FOR AGENDA

EBS/08/67
Correction 1

June 27, 2008

To: Members of the Executive Board

From: The Secretary

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

The attached corrections to EBS/08/67 (6/9/08) have been provided by the staff:

Typographical Errors

Page 43, line 1: for "On June 20, 2008" read "On June 30, 2008"

Page 43, footnote 24, last sentence: for "June 20, 2008" read "June 30, 2008"

Page 58, paragraph 12 (continued), line 1: for the blank space, read "plan and the corresponding release of budget appropriations. For programming purposes, a domestic payment obligation to suppliers is deemed to be in arrears if it has not been paid within the normal grace period of 60 days (30 days for government salaries and debt service) or such other period either specified by the budget law or contractually agreed with the supplier after the verified delivery of the concerned goods and services, unless the amount or the timing of the payment is subject to good faith negotiations between the government and the creditor."

Questions may be referred to Mr. Leigh, AFR (ext. 36518).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (2)

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Department Heads

APPENDIX I

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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

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

IMF Concludes 2008 Article IV Consultation with Cape Verde

On June 30, 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 30, 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 support of the exchange rate peg is also excluded from the definition of nonconcessional external debt. The assessment criterion on medium- and long-term nonconcessional external indebtedness applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00) but also to commitments contracted or guaranteed for which value has not been received. With respect to the assessment criterion on short-term nonconcessional external indebtedness, the term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00).

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

D. Net International Reserves of the Central Bank

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

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

E. Nonaccumulation of New Domestic Payments Arrears

12. As part of the program, the government will not accumulate any new domestic payments arrears. This will be monitored through the monthly execution of the cash-flow

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

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

F. Nonaccumulation of External Payments Arrears

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

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

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

II. STRUCTURAL ASSESSMENT CRITERIA [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.