COUNTRY BRIEF MARCH 2017

Cabo Verde

Introduction

Cabo Verde is a country off the coast of West Africa comprising an archipelago of 10 islands covering a combined area of around 4,000 square kilometres. It has a total population of around 515,000 made up of largely urban inhabitants with a remarkable literacy rate of over 85%, and an equally large diaspora primarily based in the USA. Despite its lack of natural resources, the country has made impressive progress in economic development and poverty reduction over the last two decades. Cabo Verde's rapid economic growth has allowed the country to triple per capita GDP and graduate to middle-income country status with services being the mainstay of the economy. Cabo Verde's tourism, fisheries, banking and telecomunications industries are strong assets as is its stable political climate and economic governance. However, the country's high level of public debt and dependence of FDI and remittances can be source of macroeconomic management challenges, especially in a context of heightened global volatility and creeping protectionism.

Political environment

Cabo Verde has a robust democracy and has enjoyed prolonged political stability. After 15 years in opposition, the center-right Movimento para Democracia (MpD) won an absolute majority in the parliamentary elections of March 2016 and landslide victories in subsequent municipal and presidential elections—ending a prior cohabitation with the African Party for the Independence of Cabo Verde (PAICV, the largest party in the Assembly).

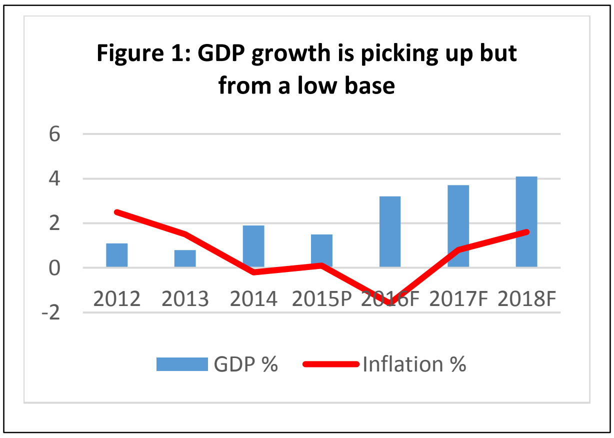
The transfer of power was smooth, testifying to the country's institutional strength and maturity. The end to cohabitation should ensure the adoption of structural reforms and the introduction of measures favourable to private investors. Cabo Verde is among the top-ranked countries in the world, according to World Bank Governance indicators (45th out of 214 countries). It also ranks among the top scorers in the Mo Ibrahim Index of African governance and its former President, Pedro Pires, won the Mo Ibrahim Prize in 2011.

Economic overview

GDP. Under the combined effects of a challenging external environment—especially in Europe, a slowdown in public investments and foreign direct investments (FDI), a drop in remittance transfers from Cabo Verdeans abroad, and official development assistance the Cabo Verdean economy averaged growth of 1.3% between 2009-2015.

The Cabo Verdean economy appears to be emerging from this low growth trend, however. According to the latest IMF estimates the country achieved a growth rate of 3.2% in 2016, up from 1.5% in 2015. The IMF forecasts 2017 growth at 3.7% rising to 4.1% through 2021—which the authorities view as conservative given their expectation of higher private sector credit growth.

The drag on growth is now being replaced by stronger FDI, firmer domestic demand and more robust agriculture and tourism sectors. Tourism receipts from Europe have been boosted by the ongoing transition out of the fiscal and sovereign debt crisis, although headwinds related to Brexit and a weaker sterling might stymie momentum in the near term. The confirmation, at the end of 2016, of the first cases of infection caused by the Zika virus could also adversely affect tourism.



Source: IMF, Afreximbank Research

Inflation. Inflation over the last 5 years has been tame and has averaged only 0.3%. During this time, consumer prices have been marked by a long period of deflation with negative consumer prices seen between November 2015 and January 2017, due largely to weak private sector credit, low imported inflation and a stable currency (the escudo is pegged to the euro). Latest official figures show that inflation rose by 0.3% year-on-year in February 2017 and remains positive, albeit benign, on the back of brisker economic activity and higher food and commodity prices.

Fiscal balance: The overall fiscal balance has been improving but remains in a deficit estimated at 4.1% of GDP in 2015 and is forecast to fall to 3.3% of GDP in 2016 as a public investment programme (PIP) phases out. Large fiscal deficits in recent years have been mainly driven by capital spending related to PIP. According to the IMF, the Cabo Verdean authorities are well aware of the need to improve the fiscal outlook and are making progress in broadening the tax base and enhancing collection.

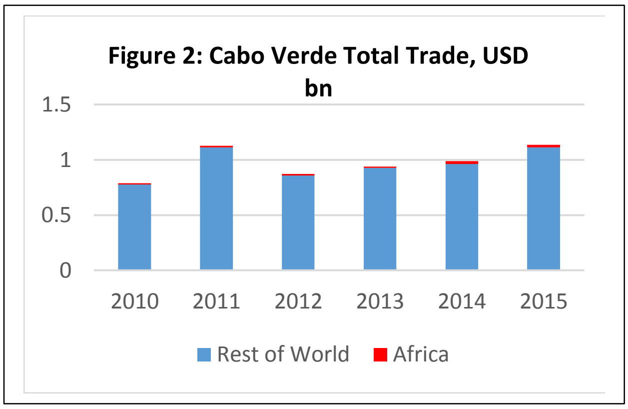
Overview of trade, reserves and financial sector

Trade. Cabo Verde largely imports capital goods, fuel and food. Fuel imports account for about 20 percent of imports. Merchandise exports are dominated by fish, which accounts for over 80% of the country's exports. The country's main trade partners are Portugal, the Netherlands, Spain, China and Brazil. Trade with Europe—especially Portugal and Spain, with which Cabo Verde has historical links and facilitated by the escudos's peg to the euro—accounted for about 90% of the country's exports and more than 80% of the country's imports in 2015. Trade with Africa remains low, and accounts for about 2% of total trade. The leading African trade partners include Senegal, Morroco and Togo. Trade with African partners could be better enhanced by developing Africa's fuel refining capacity to substitute fuel imports from the Netherlands. Establishing trade links with food surplus countries especially along the Gulf of Guinea and also South Africa could help further boost intra-african trade and improve the trade balance.

Current and capital account balances: Cabo Verde's overall balance of payments is forecast at 1.4% of GDP in 2017, down from an estimated 2.1% in 2016. However this belies a high current account deficit reflecting an elevated trade deficit on account of high fuel and consumer and capital goods imports. The current account deficit is estimated to have risen to 7.2% of GDP in 2016 up from 4.3% of GDP in 2015 on account of rising import bill. The deficit is largely being financed by government borrowing.

According to IMF forecasts, the current account deficit will widen to about 8% of GDP in 2017 owing to strong FDI and recovering growth, before gradually improving to around 7% of GDP in the medium term as goods and service exports continue to grow and the tourism sector recovers. Current account transactions have been liberalised subject to local regulations but there are still capital account restrictions and transactions must be approved by the central bank.

Reserves. The international reserves position is improving moderately and adequately covers around 6 months of prospective imports. Still, the country's high dependence on tourism and remittances represents a significant external vulnerability in the longer run.



Source: IMF, Afreximbank Research

Exchange rate: The Cabo Verdean escudo is pegged to the euro at a rate of EURCVE 110.265 (supported by Portugal) which has helped maintain a lid on imported inflation. The ministries of Finance and the Central Banks of Portugal and Cabo Verde have the authority to change the current monetary arrangements. However, at this time, we view the risk for a change to the peg to be muted.

Financial Sector: According to the IMF's 2015 report there are 8 commercial banks and 3 licenced foreign exchange Bureaux operating in the country. There is little financial sector activity outside of banking. Furthermore, asset concentration is high, and lending activity is firmly concentrated in the top three banks. The foreign debt stock is high and rising accord ing to IMF estimates. Domestic debt makes up a smaller percentage of the total nominal debt stock, accounting for just 29% of GDP vs 98% of GDP for foreign debt. However, debt remains manageable due its highly concessional nature. Elsewhere, as at 2015, external arrears were owed to Russia for which rescheduling negotiations were underway. Arrears owed to Brazil were successfully rescheduled.

Opportunities for Bank Support

Cabo Verde's tourism, fisheries, banking and telecomunications industries are strong assets that can be used to support further economic growth. Given the importance of the tourism sector in Cabo Verde, the Bank should continue to assess opportunities in the tourism sector, a sector which the Bank is already supporting. In this regard, the Bank may want to assess opportunities within the transportation industry which facilitates inter-island transportation as this will support both domestic and international tourism. Furthermore, the fisheries sector which provides potential for structural transformation and economic diversification could also be supported under the Bank's Blue Economy Strategy that is under development.

Additonally, with the number of Cabo Verdeans living abroad exceeding the number of domestic residents (approximately 700,000 Cabo Verdeans live abroad, mainly in the United States (260,000) and Europe (including 100,000 in Portugal); the large Diaspora community provides an opportunity for the Bank's Diaspora Bond and/or Remittance programme.

Table 1: Cabo Verde: Selected Macroeconomic and financial indicators

	2012	2013	2014	2015P	2016F	2017F	2018F
Real GDP %	1.1	0.8	1.9	1.5	3.2	3.7	4.1
Inflation %, Annual average	2.5	1.5	-0.2	0.1	-1.6	0.8	1.6
Exports of Goods and Services (of which Tourism) % y/y	8.4 (21.4)	6.9(8.6)	2.7(-12.5)	-9.8(3.3)	4.8(9.3)	7.5(7.5)	7.5(7.5)
Current acc. (incl. Official transfers)% GDP	-12.6	-4.9	-9.0	-4.3	-7.2	-8.8	-8.4
Gross reserves, Months of import	4.1	4.5	5.9	5.8	5.8	5.7	5.5
Total nominal Gov't debt, % GDP	91.1	102.5	114.5	125.8	129.1	130.2	128.5
External aid (Grants and loans)% of GDP	16.7	15.6	14.7	11.7	10.8	9.0	7.3

Source: IMF