الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

Republic of Sudan

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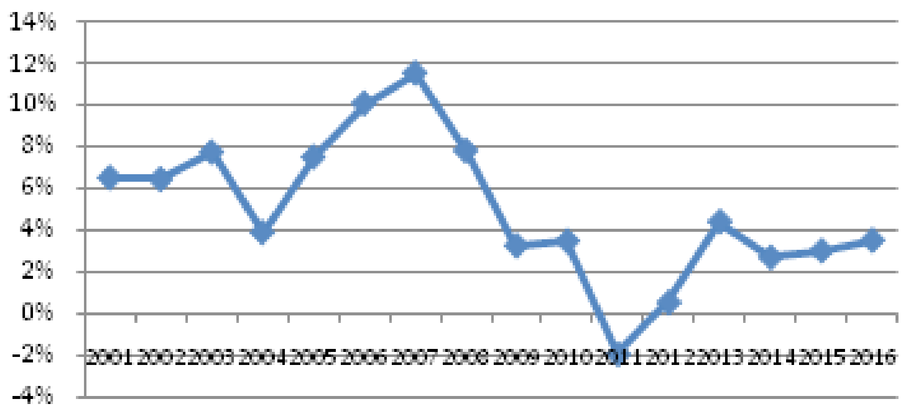
Country Profile - Situated in North-Eastern Africa, nestled between Egypt, Libya, Chad, Central African Republic, South Sudan, Ethiopia, Eritrea and the Red Sea to the East, Sudan ('Sudan' or 'the country') is home to around 40mn people. With a GDP of USD 95.6bn, which translates in a per-capita GDP of USD ~2,400, Sudan falls in the category of lower middle income countries as per World Bank classification.

With GDP growth averaging 6.8% during the 10 year period 2000-2010, Sudan was regarded as one of the fastest growing countries in the World. However, in accordance with the peace treaty signed in 2005, as the oil rich South Sudan – which housed 80% of the oil fields– seceded into a separate state in 2011, the oil-fueled GDP growth of the country was significantly impacted. Subsequently, Sudan's economy entered into a phase of stagflation, having posted slight recovery in recent years on the back of growth in agriculture and livestock activities.

Figure 13: Mudarib share trend versus proportion of income



(Source: World Bank)

Additional unresolved matters still pending since the secession include the apportionment of the USD 50bn debt (Dec'15) between the south and the north. With 84% of its debt in arrears, Sudan has been in non-accrual status with the World Bank since 1994. In order to avail debt relief, as per the Highly Indebted Poor Countries Initiative, it is imperative that the country reaches a mutual agreement on apportionment of debt with South Sudan.

Mineral exploration, which is another major contributor to the country's economic growth, has been stepped up, specifically gold that has become a major contributor to the country's export earnings (~>35%). Further, having been recently finalized in Sep'17, the country has also agreed to a deal with South Sudan to allow passage way for oil export against a transit fee; nonetheless, given instability in South Sudan, oil production remains minimal. Additional reserves available with the country to drive future growth include vast swathes of fertile land and a myriad of mineral resources, including gold, chrome, manganese, asbestos talc, gypsum, kaolin and magnetite.

Sovereign Politico - Economic Update

The Sudanese economy continues to be faced by post-secession challenges including a twin deficit situation, rampant inflation and growth rate, which is considerably below potential. As per IMF estimates, the country's economic growth rate slightly fell in 2017 as a result of weaker domestic demand, which was partially offset by higher net exports (lower imports). The reduction in import bill was largely a result of reduced purchasing power, given the depreciation in SDG/USD parity in the parallel exchange rate market and Government of Sudan's (GoS) initiative to introduce an incentivized exchange rate, close to the parallel market exchange rate, for banking transactions. The resultant sluggish domestic demand, in addition to the existing import restrictions, allowed the country to post notable improvement in current account deficit.

Table 1: Sudan's Key Economic Indicators

	2015	2016	2017 (E)
GDP Growth Rate (%)	3.0	3.5	3.2
Inflation (%)	12.6	30.5	25.1
External Debt[1] (% of GDP)	81.3	110.8	94.9
Public Debt (% of GDP)	90.5	116.2	99.6
Fiscal Deficit (% of GDP)	(1.7)	(1.6)	(1.8)
Current Account Balance (% of GDP)	(7.7)	(6.1)	(2.8)

Source: IMF, CBoS

[1] *Based on GDP estimated at the weighted average of the parallel and official exchange rate*

As per GoS reported figures, the fiscal deficit stood below the budgeted target of 2%. However, as per the IMF the fiscal balance is distorted, as several subsidies are recorded at the official exchange rate, which is considerably overvalued. Adjusting for the exchange rate difference, the deficit increases to ~6.5%. The country's gross reserves remain very low, at USD 1.1bn, covering less than 2 months of exports.

As per the approved budget for 2018, the fiscal imbalance is envisaged at 2.4%, which has been calculated on the basis of devalued exchange rate parity of 18 SDG/USD, made effective as of Jan'18; this is still overvalued in comparison to the incentivized (banking channel) exchange rate of ~30 SDG/USD and parallel market exchange rate of ~34 SDG/USD. The increase in official exchange rate, in combination with reduction in fuel subsidies, translated into a sharp increase in inflation – YoY inflation reached 54% in Feb'18 - and speculative overshooting of exchange rate parity in the parallel market in Q1'18, albeit it has since been controlled. Going forward, the government plans to continue moving towards exchange rate liberalization in a phased manner.

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.

In May'17, a National Consensus Government, which includes opposition parties, was formed in accordance with the conclusion of the National Dialogue held in 2015-16. Furthermore, development of a new constitution has also been planned. Later in Oct'17, the sanctions imposed by the United States of America (US) were revoked, albeit the country still remains on the State Sponsors of Terrorism List (SSTL). Removal from the SSTL is essential to get access to US aid, which can allow the country to progress towards debt relief. Financial support from GCC countries continues, with the latest support coming from United Arab Emirates, in the form of a deposit of USD 1.4bn in Q1'2018.

The country's growth is expected to increase slightly in 2018 to around 4%, on the back of growth in agriculture and mining sector activities. Given the heightened inflation, continued twin deficits and uncertainty over debt relief, we expect the politico-economic risk profile of the country to remain high.

…… Banking Sector

The Sudanese banking sector comprises 37 banking institutions, all of which operate in accordance with Shari'a principles. The sector features considerable concentration at the top, with the largest three banks holding close to 60% of the industry deposits. Average return on equity in excess of 38% over the past three years is indicative of strong profitability; albeit real returns have suffered as a result of currency depreciation and high inflation. During 2017, the regulatory risk, on the sector has increased following strong regulatory actions against management of various banking institutions, on account of irregularities in foreign currency transactions. As a result, some of the banks have suffered reputational damage.

Overall capitalization of the sector is considered adequate, given that CAR exceeds 20%[2] and overall leveraging of the banking system stands at ~6x. The asset quality of the banking sector has improved, as gross impairment of the sector fell to 4% as of Aug'17, vis-à-vis ~5% previously.

During 2017, as the GoS revised its policy of coupon payment on sovereign securities from in-kind to cash, the implied systemic risk on the banking sector has reduced. Furthermore, given the competitive returns on sovereign securities, these remained the preferred asset placement avenue across the sector. However, in an effort to encourage financing, the CBoS has placed maximum limit on sovereign securities portfolio to not exceed 20% of financings portfolio.

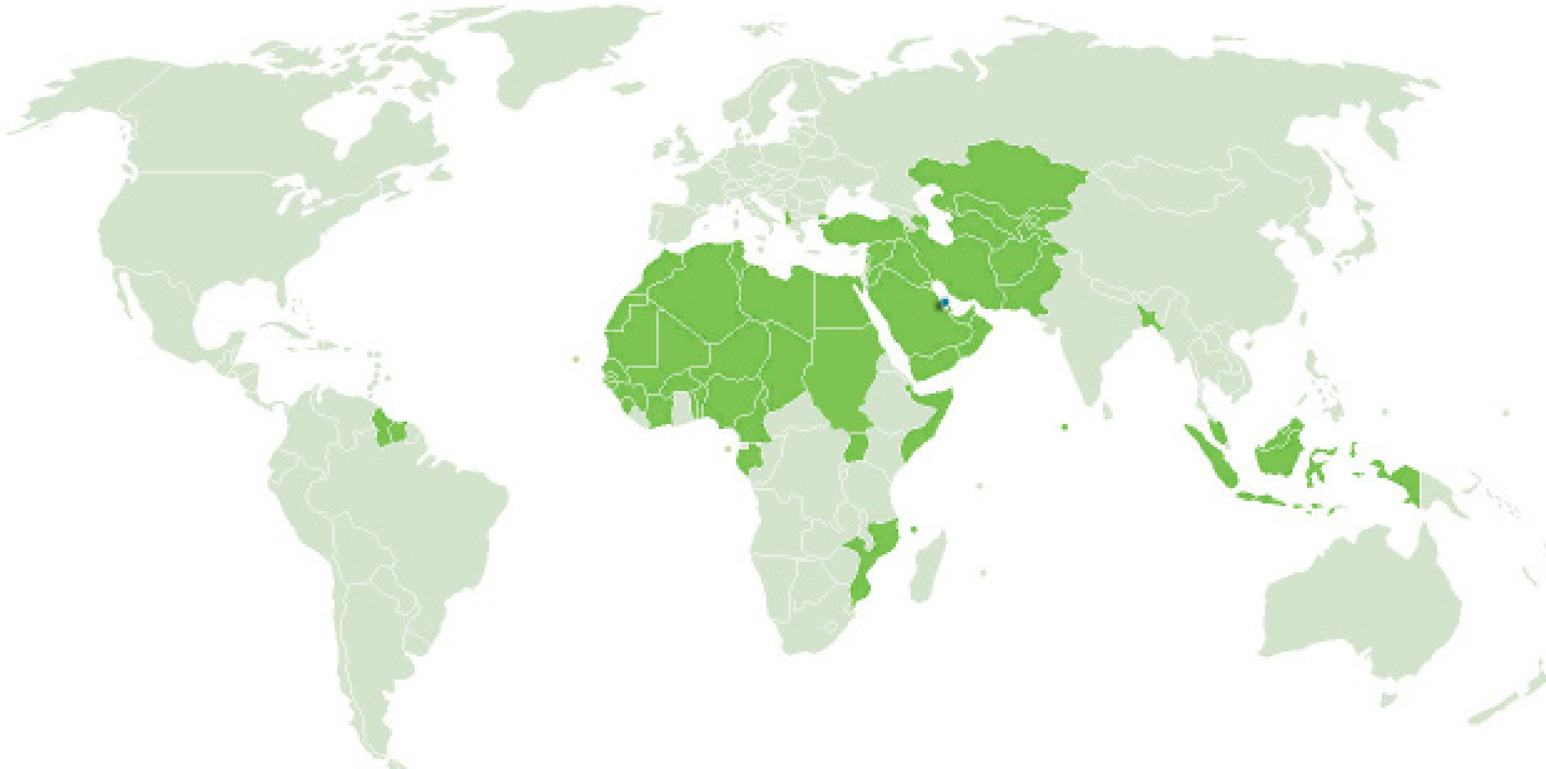
[2] *In accordance with AAOIFI standards, CAR is calculated using an alpha benefit of 50%.*

The sector's financings portfolio grew at an average of 21% over the past three years, albeit its size in relation to the asset base has not changed and remains at 60%. About a third of the financings portfolio represents credit to the private sector. Lately, in a bid to spur economic growth, the CBoS has started 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.

With only about 15% of the population, aged 15 and above, maintaining bank accounts, financial inclusion in the economy is considered to be low. This is largely owing to a lack of banking transaction channels, resulting in a disposition towards cash-based transactions. Cognizant of these deficiencies, the CBoS has issued instructions to banking institutions to deploy at least 200 Point of Sale (POS) terminals each by Dec'18. Furthermore, subsequent to removal of US sanctions, introduction of international payment settlement platforms – such as Visa &Matercard – is also on the anvil, which will help improve the movement of funds.

The Sudanese banking system has benefitted from the recent revocation of US sanctions and removal of the country from the grey list of Financial ActionTask Force (FATF). As per IMF, the sector has made notable progress in addressing AML/CFT deficiencies which has lowered the financial stability risk and eased in restoration of correspondent banking relationships (CBRs).

[5] *Liquid assets include investment deposits, sukuk, cash & cash equivalents and equities (subject to a 20% haircut)*



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