FOR AGENDA

EBS/07/132

November 30, 2007

To: Members of the Executive Board

From: The Secretary

Subject: **Cape Verde—Third Review Under the Policy Support Instrument**

Attached for consideration by the Executive Directors is a paper on the third review under the Policy Support Instrument for Cape Verde, which is tentatively scheduled for discussion on **Friday, December 21, 2007**. A draft decision appears on pages 16–18. At the time of circulation of this paper to the Board, the Secretary's Department has received a communication from the authorities of Cape Verde indicating that they consent to the Fund's publication of this paper.

Questions may be referred to Mr. Leigh (ext. 36518), Mr. Maehle (ext. 36499), and Mr. Castro (ext. 38028) in AFR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Monday, December 10, 2007; and to the African Development Bank, the European Commission, and the European Investment Bank, following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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CAPE VERDE

Third Review Under the Policy Support Instrument

Prepared by the African Department

(In consultation with other departments)

Approved by David Andrews and Mark Plant

November 29, 2007

- **Main topics:** The report recommends waivers for the nonobservance of two assessment criteria and completion of the third review under the Policy Support Instrument (PSI) and summarizes the main macroeconomic and structural reform policies for 2008.
- **PSI:** The Board completed the second PSI review on May 7, 2007. Program objectives include reducing public debt, building up international reserves, improving public financial management, and strengthening financial sector and energy sector regulation.
- **Discussions:** The mission met with Cristina Duarte, Minister of Finance and Public Administration; Carlos A. de Burgo, Governor of the Bank of Cape Verde; other officials; and representatives of commercial banks and the energy sector. The mission team comprised Mr. MacFarlan (outgoing mission chief), Mr. Leigh (incoming mission chief), Mr. Maehle, Mr. Castro, and Mr. Shanghavi (all AFR). Mr. Sembene of the Executive Director's Office and Ms. Francisco of the World Bank accompanied the mission.
- **Exchange rate regime:** Cape Verde's de facto and de jure exchange rate arrangement is a conventional peg fixed to the euro.

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EXECUTIVE SUMMARY

Cape Verde's strong performance continues under the PSI program and staff recommends completion of the third review.

- *GDP growth remains strong, unemployment and poverty rates are falling, inflation pressures remain contained and all quantitative assessment criteria for end-June 2007 were met comfortably*. The robust growth is expected to continue over the medium term driven by the tourism boom and related foreign direct investment (FDI) flows.

- *Fiscal consolidation and the build-up of official reserves have proceeded faster than program expectations.* The initial projections for both domestic debt and official reserves for 2009 are likely to be reached in 2008.

- *However, performance on structural reforms has been mixed and two assessment criteria were missed.* The new mechanism for setting base utility tariffs was not implemented and the mechanisms for adjusting utility and fuel prices were not applied. On the basis of remedial measures taken by the authorities, staff recommends granting waivers for the two missed structural assessment criteria.

Key Issues and Policy Discussions for the 2008 program under the PSI

- *Staff supports the main thrust of the authorities' 2008 budget which is based on conservative revenue forecasts and measured expenditure growth.* Beyond 2008, staff notes that the authorities should consider further fiscal consolidation to ensure that domestic demand growth allows for the reserve buildup and thereby reduce vulnerabilities to shocks. The authorities broadly concurred, and also expressed their intention to consider using some of the fiscal space for modest tax cuts and to scale up capital spending to ease infrastructure bottlenecks.

- *Progress is being made to address the long-standing weaknesses in public sector financial management* to improve budget execution and monitoring.

- *The authorities are committed to move more rapidly on a comprehensive energy sector reform* to improve utility and petroleum pricing mechanisms and encourage investment in the sector to reduce fiscal risk and support growth.

Uncertainties and risks remain

More flexible factor and product markets would enhance the ability of the economy to adjust to shocks; the recent decline in the flow of emigrant deposits provides challenges for monetary management; and there is need for large-scale investment to enable energy sector and infrastructure growth to keep pace with economic development.

I. Strong Economic and Policy Performance but Challenges Remain

1. **Cape Verde is at an important point in its history.** Since 2001 disciplined macroeconomic management, more recently under the Policy Support Instrument (PSI), has yielded significant fiscal consolidation and supported strong economic growth with generally low inflation. Reflecting this solid performance, Cape Verde will graduate from the UN least-developed-country (LDC) status in early 2008.[1] While this graduation has benefits, it also brings challenges: Cape Verde will have to prepare to become less dependent on aid. Thus, the key goal of the PSI is to help the country prepare for the opportunities and challenges associated with its graduation from LDC status in 2008.

2. **To further the reform agenda, discussions during the third review of the PSI focused on:**

- ***Consolidating macroeconomic stability gains*** *to support reserves buildup and reduce vulnerabilities to shocks including the expected decline in concessional external financing;*
- ***Improving public sector financial management*** *to enhance budget execution and monitoring;*
- ***Accelerating energy sector reform*** *to reduce fiscal risk and support growth; and*
- ***Enhancing financial sector reform*** *to safeguard stability and enhance growth prospects.*

II. Current Economic Setting and Outlook and Performance Under the PSI

3. **Real GDP growth reached nearly 11 percent in 2006, the unemployment rate has declined, and fiscal and external positions have strengthened significantly.**

- **Growth has improved.** Official data shows real GDP growth for 2006 of nearly 11 percent, the highest in almost a decade. Growth was particularly strong in tourism, telecommunications, and construction. Robust growth of 7 to 8 percent should continue this year and over the medium term, driven by tourism-related FDI, public infrastructure investment, and growth of financial services. Although still high at nearly 20 percent, the unemployment rate fell by 6 percentage points in 2006.

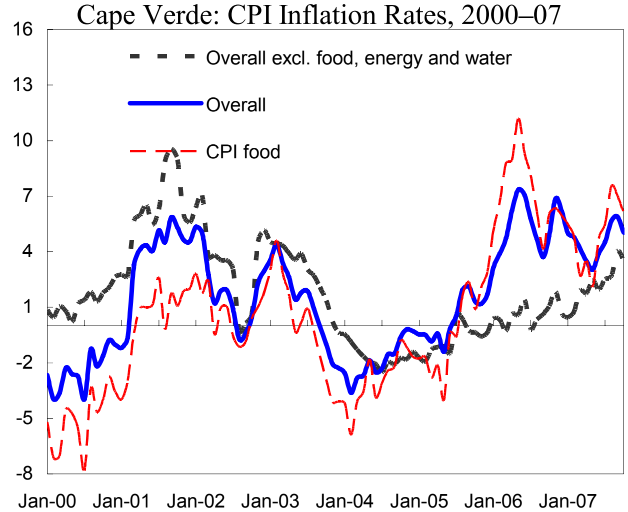
[1] In late October, the European Commission formally recommended a strategic partnership with Cape Verde to the European Parliament and European Council bringing Cape Verde one step closer to special status with the European Union.

Cape Verde: Contribution to Growth (Annual percentage change)	2003	2004	2005	2006	2007
Agriculture and fishing	0.1	0.0	0.0	0.1	0.0
Industry and energy	0.3	0.3	0.7	0.5	0.3
Construction	0.0	0.0	**1.4**	**1.5**	**1.7**
Commerce	0.8	1.0	2.0	0.9	0.9
Hotels and restaurants	0.7	0.5	0.7	**1.5**	0.9
Transport and communications	0.6	1.0	0.2	**3.3**	**1.4**
Banks and insurance[1]	-0.4	-0.1	-0.1	0.1	0.0
Public service	0.8	1.2	0.9	**1.2**	0.6
Other[2]	1.8	0.5	0.8	**1.8**	**1.2**
GDP	4.7	4.3	6.5	10.8	6.9

[1] Net of financial intermediation charges indirectly measured.
[2] Including taxes on imports.

- **Inflation pressures remain moderate**. Consumer prices increased by 5 percent in the 12-months to October 2007 largely reflecting supply shocks (poor rainfall temporarily drove up domestically produced food prices). The 12-month inflation rate is projected to reach 5¾ percent by December 2007 (5 percent annual average) and to fall thereafter to 2-3 percent consistent with the peg and inflation in the euro area.[2]

Cape Verde: CPI Inflation Rates, 2000–07



Sources: National authorities and staff calculations.

- **Domestic debt reduction is running ahead of program schedule (Figure 1).** Tax revenues to date have exceeded budget forecasts, reflecting economic growth and improvements in tax administration, and asset sales have surpassed expectations. These factors, together with expenditure restraint, are expected to lower the domestic debt-to-GDP ratio below the initial PSI target.

- **Reserve accumulation through June 2007 exceeded the program target and rapid accumulation has continued**. Reserves at end-September reached 3¾ months

[2] These projections are based on current CPI. A new CPI is expected to be released by end November with data revised back to January 2006. The new index is expected to be less susceptible to large swings in prices of a few domestically produced food items.

,of prospective imports and 130 percent of base money (Figure 2). Part of the accumulation in the first half of 2007 reflects banks drawing down on their net foreign assets position to finance purchase of central bank of Cape Verde (BCV) bills and investments in stocks and bonds on the Stock Exchange. While increasing FDI-related imports are expected to raise the current account deficit, there are no signs of a general increase in imports that would jeopardize reserves.

4. **Within the framework of the exchange rate peg, BCV continues to manage liquidity, and interest rate differentials with the euro area.** Its increased sterilization efforts, new investment opportunities for commercial banks on the Stock Exchange, and continued rapid growth in private sector credit have eased excess liquidity, causing domestic rates to rise in recent months. At the same time, reduced credit to government has dampened broad money growth (Figure 3).

5. **However, performance on the structural reforms has been mixed, and two assessment criteria were missed.** While the authorities have prevented accumulation of central government arrears, weaknesses in public finance management (PFM) still pose concerns. The new mechanism for setting base utility tariffs was not implemented and the mechanisms for adjusting electricity, water, and fuel prices were not fully and continuously applied during most of 2007. Moreover, three of the four structural benchmarks for end-June 2007, which include the implementation of the medium-term expenditure framework and the recommendations of the task force on financial sector reform were only partially met.

III. Policy Discussions

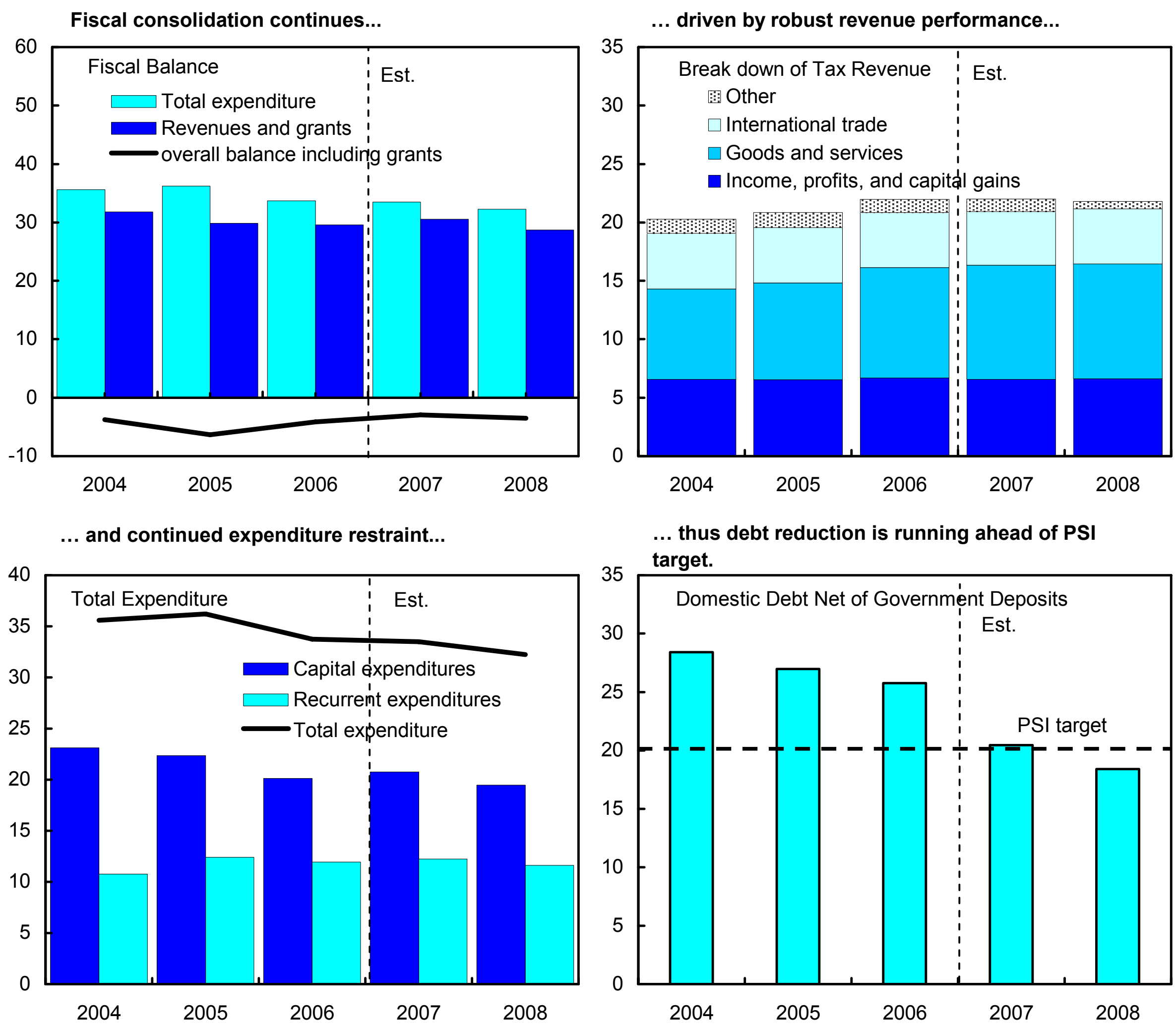
In the attached LOI and MEFP, the authorities reaffirm their commitment to the macroeconomic and structural reform objectives of the PSI program, anchored on the exchange rate peg to the euro. With program objectives unchanged since the PSI began and the authorities overperforming on key macroeconomic targets, policy discussions focused on consolidating fiscal and monetary management and accelerating structural reforms.

A. Fiscal Policy: What's Next as Debt Reduction is Running Ahead of Schedule?

6. **The mission supported the main thrust of the authorities' 2008 budget (MEFP, para. 8) which is appropriately based on conservative revenue forecasts and measured expenditure growth**.[3] The implied fiscal balance allows for further reduction in domestic

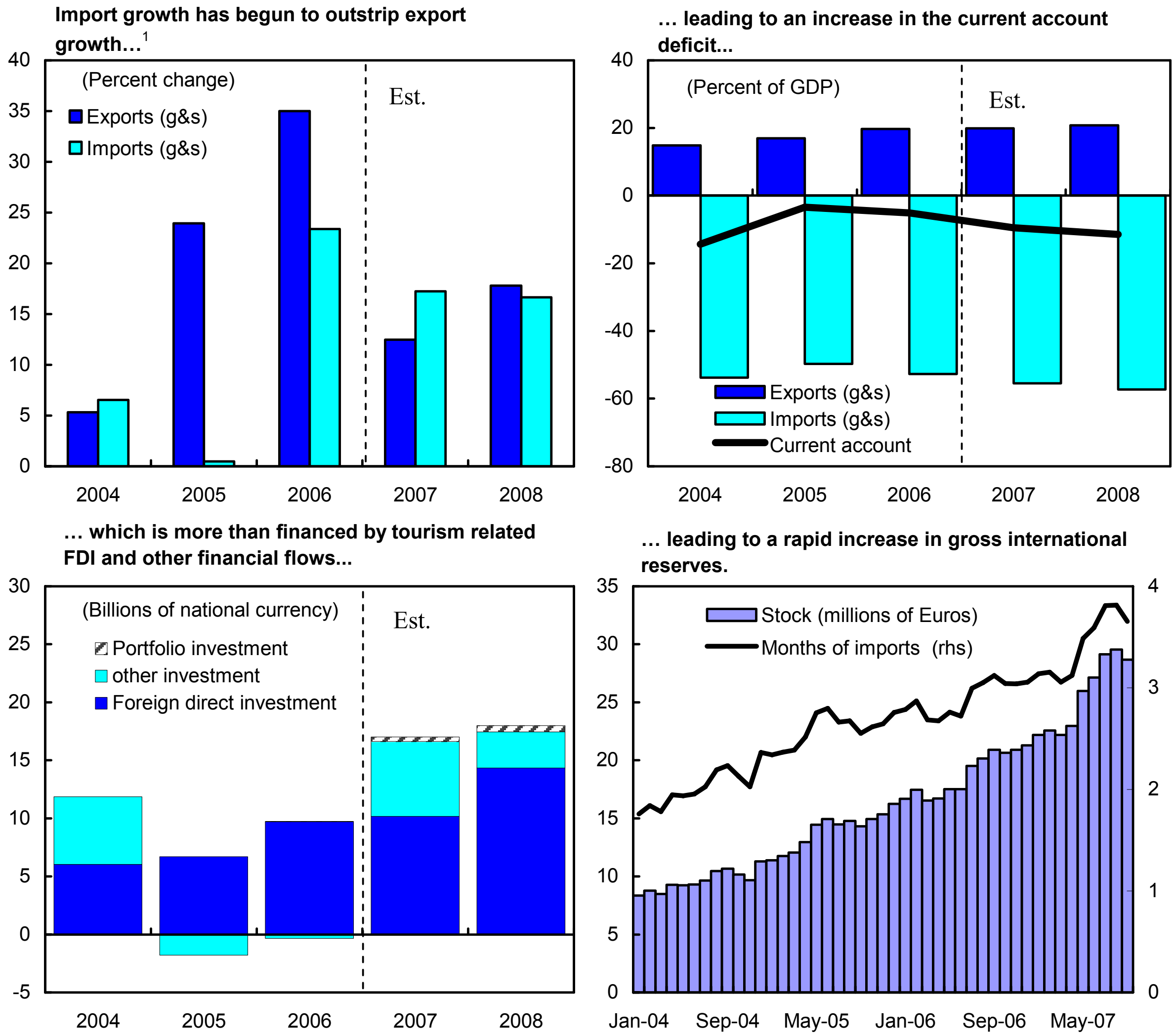
[3] The budget was presented to Parliament on October 20^{th}.

Figure 1. Cape Verde: Fiscal Sector, 2004 - 08
(Percent of GDP)



Source: National authorities and staff estimates.

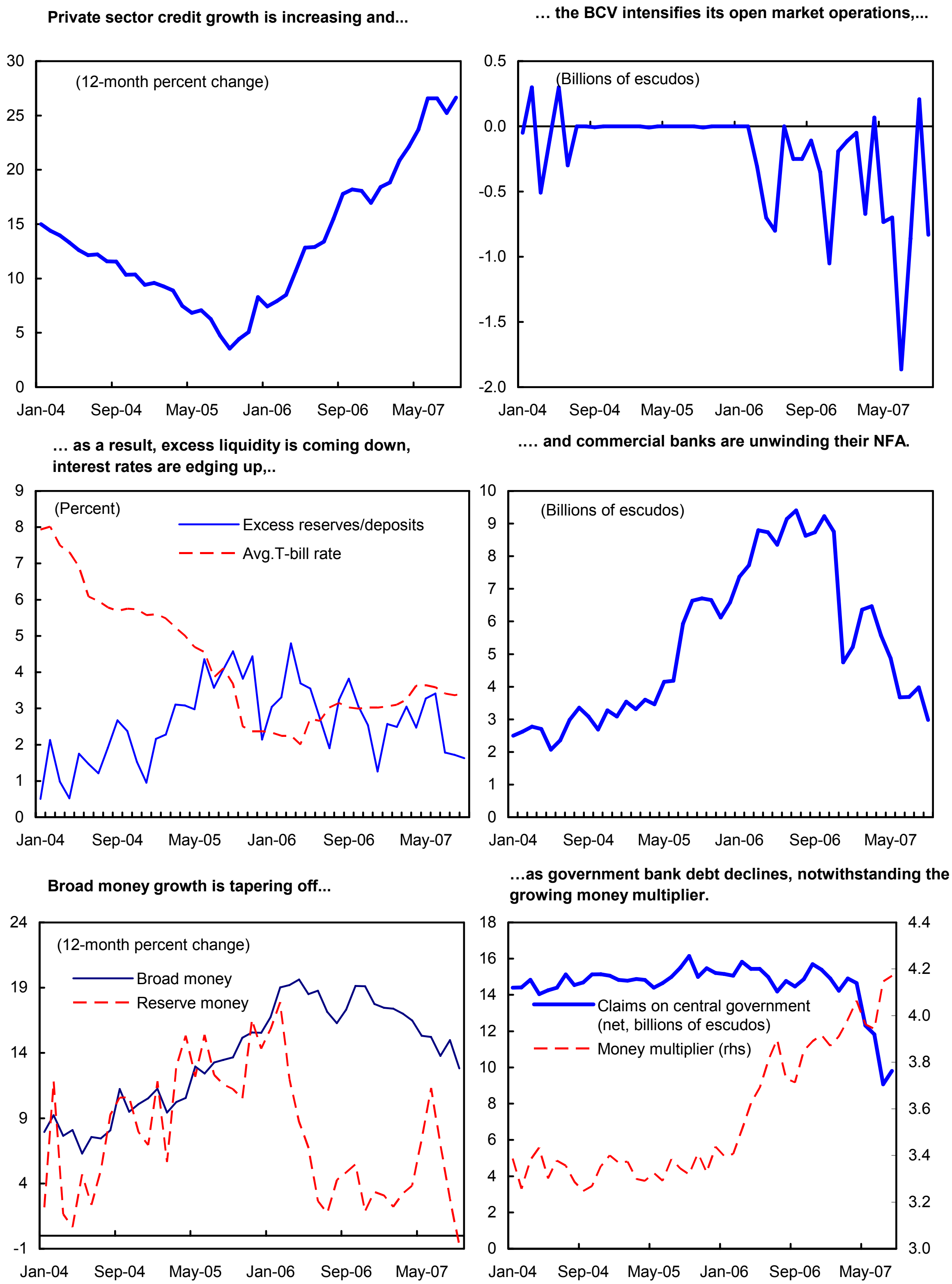
Figure 2. Cape Verde: External Developments, 2004 - 2008



Source: National authorities and staff estimates.

[1.] Growth in total exports in 2007 was dampened by a sharp decline in reexports of fuel due to the stoppage of South African Airlines refueling in Cape Verde.

Figure 3. Cape Verde: Monetary Developments, January 2004 - September 2007



Source: National authorities and staff estimates.

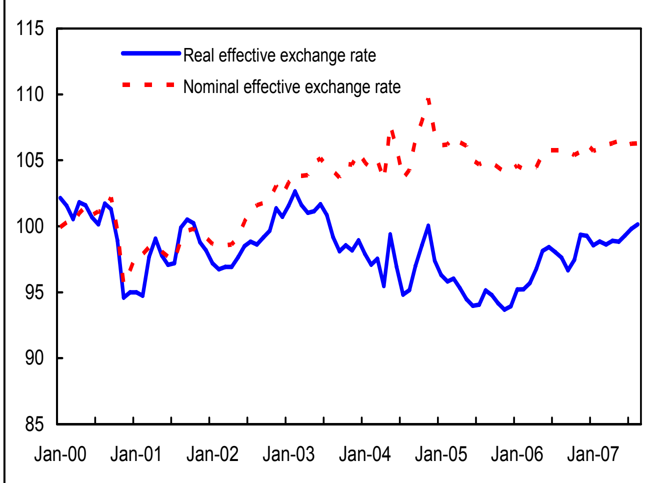
debt as a percent of GDP. Recurrent spending is contained to free resources for capital expenditures, and the budget allows for no utility and energy subsidies. Net domestic debt-to-GDP ratio is projected to decline to below 20 percent by end-2008, a year ahead of the PSI schedule. Staff suggested that beyond 2008 the authorities consider further fiscal consolidation to ensure that domestic demand growth allows for further reserve buildup and thereby reduce vulnerability to shocks. Staff noted that the joint World Bank- IMF debt sustainability analysis shows that the most important risk to debt distress would arise from a return to imprudent fiscal policy, leading to a sharp rise in the debt burden.

7. **The authorities affirmed that preserving debt sustainability is a cornerstone of their fiscal policy**. They expressed their intention to consider, once the program debt target is achieved, some tax cuts such as reducing the corporate income tax rate from 30 to 25 percent to keep Cape Verde attractive to foreign investors and help seek public support for rationalizing tax exemptions and broadening the tax base. Once they finalize their medium-term investment program, they also plan to use some of the expected fiscal space to scale up capital expenditure to ease infrastructure bottlenecks.[4]

B. Exchange Rate, Monetary Management and Financial Sector Reform: Safeguarding Financial Stability

8. **Over the last few years the exchange rate peg has served Cape Verde well as an anchor for financial stability, with both monetary management and fiscal policy supporting the peg.** The real effective exchange rate (REER) is broadly in line with fundamentals and policies as shown by staff 's CGER-type analysis. Moreover, FDI and tourism exports are booming suggesting improved competitiveness; unemployment is declining; and reserves accumulating as targeted. The recent increase in the current account deficit is driven by FDI-related imports. With no natural resource advantage, Cape Verde's performance in attracting non-debt creating FDI flows relative to neighboring economies reflects the strength of its policies and reforms. The DSA also concludes that the risk of a debt distress is low. Furthermore, while the REER has fluctuated within a 5 percent band around a constant

Exchange Rate Developments, January 2000 - August 2007

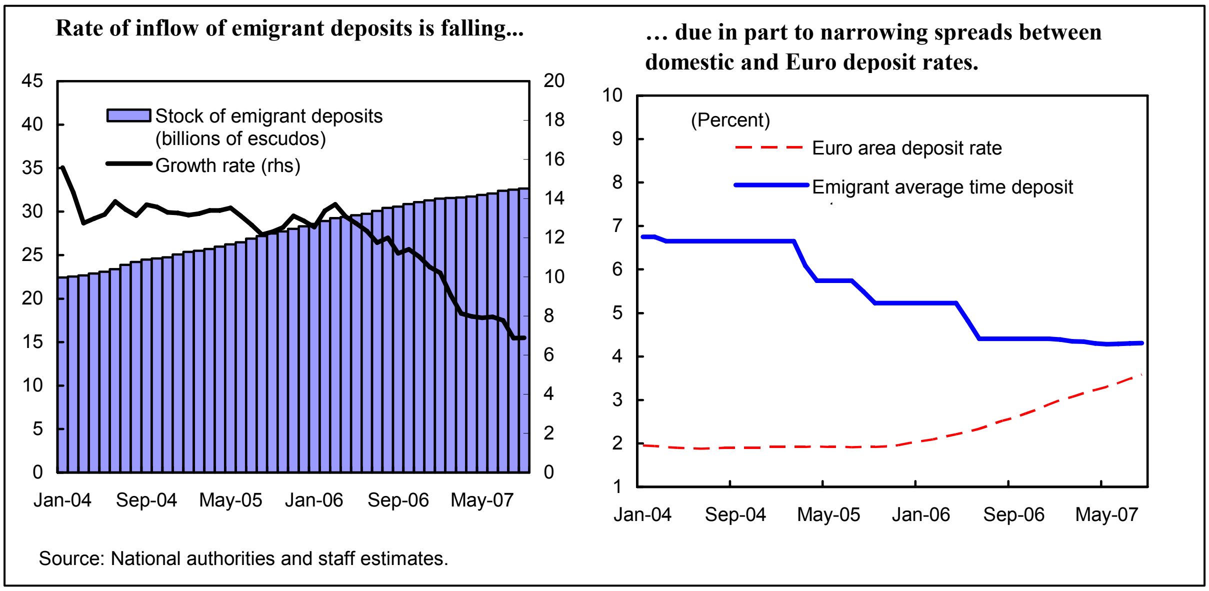


Source: IMF, *Information Notice System*.

[4] A joint Bank-Fund debt sustainability analysis shows that a temporary scaling up of capital investment will not increase the risk of debt distress in Cape Verde (Supplement to the Staff Report).

trend for the last several years largely reflecting supply-side-driven inflation differentials, the rate has appreciated in the last eighteen months reversing the depreciation during 2004-05. This said, the recent significant appreciation of the euro against the US dollar warrants close monitoring.

9. **Monetary management remains fully consistent with the goal of building foreign reserves to support the exchange rate peg**. Staff noted that the large emigrant deposits—40 percent of total bank deposits—continue to pose challenges for monetary management especially as emigrant deposit growth slowed markedly in the first half of 2007.[5] Thus, careful management of external interest differentials is warranted to guard against an outflow of emigrant deposits.



10. **Staff urged the authorities to move rapidly to strengthen financial sector regulation and supervision**. Abuse of Cape Verde's international financial center could cause significant reputational risks and third-party-enforcement actions, which could jeopardize growth and financial stability. Staff noted that strengthening the financial sector would be an important requirement for the authorities' planned liberalization of financial flows. Therefore, staff welcomed the measures committed to in their MEFP, including the three new benchmarks to establish a financial intelligence unit and strengthen the anti-money-laundering and combating-of-financing-of-terrorism framework.

[5] Total remittances from emigrants and overseas workers also declined markedly.

11. **The BCV and commercial banks concurred with staff's assessment of monetary management.** They noted that the slowdown in emigrant deposits was due to new investment opportunities being created in Cape Verde and a substantial narrowing in recent years of the spread between emigrant and euro area deposit rates. The banks are responding to the slowdown by launching savings products for emigrants with significantly higher rates, and the BCV has pushed up domestic interest rates in line with the rise in European rates.[6] The BCV will continue to monitor other indicators of monetary conditions and adjust policy operations as appropriate.

12. **The BCV emphasized their commitment to strengthen the regulation and supervision of the financial sector (MEFP para. 17).** Thus they reiterated their request for an early FSAP for Cape Verde. The staff broadly concurred, that their plan to further liberalize financial flows should not pose any near-term risk; it would largely validate the current de facto situation. Removal of the remaining restrictions, moreover, would facilitate financing of residents' participation in tourism projects and the further development of Cape Verde as an international financial center.[7]

C. PFM Reforms: Enhanced Budget Execution and Monitoring

13. **Staff urged the authorities to strengthen budget execution and monitoring.** PFM weaknesses have been a long-standing concern and contributed to repeated accumulation of arrears in the past, excess domestic borrowing, large statistical discrepancies in the fiscal accounts and weaknesses in fiscal data reporting. Staff also emphasized the need for strengthening the capacity to detect potential shortfalls in revenues and external budget support in time to take corrective actions. Thus staff recommended that the authorities introduce a mid-year review of fiscal developments to compare developments half way through the fiscal year with budget forecasts and allow corrective actions to be taken as necessary.

14. **The authorities responded that several initiatives are ongoing to strengthen budget execution and monitoring (MEFP, para. 10).** These reforms are shaped in part by the Country Financial Accountability Assessment action plan and World Bank Public Expenditure Reviews. They emphasized that it takes time for the benefit of these reforms to be fully realized and noted that capacity constraints have slowed the pace of PFM reform. Thus, the authorities are seeking additional technical assistance, including from the Fund to accelerate their PFM reforms.

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[6] Banks continue to offer a 25-basis-point interest premium on some emigrant deposits, mainly for historical reasons, their size, and the additional foreign exchange business they bring.

[7] FDI transactions, portfolio investments, and forward foreign exchange transactions are liberalized. External borrowing and foreign currency deposit accounts are formally subject to BCV regulations, which currently are nonrestrictive.

D. Energy Sector Reforms: Reducing Fiscal Risk and Bolstering Growth

15. **Staff reiterated that failure to fully and continuously apply the utility and petroleum pricing mechanisms, the missed structural assessment criteria, represents fiscal risks and could pose a threat to economic growth and poverty reduction in Cape Verde.** Utility and petroleum subsidies have for years been a serious drain on the budget: in 2006 accrued subsidies amounted to more than 2 percent of GDP.[8] Utility tariffs below cost recovery and commercial losses have for years caused severe cash-flow problems for the electricity company, Electra. Thus, much-needed investments to improve Electra's performance—one of the main impediments to growth and poverty reduction in Cape Verde—has been held up, forcing large businesses to invest in their own electricity and water production facilities. Staff stressed that tariffs need to be kept in line with current costs to prevent a repeat of past Electra cash-flow problems.[9] Automatic and transparent updates of utility tariffs and petroleum prices would help to depoliticize price setting, safeguard the budget and give companies incentives for investment and efficiency gains. Retail gasoline and diesel prices were increased by 15 and 11 percent respectively on October 24 which should clear the fiscal liabilities that had been built up since the last price adjustment in early 2007. Performance contracts with a new Electra management might induce managerial efficiency. Staff acknowledged however that it will take time before these measures result in sizable cost savings.

16. **The authorities laid out their medium-term strategy for a comprehensive overhaul of the energy sector.** They affirmed their commitment to the remedial measures for the two missed structural assessment criteria—the October fuel price adjustment, steps being taken to establish the base utility tariffs and strengthen the petroleum price adjustment mechanism (MEFP, para. 20–22). The government is also working to secure financing for Electra's investment program, including through the creation of a task force, and addressing the reasons for past underutilization of the program's non-concessional borrowing ceiling. Following the successful experience of collaborating with private firms in the utility sector on the island of Sal, this cooperation will be further encouraged to generate electricity to feed the Electra's distribution grid. In the oil sector, a new logistics company (to which the two importers will jointly import, store, and distribute petroleum) will allow economies of scale. A new and simplified fuel adjustment mechanism should help secure regular and transparent alignment of domestic fuel prices with international prices. In addition, Electra's management will be improved and generation and transmission capacity will be expanded, including with wind power.

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[8] Part of this was paid in 2006. The rest was cleared in 2007.

[9] There should be no impact on the budget from the temporary delay in adjusting utility tariffs through end-December 2007, and thereafter, utility prices would reflect market prices (para. 21 of the MEFP).

IV. Program Monitoring

17. **Assessment criteria, benchmarks, and indicative targets for the next two reviews are in Tables 1 and 2 of the MEFP**, **including a proposed modification to the end-December 2007 assessment criterion on net domestic borrowing set during the second review**. The ceiling has been lowered to reflect the government's full unwinding of the higher than programmed domestic borrowing in 2006, and an adjuster has been added to safeguard against any unexpected delays in the proceeds from land sales (Appendix I, Attachment II, paragraph 2). The review schedule is in Table 8.

V. Staff Appraisal

18. **Cape Verde's economic prospects continue to be favorable under the PSI program.** Growth remains strong, unemployment and poverty rates are falling, inflation pressures remain contained and all quantitative assessment criteria for end-June 2007 were met comfortably. The peg continues to serve Cape Verde well and the staff believes that the real exchange rate is broadly in line with fundamentals. The authorities are to be commended for their prudent macroeconomic management; now they should move ahead to consolidate the gains made on macroeconomic stability. Important tasks also remain on the structural agenda which are critical to Cape Verde's growth.

19. **Further financial sector development would help to safeguard the sector's stability and enhance growth prospects for Cape Verde.** Abuse of Cape Verde's international financial center could give rise to significant reputational risks and third party enforcement actions, which could jeopardize growth and financial stability. The measures being taken by the government to strengthen financial sector regulation and supervision, including implementing the recommendations of the recent AML/CFT assessment by the Fund, are particularly important in this regard. Strengthening the financial sector would also provide the needed foundation for the authorities' plans to further liberalize financial flows.

20. **Progress is being made to address the long-standing weaknesses in public sector financial management to improve budget execution and monitoring.** The authorities have addressed the problem with accumulation of central government arrears. The measures outlined in the authorities' MEFP, including on the Integrated Online Budget Management System, should provide the government with better tools for budget execution and monitoring. A formal mid-year review of fiscal developments the authorities have committed to should help enhance budget monitoring and allow corrective actions to be taken if necessary.

21. **The authorities should move rapidly to execute their plans on a comprehensive overhaul of the energy sector.** The past failure to fully and continuously apply the utility and petroleum pricing mechanisms represents both fiscal risks and a threat to growth and poverty reduction. Automatic and transparent updates of utility tariffs and petroleum prices

would depoliticize price setting, safeguard the budget, and give companies in the energy sector incentives for investment and efficiency gains.

22. **Staff recommends completion of the third review of the PSI program.** Based on the strength of the authorities' policies and the corrective measures taken, staff supports granting of waivers for the two structural assessment criteria that were missed.

PROPOSED DECISION

1. Pursuant to paragraph (8) of Decision No. 13561-(05/85), 10/10/05, and paragraph 1(a) of the Policy Support Instrument ("PSI") for Cape Verde (EBS/06/95 Sup. 2, 8/04/06), the Fund has conducted a review to assess program implementation.

2. The letter from the Minister of Finance and Public Administration dated November 29, 2007 (the "November 2007 Letter") with its attached Memorandum of Economic and Financial Policies (the "November 2007 MEFP") and Technical Memorandum of Understanding (the "November 2007 TMU") shall be attached to the PSI for Cape Verde, and the letter from the Minister of Finance and Public Administration dated April 17, 2007 shall be read as further supplemented and modified by the November 2007 Letter with its attachments.

3. Accordingly,

(i) a new paragraph 1(c) shall be added to the PSI to read as follows:

"(c) A fifth review is scheduled to be conducted by October 31, 2008, as specified in the first paragraph of the November 2007 Letter."

(ii) paragraph 2.E shall be amended to read as follows:

"E. with respect to the fourth review:

(1) the data as of end-December 2007 indicate that the ceiling referred to in paragraph 2.C.(1)(i) of the PSI, as set out in Table 1 of the November 2007 MEFP and further specified in the November 2007 TMU, and any of the floors and ceilings referred to in paragraph 2.C.(1)(ii) through (v) of the PSI, as set out in Table 1 of the December 2006 MEFP and further specified in the December 2006 TMU was not observed; or"

(2) by March 31, 2008, Cape Verde has not carried out its intentions with respect to the finalization and publication of the mechanism for setting base utility tariffs, as set out in Table 2 of the November 2007 MEFP and further specified in paragraph 17 of the November 2007 TMU; or"

(iii) a new paragraph 2.F. shall be added to read as follows:

"F. with respect to the fifth review:

(1) the data as of end-June 2008 indicate that any of the floors and ceilings referred to in paragraphs 2.C.(1)(i) through (v) above, and as set out in Table 1 of the November 2007 MEFP and further specified in the November 2007 TMU was not observed; or

(2) by August 31, 2008, Cape Verde has not carried out its intentions with respect to the completion of a mid-year review of revenue and expenditure developments as set out in

Table 2 of the November 2007 MEFP and further specified in paragraph 10 of the November 2007 MEFP; or”

4. The Fund waives the non-observance of: (i) the end-June 30, 2007 assessment criterion on the finalization and publication of the mechanism for setting base utility tariffs set out in paragraph 2.D(2) of the PSI; and (ii) the continuous assessment criterion on the implementation of the mechanism for setting and adjusting electricity, water and fuel prices set out in paragraph 2.A(1) (iv) of the PSI for Cape Verde, and completes the third scheduled review specified in paragraph 1(a) of the PSI for Cape Verde on the condition that the information provided by Cape Verde on its performance under these nonobserved assessment criteria and other assessment criteria related to this review is accurate.

Table 1. Cape Verde: Selected Economic and Financial Indicators, 2005–10

	2005	2006	2007	2008	2009	2010
		Prel.	Projections			
	(Annual percentage change)					
National accounts and prices						
Real GDP	6.5	10.8	6.9	7.7	7.4	7.4
Real GDP per capita	4.6	8.8	5.0	5.7	5.4	5.3
Consumer price index (annual average)	0.4	5.4	4.9	4.0	1.7	2.0
Consumer price index (end of period)	1.7	6.2	5.7	1.0	2.0	2.0
External sector						
Exports of goods and services	23.9	35.0	13.8	18.8	15.5	13.5
Of which: tourism	17.8	82.5	37.5	30.4	22.8	16.9
Imports of goods and services	0.5	23.4	18.1	16.9	16.4	14.6
Real effective exchange rate (annual average)	-2.3	-0.2	...	...	...	...
Terms of trade (minus = deterioration)	-5.2	-5.1	-0.3	1.1	1.8	1.6
Government finance						
Total revenue (excluding grants)	11.3	19.6	10.1	12.5	12.0	12.2
Total expenditure	10.1	11.7	7.6	12.9	9.2	10.5
Noncapital expenditure	3.7	11.5	7.2	3.5	12.0	5.4
Capital expenditure	25.2	12.1	8.2	30.8	4.9	18.6
Money and credit						
Net foreign assets	58.8	14.8	25.6	20.6	16.7	12.4
Net domestic assets	3.4	19.0	8.2	10.7	10.3	12.0
Of which: net claims on the central government	0.9	1.2	-38.7	-7.5	-9.9	1.9
credit to the economy[1]	9.0	17.3	27.1	13.8	13.2	13.2
Broad money (M2)	15.5	17.7	13.3	13.9	12.5	12.1
Domestic broad money (M2X)	17.3	22.4	13.3	13.9	12.5	12.1
Income velocity (GDP/M2)	1.32	1.31	1.27	1.26	1.24	1.23
	(Percent of GDP)					
Saving-investment balance						
Gross capital formation	36.7	37.8	43.2	47.6	52.4	56.9
Government	8.9	8.6	8.8	8.3	9.1	9.7
Nongovernment	27.8	29.2	34.5	39.2	43.3	47.2
Gross national savings	33.3	32.7	33.7	36.1	39.8	42.3
Of which: government	6.2	9.5	7.4	6.6	7.8	8.0
External current account (including official current transfers)	-3.4	-5.1	-9.5	-11.5	-12.6	-14.7
Government finance						
Total revenue	23.7	24.3	24.1	23.8	24.1	24.3
Total grants	6.3	5.6	6.7	4.9	6.0	6.1
Total expenditure	36.4	34.9	33.8	32.3	33.1	32.9
Overall balance before grants	-12.7	-10.6	-9.7	-8.5	-9.0	-8.5
Overall balance (including grants)	-6.3	-5.0	-3.0	-3.5	-3.0	-2.4
External financing (net)	3.1	3.0	1.8	1.8	1.4	1.6
Domestic financing (net)	0.8	2.9	0.9	1.7	1.6	0.9
Financing gap/ statistical discrepancy	2.4	-0.9	0.2	0.0	0.0	0.0
Total nominal government debt[2]	87.1	77.3	66.4	59.6	54.3	50.1
External government debt [3]	53.8	48.0	43.5	40.2	37.2	34.8
Domestic government debt, net of deposits	33.3	29.3	22.9	19.4	17.1	15.3
External current account (excluding official current transfers)	-8.0	-9.2	-14.3	-14.2	-16.2	-18.2
Overall balance of payments	5.6	4.8	7.1	4.4	4.3	3.3
External current account (millions of euros, including official transfers)	-27.3	-47.7	-99.4	-135.8	-165.8	-214.7
Gross international reserves (millions of euros, end of period)	147.4	193.1	267.7	320.3	376.9	425.4
Gross international reserves to reserve money	0.8	1.3	1.4	1.4	1.4	1.5
Gross international reserves (months of prospective imports of goods and services)	2.8	3.1	3.6	3.7	3.8	3.9
External debt service (percent of exports of goods and services)	8.6	5.7	5.0	4.5	4.3	3.8
Memorandum items:						
Nominal GDP (billions of Cape Verde escudos)	89.2	103.9	115.5	130.4	145.4	161.6
Exchange rate (Cape Verde escudos per U.S. dollar)						
Period average	88.7	87.8	…	…	…	
End period	93.5	83.5	…	…	…	

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

[1] Excluding a December 2006 purchase of a Portuguese credit to Electra and subsequent offloading on the domestic securitity market.

[2] Net of central government deposits; including verified stock of domestic and external arrears.

[3] Excluding the claims on the offshore Trust Fund.

Table 2. Cape Verde: Fiscal Operations of the Central Government, 2006-10
(Millions of Cape Verde escudos, unless otherwise indicated)

	2006		2007			2008	2009	2010
	Program	Actual	Budget	Jan-Jun	Proj.	Budget	Proj.	
Revenue, grants, and net lending	33,437	31,044	35,295	15,269	35,576	38,551	43,693	49,200
Domestic revenue (incl. net lending)	24,604	25,255	26,963	14,203	27,812	31,286	35,039	39,324
Tax revenue	21,099	22,828	24,178	12,916	25,454	28,059	32,140	36,074
Income and profit taxes	6,955	6,952	7,497	3,930	7,580	8,462	9,749	10,939
Consumption taxes	8,351	9,821	10,140	5,619	11,310	13,177	14,404	16,154
International trade taxes	4,501	4,889	5,458	2,602	5,300	5,583	7,054	7,944
Other taxes	1,291	1,166	1,083	765	1,265	837	933	1,037
Nontax revenue	3,505	2,126	2,585	1,020	2,090	3,204	2,899	3,251
Net lending	0	301	200	268	268	23	0	0
External grants	8,833	5,789	8,332	1,066	7,764	7,265	8,654	9,875
Capital grants	7,003	4,035	6,706	1,066	6,036	5,597	7,919	9,075
Budget support	1,830	1,755	1,625	0	1,728	1,668	736	800
Total expenditure	40,413	36,244	39,943	15,104	38,990	44,032	48,075	53,107
Recurrent expenditure	22,416	18,887	22,564	10,786	24,014	24,950	28,320	31,237
Primary recurrent expenditure	20,593	16,967	20,681	9,932	22,131	22,896	26,066	28,904
Wages and salaries	12,712	11,547	13,165	5,946	13,165	14,245	16,504	18,433
Goods and services	1,862	1,197	2,127	615	1,682	2,335	2,591	2,838
Transfers and subsidies	5,146	3,464	3,869	2,971	5,764	4,453	4,935	5,405
Transfers	3,921	3,172	3,834	1,627	3,927	4,395	4,871	5,333
Subsidies	1,225	292	35	1,344	1,838	58	65	72
Of which: energy subsidies	1,200	208	0	0	1,802 [5]	0	0	0
Other expenditures	873	760	1,520	400	1,520	1,863	2,035	2,228
Domestic interest payments	1,300	1,398	1,352	597	1,352	1,487	1,567	1,580
External interest payments	522	522	531	257	531	566	687	753
Extraordinary expenditures	0	0	0	0	0	0	0	0
Capital expenditure	16,290	12,415	16,340	3,534	13,438	17,581 [4]	18,441	21,870
Foreign financed	12,534	11,173	13,487	2,879	11,058	12,470	12,335	13,933
Domestically financed	3,755	1,242	2,853	654	2,380	5,111	6,105	7,937
Other expenditures (incl. arrears clearance)	1,708	4,942	1,039	784	1,537	1,500	1,314	0
Of which: energy subsidies	0	204	0	0	0	0	0	0
Overall balance, including grants (budget basis)	-6,976	-5,200	-4,648	165	-3,414	-5,481	-4,381	-3,907
Financing	6,976	5,200	4,648	-165	3,414	5,481	4,381	3,907
Foreign (net)	3,414	3,130	3,043	242	2,063	3,160	2,085	2,510
Domestic (net)	3,575	3,019	1,605	-671	1,087	2,321	2,297	1,397
Net domestic borrowing	830	1,638	-602	-1,865	-1,201	-172	797	-103
Banking system	989	185	…	-3,563	-5,959	248	-865	153
Nonbanks	-158	1,453	…	1,698	4,758 [6]	-421	1,661	-256
Privatization and other sales of assets	3,689	456	2,207	3,104	4,199	2,493	1,500	1,500
Accounts payable (*atrasados*), net	-944	925	…	-1,911	-1,911	…	0	0
Net errors and omissions	0	-949	0	263	263	0	0	0
Financing gap	-13	0	0	0	0	0	0	0
Memorandum items:								
Overall balance, including grants (excluding clearance of arrears and accounts payable)	-4,324	-4,113	-3,609	2,289	-675	-3,980	-3,068	-3,907
Arrears clearance	1,708	2,012	1,039	213	828	1,500	1,314	0
Net domestic borrowing, excluding clearance of arrears and net accounts payable	-1,821	551	-1,641	-3,988	-3,940	-1,673	-517	-103
Primary balance (including grants)[1]	-5,154	-3,280	-2,765	1,020	-1,531	-3,427	-2,127	-1,574
Recurrent domestic balance[2]	2,188	6,368	4,400	3,417	3,798	6,335	6,719	8,087
Net external flows[3]	12,234	8,919	11,375	1,308	9,827	10,425	10,739	12,386
External debt service (percent of domestic revenue)	10.7	9.9	9.8	7.8	9.5	8.3	8.3	7.5
Domestic debt (including arrears and accounts payable, net of deposits)	27,902	30,397	25,426	...	26,457	24,785	24,817	24,713

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

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

[2] Domestic revenue – recurrent expenditure.

[3] External grants + net foreign financing.

[4] The capital expenditure budget is typically underexecuted.

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

[6] Reflects borrowing from the pension fund.

Table 3. Cape Verde: Fiscal Operations of the Central Government, 2006-10
(Percent of GDP)

	2006		2007			2008	2009	2010
	Program	Actual	Budget	Jan-Jun	Proj.	Budget	Proj.	
Revenue, grants, and net lending	34.1	29.9	30.6	13.2	30.8	29.6	30.0	30.4
Domestic revenue (incl. net lending)	25.1	24.3	23.3	12.3	24.1	24.0	24.1	24.3
Tax revenue	21.5	22.0	20.9	11.2	22.0	21.5	22.1	22.3
Income and profit taxes	7.1	6.7	6.5	3.4	6.6	6.5	6.7	6.8
Consumption taxes	8.5	9.5	8.8	4.9	9.8	10.1	9.9	10.0
International trade taxes	4.6	4.7	4.7	2.3	4.6	4.3	4.9	4.9
Other taxes	1.3	1.1	0.9	0.7	1.1	0.6	0.6	0.6
Nontax revenue	3.6	2.0	2.2	0.9	1.8	2.5	2.0	2.0
Net lending	0.0	0.3	0.2	0.2	0.2	0.0	0.0	0.0
External grants	9.0	5.6	7.2	0.9	6.7	5.6	6.0	6.1
Capital grants	7.1	3.9	5.8	0.9	5.2	4.3	5.4	5.6
Budget support	1.9	1.7	1.4	0.0	1.5	1.3	0.5	0.5
Total expenditure	41.2	34.9	34.6	13.1	33.8	33.8	33.1	32.9
Recurrent expenditure	22.8	18.2	19.5	9.3	20.8	19.1	19.5	19.3
Primary recurrent expenditure	21.0	16.3	17.9	8.6	19.2	17.6	17.9	17.9
Wages and salaries	13.0	11.1	11.4	5.1	11.4	10.9	11.4	11.4
Goods and services	1.9	1.2	1.8	0.5	1.5	1.8	1.8	1.8
Transfers and subsidies	5.2	3.3	3.3	2.6	5.0	3.4	3.4	3.3
Transfers	4.0	3.1	3.3	1.4	3.4	3.4	3.3	3.3
Subsidies	1.2	0.3	0.0	1.2	1.6	0.0	0.0	0.0
Of which: energy subsidies	1.2	0.2	0.0	0.0	1.6 [5]	0.0	0.0	0.0
Other expenditures	0.9	0.7	1.3	0.3	1.3	1.4	1.4	1.4
Domestic interest payments	1.3	1.3	1.2	0.5	1.2	1.1	1.1	1.0
External interest payments	0.5	0.5	0.5	0.2	0.5	0.4	0.5	0.5
Extraordinary expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	16.6	12.0	14.1	3.1	11.6	13.5 [4]	12.7	13.5
Foreign financed	12.8	10.8	11.7	2.5	9.6	9.6	8.5	8.6
Domestically financed	3.8	1.2	2.5	0.6	2.1	3.9	4.2	4.9
Other expenditures (incl. arrears clearance)	1.7	4.8	0.9	0.7	1.3	1.2	0.9	0.0
Of which : energy subsidies	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, including grants (budget basis)	-7.1	-5.0	-4.0	0.1	-3.0	-4.2	-3.0	-2.4
Financing	7.1	5.0	4.0	-0.1	3.0	4.2	3.0	2.4
Foreign (net)	3.5	3.0	2.6	0.2	1.8	2.4	1.4	1.6
Total drawings	5.6	4.9	4.5	1.0	3.6	4.0	3.0	2.9
Amortization	-2.2	-1.9	-1.8	-0.7	-1.8	-1.6	-1.5	-1.4
Domestic (net)	3.6	2.9	1.4	-0.6	0.9	1.8	1.6	0.9
Net domestic borrowing	0.8	1.6	-0.5	-1.6	-1.0	-0.1	0.5	-0.1
Banking system	…	…	…	-3.1	-5.2	0.2	-0.6	0.1
Nonbanks	…	…	…	1.5	4.1 [6]	-0.3	1.1	-0.2
Privatization and other sales of assets	1.4	0.4	1.9	2.7	3.6	1.9	1.0	0.9
Accounts payable (atrasados), net	2.3	…	…	-1.7	-1.7	…	0.0	0.0
Net errors and omissions	0.0	-0.9	0.0	0.2	0.2	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Overall balance, including grants (excluding clearance of arrears and accounts payable)	-4.4	-4.0	-3.1	2.0	-0.6	-3.1	-2.1	-2.4
Arrears clearance	1.7	1.9	0.9	0.2	0.7	1.2	0.9	0.0
Net domestic borrowing, excluding clearance of arrears and net accounts payable	-1.9	0.5	-1.4	-3.5	-3.4	-1.3	-0.4	-0.1
Primary balance (including grants)[1]	-5.3	-3.2	-2.4	0.9	-1.3	-2.6	-1.5	-1.0
Recurrent domestic balance[2]	2.2	6.1	3.8	3.0	3.3	4.9	4.6	5.0
Net external flows[3]	12.5	8.6	9.8	1.1	8.5	8.0	7.4	7.7
Domestic debt (including arrears and accounts payable, net of deposits)	28.4	29.3	22.0	…	22.9	19.0	17.1	15.3
Nominal GDP (Millions of Escudos)	98,139	103,867	115,506	115,506	115,506	130,416	145,409	161,611

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

[1] Overall balance (including grants) – total expenditure + domestic and external interest payments.
[2] Domestic revenue – recurrent expenditure.
[3] External grants + net foreign financing.
[4] The capital expenditure budget is typically underexecuted.
[5] The energy subsidies recorded in 2007 were incurred in previous periods.
[6] Reflects borrowing from the pension fund.

Table 4. Cape Verde: Balance of Payments, 2005–10

(Millions of Cape Verde escudos, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010
	Estimates		Projections			
Current account balance (including official transfers)	-3,016	-5,259	-10,965	-14,978	-18,292	-23,686
Trade balance	-30,960	-40,654	-54,809	-65,429	-78,040	-90,926
Exports, f.o.b.	7,891	8,429	6,454	6,788	6,943	7,144
Imports, f.o.b.	-38,851	-49,083	-61,263	-72,218	-84,983	-98,069
Services (net)	6,148	13,822	21,244	27,204	32,991	38,535
Credit	24,667	35,523	43,578	52,672	61,752	70,798
Of which: tourism	10,466	19,097	26,249	34,233	42,044	49,156
Debit	-18,519	-21,700	-22,334	-25,467	-28,762	-32,263
Income (net)	-2,984	-3,952	-3,149	-3,599	-4,204	-4,934
Credit	1,641	1,627	1,923	2,285	2,623	2,993
Debit	-4,625	-5,579	-5,072	-5,884	-6,827	-7,927
Government interest	-551	-522	-531	-604	-687	-753
Interest by other sectors	-3,040	-2,443	-2,114	-2,397	-2,673	-3,012
Income on direct investment and other income	-1,034	-2,614	-2,428	-2,882	-3,466	-4,162
Current transfers (net)	24,780	25,525	25,750	26,846	30,961	33,639
Government	4,090	4,310	5,565	3,584	5,293	5,662
Other	20,690	21,215	20,185	23,261	25,668	27,976
Capital and financial account (net)	7,031	10,871	19,178	20,779	24,537	29,040
Capital transfers	1,821	1,540	2,199	2,841	3,361	4,213
Government	1,831	1,540	2,199	2,841	3,361	4,213
Other	200	0	0	0	0	0
Direct investment (net)	6,696	9,722	10,164	14,346	17,158	20,363
Portfolio investment	0	13	400	550	550	550
Government	1,880	2,266	2,229	2,329	2,085	2,510
Trust Fund	-200	0	0	0	0	0
Net official flows	2,080	2,266	2,229	2,329	2,085	2,510
Disbursements	4,314	4,240	4,176	4,403	4,321	4,697
Amortization	-2,234	-1,974	-1,947	-2,074	-2,236	-2,187
Other	0	0	0	0	0	0
Other investments	-3,366	-2,670	4,186	713	1,382	1,403
Commercial banks	-4,883	-2,543	1,823	-638	19	20
Commercial credit (net)	564	189	0	0	0	0
Other	953	-316	2,363	1,351	1,363	1,384
Net errors and omissions	986	-647	0	0	0	0
Overall balance	5,000	4,965	8,225	5,802	6,239	5,348
Financing	-5,000	-4,965	-8,225	-5,802	-6,239	-5,348
Gross international reserves (– accumulation)	-4,964	-5,044	-8,225	-5,802	-6,239	-5,348
Of which: IMF (net)	380	-96	-37	-62	-123	-184
Exceptional financing	-36	78	0	0	0	0
Financing gap	0	0	0	0	0	0
Memorandum items:						
Current account (including official transfers; percent of GDP)	-3.4	-5.1	-9.5	-11.5	-12.6	-14.7
Current account (excluding official transfers; percent of GDP)	-8.0	-9.2	-14.3	-14.2	-16.2	-18.2
Overall balance (percent of GDP)	5.6	4.8	7.1	4.4	4.3	3.3
Gross international reserves	16,260	21,304	29,529	35,331	41,570	46,917
Months of current year's import of goods and services	3.4	3.6	4.2	4.3	4.4	4.3
Months of next year's import of goods and services	2.8	3.1	3.6	3.7	3.8	3.9
External public debt	47,954	49,869	52,098	52,364	54,153	56,222
External aid (grants and loans; percent of GDP)	11.5	9.7	10.3	8.3	8.9	9.0

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

Table 5. Cape Verde: Monetary Survey, 2005–10

	2005	2006		2007	2008	2009	2010
	Dec.	Dec.		Dec.			
		Program	Actual	Projections			
	(Millions of Cape Verde escudos, unless otherwise specified)						
Net foreign assets	21,889	26,056	25,138	31,577	38,079	44,421	49,934
Of which: excluding the effect of a purchase of a Portuguese credit to Electra in 2006	21,889	26,056	29,532	…	…	…	…
Foreign assets	27,549	31,716	31,285	38,687	45,248	51,590	57,043
Of which: foreign reserves	16,260	18,356	21,304	29,529	35,331	41,570	46,917
Foreign liabilities	-5,660	-5,660	-6,147	-7,111	-7,169	-7,169	-7,109
Net domestic assets	50,754	56,456	60,398	65,340	72,317	79,771	89,337
Net domestic credit	60,193	65,127	70,487	75,472	82,492	89,988	99,599
Net claims on general government	25,697	25,854	25,632	19,672	18,965	18,100	18,248
Claims on the Trust Fund (TCMFs)	11,038	11,038	11,038	11,038	11,038	11,038	11,038
Net claims on the central government	15,207	15,406	15,392	9,433	8,726	7,861	8,014
Credit to central government	20,044	21,033	19,470	14,916	14,110	13,151	13,215
Deposits of central government	-4,837	-5,626	-4,078	-5,483	-5,384	-5,290	-5,200
Of which: project deposits	-351	-277	-716	-277	-277	-277	-277
Net claims on local government	21	-22	-311	-311	-312	-312	-312
Net claims on other government agencies (INPS)	-569	-569	-488	-488	-488	-488	-493
Credit to the economy	34,496	39,273	44,855	55,800	63,527	71,888	81,351
Of which: excluding purchase of a Portuguese credit to Electra and subsequent off loading on the domestic securities market	34,496	39,273	40,461	…	…	…	
Credit to public enterprises	431	497	634	678	703	736	770
Credit to private sector	34,040	38,751	44,205	55,106	62,808	71,137	80,565
Claims on nonbank financial institutions	26	26	16	16	16	16	16
Other items (net)	-9,439	-8,671	-10,089	-10,133	-10,175	-10,218	-10,261
Broad money (M2)	72,643	82,511	85,536	96,916	110,396	124,192	139,271
Narrow money (M1)	28,718	32,620	35,860	40,631	46,282	52,066	58,387
Currency outside banks	7,634	8,464	7,731	8,760	9,978	11,225	12,588
Demand deposits	21,084	24,156	28,129	31,871	36,304	40,841	45,799
Quasimoney	40,566	46,076	45,505	51,559	58,730	66,069	74,091
Time deposits	38,390	43,605	43,334	49,100	55,929	62,918	70,558
Other quasimonetary deposits	2,176	2,471	2,170	2,459	2,801	3,151	3,534
Foreign currency deposits	3,359	3,815	4,172	4,727	5,384	6,057	6,792
	(Change in percent of broad money 12 months earlier)						
Net foreign assets	12.9	5.7	4.5	7.5	6.7	5.7	4.4
Net domestic assets	2.7	7.8	13.3	5.8	7.2	6.8	7.7
Net domestic credit	4.6	7.9	14.2	5.8	7.2	6.8	7.7
Net claims on the central government	0.2	1.4	0.3	-7.0	-0.7	-0.8	0.1
Credit to the economy	4.6	6.5	14.3	12.8	8.0	7.6	7.6
Credit to public enterprises	0.4	0.0	0.3	0.1	0.0	0.0	0.0
Credit to private sector	4.2	6.5	14.0	12.7	7.9	7.5	7.6
Other items (net)	-1.9	0.0	-0.9	-0.1	0.0	0.0	0.0
Selected monetary indicators:							
Income velocity of money	1.32	1.27	1.31	1.27	1.26	1.24	1.23
Emigrant deposits	28,318	31,339	31,293	35,457	40,388	45,436	50,953
Excess reserves /total deposits (percent)	2.1	0.8	1.3	1.5	1.4	1.4	1.3
Money multilplier (M2/M0)	3.44	3.69	3.92	4.19	4.19	4.18	4.19
Credit to the economy (percentage change)	9.0	13.8	30.0	24.4	13.8	13.2	28.1

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

Table 6. Cape Verde: Central Bank Survey, 2005–10

	2005	2006		2007	2008	2009	2010
	Dec.	Dec.		Dec.			
		Program	Actual	Projections			
	(Millions of Cape Verde escudos, unless otherwise specified)						
Net foreign assets	15,308	17,403	20,390	28,652	34,516	40,877	46,409
Of which: net international reserves	15,109	17,204	20,216	28,477	34,341	40,703	46,235
Foreign assets	16,523	18,618	21,536	29,761	35,563	41,802	47,149
Foreign liabilities	-1,215	-1,215	-1,146	-1,109	-1,047	-924	-740
Net domestic assets	5,828	4,965	1,454	-5,517	-8,141	-11,199	-13,131
Net domestic credit	7,678	6,047	3,518	-3,412	-5,994	-9,009	-10,898
Trust Fund claims	4,605	4,605	4,605	4,605	4,605	4,605	4,605
Net claims on central government	1,882	1,093	1,748	239	239	239	239
Credit to central government	4,779	4,779	3,739	3,739	3,739	3,739	3,739
Deposits of central government	-2,896	-3,685	-1,990	-3,500	-3,500	-3,500	-3,500
Of which: project accounts	-351	-277	-716	-277	-277	-277	-277
Of which: foreign currency deposits	-1,347	-1,347	-682	-682	-682	-682	-682
Claims on local government	0	0	0	0	0	0	0
Credit to the economy	1,163	1,163	1,147	1,269	1,426	1,583	1,754
Credit to public enterprises	54	54	47	47	47	47	47
Credit to private sector	1,094	1,094	1,091	1,213	1,370	1,527	1,698
Claims on nonbank financial institutions	15	15	9	9	9	9	9
Credit to commercial banks	27	-815	-3,983	-9,525	-12,264	-15,436	-17,495
Other items (net)	-1,850	-1,082	-2,063	-2,104	-2,147	-2,189	-2,233
Assets	2,481	1,442	2,791	2,847	2,904	2,962	3,021
Liabilities	4,332	2,525	4,854	4,951	5,050	5,151	5,254
Reserve money (M0)	21,136	22,368	21,845	23,135	26,375	29,678	33,278
Currency outside banks	7,634	8,464	7,731	8,760	9,978	11,225	12,588
Cash in vaults	1,058	1,205	1,457	1,168	1,330	1,497	1,678
Deposits of commercial banks	12,443	12,697	12,654	13,205	15,064	16,954	19,009
Deposits of private sector	0	0	0	0	0	0	0
Deposits of other financial institutions	2	2	3	3	3	3	3
Gross international reserves (millions of euros)	147.4	166.4	193.1	267.7	320.3	376.9	425.4
Net international reserves (millions of euros)	137.0	156.0	183.3	258.2	311.3	369.0	419.2
Reserve money (12-month change in percent)	14.3	5.8	3.4	5.9	14.0	12.5	12.1

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

Table 7. Cape Verde: Deposit Money Bank Survey, 2005–10

	2005	2006		2007	2008	2009	2010
	Dec.	Dec.		Dec.			
		Program	Actual	Projections			
	(Millions of Cape Verde escudos, unless otherwise specified)						
Net foreign assets	6,581	8,652	4,747	2,925	3,563	3,544	3,524
Of which: excluding the effect of a purchase of a Portuguese credit to Electra	6,581	8,652	8,315	…	…	…	
Foreign assets	11,026	13,098	9,749	8,927	9,685	9,788	9,894
Foreign liabilities	-4,445	-4,445	-5,002	-6,002	-6,122	-6,244	-6,369
Of which: nonresident deposits	-3,520	-3,766	-4,214	-5,057	-5,158	-5,261	-5,366
Net domestic assets	58,427	65,395	73,055	85,232	96,854	109,423	123,159
Net domestic credit	66,016	72,982	81,080	93,257	104,880	117,448	131,184
Net claims on general government	19,209	20,156	19,279	14,829	14,122	13,256	13,404
Trust Fund claims	6,433	6,433	6,433	6,433	6,433	6,433	6,433
Other government deposits (INPS)	-569	-569	-488	-488	-488	-488	-493
Net claims on central government	13,324	14,313	13,644	9,195	8,488	7,623	7,776
Treasury bonds	9,173	9,847	10,030	5,221	4,095	2,711	2,288
Treasury bills	5,609	5,889	5,086	5,340	5,661	6,085	6,572
Oher credits	484	518	616	616	616	616	
Deposits of central government	-1,941	-1,941	-2,088	-1,983	-1,884	-1,790	-1,700
Net claims on local government	21	-22	-311	-311	-312	-312	-312
Claims on local government	276	236	271	277	282	288	294
Deposits of local government	-256	-258	-582	-588	-594	-600	-606
Credit to the economy	33,333	38,110	43,708	54,531	62,101	70,305	79,597
Of which: excluding purchase of a Portuguese credit to Electra and subsequent off loading on the domestic securities market	33,333	38,110	39,314	…	…	…	
Credit to public enterprises	377	443	587	631	656	689	724
Credit to private sector	32,945	37,656	43,114	53,893	61,438	69,609	78,867
Claims on nonbank financial institutions	11	11	6	6	6	6	6
Net claims on the Bank of Cape Verde	13,473	14,717	18,094	23,898	28,658	33,887	38,183
Total reserves	13,500	13,902	14,111	14,373	16,394	18,451	20,687
Vault cash	1,058	1,205	1,457	1,168	1,330	1,497	1,678
Deposits with central bank	12,443	12,697	12,654	13,205	15,064	16,954	19,009
Required reserves	11,051	12,117	11,670	11,914	13,643	15,413	17,344
Excess reserves	1,391	579	984	1,291	1,420	1,541	1,665
Credit to the Bank of Cape Verde	-27	815	3,983	9,525	12,264	15,436	17,495
Other items (net)	-7,589	-7,587	-8,026	-8,026	-8,026	-8,026	-8,026
Deposit liabilities to nonbank residents	65,008	74,047	77,802	88,156	100,418	112,967	126,683
Local currency deposits	61,649	70,232	73,631	83,430	95,034	106,910	119,891
Demand deposits	21,083	24,156	28,126	31,871	36,304	40,841	45,799
Of which: emigrant deposits	3,394	3,756	4,043	4,581	5,218	5,870	6,583
Quasimoney	40,566	46,076	45,505	51,559	58,730	66,069	74,091
Time deposits	38,390	43,605	43,334	49,100	55,929	62,918	70,558
Of which: emigrant deposits	23,825	26,367	26,148	29,627	33,748	37,965	42,575
Other quasimonetary deposits	2,176	2,471	2,170	2,459	2,801	3,151	3,534
Foreign currency deposits	3,359	3,815	4,172	4,727	5,384	6,057	6,792
Of which: emigrant deposits	1,100	1,217	1,102	1,249	1,423	1,600	1,795
Memorandum items:							
Emigrant deposits (as ratio to total deposits)	0.44	0.38	0.40	0.40	0.40	0.40	0.37
Other deposits (as ratio to total deposits)	0.61	0.62	0.63	0.63	0.63	0.63	0.63
Composition of emigrant deposits	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Local currency	0.96	0.96	0.96	0.96	0.96	0.96	0.96
Demand	0.12	0.12	0.13	0.13	0.13	0.13	0.13
Time	0.84	0.84	0.84	0.84	0.84	0.84	0.84
Foreign currency	0.04	0.04	0.04	0.04	0.04	0.04	0.04

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

Table 8. Cape Verde: Proposed Work Program 2008–09

Mission Date	Purpose	Board Review
February 2008	Discussions on the fourth review against end-December 2007 assessment criteria	End-April 2008
August 2008	Discussions on the fifth review against end-June 2008 assessment criteria	End-October 2008
February 2009	Discussions on the sixth review against end-December 2008 assessment criteria	End-April 2009

Appendix I—Letter of Intent

November 29, 2007

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

Dear Mr. Strauss-Kahn:

The attached Memorandum of Economic and Financial Policies, reviews implementation to date of the Cape Verde government's macroeconomic and structural program under the country's three-year Policy Support Instrument (PSI), approved by the IMF Executive Board in July 2006. Details of this program are set out in the initial Memorandum of Economic and Financial Policies (MEFP) of July 2006, which was updated in January 2007 and May 2007 in conjunction with the first and second reviews of the program. The attached MEFP builds on the initial memorandum, with particular attention to policy developments and prospects for 2008. The fourth and fifth reviews of the PSI are scheduled to be completed by end-April 2008 and end-October 2008, respectively.

The government believes that this program will provide firm support for macroeconomic stability and the exchange rate peg, and create the fiscal space needed to adjust to possible declines in concessional external financing following the country's expected graduation from Least-Developed-Country status in 2008.

Under the PSI, the government will keep the IMF regularly updated on economic and policy developments and will provide the data needed for adequate monitoring of the program, including in the context of the twice-yearly reviews. During the period of the PSI, Cape Verde will consult with the IMF on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director of the IMF requests such a consultation.

We authorize the IMF to publish this letter, the attached MEFP, and the related staff report.

Sincerely yours

/s/

Cristina Duarte
Minister of Finance and Public Administration.

Attachment I—Memorandum of Economic and Financial Policies

I. Introduction and Background

1. **Cape Verde's economic performance remains strong.** The outlook for growth and inflation is favorable, and fiscal and monetary policies are consistent with program goals. In particular, public debt is coming down as a share of GDP and international reserves are building rapidly. Important progress is also being made toward the structural objectives of the program namely public sector management, especially fiscal accounting, budget execution and control, and arrears prevention; strengthening of the financial sector and improving energy sector regulation.

2. **Reflecting this solid performance, Cape Verde is on the verge of graduation from the UN least-developed-country (LDC) status in early 2008.** While this graduation has its benefits, the government recognizes that this will also entail challenges. In particular, while the government of Cape Verde will continue to seek concessional support, we need to prepare to become less dependent on aid in the future. Further improvements in the business environment are needed to attract private capital. At the same time, to support macroeconomic stability and the exchange rate peg, we intend to reduce government's domestic debt ratio, increase foreign reserves and create fiscal space to accommodate possible declines in concessional external financing as the country graduates from LDC status.

3. **In this vein, the government's policies will continue to focus on four areas to enhance macroeconomic stability and implement structural reforms that remove barriers to productivity growth and encourage private-sector led development**. Specifically we will aim to:

- *Consolidate macroeconomic stability*, notably by reducing public debt and increasing official foreign exchange reserves;

- *Improve public sector financial management,* including by strengthening macroeconomic coordination and planning, stopping arrears, broadening the tax base, and improving internal and external audit processes;

- *Reduce fiscal risks,* including those that could arise from operations of state-owned enterprises; and

- *Strengthen regulation and supervision of the financial sector* to enhance the efficiency of the financial system, particularly in the growing offshore financial center.

II. THE CURRENT ECONOMIC SETTING

4. **Cape Verde's recent economic indicators point to high growth, falling unemployment and modest inflation.** According to new data from the National Statistical Institute (INE), growth in 2006 appears to have been much stronger than earlier estimated—reaching 10 ¾ percent. Growth was particularly strong in tourism, telecommunications, financial services, and construction. In line with this, growth for 2007 is projected to be around 7 percent. "Headline" consumer price inflation has largely come down as expected since 2006, but is now being pushed up temporarily due to poor rainfall and recent adjustments in petroleum prices. Consumer price inflation (annual average) is now projected to reach about 5 percent for 2007.

5. **The June 2007 program quantitative targets were observed by wide margins.**

- **International reserves continue to accumulate rapidly,** significantly exceeding the program target at end-June. Cape Verde has continued to attract official assistance, and tourism and foreign direct investment (FDI) flows are both surging.

- **Domestic borrowing was significantly below its ceiling**. The government has already unwound the CVEsc 2.3 billion higher-than-targeted borrowing that arose in 2006, and the end-2007 domestic borrowing ceiling has been lowered by the same amount. Tax revenues are growing higher than projected, and receipts from privatization and land sales have already surpassed the amounts budgeted for 2007. Expenditure commitments are being closely monitored and controlled, with expenditures evolving in line with budget ceilings. The government is further strengthening budget management to ensure that this strong performance continues (see below). Because of these measures and stronger growth prospects, domestic debt is expected to decline to below 23 percent of GDP by end-2007, significantly below the target set at the beginning of the PSI program.

6. **Significant progress has been made on the reform front.** In the area of public sector financial management, the government has taken firm measures to prevent a recurrence of central government payment arrears, and there has been no accumulation of such arrears in 2007. There has also been significant reduction in the accumulation of arrears by municipalities (with most of them being current). We are also strengthening budget execution and monitoring practices, including improved control of end-year spending commitments. The Bank of Cape Verde (BCV) is moving ahead with plans to strengthen banking supervision, to upgrade legislation concerning anti-money laundering and combating the financing of terrorism (AML/CFT), and to establish a financial intelligence unit. As part of its broader strategy to improve efficiency and capacity in the energy sector, the government will introduce more transparent approaches for pricing energy products, which will help to ensure that no further contingent fiscal liabilities are borne by the budget.

III. MACROECONOMIC OBJECTIVES AND POLICIES FOR 2008

A. Macroeconomic Objectives

7. **We expect growth to be about 7¾ percent in 2008,** underpinned by further growth in tourism investment and other services, and by public infrastructure investment. Inflation is expected to return to trend value of about 2 percent consistent with the peg. Gross reserves are targeted to increase by 0.1 month of imports. The specific program objectives for the remainder of 2007 and for 2008 are set out in Table 1 (attached).

B. Fiscal policy

8. **Continued fiscal consolidation remains key to our macroeconomic program and the 2008 budget aims at a further sizable reduction of the domestic debt-to-GDP ratio.** This budget is based on prudent projections for revenues and expenditures, with tax revenues and the wage bill budgeted to grow by less than nominal GDP. The goods and services budget is sufficient to ensure timely payment of recurrent bills, notably electricity, water, and fuel. To provide more flexibility in managing debt, the budget's ceiling for domestic borrowing will be on a net basis (rather than on a gross basis as in the past), and the Treasury will seek to clear arrears more rapidly if extraordinary revenues materialize. There will be no additional net domestic borrowing by the budget in 2008. Consequently, the net domestic debt-to-GDP ratio is projected to decline to below 20 percent by end-2008, one year ahead of the original target set under the PSI.

C. Monetary Management

9. **Monetary management remains fully consistent with the program goal of building up foreign exchange reserves to support the exchange rate peg to the Euro.** Within the framework of the exchange rate peg, the BCV will continue to more actively manage liquidity and interest rate differentials with the Euro area. Liquidity management will continue to be implemented through the issuance of 14-day and 6-month central bank bills and the interest rate offered on the 14-day bill constitutes the BCV's official policy rate. More generally, the BCV will continue to monitor the liquidity situation closely and its implications for domestic interest rates and credit growth, and adjust policy operations as appropriate.

D. Structural Reform Issues

Public sector financial management:

10. **The government is moving ahead with its program of strengthening public sector financial management.** In particular, the Ministry of Finance is:

- Closely monitoring spending commitments, payments, and accounts payable through the SIGOF (Integrated Online Budget Management) system, which will be expanded to include all semi-autonomous institutes and most municipalities by the end of this year. In addition a new procedures manual will be drafted with Millennium Challenge Corporation (MCC) funding to support the ongoing decentralization of budget execution and the upcoming implementation of the new budget framework law and new chart of public accounts, and to ensure that all spending units will use SIGOF consistently;

- Instituting as of 2007 an earlier (November 30) deadline for granting new spending commitments to reduce end of year payment pressures. Spending commitments after November 30 will be authorized only on an exceptional basis;

- Introducing a formal mid-year review of fiscal developments: this will assess revenue, expenditure, and financing developments halfway through the fiscal year, compare these with budget forecasts, and take corrective actions if necessary.

- A new chart of government accounts (PNCP) has been approved by Parliament and will be implemented in 2008.

- Preparing a new treasury management system;

- Moving ahead with the development of a medium-term expenditure framework.

11. **The government intends to update and strengthen the tax framework.** Drafts of the revised General Tax Code, a new Code on Judicial Processes, a Forced Tax Collection code, and bills covering individual and corporate income taxes (IRC and IRS) have been prepared, and these will be submitted to the National Assembly before end-December 2007. In addition, to further reduce and streamline the granting of tax incentives and exemptions, the government has commenced preparation of a unified law on tax benefits that will revoke all tax benefits not specifically mentioned in the new law. In support of this effort, the government requests further IMF technical assistance to meet its policy goals in this area and drafting of the associated legislation. The government intends to submit this legislation to the National Assembly in 2008. Pending the completion of this work, a moratorium has been put in place on the granting of new tax exemptions.

12. **To further improve tax administration, the government is strengthening the structure, functioning, and management of the General Directorate of Taxes (DGCI).** These reforms, which draw on the recommendations of recent technical assistance from the IMF, include refocused tax collection and control towards major tax payers. To deter tax evasion, the DGCI will cross-check, using computer tools, taxpayer information in databases in the Ministry of Labor, Social Security Institute and Customs. With the hiring of new tax inspectors, taxpayers will be audited more frequently. The DGCI is also preparing to

implement the Forced Tax Collection Code as soon as possible after its approval. The recovery of tax liabilities of large amounts and close to expiry will be given priority. Recovery processes will be opened more quickly, and assets seized in these processes will be auctioned with minimal delay.

13. **The Ministry of Finance has introduced firm measures to prevent accumulation of public sector arrears.** In particular, the Ministry is:

- carefully monitoring the payment arrears of central government entities, including semi-autonomous agencies;

- working with these entities to strengthen their budget execution and payment practices; and

- applying procedures to make the required payments on behalf of these entities if they incur arrears and deduct those amounts from government transfers to them.

14. **Furthermore, municipalities have agreed in principle to pay electricity bills on time**, and are working with Electra to ensure that the amounts billed correctly reflect their responsibilities in this regard. The government is preparing a tax on consumer electricity bills to meet the costs of public lighting, which has been a persistent area of dispute between municipalities and Electra.

15. **The government is strengthening external and internal audit processes.** A new draft law concerning the Court of Auditors (TdC) has been submitted to the National Assembly. In addition, a new customs audit court has been set up and the Tax Inspectorate will be strengthened and modernized. As for internal audit, a new budget framework law will create the positions of financial controllers in 2008 to strengthen internal audit.

16. **The government is also preparing to implement a number of civil service reforms.** The draft Civil Service Framework Law is expected to be sent to the National Assembly and come into force in 2008. The key objectives of this law were described in the LOI for the second review of the PSI.

Financial Sector Issues:

17. **The BCV is strengthening regulation and supervision of the financial sector.** In particular:

- New bank regulations on capital ratios, provisioning and loan classification; credit risk assessment, and credit concentration have been approved and will soon be published;

- New banking accounting rules based on international accounting standards will be implemented from 2008;

- Procedures for bank licensing and supervision are being strengthened, supported by technical assistance from the IMF;

- The BCV is finalizing information sharing agreements with the home country supervisor of most of the current offshore financial institutions, and seeking similar agreements with other countries;

- Following the recent AML/CFT assessment by the Fund, the BCV is preparing to implement the recommendations arising from this assessment in the first half of 2008 (a new structural benchmark under the program);

- Also drawing on the AML/CFT recommendations, legislation to set up a Financial Intelligence Unit is being prepared and will be presented to the National Assembly by end-March 2008 (a structural benchmark).

18. **The above measures to strengthen the financial sector will support the BCV's strategy of further opening the capital account.** This move will largely validate the current de facto situation regarding inward and outward capital flows. Measured liberalization will support the ongoing economic and financial development of Cape Verde, including access to international financial markets. A revised decree law to further liberalize the capital account has been drafted and should soon be submitted to the Government for approval.

Energy Sector Reform

19. **The government is putting in place a comprehensive strategy to ensure that the energy sector is able to support the growth and development of Cape Verde, and is not a source of fiscal risk.** Working with public and private participants in the sector, the government's strategy emphasizes:

- Investment to increase capacity and efficiency, including improvements in electricity generation and transmission, higher water production capacities, and development of alternative energy sources;

- Increased private sector participation in the sector's management and investment activities;

- Formation of a joint logistics company to handle importation, storage and inter-island distribution of oil products;

- Improvement in billing and collection practices, including use of pre-paid meters for electricity and reduction in illegal connections.

20. **To support the above developments, the government remains committed to improving the regulatory frameworks for the energy sector.** With the administrative council of ARE (economic regulatory agency) again at full strength, the government is determined to ensure that domestic fuel prices are adjusted in line with international prices. In this respect, retail gasoline and diesel prices were increased by 15 and 11 percent respectively on October 24 which will clear the contingent fiscal liabilities that had built up over the period while prices were unchanged. Furthermore, the government has directed ARE to ensure, through regular fuel price adjustments, that no further fiscal liabilities accrue. To support the regular and transparent alignment of domestic fuel prices with international prices, ARE intends to have a new adjustment mechanism in place no later than end-March 2008. This mechanism will be based on international benchmark prices and applied with minimal delay after each shipment of oil imports. Publication and implementation of this mechanism will be a new structural benchmark under the PSI program.

21. **An adjustment in electricity and water tariffs is not required at present.** A commission charged by the oil companies on earlier fuel supplies to Electra (the electricity and water utility) should not have been charged. The resulting balance now owed to the Treasury will be drawn on to cover the difference between the (notional) revised fuel oil and the actual price Electra will be charged for the rest of 2007. After that the market price will be charged (with consequent adjustments in electricity and water prices).

22. **Implementation of the mechanism for setting base electricity tariffs is also planned for the first quarter of 2008.** This mechanism had originally been expected to be ready by June 2007, but has been delayed by the need to confirm two new members of the ARE administrative council. Its implementation by March 2008 (which will be an assessment criterion for the fourth review under the PSI) will enable base electricity tariffs to begin to reflect the broader structural reform strategy noted above that will improve efficiency in the energy sector.

Table 1. Cape Verde: Quantitative Assessment Criteria and Benchmarks for 2007-08 Under the PSI [1, 2]

	2006	2007								Cumulative Flows from End-December, 2007 2008			
	Dec.	March			June			Sep.	Dec.	March	June	Sep.	Dec.
	Level Actual	Indicative target	Indicative target w/ adjusters	Actual	Assessment Criteria	Assessment Criteria w/ adjusters	Actual	Indicative target	Assessment Criteria	Indicative Target	Assessment Criteria	Indicative Target	Indicative Target
Quantitative targets													
Ceiling on net domestic borrowing of the central government [3]	...	-0.8	-0.2	-2.3	-1.5	-0.3	-4.0	-2.9	-3.9 [9]	-0.4 [10]	-0.8 [10]	-1.3 [10]	-1.7 [10]
Ceiling on net domestic assets of the central bank [4]	1.5	-0.7	-0.2	-0.4	-1.5	-0.2	-4.7	-2.3	-3.0	-0.7	-1.3	-2.0	-2.6
Ceiling on the accumulation of new domestic payment arrears by the central government	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0 [5]	0.0	0.0	0.0	0.0	0.0
							(Millions of U.S. dollars)						
Ceiling on the accumulation of new external payment arrears by the central government [5]	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on the contracting or guaranteeing of non-concessional external debt with original maturity of more than one year by the central government [6]	...	5.0	5.0	0.0	21.0	21.0	0.0	28.0	35.0	5.0	21.0	28.0	35.0
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one one year by the central government [5,7]	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
							(Millions of euros)						
Floor on net international reserves of the Bank of Cape Verde (BCV) [9]	183.3	10.3	9.7	8.2	20.6	19.3	53.0	30.0	41.2	13.3	26.6	38.7	53.2
Memorandum item:							(Billions of Cape Verde escudos)						
Program assumptions													
Nonproject external financial assistance, including credit line (program assumption)	...	0.7	0.7	0.0	1.5	...	0.0	2.2	3.0	0.6	1.2	1.8	2.4
External debt service	...	0.7	0.7	0.5	1.3	...	1.1	2.0	2.6	0.7	1.3	2.0	2.6
Land sales	...	...	...	...	...	...	...	...	2.0	...	...	...	...
Clearance of end-2006 stock of domestic arrears	...	0.3	0.3	0.1	0.5	...	0.2	0.8	1.0	0.4	0.8	1.1	1.5

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

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

[3] Excluding borrowing for clearance of arrears and net late payments. The ceiling will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service, and upward (downward) by the cumulative downward (upward) deviation in nonproject external financial assistance relative to program assumptions.

[4] The ceiling will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviation in nonproject external financial assistance relative to program assumptions.

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

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

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

[8] The floor on net international reserves of the Bank of Cape Verde will be adjusted upward (downward) by the cumulative downward (upward) deviations in external debt service, and downward (upward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions.

[9] The end-2007 ceiling will be adjusted upward by the downward deviation in revenue from contracted land sales relative to program assumption.

[10] The 2008 ceilings will be adjusted downward by the downward deviation in revenue from contracted land sales in 2007 relative to the 2007 program assumption.

Table 2. Cape Verde: Structural Assessment Criteria and Benchmarks for 2007–08			
Objectives	Conditionality	Timing	Status
	Structural Assessment Criteria		
Reduce fiscal risks.	Fully implement the automatic utility tariff adjustment mechanism.	End-March 2007	Met
Reduce fiscal risks.	Finalize and publish the mechanism for setting base utility tariffs	End-June 2007	Not met
Reduce fiscal risks.	Fully apply mechanisms for setting and adjusting electricity, water, and fuel prices	Continuous as of July 1, 2007	Not met
	Structural Benchmarks		
Strengthen financial supervision.	Sign formal information-sharing agreements with home country supervisors of subsidiaries and branches operating in Cape Verde.	End-December 2006	In progress
Improve budget prioritization	Implement the MTEF.	End-June 2007	In progress
Strengthen financial regulation.	Implement recommendations of the task force on financial sector reform.	End-June 2007	In progress
Strengthen fiscal control.	Implement laws to strengthen the Court of Auditors (TdC) and the National Chart of Public Accounts.	End-June 2007	In preparation
Strengthen the tax base.	Large taxpayers unit to be fully operational	End-June 2007	Met
Strengthen tax administration.	Finalize reform strategy for DGCI	End-December 2007	
Strengthen the tax base.	Submit the new General Tax Code to the National Assembly.	End-December 2007	
Strengthen the tax base.	Submit the new Code on Judicial Processes to the National Assembly.	End-December 2007	
Strengthen the tax base.	Submit the draft individual and corporate income taxes bills to the National Assembly.	End-December 2007	

Table 2. Cape Verde: Structural Assessment Criteria and Benchmarks for 2007–08, concluded[1]

Objectives	Conditionality	Timing	Status
Proposed New Measures			
	Structural Assessment Criteria		
Improve fiscal policy execution	Complete a formal mid-year review of revenue and expenditure developments that allows for taking corrective actions if necessary.	End-August 2008	
Reduce fiscal risks.	Finalize and publish the mechanism for setting base utility tariffs	End-March 2008	
	Structural Benchmarks		
Reduce fiscal risks.	Finalize and publish a revised mechanism for adjusting petroleum prices.	End-March 2008	
Improve budget control	Instituting November 30 as deadline for granting new spending commitments to reduce end year payment pressure.	End-October 2007	
Strengthen financial supervision.	Submit to the National Assembly legislation to establish a Financial Intelligence Unit.	End-March 2008	
Strengthen financial regulation.	Submit to the National Assembly legislation to criminalize financing of terrorism and facilitate the combating of financing of terrorism.	End-March 2008	
Strengthen financial regulation.	Submit to the National Assembly legislation to strengthen the framework for combating money laundering.	End-March 2008	

[1] Measures added in the third program review.

ATTACHMENT II—TECHNICAL MEMORANDUM OF UNDERSTANDING[1]

1. This memorandum sets out the understandings between the Cape Verdean authorities and the IMF staff regarding the definition of assessment criteria and indicative targets and reporting requirements under the first annual program supported by the Policy Support Instrument.

I. QUANTITATIVE ASSESSMENT CRITERIA AND INDICATIVE TARGETS

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

2. **Net domestic borrowing excluding for clearance of arrears and net late payments** is defined as the cumulative change since the start of the calendar year of the net credit to the central government from the banking and nonbanking sectors less (1) the cumulative clearance during the calendar year of the stock of arrears as of the end of the previous year and (2) the cumulative payments during the first three months of the calendar year of expenses authorized by the previous year's budget, and plus the expenses accrued during the current year that will be paid during the first three months of the next calendar year as provisioned for in the budget law (late payments or *atrasados*). The ceiling will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. Also, the end-2007 ceiling will be adjusted upward by the downward deviation in revenue from contracted land sales relative to program assumption, and the 2008 ceilings will correspondingly be adjusted downward by the downward deviation in revenue from contracted land sales in 2007 relative to the 2007 program assumption.

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

4. **Reporting requirements.** Data on the implementation of the budget compiled by the Ministry of Finance and Public Administration will be provided on a quarterly basis, to be submitted not later than five weeks after the end of each quarter, including (i) government domestic revenue by category; (ii) external budget support grants; (iii) government

[1] Unchanged from EBS/07/44, except for last sentence of paragraph 2 that has been added.

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

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

B. Net Domestic Assets of the Central Bank

6. The ceiling on the cumulative change, from the beginning of calendar-year 2006, in net domestic assets of the BCV constitutes an assessment criterion. Net domestic assets (NDA) of the BCV are defined as reserve money minus net foreign assets of the BCV, evaluated at the current end-of-period exchange rates. The program ceilings for NDA will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates. Reserve money comprises bank reserves and deposits of the monetary institutions and private sector with the central bank, as well as cash in circulation.

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

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

8. Under the program, ceilings on medium- and long-term, as well as on short-term, nonconcessional external debt constitute assessment criteria. The ceiling on medium- and long-term nonconcessional external debt is on a quarterly basis while the one on short-term nonconcessional external debt is on a continuous basis. Nonconcessional external debt is defined as debt contracted or guaranteed by the central government with a grant element of less than 35 percent, calculated using currency-specific commercial interest reference rates (CIRRs) published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). Debt rescheduling and debt

reorganization are excluded from the limits on nonconcessional external debt. The limits on new nonconcessional external debt contracted or guaranteed by the central government (excluding borrowing from the Fund) are specified in Table A1 of the Letter of Intent. The definition of short-term nonconcessional external debt excludes normal short-term (less than one year) import-related financing. The Portuguese government's precautionary credit line in support of the exchange rate peg is also excluded from the definition of nonconcessional external debt. The assessment criterion on medium- and long-term nonconcessional external indebtedness applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00) but also to commitments contracted or guaranteed for which value has not been received. With respect to the assessment criterion on short-term nonconcessional external indebtedness, the term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00).

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

D. Net International Reserves of the Central Bank

10. The floor on the cumulative change, from the beginning of calendar-year 2006, in net international reserves (NIR) of the BCV constitutes a assessment criterion under the program. The NIR of the BCV are defined as gross international reserves of the BCV net of its external reserve liabilities, calculated at the current exchange rates. Gross reserves of the BCV are those that are readily available (i.e., liquid and marketable and free of any pledges or encumbrances), controlled by the BCV and held for the purposes of meeting balance of payments needs and intervening in foreign exchange markets. They include gold, holdings of SDRs, the reserve position at the IMF, holdings of foreign exchange and traveler's checks, demand and short-term deposits at foreign banks abroad, fixed-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade securities. External liabilities of the BCV comprise liabilities to nonresidents contracted by the BCV with an original maturity of less than a year, any net off-balance-sheet position of the BCV (futures, forwards, swaps, or options) with either resident and nonresidents, any arrears on principal and interest to external creditors and suppliers, and purchases from the IMF. The program floors for the NIR will be adjusted upward (downward) by the cumulative downward (upward) deviations in external debt service and downward (upward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.

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

E. Nonaccumulation of New Domestic Payments Arrears

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

13. **Reporting requirements.** The Ministry of Finance and Public Administration, through the D.G.T., will submit on a quarterly basis a detailed table of the stock of domestic payments arrears, including the accumulation, payment, rescheduling and write-off of domestic payments arrears during the quarter. The data are to be provided within four weeks after the end of the quarter.

F. Nonaccumulation of External Payments Arrears

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

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

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

II. Structural Assessment Criteria[2]

A. Finalize and publish the mechanism for setting base utility tariffs

17. The condition for finalizing and publishing the mechanism for setting base electricity and water tariffs will be deemed complete when (i) the technical specifications have been agreed upon between Electra and the autonomous Economic Regulatory Authority (ARE); (ii) the details of the base tariff setting mechanism have been published; and (iii) base tariff levels are brought in line with the agreed mechanism.

B. Continuous application of the mechanisms for setting and adjusting electricity, water, and fuel prices

18. The condition will be deemed met when (i) base utility tariffs are set, and reset with the periodicity, as specified in the agreed base tariff setting mechanism; (ii) between resetting of base tariffs, utility tariffs are adjusted whenever input costs since the last adjustment have changed cumulatively by more than three percent as specified in the published utility tariff adjustment mechanism; and (iii) within one month of each import shipment of petroleum products, retail petroleum product prices are adjusted and brought in line with the specifications in the retail petroleum price adjustment mechanism.

III. Other Data Requirements for Program-Monitoring Purposes

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

[2] See Table A2 of the Letter of Intent of November 29, 2007.