

**FOR
INFORMATION**

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To: Members of the Executive Board

From: The Secretary

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Cabo Verde—Assessment Letter for the African Development Bank
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Background

Cabo Verde is recovering from a protracted economic slowdown. However, the economy remains vulnerable to external shocks notably from Europe, including the impact of Brexit. The scaling up of public investment since 2009 has helped fill key infrastructure gaps but also contributed to a marked rise in public debt. Sustaining the recovery and creating employment require structural reforms to promote the role of the private sector in the economy, improve the efficiency of state-owned enterprises (SOEs), and rein in the high public debt.

Recent Developments and Outlook

The near-term outlook is positive but there are significant vulnerabilities.

- **Economic activity and inflation.** In 2016 economic growth recovered markedly reaching 3.8 percent, compared to 0.9 percent on average in 2012–15. Agriculture and the services sector grew strongly supported by a recovery in credit to the private sector and double-digit growth in the number of tourist arrivals. In 2017 and over the medium term growth is projected to remain at about 4 percent supported by the continued strength of the tourism sector. Reflecting low food and energy prices average inflation turned negative in 2016 (-1.4 percent). The Banco de Cabo Verde's (BCV) decision to ease monetary policy and the recovery in energy prices will reduce deflationary pressures; average inflation is projected to reach 1 percent in 2017 and converge to 2 percent over the medium term.
- **Fiscal position.** The public sector financing needs declined substantially in 2016 but remained high owing to onlending and capitalization of SOEs, and public debt continued to increase. The budget deficit narrowed to 3.5 percent of GDP mainly due to efforts to contain capital spending. Public debt reached 129.7 percent of GDP. Budget revenues are growing fast albeit slower than envisaged in the 2017 budget. On current spending plans the deficit could widen to 4 percent of GDP. The authorities have reiterated their commitment to continue the fiscal consolidation process and to adjust spending as needed.
- **External position.** The external position strengthened in 2016 with the current account deficit estimated to have narrowed to 3.7 percent of GDP, the lowest level in over a decade, reflecting the recovery in tourism, lower oil prices, and strong migrants' remittances. International reserves reached an all-time high of €541 million (6½ months of prospective imports). In 2017 the current account is projected to widen to 6 percent of GDP as a result of higher oil prices and lower private transfers.

- **Banking sector.** Financial stability indicators have improved, but the high level of non-performing loans (NPLs) and low bank profitability remain a challenge and an impediment to faster credit growth. In line with regional trends some banks have lost their correspondent banking relations (CBRs) with global banks.

The broadly positive outlook for 2017 is subject to downside risks. Cabo Verde is highly vulnerable to fluctuations in remittances (11 percent of GDP), tourism (47 percent of total exports of goods and services), and donor support (10 percent of government revenues). It is particularly vulnerable to developments in Europe where the largest share of remittances, tourists, and FDI originate. Although public debt is mostly at concessional terms, the risk of debt distress remains high, especially as the ongoing restructuring of SOEs could have significant fiscal costs.

Policy Challenges

Cabo Verde's long term economic prospects hinge on the implementation of productivity-enhancing structural reforms and strengthening the private sector. Infrastructure gaps remain and the high public debt limits the government's ability to fill them, underscoring the need of reforms to foster private investment and attract FDI. Promoting private sector led growth and boosting employment creation require improvements in the business environment and access to credit, as well as investment in human capital to improve labor productivity. Reforming SOEs and accelerating privatization plans are crucial to improving efficiency.

The main policy challenge in the near term is to sustain fiscal consolidation efforts to place public debt on a downward trend. Critical to meeting this challenge are bolstering domestic revenue mobilization, increasing the efficiency of public expenditure while safeguarding social spending, and minimizing liabilities related to the SOEs restructuring.

IMF Relations

The 2016 Article IV consultation was concluded by the IMF Executive Board on November 18, 2016. The 2017 Article IV consultation mission is tentatively scheduled to take place in December. Cabo Verde continues to benefit from a comprehensive technical assistance program in public financial management, revenue policy and administration, central bank operations, and statistics.

Table 1. Cabo Verde: Selected Economic Indicators, 2013–17

	2013	2014	2015	2016 Prel.	2017 Proj.
(Annual percent change)					
National accounts and prices ¹					
Real GDP	0.8	0.6	1.0	3.8	4.0
GDP deflator	1.4	-0.1	1.7	-0.8	1.1
Consumer price index (annual average)	1.5	-0.2	0.1	-1.4	1.0
Consumer price index (end of period)	0.1	-0.4	-0.5	-0.3	1.1
External sector					
Exports of goods and services	6.9	2.7	-10.4	10.7	4.5
<i>Of which: tourism</i>	8.6	-12.5	1.9	6.5	5.4
Imports of goods and services	-5.7	6.3	-8.6	11.1	5.3
(Change in percent of broad money, 12 months earlier)					
Money and credit					
Net foreign assets	6.6	6.7	3.9	6.1	2.9
Net domestic assets	4.8	0.7	2.4	2.3	3.9
Net claims on the central government	1.8	2.1	0.4	1.9	1.6
Credit to the economy	1.5	-0.7	1.8	2.4	2.2
Broad money (M2)	11.4	7.4	6.3	8.4	6.8
(Percent of GDP, unless otherwise indicated)					
External sector					
External current account (including official transfers)	-4.9	-9.1	-5.0	-3.7	-6.1
External current account (excluding official transfers)	-7.9	-12.1	-8.4	-6.8	-8.5
Overall balance of payments	3.6	5.1	2.2	5.6	3.1
Gross international reserves (months of prospective imports of goods and services)	4.5	5.9	5.8	6.5	6.7
Government finance					
Revenue	24.5	22.9	26.9	26.5	28.3
Tax and nontax revenue	21.9	21.1	24.4	24.0	25.1
Grants	2.6	1.8	2.5	2.4	3.2
Expenditure	33.8	30.5	31.4	30.0	32.3
Overall balance (incl. grants)	-9.3	-7.6	-4.6	-3.5	-4.0
Net other liabilities (incl. onlending) ²	-4.6	-3.1	-3.3	-1.4	-4.2
Total financing (incl. onlending and capitalization)	13.9	10.8	7.9	4.9	8.2
Net domestic credit	1.1	0.6	1.0	3.0	3.1
Net external financing	12.8	10.1	6.7	2.0	5.0
Public debt stock and service					
Total nominal government debt	102.5	115.9	126.0	129.7	128.8
External government debt	78.3	89.0	97.0	97.6	93.2
Domestic government debt	24.2	26.9	29.0	32.2	35.6
External debt service (percent of exports of goods and services)	4.5	4.8	6.3	5.9	6.6
Present value of external debt					
Percent of GDP (risk threshold: 50%)	...	...	65.0	67.9	64.1
Percent of revenue (risk threshold: 300%)	...	...	266.3	282.7	255.2
Percent of exports (risk threshold: 200%)	...	...	155.0	150.7	143.1
Memorandum items:					
Nominal GDP (billions of Cabo Verde escudos)	153.7	154.4	158.7	163.4	171.8
Gross international reserves (€ millions, end of period)	347.5	419.7	453.3	541.0	589.8

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

¹ Last data available for national accounts is for 2016.

² Includes errors and omissions.