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To: Members of the Executive Board

From: The Secretary

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Questions:	Ms. Baker, MCD (ext. 34041) Mr. Weller, MCD (ext. 39312)

***If the authorities consent to the publication of this assessment, it may be published by the World Bank.**

Sudan—Assessment Letter for the World Bank and the United States
March 8, 2021

This letter updates the assessment of Sudan's economic conditions and policies since the IMF Executive Board endorsed the Staff Monitored Program (SMP) to be of UCT quality on September 23, 2020. Macro-economic stability remains a challenge, with inflation remaining high, a large current account deficit, external debt in distress and very limited reserves, and risks are on the downside. However, early indicators show the economy held up better than expected in 2020, and policy action strengthened significantly starting in December. The recent unification of the exchange rate and passage of several fiscal reforms are expected to reduce distortions in the economy, facilitate fiscal consolidation and support efforts to achieve debt relief. The outlook is buoyed by Sudan's removal from the U.S. State Sponsors of Terrorism List.

Context

1. **Sudan is a fragile state, with widespread poverty and an economy struggling to right itself after years of mismanagement.** Administered prices and fuel subsidies led to large fiscal and external imbalances, monetization, inflation, and exchange rate depreciation. The economy has contracted in recent years, poverty has increased, and the humanitarian situation is dire with large numbers of internally displaced people and refugees. Public debt is unsustainable. The transitional government in place since August 2019 requested an IMF Staff Monitored Program (SMP) to address these challenges and set the country on a path to possible debt relief under the Enhanced HIPC Initiative.

Recent Developments, Outlook and Risks

2. **The COVID-19 pandemic has compounded the economic challenges faced by the transitional government, with the economy experiencing a third consecutive year of contraction in 2020.** While the economy held up somewhat better than envisioned at the time of the June SMP negotiations (at the height of the pandemic), output is estimated to have contracted by 3.6 percent, while inflation continued on an upward trend reaching 304 percent year on year in January 2021, reflecting a level shift up in administered prices, rapid exchange rate depreciation, shortages of food and fuel, and inflation inertia. The external position further weakened in 2020, with a double-digit current account deficit and very low reserves covering 0.3 months of imports following sales of monetary gold. As a country with protracted arrears to multilateral creditors and in debt distress, Sudan was unable to avail itself of emergency financing from the IMF; moreover, donor funding outside of humanitarian assistance has been low.

3. **Economic conditions remain extremely challenging, but after setbacks and delays in the initial stages of the SMP, the authorities have recently made tangible progress on their reform program.** The economy is projected to register modest positive growth in 2021 as the distortions that weighed on the economy are removed. Delays in key reforms and the transfer of payments to compensate victims of terrorist attacks led to monetary expansion, higher than

expected spending, and a draw down in reserves resulting in a mixed track record of meeting end-December quantitative targets. The recent exchange rate unification, the removal of fuel subsidies, planned customs exchange rate unification, tax measures taken as part of the 2021 budget, and the increase in electricity tariffs will facilitate fiscal consolidation. This should reduce monetization and help bring down the current high rate of inflation in the second half of the year once the impact of the adjustment in the customs exchange rate is passed through. The current account deficit is projected to narrow significantly in the year ahead on strong export growth and exchange rate unification, which will incentivize remittances and other flows through formal channels. Throughout the transition, consumption will be supported in part by the Sudan Family Support Program (SFSP) launched on February 24, 2021. With the economy beginning to stabilize, growth would turn positive as inflation falls back to double digits, providing a supportive environment for much needed investment.

4. Sustained implementation of the authorities' reform program would help Sudan to exit from the current difficult economic situation, strengthen the credibility of the transitional government, and take a major step toward fulfilling the requirements for eventual clearance of arrears, HIPC debt relief, and the resumption of much-needed financing from key IFIs. Over the next few months, it will be crucial for the authorities to implement customs exchange rate reform in a timely fashion to lift revenue and competitiveness, while enhancing transparency and management of SOE operations is vital to mitigate fiscal risks and bring more revenue on-budget. The timely adoption of the Central Bank Act and establishment of an independent anti-corruption commission will help strengthen institutional independence and governance.

5. Risks to the near-term outlook are tilted to the downside, **and given the fragile starting point, downside risks have serious implications on social welfare.** On the upside, Sudan's re-engagement with the international financial community could begin to attract large development projects, both private and in collaboration with development partners. The agriculture sector could attract large regional investment, including in food processing, while the return to a dual banking system and improvements on AML/CFT could bring back correspondent banks. Downside risks are centered around reform reversals and financing shortfalls, and are exacerbated by political fragility. A return to administered prices and subsidies would add to the fiscal deficit and fuel a further monetization-inflation-depreciation spiral, while lack of action on strengthening governance and improving the investment and anti-corruption laws would hinder private investment. Lack of transparency and control over SOEs could lead to a further buildup of contingent liabilities and fiscal risks. Sustained shortfalls in external financing—including of the SFSP—is a major risk not only to increasing social spending but popular support for the economic transformation itself. Setbacks to peace could derail the entire reform agenda.

Relations with the Fund and Progress toward the HIPC Decision Point

6. Sudan has a Staff Monitored Program (SMP) with the Fund that was endorsed by the IMF Executive Board to be of Upper Credit Tranche (UCT) quality on September 23. Satisfactory performance under the 12-month SMP (July 2020 – June 2021) would count toward the minimum

6-month track record for the HIPC Decision Point required under the Enhanced HIPC initiative. As this track record begins with the IMF Executive Board's endorsement of the SMP as being of UCT quality, satisfactory performance at a minimum through end-March 2021 would be required for it to be met. Staff could conduct a formal review of the SMP based on an end-March test date approximately 2 months following the test date.

7. IMF management completed the first review of the SMP on March 5, 2021. An Executive Board meeting is scheduled for March 24 for the Board to endorse IMF management's view that the SMP continues to contain forward-looking policy commitments and conditionality of UCT quality. A mission for the second review is planned for mid-April. The assessment will cover the authorities' progress in meeting quantitative targets established under the SMP, structural benchmarks and other policy commitments in the Memorandum of Economic and Financial Policies (MEFP).

8. A necessary condition for reaching the HIPC Decision Point is the clearance of arrears to the IMF, World Bank and African Development Bank. This is in addition to the Sudanese authorities' satisfactory performance under the UCT-quality SMP and adoption of at least an interim poverty reduction strategy. To participate in the HIPC process, the IMF would need to raise sufficient resources to cover its share of Sudan's debt relief. The IMF staff is in the process of developing an arrears clearance strategy and formulating a financing package, with an IMF Board discussion on possible financing modalities tentatively planned for March 15, 2021.

Sudan: Selected Economic Indicators

Population: 40.2 million (2015)
Quota: SDR 169.7 million
Main products and exports: oil, gold, livestock, sesame
Key export markets: China, Gulf states and COMESA countries

	2019	2020		2021
		SMP	est.	proj.
Output				
Real GDP growth at market prices (%)	-2.5	-8.4	-3.6	0.4
Inflation				
Period average (%)	51.0	141.6	163.3	197.1
End of period (%)	57.0	198.0	269.3	119.6
Central government finances				
Revenue and grants (% of GDP)	7.8	6.8	4.8	11.1
Expenditure (% of GDP)	18.7	13.7	10.8	14.2
Fiscal balance (% of GDP)	-10.8	-6.9	-5.9	-3.1
Public debt (% of GDP)	200.3	259.4	249.1	208.6
Money and credit				
Reserve Money (% change)	77.5	94.5	97.0	112.6
Broad money (% change)	60.1	88.2	88.0	80.5
Credit to the private sector (% change)	45.8	90.5	78.8	80.0
Balance of payments				
Current account (% of GDP) (cash basis)	-11.4	-8.4	-13.2	-7.1
FDI (% of GDP)	2.9	2.7	2.7	2.5
Reserves (in millions of US$)	190	324	223	301
Reserves (in months of imports)	0.2	0.4	0.3	0.3
External debt (in billions of US$)	56.3	57.4	57.5	58.8
External debt (% of GDP)	167.8	176.1	167.4	164.0
Memorandum items				
Nominal GDP (in billions of SDG)	2030	4481	5168	15531
Nominal GDP (in billions of US$)	33.6	32.6	34.4	35.8
REER (% change)	-12.5	…	5.9	…

Sources: Sudan authorities; and IMF staff estimates and projections.