held with commercial banks have been consolidated at the central bank. SIGOF, the Integrated Online Budget Management System, has been expanded to cover all semi-autonomous institutes and most municipalities by the end of 2007. In addition, a new chart of government accounts (PNCP) will be implemented in 2009 that adopts accrual accounting and double-entry principles. The authorities have started reporting GFS for publication in the *GFS Yearbook*.

10. **However quality is a serious concern.** The fiscal accounts are subject to large statistical discrepancies, flows and stocks are not consistent, and recording of arrears accumulation and clearance operations is not in line with best practices. Significant delay in donor reporting of project financing also affects the accuracy of fiscal data. Despite the recent revision of external debt data, significant weaknesses affect preparation of debt sustainability analyses. Multilateral debt statistics regularly differ from data received by creditors, and debt service projections cannot be reconciled with the debt stock.

Monetary and financial statistics

11. **The quality of monetary and financial statistics is adequate,** in terms of both accuracy and timeliness. An STA mission undertaken in March 2007 helped Banco de Cabo Verde (BCV) to finalize the standardized report forms (SRFs) for reporting monetary statistics to STA. SRF-based monetary data have been published in the *IFS Supplement* since June 2007. These data are fully aligned with the recommendations of the *Monetary and Financial Statistics Manual*. The integrated monetary database that meets STA, AFR, and BCV statistical needs is now in place. Currently, there are gaps in tracking the source and direction of changes in emigrant deposits, which cause difficulties in assessing their interest sensitivity and gauging the appropriateness of the monetary policy stance.

External sector statistics

12. **With technical assistance from STA, the accuracy, periodicity, and timeliness of balance of payments statistics compiled by BCV have continued to improve.** A greater use of surveys, combined with the International Transactions Reporting System implemented by the BCV, has permitted a significant expansion of data sources and statistical coverage, which to a large extent follow the recommendations of the 5th edition of the *Balance of Payments Manual*. However, gaps in the tracking of large external flows—notably FDI, emigrant deposits, and remittances—remains. Dissemination of quarterly BOP data on the BCV website has been regular and in 2007 the BCV resumed regular and timely transmission of these data to STA for publication in *International Financial Statistics* and in the Balance of Payments Statistics Yearbook. However, the BCV does not compile an International Investment Position statement.

Cape Verde: Common Indicators Required for Surveillance

(As of November 15, 2009)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	10/31/09	11/06/09	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/31/09	11/06/09	D	W	M
Reserve/Base Money	10/31/09	11/06/09	D	W	M
Broad Money	Sep-09	Oct-09	M	M	M
Central Bank Balance Sheet	10/31/09	11/06/09	D	W	M
Consolidated Balance Sheet of the Banking System	Sep-09	Oct-09	M	M	M
Interest Rates[2]	Sep-09	Oct-09	M	M	M
Consumer Price Index	Oct-09	Nov-09	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	N/A	N/A	N/A	N/A	N/A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Jun-09	Aug-09	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec-08	Feb-09	A	A	A
External Current Account Balance	Sep-09	Oct-09	Q	Q	Q
Exports and Imports of Goods and Services	Sep-09	Oct-09	Q	Q	Q
GDP/GNP	2007	Apr-09	A	A	A
Gross External Debt	Dec-08	Feb-09	A	A	A
International Investment Position[6]	2007	Aug-08	A	A	A

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

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 09/449
FOR IMMEDIATE RELEASE
December 8, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Seventh Review Under the Policy Support Instrument for Cape Verde

The Executive Board of the International Monetary Fund (IMF) completed on December 7 the seventh review under the Policy Support Instrument (PSI) for Cape Verde. The PSI for Cape Verde was approved on July 31, 2006 (see Press Release No. 06/172) and was extended by one year on June 19, 2009 (See Press release No. 09/222).

Cape Verde's PSI is designed to enhance the sustainability of growth and development by maintaining a stable macroeconomic environment and moving forward with structural reforms. Specific attention is given to reducing fiscal risks and giving Cape Verde a margin of safety to protect the economy against exogenous shocks.

Following the Executive Board's discussion, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, stated:

" Prudent economic management and strong fundamentals have enabled Cape Verde to weather the global crisis well. Growth remains solid, inflation has returned to low levels, and domestic debt continues to decline. The global financial crisis has had little impact on the financial sector, and despite a moderate decline, international reserves remain adequate, partly because of the SDR allocation.

"The fiscal deficit in 2010 will be driven by investment needs and social spending, using the borrowing space. The planned acceleration of public investments in infrastructure, financed externally on long and concessional terms, is consistent with external stability, and should have a positive impact on medium-term growth and competitiveness.

" The risk of debt distress in Cape Verde remains low. Given the rapid increase in the debt ratios, a reduction in the fiscal deficit beyond 2010 is warranted, and a commitment to keep the deficit low over the medium term would dispel any market concerns about fiscal sustainability. Steps are being taken to strengthen revenue collection and broaden the tax base. Continued fiscal restraint and prudent monetary management are critical to safeguarding the exchange rate peg and increasing resilience to shocks.

" Cape Verde's monetary framework continues to be appropriate. Given the pressure on international reserves, the increase in the reserve requirement in the short term was necessary. Going forward, there is room to lower interest rates gradually as international country risk premiums decline. Over the medium term, it will be important to continue to improve the monetary policy transmission mechanism and to develop the domestic financial market. The authorities have made considerable progress in implementing the FSAP recommendations to improve financial sector regulation and supervision, and are encouraged to continue their efforts to enact the new banking law in 2010", added Mr. Portugal.

The IMF's framework for PSIs is designed for PRGF-eligible countries that may not need, or want, IMF financial assistance, but still seek IMF advice, monitoring and endorsement of their policies. PSIs are voluntary and demand driven. PSIsupported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PSI-supported programs are consistent with a comprehensive framework for macroeconomic, structural and social policies to foster growth and reduce poverty. Members' performance under a PSI is normally reviewed semi-annually, irrespective of the status of the program (see Public Information Notice No. 05/145).

Statement by Mr. Laurean Rutayisire, Executive Director for Cape Verde
December 7, 2009

We thank staff for the good policy dialogue maintained with our Cape Verdean authorities. Our authorities continue to value the useful advice they receive from the Fund in the context of the PSI. The PSI program has provided a sound framework under which the authorities have pursued the implementation of their policy and reform agenda. Important strides have been made in the implementation of the key priority measures set by the authorities at the time of the PSI request, including public debt reduction, reserve accumulation, and improved public financial management and regulation of the financial sector. In this light, the PSI program has served the country well and, accordingly, it is their intention to request a successor PSI as the current one expires next year.

Exceeding expectations at the time of the last review, Cape Verde's economy is poised to grow at about 4 percent in 2009 notwithstanding the initial adverse effects of the global economic turmoil on its key drivers such as tourism and FDI. This stronger-than-expected growth performance is partly reflective of the positive economic impact of the authorities' much-needed public investment program which is mainly financed by concessional external resources and aimed at filling the infrastructure gap in electricity, and water generation, ports and roads. Other good use that has also been made of the ample fiscal space freed by the sound macroeconomic policies implemented by the authorities in recent years included raising pro-poor spending and lowering corporate and income taxation to promote private sector development. At the same time, the authorities have managed to rein in nonpriority expenditures. However, the growing capital expenditure envelope coupled with the low level of tax revenues and land sales largely account for the projected increase in the fiscal deficit which is estimated to be about 8.8 percent of GDP in 2009.

Program Performance and Outlook

Program performance has continued to be satisfactory on the macroeconomic front, notably with all end-June 2009 assessment criteria being met with comfortable margins. In particular, net international reserves stood at healthy levels, net domestic borrowing remained subdued, and no accumulation of new domestic or external payment arrears arose.

On the structural front, the authorities pressed ahead with the implementation of their reform agenda, meeting the bulk of structural benchmarks—albeit some with delay. Specifically, the BCV finalized a report on BOP developments which also includes an assessment of interest sensitivity of non-resident flows to the banking system. Financial controllers were appointed in line ministries to monitor budget execution. The Cabinet examined a report on contingent liabilities that assesses risks arising notably from state-owned enterprises. A mid-year review of budget execution was performed and a medium-term fiscal framework developed that evidence the consistency of external borrowing with debt sustainability.

The authorities plan to submit the draft income tax codes to the Parliament by the end of this year. They are also in the process of devising a strategy for strengthening monetary and fiscal policy coordination, notably with a view to improving liquidity management and policy response to potential shocks. In parallel, efforts are underway to harmonize prudential norms for onshore and offshore banks, including through improved regulation of the banking sector in line with FSAP recommendations.

The economic outlook for 2010 is favorable with GDP growth expected to continue its current recovery driven by tourism, FDI, and construction. Reflecting falling global prices and strong agricultural output, consumer inflation is expected to remain low, thereby supporting the peg. The level of international reserves will remain adequate following successful efforts by monetary authorities to mitigate the global economic and financial crisis, the recent Fund allocation of SDRs, and the proceeds from external loans.

Policy Framework and Agenda for 2010 Onward

Fiscal Policy and Reform

In 2010, fiscal and monetary policy will continued to be geared at safeguarding the strong external position and preserving macro-financial stability. At the same time, increased focus will be put on preserving debt sustainability, particularly in light of the recent accelerated pace of implementation of the authorities' public investment program. As the pace of external borrowing is expected to match that of the implementation of the large infrastructure projects, the authorities will pursue the actions they have recently taken to strengthen debt management, including capacity building at the Debt Management Unit and improved ability to perform DSAs with technical assistance from the World Bank and the IMF. Because external borrowing has largely been on concessional terms, debt servicing should continue to bearable and the risk of debt distress is still low.

The overall fiscal deficit is estimated to further increase in 2010 to about 10 percent of GDP, fueled by the ongoing public investment program. In this light, there is a renewed commitment from the authorities to strengthen revenue mobilization, notably through the broadening of the tax base and the streamlining of tax exemptions. In parallel, the authorities will continue to cap net domestic borrowing in order to preserve the peg and the strong external position. For 2010, such borrowing is set so as not to exceed 2.7 percent of GDP. Going forward, efforts to contain net borrowing will be sustained and expected to be embedded in the next three-year PSI arrangement.

As part of their strategy to limit contingent liabilities stemming from public enterprises, the authorities are currently working on a restructuring plan for the electricity and airline companies. More generally, they will ensure continuous monitoring of state-owned enterprises along with regular risk assessments. A law on state enterprises has already been approved by the Cabinet and the approval of a law on public managers is imminent that will notably help improve management of the parastatals.

Monetary Policy and Financial Sector Issues

Monetary and interest rate policy conducted by the central bank (BCV) has served the country well, notably by helping preserve macroeconomic stability and the external position in the context of a largely open capital account. By raising its policy rate in Q4 2008, the BCV has been effective in mitigating the adverse effects of the recent financial turmoil on the level of international reserves. Going forward, the monetary authorities will stand ready to set the policy rate at the level which they deem appropriate to achieve the stated objectives of monetary policy. At the same time, the authorities' agenda will include working toward improving monetary transmission mechanisms and developing securities markets.

In the financial sector, one of the authorities' key priorities will be to preserve financial stability. This stability has been kept in check at the onset of the global financial turmoil sector which the banking system has effectively withstood. As rightly noted by staff, banks' soundness indicators were kept sound with adequate liquidity and loan-to-value ratios and nonincreasing nonperforming loans. After having recently enhanced their supervisory capacity, the authorities are currently in the process of strengthening the regulatory framework of the banking system. Steps were taken by the BCV back to ensure banks' compliance with the regulatory capital ratios.

Conclusion

In light of Cape Verde's continued strong performance under the PSI, we call on Directors to support the completion of the seventh review of the PSI and to consider favorably the authorities' request for modification of the end-December 2009 assessment criteria related to the ceiling on net domestic borrowing, the ceiling on nonconcessional external financing, and the floor on net international reserves.