BUFF/08/191

December 23, 2008

The Acting Chair's Summing Up
Cape Verde—Fifth Review of the Policy Support Instrument
Executive Board Meeting 08/113
December 22, 2008

Executive Directors commended the Cape Verde authorities for the progress made in consolidating macroeconomic stability, which has strengthened Cape Verde's capacity to face global economic challenges. They welcomed the faster-than-planned reduction of domestic debt and buildup of official reserves, providing buffers to absorb shocks. Directors noted that the effects of the global financial turmoil and slowdown on Cape Verde have been relatively contained, and with little impact on Cape Verde's banking sector. Growth continues to be solid, and inflation is expected to remain in low single digits. At the same time, Directors cautioned that there may be indirect adverse effects on growth and the balance of payments in the medium term stemming from reductions in remittances, tourism receipts, and foreign direct investment.

Given the rapidly changing global environment, Directors supported the revised macroeconomic framework, most notably the downward revision of the international reserves target to help cushion any downturn and accommodate external shocks. Economic buffers will need to be used judiciously, and bearing in mind the importance of maintaining fiscal restraint and strengthening monetary management in order to safeguard the exchange rate peg and reduce medium-term vulnerabilities.

Directors agreed that the 2009 budget focuses appropriately on expanding public investment to remove infrastructure bottlenecks, while restraining overall spending and raising the efficiency of the tax system. The greatly reduced level of debt achieved in recent years provides fiscal space to support economic activity. Directors recommended that the authorities continue to strengthen public debt and financial management to ensure that the risk of debt distress remains low. They were encouraged that the new measures to monitor closely the financial position of large state-owned enterprises will allow preventive policy actions to minimize fiscal risks.

Directors welcomed the recent measures taken by the Bank of Cape Verde (BCV) to strengthen monetary management, which have stemmed the decline in official reserves. They encouraged the BCV to continue to realign interest rates promptly in response to market developments, as needed to smooth short-term capital flows, consistent with the exchange rate peg. They viewed the upcoming FSAP report as an opportunity for the authorities to assess and, where needed, strengthen the system of financial regulation and supervision, helping to preserve financial stability.