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December 26, 2007

The Acting Chair's Summing Up
Cape Verde—Third Review Under the Policy Support Instrument
Executive Board Meeting 07/112
December 21, 2007

Directors commended the Cape Verde authorities' continued prudent macroeconomic management, and welcomed their reaffirmation of the objectives of the program supported by the Policy Support Instrument (PSI). Growth is strong, unemployment and poverty rates are falling, and inflation pressures are moderate. The upcoming graduation from the UN's least-developed-country status is particularly noteworthy. Directors welcomed the faster-than-expected domestic debt reduction and build-up of official reserves, with the targets initially set for 2009 likely to be reached in 2008. They reiterated that the exchange rate peg has served Cape Verde well, and considered the real exchange rate to be broadly in line with fundamentals. Some Directors advised the authorities to keep the recent deterioration of the current account deficit under close review.

Looking ahead, Directors believed that the authorities should focus on consolidating the gains made on macroeconomic stability and moving forward expeditiously with structural reforms. In that connection, stronger efforts will be needed to implement comprehensive reforms in the energy sector, including to improve pricing mechanisms. Directors considered that the continued implementation of the policies envisaged under the PSI should help reinforce macroeconomic stability, reduce dependence on aid over time, and strengthen the economy's resilience to shocks.

Directors considered it important to further develop the financial sector to safeguard its stability and enhance Cape Verde's growth prospects. They welcomed the measures being taken to strengthen financial sector regulation and supervision, including implementing the recommendations of the recent AML/CFT assessment. They supported the authorities' request for an FSAP.

Directors called for correcting the long-standing weaknesses in public financial management, which resulted in a revision of information on net domestic borrowing. They welcomed the progress being made to improve budget execution and monitoring, including by committing to undertake a formal mid-year review of fiscal developments, which will allow corrective actions to be taken, if necessary. Directors supported the authorities' request for technical assistance to accelerate public financial management reforms.

Directors stressed that the authorities should move rapidly to execute their plans for a comprehensive overhaul and strengthening of the energy sector, which will be critical for enhancing growth and poverty reduction and limiting fiscal risks. In that connection, Directors called on the authorities to redouble their efforts to establish a new base utility tariff structure and to apply continuously and automatically the fuel and utility price adjustment mechanisms. This would depoliticize price setting, safeguard the budget, and give companies in the energy sector incentives for investment and efficiency gains.