

**EXECUTIVE  
BOARD  
MEETING**

EBS/22/42  
Correction 2

June 24, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **Cabo Verde—Request for an Arrangement Under the Extended Credit Facility**

Board Action: The attached corrections to EBS/22/42 (6/3/22) have been provided by the staff:

**Evident Ambiguity** **Pages 40 and 43**

**Factual Errors Not Affecting the Presentation of Staff's Analysis or Views:** **Pages 9 and 22**

Questions: Mr. Darius, AFR (ext. 34085)



authorities' strategic plan for sustainable development (PEDS). The current account deficit is projected to narrow to about 4 percent of GDP in the medium term supported by fiscal consolidation, strong tourism performance, and higher remittances reflecting labor market improvements in advanced economies. This will help international reserves recover and stabilize at slightly above 5 months of prospective imports. The primary fiscal balance would improve by about 1 percentage point of GDP per year over the medium-term reflecting revenue mobilization and expenditure restraint. This would contribute to a substantial decline in the stock of public debt from 143 percent of GDP in 2021 to about 110 percent of GDP by 2027. Over the long term, GDP growth is projected at about 4½ percent, broadly in line with potential growth.

**16. However, the medium-term outlook is also subject to substantial risks.** The main downside risk relates to the evolution of the pandemic and its impact on the external sector through a possible decline in tourism (Annex III), as well as significant increases in fuel and food prices and tighter financial conditions owing to the Ukraine war. Other external risks include the de-anchoring of inflation expectations in advanced economies and vulnerability to natural disasters (including those associated from climate change). Domestic risks could stem from insufficient progress in fiscal consolidation and SOE reforms, and possible delays in implementing structural reforms to increase productivity and diversify the economy. On the upside, faster than expected global containment of the pandemic could support a faster recovery of tourism and strengthen the pace of the economic recovery.

**17. The authorities agreed with staff's assessment of Cabo Verde's medium-term outlook and risks (MEFP, ¶12).** They stressed uncertainties regarding the impact and duration of the Ukraine war as a significant risk to the medium-term outlook. Within this context, the BCV viewed the projected gross international reserves cover as an important buffer. On the medium term, they stressed that the economy's growth potential is high, and idle resources remain as the economy returns to pre-pandemic level of output. In that regard, they saw significant upside risk to the medium-term growth projections supported by targeted growth enhancing structural reforms.

## THE EXTENDED CREDIT FACILITY

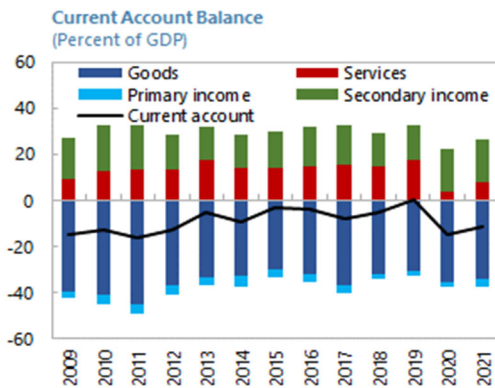
### A. Program Objectives and Policies

**18. The objectives of the program are aligned with the government's medium-term economic development plan (PSEDS) and include:**

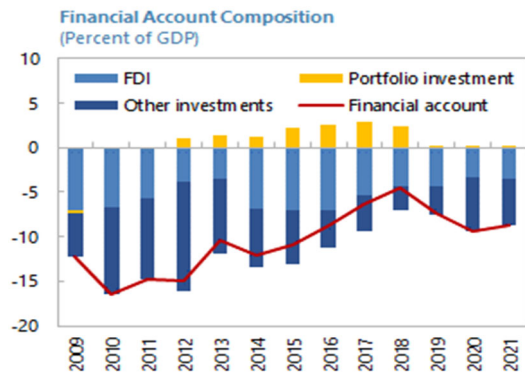
- Strengthening public finances to preserve public debt sustainability and expand social safety nets.
- Reduce fiscal risks from public enterprises and improving their financial management and transparency.
- Modernizing the monetary policy framework and improving the resilience of the financial system.

**Figure 2. Cabo Verde: External Sector Developments**

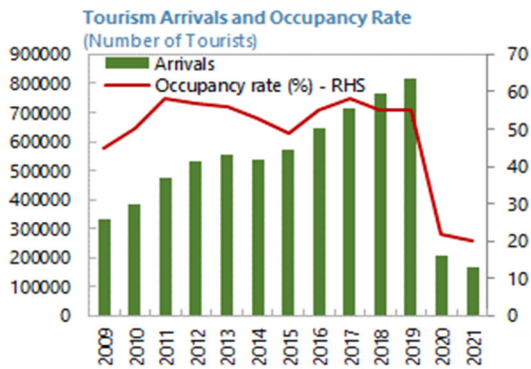
The current account deficit improves in 2021 in line with tourism recovery.



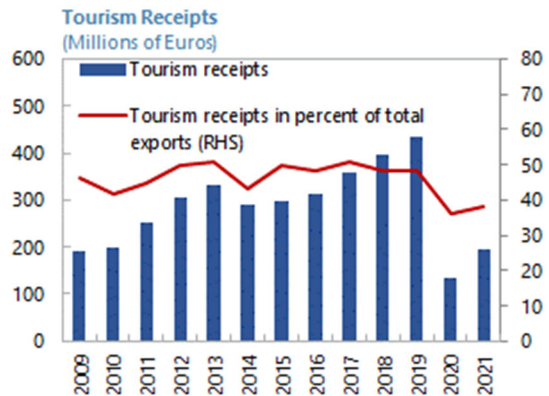
The financial account improved reflecting increased FDI.



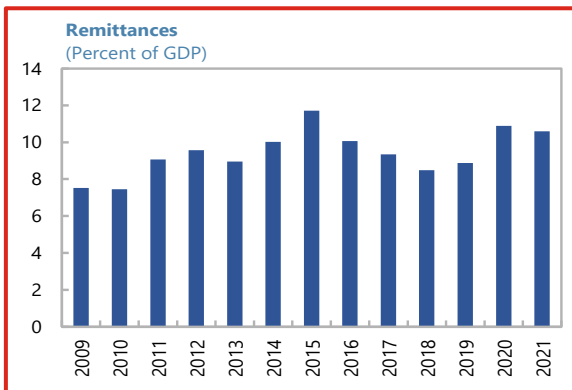
Tourism arrivals increased but remain well below pre pandemic levels.



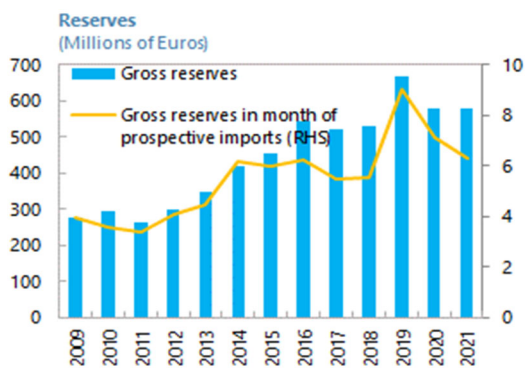
As a result, tourism receipts have only been increasing modestly.



Remittances declined slightly in 2021 compared to 2020 levels and remain an important source of foreign currency...



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



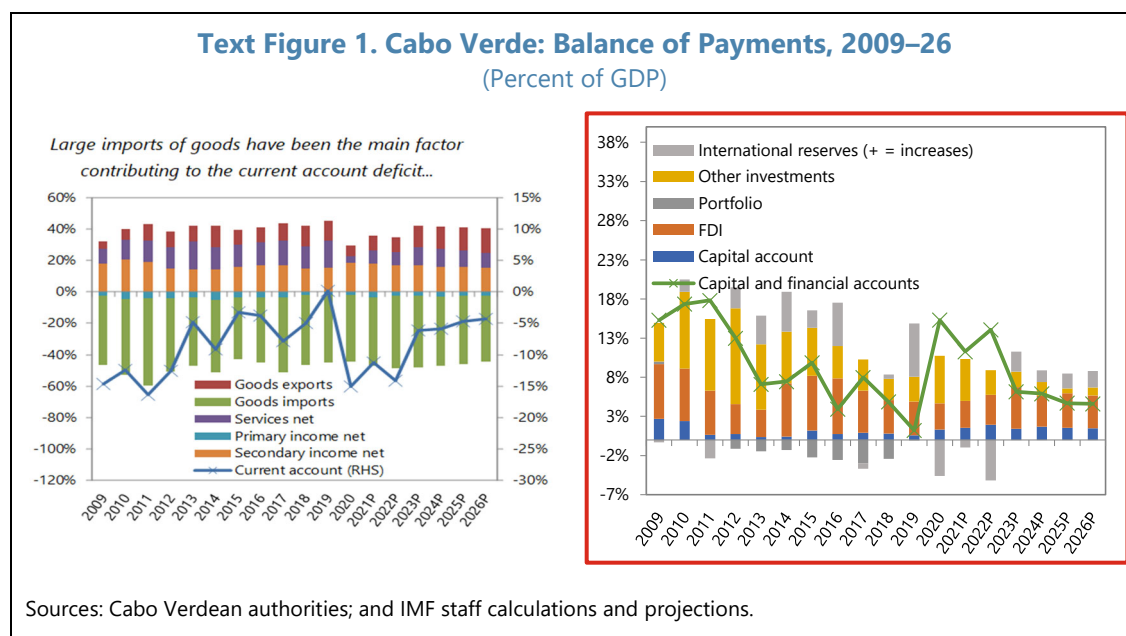
Sources: Cabo Verdean authorities; and IMF staff estimates.

## Annex IV. External Sector Assessment

Cabo Verde's external position in 2021 is assessed as substantially stronger than the level implied by fundamentals and desirable policy settings, which points to an undervaluation of the exchange rate. The high and negative net international investment position is a source of vulnerability, but the risks that it poses are partly contained by the structure of Cabo Verde's external liabilities, largely composed of FDI and long-term debt. Reserve adequacy is assessed as satisfactory, with actual reserve levels (6.3 months of imports) comfortably above the IMF LIC/MIC framework optimal level (about 3.7 months). Cabo Verde's business environment has improved in recent years, but continued structural reforms remain critical to enhance competitiveness.

### A. Current Account

**1. Background.** The negative effects of the COVID-19 pandemic resulted in the current account deficit widening from 0.4 per cent in 2019 to 15.0 percent of GDP in 2020 (Text Figure 1). This reflected a large contraction in the exports of goods and services, largely driven by a 69.1 percent decline in tourism receipts. The large contraction in the exports of goods and services growth more than offset the 23.2 percent fall in imports of goods and services. Financial flows covered the largest share of the current account deficit in 2020. The current account deficit is estimated to have narrowed to 11.3 percent of GDP in 2021 (as export growth, tourism and remittances recover) but widens in 2022 as the war in Ukraine reverses the earlier gains. It is, however, projected to narrow and improve to 4.2 percent of GDP by 2027 supported by the expansion of tourism and the implementation of the fiscal consolidation program.



**2. Assessment.** The EBA-lite methodology is based on the current account (CA) model from a panel regression of the current account which generates an estimated "norm" consistent with medium-term fundamentals and desirable policies. The CA model shows that the cyclically

**Text Table 2. Cabo Verde: Global Competitive Indicators, 2019**  
0–100 (best)

	2018	2019	Change <sup>1</sup>
Overall score	50.2	50.8	0.6
<b>Enabling environment component</b>	55.8	54.9	-0.9
Institutions	51.5	51.2	-0.3
Infrastructure	54.7	53.7	-1.0
ICT adoption	48.1	44.7	-3.4
Macroeconomic stability	68.9	70.0	1.1
<b>Human capital component</b>	62.8	67.0	4.2
Health	75.6	80.8	5.2
Skills	53.3	53.2	-0.1
<b>Markets components</b>	46.2	46.9	0.7
Product market	52.8	50.1	-2.7
Labour market	57.6	61.4	3.8
Financial system	57.3	58.5	1.2
Market size	17.1	17.5	0.4
<b>Innovation ecosystem component</b>	32.7	34.4	1.7
Business dynamism	44.0	44.0	0.0
Innovation capability	21.4	24.8	3.4

Sources: World Economic Forum, Global Competitiveness Index.

<sup>1</sup>Negative sign indicates decrease in score.

## G. Overall Assessment and Recommendations

**13. Results from staff’s assessment of Cabo Verde’s external position in 2021 suggest that the exchange rate might be slightly undervalued.** The three methodologies used: the external sustainability approach, the EBA-lite methodology based on the current account model and, the REER model point to an undervaluation of the real effective exchange rate. Nevertheless, the results should be interpreted with care as the degree of overundervaluation is relatively modest and the country has large external liabilities that suggest the external position remains highly vulnerable to shocks.

**14. Sustained medium-term fiscal consolidation and structural reforms are needed to support improvements in the external position.** Fiscal adjustment is expected to help lower external liabilities and support medium-term external sustainability. Continued implementation of structural reforms is also needed to reduce transaction costs, increase labor market flexibility, boost productivity, and support private sector development. Although the current level of reserves is assessed as adequate based on results from the application of the IMF LIC/MIC framework, building strong external buffers is critical given existing vulnerabilities, and the need to protect the peg.