INTERNATIONAL MONETARY FUND

Staff Country Reports

April 2011
IMF Country Report No. 11/86

Sudan: Second Review Under the 2009–10 Staff-Monitored Program —Staff Report; Staff Supplement; and Statement by the Executive Director for Sudan

In the context of the second review, the following documents have been released and are included in this package:

- The staff report for the Second Review Under the 2009–10 Staff-Monitored Program, prepared by a staff team of the IMF, following discussions that ended on December 14, 2010, with the officials of Sudan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 24, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of February 4, 2011 updating information on recent developments.

- A statement by the Executive Director for Sudan.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

SUDAN

Second Review Under the 2009–10 Staff-Monitored Program

Prepared by the Middle East and Central Asia Department
(In consultation with other departments)

Approved by Alan MacArthur and Jan Kees Martijn

January 24, 2011

Fund relations: The Executive Board concluded the 2010 Article IV consultation on June 24, 2010 (EBS/10/111). The PIN is available at http://www.imf.org/external/np/see/pn/2010/xx.htm. The staff report for the 2009–10 staff-monitored program (EBS/09/115) was issued to the Board on June 24, 2009 and is available at: http://www.imf.org/external/pubs/cat/longres.cfm?sk=23116

Mission: Discussions were held in Khartoum during December 1–14, 2010. The mission met with Mr. Ali Mahmood Abdul-Rasool, Minister of Finance and National Economy, Mr. Lual Achwel Deng, Minister of Petroleum, Dr. Sabir Mohamed Hassan, Governor of the Central Bank, other senior officials, and representatives of the business, donor, and diplomatic communities.

Staff team: The mission consisted of E. Gemayel (head), J. Dridi, D. Jardaneh, E. Arbatli (all MCD), L. Erasmus (FIN), L. Liu (FAD), A. Zoromé (Resident Representative), and A. Yasin (economist from the Resident Representative Office). Mr. MacArthur participated in the policy discussions.

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EXECUTIVE SUMMARY

Background

Political uncertainties ahead of the January 2011 South Sudan referendum on self-determination have been weighing heavily on the Sudanese economy, adding to the adverse effects of the global crisis in 2009. Economic growth in 2010 is projected to decelerate to about 5 percent. Average inflation is projected to remain at 11 percent.

Fiscal and monetary policies were noticeably tightened starting the second half of 2010. Shortfalls in both tax revenues and oil receipts were more than offset with notable under-execution in both capital and current expenditures. Monetary policy remained expansionary in the first half of 2010, but was tightened starting in July. The central bank recently undertook an exchange rate depreciation of about 19 percent.

Staff recommendations

- Tighten the monetary stance to reduce pressures on inflation and the exchange rate.
- Increase exchange rate flexibility in order to rebuild foreign exchange reserves.
- Enhance non-oil revenue and streamline expenditures in order to maintain macroeconomic stability and reduce dependence on oil revenues.
- Continue to strengthen the financial sector, including by improving banking supervision and restructuring the Omdurman National Bank.
- Initiate a dialogue with creditors with the aim of establishing wide support for arrears clearance and debt relief.

Authorities' views

- The reduction of the fiscal deficit will be achieved through broadening the revenue base by reducing tax exemptions and improving administration, and reducing spending.
- Building up foreign exchange reserves is important and a cautious monetary policy is needed to achieve this objective.
- Progress on debt relief, under the HIPC initiative, is essential to remove the debt overhang and regain access to concessional financing for development and social projects.
- Various policy options are being assessed to address the significant challenges posed by a possible independence of the South in 2011.

While the full implications of the referendum will only be clear in the coming months, the impact on the macroeconomic framework for Sudan will be large in many dimensions. Staff

is following developments in consultation with the authorities and will update the analysis and policy recommendations in light of new information.

I. Introduction

1. **Sudan faces enormous challenges in the period ahead.** Economic policy implementation and developments in 2010 were heavily affected by significant uncertainty ahead of the January 2011 South Sudan self-determination referendum, a key provision of the 2005 Comprehensive Peace Agreement (CPA) between the North and the South.

2. **The referendum on self-determination in Southern Sudan was held on schedule during January 9–15, 2011, a major accomplishment** (Box 1). Should the outcome of the vote be in favor of independence, discussion on key issues including **wealth sharing, currency, nationality, borders, and debt** will continue during the 6-month interim period leading to full independence.

Box 1. Sudan: The Comprehensive Peace Agreement

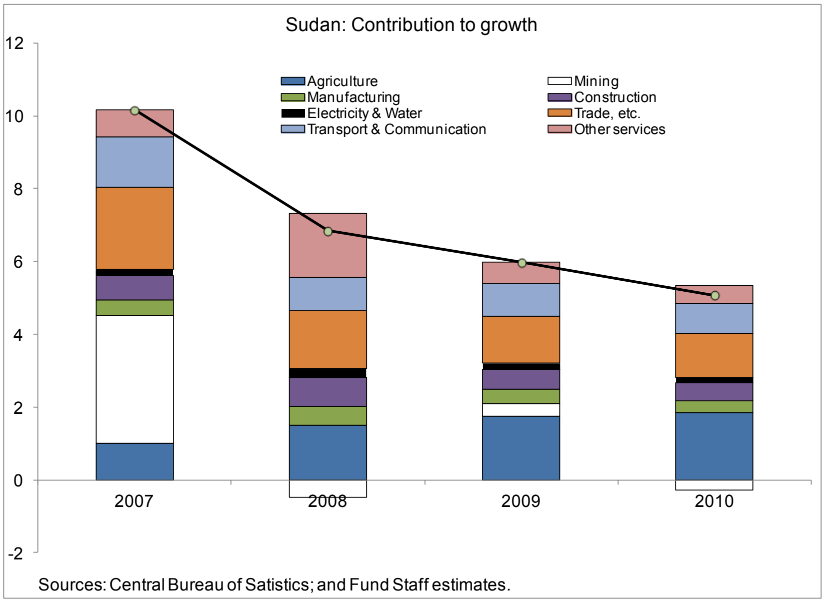
The Comprehensive Peace Agreement (CPA) was signed between the Government of the Republic of Sudan and the Sudan People's Liberation Movement/Army in January 2005. With the signing of the CPA, the two parties agreed to an interim period of 6 years culminating with the people of South Sudan's right to self determination through a referendum to determine their future status - that is unity with or independence from the North. The CPA consisted of six agreements, including arrangements for sharing power and revenue from oil and jurisdiction over the collection and sharing of types of taxes and duties during the interim period. According to these arrangements, the Government of Southern Sudan (GoSS) is allocated, during the interim period, half of the net revenue from oil produced in the South and is granted representation at the federal level in the Government of National Unity (GoNU). The CPA also calls for a separate referendum for the Abyei region to be conducted simultaneously with the referendum of Southern Sudan.

The Southern Sudan referendum was held on schedule during January 9-15, 2011. The final results of the poll are expected around mid-February 2011. In case the South chooses to secede, the CPA mandates that there will be a 6-month transition period until July 9, 2011, followed by a possible declaration of independence by South Sudan. The parties to the CPA are expected to continue to work on post-referendum issues, including oil, debt, and currency, during the transition period.

The Abyei referendum did not take place as scheduled on January 9. There is a lack of agreement on who constitutes a "resident of Abyei" for the purposes of voting. A decision on whether Abyei would join the South or North will need to be made in the future.

II. Recent Economic Developments

3. **Economic growth is estimated to have moderated further in 2010 to about 5 percent, reflecting slower growth in both the oil and non-oil sectors** (Table 1). Continued strong performance in agriculture was offset by broad-based slowdown in the rest of the economy. Oil production declined by about 2 percent to 460,000 barrels per day (bpd). Twelve-month inflation stood at 9.8 percent in November, reflecting the increase in international food prices, and an expansionary monetary policy. Inflation is expected to remain at about 10 percent by year-end.



4. **Fiscal policy was noticeably tightened starting the second quarter of 2010.** In response to the sharp decline in foreign financing inflows and shortfalls in revenues, government spending was significantly compressed. The overall commitment fiscal deficit for 2010 is now estimated at 2.7 percent of GDP, about 0.6 percent age point of GDP below the program target (Table 2). Despite these tightening efforts, both arrears clearance and net accumulation in the oil revenue stabilization account (ORSA) at the end of October were below program levels, due to the shortfall in foreign financing.

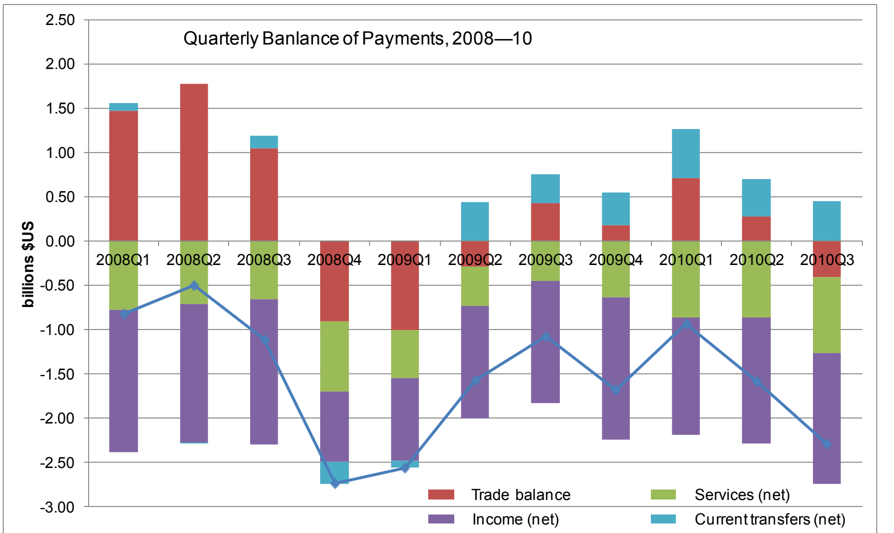
5. **Monetary policy was expansionary in the first half of 2010, but was subsequently tightened** (Tables 3 and 4). Twelve-month reserve money growth slowed to 14.5 percent at end-October compared to 28 percent in June mainly as a result of the decline in net foreign assets of the central bank. However, broad money grew by 26 percent in October (y-o-y), largely driven by strong growth in credit to the nongovernment sectors (+22 percent). In a bid to reduce inflation and mop up excess liquidity, the Central Bank of Sudan (CBOS) shifted in July to a tightening mode by raising the reserve requirement ratio on domestic and foreign currency deposits from 8 to 11 percent, and withdrawing maturing investment deposits that had been placed in commercial banks.[1]

6. **Excess liquidity and uncertainty in the run-up to the referendum have intensified pressure on the exchange rate, prompting the CBOS to undertake in**

[1] The CBOS redeemed SDG 1.22 billion up to end-November 2010. A total of SDG 1.16 billion remains deposited with banks and is expected to be redeemed upon maturity by end-2011.

November a depreciation of the guinea of about 19 percent. Instead of opting for an outright depreciation, the central bank introduced a daily premium for purchases of the guinea—currently equivalent to about19 percent—on top of the official exchange rate, in a bid to close the gap with the parallel market rate. The authorities also introduced new measures to curb the demand for foreign currency, including an increase in custom duties on various consumption goods, and an increase from 5 to 10 percent of the development tax rate, currently applied on some imports. Gross international reserves continued to decline, as a result of shortfalls in external financing as well as the authorities' exchange rate and intervention policies in the run-up to the November depreciation.

7. **The current account deficit narrowed during the first three quarters of 2010 largely driven by an increase in oil exports.** Despite a decline in oil production, export receipts increased by 43 percent compared to the first three quarters of last year, reflecting the significant increase in international prices, while imports grew by only 14 percent, driven by wheat, sugar and petroleum products. For 2010, the current account deficit is estimated to decline to 7.7 percent of GDP, compared to 10.8 percent of GDP in 2009 (Table 5).



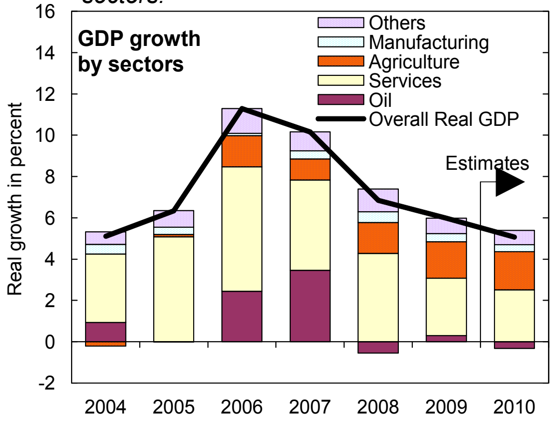
Source: Central Bank of Sudan.

8. **Financial sector indicators continue to show some improvement.** Nonperforming loans (NPLs) declined to 17 percent at end-September, down from 20 percent at end-2009, partly owing to a reduction in domestic government arrears to the banking sector. Moreover, with the implementation of measures to tighten loan classification and provisioning requirements, the ratio of provisions to NPLs showed some improvement to 26 percent in September from 24 percent at end-2009. The central bank has raised the minimum capital requirement for banks to SDG 80 million by end-2010 and to SDG 100 million by end-2011 from the current requirement of SDG 60 million. At end-September, the average capital adequacy ratio of commercial banks stood at 10 percent, up from 7 percent at end-2009.[2]

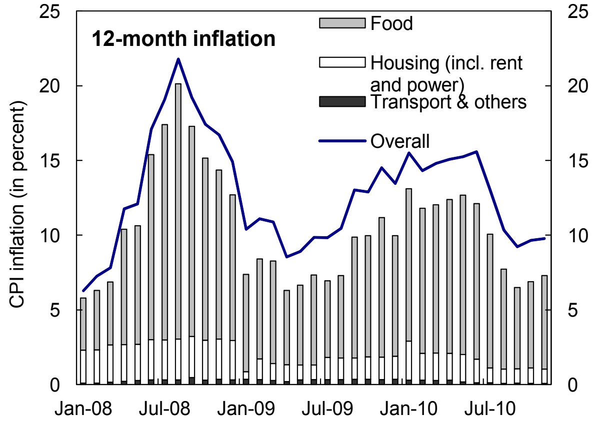
[2] The deterioration in the capital adequacy ratio (CAR) in 2009 was largely due to the implementation of a new methodology for calculating the CAR in accordance with the capital adequacy standard introduced by the Islamic Financial Services Board. The new methodology takes into consideration a broader set of risks beyond credit, to incorporate market and operational risks.

Figure 1. Sudan: Selected Economic Indicators, 2004-2010

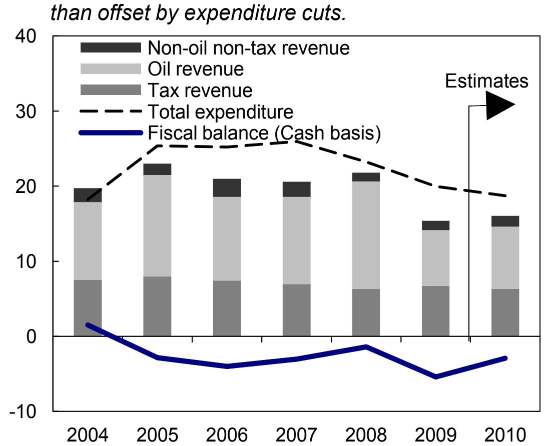
GDP growth moderated slightly reflecting slower growth in both the oil and non-oil sectors.



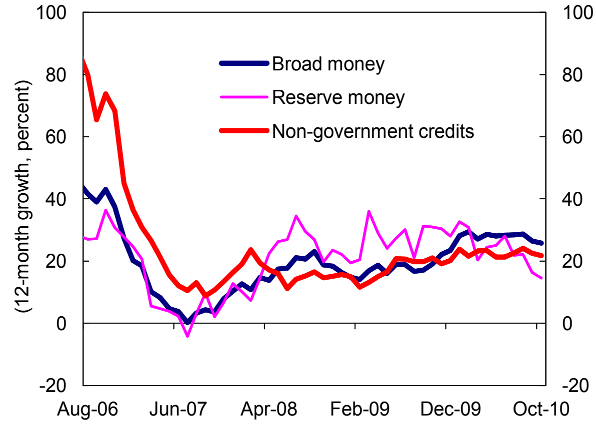
Inflation has come down to close to 10 percent after reaching a peak of 15.6 percent in June.



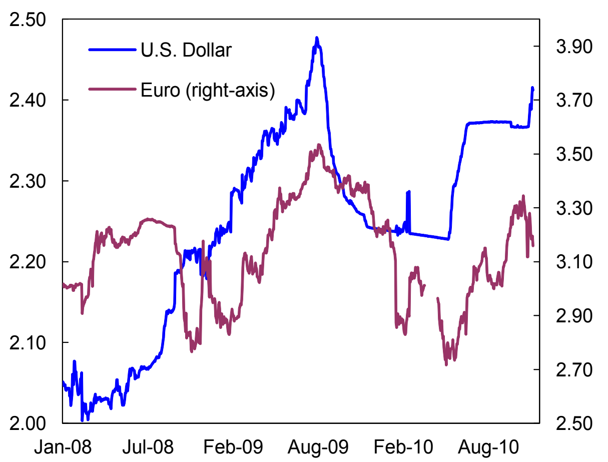
Total revenue has fallen but this has been more than offset by expenditure cuts.



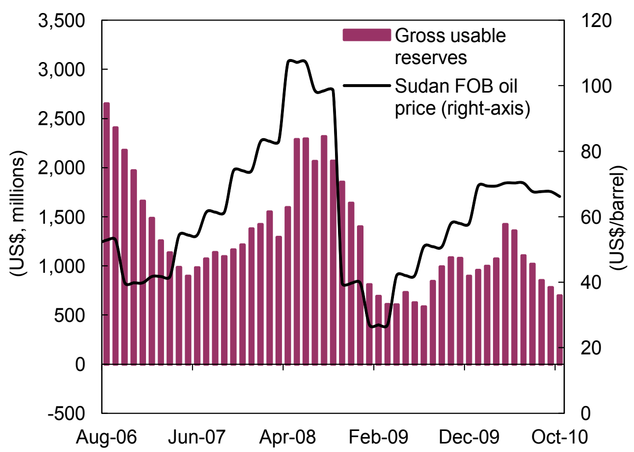
Broad money growth has been strong.



The exchange rate has depreciated since late 2008.



Gross reserves declined in 2010 as a result of continued heavy intervention.



Sources: Authorities; and Fund staff estimates.

III. POLICY DISCUSSIONS

9. **The challenges facing Sudan are immense and complex.** Sudan needs to create fiscal space to meet social and development needs, but the challenges of coping with a possible independence of South Sudan are likely to be the most pressing in the coming year. Rebuilding foreign exchange reserves, mobilizing non-oil revenue, and tightening monetary policy to contain inflationary and exchange rate pressures remain an immediate priority. In the medium term, Sudan must continue to strengthen its non-oil revenue collection and export base while developing its financial system to ensure sustainable growth. An independent South Sudan would also face daunting challenges (Box 2).

10. **Policy discussions focused on the challenges of maintaining macroeconomic stability and on post-referendum issues**. The meetings were held against the background of a further slowdown in economic activity, and uncertainties ahead of the January 2011 referendum on South Sudan's self-determination. Under the 2011 baseline scenario—which assumes unitary state—real GDP growth is projected to slow to around 4½ percent and inflation to moderate to about 9 percent, while the current account deficit will remain broadly unchanged compared to 2010.

11. **The authorities indicated their commitment to continuing cooperation with the Fund on policy implementation and payments.**

Box 2. Sudan: Challenges for South Sudan

South Sudan is one of the poorest regions in the world. It is estimated that nine out of 10 people in the region live on less than $1 a day, the region has only about 30 miles of paved roads and almost 80 percent of services such as health, education, safe drinking water and sanitation are provided by nongovernmental organizations. Furthermore, according to the UN Food and Agriculture Organization (FAO), almost half the population (about 4 million) is in need of food assistance. At the same time, South Sudan is a region endowed with large oil reserves, fertile soil and many other minerals such as uranium, gold, and copper. If these resources are properly managed, it has the potential to become a viable state and important player in the region.

To address emerging needs in case of independence, Southern Sudan will need substantial international assistance, both financially and in terms of capacity building in the years to come. South Sudan would face major challenges in creating a functioning government. These include its near total dependence on oil revenue (about 98 percent of government revenue), weak institutions, absence of virtually any infrastructure, a dearth of trained civil servants, and the lack of basic statistics. These compound the government's inability to tackle poverty and infrastructure challenges, and constrain both growth and access to basic social services. Potential political and military divisions may also inhibit the ability of the South to address the social and economic expectations of its people.

To support these efforts, the Fund is ramping up its work in its core areas of expertise, and coordinating with other technical assistance providers. These include advising on fiscal, monetary and exchange rate policies, as well as providing technical assistance to enhance the statistical base.

A. Fiscal Policy

12. **The 2011 budget reflects the authorities' ambitious effort to undertake a large fiscal adjustment while recognizing the significant uncertainties about the implications of a possible independence of South Sudan.** In the face of conservative non-oil revenue assumptions, reflecting the challenges in implementing major tax reforms during the referendum year, the budget contemplates a sizeable compression in current expenditure. The budget was prepared under the assumption of a unitary state, but a supplementary budget could be prepared depending on the outcome of the referendum.

13. **The approved budget envisages an improvement in the non-oil primary balance compared to 2010**. Conservative assumptions were made about both oil and non-oil revenues due to uncertainties during the referendum year. The drop in revenue is however

compensated by an even larger reduction in current expenditures (-2.8 percent age points of GDP), while capital outlays are projected to rise to 3.3 percent of GDP, reflecting optimistic assumptions on foreign financing inflows.

14. **Staff agreed with the authorities' intention to reduce the deficit**, but suggested that the adjustment effort be complemented by measures to strengthen tax revenues (an increase of 0.2 percent age point of GDP relative to the estimated level in 2010).[3] The proposed fiscal stance preserves a similar spending cut in wages and goods and services as in the budget approved in 2011, while maintaining the necessary social spending to protect the poor. Capital outlays are projected to be lower than in the budget (by 0.6 percent age points of GDP), consistent with more conservative foreign financing assumptions. Such a stance would deliver a significant improvement in the non-oil primary balance, from a deficit of 5.5 percent of non-oil GDP in 2010 to 3.6 percent in 2011.

15. **Despite the challenges posed by the uncertain outlook and complex political environment, structural reforms going forward are critical to meet developmental and social objectives.** A joint committee (MOFNE, Taxation Chamber and Custom) has recently completed a review of the current tax policy regime. The committee recommended a number of measures aimed at broadening the tax base and enhancing the efficiency of the revenue administration. The 2011 budget already incorporates a set of measures, including increases in tariff rates on certain vehicles, consumption and manufacturing goods.

16. **The authorities have recently implemented a number of fiscal reforms,** including modernization of the Taxation Chamber, reorganization of the Ministry of Finance and National Economy, and completion of the tax policy regime review. However, due to insufficient funding, the implementation of customs evaluation system was delayed to the beginning of 2011. Also, the establishment of a medium-term fiscal framework and the transfer of oil companies' profits to the Ministry of Finance instead of the Sudan Petroleum Company will be implemented after the referendum. Staff encouraged the authorities to complete the ongoing fiscal reforms, with the objective of further improving non-oil revenue and enhancing the quality of government expenditure. More specifically, staff highlighted the need for further reforms in the following areas: (i) reducing VAT exemptions and reforming the personal income tax based on the recent review of tax policy; (ii) establishing a targeted social safety net as a prerequisite for the gradual removal of fuel subsidy; and (iii) developing a medium-term fiscal framework anchored around the non-oil primary balance to improve fiscal management against the uncertainties of oil revenue volatilities.

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[3] Possible measures could include (i) a tightening of VAT exemptions granted to imports of certain final goods and imports by certain entities; (ii) extending the VAT to domestic services (such as electricity and water usage, in-city transportation, commercial rentals, etc.); and (iii) raising excise duties on luxury items (cars, high-end consumer goods, etc.).

B. Monetary and Exchange Rate Policies

17. **The authorities plan to maintain a tight monetary stance in the period ahead.** They have taken a number of measures to reverse the expansionary stance since the second half of 2010. In particular, the authorities have withdrawn more than half of the deposits that were placed with banks in 2009 as temporary liquidity support, and plan to withdraw the remaining deposits as they mature. The CBOS is also proceeding with efforts to strengthen open market operations and to deepen the interbank market. However, the ability to effectively manage domestic liquidity remains constrained by the limited policy instruments.

18. **The authorities believe that the recent de facto depreciation of the guinea will reduce pressure in the foreign exchange market, and broadly align the official and parallel rates.** They deem that an outright depreciation could create further downward pressure on the exchange rate, while the introduction of a premium would send a signal to the market about the temporary nature of the exchange rate level. Staff underscored the importance of continued exchange rate flexibility and pointed that while this de facto depreciation is an overdue but appropriate step, the mechanism introduced—as opposed to an outright depreciation—could create some market distortions and could undermine transparency in the CBOS policy implementation.

19. **To further curb the demand for foreign currency and ease the pressure on the exchange rate, the authorities introduced some fiscal measures to discourage some types of imports.** These include the prohibition of selected imported items, higher tariffs, excise taxes (including by expanding the number of goods subject to excises), and development tax on imports; and tightening the requirements for foreign currency accounts. Staff pointed that these measures are likely to add price distortions and are unlikely to yield the intended objectives.

20. **Efforts are underway to strengthen the financial sector**. The authorities continue to implement measures to strengthen the regulatory and supervisory framework including in the areas of loan provisioning and capital adequacy. Most banks are expected to meet the new minimum capital requirement of SDG 80 million by end-2010, and SDG 100 million by end-2011. The government's repayment of a portion of its arrears to banks also contributed to a reduction in non-performing loans (NPLs). Regarding the restructuring of Omdurman National Bank, preparations for the restructuring are underway albeit with some delay.

C. External Debt and Relations with Creditors

21. **Sudan's external debt obligations continued to increase during 2010, although at a slower pace, reflecting lower disbursements of loans during the year compared to 2009.** Total debt obligations reached $36.2 billion by the end of September, with $30.5 billion estimated to be in arrears.

22. **The authorities are aware of the risks of nonconcessional external borrowing**. They emphasized that contracting of such loans had been limited in recent years and that such loans were generally tied to specific and vital development projects, especially in infrastructure and the oil sector. Preliminary information suggests that in 2010, the contracting of such borrowing amounted to $269 million, compared to an annual limit of $700 million. These loans, which are earmarked for infrastructure projects such as power transmission grids, building of dams and sewage systems, have a long maturity and appear to have some grant element, though below the 35 percent threshold, due to their generally moderate interest rate.

23. **Resolving Sudan's overdue financial obligations remains a high priority for the authorities.** Payments to the Fund in 2010 exceeded the minimum commitment. The authorities noted that the level of payments to the Fund in 2011 should be finalized once the outcome of the referendum is known since a possible independence of South Sudan is expected to have a significant impact on Sudan's foreign exchange earnings. The authorities continue to emphasize that comprehensive debt relief will be critical in achieving external debt sustainability.

24. **Fund and Bank staff held a debt workshop in Khartoum on December 12, 2010 as part of the Sudan Technical Working Group (Box 3).** Representatives from both the North and South attended, as well as members of the donor community. The workshop focused on the general dimensions of the debt relief process, the mechanism for clearing arrears with major international financial institutions (IFIs), and past experiences in debt apportionment. Attendees from both sides stressed the importance of laying out a roadmap for Sudan to normalize its relation with IFIs and swiftly move toward arrears clearance and debt relief.

Box 3. Sudan: Technical Working Group on Debt (TWG)

In the context of the roundtable on Sudan, which was convened during the 2010 Annual Meetings, the Fund and Bank staffs –at the request of some donors/creditors—agreed to co-lead a technical working group, including Sudan's major official creditors, on Sudan's external debt. The request received support from Canada, China, Germany, Japan, Netherlands, Norway, the UK, the African Development Bank, EC, and the UN, as well as Sudan. It was also welcomed by the Paris Club at its October tour d'horizon.

The objective of the Group is to provide factual information and objective analysis for the use of the international community, including parties to the CPA, in examining and understanding issues related to Sudan's external debt.

IV. Performance under Staff-Monitored Programs

A. Performance under the 2009–10 SMP

25. **Against the backdrop of the global crisis and the vast uncertainty ahead of the January referendum and the corrective actions taken starting the second half of the year, economic performance has been broadly satisfactory, although a number of end-June targets were missed.** The appropriate tightening of the fiscal and monetary stances earlier this year as well as the recent depreciation of the exchange rate reflect the authorities' determination to implement, during difficult moments, corrective policies to address exogenous shocks. Against this background:

- Three end-June quantitative targets were missed (Table 7): NIR accumulation, domestic financing and arrears clearance, with the latter being missed by only a very small margin. The NDA and nonconcessional borrowing targets were met.

- All structural benchmarks through end-June were met, albeit with a delay (Table 8). The tax policy review was finalized in September, while the review of tax exemptions granted under Investment Encouragement Act (IEA) was completed in October.

- Payments to the Fund in 2010 reached US$11.2 million, exceeding the minimum commitment under the SMP.

- Staff believes that the 2009–10 SMP met the standard of upper-credit tranche conditionality, except for the non-concessional borrowing.

B. Performance under Previous SMPs

26. **In assessing Sudan's engagement under the SMPs,[4] staff found that such engagement helped considerably improve macroeconomic policy management and better collaboration with the Fund on payments, but problems remain in a number of areas.** Notable achievements under previous SMPs include (i) significant progress towards restoration of macroeconomic stability; and (ii) implementation of a comprehensive structural reform agenda to improve capacity in economic management. However, some problems persist, including (i) slow implementation of reforms in the area of public financial management; (ii) weak build-up of international reserves, partly due to an insufficiently flexible exchange rate; and (iii) rising expenditure pressures, particularly in the aftermath of the CPA.[5]

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[4] During the Executive Board's discussion of the 2010 Article IV consultation with Sudan, Directors endorsed the authorities' request for the Fund to conduct an assessment of engagement under 13 years of successive SMPs in terms of progress achieved under the objectives of improved cooperation of the Fund on policies and payments.

[5] See ―Assessment of Engagement with the Fund under the Staff-Monitored Programs, 1997–2009," report to the Board, January 2011.

V. Macroeconomic Implications of Independence of South Sudan

27. **Staff discussed with the authorities a tentative illustrative scenario regarding the implications of the independence of South Sudan on the Sudanese economy.**[6] Under this scenario, North Sudan could lose a significant amount of its gross oil revenues—about 75 percent—and may therefore face domestic and external imbalances (Box 4).[7] The fiscal deficit could widen, but this could be partially offset by the decline in transfers to the South. The current account deficit could also deteriorate due to a sharp decline in oil exports.

28. **The ongoing negotiations have yet to yield an agreement on key CPA-related issues.** The authorities noted that the lack of clarity, particularly on wealth sharing and debt apportionment, have made policy formulation and planning very difficult. The authorities have been evaluating the possible implications of the independence of South Sudan under alternative scenarios with the aim of improving their preparedness to implement the necessary policies and manage the macroeconomic consequences of South independence.

29. **The authorities broadly agreed with staff assessment of the economic channels of a possible independence of South Sudan and the need to take appropriate measures to enhance the economy's resilience to this permanent shock.** They noted that although the exact implications of the independence of South Sudan on North Sudan's oil production and revenues remain uncertain, it is likely that there will be a considerable drop in oil related revenues and export income receipts. Staff and the authorities agreed that the key challenges will be to manage the necessary fiscal and external adjustments within an environment of limited access to external financing and low international reserves.

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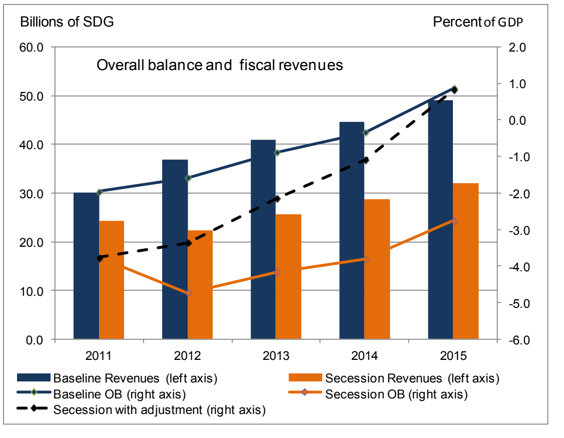
[6] Given that agreements, namely, on wealth sharing and debt are yet to be reached, staff underscored to the authorities that the assumptions underlying this scenario do not represent a projection or endorsement by staff.

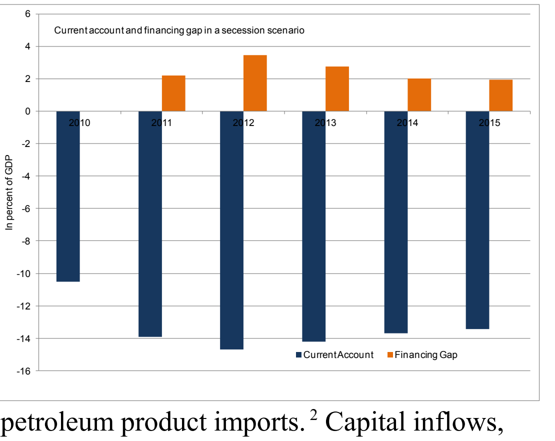
[7] This assessment is based on current geographical distribution of production. Although 75 percent of Sudan's oil production is in the South, the decline in the North's oil revenues is expected to be smaller because (i) under the current revenue sharing agreement, the North already transfers 50 percent of the oil revenues generated in the South to the Government of South Sudan; and (ii) the North is expected to receive pipeline and port fees from the South, given that the only export gateway for the South's oil is through the unique pipeline that runs through the North.

Box 4. Economic Implications of a Possible South Sudan Independence on the North

The independence of South Sudan could have significant impact on the Sudanese economy. North Sudan may lose some 75 percent of its oil revenues, which could translate into domestic and external imbalances. With oil revenue constituting more than half of government revenue and 90 percent of exports, the economy will need to adjust to a permanent shock, particularly at a time when the country has little access to external financing. The size and nature of the necessary adjustment could have significant implications for growth and macroeconomic stability.

Relative to the baseline scenario of a unitary state, the independence scenario relies on a number of assumptions,[1] including (i) a decline of about 75 percent in oil production, which roughly captures the geographic distribution of oil production; (ii) a 10 percent decline in non-oil GDP, to reflect the share of the South in total non-oil economic activity as well as a decline in oil related services; (iii) an increase in service receipts to reflect the transportation fees charged for the transportation of South's share of oil; (iv) a decline in both transportation payments and investment income payments to reflect lower oil production; (v) a decline in imports of goods to reflect the shares of the oil sector and the South; and; (vi) an increase in imports of petroleum products to reflect the shortfall in domestic production.





The effects of independence are expected to be transmitted through an immediate impact on the fiscal and external sectors. Government oil revenues are expected to drop by about 75 percent (equivalent to 6 percent of GDP). With about half of this revenue loss offset by the reduction in transfers to the South, the overall fiscal deficit is projected to widen by about 3 percent age points of GDP. The North's current account is expected to deteriorate by 4 percent age points of GDP during 2010–12, reflecting both a decline in oil exports and an increase in petroleum product imports.[2] Capital inflows, including FDI, are expected to decline in the short-run relative to the baseline scenario, contributing to the emergence of a financing gap that could reach 3–4 percent of GDP in 2012.

Maintaining macroeconomic stability will be predicated on implementing the necessary adjustments in a timely fashion. These include, exercising fiscal restraint, by streamlining non-priority spending, reducing fuel subsidies, reducing tax exemptions and enhancing revenue administration. Continuing to allow greater exchange rate flexibility, tightening monetary policy and a swift implementation of structural reform will also be crucial for a smooth adjustment and to ensure sustainable growth.

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[1] These are staff's assumptions for this illustrative scenario and do not reflect the views of the authorities, as many of these issues are still under discussion between the different parties.

[2] North's share of exports prior to secession is estimated to have been roughly 60 percent of total exports and with secession its share drops to 25 percent. The projected decline in oil exports of the North during 2010-2012 is roughly 50 percent reflecting a decline of 60 percent in volume which is offset by a 13percent projected increase in international oil prices.

VI. Staff Appraisal

30. **Sudan went through enormous challenges in the run-up to the January 2011 Southern Sudan referendum.** The economy suffered from successive shocks, starting with the food and fuel crisis in 2008, then the global financial crisis in 2009–10, and culminating in the political and economic uncertainties in the run up to the January 2011 referendum. Yet the authorities' resolve to preserve macroeconomic stability in a difficult environment are encouraging and should continue. Keeping the momentum of reforms will be critical to mitigate the impact of a possible independence of the South.

31. **The authorities' prudent fiscal policy is welcome, but the deficit financing mix should be improved.** Heavy reliance on the CBOS for financing the budget deficit in 2010 posed challenges for monetary policy implementation. The authorities should aim to have conservative foreign financing assumption in their budget in order to avoid heavy reliance on domestic financing in the event of shortfalls. The authorities should also step up efforts to enhance donors' budget support, with focus on grants and concessional lending.

32. **With the narrow tax base and rigid expenditure profile, fiscal adjustment needs to focus on widening the tax base and enhancing tax administration.** Staff urges the authorities to deepen fiscal reforms based on the recent review of the tax policy regime, with the objective of streamlining VAT and personal income tax exemptions. Staff also urges the authorities to gradually phase out fuel subsidies while simultaneously making progress on the design of a targeted social safety net using the recently completed household survey.

33. **The monetary stance should remain on a tightening bias in the period ahead.** Monetary aggregates have exceeded program targets, contributing to pressures on inflation and the exchange rate. There is, however, a need to ensure sufficient credit to the private sector to sustain growth. It will be important to closely monitor price developments and liquidity conditions, and adjust monetary policy as appropriate.

34. **Staff welcomes the recent depreciation of the exchange rate, which should ease pressures from the foreign exchange market.** Staff cautions the authorities that the depreciation mechanism introduced, albeit temporary, could create some market distortions and confusions, and should be reversed as soon as market conditions improve. Staff also calls upon the authorities to reverse the recently introduced quantitative fiscal measures aimed at discouraging some types of imports.

35. **Sudan is in debt distress and its arrears continue to constrain access to external financing.** Sudan's record of cooperation on economic policies and payments to the Fund augur well for the clearance of Sudan's arrears at the appropriate time. In the meantime, the authorities should minimize to the extent possible the contracting or guaranteeing of nonconcessional external borrowing, which would further weaken debt sustainability. The authorities should strive to begin a dialogue with creditors and donors with the aim of establishing wide support for debt relief. Staff welcomes the authorities' payments to the

Fund in excess of the minimum commitment for 2010. Given the recent deterioration in payment indicators, staff also encourages the authorities to significantly increase payments to the Fund as Sudan's payment capacity improves.

36. **Staff welcomes the authorities' efforts so far to prepare for a potential independence of South Sudan and encourages them to take appropriate measures to preserve macroeconomic stability.** The 2011 budget is a step in the right direction. In the event of a South Sudan independence, staff underscores the importance of bolder policy actions and strong coordination among government agencies to ensure a smooth transition in the period ahead through further determined adjustment measures.

37. **Looking forward, staff welcomes the authorities' resolve to undertake appropriate policies commensurate with the challenges they are facing,** namely, (i) the need to exercise fiscal restraint, especially by mobilizing non-oil revenue and streamlining expenditure; (ii) greater exchange rate flexibility; (iii) tighter monetary policy; and (iv) swift implementation of structural reforms.

Table 1. Sudan: Selected Economic and Financial Indicators, 2007–11

	2007	2008	2009 Prel.	2010 Proj.	2011 Proj.
(Annual changes in percent, unless otherwise indicated)					
Production, population, and prices					
Nominal GDP (in millions of Sudanese guinea, at market prices)	93,811	121,287	128,429	159,174	184,277
Nominal GDP (in millions of U.S. dollars)	46,531	58,028	55,802	64,365	65,554
Oil production (average, in thousands of barrels per day)	484	462	474	460	465
Population (in millions)	37.2	38.1	39.1	40.1	41.2
GNP per capita (in U.S. dollars)	1,147	1,394	1,316	1,488	1,465
Real GDP	10.2	6.8	6.0	5.1	4.7
Oil	33.0	-4.4	2.6	-3.0	1.1
Non-oil	7.5	8.5	6.4	6.1	5.1
Consumer prices (average) 1/	8.0	14.3	11.3	11.0	9.0
Consumer prices (end of period) 1/	8.8	14.9	13.4	10.0	8.0
(In percent of GDP)					
Investment and saving					
Gross investment	26.5	22.7	21.7	21.2	21.9
Gross national saving	15.6	15.0	10.9	13.5	14.1
Central government operations 3/					
Total revenue	20.6	21.8	15.4	16.0	16.4
Total expenditure	23.6	23.2	20.8	19.0	17.6
Overall balance (commitment basis)	-5.4	-1.4	-4.6	-2.7	-1.1
Non-oil primary balance 4/	-10.4	-7.6	-6.5	-5.5	-3.6
Non-oil primary operating balance 4/	-4.5	-3.6	-3.4	-2.7	0.3
Money and credit					
Broad money (change in percent)	10.3	16.3	23.5	23.0	16.2
Reserve money (change in percent)	12.8	22.2	28.1	14.3	13.2
Velocity (ratio of non-oil nominal GDP to average broad money)	4.2	4.5	4.8	4.5	4.5
(In millions of U.S. dollars; unless otherwise indicated)					
External sector					
Exports, f.o.b.	8,902	12,480	7,834	10,236	11,365
Of which: oil	8,443	11,904	7,131	9,433	10,440
Imports, f.o.b.	7,722	9,097	8,528	9,150	9,632
Current account balance (cash basis, percent of GDP)	-10.9	-7.7	-10.8	-7.7	-7.7
Terms of trade (Index 1993=100, change in percent)	-4.2	21.4	-36.3	38.4	2.7
Guineas per U.S. dollar (period average) 5/	2.02	2.09	2.30	...	...
Real effective exchange rate (change in percent)	-2.4	10.6	-4.3	...	...
External debt (in billions of U.S. dollars)	31.9	33.7	35.7	37.8	40.1
External debt (percent of GDP)	68.5	58.1	64.0	58.8	61.2
Debt service ratio (commitment basis) 6/	11.2	9.5	18.1	15.7	12.0
Debt service ratio (cash payments) 6/	2.4	2.9	5.7	4.2	3.9
Gross international reserves (in millions of U.S. dollars)	1,378	1,399	897	1,081	1,111
In months of next year's imports	1.4	1.6	0.9	1.0	1.0
Sudan's crude oil export price (U.S. dollars per barrel)	58.0	81.3	47.4	69.1	72.9

Sources: Sudanese authorities; and Fund staff estimates.

1/ CPI inflation for 2008 onward is based on a new base.
2/ Includes estimated capital spending by state governments.
3/ In calculating the base non-oil balance, oil revenues and grants were removed from revenues, while pipeline fees (recorded under goods and services) and oil-related subnational transfers were deducted from expenditures.
4/ In percent of non-oil GDP.
5/ For 2010, exchange rate is for end-November.
6/ In percent of exports of goods and services.

Table 2. Sudan: Central Government Operations, 2007–11 [1/]
(In millions of SDG)

	2007	2008	2009	2010		2011	
			Prel.	Prog.	Dec10 Proj.	Budget	Dec10 Proj.
Revenues and grants	19,307	26,424	19,780	28,003	25,542	25,814	30,145
Taxes	6,529	7,680	8,619	11,159	10,067	10,313	11,898
Oil revenues	10,893	17,338	9,519	13,984	13,156	12,276	14,957
Sales to refineries	3,283	3,513	2,840	3,875	2,792	3,551	4,026
Export revenues	7,610	13,825	6,679	10,109	10,364	8,725	10,932
Grants	522	572	719	1,317	1,061	1,164	1,228
Other nonoil nontax revenues	1,363	833	923	1,543	1,258	2,061	2,061
Expense (current expenditure)	19,835	24,331	22,073	27,536	26,060	25,056	27,119
Wages	6,368	5,951	6,836	8,348	7,649	7,961	7,961
Goods and services	1,924	2,919	2,375	2,205	2,403	1,915	1,915
Interest	897	1,088	1,254	2,027	1,364	1,420	1,420
Subsidies	1,287	2,519	712	1,163	1,380	832	1,389
Fuel	892	2,195	447	1,087	1,272	781	1,339
Other	395	324	265	76	107	51	51
Transfers	8,674	11,575	9,799	12,638	11,874	12,462	13,968
Of which: to South	3,352	6,159	4,485	5,064	5,464	4,788	5,947
to Northern states	5,323	5,396	5,288	7,520	6,353	7,631	7,976
Other expense	683	279	1,097	1,156	1,390	466	466
Operating balance (accrual basis)	-528	2,093	-2,293	467	-519	759	3,026
Net acquisition of NFA (capital expenditure)	4,525	3,838	3,572	5,713	3,748	6,121	5,016
Overall commitment balance (incl. discrepancy)	-5,053	-1,745	-5,865	-5,245	-4,267	-5,362	-1,990
Financing	5,053	1,745	5,863	5,245	4,267	5,362	1,990
Foreign	932	459	827	3,397	391	5,156	1,062
Domestic	4,120	1,286	5,036	1,848	3,876	207	927
Bank	720	-292	2,963	1,266	1,948	1,686	1,645
Of which: ORSA	-32	-869	585	-1,234	0	-759	-800
Nonbank	1,206	1,536	3,166	1,194	2,305	-779	-483
Accounts payable	2,194	42	-1,093	-612	-377	-700	-235
Of which: Arrears accumulation	2,613	471	522	0	0	0	0
Arrears paydown (-)	-419	-1,310	-1,615	-612	-377	-700	-235
Memo items: [2/]							
Overall balance (cash basis)	-2,859	-1,703	-6,958	-5,857	-4,644	-6,062	-2,225
Non-oil cash balance	-6,721	-8,391	-9,786	-11,322	-9,157	-9,660	-6,234
Non-oil cash primary balance	-5,824	-7,303	-8,532	-9,296	-7,794	-8,240	-5,737
Non-oil cash primary operating balance	-1,299	-3,465	-4,960	-3,583	-4,046	-2,119	202
Non-oil commitment balance	-8,915	-8,433	-8,693	-10,710	-8,780	-8,960	-5,999
Non-oil commitment primary balance	-8,018	-7,345	-7,439	-8,684	-7,417	-7,540	-5,502
Non-oil commitment primary operating balance	-3,493	-3,507	-3,867	-2,971	-3,669	-1,419	437

Table 2 (continued). Sudan: Central Government Operations, 2007–11 [1/]
(In percent of GDP)

	2007	2008	2009	2010		2011	
			Prel.	Prog.	Dec10 Proj.	Budget	Dec10 Proj.
Revenues and grants	20.6	21.8	15.4	17.6	16.0	14.0	16.4
Taxes	7.0	6.3	6.7	7.0	6.3	5.6	6.5
Oil revenues	11.6	14.3	7.4	8.8	8.3	6.7	8.1
Sales to refineries	3.5	2.9	2.2	2.4	1.8	1.9	2.2
Export revenues	8.1	11.4	5.2	6.4	6.5	4.7	5.9
Grants	0.6	0.5	0.6	0.8	0.7	0.6	0.7
Other non-oil nontax revenues	1.5	0.7	0.7	1.0	0.8	1.1	1.1
Expense (current expenditure)	21.1	20.1	17.2	17.3	16.4	13.6	14.7
Wages	6.8	4.9	5.3	5.2	4.8	4.3	4.3
Goods and services	2.1	2.4	1.8	1.4	1.5	1.0	1.0
Interest	1.0	0.9	1.0	1.3	0.9	0.8	0.8
Subsidies	1.4	2.1	0.6	0.7	0.9	0.5	0.8
Fuel	1.0	1.8	0.3	0.7	0.8	0.4	0.7
Other	0.4	0.3	0.2	0.0	0.1	0.0	0.0
Transfers	9.2	9.5	7.6	7.9	7.5	6.8	7.6
Of which: to South	3.6	5.1	3.5	3.2	3.4	2.6	3.2
to Northern states	5.7	4.4	4.1	4.7	4.0	4.1	4.3
Other expense	0.7	0.2	0.9	0.7	0.9	0.3	0.3
Operating balance (accrual basis)	-0.6	1.7	-1.8	0.3	-0.3	0.4	1.6
Net acquisition of NFA (capital expenditure)	4.8	3.2	2.8	3.6	2.4	3.3	2.7
Overall commitment balance (incl. discrepancy)	-5.4	-1.4	-4.6	-3.3	-2.7	-2.9	-1.1
Financing	5.4	1.4	4.6	3.3	2.7	2.9	1.1
Foreign	1.0	0.4	0.6	2.1	0.2	2.8	0.6
Disbursements	1.3	0.8	0.9	3.0	0.8	3.4	1.1
Principal repayment (-)	-0.3	-0.5	-0.3	-0.9	-0.5	-0.6	-0.6
Domestic	4.4	1.1	3.9	1.2	2.4	0.1	0.5
Bank	0.8	-0.2	2.3	0.8	1.2	0.9	0.9
Of which ORSA	0.0	-0.7	0.5	-0.8	0.0	-0.4	-0.4
Nonbank	1.3	1.3	2.5	0.8	1.4	-0.4	-0.3
Accounts payable	2.3	0.0	-0.9	-0.4	-0.2	-0.4	-0.1
Of which: Arrears accumulation	2.8	0.4	0.4	0.0	0.0	0.0	0.0
Arrears paydown (-)	-0.4	-1.1	-1.3	-0.4	-0.2	-0.4	-0.1
Memo items: [2/]							
Overall balance (cash basis) [3/]	-3.0	-1.4	-5.4	-3.7	-2.9	-3.3	-1.2
Net domestic financing (cash basis) [3/]	2.1	1.0	4.8	1.5	2.7	0.5	0.6
Non-oil cash balance [4/]	-8.7	-8.7	-8.6	-8.4	-6.8	-6.2	-4.0
Non-oil cash primary balance [4/]	-7.5	-7.6	-7.5	-6.9	-5.8	-5.3	-3.1
Non-oil cash primary operating balance [4/]	-1.7	-3.6	-4.4	-2.7	-3.0	-1.4	0.1
Non-oil commitment balance [4/]	-11.6	-8.7	-7.6	-7.9	-6.5	-5.8	-3.9
Non-oil commitment primary balance [4/]	-10.4	-7.6	-6.5	-6.4	-5.5	-4.9	-3.0
Non-oil commitment primary operating balance [4/]	-4.5	-3.6	-3.4	-2.2	-2.7	-0.9	0.3
Nominal GDP (SDG millions)	93,811	121,287	128,429	159,174	159,174	184,277	184,277
Non-oil GDP (SDG millions)	77,140	96,560	113,997	135,128	135,128	154,817	154,817

Source: Sudanese authorities; and Fund staff estimates.

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

Table 3. Sudan: Monetary Authorities' Accounts, 2007–11
(In millions of Sudanese guineas)

	2007	2008	2009	2010				2011
				Mar.	Jun.	Sept.	Dec.	
					Prel.		Proj.	Proj.
Net foreign assets	-4,098	-4,405	-5,719	-5,563	-5,878	-6,024	-4,639	-4,524
Foreign assets	3,552	4,078	3,218	3,930	4,325	4,070	5,159	5,474
International reserves	2,828	3,055	2,009	2,394	2,610	1,852	2,924	3,240
Other assets	724	1,022	1,209	1,536	1,714	2,218	2,234	2,234
Foreign liabilities	7,650	8,482	8,937	9,493	10,203	10,094	9,798	9,998
Short-term liabilities	489	920	657	1,384	1,747	1,367	1,566	1,484
Medium- and long-term liabilities	7,161	7,562	8,280	8,109	8,456	8,726	8,232	8,514
Counterpart to valuation changes	7,512	7,744	8,491	8,366	9,001	8,976	8,491	8,491
Net domestic assets	5,399	7,429	11,017	10,740	11,616	11,965	11,907	13,867
Net domestic credit	4,365	4,253	5,840	5,537	6,598	6,931	6,745	8,705
Net claims on central government	2,596	2,145	3,712	3,342	4,442	4,761	5,112	6,284
Claims	2,680	3,932	4,782	5,303	6,197	6,129	6,096	8,069
Temporary advances	592	1,432	2,877	3,037	3,887	3,887	3,685	5,185
Government securities	761	583	577	939	982	915	1,083	1,556
Long-term claims	1,328	1,918	1,328	1,328	1,328	1,328	1,328	1,328
Deposits	84	1,788	1,070	1,961	1,755	1,368	984	1,784
Of which: ORSA 1/	46	915	330	478	365	88	330	1,130
Net claims on government of the South	-3	-9	-3	-19	-4	-2	3	9
Net claims on public enterprises	295	429	333	338	323	322	333	383
Net claims on banks	1,361	1,649	1,779	1,834	1,771	1,799	1,246	2,009
Money market instruments (net)	116	39	19	41	66	51	51	20
Other items (net)	1,034	3,176	5,177	5,204	5,017	5,034	5,162	5,162
Reserve money	8,813	10,768	13,789	13,543	14,738	14,917	15,759	17,834
Currency outside banks	5,640	6,775	8,066	8,025	7,940	8,299	9,025	10,487
Reserves of commercial banks	2,836	3,495	5,387	5,113	5,946	5,800	5,991	6,604
Required reserves	792	880	763	889	917	1,337	1,431	1,665
Excess reserves	2,044	2,615	4,623	4,224	5,029	4,463	4,560	4,939
Deposits at Central Bank of Sudan included in broad money	338	498	337	406	852	818	743	743
Memorandum item:								
Central bank credit to government (cumulative change)	550	-356	1,567	-369	731	1,049	1,400	1,173

Sources: Sudanese authorities; and Fund staff estimates.

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

Table 4. Sudan: Monetary Survey, 2007–11
(In millions of Sudanese guinea)

	2007	2008	2009	2010				2011
				Mar.	Jun. Prel.	Sept.	Dec. Proj.	Proj.
Net foreign assets	-2,575	-2,328	-4,550	-3,952	-4,071	-3,978	-2,982	-2,739
Central Bank of Sudan	-4,098	-4,405	-5,719	-5,563	-5,878	-6,024	-4,639	-4,524
Commercial banks	1,523	2,076	1,169	1,611	1,807	2,046	1,657	1,785
Counterpart to valuation changes	7,492	7,786	8,526	8,426	9,044	9,021	8,534	8,537
Net foreign assets (excluding valuation adjustment)	4,918	5,458	3,977	4,474	4,973	5,043	5,552	5,799
Net domestic assets	14,812	17,476	24,338	25,683	27,111	28,268	29,275	34,670
Net domestic credit	17,268	19,052	25,129	26,004	27,726	29,247	30,481	35,876
Net claims on general government	3,960	3,663	6,632	6,394	7,692	8,153	8,586	10,237
Central Bank of Sudan net claims on central government	2,596	2,145	3,712	3,342	4,442	4,761	5,112	6,284
Central Bank of Sudan net claims on GOSS	-3	-9	-3	-19	-4	-2	3	9
Commercial banks claims on central government	1,367	1,527	2,923	3,071	3,254	3,393	3,471	3,943
Net claims on nongovernment sectors	13,308	15,390	18,497	19,610	20,035	21,095	21,895	25,639
Other items (net)	-2,456	-1,577	-791	-321	-616	-979	-1,206	-1,206
Broad money	19,715	22,933	28,314	30,156	32,084	33,311	34,827	40,469
Currency outside banks	5,640	6,775	8,066	8,025	7,940	8,299	9,025	10,487
Deposits	14,075	16,159	20,248	22,131	24,144	25,012	25,802	29,982
Demand deposits	8,247	9,796	11,381	12,661	14,321	14,530	14,947	17,227
Domestic currency	5,728	6,855	8,040	8,583	9,978	9,906	9,792	11,523
Foreign currency	2,520	2,941	3,341	4,078	4,343	4,624	5,155	5,704
Quasi-money deposits	5,828	6,362	8,867	9,470	9,823	10,482	10,855	12,755
Memorandum items:								
Reserve money (annual percentage change)	12.8	22.2	28.1	20.4	28.0	16.4	14.3	13.2
Broad money (annual percentage change)	10.3	16.3	23.5	27.2	28.3	26.5	23.0	16.2
Credit to nongovernment sector (annual percentage change)	16.3	15.6	20.2	23.3	21.3	22.6	18.4	17.1
Currency to broad money (in percent)	28.6	29.5	28.5	26.6	24.7	24.9	25.9	25.9
Foreign currency deposits to total deposits (in percent)	22.6	18.7	17.3	20.2	20.1	21.1	21.0	20.0
Broad money multiplier	2.2	2.1	2.1	2.2	2.2	2.2	2.2	2.3
Non-oil GDP velocity (average)	4.2	4.5	4.8	…	…	…	4.5	4.5
Gross international reserves (in million of U.S. dollars)	1,378	1,399	897	1,072	1,105	781	1,081	1,111
Commercial banks net foreign assets (in millions of U.S. dollars)	742	951	522	722	765	862	612	612
Commercial banks credit to the government (cumulative change)	170	64	1,396	148	331	471	548	473

Sources: Sudanese authorities; and Fund staff estimates.

Table 5. Sudan: Balance of Payments, 2007–11
(In millions of U.S. Dollars, unless otherwise indicated)

	2007	2008	2009	2010	2011
			Prel.	Proj.	Proj.
Current account balance	-5,812	-5,240	-6,906	-5,981	-5,834
Current account balance (on cash basis)	-5,074	-4,477	-6,044	-4,987	-5,073
Trade balance	1,180	3,382	-694	1,086	1,733
Exports, f.o.b.	8,902	12,480	7,834	10,236	11,365
Oil exports	8,443	11,904	7,131	9,433	10,440
Non-oil products	460	576	703	803	925
Imports, f.o.b.	-7,722	-9,097	-8,528	-9,150	-9,632
Foodstuffs	-723	-1,177	-1,441	-2,053	-1,993
Petroleum products	-256	-626	-287	-459	-510
Machinery and transport equipments	-4,099	-3,674	-3,348	-3,251	-3,432
Manufactured goods	-1,709	-1,705	-2,193	-1,917	-2,033
Services (net)	-2,934	-2,945	-2,072	-3,273	-3,325
Receipts	385	493	411	260	286
Payments	-3,319	-3,438	-2,483	-3,533	-3,611
Of which : oil transportation costs	-813	-789	-576	-808	-797
Income (net)	-4,640	-5,662	-5,200	-5,635	-5,991
Receipts	184	43	119	129	138
Non-oil payments	-857	-937	-1,063	-1,107	-841
Of which: interest cash payments	-86	-89	-120	-99	-89
Oil-related payments 1/	-3,967	-4,769	-4,256	-4,658	-5,288
Current transfers (net)	582	-15	1,059	1,842	1,750
Private transfers	209	-686	414	945	1,013
Public transfers	373	671	645	897	737
Capital account	0	0	0	0	0
Financial account (net)	4,092	3,692	5,141	4,212	5,045
Disbursements	593	422	1,156	497	746
Amortization	-270	-420	-519	-563	-557
Of which: cash payments (excluding IMF)	-88	-241	-338	-339	-368
Short-term capital flows and other assets (net) 2/	829	1,270	1,229	1,508	1,671
Commercial banks NFA (increase -)	-95	-209	429	-90	-92
FDI and portfolio investment (net)	3,036	2,628	2,846	2,860	3,277
Errors and omissions	274	648	216	558	0
Overall balance	-1,446	-901	-1,549	-1,211	-789
Financing	1,446	901	1,549	1,211	789
Change in net international reserves (increase -)	437	162	588	90	-100
Usable foreign reserves (increase -)					
Short-term foreign liabilities (increase +)					
Other foreign reserves (increase -)	122	-115	-72	-100	-50
Change in arrears	887	854	1,033	1,222	939
Financing gap	0	0	0	0	0
Memorandum items:					
Current account (in percent of GDP)	-12.5	-9.0	-12.4	-9.3	-8.9
Current account, cash basis (in percent of GDP)	-10.9	-7.7	-10.8	-7.7	-7.7
Non-oil current account (in percent of GDP)	-19.8	-18.9	-16.0	-14.7	-14.8
Gross Official Usable Reserves (end-period)	1,378	1,399	897	1,081	1,111
(in months of next years imports)	1.4	1.6	0.9	1.0	1.0
Exports (annual percentage change)	53.1	40.2	-37.2	30.7	11.0
Imports (annual percentage change)	8.7	17.8	-6.3	7.3	5.3
Crude oil exports (volume, in thousands of barrels)	139,000	144,748	151,273	137,319	140,363
Sudanese crude oil price (U.S. dollars per barrel)	58.0	81.3	47.4	69.1	72.9

Sources: Fund 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, 2007–15

	2007	2008	2009	2010	2011	2012	2013	2014	2015
		Act.				Proj.			
	(Change in percent, unless otherwise indicated)								
Production and prices									
Nominal GDP (in millions of U.S. dollars)	46,531	58,028	55,802	64,365	65,554	70,068	74,971	79,935	84,745
Real GDP	10.2	6.8	6.0	5.1	4.7	5.6	5.9	5.6	6.0
Oil	33.0	-4.4	2.6	-3.0	1.1	3.3	4.5	0.3	4.5
Non-oil	7.5	8.5	6.4	6.1	5.1	5.8	6.0	6.2	6.2
Inflation (period average)	8.0	14.3	11.3	11.0	9.0	7.0	6.0	6.0	6.0
	(In percent of GDP, unless otherwise indicated)								
Investment and saving									
Gross investment	26.5	22.7	21.7	21.2	21.9	22.0	21.7	21.5	21.3
Government 1/	9.5	6.5	5.4	5.0	5.7	5.8	5.5	5.3	5.1
Nongovernment	17.0	16.2	16.3	16.2	16.2	16.2	16.2	16.2	16.2
Gross national saving	15.6	15.0	10.9	13.5	14.1	14.4	14.2	13.9	13.7
Government	-0.6	1.7	-1.8	-0.3	1.6	2.0	2.5	2.9	3.4
Nongovernment	16.2	13.3	12.7	13.8	12.5	12.4	11.6	11.0	10.4
Central government 2/									
Total revenue	20.6	21.8	15.4	16.0	16.4	17.6	17.4	17.0	16.9
Of which: Non-oil revenue (excl. grants)	8.4	7.0	7.4	7.1	7.6	7.6	7.6	7.7	7.7
Total expenditure	23.6	23.2	20.8	19.0	17.6	18.3	17.8	17.2	16.7
Overall balance	-3.0	-1.4	-5.4	-2.9	-1.2	-0.8	-0.4	-0.1	0.3
Non-oil primary balance 3/	-7.5	-7.6	-7.5	-5.8	-3.7	-3.5	-3.2	-3.0	-2.7
Non-oil primary operating balance 3/	-1.7	-3.6	-4.4	-3.0	-0.5	-0.2	0.2	0.6	0.9
External sector									
External trade balance	2.5	5.8	-1.2	1.7	2.6	3.7	3.2	3.1	3.3
Exports, f.o.b.	19.1	21.5	14.0	15.9	17.3	18.4	17.7	17.6	17.8
Non-oil exports	1.0	1.0	1.3	1.2	1.4	1.4	1.4	1.5	1.5
Imports, f.o.b.	16.6	15.7	15.3	14.2	14.7	14.6	14.5	14.5	14.5
Current account balance on cash basis	-10.9	-7.7	-10.8	-7.7	-7.7	-7.6	-7.6	-7.6	-7.6
Gross international reserves (in months of import	1.4	1.6	0.9	1.0	1.0	1.2	1.5	1.7	1.9
Terms of trade (change in percent)	-4.2	21.4	-36.3	38.4	2.7	3.2	-2.1	0.9	1.1
Memorandum item:									
Crude oil export price (U.S. dollars per barrel) 4/	58.0	81.3	47.4	69.1	72.9	76.5	75.7	77.2	77.4
Crude oil production (thousands barrels per day)	484	462	474	460	465	480	502	504	526

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

1/ Includes estimated capital spending by state governments.

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

3/ As a percent of non-oil GDP.

4/ Sudanese oil blends. Projections are based on the latest WEO assumptions (based on future prices).

Table 7. Sudan: Status of Quantitative Targets in 2009-10 SMP

	2009 1/			2010 1/			
	Dec.			June			Dec.
	Target	Adj. Target	Actual	Target	Adj. Target	Actual	Ind. Target
(In millions of Sudanese guineas, unless otherwise indicated)							
Central Bank of Sudan net domestic assets (Ceiling) 2/	2,190	1,754	3,588	610	835	598	890
Domestic financing of the central government (Ceiling) 2/	3,003	2,567	5,038	855	1,080	1,724	3,060
Reduction in the stock of domestic arrears of the central government (Floor) 1/ 3/	721	721	1,093	200	200	195	377
Net international reserves (in millions of U.S. dollars) (Floor) 2/	-378	-183	-588	200	105	-227	-91
Contracting or guaranteeing of external nonconcessional debt							
by the government or the central bank (in millions of U.S. dollars) (Ceiling)	700	700	693	700	700	259	700
Payments to the Fund (in millions of U.S. dollars) (Floor)	10	10	11	…		3.2	10
Memorandum items:							
Broad money	4,128	…	5,381	2,691	…	3,769	6,512
Reserve money	1,292	…	3,022	1,365	…	948	1,970
Net central bank claims on government of Southern Sudan	-5	…	6	6	…	-1	6
Government oil export revenues	4,321	…	6,679	5,054	…	5,402	10,364
Of which: Net oil revenue stabilization account (ORSA) accumulation	-878	…	-585	617	…	35	0

Sources: Sudanese authorities; and Fund staff estimates.

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

Table 8. Status of Structural Measures for 2010

Measures	Objective	Timing [1/]	Status of Implementation
Tax Policy			
1. Undertake a comprehensive review of the tax policy regime with a view to (i) reducing VAT exemptions; (ii) reforming the personal income tax; (iii) clarifying tax jurisdiction issues with subnational governments; and (iv) optimizing the oil tax revenue management framework.	Raise revenue	July 2010	Not met. Done in September 2010.
2. Based on the review propose tax policy measures that could be implemented in the 2011 budget.	Raise revenue	December 2010	Done
Revenue administration			
3. Widen tax base through identifying and incorporating 400 additional companies currently outside of the tax system.	Improve tax compliance	October 2010	Done
4. Widen tax base by undertaking a review of tax exemptions granted under Investment Encouragement Act to identify entities that are no longer entitled to exemptions.	Improve tax compliance	June 2010	Not met. Done in October 2010 in the context of the 2011 budget.
5. Establish a database that allows a system of information-sharing, cooperation and coordination for registered companies in order to widen tax base.	Strengthen tax administration and improve transparency	October 2010	Done.
6. Ensure public oil companies transfer their profits directly to the Ministry of Finance and National Economy rather than to Sudan Petroleum Company.	Strengthen revenue administration	November 2010	Not done
7. (i) Implement customs evaluation system in accordance with WTO provisions and Sudan's custom law.	Improve tax compliance	July 2010	Not met.The delay was due to insufficient funding. It is expected to be done by early 2011.
(ii) Upgrade customs stations with ASYCUDA World software.		December 2010	
Expenditure Policy			
8. Based on the household survey to be completed in mid-2010, design a targeted social safety net as a prerequisite for the gradual rationalization of fuel subsidy. Specifically: (i) design a methodology study in the context of the PRSP; and (ii) propose implementation mechanism to the line ministries and states.	Protect the poor in the context of future fuel subsidy reform.	December 2010	The Household survey was compeleted, and the povertyline was determined. Work on I-PRSP and PRSP is in process, but further steps will be delayed after referendom.
Public Financial management			
9. Extend GFS 2001 budget classification to another 4 Northern states with a view to better monitoring general government's fiscal operations and tracking public spending by sector.	Strengthen fiscal management and reporting	November 2010	Done
10. Develop a medium-term fiscal framework to help buffer against the uncertainties of oil revenue volatility, and use it on a rolling basis for budget preparation.	Strengthen fiscal policy management	November 2010	Not done. Will be completed on the basis of the outcome of the referendum.
Financial sector			
11. Continue restructuring the Omdurman National Bank by: (i) closing its loss making branches (unless they become profitable); (ii) liquidating loss making companies fully owned by the bank; and (iii) implementing the remaining recommendations of the independent audit report.	Financial sector soundness	December 2010	One loss making branch has been closed and loss making companies owned by the bank have been liquidated.

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

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INTERNATIONAL MONETARY FUND

SUDAN

Staff Report for the Second Review Under the 2009–10 Staff-Monitored Program

Supplementary Information

Prepared by the Middle East and Central Asia Department
(In consultation with other departments)

Approved by Alan MacArthur and Jan Kees Martijn

February 4, 2011

1. **This supplement provides additional information on developments and performance since the issuance of the staff report for the Second Review under the Staff-Monitored Program (SMP).**[1] The information contained in this supplement does not alter the thrust of the staff appraisal.

2. **Preliminary results of the referendum on South Sudan self-determination indicate that over 99 percent of Southern Sudanese have voted in favor of independence.** These results were officially recognized by the Sudanese Vice President Ali Osman Taha. The referendum, which took place as scheduled during January 9–15, 2011 was lauded by international observers, including the United Nations, European Union, and United States, as credible, up to international standards and representative of the will of the people. Government officials in both the Northern part of Sudan and South Sudan are now turning

[1] The findings in this report are based on a staff visit to Khartoum and Juba during January 21-31, 2011. The team consisted of E. Gemayel (head) and J. Dridi (both MCD), and L. Liu (FAD Messrs. A. Zoromé (Resident Representative) and A. Yasin (economist from the Resident Representative Office) assisted the mission. Mr. A. Ndyeshobola from the ED office participated in some of the meetings. In Khartoum, the mission met with Mr. Ali Mahmood Abdul-Rasool, Minister of Finance and National Economy; Mr. Luka Biong, Minister of Cabinet Affairs; Dr. Sabir Mohamed Hassan, Governor of the Central Bank of Sudan (CBOS); other senior officials, and representatives of the business, donor, and diplomatic communities. In Juba, the mission met with Mr David Deng Athorbei, Minister of Finance and Economic Planning; Mr. Elijah Malok Aleng, President of Bank of Southern Sudan and Deputy Governor of CBOS; Mr. Kosti Manibe, Minister of Cabinet Affairs; Mr. Gabriel Changson Chang, Minister of Culture and Heritage; Mr. Stephen Dhieu, Minister of Commerce and Industry; Mr. Oyay Deng Ajak, Minister for Investment; and representatives of the business, donor, and diplomatic communities.

their attention to the unresolved CPA-related issues, namely wealth sharing, debt apportionment, currency, citizenship, border, and the status of the oil-rich area of Abyei.

I. Northern Part of Sudan

A. Recent Developments

3. **Economic indicators confirm a weakening in late 2010.** There is evidence of continued fiscal tightening in the last quarter of 2010 but price pressures appear to be mounting.

- ***Inflation increased to 15.4 percent in December (y-o-y) compared to about 10 percent in November.*** The increase was largely due to a surge in food prices, which increased by almost 20 percent during the same period. Several factors contributed to the surge in food prices, namely an increase in international food prices, uncertainties in the run-up to the referendum, depreciation of the Sudanese pound and high money growth, as well as early speculation about possible removal of subsidies on petroleum products, sugar and other products.

- ***Fiscal tightening continued in the last quarter of 2010.*** Both revenues and expenditures declined by an estimated 0.7 percentage point of GDP in the fourth quarter. About half of the drop in revenue was due to lower-than-expected oil production, while the reminder was due to a shortfall in non-oil revenue. In response, the authorities compressed current spending. The estimated overall commitment-based deficit for 2010 remained in line with the estimate in the staff report.

- ***Preliminary December data show that twelve-month reserve money and broad money grew by 17 percent and 25 percent, respectively.*** The latter was largely driven by an increase in the banking system's lending to the government, whereas credit to the nongovernment sectors grew by about 15 percent.

- ***Pressure on the exchange rate eased somewhat, following the November de facto depreciation***. Since then, the official and parallel rates have continued to converge, while the premium has slightly dropped to about 16 percent. This has allowed the Central Bank of Sudan (CBOS) to limit its intervention and rebuild its international reserves. Anecdotal evidence suggests that the depreciation has also enabled banks and exchange bureaus to attract foreign inflows from the informal market.

- ***Preliminary data suggest that four end-December indicative targets were missed****:* NDA, NIR accumulation, domestic financing and arrears clearance. The nonconcessional borrowing and payment to the Fund targets were met. The NDA target was missed due to the shortfall in government revenues and foreign

financing. The NIR target was missed due to continued intervention in the foreign exchange market although reserves have rebounded somewhat since the November depreciation.

- ***Several structural measures have been implemented, though with some delay.*** The tax review has been completed and its main recommendations will be incorporated within the context of the supplementary budget, which is expected to be issued in the second quarter of the year. The revenue administration reform has been done and incorporated within the context of the 2011 budget. The customs evaluation system has been implemented, including by purchasing a new software and conducting training to core staff with assistance from the UNCTAD. The authorities expect to finalize the upgrade by September 2011.

B. Fiscal Issues

4. **The authorities announced a number of measures in early January 2011 and is planning to issue a supplementary budget during the second quarter of the year.** The design of the supplementary budget will largely depend on the expected agreements between the CPA parties with regard to outstanding post-referendum issues, particularly oil revenue sharing.

5. **The authorities announced in early January a reduction in subsidies and introduced new safety net measures to mitigate their impact on the poor.** In response to the recent surge in international oil and food prices, the authorities raised the prices of some fuel products and sugar[2], in order to contain their budgetary impact. This is expected to yield about one percentage point of GDP in savings compared to the 2011 projections. At the same time, the government introduced new social safety measures. These include (i) an across-the-board increase in civil servants and pensioners' wages (SDG 100 per month), (ii) targeted support to poor families and students, (iii) further transfers to the health insurance programs, and (iv) additional resources for the agriculture and industry development funds.

6. **Staff welcomes the authorities' decision to raise fuel and sugar prices and to introduce social safety nets.** The subsidy reduction, through an increase in taxes on petroleum products, will narrow the gap between world and domestic prices and free up critically needed fiscal resources. Staff, however, recommended for future subsidy reductions a gradual increase in the price of the crude oil delivered to the refineries, in order to make the

[2] The price of diesel was raised from SDG4.5 to SDG6.5 per gallon; the price of gasoline was raised from SDG6.5 to SDG8.5; the price of fuel jet was raised from SDG4.65 to SDG6.5; and the price of cooking gas was raised from SDG12 to SDG13 per container. The price of a 50 kilogram sack of sugar would rise from SDG128 to SDG 148. The last increase in fuel prices was in 2006. The price of the crude oil delivered to refineries, however, has remained unchanged at $49/barrel since 2004.

subsidy more explicit and transparent. While the introduction of social safety net measures is appropriate, staff emphasized the importance of avoiding non-targeted measures. In this regard, staff called on the authorities to limit the SDG100 salary increase –equivalent to a 20 percent increase in the wage bill—to the lowest tiers of the wage scale.

7. **The authorities are currently preparing a supplementary budget to further tighten government spending and enhance non-oil revenue collection, as a result of the expected independence of South Sudan.** Several measures are being proposed on the expenditure side including a salary cut for senior ministerial positions, a reduction in the purchase of some goods and services, a budget cut for mission travel, and a reduction in diplomatic missions' spending. In addition, the authorities are also planning to restructure various ministries with the aim of downsizing both the central and state governments. On the revenue side, the authorities recently announced the removal of the VAT exemptions on some computer and medical supplies, as well as on sport equipments. Overall, these measures are expected to yield about 0.2 percent of GDP in budgetary savings this year. Plans are also underway to undertake further reforms to streamline tax exemptions and enhance revenue administration.

8. **Staff supports the above proposed measures, which would restrain government spending and mobilize non-oil revenues**. However, the required budget adjustment is likely to exceed the steps contemplated so far, which would call for additional measures. While the commitment to reduce tax exemptions on some limited items is a step in the right direction, staff underscored the importance of streamlining all exemptions. Staff also encouraged the authorities to consider further reduction in fuel subsidies. More generally, staff reiterated the importance of moving swiftly with their reform agenda.

II. SOUTH SUDAN

9. **In the context of the first visit to South Sudan, staff had fruitful discussions with local authorities on some of the key issues**, namely general IMF membership process, debt relief, currency issues, exchange rate regime, and technical assistance needs.

10. **The local authorities inquired about IMF membership and expressed their intention to apply for it soon after the results of the referendum are finalized.** In this context, the mission explained to the authorities that IMF membership is open only to countries and the Fund's determination as to whether an applicant is a country is informed by the views of the international community, in particular Fund members. The mission also highlighted the different steps required under the membership process.

11. **South Sudan plans to issue and manage its own currency by the end of the year.** However, the preparations for the introduction of a new currency may be protracted. The authorities explained to the mission that they are discussing with the Northern part of Sudan the possibility of continuing using the Sudanese pound for 6-9 months after the expiration of the CPA in the July. The mission advised the local authorities to move cautiously on this

issue and offered IMF technical assistance in this area. The authorities have also discussed the possibility of redemption of Sudanese pounds currently in circulation in the South by the North.

12. **The discussions also covered the choice of suitable new exchange rate regime.** The mission noted that a fixed regime, possibly through a currency board arrangement (CBA), would likely serve South Sudan best in view of its relative simplicity and it would also ensure fiscal discipline and economic stability. However, it underscored that a CBA would require sound public finances, absence of lending to the government, and an adequate banking supervisory framework. The mission advised against the adoption of a flexible exchange rate regime, as this would require a sophisticated institutional framework for the conduct of monetary policy. The mission also cautioned against the possible involvement of the new monetary authority in any economic activities outside the normal core functions of a central bank. Above all, the mission emphasized the importance of ownership, consensus, and political support at the highest level, for any regime they would adopt, particularly in the case of a CBA.

13. **Technical assistance in various areas is being provided by a number of donors** (DFID, EU, Norway, Swiss, USAID, UN, and WorldBank). The mission explained to the authorities the Fund's areas of expertise and its readiness to assist as needed, in coordination with other donors.

III. Debt Issues

14. **Sudan's external debt obligations continued to increase during 2010, although at a slower pace, reflecting a slowdown in loan disbursements during the year compared to 2009.** The estimated total debt obligations reached $36.8 billion by end-December, of which $30.8 billion are estimated to be in arrears.

15. **With the referendum completed peacefully and successfully, the parties to the CPA are urging that a roadmap towards debt relief should be put in place as soon as possible.** Both parties have also agreed to tackle the debt relief process jointly, even in the absence of an agreement on debt apportionment. They will launch high-level political efforts to establish broad-based international support. Also, they both believe that a stable Northern Sudan is in the best interest of its neighbors, particularly the South.

16. **The two parties expressed different views regarding debt apportionment.** From the perspective of the Khartoum authorities, debt can only be solved in the context of a comprehensive agreement on all outstanding CPA-related issues. They also consider that the South should shoulder part of this debt. The South, on the other hand, refuses to take on any of the debt, but pointed that in case of apportionment, the debt should be allocated geographically, according to the ultimate beneficiary principle.

17. **The Sudanese authorities have initiated a debt reconciliation exercise with their creditors.** As of mid-January 2011, the authorities have received creditor statements from most multilaterals, half of the Paris Club bilaterals, and about a third of the non-Paris Club bilaterals. Progress on private debt reconciliation have yet to start.

18. **The Sudan Debt Technical Working Group (TWG) met for the first time on February 3, 2011.** Discussion focused on the TWG objectives and work program over the coming months.

Statement by Mr. Moeketsi Majoro, Executive Director for Sudan
February 9, 2011

My authorities have demonstrated their commitment to peace and democracy by ending many years of internal conflict and holding the referendum on Southern Sudan self-determination on schedule. Despite the significant challenges, they have been able to achieve a strong track record of sound economic policy implementation and structural reforms as demonstrated by a series of successful Staff Monitored Programs (SMPs) over the past decade which improved economic management capacity. My authorities have also continued to cooperate with the Fund on policy implementation and clearing of arrears. In this regard, they have benefitted from IMF technical advice and have continued to make payments to the Fund broadly in line with their commitments.

While the strong engagement with the Fund has helped the authorities restore macroeconomic and financial stability, my authorities are disappointed at the slow pace of full normalization of relations with the Fund. They particularly regret that the good cooperation has not led to external debt relief which is critical for economic normalcy. Sudan’s debt burden is not sustainable without debt relief and with limited access to concessional financing, my authorities have had to borrow on non concessional terms, further compounding the debt problem. With the economy struggling to regain its growth momentum after the global downturn and the uncertainties surrounding the outcome of the recent referendum, more challenges are expected in macroeconomic management. Without the full support of the international community, it would be difficult to consolidate the peace and maintain the economic successes of the past decade. Going forward, my authorities are committed to continue their engagement with the Fund as they strive to address these issues.

Economic growth prospects

Currently, my authorities are implementing their Medium Term 5 Year Plan (2007-2011) through the FY 2011 budget designed under the assumption of a unitary state. However, my authorities are aware that the near-term economic outlook would need to reflect recent political developments following the final announcement of the referendum results and the success in resolving outstanding issues spelt out in the CPA (2005) in the transition period. In this regard, many committees for various clusters of the post referendum issues are addressing the implications of possible secession including on the macro economy. A supplementary budget is expected to capture the ensuing changes. In the medium term, development financing needs are expected to be enormous requiring significant support by the international community including resolving the external debt issue. Not only do the authorities foresee diversification of sources of growth as critical, but also promoting private sector led growth. My authorities have supported diversification by increasing government financing to the agricultural sector through the Green Mobilization Program (2008-2011) whose key objective it to revitalize the agricultural sector. They are also committed to addressing key factors in creating an enabling business environment, weak market institutions, inadequate infrastructure and cumbersome administrative barriers. The government of Southern Sudan (GOSS) is also prioritizing development of governance

institutions and structures and, to that end, is in need of substantial technical and financial support.

Monetary policy

My authorities recognize the challenges of conducting monetary policy in the context of limited foreign financing, uncertainty in oil revenues and declining foreign reserves. However, they are committed to a prudent monetary policy and they consider containing inflation as the primary objective of monetary policy. Thus, liquidity management including interventions in the foreign exchange market are all aimed at restraining inflation. In managing foreign reserves, my authorities' strategy is to rationalize demand of foreign exchange through judicious restraint on non-priority imports and also promoting non-oil exports as well as working towards encouraging non-debt creating flows, such as foreign direct investment. It is in this context that the authorities introduced measures to curb demand for foreign currency during the FY 2010 in an effort to build foreign reserves. My authorities are taking a cautious move towards a flexible exchange rate. In this regard, they intend to achieve exchange rate stability by pegging the Sudanese currency to a basket of currencies.

Fiscal policy

My authorities have implemented various measures to enhance mobilization of tax revenue and are committed to strengthen public finance management. Various tax measures have been put in place since 2000 including the introduction of VAT, a petroleum excise tax and improvements in the import tariff structure. Reducing tax exemptions and evasion as well as expanding the tax base remain an important fiscal policy objective. They have discontinued the practice of providing ad hoc exemptions under the Investment Encouragement Act (IEA) and are considering bringing a large section of the agricultural sector into the tax base. This notwithstanding, the growing services sector which mainly consists of small and medium-sized enterprises has not contributed significantly to overall tax collection while a large and growing informal sector and unrecorded transactions especially among the self-employed in rural agricultural sector and urban centers are complicating tax compliance. With the review of the tax policy completed, the authorities look forward to further deepening their tax reforms.

Significant reforms in public finance management (PFM) have been implemented including establishment of a modern budget management system, but a lot more needs to be done. Going forward, my authorities will focus on deepening PFM reforms which is complicated by limited fiscal decentralization, as most state and local authorities lack the technical skills and information technology needed to mobilize revenue from local sources. They will be seeking support in these areas from the Fund and other development partners.

Overdue financial obligations and debt

My authorities have continued to meet their overdue obligations to the Fund with payments in 2010 exceeding obligations falling due and authorities' commitments. As a result overdue

obligations have declined. It is their expectation that the Technical Working Group on Debt will finalize the debt stock reconciliation soon so that the process of resolving debt obligations is completed in the transition period. My authorities are optimistic that they will reach an agreement on how to share the debt obligations with the GOSS. They call upon the donors to support them in the efforts to qualify for debt relief and to create the necessary macroeconomic space to pursue concertedly economic growth and poverty reduction objectives.

The post-referendum period

The final official announcement of the referendum results will be made on February 14, 2011. The authorities are assessing the macroeconomic implications of a possible secession by Southern Sudan. Independence of the South would mean significant loss of oil revenue for the North, resulting in domestic and external imbalances which would require strong donor support to address, while the South would also require assistance in building the institutions to run the country and manage the economy. A balanced approach by the international community to assist both the North and the South would be critical in maintaining peace and stability of the region. In accordance with the CPA (2005), some key outstanding issues, including wealth and debt sharing, currency, nationality and borders, must be resolved in the transition period in order to maintain stability and progress. My authorities have committed to respect the outcome of the referendum and to support viability of the Southern Sudan economy. They are committed to providing needed technical assistance to the GOSS given that it faces various challenges including limited capacity in its civil service. The GOSS is also expected to use the Sudanese pound until their legal tender is in place. Further, the GOSS expects to tap into the Fund's technical assistance in setting up its monetary system including a new currency, exchange rate regime and financial systems. My authorities are committed to continue with their membership and retain their quota at the IMF while the GOSS will possibly be making an application for admission for membership of the IMF in due course and are counting on the Executive Board's support.