



Office Memorandum

To: Members of the Executive Board

August 22, 2014

From: The Secretary

Subject: **Cabo Verde—Modification—Staff Report for the 2014 Article IV Consultation**

Attached for the information of Executive Directors is a modification to SM/14/127 (5/14/14), which has been proposed by the authorities of Cabo Verde and agreed with the staff in accordance with the policy on publication of papers.

Highly Market-Sensitive Material

Page 6, para. 7, line 3: for "However, the situation of one bank raises concerns, given that its CAR has fallen just below the regulatory minimum."
read "However, in one bank the CAR has fallen just below the regulatory minimum."

Questions may be referred to Ms. Richter Hume (ext. 34978) and Mr. Hitaj (ext. 39951) in AFR.

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

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FO/DIS/14/139

Capital adequacy appears to remain solid for the banking system as a whole, with the ratio of capital to risk-weighted assets (CAR) reaching 13 percent at end-2013, comfortably above the 10 percent regulatory minimum. ~~However, the situation of one bank raises concerns, given that its CAR has fallen just below the regulatory minimum~~ However, in one bank the CAR has fallen just below the regulatory minimum. In addition, given that provisioning has not kept up with the rise in NPLs (the coverage ratio is 48 percent, down from 52 percent a year ago), there is a risk that actual capital (if impaired loans are properly provisioned) could be lower.

8. Policy implementation in 2013 was broadly in line with the Fund's policy advice.

As recommended in the last Article IV, capital and current spending was curtailed compared to the original budget. However, the Fund's recommendation to adopt an ambitious medium-term fiscal consolidation plan was not adopted. The Fund had also recommended a neutral monetary policy stance to support a rebuilding of reserves. The BCV kept rates on hold through 2013. There has also been further progress in strengthening supervision, as called for by the Fund in order to enhance Cabo Verde's financial stability framework.

9. On the political front, the next parliamentary and presidential elections are expected in 2016. Prime Minister Jose Maria Neves, who began his third consecutive term in February 2011, represents the PAICV (*Partido Africano da Independência de Cabo Verde*). President Jorge Carlos Fonseca, in power since August 2011, is from the main opposition party, the MpD (*Movimento para a Democracia*). These two parties have been central in Cabo Verdean politics since independence in 1975, with each party having ruled for about a decade and now alternating power regularly.

C. External Assessment

10. While the external position has improved somewhat, Cabo Verde remains vulnerable due to its increasing external debt and challenges to competitiveness (Box 1). International reserves have recovered to about 4½ months of prospective imports, and are projected to remain around this level over the medium term. This reflects a healthy outlook for goods and services exports, and significant official financing flows (already committed). The exchange rate is assessed as broadly in line with fundamentals, as found in the last assessment (undertaken in March 2013). However, Cabo Verde's high dependence on tourism and remittances points to significant external vulnerabilities. In addition, business sector surveys indicate that competitiveness remains a challenge. Cabo Verde is ranked 122nd out of 148 countries on global competitiveness by the World Economic Forum, with labor market efficiency, financial market development, and macroeconomic environment found to be particular challenges.