FOR AGENDA

EBS/08/67

June 9, 2008

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Cape Verde—Staff Report for the 2008 Article IV Consultation and Fourth Review Under the Policy Support Instrument**

Attached for consideration by the Executive Directors is the staff report for the 2008 Article IV consultation with Cape Verde and the fourth review under the Policy Support Instrument for Cape Verde, which will be brought to the agenda for discussion on **a date to be announced**. A draft decision appears on pages 30 and 31. 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, AFR (ext. 36518).

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 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

Staff Report for the 2008 Article IV Consultation and Fourth Review Under the Policy Support Instrument

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

Approved by David Nellor and Mark Plant

June 9, 2008

Mission	Praia, March 5–19, 2008. The mission met Minister Duarte, Governor Burgo, the Finance Committee of the National Assembly, government officials, and representatives of civil society, donors, and businesses. The IMF team comprised Messrs. Leigh (head), Castro, Ronci, and Shanghavi (all AFR).
Recommendation	The report recommends a waiver for the nonobservance of a continuous structural assessment criterion based on corrective actions taken, and completion of the 4th PSI review. All end-December 2007 quantitative assessment criteria were met.
Discussion topics	The Article IV discussions focused on policies needed to preserve external and domestic stability: • Keep debt on an appropriate path by anchoring fiscal policy in a medium-term perspective. • Safeguard financial stability by reducing reliance on non-resident deposits. • Enhance resilience to shocks by deepening structural reforms to diversify the economy and increase price flexibility.
Fund relations	The Executive Board concluded the 3rd PSI review on December 21, 2007. The previous Article IV consultation for Cape Verde, which is on a 24-month cycle, was concluded in July 2006. Cape Verde has accepted the obligations of Article VIII of the IMF Articles of Agreement and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. The de facto and de jure exchange rate arrangement of Cape Verde is a conventional fixed peg to the euro.

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Executive Summary

Over the last several years, Cape Verde has achieved a major economic transformation that is a tribute to its sound homegrown economic reform program. Real per capita GDP has increased on average by over 7 percent a year since 2001, faster than most small island economies and the average for sub-Saharan Africa. In 2006 real GDP growth reached double digits, boosted by tourism, telecommunications, and construction. Staff estimate that GDP grew by about 7 percent in 2007, and factoring in the effects from the global economic slowdown, growth is expected to moderate only slightly in 2008 as tourism and construction continue to expand. Twelve month inflation averaged about 3½ percent for December 2007–April 2008, broadly in line with inflation in the euro area.

Policy implementation under the PSI is strong. All PSI quantitative assessment criteria for end-December 2007 were met with wide margins. There was a 9 percentage points of GDP reduction in domestic public debt as revenues are ahead of the authorities' targets and expenditures are as budgeted. Official reserves are also building rapidly. Thus, domestic policies are strengthening the credibility of the exchange rate peg. Progress on structural reforms is steady, especially reforms related to public financial management, the tax system, the financial sector, and energy sector regulation. However, technical difficulties prevented implementation of the continuous assessment criterion on full application of the mechanism for setting and adjusting fuel prices. On the basis of remedial measures taken by the authorities, staff recommends granting a waiver for the missed continuous structural assessment criterion.

The 2008 Article IV consultation discussions and the 4th review of the PSI focused on policies for consolidating gains on macroeconomic stability and deepening structural reforms to sustain high growth over the medium term. The mission and the authorities reached broad understandings on measures for responding to the challenges Cape Verde faces and minimizing vulnerabilities to preserve external stability:

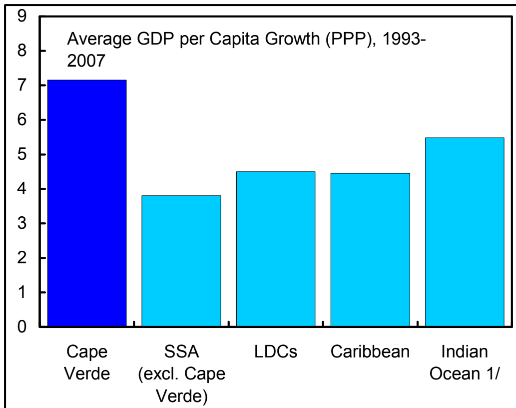
- A medium-term fiscal framework which accommodates the authorities' desire to increase investment in infrastructure and the energy sector while keeping debt on an appropriate path;

- Financial sector reforms to broaden the funding base of banks and reduce reliance on nonresident deposits, while laying the foundation for the authorities' plans for further liberalization of the capital account; and

- Structural reforms to foster private sector development, diversify the economy, and improve price flexibility in both goods (energy) and factor (labor) markets to support the exchange rate peg.

I. A SUCCESS STORY IN SUB-SAHARAN AFRICA

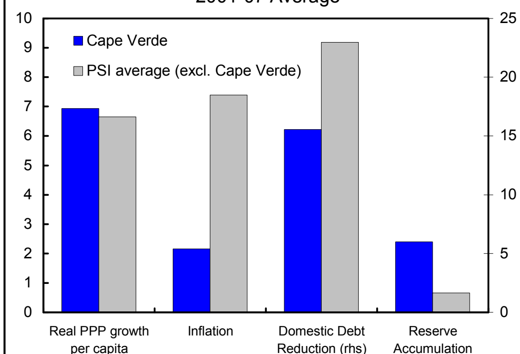
1. **Over the last several years, Cape Verde has achieved a major economic transformation.** Real per capita GDP has increased on average by over 7 percent a year, faster than other small island economies and other countries in sub-Saharan Africa. The unemployment rate fell by more than 10 percentage points between 2001 and 2006.[1] Cape Verde is also on track to achieve most of the MDGs by 2015, including halving the 1990 poverty level. This is remarkable for a small island economy with no natural resources. The transformation is reflected in an economy that is increasingly becoming service-based, led by tourism and commerce.



Source: World Economic Outlook and National authorities.
1 Mauritius, Seychelles and Maldives.

2. **Cape Verde also compares favorably with other mature stabilizers.** Growth from 2001–07 was about the average for countries that entered a PSI program, and inflation was the lowest. Although domestic debt reduction since 2001 was below the average for the PSI group, at its current rapid pace of reduction it should rival that average in a few years. The net present value of external central government debt has been reduced by 16 percent of GDP since 2001, despite the fact that, unlike most PSI countries, Cape Verde did not benefit from debt relief under the HIPC initiative and the MDRI.[2] Since 2001, reserve accumulation by Cape Verde was higher than the PSI group average. In recognition of its strong performance and policy credibility, Cape Verde was accepted as a special partner of the European Union in November 2007, was invited to join the WTO in December 2007, and graduated from UN least-developed country (LDC) status in January 2008 (the second in sub-Saharan Africa after Botswana and the first graduation in more than a decade).

Cross Country Comparison of PSI Program Countries, 2001-07 Average[1]



Source: World Economics Outlook and IMF staff estimates.
1 Includes Tanzania, Senegal, Mozambique, Nigeria and Uganda.
Note: Domestic debt reduction is in percent of GDP and reserve accumulation is in months of imports

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[1] However, at just under 20 percent, the unemployment rate is still high, mainly because of structural factors (notably the skills mismatch in the labor market, difficulties in interisland mobility that have resulted in a segmented labor market, and possibly a high reservation wage due to remittance flows).

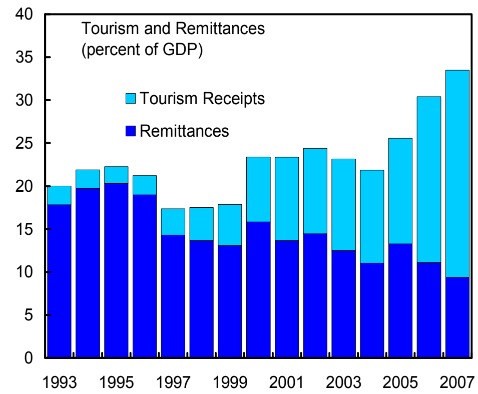
[2] Cape Verde's nominal debt to IDA, the IMF-PRGF Trust, and the AfDF at the end of 2005 was approximately US$346 million (34 percent of GDP).

3. **Cape Verde's progress owes much to a homegrown reform program that has produced good policy outcomes:**

- **Lower domestic debt:** Tax reforms, notably the introduction of the value-added tax (VAT) in 2004, which improved revenue buoyancy, and tight restraint on recurrent spending, helped by civil service reform, have reduced domestic debt considerably.

- **A stronger external position:** Good policies catalyzed high inflows of tourism-related foreign direct investment (FDI), which are breaking past dependence on aid and remittances. Thus, international reserves were rebuilt, which enhanced the credibility of the exchange rate peg.

- **Greater private sector participation:** Structural reforms were undertaken to foster competition and enhance private sector's role in the economy. Several state-owned enterprises were privatized; the government selected new management to prepare the national airline (TACV) for privatization; and the process of privatizing the ports operator (ENAPOR) is underway. Ahead of WTO accession, external tariffs were lowered. The Cape Verde Stock Exchange has been revitalized; its market capitalization is now 25 percent of GDP (from zero in 2005).



Source: World Economic Outlook and National authorities.

These economic achievements were facilitated by Cape Verde's political stability and enhanced governance.

4. **The 2008 Article IV consultation discussions and 4th PSI review focused on policies to consolidate these gains on macroeconomic stability and deepen structural reforms to sustain growth over the medium term.** Discussions centered on anchoring fiscal policy in a medium-term perspective, preserving financial stability, and enhancing the economy's resilience to shocks.

II. Recent Performance and Outlook

A. What Is Happening in the Economy Now

5. Economic growth is strong with moderate inflation: The real GDP growth rate peaked at 10.8 percent in 2006, boosted by tourism, telecommunications, and construction. Based on information from the National Statistical Institute (INE), staff estimate that GDP grew about 7 percent in 2007 and, factoring in the effects of the global economic slowdown, growth should moderate only slightly to 6 ½ percent in 2008 as tourism and construction continue to expand. With the peg to the euro and the high openness allowing rapid import price pass-through, twelve-month inflation averaged about 3½ percent for December 2007–

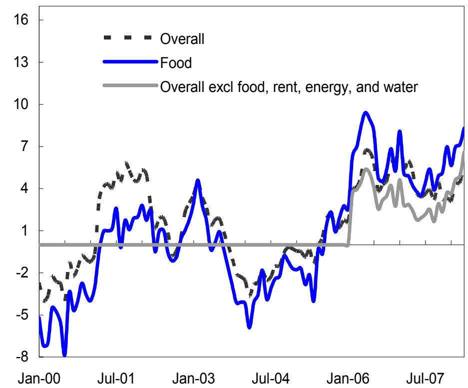
April 2008, broadly in line with inflation in the euro area.[3] While food and energy prices have risen, this has not led to generalized inflation partly due to lack of a strong wage indexation.

Cape Verde: Contribution to Growth
(Annual percentage change)

	2003	2004	2005	2006	2007 est.
Agriculture and fishing	0.1	0.0	0.0	0.1	0.0
Industry and energy	0.3	0.7	0.6	0.5	0.3
Construction	0.0	0.0	**1.4**	**1.5**	**1.7**
Commerce	0.8	1.1	1.7	0.9	0.9
Hotels and restaurants	0.7	0.5	0.6	**1.5**	0.9
Transport and communications	1.1	1.1	0.0	**3.3**	**1.4**
Banks and insurance[1]	-0.4	-0.1	-0.1	0.1	0.0
Public service	0.9	0.8	0.9	**1.2**	0.6
Other[2]	1.1	0.2	1.4	**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 housing rent, taxes on imports and all other sectors.

Cape Verde: CPI Inflation Rates, Jan 2000 – April 2008
(12 month percent change)[1]



Sources: National authorities and staff calculations.
[1] New CPI basket in effect from Feburary 2006.

6. **Fiscal policy continues to support the peg.** Staff estimate that the prudent 2008 budget will ensure that domestic debt will be further reduced to 16 percent of GDP by end-2008. Tax revenues are exceeding budget forecasts, reflecting not just economic growth but also improvements in tax administration; also, asset sales have surpassed expectations. These factors, together with continued expenditure restraint, have reduced the domestic debt-to-GDP ratio.[4] The authorities' target for domestic debt, 20 percent of GDP, was reached in 2007, two years ahead of schedule (Figure 1).

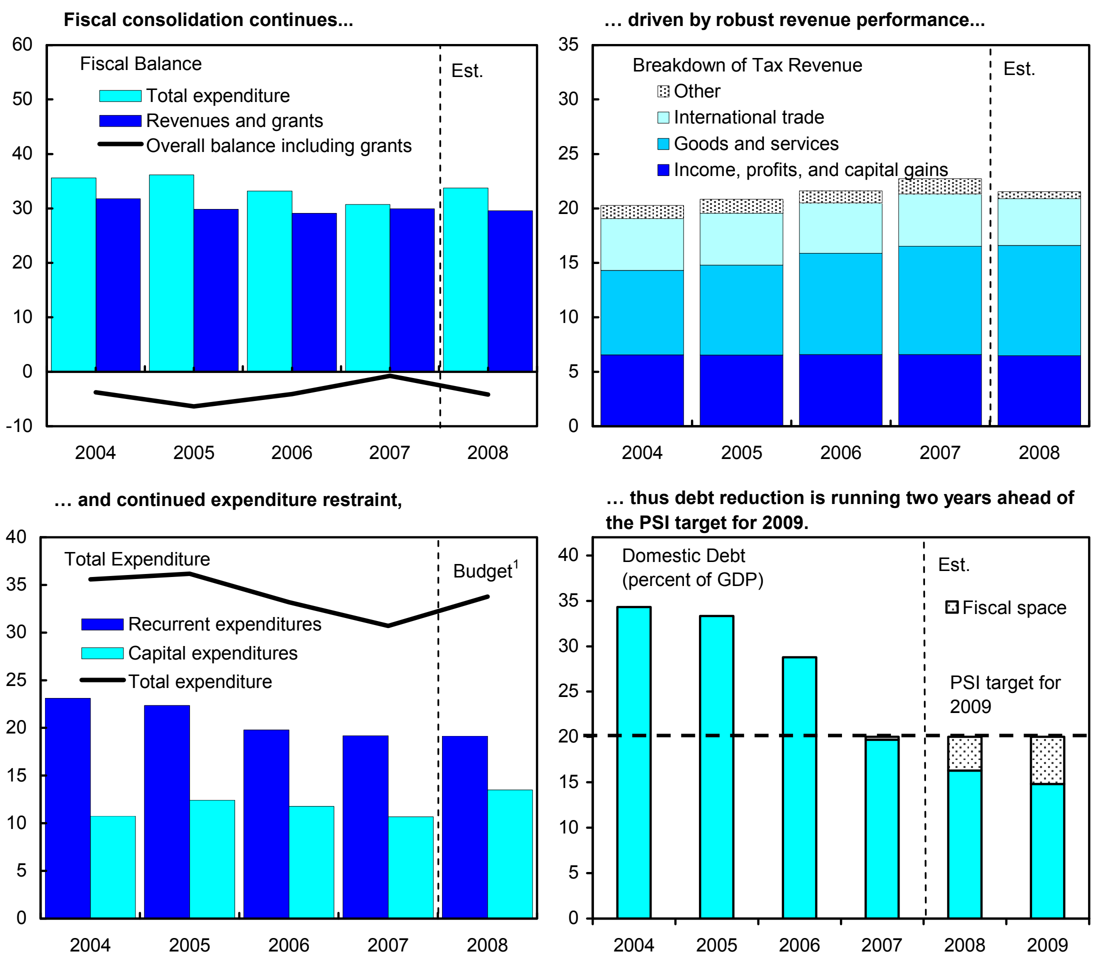
7. **The Bank of Cape Verde (BCV) continues to conduct monetary management appropriately.** Given the peg and a largely open capital account, passive monetary management by the BCV has been setting the official policy rate consistent with its endogenous equilibrium level, which smoothes and sterilizes short-term capital flows. Reserves continue to accumulate, and while FDI-related imports have led to and financed a higher current account deficit, there are no signs of a more general increase in imports that would jeopardize the targeted increase in reserves (Figure 2). Excess liquidity has been contained by sterilization, by the new investment opportunities on the Stock Exchange following rapid development of the domestic equity market, and by growth in private sector

[3] A new inflation methodology was introduced in February 2008 and the time-series was recalculated from January 2005.

[4] Many other factors explain the strong fiscal performance including the ongoing hiring freeze. The PFM innovations in the wake of the weaknesses in data reporting for 2006 were also successful. Most notably, decentralizing the budget execution and introducing the deadline of November 30 to grant new spending commitments prevented the carryover of accounts payable from 2007 into 2008.

credit (Figure 3). The buildup of government deposits at the BCV is also helping to sterilize external inflows. Thus, monetary management and fiscal prudence are both supporting the exchange rate peg and promoting external stability.

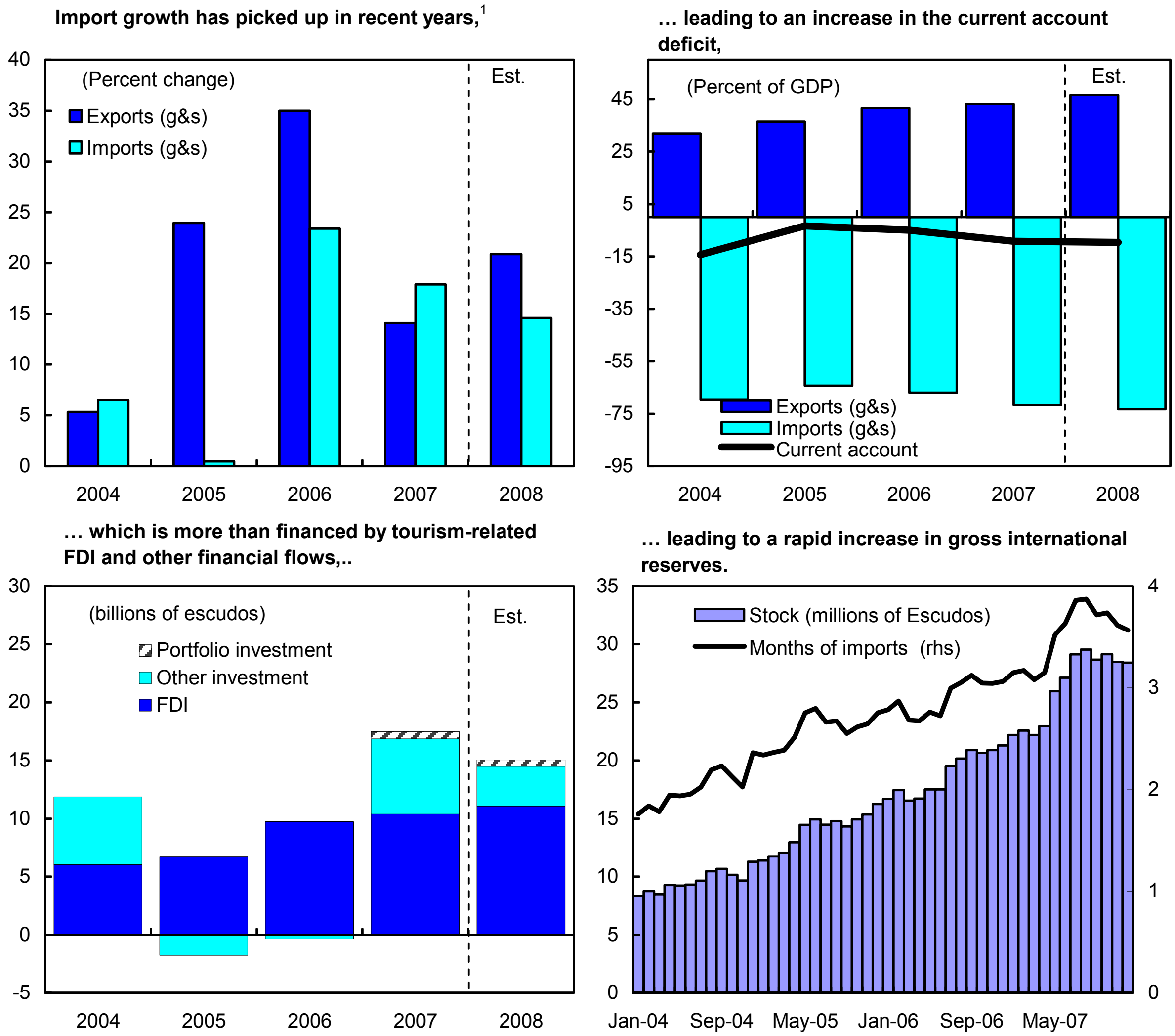
Figure 1. Cape Verde: Fiscal Performance, 2004–08
(Percent of GDP)



Source: National authorities and IMF staff estimates.

[1] The capital expenditure budget is typically underexecuted owing to capacity and donors' delays.

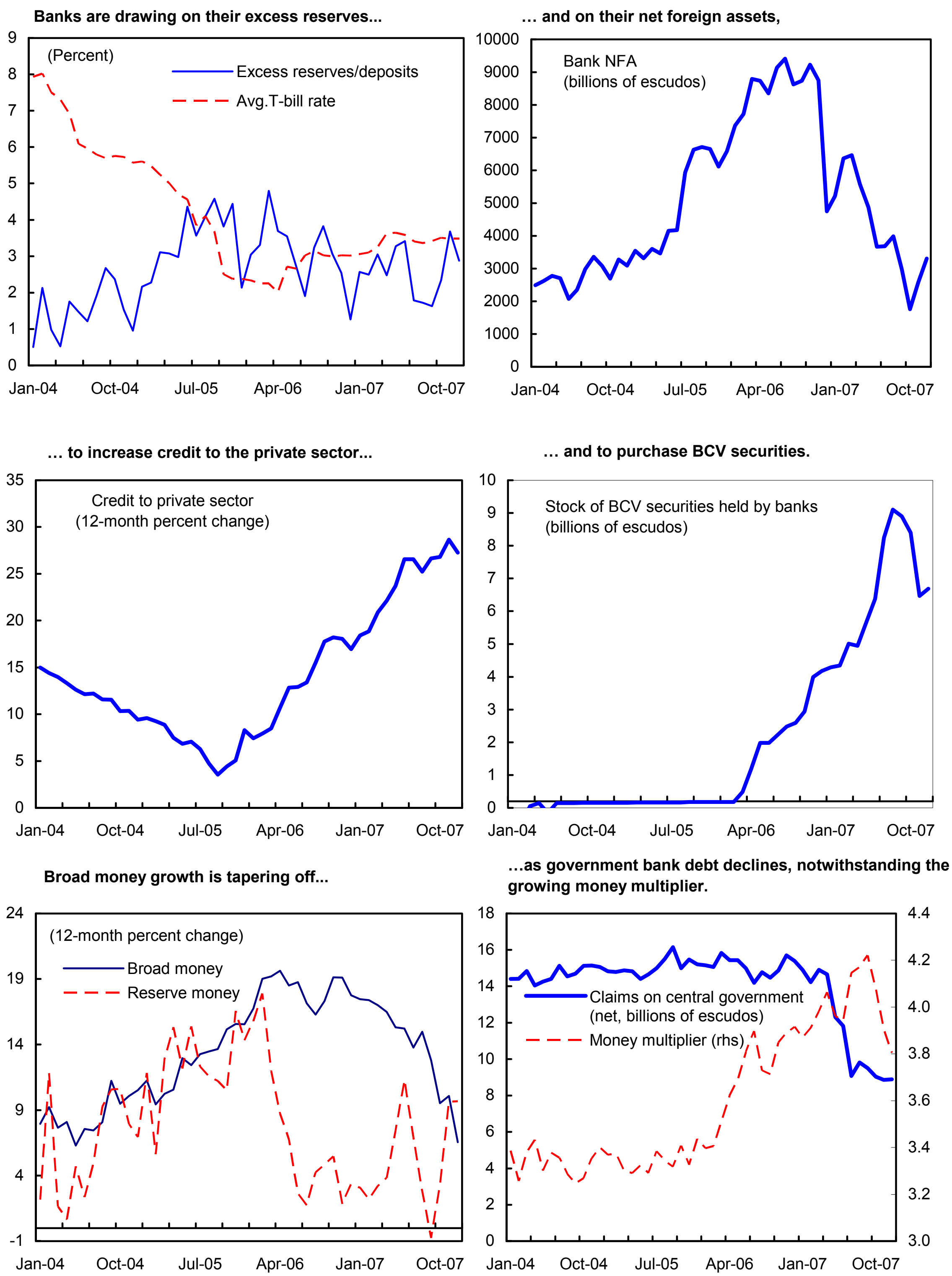
Figure 2. Cape Verde: External Developments, 2004-2008



Source: National authorities and IMF staff estimates.

[1] Growth in total exports in 2007 was dampened by a sharp decline in re-exports of fuel because South African Airlines stopped refueling in Cape Verde.

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



Source: National authorities and IMF staff estimates.

B. Policy Implementation Under the PSI

8. **All PSI quantitative assessment criteria for end-December 2007 were met with wide margins.** The ceiling on net domestic borrowing was observed by a margin of 1.8 percent of GDP reflecting a much improved public financial management system, which also prevented the accumulation of arrears. International reserves exceeded the PSI floor by about 0.2 months of imports despite some moderation in the last quarter of 2007 as FDI slowed.

9. **Despite capacity constraints, steady progress was made on implementing the structural assessment criteria:**[5]

- The authorities reported that the base utility tariffs mechanism was finalized and approved by the Economic Regulatory Agency (ARE) on March 27, 2008 and posted on ARE's website on the following day (LOI, ¶ 5). The goal of this structural assessment criterion in the program is to achieve full cost recovery to stop the accumulation of tariff deficits, a contingent liability. The adjustment of the final electricity price for consumers based on the new base tariffs will take into account the impact of the global food and oil price inflation on the poor and vulnerable segments of the population.[6]

- On the fuel pricing side, however, the complex cost structures of the two oil companies, Shell and Enacol, posed technical difficulties that prevented implementation of the continuous assessment criterion on full application of the mechanism for setting and adjusting fuel prices.[7] To solve this problem, the Economic Regulatory Agency (ARE) took two main corrective actions: First, it adjusted fuel prices on March 25, 2008, clearing implicit subsidies owed to the oil suppliers that had accrued since the previous adjustment in October 2007.[8] Second, after some delay due to lack of funding, ARE hired a consultant to develop a new fuel pricing formula (a structural benchmark for March), which is expected to be finalized and published by end June 2008. The new simplified and more transparent formula, based on a unified cost structure of the upcoming joint venture between the oil companies, will ensure regular fuel price adjustments, stop accrual of fiscal liabilities, and encourage much-needed investment in the energy sector. On the basis of these remedial measures taken by the authorities, the staff recommends granting a waiver for the missed structural assessment criterion.

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[5] Going forward, in line with the IMF-World Bank JMAP (Informational Annex), the Fund is expected to play a subsidiary role to the Bank on both energy and labor market issues.

[6] The measures being considered by the government include increasing the social transfers to CVE 3,500, expanding the eligible group, and to a lesser extent exempting grains from import duties and VAT. The estimated fiscal impact is negligible as most food items are already exempt and the increase in cash transfers will be small (around € 3 per recipient).

[7] The assessment criterion called for application of the regulation according to which fuel prices should be adjusted every time the price of an incoming shipment of fuel imports changes by ±2 percent.

[8] Prices of gasoil and heavy fuel were raised by 12 percent, butane by 7 percent, and gasoline by 2.3 percent.

10. **Important progress has also been made on implementing the structural benchmarks, despite some delays (text table).**

Cape Verde. Selected Structural Benchmarks for 2007–08[1]

Benchmark	Timing	Status
Tax Reforms		
Submit the new General Tax Code to the National Assembly (LOI ¶5).	End-Dec. 2007	To be implemented in June 2008[2]
Submit the new Code on Judicial Process to the National Assembly (LOI ¶5).	End-Dec. 2007	To be implemented in June 2008[2]
Submit the draft individual and corporate income tax bills to the National Assembly (LOI ¶5).	End-Dec. 2007	Postponed to October 2008 (LOI ¶5)
Financial Sector		
Implement the recommendations of the task-force on financial sector reform.	End-June 2007	Met in November 2007
Submit to the National Assembly legislation to establish a Financial Intelligence Unit (LOI ¶5).	End-March 2008	Met
Submit to the National Assembly legislation to criminalize financing of terrorism and facilitate the combating of financing of terrorism (LOI ¶5).	End-March 2008	To be implemented in June 2008[2]
Submit to the National Assembly legislation to strengthen the framework for combating money laundering (LOI ¶5).	End-March 2008	To be implemented in June 2008[2]
Public Financial Management		
Instituting November 30 as deadline for granting new spending commitments to reduce end year payment pressure.	End-October 2007	Met
Finalize reform strategy for General Tax Directorate (DGCI).	End-Dec. 2007	Met

[1] As in the Letter of Intent and Memorandum of Economic and Financial Policies of November 2007 for the 3rd PSI review (IMF Country Report 08/37).
[2] Submitted to the Council of Ministers in May 2008.

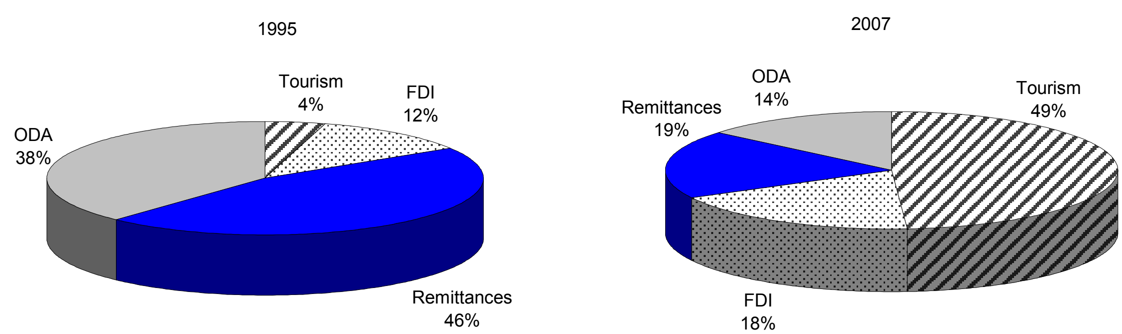
C. Outlook, Risks and Challenges

11. **The near-term outlook is broadly favorable but risks are tilted to the downside reflecting the continued high oil prices and more generally the global slowdown.** Because the Cape Verde economy is predominantly service-based and depreciation of the US dollar is containing oil prices in escudos, the oil price impact is likely to be manageable.[9] Cape Verde also remains relatively unexposed to international capital markets as non-emigrant cross-border flows are relatively small. However, the global slowdown could have knock-on effects on Cape Verde's external demand (including tourism) or FDI flows. Specifically, while none of Portugal's banks that have dominant shares in Cape Verde banks have experienced difficulties so far, Cape Verde could be somewhat affected as the turmoil appears to have had some impact in the United Kingdom, Ireland and Spain which are important sources of FDI, remittances and tourism flows.

[9] Staff simulations suggest that if oil prices were to stay just above $100/ barrel for the remainder of 2008, growth will be ¼–½ percentage point lower.

12. **Staff expect strong economic performance over the medium term.** Growth is projected to average about 6¾ percent through 2013, underpinned by tourism, FDI, and public investment. Cape Verde is expected to consolidate its position among the highly-tourism based economies (Box 1). The current account deficit will likely widen and be financed increasingly by the strong FDI flows (non-debt creating) unlike a decade ago, when debt and remittances financed the balance of payments. Emigrant remittances are expected to taper off as income in Cape Verde grows faster than in the countries where its emigrants reside and emigration declines. Staff's empirical analysis also suggests that remittances are becoming more procyclical and thus less reliable as a shock absorber (Box 2). On concessional financing, in preparing for the transition from LDC status, the authorities reached out extensively, and most donors confirmed that graduation will not lead to an abrupt end to concessional aid. Continued fiscal restraint is envisaged over the medium term and the revenue losses of WTO accession and EU- economic partnership agreement will be limited and gradual.[10]

Balance of Payments Source of Financing, 1995-2007



Source: National authorities

13. **This said, Cape Verde faces old vulnerabilities and emerging challenges:**

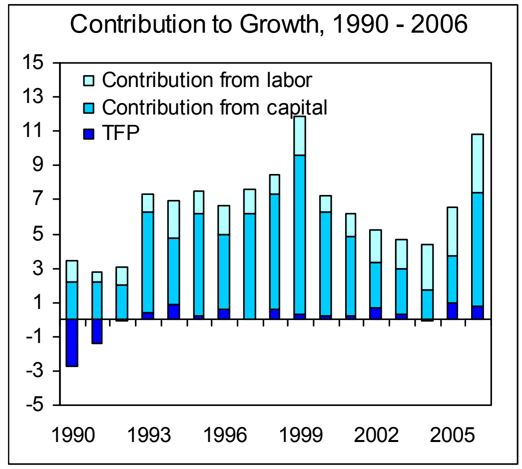
- **Infrastructure bottlenecks still constrain growth**. Continued growth in the tourism sector will require large-scale investments in transportation and energy infrastructure. Making use of the fiscal space to increase capital expenditures, while maintaining debt sustainability, poses a challenge.

- **The financial sector still relies on nonresident deposits.** These deposits constitute about 40 percent of total bank deposits making the banking system's funding base significantly reliant on them. The annual growth rate of the stock of non-resident deposits (NRD), although still respectable at about 6 ¼ percent, has slowed in recent years. However, there are doubts about how interest-sensitive these deposits are. While banks have been

[10] The applied duty rates are already below the bound rates in Cape Verde's WTO commitments; the rationalization of exemptions will broaden the tax base and revenue from non-exempt imports are expected to rise over the medium term as tourism activity grows.

pressured to launch new savings products to continue to attract NRDs in a context of declining rates,[11] the home bias and historical resilience of these remittance-based inflows significantly minimize the risks of a reversal. Thus, it remains unclear the extent to which the NRDs are a potential capital account-based source of vulnerability and hence warrant close monitoring.

- **Cape Verde's export base is narrow.** The economy is vulnerable to a weakening of international demand for tourism, especially given the scarcity of natural resources as alternative exports. To date structural reforms have not been sufficiently broad-based to sustain high growth in the long term, and there are difficulties in adjusting to demand shocks given the ongoing specialization in tourism and the limited price and wage flexibility.[12] Limiting the vulnerability associated with this specialization, diversifying sources of growth, and increasing the economy's flexibility to buffer against shocks pose a challenge.



III. Policy Discussions: Sustaining the Strong Performance

14. **The discussions focused on the policies needed to maintain Cape Verde's impressive macroeconomic performance and stability in the face of changing balance of payments flows.**

- Guided by external stability, the mission discussed a package of measures to respond to these challenges and minimize vulnerabilities to preserve macroeconomic stability. These include the use of a medium-term fiscal framework to accommodate the authorities' plans to increase infrastructure and energy sector investment while keeping debt on an appropriate path; financial sector reforms to broaden the funding base of banks and reduce reliance on non-resident deposits, while further liberalizing the capital account; and structural reforms to diversify the economy and increase price flexibility in both goods and factor markets to enhance resilience to shocks.

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[11] While banks are competing to attract NRDs by raising rates on these deposits at the margin, average interest rates across all maturities continue to decline.

[12] Capital deepening has been the key driver to growth in Cape Verde while the contribution from total factor productivity (TFP) (structural reform driven) has been historically small. The growth accounting here assumes a Cobb-Douglas production function $Y = AK^{\alpha}N^{1-\alpha}$, where Y is aggregate output, A is total factor productivity, K is capital, and N is labor.

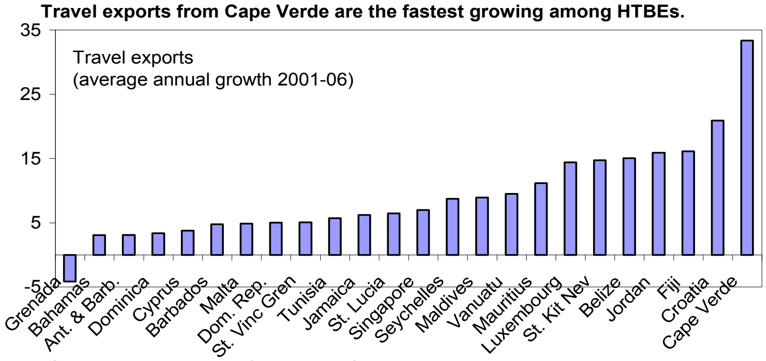
- The authorities concurred, in particular on the changing balance of payments, and welcomed the mission's work on Cape Verde through cross-country analysis of highly-tourism-based economies. Nevertheless, they emphasized that in some areas capacity constraints may hamper policy implementation and in this context reiterated that they will continue to need technical assistance from the Fund in a range of areas. In the attached Letter of Intent (Appendix), the government affirms its commitment to the policy goals described in its recent Memorandum of Economic and Financial Policies (MEFP) (EBS/07/132) and updates its plans to meet those goals.

Box 1. The Tourism Boom[1]

Cape Verde is the fastest-growing tourism market among the highly-tourism-based economies (HTBEs). It was recently discovered as a new frontier for European tourism. Travel exports have grown by more than 30 percent annually on average for more than a decade, far outpacing other HTBEs. The development of the tourism sector has been a success for Cape Verde with obvious growth benefits and poverty reduction potential.

Country-specific factors explain the comparative advantage in tourism: convenient location, good position to harness the overflow of Mediterranean tourism, a favorable sociopolitical situation, macroeconomic stability, and good governance.

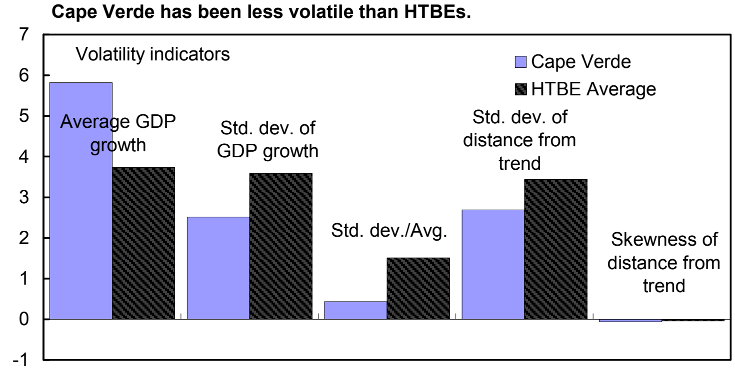
Travel exports from Cape Verde are the fastest growing among HTBEs.



Source: IMF, Balance of Payments Statistics Yearbook

However, specialization in tourism and increasing openness will bring high volatility. Dependence on a single export means that shocks to demand for that export will propagate throughout the entire economy. The tourism sector in Cape Verde is not an enclave and is becoming a conduit for external shocks and the business cycle is becoming synchronized with tourism originator countries. Cross country analysis shows that output volatility tends to increase as economies become more HTBE. HTBE also have business cycles with higher amplitude and longer duration, so large buffers are needed to smooth consumption during longer and deeper contraction phases. However, countercyclical policies are not available to Cape Verde because it has a passive monetary policy under a peg, and the small fiscal multipliers with the high import leakage. Thus, as it becomes more and more an HTBE, Cape Verde would need buffers through higher reserves and fiscal space.

Cape Verde has been less volatile than HTBEs.



Source: IMF staff estimates.

[1] Selected Issues, Chapter 1.

A. Maintaining Fiscal Prudence

Staff and the authorities agreed on the need to articulate a medium-term fiscal strategy. This would provide room for the authorities' planned increase in infrastructure spending to sustain the tourism boom and ensure that the upcoming tax reforms are broadly revenue-neutral.

15. **The mission and the authorities agreed on the need to orient fiscal policy in a medium-term perspective.**

- Staff noted that the reserves target should anchor medium term fiscal policy. By constraining domestic demand to build up foreign reserves, fiscal policy contributes directly to the credibility of the peg. The use of the reserves target to anchor medium-term fiscal policy is also consistent with keeping public debt along an appropriate path. The recent decline in the country risk premium largely reflects better fiscal fundamentals and the associated rise in official reserves. Staff's cross-country analysis shows that while growth has been higher than average and inflation lower, Cape Verde's public debt-to-GDP ratio is one of the highest among highly-tourism-based economies, and its reserves are below average (Figure 4). Thus, Cape Verde needs larger buffers in the form of higher international reserves and fiscal space (Box 1), especially in the context of declining reliability of remittances to smooth consumption and hedge against macroeconomic shocks (Box 2).

Adequacy of Central Bank's Reserves (average)

	1999-04	2005-07	2008-13	2013
		(percent)		
Reserves/ Base money	43	99	140	144
Reserves/ Short term external debt 1/	62	126	169	172
		(months of imports)		
Reserves/ Prospective Imports	1.6	3.1	3.9	4.2
Reserves/ Prospective Permanent Imports 2/	1.8	4.0	5.5	5.9

Source: National Authorities, staff estimates and projections.
1/ Short term debt based on remaining maturity.
2/ Permanent imports equal imports minus one-half of FDI and of tourism exports.

- The authorities concurred and stated that their objective is to increase reserves by about 0.1 month of prospective imports annually reaching over 4 months by 2013. This is appropriate as it is equivalent to about 6 months expunging FDI-related imports, and 172 percent of short-term debt, supported by continued fiscal restraint.

16. **Staff and the authorities reached understandings on the operational aspects of medium-term fiscal policy.** Thus, the authorities agreed to include a new structural measure in the PSI program on submitting a simplified medium-term fiscal framework (MTFF) to the Council of Ministers along with the 2009 budget proposal and publishing it on the Ministry of Finance website (LOI, ¶8).[13] Implementing this MTFF would require accelerating public financial management (PFM) reforms to enhance implementation capacity and thereby improve the quality of public investment. Given the fiscal space created by the larger-than-expected reduction in domestic debt in 2007, the envisaged medium-term baseline scenario projects that the fiscal deficit will average about 5 percent of GDP through 2013, bringing the total nominal debt-to-GDP ratio from 67 percent at the end of 2007 to 49 percent by 2013.[14] This scenario assumes that, since the authorities have already reached their domestic debt target of 20 percent of GDP, they will keep the ratio below that over the medium term to buy "policy insurance" against shocks and to support the peg. To provide room for the authorities' planned increases in infrastructure expenditures to sustain the tourism boom and reduce poverty, an alternative scenario was developed in which capital expenditures on infrastructure increase by further 2 percent of GDP annually for five years. The results show that even under this scenario, the risk of debt distress remains low (Figure 5).[15] Furthermore, the authorities' envisaged reserve buildup is preserved (¶ 15).[16] Moreover, recent steps taken by the authorities to improve the energy pricing mechanism coupled with their broader energy sector reform plan (LOI, ¶ 12), will also help reduce fiscal risks over the medium term and potentially contribute fiscal space toward infrastructure development. The MTFF will also be a tool to ensure that the upcoming tax reforms and the rationalization of tax exemptions are implemented in a broadly revenue neutral fashion. The authorities also noted that operationalizing the MTFF will enhance the implementation of the new Poverty Reduction Strategy (PRSP-2), which was finalized in May 2008.

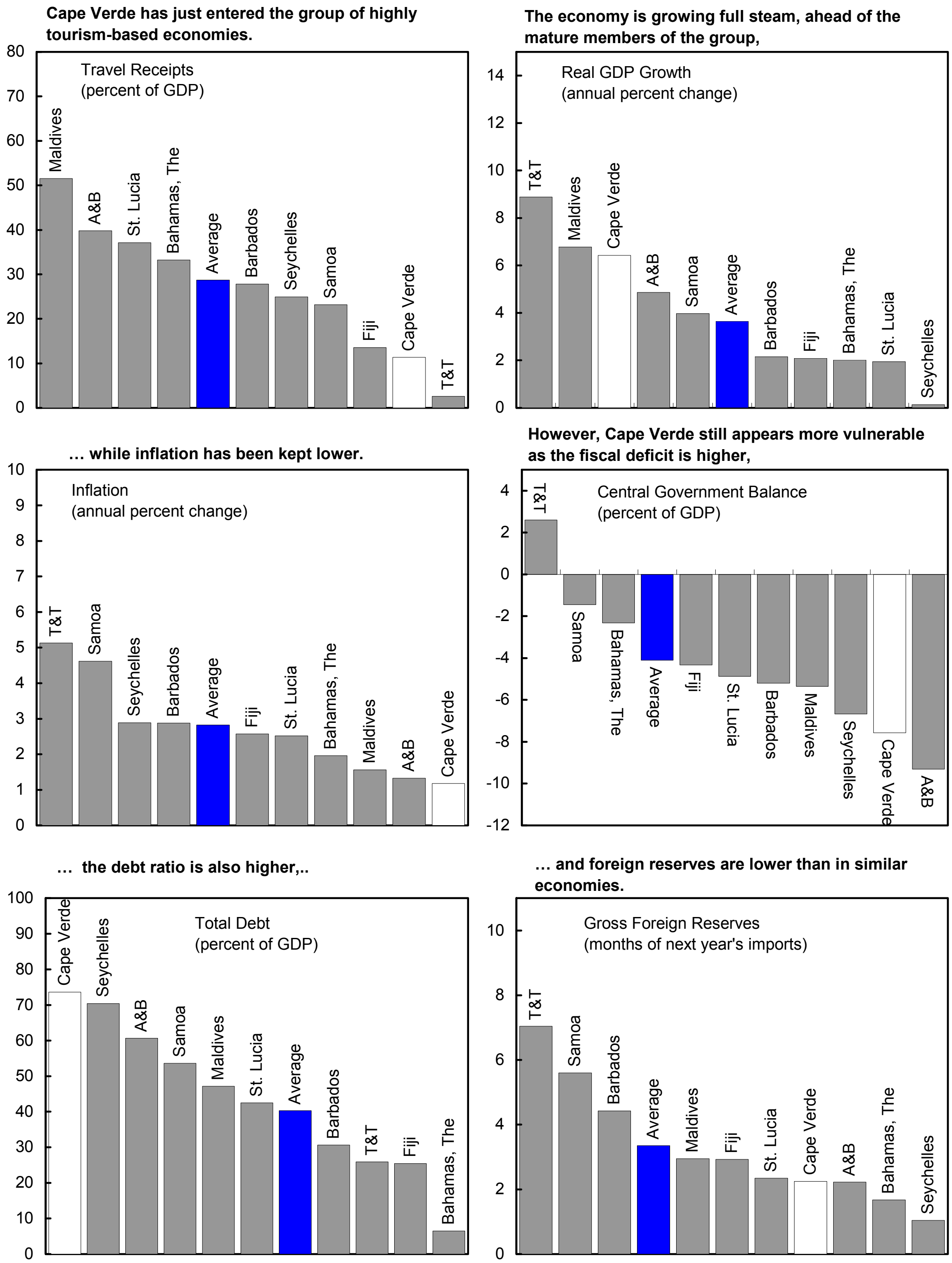
[13] A simplified MTFF indicates total annual revenues, expenditures, domestic financing, and external financing for the next three years.

[14] The domestic debt reduction path in this report is more ambitious than envisaged in the last staff report (EBS/07/132).

[15] The PSI program's US$35 million ceiling on nonconcessional external borrowing and government guarantees gives the authorities room to finance growth-enhancing energy and infrastructure projects. This ceiling remains unused owing partly to capacity constraints on debt management (LOI, ¶ 9) and partly to the continued availability of concessional financing, including from IDA and Portugal.

[16] See 2007 DSA (Country Report 08/37).

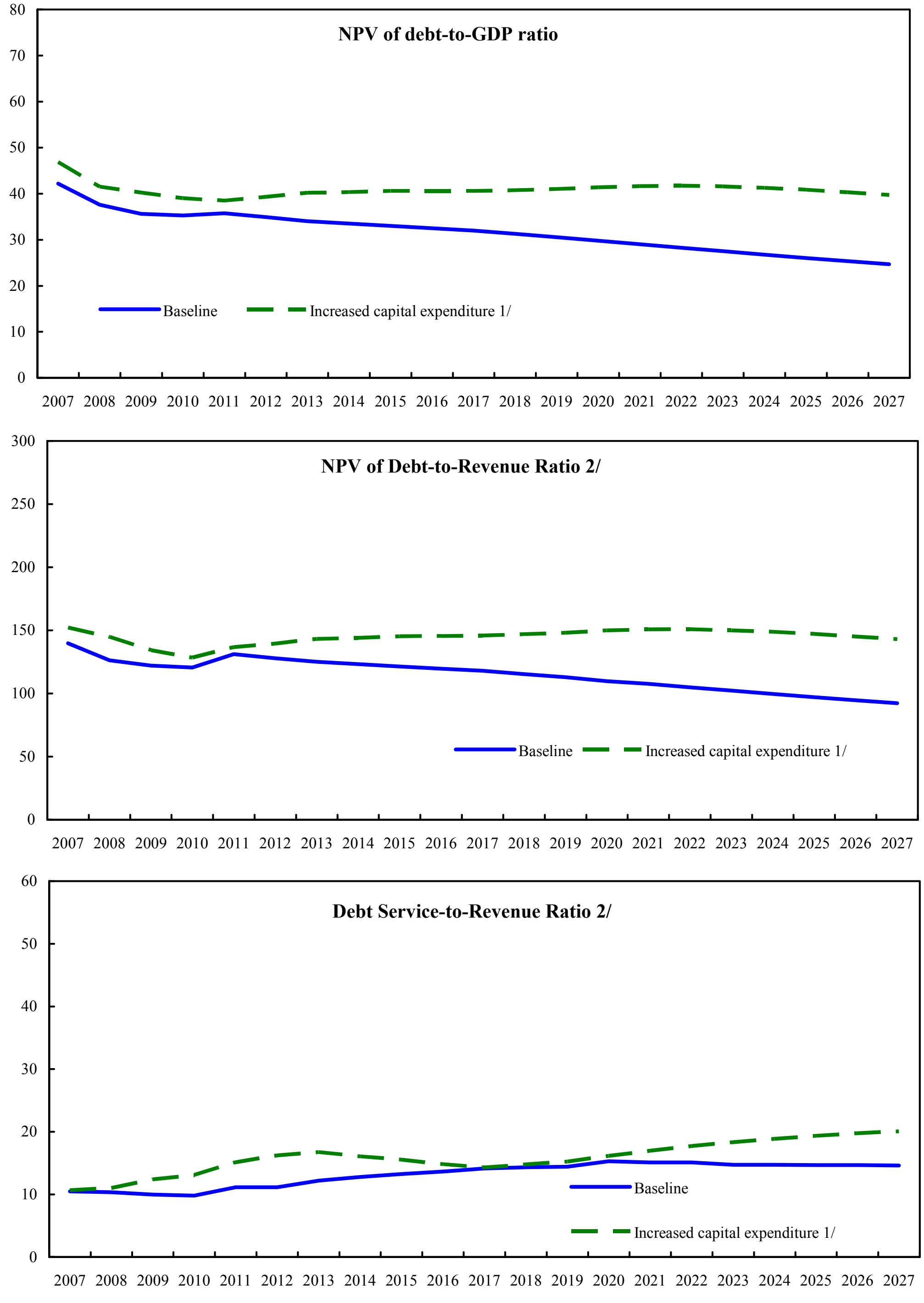
Figure 4. Cape Verde in Cross-Country Perspective, Based on Highly Tourism Based Economies (Average for 2000-06[1])



Source: *World Economic Outlook* and *International Financial Statistics.*

[1] A&B: Antigua and Barbuda; T&T: Trinidad and Tobago.

Figure 5. Cape Verde: Indicators of Public Debt Under Alternative Scenarios, 2007−27



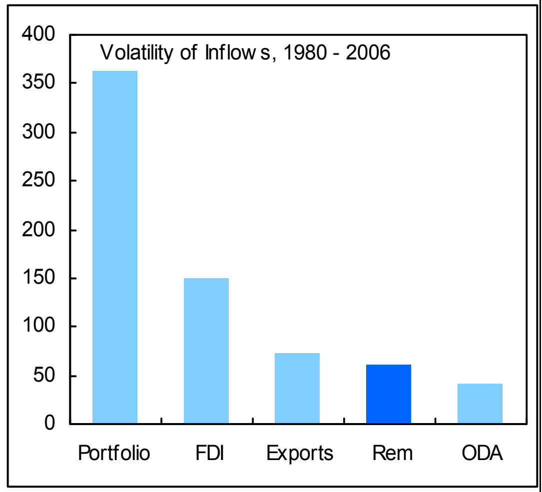
Source: Staff projections and simulations.

1/ See 2007 DSA (IMF Country Report 08/37)

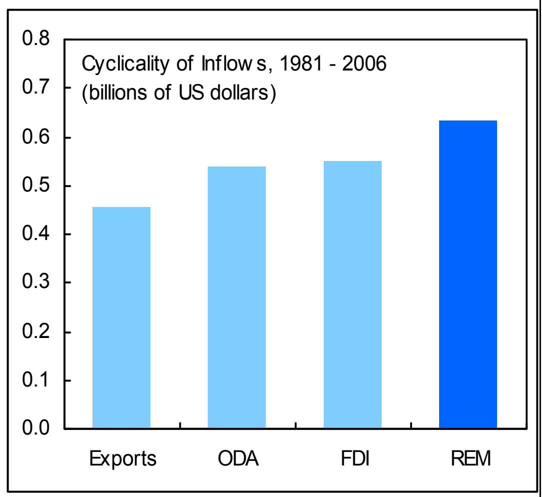
2/ Revenue including grants.

Box 2. Remittances: A Less Reliable Hedge against Macroeconomic Shocks [1]

The changing financing structure of the balance of payments calls for a closer look at the volatility of worker remittances and their role as a shock absorber. Historically, remittances from the Cape Verdean diaspora have constituted a large share of external financing. Staff's previous analysis (WP/06/132) found that remittances from Europe were largely driven by altruistic motives and thus acted countercyclically in smoothing consumption, while flows from the United States may have partly been motivated by investment in Cape Verde.



Indeed, remittances have been less volatile than foreign direct investment (FDI) and exports, and only slightly more volatile than official development assistance (ODA). Compared to other inflows, remittances remain an important source of foreign currency even as they decline in importance: remittances as a share of total foreign financing fell from 46 percent in 1995 to 18 percent in 2007.



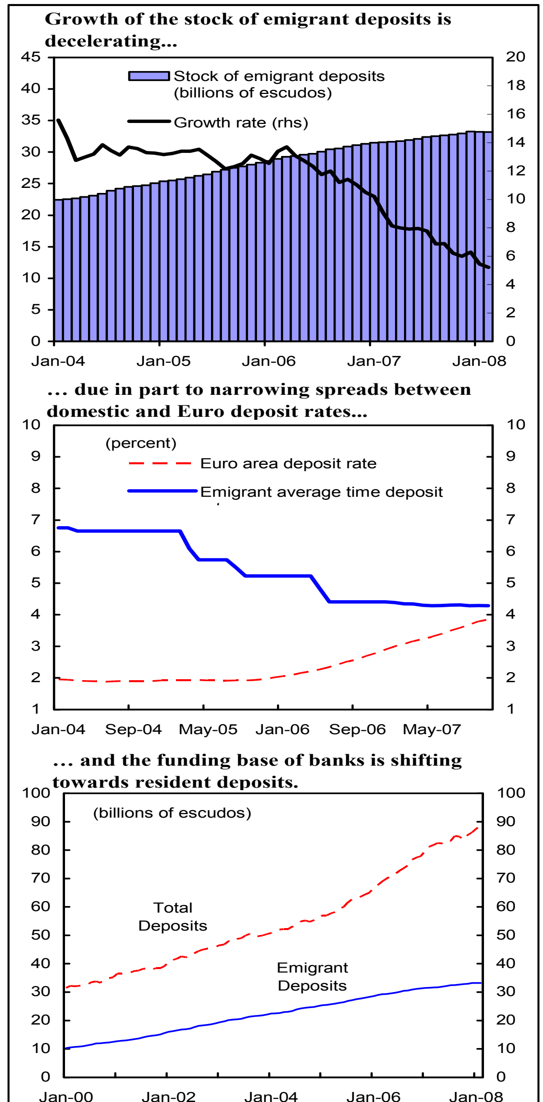
More recent econometric evidence suggests that remittances are becoming increasingly procyclical, thus reducing their role as a shock absorber. Disaggregated data from Portugal, France, and the USA suggest that remittances are positively associated with business cycles in Cape Verde: a 1 percent increase in real GDP growth in Cape Verde raises remittances by approximately 2.5 percent. Detrended by the Hodrick-Prescott filter, remittances and GDP show a relatively high correlation of 70 percent from 1980 through 2006. Overall, the relationship between remittances and GDP based on a battery of empirical analysis suggest that remittances have been increasingly motivated by investment considerations rather than altruistic considerations or for consumption smoothing.

[1] Selected Issues, Chapter 2.

B. Preserving Financial Stability

Staff and the authorities agreed on the challenges posed by the continued deceleration of the growth of nonresidents deposits in the banking system. The slowdown poses both liquidity risk for banks and a potential capital account based source of vulnerability.

17. **The mission called for enhanced monitoring of nonresident deposits in the banking system and more generally the funding base for banks.** Banks noted that the slowdown in non-resident deposit flows into the banking system was due to new investment opportunities in the Cape Verde Stock Exchange. Some nonresidents are reportedly diversifying their portfolios away from bank deposits in a search for higher yields in equities. Better monitoring of the sources and direction of these deposits is important for promptly detecting potentially destabilizing capital flows to gauge the appropriateness of the official policy interest rate. The slowdown of these deposits can be better managed on two fronts:



Source: National authorities and staff estimates.

- **Continue BCV's cautious approach of conducting monetary management consistent with the peg.** The mission noted that the BCV should continue to carefully set its short-run official policy interest rate consistent with its endogenous equilibrium level—the level that smoothes inflows or outflows of short-term capital.[17]

- **Strengthen the banking system.** Strong oversight of banking system soundness would help attract more diverse sources of financing as a way to grow out of dependence on nonresident deposits. Recent measures taken to strengthen the financial system (LOI ¶ 5) will go toward meeting this goal. The BCV should

[17] Staff's analytic work shows that BCV's policy rate (based on the 14 day BCV paper), is in the long run in line with the exogenous Euro interest rate and the exchange rate peg (the convergence is relatively fast), while in the short term the BCV adjusts its policy rate taking into account the interest differential between the domestic banks' deposit and Euro deposit rates to smooth out foreign flows.

also follow up on the recommendations of the recent MCM technical assistance for an enhanced macro-prudential surveillance framework to be built around an expanded set of financial soundness indicators.

18. **The authorities stated that the financial system is broadly sound and banks have ample liquid assets.** The BCV noted that they view the continued decline in the growth of nonresident deposits from the perspective of a changing balance of payments rather than the impact on bank liquidity, as resident deposits are gradually becoming a dominant source of funding for banks.[18] To better measure how interest-sensitive non-resident deposits are, the BCV will closely monitor external flows (including these nonresident flows), an action that will be supported under the PSI as a structural benchmark (LOI, ¶ 11). They also noted that their plans to liberalize financial flows will also support the diversification of the financial system. The authorities noted, and staff concurred, that removing bureaucratic burdens on certain types of financial flows should not pose any near-term risk; it would largely validate the current de facto situation, remove formal restrictions hampering resident participation in tourism projects, and further develop Cape Verde as an international financial center.[19]

19. **The mission recommended strengthening the framework for analyzing the real-financial sector linkages.** While the current macro-prudential surveillance framework, which is focused mostly on banks, shows a sector that seems to be generally sound, available financial soundness indicators (FSIs) are limited in scope and coverage.[20]

- Cape Verde's FSIs compare well with international benchmarks and are better than the average for sub-Saharan Africa. Banks generally comply with the prudential requirements, thanks to BCV enforcement efforts. New regulations for both on- and off-shore banks on capital ratios, provisioning and loan classification, credit risk assessment, and credit concentration were published in November 2007.

- However, the lack of a broader macro-prudential surveillance leaves considerable uncertainty about current and emerging macro-critical risks and vulnerabilities. Better understanding the links between the tourism boom and the real estate market, and the financial system is urgent. Anecdotal evidence suggests a significant price rise in the luxury end of the real estate market boosted by non-residents' demand for second homes. Although

[18] The evidence on the interest sensitivity of these non-resident deposits is mixed based on extensive econometric analysis by staff; see (WP/06/132—"Determinants of Emigrants Deposits in Cape Verde"). More recent data analysis did not radically alter that paper's conclusions.

[19] Portfolio investments and forward foreign exchange transactions are liberalized. FDI, external borrowing, and capital transfers abroad are formally subject to BCV authorization.

[20] The capital adequacy ratios of all banks are above 10 percent. The NPL ratio for the four onshore banks, which averaged about 4 percent in 2006, increased in 2007 as stricter loan classification criteria were implemented.

banks exposure to the residential real estate is mainly with residents and largely backed by collateral (with a loan-to-value ratio of 80 percent), some banks are now also venturing into large real estate projects to non-residents without a comprehensive credit risk assessment—at commercial banks themselves, and at the macro-prudential level at the BCV. While non-residents purchasing second homes are more loyal to sustain tourist arrivals, shocks to tourism could propagate to the real estate market and may affect banks. Furthermore, continued slowdown of non-resident deposits may subject the banking system to liquidity risk. The forthcoming FSAP should help to strengthen the authorities' hands on these issues.

C. Maintaining Competitiveness and Fostering Private Sector Development

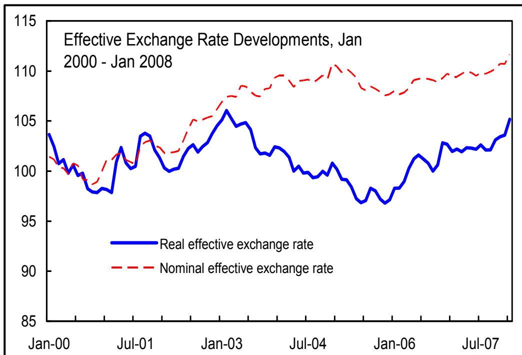
Both staff and authorities view the exchange rate as broadly in line with macroeconomic fundamentals, and the peg remains appropriate and supported by domestic policies. The authorities agreed with staff on the need for broader export diversification, and increased price flexibility consistent with the peg, and to foster private sector development.

20. **The mission called on the authorities to use the window of opportunity provided by the tourism boom to diversify the economy and improve price flexibility to enhance resilience to shocks.** Structural reforms to make the economy more flexible will be key to competitiveness and to sustaining high growth in the long term. The authorities' efforts to address both infrastructure gaps and labor market rigidities bode well for enhancing growth, as do Cape Verde's recent accession to the WTO and its commitment to liberalize trade. Sustained productivity growth is essential to maintain competitiveness.

Cape Verde: Selected Economic Integration and Openness Indicators

	1998	2006
Main merchandise import: EU share	76.9	73.2
Main merchandise export: EU share	99.3	85.8
Tourist arrivals: EU share	...	87.6
Remittances: EU share	70.5	78.5

source: National authorities



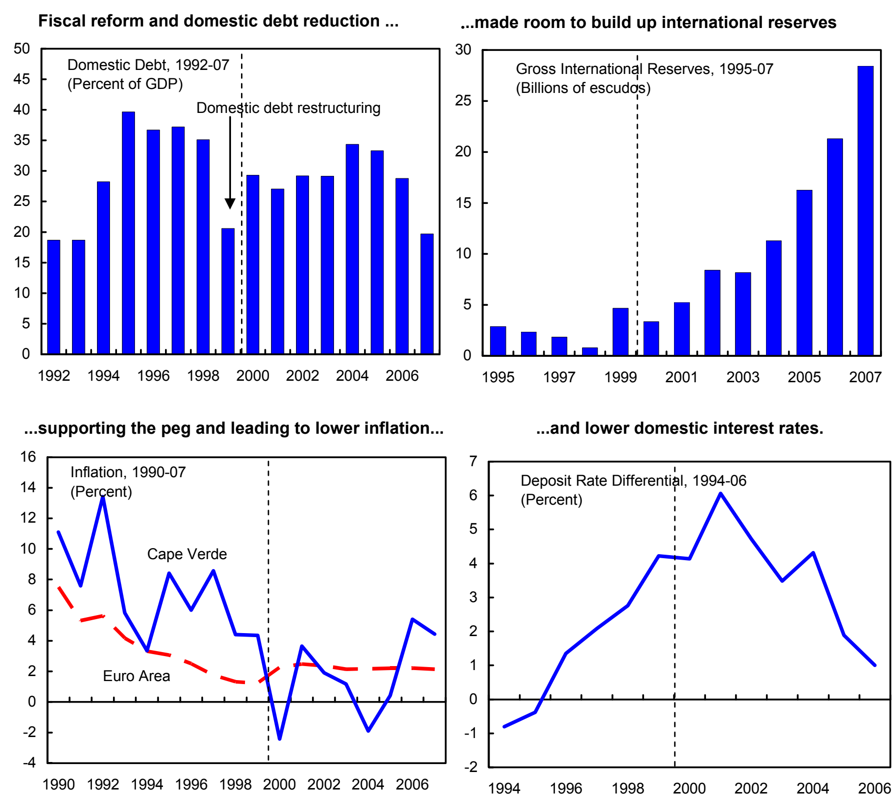
Source: IMF, *Information Notice System*.

21. **Cape Verde's balance of payments position is consistent with external stability and the tourism boom does not raise undue concerns.** Staff and the authorities agreed that the recent increase in the current account deficit is no reason for concern because it is largely linked to FDI-related imports, and there is an automatic stabilizer (imports will decelerate if tourism and FDI flows decelerate). Although tourism inflows also affect the determination of the real effective exchange rate (REER), the REER is broadly in line with fundamentals (Box 3). While the rate generally appreciated during 2005-07 reversing the depreciation of 2003–04, the REER has fluctuated around a constant for the last several years in response to

supply-side-driven inflation differentials. This said, the staff noted the significant appreciation of the euro against the US dollar warrants close monitoring.

22. **With both monetary management and fiscal policy promoting external stability, staff and the authorities agreed that exchange rate peg has served Cape Verde well as an anchor for financial stability and remains the appropriate regime.** The peg has also helped to achieve lower inflation at little apparent cost in terms of lost growth.[21] The existence of a large dominant trading partner—the European Union—whose business cycles are highly synchronized with Cape Verde, provides an obvious standard of reference for the peg. This said, staff and authorities agreed that there would be no discernible gains from hardening the peg given entrenched fiscal discipline, much enhanced policy credibility, and greater investor confidence. On the contrary, alternatives for hardening the peg would necessarily entail additional fiscal costs and the monetary and reserve management could be complicated during the transition to such arrangements.

Figure 6. Cape Verde Escudo Peg to the Euro Performance



Source: IMF *World Economic Outlook*, IMF *International Financial Statistics,* and National authorities.

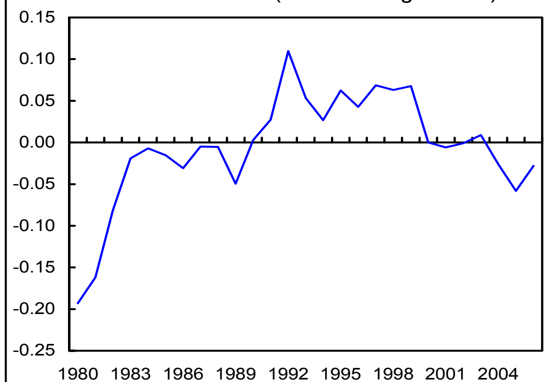
[21] This is consistent with cross-country evidence showing that for developing countries with little exposure to international capital movements, pegged exchange rates work well (Rogoff et al., 2004).

Box 3. Assessment of External Stability

The current account and fundamental misalignment: Directly estimating Cape Verde's current account norm through the macroeconomic balance approach of the Consultative Group on Exchange Rates is complicated by data limitations and frequent structural breaks resulting from rapid structural changes. The exchange rate will thus be assessed by (i) analyzing the reduced-form relationship between the real effective exchange rate (REER) and certain macroeconomic fundamentals; (ii) assessing the exchange rate regime; and (iii) assessing the sustainability of domestic policies.

- **The current and equilibrium REER:** Cape Verde's balance of payments is consistent with external stability, and there is no strong evidence of fundamental exchange rate misalignment. The results of the equilibrium real exchange rate approach show that the REER was significantly overvalued from 1992 through 1999, but after adoption of the peg in late 1998 the REER depreciated, and in recent years it has remained close to equilibrium despite large FDI inflows. Other indicators also suggest that Cape Verde's competitiveness is broadly improving (see table). Possible Balassa-Samuelson (B-S) effects coming from large tourism inflows are likely to be limited: while the actual REER will rise, given the tourism boom so will the equilibrium REER. In any case, with an unemployment rate of about 20 percent, any B-S effect on the nontradable sector is likely to be moot. In addition, there is no strong wage indexation in Cape Verde. *Assessment: The current exchange rate is broadly in line with macroeconomic fundamentals.*

Deviation from the long run equilibrium REER 1980 - 2006 (in natural logarithms)



Source: IMF staff estimates.

Cape Verde: Indicators of Competitiveness

	2000	2003	2006
Terms of trade, goods	100	96.7	123.4
Market share of Cape Verde exports (in percent)[1]			
Africa	0.02	0.01	0.07
World	0.02	0.04	0.03
European Union	0.05	0.08	0.09
Market share of imports [2]	42.1	37.9	39.8
Exports as percent of GDP	20.9	14.6	19.8
Exports as percent of imports	36.5	28.0	37.4
Volume of exports of goods and services (2000=100)	100	80.0	128.4
Profitability [3]	100	80	132

Sources: IMF, Information Notice System, national authorities, and staff estimates.
Notes:
Unless noted otherwise, an increase (decrease) in indicators implies a improvement in (deterioration of) competitiveness.
[1] Ghana exports to selected countries as percent of those countries' total imports.
[2] Imports of goods and services as percent of domestic demand. An increase (decrease) in the indicator implies a deterioration of (improvement in) competitiveness.
[3] Ratio of export price index (2000=100) to tetriary GDP deflator (2000=100).

- **Exchange rate regime:** The exchange rate peg is supported by domestic policies, has contributed to external stability, and has not pushed the REER out of line with fundamentals. Overall, the exchange rate regime has served Cape Verde well as an anchor for financial stability (see ¶ 22 and Figure 6). *Assessment: The peg has promoted external stability and remains appropriate.*

- **Domestic policies:** These have generally promoted both domestic and external stability (Figure 6). Cape Verde's success in attracting more FDI than neighboring economies despite having no natural resource advantage reflects the strength of its domestic policies and reforms. The fiscal position is solid and sustainable. The recent debt sustainability analysis shows that the risk of debt distress remains low even under alternative stress scenarios (EBS/07/132, Supplement). Continued fiscal consolidation has significantly reduced domestic debt and helped to create fiscal space for a modest increase in capital expenditure to ease infrastructure bottlenecks. Monetary management is appropriately adjusting the interest differential with the euro area and has avoided destabilizing short-term capital flows. *Assessment: Fiscal and monetary policies are consistent with domestic stability and internal balance.*

- **The capital and financial accounts and external stability:** Private capital flows are related primarily to non-debt creating FDI flows in the tourism sector. Cape Verde remains largely unexposed to movements in international capital markets and cross-border non-emigrant flows. The BCV is closely monitoring vulnerability from the recent slowdown in emigrant deposits. *Assessment: The capital and financial account does not pose major concerns for external instability.*

23. **The mission urged the authorities to facilitate the diversification of the export base and enhance the economy's resilience to shocks.** Actions to improve conditions for the private-sector-led development could be implemented in two areas:

- **Promote economic diversification to ensure that growth is sustainable for the long term:** The mission urged the authorities to implement an export diversification strategy that could draw on the conclusions of the Diagnostic Trade Integration Study (DTIS) being conducted through the Integrated Framework agency consortium.[22]

- **Improve wage and price flexibility:** Given the peg, greater flexibility in both labor market and energy prices is needed to facilitate adjustment to shocks. The mission welcomed the recent opening of the Citizen House, which will strengthen the business environment by, for instance, reducing the time to start a business from 52 days to 1 (something not yet reflected in the 2008 investment climate indicators); facilitate entrepreneurship; and ensure sustainable growth. However, staff emphasized that the authorities should address other issues related to the cost of doing business. While Cape Verde ranks above average on some indicators, it fares poorly on such labor market indicators as cost of hiring and firing.

Selected Investment Climate Indicators, 2008

	Cape Verde compared to other tourist economies	Cape Verde	Small island tourist economies [1]
Rank on ease of doing business [2]	Worse	132	61
Starting a business (Number of days)	Worse	52	29
Cost of starting a business (% of GNI per capita)	Worse	40	22
Rigidity of employment (Index= 0–100)	Worse	44	15
Firing cost of employees (weeks of salary)	Worse	91	40
Strength of investor protection (Index= 0–10)	Worse	4	6
Time to register property (Number of days)	About same	83	80
Enforcing contracts (Number of days)	Better	465	593
Cost enforcing contracts (% of claim)	Better	24	37

Source: World Bank, *Doing Business Report* (2008).

[1] Average of St. Luica, Antigua and Barbuda, Malvides, Seychelles, St. Kitts and Nevis, St. Vincent and Grenadines, Vanuatu, Dominica, Samoa, Jamica, Fiji, Mauritius, Grenada, Dominican Republic, Tonga, Trinidad and Tobago, and Paua New Guinea.

[2] A smaller index means an improvement in the rank.

24. **The authorities noted that they are moving ahead with their strategy for diversifying exports and making prices more flexible:**

- They are developing several sectors: offshore financial center, which will be enhanced by the new prudential regulation and the new AML/CFT law; the fishing and fish-processing industry, marine and transshipment services; and information technology (IT) which has already begun with a recent agreement between NOSi and Microsoft to facilitate government e-commerce and data processing across Cape Verde. They also pointed out that even within tourism there is room for diversification.

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[22] The DTIS will examine, among other issues, how Cape Verde can enter into the enormous and expanding offshore services, information technology, and business process outsourcing market.

- The authorities recognize the need to make the labor market more flexible and agreed that the recent new labor code will not do much to accomplish that. They plan to upgrade human capital, retrain labor, attract skilled workers, and improve the mechanism for addressing arbitration and labor disputes. With recent steps taken on energy pricing, a rapid pass-through of energy prices will facilitate faster adjustment to terms of trade swings.

IV. Statistics Issues

25. **The macroeconomic data are broadly adequate for surveillance and program monitoring.** The mission welcomed recent improvements in data release. INE recently released a new CPI index and a new web portal, both of which go toward strengthening data collection and improving disclosure. The authorities also now publish most of their data on the Internet.[23] In line with STA's recommendation, the mission stressed the increased importance of unambiguously indicating data links in the official websites and regularly updating the metadata for General Data Dissemination Standards (GDDS).

26. **However, capacity constraints are severe, and further improvements in data are needed**. Specifically:

- **GDP/national accounts:** The lack of reliable demand-side GDP data constrains policy formulation, although the BCV does project demand-side GDP.
- **Labor market statistics:** Data on unemployment are compiled with long delays, and wage data are nonexistent.
- **Tourism statistics:** Better data on tourism arrivals and prices would allow the authorities to gauge the economy's competitiveness, given the specialization in tourism. INE noted that it plans to compile Tourism Satellite Account statistics.
- **Fiscal data:** The new chart of public accounts (PNCP) will not be ready until 2009.

V. Staff Appraisal

27. **Cape Verde's impressive economic performance in recent years is a tribute to its sound homegrown economic reform program.** The authorities are to be commended for their prudent macroeconomic management. Good policies have catalyzed investments and export growth, especially in tourism, breaking past dependence on aid and remittances. Economic growth is strong, inflation is moderate, and the unemployment and poverty rates have been gradually falling.

28. **Staff view the exchange rate as broadly in line with macroeconomic fundamentals, and the peg remains appropriate**. Fiscal policy and monetary management

[23] Ministry of Finance: www.minfin.cv; Central Bank: www.bcv.cv; and Statistics Institute: www.ine.cv.

are promoting external stability. The peg has served Cape Verde well and helped to achieve low inflation. Staff sees no discernible gains from hardening the peg given entrenched fiscal discipline, much enhanced policy credibility, and greater investor confidence.

29. **Sustaining this strong performance requires tackling three challenges.** First, building tourism will require investments in transportation and energy. The challenge will be to use the fiscal space to increase capital expenditures while keeping debt sustainable. Second, the financial sector still relies on nonresident deposits, and their decelerating growth rate should be monitored as it is a potential capital account-based source of vulnerability. Moreover, Cape Verde's export base is narrow with increasing specialization in tourism. The challenge here is to limit the vulnerability associated with this specialization, diversify sources of growth, and increase the economy's flexibility to enhance resilience to shocks.

30. **Continuing prudence in fiscal policy is essential.** This is needed to buy policy insurance against shocks and support the peg. A medium-term fiscal strategy is needed to anchor the authorities' expenditure and tax reform plans. Given the larger-than-expected domestic debt reduction in 2007, even with current plans to increase capital spending to ease infrastructure bottlenecks, the risk of debt distress remains low and the envisaged reserve buildup is preserved. These plans would also need to be implemented within the medium term fiscal framework (MTFF) and take into account implementation capacity. Staff urges the authorities to move ahead with their plans toward publishing the MTFF as part of the 2009 budget cycle. The authorities should also pursue their plans to enhance the capacity of their debt management office including through seeking technical assistance.

31. **Strengthening the financial system further is important.** Staff welcomes the recently published regulation that broadly aligned prudential requirements for both on- and offshore banks, which should help preserve Cape Verde's good reputation. Nonetheless, there is a need to broaden the source of funds for banks so they will continue to grow out of dependence on non-resident deposits. Staff recommends improving the monitoring of these nonresident deposits to gauge better the appropriateness of BCV's policy interest rate by promptly detecting potentially destabilizing capital flows. Banks exposure to the real estate market also warrants close monitoring. Staff welcomes the BCV plans to establish an enhanced financial sector macro-prudential surveillance; this will provide a good basis for comprehensive assessment of credit risk. The forthcoming FSAP should help to strengthen the authorities' hands on these issues, including on the real-financial sector linkages.

32. **Structural reforms are necessary to maintain external competitiveness and sustain high growth over the long term.** Staff calls on the authorities to implement their strategy for export diversification. Given the peg, greater flexibility in labor markets and energy prices is also needed to facilitate adjustment to shocks. To remove labor market rigidities, the authorities should address the high cost of hiring and firing. The authorities' plans to upgrade human capital, retrain labor, and attract skilled workers are important. On energy prices, regular application of the new utilities base tariffs and fuel pricing formula is

essential for fast adjustment to terms of trade changes. Staff urges the authorities to accelerate the implementation of their broader energy sector reforms to further reduce fiscal risk and unleash Cape Verde's growth and poverty reduction potential.

33. **Staff recommends completion of the fourth review of the PSI program**. Based on the strength of the authorities' policies and the corrective measures taken, the staff supports granting a waiver for the missed structural assessment criterion.

34. **The next Article IV Consultation will be held in accordance with the decision on consultation cycles approved on July 15, 2002.**

PROPOSED DECISION

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

1. Pursuant to paragraph 8 of Decision No. 13561-(05/85), 10/10/05, and paragraph 1(b) 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 June 9, 2008 (the "June 2008 Letter") and Technical Memorandum of Understanding (the "June 2008 TMU") shall be attached to the PSI for Cape Verde, and the letter from the Minister of Finance and Public Administration dated July 11, 2006 shall be read as further supplemented and modified by the May 2008 Letter with its attachments.

3. Accordingly,

(a) the references to the November 2007 MEFP and TMU in paragraph 2.F shall be replaced with references to the June 2008 Letter and TMU."

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

"(d) a sixth review is scheduled to be conducted by April 30, 2009, as specified in paragraph 13 of the May 2008 Letter."

(c) A new paragraph 2.G. shall be added to read as follows:

"G. with respect to the sixth review, the data as of end-December 2008 indicate that any of the floors and ceilings referred to in paragraph 2.C.(1)(i) through (v) above, as set out in Table 1 of the May 2008 Letter and further specified in the May 2008 TMU was not observed."

(d) The following sentence shall be added at the end of paragraph 3:

"Completion of the fifth review will be subject to assessment criteria having been established for the sixth review."

4. The Fund waives the non-observance of the assessment criterion on the application of the mechanism for setting and adjusting electricity, water and fuel prices set out in paragraphs 2.A.(1)(iv) of the PSI for Cape Verde, and the Fund completes the fourth scheduled review specified in paragraph 1(b) of the PSI for Cape Verde on the condition that the information provided by Cape Verde on its performance under this nonobserved assessment criterion and other assessment criteria related to this review is accurate.

Table 1. Cape Verde: Selected Indicators, 2006-13

	2006	2007	2008 [1]	2009	2010	2011	2012	2013
		Est.	Proj					
			(Annual percentage change)					
National accounts and prices								
Real GDP	10.8	6.9	6.5	6.5	7.0	7.1	6.8	6.7
Real GDP per capita	8.8	5.0	4.5	4.5	5.0	5.1	4.8	4.6
Consumer price index (annual average)	5.4	4.4	3.6	2.3	2.3	2.3	2.3	2.3
Consumer price index (end of period)	6.2	3.8	2.6	2.3	2.3	2.3	2.3	2.3
External sector								
Exports of goods and services	35.0	14.1	20.9	16.5	13.9	14.5	13.3	14.1
Of which: tourism	82.5	40.6	31.6	23.8	17.7	17.0	15.1	15.4
Imports of goods and services	23.4	17.9	13.9	13.2	13.6	8.2	15.3	13.8
Real effective exchange rate (annual average)	2.7	1.3	...	...	...	...	...	...
Terms of trade (minus = deterioration)	-4.4	-0.9	-4.4	0.9	1.2	1.1	1.1	1.1
Government finance								
Total revenue (excluding grants)	19.6	17.0	5.8	13.2	13.0	9.8	14.7	14.3
Total expenditure	11.8	-0.7	22.4	12.4	14.7	3.2	12.7	12.0
Noncapital expenditure	11.6	-0.4	11.4	12.4	14.4	9.0	14.1	16.0
Capital expenditure	12.1	-1.4	43.7	12.4	15.1	-5.3 [6]	10.3	4.9
Money and credit								
Net foreign assets	14.8	22.9	20.3	16.8	11.7	17.2	15.8	14.5
Net domestic assets	19.0	5.5	7.6	10.2	14.0	7.3	13.9	14.4
Of which: net claims on the central government	1.2	-42.3	-2.1	-13.9	-12.5	-27.1	12.7	23.2
credit to the economy [2]	17.3	28.0	14.6	14.6	17.6	10.7	14.3	14.2
Broad money (M2)	17.7	10.6	11.8	12.5	13.2	10.9	14.6	14.4
Domestic broad money (M2X)	22.4	13.1	15.2	15.9	16.5	14.0	17.7	14.4
Income velocity (GDP/M2) [3]	1.34	1.29	1.29	1.29	1.29	1.27	1.28	1.28
Reserve money (M0)	3.4	9.7	12.8	12.3	13.0	10.9	14.7	14.6
			(Percent of GDP)					
Saving-investment balance								
Gross capital formation	43.0	42.6	45.0	46.9	48.7	47.2	47.6	46.1
Government	6.1	5.1	6.5	7.0	7.6	8.3	8.2	7.9
Nongovernment	36.9	37.4	38.4	39.9	41.1	38.8	39.4	38.2
Gross national savings	38.0	33.4	35.6	37.0	38.2	38.9	37.6	35.5
Of which: government	9.3	9.9	7.4	7.0	6.7	5.9	6.1	6.2
External current account (including official current transfers)	-5.0	-9.1	-9.4	-9.9	-10.5	-8.3	-10.0	-10.6
Government finance								
Total domestic revenue	23.9	25.4	24.2	24.4	24.5	24.4	24.5	24.6
Total external grants	5.5	4.8	5.6	4.7	4.7	2.9	2.8	2.7
Total expenditure	34.3	30.9	34.0	34.2	34.8	32.5	32.1	31.6
Overall balance before grants	-10.4	-5.5	-9.9	-9.7	-10.3	-8.1	-7.6	-7.0
Overall balance (including grants)	-4.9	-0.7	-4.2	-5.0	-5.5	-5.3	-4.9	-4.4
External financing (net)	3.0	2.0	2.4	2.9	3.0	2.8	2.8	2.5
Domestic financing (net)	2.9	-0.8	1.8	2.0	2.6	2.4	2.1	1.9
Financing gap/ statistical discrepancy	-0.9	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Total nominal government debt [4]	76.0	66.9	60.9	57.4	55.2	54.2	51.6	48.9
External government debt [5]	47.2	47.2	44.5	42.4	40.2	38.9	36.7	34.3
Domestic government debt, net of deposits	28.8	19.7	16.4	15.0	14.9	15.3	14.9	14.6
External current account (excluding official current transfers)	-9.1	-13.5	-12.4	-11.8	-12.2	-9.6	-11.3	-11.7
Overall balance of payments	4.7	6.1	4.2	4.2	3.0	4.5	4.3	4.0
External current account (€ millions, including official transfers)	-47.7	-96.4	-110.2	-130.0	-155.1	-135.0	-187.0	-224.2
Gross international reserves (€ millions, end of period)	193.1	257.7	307.3	363.0	407.6	481.6	561.4	646.9
Gross international reserves to reserve money	1.0	1.2	1.3	1.4	1.4	1.4	1.4	1.4
Gross international reserves (months of prospective imports of goods and services)	3.1	3.6	3.8	3.9	4.1	4.2	4.3	4.4
External debt service (percent of exports of goods and services)	5.7	4.7	4.1	3.7	3.7	3.9	4.0	4.7
Memorandum items:								
Nominal GDP (billions of Cape Verde escudos)	105.6	116.3	129.4	144.9	163.2	180.2	205.6	234.2
Exchange rate (Cape Verde escudos per US$)								
Period average	87.8	80.4	…	…	…	…	…	…
End period	83.5	75.6	…	…	…	…	…	…

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

[1] For 2008, the government finance indicators refer to budget figures.

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

[3] Velocity is nominal GDP devided by average end period broad money. Velocity declines gradually because of financial deepening.

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

[5] Excluding claims on the offshore Trust Fund.

[6] Capital expenditures decelerate in 2011 as the execution of the MCC grant is completed.

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	Prel.	Budget	Proj.	
Revenue, grants, and net lending	33,437	31,044	35,295	35,131	38,551	42,285	47,759
Domestic revenue (incl. net lending)	24,604	25,255	26,963	29,559	31,286	35,417	40,030
Tax revenue	21,099	22,828	24,178	26,423	28,059	31,859	36,015
Income and profit taxes	6,955	6,952	7,497	7,656	8,462	9,584	10,915
Consumption taxes	8,351	9,821	10,140	11,565	13,177	14,829	16,812
International trade taxes	4,501	4,889	5,458	5,592	5,583	6,509	7,232
Other taxes	1,291	1,166	1,083	1,611	837	937	1,056
Nontax revenue	3,505	2,126	2,585	2,843	3,204	3,558	4,015
Net lending	0	301	200	293	23	0	0
External grants	8,833	5,789	8,332	5,572	7,265	6,868	7,730
Capital grants	7,003	4,035	6,706	4,009	5,597	6,133	6,930
Budget support	1,830	1,755	1,625	1,563	1,668	736	800
Total expenditure	40,413	36,252	39,943	35,986	44,032	49,504	56,778
Recurrent expenditure	22,416	18,887	22,564	22,308	24,950	27,398	31,043
Primary recurrent expenditure	20,593	16,967	20,681	20,428	22,896	25,156	28,533
Wages and salaries	12,712	11,547	13,165	12,491	14,245	15,892	18,094
Goods and services	1,862	1,197	2,127	1,853	2,335	2,615	2,947
Transfers and subsidies	5,146	3,464	3,869	5,219	4,453	4,563	5,141
Transfers	3,921	3,172	3,834	3,309	4,395	4,498	5,068
Subsidies	1,225	292	35	1,910	58	65	73
Of which: energy subsidies	1,200	208	0	1,802 [1]	0	0	0
Other expenditures	873	760	1,520	864	1,863	2,086	2,351
Domestic interest payments	1,300	1,398	1,352	1,361	1,487	1,578	1,689
External interest payments	522	522	531	519	566	664	822
Extraordinary expenditures	0	0	0	0	0	0	0
Capital expenditure	16,290	12,415	16,340	12,237	17,581 [2]	19,769	22,754
Foreign financed	12,534	11,173	13,487	9,599	12,470	13,097	14,748
Domestically financed	3,755	1,242	2,853	2,638	5,111	6,672	8,006
Other expenditures (incl. arrears clearance)	1,708	4,950	1,039	1,440	1,500	2,337	2,981
Of which: energy subsidies	0	204	0	0	0	0	0
Overall balance, including grants (budget basis)	-6,976	-5,208	-4,648	-855	-5,481	-7,219	-9,018
Financing	6,976	5,208	4,648	855	5,481	7,219	9,018
Foreign, net	3,414	3,130	3,043	2,326	3,160	4,249	4,829
Domestic, net	3,575	3,027	1,605	-889	2,321	2,970	4,189
Net domestic borrowing	830	1,638	-602	-2,567	-172	1,470	2,689
Banking system	989	185	…	-6,509	248	…	…
Nonbanks	-158	1,453	…	3,941 [6]	-421	…	…
Privatization and other sales of assets	3,689	456	2,207	3,598	2,493	1,500	1,500
Accounts payable (*atrasados*), net	-944	933	…	-1,919	…	0	0
Net errors and omissions	0	-949	0	-582	0	0	0
Financing gap	-13	0	0	0	0	0	0
Memorandum items:							
Overall balance, including grants (excluding clearance of arrears and accounts payable)	-4,324	-4,129	-3,609	2,321	-3,980	-6,197	-9,018
Arrears clearance	1,708	2,012	1,039	1,257	1,500	1,022	0
Net domestic borrowing, excluding clearance of arrears and net accounts payable	-1,821	559	-1,641	-5,743	-1,673	448	2,689
Primary balance (including grants)[3]	-5,154	-3,288	-2,765	1,025	-3,427	-4,976	-6,508
Recurrent domestic balance[4]	2,188	6,368	4,400	7,250	6,335	8,018	8,987
Net external flows[5]	12,234	8,919	11,375	7,898	10,425	11,117	12,559
External debt service (percent of domestic revenue)	10.7	9.9	9.8	7.9	8.3	7.5	7.5
Domestic debt (including arrears and accounts payable, net of deposits)	27,902	30,405	25,426	22,925	21,253	21,701	24,390

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

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

[2] The capital expenditure budget is typically underexecuted.

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

[4] Domestic revenue – recurrent expenditure.

[5] External grants + net foreign financing.

[6] Reflects borrowing from the pension fund and scheduling of payments to energy companies.

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

(Percent of GDP)

	2006		2007		2008	2009	2010
	Program	Actual	Budget	Prel.	Budget	Proj.	
Revenue, grants, and net lending	34.1	29.4	30.4	30.2	29.8	29.2	29.3
Domestic revenue (incl. net lending)	25.1	23.9	23.2	25.4	24.2	24.4	24.5
Tax revenue	21.5	21.6	20.8	22.7	21.7	22.0	22.1
Income and profit taxes	7.1	6.6	6.4	6.6	6.5	6.6	6.7
Consumption taxes	8.5	9.3	8.7	9.9	10.2	10.2	10.3
International trade taxes	4.6	4.6	4.7	4.8	4.3	4.5	4.4
Other taxes	1.3	1.1	0.9	1.4	0.6	0.6	0.6
Nontax revenue	3.6	2.0	2.2	2.4	2.5	2.5	2.5
Net lending	0.0	0.3	0.2	0.3	0.0	0.0	0.0
External grants	9.0	5.5	7.2	4.8	5.6	4.7	4.7
Capital grants	7.1	3.8	5.8	3.4	4.3	4.2	4.2
Budget support	1.9	1.7	1.4	1.3	1.3	0.5	0.5
Total expenditure	41.2	34.3	34.4	30.9	34.0	34.2	34.8
Recurrent expenditure	22.8	17.9	19.4	19.2	19.3	18.9	19.0
Primary recurrent expenditure	21.0	16.1	17.8	17.6	17.7	17.4	17.5
Wages and salaries	13.0	10.9	11.3	10.7	11.0	11.0	11.1
Goods and services	1.9	1.1	1.8	1.6	1.8	1.8	1.8
Transfers and subsidies	5.2	3.3	3.3	4.5	3.4	3.1	3.1
Transfers	4.0	3.0	3.3	2.8	3.4	3.1	3.1
Subsidies	1.2	0.3	0.0	1.6	0.0	0.0	0.0
Of which: energy subsidies	1.2	0.2	0.0	1.5 [1]	0.0	0.0	0.0
Other expenditures	0.9	0.7	1.3	0.7	1.4	1.4	1.4
Domestic interest payments	1.3	1.3	1.2	1.2	1.1	1.1	1.0
External interest payments	0.5	0.5	0.5	0.4	0.4	0.5	0.5
Extraordinary expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	16.6	11.8	14.1	10.5	13.6 [2]	13.6	13.9
Foreign financed	12.8	10.6	11.6	8.3	9.6	9.0	9.0
Domestically financed	3.8	1.2	2.5	2.3	4.0	4.6	4.9
Other expenditures (incl. arrears clearance)	1.7	4.7	0.9	1.2	1.2	1.6	1.8
Of which : energy subsidies	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Overall balance, including grants (budget basis)	-7.1	-4.9	-4.0	-0.7	-4.2	-5.0	-5.5
Financing	7.1	4.9	4.0	0.7	4.2	5.0	5.5
Foreign, net	3.5	3.0	2.6	2.0	2.4	2.9	3.0
Total drawings	5.6	4.8	4.4	3.6	4.0	4.3	4.3
Amortization	-2.2	-1.9	-1.8	-1.6	-1.6	-1.4	-1.3
Domestic, net	3.6	2.9	1.4	-0.8	1.8	2.0	2.6
Net domestic borrowing	0.8	1.6	-0.5	-2.2	-0.1	1.0	1.6
Banking system	…	…	…	-5.6	0.2	…	…
Nonbanks	…	…	…	3.4 [6]	-0.3	…	…
Privatization and other sales of assets	1.4	0.4	1.9	3.1	1.9	1.0	0.9
Accounts payable (atrasados), net	2.3	…	…	-1.7	…	0.0	0.0
Net errors and omissions	0.0	-0.9	0.0	-0.5	0.0	0.0	0.0
Financing gap	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	-3.9	-3.1	2.0	-3.1	-4.3	-5.5
Arrears clearance	1.7	1.9	0.9	1.1	1.2	0.7	0.0
Net domestic borrowing, excluding clearance of arrears and net accounts payable	-1.9	0.5	-1.4	-4.9	-1.3	0.3	1.6
Primary balance (including grants)[3]	-5.3	-3.1	-2.4	0.9	-2.6	-3.4	-4.0
Recurrent domestic balance[4]	2.2	6.0	3.8	6.2	4.9	5.5	5.5
Net external flows[5]	12.5	8.4	9.8	6.8	8.1	7.7	7.7
Domestic debt (including arrears and accounts payable, net of deposits)	28.4	28.8	21.9	19.7	16.4	15.0	14.9
Nominal GDP (Millions of Escudos)	98,139	105,625	116,276	116,276	129,367	144,883	163,246

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

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

[2] The capital expenditure budget is typically underexecuted.

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

[4] Domestic revenue – recurrent expenditure.

[5] External grants + net foreign financing.

[6] Reflects borrowing from the pension fund and scheduling of payments to energy companies.

Table 4. Cape Verde: Balance of Payments, 2006–13

(Millions of Cape Verde escudos, unless otherwise indicated)

	2006	2007	2008	2009	2010	2011	2012	2013
		Est.	Projections					
Current account balance (including official transfers)	-5,259	-10,630	-12,150	-14,339	-17,103	-14,894	-20,631	-24,732
Trade balance	-40,654	-53,501	-62,113	-71,178	-81,797	-88,282	-102,969	-117,794
Exports, f.o.b.	8,429	6,134	6,981	7,242	7,487	7,788	8,132	8,649
Imports, f.o.b.	-49,083	-59,635	-69,094	-78,420	-89,285	-96,070	-111,101	-126,443
Services (net)	13,822	20,195	27,689	34,201	40,019	48,137	54,780	63,186
Credit	35,523	44,011	53,638	63,351	72,941	84,264	96,124	110,281
Of which: tourism	19,097	26,851	35,345	43,764	51,503	60,273	69,368	80,060
Debit	-21,700	-23,816	-25,949	-29,149	-32,922	-36,127	-41,344	-47,095
Income (net)	-3,952	-2,128	-2,243	-2,546	-3,016	-4,003	-4,618	-5,304
Credit	1,627	1,953	2,228	2,351	2,783	2,666	2,906	3,167
Debit	-5,579	-4,081	-4,471	-4,896	-5,799	-6,669	-7,524	-8,472
Government interest	-522	-520	-566	-664	-822	-991	-1,158	-1,312
Interest by other sectors	-2,443	-1,688	-1,727	-1,711	-2,040	-2,246	-2,359	-2,477
Income on direct investment and other income	-2,614	-1,873	-2,178	-2,522	-2,937	-3,431	-4,007	-4,683
Current transfers (net)	25,525	24,804	24,516	25,183	27,691	29,254	32,176	35,180
Government	4,310	5,083	3,847	2,719	2,809	2,482	2,626	2,758
Other	21,215	19,721	20,669	22,464	24,883	26,772	29,550	32,422
Capital and financial account (net)	10,871	19,657	17,624	20,480	22,028	23,051	29,427	34,170
Capital transfers	1,540	2,243	3,418	4,150	4,921	2,703	3,040	3,464
Government	1,540	2,219	3,418	4,150	4,921	2,703	3,040	3,464
Other	0	0	0	0	0	0	0	0
Direct investment (net)	9,722	10,378	10,996	13,039	16,080	18,468	21,893	25,413
Portfolio investment	13	561	550	550	550	550	550	550
Government	2,266	1,959	3,273	4,249	4,829	5,103	5,775	5,793
Trust Fund	0	0	0	0	0	0	0	0
Net official flows	2,266	1,959	3,273	4,249	4,829	5,103	5,775	5,793
Disbursements	4,240	3,779	5,204	6,229	7,018	7,746	8,837	10,069
Amortization	-1,974	-1,820	-1,931	-1,980	-2,189	-2,644	-3,063	-4,276
Other	0	0	0	0	0	0	0	0
Other investments	-2,670	4,518	-613	-1,508	-4,352	-3,772	-1,831	-1,051
Commercial banks	-2,543	-811	-393	8	8	8	8	8
Commercial credit (net)	189	439	0	0	0	0	0	0
Other	-316	4,890	-220	-1,516	-4,360	-3,781	-1,839	-1,059
Net errors and omissions	-647	-1,907	0	0	0	0	0	0
Overall balance	4,965	7,120	5,474	6,140	4,925	8,158	8,796	9,438
Financing	-4,965	-7,120	-5,474	-6,140	-4,925	-8,158	-8,796	-9,437
Gross international reserves (– accumulation)	-5,044	-7,120	-5,474	-6,140	-4,925	-8,158	-8,796	-9,437
Of which: IMF (net)	-96	-79	-105	-113	-169	-194	-180	-139
Exceptional financing	78	0	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Current account (including official transfers; percent of GDP)	-5.0	-9.1	-9.4	-9.9	-10.5	-8.3	-10.0	-10.6
Current account (excluding official transfers; percent of GDP)	-9.1	-13.5	-12.4	-11.8	-12.2	-9.6	-11.3	-11.7
Overall balance (percent of GDP)	4.7	6.1	4.2	4.2	3.0	4.5	4.3	4.0
Gross international reserves	21,304	28,424	33,898	40,038	44,964	53,121	61,917	71,355
Months of current year's import of goods and services	3.6	4.1	4.3	4.5	4.4	4.8	4.9	4.9
Months of next year's import of goods and services	3.1	3.6	3.8	3.9	4.1	4.2	4.3	4.4
External public debt	49,869	54,843	57,538	61,423	65,699	70,097	75,469	80,436
External aid (grants and loans; percent of GDP)	9.6	9.5	9.6	9.0	9.0	7.2	7.1	7.0

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

Table 5. Cape Verde: Monetary Survey, 2005–11

	2005	2006	2007		2008	2009	2010	2011
	Dec.	Dec.	Dec.		Dec.			
			Program EBS/07/132	Actual	Projections			
	(Millions of Cape Verde escudos, unless otherwise specified)							
Net foreign assets	21,889	25,138	30,883	30,902	37,176	43,421	48,507	56,851
Of which: excluding the effect of a purchase of a Portuguese credit to Electra in 2006	21,889	29,532	…	…	…	…	…	
Foreign assets	27,549	31,285	37,958	38,643	44,945	51,214	56,270	64,561
Of which: foreign reserves	16,260	21,304	29,128	28,424	33,898	40,038	44,964	53,121
Foreign liabilities	-5,660	-6,147	-7,074	-7,741	-7,769	-7,793	-7,763	-7,711
Net domestic assets	50,754	60,398	66,134	63,702	68,553	75,517	86,100	92,393
Net domestic credit	60,193	70,487	76,266	71,445	78,821	86,311	97,364	104,149
Net claims on general government	25,697	25,632	20,465	19,640	19,460	18,257	17,325	15,556
Claims on the Trust Fund (TCMFs)	11,038	11,038	11,038	11,038	11,038	11,038	11,038	11,038
Net claims on the central government	15,207	15,392	10,226	8,887	8,698	7,485	6,548	4,774
Credit to central government	20,044	19,470	15,709	16,082	17,392	16,180	15,243	13,469
Deposits of central government	-4,837	-4,078	-5,483	-7,195	-8,695	-8,695	-8,695	-8,695
Of which: project deposits	-351	-716	-277	-658	-277	-277	-277	-277
Net claims on local government	21	-311	-311	229	238	248	258	268
Net claims on other government agencies (INPS)	-569	-488	-488	-514	-514	-514	-519	-524
Credit to the economy	34,496	44,855	55,801	51,804	59,361	68,054	80,039	88,593
Of which: excluding purchase of a Portuguese credit to Electra and subsequent off-loading on the domestic securities market	34,496	40,461	…	…	…	…		
Credit to public enterprises	431	634	678	543	563	589	617	645
Credit to private sector	34,040	44,205	55,108	51,256	58,793	67,459	79,417	87,942
Claims on nonbank financial institutions	26	16	16	6	6	6	6	6
Other items (net)	-9,439	-10,089	-10,133	-7,742	-10,269	-10,794	-11,264	-11,756
Broad money (M2)	72,643	85,536	97,017	94,605	105,729	118,938	134,608	149,244
Narrow money (M1)	28,718	35,860	40,673	40,336	45,079	50,711	57,392	63,632
Currency outside banks	7,634	7,731	8,769	8,388	9,246	10,301	11,578	12,775
Demand deposits	21,084	28,129	31,904	31,949	35,833	40,411	45,814	50,858
Quasimoney	40,566	45,505	51,613	48,299	53,978	60,722	68,722	76,194
Time deposits	38,390	43,334	49,151	45,785	51,168	57,561	65,144	72,227
Other quasimonetary deposits	2,176	2,170	2,462	2,515	2,810	3,161	3,578	3,967
Foreign currency deposits	3,359	4,172	4,731	5,969	6,671	7,505	8,493	9,417
	(Change in percent of broad money 12 months earlier)							
Net foreign assets	12.9	4.5	6.7	6.7	6.6	5.9	4.3	6.2
Net domestic assets	2.7	13.3	6.7	3.9	5.1	6.6	8.9	4.7
Net domestic credit	4.6	14.2	6.8	1.1	7.8	7.1	9.3	5.0
Net claims on the central government	0.2	0.3	-6.0	-7.6	-0.2	-1.1	-0.8	-1.3
Credit to the economy	4.6	14.3	12.8	8.1	8.0	8.2	10.1	6.4
Credit to public enterprises	0.4	0.3	0.1	-0.1	0.0	0.0	0.0	0.0
Credit to private sector	4.2	14.0	12.7	8.2	8.0	8.2	10.1	6.3
Other items (net)	-1.9	-0.9	-0.1	2.7	-2.7	-0.5	-0.4	-0.4
Broad money (M2)	15.5	17.7	13.4	10.6	11.8	12.5	13.2	10.9
Selected monetary indicators:								
Income velocity of money [1]	1.317	1.336	1.259	1.291	1.292	1.290	1.288	1.270
Emigrant deposits	28,318	31,293	35,494	33,262	35,058	37,060	39,250	40,533
(as percent total deposits)	43.6	40.2	. . .	38.6	36.3	34.1	31.9	29.7
Excess reserves /total deposits (percent)	2.1	1.3	1.5	2.2	2.2	2.1	2.1	2.1
Money multilplier (M2/M0)	3.44	3.92	4.19	3.95	3.91	3.92	3.93	3.93
Credit to the economy (percentage change)	9.0	30.0	24.4	15.5	14.6	14.6	34.8	30.2

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

[1] Velocity is nominal GDP devided by average end period broad money. Velocity declines gradually because of financial deepening.

Table 6. Cape Verde: Central Bank Survey, 2005–11

	2005	2006	2007		2008	2009	2010	2011
	Dec.	Dec.	Dec.		Dec.			
		Actual	Program EBS/07/132	Actual	Projections			
	(Millions of Cape Verde escudos, unless otherwise specified)							
Net foreign assets	15,308	20,390	28,287	27,569	33,149	39,402	44,496	52,847
Of which: net international reserves	15,109	20,216	28,113	27,414	32,993	39,246	44,340	52,691
Foreign assets	16,523	21,536	29,360	28,632	34,106	40,246	45,172	53,329
Foreign liabilities	-1,215	-1,146	-1,073	-1,062	-957	-845	-676	-482
Net domestic assets	5,828	1,454	-5,128	-3,613	-6,130	-9,073	-10,224	-14,839
Net domestic credit	7,678	3,518	-3,023	-1,397	-3,870	-6,768	-7,872	-12,440
Trust Fund claims	4,605	4,605	4,605	4,605	4,605	4,605	4,605	4,605
Net claims on central government	1,882	1,748	239	-607	-2,107	-2,107	-2,107	-2,107
Credit to central government	4,779	3,739	3,739	3,739	3,739	3,739	3,739	3,739
Deposits of central government	-2,896	-1,990	-3,500	-4,346	-5,846	-5,846	-5,846	-5,846
Of which: project accounts	-351	-716	-277	-658	-277	-277	-277	-277
foreign currency deposits	-1,347	-682	-682	-607	-607	-607	-607	-607
Claims on local government	0	0	0	0	0	0	0	0
Credit to the economy	1,163	1,147	1,271	1,088	1,093	1,099	1,104	1,109
Credit to public enterprises	54	47	47	39	39	39	39	39
Credit to private sector	1,094	1,091	1,215	1,046	1,051	1,056	1,062	1,067
Claims on nonbank financial institutions	15	9	9	3	3	3	3	3
Credit to commercial banks	27	-3,983	-9,137	-6,483	-7,461	-10,364	-11,474	-16,047
Other items (net)	-1,850	-2,063	-2,104	-2,216	-2,260	-2,305	-2,351	-2,398
Assets	2,481	2,791	2,847	2,897	2,955	3,014	3,074	3,136
Liabilities	4,332	4,854	4,951	5,113	5,215	5,319	5,426	5,534
Reserve money (M0)	21,136	21,845	23,160	23,957	27,019	30,329	34,272	38,008
Currency outside banks	7,634	7,731	8,769	8,388	9,246	10,301	11,578	12,775
Cash in vaults	1,058	1,457	1,169	1,595	1,786	2,011	2,277	2,526
Deposits of commercial banks	12,443	12,654	13,219	13,966	15,979	18,009	20,408	22,699
Deposits of private sector	0	0	0	0	0	0	0	0
Deposits of other financial institutions	2	3	3	8	8	8	8	8
Gross international reserves (€ millions)	147.4	193.1	264.1	257.7	307.3	363.0	407.6	481.6
Net international reserves (€ millions)	137.0	183.3	254.9	248.5	299.1	355.8	402.0	477.7
Reserve money (12-month change in percent)	14.3	3.4	6.0	9.7	12.8	12.3	13.0	10.9

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

Table 7. Cape Verde: Deposit Money Bank Survey, 2005–11

	2005	2006	2007		2008	2009	2010	2011
	Dec.	Dec.	Dec.		Dec.			
		Actual	Program EBS/07/132	Actual	Projections			
	(Millions of Cape Verde escudos, unless otherwise specified)							
Net foreign assets	6,581	4,747	2,596	3,333	4,027	4,020	4,012	4,004
Of which: excluding the effect of a purchase of a Portuguese credit to Electra	6,581	8,315	…	…	…	…		
Foreign assets	11,026	9,749	8,598	10,011	10,839	10,968	11,099	11,232
Foreign liabilities	-4,445	-5,002	-6,002	-6,678	-6,812	-6,948	-7,087	-7,229
Of which: nonresident deposits	-3,520	-4,214	-5,057	-6,300	-6,426	-6,554	-6,685	-6,819
Net domestic assets	58,427	73,055	85,652	82,876	92,455	104,618	119,018	132,465
Net domestic credit	66,016	81,080	93,678	88,402	100,455	113,098	127,922	141,814
Net claims on general government	19,209	19,279	15,622	15,642	16,962	15,759	14,827	13,058
Trust Fund claims	6,433	6,433	6,433	6,433	6,433	6,433	6,433	6,433
Other government deposits (INPS)	-569	-488	-488	-514	-514	-514	-519	-524
Net claims on central government	13,324	13,644	9,987	9,494	10,805	9,592	8,655	6,881
Treasury bonds	9,173	10,030	6,014	10,330	11,564	10,250	9,197	7,298
Treasury bills	5,609	5,086	5,340	1,274	1,350	1,452	1,568	1,693
Oher credits	484	616	616	740	740	740		
Deposits of central government	-1,941	-2,088	-1,983	-2,849	-2,849	-2,849	-2,849	-2,849
Net claims on local government	21	-311	-311	229	238	248	258	268
Claims on local government	276	271	277	834	868	903	939	976
Deposits of local government	-256	-582	-588	-605	-630	-655	-681	-708
Credit to the economy	33,333	43,708	54,531	50,716	58,268	66,955	78,935	87,484
Of which: excluding purchase of a Portuguese credit to Electra and subsequent off-loading on the domestic securities market	33,333	39,314	…	…	…	…		
Credit to public enterprises	377	587	631	504	524	550	578	607
Credit to private sector	32,945	43,114	53,893	50,210	57,741	66,403	78,355	86,875
Claims on nonbank financial institutions	11	6	6	2	2	2	2	2
Net claims on the Bank of Cape Verde	13,473	18,094	23,525	22,043	25,225	30,384	34,160	41,272
Total reserves	13,500	14,111	14,388	15,561	17,764	20,020	22,686	25,225
Vault cash	1,058	1,457	1,169	1,595	1,786	2,011	2,277	2,526
Deposits with central bank	12,443	12,654	13,219	13,966	15,979	18,009	20,408	22,699
Required reserves	11,051	11,670	11,926	12,069	13,874	15,693	17,847	19,858
Excess reserves	1,391	984	1,292	1,896	2,105	2,316	2,561	2,841
Credit to the Bank of Cape Verde	-27	3,983	9,137	6,483	7,461	10,364	11,474	16,047
Other items (net)	-7,589	-8,026	-8,026	-5,526	-8,000	-8,480	-8,904	-9,349
Deposit liabilities to nonbank residents	65,008	77,802	88,248	86,209	96,483	108,638	123,030	136,469
Local currency deposits	61,649	73,631	83,517	80,239	89,812	101,133	114,537	127,052
Demand deposits	21,083	28,126	31,904	31,940	35,833	40,411	45,814	50,858
Of which: emigrant deposits	3,394	4,043	4,586	4,838	5,099	5,390	5,709	5,895
Quasimoney	40,566	45,505	51,613	48,299	53,978	60,722	68,722	76,194
Time deposits	38,390	43,334	49,151	45,785	51,168	57,561	65,144	72,227
Of which: emigrant deposits	23,825	26,148	29,658	27,187	28,655	30,291	32,081	33,130
Other quasimonetary deposits	2,176	2,170	2,462	2,515	2,810	3,161	3,578	3,967
Foreign currency deposits	3,359	4,172	4,731	5,969	6,671	7,505	8,493	9,417
Of which: emigrant deposits	1,100	1,102	1,250	1,237	1,304	1,379	1,460	1,508
Memorandum items:								
Emigrant deposits (ratio to total deposits)	0.44	0.40	0.40	0.39	0.36	0.34	0.29	0.27
Other deposits (ratio to broad money)	0.61	0.63	0.63	0.65	0.67	0.69	0.71	0.73
Composition of emigrant deposits	1.00	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	0.96
Demand	0.12	0.13	0.13	0.15	0.15	0.15	0.15	0.15
Time	0.84	0.84	0.84	0.82	0.82	0.82	0.82	0.82
Foreign currency	0.04	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: Financial Soundness of the Banking Sector, 2004–07

(End-year; percent unless otherwise indicated)

Indicator	2004	2005	2006	2007	
Capital adequacy					
Regulatory capital to risk-weighted assets	13.3	12.1	11.1	11.4	
Regulatory tier 1 capital to risk-weighted assets	14.6	13.4	11.3	11.9	
Asset quality					
Nonperforming loans to total loans	7.2	6.3	3.9	8.8	1
Nonperforming loans net of provisions to capital	0.4	-2.5	-1.7	48.9	1
Provisions to nonperforming loans	99.3	104.9	104.1	47.5	1
Earnings and profitability					
Return on assets	0.7	0.5	0.9	1.8	
Return on equity	12.3	9.7	16.4	31.5	
Interest margin to gross income	65.5	62.7	67.2	73.6	
Noninterest expenses to gross income	57.6	61.2	54.5	49.9	
Liquidity					
Liquid assets to total assets [2]	48.1	46.2	44.4	44.6	
Liquid assets to short-term liabilities [2]	176.9	170.2	111.5	108.5	
Additional indicators					
Government deposits over total deposits	3.2	4.1	4.1	4.5	
Emigrant deposits over total deposits	43.0	41.9	38.8	37.1	
Demand deposits over total deposits	31.5	32.4	36.2	37.0	
Credit to private sector over total deposits	54.1	50.7	55.4	58.2	
Personnel cost over cost of operations	50.4	52.1	…	…	
Spread (90 day lending - time deposit rate)	8.0	7.9	8.1	8.2	
Spread (emigrant deposits - euro area deposit rate)	4.7	3.2	2.3	2.1	

Sources: Bank of Cape Verde, *International Financial Statistics*, and IMF staff estimates.

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

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

Table 9. Cape Verde: Millennium Development Goals

	1990	1995	2001	2002	2004	2015 Target
Goal 1. Eradicate extreme poverty and hunger.						
Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than US$1 a day.						
1. Population below US$ 1 a day (percent)	...	...	...	...	...	...
2. Poverty gap ratio at US$ 1 a day (percent)	...	...	...	...	...	...
3. Share of income or consumption held by poorest 20 percent (percent)	...	...	...	...	...	...
3a. Percentage of poor, 2001–02	...	...	30.0	...	...	...
3b. Incidence of absolute poverty [1]	49.0 2/	...	...	37.0	...	25.0
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger.						
4. Prevalence of child malnutrition (percent of children under 5)	...	13.5	...	...	...	6.8
5. Population below minimum level of dietary energy consumption (percent)	...	...	...	...	...	...
Goal 2. Achieve universal primary education.						
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling						
6. Net primary enrollment ratio (percent of relevant age group)	...	...	...	...	99.2	...
7. Percentage of cohort reaching grade 5	...	...	...	...	92.8	...
8. Youth literacy rate (percent age 15–24)	81.5	85.0	88.6	89.1	89.1	...
Goal 3. Promote gender equality and empower women.						
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015.						
9. Ratio of girls to boys in primary and secondary education (percent)	...	96.1	...	...	99.9	100.0
10. Ratio of young literate females to males (percent ages 15–24)	87.5	90.4	93.3	93.8	93.8	100.0
11. Share of women employed in the nonagricultural sector (percent)	39.1	...	...	...	...	...
12. Proportion of seats held by women in the national parliament (percent)	12.0	11.0	11.0	11.0	11.0	...
Goal 4. Reduce child mortality.						
Target 5: Reduce by two-thirds between 1990 and 2015, the under 5 mortality rate						
13. Under 5 mortality rate (per 1,000)	60.0	50.0	38.0	36.0	35.0	20.0
14. Infant mortality rate (per 1,000 live births)	45.0	37.0	29.0	30.0	26.0	...
15. Immunization against measles (percent of children under 12 months)	79.0	66.0	72.0	...	68.0	...
Goal 5. Improve maternal health.						
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.						
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	190.0	150.0	...	...	...
17. Proportion of births attended by skilled health personnel	...	54.0	88.5	...	...	...
Goal 6. Combat HIV/AIDS, malaria and other diseases.						
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS.						
18. HIV prevalence among females (percent ages 15–24)	...	...	...	...	...	...
19. Contraceptive prevalence rate (percent of women ages 15-49)	...	...	52.9	...	...	...
20. Number of children orphaned by HIV/AIDS	...	...	...	...	...	...
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases.						
23. Incidence of tuberculosis (per 100,000 people)	...	...	182.0	166.3	167.9	...
24. Tuberculosis cases detected under DOTS (percent)	...	...	42.0	...	...	...

continued

Table 9. Cape Verde: Millennium Development Goals (concluded)

	1990	1995	2001	2002	2004	2015 Target
Goal 7. Ensure environmental sustainability.						
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources.						
25. Forest area (percent of total land area)	8.7	...	21.1	...	...	...
26. Nationally protected areas (percent of total land area)	...	0.0	0.0	...	...	
27. GDP per unit of energy use (PPP $ per kg oil equivalent)	...	...	...	...	...	...
28. CO2 emissions (metric tons per capita)	0.2	0.3	0.3	...	...	...
Target 10: Halve by 2015 the proportion of people without access to safe drinking water.						
30. Access to improved water source (percent of population)	...	...	74.0	...	80.0	...
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers						
31. Access to improved sanitation (percent of population)	...	...	71.0	...	42.0	...
32. Access to secure tenure (percent of population)	...	...	...	...	...	...
Goal 8. Develop a global partnership for development.[3]						
Target 16: Develop and implement strategies for productive work for youth.						
45. Unemployment rate of population ages 15–24 (total)	...	...	...	...	...	...
Target 18: Make available new technologies, especially information and communications.						
47. Fixed line and mobile telephones (per 1,000 people)	...	...	21.5	171.0	272.6	...
48. Personal computers (per 1,000 people)	...	81.7	68.6	...	79.7	...

Sources: World Bank, and Fund staff estimates.

[1] Absolute poverty measures the number of people in 1988 and 2002 whose income is below the 1988 national poverty line, indexed for inflation.

[2] Data for 1988.

[3] Targets 12–15 and indicators 29, 33–44 are excluded because they cannot be measured on a country specific basis. These are related to official development, assistance, market access, and the HIPC initiative. Indicators 21 and 22 are not relevant for Cap

Table 10. Cape Verde: Proposed Work Program 2008–09

Mission Date	Purpose	Board Review
September 2008	Discussions on the fifth review against end-June 2008 assessment criteria	End-November 2008
February 2009	Discussions on the sixth review against end-December 2008 assessment criteria	End-April 2009

APPENDIX I

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

Public Information Notice (PIN) No. __
FOR IMMEDIATE RELEASE
June__, 2008

IMF Concludes 2008 Article IV Consultation with Cape Verde

On June 20, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Cape Verde and [completed the fourth review of the Policy Support Instrument].[24]

Background

Over the last several years, Cape Verde has achieved a major economic transformation. Real per capita GDP has increased on average by over 7 percent a year, faster than other small island economies and other countries in sub-Saharan Africa. The unemployment rate fell by more than 10 percentage points between 2001 and 2006. Cape Verde is also on track to achieve most of the MDGs by 2015, including halving the 1990 poverty level. This is remarkable for a small island economy with no natural resources. The transformation is reflected in an economy that is increasingly becoming service-based, led by tourism and commerce. In recognition of its strong performance and policy credibility, Cape Verde was accepted as a special partner of the European Union in November 2007, was invited to join the WTO in December 2007, and graduated from UN least-developed country (LDC) status in January 2008 (the second in sub-Saharan Africa after Botswana and the first graduation in more than a decade).

Policy implementation under the PSI is also strong. All PSI quantitative assessment criteria for end-December 2007 were met with wide margins. Revenues are ahead of the

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[24] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the June 20, 2008 Executive Board discussion based on the staff report.

authorities' targets, and expenditures are as budgeted, which together have produced a significant reduction in public debt. Official reserves are also building rapidly. Thus, domestic policies are strengthening the credibility of the exchange rate peg. Progress on structural measures in the program is steady, especially reforms related to public financial management, the tax system, the financial sector, and energy sector regulation.

On recent developments, economic growth is strong with moderate inflation. The real GDP growth rate peaked at 10.8 percent in 2006, boosted by tourism, telecommunications, and construction. Based on information from the National Statistical Institute (INE), GDP growth is estimated at about 7 percent in 2007 and, factoring in the effects of the global economic slowdown, growth should moderate only slightly to 6 ½ percent in 2008 as tourism and construction continue to expand. With the peg to the euro and the high openness allowing rapid import price pass-through, twelve-month inflation averaged about 3½ percent for December 2007–April 2008, broadly in line with inflation in the euro area. While food and energy prices have risen, this has not led to generalized inflation partly due to lack of a strong wage indexation.

Fiscal policy continues to support the peg. Prudent implementation of the 2008 budget will ensure that domestic debt will be further reduced to 16 percent of GDP by end-2008. Tax revenues are exceeding budget forecasts, reflecting not just economic growth but also improvements in tax administration; also, asset sales have surpassed expectations. These factors, together with continued expenditure restraint, have reduced the domestic debt-to-GDP ratio. The authorities' target for domestic debt, 20 percent of GDP, was reached in 2007, two years ahead of schedule.

The Bank of Cape Verde (BCV) continues to conduct monetary management appropriately. Given the peg and a largely open capital account, passive monetary management by the BCV has been setting the official policy rate consistent with its endogenous equilibrium level, which smoothes and sterilizes short-term capital flows. Reserves continue to accumulate, and while FDI-related imports have led to and financed a higher current account deficit, there are no signs of a more general increase in imports that would jeopardize the targeted increase in reserves. Excess liquidity has been contained by sterilization, by the new investment opportunities on the Stock Exchange following rapid development of the domestic equity market, and by growth in private sector credit. The buildup of government deposits at the BCV is also helping to sterilize external inflows. Thus, monetary management and fiscal prudence are both supporting the exchange rate peg and promoting external stability.

Structural reforms are being undertaken to foster competition and enhance private sector's role in the economy. Several state-owned enterprises were privatized; the government selected new management to prepare the national airline (TACV) for privatization; and the process of privatizing the ports operator (ENAPOR) is underway. Ahead of WTO accession, external tariffs were lowered. The Cape Verde Stock Exchange has been revitalized; its market capitalization is now 25 percent of GDP (from zero in 2005). Cape Verde has also made major strides in the last several years in achieving the key objectives set out in the first Poverty Reduction Strategy (PRSP) and in improving the well being of its citizens. The second PRSP submitted to the IMF Board in June 2008 sets out Cape Verde's medium-term goals and provides a comprehensive and integrated strategy for achieving those goals.

Executive Board Assessment

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Cape Verde: Selected Economic and Financial Indicators, 2004–08 [1]

	2004	2005	2006	2007 Est.	2008 Proj.
	(Percent change unless otherwise stated)				
National Accounts and Prices economy					
Real GDP growth	4.3	6.5	10.8	6.9	6.5
Real GDP (per capita)	2.4	4.6	8.8	5.0	4.5
Consumer prices (in percent, annual average)	-1.9	0.4	5.4	4.4	3.6
Gross capital formation (percent of GDP)	38.9	41.0	43.0	42.6	45.0
Gross national savings (percent of GDP)	25.3	37.6	38.0	33.4	35.6
Money and Credit					
Net foreign assets	31.9	58.8	14.8	22.9	20.3
Credit to the economy	9.3	9.0	30.0	15.5	14.6
Broad money (M2)	10.5	15.5	17.7	10.6	11.8
Central Government					
Total domestic revenue (percent of GDP)	23.3	23.7	23.9	25.4	24.2
Total grants (percent of GDP)	9.0	6.3	5.5	4.8	5.6
Total expenditure (percent of GDP)	36.1	36.3	34.3	30.9	34.0
Overall balance (including grants, percent of GDP)	-3.8	-6.3	-4.9	-0.7	-4.2
External debt (percent of GDP)	55.0	53.7	47.2	47.2	44.5
Net domestic debt (percent of GDP)	34.6	33.3	28.8	19.7	16.4
External					
Exports of goods and services (local currency)	5.3	23.9	35.0	14.1	20.9
Imports of goods and services (local currency)	6.5	0.5	23.4	17.9	13.9
Real effective exchange rate (annual average)	-3.0	-2.5	2.7	1.3	...
Overall balance of payments (percent of GDP)	4.1	5.6	4.7	6.1	4.0
Current account balance (including current grants, percent of GDP)	-14.4	-3.4	-5.0	-9.1	-9.4
Gross reserves (months of prospective imports)	2.4	2.8	3.1	3.6	3.8
External debt service (percent of exports)	11.2	8.6	5.7	4.7	4.1

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

[1] As of June 4, 2008.

APPENDIX II. LETTER OF INTENT

June 9, 2008

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

Dear Mr. Strauss-Kahn:

1. **Discussions for the fourth review of the Policy Support Instrument (PSI) were held in Praia during March 5–19, 2008**. This letter of intent (LOI) reviews implementation to date of the Cape Verde government's reform program under the country's PSI which was approved by the IMF Executive Board in July 2006. It affirms our commitment to the policy priorities that were laid out in detail in our Memorandum of Economic and Financial Policies (MEFP) of November 2007, and describes policy developments since the third review of the PSI and prospects for the remainder of 2008 and early 2009.

2. **The government believes that the PSI program provides firm support to enforce its policies for macroeconomic stability and the exchange rate peg and promote growth.** By fostering a disciplined fiscal framework which has yielded significant fiscal consolidation in recent years, the program has achieved a large reduction in domestic debt (9 percentage points of GDP in 2007) and created the fiscal room needed to increase infrastructure spending to ease bottlenecks to growth. At the same time, the program has enabled significant buildup of official reserves, which together with the debt reduction, will enable Cape Verde to prepare for possible declines in concessional external financing following the country's graduation from Least-Developed-Country status in January 2008.

Recent economic developments and outlook

3. **Economic activity was strong in 2006/07 and we expect good growth in 2008/09** underpinned by further growth in tourism investment and other services, and by public infrastructure investment. Real GDP growth rate peaked at 10.8 percent in 2006 boosted by tourism, telecommunications, and construction sectors, and is estimated at about 7 percent in 2007. Real GDP growth for 2008 and 2009 is forecast to average about 6 ½ percent which takes into account the global economic slowdown. Consumer price inflation (annual average) in 2007 declined to 4.4 percent from 5.4 in 2006, despite poor rainfall and should moderate even further to trend value of 2 ½ -3 ½ percent in 2008 and 2009 in line with those of our major trading partners.

Program performance

4. **Performance on quantitative assessment criteria for end-December 2007 has exceeded expectations** (Table 1). In particular, the program ceiling on net domestic borrowing was observed by a wide margin reflecting continued expenditure restraint and buoyant tax revenue collections thanks to strong economic growth, improvements in tax administration, and higher-than-expected asset sales. Also, the program's international

reserves target was met by a large margin even though reserve accumulation slowed down somewhat in the final quarter of 2007 driven by slowdown in FDI inflows.

5. **The government is proceeding with the implementation of the structural measures in the program** (Table 2).

- Implementation of the structural benchmarks on the General Tax Code and Judicial Process Code was met with a five-month delay from end-December 2007 due both to longer-than-expected public consultation process to forge a consensus before submission to Parliament, as well as unanticipated technical problems that arose during the final stages of the legislative drafting. Subsequently, the government with further technical assistance from the IMF's Legal Department finalized and submitted the drafts to the Council of Ministers in May and submitted them to Parliament in June 2008. The income tax code (personal and corporate) will be aligned with the government's planned legislation on rationalizing tax incentives as part of a larger package to reduce economic distortions and make the income tax system more business friendly. Specifically, the government will examine existing tax holidays, and introduce loss and carry forward provisions and accelerated depreciation as part of rationalization of tax incentives and submit the new income tax codes to Parliament in October as part of the 2009 budget.

- On energy sector reform, the economic regulatory agency (ARE) finalized and posted on ARE's website the mechanism for setting the base utility tariffs for electricity and water (an assessment criterion under the PSI) by end-March 2008. The new tariffs were determined after a lengthy analysis of Electra's costs and efficiency gains targets. Specifically, by March 28 2008, (i) the technical specifications for the base utility tariffs was agreed upon between Electra and ARE; (ii) the details of the base tariff setting mechanism were posted on ARE's website and (iii) base tariff levels were brought in line with the agreed mechanism. However, the current fuel pricing formula is complex and not very transparent and this complicates its continuous application especially given the different cost structure of the two oil companies (Shell and Enacol). As a result, the government is working on a new fuel formula and will finalize and publish it in June 2008 (a structural benchmark for March). The delay in implementing the latter measure reflects lack of funding for a energy consultant to set up and calibrate the new pricing model and the financing only got secured in early March 2008.

- The BCV has also made progress on the structural benchmarks on financial sector reform. The PSI benchmark for June 2007 on the implementation of the recommendations of the financial-sector task force was met late 2007 with the publication of a new risk-oriented regulation, which broadly aligned the regulatory requirements for onshore and offshore banks. The benchmark for March 2008 on the establishment of the financial intelligence unit was met in January 2008, and the legislative drafting of the AML/CFT was concluded at end-March 2008.

Economic policies for the remainder of 2008 and for 2009

6. **The government will continue to focus on enhancing macroeconomic stability and implementing structural reforms to improve productivity growth and encourage private-sector led development.** Fiscal and monetary policies are consistent with program goals and supportive of the peg. In particular, public debt will continue to come down as a share of GDP and international reserves are expected to buildup further. The 2008 program aims at promoting structural reforms especially in fiscal accounting, budget execution and control, and arrears prevention, as well as strengthening of the financial sector and improving energy sector regulation.

Fiscal and Public Financial Management issues

7. **Continued fiscal consolidation remains crucial to our macroeconomic program and the 2008 budget aims at a further sizable reduction of the domestic debt-to-GDP ratio.**

- The budget projections for revenues and expenditures are prudent, with tax revenues and the wage bill planned to grow by less than nominal GDP relative to the 2007 budget. As the 2008 budget does not plan additional net domestic borrowing in 2008, the net domestic debt-to-GDP ratio is projected to continue to decline below 20 percent by end-2008, with the original target reached two years ahead of schedule. Going forward, we are committed to continue to reduce public debt as a share of GDP and to keep it on an appropriate path consistent with the medium term baseline debt path agreed with the IMF. Using our medium-term fiscal framework, we are considering increasing capital expenditure modestly to ease infrastructure bottlenecks for both transportation and the energy sector. Consistent with the government's overall investment program, our planned increases in capital spending, which also recognizes the need for a comprehensive overhaul of the energy sector, will be in line with the strengthening of our public financial management (PFM) and debt management.

- The rationalization of tax incentives is also a high priority to the government since it will improve procedures to grant exemptions and repeal some of the current exemptions. Reforming the corporate income tax rate will help to muster public support for rationalizing tax exemptions. To this end, we reiterate our request for technical assistance to the IMF to help us with a framework which will underpin the economic criteria for rationalizing tax incentives.

8. **The government remains fully committed to moving ahead with its program of strengthening public sector financial management as outlined in our MEFP for the third review of the PSI**. Thus, we agreed to include a new structural measure in the program which will submit a simplified medium-term fiscal framework to the Council of Ministers in the 2009 budget preparation cycle and publish it on the Ministry of Finance website in November 2008 to help to anchor fiscal policy on a medium-term perspective. This measure will help the government to build capacity for formulation of a medium-term fiscal policy, lay the basis for implementation of a medium-term expenditure framework (MTEF), program budgeting and a medium-term investment program (MTIP) in line with the forthcoming PRSP-II for 2008-11.

9. **Strengthening our debt management capacity is also a high priority**. At present our debt management office has a number of resource constraints. A strengthened debt management strategy will underpin the government's borrowing program and the country's overall medium-term fiscal framework. In this context, the government reiterates its need for technical assistance from the IMF to strengthen debt management, which could include assistance to enhance our asset-liability management. On concessional financing, the government has extensively reached out through its various donor partners, including through several high level conferences to shore up concessional financing over the medium term. Most donors have responded positively by confirming that graduation from the UN's Least Developed Country status will not lead to an abrupt end to concessional aid. Thus, we will continue to look for concessional money to finance our planned increases in infrastructure spending. In line with our plans to strengthen our debt management office and strategy, the government will review thoroughly with the IMF the borrowing necessary to finance vital projects to ease infrastructure constraints on growth and help to decisively move ahead with the much needed reform of the energy sector.

Monetary and financial sector issues

10. **Monetary management remains consistent with the program goal of building up foreign exchange reserves to support the peg to the Euro**. Consistent with the exchange rate peg, the Bank of Cape Verde (BCV) will continue to adjust domestic interest rates in the short run to smooth out capital flows. The BCV's official policy rate will remain the interest rate offered on the 14-day bill. The government's objective is to increase reserves by about 0.1 month of prospective imports annually reaching over 4 months by 2013.

11. **The BCV is strengthening the regulation and supervision of the financial sector**.

- All four onshore banks are fully compliant with the new strengthened prudential requirements. New bank regulations on capital ratios, provisioning and loan classification, credit risk assessment, and credit concentration were published in November 2007 and BCV has given banks a 5 year transitional period to meet the new requirement on provisions on non-performing loans. To further financial sector stability, the BCV agrees to a new structural benchmark to be included in the program which will establish a system to enhance the monitoring of external flows including non-resident deposits. Better monitoring of deposits is necessary to promptly detect potentially destabilizing capital flows and adjust interest rates as necessary to smooth out these capital flows. We will continue to study to what extent these deposits (or subsamples of these deposits) are interest sensitive.

- A new insurance sector regulation is being modernized to cover both life and non-life aspects of the insurance industry. Although the basic infrastructure on capital markets is in place, the operational and legal aspects are not yet fully developed and modernized including the Securities Code and the Company's Act. As a result, the capital market needs to be better oriented toward supporting economic development in Cape Verde. The government recognizes that the development of capital markets will enable domestic companies access funds from emigrants seeking investment opportunities other than emigrant deposits and is consistent with turning Cape Verde into an international financial centre. Thus, the government is working on these aspects, and will take further measures to minimize risks to the financial system before moving further with liberalization of financial flows.

Energy sector reform

12. **Despite the resource constraints that have caused delays in implementing the government's comprehensive plans to reform the energy sector, the reforms are steadily moving in the right direction.** Following the approval of the new base utility tariff mechanism, there will be regular adjustment of these tariffs, which will ease Electra's cash flow problems, clear its arrears with suppliers, help the implementation of its investment plan, and stop the accrual of tariff deficits, a government contingent liability. Thus, consistent with the government's commitment in the MEFP for the 3rd review of the PSI not to allow subsidies for energy products in the 2008 budget, ARE adjusted fuel prices by end-March 2008. A new simplified and more transparent fuel pricing formula is also being prepared to be finalized and published in June 2008. One consideration is to base the new fuel formula on international benchmark prices, which will stop the accrual of fuel price deficits owed to the oil companies, and will be in line with the joint venture for the two oil suppliers into a joint logistics company to handle importation, storage and inter-island distribution of oil products by July 2008. As part of early deliverables on Electra's reform, Electra will also strengthen its revenue collection system, including putting in place prepaid meters. To provide financial assistance to Electra, with the help of donor assistance, the government will build five power plants and lend them on to Electra. The government is also considering management contracts with the private sector to improve Electra's management. We also recognize the potential role of public private partnerships (PPP) to boost investments in the energy sector; and will therefore strengthen the regulation for PPPs to ensure that the risk-sharing arrangement in these PPP prevents any contingent liability for the government in the future.

Program monitoring and reporting

13. **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**. This extended LOI provides updates to our MEFP of November 2007 as follows: Program's quantitative targets for the end-June 2008 were reviewed and affirmed and targets were set for end-December 2008 (Table 1), and two new structural measures on public financial management and the financial sector in the program were included (Table 2). The fifth and sixth reviews of the PSI are scheduled to be completed by end-October 2008 and end-April 2009, respectively. 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.

14. We authorize the IMF to publish this letter, and the related staff report and selected issues papers.

Sincerely yours,

/s/
Cristina Duarte
Minister of Finance and Public Administration.

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

	Cumulative Flows from End-December, 2006 2007				Cumulative Flows from End-December, 2007 2008			
	Dec.				March	June	Sep.	Dec.
	Assessment Criteria	Assessment Criteria with adjusters	Actual	Level Actual	Indicative Target	Assessment Criteria	Indicative Target	Assessment Criteria
Quantitative targets	(Billions of Cape Verde escudos)							
Ceiling on net domestic borrowing of the central government [3]	-3.9	-3.7	-5.7	...	-0.4	-0.8	-1.3	-1.7
Ceiling on net domestic assets of the central bank [4]	-3.0	-3.2	-5.1	-3.6	-0.6	-1.3	-2.0	-2.5
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
	(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
Ceiling on the contracting or guaranteeing of non-concessional external debt with original maturity of more than one year by the central government [6]	35.0	35.0	0.1	...	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
	(Millions of euros)							
Floor on net international reserves of the Bank of Cape Verde (BCV) [8]	41.2	43.0	53.0	248.6	12.6	25.3	36.8	50.6
Memorandum item:	(Billions of Cape Verde escudos)							
Program assumptions								
Nonproject external financial assistance, including credit line (program assumption)	3.0	...	2.9	...	0.6	1.2	1.8	2.4
External debt service	2.6	...	2.3	...	0.7	1.3	2.0	2.6
Land sales	2.0	...	1.6	...	0.7	1.4	2.1	2.8
Clearance of end-2006 stock of domestic arrears	1.0	...	1.3	...	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 and land sales 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.

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

Objectives	Conditionality	Timing	Status
	Structural Assessment Criteria		
Reduce fiscal risks	Fully apply mechanisms for setting and adjusting electricity, water, and fuel prices (LOI ¶12).	Continuous[2]	Not met
Reduce fiscal risks	Finalize and publish the mechanism for setting base utility tariffs (LOI ¶5).	End-March 2008	Met
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	
	Structural Benchmarks		
Improve budget control	Instituting November 30 as deadline for granting new spending commitments to reduce end year payment pressure.	End-October 2007	Met
Strengthen tax administration	Finalize reform strategy for the General Tax Directorate (DGCI).	End-Dec. 2007	Met
Strengthen the tax base	Submit the new General Tax Code to the National Assembly (LOI ¶5).	End-Dec. 2007	To be implemented in June 2008 [3]
Strengthen the tax base	Submit the new Code on Judicial Process to the National Assembly (LOI ¶5).	End-Dec. 2007	To be implemented in June 2008 [3]
Strengthen the tax base	Submit the draft individual and corporate income tax bills to the National Assembly (LOI ¶5).	End-Dec. 2007	Postponed to October 2008 (LOI ¶5)
Reduce fiscal risks	Finalize and publish a revised mechanism for adjusting petroleum prices (LOI ¶12).	End-March 2008	To be implemented in June 2008
Strengthen financial supervision	Submit to the National Assembly legislation to establish a Financial Intelligence Unit (LOI ¶5).	End-March 2008	Met
Strengthen financial regulation	Submit to the National Assembly legislation to criminalize financing of terrorism and facilitate the combating of financing of terrorism (LOI ¶5).	End-March 2008	To be implemented in June 2008 [3]
Strengthen financial regulation	Submit to the National Assembly legislation to strengthen the framework for combating money laundering (LOI ¶5).	End-March 2008	To be implemented in June 2008 [3]
	New Structural Benchmarks introduced during the 4th PSI review		
Promote domestic and external stability	Submit a simplified medium-term fiscal framework (MTFF)[4] to the Council of Ministers in the 2009 budget preparation cycle and publish it on the Ministry of Finance website (LOI ¶8).	November 2008	

Promote financial stability	Prepare a quarterly report on developments on balance of payments flows, including an assessment of interest sensitivity of non-resident flows into the banking system (LOI ¶11).	December 2008

[1] Updated during the 4th PSI review.

[2] Through end-May 2008, following the coming into effect of the new base utilities tariffs and fuel price mechanisms.

[3] Submitted to the Council of Ministers in May 2008.

[4] The simplified MTFF will specify the annual revenues, expenditures, domestic financing, and external financing for the next three years.

ATTACHMENT. TECHNICAL MEMORANDUM OF UNDERSTANDING[25]

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

I. QUANTITATIVE ASSESSMENT CRITERIA AND INDICATIVE TARGETS

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

2. **Net domestic borrowing excluding for clearance of arrears and net late payments** is defined as the cumulative change since the start of the calendar year of the net credit to the central government from the banking and nonbanking sectors less (1) the cumulative clearance during the calendar year of the stock of arrears as of the end of the previous year and (2) the cumulative payments during the first three months of the calendar year of expenses authorized by the previous year's budget, 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 and land sales relative to program assumptions.

3. **Net credit to the central government from the banking and nonbanking system** is defined as the overall position of the main central government institutions vis-à-vis the banking and nonbanking system—that is, the stock of all outstanding claims on the central government (loans, advances), and all other government debt instruments, such as long-term government securities) held by the 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 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

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[25] Updated from the Country Report No. 08/37. Changes to paragraphs 2, 18, and 19.

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 1 of the Letter of Intent. The definition of short-term nonconcessional external debt excludes normal short-term (less than one year) import-related financing. The Portuguese government's precautionary credit line in

support of the exchange rate peg is also excluded from the definition of nonconcessional external debt. The assessment criterion on medium- and long-term nonconcessional external indebtedness applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00) but also to commitments contracted or guaranteed for which value has not been received. With respect to the assessment criterion on short-term nonconcessional external indebtedness, the term “debt” has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00).

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

D. Net International Reserves of the Central Bank

10. The floor on the cumulative change, from the beginning of calendar-year 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

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[26]

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.

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[26] See Table 2 of the Letter of Intent of June 2008.

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. This structural assessment criterion applies continuously only through end-May 2008, after which the new base utility tariffs and fuel price mechanisms will come into effect.

C. Complete a formal mid-year review of revenue and expenditure that allows for taking corrective measures if necessary

19. This condition will be deemed met when (i) revenue, expenditure, and financing during January–June are assessed and compared with budget forecasts; and (ii) the necessary corrective actions, if any, are identified.

III. OTHER DATA REQUIREMENTS FOR PROGRAM-MONITORING PURPOSES

20. 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.