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Editorial

This issue marks the fifth year of the *Cooperation Journal*, which continues to report on cooperation relations between Banco de Portugal and the central banks of emerging and developing countries, focusing on Portuguese-speaking countries. Since its launch, this publication has also included the main macroeconomic developments in Portuguese-speaking countries, as well as relevant issues in this area.

Following its usual structure, the first part of issue 8 provides a synopsis of the macroeconomic environment of the Portuguese-speaking African countries and Timor-Leste, supported by a concise set of statistical data on the main indicators, including estimates for 2015 and the first projections for 2016. Domestic constraints or international developments in the price of exported commodities affected economic growth in most of these countries in 2015, a trend that is expected to continue this year.

The second part of the Journal is dedicated to cooperation activities between Banco de Portugal and its counterparts in emerging and developing countries, broken down by type and geography. From a total of 103 cooperation activities envisaged in the annual programme, 38 are expected to take place in the first five months of 2016, almost the same degree of implementation as in 2015. Activities with Portuguese-speaking countries are clearly predominant, accounting for around 75% of the total.

Finally, the third section focuses on the reform of the International Monetary Fund's "Debt Limits Policy", in force since the end of June 2015, which significantly amends the framework for applying debt limits to Low-Income Countries that have a Fund-supported programme. This reform provides greater flexibility in the implementation of these limits and contributes to improving debt sustainability in these countries.

Content

Macroeconomic framework in Portuguese--speaking African countries and Timor-Leste

Angola

Despite some recovery in oil prices in the international markets, this commodity is still trading far below its levels prior to the second half of 2014, which continues to weigh on the Angolan economy. The pace of growth has exacerbated its deceleration trend, while the substantial depreciation of the kwanza has put pressure on prices, pushing inflation back to double-digits. The fall in oil revenue has also had particularly detrimental effects on public and external accounts. In an effort to counteract this adverse scenario, the Angolan authorities announced that discussions with the International Monetary Fund were under way, in order to implement an adjustment programme under the Extended Fund Facility.

	2013	2014	2015	2016
	Est.	Est.	Est.	Proj.
Real GDP (annual % change)	4.3	4.8	3.0	2.5
Inflation (year-on-year % change)	7.7	7.5	14.3	19.2
Broad money (annual % change)	13.2	16.2	11.7	14.4
Current account (% of GDP)	6.7	-2.9	-8.2	-11.6
Fiscal balance (% of GDP)	0.3	-6.6	-4.2	-7.1
External public debt (% of GDP)	22.6	28.4	32.6	36.4

Sources: Banco Nacional de Angola, Ministry of Finance (Angola) and International Monetary Fund.

Cabo Verde

Sparse domestic economic activity dynamics, particularly as regards investment, resulted in growth deceleration in Cabo Verde in 2015, despite a more favourable external environment. The reduction in imports, also related to a fall in oil goods prices, led to improvements in the current account, which also benefited from higher tourism revenue and emigrants' remittances. The decline in public investment, together with a pick-up in revenue and grants, allowed a reduction in the fiscal deficit, although financing needs have kept debt on an upward path. Disbursements on public external debt helped to strengthen official reserves, which, in a context of low inflationary pressure, made it possible to keep monetary policy accommodative.

	2013	2014	2015	2016
	Est.	Est.	Est.	Proj.
Real GDP (annual % change)	0.8	1.9	1.5	2.9
Inflation (year-on-year % change)	0.1	-0.4	-0.5	1.0
Broad money (annual % change)	11.0	7.3	5.9	3.7
Current account (% of GDP)	-5.8	-9.0	-4.3	-7.1
Official reserves (months of imports)	4.8	5.4	6.4	5.7
Fiscal balance (% of GDP)	-9.3	-7.9	-3.8	-4.6
Public debt (% of GDP)	102.5	113.7	123.8	–

Sources: Banco de Cabo Verde, Ministry of Finance and Planning (Cabo Verde), Cabo Verde National Institute of Statistics and International Monetary Fund.

Guinea-Bissau

The economic situation in Guinea--Bissau is showing signs of improvement, following a more lacklustre period during which the international price of cashew nuts (its main export) fell and political instability was prevalent in the lead up to the elections of the first half of 2014. The introduction of an adjustment programme under the Extended Credit Facility with the International Monetary Fund in 2015 reaffirmed the Bissau-Guinean authorities' commitment to implementing the reforms deemed necessary to return the country to sustainable growth. Despite political uncertainty since the summer of 2015, the IMF still forecasts strong growth this year.

	2013	2014	2015	2016
	Est.	Est.	Est.	Proj.
Real GDP (annual % change)	0.9	2.9	4.8	4.8
Inflation (year-on-year % change)	-0.1	0.2	1.2	2.5
Broad money (annual % change)	14.9	30.7	9.8	9.4
Current account (% of GDP)	-4.5	0.5	3.0	1.8
Fiscal balance (% of GDP)	-4.3	-2.6	-5.9	2.8
External public debt (% of GDP)	28.2	29.6	29.3	25.6

Sources: BCEAO National Directorate for Guinea-Bissau, Ministry of Economy and Finance (Guinea-Bissau) and International Monetary Fund.

Mozambique

Following three years of growth above 7 per cent, Mozambique is expected to grow more slowly, at approximately 6.5 per cent, in 2015 and 2016. In 2015, floods, a slowdown in the mining sector and the delayed approval of the State Budget for 2015 had a negative impact on growth. The current account deficit remains high, as a result of a depreciation of the metical, falling commodity prices and a downward trend in FDI and external aid. These developments have hampered reserve accumulation, with stock deteriorating in 2015. To overcome this constraint, Mozambique established an assistance programme with the International Monetary Fund in December 2015 (Standby Credit Facility). This programme aims at reforming public finance, which faces growing sustainability risks. The monetary policy stance was tightened, leading to credit deceleration.

	2013	2014	2015	2016
	Est.	Est.	Est.	Proj.
Real GDP (annual % change)	7.1	7.4	6.3	6.5
Inflation (year-on-year % change)	3.5	1.9	10.6	5.6
Broad money (annual % change)	16.3	22.2	26.1	12.3
Current account (% of GDP)	-38.8	-33.5	-39.5	-33.1
Official reserves (months of imports)	3.3	3.9	3.0	2.3
Fiscal balance (% of GDP)	-4.6	-7.8	-11.0	-4.0
Public debt (% of GDP)	50.9	56.6	73.4	69.5

Sources: Banco de Moçambique, Ministry of Economy and Finance (Mozambique), Mozambique National Institute of Statistics and International Monetary Fund.

S. Tomé and Príncipe

São Tomé and Príncipe's economy is severely hampered by its small size, insularity costs and scarce resources. In 2015, the delayed approval of the Budget and the subsequent deferred launch of public investment projects, together with low cocoa production, led to a reduction in output growth. The implementation of the programme signed with the IMF in 2015 and the international community's greater involvement (official aid and foreign investment) indicate that in 2016 the economy will grow at a faster pace. Due to the economic slowdown and the maintenance of the exchange rate regime implemented in 2010, inflation continued to fall.

	2013	2014	2015	2016
	Est.	Est.	Est.	Proj.
Real GDP (annual % change)	4.0	4.5	4.0	5.0
Inflation (year-on-year % change)	7.1	6.4	4.0	4.0
Broad money (annual % change)	14.0	16.8	13.2	11.6
Current and capital account (% of GDP)	-18.1	-24.3	-12.6	-12.2
Fiscal balance (% of GDP)	-2.0	-5.5	-6.3	-9.9
Domestic primary balance (% of GDP)	-2.7	-3.3	-3.0	-2.0
External public debt (% of GDP)	76.1	71.7	82.4	–

Sources: Banco Central de São Tomé e Príncipe, Ministry of Finance and Public Administration (São Tomé and Príncipe) and International Monetary Fund.

Timor-Leste

The fall in oil prices and production has continued to negatively affect total output in Timor-Leste, which is likely to deteriorate even further in 2016. In turn, non-oil output (which, in 2015, for the first time since 2004, accounted for over 50% of the total) decelerated from 2014, but is expected to slightly recover in 2016. Inflation in 2015 remained virtually nil, but a slight increase is expected in 2016, associated with a recovery in the Indonesian currency (its main supplier of consumer goods). The fall in oil revenue and income from the Petroleum Fund will strongly constrain public expenditure, thus hampering a major catalyst of economic growth in this country.

	2013	2014	2015	2016
	Est.	Est.	Est.	Proj.
Non-oil real GDP (annual % change)	2.8	5.5	4.3	5.0
Real GDP (annual % change)	-13.9	-15.8	-0.6	-8.8
Inflation (year-on-year % change)	4.0	-0.1	-0.7	3.6
Broad money (annual % change)	22.9	19.9	7.1	21.6
Current account (% of non-oil GDP)	42.7	25.1	16.5	2.0
Fiscal balance (% of non-oil GDP)	42.1	25.9	4.2	-10.4
Petroleum Fund (% of non-oil GDP)	1,136	1,206	1,149	1,088

Sources: Banco Central de Timor-Leste, Ministry of Finance (Timor-Leste) and International Monetary Fund.

Cooperation activity undertaken by Banco de Portugal

Cooperation (undertaken and planned) from 1 January to 31 May 2016

The *Cooperation Plan* for 2016 envisages a total of 103 cooperation activities (compared with 106 in 2015). There are 38 activities planned for the first five months of 2016, of which 29 are with institutions of Portuguese-speaking countries (PLP) and nine with Other Emerging and Developing Countries (OPED).

This level of execution is particularly satisfying, especially considering that a number of the Bank's traditional cooperation partners are going through adjustment processes and that, overall, central banks are facing stricter budgetary restrictions.

As has been the case in the past, cooperation activities with institutions of Portuguese-speaking countries are predominant, accounting for three quarters of activities undertaken.

During this period (from January to May), multilateral initiatives have been/will be undertaken with Portuguese-speaking institutions, such as the 5th Issue and Treasury Meeting (in May), the courses organised in Lisbon on Reserve Management, Risk Management, and Monetary and Financial Statistics, as well as the course on Balance of Payments and International Investment Position Statistics

Chart 1 • Execution by recipient

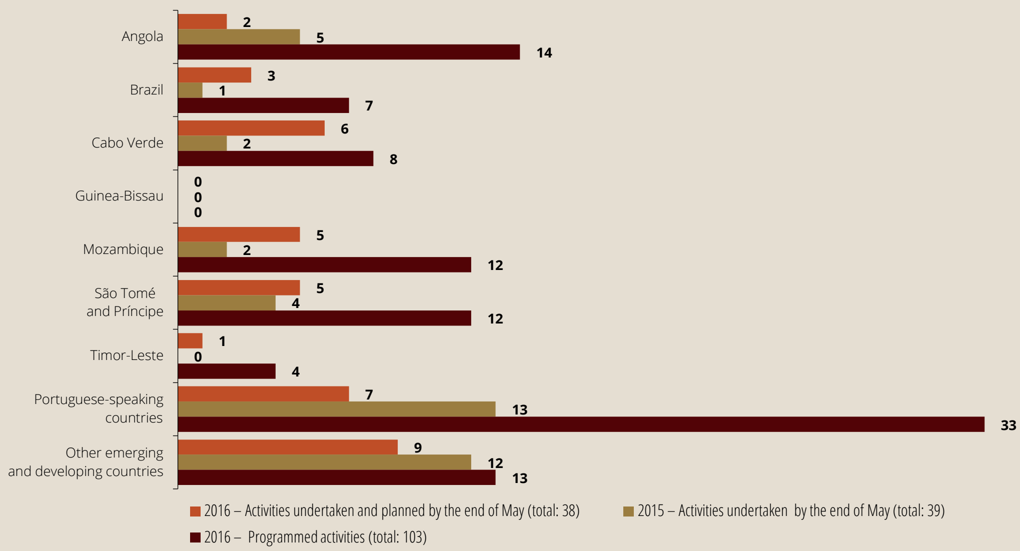
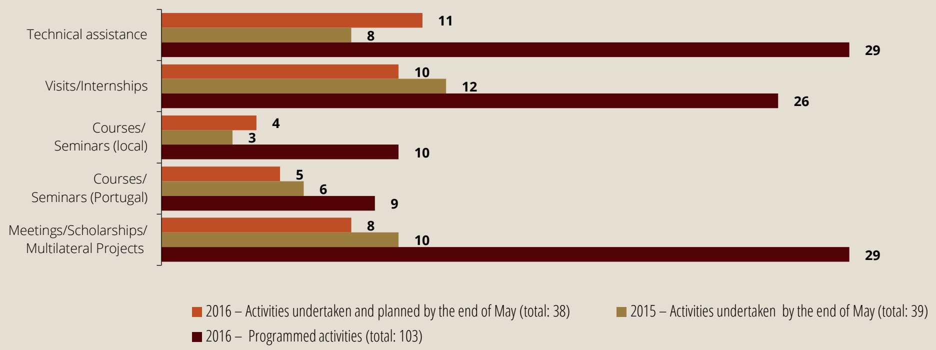


Chart 2 • Execution by type of activity



(jointly organised with the IMF Statistics Department) and the Seminar on Payment Systems, both scheduled to take place in May. The project to publish series of macroeconomic indicators of Portuguese-speaking countries, which was launched in 2015 as part of the commemorations of '25 Years of Cooperation' of Banco de Portugal, was also continued. Within this project, the indicators on the eight Portuguese-speaking countries were updated, totalling 106 statistical series.

Several bilateral initiatives were also undertaken in (and are planned for) these months, comprising technical assistance activities, work visits and internships both with institutions of Portuguese-speaking countries and institutions from other geographies.

Within the Bank's cooperation with the OPED, particularly relevant during this period is the hosting of the Meeting of Central Bank Governors of the Center for Latin American Monetary Studies (CEMLA) for the first time in Portugal, scheduled to take place on 10 and 11 May. This milestone in the long historical relationship between the two institutions (Banco de Portugal has been a collaborating member of the Center since 1980) comes at a time when cooperation with this organisation is clearly intensifying. During the week before this event, the II Meeting of the Financial Information Forum will also take place in Lisbon, within the scope of the CEMLA.

Cooperation activities in 2016 (undertaken and planned by the end of May)

Country	Type of activity	No. of activities	Subject areas of the activities
Angola	Visits/Internships	1	Statistics.
	Courses/Seminars	1	Issue and Treasury.
Brazil	Technical assistance	1	Statistics.
	Visits/Internships	2	Issue and Treasury; Financial Stability.
Cabo Verde	Technical assistance	2	Statistics; Trust Fund Management.
	Visits/Internships	3	Audit; Statistics; Banking Supervision.
	Scholarships	1	Scholarships.
Mozambique	Technical assistance	1	Audit.
	Visits/Internships	2	Audit; Payment Systems.
	Courses/Seminars	1	Accounting.
	Scholarships	1	Scholarships.
São Tomé and Príncipe	Technical assistance	3	Economic Cooperation Agreement; Statistics.
	Visits/Internships	1	Audit.
	Scholarships	1	Scholarships.
Timor-Leste	Technical assistance	1	Anti-money laundering.
Portuguese-speaking countries	Courses/Seminars	5	Balance of Payments Statistics; Monetary and Financial Statistics; Reserve Management; Risk Management; Payment Systems.
	Meetings/Projects	2	Issue and Treasury; Statistics.
Other emerging and developing countries	Technical assistance	3	Cooperation and International Relations; Statistics; Payment Systems.
	Visits	1	Statistics.
	Courses/Seminars	2	International Relations; Statistics.
	Meetings	3	International Relations; Statistics.
Total		38	

Article

Debt limits for Low-Income Countries[1]

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Macroeconomic adjustment programmes supported by the International Monetary Fund (IMF), agreed with member countries that apply for this institution's financial assistance, generally include limits on new external public borrowing. There have been several versions of this Debt Limits Policy (DLP), which has been part of adjustment programmes since the late 1960s. The current version, which has been in force since 30 June 2015, lays down the framework for the use of debt limits, putting forward two different approaches: one applicable to countries that normally rely on concessional funding, i.e. under more favourable conditions than those on commercial loans, and another used when this type of loan is not the main source of financing within a country. This division is roughly equivalent to the distinction between Low-Income Countries (LICs) and the remaining IMF member countries. The text below describes the main changes to the DLP applicable to LICs.

Framework

The IMF has in place a number of financial facilities to assist member countries in distress. As part of the IMF's financial assistance architecture, the Poverty Reduction and Growth Trust (PRGT) makes three concessional lending facilities available to eligible members (chiefly LICs), whose list is revised every two years: the Extended Credit Facility, the Standby Credit Facility and the Rapid Credit Facility (see also *Cooperation Journal No. 2*, April 2013).

As in any other facility provided by the IMF, access to these financial credit lines hinges, however, on the implementation of a macroeconomic adjustment programme, aimed at correcting the imbalances that created the need for financial assistance. When establishing these programmes, quantitative limits are usually set on new external public borrowing, in accordance with the IMF's DLP.

In December 2009, in view of changes in the circumstances surrounding LICs – more specifically, the lack of sources of concessional financing given the substantial borrowing needs and, concurrently, these countries' easier access to non-concessional loans – as well as this group's heterogeneity, the IMF reformed its DLP to better suit its members' needs. While acknowledging the challenge of maintaining the delicate balance between promoting development and debt sustainability, the IMF designed this reform to increase LICs' flexibility to borrow from different sources.

The main consequence of the 2009 reform was the change on how non-concessional loans were handled. This type of borrowing was no longer considered (virtually) off-limits and the circumstances in which they were allowed was greatly expanded. In turn, to cater for diversity among LICs, the debt limits for each country became dependent on country-specific circumstances, assessed under two dimensions: debt sustainability and macroeconomic and public financial management capacity (see also *Cooperation Journal No. 1*, November 2012).

The current Debt Limits Policy applied to LICs

The 2009 reform of the DLP produced some unintended effects and for that reason, starting in March 2013, the IMF held internal discussions on a new reform that would still provide flexibility to finance productive investments while containing medium-term risks to debt sustainability.

The 2009 reform provided a fairly detailed framework for handling non-concessional borrowing, but because concessional loans were excluded from external debt limits, overall borrowing was left unconstrained in the majority of Fund-supported programmes. At the same time, this approach had the effect of focusing programme discussions on individual projects (the separate analysis of each new loan) and/or the analysis of only one segment of external borrowing (the non-concessional one) leaving the broader fiscal framework and the corresponding financing strategy in second place. Lastly, the sharp dichotomy between concessional and semi-concessional borrowing (*i.e.*, with a degree of concessionality below the one set in the programme) was difficult to justify on economic grounds.

One of the key changes brought by the new DLP is the broadening of the focus to encompass all public debt rather than only external debt. This change brings PRGT-supported programmes closer to 'General Resources Account'-supported programmes (which provide non-concessional borrowing facilities).

The handling of external public debt was also reformed, resulting in the broadening of the scope to cover all public debt held by non-residents instead of only new non-concessional borrowing – the previous practice. Lastly, the new policy also aims to ensure a closer connection between public debt vulnerabilities and the use and definition of debt conditionality.

According to the DLP, debt limits are warranted:

- when a country has significant debt vulnerabilities; or
- when the quality and coverage of fiscal statistics favour the use of limits instead of, or as a complement to, 'above-the-line' fiscal conditionality (*i.e.*, conditionality impacting the general government balance).

Debt limits in IMF-supported programmes are set in accordance with the results of the Debt Sustainability Analysis (DSA). These analyses, which are produced by IMF staff on a regular basis, return four possible debt vulnerability ratings: low, moderate, high or in debt distress. Table 1 shows the latest ratings for Portuguese-speaking countries eligible for PRGT-supported programmes.

Table 1 • Portuguese-speaking countries eligible for PRGT-supported programmes, classified by debt vulnerability | latest debt sustainability data

Low				
Moderate	Cabo Verde May 2014	Guinea-Bissau June 2015	Mozambique December 2015	Timor-Leste April 2016
High	São Tomé and Príncipe June 2015			
In debt distress				

Source: International Monetary Fund.

Therefore, on the basis of the results of the DSA and taking into account country-specific circumstances, debt limits are set as follows:

- for countries assessed as facing a low risk of external debt vulnerability, limits are usually not warranted (though in cases where debt levels are projected to increase rapidly and significantly, programme design should take that into account);
- for countries assessed as facing a moderate risk of external debt vulnerability, limits should take the form of a Performance Criterion on the present value of new external debt contracted (concessional and non-concessional);
- for countries assessed as facing a high risk of external debt vulnerability (or in debt distress), conditionality will be much like the previous practice. Access to non-concessional loans will only be allowed under special circumstances and limits will take the form of a Performance Criterion on nominal non-concessional debt and of a Performance Criterion – or Indicative Target, if a deviation from the target specified will not have a significant impact on debt dynamics – on the nominal level of new concessional borrowing.

Lastly, two special cases are considered:

- for countries where recording and monitoring of public debt is deemed weak and for which vulnerability is moderate or high, the specification of debt limits needs to make appropriate allowance for these institutional constraints. In such cases, a Performance Criterion, specified in nominal terms, should be set on new non-concessional external borrowing, complemented by a limit (in the form of Memorandum Items) on the nominal level of new concessional borrowing. Programmes with these countries should also include measures to strengthen their capacity;
- for programme countries with significant links to international capital markets, it may be more appropriate to set a limit on total public debt rather than on external debt.

Table 2 • Debt limits for countries that normally rely on concessional financing

		Adequate debt monitoring capacity		Weak debt monitoring capacity
		Limited financial integration	Significant links to international capital markets	
External debt vulnerability	Low	Typically, debt limits are not warranted		
	Moderate	PC on the present value of new external debt	PC on total nominal public debt	PC on the nominal value of new non-concessional external debt + Limit on the nominal value of new concessional external debt
	High (or In debt distress)	PC on the nominal value of new non-concessional external debt + PC or IT on the nominal value of new concessional external debt	PC on the nominal value of new foreign currency non-concessional debt + PC or IT on the nominal value of new foreign currency concessional debt	PC on the nominal value of new non-concessional external debt + Limit on the nominal value of new concessional external debt

Note: PC – Performance Criterion; IT – Indicative Target.
Source: International Monetary Fund.

Conclusion

The new IMF's Debt Limits Policy provides greater flexibility to the framework governing the implementation of limits on debt accumulation in Low-Income Countries with Fund-supported programmes. This greater flexibility has resulted in debt limits being adjusted to country-specific circumstances, as opposed to the more rigid approach used in its previous version, where a smaller number of possible solutions was presented. Furthermore, by broadening the limits to cover all public debt and by fostering an integrated treatment of concessional and non-concessional external debt, debt sustainability is likely to improve in these countries.

Notes

1. The opinions expressed in this article are those of the author and do not necessarily reflect the views of Banco de Portugal or the Eurosystem. Any errors or omissions are the sole responsibility of the author.

2. Debt limits may consist of Performance Criteria (specific and measurable conditions in IMF-supported programmes, which must be met for the programme review to be deemed complete), Indicative Targets (to assess a country's progress towards meeting the programme's goals; non-compliance does not preclude completion of the programme review, although it is taken into account in its overall assessment) and Memorandum Items (no conditionality is attached to these items, which merely monitor the programme's indicators).

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