



Sudan

Country Economic Brief – December 2011 The World Bank – Africa Region

I. Secession affects Sudan's macroeconomic stability

Negotiations on post-CPA arrangements are not yet concluded and Sudan starts to feel the impact of the protracted negotiations with the South on oil revenue. Negotiations were scheduled to resume under the AUHIP, chaired by Pres. Mbeki, in November based on a proposal by the AUHIP for transitional financing arrangements between the two parties. But negotiations collapsed again in the last week of November, still leaving the urgent need to find an agreement. In the meantime, Sudan imposed a measure on South Sudanese oil exports through its export channels. While the measure was originally announced as a stop of exports for oil from South Sudan, the government clarified that oil is flowing but Sudan takes a share of 23 percent ('in-kind') from all South Sudanese oil volumes going through Port Sudan. This measure is expected to be in place until a deal on transit fees is reached as part of the post-CPA negotiations as according to Sudan South Sudan has not settled transit fees on oil exports for the period between July 9 and the end of October 2011. It remains unclear how the decision will affect the overall negotiations and prospects to be concluded in the so-called package deal. At the same time there is concern that protracted negotiations and conflict in bordering states may affect the debt relief process under the zero option.

Following the secession, Sudan is now experiencing a significant loss in oil revenue and exports. Since July 9, 2011 Sudan is no longer receiving any oil revenue share from Southern oil fields, which previously accounted for around 75 percent of Sudan's total oil production during the CPA period. The loss of the oil production has already brought with it a significant adverse impact on Sudan's economic growth – largely through weakened government consumption and investment as well as a deteriorating trade balance. An inevitable fiscal adjustment is expected that would significantly reduce public spending, which previously accounted for over 20 percent of nominal GDP. The negative impacts will be likely compounded by a significant deterioration of the trade balance since Sudan lost almost 90 percent of exports through the secession. As a result, recent projections show the real GDP growth of Sudan to be -0.2 percent in 2011 and -0.4 percent in 2012 (IMF, World Economic Outlook, September 2011).

Facing the loss of the major driver for growth from the past decade, the authorities now rely on the mining sector – particularly gold – to help the transition to a new model for growth. While the majority of gold production still relies on unlicensed artisanal producers, gold exports are expected to provide a significant amount of foreign exchange needed to partially offset the revenue deficit left by the loss of oil. Sudan's gold exports during the first half of 2011 increased to US\$ 532 million from US\$ 461 million during the same period of the last year; gold accounted for 60 percent of non-oil exports in the first half of 2011. The Sudanese government has signed gold mining concession with 50 companies on October 30, 2011 in various regions of Sudan, including Gedaref, North Kordofan, South Kordofan, Kassala, Red Sea, Northern and River Nile, and for the first time in South Darfur. Despite the growing expectation, however, it remains uncertain how much gold exports could contribute to finance the transition.

Given Sudan's excessive reliance on oil revenue in the past, seeking non-oil sources of exports and growth will be paramount. Turning to another natural resource as an alternative, i.e. gold, could cause the problems of fiscal management known from the past; and particularly vulnerability to volatile commodity markets. Heavy reliance on gold exports may indeed be a way to partly finance the transition at times of very high gold prices, but due attention is needed to not lose sight of the broader diversification agenda. Finding a new growth paradigm towards broad-based economic diversification is the paramount task now to address the permanent shock posed to the economy by secession.

II. Fiscal shock is already causing a major fiscal adjustment and its magnitude is likely to be much larger in 2012

The extent of the fiscal shock is causing a major fiscal adjustment. The amended budget for the second half of 2011 was approved by the National Assembly on July 21, 2011. Under the high uncertainty surrounding the post-CPA negotiation outcome, the amended budget reflected a ‘worst case scenario’ assuming zero revenues from oil production in the South Sudan. As a result, oil revenues for the full year 2011 were estimated to decline by about 40 percent and total revenues by 12 percent, compared to the original budget. Key channel for Sudan to recuperate the oil revenue losses is likely to be various fees imposed on the use of pipelines and refineries by South Sudan to export oil produced in Southern oil fields. Sudan's National Assembly has passed an Act on July 20, which allows imposing fees on transition and oil services through Sudanese oil infrastructure and the port. However, the amounts possibly to be collected through fees remain unclear, pending negotiations to be finalized.

A significant adverse impact is highly likely on the development agenda in the course of the major fiscal adjustment. Facing the huge revenue shortfall, the amended budget for 2011 planned 7 percent cuts for overall 2011 spending – the bulk of which would come from cuts in development spending and federal transfers to state governments, by 26 and 20 percent, respectively. The disproportional cuts confirm the concerns over the high vulnerability of two key pro-poor spending areas to fiscal tightening pressure. Large cuts in federal transfer to states will be a main conduit through which the federal level fiscal shock is transmitted to states. Recent field visits to three states of a World Bank task team indicated that, given their weak own revenue mobilization capacities, state governments are not capable of absorbing the fiscal shock. With the share of federal transfers among total state budgets ranging between 60-90 percent, state governments are likely to absorb much of the fiscal shock through reducing financing for state level development and basic services. The extent of the shock will be felt more severely in states with weaker own revenue capacity and higher fiscal dependency on federal support.

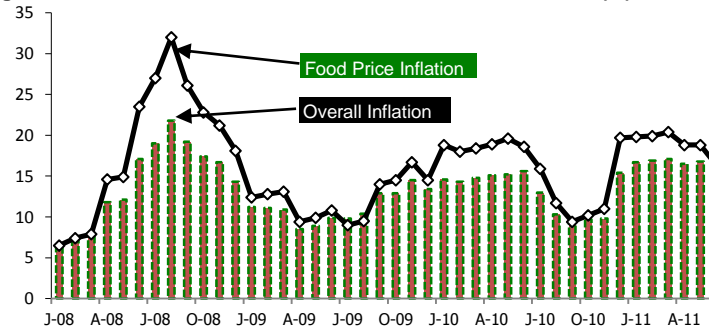
The magnitude of the fiscal shock is expected to significantly increase in 2012 as the full extent of the oil revenue loss will be felt throughout the whole year. The loss of oil revenue will likely roughly double in 2012 (World Bank estimate) – calling for subsequent adjustments in public spending. The budget for 2012 is almost finalized and currently being discussed by the Council of Ministers and subsequently the Parliament. The budget assumes several scenarios for the on-going negotiations on the post-secession arrangement critical to the macro-economic assumptions and the revenue prospect of the budget formulation. The loss of oil revenue could potentially reach up to one-third of the post-CPA level in 2011 and will double in 2012. One of the main challenges for the fiscal authorities will be to finance the deficit expected next year while mitigating its impact on inflation – the annual inflation rate reached over 20 percent in August and September.

The preparation of an Interim Poverty Reduction Strategy Paper (I-PRSP) is coming to an end – led by a Technical Committee formed under the MoFNE. A draft of the I-PRSP document has been produced and is currently under consultation with national and international stakeholders. Development partners in Khartoum have shared their comments with the government on 10 November, and consultations within Sudan are ongoing. The government claims that priorities in the I-PRSP will inform the 2012 budget and financial support from the international community will be critical to the success of the implementation of the strategy.

III. High inflation continues despite the slowdown in September and October

Inflation experienced a sharp jump over the summer due to soaring food price and has gradually eased since September. After reaching 21.1 percent in August 2011 from 15.0 percent in June, Sudan's inflation rate has slightly moderated to 20.7 percent in September and to 19.8 percent in October. The recent high inflation rates are largely attributed to a surge in food prices (cereals, rice, meat, cooking oil, vegetables and fruit), though the food price inflation rate slowed down recently. Driven by several food items – in particular tomato, cereals and meat - food price inflation successively decreased from its peak of 25.2 percent in August to 21.7 and 21.2 percent in September and October, respectively.

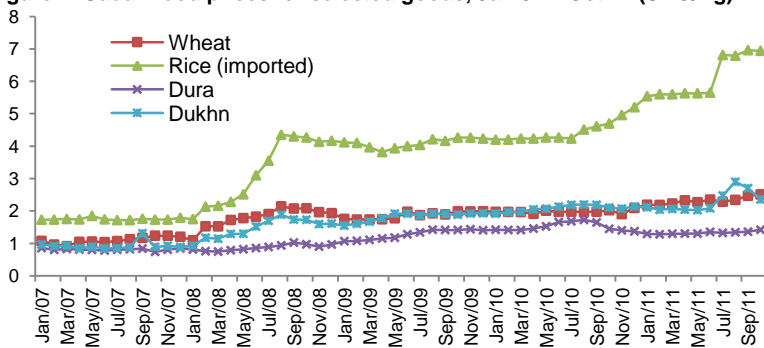
Figure 1: Sudan overall annual inflation rate, Jan 08 – Oct 11 (%)



Source: Sudan Central Bureau of Statistics

Soaring food prices are coming from both weather related supply side constraints as well as higher and more volatile world grain prices. Prices for the largely imported rice continued its rising trend over 2011 and jumped by 21 percent in July. This sharp increase in imported rice price slowed down to 3 percent during August to October 2011. Prices of wheat also have shown volatile movements but still maintain an overall rising trend. The wheat price rose by 5 percent during the July-September period and slowed down to 2 percent in October. Global prices of grain have increased by 3 percent during July to September 2011 with the global rice prices (Thai) increasing by 11 percent; global wheat

Figure 2: Sudan food prices for selected goods, Jan 07 – Oct 11 (SDG/Kg)



Source: Central Bureau of Statistics.

prices increased by 4 percent during the same period. (World Bank, Food Price Watch, November 2011). On the regional level, North Darfur, South Kordofan and Blue Nile states ranked on the top of the state level inflation rates in October, with rates of 38.5 percent, 34.8 percent, and 30.4 percent respectively. This comes mainly from on-going conflict and associated higher transaction costs.

The government has undertaken consecutive policy measures to contain the soaring food price. In addition to earlier cuts in import tariffs for wheat, flour, sugar and capital goods and releasing grain stocks of domestic reserves, the government approved additional measures to boost agricultural production on September 22, 2011; these measures included tax cuts on selected food products and eased regulation on imports of milk and chicken. Further details on these measures are not yet available.

IV. Introduction of new currency is complete, wide gap remains between official exchange rate and parallel market rate

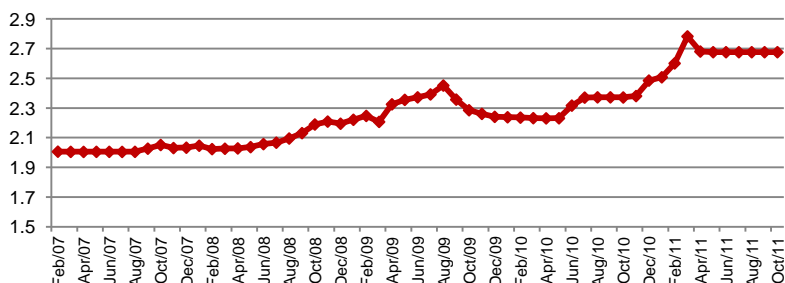
The Central Bank of Sudan (CBOS) began circulating the new Sudanese Pound on July 24, 2011. The CBOS officially announced that old 10, 20, and 50 pound notes were no longer valid for conversion as of September 1, 2011, while smaller notes (1, 2 and 5 pounds) were still valid until further notice from the Central Bank. While completed officially, it remains unclear, how much of the old currency which amounted to SDG 11bn in circulation as of June 2011 was converted to the new Sudanese Pound in the meantime. . The parallel introduction of the new currencies in Sudan and South Sudan had adversely impacted cross border trade between the two countries.

Despite the stabilization of the official exchange rate, depreciation pressures on the local currency remain significant.

The official exchange rate has been kept at SDG 2.67 per US dollar since April 2011 after the continuous depreciation from around SDG 2.4 in November 2010 to around SDG 2.7-8 in March 2011. However, the widening gap between the official

exchange rate and the parallel market rate indicates mounting depreciation pressure on the local currency: parallel exchange rates have been reported to have jumped to beyond SDG 4 per US dollar in September from around SDG 3.2 per US dollar in early June. Prolonged delay in the negotiation on post-CPA arrangement have increased concerns over foreign exchange shortages – putting further depreciation pressure on the local currency.

Figure 3: Sudan exchange rate, Jan 07 – Oct 11 (SDG per US\$)



Source: Central Bank of Sudan

Against the tightening foreign exchange market, the CBOS imposed a series of regulatory responses to ease tightening foreign exchange supply in 2011. In January, the Central Bank imposed import controls which included reduced allowances for hard currency available to individuals travelling abroad ([see also Economic Brief – February 2011](#)). Now, facing the continuous pressure, the Central Bank tightened its regulations on export traders in October. The central bank previously allowed export traders to access dollars through a letter of credit under the condition that they return the hard currency within a period of six months; this condition was now cut to three months under the new directives. There is no public information available on the foreign exchange reserves held by the authorities.

V. Technical discussions on debt relief for Sudan under zero option

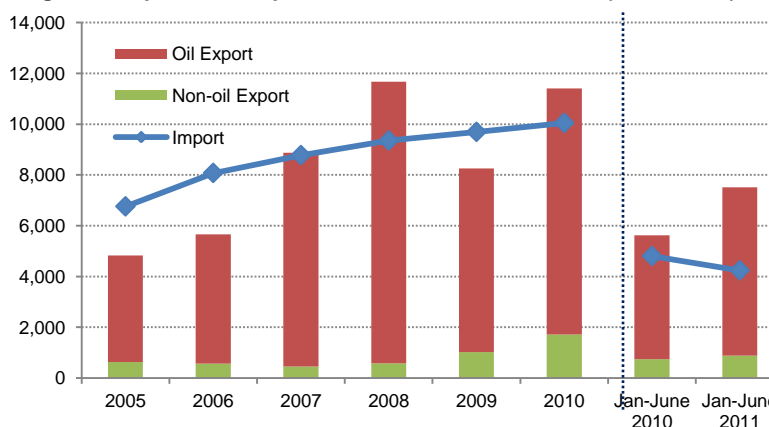
Technical discussions of debt issues are ongoing in the context of the Sudan External Debt Technical Working Group (TWG), co-chaired by the World Bank and the IMF. The second, third and fourth meetings took place in April, June and September 2011, respectively. In the April meeting, authorities from both Sudan and South Sudan participated, together with the African Union High-Level Implementation Panel for Sudan (AUHIP). In the June meeting, the TWG discussed progress on debt reconciliation and the draft technical ('timeless') roadmap for debt relief, jointly prepared by the IMF and the World Bank, on request of the authorities and the AUHIP in the April meeting. The roadmap was presented to the authorities through the IMF and the World Bank in Khartoum at the end of July 2011. The September TWG meeting included a discussion of debt relief scenarios to show the likely impact of HIPC on Sudan, results of which were shared with the authorities in Khartoum in November 2011.

VI. Large trade surplus in the second half of 2011 is expected to rapidly decline after the secession of South Sudan

A large trade surplus was recorded in the first half of 2011 with exports up by 33 percent driven by high oil prices. But the trade balance surplus is expected to rapidly decline after the secession effects of South Sudan. No reliable data are yet available to capture trade flows after the secession of South Sudan.

- **Exports between January and June, 2011 increased by 33 percent to US\$ 7.5 billion from US\$ 5.6 during the same period of 2010.** The significant increase of exports was mainly due to higher crude oil export – the US\$ value of crude oil export during the period increased by 37.9 percent thanks to soaring global oil prices while the volume of exported crude oil slightly declined by 0.7 percent. Crude oil accounted for 87 percent of total exports in the period, underlining the likely huge impact on the overall trade balance in the second half of 2011 which will account for the loss of 75 percent of oil production.
- **Non-oil exports increased by 18.4 percent during the first half of 2011 against the same period last year, largely driven by higher global gold prices.** While the volume of gold exports fell by over 3 percent, the US\$ value of exported gold increased by 15.4 percent. The share of gold exports among the total non-oil exports reached around 60 percent, followed by sesame (14 percent), sheep (8 percent) as second and third major export commodities.
- **The large reliance of non-oil exports on another commodity – gold – raises serious concern on the diversified and sustainable growth of Sudan.** While it is important to look for non-oil sources for exports, focusing on yet another commodity can only provide transitional relief. Gold is unlikely to provide a promising long-term solution to the permanent shock caused by foregone oil production. Targeted efforts to promote broad-based economic diversification are needed.
- **Imports during the period January to June declined by 11.7 percent mainly due to smaller imports of food commodities (wheat, sugar and vegetables) and manufacturing goods.** As a result, the trade surplus reached US\$ 3.3 billion, which is a significant increase from US\$ 0.8 billion during the same period in 2010. However, the trade surplus is expected to decline during the second half of 2011 along with the reduction of oil export.

Figure 4: Exports and Imports: 2005-2010, Jan-June 2011 (US\$ million)



Source: Foreign Trade Statistical Digest (April to June, 2011), CBOS

Trade between the bordering states of Sudan and South Sudan has been hampered by increasing security issues and the new currency introduction in both countries. Increasing tension and security issues in several bordering states imposed difficulties to trade, for instance through blocked river and road transport across neighboring states. The abrupt introduction of new currencies in Sudan and South Sudan also significantly raised transaction cost of cross-border trade owed largely due a lack of direct convertibility of the new currencies. High uncertainty remains for trade activities due to their largely dependence on progress of the political situation.

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