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Monetary Policy for Inclusive & Sustainable Development in Sudan Challenges, Prospects & Policy Options

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Abstract

The paper attempts to identify the challenges and prospects of monetary policy in achieving inclusive and sustainable development in the post of December 2018 revolution (Freedom, Peace, Justice) era, and it focuses on certain pillars that could make our policy stance more relevant to achieve its goals towards inclusive development, especially the ultimate objective of monetary policy in curbing inflation and achieving price stability, to be instead more pro-employment to ensure inclusive and sustainable development in Sudan.

The paper uses the descriptive analytical approach and seeks to explore the potential options for the Central Bank of Sudan (CBOS) to rethink along with more flexibility in balancing inclusive development objectives – without undermining price stability. It also identified and discussed major challenges to the conduct and implementation of monetary policy which undermine the effectiveness of monetary policy to include the presence of huge informal economy, monetary expansion, reflecting fiscal deficit monetization and exchange rate devaluation, limited fiscal resources, poor budget priorities, external sector imbalances, weak banking sector regulatory framework and governance, and inclusion of Sudan in the State of Sponsoring Terrorism List (SSTL).

The Paper recommends clear path for homegrown macroeconomic reform which will address the main sources of macroeconomic imbalances and boost inclusive development. To make monetary policy more effective and responsive to inclusive and sustainable development in Sudan, the paper, also recommends the transitional government must play a central role in coordination between CBOS and Ministry of Finance and Economic Planning (MOFEP) to ensure greater harmonization of monetary and fiscal policy to achieve the desired impact on the real productive sector.

Key Words: *Sudan, Monetary Policy, Inclusive and Sustainable Development, Economic Reform, Informal Economy.*

Acronyms and Abbreviations

CAR	Capital Adequacy Ratio
CBOS	Central Bank of Sudan
CBS	Central Bureau of Statistics
CIC	Currency in Circulation
FDI	Foreign Direct Investment
FFC	Forces for Freedom and Change
GDP	Gross Domestic Product
IFIs	International Financial Institutions
IMF	International Monetary Fund
PRSP	Poverty Reduction Stagey Paper
LDC	Least Developed Country
MOFEP	Ministry of Finance and Economic Planning
MCPs	multiple currency practices
NHBPS	National Household Budget and Poverty Survey
NPLs	Non-performing Loans
OMOs	Open Market Operations
SDGs	Sustainable Development Goals
SMP	Staff-monitored Program
SSTL	State Sponsors of Terrorism List
SRF	Sudanese Revolutionary Front
TSA	Treasury Single Account

[1] The views expressed in this paper are those of the author and do not necessarily represent the views of the Central Bank of Oman (CBO).

TMC	Transitional Military Council
WBG	The World Bank Group
QFAs	Quasi-fiscal Activities

Country Context in the Post December 2018 Revolution Era

Sudan is a low-income country boasts a wide variety of natural endowments and has the potential to become a dynamic economy and a breadbasket for the Arab world and East-Central Africa. The country is endowed with large oil and mineral endowments as well as tremendous under-utilized natural assets in agriculture (e.g. fertile land, labor force, water resources and irrigation infrastructure) that potentially provide a good basis for inclusive and sustainable development. Sudan is also located at the cross roads of the Arab world and East-Central Africa, and provides transit to the Red Sea maritime route. Strong markets for Sudan's products are in close proximity (e.g. livestock export from Sudan to the Middle-Eastern neighbors). In addition, Sudan has potential in terms of mineral wealth (e.g. oil, gold, etc.) for which there is high global demand.

In April, 11th, 2019 Sudanese peaceful revolution deposed President Omar al-Bashir and his regime after thirty years in power. The Transitional Military Council (TMC), which took over following al-Bashir overthrown, and the Forces for Freedom and Change (FFC) reached an agreement on the Political Declaration for the transitional period on July 17, 2019, followed by an agreement on the Constitutional Declaration. A new civil-led was formed in mid-August 2019 to lead the transition phase over the next three years. The transitional period has extended again after the signature of the deal with a coalition of armed groups called the Sudanese Revolutionary Front (SRF) on August 31, 2020 in Juba, capital of South Sudan.

Regime change has created a window of opportunity for fundamental reforms by the Transitional Government. However, the road of Transitional Government to achieve inclusive and sustainable development has been hampered by a number of numerous country-specific challenges that render Sudan's experience unique from other post-conflict countries in the region. These challenges triggered by the former regime heavy legacy, huge informal economy, Sudan's inclusion in the state sponsors of terrorism list (SSTL) by the United States since August 1993, political dynamics and tensions, foreign direct investment slowdown, heavy debt burden, U.S. sanctions, limited access to foreign financing.

Sudan faces macroeconomic crisis, rampant inflation, massive currency devaluation, twin deficits phenomenon, and rapidly increasing arrears on international debt. The economy contracted by 2.5 percent in 2019 after contracting by 2.2 percent in 2018 and is expected to slow sharply in 2020 due to the COVID-19 pandemic. The fiscal deficit has deteriorated (10.8 percent in 2019, and may be more than 20 percent in 2020) because of ballooning fuel subsidies (account for 79 percent of total subsidies), and weak revenue mobilization (COVID-19 has reduced revenues by 42 percent). The deficits were financed mainly by monetization, generating substantial inflation (254.3 percent in November 2020, and 143 percent as period average), and parallel exchange rate depreciation (The parallel market exchange rate depreciated from SDG85/$ in December 2019 to SDG 250/$ in November 2020). The said depreciation is mainly due to destabilizing speculations in the foreign exchange market. However, Speculations in the foreign exchange market are expected to be quite destabilizing and detrimental as long as Sudan is in the SSTL.

The Transitional Government has implemented a number of painful, but necessary packages for economic adjustment and actions for Restoring macroeconomic stability and promote inclusive and sustainable development following the overthrown al-Bashir regime. These reforms aim to improve the country's economic and financial conditions that deteriorated for more than three decades. The main objectives of these reform packages is to restoring macroeconomic stability, improving the business-enabling environment, and providing social protection for the most vulnerable as the economy transitions to a higher growth path. To achieve this end, The Transitional Government has reached an agreement for Staff Monitored Programs (SMPs) in June 2020. The program has provided the authorities with comprehensive frameworks to design and implement policies and reforms to address economic challenges, and to stabilize the economy through tight fiscal and monetary policies, and tax policy, and public financial management.

The Transitional Government had made strong policy response to contain the deterioration of economic conditions, while protecting the poorer segments of the population from becoming destitute. The said reforms will support the Transitional Government endeavors to continue its economic recovery and build the foundation for a broad-based diversified economy. Up to date a remarkable progress has been made towards restoring macroeconomic stability, containing fiscal deficit, reducing inflation and promoting economic growth.

In the same context, the Central Bank of Sudan (CBOS) Policies were aligned with the Transitional Government budget guidelines for the year 2020 and the Economic Plan for FFC focusing on achieving economic stability by curbing inflation, reducing the balance of payments disequilibrium to a sustainable level and stabilizing exchange rate through foreign exchange regulations, creating a conducive environment to achieve financial stability and efficiency in mobilizing resources and national savings to finance economic activity, assist in the development of capital markets to attract local and foreign capital flows to achieve sustainable economic growth. Moreover, the CBOS policies intended to enhance the microfinance programmes as a tool to accelerate the pace of the socio-economic development process and alleviate poverty.

The Transitional Government is in the process of formulating a full Poverty Reduction Strategy Paper (PRSP) based on the new National Baseline Household Survey (NBHS) and expected to be completed by end-2021 according to Sudan's Central Bureau of Statistics (CBS) project plan. The PRSP aiming at addressing on-going and emerging challenges for meeting the Sustainable Development Goals (SDGs) for poverty reduction and service delivery in the rural-urban continuum.

To accelerate further progress in the Sustainable Development Goals, the PRSP will aim to increase not only the rate of economic growth but also the share of income going to the proportion of people living in extreme poverty along the rural-urban continuum. The PRSP design will take into account the continuum along which extreme poverty is located. The PRSP will reiterate the Transitional Government commitments to improve service delivery and fostering of job creation to possibly offer inhabitants better livelihoods that helps reduce both urban and rural poverty.

The Transitional Government has exerted many efforts resulted in substantial commitments for recovery and development to implement Peace Agreement, and looking for looking towards a brighter future to share economic growth for all. The peace agreement between Sudanese Transitional Government and the Sudan Revolutionary Front (SRF) has signed on August 31, 2020 in Juba, capital of South Sudan. Although there is a long road ahead to achieve sustainable peace and formidable challenges remain, the hope is Sudan can turn the page on decades of war that has left hundreds of thousands dead and millions displaced.

On the external front, the Transitional Government officials have exerted many efforts to remove Sudan from the SSTL to pave the way for intended reform agenda; they have recently conducted negotiations with the U.S. government officials in Abu Dhabi in September 2020, in the wake of the approval of the Transitional Government in August 2020 to repay $335 million for the families of victims of terrorist attacks that the former Sudanese regime played a role in supporting two decades ago.

Accordingly, the U.S President tweeted on October 19th, 2020 "Trump has said the United States will remove Sudan from SSTL after the Transitional Government paid compensation of $335 million". This decision aimed at rewarding the Transitional Government for its efforts and willingness to work cooperatively with the United States on counterterrorism to enhance the security of both countries, in addition to its an increasing role in bolstering global peace.

The de-listing is a key precondition for Sudan to get its economy back on the comprehensive reform track and to boost Sudanese economic performance, which will in turn help to protect the democratic transition from any internal or external risks. Once Sudan is off from the SSTL, the CBOS is expected to formulate its monetary policy in a way to enhance the inclusive development.

I. Introduction

1. Monetary policy is one of the available tools for macroeconomic management. It aims at controlling the growth of monetary aggregates and assists other policy tools to achieve macroeconomic goals of law inflation, balance of payments viability and sustainable output growth. It is generally believed that monetary policy works with fiscal policy to boost the overall macroeconomic objectives.

2. However, Despite GDP expanding more than seven times since 1960, Sudan's economic growth has not been inclusive. While growth has averaged 3.9 percent per year since 1960, it has been volatile with a standard deviation of 140 percent. It has also depended mainly on natural resources-agriculture until 1999, oil until 2011, gold, agriculture and livestock since 2011 up to date. While a big leap in real income occurred in the late 1990s and 2000s when oil production and prices were rising and some degree of macroeconomic stability was restored, Sudan entered the post-oil, post-secession period still in a precarious situation

3. The experience has shown that the inability of economic policies in Sudan to achieve inclusive and sustainable development to ensure high employment, equal opportunities, and tackle inequality will enhance elimination of extreme poverty in the economy. Therefore, monetary policy can be conducted efficiently in an economy to achieve inclusive and sustainable development that will reduce unemployment and extreme poverty to guarantee equal opportunities and shared growth for all in the economy.

4. Development must be inclusive and sustainable in Sudan. For ethical considerations of equity, fairness and justice, development must be shared and should be inclusive across different segments of populations and regions. Economic and other shocks hurt the poor and the vulnerable most, and development that results in high disparity is unacceptable. Development with persisting inequalities in Sudan may endanger social peace, forced the poor and unemployed people into criminal activities, forced children to undesirable labor, resulting in in a waste of vast human capital that would otherwise be used productively in creating economic output for sustainable development.

5. The slow and even pace of macroeconomic recovery in Sudan after the secession of South Sudan in July 2011 highlights the need to reconsider macroeconomic policy thinking. There is the need for changing policy makers conventional thinking in the wake of December 2019 revolution, especially the role of monetary policy “curbing inflation and achieving price stability” to be, instead, more pro-employment to ensure inclusive and sustainable development. This is very crucial for the Central Bank of Sudan (CBOS) to broaden the scope and mandate of monetary policy in order to promote inclusive and sustainable development, employment and decent work for all as per Goal no. (8), the 2030 sustainable Development Goals (SDGs).

6. Section (6) of the CBOS Act 2002 amendment 2012, specified the main responsibilities of the CBOS in achieving stability of prices, maintaining stability of the exchange rate, efficiency of the banking system and issue of currency of the types thereof, organize, control and supervise the same. Formulating and implementing monetary policy, depending on the first place on the market forces in such a way to achieve the national objectives of the national macro economy in consultation with the Minister, Minister of Finance and Economic Planning (MOFEP).

7. This paper looks at the role of monetary policy in achieving inclusive and sustainable development in Sudan in the aftermath of the December 2018 revolution (Freedom, Peace, Justice), and it focuses on certain pillars that could make our policy stance more relevant to achieve its goals towards inclusive development. The rest of the paper consists of five sections. Section II presents a brief discussion on the operational framework of monetary policy and its objectives, and proposals to adopt multiple monetary policy mandates. Section III outlines the challenges of monetary Policy in achieving inclusive and sustainable Development. Section IV points out the prospects of monetary policy in inclusive growth and what is missing. Section V concludes, making some policy recommendations and Section VI is the way forward of the paper.

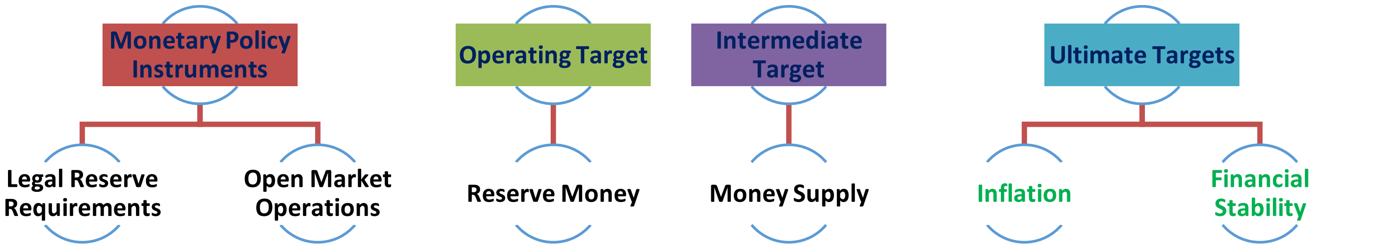
II. The Operational Framework of Monetary Policy

8. The CBOS conducts its monetary policy under a fully-fledged Islamic banking system. Under such a monetary framework, the debt-based monetary policy instruments cannot earn a positive rate of return through interest and cannot be discounted in a secondary market. However, equity-based securities can be traded in the open market, with trading values reflecting market expectations of economic performance, and rates of return. Accordingly, the CBOS relies on Islamic modes of finance and equity-based instruments issued by the government and the Central Bank to provide interbank and credit facilities. In addition, the CBOS employs quantitative control by fixing caps on banks finance to government and imposing unremunerated reserve requirements.

9. Monetary policy objectives are clearly set out in the Article of Agreement VI of the International Monetary Fund (IMF). Monetary policy is one of the available tools for macroeconomic management. Therefore, the objectives of the monetary policy under the Islamic banking system in Sudan and Conventional banking system may not differ much from each other, as they are both focusing on maintaining price stability, maintenance of a balance of payments equilibrium, promotion of employment and output growth, and sustainable development. However, the main difference comes in the mechanisms and instruments available to the Central Bank to conduct monetary policy.

10. The main objective of the CBOS is to maintain price, monetary and financial stability by achieving low inflation rates. This can be attained by targeting the growth rate of the money supply (M2) which represents the intermediate target of the CBOS monetary policy. To target M2, the reserve money is used as the operational target. However, the CBOS also has other objectives, including providing adequate liquidity to the economy in order to achieve the targeted GDP growth rate, enhancing the contribution of the private sector in the economy through increased bank financing especially to the productive sectors, and, more importantly, achieving stability of the exchange rate within a managed float framework. The below summarizes the monetary policy framework in Sudan.

Figure (1) Monetary Policy Framework in Sudan.



11. Accordingly, to make monetary policy more responsive to inclusive and sustainable development, there is the need to revise the scope of CBOS monetary policy from a narrow focus on mandate price stability to dual mandate encompassing price stability as well as inclusive development.

12. CBOS tends to adopt policies that maintain economic stability, induce positive economic growth, maintain price and exchange rate stability and alleviate poverty. In his pursuit to achieve the said macroeconomic objectives, the CBOS manages the liquidity to meet the requirements of economic activity without creating inflationary pressures. This could be done by focusing on the direct and indirect monetary policy instruments, such as open market operation (OMO), statutory reserve, internal liquidity, the inter-bank market and cost of finance.

13. To achieve monetary policy objectives, the CBOS uses a combination of monetary policy instruments. These instruments include open market operations (OMOs) and legal reserve requirements. With respect to the OMOs, the CBOS employs different types of Shari'ah-compliant securities as means to absorb or inject liquidity in the banking system in line with the adopted contractionary or expansionary monetary policy respectively. Furthermore, the CBOS often provides various incentives to banks in the context of moral suasion to induce desired responses in certain policy-related issues.

14. With respect to the reserve requirements, it represents a cornerstone in conducting monetary policy by the CBOS with the absence of conventional policy instruments such as discount rate in the fully-fledge Islamic banking system in Sudan. The legal reserve ratio increased from 14 percent of demand and saving deposits in 2004 to 18 percent in 2013 and remained constant afterward. This increase in the reserve requirements aimed at restricting banks' lending and controlling the growth of monetary aggregates, and thus easing inflationary pressures in the economy. It is worth noting that the CBOS does not currently provide any remuneration on the banks' required reserves held at the Central Bank. Moreover, similar legal reserve ratios are applied on both local and foreign currency reservable deposits (demand & margin deposits).

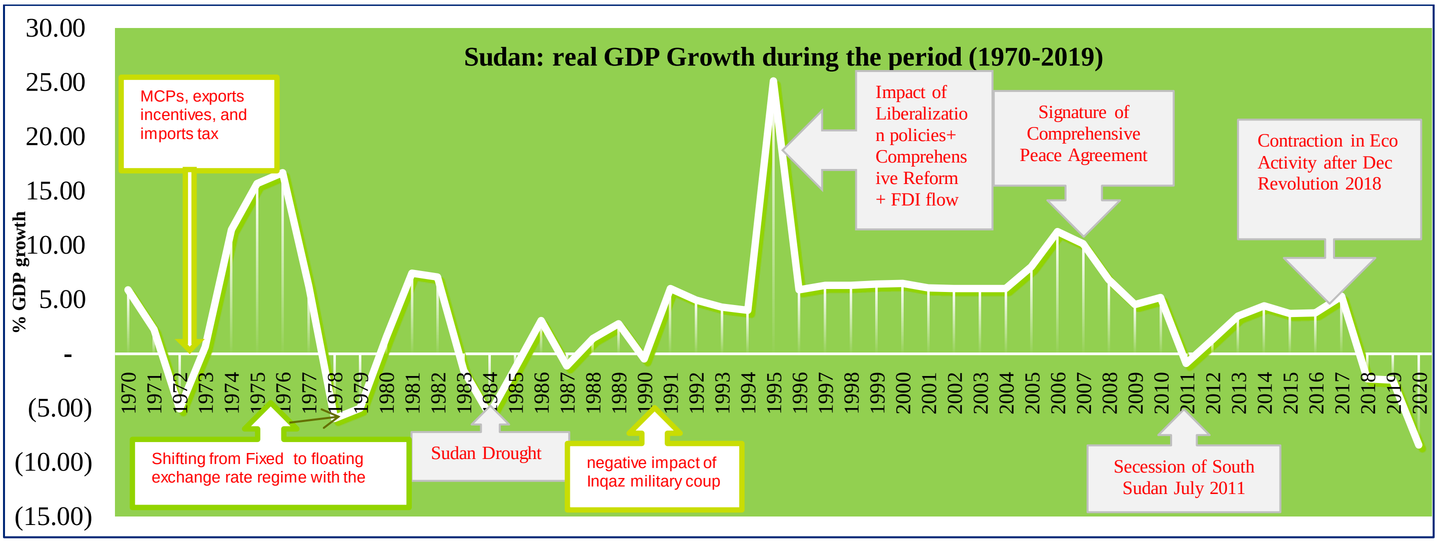
15. From an operational perspective, there are various challenges facing the conduct of monetary policy under the Islamic banking system in Sudan. The lack of short-term securities is considered a key challenge that may undermine the effectiveness of monetary policy. Furthermore, the shallow capital and financial markets have negatively affected the liquidity management in the banking system and the economy at large. In this regard, development of adequate toolkits for money market trading and central bank credit facilities are necessary to dampen inflationary pressures and improve the effectiveness of monetary policy and banks' liquidity management. More importantly, the negative effects of externalities inclusive of the South Sudan secession in July 2011 and unilateral economic sanctions and inclusion of Sudan in SSTL since August 1993 are counterproductive factors for economic development and financial stability.

III. Challenges of Monetary Policy in achieving Inclusive and Sustainable Development in Sudan

16. The monetary policy plays an important role in maintaining price stability and achieving inclusive and sustainable development in Sudan. This is supported by the evidently positive correlations between monetary growth with both inflation and real output growth. In this regard, the CBOS uses a combination of monetary policy instruments to achieve the desired monetary policy targets of inflation and economic growth. Towards this end, there are some challenges need to be addressed to strengthen the monetary policy framework and enhance the effectiveness of adopted monetary policies. These challenges constrain the monetary policy role to influence the Sudan economy and therefore constitute a serious obstacle to achieve the inclusive development.

17. Despite GDP expanding more than seven times since 1960, Sudan's economic growth has not been inclusive. While growth has averaged 3.9 percent per year since 1960, it has been volatile with a standard deviation of 140 percent. It has also depended mainly on natural resources-agriculture until 1999, oil until 2011, gold, agriculture and livestock since 2011 up to date. While a big leap in real income occurred in the late 1990s and 2000s when oil production and prices were rising and some degree of macroeconomic stability was restored, Sudan entered the post-oil, post-secession period still in a precarious situation.

Figure (2) Sudan Real GDP Growth during the period (1970-2019)



Sources: Source: IMF Article IV Consultation, Report 1970 and 2019- CBOS Annual Reports

18. The presence of huge informal economy and the emergence of illegal domestic & foreign transactions since long (UNDP 2018 estimates it at more than 60 percent of GDP), which are outside the control of the CBOS. Large quantity of money outside the banking system: currency constitutes a large portion of the money supply in the economy, because most transactions are carried out on 'cash – and – carry basis". The money owned by banks collectively constitutes a small percentage of cash in circulation. Since this money balances are small in relation to the cash available in the economy, this limits the effectiveness of monetary policy. As of August 2020; Currency in Circulation (CIC)/M2= 40.4 percent, M2= 924.1 billion; (CIC= 327 billion, of which 91 percent currency with the general public, and only 9 percent with banks). This process limits the banks' extent to create credit facilities to the people in need in the economy and also makes inflation control by CBOS difficult.

Table 1: Currency in Circulation (CIC), Currency with banks and currency with the general public in SDG million as of (2012-June 2020)

Year	2012	2013	2014	2015	2016	2017	2018	2019	June-2020
CIC	17,870	20,413	25,060	29,340	40,904	65,241	113,922	295,274	378,872
Currency with banks	1,118	1,234	1,717	1,845	2,192	3,786	1,089	13,938	32,852
Currency with the general public	16,751	19,178	23,343	27,495	38,712	61,455	112,832	281,336	346,019
%Currency with banks/ CIC	6	6	7	6	5	6	1	5	9
%Currency with the general public / CIC	94	94	93	94	95	94	99	95	91

Source: Central Bank of Sudan Annual Reports, Policies, Research & Statistics Department.

19. Mismanagement of Gold Production in Sudan has played a key role in presence of huge informal parallel foreign exchange market since 2010 up to date. The experience has shown that the supply of foreign currency in the parallel foreign exchange market in Sudan comes from five sources: smuggling of exports, trade mis-invoicing "under-invoicing of exports, over-invoicing of imports", foreign tourists, remittances of nationals working abroad, and diversion of foreign currency from official to the parallel market through

corruption. However, the major source of supply of foreign currency in the parallel market is the huge smuggling of gold.

20. The following peer comparison reveals Sudan's ranking is the third largest producer as of (2010-2019); but exports proceeds/volumes are too small because of smuggling of Artisanal miners Gold outside the Sudan to main Sudan's trade partners.

Table 2: Peer Comparison: Gold Production & Value of Exports U.S million as of (2010- 2019)

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Gold Production Ghana	76	82	86	134	137	125	124	127	127	130
Value of Exports U.S million	3,803.5	4,920.2	5,643.3	4,965.7	4,388.1	3,212.6	4,919.5	5,786.16	5,461.38	5,922.8
Gold Production SA	188	180	155	160	151	145	142	136	117	101.3
Value of Exports U.S million	8,268	10,326	9,300	7,282	6,029	4,161.05	4,047.9	4,445.1	3,736.5	3,892.7
Gold Production Sudan	29.3	38	40	70	73.3	82.3	93.4	107.3	93.6	100
Value of Exports U.S million	1,018	1,441.7	2,158.0	1,048.4	1,271.3	725.5	1,043.8	1,558.5	832.2	1,222.8

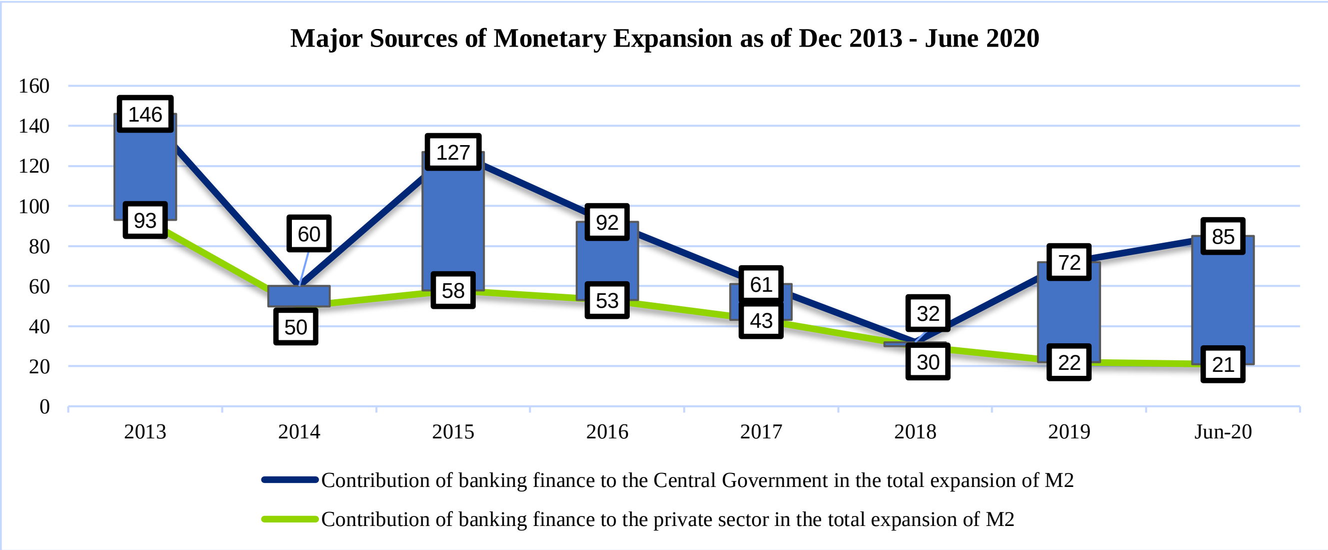
Source: Central Bank of Sudan Annual Reports, Policies, Research & Statistics Department, & Global Gold Council & Annual Reports for SA & Ghana.

21. Major Drivers of Gold Smuggling, which are hinder the effectiveness of monetary policy to achieve its goals, include Weaknesses in regulatory framework of natural resources management in Sudan. Other regulatory restrictions; Gold Council members and Jewelry Traders are the sole buyers of Gold from all miners. Lack of organized & transparent market for gold trading. Lack of fair price from CBOS to Artisanal miners. Before new regulations (in January MOFEP started allowing private sector to purchase and export Gold). CBOS bought Gold at the discount of global rate, as a result around 70 percent on average of it was smuggled abroad. The distribution of smuggled Gold among the states reveal that the sates with bigger share of smuggling are those with armed conflicts.

22. Sudan's total revenues are low and declining. Limited fiscal resources, poor budget priorities, and macroeconomic imbalances hamper inclusive development. Government revenue is low (particularly tax revenue at 6.3 percent of GDP in 2019), thereby limiting resources for social spending and investment in infrastructure critical for private sector growth. The fiscal deficit has deteriorated (10.8 percent in 2019, and may be more than 20 percent in 2020) b/C of ballooning fuel subsidies (account for 79 percent of total subsidies), and weak revenue mobilization (COVID-19 has reduced revenues by 42%). The deficit were financed mainly by monetization, generating substantial inflation (254.3 percent in November2020, and 143 percent as period average), and parallel exchange rate depreciation (The parallel market exchange rate depreciated from SDG85/$ in December 2019 to SDG 250/$ in November 2020). However, any excessive increase in the money supply would normally lead to a depreciation of the exchange rate, which increases the price of imported goods and services and thereby raises domestic prices and inflationary pressures.
It worth noting that MOFEP completed the removal of all diesel and gasoline subsidies as of the end of October 2020, it expected to generate savings of 4.5 percent of GDP in 2021 and additional 2.5 percent of GDP in 2022.

23. The fiscal dominance and reliance on central bank financing of the budget deficit is hampering the monetary policy framework in Sudan. Accordingly, a prudent fiscal policy needs to be adopted to support the implementation of monetary policy so as to anchor inflation expectation and achieve price stability.

Figure (3) Major sources of monetary expansion during the period (2013- June 2020)

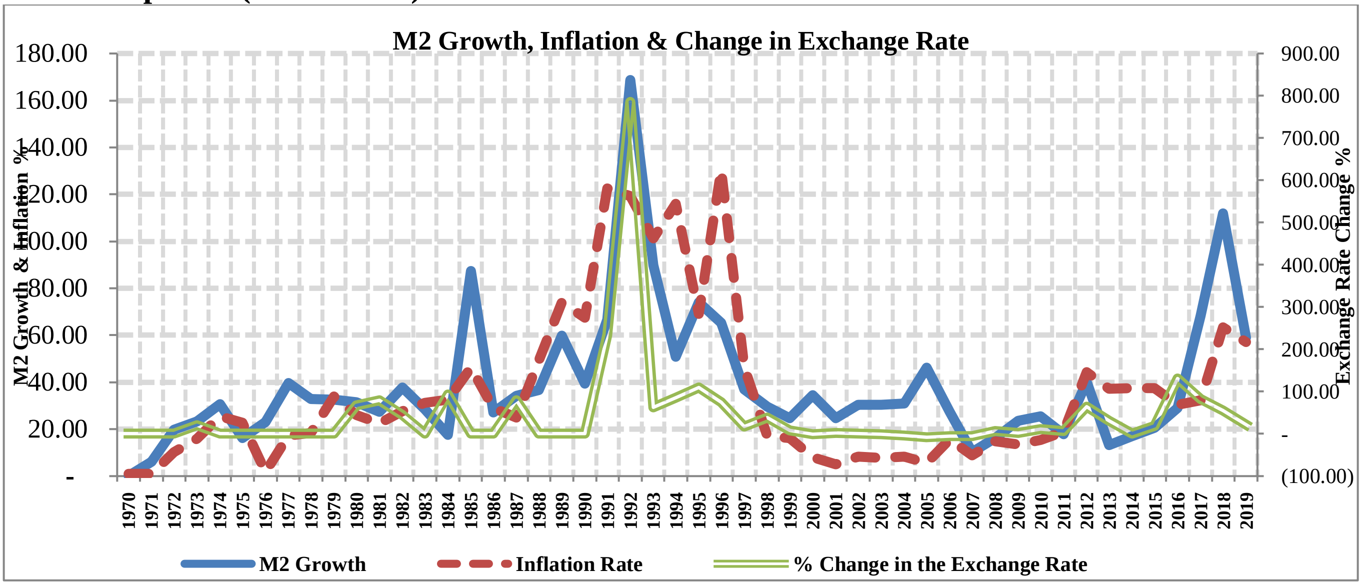


Source: Central Bank of Sudan Annual Reports, Policies, Research & Statistics Department, CBOS

24. Loose policy settings are fueling inflationary pressures. In the 1980s, central bank independence (CBI) emerged as a recipe to avoid the pervasive inflationary consequences of short-sighted electoral ambitions. The authorities urgently need to consider the components of CBI, in the top of them, (i) Appointment procedures of the Head of CBOS, (ii) Limiting lending to Government, (iii) Resolution of conflict between CBOS and other Government units. The below graph shows access to foreign currency at the overvalued official exchange rate for socially sensitive imports leads to quasi-fiscal activities that – result in continued monetization of fiscal needs, higher central bank purchases of informal sector Gold (which in turn provides foreign exchange, including for subsidized and fuel imports) causing monetary aggregates to expand rapidly and increasing inflationary pressures).

25. Macroeconomic instability—including high inflation and foreign exchange shortage—is hampering the effectiveness of monetary policy. Monetary aggregates have expanded rapidly, reflecting fiscal deficit monetization and exchange rate devaluation. The CBOS official and commercial banks exchange rates were devalued frequently since June 2012 up to January 2020. Whereas the parallel/market exchange rate has depreciated considerably (372 percent) since January 2020, while inflation is maintaining an increasing trend, rising from 64 percent in January 2020 to 245.3 percent in November 2020. As a result of monetizing the deficits, inflation is expected to accelerate. The government borrowing from the CBOS during January-November 2020 reached 95 percent of targeted borrowing for the whole year of 2020. However, without accompanying fiscal and monetary measures, the devaluation failed to reduce the premium on the parallel exchange market and the parallel exchange rate reached SDG 250 per U.S. dollar in November 2020. The parallel market continues to dominate, accounting for about 80 percent of all transactions.

Figure (4) M2 growth, inflation rates and percentage change in exchange rates in Sudan during the period (1970 – 2019)

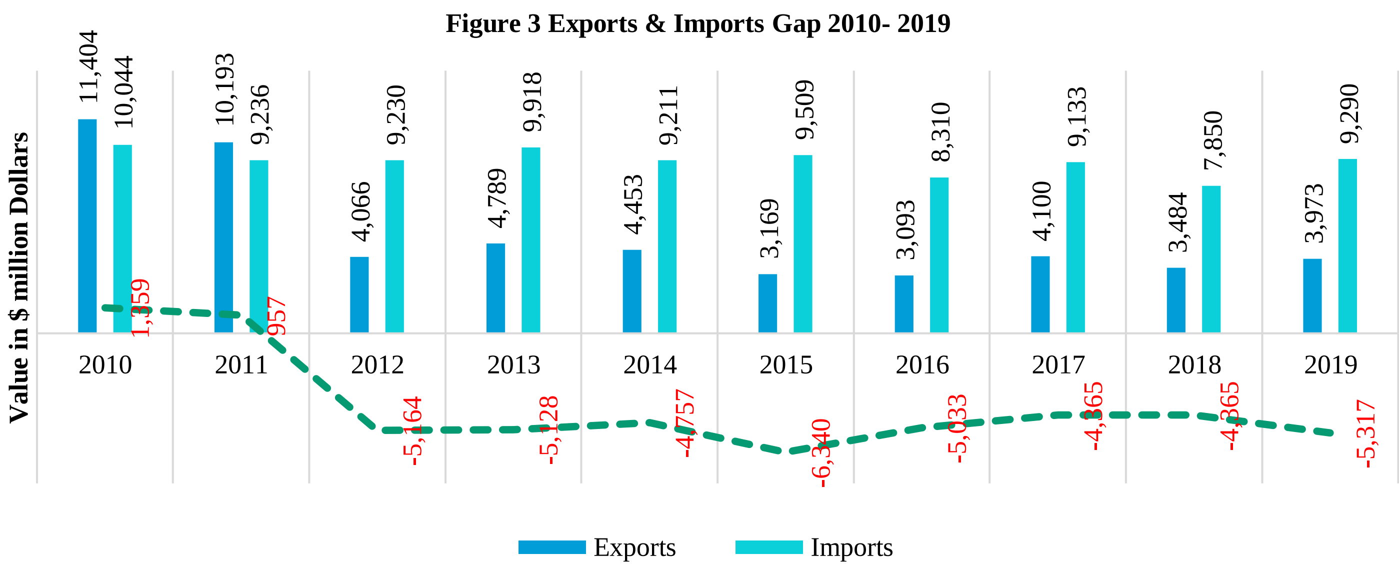


Source: Central Bank of Sudan Annual Reports, Policies, Research & Statistics Department, CBOS

26. External imbalances also worsened in 2019 and are expected to deteriorate further in 2020. Import of goods represented approximately twice the exports. The deterioration in the trade balance reflects lower exports as the agricultural sector was affected by fuel shortages that increased the cost of inputs and affected agricultural production, where Sudan is a net importer. The trade imbalance exacerbates the foreign currency situation, which already suffered from low remittances and foreign direct investment flows. At the same time, gross usable international reserves reached a very low level of $190 U.S million as of December 2019.

The large imbalances have contributed in the exchange rate excessive devaluation and inflation rate as well. As a result, the parallel market exchange rate has depreciated from SDG 85/$ at end-2019 to SDG 2250/$ in November 2020.

Figure (5) Sudan's Trade Balance performance during the period (2010 – 2019)



Sources: Foreign Trade Statistical Digest, Policies, Research & Statistics Department, CBOS.

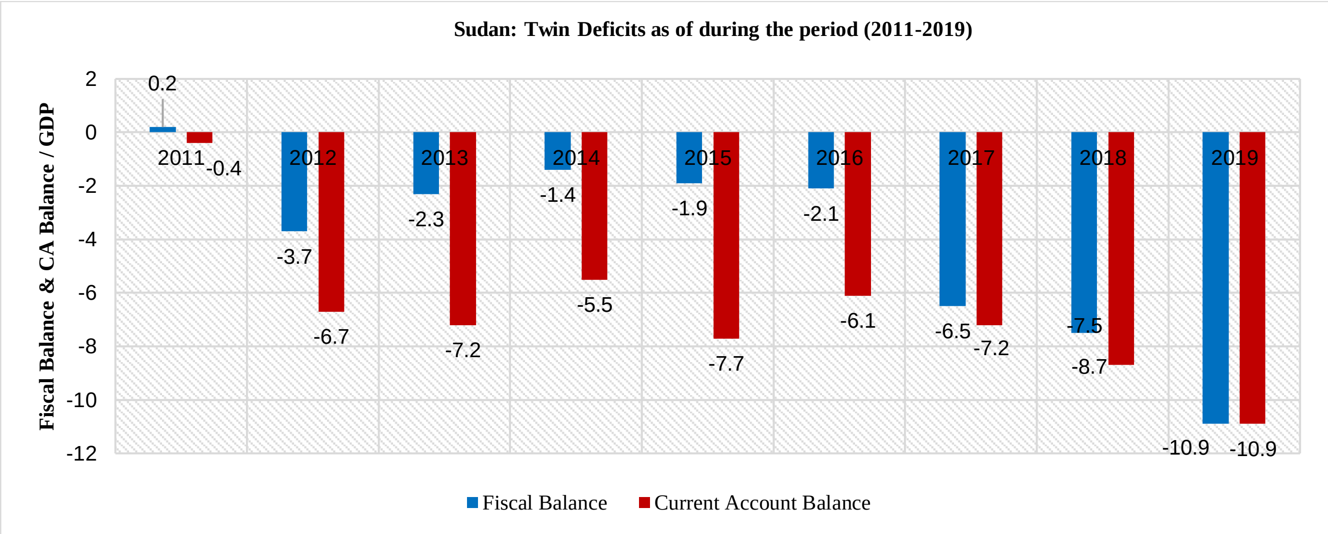
27. Sudan remains on the State Sponsors of Terrorism List (SSTL) since August 1993, which hinders external investments, and currently block progress toward much-needed debt relief and the clearance of large arrears to the International Monetary Fund (IMF) and other International Financial Institutions (IFIs). The

arrears also block access to new financing from the IFIs. Accordingly, Sudanese economy has been negatively impacted as a result of no access to many traditional avenues of external financing support to meet the developmental needs for the Transitional Government.

28. The impact of economic sanction is immense. The inclusion of Sudan in the SSTL continues to pose a significant burden on the on the role of monetary policy to achieve its objectives and constrain Sudan from reaching potential inclusive and sustainable development. Moreover, the exchange rate system remains highly distorted with multiple currency practices as long as Sudan is in the SSTL. The Forex gap is mainly due to destabilizing speculations in the parallel market. However, the said speculations are expected to be negligible following the removal from SSTL, which will in turn help the authorities to formulate sound, polices for the exchange rate reform.

29. The fiscal balance to GDP for Sudan over the last decade has largely been in negative territory during 2011 – 2019. Sudan current account (CA) balance has been in deficit for the last decade. The CA deficit to GDP has fallen largely since the secession of South Sudan in July 2011. The external current account deficit (cash basis) stood at 10.5 percent of GDP in 2019, mainly due to a widening Trade Deficit.

Figure (4) Twin deficits "Trade Deficit and the Government Budget Deficit" in Sudan during the period (1970 – 2019)



Source: IMF Article IV Consultation Reports, CBOS Annual Reports, and MOFEP Annual Budget Reports.

30. Poor Data Quality: poor data quality is a major constraint in the formulation of monetary policy in Sudan. The lack of high frequency data renders econometric analysis difficult. Similarly, weak data base gives rise to parameter uncertainty, which is also undermines the setting of accurate monetary policy targets. At current, there are major shortcomings due to capacity constraints, especially in national accounts and balance of payments statistics. Absence of Foreign Direct Investment (FDI) survey data impairs compilation of the balance of payments. More resources should be devoted to statistics and data collection.

IV. Prospects of Monetary Policy in achieving Inclusive and Sustainable Development in Sudan?

31. It is clear from our previous analysis of the challenges of monetary policy in achieving inclusive and sustainable development. These challenges have played key role in undermining the monetary policy influence the real economic sector of Sudanese economy. However, Sudan is very rich country with natural resources including large fertile agricultural lands, huge amounts of fresh and ground water along with variety of animal resources. In addition, it is distinguished with strategic geographical location which makes Sudan a path to other African countries that makes it one of the commercial and investment inlets of those countries. To make monetary policy effective to achieve inclusive and sustainable development in Sudan will require packages of structural measures to tackle these various issues:

32. Clear path for homegrown macroeconomic reform. Macroeconomic and political stability are critical to generate confidence and facilitate long-term planning for private sector saving and investment, along with Fiscal reforms are critical to address deficit monetization, reduce inflation, and support social and development programs.

- The exchange regime full exchange rate liberalization would substantially increase fiscal revenues. Moreover, exchange rate liberalization is critical for restoring macro stability and strengthening investment and growth. It would bolster competitiveness and transparency, eliminate the multiple currency practices (MCPs) and associated distortions.
- Intensified efforts to strengthen governance and institutions, and curb corruption, would be critical for sustaining public support for the government and reforms.
- Improving access to finance. Reforms to improve access to finance are urgently needed, as getting credit remains one of the lowest rated doing business indicators in Sudan. The authorities are implementing a number of them including expanding microfinance, increasing banking coverage in the countryside, developing agent banking, and strengthening the credit registry/bureau to lower costs of credit.
- Reach out to the diaspora. Encouraging investment by the diaspora would involve reforming the foreign exchange market (to facilitate transfers via official channels) and improving the business environment.
- Increasing female participation in the labor force. Providing opportunities for women to develop their full potential could significantly boost economic growth through increased labor supply. Policies should support equal access to education, support working parents, reduce the gender wage gap, and increase mobility and equal opportunity.
- Investing in human capital through education would improve growth prospects and the competitiveness of the labor force.

33. Clear plans for Sudanese banking system reform; this will require banks' restructuring, merging, amendment of laws and regulations, improving banking system governance and removing major constraints. In order to ensure the successful implementation of monetary policy through the banking system, the corrective actions need to be in place to pave the way to resolve the following challenges:

- The Sudanese banking system is currently composed of the CBOS in the apex as a supervisory body over 37 banks of variant forms of ownership and domain of activities. Four state-owned banks (with 14 percent of total banking assets) operate as specialized banks, focusing on providing credit to targeted sectors, such as agriculture or infrastructure development. Seven foreign banks are registered as branches in Sudan (accounting for 23 percent of total banking assets).Total assets of banking sector were about SDG 505 billion, accounting for 25 percent of GDP, as of December 2019.
- The-banking sector is highly concentrated. The five largest banks account for 55 percent of total assets. Banks operating under full-fledged Islamic banking system.
- The banking sector remains vulnerable with several banks undercapitalized. The CBOS sets the minimum capital adequacy ratio (CAR) at 12 percent of risk-weighted assets, but several banks' CARs have been below the requirement for many years, with some having negative CARs. In addition, the non-performing loans (NPLs) are under estimated since the Central Bank only defines the past due unpaid installments NPLs rather than the whole loan value.
- Weak banking sector governance and regulatory/supervisory shortcomings can deeply affect the system's stability and growth.

34. Monetary policy in the digital age, leveraging technology for better contribution of monetary policy in achieving inclusive and sustainable development.

- The policies should focus at developing and improving the spread of the payment systems and banking technology as well as automating the banking operations throughout the states along with using the latest technology to link the banking system via expanding the latest payment methods , introduction of electronic services using the available innovations in global banking technology, development of infrastructure of the financial sector and integrating with payment system through the integration with the systems of markets financial and institutions.

- The digital transformation of financial sector in Sudan, digital transformation has arrived in the financial sector (banks dominate the sector), the negative impact on economic environment on banking sector since long up to the Covid-19 pandemic, and the small contribution of Sudanese banks in the financial landscape in view of the presence of informal economy, lead inevitably to the quest for transformation processes that enable cost to be reduced and a boost in revenues.
- The digital revolution has changed everything. CBOS needs to react for the digital transformation in the two ways: on the demand side, we have seen massive changes in customers. They feel they need to be connected, everywhere, any time. On the supply side, banking sector is facing greater competition from new players such as Fintech companies, startups.
- Fintech has a real ability to change the structure of financial services in Sudan, making them faster, cheaper, safe and more accessible, especially to the large under-banked segment of the population "Fintech is already touching consumers and businesses everywhere, form a local merchant seeking a loan, to the family planning for retirement, to the foreign worker sending remittances home.
- Fintech-enabled financial inclusion: digital finance is increasing financial inclusion and is associated with efficient monetary transmission mechanism and higher GDP Growth.

35. There is need for greater harmonization of fiscal and monetary policy. Coordination between CBOS and MOFEP to ensure greater harmonization of monetary and fiscal policy to achieve the desired impact on the real productive sector, it should also promote long-term growth, poverty reduction, improve income distribution, financial inclusion, unemployment, education, health care, smart reform of subsidy, high quality infrastructure, and accelerating structural transformation.

V. Conclusion and policy recommendations

36. Regime Change has created space to pursue major reforms to make monetary policy more effective and responsive to inclusive development in Sudan. However, the effectiveness of monetary policy to guarantee inclusive development in Sudan will depend on the ability of the Authorities (MOFEP & CBOS) to pursue urgent reforms, which are include narrowing the fiscal deficit to 2.5 to 3.5 percent of GDP to avoid monetization of the deficit, monetary policy is tightened to contain inflation "moderate inflation is not harmful for growth; nor does it harm the poor; but sources of inflation matter", and Structural reforms are vigorously pursued to boost the business environment.

37. In the same vein, restoring macroeconomic stability through minimizing the reliance of fiscal policy on monetary policy and move forward for greater budgetary discipline. Fiscal consolidation action, including efforts to strengthen tax administration, and treasury single account (TSA) management, also continue with a view to provide more resource to social and productive sectors. In addition, efforts will continue to encourage the private sector led growth, allow greater flexibility in the exchange rate, and promoting exports. On the imports side, the program aims to contain imports and enhance import substitutions. While in the monetary policy front, immediate review of the current monetary policy operational framework should be implemented with objective of targeting lower money growth in order to prevent the current inflation surge.

38. Monetary policy should be tightened to contain rising inflation. Alongside fiscal consolidation, limits on the monetization of fiscal deficits should be reinforced, since this is a key source of inflationary pressures. The CBOS should also actively use all available instruments, including recent and planned sales of CBOS or government securities, and higher reserve requirement rate, to mop up excess liquidity and contain inflationary pressures. At the time of exchange rate reforms, more tightening would be required to prevent the buildup of second round effects on inflation.

39. Monetary policy instruments should be further developed to manage liquidity. Monetary policy is burdened by the government's large financing needs and by quasi-fiscal activities (QFAs) that lead to sizable liquidity injections. These, and a shortage of liquidity management instruments, undermine the central bank's ability to control reserve money. In response, the CBOS should continue to adhere to existing limits on advances to government, curtail QFAs to levels consistent with reserve money and international reserve targets, and develop Shari'a-compliant securities. To enhance transparency, the CBOS should report all lending to government (including payments of letters of guarantees and wheat subsidies) and QFAs as credit to government.

40. Since money growth is a key determinant of domestic inflation, it is necessary to reduce government deficit that will eliminate money printing in addition to securitizing government owned-institutions. Moreover, since inflation is a major source of economic instability, the central bank may adopt a monetary policy that targets inflation. In other words, assessing the current monetary policy is an important prelude to adopting a new monetary policy strategy that is based on inflation and the exchange rate as anchor. To curb inflation, it is critically important to adopt further measures that may strengthen and stabilize the exchange rate system that can shield the domestic economy from foreign and domestic shocks.

41. Regulatory Environment: The Authorities have to enact the right laws and regulations to contain the mounting challenges of the presence of shadow/informal economy in Sudan by filling existing gaps in the laws and regulations by developing a regulatory framework for dismantling the heavy legacy of the former regime, curbing corruption, and enhancing governance The Authorities also have to strike the right Balance between Innovation and Financial Stability (Filling existing gaps in the laws and regulations by developing a regulatory and supervisory framework for new tech-based services).

42. CBOS independence in the revolution age is crucial: (Fiscal dominance has weakened CBOS independence and the credibility of monetary policy, increasing inflationary expectations, and has facilitated the use of multiple exchange rates), monetary policy should be tightened to curb rising inflationary pressures. This can be achieved by immediate review of the current monetary policy should be implemented with objective of targeting lower money growth in order to prevent the current inflation surge. The central bank should also continue to strengthen financial sector soundness and mitigate risks, including through enhanced risk-based AML/CFT supervision.

43. Transitional Government should continue discussions with the U.S. government on the de-listing Sudan from the SSTL. The de-listing is a key precondition for Sudan to get its economy back on the comprehensive reform track and to boost Sudanese economic performance. The de-listing from the SSTL is expected to help the Transitional Government to reestablish macroeconomic stability, create conditions for stronger broad-based and sustainable economic growth, and boosting living standards for Sudanese people.

44. The CBOS should continue to upgrade its capacity to supervise and mitigate financial stability risks. Efforts to restructure remaining weak commercial banks should be completed, and regulatory and supervisory framework further strengthened to achieve the banking sector reform in the post December 2018 revolution era. Moreover, CBOS should maintain the financial stability and soundness of the banking system by achieving the international standard ratios regarding the non-performing loans, capital adequacy, and average administrative costs to total expenses for banks, through the activation of the procedures of surveillance and banking supervision in accordance with the international developments.

45. The Digital Transformation of financial sector is key: The digitalization of financial services will improve and expand provision of financial services. While introduction of innovative technologies for banking regulation & supervision, such as Suptech and Regtech reinforces the case for further improving risk management at Sudanese banks

46. Finding the Right Talent: Authorities have to develop skills of current staff (especially young talents) and hiring people with relevant background to the new functions in the digital age.

47. Communications as a Policy Tool: communicating with the General Public can play a central role in restoring and maintaining trust. An improved communications toolkit may also include behavioral insights, along with the ethical use of techniques such as audience segmentation, made easier in today's social media world. Messages that connect with and are relatable to the intended audiences' needs and interests and are tiered by channels and content can also help to build understanding.

48. The Authorities should continue improving data for more evidenced-based policy making by strengthening institutional capacity to deliver on the production of core data that is of high quality, accessible and timely. Securing political support for quality statistics is vital for effective implementation of macroeconomic reforms. Moreover, Promote greater awareness and transparency and raise the public profile for statistics to mitigate political economy constraints.

VI. The Way forward

49. Increasing agriculture productivity for inclusive and sustainable development that will reduce unemployment and extreme poverty to guarantee equal opportunities and shared growth for all in the economy. The low growth of employment, increasing unemployment and low levels of productivity remain at the core of high and persistent levels of poverty in the Sudan. Sudan has rich agricultural resources but productivity is relatively very low in the farming and livestock sub-sectors. Agriculture continues to be the main source of employment for the majority of the labor force, particularly those in the rural areas.

50. The Transitional Government in its economic plan is committed to agricultural revitalization by improving production and productivity of traditional crops and increasing exports (e.g. sorghum, millet, wheat, cotton, sesame, groundnuts and sunflower). Key policy actions include introduction of modern technology in irrigated schemes; provision of improved seeds, fertilizers, extension services, training, anti-pests, microfinance and agriculture insurance; using electricity in irrigation; and land improvement.

51. Improving the business climate to boost private sector-led growth. Priority will be given to the structural measures needed to improving business environment to stimulate private sector-led growth in the non-oil sector. Key possible areas of focus include automation of tax collection to lowering transaction costs and building basic infrastructure and institutions that help integrate Sudan's disparate markets and reducing distortions. Ensuring efficient and reliable transport route networks throughout the country to widen the market within Sudan while also increasing exports. In addition, prudent financial sector development with a view to provide adequate credit and financial services to appropriate productive sectors that reducing risks and vulnerability.

52. Shifting resources and attention from conflicts to investing in sustainable broad-based development. New opportunities are emerging for Transitional Government to resolve internal conflict through the ongoing negotiated peace agreements with Armed Movements. A comprehensive roadmap for peace was signed with Revolutionary Front in Juba in October 2020. With the ongoing efforts for a lasting and comprehensive peace throughout the country, Sudan has its greatest opportunity in a generation to concentrate on improving the lives of Sudanese, consolidate, and sustain peace needed to build an economic foundation for a diversified, inclusive and sustainable development path.

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