

**International Monetary Fund**

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**Cape Verde:** Letter of Intent

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The following item is a Letter of Intent of the government of Cape Verde, which describes the policies that Cape Verde intends to implement in the context of its request for a policy support instrument from the IMF. The document, which is the property of Cape Verde, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

## LETTER OF INTENT

June 15, 2010

Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
700 19<sup>th</sup> Street, N.W.  
Washington, D.C. 20431  
USA

Dear Mr. Strauss-Kahn:

1. Discussions for the concluding review of the Policy Support Instruments (PSI) were held in Praia during May 13–25, 2010. The PSI provided firm support for our policies for macroeconomic stability, economic growth, and poverty reduction. The PSI has served the country well and we intend to request a new one-year PSI during the fall 2010 as a bridge to a 3-year PSI after the elections.
2. Cape Verde used the policy space available from the buildup of fiscal and reserve buffers before the crisis to limit the impact of the world economic slowdown. The government accelerated its investment program and increased social spending, as well as reduced tax rates across the board. The government undertook a strong effort to cut recurrent expenditure relative to budget to help offset the shortfall in revenue, and it sought additional grants and concessional financing including from new partners. The BCV kept monetary conditions tight to protect reserves from downward pressure associated with the decline in foreign direct investment. Inflation remained subdued and in line with core inflation in the euro area.
3. All end-December 2009 PSI assessment criteria were met (Table 1) and progress has been made on the three remaining structural benchmarks. The BCV has prepared a memorandum for strengthening monetary and fiscal policy coordination, which was discussed by the PSI monitoring committee. The draft individual and corporate income tax bill has been finalized and will be submitted to the National Assembly. The government has revisited its strategy regarding offshore banks to wind down the sector and bring all banks under a single banking law; a Policy Strategy Memorandum has been discussed by the board of the BCV, and approved by the Council of Ministers.

4. The economy is expected to recover in 2010 as preliminary data suggest a pickup in activity and confidence in the first quarter, and growth should strengthen further over the medium term supported by sound policies and reforms. Medium-term fiscal policy will aim to lower the deficit to pre-crisis levels to safeguard external debt sustainability and protect reserves. Monetary policy will continue to be geared towards anchoring market expectations and keeping capital flows stable. As the recovery strengthens, risk premium narrows, and pressure on reserves eases, there may be room for further lowering the interest spread over the Euribor. Structural reforms are still needed to enhance the debt management capacity, reform loss-making SOEs, and implement financial sector reforms.

5. A successor PSI would aim at addressing these concerns, as well as ensuring continued macroeconomic stability, economic growth, and poverty reduction. We authorize the IMF to publish this letter of intent, and the related staff report.

Sincerely yours,

/s/

Cristina Duarte,  
Minister of Finance

**Table 1. Cape Verde: Quantitative Assessment Criteria and Indicative Targets for 2009-10 under the PSI<sup>1, 2</sup>**

	Cumulative Flows from End-Dec, 2008								Cumulative Flows from End-Dec, 2009					
	2009								2010					
	March	June			Sep.	Dec.			March	June	Sep.	Dec.		
Indicative Targets	Assessment Criteria	Assessment Criteria with adjusters	Flow Actual	Indicative Targets	Assessment Criteria	Assessment Criteria with adjusters	Flow est.	Indicative Targets	Indicative Targets with adjusters	Flow Prel.	Indicative Targets	Indicative Targets	Indicative Targets	
<b>Quantitative targets</b>	(Billions of Cape Verde escudos)													
Ceiling on net domestic borrowing of the central government <sup>3</sup>	-0.1	1.4	2.7	-0.4	1.7	-1.1	0.2	0.2	0.4	1.0	-0.7	0.7	1.1	1.5
Ceiling on net domestic assets of the central bank <sup>4</sup>	-0.9	4.9	5.1	1.3	4.9	4.9	4.6	2.7	0.0	0.5	...	0.1	0.1	0.1
Ceiling on the accumulation of new domestic payment arrears by the central government	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(Millions of U.S. dollars)													
Ceiling on the accumulation of new external payment arrears by the central government <sup>5</sup>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ceiling on the contracting or guaranteeing of non-concessional external debt with original maturity of more than one year by the central government <sup>6</sup>	8.8	22.5	22.5	0.0	28.8	48.0	48.0	0.0	35.0	35.0	...	35.0	35.0	35.0
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one year by the central government <sup>5,7</sup>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(Millions of euros)													
Floor on net international reserves of the Bank of Cape Verde (BCV) <sup>8</sup>	13.1	-19.5	-22.0	-8.7	-19.5	-25.2	-13.3	-3.6	3.7	-0.2	...	7.4	11.2	15.0
	(Percentage)													
Floor on the regulatory capital ratio of individual banks <sup>9</sup>	...	10.0	10.0	9.8	10.0	10.0	...	...	10.0	...	...	10.0	10.0	10.0
<i>Memorandum item:</i>	(Billions of Cape Verde escudos)													
<b>Program assumptions</b>														
Nonproject external financial assistance, including credit line (program assumption)	0.8	1.5	...	1.0	2.3	4.8	...	4.8	0.7	...	0.2	1.5	2.2	3.0
External debt service	0.5	1.4	...	1.2	2.1	2.8	...	2.5	0.7	...	0.6	1.4	2.2	2.9
Land sales	0.4	1.0	...	0.0	1.3	1.6	...	0.0	0.2	...	0.0	0.4	0.6	0.7
Clearance of end-2006 stock of domestic arrears	0.6	0.8	...	0.6	1.6	2.3	...	1.7	0.1	...	0.0	0.1	0.2	0.2

<sup>1</sup> Quantitative assessment criteria and benchmarks are described in the technical memorandum of understanding.

<sup>2</sup> For purposes of calculating program adjusters, foreign currency amounts will be converted at current exchange rates.

<sup>3</sup> Excluding borrowing for clearance of arrears and net late payments. The ceiling will be adjusted upward by the cumulative upward deviation in external debt service, and by the cumulative downward deviation in nonproject external financial assistance and land sales relative to program assumptions. The ceiling will be adjusted downward by the cumulative downward deviation in external debt service and by the cumulative upward deviation in land sales relative to program assumptions. The ceiling will be adjusted upward by the costs of restructuring state-owned enterprises up to a limit of CVE 1.5 billion.

<sup>4</sup> The ceiling will be adjusted upward by the cumulative upward deviation in external debt service and by the cumulative downward deviation in nonproject external financial assistance relative to program assumptions. The ceiling will be adjusted downward by the cumulative downward deviation in external debt service relative to program assumptions. The ceiling will be adjusted upward by the costs of restructuring state-owned enterprises up to a limit of CVE 1.5 billion.

<sup>5</sup> This assessment criterion is on a continuous basis.

<sup>6</sup> This assessment criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), but also commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are rescheduling arrangements, the Portuguese credit line, and borrowings from the Fund.

<sup>7</sup> The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt. Excluded from this performance criterion are rescheduling arrangements, the Portuguese credit line, borrowings from the Fund, and normal import-related credits.

<sup>8</sup> The floor on net international reserves of the Bank of Cape Verde will be adjusted downward by the cumulative upward deviation in external debt service, by the cumulative downward deviation in nonproject external financial assistance relative to program assumptions, and by the costs of restructuring state-owned enterprises up to a limit of 13.6 million euros. The floor will be adjusted upward by the cumulative downward deviation in external debt service relative to program assumptions. Additionally, in the case Cape Verde participates in any SDR allocation(s) between June 30, 2009 and the test date, the floor on net international reserves will be adjusted upwards by the equivalent of the amount of the cumulative additional SDR allocation(s) up to the test date measured at program exchange rates.

<sup>9</sup> The floor on banks' regulatory capital ratios is an indicative floor for all test dates. This indicative target is continuous.

<sup>10</sup> Does not include the positive flow caused by the allocation of € 9.3 million SDRs to Cape Verde.

<sup>11</sup> Differs from IMF Country Report 09/198 because of a small upward revision of net international reserves by the Bank of Cape Verde.