FOR INFORMATION

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To: Members of the Executive Board

From: The Secretary

Subject: **Cabo Verde—Assessment Letter for the World Bank**

Board Action:	Executive Directors' **information**
Publication:	No*
Questions:	Ms. Kabedi-Mbuyi, AFR (ext. 36387) Mr. Amo-Yartey, AFR (ext. 37713)

***The authorities have not consented to the publication of this assessment by the World Bank.**

Cabo Verde—Assessment Letter for the World Bank
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Due to the lack of recent comprehensive macroeconomic data, staff's assessment of recent developments and policies is limited, and that of medium-term prospects is based on the 2018 Article IV Consultation concluded by the Executive Board in March 2018.

1. Economic developments remain broadly positive. Real GDP growth is estimated at 4 percent in 2017, and projected at 4.3 percent for 2018, mostly reflecting strong activity in the tourism sector. Inflation inched up to 2.0 percent at end-July (0.3 percent at end-December 2017) due to higher food and energy prices. On the external front, the current account deficit widened to 6.2 percent of GDP in 2017 as the significant increase in imports more than offset higher tourism receipts. It is expected to deteriorate further in 2018 reflecting continued strong import demand. However, estimates for the first half of the year point to stronger-than-anticipated exports and tourism receipts that would potentially help contain the projected increase in the current account deficit for 2018. They also indicate that gross international reserves stood at about 5¾ months of prospective imports. In the financial sector, stability indicators continue to improve. In particular, non-performing loans declined to 15.4 percent of total loans in June 2018, compared with 17.4 percent of total loans a year earlier, consistent with the continued strength of economic activity.

2. The fiscal position improved in recent years, but vulnerabilities remain. The combination of strong revenue performance, expenditure restraint and higher grants strengthened the fiscal position in the last four years. Staff's current projections assume that revenue performance would improve further in 2018, helping maintain the overall deficit (including grants) at 3.0 percent of GDP. It is, however, expected to widen in 2019, because of upfront costs of State-Owned Enterprises (SOEs) restructuring. To consolidate past gains and reduce Cabo Verde's high risk of debt distress (see below), decisive actions are needed to address the significant vulnerabilities generated by loss-making SOEs, as well as the projected decline in grants (from 3.5 percent of GDP in 2017 to 0.9 percent of GDP by 2020). Hence, steadfast progress in the restructuring of SOEs, revenue-enhancing measures, and tighter expenditure controls are important priorities going forward.

3. The monetary policy stance has been appropriate and consistent with the objective of protecting the peg, and price stability. The Central bank (BCV) has maintained an accommodative monetary policy as inflationary pressures remain at bay, and the level of reserves is adequate. Nonetheless, the BCV should continue to monitor economic conditions and stand ready to take corrective measures as warranted. The external stability assessment conducted during the 2018 Article IV Consultation concluded that the real effective exchange rate is broadly in line with macroeconomic fundamentals. However, the external position is moderately weaker than implied by fundamentals and broader issues of non-price competitiveness remain.

4. The risk of debt distress is assessed as high, according to the most recent Debt Sustainability Analysis (March 2018). Under the baseline scenario, although trending downwards, the present value of external debt to GDP breaches the 50.0 percent threshold under the LIC-DSF through 2023. In nominal terms, public debt declined from 129.5 percent of GDP in 2016 to 126.0 percent of GDP in 2017, reflecting improvement in the fiscal position and the appreciation of the Escudo vis-à-vis the U.S. Dollar. Although elevated, Cabo Verde's public external debt is on highly concessional terms. This notwithstanding, public debt is vulnerable to contingent liabilities associated with SOEs' debt.

5. Medium-term outlook. Staff's last assessment of Cabo Verde's medium-term prospects was carried out at the time of the 2018 Article IV Consultation, concluded by the Executive Board in March 2018. It stressed that improving the medium-term outlook required the implementation of key reforms, particularly measures aimed at enhancing revenue performance (increasing the VAT rate to 17.0 percent, rationalization of exemptions), containing spending on goods and services as well as the wage bill; restructuring loss-making SOEs that represent an important downside risk to the outlook particularly the airline, power and housing companies; fostering financial intermediation; improving access to finance; and developing social safety nets to protect the most vulnerable portions of the population against natural disasters. The authorities have reaffirmed their commitment to advancing reforms through the implementation of their development strategy which aims at consolidating the fiscal position; reducing the public-debt-to GDP ratio over the medium term; promoting inclusive growth; and reducing vulnerabilities through the implementation of structural reforms in the abovementioned areas.

6. Engagement with the IMF. A staff team visited Praia during October 23-31, 2018 to discuss recent economic developments and policies. Guided by the policy advice in the 2018 Article IV Consultation, the team focused discussions on the macroeconomic framework underpinning the 2019 budget. It also explored the authorities' interest in benefiting from a program under the Policy Coordination Instrument.