

Interest Rate Pass-Through in Cabo Verde

Bruno Albuquerque and Nombulelo Gumata

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Prepared by Bruno Albuquerque and Nombulelo Gumata

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ABSTRACT: This paper estimates the interest rate pass-through in Cabo Verde. Using monthly data since 2001, we estimate a limited pass-through of monetary policy to banks' lending rates: a 1-percentage-point policy rate change leads to a 0.19–0.28 increase in average lending rates and 0.13–0.23 in long-term rates. Pass-through is roughly twice as strong during tightening than easing cycles but remains weak overall, including in the current cycle started in May 2023, underscoring challenges for monetary policy transmission.

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SELECTED ISSUES PAPERS

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Cabo Verde

Prepared by Bruno Albuquerque and Nombuelo Gumata



CABO VERDE

SELECTED ISSUES

January 09, 2026

Approved By
**The African
Department**

Prepared by Bruno Albuquerque, Nombulelo Gumata

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INTEREST RATE PASS-THROUGH IN CABO VERDE

This paper estimates the interest rate pass-through in Cabo Verde. The Banco de Cabo Verde (BCV) embarked on a monetary policy tightening phase since May 2023, the steepest tightening cycle in recent history. The key findings of the paper show that the policy rate pass-through is limited in Cabo Verde. Using two econometric models, the estimates point to a one-percentage point change in the policy rate leading to a medium- to long-run policy rate pass-through in the range of 0.19-0.28 for the average lending rate, and 0.13-0.23 for the long-term rate. The pass-through during tightening and easing episodes exhibits considerable heterogeneity across cycles. In particular, the pass-through is estimated to be twice as large during tightening cycles compared to easing cycles. However, the pass-through coefficient remains rather low. A larger pass-through during tightening cycles seems to be driven by the April 2001-April 2002 and January 2012-February 2014 hiking cycles. The May 2007-December 2009 and the current May 2023 cycles seem to be broadly insensitive to monetary policy, creating challenges for the effectiveness of the monetary transmission mechanism.

A. Interest Rate Channel of Monetary Policy

1. The effectiveness of the monetary policy transmission mechanism to the real economy depends on the degree and speed at which policy rate changes are passed through to lending rates. In an economy without financial friction, the optimal outcome from the social planner's point of view is for policy rate changes to be completely passed through to lending and deposit rates. This paper estimates the interest rate pass-through of the monetary policy rate to lending rates in Cabo Verde over the past two decades, while also testing for possible asymmetries in the speed of adjustment to rate increases and decreases. The literature typically shows that banks may not completely pass-through policy rate changes to bank lending rates (Beyer et al. 2024, Elias and Guimaraes 2024, and Leigh and Xu 2025). At the same time, banks may also adjust interest rates faster when the policy rate increases, compared with policy rate decreases (Yildirim, 2012, de Mello and Pisu, 2010).

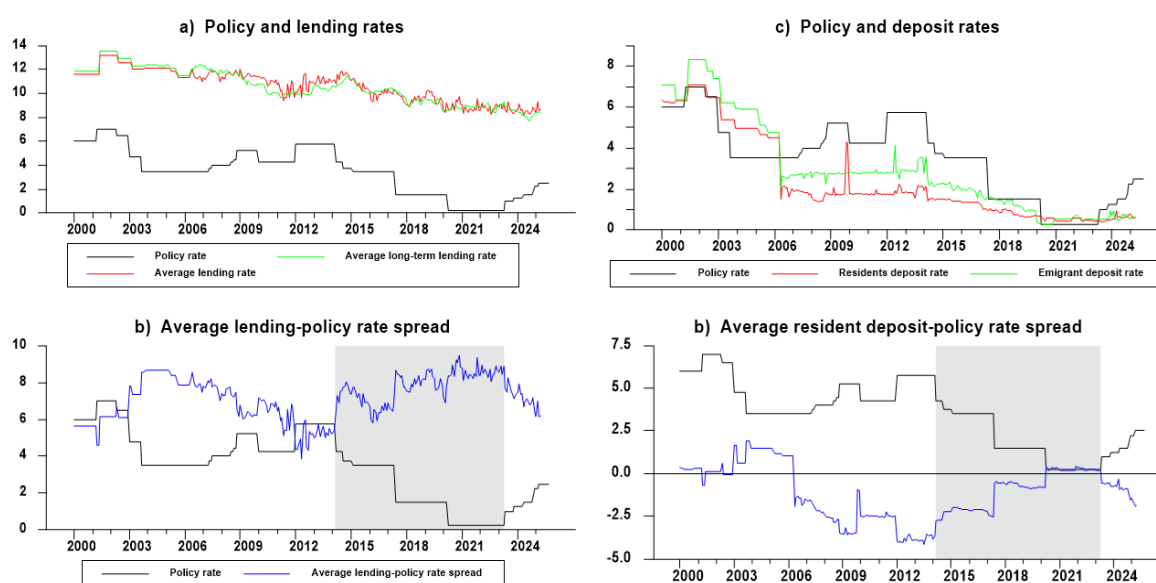
2. The Banco de Cabo Verde (BCV) embarked on a monetary policy tightening phase since May 2023 (Table 1). The current monetary policy tightening phase—amounting to a cumulative change of 225 bps in the policy rate—is the steepest over the past two decades. The large increase in the policy rate since May 2023 reflects for the most part the normalization of interest rates following the considerable loosening in monetary policy during the COVID-19 pandemic.

Table 1. Cabo Verde: BCV Interest Rate Tightening Cycles

	Duration (months)	Total increase	Number of hikes
Jan 2001 - April 2002	15	100bps	1
May 2007 - Dec 2009	32	175bps	5
Feb 2012 - Feb 2014	26	150bps	1
May 2023 - Oct 2025	30	225bps	6

Source: Cabo Verdean authorities and IMF staff estimates.

3. Lending rates have not adjusted noticeably to the recent increases in the BCV policy rate. The policy rate aims at influencing interest rates in the economy. Theoretically, average lending and long-term rates generally move in tandem. However, they have not adjusted noticeably to the recent increases in the BCV policy rate (Figures 1a and 1b). Emigrant and resident deposit rates have not increased significantly either, with a convergence among both rates since 2020, as the emigrant deposit rate premium dissipated.²

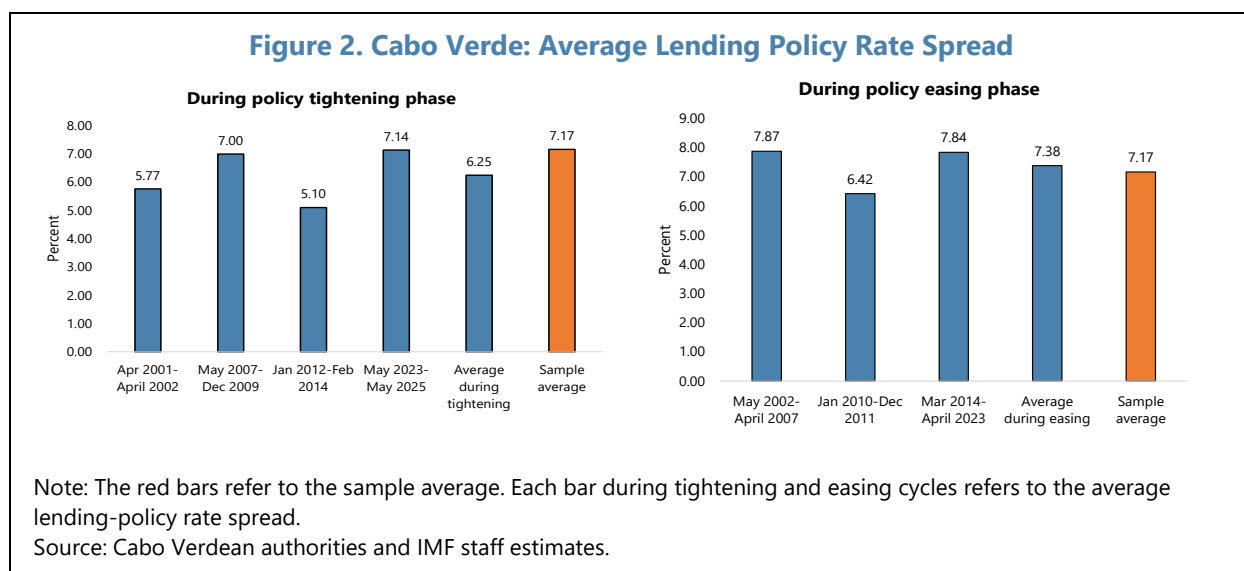
Figure 1. Cabo Verde: Deposit, Lending and Policy Rates

Note: Shaded area denotes the 2014M3-2023M4 policy loosening cycle.

Source: Cabo Verdean authorities and IMF staff estimates.

² Emigrant deposits constitute an average of 30 percent of total deposits in the banking system.

4. The spread between the average lending rate and the policy rate is on average much higher during the BCV policy loosening phases compared to tightening phases. The average spread during policy easing phases is 113 basis points higher than during policy tightening cycles (Figure 1). A higher wedge between lending rates and the policy rate during loosening cycles implies that banks tend not to reduce lending rates proportionally to the decline in the policy rate, leading to a weaker and asymmetric pass-through, and potentially impairing the monetary policy transmission mechanism. This asymmetric behavior may reflect market concentration, risk premium and consumer search costs, considerable excess liquidity in the system, and banks' high funding costs.

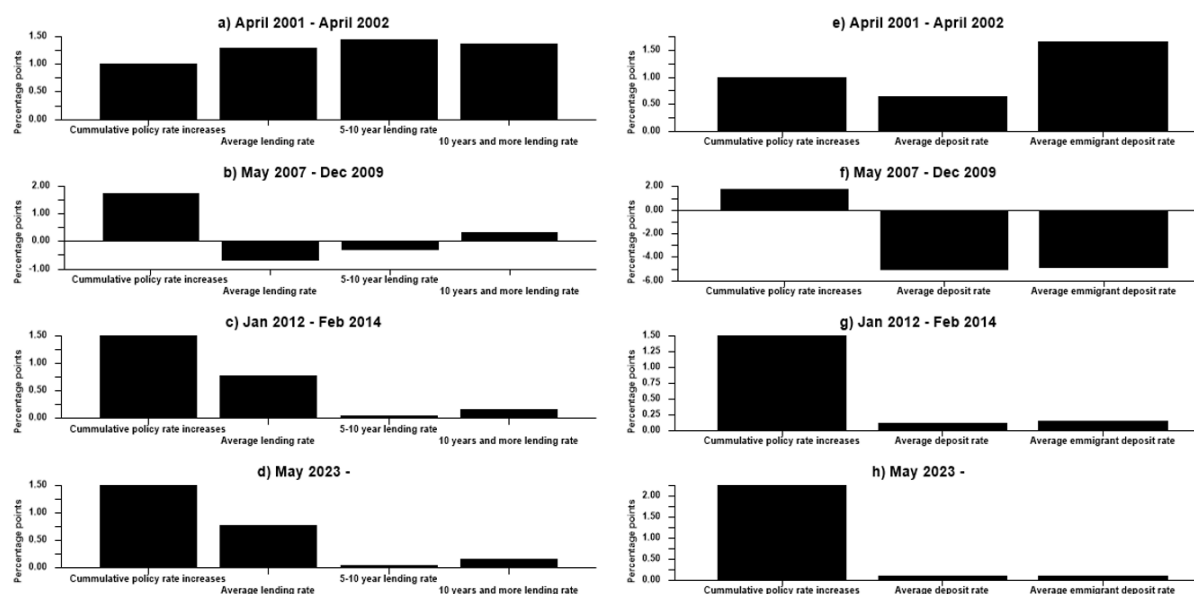


5. Interest rate betas³ seem to vary considerably over time. The policy rate increase during the 2001M4-2002M4 tightening phase seems to have been passed-through completely to bank lending rates, as illustrated by the unconditional interest rate betas (Figure 3). The complete pass-through seems to only have happened in the first tightening cycle: while there seems to have been a limited pass-through in the 2012 cycle, lending rates in both 2007 and the current tightening cycles declined. Negative betas in these cycles suggest that policy tightening was not transmitted to lending rates, with banks instead lowering rates. While the 2007 episode may have been affected by the Global Financial Crisis (GFC)—with banks not increasing rates due to the collapse in global demand—banks' behavior in the current tightening cycle may be related to a combination of different factors: excess liquidity conditions in the banking system, the need for banks to preserve their market share and non-market-based pricing. We also find considerable heterogeneity in the interest rate pass-through during loosening phases (Figure 4): in particular, banks seem not to have passed-through the policy rate decreases during the 2014-23 cycle. Overall, the policy rate then seems to act more as a signal rather than a binding cost

³ Bank interest rate betas in each monetary policy cycle are defined as the ratio of the cumulative change in bank interest rates to the cumulative increase/decreases in the policy rate.

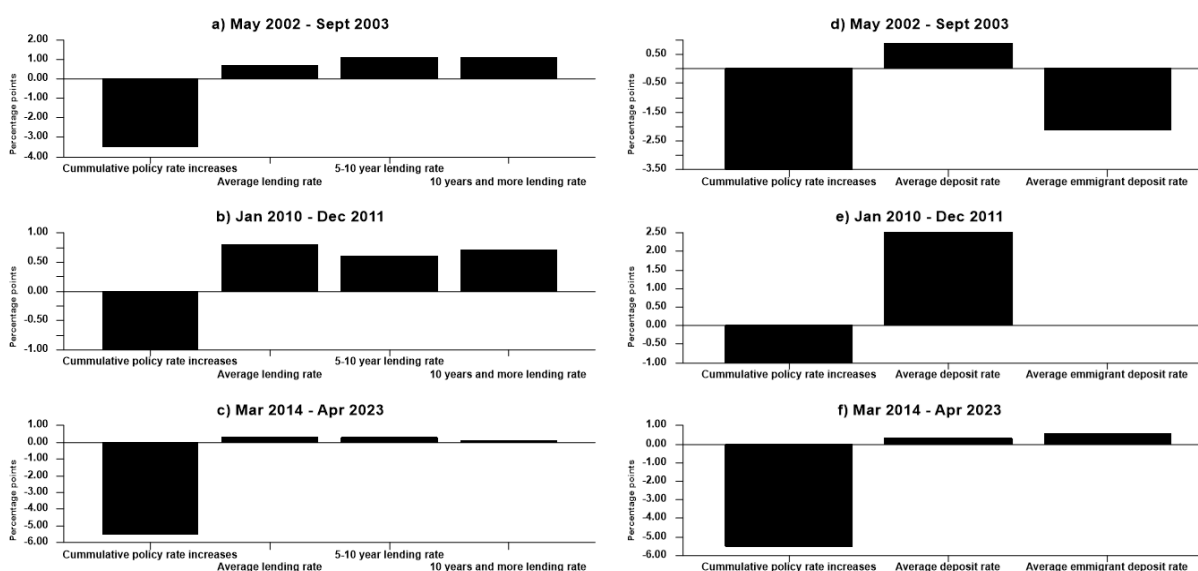
for banks' cost of funds. In fact, since banks do not rely on BCV refinancing, changes in the policy rate may not directly affect banks' funding costs.

Figure 3. Cabo Verde: Interest Rate Betas During Policy Rate Tightening Phases



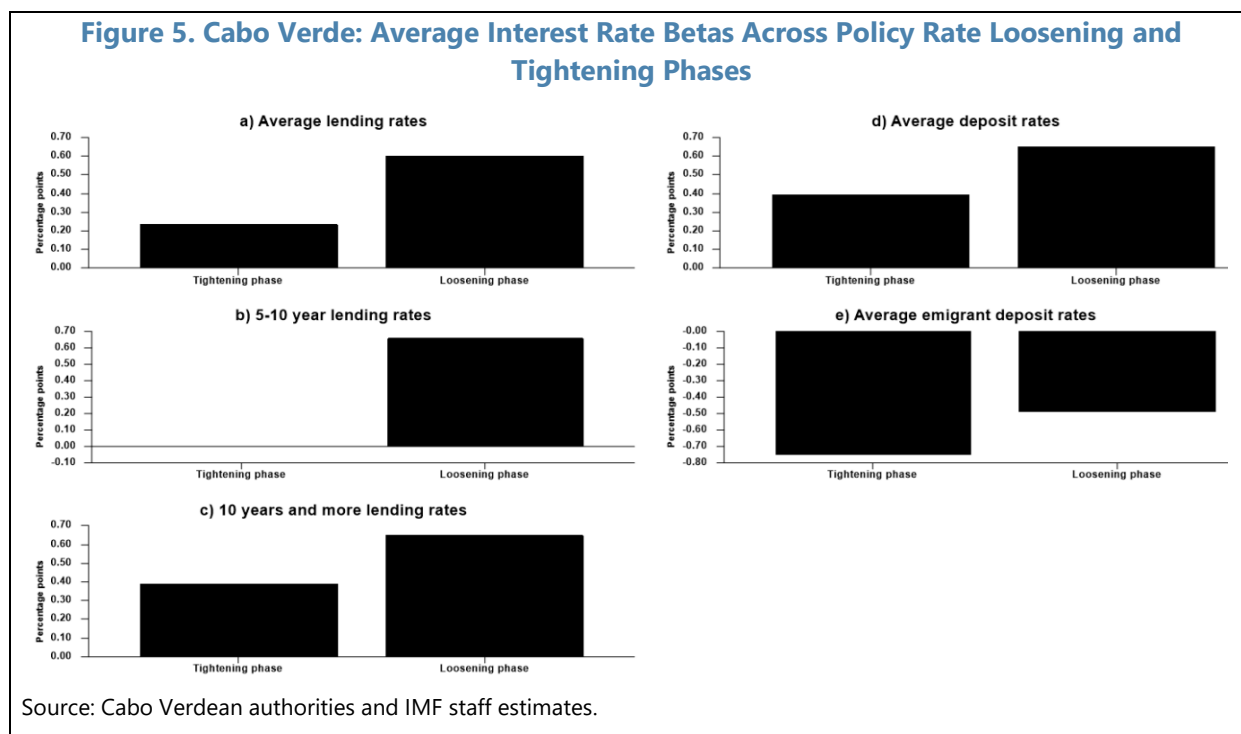
Source: Cabo Verdean authorities and IMF staff estimates.

Figure 4. Cabo Verde: Interest Rate Betas During Policy Rate Loosening Phases



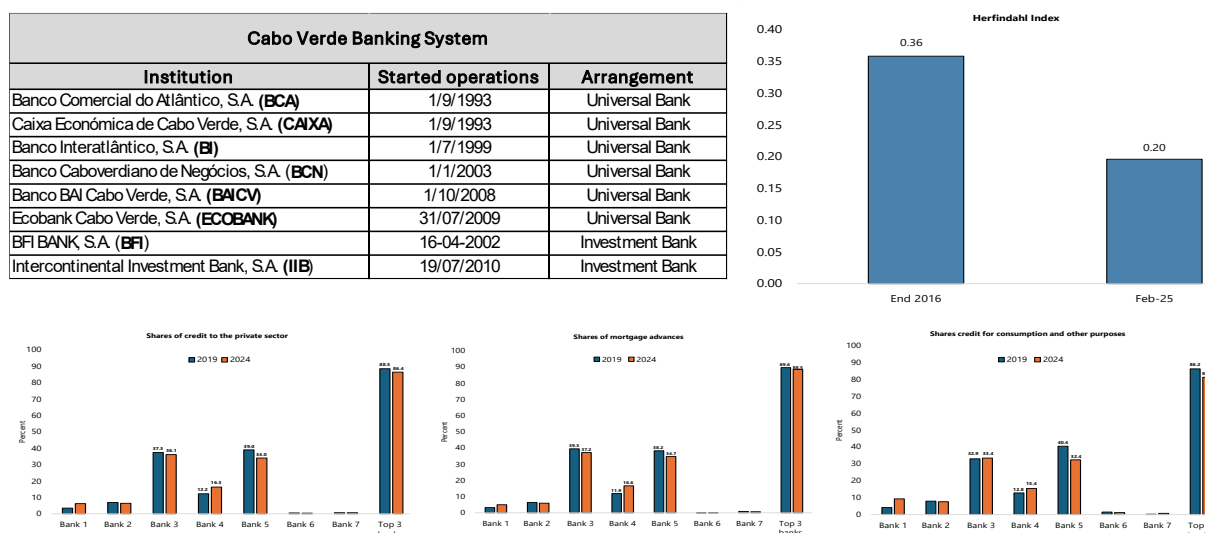
Source: Cabo Verdean authorities and IMF staff estimates.

6. Average interest rate betas across tightening and loosening cycles indicate that the pass-through tends to be incomplete (Figure 5). Pass-through falls into a range of -0.75–0.39 percentage points during tightening cycles and -0.49–0.66 percentage points during loosening cycles.



7. The banking system in Cabo Verde is dominated by three large banks. Cabo Verde has eight banks, of which three dominate the system (Table 2). Banking concentration levels, as measured by the Herfindahl index, have declined over time, as new banks have entered the market, but the credit market is still dominated by the top three banks. Bank concentration, by reducing competition, gives banks more market power to set interest rates which in turn can weaken the transmission of policy rates to bank lending and deposit rates. Table 3 shows that two banks are classified as high and moderate Domestic Systemically Important Bank (D-SIB), implying that their failure or distress could have a significant negative impact on the domestic financial system and the real economy.

Table 2. Cabo Verde Banking System



Source: Central Bank of Cabo Verde.

Table 3. Cabo Verde: Banks' of Importance in Cabo Verde

Bank	Shares of Total Assets	Share of total Credit	Share of Total Deposits	Obs.**
BCA	27.34%	25.09%	30.40%	High D-SIB
CECV	26.41%	29.04%	30.09%	High D-SIB
BIA	11.14%	11.81%	10.96%	Slight systemic importance
BCN	10.08%	16.07%	11.21%	Slight systemic importance
Banco BAICV	10.04%	10.53%	8.85%	Non D-SIB
IIB	9.93%	4.16%	3.81%	Non D-SIB
ECOBANK	5.04%	3.29%	4.67%	Non D-SIB

*As of December 2024.

**D-SIB stands for Domestic Systemically Important Bank. Classification according to internal BCV methodology.

Source: Central Bank of Cabo Verde.

B. Interest-Rate Pass-Through

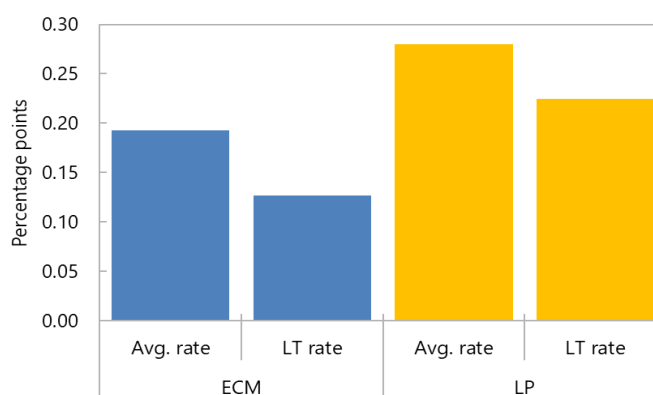
8. This section assesses the conditional policy rate pass-through to bank lending rates using two different models. Section A presented a preliminary assessment of the (unconditional) interest-rate pass-through over the different monetary policy cycles, not considering the state of the economy. For instance, banks may decrease interest rates during a monetary policy tightening cycle for reasons unrelated to monetary policy, such as in response to a large decline in credit demand (e.g., the GFC), or due to other developments in the banking sector (e.g., banking competition). Here, we assess the policy rate pass-through to lending rates by controlling for several economic

and financial developments in Cabo Verde using monthly BCV data from January 2001 to May 2025.⁴ We estimate two models: an error-correction model, using the two-step Engle and Granger procedure to estimate the long-run and error-correction equations; and a model using local projections allowing for more flexibly estimating the response of bank lending rates to policy rate changes over time (we focus on horizons one to six months ahead). We test different control variables in several specifications: (i) CPI inflation; (ii) reserve requirements ratio (RRR); (iii) non-performing loans (NPLs) as a share of total loans to capture credit risk; (iv) excess liquidity in the banking system, as it can influence the rate at which banks need to adjust lending rates in response to policy rate changes; (v) loan-to-deposit ratio (LDR) as banks with higher LDRs may adjust lending rates faster to protect their margins (as they depend more on wholesale funding, which adjusts faster); and (vi) a crisis dummy variable for the GFC period and the COVID-pandemic shock.

9. The baseline model controls for the RRR, inflation, and crisis dummy. The benchmark specification presented in this paper controls for the RRR, CPI inflation, and the crisis dummy. Although we only include these control variables in the main model, adding the other set of controls (NPLs, excess liquidity, and the LDR) does not qualitatively change the results. The advantage of using a restricted set of controls is that it allows us to take the first 2001 tightening episode into account, as the other variables are only available from 2002 onwards.

10. Medium- to long-run policy rate pass-through seems limited in Cabo Verde. Both models on the pass-through of policy rate changes to lending rates over the full sample suggest a range between 0.19–0.28 for the average lending rate, and 0.13–0.23 for the long-term rate (Figure 7). The incomplete pass-through and range during tightening and loosening cycles is comparable to the reported betas. The estimated limited pass-through is consistent with anecdotal evidence suggesting varied practices among banks, with some banks using an internally calculated index made up of the Euribor and internal factors, and others not following BCV rates as they do not use the BCV resources due to their excess liquidity.

Figure 6. Cabo Verde: Interest Rate Pass-through Across Models



Notes: ECM refers to error-correction model, and LP to local projections. Results presented for the average lending rate and the long-term lending rate. The horizon for the LP model is six months ahead.

11. Adding more macro and financial controls confirms the limited pass-through. Controlling for NPLs, excess liquidity, and the LDR—essentially discarding the first tightening

⁴ We use aggregate data due to the unavailability of detailed bank-level balance sheet data.

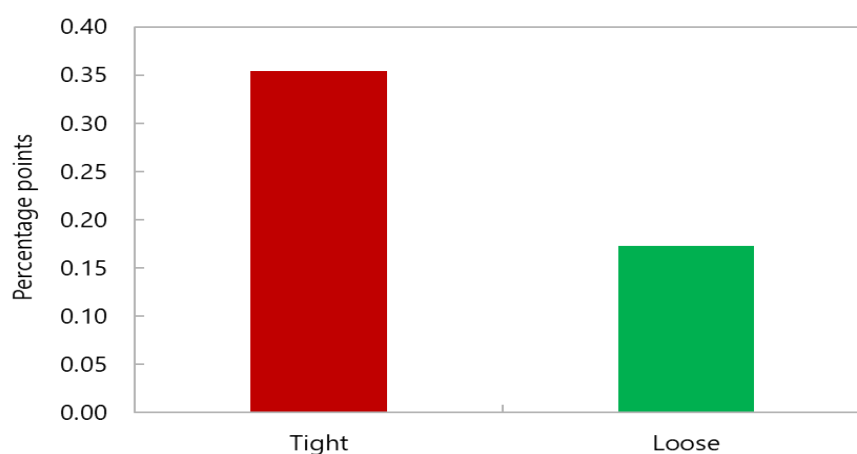
episode—leads to a pass-through in the range of 0.17–0.3 for the average lending rate, and 0.11–0.15 for the long-term rate, fully consistent with our benchmark model.

C. Asymmetric Pass-through During Loosening and Tightening Cycles

12. The interest rate pass-through seems to be larger during tightening episodes, although the transmission of policy rate changes to lending rates remains relatively limited.

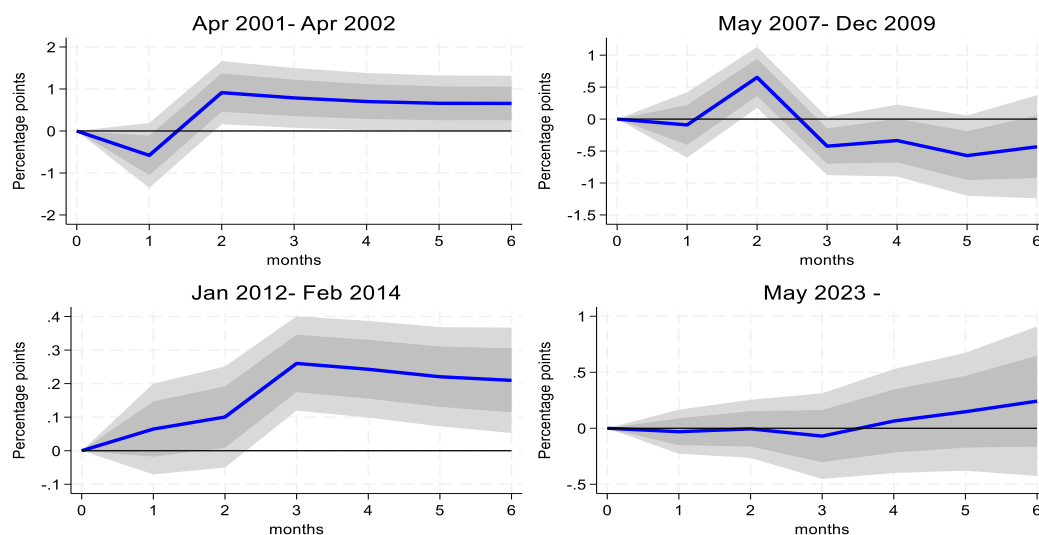
When we split the analysis of the pass-through between tightening and easing episodes, we find that lending rates adjust more during tightening episodes compared to loosening episodes. We focus on the results from the local projection model, given its flexibility in estimating nonlinear responses. Focusing on long-term rates, in particular, we find a pass-through of 0.35, which is roughly twice as large compared with 0.17 during monetary policy easing cycles (Figure 8). Although larger, the pass-through during tightening cycles is still estimated to be small.

Figure 7. Cabo Verde: Interest Rate Pass-through to Long-term Rates During Tightening and Loosening Cycles



Notes: ECM refers to error-correction model, and LP to local projections. Results presented for the long-term lending rate. The horizon for the LP model is six months ahead.

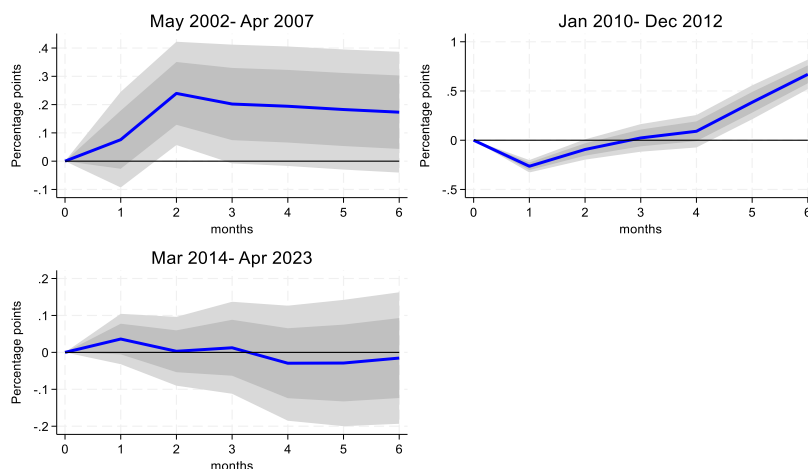
13. The pass-through during tightening episodes exhibits considerable heterogeneity across episodes. Taking advantage again of the flexibility of our local projection model to deal with nonlinearities, we expand the original model to be able to estimate the pass-through by tightening episode in the same regression. We find that our previous result—a larger pass-through during tightening cycles—seems to be driven by the 2001 and 2012 hiking cycles (Figure 9). But while the 2001 episode led to a full pass-through, the 2012 cycle was associated with a limited passthrough of around 0.2 after six months. In addition, we find that lending rates during the 2007 cycle and the current one that started in May 2023 to be broadly insensitive to monetary policy.

Figure 8. Cabo Verde: Interest Rate Pass-through During Tightening Episodes

Notes: Local projection regressions for horizons up to six months ahead, where the dependent variable is the cumulative change in banks' long-term lending rate. The blue line is the average point estimate, and the dark (light) shaded areas refer to the 68 (90 percent) confidence bands.

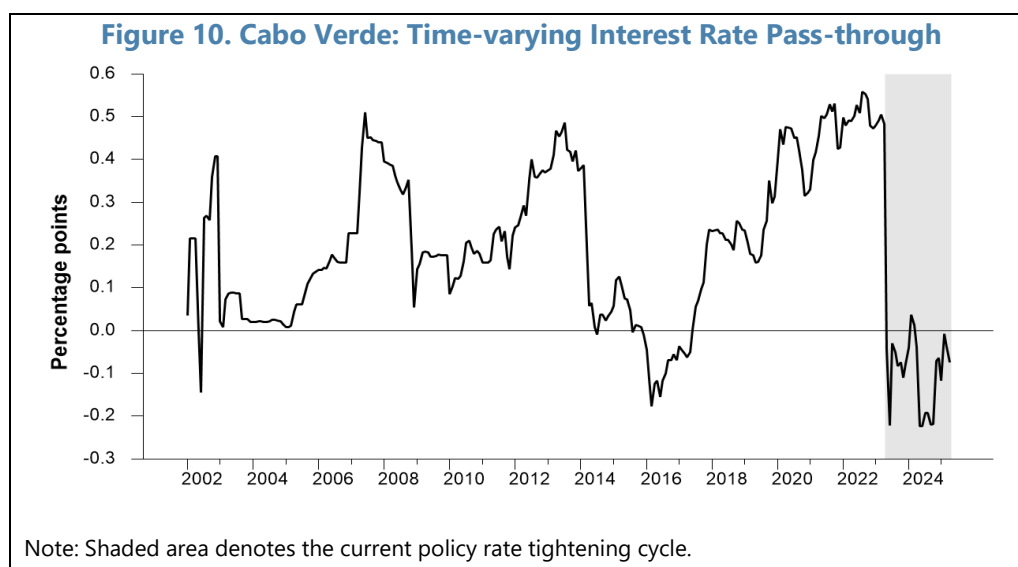
14. The pass-through during easing episodes also varies across cycles.

The pass-through is stronger for the Jan 2010-Dec 2012 cycle, even though it took some time to materialize (Figure 10). The pass-through for the March 2014-April 2023 cycle—the longest easing cycle on record—is estimated to be practically zero, i.e., we do not find that banks decreased lending rates despite the cuts in policy rates by the BCV.

Figure 9. Cabo Verde: Interest Rate Pass-through During Easing Episodes

Notes: Local projection regressions for horizons up to six months ahead, where the dependent variable is the cumulative change in banks' long-term lending rate. The blue line is the average point estimate, and the dark (light) shaded areas refer to the 68 (90 percent) confidence bands.

15. The estimated time-varying lending rate pass-through is consistent with the estimates from the impulse response functions. When estimating the time-varying pass-through in each month, we find that the current tightening cycle that started in May 2023 seems to be broadly insensitive to monetary policy (Figure 11).



D. Conclusion

16. The policy rate pass-through is estimated to be rather limited in Cabo Verde. Using two econometric models, this paper estimates the medium- to long-run policy rate pass-through to range between 0.19 and 0.28 for the average lending rate, and 0.13 to 0.23 for the long-term rate. We also find that the pass-through is roughly twice as large during tightening episodes compared to easing episodes, although still remaining relatively low. A larger pass-through during tightening cycles seems to be driven by the 2001 and 2012 hiking cycles, as the 2007 and the current May 2023 cycles seem to be broadly insensitive to monetary policy.

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