KPMG

Economic Snapshot H2, 2016

Southern Sudan

Inflation – Headline inflation spiralled in the first six months of the year, averaging 247.3% y-o-y. In July inflation quickened further, with the consumer price index (CPI) increasing 661.3% y-o-y. Information on the food and non-alcoholic beverages sub index, which accounts for 71.4% of the CPI basket, was unavailable for July but increases in the sub index were likely higher than overall CPI as has been the trend throughout the year. The ongoing instability and the precipitous decline in the value of the South Sudanese pound since the country came off its peg to the US dollar in December are the main reasons for the price increases. The CPI is compiled using data from Juba and Wau only, and prices in other areas of the country are thought to be significantly higher.

Growth – With the country's economy reliant almost exclusively on oil, economic growth has reflected the volatility of the international crude oil price and disruptions in oil production due to the civil war. Oil production has yet to recover to more than half its pre-civil war level and as such economic growth has remained subdued. In 2014, real GDP growth came in at 2.9% but is estimated to have remained just about flat in 2015 (-0.2%). With the renewed outbreak of violence in July in the capital, Juba, and the continuation of the Transitional Government of National Unity (TGoNU) in doubt, it is highly unlikely that the economy will be able to recover during the current year. The International Monetary Fund forecasts further economic contraction of 7.8%.

National development plan – Economic policy making and implementation in the country suffers due to political instability and a lack of institutional capacity. As such, little progress has been made since the South Sudan Development Plan 2011-2013 that was drawn up at independence. At present, re-establishing stability, building peace and addressing pressing humanitarian needs are the priority.

OPPORTUNITIES	STRENGTHS
Largely unrealized agricultural potential exists, with favourable fertile land, soil, water and climatic conditions.	Significant oil reserves.
Significant, unrealized profits exist for investors and entrepreneurs to help stimulate the underdeveloped economy, making rapid economic growth possible.	Large labour force.
As a least developed country (LDC), the country benefits from duty- and quota-free (DFQF) access to most developed and developing countries under the WTO's DFQF provision for LDCs.	The country has become a member of the East African Community (EAC) which should boost output through trade.

VULNERABILITIES	WHAT IS BEING DONE?
Undiversified economy reliant on oil.	Government policy aims to maintain favourable relations with Sudan to allow oil exports, longer-term plans to reduce dependence on oil.
Risk of mass atrocity crimes from Sudan.	Negotiations continue in international forums and through bilateral contacts.
Domestic security risk in the form of a faction loyal to the former First Vice-President Riek Machar in opposition to the government.	Conflict continues between President Kiir's forces and rebels loyal to Riek Machar. Regional organizations and the United Nations are attempting to get the peace process back on track.
Large parallel market activities with unstable prices.	Authorities are attempting to curb dealings in the parallel foreign exchange market and have adopted a flexible exchange rate.

MEGA TRENDS	
Population	12,042,910 (July 2015 est.); Age 15 - 64: 52.6%
Population growth rate (%)	4% (2015 est.)
Life expectancy at birth	N/a
HIV/AIDS	Adult prevalence rate: 2.8%; People living with HIV/AIDS: 180,000 (2015 est.)
Adult literacy rate (age 15 and over, can read and write)	Total population: 31.9%; male: 38.6%; female: 25.3% (2015 est.)
Urbanisation	Urban population: 18.8% of total population (2015); Urban population growth: 4.7% (2015)
Population below national poverty line	50.6% (2009 est.)
Unemployment rate	12% (2008)
Employment (% of total)	N/a
Labour participation rate (% of total population ages 15+)	N/a
Business languages	English, Arabic
Telephone & Internet users	Main lines in use: 150 (2012); Mobile cellular: 2.88 million (2014); Internet users: 1.96 million (2014)
Sources: CIA World Factbook, World Bank, ITU, Trading Economics UNAIDS & NKC Research	

Risk environment / Risk outlook

Sovereign Risk Ratings		
S&P	**Fitch**	**Moody's**
N/a	N/a	N/a

South Sudan is not currently rated by any of the major credit rating agencies, namely S&P Global Ratings, Fitch Ratings, and Moody's Investors Service.

Infrastruc-ture	Diversity of the Economy	Banking Sector	Continuity of Economic Policy	GDP Growth	Key Balances	Foreign Investment	Socio-economic Develop-ment	Forex Reserves
Very limited	Dominated by oil	Early stages of development	Stymied by political instability	Volatile	Estimated fiscal and current account deficits	Low	Low	Likely to be insufficient

Stock Market	Listed Companies	Liquidity	Market Cap	Dominant Sector	Daily Trading Volume
No	N/a	N/a	N/a	N/a	N/a
Capital Market	**Development**	**Liquidity**	**Maturity Range**	**Municipal Bonds**	**Corporate Bonds**
No	N/a	N/a	N/a	N/a	N/a

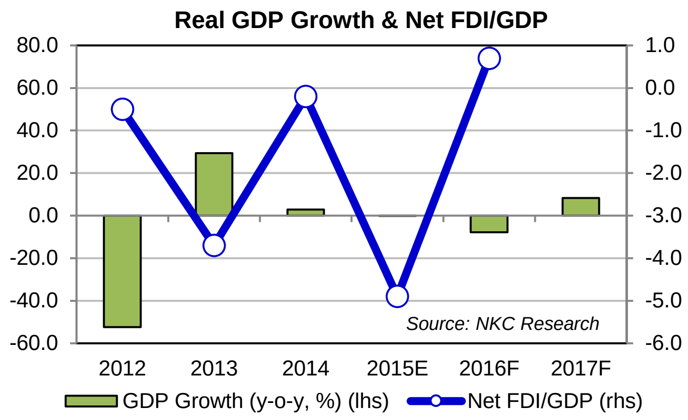
Macro-economic overview

NOTE: *Due to the lack of economic metrics, this overview focuses mainly on interpreting available estimates of economic indicators provided by multilateral organisations – such as the International Monetary Fund (IMF) and the World Bank. We must, however, emphasise that much of the policy discussion is still theoretical given the governance gap, elevated political risk and infrastructure deficit. As such, we do not consider South Sudan as economically stable. Establishing political stability and security are the main focus in the country at present. Other issues like corruption, restrictions on media freedom and the business environment have been side lined.*

South Sudan's economy is almost wholly dependent on its oil industry which historically accounts for roughly 99% of exports, 60% of GDP and 95% of government revenues, according to the African Development Bank (AfDB). The government states that oil production from existing fields peaked in 2009 at 362,000 bpd and is expected to decrease gradually until 2035 when recoverable reserves from these fields are predicted to be depleted. This puts greater impetus on the need for the country to develop its non-oil sectors. However, creating conditions conducive to economic growth in these sectors will take time as they are largely dependent on improvements in infrastructure and governance institutions. That said, the country has significant potential thanks to its many natural resources that have yet to be tapped (swathes of arable land, gold, copper, and iron, to name a few). Currently, it is estimated that 78% of South Sudanese households rely on agriculture for their livelihoods. Within the sector, subsistence farming dominates with crops largely cultivated by hand on small patches of land. The services sector still plays a relatively small role in the economy.

Prospects for economic growth in South Sudan remain closely linked to developments in the oil industry. As such, three factors will determine the direction of growth over the medium term: 1) the international oil price, 2) progress in establishing political stability in order to increase oil production, and 3) relations with Sudan in order to ensure the export of oil is uninterrupted and an agreement on transit fees. With regard to the international oil price, we see the price of Brent crude bottoming out in 2016 at an average of $43.60/bbl compared to $52.40/bbl in 2015. Over the medium term, the price should recover slowly, reaching an average of $67.50/bbl by 2020. As such, we do not expect the country to enjoy the kind of petrodollar windfalls it experienced in the first few years of its independence, and thus the revenue required for much-needed investment in infrastructure to spur growth in the non-oil economy will be in relatively short supply. Prospects for peace are similarly bleak after a recent return to open conflict that could spell the end for the Transitional Government of National Unity (TGoNU) which was established in April in accordance with the August 2015 peace agreement. With regard to relations with Sudan, the regime of President Omar Al-Bashir made positive moves earlier in the year by re-opening the country's border with South Sudan in January for the first time since independence. However, Mr Bashir ordered that the border be closed again in March. Likewise, the agreement on new transit fees that would be based on the prevailing international oil price rather than being fixed at around $24.10/bbl at first appeared to be another sign of thawing relations between the two countries. However, there has been no progress with this since its announcement in February. Relations with Sudan are unpredictable and dependent on developments inside that country where various conflicts continue.

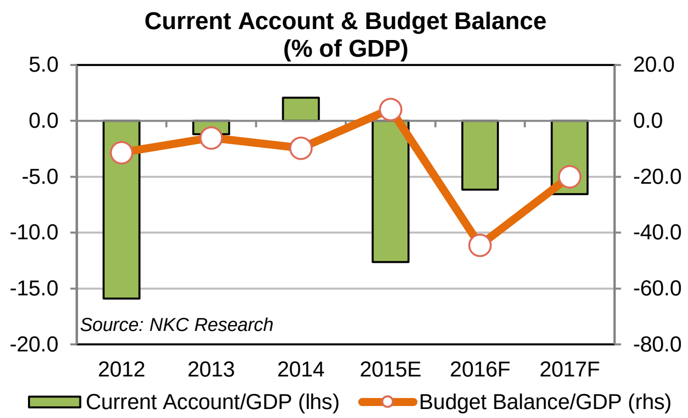
Since independence in 2011, South Sudan's economic growth has been erratic. In 2012, the economy shrank by 52.4% after the government ordered the shutting down of oil production in January of that year. The shutdown came after Sudan began diverting oil from South Sudan to its own refineries and ships at Port Sudan because the South Sudanese were refusing to pay transit fees. The South Sudanese hoped that the shutdown would cause an economic crisis in its neighbour that would bring an end to Mr Bashir's regime. Oil production restarted only 15 months later in March 2013. GDP grew 29.3% in 2013 on the back of the resumption of oil production, but the civil war prevented the country from recovering further in 2014 and 2015 with growth rates of 2.9% and -0.2%, respectively. The IMF forecasts further economic contraction in 2016 with GDP growth expected to come in at -7.8%. The Fund sees economic growth rebounding by 8.2% in 2017 and 7.2% in 2018, but obvious caveats on forecasting should be kept in mind given the volatile nature of the country.



In early-September 2015, South Sudan's Parliament passed a much-delayed budget for 2015/16. The proposed budget cut spending plans by 6% to SSP10.3bn. The government did not reveal how it expected to raise money for the budget, as oil revenues have traditionally been the main source of income. As such, it is likely that more borrowing would be required to maintain some sense of normalcy in government services. However, financing the projected deficit will be difficult since external financing has been limited as a result of the country's high level of risk for debt distress. According to IMF figures, South Sudan recorded a budget surplus of SSP1.46bn in 2015, which translates to 4.15% of GDP. This is the first time since 2011 that South Sudan has managed to record a surplus, and it is a substantial turnaround from the 9.65% of GDP deficit registered in 2014. However, the multilateral organisation expects a return to negative territory this year with a shortfall equal to 44.5% of GDP before falling back to 19.9% of GDP in 2017. As for government debt, the IMF expects South Sudan's debt stock as a ratio to GDP to lower from 56.9% in 2015 to 40.5% in 2016 before declining further to 30.5% next year.

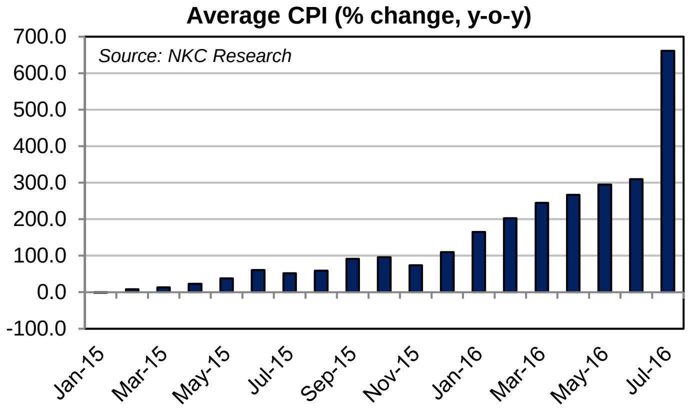
In addition to the conflict, the business environment in the country is also hampered by the lack of infrastructure, particularly roads. According to the World Bank, there are only 7,000 km of roads in South Sudan, most of which are in disrepair. The country has only about 500 km of paved roads: which includes the 192 km stretch of road between the capital, Juba, and Nimule on the Ugandan border that carries the majority of the country's trade. Apart from the country's infrastructure deficiencies, South Sudan also experiences rampant corruption, which is exacerbated by the civil conflict. According to Transparency International's 2015 Corruption Perceptions Index, South Sudan ranked 163rd out of 167 countries and territories, with 167th being the most corrupt. Only Sudan, Afghanistan, North Korea and Somalia ranked lower in the index. The country fares little better on the World Bank's 2016 Doing Business Index. The survey ranked South Sudan 187th out of 189 countries, one place weaker than the 186th ranking in the previous survey.

With the environment as hostile as it is to investment, the country has failed to attract substantial amounts of foreign direct investment (FDI). According to IMF data, FDI inflows have been negative since the country gained its independence in 2011 (indicating disinvestment). However, the IMF forecasts that this will change in 2016 with net inflows equivalent to 0.7% of GDP expected compared to - 4.9% of GDP estimated for 2015. As these forecasts predate the resumption in fighting and the consequent breaking down of the TGoNU, it is likely that the actual figures will be significantly different.



Crude oil is just about all South Sudan exports – about 99% of total exports. As such, the decision in 2012 to shut down oil production proved to be disastrous. Total exports (goods and services) fell from $12.45bn in 2011 to just $1.05bn in 2012, according to the IMF. Although crude oil production began again in March 2013, it took a while for exports to start as producers needed to replenish buffers. As such, the rebound in 2013 was not as pronounced as expected, with exports rising to $4.19bn despite Brent crude prices remaining high at an average of $108.60/bbl for the year. Despite the onset of the civil war in December 2013 and the subsequent halt in oil production in Unity State, exports continued to recover through 2014 and came in at $5.24bn – still less than half their 2011 level in nominal terms. The oil price rout that began in mid-2014 coupled with the continuation of the conflict that further suppressed production, however, put an end to the recovery. The average annual price for Brent crude nearly halved from $99/bbl in 2014 to $52.40/bbl in 2015. Consequently, exports in the country are estimated to have fallen by 45.6% from $5.24bn in 2014 to $2.85bn in 2015. This year, the IMF forecasts that exports will decline further to $1.48bn.

Import statistics for South Sudan are rare and their quality questionable, especially since large volumes of food and other commodities are traded informally across borders with countries like Uganda and Sudan. The IMF's data shows a declining trend in imports since independence. However, given the country's undeveloped state and reliance on imports, demand for imported goods is relatively inelastic. The trade balance for goods and services is estimated to have swung into deficit territory in 2015 at $170m and the Fund forecasts that it will widen this year to $560m – amounting to 18.2% of nominal GDP due to the knock this metric has taken. The devaluation of the pound and scarcity of foreign currency should cause imports to fall further as the economy adjusts to the shock. Over the long term, however, imports, especially of capital equipment, would have to increase significantly if the country were to develop and diversify its economy. The IMF estimates that the current account deficit was 12.65% of GDP in 2015 and forecasts that it will narrow to a shortfall of 6.15% of GDP this year.



Since independence in 2011 until December last year, the country's official currency – the South Sudanese Pound (SSP) – was pegged to the US dollar at an exchange rate of SSP2.95/$. The peg at the overvalued rate was manageable initially given the inflow of petrodollars from the oil industry. However, the oil price rout that started in mid-2014 and the high transit fees (relative to the prevailing oil price) the country needed to pay to export its oil through Sudan (around $24.10/bbl) resulted in dollar shortages that weighed on the local currency and caused the value of the greenback to soar on the black market. The government continued its loose monetary policy in an attempt to monetise the fiscal deficit, leading to a sharp increase in the money supply and rocketing inflation towards the end of 2015 (hitting 95.7% y-o-y in October). Following months of foreign currency shortages and accelerating inflation that crippled businesses, the South Sudanese government finally decided to abandon the peg against the US dollar on 15 December 2015. Consequently, the Bank of South Sudan (BoSS) adopted the parallel market rate, which, according to *Bloomberg*, placed it at about SSP18.50/$ compared to the previous fixed rate of SSP2.95/$. The currency has continued to depreciate throughout the year, reaching SSP45.20/$ on August 1.

Although South Sudan's consumer price index (CPI) inflation increased rapidly when the country gained its independence from Sudan in July 2011, the government's decision to shut down oil production in January 2012 put even more pressure on prices, keeping the CPI inflation rate at exceedingly high levels, with headline inflation averaging some 45% in 2012. Headline inflation moderated significantly in subsequent years as oil production resumed, with headline inflation averaging a mere 0.8% over the 2013-14 period. However, inflation surged again in 2015 as the combination of conflict and drought conditions placed upward pressure on food prices, with the food & non-alcoholic beverages sub-index carrying a substantial 71.4% weighting in the overall CPI. As a result, CPI inflation increased sharply to an average of 52.8% last year. Looking at the latest developments, CPI inflation has continued to surge in 2016 largely as a result of the currency peg being abandoned – although the oil price rout and ongoing conflicts have exacerbated the country's inflation environment dilemma. In July, CPI inflation hit 661.3% y-o-y after averaging 247.3% for the first six months of the year. With little chance of a dramatic improvement in the political and economic situation, we expect inflation to remain elevated throughout the remainder of the year.

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