

Sudan Economic Report

GRADUALLY RECOVERING ECONOMIC CONDITIONS BUT CHALLENGES REMAIN NOTABLE

- ▶ The Sudanese economy, which had considerably slowed down in 2009, started to recover again this year. According to IMF estimates and forecasts, real GDP growth is estimated to have dropped from 6.8% in 2008 to 4.5% in 2009 but is expected to rise to 5.5% in 2010 and to remain in the 5 to 6% range during the next five years.
- ▶ Real sector indicators reported mixed performances. Agriculture, an important source for non-oil growth and employment, seemed to have performed well below its potential in 2009 but improved relatively in 2010. Cement production reported an outstanding growth in 2009 and over the first few months of 2010, underpinning the buoyant construction sector activity. Trade and services indicators were uneven.
- ▶ Monetary conditions in Sudan were marked over the past year by a noticeable expansionary policy, a relevant growth in broad money supply and a double-digit level of inflation. Broad money supply (M2) expanded by 20.4% in 2009 and by a yearly 29.0% up to June 2010. Inflation reported an average of 11.3% over the past year.
- ▶ Within the context of the Central Bank's massive intervention on the foreign exchange market to support the national currency, the Central Bank's gross official reserves fell from US\$ 1.4 billion at end-2008 to US\$ 1.1 billion at end-2009, accounting for 8.7% of the broad money (M2) and covering a mere 1.5 months of imports.
- ▶ At the public finance front, a net deterioration was observed in 2009, followed by a relative improvement in the first few months of 2010. The central government deficit to GDP had widened from 1.0% in 2008 to 3.4% in 2009, along with a surge in debt ratios. The IMF forecasts a government deficit of 3.4% of GDP in 2010.
- ▶ The Sudanese banking sector, which remains to date somewhat narrowly integrated with global financial markets, managed to somewhat escape direct global financial crisis spillovers, and posted satisfactory performances until end-June 2010. Measured by total assets of banks in Sudan, banking activity grew by a yearly 23.9% up to June 2010 (16.6% in full-year 2009), with deposits and financing activities growing by 29.3% and 23.6% respectively.
- ▶ Challenges facing the Sudanese economy remain notable. Among those, we mention the need to enhance efforts aimed at creating fiscal room and meet large development needs as well as challenging politico-economic conditions. Any wavering in structural reforms could jeopardize the major gains achieved thus far and would critically put the country's economic outlook at stake.

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Sudan's economy slowed down considerably over the past year but managed to avoid a recessionary trap. Real GDP growth is estimated to have dropped from 6.8% in 2008 to 4.5% in 2009 according to IMF estimates but remained non-contractionary. Despite a small increase in oil production, real oil GDP growth was adversely affected by the significant global crisis spillover effects on oil prices in 2009 and stood at 2.6%. Real non-oil GDP growth is also estimated to have dropped by half to circa 5% last year. A considerable chunk of private investment has been delayed due to a lack of financing and concerns about political risks, while public investment in infrastructure was sacrificed in favor of current spending.

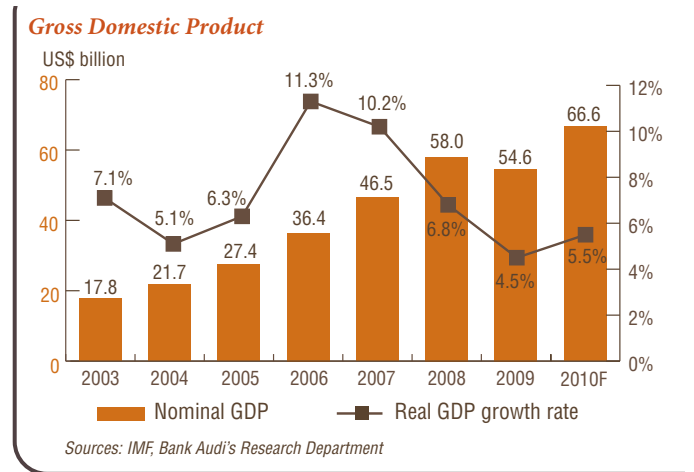
The various real sector indicators reported mixed performances. Agriculture, an important source for non-oil growth and employment (accounting for a third of GDP and 90% of non-oil exports), seemed to have performed well below its potential. Cement production yet reported an outstanding growth, underpinning the buoyant construction sector activity in Sudan, with 622 thousand metric tons of cement produced in 2009, almost 2.5 times the 2008 production level. Trade and services indicators were uneven. While air transport denominated by the number of passengers was up by 30% in 2009, maritime transport contracted by 70% as underlined by the merchandise tonnage at the Port.

At the monetary level, average inflation fell slightly to about 11%, down from 14% in 2008. Money Supply grew by a significant 20.4% in 2009 and by a yearly 29.0% up to June 2010. Within the context of a contraction in net foreign assets, the money supply growth was driven by net domestic assets and more specifically credits to the private sector. Fiscal problems continue to make monetary management difficult, with authorities struggling to shore up the depreciating FX rate. Having strengthened by 10% from August 2009 to June 2010, the local currency has started to somehow depreciate again, as fiscal pressures and political concerns weigh on the currency. Fundamentally, IMF estimates suggest the Sudanese guinea is near equilibrium in real effective terms.

At the public finance level, a net deterioration was observed in 2009. The central government deficit to GDP widened from 1.0% in 2008 to 3.4% in 2009, mainly driven by the significant decline in government revenues from 19.5% of GDP to 16.4% of GDP. Subsequently, public debt rose from US\$ 40.4 billion at end-2008 to US\$ 43.8 billion at end-2009, raising debt to GDP from 69.8% to 80.2% respectively. The IMF forecasts a government deficit of 3.4% of GDP in 2010. The government is actually looking to widen the tax base and reduce exemptions in an attempt to reduce the fiscal deficit. Public spending has yet rebounded in 2010, especially that related to the elections.

At the external sector level, Sudan's balance of payments position deteriorated in 2009 due to adverse repercussions of the global financial crisis. The current account deficit reached 12.9% of GDP as the fall in oil receipts outpaced the decline in the country's imports. Total exports, which used to account for 142% of total imports in 2008, dropped to a mere 92% of imports in 2009. In parallel, weaker than expected foreign direct investment (An estimate of US\$ 3 billion by UNCTAD) and contracting remittances (An estimate of US\$ 3.1 billion by the World Bank) kept the foreign exchange position under pressure. The Central Bank's gross official reserves remained low at US\$ 1.1 billion at end-2009, the equivalent of a mere 8.7% of Money Supply and around 1.5 months of imports.

At the banking sector level, banking activity grew at a significant pace in 2009 despite the global financial turmoil that governed the year. Assets grew by 16.6% in 2009 and by an annualized 23.9% up to June 2010. Deposits, the major driver activity for activity growth, reported a 24.1% growth in 2009 and a 29.3% annual growth up to June 2010. The growth in funding has allowed a considerable rise in bank lending to the private sector despite the global and regional deleveraging phenomenon (18.4% in 2009 and 23.6% in annual terms up to June 2010). Lending quality slightly improved but remains weak, as non-performing loans reported circa 20% of total loans in 2009 (22% in 2008). While activity growth is having a positive quantity effect on banks' bottom lines, the lingering asset quality issue continues to constrain bank return ratios at large.



The detailed performances in the real sector, external sector, public sector and financial sector follow next.

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

After a slowdown in real sector conditions in 2009, Sudan's economy is set to grow at a higher pace in 2010, on the back of strong non-oil growth. As the production of oil, the main source of foreign exchange earnings, is projected to moderate over the medium term, the authorities are directing their efforts at enhancing agricultural production, whose potential is still unexploited, and developing the agro-industry. Construction activity is witnessing a boom within the context of infrastructure rehabilitation, while the services sector is expanding.

1.1.1. Agriculture

Sudan's agricultural sector is an important pillar of the economy, accounting for more than one-third of GDP and employing around 80% of the labor force. In 2009, agricultural exports accounted for 90% of all non-oil exports. Sudan's main agricultural products are cotton, wheat and Arabic gum.

The year 2009 has witnessed a good performance for four crops in Sudan, namely cotton, Arabic gum, corn and groundnuts. Indeed, cotton production increased by 29.7% in 2009 to reach 162,000 bales, as a result of a substantial expansion in cultivated areas of 76.1%, and despite a 26.3% decline in average productivity. Arabic gum production totaled 27.9 thousand

metric tons in 2009, up by a staggering 40.9% year-on-year. Groundnuts production rose by 31.6% to reach 942 thousand metric tons in 2009, driven by an increase of 31.7% in average productivity. Corn production grew by 8.5% to reach 4,197 thousand metric tons in 2009, as a result of a rise in cultivated areas of 4.7% and a progression of productivity of 6.5%.

On the contrary, three crops saw a decline in production over last year, namely millet, wheat and sesame. Millet production reached 637 thousand metric tons, down by a yearly 11.7%, on the back of a drop in cultivated areas and land productivity. Wheat production went down by a staggering 46.5% year-on-year, totaling 343 thousand metric tons, while sesame production reached 318 thousand metric tons, down by a yearly 9.1%, also due to a decline in cultivated areas.

The agricultural sector has been growing by an average of merely 2.5% per annum over the past decade, according to the IMF. This slow growth is attributed to poor infrastructure, lack of access to capital, low-level technical efficiency, security concerns, in addition to the severe drought that has hit the country over the past couple of years. However, the agricultural sector has an important untapped potential, noting that the Sudanese land is quite fertile, benefitting from its location next to the Blue and White Nile rivers. About one third of the area of Sudan is appropriate for agricultural development but only an estimated 15-20% of Sudan's arable land is under cultivation. Half of this cultivated land is rain-fed, mostly producing subsistence crops.

In order to enhance the performance of the sector, the Sudanese authorities started to invest about US\$ 5 billion into the sector through 2012. Three dams were completed in 2009, including the US\$ 1.7 billion Merowe dam that was designed for power supply and agricultural irrigation. In April 2010, the tenth and final electricity unit at the Merowe hydroelectric power station

was launched, increasing the dam's full generation capacity to 1,250 megawatts.

Moreover, the authorities are implementing a large agricultural development program including irrigation and rain-fed farming, livestock development and expansion of non-traditional products and exports under the Revitalization of Agriculture Program. The latter consists of improving infrastructure, developing efforts to diversify harvests, initiating advanced technology, establishing agro-business industry and enhancing access to finance for farmers. As a matter of fact, public-private partnership ventures have successfully been set up in the management of pilot projects to improve production in irrigated land. Liberalization is also progressing as the monopoly of the state-owned Gum Arabic Company on the production and export of Arabic gum has recently been ended.

On the other hand, in March 2010, Beltone Private Equity and Kenana Sugar Company have signed a partnership agreement to create a private equity fund, the Mahaseel Agriculture Investment Fund, with the aim of allocating up to US\$ 1 billion in large-scale agricultural projects in Sudan and Egypt. Kenana is one of the largest sugar companies in the world located on the eastern bank of the White Nile.

Moreover, government partners and the Kenana Sugar Company have jointly developed the White Nile Sugar Project, a US\$ 1 billion large agricultural project, considered an important investment for Sudan's agricultural sector. The project aims to cultivate a total area of 150,000 feddans (63,000 ha) as well as to have an eventual annual production capacity of 450,000 tons of sugar, 1.5 million tons of processed fodder and 200 million liters of ethanol. In April 2010, the Sudanese government and the Kuwait-based Arab Fund for Economic and Social Development

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Selected Real Sector Indicators

	2004	2005	2006	2007	2008	2009	Var 05/04	Var 06/05	Var 07/06	Var 08/07	Var 09/08
Agriculture: production of major crops											
Cotton (in thousands of bales)	346	451	394	321	125	162	30.3%	-12.7%	-18.5%	-61.1%	29.7%
Corn (in thousands of metric tons)	4,690	2,619	4,327	4,999	3,869	4,197	-44.2%	65.2%	15.5%	-22.6%	8.5%
Millet (in thousands of metric tons)	769	280	675	796	721	637	-63.6%	141.1%	17.9%	-9.4%	-11.7%
Wheat (in thousands of metric tons)	398	364	416	669	641	343	-8.5%	14.3%	60.8%	-4.2%	-46.5%
Sesame (in thousands of metric tons)	399	277	400	242	350	318	-30.6%	44.4%	-39.5%	44.6%	-9.1%
Groundnuts (in thousands of metric tons)	790	520	555	564	716	942	-34.2%	6.7%	1.6%	27.0%	31.6%
Industry: oil and non-oil production											
Crude oil production (in thousands of barrels)	77,014	103,323	132,738	176,573	168,767	173,453	34.2%	28.5%	33.0%	-4.4%	2.8%
Refined oil production (in thousands of metric tons)	3,161	3,175	3,912	4,374	4,374	4,817	0.4%	23.2%	11.8%	0.0%	10.1%
Sugar production (in thousands of tons)	755	712	728	757	745	739	-5.7%	2.3%	3.9%	-1.6%	-0.9%
Cement production (in thousands of metric tons)	307	331	202	326	247	622	7.8%	-38.9%	61.3%	-24.3%	151.7%
Electricity and water											
Electricity production (gigawatts-hour)	3,749	4,125	4,521	5,021	5,506	6,372	10.0%	9.6%	11.0%	9.7%	15.7%
Electricity consumption (gigawatts-hour)	2,495	2,987	3,457	3,836	4,286	5,045	19.7%	15.7%	11.0%	11.7%	17.7%
Water production (cubic meters per day)	2,381	2,620	2,742	3,016	3,124	3,278	10.0%	4.7%	10.0%	3.6%	4.9%
Trade and services											
Air transport (national carrier: in thousands of passengers)	562.8	441.5	520.1	476.1	381.9	496.8	-21.6%	17.8%	-8.5%	-19.8%	30.1%
Maritime transport (cargo: in thousands of tons)	138.2	156.9	181.7	168.9	111.5	33.0	13.5%	15.8%	-7.0%	-34.0%	-70.4%
Railways transport (cargo: in thousands of tons)	1,265.4	1,137.1	1,318.0	1,091.0	1,008.1	907.2	-10.1%	15.9%	-17.2%	-7.6%	-10.0%

Sources: Central Bank of Sudan, Bank Audi's Research Department

signed an agreement for the fund to lend US\$ 104 million to the White Nile Sugar Project, while in November 2009 the project secured a US\$ 53 million loan from the Saudi Development Fund.

Also during the month of April of this year, a fully-owned subsidiary of Wafra, Citadel Capital's Sudanese agriculture platform, has signed an agreement with the White Nile Governorate for a 30-year lease on 60,000 feddans of land on which a large-scale commercial rice farm is to be built. Citadel Capital is a private equity firm with activities in the Middle East and Africa, focusing on building regional platforms in selected industries. The farm would produce rice primarily for domestic consumption in Sudan, a net importer of rice, allowing any excess to be exported to other countries in Africa and the Middle East. On the other hand, in August 2010, Wafra obtained a US\$ 5 million loan from the Bank of Khartoum to support the farming of its first 2,000 feddans of sorghum, an important cereal crop. The project is expected to bring 5,500 feddans per year into production for the next two years and 11,000 feddans per year thereafter for a total cultivated area of 125,000 feddans. Crops are projected to comprise sorghum, maize, cotton, legumes and sugarcane.

The agriculture sector's growth is forecast to pick up this year, taking advantage from the recent completion of the Merowe Dam and the measures adopted to revive the sector. The Sudanese authorities are indeed putting efforts to enhance the production of the sector through the construction of dams, large irrigation schemes and the financing of projects. Many companies are investing in that sector of activity, showing a growing interest in its potential. In addition, the legal system is being reinforced, comprising the introduction of more liberal rules on the leasing of agricultural land to foreign investors. Finally, foreign direct investment is set to be directed towards the agriculture sector in the coming years.

1.1.2. Oil and Industry

In recent years, the oil sector has been the main driver of growth and represents actually an important component of the Sudanese economy. In fact, the oil sector currently accounts for about 50% of total government's revenue, but the government aims at reducing the dependence of the Sudanese economy on oil through diversification plans. The oil and industry sector accounted for about 24% of Sudan's GDP in 2009, according to figures from the Central Bank of Sudan.

Oil reserves in Sudan are estimated at six billion barrels. The Ministry of Energy and Mining forecasts a slight increase of 0.5% in production in 2010, due to waning mature fields (higher quality Nile Blend) and other technical production problems. According to the IMF, oil revenues are projected to pick up by a significant 47% in 2010, on the back of higher international oil prices, while oil exports are forecast to grow by a substantial 41% year-on-year.

According to the Central Bank of Sudan's figures, crude oil production reached 173 million barrels in 2009, up by a mere 2.8% year-on-year, while refined oil production grew by 10.1% to reach 4.8 million metric tons last year. The slight rise in crude oil output in 2009 did not compensate the substantial decrease in prices and Sudan has been unfavorably affected by the global crisis through a sharp decline in oil receipts last year.

The Sudan National Petroleum Corporation (Sudapet) is active in Sudan's oil exploration and production. However, the company

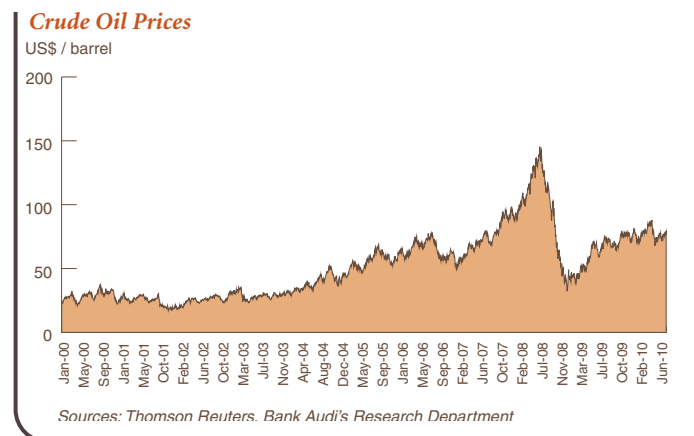
has relatively limited technical and financial resources and therefore partners with foreign companies in oil projects. Foreign companies involved in Sudan's oil sector are primarily from Asia. They are led by the China National Petroleum Corporation (CNPC), India's Oil and Natural Gas Corporation (ONGC) and Malaysia's Petronas. It is worth noting that Sudan is considered China's sixth largest crude supplier; as a matter of fact, out of the total Sudanese exports of petroleum and petroleum products, 88% were directed toward China in the first quarter of this year.

In terms of the expansion in oil activity, Sudan's oil ministry signed in August 2010 a new agreement with a small oil and gas exploration firm based in Luxembourg to explore a new block called E, which runs through five states in southern Sudan and Darfur. The block covers an area of about 50,000 square kilometers and has a potential estimated at two billion barrels of oil. The Luxembourg-based Star Petroleum company holds a 75% share of the block, the Norwegian Hamla company holds a 5% share while Sudan's two national oil companies, Sudapet and Nilepet of southern Sudan, have the remaining 20% share.

On the other hand, in July 2010, the new oil minister asked the French oil company Total to resume work in block B, a large exploration area in which Total has rights in Southern Sudan. The French company is the largest shareholder in that block but has ceased exploration in that area since 1984, because of the civil war. Also, at the end of last year, CNPC signed three oil and gas cooperation agreements with the government of Sudan. The contracts were relative to the second phase expansion of Khartoum refinery, advance payment for crude oil trading and an agreement to swap equity in CNPC's stake in block 6 for part of the stake in block 5A owned by Malaysia's Petronas. These agreements attest the continuing role of China as a large foreign investor in Sudan.

Sudan's refining sector is modern and quite important but in the medium term, continued heavy investments are required to cater for future demand for oil products. At the end of last year, Southern Sudan started to build its first ever oil refinery in Warrap State, with the plant projected to be completed over a three-year period. This contributes to increase the potential of the country's refining capacity.

As for the manufacturing sector, it is projected to witness strong growth due to the establishment of large cement and sugar factories, according to the IMF. As a matter of fact, Sudan has the potential to substantially develop its sugar production because of available fertile land along the Nile and irrigation water from the Nile. The recent US\$ 1 billion White Nile Sugar project is set to eventually increase the sugar production capacity by 450,000 tons per year. According to the Central Bank of Sudan's figures, the



sugar production remained almost unchanged in 2009 compared to the previous year, at 739 thousand tons.

On the other hand, the cement production grew by a significant 152% year-on-year to reach 622 thousand metric tons in 2009. This growth is projected to continue, especially that in July 2010, ASEC Cement, which would control more than 12 million tons of annual cement production capacity by 2013 in five countries spanning from Algeria to Iraq-Kurdistan, started production at Takamol, its cement plant located north of the Sudanese capital of Khartoum. The plant, built with advanced technology, has a capacity of 1.6 million tons per annum of cement. The total investment cost for Takamol Cement stood at US\$ 253 million. ASEC Cement is a portfolio company of ASEC Holding, Citadel Capital's Platform Company for investments in the regional engineering and construction industry.

All in all, the oil sector continues to dominate the Sudanese economy. Nevertheless, the production of oil, which is a major source of foreign exchange earnings, is expected to gradually decline below current levels after 2013, according to the IMF. In the longer term, this would represent an important challenge for the Sudanese authorities that would increasingly resort to economic diversification away from oil. On the other hand, the industrial sector has an important growth potential, illustrated by large investments in sugar and cement plants.

1.1.3. Construction

Sudan's construction activity continued to be vigorous in 2010, within the context of the infrastructure rehabilitation, as well as elevated demand on residential, office space and retail. The construction sector accounted for 3.2% of the country's GDP in 2009 and grew by about 10% last year in nominal terms, according to the Central Bank of Sudan's figures.

Sudan is witnessing a boom in construction, which is a typical phenomenon in a post-conflict economy, according to the World Bank. The country faces a large demand for construction work. This elevated demand for construction is often met by inelastic supply due to a limited supply base for construction work and limited tradability of construction services. As a result, this drives up the cost of construction work.

In July 2010, new development projects, part of the national government's efforts to support growth, were launched. The government estimated that the projects would cost US\$ 200 million, with the national government contributing 89% of the cost and the Government of Southern Sudan accounting for the rest. One of the projects comprises the construction of four dams in Southern Sudan, with a total generation capacity of 540 megawatts. Other projects are to encompass road construction.

The Dams Implementation Unit (DIU), the public body established in 2005 primarily to oversee construction of the Merowe Dam, has also plans for water harvesting projects in North Kordofan, with proposals to build dams and water reservoirs in Sodiri, Al Nuhud and Hamrat al-Sheikh. The US\$ 1.7 billion Merowe dam completed in 2009 is considered a milestone for the DIU. It is worth noting that the DIU also supervised major auxiliary projects, in particular the construction of an international airport at Merowe, the construction of a bridge over the Nile at Karima and the upgrading of the local railway line, all of which have been completed.

On the other hand, another major infrastructure project is Khartoum's new international airport whose cost amounts to

US\$ 1.8 billion. The new airport includes three phases, with the first phase costing about US\$ 1.1 billion, and is planned to be completed by 2012. The airport is expected to receive 7.4 million passengers per year, once completed. In recent months, the Islamic Development Bank has agreed on a US\$ 150 million loan to the Sudanese government to build the new airport, while the Kuwait Fund for Arab Economic Development agreed on a US\$ 47 million loan with the Sudanese government for the financing of the new airport.

Construction activity is also driven by the expansion of the private property sector. The Mushaireb mixed-use project, which includes a 5-star hotel, 8 residential and retail towers and office space, is being developed by Qatari Diar Real Estate Investment Company, fully-owned by the Qatar Investment Authority and in charge of coordinating the country's real estate development priorities. The latter announced in April 2010 that it was expanding the land size of the project located in downtown Khartoum by acquiring an additional 58,000 square meters of land, resulting in a total of 206,000 square meters. The development has already proven an attractive destination for investors seeking prime real estate in the center of the capital.

The demand for commercial office space in Khartoum is boosted by economic growth, the rise in foreign investment and the return of Sudanese nationals. The forthcoming supply of office space is mainly available in the Almogran Central District, expected to be completed close to 2013, Blue Nile City and Al Noor City, which will bring over 1,500,000 square meters of commercial space into the market with the construction of more than 60 commercial towers, according to the most recent study from Colliers International.

In addition, the economic and demographic growth coupled with a lack of supply for the expatriates and the local high-income segment brought about speculative investment in the Khartoum residential market, leading to rising sales and rental increases in recent years. However, the gradual release of additional supply has caused price corrections in the residential market. The forthcoming supply is estimated at about 4,600 apartments and 2,380 villa units by 2013.

On the retail side, Khartoum's retail market remains limited, comprising one convenience center and small stores. The low purchasing power of Sudanese nationals and high trade tariffs continue to limit retail development. Still, Colliers International estimates that about 170,000 square meters of leasable retail space would be made available into the market by 2013.

In sum, the construction activity remains vibrant and the sector is set to continue growing in 2010, as the supply of real estate remains limited relative to the elevated demand stemming from expatriates and Sudanese nationals returning to live in their home country. In addition, the government intends to develop further Sudan's infrastructure, as illustrated by Khartoum's new international airport and the recent decision to launch various development projects to boost growth in the country.

1.1.4. Transport & Telecommunication

Sudan's non-financial services sectors are witnessing slow growth. The tourism and hospitality sectors are still little developed but could expand provided the politico-security conditions in the country are stable. The government is putting efforts to enhance the transportation sector through investments in the sector and

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increased participation from the private sector.

Regarding the tourism sector, tourists visiting the country are mainly business tourists. Long stay guests have historically been an important source of revenue, with a number of hotels housing staff working for international organizations and in corporate sectors. Nevertheless, this market is estimated to witness a decline as residential compounds are completed and apartments of higher standard are being delivered. A secondary market focusing on the meetings, incentives, conferences and exhibitions segment is now emerging, as the government wishes to promote Khartoum as a center for East, North and Central African delegates.

Provided stable political conditions and concomitant economic growth, demand for international quality hotel rooms in the capital is expected to increase, driven by corporate tourism, which accounts for 90% of total visitors to Sudan. So far, Khartoum's hospitality market still suffers from an insufficient supply of hotel rooms and supporting facilities, but a forthcoming supply of 1,450 rooms is expected to enter the market by 2013, according to the latest market report from Colliers International.

In January 2010, Coral Hotels & Resorts signed a management agreement with Sudanese Kuwaiti Hotels Co. for two hotel properties in the capital Khartoum and the strategic town of Port Sudan. The first hotel, Coral Khartoum, is a 5-star hotel comprising 285 rooms, while the second one, Coral Port Sudan, features 114 rooms.

On the other hand, in order to improve its infrastructure, Sudan has launched many projects aimed at restoring existing airports. These comprise the rehabilitation of Malakal airport, the development of Abu Gibieha airport in Kordofan State and the redevelopment of Port Sudan airport and Juba airport. These projects pertain to the country's efforts to develop tourism in the longer term. The government is also constructing a new international airport located at 40 kilometers south of the center of Khartoum, at a cost of US\$ 1.8 billion and due for completion by 2012. The international airport at Khartoum is currently served by 16 airlines.

Road transport provides over 90% of inland transport services. It is worth noting that the growth of oil production and export has led to an upgrading in pipelines and port facilities at specialized terminals that allow oil production to be exported. The oil-led economic growth has increased the volume of transportation between Khartoum, where economic activity is concentrated, and Port Sudan, the country's major commercial port. The Government of National Unity has recently been working to liberalize services in transport and telecommunication and encourage private sector participation, including foreign investment that has contributed to some enhancements in the capacity and the efficiency of service delivery in these sectors.

The traditional inland water transport (IWT) link between Kosti and Malakal, Bor, and Juba on the White Nile, has resumed since the signature of the Comprehensive Peace Agreement in 2005 but remains limited to carrying goods and the overall volume of traffic is not yet back to previous levels, according to the World Bank. However, prior to the privatization of the IWT, there was a government monopoly by law in river transport services. In 2007, two companies, Nile River Transport Corporation and the Sudan River Transport Corporation were established as the result of privatization with 70% shared by the private sector and the remaining 30% shared by the public sector. As of February 2009, six private operators of vessels entered the White Nile market, and

in the medium term, privatization is expected to improve efficiency in on-shore services and port management.

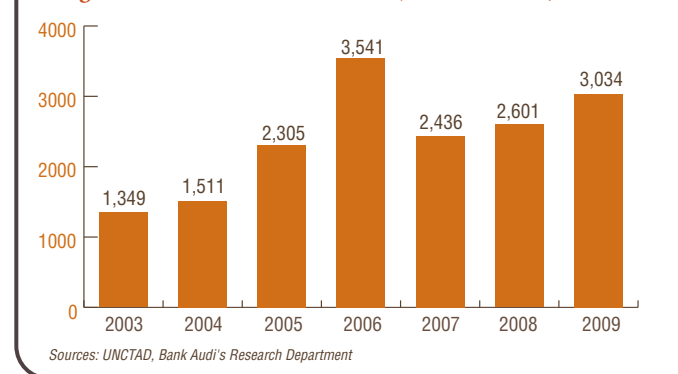
As for the railway system, the Sudanese Railway Corporation (SRC), owned by the Government of National Unity, is managing and operating a railway network of about 4,578 kilometers linking the coastal city of Port Sudan to Khartoum, Wadi Helfa and South Sudan. The only rail branch line in the Southern Sudan region is currently being rehabilitated (as it had ceased operations during the conflict) and there is a plan to extend that line to gain access to the interconnected Eastern African rail system including Kenya. Within the context of transport privatization, SRC is allowing private sector participation in railway operations, and currently, only private operators provide passenger services.

In March 2010, Citadel Capital signed a right-of-way agreement with the SRC to establish the foundation for the rail operator Nile Valley Railways to enter Sudan's cargo transport market. The agreement will allow Nile Valley Railways to offer cargo transport services on SRC's rail lines under a revenue-sharing agreement.

In terms of telecommunications, there are still many areas of the country lacking mobile access and advanced ICT services. In the North, there are extensive mobile networks, but they are largely limited to urban areas, while in the South, network coverage and service quality are still poor, according to the World Bank. In general, prices of ICT services remain high.

However, a report from Zain and Ericsson sheds a more positive light on the state of the telecommunications sector in Sudan. As per the report, mobile telephony in Sudan has gone through a period of substantial development and change. Today, there are three operators licensed who are facilitating large advances in population coverage penetration and service offering. The Kuwait-based company Zain, which runs Sudan's main mobile-phone network, is estimated to have a market share of about 60%. The penetration rate at the end of 2009 exceeded 42% or 15 million customers, up from 28% in 2008, or 10 million customers. This attests of the important growth potential of the sector.

Foreign Direct Investments in Sudan (in US\$ million)



1.2. EXTERNAL SECTOR

Merchandise trade activity in Sudan appears to be on the rebound in 2010, as per the latest figures available covering the first quarter of the year. This recovery follows a year of retreat in 2009, as trade activity caught contagion from the global financial crisis, affected by lower average international oil prices along with the shrinkage in global trade resulting from the global

recession. In particular, Sudan's exports, which are usually propped up by oil exports, saw a significant upsurge in the first quarter of the current year, buttressed by recovering oil prices, as well as higher demand for oil as the global economy emerges from one of the worst financial crises in history. Imports, on the other hand, contracted in the first quarter of the year, on account of a new rule introduced by the Central Bank of Sudan in late-2009, which requires a 100% cash basis on most imports.

In details, based on figures released by the Central Bank of Sudan, the aggregate value of goods exchanged with the rest of the world saw a significant increase of 28.8% in the first quarter of 2010 to reach US\$ 5,076 million, following a contraction of 16.6% in 2009. Exports, particularly oil exports, were behind the aforementioned two fluctuations. Indeed, in 2009 overall trade activity had regressed as the decline in exports had a greater effect than the rise in imports, whereas in the first quarter of the year, trade activity went up, as the increase in exports more than offset the decline in imports. Merchandise trade activity in Sudan is to the most part driven by fluctuations in oil prices and the global demand for petroleum products.

Sudan's exports more than doubled in the first quarter of 2010, reaching US\$ 2,731 million, compared to US\$ 1,323 million in the same period of 2009. This revival comes subsequent to a drop of 32.9% in Sudan's exports in 2009, driven by a 35.7% decline in the country's oil exports, which more than counterbalanced the increase of 21.9% in non-oil exports. Here, it is worth noting that oil accounts for more than 90% of Sudan's exports. Thus it is only normal for Sudan's exports to reach a historical record high during the oil boom of 2008, only for them to plummet in 2009, and then resume an upward trend in 2010.

In the first quarter of 2010, Sudan's oil exports increased by 123.3% to reach US\$ 2,523 million. It is worth noting that this rise is purely driven by the upsurge in average oil prices in the first quarter of 2010 relative to the same period of 2009, as in volume, Sudan's exports declined, affected by oil production cuts enforced by OPEC. Indeed, Sudan's crude oil exports in volume dropped by 5.2% in the first quarter of 2010 to reach 36.9 million barrels relative to 38.9 million barrels in the first quarter of 2009. However, it is worth noting that Sudan is to a certain extent benefitting from the fact that average oil prices have not renewed with their pre-crisis levels. Indeed, one positive factor from the relatively lower global average oil prices is that Dar Blend, which comprises more than half of Sudan's export volumes, has begun trading closer to benchmark prices (the price differential between it and Brent has narrowed to just US\$ 6/barrel in 2010 down from US\$ 7-8/barrel in 2008-09), as more refineries are now willing to process the acidic crude.

On the other hand, the much weaker non-oil exports, which comprised a mere 7.6% of total exports in the first quarter of 2010, continued to increase as the year kicked off, bearing in mind that they did not lose their momentum during the crisis in 2009. In fact, non-oil exports increased by 7.3% in the first quarter of 2010, following an important rise of 21.9% in 2009, thereby demonstrating a continuous increase in productivity. Their increase in 2010 was mainly as a result of a rise in agricultural commodities exports such as sesame, cotton, and meat.

In parallel, imports reached US\$ 2,345 million in the first quarter of 2010, down by 10.4% relative to the same period of 2009. It is worth noting that imports in Sudan traced a

continuous upward trajectory over the past five years, bearing in mind that this trend was not interrupted in 2009, contrary to forecasts earlier on during the crisis, which anticipated imports to fall due to dwindling demand in the country resulting from the global crisis, as well as the fall in average commodity prices worldwide. In the first quarter of 2010, the decline in imports was mostly the result of a new rule introduced by the Central Bank of Sudan in late-2009, which requires a 100% cash basis on most imports. This was one of the measures enforced to limit currency transfers, as foreign exchange reserves of the Central Bank hit a critically low level. However, in 2010 such reserves began to rise again and the Central Bank is expected to ease the measures adopted in late-2009. As such, imports are expected to resume their increase in later months of 2010, thereby ending the year 2010 on the uprise, as per IMF expectations.

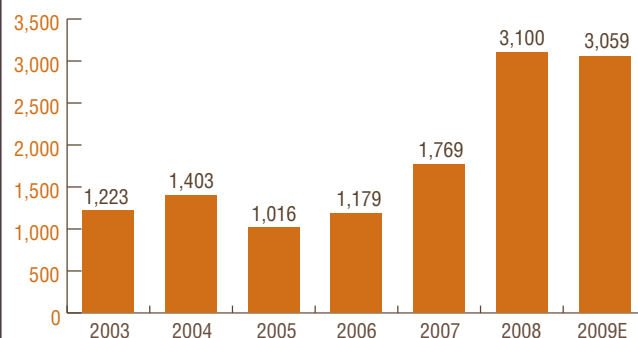
In particular, imports of manufactured goods, plastic products, and machinery and petroleum products were on the decline in the first quarter of 2010, while imports of foodstuffs products went up. It seems that the Central Bank's rule took its toll on industrial imports, as imports of consumer products, which are comprised to the most part of food products, went up by 42.8%.

The notable increase in Sudan's exports in the first quarter of 2010, accompanied by a decline in the country's imports has resulted in a significant amelioration in the country's trade balance, which shifted from a deficit of US\$ 1,294 million in the first quarter of 2009 to a surplus of US\$ 386 million in the first quarter of 2010. This surplus is deemed important, especially if the country could maintain it for the rest of the year. Historically, prior to 2007, Sudan suffered from consecutive structural trade deficits. However, in 2007 and 2008, as globally the oil market boomed, Sudan's exports received a major boost and the country recorded consecutive trade surpluses of US\$ 104 million and US\$ 2,319 million. This trend was nonetheless reversed in 2009, on account of the plummet in the oil market, and thus the trade deficit reached US\$ 1,857 million.

Recent IMF projections suggest that Sudan might in fact maintain its trade surplus especially that oil prices have continued to rise throughout 2010, so far. The IMF expected the trade surplus to reach around US\$ 1.9 billion in 2010, an amount deemed significant, yet still not enough to cover leakages from the services and income balance to result in a current account surplus. The forecasted deficit in the income balance in 2010 is mainly due to diminishing income debits related to foreign companies' profit repatriation. The other

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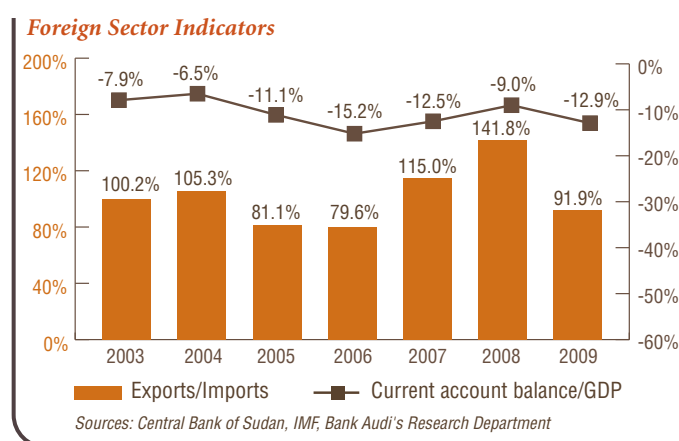
Remittances in Sudan (in US\$ million)



Sources: World Bank, Bank Audi's Research Department

invisible account weighing on the non-merchandise trade balance is net services that stood at a negative US\$ 2.2 billion in 2009, and is projected at a negative US\$ 2.4 billion in 2010. The deficit in this account has historically hovered around US\$ 2.0 billion and it usually includes payments for construction services. In parallel, Sudan's net current transfers balance is usually positive, boosted by remittances from Sudanese working abroad, which reached an important US\$ 3.0 billion in 2009. Although Sudan's remittances fell by 1.3% in 2009, as a result of the global financial crisis, the current transfers balance recorded a significant surplus of around US\$ 2.0 billion. In 2010, the current transfers surplus is forecasted to drop slightly, yet it would most likely remain at an important US\$ 1.6 billion. In fact, the IMF indicated that so far, inward remittances into Sudan have not yet displayed full recovery to resume their pre-crisis level.

Overall, the current-account deficit which expanded in 2009, to around 12.9% of GDP, on account of an aggravation in both the merchandise and non-merchandise trade balances, would contract in 2010 to about 7.1% of GDP, as per the IMF, supported mostly by the upturn in the merchandise trade balance.



Last but not least, Sudan's financial account, which has been registering significant growing surpluses since 2005 continued to do so in 2009, despite lackluster global flows, due to the crisis. In recent years, significant FDI has flooded into Khartoum, predominantly from the Middle East and China, to finance the development of the oil industry. This explains the fact that in 2009, in spite of the crisis, Sudan captured the sixth highest amount of FDI among Arab countries of US\$ 3.0 billion, which is 16.6% higher the amount registered a year earlier. In 2010, as liquidity at hand becomes more abundant, FDI is projected to continue its increase into Sudan, although no official figures on that are currently available.

In conclusion, 2010 appears to be a year of revival for Sudan's overall external sector, characterized by an improvement in current account deficit, as well as capital and financial flows. Looking ahead, the external accounts would continue to depend on oil revenues, and with the latter on the uprise and forecasted to remain steady at an improved level, prospects for the external sector currently appear healthier than they were in 2009. However, for the balance of payment to improve substantially, oil receipts are not enough, especially as the import bill would probably increase, as demand begins to pick-up in Sudan. The support should come further from non-oil related foreign direct investment, especially that the Sudanese authorities have established liberal foreign investment and foreign exchange regimes, and embarked on an ambitious privatization strategy.

1.3. PUBLIC SECTOR

Following a relatively difficult year in 2009 on the public finances front, the year 2010 seems to be a year of fiscal reforms. The Sudanese government has so far in 2010 been exerting efforts to diversify its revenues away from oil, after such revenues suffered a blow from tumbling oil prices in 2009. Meanwhile, although no official data are yet available, anecdotal evidence suggest that expenditures have been on the uprise in 2010, though expenditure policy is currently geared toward improving the quality and targeting of government spending.

In 2009, the drop in average oil prices tightly squeezed oil revenues, which account for around 50% of total government revenues and more than 90% of South Sudan's revenues. On the other hand, the response to the global financial crisis has been rather slow. Limited access to foreign funds, coupled with public debt overhang, prevented the government from adopting aggressive countercyclical policies. Instead, a tightening of the fiscal stance relative to the approved budget was observed. Still, the overall fiscal deficit more than tripled to reach US\$ 1.9 billion, the equivalent of 3.4% of GDP, up from a ratio of 1.0% in the previous year.

On the revenues front, relatively lower oil revenues and the late implementation of essential tax policy reforms such as a reduction in the stock of VAT exemptions and a lower personal income tax payments threshold, triggered a 21.2% dip in total government revenues in 2009, as per official figures, which reached US\$ 8.9 billion, or 16.4% of GDP. On the upside though, important structural reforms were completed in 2009, though some with delay. Several measures were implemented to improve tax compliance and strengthen fiscal management and administration. These included modernization of the taxation chamber and centralization of tax-payers identification numbers.

As such, tax revenues improved significantly, rising by a yearly

Selected Public Finance Indicators

US\$ billion	2003	2004	2005	2006	2007	2008	2009
Central government revenues	2.7	4.1	5.3	7.5	9.0	11.3	8.9
Central government revenues/GDP	15.2%	18.8%	19.3%	20.6%	19.3%	19.5%	16.4%
Central government expenditures	2.8	4.4	6.0	9.1	10.2	11.9	10.8
Central government expenditures/GDP	15.9%	20.3%	21.9%	24.9%	22.0%	20.5%	19.8%
Central government fiscal balance	-0.1	-0.3	-0.7	-1.6	-1.2	-0.6	-1.9
Central government fiscal balance/GDP	-0.7%	-1.5%	-2.6%	-4.3%	-2.6%	-1.0%	-3.4%

Sources: Central Bank of Sudan, Bank Audi's Research Department

9.9%, reflecting stronger revenue collection effort by the tax and customs administration. However, non-tax revenues, which encompass primarily oil revenues, as well as property revenues and administrative fees, went down by 37.8%. Specifically, oil revenues were behind this decline, as they were slashed by 41.5% to reach US\$ 4.2 billion. On the other hand, property revenues more than doubled to US\$ 273 million, while administrative fees increased by 23.0% to US\$ 159 million.

On the expenditures front, authorities found it difficult to implement a substantially tight fiscal stance within the context of the global crisis, alongside pressures from sub-national governments facing lower transfers. Most expenditures were lower than envisaged in the budget, with the notable exception of transfers to the South, fuel subsidies and elections-related expenditures. As such, total government expenditures dropped by 9.2% last year, to reach US\$ 10.8 billion, or 19.8% of GDP, down from a ratio of 20.5% in 2008. Although the 2009 budget included large expenditures on wages, transfer to states, investment and one-off election outlays, scarcer liquidity at hand prompted authorities to spend less than what was approved in the 2009 budget.

As such, with revenues falling at a faster pace than expenditures, the fiscal balance in Sudan moved further into the negative zone. On the upside, the underlying fiscal performance improved in 2009, albeit to a lesser extent than budgeted. The non-oil commitment primary deficit narrowed from 7.6% of non-oil GDP in 2008 to 6.6% in 2009. This adjustment was nonetheless 1.5 percentage points lower than what was envisaged under the budget.

Sudan's persisting fiscal deficits are being financed by public sector borrowings. Sudan still has notable debt arrears with bilateral and multilateral lenders, in addition to domestic payment arrears. Indeed, Sudan's external debt overhang remains a serious concern. The end-2009 stock of external public and publicly-guaranteed debt is estimated at US\$ 35.7 billion, as per the IMF, up from US\$ 33.7 billion at end-2008. The bulk of the increase reflects primarily a further buildup of interest arrears. It also includes new drawings from Arab multilateral and bilateral creditors, as well as from China and India.

A debt sustainability analysis has been prepared by the IMF this year and has been discussed with the authorities. The results suggest that Sudan would remain in debt distress in the foreseeable future even under a benign global environment and the implementation of appropriate policies. The authorities are aware of the risks of non-concessional borrowing. They

emphasized that contracting of such loans had been limited in recent years and that such loans were generally tied to specific and vital development projects, especially in infrastructure and the oil sector. They, however, reiterated that the lack of access to concessional finance and pressing expenditure priorities associated with development needs and the various peace agreements left non-concessional borrowing as a necessity. In 2009, the contracting of such borrowing amounted to US\$ 693 million, mainly from China. These loans, which are earmarked for infrastructure projects such as roads and power transmission grids, have a long maturity and appear to have a grant element due to their generally moderate interest rate. The authorities agreed to limit contracting of such borrowing to a program ceiling of US\$ 700 million in 2010.

Last year's public finance developments, most particularly the fiscal position's vulnerability to oil and its derivatives, highlight the pressing need for significant fiscal reforms and tightening. Within this respect, authorities are currently pressing ahead with fiscal reforms to maintain macroeconomic stability and reduce dependence on oil revenues. In this context, reforms include streamlining tax exemptions, reduce fuel subsidies and adopt a multi-year budget planning system. Moreover, a comprehensive review of the tax policy regime was completed in July 2010. As such, the pick-up in non-oil revenues, along with a rise in oil revenues, associated with revival of global oil prices would most likely result in a 40% rise in government revenues in 2010, as per the IMF. Meanwhile, expenditures would likely increase by 25.3%, although the quality of spending is improving in support the private sector and prompt economic growth. As such, the overall fiscal deficit would slightly contract in 2010, as per IMF projections.

In conclusion, a steady improvement in the non-oil primary balance is needed over the medium term. Oil production is expected to gradually decline below current levels, after 2013, given the country's ageing oil pipelines. This would be an important challenge, notwithstanding an automatic reduction in oil-related spending associated with the gradual decline in oil production and the elimination of all domestic arrears in 2010. A medium-term perspective is, therefore, needed to reduce dependence on oil and to reduce vulnerability to its price volatility.

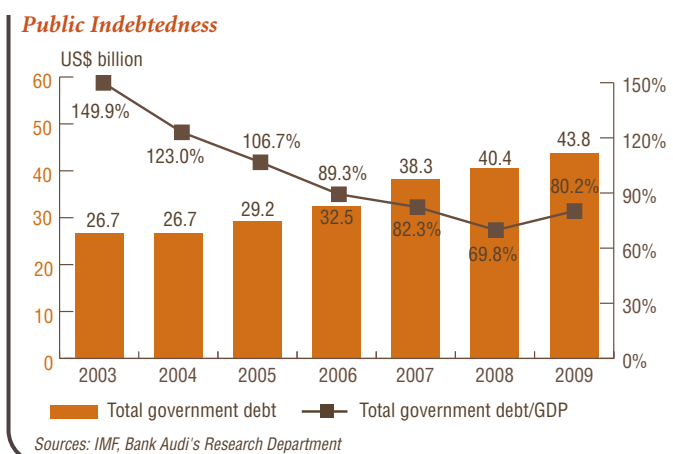
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1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Monetary conditions in Sudan were marked over the past year by a noticeable expansionary policy, a relevant growth in broad money, a double-digit level of inflation and low level of gross official reserves that triggered low coverage ratios.

Sudanese monetary authorities adopted indeed an expansionary policy in 2009 to counter the effects of the global financial downturn. Within this context, broad money supply (M2) expanded by 20.4% year-on-year to US\$ 12.6 billion. A large part of this growth is attributed to the substantial rise in net claims on public sector of 62.1% and a 15.5% yearly increase in claims on private sector, as the authorities aimed to ensure sufficient credit to the private sector to partially offset the impact of the liquidity shortage created by the global financial downturn. Broad money supply further grew by a yearly 29.0% up to June 2010, as per the latest statistics released by the Central



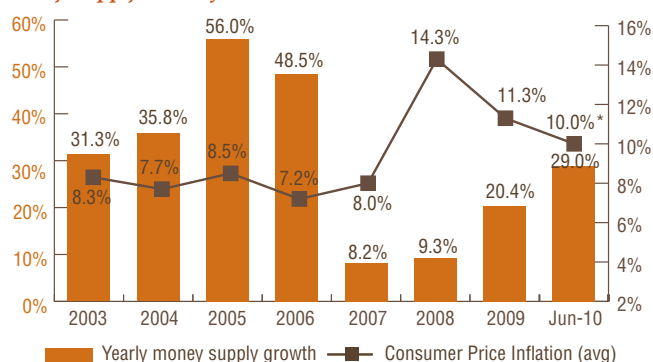
Monetary Situation

US\$ million	2003	2004	2005	2006	2007	2008	2009
Net foreign assets	-2,193	-1,396	-309	-916	-1,237	-1,063	-2,032
Offsets	3,142	3,191	3,312	3,641	3,633	3,561	3,808
Net Domestic Assets	1,872	2,037	2,975	6,151	7,209	8,002	10,865
Net Claims on public sector	539	245	360	1,968	2,408	2,454	3,979
Claims on private sector	1,090	1,688	2,949	5,259	5,998	6,270	7,239
Other Items (net)	243	104	-334	-1,076	-1,197	-722	-353
Money Supply (M2)	2,822	3,832	5,978	8,877	9,605	10,501	12,640
Money (M1)	1,762	2,411	3,527	5,227	5,542	6,244	7,190
Quasi-Money	1,059	1,421	2,452	3,650	4,063	4,256	5,450

Sources: Central Bank of Sudan, Bank Audi's Research Department

Bank of Sudan, reaching US\$ 13.6 billion at end-June 2010. It is worth highlighting that the growth in quasi-money supply accounted for circa 56% of the expansion in broad money in 2009 and 47% of it in the 12 months to June 2010.

Money Supply and Inflation



* IMF full-year 2010

Sources: Central Bank of Sudan, IMF, Bank Audi's Research Department

The Central Bank's gross official reserves fell by 21.8% year-on-year to hit US\$ 1.1 billion at end-2009, accounting for 8.7% of the broad money (M2) and covering 1.5 months of imports. The yearly drop in gross official reserves is mainly due to lower external receipts, and the Central Bank's massive intervention on the foreign exchange market to support the weakening national currency. Within this context, the IMF urged the authorities to rebuild reserves and limit the sales of foreign exchange to smooth short-term volatility.

Indeed, the depletion of foreign reserves has prompted Sudan's Central Bank to adopt several measures aimed at restricting the sale of foreign currency, like prohibiting banks from disbursing foreign transfers in foreign currency, requiring a 100% cash margin for letters of credit on most imports and recently imposing a cap on the amount of hard currency available to individuals travelling abroad and allowing travelers to receive their bought foreign currency at the airport only.

The local currency depreciated by about 3% against the US Dollar in 2009, as per the IMF, noting that the Central Bank's injection of foreign currencies on the forex market combined with the strict restrictions imposed by the Central Bank of Sudan on access to foreign exchange helped putting brakes to currency depreciation during the second half of 2009.

Under these conditions, the consumer price increase maintained a high double-digit level of 11.3% on average in 2009, as compared to 14.3% in the previous year, on the back of a mix of imported inflation fuelled by a weaker currency, and

expansionary monetary policy adopted in the aftermath of the global financial crisis. In the period ahead, consumer prices are projected to rise by 10.0% in 2010, according to the IMF, in line with global food price developments and a tightening in monetary policy.

In the aim of curbing inflationary pressures and bringing inflation back to single digits, Sudanese monetary authorities unveiled recently a plan to drop the national currency's peg to the US Dollar, possibly in the fourth quarter of 2010, in favor of a basket of international currencies particularly from countries that have large trade volumes with Sudan. The currency basket would include the Euro, British Pound and the Chinese Yuan.

In parallel, the Central Bank of Sudan started in 2010 adopting a series of austerity measures, phasing out from expansionary policies that had been designed to cope with the global economic downturn, in order to help support the country's local currency and fight inflation. For instance, the Central Bank of Sudan lifted banks' reserve requirements on both local and foreign currencies from 8% to 11% mid-June 2010. In addition, the Central Bank stated that it would be withdrawing its deposits from some commercial banks as a mean of managing liquidity, with one exception for deposits received as part of bailout package.

After a period of supporting liquidity, the second half of 2010 would see a turnaround from past expansionary policies, according to the Central Bank Governor, which would contribute to reduce pressures on inflation and the exchange rate. Within this context, the IMF recommended to adopt a monetary policy that is consistent with single-digit inflation while allowing for credit needs of the private sector, to increase exchange rate flexibility in order to rebuild foreign exchange reserves, and to develop indirect monetary instruments.

1.4.2. Banking Activity

The Sudanese banking sector, which remains to date somewhat narrowly integrated with global financial markets, managed to somewhat escape direct global financial crisis spillovers, and posted satisfactory performances so far this year. Measured by total assets of banks in Sudan, banking activity grew by a yearly 23.9% up to June 2010 to reach US\$ 17,204 million, according to the latest Central Bank of Sudan statistics (16.6% in full-year 2009).

Banks' activity remains mostly driven by total deposits, which accounted for nearly 60% of total bank balance sheets, and grew by a yearly 29.3% up to June 2010, moving from US\$ 8,143 million at end-June 2009 to US\$ 10,525 million at end-June 2010 (24.1% growth achieved in full-year 2009). Sudanese

Banking Activity

US\$ billion	2003	2004	2005	2006	2007	2008	2009	Jun-10
Total assets	3.0	4.2	6.6	11.5	12.8	14.0	16.4	17.2
% yearly growth in assets	30.4%	38.4%	57.1%	74.2%	11.0%	10.0%	16.6%	23.9%
Total deposits	1.8	2.6	4.2	6.1	7.0	7.7	9.5	10.5
% yearly growth in deposits	28.6%	43.0%	61.5%	45.2%	15.0%	9.4%	24.1%	29.3%
Total banks advances	1.1	1.7	2.9	5.3	6.3	6.9	8.1	8.4
% yearly growth in banks advances	85.4%	50.1%	70.6%	82.8%	19.0%	8.6%	18.4%	23.6%

Sources: Central Bank of Sudan, Bank Audi's Research Department

banks, mostly operating under the Islamic Sharia' law, have long been prohibited from excessive risk-taking which was witnessed across many banking sectors across the globe, and from investing in heavily complex derivative financial instruments, while having been practically isolated from some financial markets as a result of US finance and trading embargo. This, alongside deposit injection in some commercial banks in an aim to boost liquidity in the sector following the global crisis outburst, somewhat shielded Sudanese banks from the immediate spillovers of the global crisis and helped maintain overall depositor confidence in the system.

A closer look at bank deposits by currency reveals that local currency deposits accounted for the bulk of deposit growth in the 12 months to June 2010 with an 80% share, which helped maintain the currency structure of deposits, with local currency deposits continuing to account for close to 80% of total deposits at Sudanese banks at end-June 2010.

In parallel, banks' financing activity posted a 23.6% rise on an annual basis until end-June 2010 to reach US\$ 8,379 million, within the context of relatively improved global credit conditions (18.4% in full-year 2009). Such a notable performance in a period of strong deleveraging across the world -though emanating from a low base- has partly been favored by the Sudanese Central Bank increased credit to commercial banks for onward lending in an aim to alleviate the impact of the liquidity squeeze in the aftermath of the global financial crisis outburst (although credit growth turned out to be somehow lower than envisaged in 2009, according to a recent IMF country report on Sudan), and reflects increasing financial intermediation activity in a country with pent-up growth potential.

With bank advances continuing to post slightly lower rises than deposit volumes, the total bank advances to bank deposit ratio declined further to reach 79.6% at end-June 2010, comparing to 85.1% at end-December 2009 and levels hovering around the 90% mark in the previous couple of years.

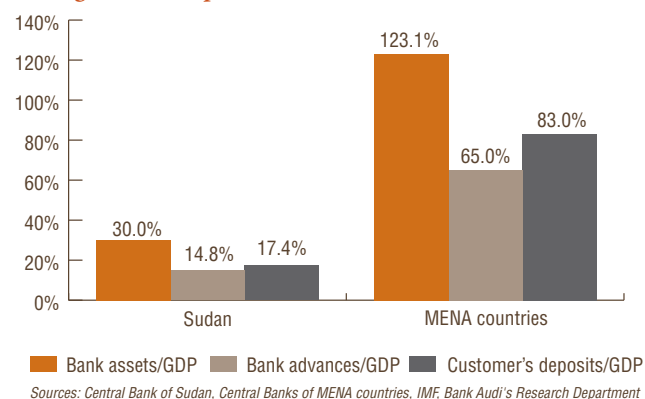
While such performances reflect the continuous development of the Sudanese banking sector, the latter's dimension in the overall economy remains narrow, both in absolute and relative terms. Bank deposits and advances each stand at less than 20% of GDP, against MENA averages of 83% and 65%, respectively, thus suggesting there is room for much further development of financial intermediation activity in the large African country blessed with abundant natural resources. As a matter of fact, banking penetration in Sudan continues to boast relatively narrow levels in spite of the steady development of banks' branch network across domestic territories. On one hand, the residents per bank branch ratio persistently remains above the 60,000 mark, bearing in mind most banking institutions are concentrated in larger cities and particularly around the capital city; on the other hand, access to bank credit remains limited,

with only 15% of Sudanese companies having loans from formal financial institutions, according to a recent World Bank study.

Apart from further developing the financial sector, local authorities are working on improving further financial soundness ratios, especially at the level of asset quality and capital adequacy. In its latest country report on Sudan, the IMF acknowledged that although soundness and efficiency indicators are generally weaker than in other countries in the region, they differ widely across banks. Anyhow, the banking sector's gross non-performing loans (NPLs)/Total loans ratio stood at 20.5% at end-2009 (latest available figures) as per IMF figures, slightly improving from 22.4% at end-2008, and thus rendering the Sudanese banking sector one of the few in the world to have witnessed an improvement at the level of asset quality last year, even though NPL ratios remain high on a comparative basis and such an amelioration is partly attributed to a reduction in government arrears. As to provisioning levels, they remain narrow in absolute and relative terms, with the loan provisions to NPLs ratio at 23.9% at end-2009, against a slightly lower 20.0% at end-2008.

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Banking Sector Comparative Ratios (Year 2009)



While NPLs remain concentrated principally in Omdurman Bank, which accounts for about half of total sector NPLs and a quarter of bank financing, authorities are implementing a restructuring plan for the bank. The plan is aiming for Omdurman's recapitalization by current shareholders other than the sector regulator, while striving to prevent further deterioration of its financial position (with planned closure of loss-generating branches, and liquidation of loss-making fully owned companies), in addition to an eventual privatization start by end-2011, as per the IMF.

While the relatively high NPL ratios continue to put strains on profitability ratios, the continued growth in banking aggregates during 2009 helped support bank bottom line figures and

slightly ameliorate profitability metrics, with the pre-tax return on assets ratio at 3.78% in 2009 as per IMF figures, against 3.0% in 2008, and the pre-tax return on equity ratio at 25.5% in 2009, against 23.3% in the previous year.

In parallel, capital adequacy ratios are below the required levels for the bulk of the banking system, as per the IMF, with the regulatory capital to risk-weighted assets ratio at 7.1% at end-2009, against 10.5% in the previous year. The Fund nonetheless acknowledges this was mostly due to a modification in the risk calculation methodology and that broadly speaking, capital adequacy requirement and non-performing loans definitions in Sudan, where banking activity is Islamic banking based, are more stringent relative to international standards for conventional banking.

Going forward, over and above the recent progress at the level of risk management and corporate governance framework, the development of the banking sector in particular, and the depth of financial intermediation in Sudan in general in years to come, are likely to hinge over the pace of reforms of local authorities, especially at the level of NPL reduction and provisioning and capitalization enhancement.

2. CONCLUSION

Within the context of a slow but gradual recovery, economic conditions in 2010 are expected to be relatively better than in 2009. The 60% surge in average oil prices in the first half of 2010 relative to the corresponding 2009 period supports such an improvement. According to IMF forecasts, Sudan's real GDP growth is expected to rise to 5.5% in 2010 and to remain in the 5 to 6% range during the next five years. While oil output is projected to moderate, such growth prospects are contingent on strong non-oil growth, ultimately leading to a more diversified sectoral structure for the Sudanese economy at large.

There is indeed a growing need for economic diversification away from oil which today accounts for about 95% of Sudan's exports and more than half of government revenues. With oil production expected to steadily decline below current levels after 2013, a steady improvement in the non-oil primary balance is needed over the medium term. Volatile oil revenues and a deceleration in oil production in the coming years highlight the need to maintain prudent policies and move ahead with structural reforms to sustain growth.

It is within this context that Sudanese authorities have recently embarked on an overall program aiming to invest US\$ 5 billion through 2012 to develop the agricultural sector whose potential remains largely untapped, with a mere 15 to 20% of Sudan's

arable land being under cultivation. The government plan focuses on attracting strategic foreign investors by providing better infrastructure, removing structural rigidities and distortions, liberalizing investment and the labor markets and reforming the legal system, including the enhancement of property rights and land leasing arrangements.

Challenges facing the Sudanese economy remain considerable. The country needs to enhance its efforts aimed at creating fiscal room and meeting development needs as well as its obligations under the peace agreements. A medium term fiscal adjustment strategy is key. Fiscal prudence is a must for containing inflation and maintaining macroeconomic stability at large. According to the recently released IMF Article IV Consultation mission report on Sudan, fiscal adjustment needs to focus on widening the tax base given the narrowness of such a base on one hand and the rigid expenditure profile on the other hand.

Rebuilding foreign exchange reserves also rise among the top adjustment priorities. Although oil prices rose considerably in the second half of 2009 and the first half of 2010, foreign reserves remain relatively low mainly due to considerable sales of foreign exchange on behalf of monetary authorities. Although this has led to limited exchange rate fluctuations so far, the IMF believes that limiting sales of foreign exchange and allowing for greater exchange rate flexibility is needed to mitigate the impact of external shocks and build foreign exchange reserves to a more comfortable level.

In parallel, strengthening the financial sector is a must for any structural adjustment scenario. The renewed emphasis on increasing enforcement of prudential regulations by taking corrective actions in case of shortfalls is an important development in that direction. But there is a need for more measures to reduce banks' non-performing loans and increase provisioning and capital. It is important as well to intensify efforts for the enhancement of financial intermediation through putting in place an appropriate legal and supervisory framework for the development of non-bank financial institutions at large.

Finally, when addressing Sudan's economic prospects, a number of downside risks come to the fore. Among the most important of such risks rise the difficult political and security situation, the high dependence on oil and the debt overhang with related public finance vulnerabilities. Those risks are exacerbated by the large and complex challenges linked to the slow recovery from the global crisis, the projected decline in oil receipts in the medium term and the large development needs. As such, any wavering in structural reforms, in response to deterioration in the political or security situation, would jeopardize the major gains achieved thus far and would critically put the country's economic outlook at stake.

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