الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

Republic of Sudan

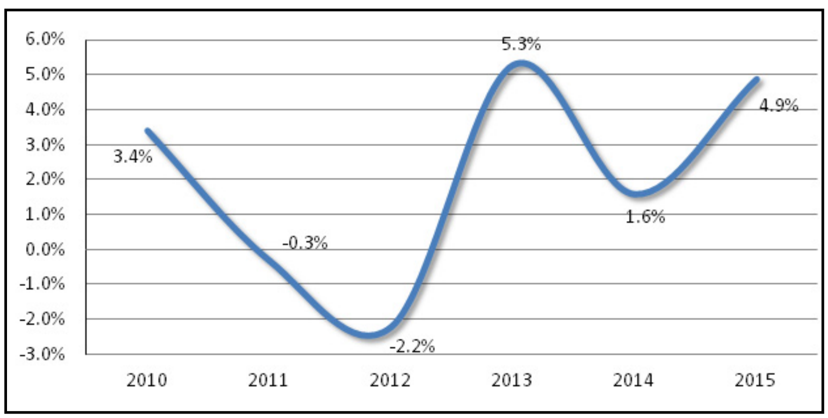
February, 2017

TRUST . TRANSPARENCY . INDEPENDENCE

Sudan is a country situated in North-Eastern Africa with a population of around 40m and GDP per capita of about USD 1,800. The World Bank classifies Sudan among lower middle income countries. Over the years the country has experienced continued social conflicts, including 3 separate civil wars since its independence in 1956; the third civil war i.e. the conflict between South Kurdofan and Blue Nile States, is yet to be concluded. President Omar Hassan al-Bashir, has remained in power since 1989 and was later elected as president in 1996. Subsequently he has been re-elected several times, most recently in 2015, when Mr. Bashir assumed power for another 5 year term. In an effort to reconcile opposition parties, the ruling party announced a 'National Dialogue' (ND) in Jan'14, which was finally commenced in Oct'15. The conclusion of ND suggested the set-up of transitional institutions, with both government and opposition representation, which will approve the general revisions to the constitution. The ND failed to gain traction with major armed groups and parts of opposition.

Table 1: Economic Indicators	2014	2015	2016 (P)
GDP (in USD Billions)	73.8	84.1	-
Inflation (%)	36.9	16.9	13.5
External Debt[1] (% of GDP)	101.3	99.5	120.7
Fiscal Account Balance (% of GDP)	(1.4)	(1.9)	(2.1)
Current Account Balance (% of GDP)	(4.8)	(5.9)	(4.2)
Exchange Rate (SDG per USD)[2]	6.1	6.2	6.8

Financial position of Sudan has weakened considerably over the past decade. The adverse financial position is largely a result of the secession of South Sudan in 2011, in accordance with the provisions agreed in the Comprehensive Peace Agreement of 2005. This secession translated in wide economic imbalances for the country, as oil production from the South comprised about three-quarters of the aggregate production, 55% of the fiscal revenues and about two thirds of the foreign exchange earnings. Given the ensuing external deficits, the country has experienced significant local currency depreciation with SDG/USD rate falling to ~7 in the official market, and ~19[3] in the parallel market, by Nov'16 vis-à-vis 2 as of 2011. In an effort to attract foreign currency denominated deposits to the banking system, the government has allowed banks to offer incentivized rate of 15.9% to depositors. As of lately, Sudan's foreign exchange reserves stood around USD 1b, providing coverage of about 1 month of imports.



Sudan's economic growth showcased improvement during 2015, which was primarily led by non-oil segment whilst oil segment continued to contract. The non-oil segment largely comprises agricultural activities, which reported above average output on the back of favorable climate conditions; however this above average output could not contain the country's external deficit, which widened further as a result of a dip in commodity prices specifically livestock, gold, oil & sesame and higher oil import financing costs reflecting Sudan's high country specific risk. In addition to widening current account deficit, the high oil import financing cost also increased the amount of government subsidies, thus also impacting the fiscal balance. In order to address the twin deficit issue and the high inflation, the CBoS continues to maintain a tight fiscal and monetary policy stance. Lately, in an effort to reduce the fiscal deficit, the government has embarked on an austerity drive, partially reducing fuel subsidies, which has increased fuel prices by 30%. Additional measures included subsidy reduction for electricity and medicines; the latter has caused much furor, with opposition parties lately having staged civil disobedience strikes.

Note: *Economic indicators used herein have been taken from international financial organizations such as the International Monetary Fund and World Bank. Data reported from national sources has been disregarded, due to variation in reported figures and non-availability and staleness in reporting.*

[1] *Based on GDP estimated at the parallel exchange rate*

[2] *Indicative year end exchange rates as reported by Central Bank of Sudan*

[3] *As per unofficial channels*

Given high levels of external and public debt, the country's debt profile is considered unsustainable. With most of the country's external debt being in arrears, the country has limited access to external financing. Lately however, Sudan has been offered some financial support, of USD 2.2b, from GCC nations.

The country's economic outlook remains subject to several politico-economic risks.GDP growth is expected to rise to ~6%, assuming strong agricultural recovery and gradual uptick in oil prices. The government has made some headway in form of ND and improving international relationships. The recent provisional removal of sanctions imposed by the US Agencies in 1997 is being viewed positively, as it depicts a change in international policy towards Sudan. This is expected to ease external trade and attract foreign direct investment, and over time meaningfully impact the country's economic growth. In the meanwhile, the economy continues to bear the additional costs supporting displaced people from South Sudan, ongoing internal conflicts (South Kurdofan & Blue Nile), and political strife among political parties leading to strikes.

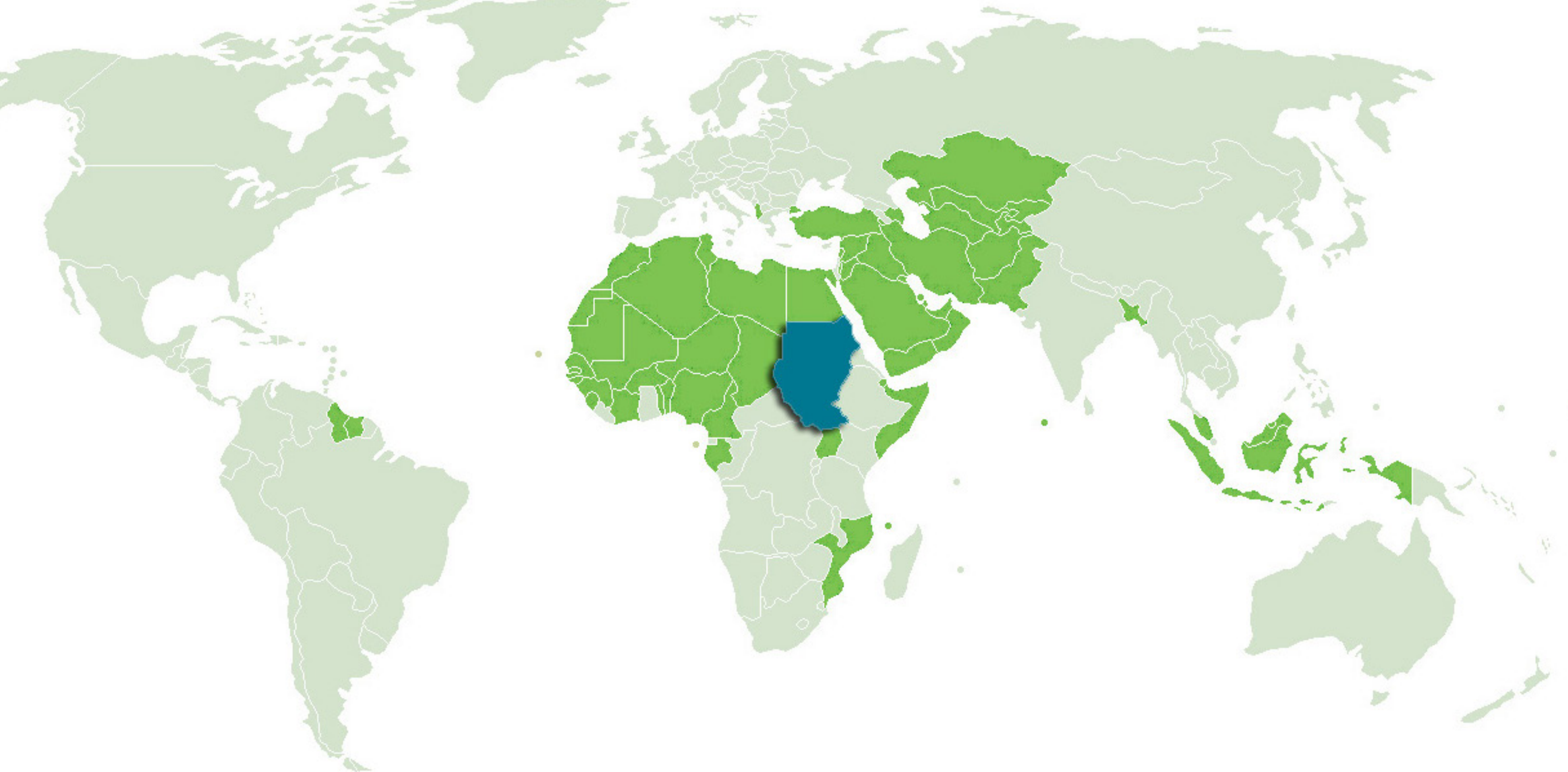
Banking Sector

The Sudanese banking sector comprises 37 banking institutions, all of which operate in accordance with Shari'a principles. With only about 15% of the population, aged 15 and above, maintaining bank accounts, financial inclusion in the economy is considered to be low. Overall financial indicators of the banking system have showcased improvement over time, as evident from increasing CARs and reduced impairment levels as illustrated in Table 4. Nonetheless the increasing risk profile of Government of Sudan (GoS) poses significant risk to the banking sector, as sovereign exposure comprises 35% of the banking sector assets.

Table 2: Financial Indicators	**2014**	**2015**	**Q1'16**
CAR (%)	18.0	20.2	21.0
Liquid Assets to Total Assets (%)	39.1	37.4	35.8
Gross Impairment (%)	7.1	5.1	5.1
Provisioning Coverage (%)	61.0	90.6	85.5
Net Non-Performing to Equity (%)	12.8	3.0	4.0
RoAA (before tax)(%)	4.0	4.0	1.0
RoAE (before tax)(%)	33.7	37.1	8.79

Furthermore, given limited liquidity placement avenues, the sector broadly relies on holding of short-term sovereign securities and placements with the LMF. Profits accrued on these securities are paid in form of additional issuances. Given that a sizable proportion of income of banking institutions emanates from sovereign securities portfolio, the absence of any cash based returns, on these securities, has a direct impact on the earnings risk profile of the banking sector. Furthermore, with the continuing supply of these securities and GoS's increasing credit risk profile, secondary market liquidity of these securities has been impacted. Given that sovereign securities are the underlying asset for the sovereign inter-bank fund i.e. Liquidity Management Fund (LMF), the operations of LMF are also expected to be impacted. As of Dec'15, about 15% of the cumulative asset base of the largest 3 banks in the country, reflected exposure to sovereign securities and LMF. In overview of these developments, the systemic risk of the banking sector has increased.

The recent provisional removal of US sanctions has lowered the operational risks faced by the banking sector, which were particularly highlighted during the recent 'de-risking' measures employed by international banks on account of dealing with countries under sanctions. However, we believe long-term normalization of Correspondent Banking Relationships will only materialize over the medium term horizon, depending on pending review from US Agencies in July'2017. Besides the removal of sanctions, the country has recently been removed from the Financial Action Task Force's (FATF) 'gray list', given the strengthening in Anti Money Laundering / Combating the Financing of Terrorism (AML/CFT) framework.



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