SUPPORTING ECONOMIC TRANSFORMATION

Economic impacts of and policy responses to the coronavirus pandemic: early evidence from Cape Verde

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Key messages

- The social and economic impact of the worldwide crisis generated by the COVID-19 pandemic is expected to trigger a crisis in Cape Verde, given the vulnerability of the real economy to external shocks and government fiscal constraints.
- The main channels through which the crisis impact may be aggravated are current account deterioration, the crash of tourism and a potential sovereign debt crisis that would have contagious effects on the financial and banking systems.
- National authorities are taking measure to mitigate the crisis, decreeing a moratorium on loan payments and supporting businesses and citizens though a fiscal stimulus package of CVE 3.5 billion ($34 million, 1.9% of 2020 GDP). The international community is supporting the government through a $5 million World Bank concessional loan and advocating for the suspension of debt payments to G20 countries.

Introduction

The first case of COVID-19 in Cape Verde was reported on 20 March, 2020. As of 15 April, 11 COVID-19 cases had been officially confirmed, and 1 fatality. From 27 February, the government took restrictive measures, limiting air and maritime traffic, preparing quarantine areas in hospitals and, finally, declaring the state of emergency, which put in place confinement and social distancing measures.

Cape Verde's economy was performing well before the outbreak, growing at 6% GDP in 2019; however, the crisis is likely to trigger a recession. The country is not well prepared for a health crisis and it is fiscally constrained, with a fiscal deficit of 3.6% and public debt of 118.7% of GDP in 2019.

Domestic government health expenditure budgeted for 2019 was equal to CVE 6.9 billion ($70 million, 3.5% of GDP), which is high compared with country peers, while **external health expenditure** was estimated to be CVE 788 million ($8 million, 0.4% of GDP). Health sector performance has improved in recent years.

Economic and social impacts

Trade and production impacts so far

The GDP growth rate forecast for 2020 has fallen from 5.5% to -4.1% as a result of the impact of the worldwide recession on Cape Verde, whose openness to trade index is over 100% GDP. In 2019 the **trade deficit** reached 37.1% of GDP. Normally, the deficit is partially compensated for by revenue generated by tourism, at 22.8% of GDP in 2019, but this is expected to fall to 9.1% of GDP in 2020. Imports, meanwhile, are forecast to decline from 40.3% to 34.5% of GDP. The volume of the main export product, **canned fish**, fell by 14.3% in 2019. This trend is likely to continue, leading to deterioration in the current account, given that the main export destinations – Spain, Portugal, Italy and the US – are slowing down.

Cape Verde's real economy is very vulnerable to external shocks. Trade is the largest sector as a share of GDP, at 10.5%. Transport and logistics (9.3%) and tourism (7.4%) are also very important. Negative trade conditions, weaker internal demand and movement restrictions will impact all these sectors. Tourism is expected to lose 536,080 visits in 2020, leading to a reduction of 60.4% in overnight stays and 4.7% in tourist average expenditure. **Inflation remains stable around 1.1%**, despite stock breaks and a potential increase in consumption prices.

Finance

Cape Verde is relatively well integrated in global financial markets, and financial services amounted **4.4% of GDP in 2019.** Nevertheless, Cape Verde has **few portfolio investment opportunities,** with operations decreasing by 2% in 2019. The market is scarcely diversified. Sovereign bonds represents 84.6% of the total capitalisation (CVE 64.5 billion, $654.8 million, 33% of GDP) and the banking system holds 80% of the assets. Therefore, **a sovereign debt crisis would have impacts on the capital market and, through this, the banking system, affecting deposits and, hence, consumption.**

The inward portfolio stock is forecast to grow up to CVE 959.6 million in 2020 ($9.3 million, 0.5% of GDP) and the outward stock to CVE 17,228.4 million ($168.4 million, 9.2% of GDP). However, a worldwide financial crisis could lead to a **sudden stop or quick reversal of inflows,** worsening domestic financial conditions.

Only four companies (SCT, CVE, BCA and CEC) **issue shares in the Cape Verde stock market**. So far in 2020, total market capitalisation has fallen by 3.4% to CVE 6.8 billion, led by the crash of national banks.

FDI is an important source of finance for the country, although high interest rates and lack of internal credit hinder it. In 2019, inward FDI flows equalled CVE 10.4 billion ($105.6 million, 5.3% of GDP) and the stock reached CVE 213.7 billion ($2.2 billion, 109% of GDP). In 2020, flows are expected to increase to CVE 10.6 billion ($103.6 million,[1] 5.7% of GDP) and the stock to CVE 224.4 billion ($2.2 billion, 119.5% of GDP). Nonetheless, the crash of the tourist sector, the main FDI receptor, could lead to cancellations or disinvestments.

Remittances are expected to grow in 2020 to CVE 20 billion ($195.5 million, 10.6% of GDP), but slower as a result of global job losses and production stops. The fluctuation risk is limited by the **peg of the CVE at CVE 110.27 to the euro**. However, the US$/CVE is expected to depreciate to 102.32 in 2020. The central bank has **reserves to cover 11 months of imports.**

Social impact

Cape Verde has succeeded in reducing poverty, lowering the extreme poverty rate from 30% in 2001 to 10% in 2015. Lower remittances, economic slowdown and 17,664 job losses will increase poverty.

Food prices increased in March, 2020, (0.2% month-on-month and 4.2% year-on-year). Lack of nutritional sovereignty – Cape Verde had imported food for CVE 3.3 billion ($32.3 million, 10.6% of GDP) by February 2020 – and limited international trade may raise prices.

Fiscal impacts

Government revenue is forecast to drop significantly to 27.3% of 2020 GDP, mainly as a result of a reduction in tax collection. **Public expenditure is forecast to rise to 37.7% of 2020 GDP.** This would create a fiscal deficit of 10.4% GDP in 2020. **Cape Verde efforts to reduce public debt will be reverted,** reaching 134.2% of 2020 GDP. The debt service ratio was 74.5% in 2019. This, plus lower export revenue and a high risk of external debt distress, can create problems in meeting debt service obligations.

Monetary and financial policy

The Central Bank of Cape Verde has **reduced reserve requirement rates**, in order to increase the liquidity of the banking system, and decreed a **moratorium on loans payments** until June, 2020, for households, firms, social economy entities and city councils.

Fiscal policy

The government will reallocate CVE 76 million ($0.7 million) to an **emergency plan** covering new heath care needs. It is **supporting businesses** with CVE 3 billion in loan guarantees ($29.3 million, 1.6% of 2020 GDP), tax facilities and a CVE 4 million credit line ($39,093) for all firms. 500 firms have already requested a CVE 1 million. Finally, CVE 378.6 million ($3.7 million, 0.2% of 2020 GDP) will be spent in **social protection** and wages will be subsidised.

Other policy

Regarding **labour market policy**, public enterprises cannot resort to job contract termination, unless absolutely necessary, while private job contract suspensions have been eased. Health professionals and public security forces involved in the COVID response will have public life insurance.

A **social emergency programme** will protect the most vulnerable. It will last up to three months with a total expected cost of CVE 1.1 million ($10,750).

Donor support

The **World Bank** has approved a $5 million concessional loan to support the National COVID Preparation Plan. The funds will be employed to buy emergency material, medical equipment and vehicles for emergency operations, and to reinforce laboratories' capacity. **UN public servants** have organised a donation campaign to collect funds.

The **World Bank and the IMF** have asked the G20 to suspend debt payments from IDA countries. This could grant between CVE 514.3 million ($5 million, 0.3% of 2020 GDP) and CVE 658.5 million ($6.4 million, 0.4% of 2020 GDP) to the government in additional liquidity.

Information in this note is correct as of 15 April 2020. Carlos Alberto Coca Gamito is an ODI Fellow with the Ministry of Economy in Guinea-Bissau; this note is written in a personal capacity. Comments welcome to: c.c.gamito.fs@odi.org.uk.

[1] US$/CVE appreciation will decrease the total amount in US$.