INTERNATIONAL MONETARY FUND

Staff Country Reports

June 2008
IMF Country Report No. 08/174

Sudan: First Review of Performance Under the 2007-08 Staff-Monitored Program

This paper on the first review of performance under the 2007-08 staff-monitored program for Sudan was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on May 15, 2008. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Sudan or the Executive Board of the IMF.

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SUDAN

First Review of Performance Under the 2007–08 Staff-Monitored Program

Prepared by the Middle East and Central Asia Department
(In Consultation with Other Departments)

Approved by Adam Bennett and Matthew Fisher

May 15, 2008

Mission dates: March 11–March 24. The mission met with Dr. Awad Al-Jaz (Minister of Finance and National Economy), Dr. Sabir Mohamed Hassan (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), T. Schneider, A. Naseer, K. Moriyama (all MCD), M. Tareen (PDR), S. A. Abbas (FAD), and K. Abdallah (Resident Representative). Mr. Uanguta (OED) attended the policy meetings.

Fund relations: The 2007 Article IV consultation was completed on September 7, 2007. The current SMP covers the period July 2007 through December 2008. Under the SMP, the authorities are committed to repay the Fund at least US$50 million annually in 2007 and 2008.

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EXECUTIVE SUMMARY

Key developments

- **Economic performance in 2007 was mixed**. Overall economic growth was strong (10 percent) and average inflation was relatively low (8 percent). However, due partly to delays in implementing key public expenditure control measures, there was an accumulation of domestic arrears of about 2.8 percent of GDP.

- **Performance under the SMP has been uneven**. Bold actions were taken to rein-in tax exemptions, widen the tax base, and strengthen tax and budget administration. However, some structural benchmarks related to public financial management reforms were delayed.

- **Looking ahead, the surge in oil prices provides an important opportunity to reduce domestic arrears**. The recent hike in international oil prices suggests an additional 3.3 percent of GDP in government revenue in 2008. However, only a portion of this can be used to clear central government domestic arrears as oil revenues must be shared with the states.

Staff recommendations

- **Implementing the delayed measures** on public financial management and financial sector reform will be crucial to restoring fiscal credibility and financial soundness. These were set as prior actions to conclude the staff assessment.

- **The additional usable oil revenues should be used to reduce the stock of domestic arrears**. Reducing these arrears should help to re-invigorate private sector activity and repair the damage to corporate and banks' balance sheets that occurred in 2006–07.

- **Monetary policy must balance reviving private sector credit and ensuring low inflation**. It will be important to closely monitor price developments, improve coordination between the central bank and the finance ministry on arrears clearance, and, if necessary, tighten the monetary targets to maintain single-digit inflation.

Outlook. Sudan's economic outlook is favorable, but will hinge on the authorities' ability to correct past slippages, reestablish fiscal credibility, and restore the safety and soundness of the financial system. This will not be an easy task given the heavy commitments imposed by various peace agreements and an uncertain regional environment. The rise in world food prices poses a particular challenge to containing inflation, requiring cautious monetary and fiscal policy implementation.

I. Introduction

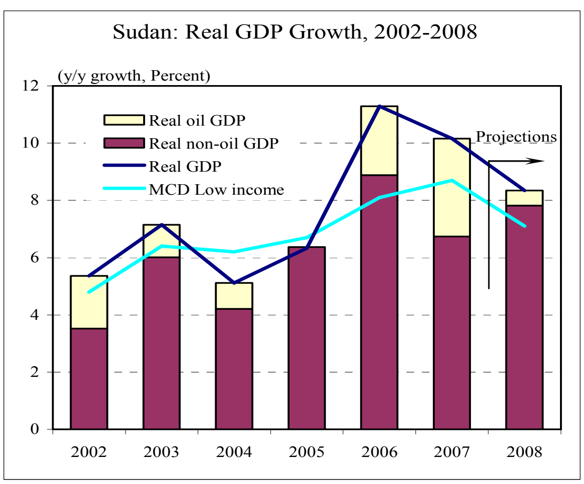
1. **Sudan has maintained close cooperation with the Fund over the last decade.** Performance under successive staff-monitored programs has been generally good. The latest SMP was negotiated in June 2007 and considered by the Board on September 7, 2007. The SMP covers the period July 2007 through December 2008. This is the first of two staff assessments under the SMP.

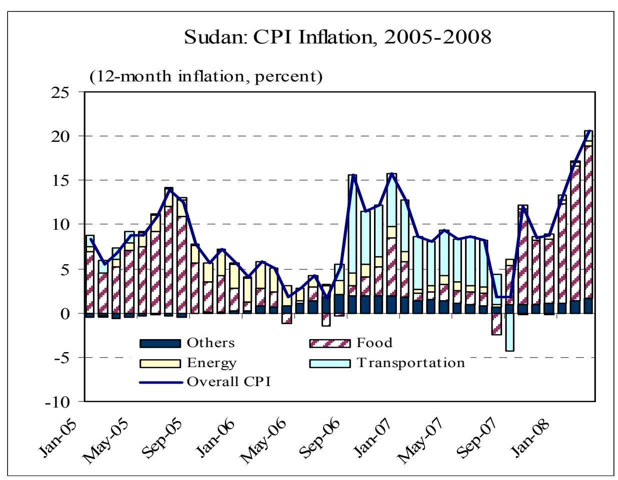
II. Political Situation

2. **The political and security situation remains difficult.** The Darfur issue is far from resolved, despite the advent of the UN-African Union Mission in Darfur (UNAMID). Further, relations between North and South remain tense. Under the Comprehensive Peace Agreement (CPA), local, legislative, and presidential elections are mandated to take place in 2009, followed by a referendum in Southern Sudan before the end of 2010 to decide on unity or secession.

III. Recent Developments and Performance Under the SMP

3. **Economic growth in 2007 remained strong by regional standards but has moderated relative to 2006**. Real GDP growth in 2007 is estimated at about 10 percent with non-oil growth at just under 8 percent—compared with 11 and 10 percent, respectively, in 2006. While oil production was higher than in 2006, it was less than projected. Sharp drops in foreign investment and private sector credit, the impact of regional floods, and lower-than-projected agricultural output contributed to the slowdown in non-oil growth. Inflation at end-2007 was 8.8 percent, somewhat higher than projected. Inflation surged to 20 percent by end-March 2008, however, driven almost entirely by a rise in food prices (in line with a similar increase in world food prices).[1]





[1] Increases in bread prices alone explain about two-thirds of inflation after October 2007.

4. **The fiscal position on a cash basis improved in 2007, but delays in implementing expenditure controls led to the accumulation of some new domestic arrears (Box 1)**. The fiscal deficit (on a cash basis) dropped from an annualized 6.0 percent of GDP at end-March to an estimated 3.1 percent by end-December—reflecting higher oil revenue and lower current expenditures (despite some 0.4 percent of GDP in domestic arrears repayment). However, delays in implementing key structural measures related to public spending controls and to the establishment of a centralized domestic debt unit contributed to the emergence of new domestic arrears in 2007 of some SDG 2.6 billion. As a result, the fiscal deficit on a commitment basis was 5.4 percent of GDP. The challenges of implementing the various peace agreements, disarmament, and fiscal decentralization have also impacted fiscal performance. For example, central government transfers to the states quintupled between 2004 and 2007—from 1.5 to 8 percent of GDP; and from 8 to 34 percent of total central government expenditures.

Box 1. Domestic Government Arrears: Origins and Size

Sudan's domestic government arrears problem has worsened in recent years. Although small amounts of arrears were not uncommon in earlier years, large arrears began to be incurred in 2005. The current stock of arrears is estimated at SDG 2.6 billion (about 2.2 percent of 2008 GDP), comprising overdue cash payments to suppliers of goods and services (35 percent); domestic debt obligations matured but not paid (26 percent); wage, social security and pension-related liabilities (18 percent); and dues owed to development project contractors and subnational governments. These arrears have strained corporate liquidity, led to a sharp increase in banks' nonperforming loans (NPLs), and a slowdown in private sector credit. They have also contributed to a build-up in the government's domestic debt, constraining future fiscal space.

Weak reporting and ineffective public spending commitment controls have been at the core of the problem. Expenditure commitments continued to be guided by the approved budget, rather than the availability of cash resources. The latter tightened considerably in 2007 due to lower-than-budgeted domestic financing from the banking system, higher payments with respect to debt service, and higher oil-related transfers to the South. Also, until end-2007, the government used a cash-based expenditure reporting system, which did not consider a liability to be "in arrears" until the end of the fiscal year. Arrears incurred during the year were thus not tracked, and the issue not addressed until the following year. The absence of a functional domestic debt unit further complicated timely assessment. The adoption of GFSM 2001 for the 2008 budget should facilitate the monitoring of arrears, as expenditures will be recorded on a "payments due" basis. The recent establishment of a centralized domestic debt unit is also critical to tracking domestic debt developments, including the burden of arrears rescheduled to future years.

5. **Monetary growth slowed sharply—reflecting weakness in the financial sector, the overhang of government arrears, and slower than anticipated growth of net foreign assets (NFA)**. The drop in money and credit growth that followed the surge in government arrears and the intervention of Omdurman Bank in late 2006 and early 2007 continued through much of the year. By the third quarter of 2007, twelve-month reserve money growth had turned negative, broad money growth had fallen to zero, and private sector credit had

dropped to as low as 8 percent.[2] To counter the liquidity squeeze, the Central Bank of Sudan began in mid-2007 to inject liquidity into the banking system—first through purchase of government securities from the banking system, and then through deposits with selected commercial banks (i.e., those more in a condition to lend to the private sector). This strategy met with some success. Reserve money, broad money, and private sector credit growth recovered to 13 percent, 10 percent, and 16 percent, respectively, by end-2007.

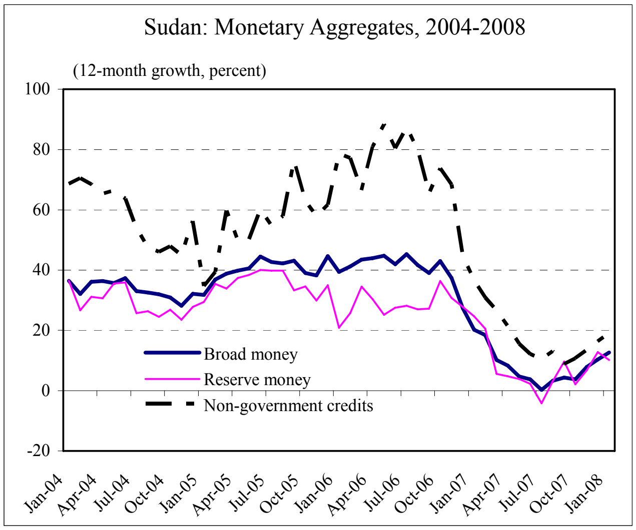
6. **Higher oil prices and renewed exchange rate flexibility facilitated a rise in net international reserves (NIR) of the central bank, but at a slower rate than anticipated**. NIR rose from US$563 million in May to an estimated US$981 million by end-December 2007 (1 month of imports). While the increase is encouraging, it is less than the level targeted under the SMP. Despite higher oil prices, NIR also fell slightly in January 2008 to about US$940 million—possibly reflecting lower FDI and higher outward remittances.[3] The exchange rate has shown increasing flexibility since the end of the currency conversion in July, with the pound depreciating by over 2 percent during August-December 2007. However, the shift to greater flexibility was accompanied by periods of unwarranted volatility, resulting in continued sales of foreign exchange by the central bank to smooth short-term turbulence.[4] In real effective terms, the pound depreciated by about 2 percent during 2007.

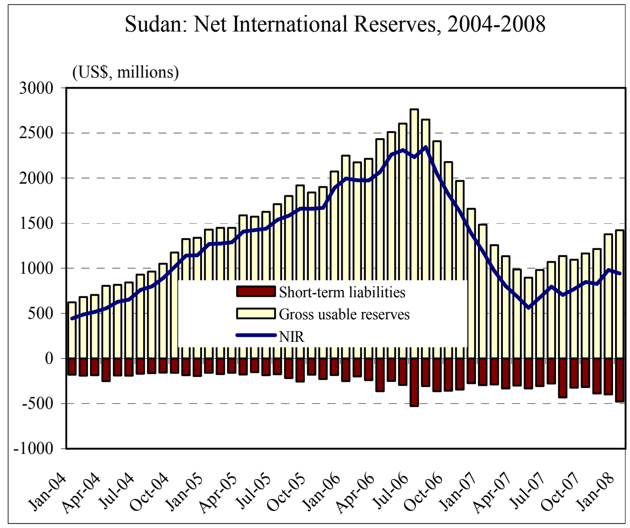
7. **The external current account improved in 2007, due mostly to higher oil receipts.** Oil exports rose by 54 percent in volume terms and by 66 percent in dollar terms (reflecting the surge in oil prices in the last five months of the year). Non-oil exports remained weak. Imports registered the smallest increase in five years—with a significant slowdown in machinery, transport equipment, and crude materials. The overall current account deficit (on a cash basis) was 11.0 percent of GDP for 2007, compared with 13.5 percent in 2006. Notably, however, inflows of foreign exchange registered a sharp drop—due mainly to lower foreign direct investment and net private current transfers. Net FDI fell by some US$500 million, while net private transfers (mainly remittances) fell by close to US$800 million compared with 2006.

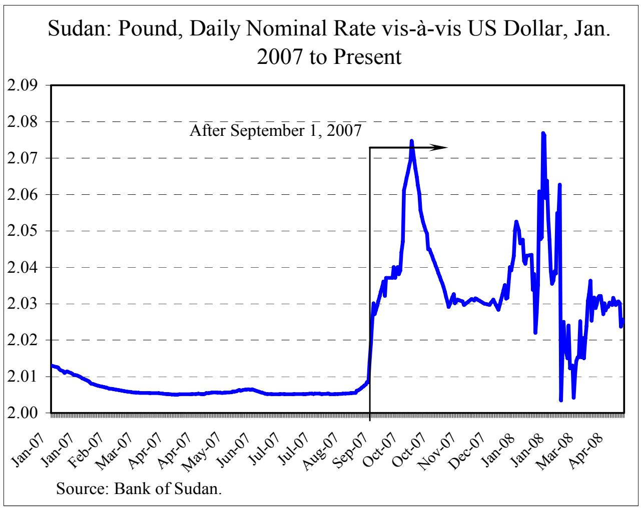
[2] A significant portion of government arrears (about 60 percent) were to private contractors. The inability of the government to make cash payment of these obligations led to private contractors being unable to repay loans from commercial banks—engendering a rapid rise in NPLs. To deal with this rise in problem assets, banks have in turn restricted new lending to focus on repairing their balance sheets.

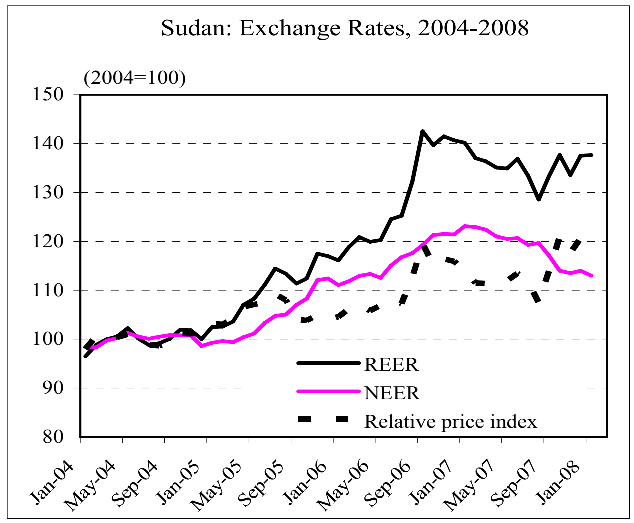
[3] The decline in net remittances is not fully understood, but the drop in FDI is likely due in part to the completion of several major oil infrastructure projects (including a new marine terminal in Port Sudan).

[4] Day-to-day flexibility of the pound has been some 60 times higher since the end of the currency conversion.





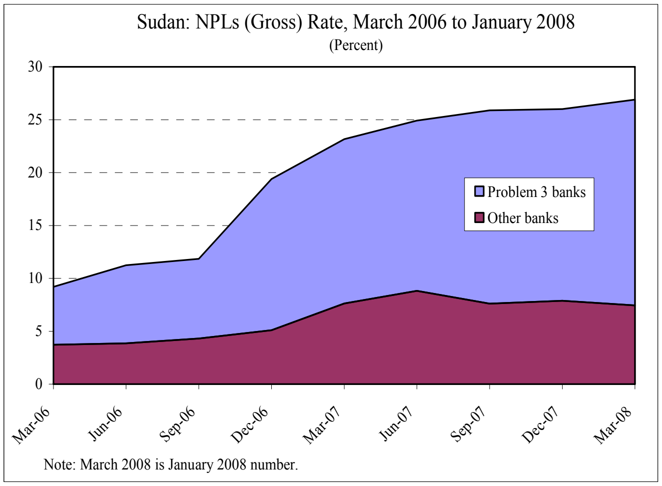


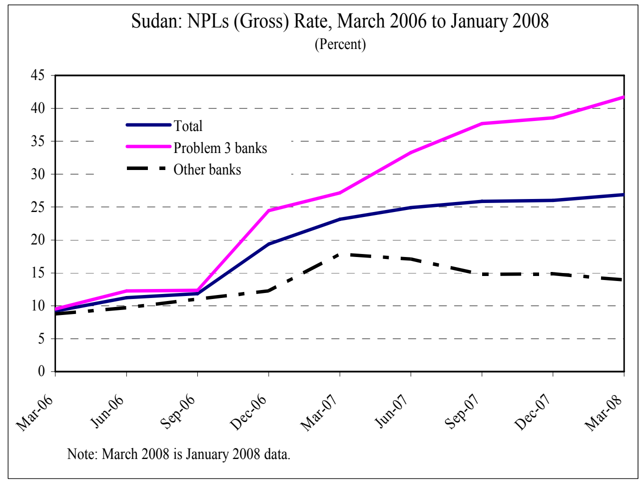


8. **Financial sector indicators show continued vulnerability, but there are some signs of recovery.** Gross nonperforming loans (NPLs) remained high at 26 percent by end-2007 (compared with 19 percent at end-2006), but three problem banks account for more than 70 percent of these problem assets. Together, these three banks have gross NPL ratios in excess of 40 percent. By comparison, the average NPL ratio for the remaining commercial banks declined to less than 15 percent by end-2007.

9. **Performance under the SMP was uneven during July–December 2007**. Three out of the six quantitative targets for end-2007 were missed. On the positive side, the government did meet the targets on domestic financing of the central government, the ceiling on nonconcessional borrowing, and repayments to the Fund (US$50.6 million was repaid in 2007). However, the ceiling on net domestic assets (NDA) of the central bank was not met,

reflecting the need to address a credit crunch that threatened growth prospects.[5] Due to shortfalls in public financial management, the government missed the target for net reduction in domestic arrears. Finally, the central bank was also not able to meet the target for accumulation of net international reserves (NIR).





10. **Performance on structural measures was also mixed**. The 2008 budget was prepared using the GFSM 2001 framework[6]—which should facilitate an improvement in transparency and timely monitoring of arrears. Bold steps were taken to rein in tax exemptions, widen the tax base, and improve tax administration (see MEFP, ¶9). Of particular note were decisions by the government to amend the Investment Encouragement Act and completely halt the granting of new tax holidays under it, impose a 3 percent net profit tax on exempt corporations, and adopt self-assessment by large corporate taxpayers. However, several key public financial management reforms (such as establishment of a centralized debt unit and commitment controls to limit expenditures by budget units) were delayed. An independent audit of Omdurman Bank—which was to begin by end-2007 as a first step toward restructuring/resolution of the bank—was also delayed.

IV. Policy Discussions and Outlook for 2008

11. **The discussions focused on corrective actions to achieve the main objectives of the program**. In particular, the discussions centered on (i) implementation of delayed structural measures to bolster public financial management, enhance transparency, and address weakness in the financial sector—which were set as prior actions to conclude the assessment; (ii) a revised macroeconomic program based on significantly higher international

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[5] Specifically, the central bank purchased securities from banks (in line with staff's recommendations) and increased deposits with selected commercial banks.

[6] Starting January 2008, government expenditures are recorded on a payment-due basis.

oil prices than those envisaged when the 2008 budget was formulated; and (iii) how to use the additional oil revenues to reduce the stock of government arrears accumulated in 2007.

12. **The economic outlook for 2008 envisages a resumption of non-oil growth to levels seen before the fiscal and financial difficulties of late 2006-early 2007**. Overall real GDP growth is forecast at 8.3 percent—encompassing 4.4 percent real growth in the oil sector and 8.9 percent growth in the non-oil sector. The resumption of strong activity in the non-oil sector hinges upon the repayment of domestic government arrears, and a related pick-up in private sector credit. The external current account is expected to improve, reflecting increased oil exports, but the overall balance of payments will also depend on developments in private transfers and FDI, which fell sharply in 2007. Conservative assumptions in this regard suggest room to rebuild net international reserves of the central bank to at least US$1.5 billion. Inflation is expected to increase in light of the projected rise in international commodity prices, but to remain within single digits for the year as a whole.

Sudan: Selected Economic Indicators
(In percent of GDP, unless otherwise indicated)

	2005	2006	2007	2008 Prog.
Production and prices				
Real GDP Growth (in percent)	6.3	11.3	10.2	8.3
Oil	-0.2	26.5	33.0	4.4
Non-Oil	7.0	9.7	7.5	8.9
Consumer prices (average, in percent)	8.5	7.2	8.0	9.5
Broad money growth (in percent)	44.7	27.4	10.3	25.2
Government accounts				
Revenue	21.7	20.0	19.9	22.2
Expenditure	23.4	24.3	23.0	25.1
Balance of the central government 1/	-1.8	-4.3	-3.1	-2.9
External sector				
External current account balance 1/	-8.5	-13.5	-11.0	-7.2
Foreign direct investment	8.6	9.7	6.6	5.7
Net international reserves (in months of imports)	2.4	1.6	1.0	1.4

Sources: Sudanese authorities; and Fund staff estimates.
1/ Cash basis.

Fiscal policy and reforms

13. **The official 2008 budget envisaged an overall fiscal deficit (cash and commitment) of 3.4 percent of GDP**. It did not anticipate cash payment of domestic arrears accumulated in 2007, but rather a rescheduling of payments to 2009–10.

14. **The surge in international oil prices that followed formulation of the budget provides an important opportunity to reduce domestic arrears**. Given the volatility of oil production and of the government's share during the past two years, the authorities and the mission agreed that the new baseline should keep these assumptions unchanged relative to the budget. However, in light of higher international oil prices, total oil revenues are now projected to be higher-than-budgeted by about 3.3 percent of GDP.

15. **The 2008 program envisages reducing the stock of domestic arrears by nearly one-half**. Not all of the additional oil revenues, however, can be used to reduce the stock of domestic arrears. The wealth sharing protocol embodied in the CPA and Sudan's federal fiscal structure require that a significant portion (1.7 percent of GDP) of this additional oil revenue must be automatically transferred to the states (if not saved in the Oil Revenue Stabilization Account—ORSA). Additionally, the rise in international prices implies an increase in the domestic fuel subsidy (of 0.6 percent of GDP), which the authorities preferred not to adjust given the upward pressure this would put on inflation. After allowing for the above, usable oil revenues—above what was programmed—would amount to the equivalent of around one percent of GDP. Use of these resources would permit about 40 percent of the outstanding stock of arrears to be paid off in 2008. Notably, this process has already begun with some SDG337 in domestic arrears repayments by early April. It is intended that the remainder of the outstanding arrears would be cleared in 2009. The authorities agreed to further reduce arrears and/or bolster the ORSA in 2008 if oil revenues exceed the revised program levels (see MEFP, ¶21).

Sudan: Fiscal Adjustment Under the SMP, 2008
(In percent of GDP)

	Budget	Staff prop	Change
Revenues	18.7	22.2	3.5
of which: Tax	6.3	6.5	0.2
Oil	10.6	13.9	3.3
Expenditures	22.1	25.1	3.0
of which: Arrears clearance	0	1.0	1.0
Goods and services	2.5	2.4	-0.1
Fuel subsidy	1.0	1.6	0.6
Other current	0.6	0.5	-0.1
Transfers	8.3	10.0	1.7
Capital expenditures	3.2	3.1	-0.1
Overall cash balance	-3.4	-2.9	0.5

16. **The fiscal program[7] entailed additional adjustments of 0.5 percent of GDP relative to the budget**. Most of the adjustment (0.3 percent of GDP) is to come from cuts in nonpriority current and capital expenditures. The remainder is expected from higher-than-budgeted tax revenues—based on the promising first quarter collection and recent reforms to tax administration (reorganization of the tax chamber and introduction of self-assessment). The willingness of the authorities to undertake additional adjustment is indicative of their commitment to reestablish fiscal credibility and macroeconomic stability. Overall, the 2008 fiscal deficit on a commitment basis is programmed at 2.0 percent of GDP (2.9 percent on a cash basis), reflecting a reduction in the deficit by 3.4 percent of GDP relative to the 2007 outturn (see MEFP, ¶19).

[7] There are several presentational differences between the figures presented in the staff report (IMF format) and the figures presented in the MEFP (the authorities' format). On tax revenues, the IMF format excludes from VAT revenues the VAT transfers to states; on oil revenues, the IMF format includes both ORSA accumulation and a different calculation of the fuel subsidy; on expenditures, the IMF format includes a different fuel subsidy calculation, but excludes VAT transfers to states; on the overall deficit, the IMF presentation includes ORSA accumulation as a deficit-reducing item (i.e., part of government revenues).

17. **Strong fiscal reforms are envisaged under the program**. In addition to repaying a substantial portion of the arrears accumulated in 2007, there was broad agreement on the need to stem the flow of new arrears in 2008. To this end, the authorities recently implemented measures to bolster public financial management and improve transparency. These include implementing commitment controls that limit expenditures by budget units to quarterly cash plans,[8] starting a centralized domestic debt unit to track the stock of domestic debt and arrears, and providing the Fund a summary of the 2004 and 2005 financial audits of Sudapet (see MEFP, ¶18).[9] Going forward, the authorities intend to further increase revenue collection and improve transparency by preparing a risk-based audit strategy, introducing taxpayer identification numbers, and aligning the budget preparation and execution of several government entities with the GFSM 2001 classification (see MEFP, ¶20).

Monetary and exchange rate policies

18. **The monetary program aims to contain inflation while allowing sufficient liquidity to the private sector**. It targets reserve and broad money growth of 18 and 25 percent, respectively, which will allow private sector credit to recover to about 36 percent (higher than 2007 but well below growth rates seen in 2004–06) (see MEFP, ¶16). The authorities expressed concern regarding tight liquidity conditions and the need to respond if progress on domestic arrears clearance is slow. At the same time, they recognized the risk to inflation should liquidity expand more rapidly than envisaged. In this context, they emphasized that their approach to liquidity injections would continue to be selective (targeting those banks in a condition to lend), and that they would monitor inflation developments closely. If necessary, the monetary targets will be reevaluated during the next review in September. The authorities also reaffirmed their commitment to a managed float exchange rate regime, but highlighted the need to minimize unwarranted volatility—particularly given the strong pass-through to inflation (see MEFP, ¶17).

Financial sector reforms

19. **Reforms to restructure and strengthen the banking system are ongoing and concrete progress is expected on restructuring the three problem banks**. The independent audit of Omdurman Bank has started—this is a necessary first step to formulate a strategy for its restructuring and/or privatization. The second problem bank has recently taken steps to merge with a strategic partner, which should entail additional new capital to absorb the bank's problem assets. Finally, the third problem bank is to submit a time-bound action plan to accumulate sufficient provisions to reduce net nonperforming loans and to raise its capital adequacy ratio to meet existing prudential standards (see MEFP, ¶23).

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[8] A cash release committee, chaired by the Undersecretary of the MOFNE, has begun regular meetings at the beginning of each month to set commitment ceilings for budget units based on a rolling quarterly cash plan.

[9] Due to legal constraints, it was not possible to provide the full audit results of Sudapet for 2004-05, but a summary of these audits were provided to Fund staff.

External debt issues

20. **Considerable success was achieved in 2007 in negotiating better terms for external borrowing**. The concessionality of new borrowing in 2007 increased while nonconcessional borrowing dropped. More recently, however, the level of nonconcessional borrowing has increased. In the first quarter of 2008, the government contracted US$522 million in nonconcessional debt—including new asset-backed debt instruments to raise additional capital for oil-related infrastructure investment.[10] The authorities acknowledged concerns with respect to nonconcessional borrowing, and reiterated their commitment to keeping such borrowing below the program ceiling. However, they also emphasized Sudan's limited access to concessional borrowing and the need for external financing for important peace-related infrastructure, development, and reconstruction projects if progress is to be made on building peace and reducing poverty.

Sudan: Contracting of External Loans, 2006-08
(US$ million)

	2006	2007	2008 (Q1)
Concessional	56	194	58
of which: bilateral	0	124	0
non-bilateral \1	56	70	58
Nonconcessional	589	145	522
of which: bilateral	589	0	0
non-bilateral \1	0	145	522
of which: Islamic bonds	0	0	100
Weighted average grant element	14%	30%	27%

Source: Sudanese authorities.
1\ Includes regional development funds (Saudi Fund, Kuwait Fund, Arab Fund for Economic and Social Development, and OPEC).

V. Staff Appraisal

21. **The past year has brought both opportunities and challenges**. Higher oil prices and production following disruptions in early 2007 have raised government revenues and contributed to strong growth performance. At the same time, like other countries in the region, Sudan suffered some of the worst floods in decades. Moreover, there continues to be challenges associated with implementing the various peace agreements, disarmament, and fiscal decentralization.

22. **Performance under the SMP has been uneven thus far**. On the upside, bold actions were taken to rein in tax exemptions, widen the tax base, and implementing the GFSM 2001 framework to improve transparency and the timely monitoring of domestic arrears. On the downside, structural benchmarks related to public financial management reforms were delayed or not fully implemented, contributing to a sizeable accumulation of domestic arrears.

[10] These are Islamic bonds (salam sukuk); 3-year instruments backed by future sales of oil at a guaranteed minimum price (equivalent to a minimum return of 9 percent per annum). These instruments are non-concessional.

23. **The recent implementation of key reforms is a strong signal of the authorities' commitment to the SMP**. In particular, the effective establishment of a centralized debt unit and the implementation of expenditure commitment controls (which limit spending by budget units to quarterly cash plans should help stem the flow of new domestic arrears. Moreover, an independent audit of Omdurman Bank has started, a necessary first step to its restructuring and to restoring credibility of the financial system. In light of recent experience, it will be critical that these measures be fully implemented.

24. **The 2008 program rightly focuses on fiscal consolidation and reducing the stock of domestic arrears**. Staff welcomes the authorities' intention to clear nearly half of the stock of domestic arrears. Such a reduction is critical to restoring fiscal and financial credibility and enhancing growth prospects. It would have been preferable to reduce arrears even further in 2008. However, this will not be possible under Sudan's fiscal system, which requires that most of the higher-than-budgeted oil revenues be transferred to the states, in line with Sudan's wealth-sharing agreements. Nevertheless, it will be critical for the government to resist the pressures for additional discretionary spending (a temptation typically associated with higher oil revenues) and to closely coordinate policies with the central bank to prevent the repayments of domestic arrears from creating too much domestic liquidity.

25. **The conduct of monetary policy will likely be more challenging with international commodity prices on the rise**. There are competing policy objectives. On the one hand, sustained non-oil economic growth will require sufficient liquidity in the banking system to allow for a further recovery of credit to the private sector. On the other hand, rising inflationary pressures will need to be contained to preserve macroeconomic stability. Accordingly, and given the significant increase in current spending (via transfers to states) tied to arrears clearance, it will be important to closely monitor price developments, improve coordination between the central bank and the finance ministry on the timing of arrears clearance, and, if necessary, adjust the monetary targets. Greater exchange rate flexibility would help buffer the economy from external shocks and further rebuild foreign exchange reserves.

26. **Fiscal reforms are needed to improve the revenue base**. Sudan's pressing development needs will require greater efforts to increase government revenues to finance infrastructure and pro-poor spending. Important measures were recently adopted, and staff welcomes the emphasis in the 2008 program on increasing revenues and improving transparency. The decision to abolish tax holidays, in particular, reflects a significant achievement by the authorities. If momentum in this direction can be sustained, there is the potential for much-needed increases in tax revenues going forward. However, more needs to be done over the medium term to address the erosion of fiscal space that has accompanied the rise in transfers to the states and the decline in revenue collection at the local and state levels of the past few years. Of particular importance in this context will be additional work on fiscal federalism and further reforms to personal income tax.

27. **Sustaining growth will require strengthening the banking sector**. With the exception of three banks, most commercial banks have made steady progress in reducing their stock of nonperforming loans and strengthening their balance sheet. This process should accelerate as the government moves to address overdue payment obligations. Staff welcomes

the progress being made in addressing problems with the remaining banks, particularly Omdurman Bank given its size and importance. It also urges the authorities to move forward with its restructuring, based on the results of an independent audit.

28. **The level of nonconcessional borrowing needs to be carefully monitored**. Nonconcessional borrowing dropped noticeably in 2007, but has picked up sharply in 2008. Most of the recent nonconcessional borrowing is from developmental institutions, except for the recent issuance of US$100 million of Islamic bonds. 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 the process of securing creditors' participation in a potential debt-relief operation.

29. **The staff believes that 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 reform momentum. It contains important actions to restore fiscal discipline and promote financial sector development. It also provides a framework within which donors can support the peace process and afflicted areas.

30. **Sudan's economic prospects are good, but important risks remain**. The main risk continues to be a weakening of political resolve to maintain macroeconomic stability, particularly in the context of the forthcoming elections. Downside risks to fiscal performance also remain given the constraints of flood-related spending and the numerous peace-related commitments (including the census). Moreover, the rise in world food prices poses a particular challenge to containing inflation, requiring cautious implementation of monetary and fiscal policies.

Table 1. Sudan: Selected Economic and Financial Indicators, 2004–08

	2004	2005	2006	2007		2008
				Prog.	Prel.	Proj.
	(Annual changes in percent, unless otherwise indicated)					
Production, population, and prices						
Nominal GDP (in millions of Sudanese pounds, at market prices)	55,925	66,714	79,046	93,726	93,200	116,887
Nominal GDP (in millions of U.S. dollars)	21,685	27,386	36,401	46,708	46,228	58,443
Oil production (average, in thousands of barrels per day)	288	287	364	505	484	505
Population (in millions)	34.5	35.3	36.2	...	37.2	38.1
GNP per capita (in U.S. dollars)	597	738	941	1,182	1,139	1,390
Real GDP	5.1	6.3	11.3	11.2	10.2	8.3
Oil	9.9	-0.2	26.5	38.8	33.0	4.4
Non-oil	4.6	7.0	9.7	8.1	7.5	8.9
Consumer prices (average)	8.4	8.5	7.2	8.0	8.0	9.5
Consumer prices (end of period)	7.3	5.6	15.7	7.0	8.8	8.0
	(In percent of GDP)					
Investment and saving						
Gross investment	22.5	23.7	24.8	24.1	24.2	23.6
Government 1/	5.0	5.5	6.4	7.1	7.2	7.4
Nongovernment	17.5	18.2	18.4	17.0	17.0	16.2
Gross national saving	18.7	15.2	11.4	14.7	13.3	16.4
Government	6.5	3.7	2.1	3.2	4.2	2.7
Nongovernment	12.3	11.5	9.3	11.5	9.1	13.7
Central government operations 2/						
Total revenue	19.7	21.7	20.0	18.7	19.9	22.2
Total expenditure	18.2	23.4	24.3	22.5	23.0	25.1
Overall balance	1.5	-1.8	-4.3	-3.8	-3.1	-2.9
Non-oil balance	-8.3	-15.7	-16.5	-14.5	-16.4	-20.0
Money and credit						
Broad money (change in percent)	32.1	44.7	27.4	24.0	10.3	25.2
Reserve money (change in percent)	27.8	34.9	27.8	18.0	12.8	18.2
Velocity (ratio of non-oil nominal GDP to average broad money)	5.7	4.7	3.9	4.2	4.2	4.2
	(In millions of U.S. dollars; unless otherwise indicated)					
External sector						
Exports, f.o.b.	3,778	4,878	5,813	7,567	8,902	12,718
Of which: oil	3,101	4,240	5,244	7,014	8,443	12,174
Imports, f.o.b.	3,586	5,946	7,105	7,518	7,722	9,413
Non-oil export volume (change in percent)	7.8	-12.4	-13.2	-3.4	-36.9	2.2
Non-oil import volume (change in percent)	32.9	54.0	15.8	5.6	14.4	11.1
Current account balance (cash basis, percent of GDP)	-3.8	-8.5	-13.5	-9.3	-11.0	-7.2
Terms of trade (Index 1993=100, change in percent)	20.3	25.1	5.5	-13.2	0.8	26.2
Pounds per U.S. dollar (period average)	2.58	2.44	2.17	2.00	2.02	...
Real effective exchange rate (change in percent) 3/	2.4	16.9	20.4	...	-2.3	...
External debt (in billions of U.S. dollars) 3/	23.3	26.7	26.6	28.0	28.0	29.9
External debt (percent of GDP)	107.6	97.3	73.0	60.0	60.6	51.1
Debt service ratio (commitment basis) 4/	26.0	20.9	16.9	14.3	10.2	8.6
Debt service ratio (cash payments) 4/	9.0	6.3	5.8	5.7	2.4	3.7
Net international reserves (in millions of U.S. dollars) 3/	1,144	1,889	1,384	1,300	981	1,500
In months of next year's imports	1.9	2.4	1.6	1.4	1.0	1.4
Sudan's crude oil export price (U.S. dollars per barrel) 5/	36.2	49.7	54.4	46.8	56.3	77.0

Sources: Sudanese authorities; and Fund staff estimates.

1/ Includes estimated capital spending by state governments.
2/ Cash basis.
3/ End of period. REER is based on December 2007 data.
4/ As a share of exports of goods and services.
5/ Average of Sudanese blends. Since 2006, the price reflects the introduction of a new crude (Dar blend) that trades at a substantial discount because of its low quality.

Table 2. Sudan: Central Government Operations, 2004-08

	2004	2005	2006	2007		2008	
				Prog. SMP	Year Prel.	Auth. Budget	IMF prop 6/
	(in millions of Sudanese pounds)						
Total revenue and grants	11,045	14,729	15,792	17,488	18,555	21,854	25,924
Tax revenue	4,205	4,721	5,099	5,780	5,777	7,361	7,591
Direct taxes	747	922	952	1,093	1,097	1,146	1,376
Indirect taxes	3,458	3,799	4,147	4,687	4,680	6,216	6,216
Taxes on international trade	1,589	2,018	2,120	2,247	2,189	2,079	2,079
Excise duties	1,137	915	1,036	1,100	1,162	1,849	1,849
VAT 1/	732	866	991	1,340	1,329	2,288	2,288
Nontax revenue	6,840	10,008	10,332	11,149	12,256	13,661	17,501
Oil revenue 2/	5,793	9,010	8,794	9,130	10,893	12,408	16,249
Other 3/	1,047	997	1,538	2,019	1,363	1,252	1,252
Grants			361	560	522	832	832
Total expenditure	10,195	15,939	19,231	21,074	21,414	25,885	29,360
Current expenditure	7,625	13,827	15,846	17,678	17,612	22,137	25,738
Chapter one (wages and salaries)	2,738	3,011	3,945	5,208	4,901	6,050	6,050
Chapter two (other current spending)	4,046	6,510	6,143	4,833	5,352	6,352	8,030
Debt service (interest and profits)	811	862	930	965	897	1,469	1,469
Domestic arrears repayment	339	524	221	380	419	0	1,156
Goods and services 4/	710	724	930	974	1,127	2,922	2,795
General reserves (including section 3) 4/	1,443	1,233	1,254	1,088	938	0	0
Other	1,081	3,691	2,808	1,426	1,971	1,961	2,609
Of which: Fuel subsidy	...	2,375	1,777	300	892	1,150	1,925
Chapter three (transfers to subnational governments)	842	4,307	5,758	7,637	7,359	9,735	11,659
Transfers to GOSS and oil producing states	240	1,909	2,957	2,897	3,352	3,952	5,540
Transfers to Northern states 1/	602	2,398	2,800	4,740	4,008	5,783	6,119
Net acquisition of NFA (capital expenditure)	2,772	2,276	3,118	3,396	3,801	3,748	3,622
Locally financed (net of disposal)	2,275	1,781	2,324	2,326	2,625	2,247	2,120
Foreign financed	497	495	794	1,070	1,177	1,501	1,501
Overall balance (cash basis)	850	-1,211	-3,438	-3,585	-2,859	-4,032	-3,436
Financing	-850	1,211	3,438	3,585	2,859	4,032	3,436
Foreign financing	52	115	223	525	932	1,090	1,090
Disbursement	497	554	606	1,010	1,210	1,814	1,814
Repayment	445	439	383	485	277	724	724
Domestic financing	-902	1,096	3,216	3,060	1,926	2,942	2,346
Central bank	-859	446	1,313	950	550	570	370
Of which: Oil Savings Accounts (OSA)		-646	630	0	-32	-664	-664
Commercial banks	90	298	838	850	170	682	482
Nonbank 5/	-133	349	961	1,060	985	1,855	1,659
Privatization (net of acquisition of shares)		3	103	200	221	-165	-165
Memorandum items:							
Non-oil balance - cash basis	-4,084	-8,727	-10,994	-11,675	-12,673	-15,272	-18,517
Non-oil cash balance - excluding transfers to the South	-3,844	-6,818	-8,036	-8,778	-9,322	-11,320	-12,977
Gross domestic arrears accumulation				0	2,612	0	0
Net domestic arrears accumulation				-380	2,193	0	-1,156
Overall balance - commitment basis				*-3,205*	*-5,052*	*-4,032*	*-2,280*
Non-oil commitment balance				*-11,295*	*-14,866*	*-15,272*	*-17,361*
Non-oil commitment balance - excluding oil-related transfers to the South				*-8,398*	*-11,515*	*-11,320*	*-11,821*

Table 2 (concluded). Sudan: Central Government Operations, 2004-08

	2004	2005	2006	2007		2008	
				Prog. SMP	Year Prel.	Auth. Budget	IMF prop 6/
				(In percent of GDP)			
Total revenue and grants	19.7	21.7	20.0	18.7	19.9	18.7	22.2
Tax revenue	7.5	6.9	6.5	6.2	6.2	6.3	6.5
Direct taxes	1.3	1.4	1.2	1.2	1.2	1.0	1.2
Indirect taxes	6.2	5.6	5.2	5.0	5.0	5.3	5.3
Taxes on international trade	2.8	3.0	2.7	2.4	2.3	1.8	1.8
Excise duties	2.0	1.3	1.3	1.2	1.2	1.6	1.6
VAT 1/	1.3	1.3	1.3	1.4	1.4	2.0	2.0
Nontax revenue	12.2	14.7	13.1	11.9	13.2	11.7	15.0
Oil revenue	10.4	13.3	11.1	9.7	11.7	10.6	13.9
Sales to domestic refineries	1.8	4.3	4.3	2.8	3.5	3.1	3.7
Export revenues	8.5	8.9	6.8	6.9	8.2	7.5	10.2
Other	1.9	1.5	1.9	2.2	1.5	1.1	1.1
Grants	...	...	0.5	0.6	0.6	0.7	0.7
Total expenditure	18.2	23.4	24.3	22.5	23.0	22.1	25.1
Current expenditure	13.6	20.3	20.0	18.9	18.9	18.9	22.0
Chapter one (wages and salaries)	4.9	4.4	5.0	5.6	5.3	5.2	5.2
Chapter two (other current spending)	7.2	9.6	7.8	5.2	5.7	5.4	6.9
Debt service (interest and profits)	1.5	1.3	1.2	1.0	1.0	1.3	1.3
Domestic arrears repayment	...	0.0	0.3	0.4	0.4	0	1.0
Goods and services 4/	1.3	1.1	1.2	1.0	1.2	2.5	2.4
General reserves (including section 3) 4/	2.6	1.8	1.6	1.2	1.0	0	0
Other	1.9	5.4	3.6	1.5	2.1	1.7	2.2
Of which: Fuel subsidy	...	3.5	2.2	0.3	1.0	1.0	1.6
Chapter three (transfers to subnational governments)	1.5	6.3	7.3	8.1	7.9	8.3	10.0
Transfers to GOSS and oil producing states	0.4	2.8	3.7	3.1	3.6	3.4	4.7
Transfers to Northern states	1.1	3.5	3.5	5.1	4.3	4.9	5.2
Net acquisition of NFA (capital expenditure)	5.0	3.3	3.9	3.6	4.1	3.2	3.1
Locally financed (net of disposal)	4.1	2.6	2.9	2.5	2.8	1.9	1.8
Foreign financed	0.9	0.7	1.0	1.1	1.3	1.3	1.3
Overall balance (cash basis)	1.5	-1.8	-4.3	-3.8	-3.1	-3.4	-2.9
Financing	-1.5	1.8	4.3	3.8	3.1	3.4	2.9
Foreign financing	0.1	0.2	0.3	0.6	1.0	0.9	0.9
Disbursement	0.0	0.0	0.8	1.1	1.3	1.6	1.6
Repayment	0.0	0.0	0.5	0.5	0.3	0.6	0.6
Domestic financing	-1.6	1.6	4.1	3.3	2.1	2.5	2.0
Central bank	-1.5	0.7	1.7	1.0	0.6	0.5	0.3
Of which: Oil Savings Accounts (OSA)	0.0	-0.9	0.8	0.0	0.0	-0.6	-0.6
Commercial banks	0.2	0.4	1.1	0.9	0.2	0.6	0.4
Nonbank 5/	-0.2	0.5	1.2	1.1	1.1	1.6	1.4
Privatization (net of acquisition of shares)	0.0	0.0	0.1	0.2	0.2	-0.1	-0.1
Memorandum items (in percent of GDP unless stated otherwise)							
Tax revenue (in percent of non-oil GDP)	8.6	8.1	7.7	7.2	7.5	7.9	8.2
Non-oil revenue excluding grants (in percent on non-oil GDP)	10.7	9.8	10.0	9.7	9.3	9.3	9.5
Transfers (in percent of GNU expenditures)	8.3	27.0	29.9	36.2	34.4	37.6	39.7
Non-oil cash balance (in percent of non-oil GDP)	-8.3	-15.3	-16.5	-14.5	-16.4	-16.5	-20.0
Non-oil cash balance excluding transfers to South (% of non-oil GDP)	-7.8	-12.0	-12.1	-10.9	-12.1	-12.2	-14.0
Gross domestic arrears accumulation				0	2.8	0	0
Net domestic arrears accumulation				-0.4	2.4	0	-1.0
Overall balance - commitment basis				*-3.4*	*-5.4*	*-3.4*	*-2.0*
Non-oil commitment balance (in percent of non-oil GDP)				*-14.0*	*-19.3*	*-16.5*	*-18.7*
Non-oil commitment balance excluding transfers to South (% of non-oil GDP)				*-10.4*	*-14.9*	*-12.2*	*-12.8*
Nominal non-oil GDP (in millions of Sudanese pounds)	49,143	56,862	66,575	80,563	77,140	92,631	92,631
Nominal GDP (in millions of Sudanese pounds)	55,925	67,976	79,046	93,726	93,200	116,887	116,887

1/ Excluding VAT transfers to Northern states.
2/ Valued at international prices.
3/ Includes departmental fees, public enterprise profts and revenues from government joint ventures.
4/ In 2008, general reserves were shifted under goods and services.
5/ Includes letters of guarantee and standing orders, net issuance of GMCs and GICs to nonbank sector, and sanadat issued to finance the deficit (i.e. net of those issued to securitize arrears). Also subsumes statistical discrepancy for 2007.
6/ Oil revenue asumptions are based on an international price of $88.5/bbl for Nile blend, and $69.5/bbl for Dar Blend. Production and government share remain as projected in the government's budget. OSA balances in excess of SDG 664 million are assumed to be spent on arrears clearance (after netting out the mandatory intergovernmental transfers).

Table 3. Sudan: Monetary Authorities' Accounts, 2005-08

	2005	2006	2007				2008		
	Dec.	Dec.	Jun.	Sep.	Dec.		Mar.	Jun.	Dec.
	Act.	Act.	Act.	Act.	Prog.	Prel.	Proj.	Proj.	Proj.
Net foreign assets	-2,190	-3,147	-4,269	-4,584	-3,364	-4,097	-3,847	-3,556	-2,984
Foreign assets	5,804	4,298	2,959	3,001	4,272	3,552	3,723	3,971	4,458
International reserves	4,355	3,342	1,970	2,232	3,392	2,828	2,999	3,247	3,734
Other assets	1,450	956	989	769	880	724	724	724	724
Foreign liabilities	7,995	7,445	7,228	7,585	7,636	7,650	7,569	7,527	7,442
Short-term liabilities	423	556	612	663	791	814	779	764	734
Medium- and long-term liabilities	7,571	6,889	6,617	6,922	6,844	6,835	6,791	6,763	6,708
Counterpart to valuation changes	7,569	7,241	7,076	7,319	7,178	7,512	7,190	7,190	7,190
Net domestic assets	739	3,722	4,317	4,958	5,411	5,399	5,615	5,751	6,214
Net domestic credit	198	3,069	3,235	3,460	4,676	4,365	4,547	4,700	5,254
Net claims on central government	418	1,731	1,646	1,879	3,231	2,596	2,751	2,855	3,051
Claims	1,537	1,991	2,378	2,710	3,491	2,680	3,000	3,268	3,800
Temporary advances	275	590	589	583	315	592	730	868	1,145
Government securities	210	348	462	799	1,848	761	942	1,072	1,328
of which: Purchased from DMB since June 2007	…	…	96	353	550	315	400	400	400
Long-term claims	1,053	1,053	1,328	1,328	1,328	1,328	1,328	1,328	1,328
Deposits	1,120	260	732	831	260	84	249	413	748
Of which: Oil Savings Account 1/	644	14	124	156	140	46	211	375	710
Net claims on government of the South	-631	-133	-99	0	0	-3	-3	-3	-3
Net claims on public enterprises	198	301	311	311	296	295	308	322	348
Net claims on banks	350	1,038	1,257	1,268	1,069	1,361	1,404	1,435	1,756
Money market instruments (net)	-135	132	120	2	80	116	86	91	102
Other items (net)	540	653	1,083	1,498	736	1,034	1,068	1,051	960
Reserve money	6,117	7,816	7,124	7,693	9,226	8,813	8,958	9,385	10,420
Currency outside banks	3,740	5,355	4,442	4,575	6,094	5,640	5,868	6,390	7,064
Reserves of commercial banks	1,889	2,059	1,981	2,508	2,507	2,836	2,752	2,657	3,019
Required reserves	777	862	769	785	1,010	792	825	900	998
Excess reserves	1,112	1,196	1,211	1,723	1,497	2,044	1,927	1,758	2,021
Deposits at CBOS included in broad money	488	402	701	611	624	338	338	338	338
Memorandum item:									
Central bank credit to government (cumulative change)	446	1,313	-180	-205	950	550	70	174	370

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, 2005–08

	2005	2006	2007		2008		
	Dec.	Dec.	Dec.		Mar.	Jun.	Dec.
	Act.	Act.	Prog.	Prel.	Proj.	Proj.	Proj.
Net foreign assets	-579	-1,844	-2,256	-2,574	-2,348	-2,042	-1,439
Central Bank of Sudan	-2,190	-3,147	-3,364	-4,097	-3,847	-3,556	-2,984
Commercial banks	1,612	1,303	1,108	1,523	1,499	1,514	1,544
Counterpart to valuation changes	7,633	7,331	7,250	7,492	7,170	7,170	7,170
Net foreign assets (excluding valuation adjustment)	7,055	5,488	4,994	4,918	4,822	5,128	5,730
Net domestic assets	6,977	12,385	17,167	14,812	15,691	17,208	18,962
Net domestic credit	8,346	14,551	20,926	17,268	18,062	19,377	22,890
Net claims on general government	460	3,110	5,043	3,960	4,150	4,350	4,812
Central Bank of Sudan net claims on central government.	418	1,731	3,231	2,596	2,751	2,855	3,051
of which: Purchased securities from commercial banks since June 2007	…	…	550	315	400	400	400
Central Bank of Sudan net claims on the government of the South	-631	-133	0	-3	-3	-3	-3
Commercial banks claims on central government	674	1,512	1,812	1,367	1,402	1,499	1,763
Net claims on nongovernment sectors	7,887	11,441	15,883	13,308	13,912	15,027	18,078
Other items (net)	-1,370	-2,166	-3,759	-2,456	-2,372	-2,170	-3,928
Broad money	14,031	17,872	22,161	19,715	20,513	22,336	24,693
Currency outside banks	3,740	5,355	6,094	5,640	5,868	6,390	7,064
Deposits	10,291	12,516	16,067	14,075	14,645	15,946	17,629
Demand deposits	7,052	7,433	9,468	8,247	9,293	9,723	10,548
Domestic currency	4,440	5,162	6,706	5,728	6,623	6,615	7,185
Foreign currency	2,612	2,271	2,762	2,520	2,670	3,108	3,362
Quasimoney deposits	3,239	5,083	6,599	5,828	5,352	6,223	7,081
Memorandum items:							
Reserve money (annual percentage change)	34.9	27.8	18.0	12.8	24.0	31.7	18.2
Broad money (annual percentage change)	44.7	27.4	24.0	10.3	16.0	25.0	25.2
Credit to nongovernment sector (annual percentage change)	61.7	45.1	38.8	16.3	18.1	22.1	35.8
Currency to broad money (in percent)	26.7	30.0	27.5	28.6	28.6	28.6	28.6
Foreign currency deposits to total deposits (in percent)	26.6	18.6	17.7	22.6	21.8	21.1	19.6
Broad money multiplier	2.3	2.3	2.4	2.2	2.3	2.4	2.4
Non-oil GDP velocity (average)	4.7	3.9	4.2	4.2	...	...	4.2
Usable international reserves to broad money (in percent)							
Net international reserves (in million of U.S. dollars)	1,889	1,384	1,300	981	1,110	1,242	1,500
Commercial banks net foreign assets (in millions of U.S. dollars)	699	647	554	742	750	757	772
Commercial banks credit to the government (cumulative change)	298	838	850	170	120	217	482

Sources: Sudanese authorities; and Fund staff estimates.

Table 5. Sudan: Balance of Payments, 2004–08

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

	2004	2005	2006	2007 Prel.	2008 Proj.
Current account balance	-1,399	-2,977	-5,489	-5,718	-4,830
Current account balance (on cash basis)	-815	-2,324	-4,903	-5,074	-4,213
Trade balance	192	-1,068	-1,291	1,180	3,306
Exports, f.o.b.	3,778	4,878	5,813	8,902	12,718
Oil exports	3,101	4,240	5,244	8,443	12,174
Non-oil products	677	638	569	460	545
Imports, f.o.b.	-3,586	-5,946	-7,105	-7,722	-9,413
Foodstuffs	-456	-713	-656	-723	-1,239
Petroleum products	-89	-283	-364	-256	0
Machinery and transport equipments	-1,602	-2,747	-3,785	-4,099	-4,972
Manufactured goods	-877	-1,433	-1,444	-1,709	-1,890
Other imports	-562	-770	-855	-935	-1,312
Services (net)	-1,020	-1,641	-2,689	-2,934	-2,897
Receipts	44	114	201	385	573
Payments	-1,064	-1,755	-2,890	-3,319	-3,470
Of which : oil transportation costs	-434	-404	-602	-813	-807
Income (net)	-1,694	-1,989	-2,898	-4,546	-6,057
Receipts	22	44	89	184	198
Non-oil payments	-678	-762	-696	-763	-798
Of which: interest cash payments	-83	-101	-94	-86	-148
Oil-related payments 1/	-1,038	-1,271	-2,292	-3,967	-5,457
Current transfers (net)	1,123	1,721	1,390	582	819
Private transfers	1,095	1,487	1,034	209	343
Public transfers	28	234	356	373	476
Capital account	0	0	0	0	0
Financial account (net)	1,165	2,806	4,257	4,092	4,659
Disbursements	80	309	286	613	939
Amortization	-280	-290	-336	-219	-385
Of which: cash payments (excluding IMF)	-187	-182	-213	-88	-297
Short-term capital flows and other assets (net) 2/	-58	666	767	809	874
Commercial banks NFA (increase -)	-26	-204	52	-95	-30
FDI and portfolio investment (net)	1,481	2,355	3,533	3,036	3,311
Errors and omissions	382	220	30	309	0
Overall balance	149	49	-1,202	-1,317	-170
Financing	-148	-49	1,202	1,317	170
Change in net international reserves (increase -)	-855	-745	505	403	-519
Other foreign reserves (increase -)	30	-23	-30	122	-15
Change in arrears	677	719	726	792	704
Financing gap	0	0	0	0	0
Memorandum items:					
Current account (in percent of GDP)	-6.5	-10.9	-15.1	-12.4	-8.3
Current account, cash basis (in percent of GDP)	-3.8	-8.5	-13.5	-11.0	-7.2
Net international reserves (end-period)	1,144	1,889	1,384	981	1,500
(in months of next years imports)	1.9	2.4	1.6	1.0	1.4
Sudanese crude oil price (U.S. dollars per barrel)	36.2	49.7	54.4	56.3	77.0
Nominal GDP	21,685	27,386	36,401	46,228	58,443

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.

Table 6. Sudan: Medium-Term Macroeconomic Scenario, 2007–13

	2007	2008	2009	2010	2011	2012	2013
	Est.	Projections					
	(Change in percent, unless otherwise indicated)						
Production and prices							
Nominal GDP (in millions of U.S. dollars)	46,228	58,443	66,836	75,387	84,391	93,457	101,072
Real GDP	10.2	8.3	9.7	8.0	7.6	7.1	4.9
Oil	33.0	4.4	18.0	7.9	7.1	5.8	-0.8
Non-oil	7.5	8.9	8.6	8.1	7.6	7.3	5.7
Inflation (period average)	8.0	9.5	6.5	4.5	4.0	4.0	4.0
	(In percent of GDP, unless otherwise indicated)						
Investment and saving							
Gross investment	24.2	23.6	23.8	23.9	24.1	24.2	24.2
Government 1/	7.2	7.4	7.4	7.5	7.5	7.4	7.1
Nongovernment	17.0	16.2	16.4	16.4	16.6	16.8	17.1
Gross national saving	13.3	16.4	17.3	18.2	19.6	20.2	20.1
Government	4.2	2.7	5.1	5.4	5.8	5.6	5.4
Nongovernment	9.1	13.7	12.2	12.8	13.7	14.6	14.7
Central government							
Total revenue	19.9	22.2	22.6	22.7	23.0	23.0	22.4
Of which: Oil revenue 2/	11.7	13.9	14.1	14.0	14.1	13.7	12.6
Non-oil revenue	8.2	8.3	8.6	8.7	9.0	9.3	9.9
Total expenditure	23.0	25.1	25.0	24.8	24.8	24.8	24.2
Overall balance (cash basis)	-3.1	-2.9	-2.3	-2.1	-1.7	-1.8	-1.8
External sector							
External trade balance	2.6	5.7	4.8	5.0	5.7	5.3	4.1
Exports, f.o.b.	19.3	21.8	20.1	19.1	18.9	18.1	16.4
Imports, f.o.b.	16.7	16.1	15.4	14.1	13.2	12.8	12.4
Current account balance on cash basis	-11.0	-7.2	-6.6	-5.7	-4.6	-4.1	-4.1
Net international reserves (in months of imports)	1.0	1.4	1.5	1.6	2.0	2.4	2.5
Non-oil export volume (change in percent)	-36.9	2.2	3.5	1.6	3.5	2.2	2.3
Non-oil import volume (change in percent)	14.4	11.1	9.4	2.7	4.3	6.1	4.3
Terms of trade (change in percent)	0.8	26.2	-5.3	2.2	2.2	-0.4	-0.2
Memorandum item:							
Crude oil export price (U.S. dollars per barrel) 3/	56.3	77.0	72.0	74.3	76.9	77.4	77.3

Sources: Sudanese authorities; and Fund staff estimates and projections.

1/ Includes estimated capital spending by state governments.
2/ Crude oil revenue.
3/ Sudanese oil blends. Projections are based on the latest WEO assumptions.
(based on future prices).

Table 7. Sudan: Quantitative Targets for 2007 and 2008

	2007 1/			2008 1/		
	Dec.			Mar	Jun	Dec.
	Target	Target w/adj.	Prel.	Indic. Target	Target	Target
	(In millions of Sudanese pounds, unless otherwise indicated)					
Central Bank of Sudan net domestic assets (Ceiling) 3/	1,689	599	1,764	215	352	815
Domestic financing of the central government (Ceiling) 3/	3,060	1,973	1,926	127	333	2,346
Reduction in the stock of domestic arrears of the central government (Floor) 1/ 2/ 3/	380		-2,193	0	400	1,156
Net international reserves (in millions of U.S. dollars) (Floor) 3/	-83	458	-403	129	260	519
Contracting or guaranteeing of external nonconcessional debt						
by the government or the central bank (in millions of U.S. dollars) (Ceiling)	700		145	…	…	700
Payments to the Fund (in millions of U.S. dollars) (Floor)	50		51	12.5	25.0	50
Memorandum items:						
Broad money	4,289		1,843	799	2,621	4,978
Reserve money	1,411		998	144	572	1,607
Net central bank claims on government of Southern Sudan	133		129	0	0	0
Government oil export revenues	6,523		7,610	2,969	5,937	11,874
Of which: Net oil savings account (OSA) accumulation	0		32	164	329	664

Sources: Sudanese authorities; and Fund staff estimates.

1/ Cumulative flow during 2007 and 2008.
2/ Any new domestic arrears incurred during January–June should be cleared by end-June, and those incurred during July–December should be cleared by end-December. Arrears are defined as overdue financial obligations of the central government outstanding for 90 days or more.
3/ Subject to an adjustor (asymmetric) to take account of oil production and/or prices being more than assumed in the program.

Table 8. Status of 2007 Structural Measures Under the SMP

Measures Under the SMP	Objective	Timing 1	Status
1. Ministry of Finance to issue a decree establishing that line ministries cannot undertake commitments without permission of Ministry of Finance.	Expenditure control	July 15, 2007	Met
2a. Provide to Fund staff the stock of domestic debt, including arrears, at end-2006, by type of instrument (loans from BOS, GICs, GMCs, standing orders, guarantees, development sanadats, and securitized arrears (debt extinction sanadats)).	Stop build-up of public debt	June 26, 2007	Met
2b. Establish a centralized domestic debt unit that will compile and monitor on a monthly basis the stock of domestic debt by debt instrument, and on a quarterly basis the stock of domestic arrears (payments due for over 3 months) by debt instrument and provide on a quarterly basis accounting data on expenditure committed and expenditure paid, by main budgetary items and chapters.	Stop build-up of public debt	July 1, 2007	Met pro forma, but was not operational.
3a. Establish a zero-balance Treasury Single Account in line with recommendations of the FAD Public Financial Management mission of October 2006.	Expenditure control	August 15, 2007	Met except for zero balance aspect--due to problems with existing software.
3b. Implement commitment controls that limit expenditures by line ministries to monthly or quarterly cash plans, which reflect likely cash availability rather than budgeted allocations.	Expenditure control	September 1, 2007	Not met
4. Adopt for the 2008 budget the full economic and functional classifications of the GFSM 2001.	Improve budget execution	December 2007	Met
5. Reduce VAT exemptions granted by ministerial decree to achieve an additional SD 15-20 billion in revenue on an annual basis.	Broaden tax base and raise revenue	December 2007	Not met. However, numerous income tax exemptions were eliminated in the 2008 budget.
6. Continue to suspend the granting of any new VAT or income tax exemptions by the Ministry of Finance.	Raise revenue	Continuous	Met
7a. Ministry of Finance to prepare a program to progressively reduce income tax holidays for new investments under the IEA.	Broaden tax base and raise revenue	October 2007	Met/surpassed--exemptions for new investment eliminated.
7b. Recommendations of the program to be incorporated and implemented as part of the 2008 budget.	Broaden tax base and raise revenue.	December 2007	Met
7c. Implement an accelerated depreciation mechanism, and approve a single profit tax rate for implementation in 2009.	Broaden tax base and raise revenue.	December 2007	Met/surpassed--single rate as of Jan. 1, 2008.
7d. Existing exemptions to be grandfathered, but eliminated at the time of expiration (no renewal).	Broaden tax base and raise revenue.	December 2007	Met
8. Implement self-assessment (based on IMF technical assistance recommendations) for business income tax, starting with taxpayers covered under the Large Taxpayer Office (LTO).	Improve tax administration	January 2008	Met
9. Provide to the Fund the 2004 and 2005 financial audits of Sudapet.	Transparency	October 2007	Not met
10. Begin publication on the MOFNE website the following information (one month lag): volume of oil production; total volume of crude oil exports; volume of government oil exports; volume of input to refineries; volume of petroleum product production; import/export of products.	Transparency	December 2007	Partially met--some data not available, other data exceeds lag time by 1-2 months.
11. Begin an audit of Omdurman Bank by a local affiliate of one of the internationally recognized auditing firms. The audit should be consistent with international good practices and following international auditing standards as established by the International Auditing and Assurance Standard Board.	Financial sector soundness	December 2007	Not met.
12. Commercial banks to undertake and submit to central bank well-specified actions plans to achieve full compliance with existing regulations on capitalization and provisioning.	Financial sector soundness	December 2007	Met
13. Remove the central bank floor on cash margins for sight letters of credit (SLC) and import credits.	Current account liberalization.	December 2007	Met

1/ Unless otherwise specified, measures are for end-month.

ATTACHMENT I. SUDAN: LETTER OF INTENT

May 15, 2008

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

Dear Mr. Strauss-Kahn:

Sudan has maintained close cooperation with the IMF over the last decade. 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.

Progress under the current 18-month SMP has generally been good, notwithstanding important challenges. Sudan, like several other countries in the region, suffered some of the worst floods in decades—resulting in significant damage to agricultural land, infrastructure, and households. The government also continued to meet the challenges of implementing numerous peace agreements, disarmament, and fiscal decentralization.

We recognize that there have been some policy shortcomings, in particular related to public financial management. The attached Memorandum of Economic and Financial Policies (MEFP) sets out our 2008 program, which contains important measures to address these shortcoming; indeed, some of these measures have already been implemented. We are committed to maintaining macroeconomic stability and advancing the reform agenda, which will focus on fiscal and financial sector reforms. The Government believes that the policies and measures set forth in the attached MEFP are adequate to achieve the objectives of the program, but it stands ready to take additional measures that may be appropriate for this purpose. The Government intends to make these understandings public and authorizes the IMF to publish this letter, the attached MEFP, and the IMF staff report.

We are committed to a process of 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 take concrete action on debt relief for Sudan comparable to that provided to numerous other countries.

Sincerely yours,

s/	s/
Dr. Awad Al-Jaz Minister of Finance and National Economy Ministry of Finance and National Economy	Dr. Sabir Mohamed Hassan Governor Central Bank of Sudan

Attachment II. Sudan: Memorandum of Economic and Financial Policies

May 15, 2008

1. This memorandum sets out the economic and financial policies and objectives of the Government of National Unity (GNU) for 2008. These policies will be pursued in the context of an IMF staff-monitored program (SMP).

I. Recent Developments

2. The past year has brought a mix of challenges and opportunities with respect to economic growth and development. The government endeavored to maintain its focus on enabling high levels of growth with low inflation, and in this respect success was achieved. Oil production registered a substantial increase, non-oil growth was relatively strong, and inflation declined relative to end-2006. The government was also successful in carrying out a smooth conversion from the dinar to the new Sudanese pound. The year was not without challenges, however. Sudan, like several other countries in the region, suffered some of the worst floods in decades—resulting in significant damage to agricultural land, infrastructure, and households. The government also continued to meet the challenges of implementing numerous peace agreements, disarmament, and fiscal decentralization.

3. Sudan's real GDP growth in 2007 is estimated at about 10 percent with non-oil growth at just under 8 percent—compared with 11 and 10 percent, respectively, in 2006. A substantial gain in oil production to some 484,000 barrels per day helped bolster this strong overall performance. Nonoil growth, while still relatively strong, declined relative to 2006, largely on account of tight private sector credit, a decrease in foreign direct investment, and the continuing impact of regional developments. Notably, however, consumer price inflation declined from nearly 16 percent at end-2006 to just under 9 percent by end-2007. The exchange rate remained relatively stable in nominal terms vis-à-vis the US dollar, but depreciated by some 15 percent relative to the Euro. In real effective terms, the Sudanese pound fell by 2 percent during 2007.

4. Boosted by the rise in oil production and a surge in international oil prices, the external current account deficit dropped from 13.5 percent of GDP in 2006 to 11 percent in 2007. Exports of crude oil rose by 54 percent in volume terms and by over 66 percent in value terms relative to 2006. Of particular note, Dar Blend crude—which encountered a number of quality and marketing problems in 2006 and early 2007—gained momentum in the second half of the year with both export volumes and prices showing a marked improvement. Nonoil exports, on the other hand, continued to decline, dropping by some 19 percent compared with 2006, with sharp declines in sesame, cotton, and livestock exports. The growth rate of imports in dollar terms registered some 9 percent—about half the growth rate seen in 2006. The decline in import growth may be related to a similar decline in foreign direct investment, which dropped by about US$500 million compared with 2006. Net international reserves of the central bank fell to a low of US$563 million in May, but

recovered to just under US$1 billion by the end of the year. In light of continued sanctions, the central bank also moved to shift the bulk of foreign exchange reserves from the U.S. dollar to Euro.

5. The fiscal deficit on a cash basis (inclusive of ORSA accumulation) improved steadily during the year, dropping from an annualized 6 percent of GDP at end-March 2007 to an estimated 3.1 percent by end-December. However, a revenue shortfall in the first half of the year (due to lower-than-expected oil receipts) combined with the repayment of arrears accumulated in 2006 led to a squeeze in the budget. In the continued absence of commitment control measures this led to a sizeable accumulation of new arrears in 2007—despite a recovery of oil revenues in the second half of the year and a drawdown of resources from the Oil Revenue Stabilization Account. This was reflected in a fiscal deficit, on a commitment basis, of 5.4 percent of GDP by the end of the year.

6. The accumulation of government arrears rippled through the financial system in the form of a rapid rise in nonperforming loans (NPLs). NPLs net of provisions have risen from 17 percent at end-2006 to an estimated 23 percent by end-2007. Continued weakness in two large banks—Omdurman National Bank (ONB) and Bank of Khartoum—remain at the heart of the problem. The need for action on ONB is well understood, and the central bank has taken steady action to improve supervision and move ONB back to financial health. An independent audit will be a critical element toward an eventual restructuring. Bank of Khartoum, on the other hand, has taken steps to merge with a strategic partner, which should help to address deficiencies in the bank's balance sheet. Remaining commercial banks have made steady progress in reducing their outstanding stock of NPLs and strengthening their balance sheet. This process will hopefully accelerate as the government moves to address overdue payment obligations.

7. Growth in monetary aggregates was slow during the year—reflecting the overhang of government arrears and weakness in the financial sector. The drop in money and credit growth that followed the surge in government arrears in late 2006 and early 2007 and the intervention of Omdurman Bank continued through much of the year. The central bank responded forcefully to alleviate the credit crunch through purchase of government securities from the banking system and increasing central bank deposits in commercial banks. The decline in monetary aggregates appears to have bottomed-out in late 2007. Broad money, reserve money, and private sector credit began to recover in the fourth quarter—growing at 10 percent, 13 percent, and 16 percent, respectively, by end-December.

II. Performance under the SMP During 2007

8. Program performance under the first six months of the SMP was uneven. Importantly, the government did meet the target on domestic financing of the central government, and the ceiling on nonconcessional borrowing by a significant margin. Moreover, Sudan repaid the IMF over US$50 million in 2007—in line with its commitment under the SMP and enough to

reduce the overall stock of obligations. Three quantitative targets, however, were not met, due to a combination of difficult economic and financial challenges and some shortfalls in public financial management. Specifically, the ceiling on growth of net domestic assets was not met, reflecting the need to address a credit crunch that threatened overall growth prospects—a policy deemed appropriate given relatively low inflation during the second half of 2007. Due to shortfalls in public financial management, the government did not meet the target for net reduction in domestic arrears. The central bank was also not able to meet the target for accumulation of net international reserves (NIR).

9. A number of important structural reforms were completed in 2007, but there were also some delays. On the positive side, the 2008 budget was prepared using the GFSM 2001 framework, which has facilitated a notable improvement in transparency and timely monitoring of arrears. Bold steps were also made with respect to reining-in tax exemptions, widening the tax base, and improving tax administration:

- The Investment Encouragement Act has been amended to completely halt the granting of new tax holidays.
- A 3 percent net profit tax has been imposed on exempt corporations to bring them into the tax net as well as ensure fair competition with new investors who will now be taxed at the standard 15 percent rate.
- No new VAT exemptions were granted via ministerial decree.
- A unique turnover criterion was adopted for defining medium and large size taxpayers.
- A reorganization of the tax chamber is underway with a view to establishing a functions-based headquarters structure.

10. These positive steps notwithstanding, several key public financial management reforms (such as establishment of a centralized debt unit and commitment controls to limit expenditures by budget units) were delayed. Moreover, there was also a delay in beginning an independent audit of Omdurman Bank—which was to begin by the end of 2007 as a first step toward restructuring and/or privatization of the bank.

III. Medium-Term Outlook and Challenges

11. Meeting Sudan's medium-term challenges will require macroeconomic stability, a strong commitment to reform, and flexibility in dealing with a rapidly changing economic landscape. We would highlight in this context that Sudan has only recently emerged from a long period of civil conflict. The demands of implementing the Comprehensive Peace Agreement (CPA), the Darfur Peace Agreement (DPA), and the Eastern States Peace Agreement (ESPA) are substantial. The commitments made under these agreements must be

met even if—as has been the case in recent years—the international community fails to fully meet earlier pledges of support. These peace-related demands are likely to increase given the pressing need to proceed with demobilization, and to provide support to the United Nations/African Union Mission in Darfur (UNAMID). Meeting these obligations while simultaneously undertaking critical infrastructure and pro-poor spending limits our maneuverability on a number of economic and financial policies. The situation would be improved considerably if the international community would both recognize our accomplishments and fully honor the commitments made to help support the peace process.

12. The medium-term macroeconomic framework envisages growth of about 7-8 percent, based on prudent macroeconomic policies designed to ensure single digit inflation, enable non-oil growth, and rebuild international reserves. Increasing production of oil will provide one source of growth, but we also anticipate robust activity in nonoil sectors—including construction, manufacturing, transport, and services. We will also seek to boost the performance of our agricultural sector through market reforms, investment, and removal of transport, finance, and input bottlenecks.

13. In addition to targeting high and sustainable levels of growth, the government's medium-term policies will focus on poverty alleviation and development. To this end, we have developed a work plan to prepare a national Poverty Reduction Strategy Paper (PRSP). We expect the final PRSP to be ready before the end of the year. The PRSP will place heavy emphasis on relevant and flexible policies to ensure a macroeconomic framework consistent with post-conflict challenges, decentralization, an enabling environment for private sector growth, and capacity and institution building. We are also pleased to report that the Central Bank of Sudan, in cooperation with the World Bank, has initiated 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.

IV. Policies for 2008

14. The challenges to economic and financial management are not expected to diminish in 2008. Already, new volatility in international commodity markets is bringing both benefits (in terms of higher oil prices) and problems (higher food prices which are feeding through to inflation). Government policies in 2008 will need to be flexible in light of changing conditions, but with a consistent focus on: (i) maintaining strong, non-inflationary growth; (ii) addressing past weaknesses in public financial management; and (iii) ensuring the safety and soundness of the financial system.

A. Real Sector

15. The program envisages real economic growth of 8 percent in 2008. Oil GDP is expected to grow by about 4 percent in 2008, reflecting relatively stable levels of production compared with the end of 2007. With due attention to resolving government arrears and

enabling a further recovery of private sector credit, nonoil growth is expected to rise to about 9 percent in real terms. Given recent increases in international commodity prices—which have already made an impact in January-March, average inflation for the year is expected to reach about 9.5 percent.

B. Monetary and Exchange Rate Policies

16. The coming year presents a number of important challenges for monetary policy. On the one hand, rising inflationary pressures will need to be contained to preserve macroeconomic stability. On the other hand, sustained nonoil economic growth will require sufficient liquidity in the banking system to allow for a further recovery of credit to the private sector. Achieving a balance between these two objectives will require coordination between the central bank and the government with respect to the payment of domestic arrears (which will alleviate current pressures on the banking system), and a careful eye with respect to price developments. The program will target a broad money growth rate of 25 percent and reserve money growth of 18 percent in 2008—consistent with GDP growth and inflation objectives, and an increase in money demand reflecting the reintegration of the south. We will closely monitor monetary developments to ensure that broad money growth remains in line with the inflation objective.

17. The exchange rate will be allowed to move in line with fundamental forces, and foreign exchange interventions will focus primarily on serving government and market needs. Given the lumpiness of foreign exchange movements related to oil production and FDI flows, occasional limited intervention may be needed to smooth short-term volatility. However, in light of the need to rebuild foreign exchange reserves to prudent levels, the central bank will avoid resisting sustained and fundamental pressures on the pound.

C. Fiscal Policy and Reforms

18. Restoring confidence in public financial management will be a central objective of fiscal policy during 2008. Given the difficulties that have emerged in the past from a mismatch between expenditure commitments and available resources, the government is committed to strictly adhering to the fiscal stance outlined in the 2008 budget and addressing the stock of domestic arrears accumulated in 2007. To the extent that additional resources become available through either higher oil production or prices, the additional GNU revenues will be used to either rebuild the Oil Revenue Stabilization Account (ORSA) or to pay down the sizeable government arrears that were accumulated in 2007. The latter option, in particular, is seen as essential to alleviating pressure on banks and private firms, creating room for new private sector credit, and enhancing the prospects for nonoil growth. To further bolster public financial management and increase transparency, the government has recently taken the following measures:

- Identified the size of domestic arrears, assessed vulnerability of key holders, and prioritized arrears repayments.

- Operationalized a centralized domestic debt unit that will compile and monitor on a monthly basis the stock of domestic debt by debt instrument, and on a quarterly basis the stock of domestic arrears.

- Implemented commitment controls that limit expenditures by budget units to quarterly cash plans.

19. The fiscal deficit (excluding oil revenues accumulating in the ORSA) for 2008 will be contained to no more than SDG 4,100 million on a cash basis, and to no more than SDG 2,943 million on a commitment basis. All standing orders, guarantees, sanadats, and other obligations coming due will be paid, and no new domestic arrears will be created in 2008. Moreover, we intend to repay SDG 1,156 million of the existing stock of arrears, with the remaining SDG 1,457 million to be repaid in 2009–10. Fiscal revenues are expected to reach SDG 24.8 billion in 2008,[1] including some SDG 14.4 billion in oil revenue reflecting the substantial increase in international oil prices that has emerged since the budget was approved. Total central government expenditures are programmed to be SDG 28.9 billion in 2008.

20. To further increase revenue collection in 2008 and beyond and to improve transparency, the government will undertake the following measures:

- Prepare a risk-based audit strategy providing for comprehensive joint income tax-VAT post audits for not less than 20 percent of all self-assessed corporate tax returns submitted for 2008 (structural measure for June 2008).

- Introduce Tax Identification Numbers (TIN) for all corporate and individual income taxpayers (structural measure for June 2008).

- Submit to parliament a modified Customs Law that provides valuation guidelines for questionable assessments (structural measure for June 2008).

- Align the budget preparation and execution of the social security fund, government universities, and the student support fund with GFSM 2001 classification (structural measure for November 2008).[2]

[1] Important with respect to the revenue target are expected gains in VAT collection. Performance of VAT will be evaluated during the next IMF review in September.

[2] This would be an important first step toward a consolidated presentation of government budget accounts, as mandated in the Comprehensive Peace Agreement.

- Prepare studies on the impact of removing VAT exemptions on capital goods, while providing for deferral of VAT payment for new businesses, and on the potential revenue impact of raising the VAT registration threshold from the current SD 100,000 to 120,000-150,000.

21. The government is fully aware of the risks associated with oil revenue projections given the volatility of international oil prices, and the uncertainties with respect to production and shipment. Flexibility and frequent review of expenditures and commitments will thus be needed to ensure that the deficit stays at or below the agreed level. Specifically, if oil revenues are lower-than-programmed, we will (to the extent that such resources are available) compensate for the revenue shortfall by drawing from the ORSA, or otherwise reduce spending to maintain the fiscal deficit unchanged. If oil revenues exceed programmed levels (specifically, from Nile blend), the additional useable revenue will be deposited in the ORSA or used to reduce the stock of domestic arrears from 2007.

D. Balance of Payments

22. The external current account deficit (cash basis) is expected to narrow significantly to some 7 percent of GDP, compared with a deficit of 11 percent in 2007. The improvement mirrors a sharp increase in oil exports, as Sudan benefits from the recent, sustained surge in international oil prices. Non-oil exports, however, are unlikely to rise significantly given continued infrastructural bottlenecks, the real effective appreciation of the pound in recent years, and strong domestic demand for agricultural and manufactured goods. Imports are also expected to rise by about 22 percent in dollar terms—mainly in the form of materials and capital goods required for the implementation of large scale projects financed by loans and FDI. Food imports are also expected to register a substantial increase, however, given the recent sharp rise in international commodity prices. With the net increase in foreign exchange inflow generated by the improvement in the current account, we anticipate being able to rebuild net international reserves of the central bank to a level of US$1.5 billion (1.4 months of imports) by the end of 2008. The government will also continue to seek external financing on the most concessional terms possible.

E. Financial Sector

23. We will continue our plans to restructure and strengthen the banking system. An independent audit of Omdurman Bank—consistent with international good practices—has already begun. On the basis of this audit we intend to formulate by end-September a strategy for restructuring and/or privatizing the bank (structural measure). Similarly, we will require remaining problem banks to submit a time-bound action plan to accumulate sufficient provisions to reduce net nonperforming loans and to raise their capital adequacy ratio to meet existing prudential standards (structural measure for June 2008).

V. Relations with the Fund and Other Creditors

24. **External debt issues**. In 2008, Sudan's debt service capacity will be constrained by the burden of implementing the various peace agreements, addressing the damage of the 2007 floods, paying off domestic arrears, rebuilding foreign exchange reserves, and addressing critical poverty and reconstruction requirements. Further shortfalls or delays in donor assistance or a negative shock to oil prices would further limit our capacity to service our obligations. Based on the available data, the end-2007 stock of public and publicly-guaranteed debt is estimated at over US$28 billion in nominal terms, up by about US$8 billion since end-2000. We wish to convey to the international community that Sudan has made every effort at cooperation on policies and payments for more than a decade, and in that context met all the conditions and requirements for debt relief. We remain hopeful that the international community will recognize our track record, accord us equality of treatment, and take concrete action on debt relief for Sudan comparable to that provided to numerous other countries.

25. **External financing**. Sudan continues to suffer from limited access to concessional loans because of the difficulties in resolving our debt and arrears situation. Given our sizeable external debt, we have sought more concessional terms for new loans in recent years. We have had some success in this regard, but some new borrowing is nonconcessional. We are unable to put critical infrastructure, reconstruction, and social development projects on hold indefinitely, however. These projects are an essential component of our strategy to unite the country after the signing of multiple peace agreements. Consequently, we have had to make recourse to non-concessional borrowing in recent years. We are keenly aware of the concern of other creditors regarding this borrowing, and of the risks it may pose over the medium- and long-term. We will therefore seek to limit the contracting or guaranteeing of such obligations as much as possible. For 2008, we will limit such contracting to US$700 million.

26. **Payments to the Fund**. In addition to cooperation with the Fund on matters of economic policy, Sudan's payments to the Fund have exceeded program levels under the SMP, and in this context we achieved a reduction in the stock of external obligations. Payments to the Fund amounted to US$50.6 million in 2007, and the Fund's preferred creditor status will be maintained by ensuring that our payments continue in 2008 to exceed obligations falling due. To demonstrate our continued cooperation, we will make minimum payments of US$50 million in 2008. Further, we intend to move to a monthly payment basis. We would hasten to point out, however, that these payments—while demonstrating our good intentions—are not a solution to Sudan's arrears to the Fund. We appeal to the international community in this context 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.

VI. Program Targets and Monitoring

27. The proposed semi-annual quantitative targets for the periods up to end June 2008, and end-December 2008 are set forth in Table 1, and the structural benchmarks are detailed in Table 2. We will closely monitor financial and economic developments in coming months and will implement any measures that may be needed to safeguard macroeconomic stability in consultation with the Fund staff.

28. To ensure the effective monitoring of the program, the relevant ministries, the CBOS, and the Central Bureau of Statistics will compile and share with the Fund staff all economic and financial data necessary, on a timely basis, as specified in the Technical Memorandum of Understanding (TMU) of July 2007 and the attached Addendum to the TMU.

Table 1. Sudan: Quantitative Targets for 2007 and 2008

	2007 1/			2008 1/		
	Dec.			Mar	Jun	Dec.
		Target		Indic.		
	Target	w/adj.	Prel.	Target	Target	Target
	(In millions of Sudanese pounds, unless otherwise indicated)					
Central Bank of Sudan net domestic assets (Ceiling) 3/	1,689	599	1,764	215	352	815
Domestic financing of the central government (Ceiling) 3/	3,060	1,973	1,926	127	333	2,346
Reduction in the stock of domestic arrears of the central government (Floor) 1/ 2/ 3/	380		-2,193	0	400	1,156
Net international reserves (in millions of U.S. dollars) (Floor) 3/	-83	458	-403	129	260	519
Contracting or guaranteeing of external nonconcessional debt						
by the government or the central bank (in millions of U.S. dollars) (Ceiling)	700		145	…	…	700
Payments to the Fund (in millions of U.S. dollars) (Floor)	50		51	12.5	25.0	50
Memorandum items:						
Broad money	4,289		1,843	799	2,621	4,978
Reserve money	1,411		998	144	572	1,607
Net central bank claims on government of Southern Sudan	133		129	0	0	0
Government oil export revenues	6,523		7,610	2,969	5,937	11,874
Of which: Net oil savings account (OSA) accumulation	0		32	164	329	664

Sources: Sudanese authorities; and Fund staff estimates.

1/ Cumulative flow during 2007 and 2008.
2/ Any new domestic arrears incurred during January–June should be cleared by end-June, and those incurred during July–December should be cleared by end-December. Arrears are defined as overdue financial obligations of the central government outstanding for 90 days or more.
3/ Subject to an adjustor (asymmetric) to take account of oil production and/or prices being more than assumed in the program.

Table 2. Status of 2007 Structural Measures Under the SMP

Measures Under the SMP	Objective	Timing 1	Status
1. Ministry of Finance to issue a decree establishing that line ministries cannot undertake commitments without permission of Ministry of Finance.	Expenditure control	July 15, 2007	Met
2a. Provide to Fund staff the stock of domestic debt, including arrears, at end-2006, by type of instrument (loans from BOS, GICs, GMCs, standing orders, guarantees, development sanadats, and securitized arrears (debt extinction sanadats)).	Stop build-up of public debt	June 26, 2007	Met
2b. Establish a centralized domestic debt unit that will compile and monitor on a monthly basis the stock of domestic debt by debt instrument, and on a quarterly basis the stock of domestic arrears (payments due for over 3 months) by debt instrument and provide on a quarterly basis accounting data on expenditure committed and expenditure paid, by main budgetary items and chapters.	Stop build-up of public debt	July 1, 2007	Met pro forma, but was not operational.
3a. Establish a zero-balance Treasury Single Account in line with recommendations of the FAD Public Financial Management mission of October 2006.	Expenditure control	August 15, 2007	Met except for zero balance aspect--due to problems with existing software.
3b. Implement commitment controls that limit expenditures by line ministries to monthly or quarterly cash plans, which reflect likely cash availability rather than budgeted allocations.	Expenditure control	September 1, 2007	Not met
4. Adopt for the 2008 budget the full economic and functional classifications of the GFSM 2001.	Improve budget execution	December 2007	Met
5. Reduce VAT exemptions granted by ministerial decree to achieve an additional SD 15-20 billion in revenue on an annual basis.	Broaden tax base and raise revenue	December 2007	Not met. However, numerous income tax exemptions were eliminated in the 2008 budget.
6. Continue to suspend the granting of any new VAT or income tax exemptions by the Ministry of Finance.	Raise revenue	Continuous	Met
7a. Ministry of Finance to prepare a program to progressively reduce income tax holidays for new investments under the IEA.	Broaden tax base and raise revenue	October 2007	Met/surpassed--exemptions for new investment eliminated.
7b. Recommendations of the program to be incorporated and implemented as part of the 2008 budget.	Broaden tax base and raise revenue.	December 2007	Met
7c. Implement an accelerated depreciation mechanism, and approve a single profit tax rate for implementation in 2009.	Broaden tax base and raise revenue.	December 2007	Met/surpassed--single rate as of Jan. 1, 2008.
7d. Existing exemptions to be grandfathered, but eliminated at the time of expiration (no renewal).	Broaden tax base and raise revenue.	December 2007	Met
8. Implement self-assessment (based on IMF technical assistance recommendations) for business income tax, starting with taxpayers covered under the Large Taxpayer Office (LTO).	Improve tax administration	January 2008	Met
9. Provide to the Fund the 2004 and 2005 financial audits of Sudapet.	Transparency	October 2007	Not met
10. Begin publication on the MOFNE website the following information (one month lag): volume of oil production; total volume of crude oil exports; volume of government oil exports; volume of input to refineries; volume of petroleum product production; import/export of products.	Transparency	December 2007	Partially met--some data not available, other data exceeds lag time by 1-2 months.
11. Begin an audit of Omdurman Bank by a local affiliate of one of the internationally recognized auditing firms. The audit should be consistent with international good practices and following international auditing standards as established by the International Auditing and Assurance Standard Board.	Financial sector soundness	December 2007	Not met.
12. Commercial banks to undertake and submit to central bank well-specified actions plans to achieve full compliance with existing regulations on capitalization and provisioning.	Financial sector soundness	December 2007	Met
13. Remove the central bank floor on cash margins for sight letters of credit (SLC) and import credits.	Current account liberalization.	December 2007	Met

1/ Unless otherwise specified, measures are for end-month.

Table 2 (concluded). Structural Measures for 2008 Under the Staff Monitored Program

Measures Under the SMP	Objective	Timing [1]
1. Operationalize a centralized domestic debt unit that will compile and monitor on a monthly basis the stock of domestic debt by debt instrument, and on a quarterly basis the stock of domestic arrears (payments due for over 3 months) by debt instrument and provide on a quarterly basis accounting data on expenditure committed and expenditure paid, by main budgetary items and chapters.	Expenditure control	**Prior Action**
2. Implement commitment controls that limit expenditures by budget units to monthly or quarterly cash plans, which reflect likely cash availability rather than budgeted allocations.	Expenditure control	**Prior Action**
3. Provide to the Fund a summary of the 2004 and 2005 financial audits of Sudapet.	Transparency	**Prior Action**
4. Begin an audit of Omdurman Bank by a local affiliate of one of the internationally recognized auditing firms. The audit should be consistent with international good practices and following international auditing standards as established by the International Auditing and Assurance Standard Board.	Financial sector soundness	**Prior Action**
5. Prepare and share with IMF staff a risk-based audit strategy providing for comprehensive joint income tax-VAT post audits for not less than 20 percent of all self-assessed corporate tax returns submitted for 2008.	Raise revenue	June 2008
6. Introduce Tax Identification Numbers (TIN) for all corporate and individual income taxpayers.	Raise revenue	June 2008
7. Submit to parliament a modified Customs Law that provides valuation guidelines for questionable assessments.	Raise revenue	June 2008
8. Align the budget preparation and execution of the social security fund, government universities, and the student support fund with GFSM 2001 classification.	Transparency	November 2008
9. Based on results of audit of Omdurman Bank, the government will prepare a restructuring/privatization plan for the bank.	Financial sector soundness	September 2008
10. Central bank to require remaining problem banks to submit a time-bound action plan to accumulate sufficient provisions to reduce net nonperforming loans and to raise the capital adequacy ratio to meet existing prudential standards.	Financial sector soundness	June 2008

1\ Unless otherwise specified, measures are for end-month.

ATTACHMENT III. SUDAN: ADDENDUM TO TECHNICAL MEMORANDUM OF UNDERSTANDING

The Technical Memorandum of Understanding (TMU) of July 27, 2007 remains operational with the following amendments to paragraphs 5 and 9, as well as Table 1.

5. **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 are comprised of the following items: (i) short-term liabilities, as noted in the balance sheet of the Central Bank of Sudan; (ii) IMF deposit accounts; (iii) nonresident deposits; and (iv) (overdrawn) foreign correspondent accounts.

9. **Oil revenue adjustor** (symmetric). The gross programmed government oil revenue from crude oil exports is based on the program's assumptions about oil prices (f.o.b. Port Sudan) and quantities to be exported (see Table below). Accrued revenue is the cumulative government oil revenue inflows based on actual shipments at current international prices (f.o.b. Port Sudan).[1] Accrued government oil revenue in excess of the programmed amounts is deposited in an oil savings account (OSA), a locked sub-account within net credit to the government at the CBOS, or used to clear domestic arrears.

The oil revenue adjustor will work as follows:

- If the accrued government revenue from crude oil exports exceeds the programmed amount (either because of the price and/or volume exceed the programmed levels), then:
  - If deposited in the OSA, the program targets for domestic financing of the budget deficit and NDA will be reduced, and the international reserves target will be increased, by the difference between the accrued and the programmed amounts.
  - If used to reduce domestic arrears, the program target for arrears clearance will be increased by the difference between the accrued and the programmed amounts. The targets for international reserves, domestic financing of the budget, and NDA will remain unchanged.

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

- If the government revenue from crude oil exports falls short of the programmed amount, the program target for international reserves will be reduced by the difference between the programmed and the accrued amounts, and the target for arrears clearance will be reduced by one-half of the difference between the programmed and accrued amounts.

- If within a given quarter the accrued oil revenue that goes to the budget falls below the planned amount (either because of the price and/or volume are less than the programmed levels), appropriate amounts will be withdrawn from the OSA (subject to these resources being available) to ensure that cumulative oil revenues for use in the budget match the cumulative amounts planned in the fiscal program, and the targets for NDA and net credit to government will be increased by the difference between the programmed and accrued amounts. If such resources are not available from the OSA, the government will undertake appropriate expenditure adjustment to ensure that the deficit does not exceed the targeted level of SDG 3,354 million (cash basis) in 2008.

Table 1. Sudan: Government oil revenues from crude exports

		2008				
		Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.	Year Prog.
Nile blend crude (including crude from Block 5A)						
Price (f.o.b. Port Sudan)	US$/barrel	87.5	87.5	87.5	87.5	87.5
Volume exported	Million barrels	9.1	9.2	9.3	9.3	36.9
Export revenue \1	US$ millions	799	801	813	816	3,230
Of which: OSA accumulation	US$ millions	82	82	84	84	332
Dar blend crude						
Price (f.o.b. Port Sudan)	US$/barrel	69.5	69.5	69.5	69.5	69.5
Volume exported	Million barrels	10.3	9.8	9.9	9.9	40.0
Export revenue \1	US$ millions	696	666	671	673	2,707
Of which: OSA accumulation	US$ millions	0.0	0.0	0.0	0.0	0.0
Memo item:						
Revenue from crude exports	US$ millions	1,495	1,468	1,485	1,489	5,937
Revenue from crude exports	SDG millions	2,991	2,935	2,969	2,979	11,874
Of which: programmed OSA accumulation	SDG millions	164	165	167	168	664
Oil export revenue for use in the budget	SDG millions	2,827	2,770	2,802	2,811	11,210

1\ Net of SPC fees.