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To: Members of the Executive Board

From: The Secretary

Subject: **Cabo Verde—First Review Under the Policy Coordination Instrument and Request for Modification of Targets—Supplementary Information**

Board Action:	Executive Directors' consideration on a lapse of time basis
Publication:	Yes*
Questions:	Ms. Kabedi-Mbuyi, AFR (ext. 36387)
Document Transmittal in the Absence of an Objection and in accordance with Board policy:	After Board Consideration—African Development Bank, European Investment Bank, World Trade Organization

***The Secretary's Department has been notified by the authorities that their explicit consent is required prior to the publication of Board documents. At the time of circulation of this paper to the Board, the authorities have indicated that they consent to the Fund's publication of this paper.**



CABO VERDE

March 20, 2020

FIRST REVIEW UNDER THE POLICY COORDINATION INSTRUMENT AND REQUEST FOR MODIFICATION OF TARGETS—SUPPLEMENTARY INFORMATION

So far, there have been no reported cases of COVID-19 in Cabo Verde. But even so, Cabo Verde, as a small tourism-dependent island, is being severely impacted by the epidemic through the global economic downturn and travel restrictions. This supplement provides information on the potential impact of COVID-19 on Cabo Verde, preparedness measures taken by the authorities, and potential implications for the authorities' program supported by the Policy Coordination Instrument. It does not alter the thrust of the staff appraisal which is based on reforms underpinning the authorities' Strategic Plan for Sustainable Development.

1. The impact of COVID-19 on Cabo Verde is expected to be very strong.

Even with no domestic outbreak so far (see below), the economy is being affected through the global economic downturn, travel restrictions, and commodity prices.

- **Tourism flows and related activities.** Cabo Verde's economy is tourism-dependent. Tourism activities are estimated to account for about 25 percent of GDP and some 50 percent of export receipts, with the largest share of tourists arriving from the United Kingdom and the euro area. The global economic downturn, travel restrictions and recent border closings in many countries are expected to have a devastating impact on tourism flows. Operators in the tourism sector have estimated a decline close to 60 percent in arrivals in 2020 if the current situation persists through end-September, which would trigger a decline in tourism receipts of the same order of magnitude.
- **Transport sector.** Activities in the transport sector, together with communications, account for over 15 percent of GDP. They are expected to contract significantly due to travel restrictions and their impact on tourism as well as on the airline (CVA – Cabo Verde Airlines). Travel restrictions will have a significant impact on CVA's financial situation. The company, currently almost grounded, had been working towards financial viability following its privatization in March 2019, as explained in the Staff Report.
- **Imports of goods.** The decline in commodity prices, notably for petroleum products, could lower imports, along with a possible decline in demand for capital and intermediate goods, which account for some 30 percent of total imports.

However, the positive impact of lower import demand on the trade balance will be more than compensated by the deterioration in the services balance, driven by the expected sharp decline in tourism receipts.

- **Remittances.** The economic slowdown and uncertainties in the United States and Europe, two major centers of the diaspora, may adversely impact remittances. While past experience points to increased remittances flows when the economy was adversely affected by an exogenous shock, as the large Cabo Verde diaspora seeks to financially support families at home, in this case the common COVID-19 shock may make such an increase challenging.

2. The authorities have taken measures to prevent a local outbreak.

- There are no confirmed cases of COVID-19 reported by the authorities to date. With nine inhabited islands spread across a large area in the Atlantic Ocean, a local outbreak of COVID-19, however limited, would be a major test for the country's infrastructure and health systems. Health care facilities would be overwhelmed and distances between the islands will be an important challenge for health services delivery.
- Preventive measures taken by the authorities very early include the installation of body temperature scans in airports, suspension of official travel and flights to China and other heavily affected countries, and preparation of quarantine areas in hospitals. The authorities also prepared a contingency plan, put in place a rapid response team, and activated an emergency plan with initial funding of CVE 76 million (0.04 percent of GDP) by reallocating budgetary appropriations to cover additional expenses for personnel, training and medical equipment. On March 17, they introduced further travel restrictions, including suspension of flights from European countries affected by COVID-19, the United States, Brazil, Senegal and Nigeria, as well as maritime traffic; with a few exceptions.

3. While external buffers provide a first line of defense, the possible size of the shock calls for concerted action. The authorities' preliminary estimates point to a real GDP contraction of 4 percent in 2020. While the authorities stand ready to reprioritize spending, the likely fall in revenue leaves little fiscal space. The authorities have been seeking additional financial support to address the economic and social impact of COVID-19, advocating for grants to cover the additional financing needs, consistent with their resolve to reduce the debt-to-GDP ratio below 100 percent over the medium term. They continue to engage the country's development partners and have expressed interest in potential emergency financial support from the World Bank and the IMF. They are also planning to meet with private sector representatives to discuss the expected impact of COVID-19 and potential contributions from the sector.

4. Potential implications for the PCI-supported program. Staff is working with the authorities on a revised macroeconomic baseline, potential implications for quantitative targets under the program as well as additional financing. Staff is not proposing an adjustment to

program targets at this juncture. COVID-19 implications are constantly evolving, making it difficult to formulate a credible new macroeconomic baseline. Staff will continue to cooperate closely with the authorities, and coordinate with Cabo Verde's development partners, especially the World Bank.