الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

Republic of the Sudan

December, 2019

TRUST . TRANSPARENCY . INDEPENDENCE

ECONOMIC OVERVIEW

Republic of the Sudan ('Sudan' or 'the country') is home to around 40m people. With a GDP of US$117.5b[1] - as of 2017 - which translates in per-capita GDP of ~US$2,900, Sudan falls in the category of "lower middle-income countries" as per World Bank classification.

Following the secession of South Sudan in 2011, the Sudanese economy has been weighed down by the shortages of foreign currency, limited access to external financing, low oil transit receipts from South Sudan, a weak business environment, and absence of foreign correspondent banking relationships, along with US sanctions. Many of its challenges have continued unresolved. As the government monetized the fiscal deficit, the economy entered an inflationary cycle, coupled with a devaluing currency and declining reserves, and with the CBoS striving to maintain an overvalued peg. Continuous food price hikes were also one of the more significant causes for recent unrest which started in December 2018 and which led to the ouster of former President in April of this year.

In the beginning of August of this year, the military and peoples' representatives signed a constitutional declaration which paved the way for the formation of a transitional government. The agreement dictates the formation of a Sovereign Council, Cabinet, and a legislative body. There will be 39 months of power sharing with the Council, comprising 11 members; 5 civilian and 5 military nominees plus one agreed by consensus, being led by a General for 21 months and a civilian for 18 months. After this period, there will be general elections. A prime minister, nominated by the pro-democracy movement, will head the cabinet. Indeed, on August 22nd, Mr. Abdalla Hamdok was appointed new prime minister. Commanding a PhD degree in economics and having worked as an economist in United Nations and African Development Bank, economic reforms may be expected, given that the present situation is one of the biggest challenges at hand. On September 9th, the new Ministerof Finance, Ibrahim al-Badawi, announced a 200-day plan which was based on five main pillars: macroeconomic stabilization, measures to stabilize commodity prices, addressing youth unemployment, transition from humanitarian aid to sustainable development and capacity building of economic management institutions.

The economy is driven in most part by consumption, with constrained contribution from investments and negative performance of the external sector. Significant reliance economic supply is on agriculture with relatively more limited industrial output. According to the CBoS data, the Sudanese economy grew by 5.7% in 2018 following a 5.2% growth observed in the prior year. Average growth rate for the last 10 years stood at 4.3%. For the year 2019, government's budget forecasts incorporated 5.1% GDP growth with higher share of agriculture at 28%.

In December 2017, the Government announced the devaluation of Sudanese Pound from 6.7 SDG/USD to 18 SDG/USD to be effective in January 2018 and then to 47.5 SDG/USD in October. Following the latest devaluation, authorities set up a new system under which a group of banks and exchange houses set a daily rate. Since then, there was a moderate appreciation of the exchange rate which came to 45.0 SDG as September 2019 while the parallel exchange rate hovered around 65 SDG/USD.

Sudan has relatively high inflation rates. Annual consumer price inflation (CPI) averaged 30% between the years 2012 and 2017. Practice of "monetizing the fiscal deficit has resulted in rapid money supply growth both in 2017 and 2018 and incited an inflationary spiral. Having surged to as high as 72.9% at the end of 2018 from 25.2% in 2017, in tandem with the sharp depreciation of the SDG and reduction in fuel subsidies. Annual inflation retreated to 52.6% as of July 2019 as currency stabilized. Sudan's 2019 budget projections foresaw the year-end inflation at 29%.

The monetary and fiscal policy is expected to be tightened, in order to control inflation. In this regard, the subsidies are expected to be replaced with targeted subsidy programs. Furthermore, the country's tax to GDP ratio – which, at 5.3%, is lower than the average for the Sub-Saharan Africa region of 16.8% - is planned to be enhanced by reduction in tax exemptions/holidays and other tax reforms.

Gold, livestock, sesame, and oil are the major export items for 2018. Imports of the country are dominated by manufactured

[1] *Source: World Bank.*

goods (18.1%), machinery & equipment (18%), petroleum products (12.6%), wheat (9.2%), and transport equipment as of the year-end 2018. A persistent current account deficit weakens the economy on the external front; deficit declined by 78% to USD1.0b in 2018 following the 81% drop in trade deficit, as sizable depreciation helped external balances. The current account registered a deficit of USD0.9b during the first quarter of 2019 compared with a deficit of USD 1.6b Q4'2018.

On the fiscal side, country's 2019 projections points to 39% increase in revenues to SDG162.8b while the budget deficit as a percentage of GDP is to reduce to 3.3% from 3.7% in the prior year. Tax revenues estimated at SDG 47b, imply a 29% increase over previous year and borrowing from the Central Bank is expected to be within 15% of the total national revenues. Fiscal balance has been negatively impacted by elevated spending on security which was estimated to have reached around 70% of total budget.

According to IMF officials, Sudanese authorities had not approached IMF for new lending and they cannot provide financing as the country incurs arrears. Meanwhile in April 2019, KSA and UAE announced a joint USD3b package of economic aid for Sudan, including a USD500m deposit in CBoS to strengthen the currency. The remainder is allocated for food, medicine and petrochemicals purchases.

US sanctions on Sudan were lifted in October 2017 which generated initial wave of optimism. However, until now, foreign investors and commercial banks have not been eager to restart trade and financial transactions with Sudan. Complete normalization of relations with the US is still pending.

Key challenges of the Sudanese economy include institutional weaknesses, high youth unemployment, and a high external debt burden. More than 130,000 young people enter the labor market every year, but only 30,000 positions are available, posing a serious challenge for the country[2]. External debt stock— which increased from USD18b in 1995 to USD53.6b in 2016 and to USD56b in 2018— is unsustainable.

Banking Sector

The Sudanese banking sector comprises 35 banking institutions, all of which operate in accordance with Shari'aprinciples. The sector features considerable concentration at the top, with the largest three banks holding majority of the industry deposits. The banking system has been constrained by the breakdown of correspondent bank relations since mid-2014, yet with the expected removal of the Country from the State Sponsors of Terrorism List, these relations are expected to be revived. Sector`s aggregate financial stability indicators suggest improvement with adequate capital buffers as per local regulatory requirements, declining non-performing loans and increased profitability over time. This assessment may however be qualified by the potentially heightened risk environment, and efficiency losses in the wake of recent turbulence, and which may be manifested in data, yet to emerge.

Total assets of the Sudanese banks stood at SDG514.7b as of June 2019 growing 14.9% year to date. In the year 2018, asset base of the system more than doubled to SDG447.9b (up 112% YoY) due partly to massive devaluation of the currency while the CAGR for the 2012-2017 period was registered as 28.5%.

Within the 2015-2018 period, Sudanese banks' financing portfolio grew with a CAGR of 46.4% and reached SDG167.7b, however, its share as a percentage of assets declined to 37.4% from the peak of 51% observed in 2016, as banks accumulated liquidity faced with a high-risk business environment. Of these financings, around three-fourth represents credit to the private sector. Following the 62.9% surge in the prior year, financing portfolio growth remained contained so far in 2019 with an 11.7% increase in the first half of the year.

In a bid to spur economic growth, the CBoS has begun promoting lending to Micro, Small & Medium Enterprises (MSMEs) by requiring all banking institutions to grow aggregate MSME exposure to at least 15% of the financings portfolio by Dec'18. On the other hand, consumer financing across the sector remains minimal as the CBoS prohibits financing of imported goods.

[2] *https://www.afdb.org/en/countries/east-africa/sudan/sudan-economic-outlook*

As UAE made efforts to diversify economically, the sector has also witnessed consolidation of 2 major banks and reduction in the physical banking channels of distribution for attaining cost efficiency. A general year-over-year ("YoY") slowdown was observed in the overall banking sector vis-à-vis assets, deposits and financings during 2017. On the other hand, growth in IB assets over 2017 and through Q1'18, was in line with the previous year, primarily driven by faster growth in deposits. CBUAE's quarterly credit sentiment surveys for 2017 and following Q1'18 indicate moderate growth in demand for corporate loans while demand for retail loans have either remained flat or weakened.

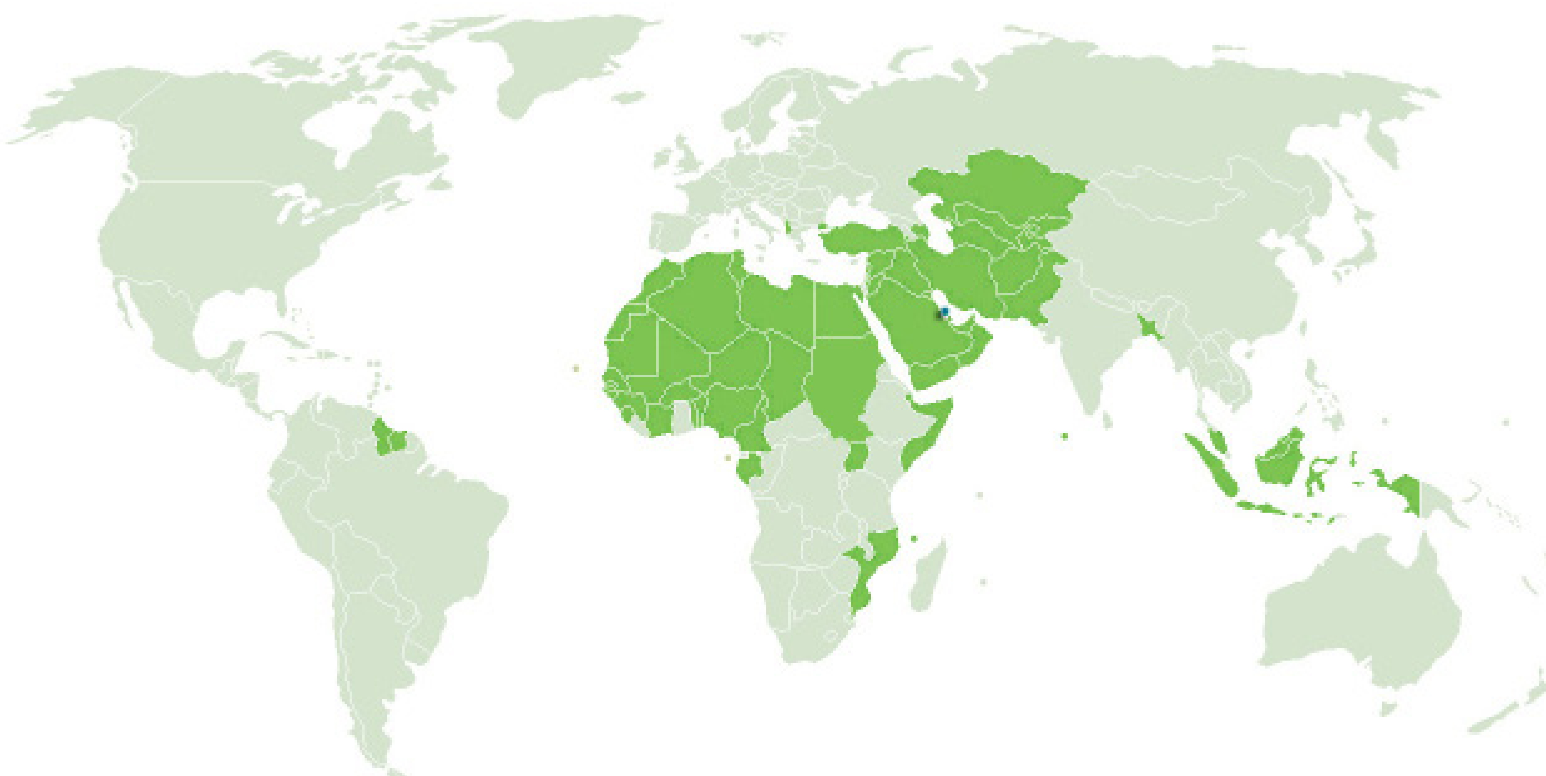
It is noteworthy that most of the increase in corporate financings was led by real estate sector, while financings to Government Related Entities ("GREs") showcased contraction during this period. As such, real estate exposure for the UAE banking sector increased to 19.9% in 2017 from 16.4% a year ago, which may be a cause of concern for the sector particularly in the light of existing oversupply, weakening demand and subdued prices.

Nonetheless, UAE banking sector remained healthy in Q1'18 with adequate capitalization and strong profitability metrics. With stable sources of funding and slower financings growth, asset allocation strategy shifted towards liquid assets in UAE. In the overall industry context, slight deterioration in asset quality was observed in 2017, while impairments remained contained in Islamic banks. At the same time, such impaired financings were adequately provided for with provisioning coverage in excess of 100%[13]. Further, the banking sector resilience was also captured in the 2017 regulatory stress test conducted by CBUAE that yielded satisfactory results.

In terms of regulatory developments, in 2017 CBUAE issued the UAE Basel III capital standard and IFRS 9 guidance note. While IFRS 9 has already been rolled out, the central bank expects to fully implement Basel III capital framework in phases until 2019. Similarly, further Basel III standards (Pillar 2 and 3) are likely in the pipeline to be published by the end of 2018. During 2016-2017, the central bank also designated 4 D-SIBs based on the criteria recommendations of Basel Committee on Banking Supervision ("BCBS"). As such, designated D-SIBs are subject to stringent capital requirements that shall be tightened over the transitional period until 2019. A snapshot of the minimum transitional arrangement in terms of minimum capital and capital buffer requirements in UAE is provided in Table 5.

In addition, the central bank has finalized new risk management and country and transfer risk regulations during this year. Furthermore under its 5-year 2017-2021 strategy, CBUAE has also been developing macro-prudential policy framework aligned with international best practices. Other major regulatory developments were in the areas of corporate governance ("CG"), internal controls, financial reporting and external audit, outsourcing, dormant accounts, supervisory cooperation and coordination, micro and SME financings, loan-based crowd funding and Islamic finance.

The regulatory framework for IB is still evolving. Islamic banks are governed under the federal law no. 6 promulgated in 1985. Further, in 2016 the country established central Shari'a board – "Higher Shari'a Authority" to bring uniformity in IB practices with central supervision and guidance to financial institutions.



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