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Sudan: Staff–Monitored Program for 2009-10

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SUDAN

Staff-Monitored Program for 2009–10

Prepared by the Middle East and Central Asia Department

(In consultation with other departments)

Approved by Juan Carlos Di Tata and Dominique Desruelle

June 24, 2009

- **Mission dates:** February 24–March 11, 2009 and May 3–8, 2009. The mission met with the Minister of Finance and National Economy, the Governor of the Central Bank of Sudan, other senior officials, and representatives of the donor community and the private sector.

- **IMF team:** H. Al-Atrash (head), A. Naseer, K. Moriyama (all MCD), and S. A. Abbas (FAD). A. Zoromé (the Fund's Resident Representative) assisted the mission.

- **Fund relations:** The Executive Board concluded the 2008 Article IV Consultation and second review under the 2007–08 staff-monitored program on September 7, 2008. The PIN was made available at: http://www.imf.org/external/np/sec/pn/2009/pn0901.htm, but the staff report was not published.

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EXECUTIVE SUMMARY

Key developments

Sudan has been hard hit by the global crisis, mostly through a sharp decline in oil revenues. There are risks that the major achievements of the past several years, in terms of maintaining macroeconomic stability and strong growth, could be jeopardized. Foreign exchange reserves have fallen sharply, to less than two weeks of imports.

Staff recommendations

The discussions on a new staff-monitored program (SMP) focused on crisis prevention. The objectives of the new 18-month SMP (July 2009–December 2010) are to (i) maintain macroeconomic stability and (ii) safeguard and rebuild foreign exchange reserves. Sudan's limited access to foreign financing means that significant adjustments in imports and expenditures are inevitable.

Exchange rate flexibility is key to external adjustment. The pass-through effect of the exchange rate on the price level is likely to be limited in light of the decline in world food prices and tight monetary and fiscal policies. Moreover, the terms of trade shock associated with lower oil prices has reduced the equilibrium exchange rate, necessitating greater flexibility. Recently introduced exchange restrictions should be removed by year's end.

Fiscal policy needs to be significantly tightened. The sharp fall in oil receipts underlines the need to do much more to strengthen tax revenues. There is an urgent need to undertake a comprehensive review of the tax policy regime and expeditiously move to (i) reducing value-added tax (VAT) exemptions; (ii) reforming the personal income tax; and (iii) clarifying tax jurisdiction issues with subnational governments. Capital spending should be increased if additional foreign financing materializes and/or revenues turn out above program levels.

The level of nonconcessional borrowing needs to be carefully monitored. It should be limited to US$700 million in 2009.

Payments to the Fund will fall sharply in 2009 in light of Sudan's very difficult foreign exchange position. Repayments should increase in 2010 if the reserve position improves.

Risks

The risks to macroeconomic stability have increased greatly. Given the uncertainties associated with the crisis, the authorities will need to react quickly to changing circumstances to avoid a disruptive balance of payments adjustment.

I. Introduction

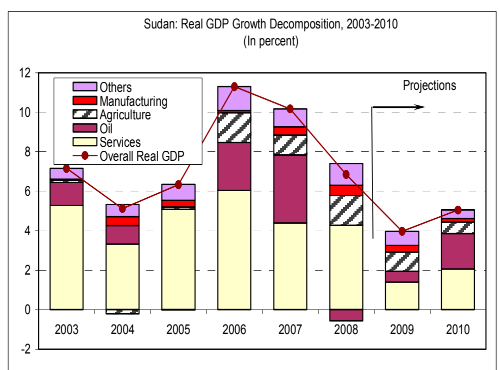
1. **Sudan has maintained close cooperation with the Fund for over a decade**. This is evidenced by a generally good performance under successive staff-monitored programs (SMPs) and repayments to the Fund that have exceeded obligations falling due. Sudan repaid the Fund US$50 million annually in 2007 and 2008, while obligations falling due amounted to US$26 million and US$18 million, respectively.

2. **Negotiations on a new SMP took place against the backdrop of the global recession, which has severely impacted Sudan and contributed to a large drop in foreign exchange reserves**. Sudan has been hard hit by the global crisis largely via a sharp deterioration in its terms of trade. Oil accounted for 60 percent of government revenues and 95 percent of exports in 2008; it accounts for about 98 percent of South Sudan's revenues. Foreign exchange reserves have fallen sharply as policy delays in a rapidly changing environment reversed the gains achieved in 2007–2008. The authorities' slow response to the decline in oil prices—in particular, the delay in adopting a flexible exchange rate policy and the insufficient tightening of fiscal policy—contributed to the deterioration in the macroeconomic situation and the significant loss in foreign exchange reserves.

3. **The policy discussions focused on crisis-prevention.** The objectives of the new 18-month SMP (July 2009–December 2010) are to (i) maintain macroeconomic stability, a prerequisite to protecting the most vulnerable segments of the population; and (ii) safeguard and rebuild foreign exchange reserves to avoid an abrupt and costly external adjustment. Sudan's limited access to foreign financing means, however, that significant adjustments in imports and expenditures are inevitable.

II. Recent Economic Developments

4. Despite a weak final quarter, Sudan's economic indicators remained fairly strong during 2008, while inflation trends mirrored developments in world food prices (Table 1). Real GDP growth is estimated at about 7 percent in 2008, with non-oil growth of 8.5 percent—compared with 10 and 7.5 percent, respectively, in 2007. The buoyant non-oil growth, driven by the services sector, compensated for lower oil production. After peaking at 25 percent in August, twelve-month inflation declined to 8 percent by end-2008, in line with movements in world food prices.[1]



Source: Sudanese authorities.

[1] A new CPI, released in September 2008, with an expanded basket and broader coverage of rural areas, shows higher inflation compared to the old CPI. According to the new CPI, inflation ended below 15 percent at end-December 2008, after peaking at 22 percent in August.

5. **Fiscal performance in the first three quarters of 2008 was broadly satisfactory but masked underlying weaknesses** (Table 2 and Text Table). Strong oil revenues (driven by the oil price surge in the first eight months of the year) and tight control on most discretionary spending kept the overall deficit within program limits. This was despite a 1 percent of GDP shortfall in non-oil revenues relative to the program, on account of low parastatal profits and increasingly difficult enforcement of a tax system featuring wide-spread exemptions. On the expenditure side, oil-related transfers were higher than envisaged, consistent with the oil price increase and the rising share of the Southern-based Dar blend in oil production. Moreover, the fuel subsidy bill was 0.7 percent of GDP higher-than-programmed, reflecting primarily the widening gap between international and refinery gate prices through late 2008. The fiscal space afforded by higher oil revenues and the reduction in discretionary spending were used to lower domestic arrears and replenish the oil revenue stabilization account in excess of program targets.

Sudan: Fiscal outcome, 2008
(As a percent of GDP)

	Prog.	Est.
Revenue and grants	22.0	21.8
Oil	13.4	14.3
Non-oil	8.6	7.5
Expenditure 1/	23.9	23.3
Current	20.9	20.1
Capital	3.0	3.2
Commitment balance	-1.9	-1.5
Cash balance	-2.8	-1.4
Non-oil primary balance 1/ 2/	-7.0	-7.8

1/ Commitment basis; 2/ Percent of non-oil GDP.

Source: Ministry of Finnace and National Economy and Central Bank of Sudan.

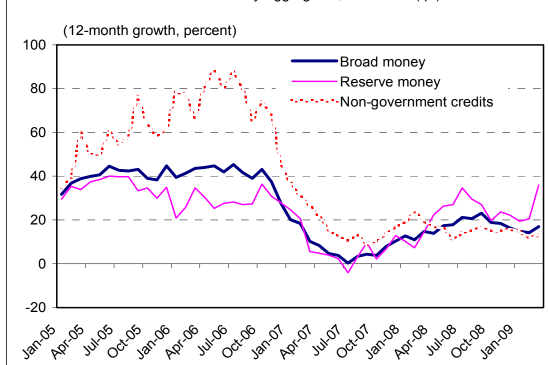
6. **In the fourth quarter, the sharp drop in oil prices put significant pressure on the public finances, leading to some arrears accumulation.** The decline in oil revenues, coupled with continued weakness in non-oil collections and financing rigidities, implied a sharp reduction in the government's overall resource envelope. The needed expenditure adjustments severely tested the commitment control system introduced earlier in the year, as the larger budget units overshot the tight spending ceilings that were imposed. In some cases, budget units used their goods and services allocations to defray non-priority commitments, allowing arrears to accumulate on important recurring expenses like utility bills. As a result, new arrears, estimated at 0.4 percent of GDP, were incurred in the last quarter of 2008, bringing the stock of arrears to SDG 1.7 billion (1.5 percent of GDP) at end-2008, compared with SDG 2.6 billion (2.8 percent of GDP) at end-2007.

7. **The authorities have already begun to implement the adjustment necessitated by the oil price decline and binding financing constraints**. Preliminary fiscal data through March 2009 indicate that expenditure execution was about 60 percent of the 2009 budget for the first quarter, in line with tight spending ceilings and expenditure prioritization. On the revenue side, oil receipts were half the budget's quarterly projection, but non-oil revenues were much more robust (notwithstanding the slowdown in economic growth), with the out-turn at over 90 percent of budgeted levels. This reflects a noticeably stronger revenue collection effort by the tax and customs administration, as well as the impact of the exchange rate depreciation on import taxes.

8. The binding foreign exchange constraint has also prompted the authorities to ask Sudan's major creditors to reschedule external debt service falling due in 2009. Some creditors have expressed a tentative willingness to reschedule Sudan's obligations for a year

or two, while negotiations with others are continuing. In the first quarter, Sudan repaid about one-third of the budgeted debt service. In some cases, non-payment of debt service has led to delays in scheduled disbursements.

9. **Monetary growth recovered somewhat following the sharp slowdown in 2007—reflecting partly the reduction in the stock of government arrears** (Tables 3 and 4) Broad money and reserve money grew at 16 percent and 22 percent in 2008, respectively. Private sector credit growth, however, remained more subdued, as funds made available through government arrears clearance reduced businesses' demand for credit. Data for the first 3 months of 2009 show a continuation of these trends. By end-March, 12-month growth of broad money had slowed to 17 percent owing to a sharp drop in net foreign assets, while the growth of private sector credit slowed to 13 percent, in line with a drying up of credit lines from foreign banks.



Sudan: Monetary Aggregates, 2005-2009(q1)

Source: Central Bank of Sudan.

10. **The sharp drop in world oil prices in the last quarter of 2008 reversed the increase in foreign exchange reserves achieved earlier in the year** (Table 5). Higher international oil prices in the first nine months of 2008 boosted government revenues and led to an increase in net international reserves (NIR) from US$1.1 billion at end-2007 (1.2 months of import coverage) to about US$2.0 billion in May–August—coinciding with the peak in international oil prices. However, insufficient adjustment to the sharp drop in oil prices (combined with heavy central bank intervention) subsequently contributed to a reversal of these gains, with NIR falling to below US$1.0 billion (1.2 months of imports) by year's end and to about US$300 million (less than 2 weeks of imports) by end-March 2009. To curb import demand, the authorities imposed exchange restrictions in early 2009.[2]

11. **The exchange rate has shown greater flexibility in the past few months**. In late 2008, despite substantially lower foreign exchange earnings, the central bank did not reduce its net supply of foreign exchange to the market, thus preventing a meaningful adjustment in the exchange rate (4 percent depreciation against the U.S. dollar from end-August to end-December 2008).[3] Subsequently, central bank support to the foreign exchange

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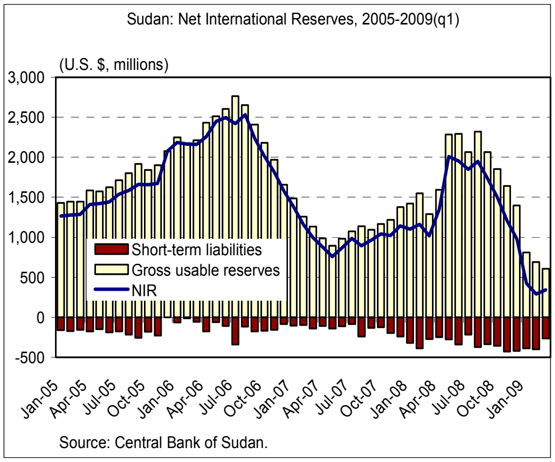
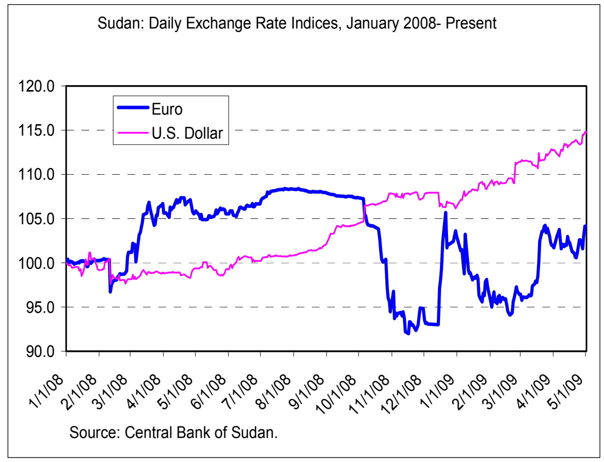
[2] Specifically, the central bank introduced a 100 percent cash margin on most imports in February 2009 and a limit on the purchase of foreign exchange (of €3,000) for travel purposes in March. The former measure is also a multiple currency practice.

[3] The Central Bank of Sudan is the primary earner and source of foreign exchange to the market as over 95 percent of foreign exchange receipts are from official oil exports that are surrendered to the central bank. The central bank supplies foreign exchange to bureaus and commercial banks to meet private demand.

market diminished, contributing to a faster depreciation of the exchange rate (8 percent against the U.S. dollar from January through April 2009). Preliminary end-April data suggest that the loss of foreign exchange reserves has stopped.





12. **Financial sector indicators reveal continued weakness, but some signs of improvement are emerging.** Gross nonperforming loans (NPLs) have declined to 22 percent at end-2008, compared to 26 percent at end-2007, due partly to the reduction in domestic government arrears accumulated in 2007. Much of the NPLs problem is due to the state-owned Omdurman National Bank (ONB)—which accounts for more than half of the NPLs and 28 percent of bank lending. Loan provisions to NPLs, which remained at about 15 percent through 2008, have increased to 20 percent by end-March 2009, following recent initiatives to strengthen prudential regulations on loan provisioning.[4] The capital adequacy ratio, however, deteriorated to 11 percent at end-2008, from 22 percent at end-2007, largely on account of ONB (the minimum required level is set at 12 percent of risk-weighted assets).

Sudan: Financial Soundness Indicators
(In percent)

	Dec-07	Dec-08	Mar-09
Asset composition and quality			
Gross NPLs to loans	26.0	22.3	23.5
of which: Omdurman Bank			
NPLs net of provisions to gross loans	22.2	19.0	18.8
Loans provisions to NPLs	14.6	14.9	19.9
Capital adequacy			
Regulatory capital to risk-weighted assets	22.50	10.50	...

Source: Central Bank of Sudan.

III. Policy Discussions

A. Overview

13. The discussions focused on the design of an 18-month SMP for the period July 2009 through December 2010. The program aims at addressing the weaknesses underlying the

[4] The central bank required banks to prepare actions plans and subsequently set targets for individual banks to improve loan provisions for NPLs and capital adequacy.

emergence of macroeconomic imbalances in late 2008, ensuring macroeconomic stability and growth, rebuilding the foreign exchange reserves, and reducing Sudan's dependence on oil revenues. Proposed semi-annual quantitative targets for end-December 2009 as well as structural benchmarks are detailed in Tables 1 and 2 of the attached Memorandum of Economic and Financial Policies (MEFP). The program envisages semi-annual staff assessments.

B. Macroeconomic Policies

Growth and inflation

14. **Real GDP growth is expected to nearly halve in 2009, while inflation is projected to decline to single digits.** The global crisis will impact Sudan's economy mainly through lower oil prices. Total oil production is projected to increase somewhat in 2009, but the non-oil sector is likely to slow down significantly owing to the global slowdown and the impact of domestic demand policies aimed at containing import pressures in the face of declining foreign exchange reserves. Both the services and agricultural sectors would be affected by lower FDI inflows and possibly a slower reduction of domestic arrears. Overall real GDP growth is projected at about 4 percent in 2009 (and would pick-up slightly to 5 percent in 2010). Average inflation is expected to decline to 9 percent, reflecting lower world food prices and tighter financial policies.

Fiscal policy

15. **A medium-term adjustment strategy is needed in view of the markedly weaker oil revenues**. Annual oil revenues in 2009–12 are projected to be 6 percentage points of GDP lower than in 2005–08. Since running large deficits is not an option for Sudan given its vulnerable debt position, much of the resource gap will have to be addressed through tax and expenditure measures. Sudan's low tax-to-GDP ratio makes it urgent to streamline tax exemptions, which could yield additional revenues of at least 2–3 percent of GDP over 2009–12. The remaining adjustment will have to come from the expenditure side, including by reforming the blanket subsidy scheme, improving targeting of social spending, and better prioritizing capital expenditures.

16. **The approved budget for 2009 was expansionary**. The budget envisaged an overall cash deficit of 6.9 percent of GDP and a non-oil primary deficit of 9.1 percent of non-oil GDP. Despite markedly lower oil revenues, the budget incorporated large outlays on wages, investment, and transfers to states, as well as one-off election expenses. Important tax policy reforms—such as a reduction in the stock of VAT exemptions and a lower personal income tax payments threshold—were postponed. However, this was partially compensated by other measures, such as an increase in the VAT rate for telecoms (from 15 percent to 20 percent) and the introduction of a development levy of 5 percent on non-zero tariff imports. Moreover, the excise duty on cars was raised.

17. **However, some of the key parameters underlying the 2009 budget have been overtaken by subsequent events**. Specifically, the budget was prepared using an international oil price assumption of US$65/bbl, yielding an oil revenue projection about 2 percentage points of GDP higher than under the WEO projections of April 2009.[5] Moreover, the sources of half of the proposed foreign disbursements underpinning the capital expenditure budget were unidentified, suggesting that the assumptions on foreign financing were not realistic. If disbursements are broadly in line with past trends, a budgetary financing gap of almost 4 percent of GDP would emerge in 2009.

18. **The authorities recognize that fiscal adjustment is inevitable to maintain macroeconomic stability.** Accordingly, they intend to reduce the size of the cash and commitment deficits to 4.8 percent of GDP and 4.2 percent, respectively (compared to a deficit of 8.8 percent of GDP under the approved budget evaluated at current oil prices). This implies an adjustment effort of over 4 percent of GDP relative to the approved budget (see MEFP, ¶15). The program also envisages a further reduction of arrears of 0.6 percent of GDP in order to lower the outstanding stock to about 1 percent of GDP by end-2009. The authorities noted the difficulties in implementing such a tight fiscal stance in an environment of a slow growth and bottom-up pressures from subnational governments facing sharply reduced oil-related transfers. They recognized, however, that given the limited access to foreign financing, they had little choice but to tighten fiscal policy relative to the approved budget. It was agreed that capital spending and transfers to subnational governments would be increased if additional foreign financing materialized and/or oil revenues turned out above program levels. If oil prices exceed US$70 per barrel (for Nile blend), in the context of the first review the mission will propose that part of the oil revenue surplus be saved in order to further build-up international reserves.[6]

Sudan: Proposed Fiscal Adjustment, 2009
(As a percent of GDP)

	2007-08	2009	
	Average	Budget 1/	SMP
Revenue and grants	21.2	14.1	14.7
Oil	13.0	5.5	5.5
Non-oil	8.2	8.7	9.2
Expenditure 2/	24.6	22.9	18.9
Current	20.6	18.8	16.2
Capital	4.0	4.1	2.7
Commitment balance	-3.4	-8.8	-4.2
Cash balance	-2.2	-8.8	-4.8
Foreign Financing	0.7	3.9	1.9
Domestic Financing (cash)	1.5	4.9	3.0
Memo: Non-oil primary balance 2/ 3/	-9.1	-9.9	-4.9

1/ At current oil prices 2/ Commitment basis 3/ Percent of non-oil GDP.

Source: Ministry of Finance and National Economy and Central Bank of Sudan.

19. **The bulk of the adjustment will take place on the expenditure side, although some revenue measures are also envisaged.** Subnational transfers and capital spending will be most impacted, due to their link with oil revenues and available foreign financing.

[5] This corresponds to a weighted average export price for Sudan's crude oil of about US$50/bbl. In comparison, staff assumed a world price of US$52/bbl, corresponding to US$37/bbl for Sudan's crude oil. For 2010, staff assumed a world oil price of US$62/bbl, equivalent to US$45/bbl for Sudan's crude oil.

[6] Given the very low prices prevailing in the first quarter of the year, and imputing the lags with which the ongoing increase in prices will translate into budgetary resources, an average price of US$65–70 per barrel (for Nile blend) through December would be consistent with a near-zero fuel subsidy for the year.

However, the program also envisages discretionary cuts of about 0.7 percent of GDP, largely in goods and services. New revenue measures (over and above those already incorporated in the 2009 budget) include an increase in taxes on beverages and cigarettes, and a considerable strengthening in tax collection efforts (see MEFP, ¶16–17). The staff underlined that the new oil revenue outlook warranted further urgent tax measures to protect critical social and development programs; accommodate additional peace-related spending pressures (including those arising from subnational governments); and guard against possible revenue shortfalls. In particular, the mission recommended, *inter alia*, (i) reforming the personal income tax by lowering the payment threshold and removing exemptions to persons above the age of 50; and (ii) removing VAT exemptions granted to key domestic sectors (such as electricity) and to final goods imports by selected public and private entities. The authorities plan to study these proposals in the context of a comprehensive tax policy review to be completed by October 2009 (see MEFP, ¶16–17).

20. **The program seeks to mitigate the impact of the adjustment on the most vulnerable segments of the population.** To that end, the program (i) fully preserves the budgeted social subsidy expenditure envelopes, (ii) allows for full spending of higher-than-programmed revenues on capital expenditures and subnational transfers, and (iii) calls for the introduction of a targeted safety net scheme to replace blanket subsidies (see MEFP, ¶18).

Monetary and exchange rate polices

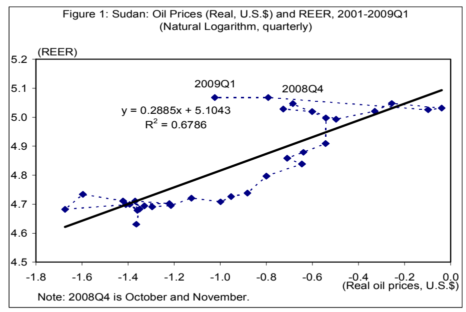
21. **A monetary program allowing for a resumption of credit to the private sector is critical.** While cognizant of the need to rebuild foreign exchange reserves, maintain inflation in the single digits, and reduce NPLs, the authorities stressed that it was also important to provide sufficient liquidity to the private sector—particularly given the emerging credit crunch associated with lower foreign inflows. In this context, reserve money and broad money growth are projected at 12 percent and 18 percent, respectively, in 2009 (see MEFP, ¶23). These targets will allow for ample private sector credit growth of about 22 percent during 2009.

22. **Exchange rate flexibility is key to safeguard and rebuild foreign exchange reserves.** The current account deficit is projected to widen to about 10 percent of GDP in 2009, reflecting lower oil export receipts. However, identified foreign financing is likely to be higher than in recent years on account of projects that are already in the pipeline. Accordingly, the SMP targets an increase in net international reserves to US$600 million (0.8 months of imports) by end-2009 (see MEFP, ¶24). The target for 2010 will be set taking into account the recent improvement in oil prices. Exchange rate flexibility is essential to meet the international reserve target, particularly given that the terms of trade shock associated with lower oil prices has depreciated the equilibrium real exchange rate (Box 1). Moreover, there is a trade-off between greater exchange rate flexibility and the need for additional fiscal tightening, with the risk that the latter could result in expenditure arrears. While the authorities recognized this trade-off, and agreed to pursue a flexible exchange rate policy, they expressed concern that greater exchange rate flexibility could contribute to

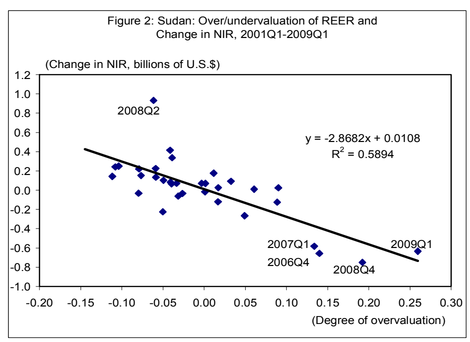
inflationary pressures. The mission acknowledged the pass-through effect of changes in the exchange rate on overall prices, but argued that low international prices for food combined with tight monetary and fiscal policies should help ease inflationary pressures at this juncture. The authorities agreed to remove the cash margin on letters of credit and import credits and the limit on the purchase of foreign exchange for travel purposes by the end of 2009.

Box 1. Impact of Lower Oil Prices on the Exchange Rate and International Reserves

The recent terms of trade shock has reduced the equilibrium real exchange rate, underscoring the need for greater exchange rate flexibility. There is a strong relationship between the real effective exchange rate (REER) and real oil prices in Sudan since the start of oil production, reflecting the large share of oil in total exports and total revenues, as well as the strong correlation between government spending and oil revenue—these are all considered to be critical factors in determining the equilibrium real exchange. A simple regression of the REER on real oil prices suggests that the sharp drop in oil prices has made the REER overvalued starting in the fourth quarter of 2008; this is measured by the distance of the REER from the solid line in Figure 1. While the exact amount of the overvaluation is subject to a large degree of uncertainty—and is therefore difficult to quantify—it is clear that the authorities need to allow for greater exchange rate flexibility.



Without greater exchange rate flexibility and a prudent fiscal policy stance, it would be difficult to rebuild reserves from the current low levels. A simple regression of the size of over-valuation of the exchange rate on a change in net international reserves demonstrates a clear negative relationship, suggesting that the central bank has lost a significant amount of reserves owing to the overvaluation of the currency (Figure 2).



C. Structural Reforms

Fiscal reforms

23. **The authorities intend to undertake an ambitious range of structural reforms aimed at raising non-oil revenues and improving the quality of government spending** (Box 2). A comprehensive tax policy review will be completed by October 2009 with the objective of identifying concrete measures to sharply reduce VAT exemptions, raise personal income tax collections, resolve tax jurisdiction issues vis-à-vis subnational governments, and optimize the government's net take from the oil sector. Revenue administration reforms will include widening the use of a unique taxpayer identification number across revenue agencies,

launching a VAT refund system for large business tax payers, and adopting WTO-consistent valuation principles for questionable customs assessments. Important reforms are also expected in the areas of public financial management (PFM) and expenditure policy, involving, most notably, the reorganization/modernization of the Ministry of Finance and National Economy, the extension of the GFSM 2001 budget classification to Northern states, and a modification of the petroleum pricing regime toward an automatic adjustment formula.

Box 2. Structural Fiscal Reforms under the SMP

The authorities intend to undertake an ambitious structural fiscal program over 2009-10 on the heels of a series of substantive first-generation reforms implemented through 2008 (see MEFP, ¶16–20). The main objectives of the program will be to widen the non-oil tax base, optimize the government share from extractive industries, modernize and strengthen revenue administration, reorganize the finance ministry, and improve the quality and targeting of government spending (including at subnational levels).

An important element of the program is a comprehensive tax policy review, to be completed by October 2009. The review will focus on ways to strengthen the tax system by addressing weaknesses identified by Fund technical assistance missions including: overly-generous VAT exemptions granted to domestic sectors and final good imports by certain public and private entities; a high threshold for paying the personal income tax (approaching four times per capita income) and exemptions granted to individuals above the age of 50; tax jurisdiction conflicts with subnational governments in relation to the collection of stamp duty and the taxation of large individuals; and low net government take from the extractive industries sector, especially oil. The survey is expected to identify policy reforms that can be implemented starting 2010.

Efforts to strengthen revenue administration have already commenced with a serious drive to pursue tax evaders and arrears, conduct risk-based audits, and curb smuggling. Over the coming 18 months, reforms will focus on (i) extending the use of a unique taxpayer identification number to all revenue collecting agencies; (ii) consolidating all agreed-to modernization initiatives of the taxation chamber into an integrated and fully costed modernization plan; (iii) adopting WTO-consistent valuation principles for customs (which was a benchmark under the previous SMP); (iv) facilitating trade through electronic container scanning and real-time e-mail communication between customs and various other government departments.

Expenditure policy reforms will be geared to improving targeting of government spending and the removal of impediments to privatization. The authorities have undertaken to reform the petroleum pricing regime toward an automatic adjustment formula, while simultaneously initiating the establishment of a targeted safety net for the poor. Given the possibility of world oil prices rising above the refinery gate price, this measure is critical to prevent a recurrence of the large fuel subsidy losses experienced in 2007–08. The authorities will also submit to parliament, later this year, uniform privatization legislation to ensure the consistent treatment of retrenched employees' compensation across parastatals, with a view to expediting the privatization process.

A reorganization of the finance ministry, broadly consistent with Fund TA advice, will set the stage for the implementation of a battery of second-generation PFM reforms. The reorganization is expected to significantly strengthen the ministry's ability to deliver treasury, fiscal policy planning and debt management functions. The strengthened federal finance ministry is also expected to support better fiscal management and reporting at subnational levels, including by extending the GFS 2001 budget classification to at least 5 Northern states. This will help monitoring of the general government fiscal operations and sectoral tracking of public spending. Plans are also underway to adopt multi-year budget planning in order to avoid large year-to-year fluctuations in expenditures (and transfers) linked to oil price movements.

Financial sector reforms

24. **Continued reform and development of the financial sector are essential for Sudan's medium and long-term prospects.** While some progress has been made, ensuring the soundness of the banking system constitutes the overriding objective. Regarding specific measures, an action plan for the restructuring of Omdurman National Bank (ONB) will be prepared by the end of 2009, based on the recommendations of an independent audit (see MEFP, ¶ 26).[7] Also, commercial banks are being required to comply with existing regulations on capital adequacy and provisioning of NPLs.

D. External Debt and Relations with Creditors

25. **Sudan's external debt overhang remains a serious concern**. The end-2008 stock of public and publicly-guaranteed debt is estimated at about US$34 billion, up by about US$15 billion since end-2000. The bulk of the increase reflects a further buildup of arrears to Paris Club and non-Paris Club creditors. It also includes some new drawings from Arab multilateral and bilateral creditors, as well as from China and India. The authorities expressed concern that, notwithstanding a decade of cooperation on policies and payments, no concrete progress has been made on alleviating Sudan's external debt burden—despite debt relief provided to other countries in similar circumstances—severely limiting Sudan's prospects for meeting the Millennium Development Goals (MDGs).

26. **The authorities agreed on the needed to keep nonconcessional borrowing to a minimum**. They emphasized that the contracting of nonconcessional loans had been limited in recent years and that these loans were generally tied to specific development projects. In 2008, the government contracted US$426 million in nonconcessional debt, mostly from regional development funds. The authorities mentioned that limited fiscal space (mainly due to the decline in oil prices), the lack of access to more traditional forms of concessional finance, and pressing development needs associated with the various peace agreements, had rendered some nonconcessional borrowing indispensable. They acknowledged concerns with respect to nonconcessional borrowing, and indicated that they intend to limit such borrowing to US$700 million in 2009 (see MEFP, ¶28). This borrowing will be used to finance infrastructure and social development projects in areas such as power, oil refining, water

Sudan: Contracting of External Loans, 2007 and 2008
(In millions of U.S. dollars)

	2007	2008
Total amount of loans contracted	**339**	**1,105**
Concessional loans	194	679
of which: bilateral	124	10
non-bilateral 1/	70	669
Non-concessional loans	145	426
of which: bilateral	-	75
non-bilateral 1/	145	351
of which: Islamic Bonds	-	100

1/ Includes regional development funds (Saudi Fund, Kuwait Fund, Abu Dhabi Fund, Arab Fund for Economic and Social Development, and OPEC).

Sources: Ministry of Finance and National Economy, and Central Bank of Sudan.

[7] The restructuring plan for the ONB, a structural benchmark under the previous SMP, was not met on account of delays in completing the private audit of the bank.

supply, and transportation. Debt units at the central bank and the ministry of finance are in charge of monitoring and compiling data on disbursements and repayments of all external borrowing.

27. **The authorities are committed to maintaining a close cooperation with the Fund, but intend to reduce repayments in light of Sudan's difficult foreign exchange position**. The authorities' payments to the Fund were in line with their commitment in 2008 but, owing to Sudan's uncomfortable foreign exchange position, they intend to reduce repayments to US$10 million in 2009. The authorities indicated that repayments would be increased in 2010 if the reserves position improved. They have also reduced repayments to other creditors and have requested a rescheduling of debt service from their main new creditors (see MEFP, ¶29). The authorities expressed their intention to continue cooperating with the Fund in this regard, but highlighted that token payments were not a meaningful solution to Sudan's obligations to the Fund—the lion's share of which is in overdue charges rather than original principal. Resolving Sudan's overdue financial obligations remains a high priority for the government. Finally, the authorities reiterated their position that debt service payments should be attributed to reducing GRA principal rather than charges, as entitled under the Articles of Agreements.

IV. Staff Appraisal

28. **Sudan's economic situation will be difficult in 2009**. The global crisis has severely impacted Sudan's macroeconomic fundamentals by sharply reducing oil revenues. At the same time, the authorities' slow response to the changing environment and, in particular, continued heavy intervention in the foreign exchange market, have contributed to a marked deterioration in the external position. Given that access to external assistance is limited, the Sudanese authorities have little option but to significantly tighten macroeconomic policies. In the absence of a significant adjustment, there are risks that the major achievements of the past several years in terms of maintaining macroeconomic stability and strong growth could be jeopardized.

29. **There is a need to proceed decisively with the required adjustment effort.** The program envisages a timely and orderly macroeconomic adjustment to safeguard the external position through a mutually reinforcing set of policies—fiscal, monetary, and exchange rate—while protecting, to the extent possible, key infrastructure and pro-poor programs. The authorities are to be commended for adopting this program ahead of the elections scheduled for early 2010. Looking forward, a vigorous implementation of the program is crucial.

30. **A significant fiscal effort is inevitable**. Most of the adjustment effort will need to focus on reducing government expenditures, notably subnational transfers and capital spending, owing to their direct link with oil revenues and available foreign financing. These could have an adverse impact on growth and vulnerable groups of the population. Accordingly, the program calls for full spending of higher-than-programmed revenues on infrastructure projects and subnational transfers, and underlines the importance of

introducing a targeted social safety net to replace blanket subsidy schemes. Moreover, the program envisages a reduction of the existing stock of domestic arrears to prevent a repeat of the problems experienced in 2007–08, which contributed to the significant weakening of private sector activity.

31. **The conduct of monetary policy will require flexibility, given the ongoing changes in economic conditions**. Lower foreign exchange flows and the process of monetization of the South make it particularly important to monitor monetary developments closely in order to ensure the achievement of the inflation and international reserve targets.

32. **Exchange rate flexibility is key to safeguarding and rebuilding foreign exchange reserves**. The recent terms of trade shock has depreciated the equilibrium real exchange rate, underscoring the need for greater exchange rate flexibility. Otherwise, there will be a need for further greater fiscal restraint, which could lead to the accumulation of domestic arrears. Sustained exchange rate intervention and the introduction of exchange restrictions will not address the underlying problem of excess demand for foreign exchange, and should be avoided. At the same time, the declining trend in world food prices and the slower growth in domestic demand should help reduce the inflation concerns associated with greater exchange rate flexibility. Staff welcomes the authorities' decision to eliminate the exchange restrictions and the multiple currency practice arising from the imposition of a floor on cash margins for letters of credit and a ceiling on transfers for travel purposes. Given that these measures are temporary, non-discriminatory, and adopted for balance of payments reasons, staff recommends the approval of these restrictions and multiple currency practice until end-2009. A brief supplement will be issued shortly with a proposed decision on these exchange restrictions and the multiple currency practice.

33. **On the structural front, tax reforms are needed to expand the revenue base**. In recent years, there has been important progress toward reducing tax exemptions, simplifying the tax system, and improving tax administration. But the sharp fall in oil revenues underscores the importance of doing much more to strengthen revenues. In particular, there is an urgent need to conduct a comprehensive review of tax policy and to move expeditiously toward (i) reducing VAT exemptions; (ii) reforming the personal income tax (including by lowering the tax threshold and removing exemptions to persons aged 50 years and above); and (iii) clarifying tax jurisdiction issues with subnational governments. Staff welcomes the government's intention to undertake such a review and to significantly strengthen tax collection efforts.

34. **Efforts must also be stepped up to strengthen the banking system**. A quick resolution to the troubled Omdurman National Bank is critical. The bank's financial position remains a cause for concern, and its soundness indicators deteriorated further in 2008. In this regard, staff welcomes the authorities' confirmation of their objective to move toward the restructuring and privatization of the bank.

35. **The level of nonconcessional borrowing needs to be carefully monitored**. The US$700 million limit on the contracting of nonconcessional debt seeks to balance the need to finance vital investment and poverty-reduction projects, given Sudan's limited access to concessional assistance, while limiting nonconcessional borrowing in light of the debt situation. Staff urges the authorities to minimize to the extent possible the contracting or guaranteeing of nonconcessional debt as such borrowing further weakens debt sustainability and could delay creditors' participation in a potential debt-relief operation.

36. **Staff note the authorities' intention to reduce payments to the Fund in 2009**. The uncertainties associated with the global financial crisis and Sudan's very low level of foreign exchange reserves make it difficult at this juncture to maintain repayments at the same level of previous years, but Fund repayments would be increased in 2010 in line with the prospective improvement in the reserves position. Staff also urges that the Fund's preferred creditor status be maintained, and that payments to the Fund be made on a more regular basis.

37. **Staff believes that for 2009 the program meets the standard of upper-credit-tranche conditionality, except for the proposed level of nonconcessional borrowing**. The SMP is a valuable tool to support the momentum for reform and contains important actions to restore fiscal discipline and promote financial sector development. It will be important to build on these policies and accelerate macroeconomic consolidation and the implementation of the structural reform agenda in 2010. In particular, the authorities need to follow-up on the recommendations of the tax policy review and the plan to restructure Omdurman National Bank.

38. **The SMP is subject to considerable risks**. Given the uncertainties associated with the crisis, Sudan's limited access to foreign financing, and the fragile foreign exchange reserve position, the authorities will need to react quickly to changing circumstances in order to avoid a disruptive balance of payments adjustment. A weakening of political resolve to maintain macroeconomic stability and advance critical reforms is another major risk to the program. In particular, given the stage of the electoral cycle, some of the more ambitious structural tax and expenditure policy measures risk being delayed until late 2010 or 2011.

Table 1. Sudan: Selected Economic and Financial Indicators, 2006–10

	2006	2007	2008	2009	2010
			Prel.	Proj.	
	(Annual changes in percent, unless otherwise indicated)				
Production, population, and prices					
Nominal GDP (in millions of Sudanese guniea, at market prices)	79,046	93,811	121,059	120,091	139,525
Nominal GDP (in millions of U.S. dollars)	36,401	46,531	57,919	52,214	60,663
Oil production (average, in thousands of barrels per day)	364	484	462	485	562
Population (in millions)	36.2	37.2	38.1	39.1	40.1
GNP per capita (in U.S. dollars)	941	1,147	1,394	1,251	1,400
Real GDP	11.3	10.2	6.8	4.0	5.0
Oil	26.5	33.0	-4.4	4.9	15.8
Non-oil	9.7	7.5	8.5	3.8	3.7
Consumer prices (average) 1/	7.2	8.0	14.3	9.0	8.0
Consumer prices (end of period) 1/	15.7	8.8	14.9	8.5	7.5
	(In percent of GDP)				
Investment and saving					
Gross investment	25.1	26.5	22.8	21.7	21.5
Government 2/	6.7	9.5	6.6	5.4	5.3
Nongovernment	18.4	17.0	16.2	16.3	16.2
Gross national saving	11.6	15.6	15.1	11.6	13.0
Government	-0.2	-0.6	1.7	-1.5	-0.4
Nongovernment	11.8	16.2	13.4	13.2	13.4
Central government operations 3/					
Total revenue	21.0	20.6	21.8	14.7	16.6
Total expenditure	25.0	23.6	23.2	19.5	20.6
Overall balance	-4.0	-3.0	-1.4	-4.8	-4.0
Non-oil primary balance 4/	-8.6	-7.5	-7.7		-5.8
Non-oil primary operating balance 4/	-3.8	-1.7	-3.7	-2.9	-2.7
Money and credit					
Broad money (change in percent)	27.4	10.3	16.3	18.0	18.0
Reserve money (change in percent)	27.8	12.8	22.2	12.0	14.0
Velocity (ratio of non-oil nominal GDP to average broad money)	3.9	4.2	4.5	4.5	4.8
	(In millions of U.S. dollars, unless otherwise indicated)				
External sector					
Exports, f.o.b.	5,813	8,902	12,394	5,939	8,655
Of which: oil	5,244	8,443	11,818	5,347	7,958
Imports, f.o.b.	7,105	7,722	9,097	6,616	7,051
Non-oil export volume (change in percent)	-13.3	-19.3	-5.3	16.3	15.2
Non-oil import volume (change in percent)	12.6	-0.4	0.1	-23.6	5.0
Current account balance (cash basis, percent of GDP)	-13.5	-10.9	-7.7	-10.1	-8.5
Terms of trade (Index 1993=100, change in percent)	2.8	-4.2	20.6	-47.3	17.7
Guineas per U.S. dollar (period average)	2.17	2.02	2.09	...	...
Real effective exchange rate (change in percent)	20.4	-2.4	0.9	...	...
External debt (in billions of U.S. dollars)	28.4	31.9	33.7	36.7	39.7
External debt (percent of GDP)	78.1	68.5	58.1	70.3	65.5
Debt service ratio (commitment basis) 5/	17.7	11.2	10.6	22.0	17.1
Debt service ratio (cash payments) 5/	5.8	2.4	2.9	8.4	7.3
Net international reserves (in millions of U.S. dollars)	1,576	1,139	978	600	1,000
In months of next year's imports	1.8	1.2	1.4	0.8	1.2
Sudan's crude oil export price (U.S. dollars per barrel)	54.4	58.0	80.6	36.8	44.7

Sources: Sudanese authorities; and Fund staff estimates.

1/ CPI inflation for 2008 onward is on the new base.

2/ Includes estimated capital spending by state governments.

3/ Cash basis. In calculating the base non-oil balance, oil revenues and grants were removed from revenues, while pipeline fees (recorded under goods and services) and oil-related subnational transfers were deducted from expenditures. In augmented versions, interest expense and net NFA acquisition were deducted from expenditures to yield the primary and operating balances, respectively.

4/ As a percent of non-oil GDP.

5/ As a share of exports of goods and services.

Table 2. Sudan: Central Government Operations, 2007-10 1/
(In millions of SDG)

	2007	2008	2009		2010
		Prel.	Budget	Prog.	Proj.
Revenues and grants	19,307	26,424	19,210	17,641	23,231
Taxes	6,529	7,680	8,105	8,725	10,988
On income, profits and capital gains	925	849	879	979	1,331
On property (including registration fees)	0	35	35	35	42
On goods and services	3,393	4,761	4,927	5,451	7,104
On international trade and transactions	2,189	1,978	2,207	2,203	2,442
Other	23	57	56	56	69
Oil revenues	10,893	17,338	8,777	6,550	9,100
Sales to refineries	3,283	3,513	2,926	2,229	4,045
Export revenues	7,610	13,825	5,851	4,321	5,056
Grants	522	572	848	886	1,306
Other nonoil nontax revenues	1,363	833	1,480	1,480	1,836
Expense (current expenditure)	19,835	24,331	22,555	19,497	23,814
Wages	6,368	5,951	6,847	6,847	7,955
Goods and services	1,924	2,919	2,459	2,213	2,571
Interest	897	1,088	1,597	1,278	1,985
Subsidies	1,287	2,519	891	-232	231
Fuel	892	2,195	605	-518	-68
Other	395	324	286	286	299
Transfers	8,674	11,575	9,528	8,608	9,728
Of which: to South	3,352	6,159	3,227	3,009	3,786
to Northern states	5,323	5,396	5,823	5,283	5,577
Current	3,520	3,169	3,446	3,344	3,530
Capital	1,803	2,227	2,377	1,939	2,047
Other	0	21	478	316	366
Other expense	683	279	1,234	784	1,345
Operating balance (accrual basis)	-528	2,093	-3,346	-1,856	-583
Net acquisition of NFA (capital expenditure)	4,525	3,838	4,960	3,234	3,870
Overall accrual balance (including discrepancy)	-5,053	-1,745	-8,306	-5,090	-4,453
Financing (accrual basis)	5,053	1,745	8,306	5,090	4,453
Foreign	932	459	4,692	2,225	2,588
Disbursements	1,210	1,020	5,598	2,983	3,480
Principal repayment (-)	-277	-561	-906	-758	-892
Domestic	4,120	1,286	3,614	2,865	1,866
Bank	720	-292	2,462	1,867	1,193
Of which: ORSA	-32	-869	-234	878	-200
Nonbank	1,206	1,536	1,153	1,720	1,775
Accounts payable	2,194	42	0	-721	-1,103
Of which: Arrears accumulation	2,613	471	0	0	0
Arrears paydown (-)	-419	-1,310	0	-721	-1,103
Memo items: 2/					
Overall balance (cash basis)	-2,859	-1,703	-8,306	-5,811	-5,556
Net domestic financing (cash basis)	1,926	1,244	3,614	3,586	2,969
Non-oil cash balance	-6,703	-8,532	-11,580	-7,732	-9,153
Non-oil cash primary balance	-5,805	-7,443	-9,984	-6,455	-7,168
Non-oil cash primary operating balance	-1,280	-3,606	-5,024	-3,221	-3,299
Non-oil commitment balance	-8,897	-8,573	-11,580	-7,011	-8,050
Non-oil commitment primary balance	-7,999	-7,485	-9,984	-5,733	-6,066
Non-oil commitment primary operating balance	-3,474	-3,648	-5,024	-2,500	-2,196

Table 2 (continued). Sudan: Central Government Operations, 2007-10 1/
(In percent of GDP)

	2007	2008	2009		2010
		Prel.	Budget	Prog.	Proj.
Revenues and grants	20.6	21.8	16.0	14.7	16.6
Taxes	7.0	6.3	6.7	7.3	7.9
On income, profits and capital gains	1.0	0.7	0.7	0.8	1.0
On property (including registration fees)	0.0	0.0	0.0	0.0	0.0
On goods and services	3.6	3.9	4.1	4.5	5.1
On international trade and transactions	2.3	1.6	1.8	1.8	1.8
Other	0.0	0.0	0.0	0.0	0.0
Oil revenues	11.6	14.3	7.3	5.5	6.5
Sales to refineries	3.5	2.9	2.4	1.9	2.9
Export revenues	8.1	11.4	4.9	3.6	3.6
Grants	0.6	0.5	0.7	0.7	0.9
Other nonoil nontax revenues	1.5	0.7	1.2	1.2	1.3
Expense (current expenditure)	21.1	20.1	18.8	16.2	17.1
Wages	6.8	4.9	5.7	5.7	5.7
Goods and services	2.1	2.4	2.0	1.8	1.8
Interest	1.0	0.9	1.3	1.1	1.4
Subsidies	1.4	2.1	0.7	-0.2	0.2
Fuel	1.0	1.8	0.5	-0.4	0.0
Other	0.4	0.3	0.2	0.2	0.2
Transfers	9.2	9.6	7.9	7.2	7.0
Of which: to South	3.6	5.1	2.7	2.5	2.7
to Northern states	5.7	4.5	4.8	4.4	4.0
Current	3.8	2.6	2.9	2.8	2.5
Capital	1.9	1.8	2.0	1.6	1.5
Other	0.0	0.0	0.4	0.3	0.3
Other expense	0.7	0.2	1.0	0.7	1.0
Operating balance (accrual basis)	-0.6	1.7	-2.8	-1.5	-0.4
Net acquisition of NFA (capital expenditure)	4.8	3.2	4.1	2.7	2.8
Overall accrual balance (incl. discrepancy)	-5.4	-1.4	-6.9	-4.2	-3.2
Financing (accrual basis)	5.4	1.4	6.9	4.2	3.2
Foreign	1.0	0.4	3.9	1.9	1.9
Disbursements	1.3	0.8	4.7	2.5	2.5
Principal repayment (-)	-0.3	-0.5	-0.8	-0.6	-0.6
Domestic	4.4	1.1	3.0	2.4	1.3
Bank	0.8	-0.2	2.0	1.6	0.9
Of which ORSA	0.0	-0.7	-0.2	0.7	-0.1
Nonbank	1.3	1.3	1.0	1.4	1.3
Accounts payable	2.3	0.0	0.0	-0.6	-0.8
Of which: Arrears accumulation	2.8	0.4	0.0	0.0	0.0
Arrears paydown (-)	-0.4	-1.1	0.0	-0.6	-0.8
Memorandum items: 2/					
Overall balance (cash basis) 3/	-3.0	-1.4	-6.9	-4.8	-4.0
Net domestic financing (cash basis) 3/	2.1	1.0	3.0	3.0	2.1
Non-oil cash balance 4/	-8.7	-8.8	-10.6	-7.0	-7.4
Non-oil cash primary balance 4/	-7.5	-7.7	-9.1	-5.9	-5.8
Non-oil cash primary operating balance 4/	-1.7	-3.7	-4.6	-2.9	-2.7
Non-oil commitment balance 4/	-11.5	-8.9	-10.6	-6.4	-6.5
Non-oil commitment primary balance 4/	-10.4	-7.8	-9.1	-5.2	-4.9
Non-oil commitment primary operating balance 4/	-4.5	-3.8	-4.6	-2.3	-1.8
Tax revenue 4/	8.5	8.0	7.4	8.0	8.9
Non-oil domestic revenue 4/	10.2	8.8	8.7	9.3	10.4
Oil revenue (share of total revenue and grants)	56	66	46	37	39
Subnational transfers (share of total expenditure)	36	41	33	36	34
Nominal GDP (SDG millions)	93,811	121,059	120,091	120,091	139,525
Non-oil GDP (SDG millions)	77,140	96,570	109,678	109,678	123,698

1/ The exact characterization of Sudan's reporting basis is neither accrual nor cash. Revenues and most expenditures are still reported on a cash basis; however, goods and services spending (the main source of domestic arrears) are recorded on a payment-order due basis (starting January 2008) in the context of the switch to the GFS 2001 system.
2/ In calculating the base non-oil balance, oil revenues and grants were removed from revenues, while pipeline fees (recorded under goods and services spending) and oil-related subnational transfers were deducted from expenditures. In augemented versions, interestexpense and net NFA acquisition were deducted from expenditures to yield the primary and operating balances, respectively.
3/ Share of nominal GDP.
4/ Share of non-oil GDP.

Table 3. Sudan: Monetary Authorities' Accounts, 2006-10
(In millions of Sudanese guineas)

	2006	2007	2008	2009	2010	
	Dec.	Dec.	Dec.	Dec.	Jun.	Dec.
			Act.		Proj.	
Net foreign assets	-3,147	-4,097	-4,405	-5,303	-4,684	-4,171
Foreign assets	4,298	3,552	4,078	3,306	3,708	4,111
International reserves	3,342	2,828	3,055	2,284	2,686	3,089
Other assets	956	724	1,022	1,022	1,022	1,022
Foreign liabilities	7,445	7,650	8,482	8,609	8,392	8,282
Short-term liabilities	168	489	920	904	846	789
Medium- and long-term liabilities	7,277	7,160	7,562	7,705	7,546	7,493
Counterpart to valuation changes	7,241	7,512	7,744	7,744	7,744	7,744
Net domestic assets	3,722	5,399	7,429	9,619	9,313	10,175
Net domestic credit	3,069	4,365	4,253	6,323	6,017	6,880
Net claims on central government	1,731	2,596	2,145	3,625	3,873	4,121
Claims	1,991	2,680	3,932	4,535	4,883	5,231
Temporary advances	590	592	1,432	1,648	1,648	1,648
Government securities	348	761	583	969	1,317	1,666
Long-term claims	1,053	1,328	1,918	1,918	1,918	1,918
Deposits	260	84	1,788	910	1,010	1,110
Of which: Oil Savings Account 1/	14	46	915	37	137	237
Net claims on government of the South	-133	-3	-9	-14	-20	-20
Net claims on public enterprises	301	295	429	471	521	571
Net claims on banks	1,038	1,361	1,649	2,179	1,577	2,138
Money market instruments (net)	132	116	39	62	65	68
Other items (net)	653	1,034	3,176	3,296	3,296	3,296
Reserve money	7,816	8,813	10,768	12,060	12,373	13,748
Currency outside banks	5,355	5,640	6,775	7,994	8,183	9,433
Reserves of commercial banks	2,059	2,836	3,495	3,567	3,691	3,817
Required reserves	862	792	880	1,038	1,189	1,485
Excess reserves	1,196	2,044	2,615	2,529	2,502	2,332
Deposits at Central Bank of Sudan included in broad money	402	338	498	498	498	498
Memorandum item:						
Central bank credit to government (cumulative change)	1,313	550	-356	1,480	248	497

Sources: Sudanese authorities; and Fund staff estimates.

1/ Balance of the Oil Savings Account of the National Unity Government (as envisaged in the peace agreement with the South).

Table 4. Sudan: Monetary Survey, 2006–10
(In millions of Sudanese guinea)

	2006	2007	2008	2009	2010	
	Dec.	Dec.	Dec.	Dec.	Jun.	Dec.
			Act.	Proj.	Proj.	
Net foreign assets	-1,844	-2,574	-2,328	-3,593	-3,112	-3,014
Central Bank of Sudan	-3,147	-4,097	-4,405	-5,303	-4,684	-4,171
Commercial banks	1,303	1,523	2,076	1,710	1,572	1,157
Counterpart to valuation changes	7,331	7,492	7,786	7,788	7,788	7,788
Net foreign assets (excluding valuation adjustment)	5,488	4,918	5,458	4,196	4,677	4,775
Net domestic assets	12,385	14,812	17,476	22,866	23,026	27,158
Net domestic credit	14,551	17,268	19,052	24,322	24,483	28,614
Net claims on general government	3,110	3,960	3,663	5,524	6,115	6,712
Central Bank of Sudan net claims on central government	1,731	2,596	2,145	3,625	3,873	4,121
Central Bank of Sudan net claims on the government of the South	-133	-3	-9	-14	-20	-20
Commercial banks claims on central government	1,512	1,367	1,527	1,913	2,262	2,610
Net claims on nongovernment sectors	11,441	13,308	15,390	18,798	18,368	21,903
Other items (net)	-2,166	-2,456	-1,577	-1,457	-1,457	-1,457
Broad money	17,872	19,715	22,933	27,061	27,702	31,932
Currency outside banks	5,355	5,640	6,775	7,994	8,183	9,433
Deposits	12,516	14,075	16,159	19,067	19,519	22,499
Demand deposits	7,433	8,247	9,796	11,559	12,136	13,768
Domestic currency	5,162	5,728	6,855	8,089	7,930	9,397
Foreign currency	2,271	2,520	2,941	3,470	4,206	4,371
Quasi-money deposits	5,083	5,828	6,362	7,508	7,383	8,731
Memorandum items:						
Reserve money (annual percentage change)	27.8	12.8	22.2	12.0	17.0	14.0
Broad money (annual percentage change)	27.4	10.3	16.3	18.0	15.5	18.0
Credit to nongovernment sector (annual percentage change)	45.1	16.3	15.6	22.1	15.9	16.5
Currency to broad money (in percent)	30.0	28.6	29.5	29.5	29.5	29.5
Foreign currency deposits to total deposits (in percent)	18.6	22.6	18.7	18.7	22.2	20.0
Broad money multiplier	2.3	2.2	2.1	2.2	2.2	2.3
Non-oil GDP velocity (average)	3.9	4.2	4.5	4.5	…	4.8
Net international reserves (in million of U.S. dollars)	1,576	1,139	978	600	800	1,000
Commercial banks net foreign assets (in millions of U.S. dollars)	647	742	951	744	683	503
Commercial banks credit to the government (cumulative change)	838	170	64	386	348	697

Sources: Sudanese authorities; and Fund staff estimates.

Table 5. Sudan: Balance of Payments, 2006–10

(In millions of U.S. dollars, unless otherwise indicated)

	2006	2007	2008	2009	2010
			Prel.	Proj.	
Current account balance	-5,540	-5,812	-5,228	-6,017	-5,977
Current account balance (on cash basis)	-4,903	-5,074	-4,438	-5,252	-5,166
Trade balance	-1,291	1,180	3,297	-677	1,604
Exports, f.o.b.	5,813	8,902	12,394	5,939	8,655
Oil exports	5,244	8,443	11,818	5,347	7,958
Non-oil products	569	460	576	592	697
Imports, f.o.b.	-7,105	-7,722	-9,097	-6,616	-7,051
Foodstuffs	-656	-723	-1,177	-747	-852
Petroleum products	-364	-256	-626	-305	-320
Machinery and transport equipments	-3,785	-4,099	-3,674	-2,790	-2,938
Manufactured goods	-1,444	-1,709	-1,705	-1,286	-1,353
Other imports	-855	-935	-1,917	-1,488	-1,588
Services (net)	-2,689	-2,934	-2,931	-1,785	-2,088
Receipts	201	385	493	530	609
Payments	-2,890	-3,319	-3,424	-2,315	-2,698
Of which: oil transportation costs	-602	-813	-775	-786	-906
Income (net)	-2,949	-4,640	-5,578	-4,032	-5,293
Receipts	89	184	43	192	192
Non-oil payments	-747	-857	-964	-1,020	-1,099
Of which: interest cash payments	-94	-86	-89	-250	-284
Oil-related payments 1/	-2,292	-3,967	-4,658	-3,204	-4,386
Current transfers (net)	1,390	582	-15	478	-199
Private transfers	1,034	209	-686	-282	-909
Public transfers	356	373	671	760	710
Capital account	0	0	0	0	0
Financial account (net)	4,257	4,092	3,645	4,585	5,488
Disbursements	431	593	488	1,122	1,513
Amortization	-336	-219	-482	-410	-486
Of which: cash payments (excluding IMF)	-213	-88	-241	-276	-388
Short-term capital flows and other assets (net) 2/	622	829	1,270	1,285	1,413
Commercial banks NFA (increase -)	52	-95	-209	207	241
FDI and portfolio investment (net)	3,533	3,036	2,628	2,396	2,837
Errors and omissions	35	345	569	0	0
Overall balance	-1,248	-1,375	-1,013	-1,431	-489
Financing	1,248	1,375	1,013	1,431	489
Change in net international reserves (increase -)	500	437	162	378	-400
Other foreign reserves (increase -)	-30	122	-115	155	-20
Change in arrears	777	816	967	899	909
Financing gap	0	0	0	0	0
Memorandum items:					
Current account (in percent of GDP)	-15.2	-12.5	-9.0	-11.5	-9.9
Current account, cash basis (in percent of GDP)	-13.5	-10.9	-7.7	-10.1	-8.5
Net international reserves (end-period)	1,576	1,139	978	600	1,000
(in months of next years imports)	1.8	1.2	1.4	0.8	1.2
Sudanese crude oil price (U.S. dollars per barrel)	54.4	58.0	80.6	36.8	44.7
Nominal GDP	36,401	46,531	57,919	52,214	60,663

Source: Staff estimates based on information provided by the Sudanese authorities.

1/ Includes payments to oil companies related to profit-sharing arrangements.

2/ Net short-term trade and other credit facilities of the government and commercial banks.

ATTACHMENT I. SUDAN: LETTER OF INTENT

June 18, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

Sudan has maintained a close cooperation with the IMF over the past many years. This cooperation has helped us implement economic policies that aim at maintaining economic stability, fostering growth, and reducing poverty—which are necessary to promote peace and reconciliation throughout the country.

Like many other countries, Sudan has been impacted by the global crisis, which has sharply reduced oil revenues and foreign direct investment. In the attached Memorandum of Economic and Financial Policies (MEFP), we set out the measures we intend to undertake to minimize the impact of the global crisis on our economy. These policies and measures will be supported by a new 18-month Staff Monitored Program (SMP) covering the period July 2009 through December 2010. The emphasis will be on sustaining economic growth, maintaining macroeconomic stability, and rebuilding foreign exchange reserves. The Government and the Central Bank of Sudan (CBoS) believe that the policies and measures set forth in the attached MEFP are adequate to achieve these objectives, but stand ready to take additional measures that may be appropriate for this purpose. Sudan will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations. We intend to make these understandings public and authorize the IMF to publish this letter, the attached MEFP, and the IMF staff report.

We are committed to enhancing economic integration, both within Sudan and with the international community. But our success will in part depend on the level of support from multilateral institutions and development partners. We remain hopeful that the international community will recognize the important efforts that we have made over the past decade with respect to cooperation on policies and payments, and will take concrete action on debt relief for Sudan comparable to that provided to numerous other countries.

Sincerely yours,

/s/

Dr. Awad Ahmed Al-Jaz
Minister of Finance and National Economy
Ministry of Finance and National Economy

/s/

Dr. Sabir Mohamed Hassan
Governor
Central Bank of Sudan

ATTACHMENT II. SUDAN: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

June 18, 2009

1. This memorandum sets out the economic policies and objectives of the Government of National Unity (GNU) for 2009, in the context of an IMF Staff-monitored program (SMP) for the period July 2009 to December 2010. These policies are being implemented against the backdrop of a severe global crisis that has significantly impacted Sudan, including by sharply reducing oil revenues, foreign direct investment and financing.

I. RECENT DEVELOPMENTS

2. Despite the numerous challenges in implementing various peace agreements—and the sharp volatility in world commodity prices, in particular, of oil and food—the government has endeavored to maintain high levels of economic growth within an environment of macroeconomic stability. For the most part, we have been successful in these objectives, although the fall in oil prices in the last quarter of 2008 was much larger than expected, contributing to a sharp decline in our foreign exchange reserves.

3. Economic growth continued to be strong in 2008. Real GDP growth was nearly 7 percent, with non oil growth of about 8½ percent. The buoyant non-oil growth, driven by the services sector, compensated for a decline in oil production. Inflation trends mirrored developments in world food prices, with 12-month inflation (measured by the new CPI index) peaking in August before falling to 11 percent by end-year.

4. Fiscal performance was broadly in line with program, supported by improved expenditure control and strong oil revenues due to high world oil prices in the first eight months of the year. The overall fiscal deficit (commitment basis) was 1.4 percent of GDP, compared with 1.9 percent envisaged under the program. With most discretionary items kept within conservatively set budget ceilings, the fiscal space afforded by higher oil revenues was used to clear over half of the domestic arrears inherited from 2007. This was an important achievement considering both the shortfall in non-oil revenue and higher burden of oil related transfers and subsidies, and the fact that cash savings in the oil revenue stabilization account (ORSA)—0.7 percent of GDP—were in excess of program targets.

5. However, the dramatic and unexpected plunge in oil revenues in the last quarter of the year created significant liquidity pressures, resulting in an accumulation of domestic arrears of 0.4 percent of GDP. Although the problem primarily reflected weak cash management and financing rigidities, difficulties to enforce tight spending ceilings also contributed to this outcome. In particular, some budget units used their goods and services allocations to defray non-priority commitments, allowing arrears on important running expenses, like utility bills. There is nevertheless a clear commitment to clear as soon as possible the arrears generated in 2008 and to identify mechanisms to directly settle those recurrent items that are most susceptible of generating further arrears.

6. Monetary growth recovered somewhat following the slowdown of 2007, reflecting partly the reduction in government arrears. Broad money and reserve money grew by 16 percent and 22 percent, respectively, in 2008. Private sector credit growth recovered gradually to nearly 16 percent.

7. The balance of payments improved significantly through August, resulting in a sizeable build-up of reserves. The subsequent sharp drop in world oil prices in the last quarter of 2008 reversed the increase in foreign exchange reserves achieved earlier in the year. While foreign exchange receipts from oil export declined sharply, imports—both public and private—did not. Moreover, exchange rate flexibility ex-post was less than needed to offset the unexpectedly large depreciation of the real equilibrium exchange rate induced by the terms of trade shock associated with the drop in oil prices. Net international reserves (NIR), after peaking at US$2.0 billion in August, fell to about US$1.0 billion by end-year. The foreign exchange reserve position continued to deteriorate in early 2009 due to a further drop in oil prices, strong demand for imports, and lags in the economy's response to policy measures. On a temporary basis, we have introduced measures to curb the demand for foreign exchange, including a cash margin for letters of credit for most imports and a ceiling on transfers for travel purposes. The exchange rate depreciated by over 6 percent vis-à-vis the U.S. dollar in 2008 and by a further by 5 percent in the first two months of 2009. In addition, to ease exchange rate pressures and stem reserve losses, the Central Bank of Sudan (CBoS) recently introduced on a temporary basis a 100 percent cash margin on most imports, which we intend to remove by end-2009.

8. Despite the global financial crisis, financial sector indicators showed some improvement in 2008 as the sanctions imposed on Sudan has made our financial system relatively immune to developments in the international financial markets. Moreover, our Islamic financial system provided built-in resilience against financial market volatility induced by problems in the derivatives market. Gross nonperforming loans (NPLs) declined to 22 percent at end-2008, from 26 percent at end-2007, partly owing to the reduction of domestic government arrears accumulated in 2007. The ratio of loan provisions to NPLs increased to 15 percent at end-2008, from 14 ½ percent at end-2007, following initiatives to strengthen prudential regulations on loan provisioning. However, the average capital adequacy ratio deteriorated to 11 percent at end-2008, from 22 percent at end-2007. In particular, the financial position of Omdurman National Bank—which accounts for more than half of the NPLs and about 28 percent of bank lending—remains weak, while that of other banks has improved in 2008.

9. Important structural reforms were completed in 2008. Steps were taken to rein in corporate income tax exemptions, simplify the tax regime (by unifying the business profit tax rate across sectors), and improve tax administration through a reorganization of the taxation chamber headquarters along functional lines. Moreover, significant progress was made on key public financial management reforms, such as adoption of the GFS 2001 classification for the budget, the establishment of a centralized domestic debt unit, and enforcement of

commitment controls to limit expenditures by budget units. Also, an independent audit of Omdurman National Bank was completed.

II. Policies for 2009

10. The global economic crisis and, in particular, the sharp drop in world oil prices in the last quarter of 2008, have significantly complicated macroeconomic management. In recent years, oil revenues have accounted for about 90 percent of export receipts and more than half of government revenues. Moreover, foreign direct investment, which has been an important source of growth, is likely to drop with the slowdown in global economic activity and trade. In addition, foreign financing is likely to be lower than in previous years due to economic and financial problems in lender countries. We have already experienced a substantial drop in our foreign exchange earnings. In the current circumstance, we fully recognize the need to proceed without delay with a significant macroeconomic adjustment, coordinating and implementing our policies in order to arrest a sharply deteriorating situation that could result in price pressures and accumulation of domestic arrears. The emphasis will be placed on maintaining macroeconomic stability, safeguarding and rebuilding foreign exchange reserves, and sustaining growth.

A. Real Sector

11. Like elsewhere in Africa and around the world, we expect economic growth to slow down in 2009. In particular, the global crisis will impact Sudan's economy through lower oil prices and FDI inflows. Total oil production is projected to increase somewhat in 2009, but the non-oil sector is expected to slow down significantly due to the impact of global conditions and domestic demand management policies aimed at containing import pressures. Both the services and agricultural sectors are likely to be impacted by lower FDI inflows and, possibly, a slower reduction in domestic arrears. Nevertheless, we intend to proceed with policy measures aimed at attracting investment, especially in the agricultural sector. These include easing structural rigidities, liberalizing investment policies and the labor market, reducing the cost of doing business, reforming the legal system, providing the requisite infrastructure, and improving the general business environment. Overall growth is expected to be about 4 percent in 2009, and we will seek to mitigate the impact of the crisis on the vulnerable segments of the population. Average inflation, using the new CPI index, is projected to be 9-10 percent—largely due to lower world commodity prices and adjustments in fiscal and monetary policies. For 2010, we expect growth to slightly pick up, due to an increase in oil production. Inflation would remain in the single digits.

12. While the global crisis may delay the effect of our efforts to further reduce poverty, we are preparing a National Poverty Reduction Strategy Paper (PRSP). We expect the final PRSP to be ready by end-2009. The PRSP will place heavy emphasis on a macroeconomic framework consistent with post-conflict challenges, decentralization, an enabling environment for private sector growth, and capacity and institution building. The CBoS, in cooperation with the World Bank, has already established a microfinance unit. The unit

focuses on creating financial access for the poor, setting up the legislative and organizational framework for microfinance work, and establishing an information network for microfinance providers.

B. Fiscal Policy and Reform

13. Maintaining macroeconomic stability will be a central objective of fiscal policy during 2009. The approved 2009 budget envisaged an overall fiscal deficit of 7.1 percent of GDP on a commitment and cash basis. Consistent with the sharp oil price decline, total revenues were projected at 15.3 percent of GDP, almost 6 percentage points of GDP less than the 2008 out-turn. Tax collections were budgeted to rise by 0.4 percentage point of GDP on account of several tax policy measures: an increase in the VAT rate (to 20 percent) for telecoms; the introduction of a 5 percent development levy on taxable imports; and increased excise duty rates for cars. Although the approved envelope for current expenditure (18.3 percent of GDP) was lower than the 2008 out-turn, capital spending (at 4.1 percent of DP) was significantly higher (by 1.1 percent of GDP).[1]

14. However, the further decline in oil prices and the severity of the global slowdown have far exceeded the expectations prevailing at the time of budget formulation. The budget was prepared using an oil price assumption of US$50/bbl (for Nile blend),[2] higher than the current level of US$40/bbl. Moreover, the foreign financing prospects are less favorable than the budget assumptions in light of the impact of the global crisis on some of our leading creditors. Accordingly, we recognize that a sizable fiscal adjustment will be required to help keep inflation within single digits, protect private sector credit growth, and rebuild foreign exchange reserves.

15. Specifically, the 2009 fiscal deficit will be contained to no more than SDG 4,211 million (3.5 percent of GDP) on a commitment basis.[3] We intend to pay off over SDG 700 million from the end-2008 stock of government arrears, with the remaining amount of SDG 1 billion to be repaid in 2010–11. This implies a cash deficit in 2009 of

[1] The figures in this paragraph are based on the definition of revenues and expenditures used by the Ministry of Finance and National Economy. Specifically, revenues exclude 0.2 percent of GDP corresponding to the accumulation in the ORSA and 0.5 percent of GDP equivalent of the fuel subsidy. Similarly, expenditures exclude the aforementioned fuel subsidy. Under the IMF format, which reports oil revenues at market prices, the revenue, total expenditure, and commitment deficit figures are 16 percent, 22.9 percent, and 6.9 percent of GDP, respectively.

[2] This corresponds to an international price for Nile blend of US$60/bbl.

[3] This deficit figure is based on our fiscal reporting format, which treats the net ORSA withdrawal of SDG 878 million (proposed for 2009) as revenue to the budget. Under the IMF staff definition, this withdrawal shows up in increased financing (rather than oil revenues); so that the IMF staff comparable deficit target amounts to SDG 5,090 million.

SDG 4,932 million (or 4.1 percent of GDP). Fiscal revenues are expected to reach SDG 19 billion (including tax revenues of SDG 8.7 billion), while total expenditures are programmed at SDG 23.2 billion.[4] Compared with the budget, these figures imply an expenditure reduction of 3 percent of GDP and a tax revenue effort of 0.7 percent of GDP. This clearly constitutes a very large adjustment, especially considering the projected slowdown in growth and the pressures for countercyclical fiscal policy it will certainly generate. However, as noted earlier, we realize that the benefits of maintaining macroeconomic stability outweigh the costs associated with adjustment. We therefore commit to anchoring the revised 2009 fiscal program, and continued strengthening of the fiscal position in subsequent years, in a number of concrete tax and expenditure measures, as follows:

16. In the area of **tax policy**, we intend to:

- undertake a comprehensive review of the tax policy regime with a view to: (i) sharply reducing VAT exemptions, (ii) reforming the personal income tax, (iii) clarifying tax jurisdiction issues with subnational governments; and (iv) optimizing the net government take from the oil sector [structural measure for October 2009].

- increase excise duty rates to 25 percent on soft drinks; and impose excise duty of 15 percent on perfumes, cosmetics, washing machines, high-end electronics, motorcycles, and leather products [by July 2009].

- introduce the federal customs and excise duty regimes in Southern Sudan to more effectively tax high revenue-yielding items such as beverages and cigarettes [by July 2009].

- eliminate the trade restriction on imports of raw sugar, which will generate additional revenue of about SDG75 million [by July 2009].

- give consideration to lowering the threshold for paying the personal income tax to about SDG 7,000 and removing the exemption to persons aged 50 years and above [by January 2010].

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[4] Our definition of revenues includes both the negative fuel subsidy (SDG 518 million)—the difference between the $49/bbl refinery gate price and the international price on local crude oil sales—and the net ORSA drawdown (SDG 878 million). Both these items are excluded from the IMF staff's definition of revenues, which is based on the market value of oil revenue sales during the year. The corresponding figure for revenues under the IMF definition is, therefore, SDG 17.6 billion. Similarly, our definition of total expenditures excludes the negative fuel subsidy spending, while the IMF staff definition includes it. Consequently, the corresponding figure for total expenditures under the IMF definition is SDG 22.7 billion.

17. In the area of **revenue administration**, we have launched a comprehensive drive to curb tax evasion, including by (i) expediting the collection of income tax arrears; (ii) conducting risk based joint-income tax-VAT audits; (iii) using a unique taxpayer identification number across the various tax collection agencies (see below); and (iv) reducing the flow of smuggled items (such as mobile phones, cigarettes, sugar etc.) into the country. Efforts are also underway to facilitate trade through electronic container scanning and real-time e-mail communication between customs and various other government departments. We are also committed to undertaking the following measures:

- centralizing the issuance of taxpayer identification numbers, and operationalize their use by the customs administration [by July 2009].

- consolidating all agreed-to modernization initiatives of the taxation chamber into an integrated and fully costed modernization plan [by October 2009].

- submitting to parliament customs legislation containing provision to adopt WTO-consistent valuation principles [by September 2009].

- launching a VAT refund system for large business taxpayers to help bring capital goods imports and electricity consumption (both currently exempted from VAT) under the VAT net [by June 2010].

18. In the area of **expenditure policy**, we will:

- submit to parliament privatization legislation to ensure the consistent treatment of retrenched employees' compensation across parastatals, with a view to expediting the privatization process [by November 2009].

- reform the petroleum pricing regime by introducing an automatic adjustment system while simultaneously initiating the establishment of a targeted safety net for the poor [January 2010].

19. In the area of **public financial management** (PFM), we will:

- undertake reorganization/restructuring of the Ministry of Finance and National Economy broadly in line with recent IMF technical assistance [by August 2009].

- extend GFS 2001 budget classification to at least 5 Northern states, with a view to better monitoring the general government's fiscal operations and tracking public spending by sector [by December 2009].

20. To effectively guard against possible arrears accumulation in an extremely difficult year, we will strengthen our commitment control and cash management systems by (a) continuing to enforce expenditure ceilings for budget units in line with actual resource

availability; (b) obtaining spending plans from budget units based on 75 percent of their approved budgetary allocations; (c) preparing forward-looking cash plans that take into account the seasonality of revenues and spending, as well as unused balances in spending units' accounts; and (d) implementing the TSA feature of sweeping unused balances of spending units at the end of each month. Also, we will closely track budget execution and arrears developments by preparing monthly government operations and domestic debt reports that will be shared with the IMF no later than 45 days after the end of each month.

21. The 2010 budget parameters will be reviewed later in 2009, as the preparation of the budget advances.

C. Monetary and Exchange Rate Policies

22. With respect to monetary policy, the central bank will—in the context of a managed float exchange rate system—continue to maintain its focus on price stability and rebuilding foreign exchange reserves. The declining trends in world food prices and the slowdown in domestic demand should help attain this objective. The guinea will be allowed to move in line with fundamentals, and the central bank will avoid resisting sustained pressures in the foreign exchange market. Sales of foreign exchange will focus primarily on serving market needs. However, in light of the need to rebuild foreign exchange reserves to more prudent levels, interventions will be kept to a minimum.

23. The program will target broad and reserve money growth at 18 percent and 12 percent, respectively, in 2009, consistent with the GDP growth and inflation objectives. The monetary targets and the projected change in foreign exchange reserves will allow for an appropriate growth of credit to the private sector. The conduct of monetary policy will be challenging given the changing economic situation and will seek to be flexible in the face of shifting FDI flows and volatility in oil-related foreign exchange movements and aid disbursements. To ensure that broad money growth remains in line with the inflation and reserve adequacy objectives, we will monitor monetary and foreign exchange reserves developments closely during the program period and, if required, quickly adjust our policies. In this context, we will continue to monitor daily CBoS balance sheet indicators, international reserves, sales and purchases of foreign exchange, and the exchange rate, and share these data with IMF staff on a weekly basis.

24. Rebuilding international reserves from the currently low level must take priority in our macroeconomic program for 2009, and we will devote all the necessary means to this end. The external current account deficit (cash basis) is expected to widen to about 10 percent of GDP in 2009, from 8 percent in 2008. This deterioration mirrors the drop in oil exports. Imports are expected to contract sharply in light of the drop in oil exports and FDI, as well as the tightening of macroeconomic policies. As a result, we anticipate being able to substantially rebuild the net international reserves of the central bank.

D. Financial Sector

25. While progress has already been made, we are stepping up efforts to further strengthen the financial system. In particular, we will require problem banks, based on plans submitted last year, to accumulate sufficient provisions to reduce net nonperforming loans and raise capital adequacy in order to meet existing prudential standards. In particular, we will require all non-complying banks, excluding ONB, to increase their provisions to NPLs ratio by at least 2 percentage points, relative to their level at end-2008. Targets have also been set for individual banks to comply with other prudential regulations, and progress is being monitored effectively. These reforms have already translated into an improvement in financial sector indicators but more tangible results of these and other measures introduced starting in mid-2008 are expected to be fully reflected on the financial sector indicators in 2009. Moreover, the CBoS will actively enforce prudential standards and ensure that all banks comply with existing regulations.

26. We realize the unique nature and problems of Omdurman National Bank (ONB). We are preparing a plan to restructure the Bank in line with recommendations of the independent audit completed last year (structural benchmark for December 2009). Our ultimate objective is to privatize the ONB.

III. Relations with the Fund and Other Creditors

27. **External debt issues**. In 2009, Sudan's debt service capacity will be constrained by revenue shortfalls associated with lower oil prices, the need to rebuild foreign exchange reserves, the burden of implementing the various peace agreements, and the need to address critical poverty and reconstruction requirements. Further shortfalls or delays in donor assistance or a continued significant negative shock to oil prices would further limit the capacity to service our obligations. Based on the available data, the end-2008 stock of public and publicly guaranteed debt is estimated at US$34 billion. We wish to convey to the international community that Sudan has cooperated on policies and payments for many years, and in that context has met all the conditions and requirements for debt relief. We remain hopeful that the international community will recognize our track record, and take concrete action on debt relief comparable to that provided to other countries.

28. **External financing**. Sudan continues to suffer from limited access to concessional loans because of the difficulties we face to resolve our debt and arrears situation. While many low income countries are benefiting from the IMF's concessional facilities, we are implementing a difficult program during an unprecedented global crisis without access to concessional financing. We cannot put critical infrastructure, reconstruction, and social development projects on hold indefinitely. These projects are an essential component of our strategy to unite the country after signing the multiple peace agreements. Consequently, in recent years, we have had to resort to nonconcessional financing, but limited the contracting of such borrowing to minimum levels (US$426 million in 2008 compared to a ceiling of US$700 million). We are keenly aware of the concern of other creditors about this

borrowing, and of the risks it may pose over the medium-and long-term. Therefore, we will seek to limit the contracting of such obligations as much as possible. For 2009, we will limit the contracting of non-concessional borrowing to US$700 million. The limit for 2010 will be established in the context of the first review under the SMP.

29. **Payments to the Fund**. In addition to cooperating with the Fund on economic policy, Sudan's payments to the Fund have been in line with program levels under the SMPs. We will ensure that the Fund's preferred creditor status will be maintained by ensuring that our payments in 2009 continue to exceed obligations falling due. To demonstrate our continued cooperation, we will make payments of US$10 million in 2009, despite our much reduced foreign exchange earnings. We intend to make significantly higher payments in 2010 if the NIR position improves as programmed. We would also point out that we have reduced repayments to other creditors in light of our difficult NIR position and that we have requested from our main creditors a rescheduling of debt service falling due in 2009. Further, it is our intention to move to a monthly payment basis. However, while demonstrating our good intentions, these payments are not a solution to Sudan's arrears to the Fund. We appeal to the international community to recognize our accomplishments, act in accordance with the principle of equal treatment, and work toward a rapid resolution of Sudan's debt and arrears problem.

IV. Program Targets and Monitoring

30. The proposed quantitative targets up to end-December 2009 are set forth in Table 1, and the structural benchmarks are detailed in Table 2. We will closely monitor financial and economic developments in the coming months and will implement any measure that may be needed to safeguard macroeconomic stability in consultation with IMF staff. The end-June 2010 targets will be established in the context of the first review under the SMP.

31. Policies for 2010 will be set with a view to consolidating the gains made in the second half of 2009. Specific targets will be set in the context of the first review.

32. To ensure the effective monitoring of the program, the relevant ministries, the CBoS and the Central Bureau of Statistics will compile and share on a timely basis with IMF staff all the necessary economic and financial, as specified in the attached Technical Memorandum of Understanding (TMU).

Table 1. Sudan: Quantitative Targets for 2009

	2008 1/	2009 1/
	Dec.	Dec.
	Prel.	Target
(In millions of Sudanese guineas, unless otherwise indicated)		
Central Bank of Sudan net domestic assets (Ceiling) 2/	2,311	2,190
Domestic financing of the central government (Ceiling) 2/	2,125	3,003
Reduction in the stock of domestic arrears of the central government (Floor) 1/ 3/	1,310	-721
Net international reserves (in millions of U.S. dollars) (Floor) 2/	-162	-378
Contracting or guaranteeing of external nonconcessional debt		
by the government or the central bank (in millions of U.S. dollars) (Ceiling)	426	700
Payments to the Fund (in millions of U.S. dollars) (Floor)	50	10
Memorandum items:		
Broad money	3,219	4,128
Reserve money	1,954	1,292
Net central bank claims on government of Southern Sudan	-5	-5
Government oil export revenues	13,825	4,321
Of which: Net oil savings account (OSA) accumulation	869	-878

Sources: Sudanese authorities; and Fund staff estimates.

1/ Cumulative flow during the year.
2/ Subject to an adjustor to take account of oil production and/or prices being different than assumed in the program.
3/ Arrears are defined as overdue financial obligations of the central government outstanding for 90 days or more.

Table 2. Sudan: Structural Measures Under the Proposed 2009-10 SMP

Measures	**Objective**	**Timing** 1/
Tax Policy		
1. Undertake a comprehensive review of the tax policy regime with a view to: (i) sharply reduce VAT exemptions; (ii) reform the personal income tax; (iii) clarify tax jurisdiction issues with subnational governments; and (iv) optimize the net government take from the oil sector.	Raise revenue	October 2009
Expenditure policy:		
2. Reform the petroleum pricing regime by introducing an automatic adjustment system while simultaneously initiating the establishment of a targeted safety net for the poor.	Limit fuel subsidy while protecting poor	January 2010
Public financial management:		
3. Extend GFS 2001 budget classification to at least 5 Northern states with a view to better monitoring the general government's fiscal operations and tracking public spending by sector.	Strengthen fiscal management and reporting	December 2009
4. Undertake reorganization/modernization of the Ministry of Finance and National Economy in line with recent IMF technical assistance.	Strengthen fiscal policy management	August 2009
Revenue administration:		
5. Submit to parliament customs legislation containing provision to adopt WTO-consistent valuation principles.	Modernize customs administration	September 2009
6. Consolidate all agreed-to modernization initiatives of the taxation chamber into an integrated and fully-costed modernization plan.	Strengthen tax administration	October 2009
7. Centralize issuance of taxpayer identification numbers and operationalize their use by the customs administration.	Improve tax compliance	July 2009
Financial sector		
8. Prepare a time bound restructuring plan for Omdurman Bank in line with the recommendations of the independent audit completed last year.	Financial Sector soundness	December 2009

ATTACHMENT III. SUDAN: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum specifies the understanding reached with the Fund staff regarding quantitative targets, structural benchmarks, and reporting for the 2009 staff-monitored program (SMP).

2. The SMP relies on six quantitative targets for end-December. The targets are (i) ceilings on the change in net domestic assets of the Central Bank of Sudan (CBoS); (ii) ceilings on the domestic financing of the fiscal deficit; (iii) floors for the buildup of net international reserves of the central bank; (iv) ceilings on new nonconcessional external loans contracted or guaranteed by the government or the central bank; (v) floors for payments to the Fund; and (vi) change in domestic arrears. Broad money, reserve money, and total government revenues from crude oil exports will be monitored as memorandum items. Some of these targets are subject to adjustors depending on the financial position of the government of South Sudan, total government oil revenue performance, and the transfers from the central government to subnational governments. The definitions of these variables and the adjustors are set out below. All the quantitative targets and structural benchmarks are displayed in Tables 1 and 2 of the MEFP.

3. **Net domestic assets (NDA)** of the CBoS are defined as the sum of the Net Domestic Credit of the CBoS, the net issue of money market instruments and other items net. Net Domestic Credit is defined as net credit to the central government (i.e. Government Musharaka Certificates (GMCs), Government Investment Certificates (GICs), and any other form of central bank credit to the central government minus total central government deposits) plus net central bank claims on state and local governments, central bank claims on public enterprises, and claims on banks, and minus Central Bank Ijara Certificates (CICs). The definition of the central government comprises all accounts of line ministries and agencies controlled by the government (corresponding to Group no. 11, Group no. 12, and some accounts of the Group no. 19 in the CBoS general ledger), the Zakat funds (recorded under Group no. 13), and margin deposits placed with the CBoS by the central government against letters of credit issued by the CBoS. The definition includes all oil-related accounts controlled by the government (e.g., OSA). To evaluate program targets, the guinea equivalent values of foreign exchange denominated items in the balance sheet of the central bank will be calculated at the program exchange rate.

4. **Net international reserves** (NIR) are total gross non-earmarked official foreign reserve assets on active accounts plus reserve assets of the government of Southern Sudan in the central bank minus official short-term liabilities (i.e. no more than one-year maturity). The assets are maintained on accounts with overseas correspondent banks and foreign exchange banknotes in the vaults of the central bank. Short-term liabilities comprised of the following items: (i) short-term liabilities, as noted in the balance sheet of the CBoS; (ii) IMF deposit accounts; (iii) nonresident deposits; and (iv) (overdrawn) foreign correspondents accounts net of dormant accounts.

5. **Domestic financing of the fiscal deficit** is defined as total net domestic borrowing by the central government, including net borrowing from the banking system (including GMCs and GICs), net sales of GMCs and GICs outside the banking system, promissory notes (i.e., standing orders, letters of guarantee, sanadats, etc.), revenues from privatization (net of new acquisition of shares), net buildup of domestic government arrears, and drawdown in government cash deposits at the CBoS (including OSA). The definition of central government for the purpose of this criterion is the same as the one applied for the NDA of the central bank.

6. Limits on **contracting or guaranteeing of nonconcessional external debt** apply to all forms of debt of more than one-year maturity contracted or guaranteed by the government or the CBoS. The limit 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 to commitments contracted or guaranteed for which value has not been received. The degree of concessionality of debt will be calculated as specified in the Guidelines.[1]

7. **Broad money** is defined as the sum of local currency circulating outside of the banks, banks' demand, and time and savings deposits. It also includes transferable deposits and margin deposits against letters of credit placed by state and local governments, nonfinancial public enterprises, and the nonbank private sector with the CBoS. **Reserve money** is defined as the sum of local currency circulating outside of the banks, total reserves (required and excess) for banks, and deposits at the CBoS included in broad money.

8. **Adjustor on the financial position of the government of South Sudan** (capped). The program target for changes in the NDA of the central bank will be reduced (increased) and the international reserve target will be increased (reduced) by the amount of any decline (increase) in net central bank claims on the government of South Sudan. The NIR target will also be increased by the amount of the new SDR allocation. The adjustor will not apply if the stock of net claims on the government of South Sudan turns positive.

9. **Oil revenue adjustor**. The gross programmed government oil revenue is based on the program's assumptions about crude oil prices (f.o.b. Port Sudan) and volumes (government share). Accrued revenue is the cumulative government oil revenue inflows based on actual shipments (including deliveries to refineries) at current international prices

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[1] For program purposes, a loan is considered concessional if the grant element is at least 35 percent calculated using a discount factor based on the Commercial Interest Reference Rates (CIRRs) published by the OECD plus margins depending on the loan maturity. The margins are 0.75 percent for repayment periods of less than 15 years, 1 percent for 15–19 years, 1.15 percent for 20–29 years, and 1.25 percent for 30 years or more. The average of the CIRRs over the last ten years will be used for loans with a maturity of at least 15 years and the average of the CIRRs for the preceding six months will be used for shorter maturities.

(f.o.b. Port Sudan).[2] The local currency equivalent of the dollar difference between the programmed and accrued oil revenues, needed to calculate the adjuster, will be obtained by multiplying the dollar difference by the average of the monthly exchange rates prevailing during the period in question. The programmed government oil revenue for 2009 is programmed at SDG 6,550 million for the year.[3]

The oil revenue adjustor will work as follows:

- If the accrued government revenue exceeds the programmed amount (because of price and/or volume increases), then:

  - the program targets for domestic financing of the budget deficit and NDA will be reduced, by one half of the local currency equivalent difference between the accrued and the programmed amounts, and the international reserves target will be increased by one half the local currency equivalent excess of accrued export oil revenues over the corresponding programmed level unless the difference is used for capital expenditures and/or peace related spending in which case the program targets remain unchanged.

- If the accrued government revenue falls short of the programmed amount (because of price and/or volume decreases), then:

  - the program targets for domestic financing of the budget deficit and NDA will be increased, by one half of the local currency equivalent difference between the programmed and accrued amounts, and the international reserves target will be reduced by one half the local currency equivalent shortfall of the actual amounts accrued from the programmed export oil revenues.

10. **Data Reporting.** The following table contains the agreed reporting framework. To the extent possible, the data will be submitted in both printed and electronic form to the IMF local office.

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[2] As compiled monthly by the Ministry of Finance and Economy (MOFNE).

[3] The oil revenue figure of SDG 6,550 million for the year included both the projected negative fuel subsidy (SDG 518 million) and the net ORSA withdrawal (SDG 878 million).

Reporting Agency	Type of Data	Description of Data	Frequency	Timing (within period specified)
CBoS	Flash report	Weekly data for movement in main indicators of the CBoS balance sheet, international reserves, sales and purchases of foreign exchange, exchange rate.	Weekly	Tuesday of each week
	CBoS balance sheet	Detailed CBoS balance sheet.	Monthly	1 month after the end of each month
	Monetary survey	Banking system balance sheet and consolidated balance sheet of commercial banks	Monthly	1 month after the end of each month
	Cash flow of foreign exchange	Cash flow data of foreign exchange, including sales and purchases by the dealing room at the CBoS.	Monthly	1 week after the end of each month
	Banking indicators	Capital adequacy; asset composition and quality including non-performing loans; profitability; liquidity; open FX positions; and compliance with prudential norms	Quarterly	1 month after the end of each quarter
	Balance of payments	Detailed composition	Quarterly	2 months after the end of each quarter
Ministry of Finance	Central government operations	Revenues, expenditures, and financing as in GFSM 2001 format	Monthly	45 days after the end of each month
	GOSS	Revenues, expenditures, and financing	Monthly	Data for January-April by end-June; for the remaining months 45 days after the end of each month
	Privatization receipts	Detailed figures for each transaction and nature of the transaction	Quarterly	2 months after the end of each quarter
	Central government domestic debt	End-month stocks, and monthly issuances and repayments, of all domestic debt instruments: GMCs, GICs, loans and advances from the ban king system, sanadat, letters of guarantee, standing orders, accounts payable (including arrears)	Monthly	45 days after the end of each month
	External debt	Disbursements, debt service, and contracting or guaranteeing of medium-and long-term external debt of the government, the CBoS, and state-owned companies	Quarterly	1 month after the end of each quarter
Central Bureau of Statistics	CPI	Including detailed data.	Monthly	1 week after the end of each month
Ministry of Finance/ Ministry of Energy	Crude oil exports	Shipment data, listing by blend specifying date, quantity, prices, and values in US$ and in guinea	Monthly	1 month after the end of each month
	Sales to refineries	Sales listing by refineries specifying date, quantity, prices, and values in US$ and in guinea	Monthly	1 month after the end of each month
	Net operating income transfers to the treasury	Net income of SPC (including those derived from exports of petroleum products)	Quarterly	1 month after the end of each quarter