# Cabo Verde: Joint Bank-Fund Debt Sustainability Analysis

April 2020

Prepared jointly by the staffs of the International Development Association (IDA) and the International Monetary Fund (IMF)

Approved by Marcello Estevão (IDA) Annalisa Fedelino and Johannes Wiegand (IMF)

| Cabo Verde: Joint Bank-Fund Debt Sustainability Analysis<sup>1</sup> | 
|---|---|
| **Risk of external debt distress** | High<sup>2</sup> |
| **Overall risk of debt distress** | High |
| **Granularity in the risk rating** | Sustainable |
| **Application of judgment** | No |

**Macroeconomic projections**

Growth is projected to contract in 2020 with the sharp contraction in the tourism and transport sectors, directly affected by the external shocks, and the decline in activity across all sectors reflecting spillovers from the tourism and transport sectors and the impact of mitigating measures. The external and fiscal positions are projected to deteriorate significantly.

**Financing strategy**

Additional financing needs for 2020 will be filled by grants, Rapid Credit Facility resources and other concessional loans.

| Realism tools flagged | None |
| Mechanical risk rating under the external DSA | High |
| Mechanical risk rating under the public DSA | High |

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<sup>1</sup> Debt coverage is the same as in the last DSA.

<sup>2</sup> The Composite Indicator score is 3.283, with a classification of strong debt-carrying capacity.
Cabo Verde’s risk of external and overall debt distress is rated “high” as in the previous DSA (July 2019) with risks tilted to the downside. However, public and publicly guaranteed (PPG) debt is assessed to be sustainable, conditional on the implementation of prudent fiscal policies following the COVID-19 crisis and in view of manageable debt service ratios. The shocks from the COVID-19 pandemic will heavily impact tourism, the most important sector of Cabo Verde’s economy, and are expected to deepen current account and fiscal deficits, resulting in a higher debt path compared to the previous DSA. The baseline scenario assumes that concessional loans from multilateral institutions and grants will help cover the health costs and financing needs triggered by the global health crisis. However, debt sustainability is subject to considerable downside risks, including from a more severe or prolonged impact of the COVID-19 shock.

Both the present value (PV) of PPG external debt-to-GDP ratio and of total public debt-to-GDP ratio breach their respective thresholds over the medium term under the baseline scenario, signaling a high risk of external and overall debt distress. In addition, they are particularly sensitive to export, depreciation, and contingent liabilities shocks. However, they are both projected to gradually decline as the forecast horizon advances, falling below their thresholds from 2024 and 2028 onwards, respectively. Similarly, the PV of PPG external debt-to-exports ratio exhibits a continuous downward trend over the projection period. In addition, debt service indicators are forecast to remain below their respective thresholds. Based on PPG external and overall debt dynamics, PPG debt is deemed sustainable.
Figure 1. Cabo Verde: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2020–30

**Customization of Default Settings**

<table>
<thead>
<tr>
<th>Setting</th>
<th>Size</th>
<th>Interactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standardized</td>
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<tr>
<td>Tailored Tests</td>
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<tr>
<td>Combined CLs</td>
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<tr>
<td>Natural Disasters</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Commodity Prices</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Market Financing</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

**Borrowing Assumptions for Stress Tests**

<table>
<thead>
<tr>
<th>Source of Additional Financing</th>
<th>Default</th>
<th>User defined</th>
</tr>
</thead>
<tbody>
<tr>
<td>External PPG MLT debt</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2030. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

*Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.
### Borrowing Assumptions for Stress Tests*

<table>
<thead>
<tr>
<th>Shares of marginal debt</th>
<th>Default</th>
<th>User defined</th>
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</thead>
<tbody>
<tr>
<td>External PPG medium and long-term</td>
<td>36%</td>
<td>36%</td>
</tr>
<tr>
<td>Domestic medium and long-term</td>
<td>62%</td>
<td>62%</td>
</tr>
<tr>
<td>Domestic short-term</td>
<td>1%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Terms of marginal debt

| External MLT debt | 1.8% | 1.8% |
| Avg. nominal interest rate on new borrowing in USD | 22 | 22 |
| Avg. maturity (incl. grace period) | 6 | 6 |

| Domestic MLT debt | 3.2% | 3.2% |
| Avg. nominal interest rate on new borrowing | 6 | 6 |
| Avg. maturity (incl. grace period) | 0 | 0 |

| Domestic short-term debt | 0% | 0.0% |
| Avg. real interest rate |  |  |

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

**Sources:** Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2030. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.
Figure 3. Cabo Verde: Drivers of Debt Dynamics - Baseline Scenario

Gross Nominal PPG External Debt (in percent of GDP; DSA vintages)

External debt
Debt-creating flows (percent of GDP)

Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)

Public debt

Gross Nominal Public Debt (in percent of GDP; DSA vintages)

Debt-creating flows (percent of GDP)

Unexpected Changes in Debt 1/
(past 5 years, percent of GDP)

Sources: Country authorities; and staff estimates and projections.
1/ Difference between anticipated and actual contributions on debt ratios.
2/ Distribution across LICs for which LIC DSAs were produced.
3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.
Figure 4. Cabo Verde: Realism tools

<table>
<thead>
<tr>
<th>Year</th>
<th>Historical</th>
<th>Projected (Prev. DSA)</th>
<th>Projected (Curr. DSA)</th>
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<tr>
<td>2016</td>
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<td>2017</td>
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<td>2020</td>
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<td>2022</td>
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<td>2023</td>
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<td>2024</td>
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<tr>
<td>2025</td>
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</table>

Sources: Country authorities; and staff estimates and projections.
### Table 1. Cabo Verde: External Debt Sustainability Framework, Baseline Scenario, 2017–40

(In percent of GDP, unless otherwise indicated)

<table>
<thead>
<tr>
<th>Actual</th>
<th>Projection</th>
<th>Average</th>
<th>Historical</th>
<th>Projections</th>
</tr>
</thead>
<tbody>
<tr>
<td>External debt (nominal) 1/</td>
<td>107.7</td>
<td>102.6</td>
<td>99.7</td>
<td>103.2</td>
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<tr>
<td>of which: public and publicly guaranteed (PPG)</td>
<td>95.0</td>
<td>92.3</td>
<td>90.8</td>
<td>93.6</td>
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<tr>
<td>Change in external debt</td>
<td>-2.2</td>
<td>-4.0</td>
<td>-2.9</td>
<td>-3.4</td>
</tr>
<tr>
<td>Identified net debt creating flows</td>
<td>-3.9</td>
<td>-9.5</td>
<td>-8.9</td>
<td>-13.5</td>
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<tr>
<td>Non-interest current account deficit</td>
<td>3.2</td>
<td>1.5</td>
<td>-2.6</td>
<td>8.4</td>
</tr>
<tr>
<td>Deficit in balance of goods and services</td>
<td>21.5</td>
<td>19.2</td>
<td>14.5</td>
<td>25.3</td>
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<tr>
<td>Exports</td>
<td>45.4</td>
<td>49.2</td>
<td>50.9</td>
<td>53.2</td>
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<tr>
<td>Imports</td>
<td>66.9</td>
<td>64.4</td>
<td>65.4</td>
<td>58.5</td>
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<tr>
<td>Net current transfers (negative = inflows)</td>
<td>-17.0</td>
<td>-16.2</td>
<td>-16.4</td>
<td>-14.3</td>
</tr>
<tr>
<td>of which: official</td>
<td>-3.4</td>
<td>-2.0</td>
<td>-3.0</td>
<td>-4.4</td>
</tr>
<tr>
<td>Other current account flows (negative = inflows)</td>
<td>-1.3</td>
<td>-1.6</td>
<td>-0.1</td>
<td>0.6</td>
</tr>
<tr>
<td>Non FDI (negative = inflows)</td>
<td>-1.5</td>
<td>-4.1</td>
<td>-4.0</td>
<td>-4.7</td>
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<tr>
<td>Endogenous debt dynamics 2/</td>
<td>-1.6</td>
<td>-6.0</td>
<td>1.2</td>
<td>9.6</td>
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<tr>
<td>Contribution from non-aid interest rate</td>
<td>4.7</td>
<td>4.2</td>
<td>2.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Contribution from non-aid GDP growth</td>
<td>-3.7</td>
<td>-4.4</td>
<td>-5.8</td>
<td>-5.9</td>
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<tr>
<td>Contribution from price and exchange rate changes</td>
<td>-2.7</td>
<td>-6.4</td>
<td>5.0</td>
<td>6.8</td>
</tr>
<tr>
<td>Residual 3/</td>
<td>6.1</td>
<td>4.6</td>
<td>-1.3</td>
<td>-11.1</td>
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<td>of which exceptional financing</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
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</tbody>
</table>

#### Sustainability indicators

- **PV of FDI external debt-to-GDP ratio**
  - Actual: 58.7
  - Projection: 60.6
  - Historical: 54.4
  - Projections: 52.4
- **PV of FDI external debt-to-exports ratio**
  - Actual: 115.3
  - Projection: 219.1
  - Historical: 144.4
  - Projections: 125.0
- **FDI debt service-to-exports ratio**
  - Actual: 3.9
  - Projection: 3.9
  - Historical: 3.8
  - Projections: 3.8
- **FDI debt service-to-revenue ratio**
  - Actual: 18.1
  - Projection: 16.3
  - Historical: 16.4
  - Projections: 16.0

#### Key macroeconomic assumptions

- Real GDP growth (in percent)
- GDP deflator in US dollar terms (change in percent)
- Effective interest rate (percent)
- Growth of imports of G&S (US dollar terms, in percent)
- Growth of imports of G&S (US dollar terms, in percent)
- Growth of exports of G&S (US dollar terms, in percent)
- Grant element of new public sector borrowing (in percent)
- Government revenues (excluding grants, in percent of GDP)
- Aid flows (in Million of US dollars) 5/ 1690.0
- Grant-equivalent financing (in percent of GDP) 6/ 0.3
- Grant-equivalent financing (in percent of external financing) 6/ 0.3
- Nominal GDP (in Billion of US dollars) 1,770.0
- Nominal dollar growth 6.4
- Non-interest current account deficit that stabilizes debt ratio 1.1

#### Memorandum Items:

- **Of which: Private**
- **PV of FDI external debt 7/**
- **External debt service-to-exports ratio**
- **PV of FDI external debt (in Million of US dollars)**
- **PV of FDI external debt (in Million of US dollars)**
- **PV of FDI external debt (in Million of US dollars)**
- **PV of FDI external debt (in Million of US dollars)**

#### Sources:

- County authorities, and staff estimates and projections.
- Historical averages are generally derived over the past 10 years.
- Subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.
- 1/ Includes both public and private sector external debt.
- 2/ Derived (a) / p = (p+mg)/(p+mg+g+e) where p = real GDP growth, g = real GDP growth of deflator in U.S. dollar terms, e = nominal appreciation of the local currency, and m is share of local currency-denominated external debt in total external debt.
- 3/ Includes exceptional financing (i.e., changes in arrears and debt relief), changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
- 4/ Current-year interest payments divided by previous period debt stock.
- 5/ Defined as grants, concessional loans, and debt relief.
- 6/ Grant equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).
- 7/ Assumes that PV of private sector debt is equivalent to its face value.
### Table 2. Cabo Verde: Public Sector Debt Sustainability Framework, Baseline Scenario, 2017–40

(In percent of GDP, unless otherwise indicated)

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</thead>
<tbody>
<tr>
<td>Public sector debt 1/</td>
<td>127.2</td>
<td>125.6</td>
<td>124.2</td>
<td>127.4</td>
<td>132.0</td>
<td>122.5</td>
<td>114.0</td>
<td>106.3</td>
<td>95.4</td>
<td>71.2</td>
<td>41.0</td>
</tr>
<tr>
<td>of which: external</td>
<td>59.0</td>
<td>52.3</td>
<td>90.6</td>
<td>90.6</td>
<td>93.5</td>
<td>86.5</td>
<td>80.1</td>
<td>73.8</td>
<td>60.2</td>
<td>47.3</td>
<td>23.7</td>
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<td>Change in public sector debt</td>
<td>-1.1</td>
<td>-1.6</td>
<td>-1.4</td>
<td>1.33</td>
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<td>-0.9</td>
<td>-0.8</td>
<td>-0.7</td>
<td>-0.7</td>
<td>-0.9</td>
<td>-0.7</td>
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<tr>
<td>Identified debt-creating flows</td>
<td>-0.8</td>
<td>5.2</td>
<td>-0.3</td>
<td>10.4</td>
<td>-0.6</td>
<td>-0.6</td>
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<td>-0.7</td>
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<td>Primary deficit</td>
<td>9.4</td>
<td>0.3</td>
<td>-0.7</td>
<td>4.2</td>
<td>1.8</td>
<td>1.0</td>
<td>1.2</td>
<td>1.2</td>
<td>1.3</td>
<td>1.2</td>
<td>0.7</td>
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<tr>
<td>Revenue and grants</td>
<td>3.7</td>
<td>1.4</td>
<td>3.2</td>
<td>3.5</td>
<td>2.5</td>
<td>1.9</td>
<td>1.1</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
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<td>of which: grants</td>
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<td>28.4</td>
<td>29.4</td>
<td>26.6</td>
<td>27.5</td>
<td>29.4</td>
<td>25.0</td>
<td>28.7</td>
<td>28.6</td>
<td>28.7</td>
<td>27.5</td>
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<tr>
<td>Primary (noninterest) expenditure</td>
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<td>0.0</td>
<td>0.0</td>
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<tr>
<td>Automatic debt dynamics</td>
<td>-9.1</td>
<td>5.0</td>
<td>-2.3</td>
<td>9.7</td>
<td>-7.3</td>
<td>-8.6</td>
<td>-7.5</td>
<td>-6.6</td>
<td>-5.6</td>
<td>-4.4</td>
<td>-5.9</td>
</tr>
<tr>
<td>Contribution from interest rate/growth differential</td>
<td>1.8</td>
<td>-0.3</td>
<td>-6.0</td>
<td>8.0</td>
<td>-6.7</td>
<td>-8.1</td>
<td>-7.1</td>
<td>-6.2</td>
<td>-5.6</td>
<td>-4.8</td>
<td>-5.8</td>
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<tr>
<td>of which: contribution from average real interest rate</td>
<td>6.2</td>
<td>5.8</td>
<td>-0.8</td>
<td>0.7</td>
<td>0.1</td>
<td>-0.1</td>
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<td>-0.1</td>
<td>-0.1</td>
<td>-0.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>of which: contribution from real GDP growth</td>
<td>-4.6</td>
<td>-5.5</td>
<td>-6.7</td>
<td>7.3</td>
<td>-6.6</td>
<td>-8.0</td>
<td>-6.9</td>
<td>-6.1</td>
<td>-5.5</td>
<td>-3.6</td>
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<td>0.7</td>
<td>0.8</td>
<td>0.9</td>
<td>0.9</td>
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<tr>
<td>Other identified debt-creating flows</td>
<td>9.2</td>
<td>9.7</td>
<td>0.2</td>
<td>6.7</td>
<td>0.5</td>
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<td>0.8</td>
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<td>Privatization receipts (negative)</td>
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<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
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<tr>
<td>Recognition of contingent liabilities (e.g., bank recapitalization)</td>
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<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
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<td>0.0</td>
<td>0.0</td>
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<tr>
<td>Debt relief (HIPC and other)</td>
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<td>0.0</td>
<td>0.0</td>
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<td>0.0</td>
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<tr>
<td>Other debt-creating or reducing flow (please specify)</td>
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<tr>
<td>Result</td>
<td>-7.6</td>
<td>-7.1</td>
<td>-6.1</td>
<td>-7.4</td>
<td>-6.6</td>
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<td>-5.2</td>
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</tr>
<tr>
<td>PV of public debt-to-GDP ratio 2/</td>
<td>...</td>
<td>...</td>
<td>92.3</td>
<td>...</td>
<td>106.6</td>
<td>103.5</td>
<td>96.7</td>
<td>90.5</td>
<td>80.0</td>
<td>59.3</td>
<td>35.1</td>
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<td>PV of public debt-to-revenue and grants ratio</td>
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<td>...</td>
<td>311.8</td>
<td>...</td>
<td>401.0</td>
<td>376.1</td>
<td>329.1</td>
<td>311.8</td>
<td>296.6</td>
<td>277.8</td>
<td>260.7</td>
</tr>
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<td>Debt service-to-revenue and grants ratio 3/</td>
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Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central government plus extra-budgetary funds, central bank, government-guaranteed debt. Definition of external debt is Residency-based.
2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.
3/ Debt service is defined as the sum of interest and amortization of medium- and long-term, and short-term debt.
4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt-creating/reducing flows.
5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio (i.e., a primary surplus), which would stabilize the debt ratio only in the year in question.
6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.
Table 3. Cabo Verde: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2020–30 (Percent)

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Sources: Country authorities, and staff estimates and projections.

1/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Includes official and private transfers and FDI.
Table 4. Cabo Verde: Sensitivity Analysis for Key Indicators of Public Debt, 2020–30
(Percent)

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**PV of Debt-to-GDP Ratio**

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1/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
2/ Includes official and private transfers and FDI.