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To: Members of the Executive Board

From: The Secretary

Subject: Sudan—Staff—Monitored Program—Report on Developments Through June

Attached for the information of the Executive Directors is a report on developments through June of the staff-monitored program for Sudan.

Mr. Sundararajan (ext. 38573) or Mr. Treichel (ext. 34045) is available to answer technical or factual questions relating to this paper.

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INTERNATIONAL MONETARY FUND

SUDAN

Staff-Monitored Program—Report on Developments Through June

Prepared by the Middle Eastern and Policy Development
and Review Departments

Approved by P. Chabrier and T. Leddy

July 15, 1997

1. Subsequent to the Executive Board's consideration of Sudan staff-monitored program for 1997¹ and the finding of the Executive Board as a whole that the program was broadly of a quality that warranted monthly monitoring by the staff, the staff has conducted monthly visits to Sudan since April. So far, two monthly reports on developments in April and May 1997 have been issued for the information of the Executive Board.² Based on the third visit during June 22–29, 1997,³ this note provides information on recent developments in economic performance and policies, compliance with the quantitative benchmarks through end-May 1997, and compliance with the structural benchmarks for June 1997.
2. Payments to the Fund through June were effected as committed (for a total of US\$32.5 million during January–June 1997). Payments to other international organizations totaled US\$1.2 million during the first five months of 1997.
3. Data and economic information have been reported to the Fund as specified under the staff-monitored program.
4. The structural benchmarks for the month of June were met as detailed in Table 2. The authorities were assisted with MAE technical assistance in complying with some of the benchmarks.

¹See EBS/97/45 (3/14/97), considered at EBM/97/29 (3/27/97).

²See EBS/97/83 (5/14/97) and EBS/97/101 (6/11/97).

³The staff team comprised Messrs. Sundararajan (head), Shabsigh, and Treichel (all MED), and Mr. Lin (PDR), and overlapped with a MAE technical assistance mission headed by Mr. Marston.

5. Recent economic data through May point to continued improvements on several fronts, reflecting in part, the tight macroeconomic policies. On a year-to-year basis, inflation has continued to decline, reaching 70 percent in May and 42 percent in June compared to 114 percent in December 1996. On a month-to-month basis, the inflation rate fluctuated widely, reflecting variations in food prices, and increased from -0.8 percent in April to 2.5 percent in May and 4.8 percent in June. The exchange rate in the free accounts-to-accounts market remained stable in May and June. The official dealer rate was adjusted downward by a cumulative 1.3 percent during June and the spread between the accounts-to-accounts and official rates declined to 12.6 percent, less than the program ceiling of 13 percent set for end-June (see Attachment I, Appendix I in EBS/97/45). The real effective official exchange rate appreciated by 3.3 percent during January-June 1997.

6. Preliminary data through May show that the improvement in the trade balance that began in April has continued. Exports in May 1997 rose sharply from the same month in 1996; the continued strong growth in cotton and nontraditional exports was more than adequate to offset the weak performance of several traditional products (in particular, gum arabic and sesame seed). Partly reflecting tight financial policies, the demand for imports continued to be weak, and imports fell by 14 percent in May from a year earlier. Since March 1997, imports have fallen significantly compared to the same period in 1996, and imports of all major categories have fallen. As a result, the trade deficit narrowed significantly in April and May, in spite of a deterioration in the prices of key commodities, including cotton. For the period January-May as a whole, the trade deficit is estimated at US\$325 million, slightly lower than that during the same period in 1996.

7. A sharp increase in broad and in reserve money, mainly reflecting growth in currency outside the Bank of Sudan (BOS), was observed in April.⁴ This was mainly related to technical accounting factors associated with the introduction of new currency bills. Preliminary monetary data for May and June showed a substantial decline in reserve money (in NDA and the domestic currency component of broad money) corresponding to the retirement of old currency bills in those months, which had been counted as part of currency in circulation in April. From December 1996 through May 1997, reserve money grew by about 5 percent, some 3 percent below program projections. Given these developments, no additional measures to contain monetary expansion appear necessary at this stage. The authorities are, however, committed to carefully monitoring fiscal and monetary developments in the coming months and stand ready to take adequate measures to ensure compliance with program targets.

8. Revenue collection improved significantly in May, rising by 16.4 percent over April, and the cumulative revenue for January-May was slightly above program projections. Improved revenue performance reflected increases in all revenue categories and in particular from customs duties and increased transfers from public enterprises. Increased profits of the

⁴See EBS/97/101, para. 6 and Table 1.

Government Petroleum Company (arising from domestic petroleum prices that exceed international prices at the current official exchange rate) were transferred only partially to the budget, as the remaining surplus was transferred to the contingency fund (see EBS/97/45). Expenditure remained under tight control, reflecting curtailments in the operational expenditures of ministries to only 80 percent of their budgeted level and cuts in capital expenditures. As a result, cumulative credit to the government amounted to LSD 40.9 billion through May, just below its program level of LSD 41 billion.

9. The Ministry of Finance (MOF) made further progress in developing a comprehensive budget monitoring system, including daily reports on the government's cash position, weekly estimates of the budget position, and rolling three months forecasts for revenues and expenditures. In addition, the MOF intensified its inspection of government units to ensure prompt transfers of revenue collected, and to enforce spending discipline. As a result, the cash management of the budget improved significantly and was an important contributing factor in improving revenue performance and achieving tighter control of expenditures.

10. With regard to tax reform, the authorities reaffirmed their commitment to a phased implementation of the value-added tax (VAT), to be initiated in the context of the 1998 budget. As agreed with the staff in May, a study on the revenue impact of the proposed VAT was completed by the authorities in early June, which concluded that the introduction of a VAT at an indicative rate of 10 percent and specified exemptions would ensure that there would be no revenue loss. Also, a near-term work program for the adoption of the VAT has been formulated, including a timetable for the drafting of a law on the VAT, the preparation of a study on import tariff reform, and the development of an action plan to raise public awareness and organize appropriate training programs to facilitate smooth implementation of the VAT.

11. To improve the effectiveness of the BOS's conduct of monetary policy, understandings have been reached on measures to develop a short-term information system to monitor monetary and credit developments, banking activities, and foreign exchange markets; and to establish a monetary policy committee within the BOS to periodically review the data from the information system, assess their monetary policy implications, and advise the BOS's management.

12. In coordination with the MAE technical assistance mission, understandings have been reached with the authorities (see paras. 13, 14, and 15 below) on: (i) a comprehensive action plan and implementation timetable to reform BOS's monetary policy instruments and improve the operational framework of the interbank market; (ii) the introduction of new instruments of liquidity management, in coordination with the development of public debt management and in conformity with Islamic banking practices; and (iii) strengthening prudential supervision of the banking system, including plans for improving commercial banks' practices, and phasing in capital adequacy norms, provisioning rules, foreign exchange exposure limits, and other supervisory standards, as relevant under the Islamic banking practices.

13. In line with the understandings reached in April 1997, the authorities have introduced a reserve requirement on foreign currency deposits, and initiated measures to improve the effectiveness of the overall reserve requirement, taking into account MAE recommendations. In addition, the BOS will take steps by end-July 1997 to improve the operational framework of the interbank market by removing the approval requirement for interbank trading, tightening the rules governing the overdraft facility, and designing measures to streamline clearing and settlement procedures.

14. With MAE technical assistance, a new market-based instrument of government borrowing that would be in conformity with Islamic financial practices and could also be used as a monetary policy tool, was developed. Understandings have been reached on the broad design of this instrument and a timetable of steps was agreed to further develop and implement the new instrument. As currently envisaged, the proposed instrument would be sold to both banks and nonbanks and signify investors' participation in the government spending program; the rate of return would be linked to future tax revenues and other macroeconomic indicators. The proposal will be submitted to the High Shariaa Supervisory Council for consideration and decision by end-September 1997. A joint MOF/BOS committee will be formed by mid-July to study the design and operational modalities of the new instrument, including legislative and informational requirements. By end-September 1997, assuming a positive decision by the High Council, the MOF will announce in the quarterly budget statement its intention to use the new instrument as a financing instrument, and immediately initiate consultations with banks to further refine operational modalities, for possible introduction in January 1998.

15. Understandings have been reached to strengthen capital adequacy regulations and rules for loan classification and provisioning, and accounting standards for banks, and their enforcement, in collaboration with MAE technical assistance. By end-September 1997, the BOS expects to reach agreement on a compliance program with banks that do not currently meet the capital adequacy requirements. Appropriate guidelines for net open foreign exchange positions are being developed with Fund technical assistance, for implementation by end-October 1997. Furthermore, by end-December 1997, the BOS will review and standardize banks' accounting methodology for income recognition and profit computation, and also develop pro forma bank returns which would incorporate liquidity and risk-weighted categories. These reforms will be part of a medium-term plan that the BOS is formulating to introduce a comprehensive accounting reform that is suitable for Islamic banking practices.

16. As agreed under the staff-monitored program, the BOS's sectoral credit guidelines have been reviewed, in coordination with the MAE technical assistance mission. The BOS is using these guidelines only as indicative targets, and this does not constrain the allocation of banks' credit resources, with the exception of a 10 percent ceiling on lending for local trade. The BOS will continue its policy of flexible enforcement of the guidelines, and encourage prudent allocation of credit resources.

17. In line with the understandings reached in April (EBS/97/83, para. 11), the authorities agreed to further increase by August 15, 1997, the exporters' retention ratio from 55 percent to 60 percent for 13 specific items, these items accounting for 15 percent to 20 percent of total export receipts, while reducing the surrender requirement to the BOS and commercial banks from 45 percent to 40 percent. In addition, the authorities agreed to consider steps to further increase the retention rights of exporters for the remaining exports, as part of the action plan to phase out export surrender requirements that will be adopted in coordination with the transfer of public sector imports to the private sector.⁵

18. Understandings have been reached on a plan to abolish export taxes in the context of the 1998 budget, pending the completion of a review by the Committee on Supply-Side Policies. Understandings have also been reached on further tariff reform in coordination with the introduction of the VAT, in particular on preparing and finalizing proposals for further tariff reform by end-October 1997.

19. During the July visit, the staff will conduct a comprehensive review of economic developments so far and of the performance under the staff-monitored program during the first six months of 1997. The staff report based on this review will be presented for the Executive Board's consideration by August 29, 1997, in accordance with its decision EBS/97/6, Supplement 2.

⁵In line with understandings reached in April, such a plan is to be developed by August 15 and to be adopted by end-September (see EBS/97/83, para. 11).

Table 1. Sudan: Quantitative Benchmarks

(In billions of Sudanese Pounds; except if indicated otherwise)

	1996	1997								
	Dec.	Jan.	Feb.		Mar.		Apr.		May	
	Actual	Actual	Estimate	Actual	Prog.	Actual	Prog.	Actual	Prog.	Prel.
	revised 1/	revised 1/								
Benchmarks										
Ceiling on banking system's NDA 2/ 3/	989	44	25	-2	37	11	52	50	72	9
Ceiling on net credit to government 2/ 4/	589	10	20	10	28	26	35	37	41	41
Ceiling on new nonconcessional borrowing contracted or guaranteed by the government	--	--	--	--	--	--	--	--	--	--
Floor on NFA on the Bank of Sudan (in millions of US\$) 5/	-3,245	54	--	62	--	66	--	93	--	66
Payments to the Fund (in millions of US\$)	--	--	15.3	15.3	4.3	4.3	4.3	4.3	4.3	4.3
Memorandum items										
Reserve money 2/	649	-15	24	17	34	20	44	53	52	29
Central government revenue 2/	702	60	141	127	217	222	300	297	381	383

Sources: Bank of Sudan; and staff estimates.

1/ December 1996 and January 1997 were revised to correct for a misclassification of certain accounts in the Bank of Sudan's balances.

2/ Outstanding stocks in December 1996; cumulative changes through May 1997.

3/ Banking system's NDA was revised to reflect the correct valuation adjustment.

4/ Excluding changes in government deposits.

5/ Changes in stocks over end-December level are converted into the U.S. dollar at end-of-period official exchange rates. The increase in NFA through May 1997 reflects primarily the impact of the appreciation of the U.S. dollar against the SDR.

Table 2. Sudan: Status of End-June Structural Benchmarks

Benchmarks	Implementation
June Payment to the Fund of US\$ 4.3 million.	Received on June 23, 1997.
Adjustment in domestic petroleum prices to eliminate any remaining subsidization and ensure the budgeted contribution.	Domestic petroleum prices remain higher than international prices.
Reduction of the exchange rate spread between the official exchange rate and the free accounts-to-accounts market rate to a maximum of 13 percent by end-June.	Spread was reduced to 12.6 percent by end-June.
Elaboration of current action plan for strengthening prudential supervision, with appropriate phasing in of capital adequacy norms, provisioning rules, and foreign exposure limits.	Understanding was reached on a timetable of specific steps (see paragraph 15 above).
Development of an action plan to introduce new monetary instruments for liquidity management, based on the experience of other Islamic countries, in coordination with the development of public debt management.	Understanding was reached on a timetable of specific steps (see paragraph 14 above).
Introduction of a reserve requirement on commercial banks' holdings of foreign currency deposits.	Draft regulations were discussed with Fund staff in June and introduced on July 1, 1997 incorporating MAE technical assistance recommendations (see paragraph 13 above).
Agreement of a timetable for further increases in the retention rights of exporters	Retention ratio will be raised by 5 percentage points for 13 products by August 15, 1997 and further steps to rationalize the retention system will be considered (see paragraph 17 above).
Adoption of an action plan, specifying the steps for for further reform of import tariffs (with Fund technical assistance).	Authorities will finalize plan for tariff reform by end-October, in coordination with the evolving plans for the adoption of the VAT.
Review of the current system of directed credit to further liberalize the BOS' guidelines on sectoral allocation of bank credit.	BOS agreed to continue using the sectoral guidelines only as indicative benchmarks.
Statistical reporting	Observed.

Table 3. Sudan: Selected Economic and Financial Indicators, 1994-95/1997 1/

	1994/95	1995	1996	1997			
				Staff Mon. Prog.	March Actual	April Prel.	May Prel.
(Annual changes in percent)							
National income, prices and exchange rate							
Real GDP (at factor cost)	4.5	4.4	4.7	4.9	...	...	...
Consumer prices (month on year ago month)	57	71	118	65	90	75	70
Consumer prices (period average)	85	68	133	59	...	...	...
Official exchange rate end of period (LSd/US\$)	524	838	1,460	...	1525	1,525	1570
Real effective exchange rate (period average: depreciation -)	-18.4	-22.9	-0.4	...	2.6 3/	2.2 3/	2.0 3/
(end period: depreciation -)	-39.7	-24.2	14.5	...	5.8 3/	0.9 3/	1.6 3/
Central government operations							
Total revenue	117.6	75.5	92.0	81.2 2/	31.7 3/	42.3 3/	54.6 3/
Total expenditure (including interest arrears)	88.5	95.7	142.7	32.5 2/	11.4 3/	15.03 3/	18.8 3/
Expenditure (excluding interest arrears)	69.9	87.7	107.9	35.9 2/	...	...	...
External sector							
Exports, f.o.b.	-16.1	31.8	11.6	0.5	-1.4 4/	-1.0 4/	5.0 4/
Imports, c.i.f.	-16.6	19.1	25.9	-5.8	16.7 4/	7.3 4/	1.8 4/
(In percent of GDP)							
Central government operations							
Total revenue	9.4	8.7	6.9	7.5	...	...	...
Total expenditure (including interest arrears)	22.0	24.0	23.9	19.0	...	...	...
Expenditure excluding interest arrears	11.1	12.1	10.3	8.4	...	...	...
Overall balance (on an accrual basis)	-12.7	-15.3	-17.0	-11.5	...	...	...
Overall balance (on a cash basis)	-1.7	-3.2	-3.4	-0.9	...	...	...
Primary balance	-0.9	-2.3	-2.4	-0.2	...	...	...
Balance of payments and external debt							
Current account deficit	-20.1	-20.8	-25.0	-22.7	...	...	...
Exports, f.o.b.	6.0	7.8	8.1	7.7	...	...	...
Imports, c.i.f.	14.4	17.2	20.2	17.9	...	...	...
External debt	263.9	272.0	267.5	263.7	...	...	...
External interest due	13.1	12.9	13.5	13.4	...	...	...
External debt paid 5/	0.9	1.0	0.7	0.8	...	...	...
(Annual changes as percent of beginning stock of broad money)							
Money and credit							
Net foreign assets	...	-462.9	-270.5	-190.5	-5.2	-1.7	-15.7
Net domestic assets	...	137.7	54.6	5.8	5.0	8.8	7.6

Table 3. Sudan: Selected Economic and Financial Indicators, 1994-95/1997 1/

	1994/95	1995	1996	1997			
				Staff Mon. Prog.	March Actual	April Prel.	May Prel.
Domestic credit	18.6	46.4	59.3	17.2	2.2	2.7	4.6
Net credit to the central government	5.5	31.2	31.7	6.9	-0.7	-0.1	1.8
Claims on nongovernment sector	13.1	15.2	27.5	10.4	2.9	2.9	2.8
Other items (net)	...	91.3	-4.7	-	2.8	6.1	3.0
Counterpart to valuation changes	...	472.4	281.1	202.0	10.3	6.2	22.9
Money and quasi-money	54.2	147.2	65.2	33.8	10.0	13.5	14.7
Reserve money 5/	...	76.7	81.8	17.3 3/	3.1 3/	8.2 3/	4.4 3/
Velocity (GDP/average M2)	7.6	7.5	10.6	12.5	...	...	...
(As percent of total current account receipts, unless otherwise indicated)							
Total external debt service							
Commitment basis	215.1	160.6	185.5	181.1	...	...	...
Actual payments 6/	11.6	9.7	8.0	8.5	...	...	...
Memorandum item:							
Nominal GDP (annual; in billions of Sudanese pounds)	3,050	4,179	10,203	17,008	...	...	...

Sources: Fund staff estimates and projections based on information provided by the Sudanese authorities.

1/ Starting in 1996, all official accounts moved from a fiscal year (July-June) to a calendar year basis.

2/ For the purpose of comparison with the 1996 outcome, revenue and expenditure figures include LSd 145 billion from taxes collected by the Central Government on behalf of the state governments, and transferred to state governments.

3/ Cumulative percent change during 1997.

4/ Percent change during 1997 over the same period in 1996.

5/ percentage change

6/ Including payments of arrears to the Fund and burden sharing refunds.