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REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GUINEA-BISSAU

In the context of the Request for Disbursement Under the Rapid Credit Facility, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 3, 2014, following discussions that ended on September 26, 2014, with the officials of Guinea-Bissau on economic developments and policies underpinning the IMF arrangement under the Rapid Credit Facility. Based on information available at the time of these discussions, the staff report was completed on October 20, 2014.
- An **Informational Annex** prepared by the IMF.
- An update of the **Debt Sustainability Analysis** prepared by the staff of the IMF.
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement by the Executive Director** for Guinea-Bissau.

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

Letter of Intent sent to the IMF by the authorities of Guinea-Bissau*
Memorandum of Economic and Financial Policies by the authorities of Guinea-Bissau*
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

GUINEA-BISSAU

REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY

October 20, 2014

KEY ISSUES

Context: In 2012 and 2013, Guinea-Bissau suffered a severe balance of payments shock as the international price of raw cashew nuts—the main export product—fell by about 20 percent per year. The economic hardship was aggravated by the suspension of most donor support and an increase in institutional weaknesses in the wake of a military *coup* in 2012. During this period, GDP fell by 2 percent, revenue ratios declined, expenditure control weakened, and poverty rose (the share of rural population facing severe food insecurity increased from 20 to 40 percent). Following elections in April-May 2014, a democratically-elected government—fully recognized by the international community—took office in early July. Institutional capacity has been severely eroded over the last few years. Rebuilding this capacity will need to be carefully prioritized and will take time.

Request for disbursement under the Rapid Credit Facility (RCF): The authorities have requested assistance under the RCF (in an amount equivalent to SDR3.55 million or 25 percent of quota) to help address the urgent balance of payments and fiscal financing needs for 2014. The RCF would also catalyze the resumption of donor support and initiate necessary medium-term reforms to strengthen public financial management and formulate a medium-term reform strategy that could create the conditions necessary for a possible arrangement under the Extended Credit Facility (ECF) in 2015.

Main policy commitments:

- Restore fiscal discipline and normalize government operations: Adopt and publish a prudent budget for 2014 and prepare the 2015 budget. Introduce a high-level treasury committee to enhance fiscal controls and prepare a monthly cash flow plan.
- Resume the implementation of fiscal structural reforms: Strengthen tax and customs administration procedures to improve tax revenues and streamline tax exemptions.
- Restore conditions for sustained economic growth: Prepare a medium-term country strategy, including measures aimed at improving the business environment, increasing financial deepening, and promoting the development of the cashew sector.

Approved By
Roger Nord and Peter Allum

Discussions took place in Bissau from September 15–26, 2014. The staff team comprised Messrs. Felix Fischer (head), Tito da Silva Filho and Gonzalo Salinas (all AFR), and Mr. Torrez (resident representative). Mr. Justin Matz (AFR) also provided support from headquarters. Mr. Roger Nord, Deputy Director of the African Department and Woury Mamadou Diallo (Alternate Executive Director) participated in some of the discussions. Mr. Fonseca (local economist of the IMF office in Bissau) provided assistance to the mission. The team met with His Excellency President of Guinea-Bissau José Mario Vaz; the Prime Minister Mr. Domingos Simões Pereira; the Minister of Economy and Finance Mr. Geraldo Martins; the National Director of the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) Mr. João Fadia, other senior officials, Members of Parliament, and representatives from the private sector and development partners.

CONTENTS

FIGURES

TABLES

APPENDICES

Glossary

AfDB	African Development Bank
AML/CFT	Anti-money laundering/Combating the Financing of Terrorism
ASYCUDA	Automated Systems for Customs Data
BCEAO	Central Bank of West African States
BOAD	*Banque Ouest Africaine de Développement*
CPLP	Community of Portuguese-Speaking Countries
DSA	Debt sustainability analysis
DSSRP	Defense Security Sector Reform Program
ECF	Extended Credit Facility
ECOWAS	Economic Community of West African States
EU	European Union
FUNPI	Fund to promote the industrialization of agricultural products
GDP	Gross domestic product
HIPC	Highly Indebted Poor Countries
IGV	Impuesto general a las ventas (general sales tax)
MFI	Micro finance institution
NGO	Non-government organization
NPL	Non-performing loan
PFM	Public financial management
PIP	Public investment program
PRSP	Poverty Reduction Strategy Paper
RCF	Rapid Credit Facility
SIGRHAP	Personnel Management System
SSA	Sub-Saharan Africa
SSR	Security sector reform
SYGADE	Debt Management System
UCT	Upper Credit Tranche
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
VAT	Value added tax
WAEMU	West African Economic and Monetary Union

BACKGROUND, RECENT ECONOMIC DEVELOPMENTS, OUTLOOK AND RISKS

A. Context

1. **After two years of political transition and uncertainty, a democratically-elected government—fully recognized by the international community—took office in early July.** The April 2012 coup d'état interrupted a relatively successful post-HIPC momentum of economic reforms under an ECF-supported program. In late April 2013, following pressure from the international community the interim government reached a broad agreement to form an inclusive transitional government and to conduct elections in November 2013. The transition government that was appointed following the April 2012 coup d'état was able to organize presidential and parliamentary elections thanks to the decisive financial and operational support of the international community. Nigeria, Timor-Leste, the European Union (EU), the Economic Community of West African States (ECOWAS), among others, provided around US$20 million (1.9 percent of GPD) of financial support, while a peacekeeping force from ECOWAS that has been stationed in Guinea-Bissau since the coup helped guarantee peaceful elections.

2. **The fall in cashew prices and the 2012 coup resulted in substantial external pressures and economic and social costs for Guinea-Bissau.** Cashew export prices fell by about 20 percent per year between 2011 and 2013, contributing to large trade deficits, despite a compression of imports. The current account deficit (excluding official transfers) in percent of GDP doubled from -3.3 percent in 2011 to -6.6 in 2012 and remained high at -4.9 percent 2013. Together with the suspension of financial support from traditional foreign partners after the *coup*, this resulted in a large balance of payments deficit in 2012 financed by a drawdown of government deposits with the Central Bank of West African States (BCEAO). The domestic impact of the cashew crisis was exacerbated by an even larger fall in producer prices (60 percent between 2011 and 2013) in part due to the regressive incidence of contributions to an agribusiness (especially cashew) development fund (FUNPI) in the form of an additional (specific) export tax. The latter contributed to an increase in poverty (more than 70 percent of the population is estimated to live below US$2 per day) and a collapse in barter prices between rice and cashew (from 1:1 in 2011 to 1:3 in 2013). As a result, a 2013 survey on food security by the World Food Program found that the percentage of rural population facing severe food insecurity increased from 20 percent in 2011 to 40 percent in 2013. Fiscal governance also deteriorated, as reflected in the fall in revenues, increased reliance on simplified spending procedures (despesas não tituladas), and the accumulation of wage and external arrears. Support from regional partners (i.e., Nigeria and ECOWAS), which helped to partially compensate for the absence of traditional donors in 2012, was discontinued in 2013, and external arrears accumulated as well.

3. **The difficulties in past cashew campaigns have led to a significant increase in the ratio of non-performing loans (NPL) in the banking system.** The sharp decline of cashew exports—the cashew sector accounts for about a quarter of total loans—led to an increase in NPLs from 11.6 percent at end-2013 to 26 percent by June 2014. Banks have reportedly been provisioning

against NPLs and the government is examining options, with the help of Fund technical assistance, to recapitalize banks.

4. **Overall, real GDP fell by 2 percent over 2012–13 and inflation remained muted due to the contraction in domestic demand, including a collapse in public investment.** During this period, macroeconomic stability was largely preserved as a result of a forced reduction in authorized government spending commitments and increased reluctance of suppliers and contractors to provide goods and services to the government without advance payments. It is estimated that the government accrued domestic arrears (mainly salaries) of about 1.9 percent of GDP in 2013 alone. Institutional capacity has been severely eroded over the last few years. Rebuilding this capacity need to be carefully prioritized and will take time.

5. **Implementing a comprehensive security sector reform along with an inclusive growth strategy supported by the resumption of key government functions remain key requirements for durable internal stability.** The new government is keen on resuming economic reforms. Traditional donors have started to reengage and a donor roundtable is expected in the first half of 2015. Meanwhile, the European Union pledged to resume its support contingent on sound economic policies and the approval of the 2014 budget. The World Bank's commitments amount to US$81.3 million, of which US$46.5 are yet to be disbursed; projects focus on social protection, energy, extractive industries, water, environment, fisheries and agri-business. The World Bank paid the salaries of teachers and health workers for the first six months of 2014 and may continue such support in 2015. The African Development Bank is also actively considering the resumption of budget support in 2015. ECOWAS has committed to contribute US$64 million (6.1 percent of GDP) to the security sector reform.

B. Recent Economic Developments

6. **A seasonal recovery in domestic revenue and the placement of Treasury bills in the regional capital market has allowed the new government to eliminate all wage arrears accrued over the last year.** While the interim government pursued a fairly prudent fiscal policy, curtailing spending in the face of limited resources, by the end of the transition government in June this year, wage arrears from 2013 and 2014 equivalent to about four months had been accumulated. Since taking office, government financial resources have been boosted by seasonally high tax revenue from cashew nuts exports and the successful placement of CFAF15 billion in one-year Treasury bills (3 percent of GDP), which, together with salary payments using financial assistance from the World Bank, has allowed the government to eliminate almost all wage arrears. Some non-wage arrears from 2013, totaling around CFAF 3 billion (0.6 percent of GDP), still remain.[1] External arrears (including 2014 external debt service) are about 0.6 percent of GDP. The government plans to eliminate all remaining arrears accumulated in 2013 and 2014 by end-2014.

[1] Guinea-Bissau also has a stock of domestic arrears of about 10 percent of GDP that predates the last government. These arrears were certified in 2000 and 2007. The stock through 2000 was certified and recognized by the government and payments for the clearance of these arrears were made until 2011, with a remaining balance of 14 billion CFAF. A preliminary audit estimated the 2000–07 arrears at 86 billion CFAF, which the Government has not yet recognized.

C. Outlook

7. The expected resumption of financial support from traditional development partners is critical for short- and medium-term poverty reduction and economic prospects. Resumed budget support and fishing compensation later this year from the EU would allow to pay wages and restore the state's operational expenses, and thus to normalize the 2014 fiscal situation. That, together with higher cashew export and producer prices, should lead to an increase in real GDP of about 2.5 percent in 2014, while inflation should reach 2.1 percent by the end of 2014 as a result of stronger domestic demand. Over the medium-term, real GDP growth is estimated to stabilize at close to 4 percent per year assuming continued external financial support, political stability, and a sustained recovery in agricultural production, mining, and fishing activities. Inflation should converge towards 2.5 percent per year. The overall balance of payments should gradually improve, supported by some increase in FDI and donor support, although the current account is expected to deteriorate initially as foreign investment-related imports increase stronger during the investment phase than exports (Text Table 1).

Text Table 1. Guinea-Bissau: Medium-term Projections

	2013	2014	2015	2016	2017	2018	2019
Real GDP growth (%)	0.3	2.5	4.0	3.7	3.7	3.7	3.7
Real per capita income growth (%)	-1.9	0.3	1.7	1.4	1.4	1.4	1.4
Consumer price inflation (%, annual average)	0.8	-0.8	3.3	2.3	2.5	2.5	2.5
Grant and external loan financing (% of GDP)	3.7	8.1	5.2	5.2	5.2	5.2	5.1
Fiscal revenue (% of GDP)	8.7	11.4	10.6	11.0	11.2	11.4	11.7
Overall fiscal balance (incl. grants, cash basis, % of GDP)	-2.0	-4.1	-3.9	-3.4	-3.4	-3.0	-2.7
External current account (% of GDP)	-4.1	-0.4	-3.9	-4.5	-5.0	-5.5	-5.8

Source: IMF staff estimates

8. Guinea-Bissau remains at moderate risk of debt distress. The country's external and public debt indicators improved significantly following HIPC and MDRI assistance and remain below the indicative thresholds throughout the projection period. Based on an updated DSA, the debt indicators are lower than previously estimated due to revisions to the debt stock and GDP, and the exclusion of debts in technical arrears (i.e. arrears to creditors with whom rescheduling agreements are pending). The external debt ratios are expected to remain relatively stable over the near term as the authorities intend to finance some key infrastructure projects mainly through concessional loans from development partners. However, reflecting Guinea-Bissau's narrow export base, the DSA finds that there is a large and protracted breach of the present value of debt to exports threshold in an exports shock scenario. The assessment depends on the post-crisis recovery and on the assumption that the authorities will reestablish prudent fiscal and debt management policies, implement structural reforms, and continue to rely largely on concessional borrowing.

RESTORING MACROECONOMIC STABILITY

The near-term outlook has improved considerably in recent months given the peaceful restoration of democracy and a high degree of consensus within the (inclusive) government on the much-needed measures and structural reforms. However, maintaining fiscal discipline is crucial to take maximum advantage of the current positive momentum and get back on track on inclusive growth and development.

A. Restoration of Fiscal Discipline and Normalization of Government Operations

9. The government has taken important steps to improve budget execution (MEFP, §14, b, c). The authorities have prepared a monthly cash flow plan for the remainder of the year, which will help them prioritize spending commitments, prepare access to short-term bank financing when needed and minimize the use of emergency spending procedures. Moreover, (in addition to the conventional Treasury committee), it plans to create a high-level Treasury committee to enhance fiscal control, which will consist of representatives from the Presidency, the Prime Minister's office, the Ministry of Economy and Finance, the BCEAO, the IMF and donors. The objective of this committee will be to set priorities for spending, set limits for non-regularized expenditures, assess requests for exceeding these limits on an exceptional basis, and reconcile payment orders with bank statements on a monthly basis. Both committees are expected to be operational by mid-October.

10. The authorities acted fast and presented a prudent budget for 2014 (MEFP, §14, b). The 2014 budget is based on realistic estimates of fiscal revenue and donor financing. Its approval and publication is a prior action for the RCF disbursement and, even this late in the year, helps to control spending commitments and thereby impose fiscal discipline. The prior action will also help the RCF disbursement have a full catalytic role by sending a strong signal that the government is restoring proper operating procedures. The 2014 budget includes a spike in recurrent expenditures due to a resumption of spending on basic supplies and election-related spending, as well as a higher wage bill on account of the inclusion of health workers and teachers that were previously not included in the budget.

11. Assistance under the RCF will help close the residual financing gap for 2014. The prospect of potential assistance under the RCF is already playing a crucial catalytic role as donors have begun to resume budget support, which along with Fund support will help close the large balance of payments and fiscal financing gaps for 2014. However, despite the prospects of a fully-financed 2014 budget, the timing mismatch between expected expenditures and budget support will require a prudent fiscal policy and careful liquidity management.

12. The authorities are now focusing on the preparation of the 2015 budget (MEFP, §16). The authorities aim at having the 2015 budget in place and published by early next year with fiscal targets in line with expected available resources. Preliminary estimates point, at this stage, to a still large residual financing gap in 2015. Therefore, the authorities are planning expenditures in line with a conservative budget envelope while simultaneously intensifying their efforts to get additional budget support, including at the round table tentatively scheduled to take place in early 2015.

B. Resumption of Fiscal Structural Reforms

13. The pace of structural fiscal reforms has slowed substantially since 2012. Over the last two years, fiscal reforms have practically come to a halt except for some progress in terms of the integration of all civil servants, with the exception of the army and the police, in a system to pay their wages through the banking system and the approval of an appropriate organizational structure for tax administration on a functional basis as recommended by past FAD technical assistance.

14. Given the pressing and vast need for fiscal structural reforms, the authorities intend to carefully prioritize them in light of their limited institutional capacity. In the short-run, the authorities will focus on (i) introducing a high-level committee to enhance fiscal controls and reduce the fiduciary risk by donors; (ii) streamline tax exemptions on fuel imports and (iii) expand the customs IT system to the border post Safim (see Structural Benchmarks in Table 2 of the MEFP). These measures should improve cash management and help recovering the fiscal revenues that were lost over the last two years. Over the medium-term, to finance the large development needs, the authorities will aim at increasing revenue collection much beyond the relatively low levels observed before the military coup (see Box 1 for tax administration reforms). The structural reform agenda under the 2010 ECF arrangement focused on the areas of public financial and payroll management, tax and customs administrations, as well as debt management. Capacity building, including from the Fund, will be crucial to regain momentum in these areas.

15. The government intends to resume the reforms of payroll management (MEFP, §23, c). The government aims to complete the administrative module of the payroll management system (SIGRHAP) and integrate it with the financial module in order to integrate the ministries of public administration and economy and finance. The authorities are planning to extend SIGRHAP and the payment of salaries through the banking system to military personnel and the Ministry of the Interior.

16. The government will strengthen debt management (MEFP, §23, b). The authorities are working to complete the external debt assessment and clear any external arrears (currently estimated at 0.6 percent of GDP), while accurately scheduling future payments to avoid new ones. The government intends to resume its efforts to reach rescheduling agreements with non-Paris Club creditors, which are still pending after reaching the HIPC Completion Point. To increase transparency, the Ministry of Economy and Finance plans to compile and publish information on public debt (external and domestic) on a quarterly basis. To accomplish that, the authorities are seeking training opportunities to improve the capacities at the debt unit.

17. The government has started to closely monitor and streamline tax exemptions (MEFP, §14, e; §23, d). The government created a committee to assess all tax exemptions on a weekly basis and has started to align fuel consumption by ministries, including the ministry of defense, to their estimated needs. Fuel subsidies are currently estimated at 0.9 percent of GDP, while below-market reference prices for imported goods and cashew exports add another 0.3 percent of

GDP. The authorities aim at drastically reducing tax exemptions and are considering aligning reference prices to market prices.

Box 1. Reforming Tax Administration in Guinea-Bissau

Guinea Bissau's tax revenue to GDP ratio is one of the lowest in Africa. In 2013, Guinea-Bissau's tax revenue amounted to 7.4 percent of GDP down from the (very low) record high of 8.0 percent in 2010. Poor revenue mobilization is at the core of the chronic fiscal imbalances in Guinea Bissau. The non-diversified—largely informal—economy, a poorly structured tax system, institutional weaknesses, chronic economic and political instability and capacity constraints make tax collection a challenge. Political instability and weak institutions have fostered rent seeking behavior, corruption, political pressures on tax administration, and lack of political resolve (or proper incentives) to implement tax and customs administration reform. A recent TA mission from the Fiscal Affairs Department identified measures to boost tax and customs collection.

Key recommendations to increase tax collection over the medium term include: (i) improving the tax department's (DGCI) basic infrastructure, including suitable furbished offices with computers; (ii) implementing a human resources policy, including a new professional audit career and with a trained core staff with clear-cut responsibilities; (iii) drafting of manuals and defining of work procedures for tax collection, auditing and enforcement of tax liabilities, which helps shielding tax officers from political interference; (iv) defining a work program that focuses initially on large contributors; and (v) implementing a new IT system for tax administration.

Key recommendations to boost customs collection include: (i) increasing the operational efficiency of Bissau's port and other customs posts. Key components to increase operation efficiency include the definition of work procedures and the rollout of the IT software SYDONIA++ to all main customs posts, including Safim, São Domingos, Bafatá and Gabú; (ii) installing scanners at Bissau's port and borders to increase control; (iii) reducing under-invoicing through improved valuation of goods through an improved exchange of information with customs administrations of the main exporting countries and setting up of a database with international prices of traded goods ; (iv) clear arrears with internet provider (Oracle) to ensure continued service of the custom's IT system; (v) preventing fraud by resuming the coloring of customs duty exempt fuel; and (vi) developing audits of post-clearance and of duty exemptions and enhancing intelligence to detect fraud.

Structural reforms need to be complemented with capacity building to ensure their effectiveness and sustainability. The Fund and development partners play a key role in providing training and technical assistance and have started to coordinate in the areas of public financial management and revenue administration.

18. **Building on recommendations from recent Fund technical assistance, the authorities intend to prepare an action plan for PFM reforms (Box 2) (MEFP, §18; §23, a).** The authorities are discussing with the Fiscal Affairs Department measures and procedures that would enable them to substantially reduce the use of simplified spending procedures and restore their proper recording within the budget management system (SIGFIP). Over the medium-term, the government sees a need to improve their forecasting capacity, consolidate Treasury accounts; prepare and publish budget execution reports; and strengthen internal and external control practices.

Box 2. Strengthening Public Financial Management (PFM) in Guinea Bissau

PFM in GNB still suffers from severe weaknesses that hamper its efficiency and transparency. The absence of a PFM reform strategy and action plan formally adopted by authorities as well as the lack of an institutional framework to pilot and coordinate needed reforms on a full time basis together with capacity constraints did not allow for significant progress in implementing recommendations of past technical assistance (TA) missions. Overall, the performance of the system is hampered by institutional weaknesses in budget preparation and execution as well as deficient accounting and fiscal reporting.

Some progress has been made in the area of budget execution. The legal framework of budgeting and accounting slightly improved with the adoption, in 2010, of a decree transcribing the outdated 1998 WAEMU directive on accounting regulation; the directorate in charge of ex-ante control of budget execution (i.e. "Contrôle Financier") has been separated from the budget directorate and the institutional framework of the procurement directorate has been strengthened. However, the system is still characterized by late approval of the annual budget, lengthy and complex budget execution procedures, and non-transparent and redundant controls, leading to an abusive use of exceptional procedures (DNT) often bypassing the budget information system (SIGFIP) and contributing to the accumulation of domestic arrears. Recent recommendations from technical assistance missions include:

The Budget should be executed in a predictable and orderly fashion in order to restore fiscal discipline and transparency. Priority measures include; (i) adopting 2015 budget before end of 2014; (ii) aligning budget allocations to commitment plans (forward looking) rather than as currently practiced to the previous year's budget execution (backward looking); (iii) adopting a decree restricting the use of DNT to pre-defined nature of expenditure through SIGFIP; and (iv) streamlining budget execution procedures while observing its mandatory steps.

The treasury committee should be reactivated to improve fiscal discipline and cash management. In the recent years, the lack of cash management plans regularly updated in treasury committee meetings led to high domestic arrears. To improve fiscal discipline: in the short term (i) the treasury committee should be reinstated and enhanced later on; and (ii) annual and monthly cash management plans should be prepared, implemented and updated regularly. In the medium term, a Treasury Single Account needs to be established in order to facilitate cash management and budgetary controls.

The financial statements from 2009 to 2013 should be issued by the government and subsequently audited and approved by the Supreme audit institution (SAI, "Tribunal des comptes) as soon as possible. Organizational weaknesses at the General Treasurer's office have negative impacts on accounting and closure of the trial balance. Impairments in closing the financial statements together with deficiencies in the accounting processes hamper the production of annual accounts. To improve the production of accounts the government should draft a manual detailing accounting procedures and prepare the terms of reference for employees within the General Treasurer's office. The trial balance should be produced, controlled and approved on a monthly basis.

The government needs to better use the current PFM software (SIGFIP) which has all needed functionalities to support budget preparation and execution and accounting. For example, the accounting module is only partially used, the General Ledger is not complete and the trial balances are not produced. As a result, the quality of accounts is poor. For a better use of SIGFIP, all users should be trained properly and the SIGFIP accounting module should be fully implemented.

C. Structural Reforms to Create Conditions for Sustained Economic Growth

19. A comprehensive security sector reform is a prerequisite for durable economic growth and decisive poverty reduction (MEFP, §27). Chronic political and economic instability has been a heavy development deterrent, and has caused Guinea-Bissau to lag well behind its peer countries. In this context, the authorities have started to design, with the help of development partners, a security sector reform that includes a pension and gratuity system, and are seeking additional funding for the reform to be sustainable and fully-financed.

20. The authorities plan to fundamentally overhaul support to the cashew sector (MEFP, §29, Box 3). FUNPI was introduced at a time of high cashew prices as an extra (specific) tax on exports aimed at developing the local transformation of cashew nuts. However, the fund has failed in its objectives. Producer prices have fallen sharply, increasing incentives for smuggling and reducing official exports, and financial resources were diverted to other purposes—often in ways lacking transparency. Given that poor farmers were bearing the lion share of the FUNPI tax, its elimination would immediately increase their household income and, as estimated by the World Bank, reduce the national poverty rate by 2 percentage points and extreme poverty by 3 percentage points. Furthermore, its elimination together with improved customs controls would reduce smuggling and increase the government's tax revenues. There are a number of alternative vehicles to promote the production and industrialization of cashew and other agricultural products. Development partners, including the World Bank, are ready to support the cashew sector, including through lending, guarantee funds, and technical assistance. In light of FUNPI's poor performance, the government has integrated the FUNPI resources into the budget and decided to conduct a comprehensive audit of FUNPI's past activities and to explore more efficient and pro-poor alternatives to promote the cashew sector in Guinea-Bissau, including attracting FDI in the sector. It recently signed an agreement with FUNDEI,[2] a fund that has a good track record, to finance projects for processing cashew nuts with funds drawn from the FUNPI. Finally, if the elimination of the fund is politically too difficult, the authorities commit, at minimum, to reduce the FUNPI surcharge from CFAF40 to CFAF10 per kilogram.

21. The authorities are determined, over the medium-term, to identify policies to diversify the economy, reduce widespread poverty, generate employment opportunities, and consolidate political stability. Poor infrastructure and government services, low levels of human capital, a poor regulatory framework for business, and limited access to financial services have led to a vicious cycle of low rates of economic growth and political instability. In the short run, the government will focus its efforts on improving the provision of electricity and the operation of the poorly operated port. The authorities also see a need to develop and implement strategies to increase the efficiency and governance of the public companies, with tariff policies that generate sufficient resources for maintenance and development of infrastructure. The authorities are also discussing with its development partners ways to better develop the country's vast natural resources.

[2] FUNDEI stands for *Fundação Guineense para o Desenvolvimento Empresarial Industrial* (Guinean Foundation for Enterprise and Industrial Development.

22. Over the long run, financial deepening is both an outcome and a key factor to sustainable development (Appendix 1) (MEFP, §24, 32). The authorities aim at preparing a strategic plan to strengthen the financial system and to increase the access to financial services.

Box 3. The FUNPI: Design, Implementation and Impact[1]

In recent years the government has collected a surcharge tax on raw cashew exports to finance a fund designed to promote agribusiness, called FUNPI[2]. In 2011, when cashew exports from Guinea Bissau were selling at historically high levels (close to USD 1400 per ton), the government and the chamber of commerce sought to take advantage of the increased export revenues from raw cashew to promote the processing of this and other agricultural products. FUNPI was created and financed by a surcharge of 50 CFAF per kg (approximately USD 100 per ton) on exports of raw cashew nuts. This surcharge came on top of other export taxes with amount to 11 percent of the reference price.[3] However, the specific objectives and decision-making mechanisms remained unclear.

Uncertainty over the level of the surcharge each year led to inefficient and speculative behavior in the cashew sector and the high level of taxes encouraged smuggling. Being a per unit tax, without a predetermined mechanism to adjust to cashew price fluctuations, the level of the surcharge imposed in 2011 was erratically adjusted several times in 2012 when the international price declined by about 30 percent. Cashew exporters argue that the uncertainty generated about the FUNPI contribution and the wide fluctuations in the cashew price led to speculative changes in stockpiling plans, timing of sales, and financial decisions in general, thus contributing to the currently dire financial situation of cashew traders and their high levels of non-performing bank loans. The high taxes also encouraged smuggling. It is estimated that in 2013 65,000 tons of raw cashew left the country through smuggling implying a high loss in foregone government revenues (CFAF3 billion in foregone fiscal revenues and CFAF300 million in foregone port charges).

FUNPI was not used for its intended purpose and failed to achieve its objective of promoting cashew processing. FUNPI's weak institutional basis and lack of accountability resulted in mismanagement of the fund which was further exacerbated during the period following the military coup of 2012. FUNPI revenues, estimated at some US$30 million, have partly been used by the transitional government in the context of a tight budget situation. However, a full external audit, as the new government plans to commission, is needed to account for the use of all the funds.

The FUNPI tax has significantly increased poverty. The majority of cashew farmers are very small and poor producers. Of the 100,000 cashew producers who support about 800,000 people. Over 70 percent live below the poverty line. Thus, cashew production is a major source of income for half of Guinea-Bissau's population and more than half of its poor. As farmers face perfect competition in the market, they have limited bargaining power and little choice but to sell at the offered price. A World Bank study estimates that at least 80 percent of the tax is passed on to farmers. As a result, the FUNPI tax reduces farmgate prices by 20 percent and the producers' consumption by 11 percent.

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[1] This box draws on bilateral discussions with representatives of the cashew industry, banking institutions, and officials of the government of Guinea-Bissau, as well as the findings of Cont and Porto, 2014, "Measuring the Impact of a Change in the Price of Cashew Received by Exporters on Farmgate Prices and Poverty in Guinea-Bissau," World Bank Policy Research Working Paper, No. 7036, Macroeconomics and Fiscal Management Global Practice Group, September, Washington, DC.

[2] The production and export of cashew nuts is the largest economic activity in Guinea Bissau, accounting for about 90 percent of the country's exports and 10–12 percent of tax revenues.

[3] The FUNPI surcharge amounts to about 12 percent of the reference price.

REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY

23. **The authorities have requested financial assistance from the Fund under the RCF in an amount equivalent to SDR 3.55 million (25 percent of quota) to close Guinea-Bissau's fiscal financing gap and to meet its urgent balance of payment needs (see Text Table 2), which if not addressed would result in an immediate and severe economic disruption.** Guinea-Bissau's financial difficulties are not predominantly caused by a withdrawal of financial support by donors and it lacks the capacity to implement an Upper Credit Tranche (UCT)-quality economic program owing to is limited policy implementation capacity. The RCF disbursement would also be catalytic in mobilizing additional balance of payments and budgetary support. The prospect of an RCF has led to an expected CFA11 billion in budget support from the European Union and East Timor (Text Table 2).[3] Although exports have been improving somewhat compared to 2013, they remain substantially below the pre-crisis level of 2011: accordingly, Guinea Bissau faces an urgent balance of payments need relating to a current account deficit that is estimated to remain high in 2014, as well as to strengthen the overall balance to help rebuild regional reserves. The external deficit translates into significant fiscal financing needs estimated at 8.5 percent of GDP, of which 5.7 percent is already financed (Text Table 2). Taking into account further expected budget support contingent on the RCF disbursement, a residual financing gap of CFA2.7 billion (0.7 percent of GDP) remains, which could be met by the RCF disbursement (SDR3.55 million, or 25 percent of quota).

Text Table 2. Financing Needs and Potential Financing Sources 2014

	CFAF billion	In percent of GDP
Financing Needs (A)	**43**	**8.5**
Domestic fiscal deficit (commitment basis)	26	5.2
Repayment of domestic arrears	10	1.9
Amortizations and external arrears	1	0.2
Accumulation of deposits	6	1.2
Financing Sources (B)	**29**	**5.7**
Treasury bills	15	**3.0**
Budget support	14	**2.7**
(o/w) Elections	9	**1.8**
Financing Gap (C=A-B)	**14**	**2.8**
Conditional Budget Support (D)	**10**	**2.1**
European Union	7	1.3
East Timor	4	0.8
Residual Financing Gap (E=C-D)	**4**	**0.7**

Source: IMF staff estimates

24. **The RCF disbursement would provide the authorities with the immediate resources required to implement emergency measures and resume basic government functions.** It would also give the authorities the time necessary to firm up the medium-term macroeconomic framework

[3] In addition to official transfers, the resumption of the EU's fishing compensation (CFA 6.5 billion) is also contingent on the RCF disbursement.

and to resume comprehensive structural reforms in the areas of PFM, tax administration and private sector development. Progress in these areas is necessary to meet the minimum quality standards of an UCT-quality program such as an arrangement under the ECF.

25. Guinea-Bissau's capacity to repay is adequate (Table 5) but the outlook is subject to risks. The recent large volatility in cashew prices makes the economy highly vulnerable as cashew exports represent more than 90 percent of total exports and around 10–12 percent of fiscal revenue. The political situation appears to be relatively stable thanks to strong domestic support for the governing party and the appointment of a few ministers belonging to the second largest political party. However, potential resistance to the implementation of the security sector reform in particular could jeopardize the recovery and adversely affect the size and timing of donor support. Indeed, the cost of the latest proposal for a pension and gratuity fund for military demobilization exceeds the committed external support by ECOWAS. Delays in the rainy season may have an impact on crop production and food security. Finally, a potential spread of Ebola into the country could severely test the very limited health infrastructure and economic activities. Strong reliance on donor support also constitutes a risk, especially as global growth forecasts have been revised downwards. Guinea-Bissau is part of the regional central bank, BCEAO, which is subject to a safeguards assessment once every four years. The next assessment of the BCEAO is scheduled for 2017.

STAFF APPRAISAL

26. The newly-elected government of Guinea-Bissau has inherited very difficult conditions and is confronted with daunting challenges. After two years of economic disruption, eroded government revenues, a compression in social spending and accumulated external and domestic arrears, basic government functions have broken down and poverty has increased markedly. The economic infrastructure, including roads and supply of electricity and water, is in very poor condition. During the past two years, Guinea-Bissau has operated without a budget and expenditures occurred mostly outside normal expenditure procedures.

27. After peaceful elections, the new government has a historic window of opportunity to break from Guinea Bissau's past of fragility with visible positive results. The government benefits from wide public support including from the opposition parties, and traditional donors have returned in support of Guinea-Bissau. Both the government program for 2014–2018 and the 2014 budget were approved by Parliament with unanimity. The government has also cleared almost all wage arrears of 2013 and 2014 and has started to rebuild domestic revenues. The 2014 August customs revenues were 33 percent above the revenues of a year earlier.

28. The government has been normalizing budgetary operations, which it will need to sustain through improved budget and cash management. Under the approved 2014 budget and the 2015 budget under preparation, the government allocates its scarce resources by striking a balance between protecting social expenditures, timely payment of wages, clearance of remaining government arrears from 2013 and 2014, and stepped-up public investment. To avoid the reoccurrence of arrears, the authorities should avoid the use of extra-budgetary expenditures and improve cash management. The authorities' intention to reinstate a treasury committee and to prepare annual and monthly cash management plans is welcome.

29. The government is benefitting from extensive Fund technical assistance to make headway in recovering tax and customs revenues and improving public financial management. Staff welcomes the authorities' efforts to tackle the challenges in this area. A speedy elaboration and subsequent implementation of action plans will be crucial to sustaining recent improvements in fiscal management. Guinea-Bissau's current domestic revenues are insufficient and budgetary procedures inefficient to cope with the enormous developmental needs the country is facing. Staff urges the authorities to prioritize reforms focusing on quick wins. Those include bringing on-line key customs posts, introducing scanners and limiting tax exemptions for fuels in particular.

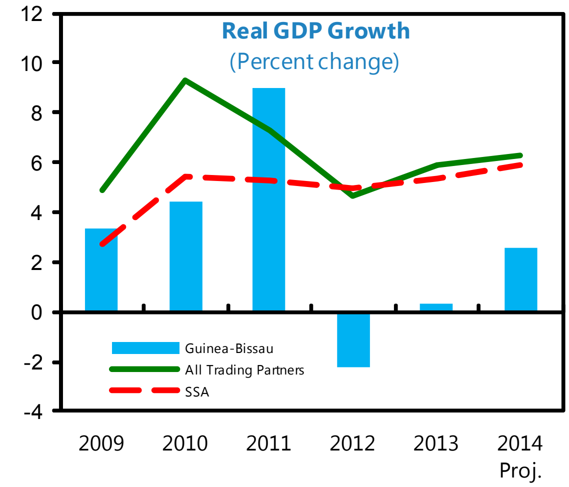
30. Staff welcomes the government's decision to audit the mismanaged cashew fund FUNPI and strongly urges the authorities to eliminate the fund. The elimination of the FUNPI would have an important and immediate impact on reducing poverty and improving the business environment. Staff encourages the authorities to elaborate, with the help of its development partners, more efficient, pro-poor and better targeted alternatives to support the cashew production and transformation. Staff also urges the authorities to carefully evaluate, with the help of Fund technical assistance, options to recapitalize the banking system that would limit the contingent fiscal costs.

31. The risks to the outlook are significant. Guinea-Bissau's dependence on cashew and its history of economic and political instability have proven to be significant vulnerabilities in the past. However, the authorities' strong commitment to the policies supported by the RCF, and the strong support both domestically and by the international community, offers Guinea-Bissau a unique opportunity to break with the past. A comprehensive security sector reform will be essential to make the recent stability sustainable.

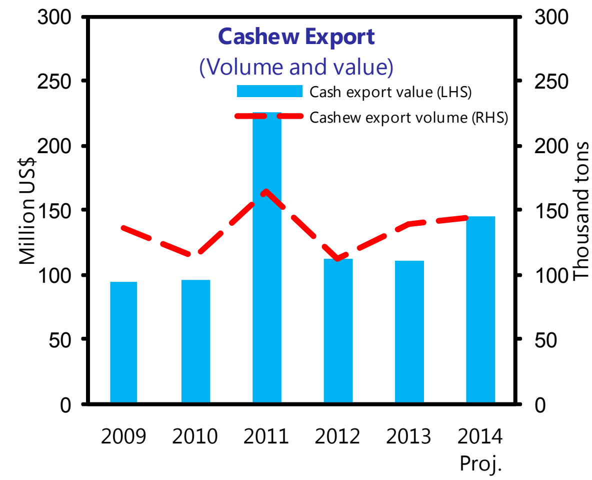
32. Staff supports the authorities' request for assistance under the RCF in view of their currently limited capacity to implement policies of an upper credit tranche-quality economic program, the large and urgent balance of payments need, and the catalytic effect of IMF support for other external financing.

Figure 1. Guinea-Bissau: Economic Developments, 2009–14

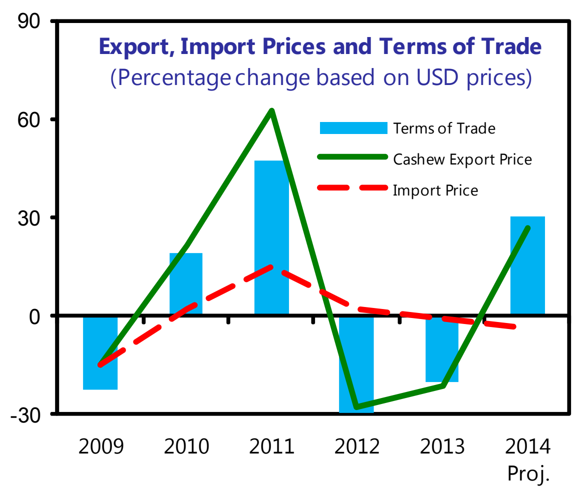
GDP growth is recovering after severely contracting following the 2012 coup…



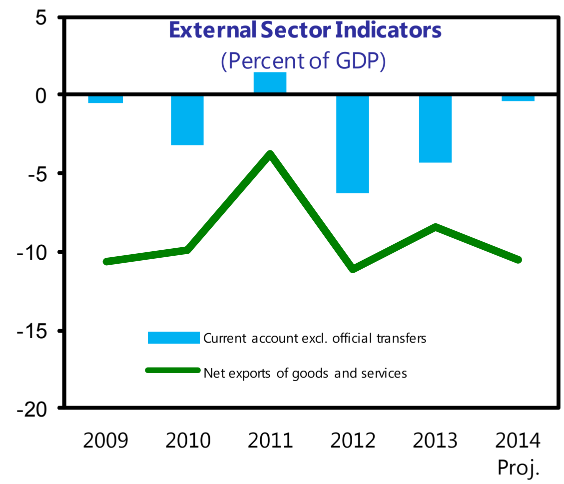
…and the sharp drop in cashew exports,



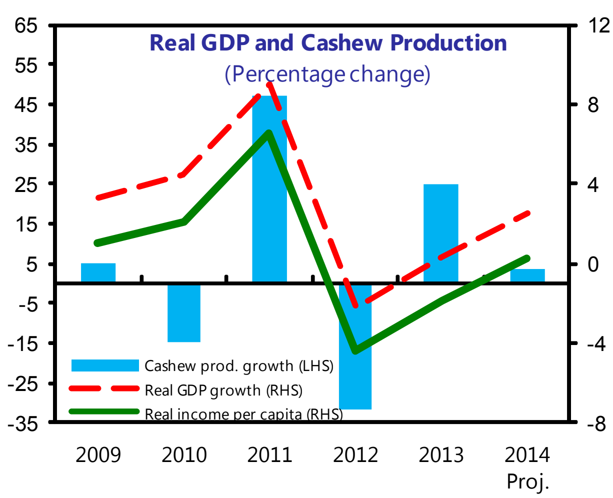
…and leading to an improvement in the terms of trade.



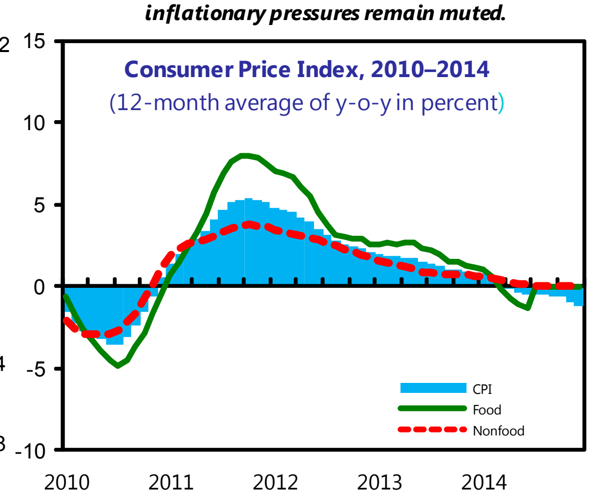
Higher exports and a resumption in foreign aid are narrowing the current account deficit.



Per capita income is recovering hand in hand with GDP

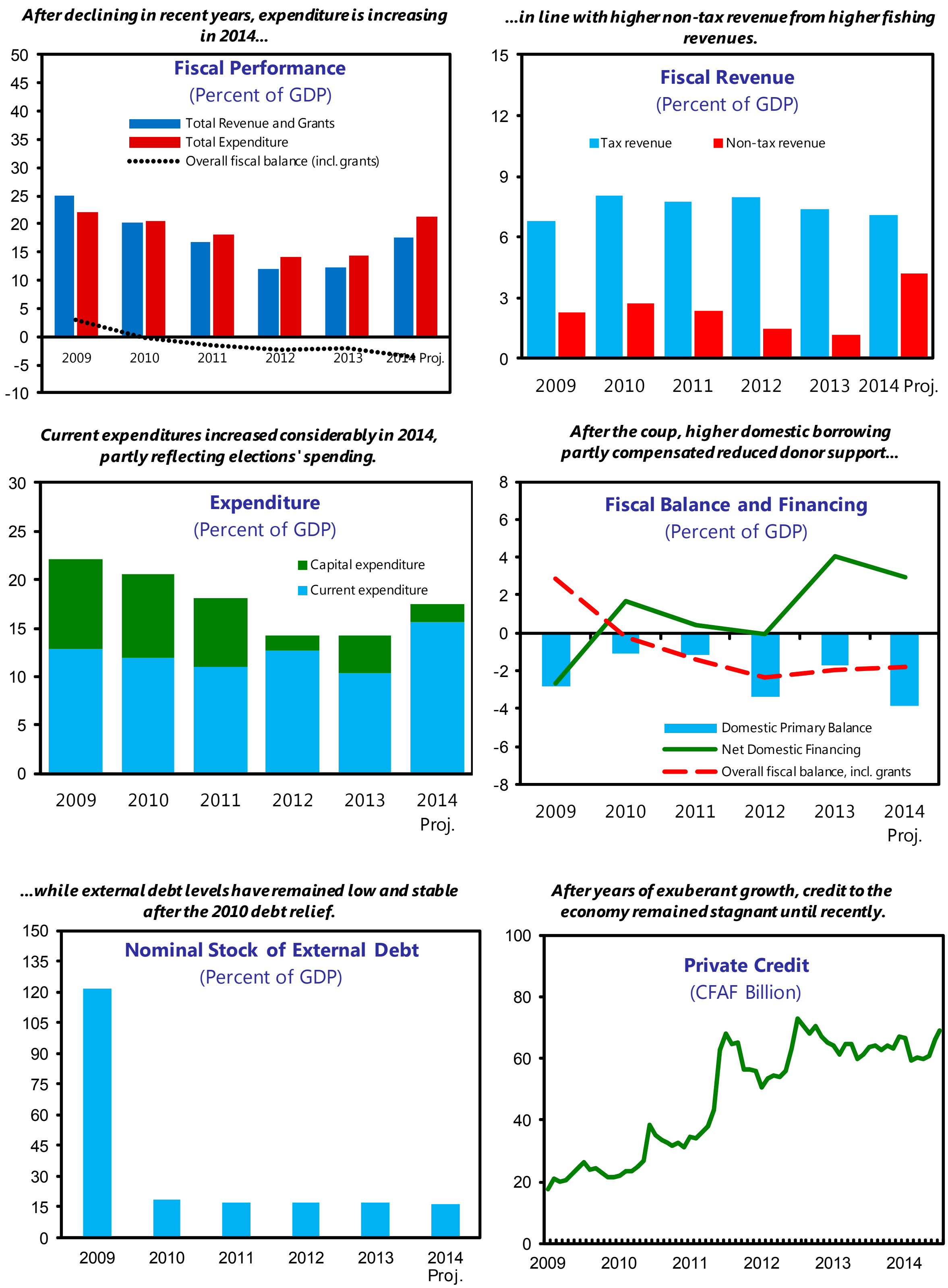


And with still low growth in domestic demand, inflationary pressures remain muted.



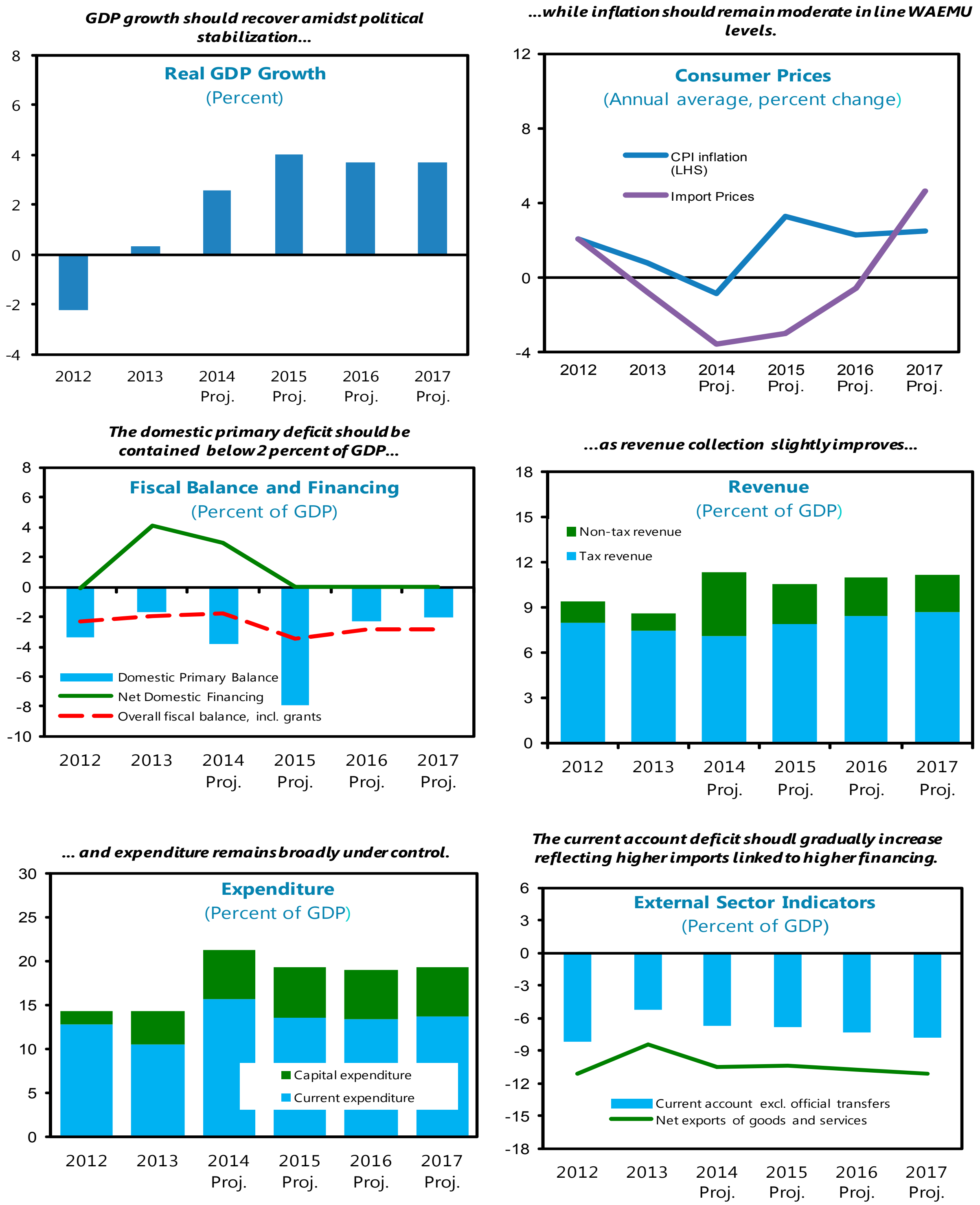
Sources: Guinea-Bissau's authorities and IMF staff estimates.

Figure 2. Guinea-Bissau: Additional Economic Developments, 2009–14



Sources: Guinea-Bissau's authorities and IMF staff estimates.

Figure 3. Guinea-Bissau: Medium-Term Outlook, 2012–17



Sources: Guinea-Bissau's authorities and IMF staff estimates and projections.

Table 1. Guinea-Bissau: Selected Economic Indicators, 2011–16

	2011	2012	2013	2014	2015	2016
				Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)					
National accounts and prices						
Real GDP at market prices	9.0	-2.2	0.3	2.5	4.0	3.7
Real GDP per capita	6.5	-4.4	-1.9	0.3	1.7	1.4
GDP deflator	13.8	-3.9	-3.4	3.7	2.8	2.2
Consumer price index (annual average)	5.1	2.1	0.8	-0.8	3.3	2.3
External sector						
Exports, f.o.b. (based on US$ values)	118.0	-39.5	5.1	14.8	4.9	3.3
Imports, f.o.b. (based on US$ values)	22.1	-24.4	1.2	26.2	4.2	6.1
Export volume	34.3	-16.5	33.0	-9.3	4.9	3.3
Import volume	6.0	-25.9	2.0	30.9	7.4	6.7
Terms of trade (deterioration = -)	47.1	-29.6	-20.2	30.2	3.0	0.6
Real effective exchange rate (depreciation = -)	-4.7	4.9	-7.6	…	…	…
Nominal exchange rate (CFAF per US$; average)	471.4	510.2	493.9	…	…	…
Government finances						
Domestic revenue (excluding grants)	16.3	-12.5	-10.6	39.5	-0.6	10.2
Total expenditure	9.4	-26.3	-2.1	58.2	-3.3	4.5
Current expenditure	14.6	8.6	-20.1	58.6	-6.8	4.6
Capital expenditure	2.1	-80.4	152.9	57.1	6.5	4.2
Money and credit						
Net domestic assets [1]	18.2	14.0	8.4	-1.1	7.3	7.9
Credit to government (net)	-4.5	16.8	0.2	8.2	0.0	0.0
Credit to the economy	12.9	7.9	1.4	2.2	2.4	4.2
Velocity (GDP/broad money)	3.0	3.0	2.5	2.5	2.4	2.4
	(Percent of GDP, unless otherwise indicated)					
Investments and savings						
Gross investment	5.3	7.1	7.1	7.1	7.1	7.1
Of which: government investment	2.6	1.9	1.9	1.9	1.9	1.9
Gross domestic savings	1.3	-2.7	-2.7	-2.7	-2.7	-2.7
Of which: government savings	-5.5	-2.9	-3.8	-8.0	-6.8	-6.1
Gross national savings	5.4	1.4	2.5	9.7	6.4	5.7
Government finances						
Budgetary revenue	10.1	9.4	8.7	11.4	10.6	11.0
Total domestic primary expenditure	11.2	12.8	10.4	15.3	18.4	13.3
Domestic primary balance	-1.1	-3.4	-1.7	-3.9	-7.8	-2.3
Overall balance (commitment basis)						
Including grants	-1.4	-2.3	-1.9	-1.8	-3.5	-2.8
Excluding grants	-8.0	-4.8	-5.7	-10.0	-8.7	-8.0
External current account (including official current transfers)	-0.2	-4.7	-4.1	-0.4	-3.9	-4.5
Excluding official transfers	-3.3	-6.6	-4.9	-6.7	-6.8	-7.4
Memorandum item:						
Nominal GDP at market prices (CFAF billions)	520.8	489.5	474.7	504.5	539.5	571.8

Sources: Guinea-Bissau authorities; and IMF staff estimates and projections.

[1] Contribution to the growth of broad money in percent.

Table 2a. Guinea-Bissau: Central Government Operations, 2011–16

(CFAF Billions)

	2011	2012	2013	2014	2015	2016
				Proj.	Proj.	
Revenue and Grants	87.0	58.1	58.9	98.4	85.1	92.6
Revenue	52.6	46.0	41.1	57.4	57.0	62.8
Tax revenue	40.3	38.9	35.4	36.0	42.5	48.1
Nontax revenue	12.3	7.1	5.7	21.4	14.5	14.8
(o/w) FUNPI	n.a.	n.a.	n.a.	5.6		
Grants	*34.4*	*12.1*	*17.8*	*41.0*	*28.0*	*29.7*
Budget Support	8.7	9.1	4.0	24.1	10.0	10.6
(o/w) Elections Support	n.a.	n.a.	n.a.	9.3		
Project grants	25.7	3.1	13.8	16.9	18.1	19.2
Total expenditure	94.4	69.5	68.0	109.2	106.0	111.9
Current expenditure	57.3	62.3	49.7	79.8	74.5	79.2
Wages and salaries	23.6	25.1	24.3	30.4	30.8	32.6
Goods and services	8.4	12.8	9.0	10.9	12.7	13.5
Transfers	11.8	12.8	12.6	14.6	14.6	15.4
Other current expenditures	12.9	11.4	3.5	23.4	14.1	14.9
Scheduled interest	*0.6*	*0.1*	*0.4*	*0.5*	*2.4*	*2.7*
Domestic interest	0.2	0.0	0.0	0.1	1.5	2.2
External interest	0.3	0.1	0.4	0.4	0.9	0.5
Capital expenditure and net lending	37.0	7.2	18.3	29.4	31.5	32.7
Public investment program	*36.9*	*7.1*	*18.3*	*29.3*	31.3	32.5
Domestically financed	1.8	0.6	0.0	2.2	2.4	2.6
Foreign financed	35.1	6.5	18.3	27.0	28.9	29.9
Other capital expenditure	*0.1*	*0.1*	*0.0*	*0.1*	0.2	*0.2*
Domestically financed	0.1	0.1	0.0	0.1	0.2	0.2
Foreign financed	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment)	-7.3	-11.4	-9.2	-10.8	-21.0	-19.3
Overall balance, excluding grants (commitment)	-41.8	-23.5	-26.9	-51.8	-49.0	-49.0
Net domestic arrears[1]	-3.2	3.5	9.7	-9.7	0.0	0.0
Accumulation current year	0.0	3.5	9.7	0.0	0.0	0.0
Payment previous years	-3.2	0.0	0.0	-9.7	0.0	0.0
External interest arrears current year	0.0	0.0	0.0	0.0	0.0	0.0
Float and statistical discrepancies	0.1	-5.8	9.9	0.0	0.0	0.0
Overall balance (cash)	-10.4	-13.7	-9.4	-20.5	-21.0	-19.3
Financing	10.4	13.7	9.4	20.5	21.0	19.3
Domestic financing	*1.1*	*9.0*	*4.9*	11.1	0.0	-0.5
Bank financing	*1.1*	*9.0*	*4.9*	11.1	*0.0*	*-0.5*
BCEAO credit	1.3	0.0	0.0	2.7	0.0	-0.5
(o/w) IMF	3.5	0.0	0.0	2.7	0.0	-0.5
Deposits at the BCEAO (- = build up)	-4.8	9.3	-0.8	-6.6	0.0	0.0
Domestic banks	4.6	-0.3	*-4.3*	0.0	0.0	0.0
Regional (including T-bills)	0.0	0.0	10.0	15.0	0.0	0.0
Nonbank financing (e.g. Boad)	*0.0*	*0.0*	*0.0*	*0.0*		*0.0*
Foreign financing (net)	9.4	4.6	4.5	9.4	9.5	9.5
Disbursements	*9.4*	*5.1*	*4.6*	10.1	10.8	10.7
Projects Loans	9.4	5.1	4.6	10.1	10.8	10.7
Programs	0.0	0.0	0.0	0.0	0.0	0.0
Amortization (scheduled and arrears)	-0.7	-0.5	-0.1	-3.2	-1.3	-1.2
External arrears	-91.4	0.0	0.0	0.0	0.0	0.0
Debt relief	92.1	0.0	0.0	2.5	0.0	0.0
Gross financing gap (+ = financing need)	0.0	0.0	0.0	0.0	11.4	10.3
Additional financing	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	0.0	0.0	11.4	10.3
Domestic primary balance	-6.1	-16.8	-8.2	-24.3	-17.7	-16.4
Revenue	52.6	46.0	41.1	57.4	57.0	62.8
Primary expenditure	58.7	62.9	49.4	81.7	74.7	79.3

Sources: Guinea-Bissau authorities; and IMF staff estimates and projections.

[1] Recorded as arrears when payments were not made more than 30 days for wages and more than 90 days for other expenditure.

Table 2b. Guinea-Bissau: Central Government Operations, 2011–16

(Percent of GDP)

	2011	2012	2013	2014	2015	2016
				Proj.	Proj.	
Revenue and grants	16.7	11.9	12.4	19.5	15.8	16.2
Revenue	10.1	9.4	8.7	11.4	10.6	11.0
Tax revenue	7.7	7.9	7.5	7.1	7.9	8.4
Nontax revenue	2.4	1.5	1.2	4.2	2.7	2.6
(o/w) FUNPI	n.a.	n.a.	n.a.	1.1		
Grants	6.6	2.5	3.7	8.1	5.2	5.2
Budget support	1.7	1.8	0.8	4.8	1.8	1.8
(o/w) Elections Support	n.a.	n.a.	n.a.	1.8		
Project grants	4.9	0.6	2.9	3.4	3.4	3.4
			3.7			
Total expenditure	18.1	14.2	14.3	21.6	19.7	19.6
Current expenditure	11.0	12.7	10.5	15.8	13.8	13.8
Wages and salaries	4.5	5.1	5.1	6.0	5.7	5.7
Goods and services	1.6	2.6	1.9	2.2	2.4	2.4
Transfers	2.3	2.6	2.6	2.9	2.7	2.7
Other current expenditures	2.5	2.3	0.7	4.6	2.6	2.6
Scheduled interest	0.1	0.0	0.1	0.1	0.4	0.5
Domestic interest	0.0	0.0	0.0	0.0	0.3	0.4
External interest	0.1	0.0	0.1	0.1	0.2	0.1
Capital expenditure and net lending	7.1	1.5	3.9	5.8	5.8	5.7
Public investment program	7.1	1.4	3.9	5.8	5.8	5.7
Domestically financed	0.3	0.1	0.0	0.4	0.5	0.5
Foreign financed	6.7	1.3	3.9	5.4	5.4	5.2
Other capital expenditure	0.0	0.0	0.0	0.0	0.0	0.0
Domestically financed	0.0	0.0	0.0	0.0	0.0	0.0
Foreign financed	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, including grants (commitment)	-1.4	-2.3	-1.9	-2.1	-3.9	-3.4
Overall balance, excluding grants (commitment)	-8.0	-4.8	-5.7	-10.3	-9.1	-8.6
Net domestic arrears[1]	-0.6	0.7	2.0	-1.9	0.0	0.0
Accumulation current year	0.0	0.7	2.0	0.0	0.0	0.0
Payment previous years	-0.6	0.0	0.0	-1.9	0.0	0.0
External interest arrears current year	0.0	0.0	0.0	0.0	0.0	0.0
Float and statistical discrepancies	0.0	-1.2	2.1	0.0	0.0	0.0
Overall balance, including grants (cash)	-2.0	-2.8	-2.0	-4.1	-3.9	-3.4
Financing	2.0	2.8	2.0	4.1	3.9	3.4
Domestic financing	0.2	1.8	1.0	2.2	0.0	-0.1
Bank financing	0.2	1.8	1.0	2.2	0.0	-0.1
BCEAO credit	0.2	0.0	0.0	0.5	0.0	-0.1
(o/w) IMF	0.7	0.0	0.0	0.5	0.0	-0.1
Deposits at the BCEAO (- = build up)	-0.9	1.8	-0.2	-1.3	0.0	0.0
Domestic banks[4]	0.9	-0.1	-0.9	0.0	0.0	0.0
Regional (including T-bills)	0.0	0.0	2.1	3.0	0.0	0.0
Use of deposit at BCEAO	-0.9	1.9	-0.2	-1.3	0.0	0.0
Foreign financing (net)	1.8	0.9	0.9	1.9	2.0	1.7
Disbursements	1.8	1.0	1.0	2.0	2.0	1.9
Projects	1.8	1.0	1.0	2.0	2.0	1.9
Programs	0.0	0.0	0.0	0.0	0.0	0.0
Amortization (scheduled and arrears)	-0.1	-0.1	0.0	-0.6	-0.2	-0.2
External arrears	-17.5	0.0	0.0	0.0	0.0	0.0
Debt relief	17.7	0.0	0.0	0.5	0.0	0.0
Gross financing gap (+ = financing need)	0.0	0.0	0.0	0.0	2.1	1.8
Additional financing	0.0	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	0.0	0.0	2.1	1.8
Domestic primary balance	-1.2	-3.4	-1.7	-4.8	-3.3	-2.9
Revenue	10.1	9.4	8.7	11.4	10.6	11.0
Primary expenditure	11.3	12.8	10.4	16.2	13.9	13.9

Sources: Guinea-Bissau authorities; and IMF staff estimates and projections.

[1] Recorded as arrears when payments were not made more than 30 days for wages and more than 90 days for other expenditure.

Table 3. Guinea-Bissau: Monetary Survey, 2011–16[1]

	2011	2012	2013	2014	2015	2016
				Proj.	Proj.	
	(CFAF billions, unless otherwise indicated)					
Net foreign assets	119.3	84.5	94.9	114.3	115.7	117.4
Central Bank of West African States (BCEAO)	95.4	65.0	72.1	92.1	94.1	96.1
Commercial banks	23.9	19.5	22.8	22.2	21.7	21.4
Net domestic assets	41.5	67.1	80.9	90.1	105.0	122.3
Credit to the government (net)	5.7	15.7	16.2	31.2	31.2	31.2
Credit to the private sector	50.5	64.2	66.6	70.7	75.7	85.0
Other items (net)	-14.7	-12.8	-1.9	-11.9	-1.9	6.1
Money supply (M2)	173.3	162.8	186.9	204.3	220.7	239.7
Currency outside banks	85.5	83.4	90.9	99.4	107.4	116.7
Bank deposits	87.8	79.4	96.0	104.9	113.3	123.1
Base money (M0)	87.1	83.6	91.2	99.7	107.7	116.9
	(change in percent of beginning-of-period broad money)					
Contribution to the growth of broad money						
Money supply (M2)	39.1	-6.0	14.8	9.3	8.0	8.6
Net foreign assets	20.9	-20.1	6.3	10.4	0.7	0.8
BCEAO	24.9	-17.6	4.4	10.7	1.0	0.9
Commercial banks	-4.0	-2.5	2.0	-0.3	-0.3	-0.1
Net domestic assets	11.4	14.8	8.4	4.9	7.3	7.9
Credit to the central government	3.7	5.7	0.3	8.0	0.0	0.0
Credit to the private sector	12.9	7.9	1.4	2.2	2.4	4.2
Other items net	-5.2	1.1	6.7	-5.4	4.9	3.6
Memorandum items:						
Money supply (M2, annual percentage change)	39.1	-6.0	14.8	9.3	8.0	8.6
Base money (M0, annual percentage change)	15.7	-4.0	9.0	9.3	8.0	8.6
Credit to the private sector (annual percentage change)	46.7	27.2	3.6	6.3	6.9	12.4
Velocity (GDP/M2)	3.0	3.0	2.5	2.5	2.4	2.4
Money Multiplier (M2/M0)	2.0	1.9	2.1	2.1	2.1	2.1

Sources: BCEAO; and IMF staff estimates and projections.

1/ End of period

Table 4. Balance of Payments, 2011–16
(CFAF Billions, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016
				Proj.	Proj.	
Current Account Balance						
Including all official transfers	-1.2	-22.8	-19.4	-2.0	-20.8	-25.5
Including official transfers not contingent to an RCF	...	...	...	-12.4	...	...
Including official transfers not contingent to an RCF and not related to elections	...	...	...	-21.7	...	...
Excluding official transfers	-17.0	-32.1	-23.4	-33.8	-36.8	-42.1
Excluding official transfers and interest payments	-16.7	-31.6	-22.9	-33.3	-36.3	-41.6
Goods and services	-28.9	-46.3	-39.0	-53.1	-56.4	-62.0
Goods	-2.9	-20.4	-17.3	-29.7	-30.6	-34.7
Exports, f.o.b	110.5	72.4	73.6	82.9	87.6	90.0
Of which : cashew nuts	97.7	65.3	56.0	70.2	73.6	75.4
Imports, f.o.b.	-113.3	-92.8	-90.9	-112.5	-118.2	-124.8
Of which : food products	-32.0	-32.2	-31.4	-38.9	-41.6	-44.0
petroleum products	-29.8	-21.7	-21.5	-26.6	-26.9	-27.9
Services (net)	-26.0	-25.9	-21.7	-23.4	-25.8	-27.2
Credit	21.1	11.1	11.5	11.6	11.7	12.3
Debit	-47.0	-37.0	-33.2	-39.6	-41.8	-44.2
Income (interest scheduled)	-0.3	-0.5	-0.5	-0.4	-0.5	-0.5
Current transfers (net)	28.0	24.0	20.1	51.5	36.1	36.9
Official [1]	15.8	9.3	4.0	31.8	16.0	16.6
Of which: balance of payments support grants	8.7	9.1	4.0	24.1	10.0	10.6
EU fishing compensation	7.1	0.2	0.0	7.7	6.0	6.0
others	0.0	0.0	0.0	0.0	0.0	0.0
Private	12.2	14.8	16.1	19.7	20.1	20.3
Of which : remittances	10.5	12.4	14.1	15.8	16.2	16.4
license fees	1.7	2.4	2.0	3.9	3.9	3.9
Capital and financial balance	16.7	30.7	23.1	22.0	22.8	27.5
Capital account	26.9	3.1	14.1	17.2	18.3	19.4
Financial account	-10.3	27.6	9.0	4.8	4.5	8.1
Official medium- and long-term disbursements	9.4	3.4	4.6	10.1	10.8	10.7
Project loans	9.4	3.4	4.6	10.1	10.8	10.7
Scheduled amortization	-0.7	-0.5	-0.1	-0.7	-1.1	-1.2
Treasury bills and regional financing	0.0	0.0	10.0	15.0	0.0	0.0
Commercial bank net foreign assets	4.7	4.4	-3.3	0.6	0.5	0.3
Private net foreign assets	-23.7	-18.1	1.3	-20.3	-5.7	-1.7
Errors and Omissions	14.9	-38.3	3.4	0.0	0.0	0.0
Overall balance	30.3	-30.4	7.1	20.0	2.0	2.0
Financing	-30.3	30.4	-7.1	-20.0	-2.0	-2.0
Of which: IMF RCF financing	...	...	...	-2.7	...	...
Net foreign assets (increase = -)	-31.0	30.4	-7.1	-20.0	-2.0	-2.0
Memorandum items:						
Export volume of goods (annual percentage change)	34.3	-16.5	33.0	-9.3	4.9	3.3
Cashew export prices[2](US$ per ton)	1380	1000	790	1000	1000	1000
Import volume of goods (annual percentage change)	6.0	-25.9	2.0	30.9	7.4	6.7
Imputed international reserves						
US$ millions	182.6	139.8	...	...	...	...
As percent of broad money	49.7	36.9	...	...	...	...
WAEMU gross official reserves (billions US$)	15.8	12.9	...	...	...	...
Percent of broad money	58.0	54.1	...	...	...	...
WAEMU gross official reserves (months of WAEMU imports)	5.9	5.2	...	...	...	...
Scheduled debt service						
Percent of exports and service credits	-69.3	1.6	2.1	-1.5	1.6	2.2
Percent of total government revenue	-173.2	2.9	4.4	-2.5	2.9	3.6
Current account balance (percent of GDP)						
Including official transfers	-0.2	-4.7	-4.1	-0.4	-3.9	-4.5
Including official transfers not contingent to an RCF	...	...	...	-2.5	...	...
Including official transfers not contingent to an RCF and not related to elections	...	...	...	-4.3	...	...
Excluding official transfers	-3.3	-6.6	-4.9	-6.7	-6.8	-7.4
Excluding official transfers and interest payments	-3.2	-6.4	-4.8	-6.6	-6.7	-7.3

Sources: BCEAO; and IMF staff estimates and projections.

[1] Includes food aid and technical assistance to projects.

[2] Until 2011, BCEAO average prices. The prices for 2011 and onward are based on the WEO projections for ground nut prices.

Table 5. Guinea-Bissau: Indicators of Capacity to Repay the Fund, 2014–24

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Projections					
Fund obligations based on existing credit											
(SDR millions)											
Principal	0.0	0.0	0.7	1.5	1.5	1.5	1.5	0.7	0.0	0.0	0.0
Charges and interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Fund obligations based on existing and prospective credit											
(SDR millions)											
Principal	0.0	0.0	0.7	1.5	1.5	1.5	2.2	1.4	0.7	0.7	0.7
Charges and interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations based on existing and prospective credit											
SDR millions	0.0	0.0	0.7	1.5	1.5	1.5	2.2	1.4	0.7	0.7	0.7
CFAF billions	0.0	0.0	0.5	1.1	1.1	1.0	1.6	1.0	0.5	0.5	0.5
Percent government revenue	0.0	0.0	0.9	1.7	1.6	1.4	2.0	1.2	0.5	0.5	0.5
Percent exports of goods and services	0.0	0.0	0.6	1.2	1.2	1.2	1.6	1.0	0.5	0.4	0.4
Percent debt service	0.0	0.0	15.1	26.6	22.2	22.5	24.4	17.9	8.1	8.1	8.0
Percent GDP	0.0	0.0	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Percent quota	0.0	0.0	5.1	10.2	10.2	10.2	15.2	10.1	5.0	5.0	4.7
Percent reserves	0.0	0.0	0.8	1.5	1.5	1.4					
Outstanding Fund credit											
SDR millions	10.8	10.8	10.1	8.6	7.2	5.7	3.6	2.1	1.4	0.7	0.0
CFAF billions	8.0	8.0	7.4	6.3	5.2	4.1	2.6	1.5	1.0	0.5	0.0
Percent government revenue	16.5	15.2	13.1	10.3	7.8	5.7	3.2	1.7	1.1	0.5	0.0
Percent exports of goods and services	9.5	9.2	8.4	7.0	5.7	4.6	2.7	1.5	0.9	0.4	0.0
Percent debt service	298.6	265.2	211.7	158.0	110.0	88.8	40.2	26.7	16.3	8.2	0.0
Percent GDP	1.6	1.5	1.3	1.1	0.8	0.6	0.4	0.2	0.1	0.1	0.0
Percent quota	76.0	76.0	70.9	60.7	50.5	40.3	25.1	15.0	10.0	5.0	0.0
Percent reserves	12.7	12.5	11.3	9.2	7.3	5.7					
Net use of Fund credit (SDR millions)	**3.6**	**0.0**	**-0.7**	**-1.5**	**-1.5**	**-1.5**	**-2.2**	**-1.4**	**-0.7**	**-0.7**	**-0.7**
Disbursements	3.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	0.0	0.0	0.7	1.5	1.5	1.5	2.2	1.4	0.7	0.7	0.7
						(CFAF billions)					
Memorandum items:											
Nominal GDP	502.7	533.9	565.6	599.7	636.7	677.6	725.3	776.4	831.0	889.5	952.1
Exports of goods and services	83.8	86.1	88.6	90.1	90.6	90.5	96.8	102.9	109.3	116.2	123.5
Government revenue	48.5	52.4	56.5	61.3	66.6	72.6	79.8	87.9	97.0	103.9	111.4
Debt service	2.7	3.0	3.5	4.0	4.7	4.6	6.4	5.7	6.3	6.3	6.4
Net Foreign Assets Central Bank	62.7	63.6	65.2	68.5	71.4	72.9	…	…	…	…	…
CFAF/SDR (period average)	740.5	737.7	735.0	731.0	725.8	720.7	720.7	720.7	720.7	720.7	720.7
Quota (SDR)	14.2	14.2	14.2	14.2	14.2	14.2	14.2	14.2	14.2	14.2	15.2

Sources: IMF staff estimates and projections.

Appendix I Financial Stability and Development in Guinea-Bissau

The small banking sector of Guinea-Bissau has been affected by exogenous shocks that hit the country in 2012. Despite rapid credit growth in 2009–12, bank credit to the economy is equivalent to only about 14 percent of GDP and only about 1 percent of households have access to banking services. Furthermore, the rapid credit growth experience in 2009–12 was drastically reversed in 2012 after the military coup and a 30 percent decline in cashew prices. The military coup affected creditors across many sectors partly by restricting public services and investments as well as through the resulting suspension of donor activities in the country.

As a result, Financial Soundness Indicators have gradually deteriorated since 2012. While liquidity ratios remain high, non-performing loans (NPLs) have increased from 6.4 percent of total loans in 2012 to 25.7 percent in June 2014. The bulk of the NPLs are concentrated in two banks that have significant exposure to the cashew sector. Bank credit to the economy contracted by 20 percent between mid-2012 and end 2013, but has recovered somewhat during the first half of 2014 as a result of continuous credit growth from the non- affected banks.

Guinea-Bissau: Financial Indicators for the Banking Sector, 2007–2014

	2007	2008	2009	2010	2011	2012	2013	June 2014
				(in percent)				
Capital								
Tier 1 capital to risk-weighted assets	27.3	23.4	24.9	28.5	22.3	22.3	23.1	21.4
Capital to total assets	10.6	10.6	10.5	15.3	11.8	13.2	13.5	11.0
Asset quality								
Non-performing loans to total loans	6.6	7.2	8.5	9.8	6.5	6.4	11.6	25.7
Provisions to gross loans	10.4	8.0	23.9	16.3	13.0	10.7	11.6	19.0
Earnings and profitability								
Net Income to average assets (ROA)				1.1	2.5	2.6	2.9	2.9
Net Income to average capital (ROE)	-15.1	-3.6	-2.5	6.2	17.7	18.0	17.9	17.5
Liquidity								
Liquid assets to short term liabilities	32.1	48.0	56.8	33.0	42.2	49.0	49.5	60.1
Memorandum items								
Deposit rate	1.9	4.3	4.0	3.6	3.8	4.7	4.7	4.7
Lending rate	10.9	1.8	10.9	10.6	10.6	10.2	9.2	9.2

Source: BCEAO

The banking sector has made significant inroads into financing the cashew sector but needs to better diversify its risks. While traditionally cashew exports were pre-financed by their foreign cashew importers, the local banking system is playing an increasingly active role in financing this sector. This trend reflects the highly lucrative nature of the sector, as well as limited growth opportunities in other, less enclave sectors. However, some banks have become excessively exposed to the cashew sector and will need to seek better diversification or larger capital buffers.

There is a need to broaden financial intermediation as credit growth has been benefitting only a small segment of the population. Credit has been concentrated mainly on large companies and public enterprises, and only about 1 percent of households have access to banking services. Hence, reactivating microfinance activities on the basis of an action plan and the implementation of a recently approved regulatory system, together with adequate training and external financial resources could be a first step towards financial deepening. Such efforts would need to be complemented by reforms aiming at improving the judiciary to facilitate contract enforcement, the accounting industry to provide reliable corporate accounts and training and coaching to turn business opportunities into bankable projects. Improvements in the credit reference system and the payments and settlement system are also needed to make the banking system more resilient.

Appendix II. Letter of Intent[1]

Bissau, September 25, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700, 19th Street, N.W.
Washington, D.C. 20431
United States

Dear Madam Managing Director:

1 The two years following the coup d'état in April 2012 were very difficult for the people of Guinea-Bissau and have left deep marks in the economy, the institutions and the country's social fabric. The economic and political instability that followed clouded our vision of the future. Meanwhile, the hope and confidence in a better future have rapidly started to emerge following the long awaited parliamentary and ptresidential elections in April and May, and after the taking office of the new government, between the end of June and the beginning of July. The new government is determined to seek rapid solutions to the severe problems that currently affect our country and to meticulously plan an in-depth strategy to place Guinea-Bissau on the road to sustainable growth. Thus, the government's ultimate aim is to build a solid foundation for the economy to grow rapidly, consistently reducing the high level of poverty that rages in our country.

2 The government's key priorities include promoting a social and political environment in order to maintain macroeconomic and financial stability. We are also developing a medium-term plan to bring the economy of Guinea-Bissau back on its path of sustained and inclusive growth. To help us achieve this aim, we count on the financial support of the international community, whose presence is indispensable in future years to support our efforts to increase jobs, reduce poverty and improve the standards of living of the population. We therefore request from the International Monetary Fund immediate support in the form of a disbursement under the RCF in an amount equivalent to 25 percent of the Guinea-Bissau quota, i.e., SDR 3.55 million.

3 The Memorandum of Economical and Financial Policies attached lays out the policies planned for the next six months. The government of Guinea-Bissau is convinced that the policies and

[1] The Letter of Intent, Memorandum of Economic and Financial Policies and the Technical Memorandum of Understanding have been translated from the original Portuguese version.

measures included in this Memorandum will help solve the difficulties in the balance of payments and promote our objectives of growth and poverty reduction. The government will hold consultations with the IMF staff, either on its own initiative or by request of the IMF, prior to adopting any additional measures which may be deemed necessary, or in the case of changes to the policies set forth in this Memorandum. The government undertakes to cooperate fully with the IMF to achieve its policy aims, and undertakes furthermore not to introduce measures or policies that could worsen the current balance of payments difficulties in Guinea-Bissau.

4 The authorities of Guinea-Bissau agree on the publication of this Letter of Intent, of the Memorandum of Economic and Financial Policies and of the Technical Memorandum of Understanding attached, as well as the Staff Report associated to the request for disbursement under the Rapid Credit Facility and the Debt Sustainability Analysis. We hereby authorize the publication in print and on the IMF Website, following approval by the IMF's Executive Board.

Sincerely,

/s/

Mr. Geraldo Martins,
Minister of Economy and Finance

Attachments:

1. Memorandum of Economic and Financial Policies
2. Technical Memorandum of Understanding

Attachment I—Memorandum of Economic and Financial Policies

25th September, 2014

Background

1. Guinea-Bissau has just emerged from two years of difficulties in the economic, social and political spheres. Following the 2012 coup d'état, the country, which had seen high growth rates after the adoption of a medium-term program with the IMF, went off track. As the institutional capacity deteriorated, financial support from donors and international partners fell, and tax revenue dropped. In addition, the price of cashew nuts, the main export product, was severely reduced in the international market, both in 2012 and 2013.

2. The economic activity was severely affected by those two shocks, and GDP dropped 2 percent between 2012 and 2013. Infrastructure and social investment levels, already low and highly dependent on the foreign resources, were considerably reduced. The domestic revenue/GDP ratio, one of the lowest in African countries, dropped even lower. The social consequences were severe. The chronic lack of resources prevented timely payment of civil servants' salaries, particularly in the education and health sectors, where delays reached several months, leading to frequent strikes and jeopardizing the school year. Interruption in water and energy supply contributed to the outbreaks of cholera, further worsening the general health conditions of the population.

3. Political instability exacerbated institutional weaknesses and, in addition to lower tax pressure, this instability was also reflected in frequent changes in policy in the cashew sector, which further worsened farm gate prices. The exchange rate between rice and cashew, which was 1 to 1 in 2011, dropped to 1 to 3 in 2013, and has not yet recovered in 2014 (1 to 1.5). This had a significant effect on the level of poverty and food security. A recent World Bank study indicates that the portion of the population facing severe food insecurity went from 20 percent in 2011 to 40 percent in 2013. It is also estimated that over 70 percent of the population live on less than US$2 a day.

4. After a long transition period, parliamentary and presidential elections were held. The results were recognized as valid and legitimate by the international community. The new coalition government took office during June and July. It is highly committed to economic and political stability, and has embraced economic reforms, transparency in public management and improvement of the business environment. To this end, some important measures have already been

taken since the inception of this new government, namely the successful placing of CAF15 billion to help clear salary arrears, and the merging of the ministries of Economy and Finance, aimed at achieving greater flexibility when implementing economic policies.

Recent Economic Developments

5. The effects of the coup d'état of April 2012 were far-reaching and deep, and are still being felt. It had ample repercussions on the economy and the institutions of Guinea-Bissau. The economic effects were rapidly felt, both through the drop in the volume of budget support and the severe reduction in the number of project loans and grants. Whilst in 2012 the absence of some budget support partners was compensated by aid from other donors, in 2013 the volume of budget support was reduced considerably, dropping more than 56 percent. The resources available for public investment also fell drastically. Consequently, the level of public investment dropped by 41.1 percent in 2012 and by 15 percent in 2013.

6. Apart from the adverse effects of the political shock, the economy was affected by the considerable drop in cashew prices. After rising 62 percent in 2011, the price of cashew dropped 28 percent in 2011 and 21 percent in 2013, contributing to the contractionary impact of political instability. Additionally, the effects of an erratic policy with regard to the FUNPI contributions were reflected on a drop of farm gate prices of almost 50 percent in 2013. As a result, the economy, which had grown 4.4 and 9.0 percent in 2010 and 2011, respectively, retracted by 2.2 percent in 2012 and virtually stagnated in 2013 (0.3 percent).

7. The contraction of economic activity and government's worsened management capacity resulted in the significant drop in domestic revenues and deterioration in the fiscal pressure. Between 2011 and 2013 tax revenue dropped by 12 percent, whilst non-tax revenue dropped 58 percent, although this largely reflects the suspension of financial fishing compensation payments by the European Union. Customs revenues, in turn, dropped 12 percent in the same period. The efficiency loss of the tax administration was an important factor behind the drop in the tax to GDP ratio, which fell from 10.1 percent in 2011 to 8.6 percent in 2013.

8. The severe drop in both tax revenue and foreign financial support obliged the government to cut expenditure. The lack of resources forced the government to reduce the volume of current expenditure by 3 percent between 2011 and 2012. On the other hand, the drop in project grants and financing was reflected in the serious contraction of public investments, which dropped by half over the same period. As a result, investment in the social area and in infrastructure projects suffered severe cuts.

9. Although the government reduced its level of spending in an attempt to adjust to lower revenues, payment delays continued to build up during the transition period. To maintain fiscal discipline, the government reacted to the drop in revenue by lowering the level of expenditure; however, the accumulation of arrears was inevitable. At the end of 2013, the volume of arrears reached 2 percent of GDP. After the recent issue of FCFA 15 billion by the new government, the stock of arrears fell to 0.6 percent of GDP at the present time.

10. The slowdown of economic activity, together with the appreciation of the exchange rate contributed to the maintenance of price stability. After reaching 5.7 and 3.4 percent in 2010 and 2011, respectively, the consumer price index (CPI) rose by 1.6 percent in 2012 and remained stable in 2013 (-0.1 percent). Over the past twelve months, until August, the CPI shows a deflation of -1.1 percent, reflecting, in part, the delays in salary payments. After remaining stable in 2011 and 2012 (0.3 and 0.5 percent, respectively), the exchange rate appreciated by 4.3 percent in 2013.

11. In spite of higher prices, the volume of formally exported cashew dropped due to the increase in smuggling. After substantial drops in the two previous years, the prices recovered in 2014, increasing, on average, by 27 percent during the export period. Nevertheless, the export volume from the formal sector, which reached 140 thousand tons in 2013, is expected to reach 136 thousand tons in 2014. This drop is due to a large volume of cashew smuggled into Senegal and the Gambia, partly due to the high tax (FCFA 40 per kilo) set for FUNPI in 2014.

12. Higher cashew prices, payment of several months of salary arrears, and the peaceful solution of institutional instability should help economic recovery in 2014. The substantial inflow of resources into the economy due to higher cashew prices, both to the exporter and to the producer, as well as the payment of four months of salary arrears should push up domestic demand. Added to that, with institutions returning to normal, the inflow of capital has started to increase. Thus, it is expected that the economy grow by 2.5 percent in 2014.

13. Exports continue to recover in 2013, whilst budget support starts to once again flow into the country. The increase in the international cashew prices should, compared with 2013, result in an increase of FCFA 6 billion in exports. On the same time, the increase in imports is being largely financed through the increase in budget support. Thus, after reaching a peak of 6.5 percent in 2012, the current account deficit will continue to drop in 2014, and should reach 0.4 percent of GDP. The accumulation of international reserves should accelerate, driven by an improvement of the current account and the increase of direct investment and public sector loans.

2014 and Medium-term Policies

14. The new government found the country in a very difficult situation, and its immediate priority was to restore a minimum level of normal operations. The following emergency measures were taken:

a) **Arrears:** The government needed to act rapidly to clear the volume of salary arrears amounting to four months, as a way to kick-start the economy and install confidence in the economic agents. To this end, FCFA 15 billion in Treasure Bonds were successfully issued, and purchased by both residents and non-residents. This issue, along with the World Bank budget support, helped bring down the volume of arrears from FCFA 9.7 billion to FCFA 2. billion. Almost all salary arrears have been cleared.

b) **Normalization of the budget procedure:** As it took office, the new government faced a country without a budget. In the first two months of its term, the government drafted the State Budget for 2014, which is currently being discussed in Parliament, and should be submitted for approval by the end of September. It has also drafted a Treasury Plan through the end of the year, in order to obtain a precise idea of the country's financial needs and to manage the liquidity difficulties until the end of 2014. The budget for 2015 will start to be drafted soon and should be ready by the end of the year.

c) **Treasury Committee:** apart from the conventional Treasury committee (operational), charged with the daily cash flow management, which should be composed of representatives from the directorates of tax (DGCI), customs (DGA), budget (DGO) and treasury (DGT), Fisheries, the Economic Environment and Forecasting Unit and the BCEAO, the government will also set up a high-level Treasury Committee. This committee will be composed of representatives from the Presidency of the Republic, the Prime Minister’s office, the Ministry of Economy and Finance, the BCEAO, the IMF and donors. This high-level committee should, when necessary, set priorities for spending, approve non-regularized expenditure when these go beyond pre-stablished amounts and reconcile payment orders with bank statements on a monthly basis. Both committees should be set up and be operational by mid-October, following the approval of the State Budget and of the government Program for the 2014–2018.

d) **Foreign Financial Aid:** Given the substantial needs of resources required by the government to resume normal operations and to recover its investment capacity, the government has sought and continues to actively seek resources from donors. There are already initial results, and the country has already received US$6 million in grants from East Timor and, by the end of the year will have received a further €10 million in budget support from the EU. The government of Guinea-Bissau and the EU have also reached an agreement for resumption of fishing compensation payments which had been suspended following the coup d’état in 2012. The agreement will enable the government to receive €9.2 million. The government intends to organize a round-table in January 2015 in order to present its development plans to the development partners.

e) **Exemption Committee:** The government has set up a committee to identify, analyze, quantify and rationalize the use of tax exemptions, which currently bear a high fiscal cost to the country in a context of a chronic lack of resources.

15. The concentration of foreign financial aid at the end of the year could lead to difficulties in terms of managing cash flows in 2014. Although the projected volume of financial resources until the end of the year (including the requested disbursement under the IMF's Rapid Credit Facility) should be sufficient to cover the projected volume of spending, there will be a mismatch in the timing between the two flows. For that reason, management of government cash flows until the end of the year should be careful and parsimonious. Nevertheless, and depending on the circumstances, the government may have to issue short-term Treasury bonds to avoid the accumulation of new arrears.

16. The government will start drafting its 2015 budget at the beginning of October in order to obtain Parliamentary approval by the end of the year. As for the 2014 budget, the government strives to include as much revenues and expenditures in the budget, including those that had previously been outside the budget. The 2015 spending will be limited to available domestic resources, foreign aid and concessional loans for foreign investment, without resort to the banking sector. Bearing in mind the uncertainty of the impact of the various measures related to the increase in revenue, the government will make conservative projections for the 2015 revenues, with which it intends to: finance essential social spending (see floor for social expenditure); pay salaries in line with 2014; resume public investment and make some payments to further reduce domestic arrears.
The totally funded budget will allow selected payments and prevent repetition of domestic or foreign arrears. Should government revenue exceed those conservative projections, it will primarily increase public investments and further reduce domestic arrears.

17. The government program for 2014–1018, just approved, makes a distinction between current and structural needs, as follows:

a) **Emergency Program:** includes timely action to deal with emergency issues. For example:

- Payments of salaries in arrears: the high volume of salaries in arrears has already been paid.

- Completing the school year: delays in teacher salaries and teacher strikes represent a risk for the completion of the school year. With the payment of salary arrears and the resumption of classes, the loss of a school year could be prevented.

- Water and energy: the chronic lack of clean water and energy imposes a high cost on the population. The government has already taken measures to increase the supply of those services.

- Cashew campaign: to improve cash flow due to the limitations of the Port of Bissau, timber exports have been suspended, permitting the increase of the export of cashew.

- Agriculture: the late and irregular rainfall will affect agricultural production this year. Amongst other measures, the government intends to distribute rice seed to promote production, to offset this impact.

b) **Contingency Program:** the government has decided that all contracts signed by the administration should be analyzed and made public with a view to increasing transparency and credibility in public administration. Following an assessment, structural measures should be taken to improve operational viability and provision of public services, by adopting targets and monitoring execution, as well as increasing management transparency. The following will be assessed:

- Natural resources: assessment of contracts for prospection and exploitation of natural resources (i.e., phosphate (Farim), bauxite (Boé) and heavy sands (Varela)).

- Oil: prospecting contracts and feasibility.

- Public Companies: Guinea-Bissau Energy Company, Guiné Tel and Guiné Telecom.

- Privatization: audit to privatized companies.

- Autonomous funds: audit of autonomous funds with the participation of the Administration (e.g., FUNPI, Road Fund, Tourism Fund, Mining Fund, etc.)

c) **Development Program:** The government intends to implement a development program focusing on three areas: infrastructure, with a view to increasing production and competitiveness of the country; industrialization, with a view to diversifying the productive structure of the economy, and urban development, to improve the well-being of the populations.

Measures to Improve Public Finance Management

18. The government is committed to minimizing the use of "non-regularized spending" (DNTs). Once the budget process is on track and the Treasure Plan is completed, and once technical assistance from the IMF in public financial management is in place, the government will make efforts to reduce the amount of non-regularized spending. The High-level Treasury Committee will also set ceilings for DNTs, which could only be exceeded with the approval of the Committee.

19. The government will take all steps necessary to clear foreign arrears as quickly as possible. The government is planning to clear foreign arrears to BOAD by the end of the year and, as soon as

possible, to start negotiations to come to an agreement with the remaining foreign creditors. In particular, the government will make efforts to reschedule its debt with the remaining Paris Club and other creditors, still pending since the conclusion of the HIPC initiative: Brazil, Russia and Portugal. In addition, while there is already a verbal agreement, the renegotiation of the Angola debt still needs to be signed, and the government will do its best to proceed with it as quickly as possible. The government also feels that the old debt to the Franco-Portuguese bank should be considered sovereign debt to Portugal and, therefore, subject to the same terms as the agreement with the Paris Club creditors. By the end of the year, the government will do its best to resume negotiations. Finally, the government will try, once again, to contact the governments of Libya, Pakistan and Taiwan in an attempt to renegotiate its debt to those countries.

20. The government is committed to avoiding the accumulation of new budget arrears in 2014 and to paying the remaining stock of 2013 arrears as soon as possible. By the end of this year, the government will have cleared the arrears carried over from 2013. It is also committed not to accumulate arrears in 2014. Should there be any temporary liquidity difficulties due to mismatch between revenue and expenditure, the government will resort to issuing short-term government bonds.

21. The government commits to solving, in a timely fashion, the question of older domestic arrears. The volume of old arrears can be divided into three parts: The first relates to arrears accumulated between 1974 and 1999. The second, between the years 2000 and 2007, and the third, between 2008 and 2012, including government-backed guarantees. The first part was audited and the government has already paid a part of the amount recognized as valid. The second part was also audited, but the government has doubts about the legitimacy of some of these debts, and thus will have the authenticity of these debts assessed through an international audit. The third part is yet to be audited, and requires an external audit to assess the situation. Once the audits are concluded, the government will design a strategy on how to clear those arrears, taking into consideration the macroeconomic environment and the resources available.

22. The government commits to only seeking concessional loans. Considering the tight budget and the pressing needs for investment in different areas, Guinea-Bissau needs to resort to loans to implement its development plan. Nonetheless, under the circumstances, the country should only resort to concessional credit lines.

Measures to Increase Tax Revenue

23. Fiscal revenue and fiscal pressure should be increased urgently. The government must do its utmost to increase tax collection, which was significantly reduced after the coup in 2012. Some measures will help increase tax revenue on the short term, such as: (i) expanding the tax base through implementation of the adoption of tax identification numbers (NIF) to the main operators in the informal sector; (ii) enforce payment by chronic tax evaders; (iii) reconcile imports/export volumes with tax payments. In addition, to increase the tax base, it is important to implement structural reforms in public finance management, payroll management, tax and customs administration (DGCI and DGA) and debt management. The GDP/tax collection ratio in Guinea-Bissau is lower than in the majority of the neighboring countries, and is one of the lowest in the world. The 33 percent increase in customs duties collection of August 2014 (compared to August 2013) is encouraging. Some measures and structural reforms in the government's pipeline are:

a) **Improving public finance management:** the government will devise a medium-term strategy to modernize public finance management, with technical support from the IMF and international partners to, among other things:

- Increase forecasting capacity;
- Complete implementation of SIGFIP.(Integrated System of Public Finance Management)

b) **Improve Debt management:** increase the use of SYGADE and increase the level of training of the Debt Office staff. Other aims are:

- Quarterly publication of public debt levels, including disbursements and amortizations, improving both the control and transparency of debt management.
- Renegotiating and rescheduling of foreign debt and arrears to international creditors, drafting of a payment plan.

c) **Improving Payroll Management:** consolidate the reform of payroll management through SIGRHAP (Integrated System for Human Resource Management in Public Administration).

- The financial module is already operational and the government has already registered all civil servants whose salaries will now be paid through a bank transfers.
- The government has already received a list of all military personnel to be gradually entered into the system, starting with the higher-ranking officers. By the end of the year, the civil servants under the Ministry of the Interior should also be included.

- The Administrative module (human resources) is still under construction.

d) **Improving Customs control and efficiency:** some important measures are:

- Improving the operational efficiency of the Port of Bissau and other customs points, including Safim.

- Drastically reducing tax exemptions.

- Urgent payment of the Oracle license, to avoid having the services interrupted.

- Extend the use of SYDONIA++ to São Domingos, Bafatá and Gabú. The contract with the company hired to manage the system should include the supply of energy and internet.

- By the end of the year, controls should increase with the marking of fuel and the installation of scanners in the port and border points.

e) **Render tax collection efficient**

- Improving the infrastructure of DGCI facilities by allocating the necessary resources in the budget.

- Introduce a Human Resources Policy in the DGCI, including the creation of professional auditor career.

- Streamline the DGCI procedures (Mapping Processes) to lend security and flexibility to taxpayers.

- Introduce a new computer system to DGCI, including a communication network between the head office and the local/regional tax offices.

- Rapidly increase control and auditing of large and medium-sized enterprises.

Other Measures

24. With the support of the IMF, the government is seeking to identify a solution to the large volume of non-performing loans in the economy. Two of the four commercial banks in Guinea-Bissau have rates of non-performing loans that exceed the prudential norms. Despite the difficulties, the volume of credit to the economy continued to grow in the first half of 2014. The government wants to evaluate options to solve this problem and to avoid future financial

difficulties, and is expecting technical assistance from the Monetary and Capital Markets Department (MCM) of the IMF quite soon to assist the authorities in identifying optimal solutions.

25. The government will carry out an extensive study to identify all tax exemptions currently granted in the country, in order to make them transparent to the public and to assess their true cost to the country. As soon as possible, the government wishes to identify and measure all tax exemptions granted today and to make their cost transparent in the budget, thus increasing transparency and accountability to society. In addition, it wishes to analyze whether those exemptions have, in fact, achieved their purpose, particularly those intended to benefit the poorer portions of the population. In other words, apart from their financial cost, which is clear and objective, the aim is to, above all, to assess the economic costs and its social equity.

26. The government intends to increase the efficiency of public enterprises in water and electricity, which have not managed to supply quality services to the population. As soon as possible, the government wishes to bring to an end the constant interruptions and rationing in clean water and electricity supply. The first step is to ensure that those companies become operationally viable and capable of self-financing their own growth in the long term through an adequate level of investment. To this end, the government will strive to identify appropriate strategies to solve the problem of lack of water and energy. Those strategies should include not only management and improvements and operational efficiency, but also efforts to reduce waste. This could imply a realignment of tariffs to levels compatible with the cost of maintenance and amortization of investment.

27. The government believes that the security sector reform is a sine qua non conditions to political and economic stability in Guinea-Bissau. Without political stability, neither economic stability nor prosperity can be achieved. The government is determined to reform the security sector that has been a source of instability. The first step has already been taken with the replacement of the Chief of the Armed Forces. In a second phase, there will be a need to finance the reform and to fill the financing gaps with the help of international partners, so that the pension fund and the payment of bonuses will be totally financed by donors.

28. Improving the business environment is one of the government's priorities. The new government considers the private sector a key partner on the road to sustainable development in Guinea-Bissau. Moreover, it considers that essential measures to improve the business environment include not only the reduction of the cost of doing business but, above all, the promotion of a stable and foreseeable environment based on rule of law and an even level playing field for all.
An improved business environment will contribute towards meeting other important objectives.

29. The government wishes to develop the cashew sector. Recognizing the negative impact of smuggling, the loss of tax revenue and its perverse effect on poverty, the government is considering alternatives to the FUNPI, which are more efficient and socially fairer. In this respect, the IMF argues in favor of the immediate abolition of the FUNPI with a view to promoting the sector, increasing government revenue and reducing poverty. The government has also decided to conduct an external audit of the FUNPI, since its inception in 2011, with a view to assessing its functioning, efficacy and the use of its resources.

30. It is essential to increase expenditure in infrastructure investment without compromising the sustainability of public debt. Guinea-Bissau is a country that requires investment in different sectors, particularly in infrastructure, education and health. The government's medium-term investment plan should be in line with a strategy of debt management that preserves the sustainability of public debt. To that effect, public sector access to foreign financing should be limited to loans at concessional interest rates. If that is not possible, the IMF and the World Bank staff should be consulted before the country contracts loans under less favorable conditions.

31. The government is prepared should Ebola arrive to the country. While there are no cases of Ebola in Guinea-Bissau, some of its neighboring countries have reported innumerous cases. Therefore, the country must be prepared for an Ebola outbreak in Guinea-Bissau. The government has prepared a contingency program estimated at US$5 million with assistance from the World Health Organization. In addition, the World Bank has already made available US$500,000 for emergency measures. Because the country imports large amounts of rice, for instance, any interruption in supply would cause an undesirable hike in inflation. Therefore, as a precaution, the government is warehousing rice.

32. Apart from seeking a solution to the current banking problems, the government wishes to promote the responsible bank coverage of the economy. Given that only a small portion of the population has access to bank services, and that the sector has developed mainly towards the cashew sector, the government wishes to adopt measures to increase access to the banking and financing system in general. To this end, the government recognizes the following conditions as essential to the broadening of the financial system: reforms in infrastructure, education and legal system; institutional stability; sporadic measures to improve legislation to recover loans; creation of a credit rating agency; strengthening payment and settlement systems. The government also intends to request financial and technical assistance from donors to implement the Microfinance Master Plan approved in April 2014.

Table 1. Guinea-Bissau: Indicative Targets[1]
(Cumulative, CFAF millions)

	End-Dec 2014	End-March 2015	End-June 2015
	Prog.	Prog.	Prog.
1. Accumulation of Treasury deposits at BCEAO	3,000	0	0
2. Floor of domestic revenues	41,000	8,750	14,750
3. New domestic arrears	0	0	0
4. External nonconcessional public borrowing	0	0	0
5. New external payment arrears	0	0	0
6. Domestic primary balance (commitment basis)	-19,400	-8,000	-8,200
7. Social spending	12,200	3,200	7,407

Sources: The Authorities of Guinea-Bissau and IMF Staff Estimates
[1] Cumulative from January 1. The definition of the aggregates and adjustors is provided in the Technical Memorandum of Understanding (TMU).

Table 2. Guinea-Bissau: Structural Benchmarks[1]

Measures	Proposed Due Dates
Prior action	
Adopt and publish a prudent budget for 2014, based on conservative estimates of fiscal revenue and donor financing and with no financing gap	
Structural benchmarks	
Introduce a high-level treasury committee to enhance fiscal controls and reduce the perception of fiduciary risks by donors	End of October 2014
Undertake a comprehensive audit of past activities of FUNPI	Endof March 2015
Streamline tax exemptions on fuel imports	Endof March 2015
Expand SYDONIA++ system to the Safim post	End of December 2014

Sources: The Authorities of Guinea-Bissau and IMF Staff Estimates
1/ RCF do not have any ex-post conditionalities. The benchmarks reflect the authorities' intended structural reforms.

Attachment II—Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding defines the variables adopted to establish the indicative targets for 2014 and 2015, how they are calculated, and any adjustments that may be necessary. Unless otherwise indicated, the flow variables are measured by the accumulation of values since the beginning of 2014 and 2015 respectively.

A. Absence of New Domestic Arrears.

2. Domestic arrears are defined as accounts payable accumulated over the year, and still unpaid by the month following the quarter for salaries and wages including pensions, and up to three months for goods, services and transfer, evaluated at the end of December 2014, March 2015 and June 2015.

B. Maximum Ceiling for Foreign Arrears.

3. Foreign arrears are defined as foreign payments due but not paid (i.e., payment of principal and interest) at the date of maturity. If the creditor has granted a grace period after the maturity date in the contract, the foreign payment will be considered in arrears at the end of the grace period. Within the scope of the program, the government commits not to accumulate arrears on its foreign debt, with the exception of those under renegotiation with creditors, including bilateral creditors outside the Paris Club. This quantitative objective will be permanently monitored.

C. Absence of Non-Concessional Foreign Loans.

4. For the purpose of this objective, a debt is considered concessional when it includes at least a 35 percent grant element;[1] the grant element is the difference between current value of the debt and its nominal value expressed as a percentage of the debt nominal value. The current value of the debt at contract is calculated by deducting the future flow of debt service payments.[2] The discount

[1] The IFM Website contains a link to a tool that allows the calculation of the grant element in a wide range of financing packages: http://www.imf.org/external/np/pdr/conc/calculator.

[2] For the purpose of calculation of concessionality, all aspects of the debt agreement should be taken into consideration, namely: term, grace period, repayment period, initial commission and administrative fees.

rates applied to that effect are the commercial interest reference rates for a specific currency (CIRR), as published by the OECD.[3]

D. Ceiling for Domestic Primary Deficit (Commitment Basis).

5. This is calculated as the difference between public revenue and domestic primary expenditure on a commitment basis. Public revenue includes all tax and non-tax revenue and excludes foreign grants. Primary domestic expenditure consists of current expenditure plus domestically financed investment excluding all interest payments.

6. Government commitments include all expenditure earmarked and approved by the Ministry of Economy and Finance; automatic spending (such as wages and salaries, pensions, utilities and other expenses which are paid centrally), and expenses through compensation operations.

E. Floor for Tax Revenue.

7. Tax revenue includes direct and indirect taxes as well as recovery of tax arrears and additional collection efforts.

F. Ceiling of Non-Regularized Expenditure.

Defined as any payment by Treasury without classification in the table of expenditure submitted by DG Budget.

G. Floor for Social and Priority Spending.

8. Defined as the total current expenditure in Education and Health.

[3] For debt in foreign currency, for which no CIRR is calculated by OECD, the grant element shall be based on the composite CIRR (weighted average) of the currencies in the SDR basket.

INTERNATIONAL MONETARY FUND

GUINEA-BISSAU

REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY—INFORMATIONAL ANNEX

October 20, 2014

Prepared By | The African Department (In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of October 3, 2014)

Membership Status

Joined: March 24, 1977; Article VIII

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	14.20	100.00
Fund holdings of currency (Exchange Rate)	13.96	98.31
Reserve Tranche Position	0.32	2.26

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	13.60	100.00
Holdings	12.39	91.02

Outstanding Purchases and Loans:	**SDR Million**	**Percent Quota**
ECF Arrangements	7.24	51.00

Latest Financial Arrangements:

Type	**Date of Arrangement**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
ECF	May 07, 2010	May 06, 2013	22.37	15.12
ECF [1/]	Dec 15, 2000	Dec 14, 2003	14.20	5.08
ECF [1/]	Jan 18, 1995	Jul 24, 1998	10.50	10.50

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

	Forthcoming				
	2014	2015	2016	2017	2018
Principal			0.72	1.45	1.45
Charges/Interest	0.00	0.02	0.02	0.02	0.01
Total	0.00	0.02	0.74	1.46	1.46

[1/] Formerly PRGF.

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

Implementation of HIPC Initiative:

	Enhanced Framework
I. Commitment of HIPC assistance	
Decision point date	Dec 2000
Assistance committed by all creditors (US$ Million) 3/	421.70
Of which: IMF assistance (US$ million)	11.91
(SDR equivalent in millions)	9.20
Completion point date	Dec 2010
II. Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	9.20
Interim assistance	1.56
Completion point balance	7.64
Additional disbursement of interest income 4/	0.23
Total disbursements	9.43

Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI-eligible debt (SDR Million) 5/	0.51
Financed by: MDRI Trust	0.00
Remaining HIPC resources	0.51

II. Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGT**	**Total**
December 2010	N/A	0.51	0.51

3/ Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts cannot be added.

4/ Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

5 /The MDRI provide 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

Implementation of Post-Catastrophe Debt Relief (PCDR): Not Applicable

Safeguards Assessments:

The Central Bank of West African States (BCEAO) is a common central bank of the countries of the West African Economic and Monetary Union (WAEMU). The most recent safeguards assessment of the BCEAO was completed on March 1, 2010. The 2010 update assessment found that the BCEAO continues to have controls in place at the operational level. The overall governance framework needed nonetheless to be strengthened by the addition of an audit committee to ensure that the Board of Directors exercises appropriate oversight over the control structure, including the audit mechanisms and financial statements. Such committee was established after the completion of the assessment following the Institutional Reform of the WAMU and the BCEAO. Efforts to implement fully the International Financial Reporting Standards should also be pursued. An update assessment was initiated in February 2013.

Exchange System and Exchange Rate Arrangement

Guinea Bissau accepted the obligations of Article VIII, Sections 2, 3, and 4 with effect from January 1, 1997. It joined the WAEMU in 1997, and has no separate legal tender. The exchange system common to all members of the union is free from multiple currency practices and exchange restrictions on the making of payments and transfers for current international transactions. Since January 1, 1999, the CFA franc has been pegged to the Euro at a fixed rate of € l=CFAF 655.957. On April 30, 2013, the rate of the CFA franc in terms of the SDR was CFAF 757.217=SDR 1. Effective January 1, 2007, the exchange arrangement of the WAEMU countries has been reclassified to the category of conventional pegged arrangement from the category of exchange arrangement with no separate legal tender. The new classification is based on the behavior of the common currency, whereas the previous classification was based on the lack of a separate legal tender. The new classification thus reflects only a definitional change, and is not based on a judgment that there has been a substantive change in the exchange regime or other policies of the currency union or its members.

Article IV Consultation

Guinea-Bissau is on the 24-month consultation cycle. The last Article IV consultation discussions with Guinea-Bissau were held in Bissau April 29 to May 10, 2013. The staff report (SM/13/141), issued was discussed by the Executive Board on June 5, 2013.

Technical Assistance (2008–14)

Department	Type of Assistance	Time of Delivery	Purpose
West AFRITAC	Short-term expert	June 2008	Customs administration
West AFRITAC	Short-term expert	June 2008	Public Expenditure management
STA	Expert	June 2008	Balance of Payment Statistics
West AFRITAC	Short-term expert	July 2008	Government finance statistics
West AFRITAC	Short-term expert	August 2008	Multi-sector Statistics
West AFRITAC	Short-term expert	September 2008	Real sector Statistics
West AFRITAC	Short-term expert	May 2009	National Accounts
West AFRITAC	Long-term expert	June 2009	National Accounts
West AFRITAC	Short-term expert	June 2009	Public Expenditure management
West AFRITAC	Short-term expert	June 2009	Public Debt management
West AFRITAC	Short-term expert	June 2009	Bank Supervision
West AFRITAC	Short-term expert	September 2009	Customs administration
West AFRITAC	Short-term expert	November 2009	Public Debt management
West AFRITAC	Short-term expert	November 2009	Real Sector Statistics
West AFRITAC	Short-term expert	February 2010	Public Debt Management
West AFRITAC	Short-term expert	February 2010	Government Finance Statistics
West AFRITAC	Short-term expert	May 2010	Revenue administration
West AFRITAC	Short-term expert	July 2010	National Accounts
FAD	Staff	September 2010	Tax Revenue and Customs Administration
West AFRITAC	Short-term expert	September 2010	Expenditure management
West AFRITAC	Short-term expert	September 2010	National Accounts
West AFRITAC	Short-term expert	February 2011	Tax Administration
West AFRITAC	Short-term expert	February 2011	Government Finance Statistics
West AFRITAC	Short-term expert	March 2011	Government Finance Statistics
West AFRITAC	Short-term expert	April 2011	Public Debt Management
West AFRITAC	Short-term expert	April 2011	Public Financial Management,
West AFRITAC	Short-term expert	April 2011	Public Financial Management
West AFRITAC	Short-term expert	April 2011	Real Sector Statistics
West AFRITAC	Short-term expert	June 2011	Government Finance Statistics
FAD	Staff	September 2011	Tax Reform Strategy, Modernization of the DGCI and Revenue Mobilization
FAD	Staff	September 2011	Customs Administration
FAD	Short-term expert	October 2011	Tax Administration
West AFRITAC	Short-term expert	October 2011	Modernization of the DGCI
West AFRITAC	Short-term expert	October 2011	Real Sector Statistics, National Accounts
West AFRITAC	Short-term expert	January 2012	Public Financial Management, Accounting
West AFRITAC	Short-term expert	January 2012	Public Financial Management
FAD	Short-term expert	February 2012	Tax Administration
West AFRITAC	Short-term expert	February 2012	Public Financial Management
West AFRITAC	Short-term expert	February 2012	Real Sector Statistics

Department	Type of Assistance	Time of Delivery	Purpose
FAD	Short-term expert	March 2012	Tax Administration
West AFRITAC	Short-term expert	March 2012	Customs Administration
West AFRITAC	Short-term expert	February 2013	Public Financial Management
West AFRITAC	Short-term expert	April 2013	Public Financial Management
West AFRITAC	Short-term expert	April 2013	National Accounts
FAD	Staff	April 2013	Revenue Administration
West AFRITAC	Short-term expert	September 2013	Real Sector Statistics
West AFRITAC	Short-term expert	September 2013	Customs Administration
West AFRITAC	Short-term expert	October 2013	Government Finance Statistics
West AFRITAC	Short-term expert	March 2014	Real Sector Statistics
West AFRITAC	Short-term expert	August 2014	Fiscal Administration
West AFRITAC	Short-term expert	September 2014	Customs Administration
FAD	Staff	September 2014	Public Finance Management
FAD	Short-term expert	September 2014	Revenue Management

Resident Representative

The Resident Representative in Senegal also covered Guinea-Bissau from September 1997 through July 2007. The Resident Representative Office in Guinea-Bissau was reopened in June 2011 and Mr. Torrez assumed the position.

Table 1: Guinea-Bissau—Arrangements with the IMF, 1984–2014

Arrangement	Date Approved	Amount Approved	Remarks
First credit tranche purchase	August 27, 1984	SDR 1.875 million	
Structural Adjustment Facility	October 14, 1987	SDR 5.25 million	2nd annual arrangement delayed; no 3rd annual arrangement.
Enhanced Structural Adjustment Facility	January 18, 1995	SDR 10.5 million	Arrangement increased by SDR 1.05 million (10 percent of quota) with 3rd annual arrangement.
Emergency post-conflict assistance	September 14, 1999	SDR 2.13 million	
Emergency post-conflict assistance	January 7, 2000	SDR 1.42 million	
Poverty Reduction and Growth Facility	December 15, 2000	SDR 14.2 million	PRGF expired without completion of a review.
Emergency post-conflict assistance	January 10, 2008	SDR 1.77 million	
Emergency post-conflict assistance	May 20, 2009	SDR 1.77 million	
Extended Credit Facility	May 7, 2010	SDR 22.365 million	The arrangement expired on May 6, 2013.

WORLD BANK GROUP RELATIONS

1. **The recent World Bank Group (WBG) engagement can be divided into three phases.** They span both IDA 16 and IDA 17. During phase I, the WBG remained engaged in Guinea-Bissau in spite of the military coup of 2012. Phase II involved the scaling up of the WBG's program through an emergency program, supporting the country's transition back to democracy. Phase III described a longer-term engagement. The WBG is developing an Interim Strategy Note (ISN) for FY15. To increase its financing envelope, the WBG is also looking into possibility of accessing additional resources through a so-called Turn-Around Facility which is supposed to support fragile states which are in a transition process. Amounts of this Turn- around Facility are yet to be determined.

2. **Total commitments currently amount to US$ 81.3 million, of which US$46.5 are yet to be disbursed.** This includes 5 national IDA operations (US$67.5 million), one regional IDA operation on fisheries (US$6 million), and Trust-Fund-supported operations (US$7.7 million). In FY14, the program was scaled up with three emergency operations (including in water and energy, the cashew sector, and payment of salaries of teachers and health workers), delivered with US$45 million, a record delivery. The WBG's portfolio is dominated by activities in Social Protection (31%), energy and extractive industries (22%), water (27%), environment and fisheries (10%), and trade and competitiveness (10%).

	Project	Percent Disbursed
	National IDA	
	Rural Community-Driven Development Project	95.16%
1	Rural Community-Driven Development Project	53.07%
2	Guinea-Bissau Biodiversity Conservation Project	59.44%
	Guinea-Bissau: Emergency Electricity and Water Rehabilitation Project	92.47%
3	Guinea-Bissau: Emergency Electricity and Water Rehabilitation Project	100.00%
4	Emergency Water and Electricity Services Upgrading Project	0.00%
5	Private Sector Rehabilitation; Agribusiness Development	0.00%
	Regional IDA	
1	Second APL (APL-B1) West Af. Reg. Fisheries Program (Guinea Bissau)	17.01%
	Trust Funds	
1	Participatory Rural Development Project	90.63%
2	Guinea-Bissau: Extractive Industries Sectors TA	0.00%

Budget Support Operations

1. **The WBG stopped providing budget support in light of the 2012 military coup.** For FY14 and FY15, no new budget support operations are envisaged and the WBG will focus on financing specific projects instead. Future budget support will crucially depend on progress made on fiduciary safeguards and the PFM agenda.

Lending Program

2. **The WBG is currently finalizing its ISN,** as the preparation of a new, full-fledged Country Assistance Strategy (CAS) was interrupted by the coup in 2012. A preliminary pipeline of projects under the new ISN focuses on the twin objectives of building institutions and supporting the economic recovery, including support to the productive sectors (e.g. agriculture) and enabling sectors (e.g. water and energy). Anticipated projects focus on public sector/PFM TA, agriculture rehabilitation, support to energy and water (including the Regional OMVG Energy Project), and social safety nets.

AFRICAN DEVELOPMENT BANK GROUP RELATIONS

1. **As of October 2014, the AfDB had approved 49 operations for Guinea-Bissau, excluding multinational projects.** These include 33 projects, 3 studies and 8 institutional supports, 4 emergency assistance operations and 1 line of credit representing a net commitment of UA 368 million (about CFAF 271 billions). 29.7 percent of the amounts committed have been in the social sector, 29.2 in infrastructure, 21.3 percent in the multi-sector and 17.5 percent in agriculture. As of October 2013, the active portfolio comprises five ongoing projects representing a total net amount of UA 22.28 million and a disbursed amount of UA 6.39 million.

Lending Program

2. **During the period January 2008–October 2013,** AfDB approved an interim HIPC debt release (US$17.48 million), a Fragile State Facility grant (UA 2 million), a fish sector support grant (UA 2 million), a health sector grant (UA 6 million), two emergency support grant to cholera (UA 0.33 million and UA 0.67 million), a capacity building grant to public administration (UA 7.86 million) and an emergency budget support to budgetary reforms (UA 5.7 million).

Non-lending Program

3. **The AfDB is currently elaborating its Country Strategy Paper (CSP) for the 2014–2018 periods together with a Country Portfolio Performance Assessment.** The AfDB allocation for Guinea-Bissau stands at UA 28.3 million for the 2014–2017 period covered by the XIIIth replenishment of the African Development Fund (ADF), excluding funds which can be

mobilized by the AfDB pool of regional resources and diverse Trust Funds. A Regional Integration Strategy Paper for West Africa for 2011–2015 was released in March 2011, and is currently undergoing a mid-term review. Africa-wide Country Performance Assessment (CPA), Country Governance Rating (CGR), Country Policy and Institutional Assessment (CPIA), all which included Guinea-Bissau, were released in March 2013.

4. **Several new studies have been launched by the AfDB**: A gender profile of Guinea-Bissau is being conducted alongside a study on transport and regional integration and a comprehensive review of infrastructure bottlenecks affecting the agriculture sector.

STATISTICAL ISSUES

GUINEA-BISSAU—STATISTICAL ISSUES APPENDIX As of October 17, 2014
Assessment of Data Adequacy for Surveillance
General: Data have serious shortcomings that significantly hamper surveillance. Shortcomings are most serious in the national accounts and external sector statistics. Given weak capacity and outdated practices, the authorities are improving their data compilation in the recent years, with technical assistance from international and regional institutions.
National Accounts: During the past few years, the National Institute of Statistics (INE) has received several technical assistance missions from West AFRITAC on real sector statistics, especially on national accounts. This has resulted in improving the compilation of GDP figures. However, unavailability or/and difficulty in collecting basic data remain an issue to be addressed. INE has recently published revised GDP estimates in current and constant prices (2003) from 2010-2012, based on the *System of National Accounts 1993*. The new series has a broader coverage of all sectors of the economy. The INE intends to implement the *2008 SNA* by 2015 along with the compilation of a new base year.
Price Statistics: Since July 2002, a harmonized consumer price index (HCPI) has been compiled, based on the same methodology as in other West African Economic and Monetary Union (WAEMU) countries. The HCPI was updated in 2010 (new base year 2008-2009, improvement in compilation techniques, extended coverage of products and increase in outlets), but its coverage remains only the capital city, Bissau.
Government Finance Statistics: Since 2007, the monthly worksheet table for the State Financial Operations is compiled on a regular basis and used as a basic tool for monitoring the program by the IMF. In March 2010, a government finance statistics (GFS) mission from West AFRITAC provided technical assistance to the authorities in compiling and disseminating GFS and implementing action plans designed to improve the GFS data dissemination to users. Under the West AFRITAC work program, a government finance

statistics technical assistance mission is planned for November 2014.
Monetary and Financial Statistics: Monetary and financial statistics are compiled and disseminated by the regional Central Bank of West African States (BCEAO). Despite recent improvements, monetary statistics continue to have shortcomings. These include inconsistencies in source data and lack of proper sectorization of the domestic economy to ensure that the BCEAO adheres fully to the methodology of the *Monetary and Financial Statistics Manual*. The 2011, 2013, and 2014 STA missions to the BCEAO's headquarters in Dakar, Senegal, made a number of recommendations for addressing the above shortcomings. The missions also assisted BCEAO staff in developing the standardized report forms (SRFs) for the central bank accounts and initiated work on the SRF for reporting the data of other depository corporations (ODCs).
Financial Sector Surveillance: The BCEAO has accepted STA's invitation to begin regular reporting of its member countries' FSIs for dissemination on the IMF website.
External Sector Statistics: Guinea-Bissau reports trade data to AFR for operational purposes, using information from customs. Balance of payments data are weak, mostly due to substantial unregistered trade and inconsistencies between data on net foreign assets as reported by the BCEAO and other economic indicators. The large number of small-scale operators, a large informal sector, and institutional weaknesses (only some 20 percent of businesses file tax returns) hamper the data collection. While no external debt data are published by the Ministry of Finance, stock and flow data are regularly produced and transmitted to the BCEAO.

Data Standards and Quality

Guinea-Bissau has participated in the General Data Dissemination System since November 2001. Metadata for all data categories and plans for improvement need to be updated.	No data ROSC is available.

Reporting to STA

Currently no monthly, quarterly or annual government finance data is submitted for reporting in the *International Financial Statistics (IFS)* or the *Government Finance Statistics Yearbook*. Monthly data on monetary statistics for Guinea Bissau are reported on a regular basis for publication in the *IFS* with some delays. Guinea-Bissau reports balance of payments and international investment position statistics to STA on an annual basis with considerable delays. The latest data relate to 2010.

Guinea-Bissau: Table of Common Indicators Required for Surveillance

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]
Exchange rates	Current	Current	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	Mar. 2013	Apr. 2013	M	M	M
Reserve/base money	Jun. 2014	Sep. 2014	M	M	M
Broad money	Jun. 2014	Sep. 2014	M	M	M
Central bank balance sheet	Jun. 2014	Sep. 2014	M	M	M
Consolidated balance sheet of the banking system	Jun. 2014	Sep. 2014	M	M	M
Interest rates[2]	Aug. 2014	Sep. 2014	M	M	M
Consumer price index	Jul. 2014	Aug. 2014	M	M	M
Revenue, expenditure, balance and composition of financing[3] – general government[4]	Mar. 2013	Mar. 2013	M	Q	Q
Revenue, expenditure, balance and composition of financing[3]– central government	Mar. 2013	Mar. 2013	M	Q	Q
Stocks of central government and central government-guaranteed debt[5]	Dec. 2011	Apr. 2013	A	I	I
External current account balance	Feb. 2013	Apr. 2013	A	I	I
Exports and imports of goods and services	Feb. 2013	Apr. 2013	A	I	I
GDP	2012	Apr. 2013	A	I	I
Gross external debt	2012	Apr. 2013	A	I	I
International Investment Position[6]	2010	Jan. 2012	A	I	I

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[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); Not Available (NA)

INTERNATIONAL MONETARY FUND

GUINEA-BISSAU

REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS UPDATE

October 20, 2014

Approved By
Roger Nord and Peter Allum (IMF)

Prepared by the Staff of the International Monetary Fund (IMF).[1,2]

Guinea-Bissau remains at moderate risk of debt distress. The country's external and public debt indicators improved significantly following HIPC and MDRI assistance and remain below the indicative thresholds throughout the projection period. However, there have been improvements compared to last year's assessment[3], as only one debt-burden indicator (under the most extreme scenario) breaches the associated benchmark. There is a large and protracted breach of the present value of debt to exports threshold in an exports shock scenario. The improvements are due to revisions to the debt stock and GDP, the reclassification of BOAD debt from external to internal debt, and by the exclusion of debts in technical arrears. Despite the better outlook, domestic public debt has increased markedly in recent years, reinforcing the need to pursue prudent fiscal and debt management policies, implement structural reforms, such as export diversification and higher tax collection, and continue to strongly rely on concessional borrowing.

[1] The DSA was prepared by Fund staff, in consultation with the Debt Management Unit of the Bissau-Guinean Ministry of Finance, and benefitted from comments from the World Bank. The fiscal year for Guinea-Bissau is January 1- December 31.

[2] Debt sustainability thresholds are determined by the three-year (2010–12) average of the Country Policy and Institutional Assessment (CPIA) rating (2.7), which classifies Guinea-Bissau as having low-quality policies and institutional frameworks.

[3] The previous DSA was prepared in June 2013. IMF Country Report No. 13/197.

BACKGROUND

1. **Overall, Guinea-Bissau's debt outlook has improved considerably since the country benefited from a substantial debt relief, but careful debt management remains crucial.** The implementation of the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative in December 2010 and the Multilateral Debt Relief Initiative (MDRI) in May 2011, has significantly reduced the ratio of public and publicly guaranteed (PPG) external debt to GDP from the pre-debt relief peak of 113 percent of GDP at end-2009 to 28 percent of GDP[4] at end-2013. However, the debt burden has slowly been increasing in recent years (Text Table 1). Most of the debt owed to multilaterals and official bilateral creditors was canceled, while about half of the remaining debt owed to non-Paris Club creditors is subject to rescheduling.

Text Table 1. Guinea-Bissau: Nominal external debt stock, 2011-13

	2011	2012	2013	2013
		Percent of GDP		*Percent of total debt*
Total	24.4	28.2	28.0	100.0
Multilateral creditors	12.1	14.0	13.9	49.5
of which				
IMF	1.0	1.2	1.2	4.1
IDA	5.2	5.8	5.7	20.5
AfDB	1.6	2.0	1.9	6.8
Others	4.4	5.1	5.1	18.1
Bilateral creditors	12.3	14.1	14.1	50.4
Paris Club	0.0	0.0	0.0	0.0
Non-Paris Club	12.3	14.1	14.1	50.4
Commercial	0.0	0.0	0.0	0.1
Memorandum item:				
Debt in technical arrears[1]	8.0	9.2	9.2	32.9

[1] Based on preliminary findings. Includes debt of $48.2 million to Taiwan, $32.8 million to Angola, $3.7 million to Libya, $3 million to Pakistan, $0.3 million to Abu Dhabi, and $0.3 million to a commercial bank.

Source: Guinea-Bissau authorities and staff estimates

2. **Public domestic debt has increased substantially in recent years due, in part, to limited access to official external financing, as well as to a reclassification of BOAD loans that are now considered as internal debt as they are denominated in domestic currency.** The ratio of domestic debt to GDP has remained stable around 35-36 percent from end-2009 to end–2013. However, it has gone up recently as the authorities started to rely more heavily on borrowing from the West African Development Bank (BOAD), a regional development bank, to finance public investment projects in road construction and

[4] Excludes $88.5 million of debt in technical arrears to Taiwan, Angola, Libya, Pakistan, Abu Dhabi, and a closed commercial bank. Technical arrears stem from payments falling due in situations when the creditor has agreed to a rescheduling of the debt, but it has not yet taken place. Staff has requested additional information about the status of debt renegotiations to firm up the classification of these loans.

rehabilitation, rice production and food security support. In addition, government placed CFAF10 billion and CFAF15 billion in treasury bonds in 2013 and 2014. BOAD debt, denominated in domestic currency and thus considered to be domestic debt,[5] has increased from 1 percent of GDP in 2009 to about 6 percent of GDP in 2013. The ratio of public domestic debt to GDP is expected to lie around 37 percent at end-2014, and to increase to 47 percent in 2017 before beginning to decrease.

UNDERLYING ASSUMPTIONS

3. **The macroeconomic outlook has been revised to reflect a decrease in macroeconomic and political uncertainty as Guinea-Bissau returns to democracy following a coup in 2012.** The recent successful elections, along with prospects for an RCF, are already leading to a resumption of financial support. Moreover, political stability will also increase macroeconomic predictability. Therefore, the baseline scenario assumes that economic recovery will be driven by a restoration of traditional development partners' support and an increase in investment levels. In particular, compared to the previous DSA assumptions:

Text Table 2. Guinea-Bissau: Evolution of selected macroeconmic indicators

	2012	2013	2014	Long Term[1]
Real GDP growth (percent)				
Previous DSA	-1.5	3.5	2.4	4.0
Current DSA	-2.2	0.3	2.5	4.0
Primary fiscal balance (percent of GDP)				
Previous DSA	-2.8	0.8	-0.7	-0.2
Current DSA	2.1	1.7	-0.4	0.4
Non-interest current account deficit (percent of GDP)				
Previous DSA	6.5	5.5	4.5	2.4
Current DSA	4.6	4.0	0.3	4.9
Growth of exports (percent)				
Previous DSA	-44.4	23.7	14.7	6.3
Current DSA	-41.4	5.4	13.2	6.4

Sources: Guinea-Bissau authorities; IMF Staff estimates
1 Long-term value of the indicator is defined as an average over the last 15 years of the projections

- The medium-term growth scenario projects a strong recovery relative to the two previous very weak years (-2.2 and 0.3 percent growth), with long-term growth remaining at 4 percent per year, but with stronger underlying fundamentals in terms of international support. This assumes the implementation of sound macroeconomic policies, structural reforms and continued efforts to increase public investment.

- The primary fiscal deficit is projected to improve, converging towards 0.4 percent of GDP in the long term, reflecting the authorities' efforts to increase revenue mobilization in the context of limited access to borrowing.

[5] This treatment represents an important change relative to more recent DSAs for Guinea-Bissau and it is in line with the treatment applied by other WAEMU countries and in the Technical Memorandum of Understanding of the more recent arrangement under an Extended Credit Facility (ECF).

- The non-interest external current account deficit is expected to improve in the long term reflecting an upward revision in the fiscal balance and a slightly lower growth in imports.

4. Risks to the baseline scenario are linked to the country's high dependence on cashew exports and foreign (concessional) support as well as new episodes of political instability. Much will depend on the availability of concessional external financing as well as on the authorities' debt management capacity. Externally, a weakening external environment could result in lower-than-expected exports and remittances.[6] Therefore, those factors translate into important downside risks to growth, FDI and the current account dynamics.

Box 1. Macroeconomic Assumptions

In the medium term (2014-19) projections are consistent with the macroeconomic framework under a request for an RCF arrangement. **Long-term (2020-2034)** projections assume enduring political stability and the resulting macroeconomic stability gains, for example, higher investment levels boosted by lower macroeconomic uncertainty and higher revenue collection through stronger institutions.

Real GDP growth is projected to reach 2.5 percent in 2014 following two years of poor economic growth (-2.2 percent in 2012 and 0.3 percent in 2013). Over the medium term, the rate of economic growth is expected to pick up to 3.7 percent, reflecting higher macroeconomic stability and increased levels of capital flows and investment due to lower political risk. Over the long run, growth is expected to stabilize around 4 percent, as a result of better economic policies, increased investment levels, mainly in infrastructure, structural reforms and the associated efficiency gains.

Inflation (measured by the CPI) is projected to reach 2.1 percent by the end of 2014, following higher disposable income from higher cashew prices as well as stronger demand, and to converge to 2.5 percent in the medium run, hovering around that level over the long term.

The primary fiscal deficit is assumed to slightly increase from 1.7 percent of GDP in 2013 to 1.8 percent in the medium term. Over the long run, the primary fiscal balance is projected to remain at about 0.4 percent of GDP. Over the near-term, government's domestic debt is projected to slightly increase from 35 percent of GDP in 2013 to 41 percent of GDP in 2019. In the long term, domestic debt is expected to decrease to about 7 percent reflecting the authorities' commitment to a prudent borrowing strategy and a regular repayment of outstanding debt.

The non-interest external current account deficit is projected to slightly increase from 4.0 percent of GDP in 2013 to 5.7 percent of GDP in 2019. In the long term, the current account deficit would stabilize at about 5 percent of GDP, reflecting improved exports and fiscal performance.

Net foreign direct investment is projected to pick up in the medium and long terms owing to the stabilization of the political situation, a more favorable business climate, and improved infrastructure.

Net aid flows (official grants and concessional loans) are expected to hover around 7 percent of GDP in the medium run, and decrease slightly but consistently until the end of the projection period. Concessional loans are assumed to be at standard terms, i.e. on 0.75 percent interest rate with 40 (IDA) and 50 (AFDB) years maturity and ten-year grace period. The average grant element of new external disbursements is assumed to remain around 50 percent throughout the projection period.

[6] The inclusion of remittances in the analysis, accounting on average for 2.8 percent of GDP in the last five years, results in minor changes of debt burden indicators.

EXTERNAL AND PUBLIC DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

5. **All debt burden indicators are expected to remain below their thresholds[7] in the baseline scenario, but the most extreme shock[8] scenario leads to a significant breach of one of them (Figure 1, Tables 1 and 2).** In the baseline scenario, no debt burden indicator breaches its respective threshold for the whole projection period. However, under the most extreme shock scenario the PV of debt-to-export ratio breaches the benchmark for an extended period of time. Stress tests indicate that the economy remains vulnerable to a fall in exports. In this case the PV of debt-to-export ratio would increase from about 53 percent in 2014 to 165 percent of GDP in 2019 and then remain above the threshold during the projection period. On this basis, Guinea-Bissau remains classified as a moderate risk country. Nonetheless, under the baseline scenario exports are expected to increase somewhat over the long-term due to improved road infrastructure and some product diversification. If those gains were to materialize earlier or diversification was to be larger, future dynamics would be more favorable. Finally, it is worth noticing that, under the most extreme shock scenario, all other indicators remain well below their associated thresholds during the entire projection period.

6. **The current assessment presents a better debt outlook than the previous DSA.** In the previous DSA one debt burden indicator breached the threshold under the baseline scenario, compared to none in the current DSA. Moreover, in the previous DSA three debt burden indicators breached their associated thresholds under the most extreme shock scenario, compared to just one indicator this time. The improvements are due to revisions to the debt stock and GDP, the exclusion of debts in technical arrears as well as the reclassification of BOAD debt as domestic debt.

B. Public Debt Sustainability Analysis

7. **Total (external and domestic) public debt indicators are projected to decline gradually over time (Figure 2, Tables 3 and 4)**. In the baseline scenario, the PV of debt-to-GDP ratio is expected to decrease markedly from 47 percent in 2014 to 19 percent in 2034, after increasing somewhat in the next three years due to large infra-structure projects that are in the pipeline. The PV of debt-to-revenue ratio is projected to sharply decline from 242 percent to 114 percent, and the debt service-to-revenue ratio is expected to stabilize around the 6 percent value expected for 2014. However, The PV of debt-to-GDP ratio should lie above its corresponding threshold for half of the projection period, notwithstanding its marked improvement over last year's DSA.[9]

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[7] Debt sustainability thresholds are determined by the three-year (2010–12) average of the Country Policy and Institutional Assessment (CPIA) rating (2.7), which classifies Guinea-Bissau as having low-quality policies and institutional frameworks.

[8] The most extreme shock is calibrated as an export shock in 2015–2016 equal to the historical average (2004–2013) of export growth minus one standard deviation (in the same period), or a one-time, 30-percent nominal currency depreciation.

[9] However, note that no threshold on total public debt existed in the previous DSA. Applying this new threshold to the previous DSA would have produced a similar result.

8. Risks to the baseline scenario are linked to the country's high dependence on cashew exports, the availability of concessional external financing and new episodes of political instability. The initial increase in the PV of debt is driven by the large expected volume of BOAD disbursements in the medium-term. However, they are associated to key infrastructure investment, which should boost GDP afterwards and help to decrease vulnerabilities. On the other hand, new episodes of political instability could lead to lower volume of concessional financing and grants, which would require additional issuance of Treasury bills, on top of recent sizable placements totaling 25 billion in 2013 an 2014. In an extreme case even the rolling over this debt cannot be taken for granted. A weaker external environment in the medium term could result in lower-than-expected exports and remittances.[10] Those factors translate into downside risks to growth, FDI and the current account dynamics. Finally, even though the debt to the BCEAO has been successfully rescheduled, there is uncertainty about the amount of additional old internal arrears that will be certified, since their volume is under dispute.[11]

CONCLUSION

9. In the staff's view, Guinea-Bissau faces a moderate risk of debt distress; however debt management should be enhanced and carried out with caution. Under the assumptions of medium-term gradual economic recovery, sound policies, and continued structural reforms the risk of debt distress is assessed as moderate. However, this assessment has greatly benefited from the HIPC and MDRI initiatives, and efforts should be made to make those gains permanent, mainly in a situation in which recent years' difficulties to accessing external borrowing should improve substantially in the following years (under the baseline). Therefore, authorities should consider carefully borrowing opportunities and accept only concessional financing.

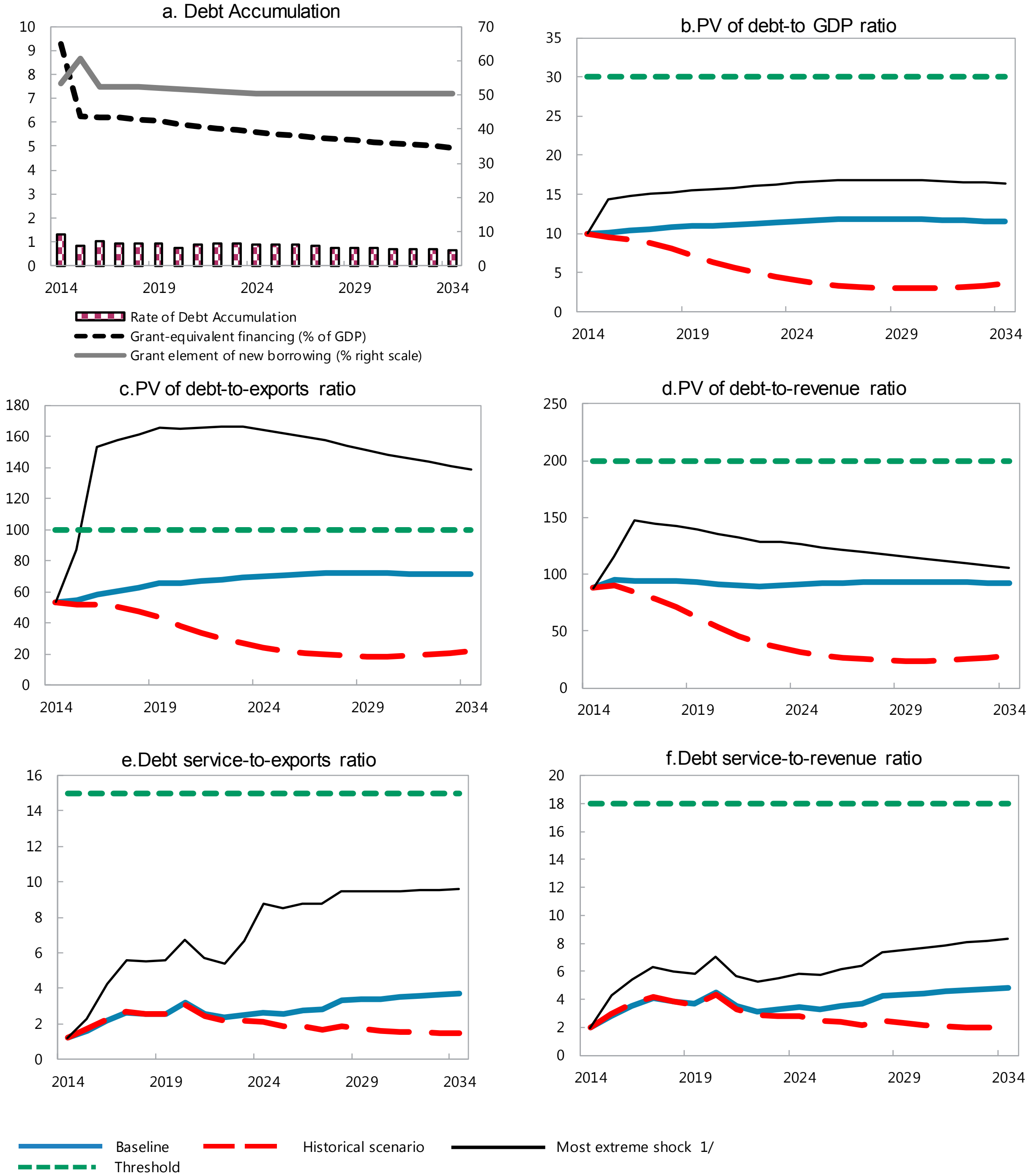
10. Despite improvements in the debt outlook, domestic debt has risen substantially in recent years. In part as a result of difficulties in accessing external financing, authorities have resorted to domestic debt (including BOAD) in recent years. As a consequence, domestic debt relative to GDP has risen from 26 percent in 2011 to 35 percent in 2013. Therefore, better debt management and sound policies are crucial to sustainable growth. Indeed, the inclusion of domestic public debt in the debt sustainability analysis confirms that GNB's debt position is vulnerable, as the PV of debt-to-GDP ratio surpasses its threshold for the next ten years.

11. The authorities broadly agree with the staff conclusions and policy recommendations. The authorities concur that debt sustainability depends critically on the ability to access concessional financing, improvements in potential economic growth, and sound macroeconomic and prudent debt management policies

[10] The inclusion of remittances in the analysis, accounting on average for 2.8 percent of GDP in the last five years, results in minor changes of debt burden indicators.

[11] The DSA includes the already audited and recognized stock of arrears related to the 1974–1999 period, as well as CFA14 billion related to the 2000–2007 period. Arrears from the 2008–2012 period, which have neither been audited nor recognized, are not included.

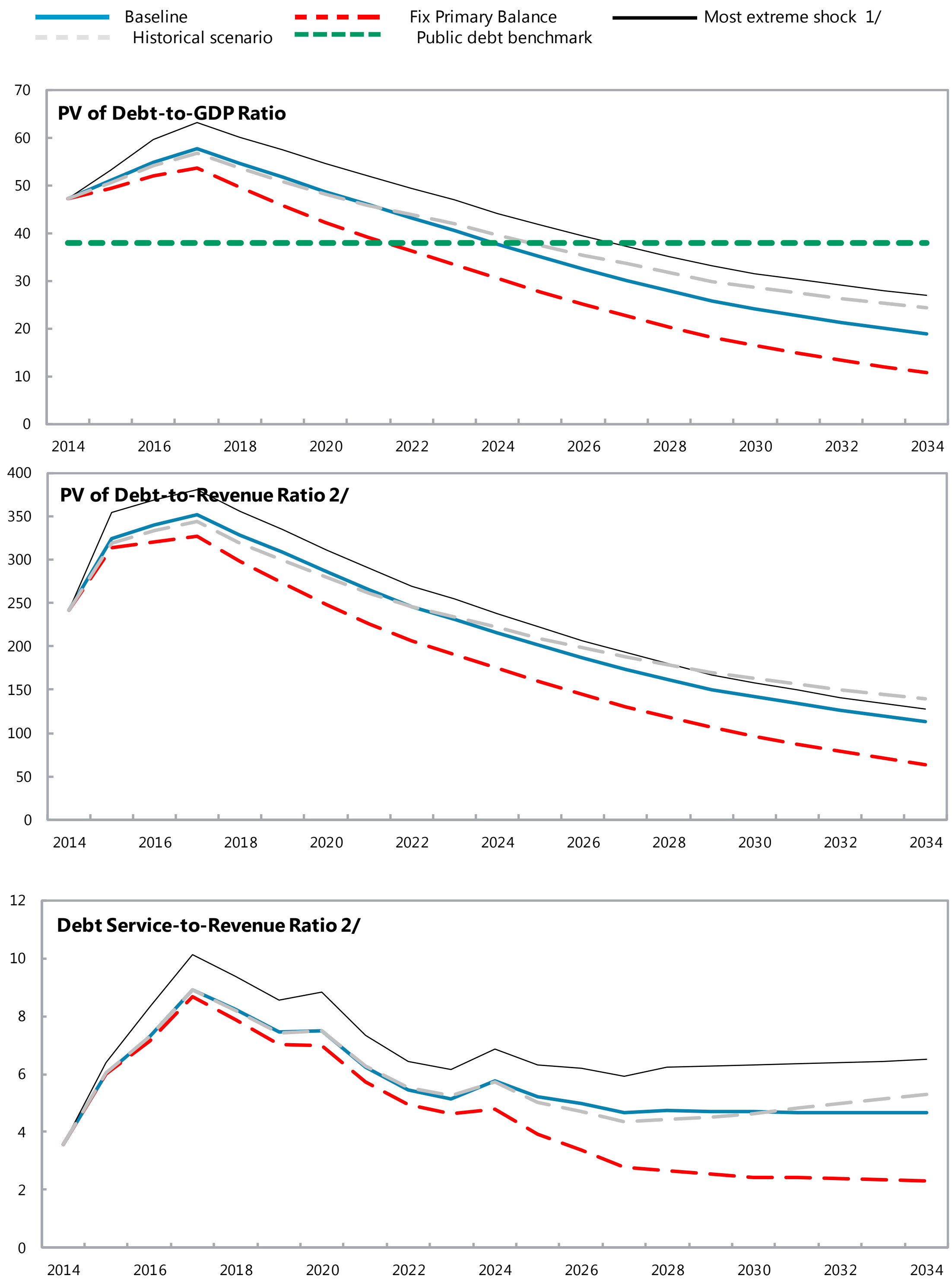
Figure 1. Guinea-Bissau: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2014–2034 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a Exports shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Guinea-Bissau: Indicators of Public Debt Under Alternative Scenarios, 2014–2034 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.
2/ Revenues are defined inclusive of grants.

Table 1 .Guinea-Bissau: External Debt Sustainability Framework, Baseline Scenario, 2011-2034 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical [6/]	Standard [6/]	Projections									
				Average	Deviation							2014-2019			2020-2034
	2011	2012	2013			2014	2015	2016	2017	2018	2019	Average	2024	2034	Average
External debt (nominal) 1/	**17.3**	**18.6**	**18.2**			**19.6**	**19.7**	**20.0**	**20.2**	**20.3**	**20.4**		**20.5**	**19.5**	
of which: public and publicly guaranteed (PPG)	17.3	18.6	18.2			19.6	19.7	20.0	20.2	20.3	20.4		20.5	19.5	
Change in external debt	4.4	1.2	-0.4			1.4	0.1	0.3	0.2	0.1	0.1		0.0	-0.1	
Identified net debt-creating flows	-5.0	6.6	2.6			-1.9	1.1	1.4	1.7	2.1	2.5		1.8	0.7	
Non-interest current account deficit	**0.2**	**4.6**	**4.0**	**3.0**	**3.9**	**0.3**	**3.8**	**4.4**	**4.9**	**5.4**	**5.7**		**5.2**	**4.4**	4.9
Deficit in balance of goods and services	5.5	9.5	8.2			10.5	10.5	10.8	11.1	11.4	11.5		10.1	8.0	
Exports	25.3	17.1	17.9			18.7	18.4	17.9	17.5	17.1	16.7		16.6	16.2	
Imports	30.8	26.5	26.1			29.2	28.9	28.7	28.6	28.5	28.2		26.7	24.2	
Net current transfers (negative = inflow)	-5.4	-4.9	-4.2	-8.6	3.0	-10.2	-6.7	-6.5	-6.2	-6.0	-5.8		-4.9	-3.6	-4.5
of which: official	-3.0	-1.9	-0.8			-6.3	-3.0	-2.9	-2.8	-2.8	-2.7		-2.5	-2.2	
Other current account flows (negative = net inflow)	0.0	0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Net FDI (negative = inflow)	**-2.2**	**-0.7**	**-1.5**	**-1.9**	**0.9**	**-1.9**	**-2.0**	**-2.4**	**-2.6**	**-2.7**	**-2.6**		**-2.7**	**-2.9**	-2.7
Endogenous debt dynamics 2/	**-2.9**	**2.6**	**0.0**			**-0.3**	**-0.6**	**-0.6**	**-0.6**	**-0.6**	**-0.6**		**-0.7**	**-0.7**	
Contribution from nominal interest rate	0.1	0.0	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.0	0.0	
Contribution from real GDP growth	-0.9	0.4	-0.1			-0.4	-0.7	-0.7	-0.7	-0.7	-0.7		-0.8	-0.7	
Contribution from price and exchange rate changes	-2.1	2.2	0.0			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**9.3**	**-5.3**	**-3.0**			**3.3**	**-1.1**	**-1.1**	**-1.5**	**-2.0**	**-2.4**		**-1.8**	**-0.9**	
of which: exceptional financing	-0.1	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/	...	...	9.0			10.0	10.1	10.4	10.6	10.8	10.9		11.6	11.5	
In percent of exports	...	...	50.4			53.3	54.7	57.9	60.5	62.9	65.4		69.9	71.1	
PV of PPG external debt	**...**	**...**	**9.0**			**10.0**	**10.1**	**10.4**	**10.6**	**10.8**	**10.9**		**11.6**	**11.5**	
In percent of exports	**...**	**...**	**50.4**			**53.3**	**54.7**	**57.9**	**60.5**	**62.9**	**65.4**		**69.9**	**71.1**	
In percent of government revenues	**...**	**...**	**104.4**			**87.7**	**95.2**	**94.4**	**94.4**	**94.0**	**93.5**		**91.2**	**91.8**	
Debt service-to-exports ratio (in percent)	**0.7**	**1.1**	**2.0**			**1.2**	**1.6**	**2.2**	**2.6**	**2.6**	**2.6**		**2.6**	**3.7**	
PPG debt service-to-exports ratio (in percent)	**0.7**	**1.1**	**2.0**			**1.2**	**1.6**	**2.2**	**2.6**	**2.6**	**2.6**		**2.6**	**3.7**	
PPG debt service-to-revenue ratio (in percent)	**1.8**	**2.0**	**4.1**			**2.0**	**2.8**	**3.5**	**4.1**	**3.8**	**3.6**		**3.4**	**4.8**	
Total gross financing need (Millions of U.S. dollars)	-20.3	39.4	27.8			-14.0	23.2	28.3	35.5	42.0	51.1		58.9	77.3	
Non-interest current account deficit that stabilizes debt ratio	-4.2	3.4	4.4			-1.1	3.7	4.0	4.7	5.3	5.6		5.2	4.5	

Table 1 .Guinea-Bissau: External Debt Sustainability Framework, Baseline Scenario, 2011-2034 1/ Cont.

(In percent of GDP, unless otherwise indicated)

Key macroeconomic assumptions															
Real GDP growth (in percent)	9.0	-2.2	0.3	3.1	2.9	2.5	4.0	3.7	3.7	3.7	3.7	3.6	4.0	4.0	4.0
GDP deflator in US dollar terms (change in percent)	19.3	-11.2	-0.2	4.6	11.0	5.7	2.0	2.8	3.2	3.1	3.1	3.3	2.5	2.5	2.5
Effective interest rate (percent) 5/	0.6	0.1	0.4	0.7	0.4	0.5	0.5	0.5	0.4	0.4	0.3	0.4	0.2	0.1	0.2
Growth of exports of G&S (US dollar terms, in percent)	84.1	-41.4	5.4	12.8	32.9	13.2	4.3	3.7	4.5	4.5	4.6	5.8	6.4	6.1	6.4
Growth of imports of G&S (US dollar terms, in percent)	13.6	-25.2	-1.2	10.0	14.7	21.2	4.7	6.1	6.6	6.4	5.7	8.5	5.5	5.6	5.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	53.3	60.7	52.4	52.4	52.4	52.1	53.9	50.5	50.5	50.7
Government revenues (excluding grants, in percent of GDP)	10.1	9.4	8.7			11.4	10.6	11.0	11.2	11.4	11.7		12.7	12.5	12.6
Aid flows (in Millions of US dollars) 7/	82.9	42.2	42.9			94.1	78.1	83.5	87.8	94.0	97.6		124.8	212.7	
of which: Grants	73.0	23.8	35.9			84.6	57.4	61.2	65.5	70.0	73.7		93.9	154.2	
of which: Concessional loans	9.9	18.5	7.0			9.4	20.7	22.3	22.2	24.0	23.9		30.9	58.6	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			9.3	6.2	6.2	6.2	6.1	6.0		5.6	4.9	5.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			90.2	90.4	87.4	87.3	87.9	87.6		87.1	85.7	86.8
Memorandum items:															
Nominal GDP (Millions of US dollars)	1104.7	959.4	961.1			1041.8	1105.0	1177.4	1260.1	1346.7	1439.3		1981.3	3754.2	
Nominal dollar GDP growth	30.1	-13.2	0.2			8.4	6.1	6.6	7.0	6.9	6.9	7.0	6.6	6.6	6.6
PV of PPG external debt (in Millions of US dollars)			89.7			102.5	111.5	122.6	133.8	145.3	158.0		230.3	433.0	
(PVt-PVt-1)/GDPt-1 (in percent)						1.3	0.9	1.0	1.0	0.9	0.9	1.0	0.9	0.7	0.8
Gross workers' remittances (Millions of US dollars)	22.3	24.3	28.5			32.6	33.2	33.7	34.3	34.9	35.5		38.6	45.7	
PV of PPG external debt (in percent of GDP + remittances)	...	...	8.8			9.7	9.8	10.1	10.3	10.5	10.7		11.4	11.4	
PV of PPG external debt (in percent of exports + remittances)	...	...	43.3			45.6	47.0	49.9	52.4	54.6	57.0		62.5	66.1	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	1.7			1.0	1.4	1.9	2.3	2.2	2.2		2.3	3.4	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

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

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

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

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

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

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

Table 2. Guinea-Bissau: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014-2034

(In percent)

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
PV of debt-to GDP ratio								
Baseline	10	10	10	11	11	11	12	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	10	10	9	9	8	7	4	4
A2. New public sector loans on less favorable terms in 2014-2034 2	10	11	11	12	13	13	16	18
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	10	10	11	11	12	12	12	12
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	10	12	16	16	16	16	16	13
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	10	11	12	13	13	13	14	14
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	10	11	12	13	13	13	13	12
B5. Combination of B1-B4 using one-half standard deviation shocks	10	12	15	15	15	15	15	14
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	10	14	15	15	15	16	16	16
PV of debt-to-exports ratio								
Baseline	53	55	58	61	63	65	70	71
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	53	52	52	50	47	43	24	22
A2. New public sector loans on less favorable terms in 2014-2034 2	53	58	64	69	74	79	94	113
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	53	55	58	61	63	66	70	71
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	53	87	153	157	161	165	164	139
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	53	55	58	61	63	66	70	71
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	53	60	70	72	75	77	80	75
B5. Combination of B1-B4 using one-half standard deviation shocks	53	65	86	88	91	94	96	89
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	53	55	58	61	63	66	70	71
PV of debt-to-revenue ratio								
Baseline	88	95	94	94	94	93	91	92
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	88	90	84	78	71	62	32	28
A2. New public sector loans on less favorable terms in 2014-2034 2	88	101	104	107	110	112	122	145
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	88	99	102	102	101	101	98	99
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	88	116	147	145	142	139	126	106
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	88	104	113	113	113	112	109	110
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	88	105	114	113	111	110	104	97
B5. Combination of B1-B4 using one-half standard deviation shocks	88	110	133	132	130	129	120	110
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	88	135	134	134	134	133	130	131

Table 2. Guinea-Bissau: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014-2034 (continued)

(In percent)

Debt service-to-exports ratio								
Baseline	1	2	2	3	3	3	3	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	1	2	2	3	3	3	2	2
A2. New public sector loans on less favorable terms in 2014-2034 2	1	2	2	3	3	4	4	7
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	1	2	2	3	3	3	3	5
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	1	2	4	6	6	6	9	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	1	2	2	3	3	3	3	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	1	2	2	3	3	3	4	5
B5. Combination of B1-B4 using one-half standard deviation shocks	1	2	3	4	4	4	5	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	1	2	2	3	3	3	3	5
Debt service-to-revenue ratio								
Baseline	2	3	4	4	4	4	3	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	2	3	4	4	4	4	3	2
A2. New public sector loans on less favorable terms in 2014-2034 2	2	3	4	5	5	5	5	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	2	3	4	5	5	4	4	6
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	2	3	4	5	5	5	7	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	2	3	5	5	5	5	5	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	2	3	4	5	4	4	5	6
B5. Combination of B1-B4 using one-half standard deviation shocks	2	3	4	5	5	5	6	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	2	4	5	6	6	6	6	8
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	50	50	50	50	50	50	50	50

Sources: Country authorities; and staff estimates and projections.

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

Table 3. Guinea-Bissau: Public Sector Debt Sustainability Framework, Baseline Scenario, 2011-2034

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034	2020-34 Average
	0.6	2.1	1.7			-0.4	3.1								
Public sector debt 1/	43.7	49.2	53.7			56.8	60.7	64.6	67.4	64.2	61.3		46.5	26.9	
of which: foreign-currency denominated	17.3	18.6	18.2			19.6	19.7	20.0	20.2	20.3	20.4		20.5	19.5	
	26.4	30.6	35.5			37.2	41.0	44.6	47.2	43.9	40.9		26.1	7.4	
Change in public sector debt	-0.2	5.4	4.5			3.1	3.9	3.9	2.8	-3.2	-2.9		-3.0	-1.1	
Identified debt-creating flows	-25.4	5.2	2.7			-3.3	-0.3	-0.7	-1.0	-1.6	-1.7		-2.4	-1.0	
Primary deficit	0.6	2.1	1.7	1.0	3.3	-0.4	3.1	2.4	2.2	1.8	1.6	1.8	0.3	0.6	0.4
Revenue and grants	16.7	11.9	12.4			19.5	15.8	16.2	16.4	16.6	16.8		17.5	16.6	
of which: grants	6.6	2.5	3.7			8.1	5.2	5.2	5.2	5.2	5.1		4.7	4.1	
Primary (noninterest) expenditure	17.3	14.0	14.1			19.1	18.9	18.5	18.6	18.4	18.4		17.7	17.3	
Automatic debt dynamics	-8.3	3.1	1.0			-2.4	-3.4	-3.1	-3.1	-3.4	-3.2		-2.7	-1.7	
Contribution from interest rate/growth differential	-7.1	2.0	0.9			-2.5	-3.1	-2.9	-2.9	-3.2	-3.1		-2.6	-1.6	
of which: contribution from average real interest rate	-3.5	1.0	1.0			-1.2	-0.9	-0.7	-0.6	-0.8	-0.8		-0.7	-0.5	
of which: contribution from real GDP growth	-3.6	1.0	-0.2			-1.3	-2.2	-2.2	-2.3	-2.4	-2.3		-1.9	-1.1	
Contribution from real exchange rate depreciation	-1.2	1.1	0.1			0.1	-0.3	-0.2	-0.2	-0.2	-0.2		...	...	
Other identified debt-creating flows	-17.7	0.0	0.0			-0.5	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-17.7	0.0	0.0			-0.5	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	25.2	0.2	1.8			6.5	4.2	4.6	3.8	-1.7	-1.2		-0.6	-0.1	
Other Sustainability Indicators															
PV of public sector debt	...	...	44.5			47.2	51.1	54.9	57.8	54.6	51.8		37.7	18.9	
of which: foreign-currency denominated	...	...	9.0			10.0	10.1	10.4	10.6	10.8	10.9		11.6	11.5	
of which: external	...	...	9.0			10.0	10.1	10.4	10.6	10.8	10.9		11.6	11.5	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	7.6	8.9	8.9			6.4	9.8	8.6	8.2	7.2	6.4		3.1	1.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	358.8			241.9	324.0	339.4	352.0	328.3	307.9		215.8	113.6	
PV of public sector debt-to-revenue ratio (in percent)	...	...	513.7			414.7	483.3	499.9	515.2	477.5	442.5		296.3	150.9	
of which: external 3/	...	...	104.4			87.7	95.2	94.4	94.4	94.0	93.5		91.2	91.8	
Debt service-to-revenue and grants ratio (in percent) 4/	2.3	4.5	6.3			3.6	6.0	7.3	8.9	8.2	7.5		5.8	4.7	
Debt service-to-revenue ratio (in percent) 4/	3.8	5.7	9.0			6.1	8.9	10.8	13.1	12.0	10.7		7.9	6.2	
Primary deficit that stabilizes the debt-to-GDP ratio	0.8	-3.3	-2.8			-3.6	-0.8	-1.5	-0.7	5.0	4.5		3.3	1.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	9.0	-2.2	0.3	3.1	2.9	2.5	4.0	3.7	3.7	3.7	3.7	3.6	4.0	4.0	4.0
Average nominal interest rate on forex debt (in percent)	0.6	0.1	0.4	0.7	0.4	0.5	0.5	0.5	0.4	0.4	0.3	0.4	0.2	0.1	0.2
Average real interest rate on domestic debt (in percent)	-11.7	4.7	4.0	-1.8	6.1	-2.9	-1.9	-1.2	-0.8	-1.0	-1.0	-1.4	-1.4	-1.7	-1.5
Real exchange rate depreciation (in percent, + indicates depreciation	-10.0	6.4	0.5	-1.2	7.4	0.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	13.8	-3.9	-3.4	2.6	6.5	3.7	2.8	2.2	2.3	2.4	2.4	2.6	2.5	2.5	2.5
Growth of real primary spending (deflated by GDP deflator, in percer	2.4	-21.1	1.1	-1.7	6.8	38.9	2.9	1.8	3.8	3.0	3.4	9.0	3.7	3.8	3.6
Grant element of new external borrowing (in percent)	...	...	...	...	...	53.3	60.7	52.4	52.4	52.4	52.1	53.9	50.5	50.5	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

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

3/ Revenues excluding grants.

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

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

Table 4. Guinea-Bissau: Sensitivity Analysis for Key Indicators of Public Debt 2014-2034

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
PV of Debt-to-GDP Ratio								
Baseline	47	51	55	58	55	52	38	19
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	47	51	54	57	54	51	40	24
A2. Primary balance is unchanged from 2014	47	49	52	54	50	46	30	11
A3. Permanently lower GDP growth 1/	47	51	56	59	56	54	42	28
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	47	53	60	63	60	57	44	27
B2. Primary balance is at historical average minus one standard deviations in 2015-201	47	52	56	59	56	53	39	20
B3. Combination of B1-B2 using one half standard deviation shocks	47	52	57	60	57	55	41	23
B4. One-time 30 percent real depreciation in 2015	47	55	58	60	57	53	38	17
B5. 10 percent of GDP increase in other debt-creating flows in 2015	47	56	60	62	59	56	41	21
PV of Debt-to-Revenue Ratio 2/								
Baseline	242	324	339	352	328	308	216	114
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	242	320	333	344	319	299	221	139
A2. Primary balance is unchanged from 2014	242	313	321	327	298	272	174	64
A3. Permanently lower GDP growth 1/	242	326	343	358	336	317	236	166
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	242	333	360	376	353	334	248	159
B2. Primary balance is at historical average minus one standard deviations in 2015-201	242	328	349	361	337	316	223	118
B3. Combination of B1-B2 using one half standard deviation shocks	242	328	349	363	340	321	233	139
B4. One-time 30 percent real depreciation in 2015	242	347	359	368	341	318	217	102
B5. 10 percent of GDP increase in other debt-creating flows in 2015	242	355	369	380	355	334	238	127
Debt Service-to-Revenue Ratio 2/								
Baseline	4	6	7	9	8	7	6	5
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	4	6	7	9	8	7	6	5
A2. Primary balance is unchanged from 2014	4	6	7	9	8	7	5	2
A3. Permanently lower GDP growth 1/	4	6	7	9	8	8	6	6
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-20	4	6	8	9	9	8	6	6
B2. Primary balance is at historical average minus one standard deviations in 2015-201	4	6	7	9	8	8	6	5
B3. Combination of B1-B2 using one half standard deviation shocks	4	6	8	9	9	8	6	6
B4. One-time 30 percent real depreciation in 2015	4	6	8	10	9	9	7	6
B5. 10 percent of GDP increase in other debt-creating flows in 2015	4	6	8	9	9	8	7	6

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

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Washington, D.C. 20431 USA

IMF Executive Board Approves US$5.24 million Disbursement Under the Rapid Credit Facility for Guinea-Bissau

The Executive Board of the International Monetary Fund (IMF) approved today emergency financial assistance under the Rapid Credit Facility (RCF)[1] equivalent to SDR3.55 million (about US$5.24 million) for Guinea-Bissau to enable the authorities to meet their urgent balance of payment and fiscal needs. The Board's approval enables the immediate disbursement of the full amount, which is equivalent to 25 percent of Guinea Bissau's quota in the IMF.

The IMF financial assistance is aimed at restoring macroeconomic stability. It will help address urgent budgetary and balance of payments gaps, reduce poverty by resuming key government services and strengthen the capacity of the government of Guinea-Bissau. The Board's approval of the RCF disbursement will also enable the authorities to engage in discussions with development partners' regarding further assistance.

The newly elected government inherited very difficult conditions. After two years of economic disruption, eroded government revenues, a compression in social spending and accumulated external and domestic arrears, real gross domestic product (GDP) fell by 2 percent and poverty increased markedly. In its first months, the new government started to rebuild government revenues, which, together with renewed donor assistance and the placement of treasury bills in the regional market, allowed for the elimination of almost all salary arrears. Economic activity is projected to gradually recover and grow by 2.5 percent in 2014.

[1] The RCF provides immediate financial assistance with limited conditionality to low-income countries with an urgent balance of payments need. In this context, the economic policies of a member receiving RCF financing are expected to address the underlying balance of payments difficulties and support policy objectives including macroeconomic stability and poverty reduction. Financing under the RCF carries zero interest (until end 2014), has a grace period of 5.5 years, and a final maturity of 10 years. The Fund reviews the level of interest rates for all concessional facilities every two years.

Following the Executive Board discussion on Guinea-Bissau[2], Mr. Min Zhu, Deputy Managing Director and Acting Chair, issued the following statement:

"The newly-elected government of Guinea-Bissau is taking action to confront the country's economic and social challenges. After two years of economic disruption and worsening fiscal imbalances, the authorities have resumed many of the basic government functions, approved the 2014 budget, and cleared most of wage arrears incurred since 2013.

"To maintain macroeconomic stability, the government must continue with a prudent fiscal policy that limits spending to available resources and prioritizes it carefully. Clearing the still outstanding domestic arrears of 2013 and 2014 and all external arrears by year-end will be an important step to support the recovery. Going forward, the authorities should focus on preventing re-emergence of arrears by avoiding extra-budgetary expenditures and improving cash management. In this regard, the reinstatement of the treasury committee and the preparation of cash management plans are steps in the right direction.

"International financial support for Guinea-Bissau needs to be complemented by further efforts to mobilize domestic revenues and strengthen public financial management. Technical assistance from development partners to prioritize fiscal reforms, and boost implementation capacity will be crucial in the period ahead.

"The government's intention to audit the operations of the national cashew fund is welcome. Abolition of this fund would have an immediate beneficial impact on household consumption. The authorities will need to elaborate more efficient and pro-poor alternatives to support agriculture and the cashew sector.

"The medium-term prospects for poverty reduction and economic development in Guinea Bissau hinge on addressing pervasive economic and political vulnerabilities. In addition to the security sector reform, this calls for structural reforms on a broad front to diversify the economy and improve governance and the business environment."

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/eternal/np/sec/misc/qualifiers.htm.

Statement by Ngueto Tiraina Yambaye, Executive Director for Guinea-Bissau
November 3, 2014

Introduction

My Bissau-Guinean authorities express their deep appreciation to the Executive Board, Management and Staff for the support they are receiving from the Fund in the wake of the legislative and presidential elections held in April and May 2014 marking the return to constitutional order. They are appreciative of the meeting the President Jose Mário Vaz held with Management early last August on the daunting challenges facing Guinea-Bissau and the Fund's role in their efforts to address these challenges. Cognizant of the sizable economic difficulties resulting from the transitional period, my Bissau Guinean authorities are strongly committed to restore macroeconomic stability, put the economy on the road of higher and sustained growth and make significant progress in reducing poverty.

In order to achieve these objectives in a context of limited capacities, the Bissau Guinean authorities are seeking the technical and financial assistance of the international community, including the IMF. In this regard, the authorities are requesting Fund support under the Rapid Credit Facility (RCF) to address the urgent balance of payments and financing needs for 2014. This financial support will also catalyze the resumption of donor's assistance and pave the way for the implementation of a comprehensive program of structural reforms under a medium-term program for which they intend to request Fund support under the Extended Credit Facility (ECF). The authorities plan to organize a Donors' Roundtable during the first half of 2015 to mobilize the external financing needed to execute the authorities' development programs.

Recent Economic Developments

Guinea-Bissau experienced a very difficult situation after the coup d'état that occurred in April 2012. It translated into severe disruptions of economic activities and public services, sharp decrease in government revenues, tight compression in social spending and large accumulation of domestic and external arrears. These developments caused economic growth to contract by 2. 2 percentage points in 2012 and to stagnate in 2013. Moreover, the sharp drop of cashew prices by 21 percent in 2013 led to the decline of cashew exports which account for more than two thirds of exports earnings and tax revenue.

The severe decrease in tax revenue and external support led the authorities to cut expenditures. However, despite this effort of adjustment to lower revenues, the overall fiscal balance, excluding grants, deteriorated further from 4.8 percent in 2012 to 5.7 percent of GDP in 2013. Besides this, payments delays continued to build up and reached 2 percent of GDP at the end of 2013.

After rising by 1.6 percent in 2012, inflation is on a declining trend since 2013 and registered a -1.1 percent last August. In addition, the sharp decline of cashew exports over the recent years has led to a significant increase in the ratio of non-performing loans.

Short-Term Measures

Mindful of the urgent need to reverse this severe deterioration in the economic and financial situation while restoring key administrative functions, the authorities have implemented, since they took office in July, bold measures to secure the newly retrieved internal stability and create favorable conditions for a reform program. Based on the peaceful restoration of constitutional order and strong consensus on the needed reforms, the authorities have adopted a prudent budget for 2014 and taken important measures to normalize the budget procedures including the establishment of a Treasury Committee for the daily cash flow management. They will also set up a high–level Treasury Committee made up of Bissau-Guinean and representatives of donors to set, in particular, spending priorities. The authorities have also established an Exemption Committee to streamline the use of tax exemptions which bear a high fiscal cost to the budget.

The authorities have acted rapidly to clear the salary arrears with a view to stimulate the economy and restore confidence. In this regard, they successfully issued Treasury Bills of CFA Francs 15 billion purchased by both residents and non-residents. This T-Bills issuance together with the World Bank budget support, helped clear salary arrears and significantly reduced the volume of payment arrears.

With the implementation of these measures, the authorities have demonstrated their strong determination to resume normal operations, enhance macroeconomic stability and build a solid foundation for the economy. This implementation has also led bilateral and multilateral donors to resume their financial assistance suspended after the political crisis in April 2012. In this context, the European Union and the authorities have reached an agreement for resumption of fishing compensation payments. The authorities are hopeful that the donors' roundtable scheduled for 2015 will garner full support from all their development partners. In this respect, they will be grateful for Fund's active participation.

In addition, remarkable progress has been made in moving forward the security sector reform which is defined as a sine qua non condition to political and economic stability in Guinea-Bissau. After the replacement of the Chief of Staff of the Armed Forces last September, the authorities plan to mobilize the reform's financing, notably the pension fund and payments of bonuses with the help of international partners.

Medium-Term Policies and Reforms

Following the restoration of fiscal discipline and normalization of government operations as well as the adoption of a prudent budget for 2014, the authorities' efforts will focus on implementing required structural reforms to solve protracted fiscal difficulties and creating conducive conditions for a sustained economic growth. Given the heavy capacity constraints facing the country, the authorities will seek adequate technical assistance from the Fund and other development partners to help design and successfully carry out these reforms.

In the **fiscal sector**, the authorities will aim at increasing fiscal revenues through structural reforms in public finance management, payroll management, tax and customs administration and debt management. Reforms in these areas and the work expected to be done by the exemption committee on tax exemptions will help enlarge the tax base as well as the GDP/tax collection ratio to the level of peers' countries.

Concerning the **financial sector**, the authorities with the support of the Fund and other partners will identify optimal solutions to the large volume of non-performing loans plaguing the economy. In this regard, discussions are underway with the *Banque Ouest Africaine de Developpement* (BOAD) for the securitization of these banking loans. The authorities plan also to adopt needed measures to increase access to the banking system given that only a small segment of the population has access to bank services. The measure related to the payment of salaries through the banking system is helpful in this regard. Moreover, measures to improve the education and legal systems, legislation to recover loans and the creation of a credit rating agency as well as strengthening payment and settlement system will be implemented to further broaden and enhance the financial system.

On the improvement of the **business environment**, the authorities will increase their efforts through the reduction of the cost of doing business and the promotion of the rule of law with a view to create a stable and foreseeable environment attracting further private investment. In the same vein, the authorities will increase the efficiency of public enterprises notably in water and electricity sectors. To this end, strategies envisaged will include improvements in management and operational efficiency as well as reduction of waste which could imply realignments of tariffs to levels compatible with the cost of maintenance and amortization of investment.

With regard to the cashew sector which provides the bulk of export receipts, the authorities are determined to reverse the loss of tax revenue and its perverse effect on poverty. To this end they will conduct an external audit of the FUNPI in order to assess its functioning, efficacy and the use of its resources. They will also explore all possibilities leading to more efficient and better targeted initiatives to support cashew production and domestic transformation. The authorities are also determined to diversify the production and exports base to reduce the economy's dependence on the cashew sector. They will promote the exploitation of the country's natural resources including the assessment of contracts for prospection and exploitation of bauxite, phosphates, oil and heavy sands.

With regard to the outbreak of the Ebola virus epidemic in West Africa, there are no cases registered in Guinea-Bissau. However, the authorities have prepared a contingency plan estimated at US$ 5 million. As precautionary measures, they have also closed their borders with the affected countries and are building up stocks of the main imported staples to avoid any interruption in the supply chain.

Conclusion

Over the recent years, the economic activities in Guinea-Bissau have been severely affected by the political instability and the significant drop of cashew prices. Based on the peaceful restoration of the constitutional order and the large consensus of all parties to move the country forward, the Bissau Guinean authorities are strongly committed to create the conducive environment for a sustained and higher economic growth. In this regard, they are grateful for the support received from the Fund and other development partners. They are hopeful that this support will continue given the limited resources and heavy capacity constraints they face. On their behalf, I would appreciate the Board's support for the Fund's assistance under the Rapid Credit Facility. It is also my authorities' hope that Fund's assistance will continue under an ECF-supported program as well as through scaled up technical assistance.

Mr. Chodos and Mr. Corvalan Mendoza submitted the following statement:

Guinea-Bissau's political transition is advancing and the medium-term economic outlook is heavily dependent on reform implementation to maintain debt at sustainable levels. The country benefited from the implementation of Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief initiative (MDRI) in 2010 and 2011 respectively, which helped reduce the ratio of public and publicly guaranteed debt levels to a sustainable path, and we support the authorities' request for disbursement under the Rapid Credit Facility.

We concur with the main thrust of the staff appraisal on structural challenges needed to boost private sector development and welcome the authorities' commitment to the reform agenda to promote macroeconomic stability, given the political transition and security related issues. Positive signals to market participants should boost domestic and foreign investor confidence in the economy, as much as consumer behavior and donor support to the country's development needs. Rapid Credit Facility disbursements together with donor support are projected to close the financing needs of the government budget.

We welcome the authorities' swift implementation of a prudent budget for 2014 in order to impose fiscal discipline, and also the preparation of the 2015 budget in line with prudent expectations of resources. We understand a large residual financing gap for 2015 will be a challenge for the authorities; therefore, this chair supports all the technical assistance from the Fund and other international and regional organization to help meet the country's needs. Donor support to the budget is important for public investment and social spending, given the compression in these two spending components in recent years and the need to formulate a short and medium-term strategy to address the country's development plan, is understandable. We encourage the authorities to persist on the structural reform agenda already identified for the country, in order to materialize positive outcomes in the short and medium term.

It will be a positive economic outcome to improve the regulatory framework of the financial sector in the near future. The limited exposure of financial institutions to the private sector through loans is 14 percent. Nevertheless, much of these loans are oriented to the cashew sector or public enterprises, whereas only 1 percent of households have access to banking services. Broadening financial intermediation will benefit a bigger proportion of the population. The transformation of savings to private consumer credit or private investment is almost inexistent and restrains the ability of the economy to work properly. Moving swiftly to adhere to international best practices for the regulation and supervision of the financial system, as well as strengthening anti-money laundering policies, might improve market confidence in the economy and further motivate private sector involvement in the country's activity.

With these comments, we thank Mr. Yambaye for his informative Buff statement, the staff for its report, and wish the authorities and people of Guinea-Bissau every success in their future endeavors.