

**INFORMAL
SESSION TO
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To: Members of the Executive Board

From: The Secretary

Subject: **Sudan—Statement by the Staff Representative on Proposed High Access Under the Poverty Reduction and Growth Trust**

Board Action: **Informal session to engage** Executive Directors

Tentative Board Date: **Wednesday, April 14, 2021**

Questions: Ms. Baker, MCD (ext. 34041)
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**Statement by the Staff Representative on Proposed High Access
Under the Poverty Reduction Growth Trust for Sudan
Informal Board Meeting
April 14, 2021**

The Sudanese authorities have requested Fund assistance under the Extended Credit Facility (ECF) in the context of their efforts to secure debt relief under the Enhanced HIPC Initiative. Sudan's current exposure to PRGT resources stands at 34.9 percent of current quota. With staff's proposal to provide the equivalent of 275 percent of quota over a 39 month period, and based on the planned disbursements and repayments schedule, total access to PRGT resources would remain below the 300 percent of quota stock trigger at any point of time, but exceed the 240 percent of quota flow trigger, which activates the high access procedure. Discussions with the authorities are planned to start in mid-April 2021.

I. Context

1. Sudan is the Fund's last protracted arrears case and is eligible for debt relief under the Enhanced HIPC Initiative. The transitional government established in August 2019 is currently implementing an ambitious reform program under an SMP which the Executive Board has endorsed to be of UCT quality. A minimum 6-month track record of satisfactory program performance required to reach the HIPC Decision Point could be achieved based on an end-March 2021 test date.

2. The proposed arrangement forms part of the financing package to clear Sudan's arrears to the IMF which amount to SDR965 million. The high access is driven by the large size of Sudan's arrears and financing needs. The disbursements are heavily front loaded because the initial disbursement will be used by Sudan to repay the intra-day bridge loan used to clear its arrears upon approval, with additional access provided over the remainder of the arrangement to support reserve accumulation.

II. Background

3. Sudan is on a path to reintegrating with the international financial community and resolving its unsustainable debt burden. In December 2020, Sudan was removed from the U.S. list of State Sponsors of Terrorism (SSTL), lifting sanctions, and on March 26, 2021 Sudan cleared its arrears to the World Bank, thereby regaining access to multilateral funding through IDA facilities and windows. Arrears clearance to the African Development Bank (AfDB) is in train, and progress has been made on identifying a financing package for the clearance of arrears to the IMF. The ECF-supported program would aim to support Sudan in reaching the HIPC Completion Point (CP) and to guide the needed reforms for eventual debt relief.

4. The authorities have taken difficult first steps to remove economic distortions but large financing needs weigh on macroeconomic stability. In addition to the impact of COVID-19 and historic flooding in 2020, massive monetization of the fiscal deficit, low reserves which

contributed to pervasive food and fuel shortages, and the level shift up in administered prices fueled an inflation-depreciation spiral and triple digit inflation (269 percent in December 2020). The fiscal adjustment resulting from the removal of large retail gasoline and diesel subsidies and the move to a managed float exchange rate regime are significant, but fiscal revenue is low and financing needs are large—without additional budget financing monetization will continue over 2021–22, albeit at a much lower level than during previous years. Recent arrears clearance would unlock multilateral resources.

5. Policy actions and the strong support of the international community contribute to an improved outlook. Growth is expected to pick up gradually as domestic activity recovers from the COVID-19 pandemic and the Sudan Family Support Program (SFSP) provides support to an increasing number of families to offset the impact of needed reforms. Arrears clearance would unlock multilateral resources and the recent unification of the exchange rate and fiscal policy measures to raise revenue and reorient spending will help to engender greater macroeconomic stability, while an improved business climate is expected to attract FDI and support job-creating small and medium enterprises (SMEs). Growth is expected to peak at 6.8 percent in 2025, driven by strong grant financing and FDI, before gradually settling at 4½ percent over the long-term. Inflation would decline to the low double digits next year as monetization is reduced and the transitory effect of the customs exchange rate unification and tariff reform is passed through, before stabilizing at 6 percent over the medium-to-long-term.

6. While near-term risks are tilted to the downside, medium-term risks are balanced. The sustained implementation of policies that stabilize the economy and strengthen the business climate would help to stimulate a virtuous cycle of lower inflation and higher investment (including FDI) that would leave Sudan well-placed for stronger and more inclusive growth.

7. Yet, the socio-economic-political situation remains fragile with significant risks. The sources of fragility are deeply rooted in history, wide-ranging and many will persist in the period ahead as the country moves forward toward eventual elections. While financial reintegration and access to multilateral resources will help reduce financing needs, development needs are large and Sudan will continue to rely on grants in the period ahead at a time when the availability of donor financing has been impacted by the COVID-19 pandemic. At the same time, shortages of food and fuel have added to inflationary pressures resulting from the liberalization and adjustment of prices and international reserves are low, while violence on the Eastern border has added to the large refugee and displaced person population of over 1 million. Institutional capacity is weak as is data, and work remains to be done to bring together a legislative body capable of working effectively together in support of advancing the policy agenda.

III. Policy Framework Underpinning the Proposed Program

With initial reforms under the SMP addressing some of the key distortions in the economy, the ECF-supported program will focus on structural reforms required to address balance of payments needs, strengthen governance and avoid a return to distortionary economic policies while bringing about sustained and inclusive private-sector-led growth in support of economic stability and durable

poverty reduction. Conditionality will also support progress toward the floating HIPC Completion Point Triggers and debt relief. Measures under the program will be appropriately ambitious taking into account Sudan's fragilities and reform needs.

8. The structural reform agenda proposed in the ECF-supported program is expected to be broad and well targeted to Sudan's key needs, with a particular focus on institution building in support of durable reform.

- **Fiscal Reforms and Framework:** The program would aim to strengthen budget preparation, fiscal reporting and transparency while targeting an overall fiscal deficit of around 1 percent of GDP over the medium-term. Such an anchor reflects a conservative view of the outlook for foreign financing, the amount that can be comfortably financed from non-inflationary domestic sources, and the required adjustment to sustain a low public debt-to-GDP ratio after HIPC debt relief, while allowing a needed increase in social and capital spending. Adoption of a 2022 budget consistent with program priorities including the aforementioned fiscal anchor is expected under the program, as is developing a PFM Roadmap and broadening budget reporting to include general government and the largest SOEs. The program also seeks to enhance domestic revenue mobilization through customs exchange rate unification, the elimination of exemptions, strengthening of the Large Taxpayer Office, and adjustments to the corporate and personal income tax regimes.
- **Monetary and Exchange Rate Policies:** A key goal is for the central bank to gain control over monetary aggregates by eliminating monetization and developing effective monetary instruments in support of reserve money targeting. Work underway to strengthen central bank independence and adopt a dual banking system with both Islamic and conventional banking will greatly improve monetary control once fiscal dominance is eliminated and a domestic securities market is developed. The proposed program will also likely involve maintenance of the recent move to a market-determined exchange rate, revisiting the size and need for the band, and limiting intervention and avoiding actions which will lead to market fragmentation or re-emergence of a parallel market.
- **SOEs:** The SOE sector is large and opaque with many companies operating outside of the control of government. Reducing the role of the state would not only reduce fiscal risks but create a more enabling environment for private sector-led growth. The proposed program could involve development of an SOE strategy and transfer of financial control of all SOEs to the MOF, as well as targeting a strengthening of the legal and regulatory framework of SOE governance including financial reporting, external audit, and disclosure requirements.
- **Governance and Transparency:** Improvements in governance and transparency permeate all areas of the proposed program. Work is underway to pass the anti-corruption law and establish an Anti-Corruption Commission. Beyond those previously mentioned, other areas proposed in the program include: strengthening AML-CFT including to support the return of correspondent banking; divestiture of CBOS holdings in commercial and development banks; and strengthening procurement. A Governance Diagnostic currently underway is expected to produce a roadmap of reform priorities over the coming 12-18 months to inform the agenda.

- **Debt Management and Statistical Capacity:** Statistical capacity remains very weak despite extensive TA while fragmented oversight of debt hinders effective debt management. The program proposes establishment of a single debt management office with the mandate to manage external and domestic debt, promulgate regulations and operations procedures for approval, issuance and monitoring of loan guarantees, and enhance coordination with fiscal policy. Transparency would be supported by quarterly and annual published debt reports that also feed into the budget process, and strengthening the Supreme Audit Institution's role in providing oversight of the budget process. Policy making and debt analysis rely on strong national accounts data which is currently lacking in Sudan. Critical actions in the statistical area could include updating the base year of National Account data (currently 1981); expanding the fiscal accounts to include General Government statistics; and addressing the large Errors and Omissions in the BOP through better data collection and reporting. An ambitious TA workplan would support these actions.

IV. Modalities and Impact on the Fund's Concessional Resources

9. Staff intends to propose a 39-month ECF arrangement with access of 275 percent of Sudan's new quota (SDR 1.733 billion) with phasing in line with the arrears clearance process and financing needs.

The arrangement will be proposed for Board consideration following the clearance of Sudan's arrears to the Fund and its quota payment. A first disbursement of 157 percent of quota will provide for arrears clearance (153.05 percent of quota) and also support accumulation of reserves. Disbursement of the remaining access of 118 percent of quota to further support reserve accumulation will be backloaded. Sudan's reserve coverage is well below adequate levels and its balance of payments needs are protracted. Fund disbursements would constitute budget support insofar as there is continued monetization, requiring an MOU to be signed between the CBOS and MOF.

10. In addition to the ECF disbursement, identified grant financing from other multilateral and bilateral donors are expected to help cover financing needs.

Staff is in close discussion with the World Bank and other donors to ascertain firm financing assurances for 2021–22 including the possibility for greater budget support to help eliminate monetization, and the expected support envelop for the following years. The World Bank is expected to provide substantial grant support to Sudan, including the Sudan Family Support Program. Moreover, the authorities will seek to secure the necessary financing assurances from other external creditors that they will provide relief in line with the HIPC Initiative. Staff will confirm financing assurances for the first 12 months of the program, and that there are good prospects over the remainder the program.

11. Program performance will be monitored through semi-annual reviews. Quantitative performance criteria aim at maintaining fiscal discipline through a ceiling on net credit to government; ensuring low inflation and monetary stability via a ceiling on net domestic assets; strengthening the external position through a floor on net international reserves; preventing the non-accumulation of non-concessional debt and guarantees as well as external arrears; and maintaining a well-functioning exchange rate system through a ceiling on the introduction of

exchange rate restrictions. Indicative targets would support critical social spending and monitor tax revenues (floors); cap fuel subsidies and ensure the non-accumulation of domestic payment arrears; and support fiscal discipline through a ceiling on the primary balance and reserve money. In light of the frontloading of access, any reforms considered but not completed under the SMP could be converted to prior actions or structural benchmarks under the ECF.

12. Following the provision of debt relief under the HIPC framework Sudan's capacity to repay the Fund will be adequate. Standard indicators of Fund exposure show that credit outstanding would peak at USD1.99 billion (SDR 1.36 billion) or 216 percent of quota in 2023 and then decline following the HIPC Completion Point and application of HIPC and beyond-HIPC debt relief. Obligations to the Fund would peak at 4 percent of GDP and 74 percent of reserves in 2023. Risks to debt servicing will be mitigated by HIPC debt relief, continued access over the foreseeable future to concessional financing and improved debt management capacity under the program.

13. Sudan's public debt would become sustainable on a forward-looking basis, but only contingent on the full delivery of HIPC debt relief. Under the baseline scenario, in which traditional debt relief is delivered at HIPC Decision Point in 2021, Sudan's debt remains unsustainable with all external and public debt indicators remain significantly above the respective thresholds for the medium term despite traditional debt relief. Without additional debt relief there is a significant and protracted breach of the present value (PV) of debt-to-GDP ratio and the PV of external debt-to-exports ratio does not fall below the threshold until the end of forecast horizon. Under this scenario Sudan continues to be in debt distress as substantial external arrears remain. However, contingent on the full delivery of the debt relief under HIPC, MDRI, and beyond-HIPC at the Completion point, Sudan's debt improves dramatically to manageable levels during the forecast horizon. Under this scenario, which also underpins the macroframework for the proposed ECF-supported program, Sudan's debt is judged as sustainable in a forward-looking sense. This analysis is subject to the caveat that the quality and coverage of debt data is limited in Sudan.

14. Financial implications and risks associated with the high-access program requested by Sudan will likely be sizeable but probably manageable, provided a plan to raise PRGT subsidy resources could be put in place in a timely manner. Based on projections presented to the Board on March 22 on the "Temporary Extensions and Modifications of Access Limits in the Fund's Lending Facilities", an estimated SDR 2.3 billion in new subsidy resources are needed for PRGT-eligible countries under current policies and to avoid access erosion in real terms. Consistent with the PRGT's three-pillar strategy, the upcoming Review of Concessional Financing and Policies will lay out possible contingency measures, including funding options and policy changes. Staff is of the view that the demand for PRGT resources in the remainder of 2021—about SDR 9 billion under the central-case demand scenario assuming current policies—remains manageable.

Sudan: Indicators to Capacity to Repay to the Fund, 2021–33 1/
(Under Obligated Repurchase Schedule)
(In millions of SDRs)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Fund repurchases and charges													
In millions of SDRs	0	0	0	992	0	0	6	37	93	148	148	142	111
In millions of dollars	0	0	0	1457	0	0	9	55	137	219	219	210	164
In percent of gross international reserves	0	0	0	74	0	0	0	1	3	4	3	3	2
In percent of exports of goods and services	0	0	0	17	0	0	0	0	1	1	1	1	1
In percent of GDP	0	0	0	4	0	0	0	0	0	0	0	0	0
In percent of quota	0	0	0	157	0	0	1	6	15	24	24	23	18
Fund credit outstanding (end of period)													
In millions of SDRs	992	1115	1362	742	742	742	735	698	606	457	309	167	56
In millions of dollars	1433	1625	1995	1090	1093	1096	1087	1032	895	676	457	247	82
In percent of gross international reserves	287	169	136	55	41	29	24	20	17	11	7	3	1
In percent of exports of goods and services	23	24	26	13	11	10	9	8	6	4	3	1	0
In percent of GDP	4	5	5	3	3	2	2	2	2	1	1	0	0
In percent of quota	157	177	216	118	118	118	117	111	96	73	49	26	9
Memorandum items:													
Gross international reserves	500	959	1462	1971	2649	3761	4561	5072	5399	6162	6956	7772	8628
Exports of goods and services	6126	6901	7634	8614	9928	10971	12072	13224	14350	15429	16445	17523	18684
GDP (millions of dollars)	33032	34311	36626	39718	43203	46866	50647	54502	58371	62218	66318	70688	75347
Quota (millions of SDR)	630	630	630	630	630	630	630	630	630	630	630	630	630

Source: Fund staff estimates.

1/ Projections are based on the full application of HIPC, MDRI, and beyond-HIPC debt relief at Completion Point in 2024.

V. Next Steps

15. Program discussions. A (virtual) negotiation mission is expected to take place in the second half of April 2021.

16. Consideration by the Executive Board. A program request is expected to be presented for Executive Board consideration in June 2021 in the context of the HIPC Decision Point.

Table 1. Sudan: Selected Economic Indicators, 2018–26

	2018	2019	2020	2021	2022	2023	2024	2025	2026	
			SMP			Proj.				
Output and prices										
	(Annual change in percent)									
Real GDP (market prices)	-2.3	-2.5	-8.4	-3.6	0.9	3.5	5.0	6.5	6.8	6.5
Consumer prices (end of period)	72.9	57.0	198.0	269.3	97.2	24.4	10.3	8.3	8.0	8.0
Consumer prices (period average)	63.3	51.0	141.6	163.3	172.9	38.5	16.4	9.2	8.2	8.0
Central government										
	(In percent of GDP)									
Revenue and grants	8.9	7.8	6.8	4.8	12.4	14.9	14.2	14.0	13.7	13.3
Revenue	8.7	7.4	5.3	4.7	7.4	10.7	10.9	11.4	11.6	11.5
Tax revenue	6.7	5.4	3.5	3.0	4.7	7.6	8.1	8.9	9.3	9.3
Expenditure 2/	16.7	18.7	13.7	10.8	15.1	16.3	15.5	15.0	14.7	14.3
Current 2/	16.2	18.5	13.3	10.6	13.5	14.2	13.2	12.9	12.7	12.5
Wage bill	2.4	2.9	5.1	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Goods and services	1.2	1.0	1.0	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Interest	0.2	0.2	0.0	0.0	0.1	0.1	0.2	0.3	0.4	0.4
Subsidies 2/	9.6	11.8	3.8	4.8	2.2	2.1	1.9	1.6	1.5	1.4
Transfers	2.1	1.7	1.2	1.5	3.8	4.8	5.2	5.1	5.1	5.0
Other current	0.8	0.9	2.2	0.8	3.8	3.6	2.4	2.3	2.1	2.1
Capital	0.5	0.1	0.4	0.1	1.6	2.1	2.3	2.1	2.0	1.8
Overall balance 2/	-7.9	-10.8	-6.9	-5.9	-2.7	-1.3	-1.3	-1.0	-1.0	-1.0
Public debt 1/	158.3	170.5	259.4	172.5	180.3	179.2	173.2	164.5	156.1	148.6
Monetary sector										
	(Annual changes in percent)									
Broad money	111.8	60.1	88.2	88.0	78.0	47.7	28.6	23.0	24.5	29.8
Reserve money	170.5	77.5	94.5	97.0	103.1	38.6	20.8	15.8	14.0	14.0
Balance of payments										
	(In percent of GDP, unless otherwise indicated)									
Exports of goods	9.7	11.1	14.2	11.1	13.4	14.6	15.2	15.8	16.8	17.2
Imports of goods	19.7	25.0	25.0	25.9	26.4	27.3	28.0	28.4	28.2	27.0
Trade balance	-9.0	-14.0	-11.1	-14.7	-12.5	-12.0	-12.1	-11.7	-10.2	-8.3
Current account balance (cash basis)	-8.7	-11.4	-8.4	-13.2	-6.0	-7.8	-7.5	-7.2	-6.3	-4.2
PPG External debt 4/	148.7	167.8	146.2	138.7	73.2	70.9	67.8	12.5	11.6	10.7
PPG External debt (in billions of US\$) 4/	55.1	56.3	47.7	47.7	24.2	24.3	24.8	5.0	5.0	5.0
Gross usable international reserves (in millions of US\$)	178	190	324	223	214	477	867	1,301	1,896	2,909
In months of imports	0.2	0.2	0.4	0.3	0.5	1.0	1.3	1.7	2.1	2.8
Memorandum items:										
Nominal GDP (in billions of SDGs)	1,370	2,030	4,481	5,168	14,391	20,560	25,067	29,105	33,572	38,568
Nominal GDP (in \$US billion)1/	35.9	33.6	32.6	34.4	33.0	34.3	36.6	39.7	43.2	46.9
Exchange rate (SDG/US\$, end of period) 1/	45.2	71.6	...	221.4	537.0	655.2	709.1	753.1	797.7	844.7
Exchange rate (SDG/US\$, period average) 3/	38.2	60.5	...	150.4	435.7	599.2	684.4	732.8	777.1	822.9
NEER (2007=100, percent change, period average)	-52.2	-40.7	...	-59.8	-65.5	-27.3	-12.4	-6.6	-5.7	-5.6
REER (2007=100, percent change, period average)	-24.5	-12.5	...	5.9	-7.6	-1.3	-0.1	0.0	0.0	0.0

Sources: Central Bank of Sudan and Ministry of Finance and Economic Planning; and IMF staff estimates and projections.

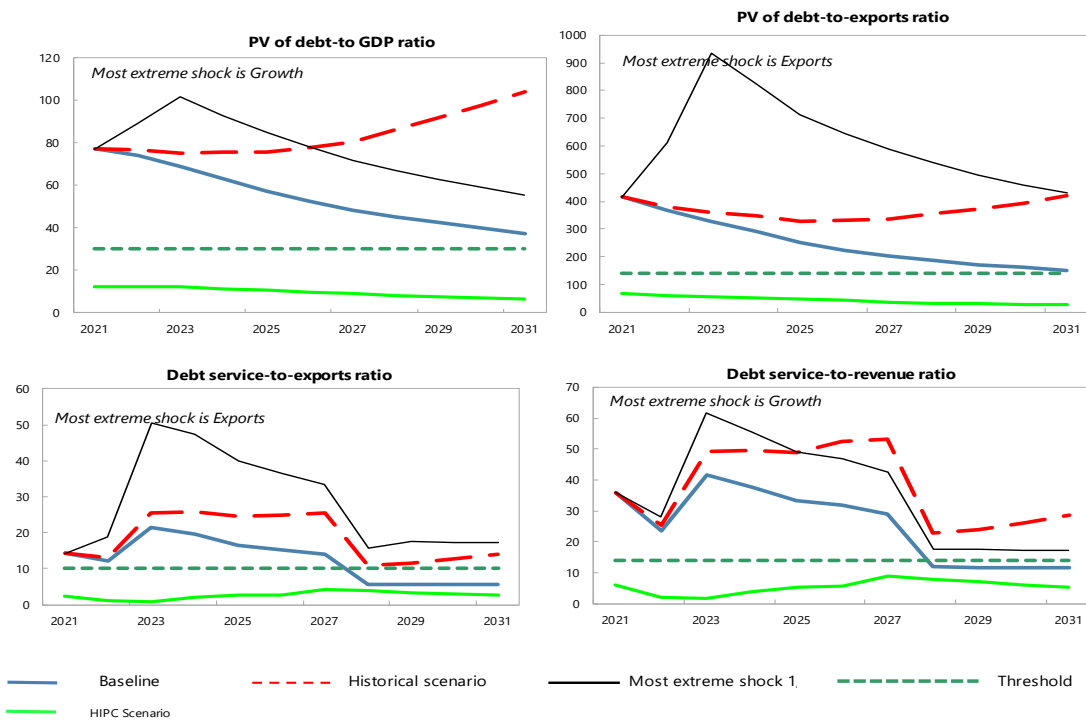
1/ GDP and public debt estimated at the weighted average of the parallel and official exchange rate before the exchange rate unification in 2021.

2/ Including implicit subsidies recorded on central bank's balance sheet.

3/ Exchange rate is calculated as the weighted average of official and parallel exchange rate before the exchange rate unification in 2021.

4/ The reconciliation of external debt begins with outstanding debt at end-2019.

Figure 1. Sudan: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2021–2031



Customization of Default Settings			Borrowing Assumptions for Stress Tests*		
	Size	Interactions		Default	User defined
Standardized Tests		Yes	Shares of marginal debt		
Tailored Tests			External PPG MLT debt	100%	
Combined CLs	Yes		Terms of marginal debt		
Natural Disasters	n.a.	n.a.	Avg. nominal interest rate on new borrowing in USD	0.8%	0.8%
Commodity Prices ^{2/}	n.a.	n.a.	USD Discount rate	2.0%	2.0%
Market Financing	n.a.	n.a.	Avg. maturity (incl. grace period)	37	37
			Avg. grace period	5	5

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

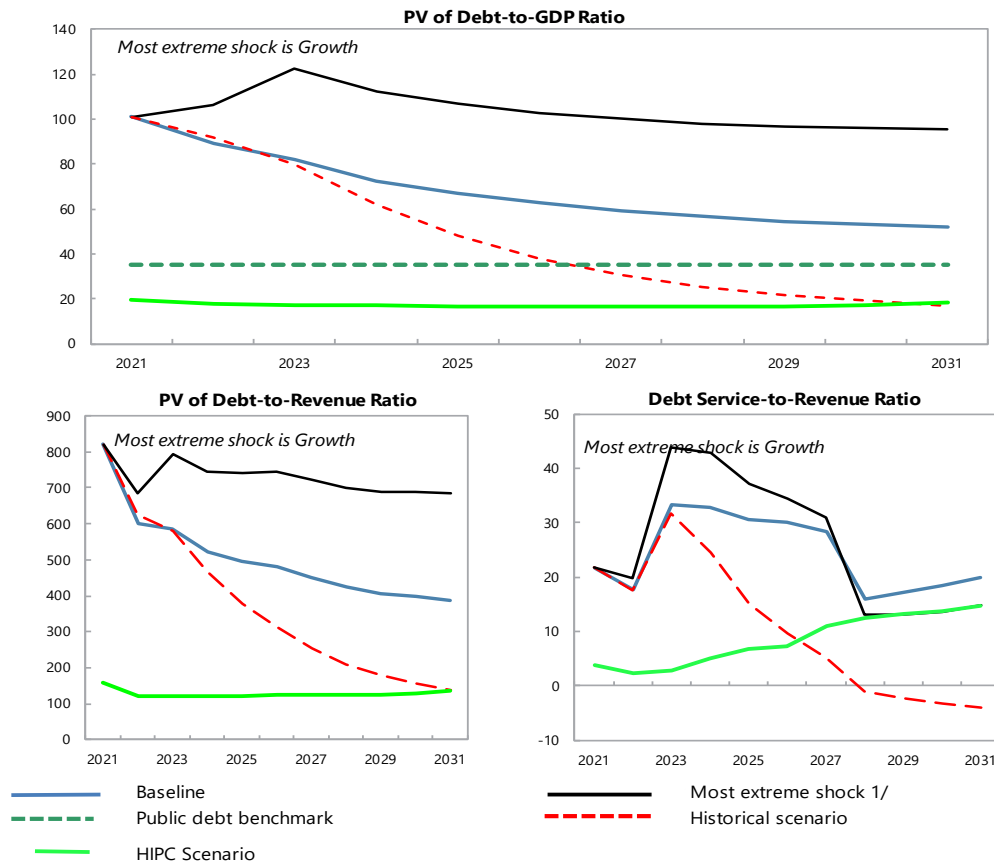
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. Stress tests with one-off breaches are also presented (if any), while these one-off breaches are deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

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

Figure 2. Sudan: Indicators of Public Debt Under Alternative Scenarios, 2021–31



Borrowing Assumptions for Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	44%	44%
Domestic medium and long-term	51%	51%
Domestic short-term	5%	5%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	0.8%	0.8%
Avg. maturity (incl. grace period)	37	37
Avg. grace period	5	5
Domestic MLT debt		
Avg. real interest rate on new borrowing	-26.3%	-26.3%
Avg. maturity (incl. grace period)	47	47
Avg. grace period	46	46
Domestic short-term debt		
Avg. real interest rate	-14.3%	-14.3%

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

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.