**EXECUTIVE BOARD MEETING**

SM/17/33

March 1, 2017

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of South Sudan—Staff Report for the 2016 Article IV Consultation**

| | |
|---|---|
| Board Action: | Executive Directors' **consideration** (Formal) |
| Tentative Board Date: | **Wednesday, March 15, 2017** |
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| Questions: | Mr. Mikkelsen, AFR (ext. 38735)<br>Mr. Tjirongo, AFR (ext. 35574) |

***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**

INTERNATIONAL MONETARY FUND

# REPUBLIC OF SOUTH SUDAN

February 28, 2017

## STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

## KEY ISSUES

**Context:** South Sudan has suffered civil conflict, political instability and external shocks in the past three years. A steep decline in oil production and a sharp drop in oil prices have caused large shortfalls in foreign exchange receipts and government revenue. Continued high government spending led to massive fiscal deficits that were either monetized or financed through accumulation of arrears. The country is in a deep economic crisis with annual inflation peaking at 550 percent in September 2016 and a precipitous currency depreciation. Gross international reserves have dropped to about one week of import cover. A relapse of violence in July 2016 following the formation of the Transitional Government of National Unity three months earlier compounded the already existing humanitarian crisis and derailed the peace process. The hope is that the country charts a new course toward a broad-based and inclusive political process and economic development.

**Focus of the consultation:** The discussions focused on the urgent need to restore macroeconomic stability. Addressing the macroeconomic imbalance and reforming the public financial management systems will be required to rebuild confidence and regain access to external financial support from development partners.

**Key issues and recommendations:** The immediate priority is to address the macroeconomic imbalance through tighter fiscal and monetary policies. Without policy adjustment, the economic situation will deteriorate further contributing to insecurity, which could undermine an already fragile peace process. While restoring stability will require a collaborative effort by South Sudan and its development partners, the government must take the lead by raising revenue and cutting expenditures to reduce the financing need to a sustainable level. Meanwhile, the central bank should combat inflation by refraining from lending to the government, and gradually start replenishing its international reserves. There is a need to strengthen public financial management and government priorities should shift from security to development spending. Since late 2016, the authorities have shifted strategy and embarked on an economic adjustment program in line with staff recommendations.

**Debt sustainability:** Based on external debt indicators, South Sudan is currently in debt distress. Accumulation of arrears, low capacity to repay, and very low foreign exchange reserves indicate unsustainable debt dynamics.

Approved By
**Roger Nord (AFR) and Zeine Zeidane (SPR)**

The discussions took place on February 17-March 2, 2016 and May 24-June 1, 2016 in Juba, and on December 4-10, 2016 in Nairobi. The staff team of the most recent mission comprised Messrs. Mikkelsen (head), Tjirongo and Hasegawa, and Ms. Farahbaksh (all AFR). Messrs. Egoume (resident representative) and Chany (national economist) assisted the mission. Mr. Nakunyada (OED) also participated. The staff met with Finance Minister Stephen Dhieu Dau, Bank of South Sudan Governor Koriom Mayik, and other senior officials. In the two earlier missions, the team met with President Kiir, First Vice President Machar, other ministers, parliamentarians, private sector representatives, and representatives of the diplomatic community and the civil society.

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# CONTEXT

**1. South Sudan is suffering tremendously in the aftermath of internal conflict and external shocks.** The country descended into a civil war about three years ago, as a power struggle between President Kiir and Vice President Machar triggered a conflict along ethnic lines, which left thousands dead, nearly 2 million internally displaced, more than a million refugees in neighboring countries, and over 5 million out of an estimated total population of 12 million in need of humanitarian assistance. The war also caused significant damage to the country's infrastructure and oil fields and undermined already fragile institutions. The sharp decline in oil prices from late 2014 caused further decline in foreign exchange receipts, government revenue, and real disposable income.

**2. The country continues to face multi-faceted challenges.** After long delay, the Transitional Government of National Unity (TGNU) was formed in April 2016, in line with the August 2015 peace agreement. The return to Juba of former Vice President Machar paved the way for the new government, headed by President Kiir with Machar as First Vice President. However, the onset of fighting between the parties only three months later and the subsequent ouster of Machar have since challenged the peace process. Political uncertainty remains and clashes along ethnic lines continue in several regions of the country. Going forward, President Kiir's recent call for an all-inclusive national dialogue is a welcome step. Success in restoring the country's credibility will require urgent simultaneous efforts to immediately address the insecurity, the humanitarian emergency, and the economic and financial crises. These challenges are interdependent and failure to address any of them could quickly compromise a successful peace process. On the economic front, restoring macroeconomic stability will require tighter fiscal and monetary policies, and establishment of sound economic management to foster renewed growth and employment creation.

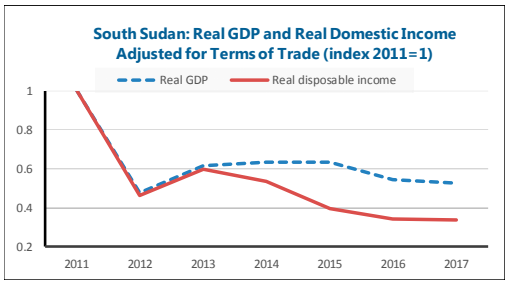
**3. Peace dividends.** Lasting peace achieved through an inclusive political dialogue will be necessary to successfully restore macroeconomic stability, refocus on developing economic activities, and restore social services. Protecting public resources and putting them to productive and peaceful good use will be crucial. The challenge of returning to normalcy is to make sure that peace dividends are widely shared (Annex II).

**4. Implementation of recommendations from the 2014 Article IV consultation has been hampered by the civil war**. In concluding the consultation, the Executive Board urged the government to implement measures to address fiscal imbalances, including exchange rate unification, and stressed the importance of peace and political inclusion to set the basis for growth and development. They supported the authorities' intention to mobilize non-oil revenue, and emphasized the importance of improving expenditure management and preventing domestic arrears. Directors cautioned against increased central bank financing of the fiscal deficit, which would fuel inflation and further weaken the local currency. There has been little progress in these

areas, except for the exchange rate liberalization in December 2015 and, more recently, the lowering of central bank financing and new measures to improve non-oil revenue.

# MACROECONOMIC DEVELOPMENTS

**5. Economic conditions have deteriorated rapidly since the beginning of the civil conflict.** Real GDP growth is estimated to have declined by 18.8 percent in the two years through 2015/16 (July-June) and annual inflation rose to about 550 percent in September 2016 (Table 1 and Figure 1). However, with the recent tightening of policies, inflation declined to about 370 percent in January and monthly price changes have been in single digits in recent months. The conflict and the collapse in oil prices have led to closure of oil fields and lack of maintenance and investments which in turn have resulted in dwindling production. South Sudan's effective average oil export price declined from US$98 per barrel in 2013/14 to about US$33 per barrel in 2015/16, while daily production has fallen by about 40 percent of the level produced immediately before the conflict (Box 1). The conflict, poor rains, and decline in oil activity also weakened the non-oil sector, including food crop production. Non-oil GDP declined by an estimated 17 percent over the last two years. Moreover, real domestic income adjusted for terms of trade declined by an estimated 35 percent since 2013.




**6. A large and widening fiscal deficit has exacerbated economic instability.** Depressed oil revenue, weak non-oil revenue mobilization, and runaway security-related expenditure caused the deficit to rise rapidly. Oil revenue net of transfers to Sudan[1] dropped from about US$2.3 billion in 2013/14 to US$0.5 billion in 2015/16 (Text Table 1; Table 2a and 2b). With unadjusted spending, the overall fiscal deficit increased rapidly from 3 percent of GDP in 2013/14 to 31 percent of GDP in 2015/16).[2] With limited access to external financing, the deficits were primarily financed through discretionary central bank financing and accumulation of arrears, including on salaries and external obligations. The fiscal deterioration in 2015/16

**Text Table 1. Government Net Oil Revenue (in US$ millions)**

| | 2013/14 | 2014/15 | 2015/16 | 2016/17 |
|---|---|---|---|---|
| Oil revenue (gross) | 3,204 | 2,082 | 796 | 852 |
| Transit fees | 329 | 291 | 11 | 186 |
| Transfers to Sudan | 549 | 420 | 276 | 313 |
| Net oil revenue | 2,326 | 1,371 | 509 | 353 |

[1] Under the agreement signed with Sudan in 2012, the South Sudanese government pays oil transit and pipeline fees of US$9.10 per barrel of oil export and transitional financial transfers to Sudan of US$15 per barrel of oil exports. In 2015/16, South Sudan accumulated payment arrears on the Transitional Financial Arrangement (TFA) and transit fees to Sudan of US$291 million.

[2] The sharp depreciation of the South Sudanese pound in the second half of 2015/16 (the SSP/US$ rate rose ten-fold) caused a jump in foreign currency denominated revenues and expenditures in 2015/16. Since nominal GDP rose only by a fraction of the exchange rate depreciation, foreign currency denominated budget categories also rose markedly as a percent of GDP.

reflected rising foreign currency denominated outlays due to the exchange rate liberalization and a salary raise by 200-300 percent (depending on grade) in March 2015. Arrears on external and domestic payments rose by an estimated 23 percent of GDP in 2015/16.

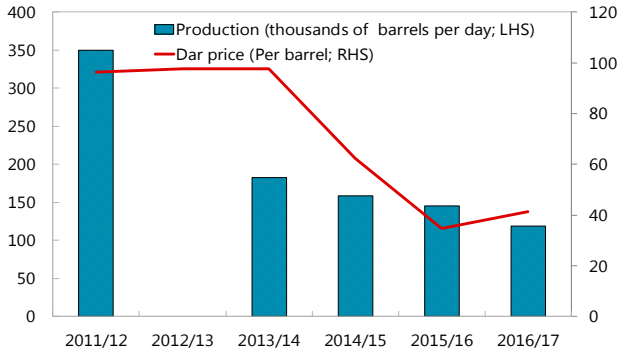
## Box 1. South Sudan. Oil Sector

Oil production plays an important role in the South Sudan economy, contributing slightly more than half of GDP, 95 percent of exports, 90 percent of government revenue and a significant share of private sector employment.

The oil sector of South Sudan remains closely linked to Sudan. Most of the former Sudanese oil fields are now in South Sudan, but the processing facilities, pipelines, export terminals, and refineries are in Sudan. Transit and processing fees and oil-related transfers represent an important income stream for Sudan.

Following the departure from Sudan of western oil companies in the early 1990s, the Chinese oil company, China National Petroleum Corporation, started investments in Sudan by mid-1990s. The Chinese company was followed by the Malaysian-owned Petronas and the Indian-owned Oil and Natural Gas Corporation Limited. These companies financed development of the current oil fields in South Sudan and built a network of pipelines, refineries, and export terminals in Sudan that enabled the sector to grow. South Sudan's Nile Petroleum, a state-owned oil company, holds minority shareholding in production-sharing contracts with the foreign oil companies. China is the largest export destination for crude oil from South Sudan.

**Republic of South Sudan: Oil Production and Prices**



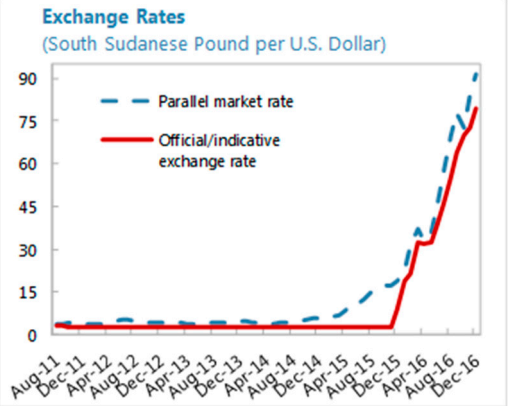

Source: South Sudanese authorities.

When South Sudan became independent in 2011, it gained control of three-quarters of Sudan's oil production, which amounted to 490,000 barrels per day (bpd) in 2010. South Sudan is estimated to have proven oil reserves of 3.75 billion barrels as of January 2014, ranking 38th in the world and 3rd in Sub Sahara Africa.

South Sudan has experienced frequent disruptions to oil production since independence. In January 2012, South Sudan shut down its oil production for 15 months because of a dispute with Sudan over transit fees and transfers. Oil production resumed in April 2013, following an agreement under which South Sudan would pay to Sudan US$9.10/barrel in transit fees and US$15/barrel under the Transitional Financial Arrangement. However, production was partially shut down again later in the year because of civil conflict and it has not fully recovered since. As oil fields in South Sudan are mature, output will naturally decline over time unless new investments in enhanced oil recovery (EOR) techniques are made. The civil conflict and low oil prices led to a postponement in investment in EOR.

### Box 2. South Sudan. The Evolution of the Exchange Rate Regime

From September 2011 until December 2015, the South Sudanese pound was pegged to the U.S. dollar at 2.96 SSP/$US. Under this system, the government's foreign exchange earnings from oil, by far the largest part of foreign exchange earnings, was sold to the Bank of South Sudan (BSS) at the official rate. The BSS then allocated the foreign exchange to economic agents at the same rate. While ostensibly aimed at ensuring the supply of essential goods, BSS foreign exchange allocations were prone to being captured by rent seekers who sought to benefit from the large spread between the official and parallel market rates. The allocation of a fixed amount of foreign exchange to each bank (initially weekly sums of US$1 million for foreign-owned banks and US$1.7 million for domestic banks) and smaller amounts to foreign exchange bureaus, led to an increase in the number of banks, many of which focused purely on arbitrage opportunities. Similarly, part of the foreign exchange allocated to government ministries for imports of goods and services found its way to the parallel market. Non-government imported goods tended to be priced at parallel market rates, with prices adjusting rapidly to rate changes.




The official exchange rate became increasingly unrealistic as oil revenues and foreign exchange receipts fell; first during the 2012 government's shutdown of oil production and again when oil prices and production fell in 2014. From mid-2014, the parallel market rate rose from about SSP 4/US$ to SSP 17/US$ by late 2015. The widening gap between the official and parallel exchange rates discouraged investment and spurred further rent-seeking. Initial attempts to reform the system were defeated by vested interests in late 2013.

In December 2015, the authorities officially switched to a de jure floating exchange rate system, with a view to eliminating the parallel exchange rate market. Under the new regime, the BSS supplies foreign exchange through market-based auctions and commercial banks are free to determine their rates with customers. The reform was initially successful in reducing the spread between the official market rate and rates in the parallel cash market. However, excessive monetary expansion and shortage of foreign exchange connected with the security crisis have continued to exert downward pressure on the exchange rate and has undermined convergence of the official and parallel rates. The de facto exchange rate arrangement was reclassified to other managed from conventional peg, effective December 15, 2015. The reform also led to the removal of several exchange restrictions and multiple currency practices (MCPs).1

[1] South Sudan removed the following measures earlier maintained under Article XIV transitional arrangements: (i) the exchange restrictions arising from limiting the availability of foreign exchange through the rationing and further earmarking of foreign exchange by the central bank; (ii) the exchange restriction arising from requiring a tax clearance certificate for access to foreign exchange for priority imports; and (iii) the MCP arising from the spread of more than 2 percent between the official exchange rate (buying and selling exchange rates of the central bank) and the exchange rate at which commercial banks sell foreign currency within the limits set by the central bank. South Sudan also removed the MCP maintained under Article VIII arising from the exchange rate guarantee arrangements maintained by the BSS.

**7. Fiscal dominance undermined monetary policy objectives**. The Bank of South Sudan (BSS) financing of the government deficit grew five-fold from June 2013 to June 2016. This credit expansion led to strong money growth which was exacerbated by the exchange rate depreciation (Table 3). Broad money grew by 219 percent in the 12-months through June 2016. The combination of policy slippages, resumption of conflict, and an external shock led to a rapid rise in annual

inflation, which peaked at 550 percent in September 2016. Rapid money growth and exchange rate pressure led to the liberalization of the foreign exchange market in December 2015 (Box 2). Since then, the value of the South Sudanese pound lost about 95 percent against U.S. dollars. Moreover, international reserves fell to about two weeks of imports by June 2016 and further to about one week of imports by December 2016 (Table 4).

# POLICIES TO ADDRESS THE ECONOMIC CRISIS

**8. The discussions focused on how to restore macroeconomic stability.** A credible pathway toward lasting peace and decisive economic stabilization is crucial to rebuilding confidence and reversing the economic decline. Reinstating fiscal discipline is the only way to reduce monetary expansion, stabilize domestic prices, and restore external stability. While available domestic instruments are rudimentary to address the sizable fiscal problems in an environment with limited availability of external financing, the authorities need to formulate a credible set of fiscal measures combined with more transparency in public financial transactions and improvements in public financial management to regain credibility and access to external financing.

**9. Restoration of macroeconomic stability and peace will support economic growth.** A quick return to fiscal discipline will restore confidence and support an urgent increase in investments, including in the oil sector, and foreign exchange inflows from development partners. Moreover, government priorities should shift from security to development spending on infrastructure and human resources. A turnaround from high inflation and negative growth (real GDP is projected to decline by about 10 percent in 2016/17) will require immediate macroeconomic adjustment and a successful inclusive process towards peace in the coming months.

**10. The authorities have recognized the severity of the economic problems and the need to immediately address them by taking strong policy measures.** While expressing skepticism about the need for stabilization policies in discussions since the beginning of the crisis, the authorities shifted course in late 2016 with the passing of a new budget for 2016/17, which incorporates strong fiscal measures that will significantly contribute to restore macroeconomic stability. It also includes measures to limit government borrowing from the central bank and improve public financial transparency.

## A. Fiscal Policy

**11. The 2016/17 budget reflects an ambitious fiscal consolidation objective**. The fiscal trajectory in recent years has been unsustainable and strong fiscal measures are needed to reduce the deficit to a level consistent with price and exchange rate stability. The 2016/17 budget and the accompanying policy measures go a long way towards restoring macroeconomic stability. The budget presents a substantial reduction of the deficit (accrual) from about 31 percent of GDP in

2015/16 to 8½ percent of GDP and it intends to stop direct borrowing from the BSS (Text Table 2). The budget includes a string of revenue measures, including increases in sales and excise taxes, and introduction of a new departure tax, that could raise annual revenue by 1.4 percent of GDP (Text Table 3), and tough spending limits across the board, including on travel, purchases of goods and services, wages, and domestically financed capital spending. The savings on the latter implies a steep decline in real spending compared to previous years.

**Text Table 2. Fiscal Adjustment in 2016/17 (Percent of GDP)**

| | 2015/16 | 2016/17 | |
|---|---|---|---|
| | Act. | Budget | Proj. |
| Total revenue and grants | 29.0 | 26.7 | 34.4 |
| Total expenditure 1/ | 59.8 | 35.1 | 35.8 |
| Overall balance (accrual) | -30.8 | -8.4 | -1.3 |
| Financing gap | 0.0 | 5.6 | 0.0 |
| Closing the financing gap: | | | |
| Total | | | 5.6 |
| Additional measures | | | 0.4 |
| Salary raise in Jan 2017 | | | -1.0 |
| Lower domestic financing from banks | | | -1.0 |
| Oil price and other ajustments | | | 7.2 |

1/ include change in arrears and errors and omissions.

**12. Nevertheless, the mission urged the authorities to consider additional measures and adjustments to eliminate a budgeted external financing need.** The adopted budget for 2016/17 implies domestic financing of 5 percent of GDP and an estimated external financing requirement of about US$200 million. Since no external financing is readily available, the budget implies a financing gap of 5.6 percent of GDP. Moreover, the assumed domestic financing, mostly through Treasury bill issuances, is unrealistically high given the undeveloped nature of the financial market. In this context, staff proposed additional measures, including (i) maintaining foreign currency-denominated operational spending notwithstanding the exchange rate adjustments; (ii) eliminating subsidies to Nile Petroleum (Nilepet) and raising domestic fuel prices to cost recovery; and (iii) reducing the cost of operating foreign diplomatic missions (the estimated budgetary effect in 2016/17 of these measures is 0.4 percent of GDP). Moreover, updated assumptions for the exchange rate, which has continued to depreciate, oil prices, and oil production in line with current production, are estimated to improve the budget by 7.2 percent of GDP. The additional measures and updated assumptions would close the financing gap while allowing for (i) reducing domestic financing by 1 percent of GDP, and (ii) raising civil servant salaries by 30 percent in January 2017. Given the recent steep decline in real wages for civil servants, staff proposed the salary adjustment and advised the authorities to let it primarily benefit the lower grades.

**Text Table 3. Revenue Measures January 2017 (Percent of GDP)**

| | 2016/17 | 2017/18 |
|---|---|---|
| • Raise sales tax from 15% to 18% | 0.07 | 0.20 |
| • Raise excise tax on alcohol (50% to 100%) and tobacco from 30% to 50% | 0.20 | 0.40 |
| • Impose 8% withholding tax on government contracts and 10% withholding tax on fees paid to contractors | 0.05 | 0.08 |
| • Departure tax of US$20 per passenger | 0.09 | 0.13 |
| • Implement new customs tariff schedule | 0.10 | 0.20 |
| • Moratoriam on customs exemptions | 0.05 | 0.05 |
| • Update customs valuation schedule | 0.10 | 0.20 |
| • Strengthen tax admin. and information exchange | 0.08 | 0.15 |
| **Total impact of measures** | **0.73** | **1.41** |

**13. The proposed measures are estimated to reduce the fiscal deficit to 1½ percent of GDP in 2016/17.** This would reduce the domestic financing requirement to 4 percent of GDP and allow for repayment of external obligations in 2016/17. This would broadly achieve the objective of moving towards a domestic borrowing requirement of 2-3 percent of GDP, which in staff's assessment is consistent with a return to price stability, and eliminate the need to borrow from the BSS.

**14. Successful fiscal consolidation would contribute to regaining credibility and getting access to external financial support.** Given improvements to the political environment and a path toward macroeconomic stability, the coming years would offer an opportunity to reinforce the gains while gradually shifting spending from security towards development and social services. With a small amount of external borrowing, and a deficit targeted at 3½ percent of GDP, domestic financing could be contained at 2-3 percent of GDP in 2017/18.

**15. The mission welcomed the recent measures to improve public financial management (PFM).** Consistent with staff recommendations (Box 3), the authorities have taken measures to require all revenue to be immediately transferred from government accounts in commercial banks to the treasury account, and established a Cash Management Committee. The mission urged the authorities to take additional steps to strengthen the PFM framework, including measures to enforce

### Box 3. South Sudan. Public Financial Management (PFM) Reforms

**South Sudan's nascent PFM institutions and processes largely collapsed during the economic and political turmoil in recent years.** With falling revenue, high inflation, and expenditure pressures, financial controls were circumvented. As a result, payroll control was lost, payment decisions became ad hoc and based on non-transparent criteria, expenditure arrears grew, and the use of the budget as a policy instrument has been undermined as significant spending takes place outside the budget.

**The authorities devised a short-term reform program in late 2016 to jumpstart the restoration of PFM integrity**. Rebuilding the PFM institutions will take several years, but some immediate actions can be taken to reestablish core routines, enhance transparency, and strengthen the integrity of the system. The program, recommended by a FAD TA mission in mid-2016, aims at implementing a number of basic and quickly achievable PFM measures. For simplicity and in order not to divert limited policy implementation capacity into too many reforms at a time, it is organized in reasonably ambitious monthly milestones to improve budget preparation, budget execution, and accounting and fiscal reporting procedures.

**The PFM reform milestones for implementation include:**

- remittance of all revenue collected to the consolidated treasury account;
- registration of all civil servants (including military) on payroll system;
- completion of payroll audit and removal of ghost workers;
- establishment of a Treasury Single Account (TSA) structure;
- verification of the 2015/16 non-salary arrears and formation of a clearance plan;
- enactment of the Public Procurement Bill; and
- enactment of the Public Financial Management and Accountability Act (PFMAA).

commitment control, conduct a payroll audit, strengthen reporting of public sector accounts, and adopt the Procurement Act. Staff also provided a set of recommendations to improve the effectiveness of the Cash Management Committee and complete verification of domestic arrears.

**16. The mission urged the authorities to seek support from development partners to develop and finance a program for disarmament, demobilization and reintegration (DDR)**. Such a program would not only release budgetary resources toward other priorities but it would also support a move away from the current war economy. An estimated 70 percent of the wage bill is currently spent on the armed and organized forces; hence, a properly implemented DDR program that would provide an alternative source of living for redundant soldiers could be an important measure to achieve a sustainable budget. Over the medium term, a reduction in the need for humanitarian assistance could allow room for additional donor support for DDR.

**Authorities' views**

**17. The authorities broadly agreed that strong fiscal adjustment is necessary to restore macroeconomic stability.** The authorities agreed to revise the budget to eliminate the financing gap and pursue strict fiscal discipline to avoid any new borrowing from the BSS. Preliminary information indicates that the authorities already have taken initiatives to eliminate transfers to Nilepet and reduce costs in foreign missions. Moreover, based on preliminary reports on execution and financing, the envisaged budgetary tightening for 2016/17 has been broadly implemented in the early parts of the fiscal year. Moreover, the authorities have started implementing the needed reforms to strengthen the PFM systems.

## B. Monetary and Financial Policies

**18. Monetary policy should focus on reducing inflation, gradually replenishing international reserves, and strengthening monetary policy instruments.** The proposed fiscal adjustment will set the stage to achieve this, including through eliminating BSS direct lending to government and the full financing of the deficit through Treasury bills. Tighter monetary conditions will gradually lower inflation and stabilize the foreign exchange market. With the proposed fiscal tightening, broad money growth could decelerate to about 40 percent in 2016/17 and further to near 25 percent in 2017/18, supporting a lowering of inflation to about 20 percent (year-on-year).[3] With banks holding large excess reserves, the BSS should urgently enforce the statutory minimum reserve requirement. In particular, it should apply the adopted increase in reserve requirements from 15 percent to 20 percent, and begin reserve averaging. The staff support the authorities' plan to introduce repurchase agreements for liquidity management. A tighter monetary policy stance will also support a gradual recovery in foreign exchange reserves and enhance confidence in the South Sudanese pound.

[3] Information through December 2016 confirms that money growth indeed is slowing down and that new direct BSS lending to the government has been small in recent months.

**19. The BSS should enforce the minimum capital requirement for all banks.** Since the decision to raise capital requirements for commercial banks in 2013 (US$30 million for foreign-owned banks and US$15 million for locally-owned banks to be met over two years), only about half of the banks have met the requirements. Indeed, financial soundness indicators reveal that capital adequacy ratios, earnings, non-performing loans (NPLs), and profitability have declined, and asset quality has been eroded. (Figure 5 and Table 6). The recent pick-up in NPLs and drop in earnings reflect the worsening of the security situation in July 2016, which particularly affected the construction and service sectors. The staff urged the authorities to address the undercapitalized banks by adopting bank resolution regulations, and fostering banking system consolidation by closing banks that do not meet the capital requirements.

**Authorities' views**

**20. The BSS agreed with the assessment and recommendations on monetary policy**. It has stopped direct lending to the government, and plans to finance the fiscal deficit solely through the issuance of Treasury bills. The BSS plans to enforce reserve requirements and reserve averaging by early 2017. It instructed banks to address the inadequate capitalization, and will either agree on a specific plan with the delinquent banks or start withdrawing banking licenses. The audit of BSS's financial statements for 2013-15 is expected to be completed in the first half of 2017.

## C. Exchange Rate Policy and External Stability

**21. Overvaluation of the official exchange rate was broadly eliminated with the exchange rate liberalization in December 2015.** Given the resistance from vested interests, this was a courageous and crucial step in the right direction that broadly eliminated a large overvaluation of the official rate and reduced the spread to the parallel market. However, given the current economic and political uncertainties, the volatility in the parallel market remains high and the cash premium has risen substantially. This has caused the spread to the official indicative rate to increase substantially since mid-2016. With the current low inflow of foreign exchange, the BSS should continue to conduct regular auctions with smaller amounts to send price signals to the market. The authorities will need to ensure that the spread between the official and parallel rates is reduced by allowing the auction and indicative rates to reflect market conditions.

**22. Restoration of external stability will require improvement in policies and external support (Annex I).** While exchange rate flexibility will help, tighter fiscal and monetary policies combined with some external financing are required to restore external stability and to gradually rebuild reserves. In particular, urgent measures are needed to minimize foreign exchange expenditure by the government in light of the current very weak reserve position. The tighter fiscal conditions should over time allow the BSS to increase reserves. Over the medium term, structural reforms to address business environment will be essential to diversify the economy and build competitiveness.

# MEDIUM TERM: REBUILDING BUFFERS AND REFOCUSSING ON ECONOMIC DEVELOPMENT

## A. Economic Outlook

**23. The medium-term outlook faces challenges and significant downside risks.** While there are external risks, including of lower than anticipated oil prices and climate-related shocks, the possibility of lack of internal political inclusiveness may derail the peace process and prevent the government from embarking on economic stabilization and reforms. In the event of insufficient progress towards peace and economic stabilization, the trajectory of the economy becomes highly unstable and could lead to further economic deterioration, which in turn would further undermine the implementation of a fragile peace process. The consequences of insufficient efforts to address the economic crisis and to achieve peace are illustrated in staff's downside scenario (Box 4). In this scenario, which assumes a three-year delay in peace and economic adjustment, the fiscal deficit remains high and economic activity will be stagnant. This would lead to further instability through high inflation, exchange rate volatility, and low foreign exchange reserves.

**24. A sustainable medium-term outlook hinges on progress toward normalization of the political and security situation, sustained economic adjustment and reforms, and renewed access to external financing.** Leveraging on peace, the medium-term strategy should focus on restoring economic growth and poverty reduction. Fiscal policies should be anchored by debt sustainability and domestic financing consistent with low inflation. Under these assumptions and progress toward political normalization, the fiscal deficit is projected to fall to 2-3 percent of GDP in the coming years assuming a moderate recovery in oil production and higher capital spending (Table 5). In the next five years, annual GDP growth could increase to 5-6 percent, reflecting a recovery in oil production and in non-oil GDP. The latter is based on the positive effects of improved security on agricultural production (gradual return of internally displaced persons to their land), post-conflict rebuilding efforts, and a better investment climate for services and light manufacturing. The path for oil production assumes investments in existing wells and daily production is projected to increase from the current 120,000 barrels to about 155,000 barrels in 2020/21. Higher than anticipated oil prices may encourage oil companies to invest more and earlier in enhanced oil recovery techniques which could further raise production.

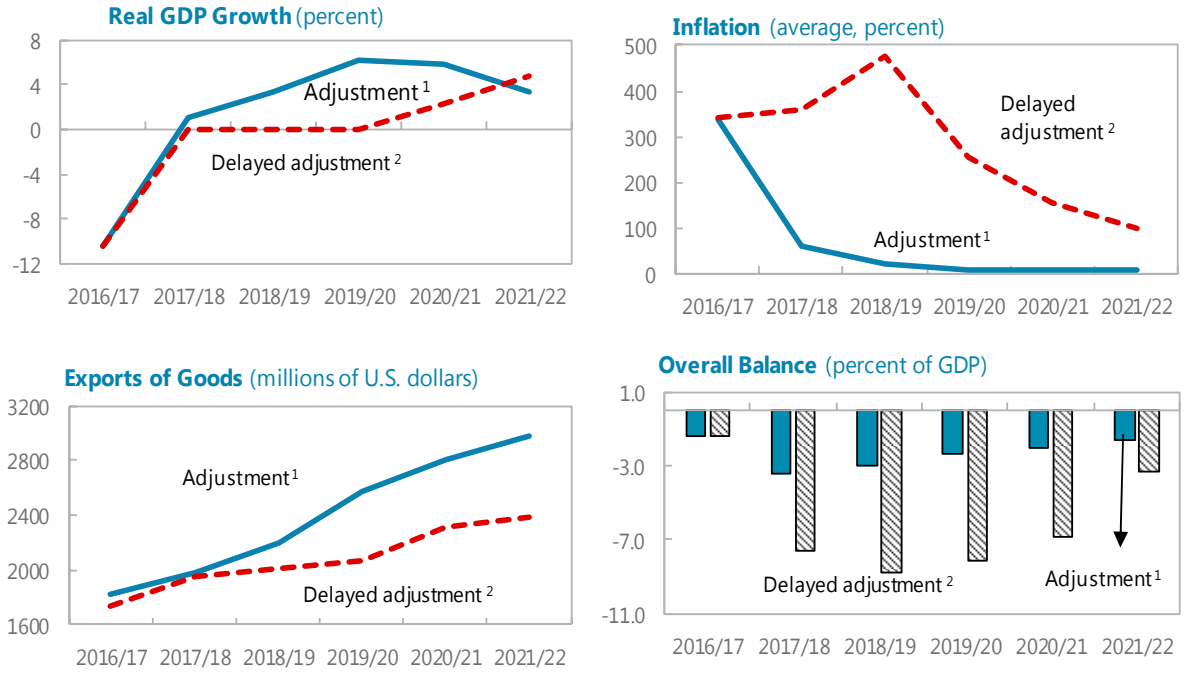
**25. Policies should focus on reprioritizing budgetary spending and rebuilding foreign exchange reserves.** Beyond the immediate stabilization efforts, there is a need to shift away from security-related spending toward investment in education, health, infrastructure and rural development. Moreover, efforts should be made to diversify the revenue base, including by exploring options in mining, agricultural reforms, and promoting private sector. Further, the authorities would need to gradually rebuild foreign exchange reserves to restore credibility to the South Sudanese pound so that the economy can better withstand external shocks. The projection

## Box 4. The Risks of a Delay in Policy Action

Without significant progress towards peace and economic stabilization, as assumed in the baseline projection, the economic trajectory for South Sudan becomes highly unstable. A downside scenario demonstrates the risks of the baseline by assuming a three-year delay in achieving peace and implementing economic stabilization policies. The underlying assumptions include (i) stagnating oil production because oil companies are unwilling to invest to rehabilitate the aging oil wells in the middle of civil war; (ii) rising instability will maintain a large number of internally displaced people and refugees, which will dampen activity in the nonoil sector; (iii) the country will continue to have no access to external financing; and (iv) budgetary spending will accelerate reflecting higher security-related expenses. Key macroeconomic indicators under this scenario will therefore deviate significantly from the baseline scenario:

- *Growth.* The delay in peace will prevent investments in the oil sector and prevent a pick-up in agriculture and construction. As a result, real GDP growth will be flat for the next three years and export values will only grow slowly with slightly higher international prices.
- *Fiscal policy.* With rising security-related spending against declining domestic revenue, the fiscal deficit is projected to rise gradually to 10 percent of GDP in the next three years (comparable to what happened in recent years).
- *Monetary policy.* The central bank will resume printing money to finance the government deficit, which will fuel inflation and the depreciation of the South Sudanese pound. Moreover, foreign exchange reserves will decline further to less than a week of imports.
- *Inflation*. The combination of high money growth and exchange rate depreciation will lead to continued high inflation and high price volatility. Annual consumer price inflation is projected to stay at 400-500 percent.

**Republic of South Sudan: Medium-Term Scenarios, 2016/17–2021/22**




Sources: South Sudanese authorities; and IMF staff estimates and projections.

[1] Adjustment scenario is equal to Table5.

[2] Delayed adjustment scenario assumes 3 year dealy in economic adjustment and achieving peace.

assumes public investment of 10–12 percent of GDP annually in the medium term and an increase in gross foreign exchange reserves to about 1.5 months of imports by 2020/21.

**Authorities' views**

**26. The authorities agreed that the situation remains fragile and concurred that the macroeconomic imbalances need to be addressed to prevent further economic deterioration.** They agreed that the economic stabilization efforts need to be complemented by peace, reconciliation, and an inclusive political process, and in this respect the authorities referred to their commitment to make the new national dialogue initiative a successful vehicle for political normalization. Moreover, the authorities are keenly aware of the need to shift resources away from the security sector towards economic and social development in the medium term.

## B. Debt Sustainability

**27. South Sudan is in debt distress.** Despite moderate levels of external debt, the combined impact of a decline in oil prices, civil war, and high levels of fiscal spending has left South Sudan in debt distress. Payment delays have arisen on international obligations, civil servant salaries, and other government obligations. Moreover, international reserves are near exhaustion and the country is currently constrained from accessing longer-term external financing. While the current situation is difficult, the debt sustainability analysis suggests that implementation of the adopted adjustment policies and a return to peace would improve the debt outlook and allow for a gradual resumption of external financing.[4] However, as debt vulnerabilities will remain, the authorities are encouraged to seek financing on the most concessional terms to prevent falling into debt distress in the face of negative shocks.

## C. Managing Oil Revenue

**28. Appropriate oil revenue management is vital to ensuring fiscal sustainability.** The Petroleum Revenue Management Act (PRMA) was enacted in 2015 but has only been partially implemented. The PRMA includes provisions to prevent corruption and mismanagement and to ensure proper use of funds in the future. The PRMA stipulates that oil revenue should flow through specific accounts and that utilization of the resources must go through the budget. It also prescribes prudent financial management guidelines, including for the investments of saved funds and on auditing requirements. The authorities agreed to implement the PRMA in full and seek the necessary technical support.

## D. Reforming the Domestic Oil Sector

**29. There is a need to reform the domestic market for oil products.** Fuel and other oil products are imported as there is no refining capacity in South Sudan. The existing subsidy at the

[4] See the accompanying staff report for the Debt Sustainability Analysis.

pump (prices are currently significantly below import cost) has led to fuel shortages and the emergence of a parallel market. Eliminating the subsidy will help the budget and price liberalization will support normalization of supply. The state-owned Nilepet imports petroleum products while holding and managing South Sudan's shares in crude oil production ventures. The use of the dividends from shares are unclear since Nilepet does not provide transparent accounting of its financial activities and no dividends are paid to the central government.

**30. In reforming the domestic oil sector,** staff recommends the authorities to: (i) eliminate fuel subsidies to Nilepet and raise pump prices to cost-recovery level to help alleviate supply shortages and informal trade, (ii) review domestic fuel prices periodically, and (iii) subject Nilepet to external audits. Nilepet should solely focus on its core business as a fuel importer and its proceeds from government crude oil shares should be transferred to the consolidated government fund on a monthly basis. The authorities concurred with staff and a policy document for Cabinet approval is under preparation.

## E. Promoting Private Sector Development

**31. South Sudan needs to diversify its economy and create non-security related employment opportunities for its people.** The ongoing conflict and uncertainty about macroeconomic stability have impeded non-oil exports and import-substituting production. In the event of a successful peace process, maintaining a liberalized exchange rate regime, and implementing the necessary economic stabilization policies, these impediments will be reduced. The next step should be to build on this in the medium term by addressing the remaining key constraints on private sector growth, including an undeveloped banking sector, insufficient infrastructure, lack of rule of law, and endemic corruption. On the latter, in order to ensure enforcement of transparency measures, acts of corruption should be effectively prosecuted, in line with the United Nations Convention Against Corruption. Over the medium term, and with the support of donors and creditors, it will be vital to create a framework, including through public private partnerships, for supplying public goods, which are currently lacking in South Sudan, such as water, sewage, electricity and transport.

# CAPACITY DEVELOPMENT ISSUES

**32. The IMF launched a dedicated five-year capacity development program in 2012 funded by a multi-donor trust fund.** While the needs for capacity building are enormous, efficient provision of technical assistance has been a challenge because of political instability, high staff turnover, limited local resources, and insufficient political commitment to reform. As a result, delivery of technical assistance was scaled back in 2015 to focus on areas with sufficient traction (these included support to core functions of the central bank, macroeconomic analysis and coordination, production of statistics, and tax administration). The escalation of violence in July 2016 led to a nearly complete stop of TA activities. Depending on the peace efforts and the willingness of donors to keep funding the TA, the trust fund supported activities could be resumed in the future,

including by supporting a strengthening of public financial management. The authorities have expressed a strong desire to resume the trust fund-supported activities and they committed to implement measures to strengthen capacity.

# STAFF APPRAISAL

**33. South Sudan faces massive economic and political challenges in the wake of prolonged internal conflict and subdued oil prices.** The shocks over the past three years have exacerbated an already fragile situation in the world's youngest nation endowed with an underdeveloped economy, high poverty rates, weak institutions, and deficient infrastructure. Real income has declined massively and the number of people in need of immediate humanitarian assistance has risen to unprecedented proportions.

**34. Decisive economic stabilization and a credible path towards lasting peace are necessary to rebuild confidence and prevent economic collapse.** Excessive budgetary spending and falling oil revenue, combined with loose monetary policy, have led to large macroeconomic imbalances and have eroded all economic buffers. Failure to arrest this situation will cause further income loss, price and exchange rate instability, and loss of credibility that will make a recovery even more difficult. Restoring macroeconomic stability and confidence will not only require implementation of economic adjustment policies but also simultaneous efforts to promote reconciliation, address the security challenges, and alleviate the humanitarian emergency.

**35. Against this background, staff commends the South Sudanese authorities for their commitment to economic stabilization and initiative for an all-inclusive national dialogue.** The adopted 2016/17 budget and accompanying policy measures, including a decision to stop monetizing the fiscal deficit and improve public financial management, are important first steps in restoring macroeconomic balance.

**36. The immediate focus should be on restoring fiscal discipline.** This is the only way to reduce money expansion, stabilize domestic prices, and restore external stability. In this respect, staff urges the government to implement the proposed revenue measures and spending cuts in the 2016/17 budget and take additional measures to fully eliminate the financing gap and reduce domestic financing to a level consistent with macroeconomic stability. While these measures indeed will constrain government activities to an absolute minimum, they will not only address the current macroeconomic imbalances but also contribute to restoration of credibility that will help to restore access to external financing.

**37. The public financial management systems are in dire need of improvement.** While recent improvements have been made, additional steps should be taken to enforce commitment control, conduct a payroll audit, bolster reporting of public sector accounts, and adopt the Procurement Act. Moreover, the Petroleum Revenue Management Act should be fully implemented. The Act includes key provisions to prevent corruption and mismanagement and to ensure proper

use of funds. The Fund stands ready to support these steps with technical support as soon as the security condition allows for resumption of missions.

**38. The authorities should seek support from development partners for a disarmament, demobilization and reintegration (DDR) program.** This will contribute to lower the high share of budgetary resources allocated for security personnel and more importantly it would provide an alternative living for former soldiers.

**39. Monetary policy should focus on reducing inflation and gradually replenishing international reserves.** The proposed fiscal adjustment supports tighter monetary conditions that will gradually lower inflation and stabilize the foreign exchange market. To this end, the BSS should stop direct lending to the government and domestic financing of the budget could instead be achieved by issuance of Treasury bills. Also, the BSS should enforce the statuary minimum reserve requirements and the minimum capital for all banks to reduce vulnerabilities in the banking system.

**40. Staff welcomes the exchange reforms and removal of two exchange restrictions and the two MCPs** and encourages the authorities to continue the efforts to remove the remaining exchange restrictions and MCP as soon as conditions permit.

**41. Medium-term policies should be motivated by reprioritizing budgetary spending and rebuilding foreign exchange reserves.** As economic stabilization takes hold budgetary spending should be shifted away from security-related outlays towards public services and infrastructure investment. Assuming progress towards lasting peace and security, a coherent economic policy package would boost economic activity, including gradual recovery in oil production. Economic growth could bounce back to 5-6 percent a year within a few years under the right conditions. In support of this objective, the authorities should seek assistance to develop a coherent and well prioritized public investment program.

**42. A reform of the domestic oil market is needed.** Removing domestic fuel subsidies, ensuring that the proceeds from the government's crude oil interests are transparently transferred to the budget, and liberalizing the domestic market for fuel will improve the budgetary situation and address the current shortages in the domestic fuel market.

**43. South Sudan is in debt distress.** Despite moderate levels of external debt, the combined impact of a decline in oil prices, civil war, and high levels of fiscal spending has left South Sudan in debt distress. While the current situation is difficult, the debt sustainability analysis suggests that steadfast implementation of the announced adjustment policies and a return to peace would improve the debt outlook and allow for a gradual resumption of external financing.

**44. Downside risks are substantial.** The main risk to economic recovery and solving the humanitarian crisis is the failure to achieve sufficient internal political inclusiveness to bring the peace process back on track. In the event this does not happen, the trajectory of the economy

becomes highly unstable and the country risks falling into a spiraling trap of deteriorating economic performance and worsening security conditions with devastating humanitarian costs.

**45. It is recommended that the next Article IV consultation be held on the standard 12-month schedule.**

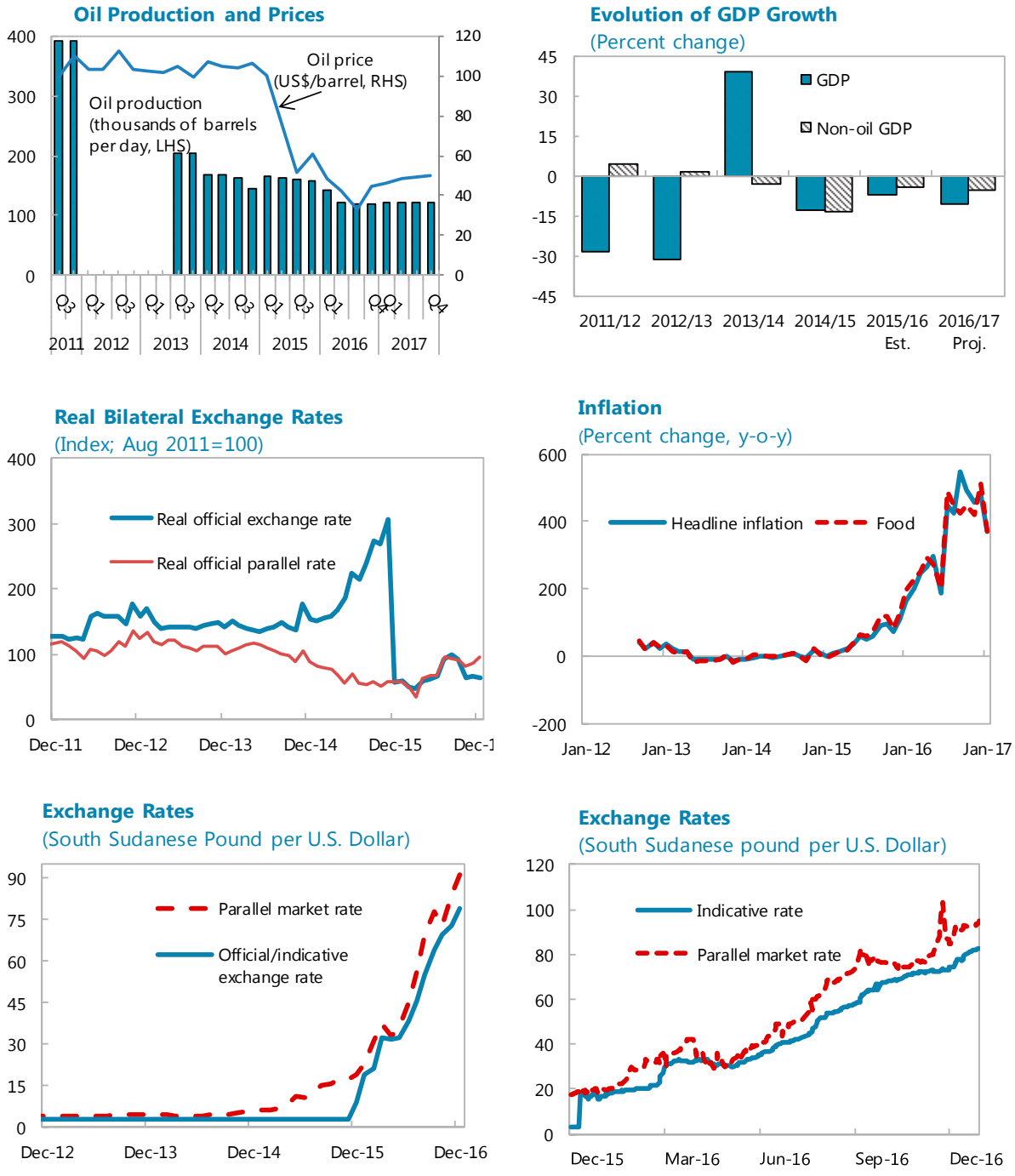
# Proposed Decision

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

1. The Fund takes this decision in concluding the 2016 Article XIV consultation with the Republic of South Sudan.

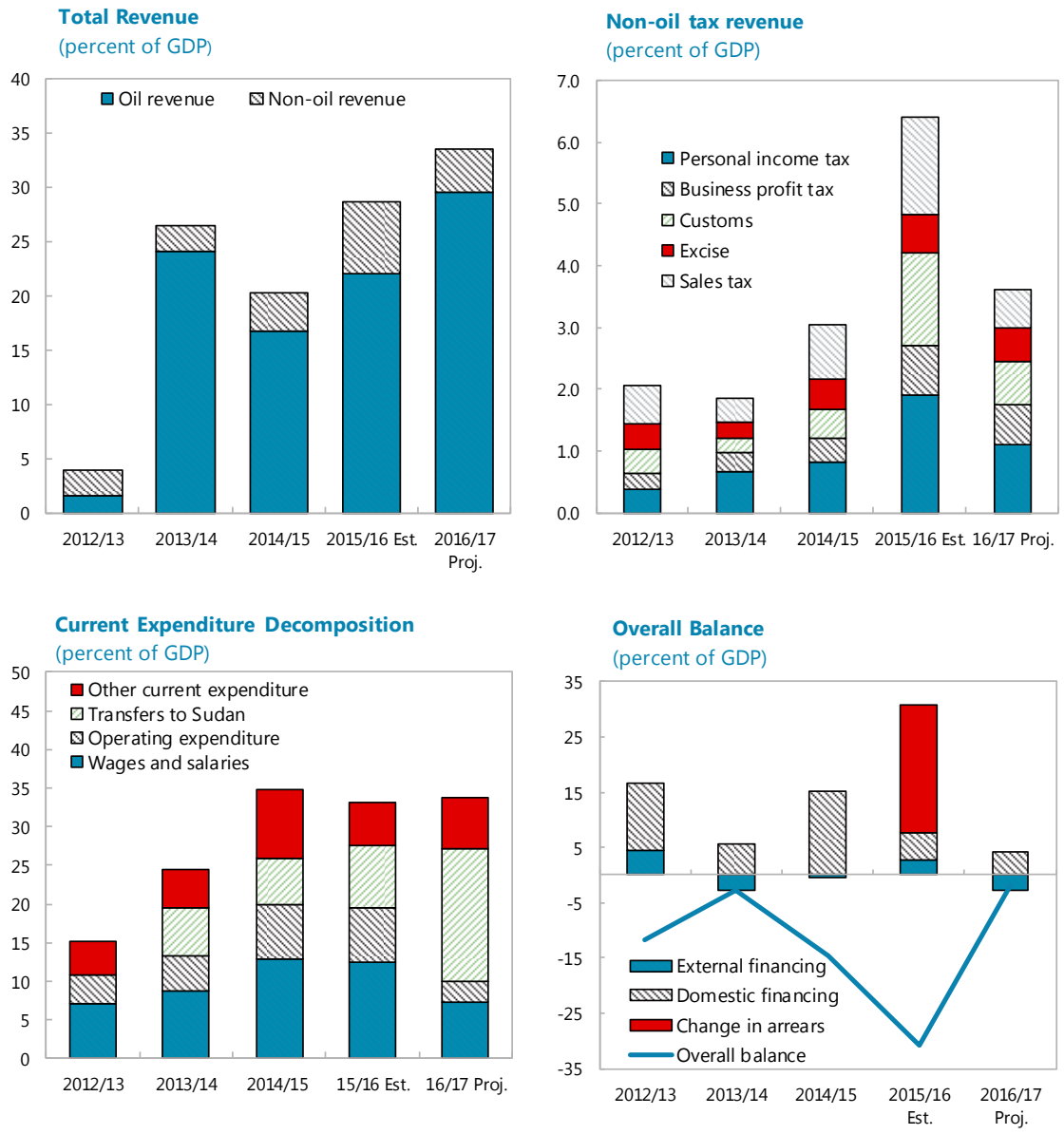
2. The Republic of South Sudan continues to maintain restrictions on the making of payments and transfers for current international transactions under the transitional arrangements of Article XIV, Section 2, as described in SM/17/33. The Fund encourages the Republic of South Sudan to eliminate the measures maintained under Article XIV, Section 2 as soon as its balance of payments position permits.

## Figure 1. Republic of South Sudan: Recent Economic Developments



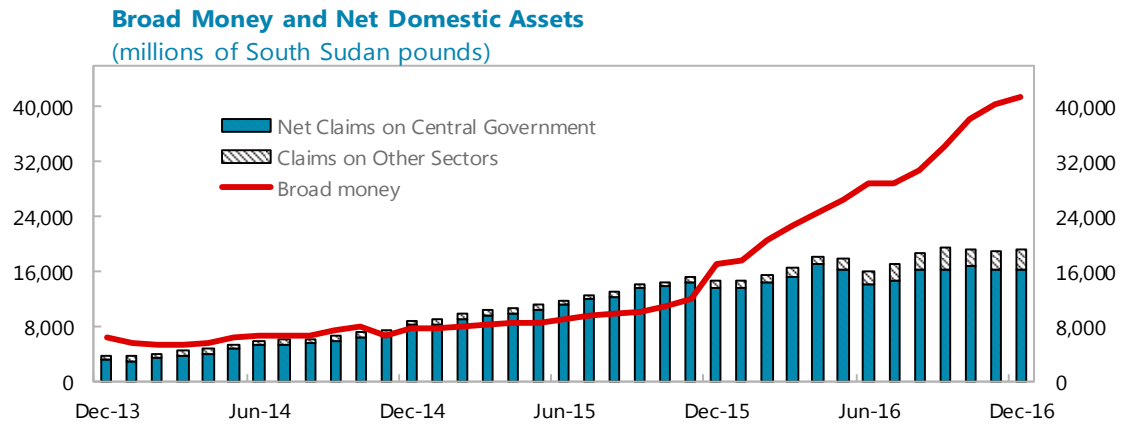

Sources: South Sudanese authorities and IMF staff calculations.

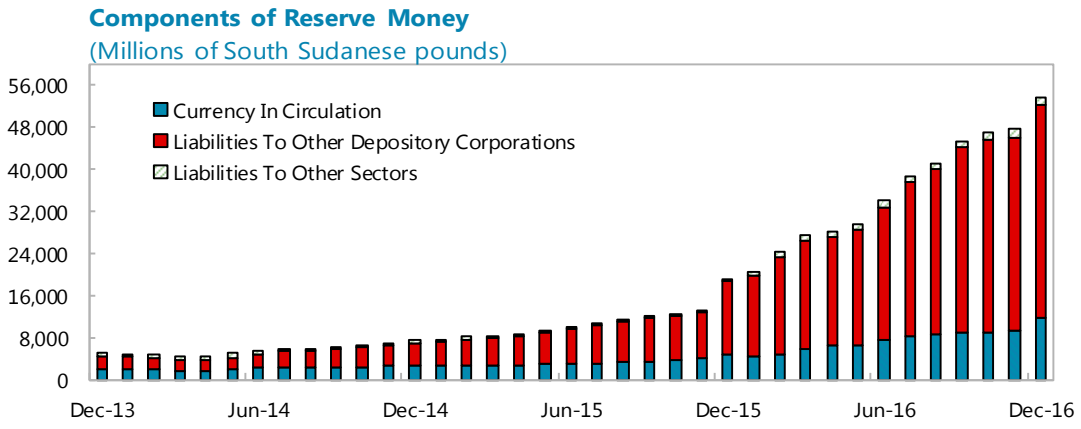
## Figure 2. Republic of South Sudan: Fiscal Developments

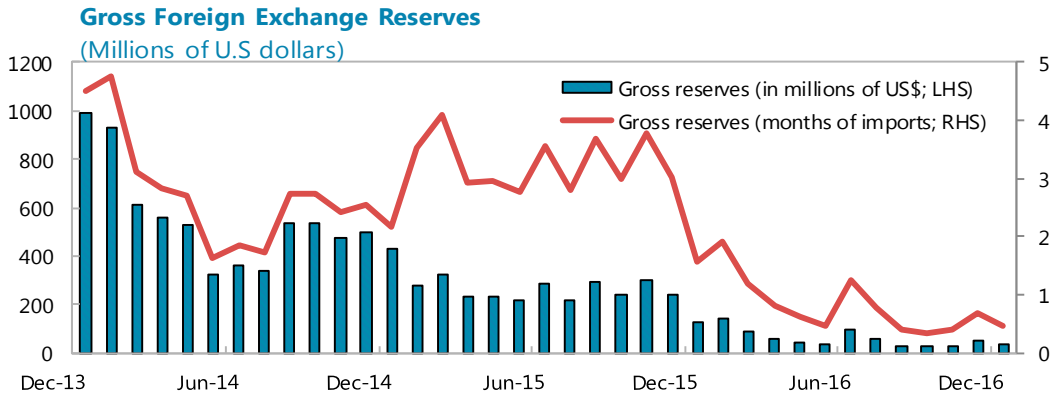



Sources: South Sudanese authorities, and IMF staff calculations.

## Figure 3. Republic of South Sudan: Monetary Developments

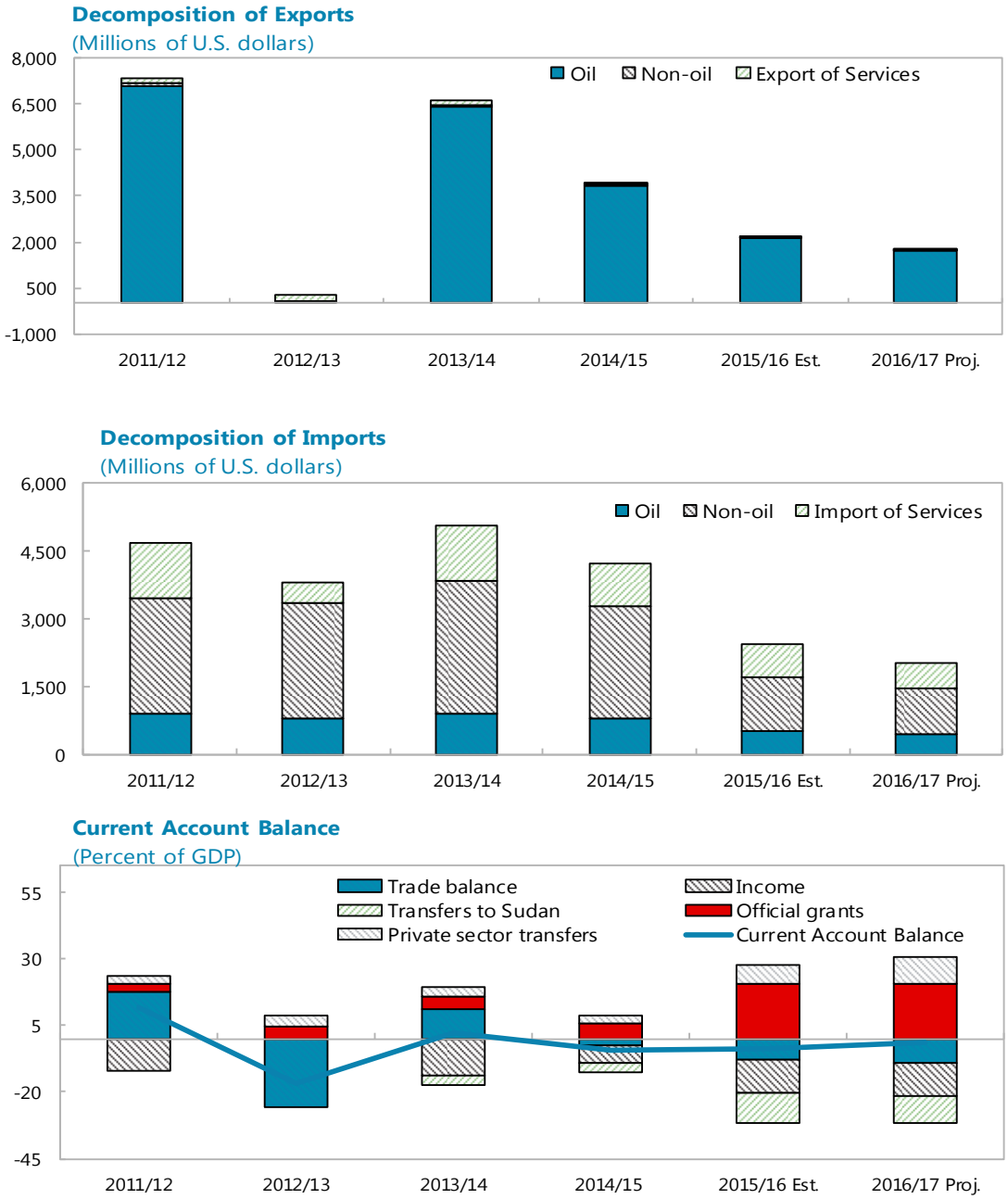


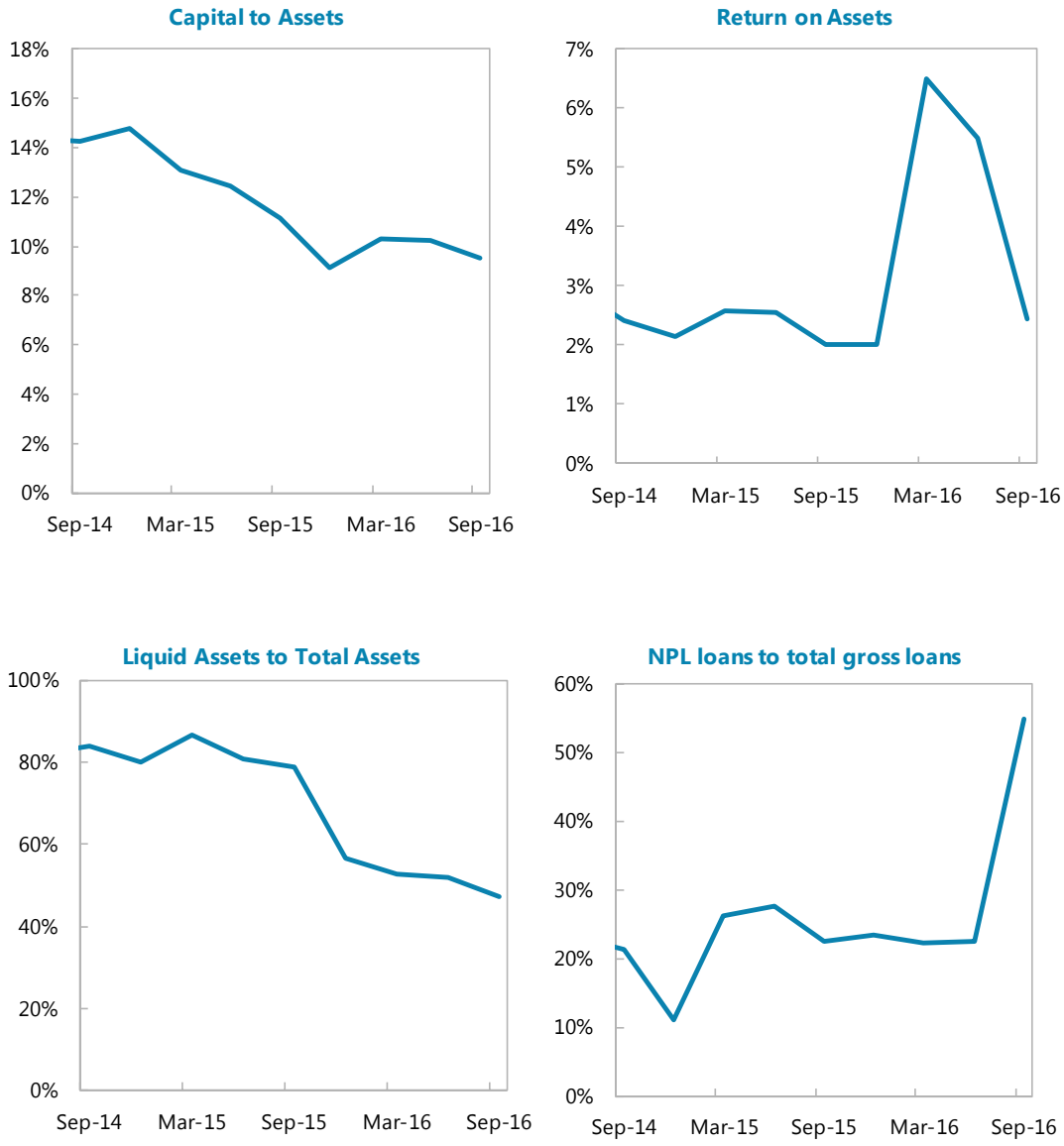

Sources: South Sudanese authorities and IMF staff calculations.

## Figure 4. Republic of South Sudan: External Sector Developments




Sources: South Sudanese authorities and IMF staff calculations.

**Figure 5. Republic of South Sudan: Selected Financial Stability Indicators, 2014–16**




Source: Bank of South Sudan.

## Table 1. Republic of South Sudan: Selected Economic Indicators, 2013/14–2017/18

| | 2013/14 Act. | 2014/15 Act. | 2015/16 Est. | 2016/17 Proj. | 2017/18 Proj. |
|---|---|---|---|---|---|
| | (Annual percent of change, unless otherwise indicated) | | | | |
| **Output, prices, and exchange rate** | | | | | |
| Real GDP (percent change) | 39.3 | -12.8 | -6.9 | -10.5 | 1.1 |
| Oil | 263.0 | -11.6 | -10.6 | -18.4 | 0.6 |
| Non-oil | -3.2 | -13.6 | -4.1 | -5.1 | 1.4 |
| Inflation (end-of-period) | 0.6 | 61.2 | 187.0 | 237.9 | 20.0 |
| Inflation (average) | -5.6 | 14.8 | 158.7 | 336.2 | 61.9 |
| Exchange rate (SSP/US$, average) | 3.0 | 3.0 | 16.9 | ... | ... |
| Exchange rate (SSP/US$, end period) | 3.0 | 3.0 | 52.0 | 97.1 [1] | ... |
| **Money and credit** | | | | | |
| Broad money | 20.5 | 36.9 | 219.1 | 38.7 | 26.1 |
| Reserve money | 37.0 | 81.1 | 239.6 | 56.6 | 9.5 |
| Credit to non-government sector | 4.6 | 13.7 | 172.6 | 46.9 | 28.5 |
| M2/GDP (percent) | 15.9 | 23.2 | 48.3 | 18.4 | 15.0 |
| | (Percent of GDP, unless otherwise indicated) | | | | |
| **Central government budget** | | | | | |
| Total Revenues and Grants | 26.4 | 28.6 | 29.0 | 34.4 | 33.4 |
| *Of which* : Oil | 24.1 | 16.7 | 22.0 | 29.5 | 25.7 |
| *Of which* : Non-oil tax revenue | 1.8 | 3.1 | 6.1 | 3.7 | 4.2 |
| *Of which* : Grants | 0.0 | 8.3 | 0.4 | 0.9 | 3.1 |
| Expenditures | 28.1 | 37.2 | 38.4 | 36.3 | 36.9 |
| Current | 24.5 | 34.7 | 33.0 | 33.7 | 32.2 |
| *Of which* : transfers to Sudan | 6.2 | 5.9 | 7.9 | 17.2 | 15.0 |
| Net acquistition of non-financial assets | 3.6 | 2.4 | 5.4 | 2.6 | 2.6 |
| Errors and omissions | 1.1 | 6.0 | -1.8 | -0.5 | 0.0 |
| Overall balance (cash) | -2.9 | -14.6 | -7.6 | -1.3 | -3.5 |
| Change in arrears | 0.0 | 0.0 | 23.2 | 0.0 | 0.0 |
| Overall balance (accural) | -2.9 | -14.6 | -30.8 | -1.3 | -3.5 |
| **Public debt** | | | | | |
| Total Public External Debt [2] | 4.2 | 5.5 | 28.6 | 38.7 | 31.1 |
| **External sector** | | | | | |
| Exports of goods and services | 46.7 | 29.5 | 61.5 | 66.3 | 61.1 |
| Imports of goods and services | 35.8 | 31.8 | 69.4 | 72.8 | 75.4 |
| Current account balance (including grants) | 2.3 | -4.2 | -3.7 | 2.1 | -6.6 |
| Current account balance (excluding grants) | -2.6 | -9.2 | -20.3 | -20.4 | -23.1 |
| Gross foreign reserves (millions of US dollars) | 363 | 282 | 73 | 50 | 131 |
| Gross foreign reserves (in months of imports) | 1.0 | 1.4 | 0.4 | 0.2 | 0.6 |
| **Memorandum Items:** | | | | | |
| Population (millions) | 11.1 | 11.6 | 12.2 | 12.8 | 13.5 |
| Oil production (millions of barrels) | 66.8 | 57.8 | 53.1 | 43.4 | 43.7 |
| South Sudan's oil price (U.S. dollars per barrel) | 97.8 | 62.4 | 34.7 | 41.4 | 44.6 |
| Brent price (U.S. dollars per barrel) | 105.5 | 71.8 | 42.2 | 48.9 | 51.9 |
| Nominal GDP (billions of SSP) | 42 | 39 | 60 | 218 | 338 |
| GNI per capita (US dollars) | 1,154 | 1,060 | 240 | 210 | 226 |
| Nominal GDP (percent change) | 2.1 | -6.2 | 53.4 | 263.5 | 55.3 |

Sources: South Sudanese authorities; and IMF staff estimates and projections.

[1] Exchange rate as of February 13, 2017.

[2] Public external debt in U.S. dollars in percent of U.S. dollar GDP.

## Table 2a. Republic of South Sudan: Fiscal Operations of the Central Government, 2013/14–2017/18

(Billions of South Sudanese Pounds)

| | 2013/14 | 2014/15 | 2015/16 | 2016/17 | | 2017/18 |
|---|---|---|---|---|---|---|
| | Act. | Act. | Est. | Budget | Proj. | Proj. |
| Total revenue and grants | 10.4 | 11.2 | 17.4 | 58.2 | 75.0 | 113.1 |
| Total oil revenues | 9.5 | 6.5 | 13.2 | 46.8 | 64.3 | 87.0 |
| Government share from oil exports | 9.5 | 6.5 | 13.2 | 46.8 | 64.3 | 87.0 |
| Signature bonuses | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non-Oil Tax Revenue | 0.8 | 1.2 | 3.7 | 8.7 | 8.0 | 14.3 |
| Other GoSS Revenue | 0.2 | 0.2 | 0.3 | 0.6 | 0.7 | 1.2 |
| Grants | 0.0 | 3.2 | 0.2 | 2.0 | 2.0 | 10.6 |
| Total expenditure | 11.7 | 14.5 | 23.0 | 77.7 | 79.1 | 124.9 |
| Current expenditure | 10.2 | 13.6 | 19.8 | 72.0 | 73.4 | 109.0 |
| Salaries | 3.6 | 5.0 | 7.5 | 14.0 | 16.1 | 26.5 |
| Operating expenses | 1.9 | 2.8 | 4.2 | 5.5 | 5.6 | 15.5 |
| Interest | 0.3 | 0.5 | 0.7 | 0.2 | 0.3 | 0.4 |
| Other expenses | 4.7 | 3.1 | 3.0 | 9.8 | 9.1 | 12.3 |
| Emergency contingency fund | 0.0 | 0.0 | 0.0 | 1.4 | 1.4 | 3.0 |
| Transfers to states | 1.8 | 1.6 | 1.7 | 4.6 | 4.6 | 10.3 |
| Conditional transfers | 1.0 | 1.5 | 1.7 | 4.2 | 4.2 | 7.6 |
| Current transfers to states | 1.0 | 1.5 | 1.7 | 4.2 | 4.2 | 7.6 |
| Capital transfers to states | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Transfers to oil producing states (5%) | 0.1 | 0.1 | 0.0 | 0.5 | 0.5 | 0.5 |
| Block grants to states | 0.7 | 1.0 | 0.4 | 2.2 | 1.8 | 2.1 |
| Subsidies | 0.0 | 0.5 | 0.9 | 1.5 | 1.2 | 0.0 |
| Transfers to Sudan | 2.6 | 2.3 | 4.8 | 37.7 | 37.6 | 50.6 |
| Transportation and transit fees | 1.0 | 0.9 | 0.2 | 14.0 | 14.4 | 19.1 |
| Financial transfer | 1.6 | 1.4 | 4.6 | 23.6 | 23.1 | 31.5 |
| Peace agreement | ... | ... | ... | 4.8 | 4.8 | 7.0 |
| Net acquistition of Non-Financial Assets | 1.5 | 0.9 | 3.2 | 5.7 | 5.7 | 15.9 |
| Domestically financed | 1.5 | 0.7 | 2.1 | 1.0 | 1.0 | 3.4 |
| Foreign financed | 0.0 | 0.3 | 1.1 | 4.7 | 4.7 | 12.5 |
| Errors and omissions | -0.1 | 2.3 | -1.1 | -1.2 | -1.2 | 0.0 |
| Overall balance (Cash) | -1.2 | -5.7 | -4.5 | -18.3 | -2.9 | -11.8 |
| Change in Arrears | 0.0 | 0.0 | 13.9 | 0.0 | 0.0 | 0.0 |
| Overall balance (Accrual) | -1.2 | -5.7 | -18.4 | -18.3 | -2.9 | -11.8 |
| Financing | 1.2 | 5.7 | 4.5 | 6.0 | 2.9 | 11.8 |
| Domestic (net) | 2.3 | 5.9 | 3.0 | 11.2 | 9.0 | 7.3 |
| Net credit from the central bank | 2.3 | 5.6 | 2.5 | 2.2 | 2.2 | 0.0 |
| Net credit from commercial banks | 0.0 | 0.3 | 0.5 | 9.0 | 6.8 | 7.3 |
| Foreign (net) | -1.1 | -0.2 | 1.6 | -5.2 | -6.0 | 4.4 |
| Disbursement | 1.2 | 0.6 | 2.8 | 2.6 | 2.6 | 23.0 |
| Amortization | -2.3 | -0.9 | -1.3 | -7.9 | -8.7 | -18.6 |
| Financing gap | 0.0 | 0.0 | 0.0 | 12.3 | 0.0 | 0.0 |
| Memorandum Items: | | | | | | |
| Off-budget grant-financed current spending | 2.1 | 2.4 | 12.1 | 40.8 | 40.8 | 72.2 |
| Non-oil domestic current fiscal balance [1] | -4.4 | -6.7 | 5.0 | -22.5 | 31.9 | 45.8 |
| Nominal GDP (billions of South Sudanese pounds) | 41.7 | 39.1 | 60.0 | 218.0 | 218.0 | 338.5 |

Sources: South Sudanese authorities; and IMF staff estimates and projections.

[1] Non-oil revenue excluding grants minus domestically-financed current expenditure minus transfers to Sudan (including pipeline fees), minus tranfers to oil producing states and communities.

## Table 2b. Republic of South Sudan: Fiscal Operations of the Central Government, 2013/14–2017/18

(Percent of GDP, unless otherwise indicated)

| | 2013/14 | 2014/15 | 2015/16 | 2016/17 | | 2017/18 |
|---|---|---|---|---|---|---|
| | Act. | Act. | Est. | Budget | Proj. | Proj. |
| Total revenue and grants | 25.0 | 28.6 | 29.0 | 26.7 | 34.4 | 33.4 |
| Total oil revenues | 22.7 | 16.7 | 22.0 | 21.5 | 29.5 | 25.7 |
| Government share from oil exports | 22.7 | 16.7 | 22.0 | 21.5 | 29.5 | 25.7 |
| Signature bonuses | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non-oil tax revenue | 1.8 | 3.1 | 6.1 | 4.0 | 3.7 | 4.2 |
| Other revenue | 0.4 | 0.5 | 0.5 | 0.3 | 0.3 | 0.3 |
| Grants | 0.0 | 8.3 | 0.4 | 0.9 | 0.9 | 3.1 |
| Total expenditure | 28.0 | 37.2 | 38.4 | 35.6 | 36.3 | 36.9 |
| Current expenditure | 24.4 | 34.7 | 33.0 | 33.0 | 33.7 | 32.2 |
| Salaries | 8.7 | 12.9 | 12.5 | 6.4 | 7.4 | 7.8 |
| Operating expenses | 4.5 | 7.1 | 7.0 | 2.5 | 2.6 | 4.6 |
| Interest | 0.6 | 1.4 | 1.2 | 0.1 | 0.1 | 0.1 |
| Other expenses | 11.2 | 7.9 | 4.9 | 4.5 | 4.2 | 3.6 |
| Emergency contingency fund | | 0.0 | 0.0 | 0.7 | 0.7 | 0.0 |
| Transfers to states | 4.4 | 4.1 | 2.8 | 2.1 | 2.1 | 3.0 |
| Conditional transfers | 2.4 | 3.9 | 2.8 | 1.9 | 1.9 | 2.3 |
| Current transfers to states | 2.4 | 3.9 | 2.8 | 1.9 | 1.9 | 2.3 |
| Capital transfers to states | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Transfers to oil producing states (5%) | 0.3 | 0.2 | 0.0 | 0.2 | 0.2 | 0.2 |
| Block grants to states | 1.7 | 2.6 | 0.6 | 1.0 | 0.8 | 0.6 |
| Subsidies | 0.0 | 1.3 | 1.5 | 0.7 | 0.5 | 0.0 |
| Transfers and oil service payments to Sudan | 6.2 | 5.9 | 7.9 | 17.3 | 17.2 | 15.0 |
| Transportation and transit fees | 2.3 | 2.4 | 0.3 | 6.4 | 6.6 | 5.6 |
| Financial transfer | 3.9 | 3.5 | 7.6 | 10.8 | 10.6 | 9.3 |
| Peace agreement | ... | ... | ... | 2.2 | 2.2 | 2.1 |
| Net acquistition of Non-Financial Assets | 3.6 | 2.4 | 5.4 | 2.6 | 2.6 | 4.7 |
| Domestically financed | 3.6 | 1.7 | 3.5 | 0.5 | 0.5 | 1.0 |
| Foreign financed | 0.0 | 0.8 | 1.9 | 2.1 | 2.1 | 3.7 |
| Errors and Omissions | -0.1 | 6.0 | -1.8 | -0.5 | -0.5 | 0.0 |
| Overall balance (Cash) | -2.9 | -14.6 | -7.6 | -8.4 | -1.3 | -3.5 |
| Change in arrears | 0.0 | 0.0 | 23.2 | 0.0 | 0.0 | 0.0 |
| Overall balance (Accrual) | -2.9 | -14.6 | -30.8 | -8.4 | -1.3 | -3.5 |
| Financing | 2.9 | 14.6 | 7.6 | 2.7 | 1.3 | 3.5 |
| Domestic (net) | 5.5 | 15.1 | 5.0 | 5.1 | 4.1 | 2.2 |
| Net credit from the central bank | 5.6 | 14.3 | 4.1 | 1.0 | 1.0 | 0.0 |
| Net credit from commercial banks | -0.1 | 0.8 | 0.8 | 4.1 | 3.1 | 2.2 |
| Net acquisition of financial assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Foreign (net) | -2.7 | -0.6 | 2.6 | -2.4 | -2.8 | 1.3 |
| Disbursement | 2.8 | 1.6 | 4.7 | 1.2 | 1.2 | 6.8 |
| Amortization | -5.5 | -2.2 | -2.1 | -3.6 | -4.0 | -5.5 |
| Financing gap | 0.0 | 0.0 | 0.0 | 5.6 | 0.0 | 0.0 |
| Memorandum Items: | | | | | | |
| Off-budget grant-financed current spending | 5.0 | 6.0 | 20.2 | 18.7 | 18.7 | 21.3 |
| Non-oil domestic current fiscal balance[1] | -10.6 | -17.3 | 8.4 | -10.3 | 14.6 | 13.5 |
| Nominal GDP (billions of South Sudanese pounds) | 41.7 | 39.1 | 60.0 | 218.0 | 218.0 | 338.5 |

Sources: South Sudanese authorities; and IMF staff estimates and projections.

[1] Non-oil revenue excluding grants minus domestically-financed current expenditure minus transfers to Sudan (including pipeline fees), minus tranfers to oil producing states and communities.

**Table 3. Republic of South Sudan: Monetary Accounts, June 2014–June 2018**
(Billions of South Sudanese Pounds, unless otherwise indicated)

| | 2014 Jun Act. | 2015 Jun Act | 2015 Dec Act. | 2016 Jun Est. | 2017 Jun Proj. | 2018 Jun Proj. |
|---|---|---|---|---|---|---|
| | | | **Monetary Survey** | | | |
| Net foreign assets | 1.2 | 0.8 | -9.3 | -23.2 | -50.7 | -59.9 |
| Claims on nonresidents | 3.1 | 3.2 | 7.7 | 23.6 | 43.1 | 69.1 |
| Central bank | 1.5 | 1.2 | 4.9 | 17.9 | 32.0 | 53.9 |
| Commercial banks | 1.6 | 1.9 | 2.8 | 5.7 | 11.1 | 15.2 |
| Liabilities to nonresidents | 1.9 | 2.4 | 17.0 | 46.8 | 93.7 | 129.0 |
| Central bank | 0.9 | 0.8 | 5.3 | 20.1 | 39.6 | 54.6 |
| Commercial banks | 1.0 | 1.6 | 11.8 | 26.7 | 54.1 | 74.5 |
| Net domestic assets | 5.4 | 8.3 | 26.4 | 52.2 | 90.8 | 110.5 |
| Net domestic credit | 5.9 | 11.9 | 14.6 | 16.1 | 25.9 | 34.1 |
| Net claims on central government | 5.2 | 11.2 | 13.7 | 14.1 | 23.1 | 30.4 |
| Claims on other sectors | 0.6 | 0.7 | 1.0 | 2.0 | 2.9 | 3.7 |
| Other items (net) | -0.5 | -3.6 | 11.7 | 36.1 | 64.9 | 76.4 |
| Broad money | 6.6 | 9.1 | 17.1 | 28.9 | 40.1 | 50.6 |
| Currency outside banks | 1.9 | 2.6 | 4.1 | 6.6 | 12.2 | 16.3 |
| Transferable deposits | 2.8 | 4.8 | 9.8 | 16.3 | 21.5 | 24.9 |
| o/w: in foreign currency | 0.9 | 1.0 | 4.1 | 10.1 | 16.3 | 17.4 |
| Other deposits | 1.9 | 1.7 | 3.2 | 6.0 | 6.4 | 9.4 |
| o/w: in foreign currency | 0.2 | 0.2 | 0.8 | 2.5 | 4.5 | 4.8 |
| | | | **Central Bank** | | | |
| Net foreign assets | 0.6 | 0.4 | -0.4 | -2.2 | -7.6 | -0.6 |
| Claims on nonresidents | 1.5 | 1.2 | 4.9 | 17.9 | 32.0 | 53.9 |
| Liabilities to nonresidents | 0.9 | 0.8 | 5.3 | 20.1 | 39.6 | 54.6 |
| Net domestic assets | 4.9 | 9.6 | 19.4 | 36.2 | 60.8 | 58.9 |
| Net domestic credit | 4.5 | 9.9 | 12.4 | 12.4 | 14.5 | 14.5 |
| Claims on commercial banks | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net claims on central government | 4.2 | 9.8 | 12.3 | 12.3 | 14.5 | 14.5 |
| Claims on central government | 5.2 | 11.8 | 15.8 | 17.1 | 19.9 | 19.9 |
| Liabilities to central government | 0.9 | 2.0 | 3.5 | 4.8 | 5.5 | 5.5 |
| Other items (net) | 0.5 | -0.3 | 7.1 | 23.8 | 46.3 | 44.4 |
| Monetary base | 5.5 | 10.0 | 19.1 | 34.0 | 53.2 | 58.2 |
| Currency in circulation | 2.3 | 3.1 | 4.8 | 7.6 | 13.5 | 18.2 |
| Liabilities to commercial banks | 2.7 | 6.6 | 13.9 | 25.0 | 38.2 | 38.6 |
| Liabilities to other sectors | 0.5 | 0.3 | 0.4 | 1.4 | 1.5 | 1.5 |
| Memorandum items: | | | | | | |
| Money multiplier | 1.2 | 0.9 | 0.9 | 0.9 | 0.8 | 0.9 |
| Share of foreign currency deposits to total deposits | 0.3 | 0.2 | 0.4 | 0.6 | 0.7 | 0.6 |
| Gross foreign reserves (millions of dollars) | 363 | 282 | 124 | 73 | 50 | 131 |
| Monetary base (Year-on-year change in percent) | 37.0 | 81.1 | 154.8 | 239.6 | 56.6 | 9.5 |
| Broad money (Year-on-year change in percent) | 20.5 | 36.9 | 117.4 | 219.1 | 38.7 | 26.1 |

Sources: South Sudanese authorities; and IMF staff estimates and projections.

## Table 4. Republic of South Sudan: Balance of Payments, 2014/15–2020/21

(Millions of U.S. dollars, unless otherwise indicated)

| | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|---|---|---|---|---|---|---|---|
| | Act. | Est. | Proj. | Proj. | Proj. | Proj. | Proj. |
| Current account balance | -560 | -131 | 58 | -219 | -357 | -313 | -447 |
| Trade Balance | 594 | 437 | 358 | 109 | 90 | 320 | 316 |
| Exports of goods | 3,880 | 2,142 | 1,825 | 1,983 | 2,198 | 2,577 | 2,798 |
| Oil | 3,839 | 2,113 | 1,795 | 1,948 | 2,158 | 2,513 | 2,718 |
| Nonoil | 41 | 28 | 30 | 35 | 40 | 64 | 80 |
| Imports of goods | -3,286 | -1,704 | -1,466 | -1,873 | -2,108 | -2,256 | -2,482 |
| Balance of Services | -900 | -720 | -541 | -582 | -618 | -649 | -733 |
| Exports of services | 35 | 37 | 40 | 45 | 50 | 60 | 84 |
| Imports of services | -936 | -757 | -581 | -627 | -668 | -709 | -817 |
| *of which* non-oil | -306 | -265 | -184 | -218 | -237 | -224 | -295 |
| Income | -913 | -438 | -392 | -294 | -323 | -432 | -446 |
| Wages of expatriate oil workers | -270 | -157 | -122 | -137 | -145 | -160 | -173 |
| Investors' profits | -614 | -259 | -248 | -143 | -133 | -221 | -213 |
| Investment income (net) | -29 | -22 | -22 | -14 | -45 | -51 | -60 |
| Current Transfers (net) | 659 | 590 | 633 | 548 | 494 | 448 | 417 |
| General government | 798 | 727 | 640 | 635 | 592 | 562 | 506 |
| Workers' remittances (net) | 29 | -32 | 53 | 56 | 74 | 89 | 129 |
| Financial transfers to Sudan[1] | -466 | -394 | -315 | -326 | -332 | -371 | -398 |
| Other sectors | 298 | 289 | 255 | 183 | 160 | 168 | 180 |
| Capital and financial account | -127 | 230 | 234 | 300 | 452 | 453 | 530 |
| Capital account | 229 | 233 | 238 | 186 | 186 | 170 | 166 |
| Financial account | -356 | -3 | -4 | 114 | 266 | 283 | 364 |
| Foreign direct investment[2] | 44 | -71 | -17 | 80 | 191 | 98 | 128 |
| *of which:* non-oil | 0 | -100 | 0 | 0 | 0 | 0 | 0 |
| Change in net foreign assets of commercial banks | 89 | 527 | 103 | -81 | -70 | -47 | -58 |
| Public borrowing (net) | -4 | 107 | -66 | 161 | 164 | 252 | 309 |
| Overall balance | -687 | 99 | 292 | 80 | 94 | 140 | 84 |
| Errors and Omissions | 557 | -203 | -315 | 0 | 0 | 0 | 0 |
| Financing | 109 | 102 | 23 | -80 | -94 | -140 | -84 |
| Change in net foreign assets of the central bank | 109 | 102 | 23 | -80 | -94 | -140 | -84 |
| *of which* : Change in gross reserves | 82 | 209 | 23 | -80 | -94 | -140 | -84 |
| Change in liabilities to non-residents | 28 | -107 | 0 | 0 | 0 | 0 | 0 |
| Financing gap | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Memorandum Items: | | | | | | | |
| Current account balance including transfers (percent of GDP) | -4.4 | -3.4 | 2.1 | -6.6 | -10.4 | -8.0 | -11.1 |
| Current account balance excluding transfers (percent of GDP | -9.7 | -18.7 | -20.4 | -23.1 | -24.9 | -19.5 | -21.4 |
| External Public Debt (percent of GDP) | 5.1 | 28.7 | 0.0 | 29.8 | 28.3 | 33.2 | 35.3 |
| South Sudan oil price (dollars per barrel; weighted average) | 62.4 | 34.7 | 41.4 | 44.6 | 46.5 | 47.9 | 49.4 |
| Gross foreign reserves (millions of US dollars) | 282 | 73 | 50 | 131 | 225 | 365 | 449 |
| In months of next year's imports of goods and services | 1.4 | 0.5 | 0.2 | 0.6 | 0.9 | 1.3 | 1.6 |
| Nominal GDP (billions of U.S. dollars) | 13.3 | 3.5 | 2.8 | 3.3 | 3.4 | 3.9 | 4.0 |

Sources: South Sudanese authorities; and IMF staff estimates and projections.

[1]The agreement with Sudan over financial transfers for oil transit through its pipeline is set to expire in 2017. The figure for 2017/18 is added for illustrative purposes in order to complete the balance of payments projection and does not entail a prediction of a new agreement or any such

[2] Net of outflows associated with the repatriation of oil investments (Capex cost oil).

## Table 5. South Sudan: Medium-Term Macroeconomic Framework, 2014/15–2020/21

(Percent of GDP, unless otherwise specified)

| | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|---|---|---|---|---|---|---|---|
| | Act. | Est. | | | Proj. | | |
| **National Accounts and Prices** | | | | | | | |
| Nominal GDP (billions of U.S. dollars) | 13.3 | 3.5 | 2.8 | 3.3 | 3.4 | 3.9 | 4.0 |
| Nominal GDP (billions of South Sudanese Pounds) | 39.1 | 60.0 | 218.0 | 338.5 | 414.0 | 480.3 | 545.4 |
| GNI per capita (US dollars) | 1,060 | 240 | 210 | 226 | 230 | 233 | 241 |
| Real GDP (percent change) | -12.8 | -6.9 | -10.5 | 1.1 | 3.5 | 6.2 | 5.8 |
| Oil | -11.6 | -10.6 | -18.4 | 0.6 | 6.2 | 13.1 | 7.6 |
| Non-oil | -13.6 | -4.1 | -5.1 | 1.4 | 1.9 | 2.0 | 4.6 |
| Inflation (percent change, average) | 14.8 | 158.7 | 336.2 | 61.9 | 20.2 | 10.4 | 7.5 |
| Inflation (percent change, end period) | 61.2 | 187.0 | 237.9 | 20.0 | 7.5 | 7.5 | 7.5 |
| **Central government budget** | | | | | | | |
| Total Revenues and Grants | 28.6 | 29.0 | 34.4 | 33.4 | 33.4 | 35.8 | 36.8 |
| Oil | 16.7 | 22.0 | 29.5 | 25.7 | 25.3 | 27.5 | 28.3 |
| Non-Oil Tax Revenue | 3.1 | 6.1 | 3.7 | 4.2 | 5.0 | 5.7 | 6.1 |
| Grants | 8.8 | 0.9 | 1.3 | 3.5 | 3.2 | 2.6 | 2.4 |
| Expenditures | 37.2 | 38.4 | 36.3 | 36.9 | 36.5 | 38.2 | 38.8 |
| Current | 34.7 | 33.0 | 33.7 | 32.2 | 29.8 | 29.8 | 29.7 |
| *Of which*: transfers to Sudan | 5.9 | 7.9 | 17.2 | 15.0 | 13.8 | 14.8 | 14.7 |
| Capital | 2.4 | 5.4 | 2.6 | 4.7 | 6.6 | 8.5 | 9.2 |
| Errors and Omissions | 6.0 | -1.8 | -0.5 | 0.0 | 0.0 | 0.0 | 0.0 |
| Overall balance (cash) | -14.6 | -7.6 | -1.3 | -3.5 | -3.0 | -2.4 | -2.1 |
| Change in Arrears | 0.0 | 23.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Overall balance (accrual) | -14.6 | -30.8 | -1.3 | -3.5 | -3.0 | -2.4 | -2.1 |
| **External Sector** | | | | | | | |
| Current account balance | -4.2 | -3.7 | 2.1 | -6.6 | -10.0 | -8.0 | -11.1 |
| excl. grants | -10.2 | -24.2 | -20.7 | -25.8 | -27.3 | -22.5 | -23.6 |
| Exports of goods and services | 29.5 | 61.5 | 66.3 | 61.1 | 65.7 | 67.7 | 71.3 |
| Of which: Oil | 29.0 | 59.6 | 63.8 | 58.7 | 63.1 | 64.5 | 67.3 |
| Imports of goods and services | 31.8 | 69.4 | 72.8 | 75.4 | 81.1 | 76.2 | 81.6 |
| External debt-to-export ratio[1] | 17.3 | 46.8 | 75.8 | 59.5 | 45.4 | 41.8 | 46.5 |
| Gross foreign reserves (in months of imports) | 1.4 | 0.5 | 0.2 | 0.6 | 0.9 | 1.3 | 1.6 |
| Gross foreign reserves (in USD mill) | 282 | 73 | 50 | 131 | 225 | 361 | 441 |
| Memorandum Items: | | | | | | | |
| Oil production (millions of barrels) | 57.8 | 53.1 | 43.4 | 43.7 | 46.4 | 52.5 | 56.5 |
| South Sudan's oil price (U.S dollars per barrel) | 62.4 | 34.7 | 41.4 | 44.6 | 46.5 | 47.9 | 49.4 |

Sources: South Sudanese authorities; and IMF staff estimates and projections.

[1]Ratio of debt-to-exports of goods and services.

**Table 6. Republic of South Sudan: Financial Soundness Indicators for Banking Sector**
(Percent)

| | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 | Jun-15 | Sep-15 | Dec-15 | Mar-16 | Jun-16 | Sep-16 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Capital adequacy** | | | | | | | | | | | |
| Capital to Assets | 16.2% | 14.4% | 14.3% | 14.8% | 13.1% | 12.4% | 11.2% | 9.1% | 10.3% | 10.2% | 9.5% |
| **Asset quality** | | | | | | | | | | | |
| Nonperforming loans to total gross loans | 18.7% | 23.2% | 21.3% | 11.1% | 26.2% | 27.6% | 22.5% | 21.6% | 22.2% | 22.5% | 54.9% |
| Nonperforming loans net of provisions to capital | 6.0% | 7.1% | 4.6% | 2.0% | 2.0% | 1.9% | 2.6% | 3.0% | 3.4% | 3.8% | 3.5% |
| Foreign-Currency-Denominated Liabilities to Total Liabilities | 25.5% | 29.6% | 26.0% | 23.2% | 23.7% | 25.7% | 25.6% | 57.8% | 71.2% | 71.5% | 78.2% |
| **Profitability and earnings** | | | | | | | | | | | |
| Return on Assets (ROA) | 5.7% | 2.9% | 2.4% | 2.2% | 2.6% | 2.6% | 2.0% | 1.7% | 6.5% | 5.5% | 2.4% |
| Personal Expense to Noninterest Expense | 24.3% | 23.1% | 24.0% | 22.0% | 17.9% | 19.5% | 22.0% | 16.3% | 18.6% | 18.2% | 14.2% |
| **Liquidity** | | | | | | | | | | | |
| Liquid Assets to Total Assets | 78.7% | 81.9% | 84.0% | 79.8% | 86.4% | 80.7% | 78.8% | 60.1% | 52.7% | 51.8% | 46.7% |
| Customer Deposits to Total (noninterbank) loans | 563.4% | 783.9% | 807.5% | 577.6% | 912.4% | 1296.1% | 1379.9% | 1284.3% | 1099.6% | 1090.6% | 1012.1% |

Source: Bank of South Sudan.

**Table 7. South Sudan: Risk Assessment Matrix (RAM)[1]**

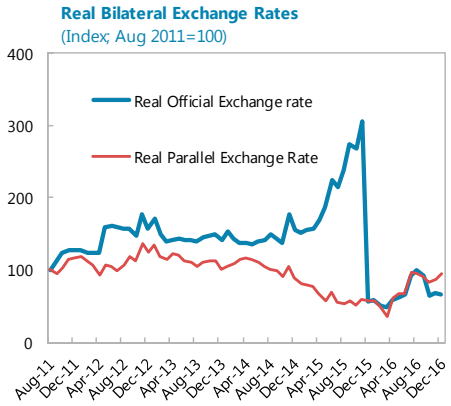
| Nature/Sources of Main Risk | | Likelihood of realization in the next one-three years | Expected impact on economy if risk is realized | Possible policy responses |
|---|---|---|---|---|
| Short term | Political instability | **High**<br>The delay in achieving sustainable peace and continuing violent clashes. | **High**<br>Diversion of resources to deal with internal conflict, heightened levels of country risk, could lead to stagnation, lower oil production, insufficient investment, and economic instability. | Political agreement on peace and reconciliation between the parties. |
| Short term | Sustained fiscal gap and shortfall in external financing | **High**<br>Weak oil revenues combined with inability to cut budgetary spending sufficiently. | **High**<br>Lack of external financing makes central bank lending and monetization of the deficit the only resort. In turn, injection of more liquidity will create more inflation and depreciate the currency, along with falling reserves. | Tighten fiscal policy and improve governance in order to secure external financing. |
| Short/Medium term | Sustained decline in commodity prices triggered by deceleration of global demand | **High**<br>Deeper than expected slowdown in China and other emerging markets coupled with higher than expected world production could lead to sustained low international oil prices. | **High**<br>Lower prices have already led to large fiscal gaps, domestic financing, high inflation and lowest levels of reserves on record. | Tighten fiscal policy through spending cuts and improving non-oil revenue collection. Some additional external financing may help the adjustment. |
| Short/Medium term | Tension with Sudan over delayed transfer payments, pipeline contracts, territory, or borders | **Medium**<br>South Sudan fell behind on its transfer fees to Sudan in 2015, thus, creating potential tensions in the repayment of these arrears. While a new three-year agreement has been signed in early 2017, there may still be disputes about the regular transfers and South Sudan's capacity to pay. | **High**<br>A disruption of oil production will be detrimental to the economy given the lower oil prices and already reduced output. It would destabilize the economy. | Advance non-oil revenue reforms and keep public spending under control. Maintain good coordination and information sharing with Sudan. |
| Short/Medium term | Delays in improving governance or capacity | **High**<br>South Sudan ranks low on a variety of governance indicators, most notably government effectiveness, regulatory quality, rule of law, and control of corruption. | **Medium**<br>Entrenched rent seeking behavior, pressures to raise current expenditures, and lower quality of public investment. Diversion of resources from development and continued threat of social and political instability. | Strengthen anti-corruption efforts, including by implement agreed transparency reforms, focus on strengthening key economic institutions, enforce petroleum and public financial management laws, and foster improvements in business environment. |

[1] The RAM shows events that could materially alter the baseline path—the scenario most likely to materialize in staff's view. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern at the time of discussions with the authorities.

# Annex I. South Sudan. External Sector Assessment

*The combination of domestic policy slippages and the oil price shock led to a rapid depletion of the South Sudan's economic buffers and forced an abandonment of the fixed exchange rate and a sharp compression in imports. Restoration of external stability will require an improvement in economic policies and support from the international community. In the short term, improved security, fiscal retrenchment and an end to monetary financing will be required to prevent an exponential depreciation of the exchange rate. Over the medium term, structural reforms to address a deficient business environment will be required to diversify the economy and attain any measure of competitiveness.*

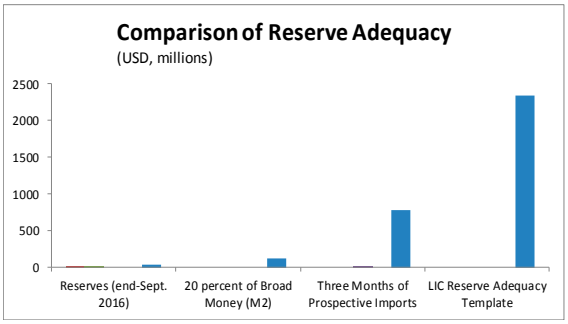
**1. The exchange rate reforms introduced at end-2015 resulted in a closing of the large gap between the official and parallel markets, though policies will have to adjust further in order to restore stability to the foreign exchange market.** Since end-2015, the official exchange rate depreciated by about 95 percent, or around 60 percent in real terms. This brought the official exchange rate broadly in line with the parallel market[1], which had itself depreciated in the course of 2015 in line with the deteriorating fundamentals. The trade balance has also narrowed as imports have fallen in response to the reduced supply of foreign exchange.




**2. An assessment of South Sudan's competitiveness and external stability is complicated by insufficient data availability and large structural changes.** With considerable uncertainty over the policy variables and the data itself, and in the context of very high inflation, it is difficult to draw firm conclusions from the standard methodologies for real exchange rate assessment at this juncture. Prior to December 2015, current account transactions by government were executed at the official exchange rate (e.g. fuel and purchases of goods and services), while most other transactions took place at the parallel market rate. The evolution of the current account balance was therefore only partly impacted by a significantly overvalued official exchange rate. However, with the unification of the exchange rate that took place at the end-2015 and the about 70 percent real depreciation in the first three quarters of 2016, the overvaluation of the exchange rate was either eliminated or greatly diminished.

[1] The continuing existence of a spread between the official and parallel markets seems to reflect in part data collection issues (in the absence of a significant interbank market), and in part market segmentation issues (e.g. the parallel market is providing for greater anonymity).

**3. Stronger evidence of the external disequilibrium is to be found in the current level of international reserves**. At the current level of US$30–50 million (about one week of prospective imports of goods and services), international reserves are inadequate by any measure. As a fragile state with an economy dependent on oil exports and exiguous domestic production requiring the importation of almost all goods consumed in the economy barring subsistence agriculture, South Sudan would benefit from substantial foreign exchange buffers. In this context, the "rule of thumb" of three months of imports would likely be suboptimal, and a level of reserves much closer to that suggested by the LIC reserve adequacy template—which proposes nine months' of imports—would be ideal.




**4. Rebuilding foreign reserve buffers will be a challenge as long as oil prices remain low.** South Sudan is unlikely to see a significant increase in oil production at current oil price levels (substantial investments are required to expand production beyond near current levels) in the near term. In this context, even significant fiscal retrenchment and monetary discipline would likely not ensure attaining sufficient reserve adequacy immediately. Moreover, the existence of substantial near term obligations to repay outstanding trade-related credits ($US5 million a month over the next five years) and other outstanding obligations to oil companies will continue to place pressure on central bank reserves, and complicate the process of rebuilding reserves. The authorities should aim to build reserves gradually, while ensuring the ability of the government to carry out its essential functions.

**5. In the short term, restoring external stability will depend on the restoration of fiscal discipline.** Large-scale monetization of budget deficits would exacerbate inflationary pressures and maintain high demand for foreign exchange, while a combination of fiscal consolidation and a shift away from domestic towards concessional external financing would reduce inflation and stabilize the foreign exchange market. Moreover, with around one-third of government expenditure taking place in foreign exchange, there is room to reduce pressure on reserves by cutting back on travel, transportation, and other non-priority spending items that constitute a drain on foreign reserves.

**6. Over the medium term, strengthening the balance of payments will entail efforts to address South Sudan's dire business climate.** The difficult business environment is evidenced by the near-absence of any manufacturing in the country. With the country's sole brewery shutting down production, almost all nonfood and most food items (with the exception of bottled water and subsistence agriculture) are imported. Another barrier is the very high transport costs: the cost to import a twenty-foot container to South Sudan was the second-highest in the world.[2] Also, the

[2] According to the World Development Indicators the cost of importing a 20ft container in 2014 was US$9,285 in South Sudan, as compared with US$6,335 in Central African Republic, US$3,375 in Uganda, and US$4,990 in Rwanda.

World Bank's Ease of Doing Business Indicators ranked South Sudan 187th out of 189 countries (Table I.1). While restoration of security and macroeconomic balance, as well as maintenance of a flexible exchange rate regime should support investment, the almost complete absence of supportive infrastructure (electricity, water, sewage, and transportation network) will remain a constraining factor for some time.

**Table I.1. South Sudan: Doing Business Indicators, 2015–16**

| | South Sudan | | SSA | LICs | Fragile States |
|---|---|---|---|---|---|
| | 2015 | 2016 | 2016 | 2016 | 2016 |
| Ease of doing business | 186 | 187 | 143 | 154 | 157 |
| Starting a business | 178 | 181 | 128 | 136 | 129 |
| Dealing with construction permits | 171 | 177 | 130 | 137 | 145 |
| Getting electricity | 183 | 187 | 149 | 158 | 144 |
| Registering property | 179 | 180 | 132 | 138 | 143 |
| Getting credit | 171 | 174 | 118 | 129 | 136 |
| Protecting minority investors | 181 | 181 | 125 | 138 | 137 |
| Paying taxes | 104 | 104 | 131 | 137 | 128 |
| Trading across borders | 179 | 179 | 136 | 137 | 132 |
| Enforcing contracts | 76 | 76 | 132 | 140 | 140 |
| Resolving insolvency | 189 | 189 | 128 | 133 | 151 |

Source: World Bank, Doing Business Indicators, 2016.

**7. Improvements are also needed to the regulatory and administrative environment.** Across a range of indicators South Sudan performs worse than its regional peers. According to the World Bank Worldwide Governance indicators (which measure governance based on six dimensions: voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law and control of corruption), South Sudan ranked among the lowest in the world in five out of the six dimensions in 2015 (in three dimensions, South Sudan ranked in the first percentile and in two dimensions, it ranked in the third percentile (where the 100 percentile is the best scoring)). This suggests that an improvement in the country's political stability and responsiveness could be an important step to improve the business climate and competitiveness.

# Annex II. South Sudan. Peace Agreement: Achieving Peace Dividends[1]

## INTRODUCTION

**1. South Sudan gained independence after a long civil war in an environment of weak institutions and poor policy making**. The decision to shut down oil production in 2012 resulted in loss of revenue and erosion of accumulated international reserves. Key economic institutions such as the Ministry of Finance and the central bank remain at an early stage of developing capacity. Insufficient transparency and accountability has fostered poor governance in the management of public resources. The delivery of public services and infrastructure has not reflected the amount of resources earned from oil, frustrating the population.

**2. Jostling between politicians for control over resources is the underlying reason behind the civil war that began in December 2013**. One consequence has been the skewed distribution of the national wealth in favor of political elites, while the vast majority of the population remains very poor and dependent on humanitarian assistance. The civil war has worsened these ills by internally displacing over two million and making more than a million refugees in neighboring countries out of a population of 12 million.

**3. The Intergovernmental Authority on Development (IGAD)-brokered peace agreement signed in August 2015 to end the civil war has been disrupted.** The agreement essentially restored the status-quo ante by reestablishing rebel leader, Riek Machar, in his position of Vice President. But it also allowed him to return to the capital city, Juba, with a small army. This proved to be a fatal flaw, as fighting between former Vice President Machar's and President Kiir's soldiers resumed in early July. The civil war has now drawn in many additional ethnic-based armed rebellions and has spread to parts of the country that were peaceful before. Restoration of peace would now require a new agreement that should include stakeholders beyond Kiir and Machar. The recently initiated "national dialogue" has the potential to do just that.

**4. The challenge of returning to normalcy is to make sure that peace dividends are widely shared among the population**. Oil wealth largely benefited a few. The key to sustained peace and development is to restore macroeconomic stability and allow economic activities, particularly agriculture and trade, to resume across the country. It is also crucial to build new or strengthen available institutions, protect public resources against unscrupulous government officials, putting them instead to work to build schools, health centers, and to provide other vital social services. When every South Sudanese sees economic and social benefits of peace in their community, peace will become entrenched. Peace dividends would also have to include a new social contract whereby political representation is inclusive and fair.

**5. The annex proceeds as follows: section II discusses the failed IGAD-brokered peace agreement and a new framework for peace; section III defines peace dividends in South**

[1] Prepared by Philippe Egoume, Resident Representative in Juba, South Sudan.

**Sudan's context; section IV discusses the agenda for providing key social services; section V analyzes what the peace dividend will mean for the agriculture sector, one of the keys to stabilizing uprooted communities; section VI looks into prospects for private investment; and section VII discusses the conditions under which South Sudan could benefit anew from donor support for development; and section VIII concludes.**

## A NEW FRAMEWORK FOR A PEACE AGREEMENT

6. **In retrospect, the IGAD-brokered peace agreement had many flaws, one fatal.** The agreement was overly ambitious and complex, creating a plethora of institutions with neither the human capacity nor the financial means to establish them. When President Kiir signed the agreement he highlighted a long list of reservations and pointedly stated that he was being forced to sign it by the international community. It is not clear what the sponsors of this agreement thought of the reservations, but these were clear warning signs that the agreement was not standing on strong footing. One of his main reservations, the agreement's provision for Machar to bring with him a small army under his command in Juba, led to the unprecedented situation where two armies under two commands were asked to cohabitate in the same city. Tensions built rapidly between these armies until fighting resumed on July 7, forcing Machar to flee Juba.

7. **A new, inclusive, peace agreement is needed.** Thousands of people have been killed recently in attacks and revenges targeting civilians on the basis of their ethnicity. These developments owe essentially to the disenfranchisement felt by many ethnic groups. The government army is also accused of using heavy-handed tactics in quelling rebellions and political dissent. Some see these developments turning into a deadlier civil war, possible genocide, and total break-up of the country. In this environment ethnic groups have been arming, seemingly to protect themselves. Only an inclusive process acknowledging various grievances and sharing power and resources can arrest the steady march towards disintegration of the country. Seemingly recognizing this risk, President Kiir recently initiated a "national dialogue" to be moderated by eminent, respected, and nonpartisan South Sudanese. It remains to be seen how this initiative will unfold and whether it will succeed in restoring peace and unity.

## DEFINING THE PEACE DIVIDEND

8. **The peace dividend has been narrowly defined as the benefit accruing to an economy as a result of the end of armed conflict whether internal or external.** But in the context of South Sudan, the concept of peace dividend has to be expanded to include conditions for restoring sustained economic growth and poverty reduction after the protracted state of civil war (including both the war of independence and the current civil war with a short hiatus in the middle). Though seemingly vast and unspecific, this definition is actually what peace is expected to deliver in this country that is struggling to build a modern economy and strong institutions. The literature on peace dividend offers some interesting insights into the situation in South Sudan.

**9. Peace dividends can prove illusory**. A 2003 World Bank report states that on average 44 percent of countries emerging from civil war return to conflict within the first five years, as the conditions that breed civil war often remain after the war has ended. Indeed, some of these countries fall in the *conflict trap* whereby conflict impoverishes the country, creating the conditions for further conflict over control of smaller resources. Analyzing the concept of peace dividend in Angola after the civil war ended, Manuel Ferreira (2005) finds that "vested interests" established during years of civil war actually prevent the peace dividend from being achieved. Strong vested interests are also a well-established feature of politics in South Sudan and they have proven quite entrenched.

**10. South Sudan unfortunately will continue to exhibit traits typical of a country that has suffered from a protracted civil war**. Collier and Hoeffler (2002) empirically identify three economic factors that determine the probability of civil war: (i) doubling of *per capita income* halves the risk of rebellion; (ii) each additional percentage point of *growth* reduces the risk of civil war by 1 percentage point; (iii) *primary commodity dependence*: it is a nonlinear effect that peaks when the country primary commodity exports represent 30 percent of GDP. They found that a decline in the price of primary commodities that the country exports is a key factor that shortens civil conflict. All of these factors apply to South Sudan and point to the need to restore growth and diversify the economy that remains too reliant on crude oil. One could argue as well that the abrupt drop in oil prices played a key role in the compromise that led to the IGAD-brokered peace agreement, as it has become financially impossible to sustain large war-related spending. The authors also identified ethnic dominance as a source of civil war. Ethnicity is certainly playing a toxic role in the current civil war. Overcoming these challenges is critical for South Sudan to benefit fully from restoration of peace.

## REFOCUSING ON THE SOCIAL AGENDA

**11. South Sudan social indicators are very poor and have worsened during the civil war**. The peace dividend in this area is to restore normalcy and for the government to restart the process of delivering public services in education and health. Generally, the government in these sectors has been substituted by donor humanitarian assistance delivered by specialized international nongovernmental organizations.

**12. In the education sector, the government has plans to improve key indicators (see table below).** The objective is to increase student enrollment as well as the teacher-to–pupil ratio in both primary and secondary education. To achieve this, the government estimates that it needs to devote an additional 4 percent of GDP to the education sector per year.

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|
| ***Primary Eductaion*** | | | | | | | |
| Enrolment | 1 391 704 | 1 583 995 | 1 769 365 | 1 944 704 | 2 129 623 | 2 323 887 | 2 527 891 |
| Gross Enrolment Ratio | 62.70% | 67.60% | 72.50% | 77.30% | 82.20% | 87.10% | 92.00% |
| Number of Teachers | 26 549 | 26 876 | 31 852 | 37 282 | 43 662 | 51 201 | 60 188 |
| Students per teacher | 52.4 | 58.9 | 55.5 | 52.2 | 48.8 | 45.4 | 42 |
| ***Secondary Education*** | | | | | | | |
| Enrolment | 44 084 | 50 590 | 57 675 | 63 026 | 68 713 | 74 684 | 80 952 |
| Gross Enrolment Ratio | 5.90% | 6.30% | 6.70% | 7.20% | 7.60% | 8.00% | 8.40% |
| Number of Teachers | 2 723 | 2 574 | 3 150 | 3 726 | 4 302 | 4878 | 5 454 |
| Students per teacher | 16.2 | 19.7 | 18.3 | 16.9 | 16.0 | 15.3 | 14.8 |

Sources: South Sudan Ministry of Education, 2014

**13. In the area of health, the Government Health Sector Development Plan envisages improving health and service delivery towards regional levels (see table below)**. Spending amounting to around 3 percent of GDP per annum was envisaged in the health sector. Because of the civil war the government fell short of the targets. The peace dividend, if realized, could provide the government with the means to make progress in achieving its health targets.

| Indicator | **South Sudan** | Regional level averages | Indicator Key |
|---|---|---|---|
| Maternal Mortality Rate | **2,045** | 210 | Deaths per 100,000 live births |
| Infant Mortality Rate | **102** | 33 | Deaths per 1000 live births |
| U5 Mortality Rate | **135** | 43 | Deaths per 1000 live births |
| Total Fertility Rate | **6.7** | 2.9 | Births per women |
| First Antenatal visit | **48%** | 78% | Visit during pregnancy |
| Institutional deliveries | **13.6*** | 65 | Deliveries attended at HFs |
| Skilled Birth Attendance | **10%** | 76 | All deliveries attended by skilled HRH |
| Contraceptives Prevalence Rate | **<3%** | 56 | Use of contraceptives among CBA women |
| DTP3 coverage (routine) | **71 (routine)** | 89 | % of children vaccinated |
| Stunting | | | |
| Access to health care (%) | **0.2 (<25%)** | NA | Visit per person/year |

## RESETTLING UPROOTED COMMUNITIES

**14. Resettling about three million South Sudanese who are either internally displaced or refugees in neighboring countries as a result of the civil war is an absolute necessity.** The task is massive as it involves not only economic factors but also ethnic, social, and political dimensions. Many among the displaced are afraid to return where their communities used to live, as they have witnessed or suffered atrocities in these places and are not sure about their safety. Ethnic tensions and fights over scarce resources, some predating the civil war, have compounded these fears. Many have lost everything and are wary to go back to start from scratch with no guarantee that they will not be victimized again. Indeed, law enforcement and protection of civilians are critically in short

supply in a country where growing lawlessness reigns in many areas. Estimates for the cost of resettlement are hard to come by, but it will require setting aside several points of GDP. Whatever the difficulties, it is important that resettlement be accompanied by some sort of economic activity so that the returnees can generate income by and for themselves.

**15. Agriculture and farming in general are excellent ways of resettling population to their original communities.** Resuming production and being able to live off of that production after years of wandering in refugee camps would surely look and feel like a peace dividend to these populations. South Sudan has the potential to become an agricultural power house as it is exceptionally endowed with fertile land, water, and ecological diversity. According to official estimates, only 4.3 percent of arable land is cultivated and that ratio has likely declined due to the civil war. Food insecurity is a real problem affecting countless communities that rely on humanitarian assistance for survival. The government's objective in the medium-to-long term is to increase areas cultivated to 9.7 percent. Increased domestic production would help address food insecurity but also save foreign exchange, as currently South Sudan paradoxically imports the vast majority of its food. An area where South Sudan is already well positioned is livestock whose headcount is close to 40 million; but lack of transportation connecting the country within and with its neighbors implies that livestock remains subsistence goods or store of value rather than commercial goods. To fully realize the peace dividend in the farming sector would require investing funds not only to resettle people, but also to develop basic transportation infrastructure that would help open untapped markets.

## POTENTIAL FOR NEW PRIVATE INVESTMENTS

**16. An important aspect of the peace dividend is South Sudan's ability to attract large inflows of foreign investment**. Civil war has reduced such prospects. But with relative peace, the areas of attractiveness in the relatively short run could be agriculture, mining, light manufacturing, and services among others. Unification of the exchange rate has helped by realigning relative prices and bringing the market for foreign exchange largely in the open.

- According to the South Sudan infrastructure action plan, transforming agriculture from essentially subsistence activity to one that contributes to exports will require investment in the order of US$200 million per year over the medium term, including for building roads. Such investment would require a combination of public, private, and donor funding.

- In the area of mining, the challenge is to transform mineral resources from a curse to an opportunity for the country. The current declining trend in commodity prices is not conducive for investment and large-scale projects have been shelved for the moment, including in oil exploration. However, the potential is there not only in the oil sector, but in other minerals such as iron, diamond, copper, nickel, marble, and gold. Artisanal gold mining is already taking place largely benefiting warlords, but with organization it could become a significant foreign exchange earner for the country.

- The light manufacturing sector has been badly affected by the dual exchange rate, the scarcity of dollars, the economic downturn, and sometimes bad policies. For example, scarcity of bottled water caused by administered pricing was eliminated as soon as price restrictions were lifted. There is a clear comparative advantage for manufacturing in South Sudan rather than importing because the country is in construction and its position far away from the coast make transportation costs very high.

- The service sector developed rapidly with banks and insurance companies, in particular, opening branches around the country. But widespread destruction and looting during the civil war seem to have set these activities back significantly and it would take some time and effort to see the kind of expansion that was taking place before the crisis. Yet the prospects are bright, as mobile phone services, for instance, continue to expand and mobile banking is poised to make a breakthrough.

## WHAT TO EXPECT FROM THE DONOR COMMUNITY?

**17. An important aspect of the peace dividend for South Sudan would be the country's ability to attract development assistance**. So far the vast majority of assistance to South Sudan has been provided in the form of humanitarian assistance. Due to civil war and governance problems donors have been reluctant to provide development support. Many donor-funded projects have been put on hold. This trend worsened after the resumption of fighting in July. Should there be peace, donors would likely condition development assistance on the existence of an IMF-supported program to help safeguarding public funds and an appropriate overall macroeconomic framework.

**18. Unfortunately, South Sudan is unlikely to receive any budget support in 2016/17**, despite the importance of the balance of payment shock and depth of macroeconomic imbalances, and notwithstanding any serious efforts at reforming. After the government has undertaken tough but realistic adjustment policies, the remaining gap to be filled could be in the range of US$300–400 million per year over at least two fiscal years. Only sustained peace would put South Sudan in a position to receive such support. It is therefore imperative for South Sudanese to come together to make peace among themselves before they could count on their friends in the international community.

## CONCLUSION

**19. Whether there is a peace dividend in South Sudan could be verified through a number of changes**. First and foremost, the fighting must stop. One should expect a reduction in the number of displaced people and refugees and resettlement of population in their communities where they would be undertaking income-generating economic activities. As the relative weight of oil in the economy declines, the economy should diversify with sectors such as agriculture making for a larger share of the economy. In the area of management of public affairs, institutions of

economic governance and of political representation must be built or reinforced; the rule of law must be strengthened, and transparency and accountability hold more sway. More than mere saving on war spending, peace dividends in South Sudan should reflect progress in refocusing the country toward building a functioning government that works for and protects all citizens and an economy that provide opportunities for a better life.

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