Sudan: Staff-Monitored Program: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

July 27, 2007

The following item is a Letter of Intent and a Memorandum of Economic and Financial Policies of the government of Sudan. The document, which is the property of Sudan, is being made available on the IMF website by agreement with the member as a service to users of the IMF website. This memorandum describes the policies that is implementing in the framework of a staffmonitored program. A member's staff-monitored program is an informal and flexible instrument for dialogue between the IMF staff and a member on its economic policies. A staff-monitored program is not supported by the use of the Fund's financial resources; nor is it subject to the endorsement of the Executive Board of the IMF.

July 27, 2007

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

Sudan has maintained close cooperation with the IMF over the past many years. This cooperation has helped us implement economic policies that aim at maintaining economic stability, fostering growth, and reducing poverty—which are necessary to promote peace and reconciliation throughout the country.

The attached Memorandum of Economic and Financial Policies (MEFP) sets forth our policy intentions under an 18-month Staff Monitored Program (SMP) covering July 2007 through December 2008. We are committed to maintaining macroeconomic stability and advancing the reform agenda, which will focus on fiscal reforms to increase the revenue base for financing needed expenditures and financial sector reforms to strengthen financial intermediation. The Government believes that the policies and measures set forth in the attached MEFP are adequate to achieve the objectives of the program, but it stands ready to take additional measures that may be appropriate for this purpose. The Government intends to make these understandings public and authorizes the IMF to publish this letter, the attached MEFP, and the IMF staff report.

We are committed to a process of economic integration, both within Sudan and with the international community. But our success depends also on the support we get from multilateral institutions and development partners. In this regard, we look forward to the IMF's Executive Board's discussion of the SMP and to the resolution of Sudan's debt and arrears problems in the future. In the meantime, we will intensify our efforts to obtain financing assurances from creditors for arrears clearance and debt relief under the Enhanced Heavily Indebted Poor Countries and the Multilateral Debt Relief Initiatives.

Sincerely yours,

s/	s/
Al-Zubeir Ahmed Al-Hassan Minister of Finance and National Economy Ministry of Finance and National Economy	Dr. Sabir Mohamed Hassan Governor Central Bank of Sudan

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES
July 27, 2007

1. This memorandum sets out the economic policies and objectives of the Government of National Unity (GNU) for the period July 2007 to December 2008. These policies will be pursued in the context of an IMF staff-monitored program (SMP).

I. PERFORMANCE UNDER THE 2006 SMP

2. Program performance under the 2006 SMP was uneven, due in large part to a number of unforeseen factors and challenges related to implementation of peace agreements. Two of the five quantitative targets (payments to the Fund and the ceiling on nonconcessional borrowing) were met. The remaining three targets (net international reserves, net domestic assets, and domestic financing of the government) were not met. Critical in this regard was the need to meet commitments under various peace agreements in the absence of disbursements from donors. Also a factor was a shortfall relative to projected revenues from oil exports. With respect to net international reserves, the need to absorb excess domestic liquidity—generated mainly by fiscal expansion and intervention in Omdurman Bank—and lower oil revenues resulted in a substantial decline in foreign exchange reserves of the central bank in the last quarter of the year. Most structural reforms under the program were implemented, although some with delays. Only three of the benchmarks—fiscal reporting on a GFSM 2001 basis, publishing of financial audits of state oil company Sudapet, and formulation of a program to revamp investment incentives—were not met.

II. RECENT DEVELOPMENTS

A. Developments in 2006

3. Despite the numerous challenges in implementing various peace agreements, the government has endeavored to maintain a focus on ensuring high levels of economic growth within an environment of macroeconomic stability. For the most part, we have been successful in these objectives. Growth was robust in 2006, and Sudan was one of the region's strongest countries in terms of attracting investment. With rapid growth have come new challenges—some have related to volatility in oil production and pricing, while others have stemmed from the need for greater flexibility and coordination in implementing macroeconomic policy.

4. The Sudanese economy achieved a growth rate of about 11.8 percent in 2006—largely in line with program expectations. A substantial increase in oil production (albeit less than hoped) contributed to this robust performance. Nonoil growth was also strong, however, at an estimated 10.3 percent—due in large part to a continued recovery in agriculture, and vibrant activity in construction, trade, and services. Average inflation was 7.2 percent. However, there was a steep rise in end-period inflation to 15.7 percent—stemming from the government's decision to reduce subsidies on domestic fuel products. Reflecting strong

capital inflows, the dinar rose by some 12 percent in nominal terms vis-à-vis the US dollar. Given the surge in inflation in the second half of the year, the dinar rose by some 21 percent in real effective terms during 2006.

5. Despite a substantial rise in oil production, the external current account position deteriorated. Exports of crude oil in 2006 increased by roughly 70 percent in volume terms over 2005, due almost entirely to production from new fields. In dollar terms, however, oil exports increased by only 24 percent. Marketing problems and the low quality of a new crude (Dar blend, which has a high level of acidity) resulted in a substantial discount relative to prevailing international prices and lower than expected export receipts. Nonoil exports, meanwhile, declined by some 11 percent in dollar terms—with notable declines in cotton, gum arabic, and livestock products. Imports—particularly shipments of capital goods—surged over the course of the year, reflecting a strong increase in foreign investment. As a result, the external current account deficit expanded from 8 percent of GDP in 2005 to roughly 13 percent in 2006. Net international reserves of the central bank declined by almost one-third, although this mainly reflected increased foreign exchange sales to mop up excess dinar liquidity associated with fiscal expansion and the injections into state-owned Omdurman Bank.

6. Fiscal performance in 2006 was weaker than programmed. The overall deficit is estimated to have widened to over 4 percent of GDP (2 percentage points higher than targeted in the revised 2006 SMP). This was in large part due to shortfalls in oil production and government oil revenue. Although total production (at some 132 million barrels) was substantially higher than in 2005, it was still much less than had been anticipated in formulating the budget. Low prices for Dar blend also had a negative impact, as did lower than projected non-oil revenues. Overall expenditures were in line with program commitments. Excess capital expenditures was compensated for by restraint in current spending. The higher fiscal deficit was financed by depletion of resources in the oil savings account, issuance of government bonds and promissory notes, central bank credit, and accumulation of domestic arrears.

7. Broad money growth (on an annual basis) remained around 40 percent through most of the year. Credit to the private sector grew at a rapid pace through much of the first half of 2006—peaking at just over 80 percent on a 12-month basis in July. The second half of the year was marked by a deceleration of this expansion. Broad money growth declined sharply to 27.4 percent by end-December, with a similar drop in growth of private sector credit, to about 45 percent. These sharp declines, which took place largely in the last quarter, were due to corrective actions by the central bank (principally foreign exchange sales to mop up domestic liquidity), a decline in deposits linked to the Omdurman Bank, and the emergence of government arrears which impacted banks' balance sheets. Reserve money growth was broadly in line with program targets at about 28 percent.

8. Important structural reforms were completed in the past year. Of particular importance has been ongoing work on fiscal management and transparency with respect to the oil sector. During 2006, the fiscal framework of the national government was converted to GFSM 2001 format, and presented to parliament for information—a critical step forward in public financial management. Also key was the compilation and public release of data on oil production, trade, and related transfers to the Government of Southern Sudan. Finally, a difficult but necessary reduction in domestic fuel subsidies was accomplished in August.

B. Developments in 2007

9. A number of the challenges that emerged in the final months of 2006 carried over into the first part of 2007—highlighting the need for a comprehensive approach to resolve emerging imbalances while simultaneously maintaining macroeconomic stability. Revenues in the first quarter were below the levels hoped for in the budget. While a weak first quarter performance in non-oil revenue (particularly tax revenue) is not unusual, oil revenues again failed to meet anticipated levels. Production and export of Dar blend crude were hampered by technical problems related to completion of a new pipeline and marine terminal. Prices for Dar blend in the first few months of the year were also lower than expected, running at an average of US$19 per barrel during January-March. Government expenditures, meanwhile, remained in line with budget allocations. As a result, the overall government deficit in the first quarter reached SD 143.6 billion (1.5 percent of annual GDP).

10. While inflation has remained in single digits and the exchange rate has been steady, monetary growth has decelerated. The 12-month rate of broad money growth fell to about 8 percent by April, due in large part to continued monthly declines in net foreign assets and less credit to the private sector. Given the expansion in government spending and imports, the use of foreign exchange reserves to mop up domestic liquidity and bring the exchange rate to a soft landing was seen by the central bank as the most prudent option.

III. Medium-Term Outlook and Challenges

11. Meeting Sudan's medium-term challenges will require macroeconomic stability, a strong commitment to reform, and flexibility in dealing with a rapidly changing economic landscape. We would highlight in this context that Sudan has only recently emerged from a long period of civil conflict. The demands of implementing the Comprehensive Peace Agreement (CPA), the Eastern Peace Agreement (EPA), and the Darfur Peace Agreement (DPA) are substantial, and the commitments made under these agreements must be met regardless of whether the international community fulfills earlier pledges of support. The demands in this area are likely to increase given the need to proceed with demobilization, as well as providing support to the joint AU-UN peacekeeping force. Meeting these obligations while simultaneously undertaking critical infrastructure and pro-poor spending limits our maneuverability on economic policies. The situation would be improved considerably with greater donor support and recognition of our accomplishments.

12. The medium-term macroeconomic framework envisages growth of about 9-10 percent, based on prudent macroeconomic policies designed to ensure single digit inflation and a rebuilding of international reserves. Increasing production of oil will provide one source of growth, but we also anticipate robust activity in non-oil sectors—including construction, manufacturing, transport, and services. We will also seek to boost the performance of our agricultural sector through market reforms and removal of transport, finance, and input bottlenecks.

13. Structural reforms and flexibility in labor and capital markets will be essential to maintain competitiveness over this period. The external position is likely to improve over time, with the external current account (cash basis) projected to stabilize at a deficit of 4-5 percent of GDP. Fiscal policy will focus on the difficult task of balancing expenditure needs with maintaining a fiscal stance consistent with macroeconomic stability. Monetary policy will continue to target a broad money growth rate consistent with inflation and growth objectives. Financial sector stability and development, in conjunction with prudent regulation and oversight, will be critical components in enhancing the prospects for medium and long-term growth of the Sudanese economy.

14. In addition to targeting high and sustainable levels of growth, the government's medium-term policies will focus on poverty alleviation and development. To this end, we have developed a work plan to prepare a national Poverty Reduction Strategy Paper (PRSP). A request for funding under the Technical Assistance Facility is pending. We expect the final PRSP to be ready by March 2008. The PRSP will place heavy emphasis on relevant and flexible policies to ensure a macroeconomic framework consistent with post-conflict challenges, decentralization, an enabling environment for private sector growth, and capacity and institution building. We are also pleased to report that the Bank of Sudan, in cooperation with the World Bank, has initiated a microfinance unit. The unit will focus on creating financial access for the poor, setting up the legislative and organizational framework for microfinance work, and establishing an information network for microfinance providers.

IV. POLICIES FOR 2007-08

15. Recognizing the seriousness of imbalances which emerged in the latter half of 2006 and the first quarter of 2007, the government has already implemented several corrective actions. On expenditure management, starting in June, the Bank of Sudan is coordinating payments for priority expenditures (wages, expenditures already committed and financed by standing orders, guarantees, and development sanadats), via direct transfer from current revenues. Remaining expenditures are based exclusively on remaining cash revenues, and will be executed by a committee including the State Minister of Finance, the Under Secretary of Finance (as co-chair), the Director of the Budget, and the Director of the Chamber of Accounts.

A. Real Sector

16. The program envisages real economic growth of 11.2 percent in 2007 and 10.7 percent in 2008. Oil GDP is expected to grow by about 39 percent in 2007 (reflecting the additional output from Blocks 3 and 7), and by nearly 12 percent in 2008 as production stabilizes. Non-oil growth is expected to moderate somewhat in 2007, but remain at a robust level of 8 percent in real terms. The moderation in growth will reflect fiscal consolidation, the need to tighten monetary policy to stem reserve outflows, weakness in the financial system during the first part of the year, and more moderate growth in agriculture and livestock production—which grew sharply in 2005–06.

B. Monetary/Exchange Rate Policy

17. With respect to monetary policy, the central bank will—in the context of a managed float exchange rate system—maintain a focus on price stability as its central mandate. The pound will be allowed to move in line with fundamental forces, and sales of foreign exchange will focus primarily on serving government and market needs. Given the lumpiness of foreign exchange movements related to oil production and FDI flows, occasional limited intervention may be needed to smooth short-term volatility. However, in light of the need to rebuild foreign exchange reserves to prudent levels, the room for further intervention will be limited. The central bank will avoid resisting sustained and fundamental pressures on the pound. We will also remove, by end-December 2007, the floor on cash margins for sight letters of credit and import credits.

18. The program will target a broad money growth rate of 24 percent in 2007, and 25 percent in 2008, consistent with GDP growth and inflation objectives, and an increase in money demand reflecting the reintegration of the south. The monetary target and the projected increase in foreign exchange reserves will allow for an appropriate growth of credit to the private sector. The conduct of monetary policy will be challenging given the changing economic landscape, but will seek to be flexible in the face of shifting FDI and other capital flows, volatility in oil-related foreign exchange movements, and aid disbursements. Accordingly, we will closely monitor monetary developments during the program period to ensure that the broad money growth rate remains in line with the inflation objective.

19. The conduct of monetary policy will increasingly rely on open market operations, with an emphasis on indirect monetary policy instruments. In the coming months, the central bank will acquire government securities from the banking system in order to increase its stocks of indirect monetary policy instruments. The trading of these instruments could in future be used to meet liquidity management objectives, rather than relying on sales of foreign exchange.

C. Fiscal Policy

20. The fiscal deficit for 2007 will be contained to no more than SD 359 billion on a cash basis, and to no more than SD 326 billion (2.9 percent of GDP) in 2008. The 2008 budget parameters will be reviewed later in 2007, as the preparation of the 2008 budget advances. All standing orders, guarantees, sanadats, and other obligations coming due will be paid, and no new arrears will be created in 2007 and 2008. Fiscal revenues are expected to reach SD 1,748 billion in 2007. This revenue will include some SD 56 billion (US$280 million) in license fees and payment of past obligations from Mobitel. Oil revenues are projected to reach 9.7 percent of GDP in 2007. The increase in oil revenues will reflect a rise in government share, as well as a narrowing discount on Dar blend relative to international prices. Total central government expenditures are programmed to be SD 2,107 billion in 2007. The government is fully aware of the risks associated with oil revenue projections given the volatility of international oil prices, and the uncertainties with respect to production and shipment. Flexibility and frequent review of expenditures and commitments will thus be required to ensure that the deficit stays at or below the agreed level. Specifically, if oil revenues are lower-than-programmed, we will (to the extent that such resources are available) compensate for the revenue shortfall by drawing from the Oil Saving Account (OSA), or otherwise reduce spending to maintain the fiscal deficit unchanged. If oil revenues exceed programmed levels, the additional revenue will be deposited in the OSA.

21. To meet the programmed revenue targets and to raise revenues over the medium-term, fiscal reform measures we intend to undertake in 2007-08 are as follows:

- The VAT rate was raised from 10 percent to 12 percent effective June 1, 2007.
- Reduce VAT exemptions granted by ministerial decree to achieve an additional SD 15-20 billion in revenue on an annual basis, effective December 2007.
- The Ministry of Finance will prepare a program by October 2007 to progressively reduce income tax holidays for new investments under the IEA.
- Recommendations of the above program will be incorporated and implemented as part of the 2008 budget.
- Implement an accelerated depreciation mechanism, and agree to adopt a single profit tax rate in 2009.
- Existing exemptions will be grandfathered, but eliminated at the time of expiration (no renewal).
- Continue to suspend the granting of any new VAT or income tax exemptions.

- Improve tax administration through introduction of self-assessment for business income tax (BIT) for taxpayers covered under the Large Taxpayer Office (LTO) by end-January 2008.

22. Fiscal expenditure has risen significantly in recent years, reflecting priority reconstruction needs and increases in transfers to states in an effort to support greater decentralization. While continuing to support these objectives, expenditure policies for 2007-08 will focus on maintaining a tighter balance between spending and available resources. Specific actions we will undertake in this regard are as follows:

- To further bolster expenditure management and preclude the emergence of domestic arrears, the ministry of finance will implement a zero-balance Treasury Single Account (TSA) by August 15 2007.

- Implement commitment controls that limit expenditures by line ministries to monthly or quarterly cash plans, which reflect likely cash availability rather than budgeted allocations.

- The MOFNE will issue a decree by July 15, 2007 establishing that line ministries cannot undertake spending commitments without the permission of the MOFNE. Reports will also be prepared on a quarterly basis for accounting data on expenditure committed and expenditure paid, by main budgetary items and chapters.[1]

- Formulate contingency measures for expenditure cuts in the event that projected revenues (oil and non-oil) fail to materialize.

23. Critical to the effective implementation of fiscal policy is a renewed commitment by the government to transparency and sound public financial management. The resort to nontraditional forms of financing in 2006-07 complicated both fiscal and monetary management and made analysis of the true fiscal position difficult. To address this problem and to increase transparency, we intend to take the following measures:

- Halt the use of sanadats, standing orders, and other nontraditional forms of finance, and to carefully monitor the existing stock of such instruments with a view to their eventual extinction. Issuance of letters of guarantee in the second half of 2007 will not exceed SD 20 billion.

---

[1] These two measures will help ensure that line ministries will not be able to independently commit amounts under their allocations, and that they would be bound by actual measures under the cash plan.

- Establish in MOFNE a centralized domestic debt unit by September 2007 that will compile and monitor on a monthly basis the stock of domestic debt, and on a quarterly basis the stock of domestic arrears (payments due for over 3 months) by debt instrument and provide on a quarterly basis accounting data on expenditure committed and expenditure paid, by main budgetary items and chapters.

- Adopt for the 2008 budget the full economic and functional classifications of the Government Financial Statistics Manual (GFSM) 2001.

D. Balance of Payments / External Debt

24. The external current account deficit (cash basis) is expected to narrow significantly to some 9 percent of GDP, compared with a deficit of 13 percent in 2006. The improvement mirrors a sharp increase in oil exports, as difficulties with oil production and shipment are expected to be resolved by mid-year. Critically, Dar blend crude appears to have found broader acceptance in international oil markets, and thus prices are likely to be more stable in the future. Transfers are also expected to rise. Imports are expected to rise by about 6 percent—mainly in the form of materials and capital goods required for the implementation of large scale projects financed by loans from official creditors and FDI. With the net increase in foreign exchange inflow, we anticipate being able to rebuild net international reserves of the central bank to a level of about US$1.3 billion (1.4 months of imports) by the end of 2007 and US$1.8 billion (1.7 months of imports) by end-2008.

E. Financial Sector

25. We will continue our plans to restructure and strengthen the banking system. A strategy for resolving recent problems with Omdurman Bank is being implemented. An audit of the bank will be started by December 2007 by a local affiliate of one of the internationally recognized auditing firms. The audit will be consistent with international good practices and follow international audit standards. Based on the findings of the audit, we will prepare a plan for resolution/restructuring of the bank by June 2008. Similarly, rehabilitation plans for Saudi Sudanese Bank will be implemented. The CBOS will actively enforce prudential standards and ensure that banks comply with existing regulations. Commercial banks will submit to the central bank by end-December 2007 well-specified action plans to achieve full compliance with existing regulations on capitalization and provisioning.

F. Other Reforms

26. With the rise in oil production has come greater demands for oil sector transparency. A number of positive steps have been made in the last year with respect to publication of oil sector and oil revenue data, but much remains to be done. With a view to increasing the level of cooperation and transparency, the government will provide to the IMF the 2004 and 2005 audits of Sudapet by October 2007. The government will also publish (on the MOFNE

website) data on volume of oil production, total volume of crude oil exports, volume of government oil exports, volume of input to refineries, volume of petroleum product production, and import/export of petroleum products.

V. Relations with the Fund and Other Creditors

27. **External debt issues**. In 2007, Sudan's debt service capacity will be constrained by revenue shortfalls, the need to rebuild foreign exchange reserves, the burden of implementing the various peace agreements, and the need to address critical poverty and reconstruction requirements. Further shortfalls or delays in donor assistance or a significant negative shock to oil prices would further limit our capacity to service our obligations. Based on the available data, the end-2006 stock of public and publicly-guaranteed debt is estimated at over US$27 billion in nominal terms, up by about US$9 billion since end-2000. This increase largely reflects a US$6.3 billion buildup in arrears to official bilateral (Paris Club and non-Paris Club) creditors, and new drawings of some US$520 million from Arab multilateral and bilateral creditors as well as from China and India. Sudan has been making debt service payments to almost all multilateral creditors and selected bilateral creditors that have provided new financing in recent years. We wish to convey to the international community that Sudan has made every effort at cooperation on policies and payments for many years, and in that context met all the conditions and requirements for debt relief. We remain hopeful that the international community will recognize our track record, and take concrete action on debt relief for Sudan comparable to that provided to numerous other countries.

28. **External financing**. Sudan continues to suffer from limited access to concessional loans because of the difficulties in resolving our debt and arrears situation. We are unable to put critical infrastructure, reconstruction, and social development projects on hold indefinitely, however. These projects are an essential component of our strategy to unite the country after the signing of multiple peace agreements. Consequently, we have had to make recourse to nonconcessional financing in recent years. We are keenly aware of the concern of other creditors regarding this borrowing, and of the risks it may pose over the medium- and long-term. We will therefore seek to limit the contracting of such obligations as much as possible. For 2007, we will limit such contracting to US$700 million, and will impose a similar limit for 2008.

29. **Payments to the Fund**. In addition to cooperation with the Fund on matters of economic policy, Sudan's payments to the Fund have exceeded program levels under the SMP, and in this context we achieved a small reduction in the stock of external obligations. Payments to the Fund have continued in the first half of 2007, even in the absence of a staff-monitored program. The Fund's preferred creditor status will be maintained by ensuring that our payments continue in the remaining months of 2007 and 2008 by ensuring that our payments continue to exceed obligations falling due. To demonstrate our continued cooperation, we will make minimum payments of US$50 million in 2007 and at least US$50 million in 2008. Further, it is our intention to move to a monthly payment basis. We

would hasten to point out, however, that these payments—while demonstrating our good intentions—are not a solution to Sudan's arrears to the Fund. We appeal to the international community in this context to recognize our accomplishments, act in accordance with the principle of equal treatment, and work toward a rapid resolution of Sudan's debt and arrears problem.

VI. Program Targets and Monitoring

30. The proposed semi-annual quantitative targets for the periods up to end December 2007, end-June 2008, and end-December 2008 are set forth in Table 1, and the structural benchmarks are detailed in Table 2. We will closely monitor financial and economic developments in coming months and will implement any measures that may be needed to safeguard macroeconomic stability in consultation with the Fund staff. It is proposed that there will be semi-annual staff assessments of the program.

31. To ensure the effective monitoring of the program, the relevant ministries, the CBOS, and the Central Bureau of Statistics will compile and share with the Fund staff all economic and financial data necessary, on a timely basis, as specified in the attached TMU.

Table 1. Sudan: Quantitative Targets for 2007 and 2008

	2006 1/	2007 2/			2008 2/		
	Dec.	June	Sep	Dec.	Mar	Jun	Dec.
	Act.	Bench-mark	Indic. Target	Target	Indic. Target	Target	Target
	(In billions of Sudanese dinars, unless otherwise indicated)						
Central Bank of Sudan net domestic assets 4/	372	101	119	169	15	36	84
Domestic financing of the central government 4/	322	112	180	307	96	161	319
Reduction in the stock of domestic arrears of the central government 2/ 3/	22	14	…	38	8	16	32
Net international reserves (in millions of U.S. dollars) 4/	1,384	-634	-452	-84	119	243	500
Contracting or guaranteeing of external nonconcessional debt by the government or the central bank (in millions of U.S. dollars)	589	...	...	700	…	…	700
Payments to the Fund (in millions of U.S. dollars)	51	...	...	50	…	…	50
Memorandum items:							
Broad money	1,787	107	246	429	100	303	554
Reserve money	782	-33	19	141	39	85	184
Net central bank claims on government of Southern Sudan	-13	7	10	13	0	0	0
Government oil export revenues	539	260	460	646	205	409	853
Of which: oil savings account	-63	0	0	0	0	0	0

Sources: Sudanese authorities; and Fund staff estimates.

1/ The 2006 figures—except for domestic financing of central government, domestic arrears, external nonconcessional debt, payment to the Fund, and government oil export revenues—are displayed as end of period stocks.
2/ Cumulative flow during 2007 and 2008.
3/ Any new domestic arrears incurred during January – June should be cleared by end-June, and those incurred during July – December should be cleared by end-December. Arrears are defined as overdue financial obligations of the central government outstanding for 90 days or more.
4/ Subject to an adjustor (asymmetric) to take account of oil production and/or prices being more than assumed in the program.

Table 2. Structural Measures Under the SMP (July 2007 to December 2008)

Measures Under the SMP	Objective	Status/Timing [1]
1. Ministry of Finance to issue a decree establishing that line ministries cannot undertake commitments without permission of Ministry of Finance.	Expenditure control	July 15, 2007
2a. Provide to Fund staff the stock of domestic debt, including arrears, at end-2006, by type of instrument (loans from BOS, GICs, GMCs, standing orders, guarantees, development sanadats, and securitized arrears (debt extinction sanadats)).	Stop build-up of public debt	June 26, 2007
2b. Establish a centralized domestic debt unit that will compile and monitor on a monthly basis the stock of domestic debt by debt instrument, and on a quarterly basis the stock of domestic arrears (payments due for over 3 months) by debt instrument and provide on a quarterly basis accounting data on expenditure committed and expenditure paid, by main budgetary items and chapters.	Stop build-up of public debt	July 1, 2007
3a. Establish a zero-balance Treasury Single Account in line with recommendations of the FAD Public Financial Management mission of October 2006.	Expenditure control	August 15, 2007
3b. Implement commitment controls that limit expenditures by line ministries to monthly or quarterly cash plans, which reflect likely cash availability rather than budgeted allocations.	Expenditure control	September 1, 2007
4. Adopt for the 2008 budget the full economic and functional classifications of the GFSM 2001.	Improve budget execution	December 2007
5. Reduce VAT exemptions granted by ministerial decree to achieve an additional SD 15-20 billion in revenue on an annual basis.	Broaden tax base and raise revenue	December 2007
6. Continue to suspend the granting of any new VAT or income tax exemptions by the Ministry of Finance.	Raise revenue	Continuous
7a. Ministry of Finance to prepare a program to progressively reduce income tax holidays for new investments under the IEA.	Broaden tax base and raise revenue	October 2007
7b. Recommendations of the program to be incorporated and implemented as part of the 2008 budget.	Broaden tax base and raise revenue.	December 2007
7c. Implement an accelerated depreciation mechanism, and approve a single profit tax rate for implementation in 2009.	Broaden tax base and raise revenue.	December 2007
7d. Existing exemptions to be grandfathered, but eliminated at the time of expiration (no renewal).	Broaden tax base and raise revenue.	December 2007
8. Implement self-assessment (based on IMF technical assistance recommendations) for business income tax, starting with taxpayers covered under the Large Taxpayer Office (LTO).	Improve tax administration	January 2008
9. Provide to the Fund the 2004 and 2005 financial audits of Sudapet.	Transparency	October 2007
10. Begin publication on the MOFNE website the following information (one month lag): volume of oil production; total volume of crude oil exports; volume of government oil exports; volume of input to refineries; volume of petroleum product production; import/export of products.	Transparency	December 2007
11a. Begin an audit of Omdurman Bank by a local affiliate of one of the internationally recognized auditing firms. The audit should be consistent with international good practices and following international auditing standards as established by the International Auditing and Assurance Standard Board.	Financial sector soundness	December 2007
11b. Based on results of the audit, the government will prepare a restructuring/resolution plan for Omdurman Bank.	Financial sector soundness	June 2008
12. Commercial banks to undertake and submit to central bank well-specified actions plans to achieve full compliance with existing regulations on capitalization and provisioning.	Financial sector soundness	December 2007
13. Remove the central bank floor on cash margins for sight letters of credit (SLC) and import credits.	Current account liberalization.	December 2007

1/ Unless otherwise specified, measures are for end-month.

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum specifies the understanding reached with the Fund staff regarding quantitative targets, structural benchmarks, and reporting for the 2007-08 staff-monitored program (SMP).

2. The SMP relies on six quantitative indicative targets for up to end-March and end-September and an equal number of quantitative targets for end-December 2007, end-June 2008 and end-December 2008. The targets are (i) ceilings on the change in net domestic assets of the Central Bank of Sudan (CBOS); (ii) ceilings on the domestic financing of the fiscal deficit; (iii) floors for the buildup of net international reserves of the central bank; (iv) ceilings on new nonconcessional external loans contracted or guaranteed by the government or the central bank; (v) floors for payments to the Fund; and (vi) change in domestic arrears. Broad money, reserve money, and total government revenues from crude oil exports will be monitored as memorandum items. Some of these targets are subject to adjustors depending on the financial position of the government of South Sudan and total government oil export revenue performance. The definitions of these variables and the adjustors are set out below. All the quantitative targets and structural benchmarks are displayed in Tables 1 and 2 of this attachment.

3. **Net domestic assets (NDA)** of the CBOS are defined as the sum of the Net Domestic Credit of the CBOS, the net issue of money market instruments and other items net. Net Domestic Credit is defined as net credit to the central government (i.e. Government Musharaka Certificates (GMCs), Government Investment Certificates (GICs), and any other form of central bank credit to the central government minus total central government deposits) plus net central bank claims on state and local governments, central bank claims on public enterprises, and claims on banks, and minus Central Bank Ijara Certificates (CICs). The definition of the central government comprises all accounts of line ministries and agencies controlled by the government (corresponding to Group no. 11, Group no. 12, and some accounts of the Group no. 19 in the CBOS general ledger), the Zakat funds (recorded under Group no. 13), and margin deposits placed with the CBOS by the central government against letters of credit issued by the CBOS. The definition includes all oil-related accounts controlled by the government. To evaluate program targets, the dinar equivalent values of foreign exchange denominated items in the balance sheet of the central bank will be calculated at the program exchange rate.

4. **Domestic financing of the fiscal deficit** is defined as total net domestic borrowing by the central government, including net borrowing from the banking system (including GMCs and GICs), net sales of GMCs and GICs outside the banking system, promissory notes (ie, standing orders, letters of guarantee, and sanadats), and revenues from privatization and changes in government cash deposits of the BOS. The definition of central government for the purpose of this criterion is the same as the one applied for the NDA of the central bank.

5. **Net international reserves** (NIR) are total gross non-earmarked official foreign reserve assets on active accounts plus reserve assets of the government of Southern Sudan in the central bank minus official short-term liabilities (i.e. no more than one-year maturity).

The assets are maintained on accounts with overseas correspondent banks and foreign exchange banknotes in the vaults of the central bank. Short-term liabilities include IMF deposit accounts, nonresident deposits, and (overdrawn) foreign correspondents accounts.

6. Limits on **contracting or guaranteeing of nonconcessional external debt** apply to all forms of debt of more than one-year maturity contracted or guaranteed by the government or the CBOS. The limit applies not only to debt as defined in point no. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision no. 12274-(00/85), August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. The degree of concessionality of debt will be calculated as specified in the Guidelines.[2]

7. **Broad money** is defined as the sum of local currency circulating outside of the banks, banks' demand, and time and savings deposits. It also includes transferable deposits and margin deposits against letters of credit placed by state and local governments, nonfinancial public enterprises, and the nonbank private sector with the CBOS. **Reserve money** is defined as the sum of local currency circulating outside of the banks, total reserves (required and excess) for banks, and deposits at the CBOS included in broad money.

8. **Adjustor on the financial position of the government of South Sudan** (capped). The program target for changes in the NDA of the central bank will be reduced (increased) and the international reserve target will be increased (reduced) by the amount of any decline (increase) in net central bank claims on the government of South Sudan. The adjustor will not apply if the stock of net claims on the government of South Sudan turns positive.

9. **Oil revenue adjustor** (symmetric). The programmed government oil revenue from crude oil exports is based on the program's assumptions about oil prices (f.o.b. Port Sudan) and quantities expected to be exported (see Table below). Accrued revenue is the cumulative government oil revenue inflows based on actual shipments at current international prices (f.o.b. Port Sudan). Oil revenue for use in the 2007 and 2008 budgets is estimated at a projected international average quarterly price of oil as indicated in Table 1 (benchmark prices).[3] The accrued government oil revenue in excess of the planned budgeted amounts is deposited in an oil saving account (OSA), a locked sub-account within net credit to the government at the CBOS. The programmed OSA accumulation for 2007 is zero.

The oil revenue adjustor will work as follows:

---

[2] For program purposes, a loan is considered concessional if the grant element is at least 35 percent calculated using a discount factor based on the Commercial Interest Reference Rates (CIRRs) published by the OECD plus margins depending on the loan maturity. The margins are 0.75 percent for repayment periods of less than 15 years, 1 percent for 15–19 years, 1.15 percent for 20–29 years, and 1.25 percent for 30 years or more. The average of the CIRRs over the last ten years will be used for loans with a maturity of at least 15 years and the average of the CIRRs for the preceding six months will be used for shorter maturities.

[3] The projected prices for 2008 will be revisited in the context of preparing the 2008 budget, based on the latest information available regarding international prices and the discounts applied to Nile blend and Dar blend.

- If the accrued government revenue from crude oil exports exceeds the programmed amount (either because the price and/or volume exceed the programmed levels), these proceeds will also be deposited in the OSA. The program targets for domestic financing of the budget deficit and NDA will be reduced, and the international reserves target will be increased, by the difference between the accrued and the programmed amounts.

- If the accrued government revenue from crude oil exports falls short of the programmed amount, the program targets for international reserves target will be reduced by the difference between the programmed and the accrued amounts.

- If within a given quarter the accrued oil revenue that goes to the budget falls below the planned amount, appropriate amounts will be withdrawn from the OSA (subject to these resources being available) to ensure that cumulative oil revenues for use in the budget match the cumulative amounts planned in the fiscal program. If such resources are not available from the OSA, the government will undertake appropriate expenditure adjustment to ensure that the deficit does not exceed the targeted level of SD 359 billion in 2007 and SD 326 billion in 2008.

Table 1. Sudan: Government oil revenues from crude exports

		2007					2008				
		Q1 Actual	Q2 Est.	Q3 Prog.	Q4 Prog.	Year Prog.	Q1 Prog.	Q2 Prog.	Q3 Prog.	Q4 Prog.	Year Prog.
Nile blend crude (including crude from Block 5A)											
Price (f.o.b. Port Sudan)	US$/barrel	54.7	59.5	60.5	61.0	59.2	63.0	64.5	64.9	65.2	64.4
Volume exported	Million barrels	6.880	9.865	9.889	9.990	36.6	10.1	11.4	10.7	10.8	43.1
Export revenue	US$ millions	376.0	586.5	597.8	609.4	2,170	639	738	696	705	2,779
Of which: OSA accumulation	US$ millions	55	0	0	0	55	0	0	0	0	0
Dar blend crude											
Price (f.o.b. Port Sudan)	US$/barrel	17.7	27.1	33.6	35.6	30.9	34.7	34.5	34.9	35.2	34.8
Volume exported	Million barrels	6.6	8.4	10.9	11.1	37.0	11.1	11.2	11.4	11.5	45.2
Export revenues	US$ millions	117	252	377	399	1,144	383	387	399	404	1,573.2
Of which: OSA accumulation	US$ millions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo item:											
Revenue from crude exports	US$ millions	493	838	975	1,009	3,314	1,023	1,125	1,095	1,110	4,352
Revenue from crude exports	SDD billions	99	168	195	202	663	205	225	219	222	870
Of which: programmed OSA accumulation	SDD billions	11	0	0	0	11	0	0	0	0	0
Oil export revenue for use in the budget	SDD billions	88	168	195	202	652	205	225	219	222	870

10. **Data Reporting.** The following table contains the agreed reporting framework. To the extent possible, the data will be submitted in both printed and electronic form to the IMF local office.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing (within period specified)
CBOS	Flash report	Weekly data for movement in main indicators of the CBOS balance sheet, international reserves, sales and purchases of foreign exchange, exchange rate, murabaha rate, musharaka shares, and inflation	Weekly	Tuesday of each week
	CBOS balance sheet	Detailed CBOS balance sheet.	Monthly	1 month after the end of each month
	Monetary survey	Banking system balance sheet and consolidated balance sheet of commercial banks	Monthly	1 month after the end of each month
	Rates of return and securities	Murabaha rate and shares of Musharaka and the rate of return on securities (GMC, GIC and CIC). Information on auctions and expiry for all certificates from the Sudan Financial Company	Monthly	1 week after the end of each month
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Quarterly	1 month after the end of each quarter
	Balance of payments	Detailed composition	Quarterly	2 months after the end of each quarter
Ministry of Finance	Central government	Revenues, expenditures, and financing as in traditional presentation	Monthly	30 days after the end of each month
	Central government	Revenues, expenditures, and financing as in GFSM 2001	Monthly	Data for January-May by end-June, for the remaining months 45 days after the end of each month
	GOSS	GFSM 2001	Monthly	Data for January-May by end-June, for the remaining months 45 days after the end of each month
	Privatization receipts	Detailed figures for each transaction and nature of the transaction	Quarterly	1 month after the end of each quarter
	Bank financing	Certificates or advances from the central bank or commercial banks, listed by transaction specifying entity, date, amount, and maturity	Monthly	1 month after the end of each month
	Nonbank financing	Sanadats, letters of guarantee, standing orders issued to any nonbank entity, listing by transaction specifying entity, date, amount and maturity	Monthly	1 month after the end of each month
	External debt	Disbursements, debt service, and contracting or guaranteeing of medium-and long-term external debt of the government, the CBOS, and state-owned companies	Quarterly	1 month after the end of each quarter
Central Bureau of Statistics	CPI	By category and income group (low, middle, high)	Monthly	1 week after the end of each month
Ministry of Finance/ Ministry of Energy	Crude oil exports	Shipment data, listing by blend specifying date, quantity, prices, and values in US$ and in dinars	Monthly	1 month after the end of each month
	Sales to refineries	Sales listing by refineries specifying date, quantity, prices, and values in US$ and in dinars	Monthly	1 month after the end of each month
	Net operating income transfers to the treasury	Net income of SPC (including those derived from exports of petroleum products)	Quarterly	1 month after the end of each quarter