



SOMALIA

February 2019

FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM—PRESS RELEASE; AND STAFF REPORT

In the context of the First Review Under the Staff-Monitored Program, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on December 6, 2018, with the officials of Somalia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 7, 2019.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Somalia*
Memorandum of Economic and Financial Policies by the authorities of Somalia*
Technical Memorandum of Understanding*

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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IMF Management Complete the First Review under the Staff-Monitored Program for Somalia

- IMF staff commends the authorities for implementing key reforms and for satisfactory performance under the Staff-Monitored Program (SMP).
- IMF staff encourages the Somali authorities to sustain their reform momentum which will help pave the way towards eventual arrears clearance and debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative.

On February 5, 2019, the Management of the IMF completed the first review under the third 12-month Staff-Monitored Program (SMP III)¹ with Somalia, which covers the period May 2018–April 2019. This current SMP, together with the previous two SMPs (covering May 2016 to April 2018), has been designed to help guide the Somali authorities as they rebuild key economic institutions and undertake critical policy reforms to re-establish macroeconomic stability and establish a track record on sound policy and reform implementation

Thanks to the authorities' strong commitment, program implementation has been satisfactory, and capacity continues to strengthen, despite a challenging environment.

Somalia's economy is recovering but further efforts are needed to secure economic resilience and reduce poverty. Since 2017, growth has rebounded, inflation has slowed, and the trade deficit has narrowed. For 2018, real GDP growth is projected at 3.1 percent and end-year inflation at 3.5 percent. The exchange rate has remained stable. But further efforts are needed to improve economic conditions, increase employment and make a significant reduction in

¹ An SMP is an agreement between country authorities and Fund staff to monitor the implementation of the authorities' economic program. SMPs do not entail endorsement by the IMF Executive Board. The SMP is supported by quantitative performance measures, indicative targets and structural measures.

poverty. Development and humanitarian partners are working with the authorities on enhancing the country's resilience. Nevertheless, risks to the outlook and program remain.

The authorities' efforts to improve domestic revenue mobilization has strengthened revenue performance. This reflects efforts to broaden the tax base, and to develop the tax policy framework and administrative capacity to collect taxes. Data through November 2018 show that domestic revenue reached \$161 million (31 percent higher than the same period in 2017), and the overall cash fiscal position was in surplus by \$8 million. New budget support grants from the EU and the World Bank are increasing grant revenues and providing further support for reforms and social transfers. Staff commends the authorities for their concerted efforts to improve domestic revenue mobilization.

Bold steps to strengthen public financial management need to continue. Reforms to improve the fiscal framework are ongoing, and the authorities continue to exhibit greater fiscal discipline and are implementing regular monthly fiscal operations reporting.

The authorities' stepped-up efforts to develop the financial sector are welcome. Staff encourages continued progress on implementing the authorities' action plan (the Financial Sector Roadmap) for reforming and developing the financial sector. Staff urges the rapid implementation of planned changes to the organizational and governance structure of the Central Bank of Somalia. Staff urges the authorities to bring the mobile money sector under its supervisory and regulatory umbrella as soon as possible. Finally, compliance with anti-money laundering and combatting the financing of terrorism (AML/CFT) regulations must be improved and identified gaps in the framework addressed.

The authorities need to complete a number of additional preparatory steps before launching the first phase of the currency reform. These include securing the needed funds and operational support; operationalizing the accountability framework; and completing the detailed project timeline and communications strategy.

Staff encourages the Somali authorities to sustain their reform momentum. The successful completion of the first two 12-month SMPs (from May 2016 to April 2018), as well as satisfactory performance under the current SMP III, reflects the strength of the authorities' policy and reform commitment. This continued commitment will help pave the way towards securing the necessary support, including from donors, for eventual debt relief and arrears clearance under the HIPC Initiative. Staff urges the authorities to begin the process of securing the necessary financial assurances to cover the costs of both HIPC debt relief and clearing arrears to the international financial institutions.

Somalia: Selected Economic and Financial Indicators, 2015–20

(IMF Quota = SDR 44.20 million; Population: 13 million, 2015 estimate)

(Main Export: Livestock)

	Est.			Proj.		
	2015	2016	2017	2018	2019	2020
National income and prices						
Nominal GDP in millions of U.S. dollars	6,669	6,840	7,128	7,484	7,907	8,345
Real GDP, annual percentage change	3.9	4.9	2.3	3.1	3.5	3.5
Per capita GDP in U.S. dollars	511	510	516	527	541	555
Consumer prices (e.o.p., percent change)	0.6	0.7	5.3	3.5	3.0	2.8
(Percent of GDP)						
Central government finances 1/						
Revenue and grants	2.1	2.5	3.5	3.7	4.3	4.4
<i>of which:</i>						
Grants	0.4	0.9	1.5	1.5	1.8	1.7
Expenditure, <i>of which:</i>	2.0	2.5	3.4	3.7	4.1	4.3
Compensation of employees 2/	0.8	0.8	1.8	1.9	2.0	2.0
Purchase of non-financial assets	0.0	0.1	0.1	0.1	0.3	0.3
Overall balance	0.1	0.0	0.0	0.0	0.1	0.1
Stock of domestic arrears	1.0	1.1	1.0	0.9	0.6	0.4
(Millions of U.S. Dollars)						
Central bank summary balances						
Foreign assets (gross)	68.6	60.9	89.2	...	...	...
Net foreign assets, excl. IMF 3/	21.6	21.6	24.0	...	...	...
CBS liabilities to govt 4/	7.2	5.4	29.3	...	...	...
(Percent of GDP)						
Balance of payments						
Current account balance	-4.4	-5.9	-5.6	-5.6	-5.3	-5.2
Trade balance	-45.0	-45.9	-55.3	-50.9	-49.2	-47.8
Exports of goods and services	15.6	15.5	13.3	16.1	16.6	16.4
Imports of goods and services	60.5	61.3	68.6	67.1	65.7	64.1
Remittances	19.9	20.0	21.4	19.1	19.3	19.5
Grants	21.2	20.4	28.7	26.6	25.0	23.6
Foreign Direct Investment	4.5	4.8	5.2	5.5	5.7	5.6
External debt	68.2	66.0	65.5	...	...	...
Market exchange rate (SOS/USD, e.o.p.)	22,285	24,005	23,605	...	...	...

Sources: Somali authorities; and Fund staff estimates and projections.

1/ Budget data for the Federal Government of Somalia. Fiscal operations are recorded on a cash basis. GDP data cover the entire territory of Somalia.

2/ Increase in compensation of employees in 2017 reflects the bringing onto budget military spending related to the loss of an off-budget grant.

3/ Program definition. Excludes position in the SDR Department and obligations to the IMF.

4/ Includes grants and other Treasury deposits.



SOMALIA

FIRST REVIEW UNDER THE STAFF-MONITORED PROGRAM

February 7, 2019

KEY ISSUES

Background and context. Recent developments are broadly favorable, and policies are aligned with staff recommendations and program priorities. Supported by a favorable rainy season, economic growth is recovering and inflation easing. However, unemployment is very high, and development and social needs are very large.

Performance under the program. Program implementation since the approval of the current 12-month Staff-Monitored Program (SMP III) in June 2018 has been satisfactory. All end-June and end-September 2018 indicative targets (ITs) and all structural benchmarks (SBs) were met. Of the 10 remaining SBs, due end-December 2018 and end-March 2019, preliminary information suggests that two have already been met, progress has been made towards achieving seven others, but completion of one SB is likely to be delayed.

Key policy actions. Over the past six months, the authorities have exceeded domestic revenue targets, operationalized the large-medium taxpayer office, reduced the use of cash advances to fund government operations, continued to strengthen financial sector supervision, and submitted key anti-money laundering/combating the financing of terrorism legislation to Parliament for approval. Further progress has also been made on macroeconomic and debt statistics.

First review under SMP III. Considering satisfactory performance under the SMP and the authorities' continued strong commitment to reform implementation, staff supports the completion of the first review under SMP III.

Program risks. Risks to the program and the outlook remain elevated, but a continued commitment to reform and donors' sustained support will help mitigate the risks.

Approved By
Thanos Arvanitis (MCD)
and Nathan Porter (SPR)

Discussions were held in Nairobi, Kenya, during December 1–6, 2018. The staff team consisted of Messrs. Elhage (Head), Kohler, de Imus (both MCD), Kalyandu (FAD), Wang (SPR), and Muir (FAD consultant), as well as Mr. Samake (Resident Representative) and Mr. Irungu (local Economist, IMF Office). The incoming mission chief, Ms. Holland, attended the latter part of the mission. Mr. Li, and Mss. De Mesa and Panagiotakopoulou (all MCD) assisted in the preparation of this report. Mr. Abdullahi (Advisor to the Executive Director) participated in key policy meetings. The mission met with the Finance Minister, Mr. Abdirahman Duale Beileh; Central Bank Governor, Mr. Bashir Issa Ali; Permanent Secretary of the Ministry of Planning, Investment, and Economic Development, Abdikadir Mohamed Adan; Special Advisor, Office of the President, Mr. Hussein Gendhish; Advisor, Office of the Prime Minister, Mr. Abdirahman Abdullahi; and other Somali officials. The mission also met with representatives of bilateral and multilateral donors and civil society.

CONTENTS

BACKGROUND AND CONTEXT	4
RECENT ECONOMIC DEVELOPMENTS	5
PERFORMANCE UNDER SMP III	6
OUTLOOK AND RISKS	6
POLICY DISCUSSIONS	7
A. Continue Improving the Fiscal Framework	7
B. Enhancing Financial and Monetary Policies Through Reform	9
C. Other SMP Related Policy Issues	11
STAFF APPRAISAL	12
FIGURES	
1. Macroeconomic Developments, 2013–18	14
2. Fiscal Developments, 2016–19	15
3. Financial Sector Developments	16
TABLES	
1. Selected Economic and Financial Indicators, 2015–20	17
2a. Federal Government Operations, 2016–20 (Millions of U.S. dollars)	18

2b. Federal Government Operations, 2016–20 (Percent of GDP)	19
3. Summary of the Accounts of the Central Bank, 2014–2018	20
4. Consolidated Commercial Banks Balance Sheet, 2015–2018	21
5a. Balance of Payments, 2015–20 (Millions of U.S. dollars)	22
5b. Balance of Payments, 2015–20 (Percent of GDP)	23
6a. External Public Debt, 2014–17 (Millions of U.S. dollars)	24
6b. External Public Debt, 2014–17 (Percent of GDP)	25
7. Off-Budget Aid, 2014–18	26

APPENDICES

I. Letter of Intent	27
Attachment I. Supplemental Memorandum of Economic and Financial Policies for 2018–20	30
Attachment II. Technical Memorandum of Understanding	44

BACKGROUND AND CONTEXT

1. Political developments and security situation. Despite continued efforts to further solidify security and peace, the environment remains challenging. There are heightened political tensions between the Federal Government (FGS) and Federal Member States (FMS), as the five FMS have entered their states' presidential elections periods and national elections are expected in late 2020. The Somali authorities, with the support of their international partners, have taken important steps to reinforce peace and security in Somalia and the region, which remains fragile despite improvements.

2. Economic situation. Although favorable weather has led to a modest economic recovery, Somalia continues to face significant development and social challenges. Growth remains too low to significantly address poverty and unemployment, particularly among the youth, and Somalia remains vulnerable to natural disasters and food insecurity. The authorities recently developed the Somalia Recovery and Resilience Framework as a long-term economic and social response to the vulnerabilities caused by natural disasters. However, it will take time for the projects to be in place. In addition, despite progress in domestic revenue mobilization, fiscal challenges remain significant and the authorities do not yet have the capacity to make any payments on Somalia's large external debt (\$ 4.7 billion, about 66 percent of GDP), which is almost all in arrears.

3. Fund relations. The FGS has been building a good track record on policy and reform implementation. The FGS successfully completed the first and second 12-month Staff-Monitored Programs, SMPs (SMP I and SMP II). A third (current) SMP was approved in June 2018 and is designed to cover a 12-month period through April 2019. Following a long gap since November 1989, the IMF completed three Article IV consultations with Somalia starting in July 2015, then February 2017, and February 2018. Somalia is among the largest beneficiaries of IMF technical assistance (TA) in recent years. Somalia's overdue obligation to the IMF were \$335.2 million (equivalent to SDR 241 million and 545 percent of quota) at end-December 2018.

4. International relations. Somalia's relationship with the international community continues to improve. The FGS and donors have established the biannual Somalia Partnership Forum (SPF) to improve coordination and the effectiveness of donors' support through a Mutual Accountability Framework (MAF). The latter lays out a comprehensive roadmap of near-term challenges under which the FGS and the international community agree to work jointly to achieve agreed milestones. Moreover, the World Bank approved two pre-arrears clearance grants and the EU approved a three-year budget finance grant for the FGS (both September 2018), totaling about \$80 million and \$115 million respectively, to be disbursed over three years.¹

¹ On September 25, 2018, the World Bank Board approved \$60 million for the Recurrent Cost and Reform Financing (RCRF) Project and \$20 million for a new Revenue Mobilization and Public Financial Management Project. The [EU approved](#) its State Building and Resilience Contract in Somalia on September 26, 2018.

RECENT ECONOMIC DEVELOPMENTS

In 2018, economic activity rebounded moderately, fiscal performance improved, and activity in the financial sector continued to increase.

5. Aided by favorable rains and sustained remittance inflows, economic activity is recovering from the 2016–17 drought (Text Table 1). For 2018, real GDP growth is projected at 3.1 percent and end-year inflation at 3.5 percent (from 2.3 and 5.3 percent in 2017) respectively. With exports recovering on the back of stronger agricultural production, and imports decelerating as drought-related relief returns to pre-drought levels, the trade deficit is expected to have narrowed to 50.9 percent of GDP (from 55.3 percent of GDP in 2017).

6. Fiscal performance continued to improve, on the back of continued strong domestic revenue mobilization (Table 2a).

Data through November 2018 show that domestic revenue reached \$161 million (31 percent higher than the same period in 2017), and the overall cash fiscal position was in surplus by \$8 million. This performance largely reflects yields from new fiscal measures and efficiency gains, including improved customs administration, as well as from the recently established Large and Medium-term Taxpayers' Office (LMTO), and is likely to be sustained. Additional grants amounting \$17 million were disbursed in December.

7. In addition, several critical fiscal reforms have been completed, including (1) taking stock of domestic arrears; (2) reducing the use of cash advances and recording them into the Somalia Financial Management Information System (SFMIS); (3) direct payment of employees' compensation through bank accounts; and (4) operationalizing the LMTO, as well as registering more large and medium taxpayers. Biometric registration of Somalia National Army (SNA) personnel has also commenced.

Text Table 1. Somalia: Selected Economic Indicators, 2016–19
(Percent of GDP, unless otherwise indicated)

	Est.		Proj.	
	2016	2017	2018	2019
National income and CPI	(Percent)			
Real GDP growth	4.9	2.3	3.1	3.5
Inflation (CPI, e.o.p.)	0.7	5.3	3.5	3.0
Fiscal 1/				
Revenue and grants	2.5	3.5	3.7	4.3
<i>of which: grants 2/</i>	0.9	1.5	1.5	1.8
Total expenditure	2.5	3.4	3.7	4.1
<i>of which: Comp. of employees 3/</i>	0.8	1.8	1.9	2.0
Overall balance	0.0	0.0	0.0	0.1
External sector and debt				
Current account balance	-5.9	-5.6	-5.6	-5.3
Trade balance	-45.9	-55.3	-50.9	-49.2
Remittances	20.0	21.4	19.1	19.3
Grants	20.4	28.7	26.6	25.0
External debt	66.0	65.5	...	...
Memorandum items	(U.S. dollar, million)			
Stock of domestic arrears	76.5	68.8	66.0	51.0

Sources: Somali authorities; and IMF staff estimates.

1/ Cash basis. Budget data for the Federal Government of Somalia (FGS); GDP data covers all of Somalia.

2/ Includes only support provided to FGS through treasury accounts at the Central Bank of Somalia.

3/ Increase in compensation of employees in 2017 reflects the bringing onto budget military spending related to the loss of an off-budget grant.

8. Financial sector activities are expanding, albeit from a low base (Table 4).

Banks' lending to the private sector has grown by an average of 60 percent year-on-year since end-2016, and financial inflows via money transfer bureaus (MTBs) remain relatively stable (see Figure 3). Despite high loan growth, the banking system remains liquid and well capitalized, and supervision continues to strengthen. The Licensing and Supervision Department (LSD) of the central bank has enhanced its off-site analysis of banks' quarterly financial data, while new asset classification regulations are improving banks' financial reporting. On anti-money laundering and combatting the financing of terrorism (AML/CFT), the cabinet approved the draft Targeted Financial Sanctions Bill and sent it to Parliament for approval.

PERFORMANCE UNDER SMP III

9. Performance under SMP III is broadly satisfactory (Memorandum of Economic and Financial Policies, MEFP 14, Tables 1 and 2). The authorities have also stepped up efforts to advance reforms ahead of the second and final review.

- All structural benchmarks (SBs) and indicative targets (ITs) for June 2018 and September 2018 were met, which included over-performance on domestic revenue, fiscal balance, and net foreign assets.
- Preliminary data suggest that the authorities are broadly on track to meet the December 2018 and March 2019 targets. They have already completed two SBs on (1) submitting the Revenue Bill to the Parliament; and (2) the take-over by the Ministry of Finance of non-tax revenue from Ministries, Departments and Administrations (MDAs). In addition, they are well on track on seven remaining SBs, including the preparation of the National Development Plan for 2020–2024 (NDP9), which is intended to serve as interim Poverty Reduction Strategy Paper (iPRSP). However, although the renegotiations of the airport and port contracts are advancing, likely delays in their conclusion puts the related SB at risk.

OUTLOOK AND RISKS

10. In the medium-run, growth is expected to stabilize and inflation to stay low. This assumes a continued gradual improvement in the security situation and the absence of any weather-related shocks. Consumption is anticipated to continue to drive growth as the population grows at a stable rate. This will be supported by high levels of grant funding and remittances. On the production side, the macroeconomic projection assumes that agricultural production continues to grow, and that the expansion in transport, construction, and telecommunications continues. The latter will also boost investment spending, which, with increased consumption, is expected to translate into a persistently large trade deficit. This performance will be backed by continued fiscal discipline and gradual expansion of financial services.

11. However, downside risks to the outlook and program are significant. The continued political tensions between the FGS and FMS or a deterioration in security could weaken economic activity and slow program implementation, especially reforms linked to fiscal federalism and revenue

sharing. Further weather-events could increase humanitarian needs. Poor revenue collection and lower-than-pledged budgetary grants, lack of fiscal discipline, and weak governance and corruption could weaken fiscal performance. Technical or financial problems in the mobile money sector, which is large and currently unregulated, could impede payments and put household savings at risk. These risks are mitigated by the authorities' continued strong commitment to the program, and donor support, including to help underpin strengthening the relations between the FGS and FMS and maintain security.

POLICY DISCUSSIONS

Policy discussions centered on the 2018 supplementary budget, the 2019 budget, as well as the macroeconomic framework. Discussions also laid the groundwork for the second and final review under SMP III and on near-term policy priorities: (1) improving the fiscal framework; (2) strengthening PFM and revenue mobilization; (3) finalizing key elements of the currency reform project; (4) reviving the financial sector, including improving Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) compliance; and, (5) promoting economic recovery and resilience programs.

A. Continue Improving the Fiscal Framework

12. The revised 2018 budget is broadly in line with the fiscal framework (Tables 2a and 2b). It targets a budget envelope of \$297.1 million, up from \$261.9 million in the program. This upward revision reflects additional grants and increased domestic revenue mobilization, including from the introduction of new measures: (1) sales tax on imports of goods; (2) sales taxes and license fees from telecommunication companies; (3) increased tax rate on khat; and, (4) transferring the collection of certain fees from the line ministries to the Ministry of Finance. To broaden the tax base, these taxes will be extended to wider sectoral activities overtime.

13. The 2019 budget, approved in December, envisages total domestic revenues and grants of \$340.1 million compared to \$288.3 million in the program (Table 2a). The budget relies on a small increase in domestic revenues (\$189.9 million) and a larger increase in grants (\$150.2 million in budgetary and project grants). Staff and the authorities agreed to a more ambitious revenue target of \$196.3 million, in line with recent trends and supporting measures (below and MEFP ¶8). Staff also urged for a somewhat more conservative estimate of grants (\$140.4 million). Given the current uncertainty, a supplementary budget will be issued later in 2019 to better reflect revenue yields from ongoing and prospective revenue measures and take account of the experience of budgetary grant disbursements and adjust expectations accordingly.

14. Revenue policy and reforms.

Tax collection will be supported by the adoption of new measures to augment the 2018 revenue yields, encompassing income and sales taxes on hotels, telecommunications and electricity companies (Text Table 2). Non-tax revenue will also be strengthened, including from airspace fees once the authorities take over management of the Somali airspace, and the issuance of telecommunication spectrum and fishing licenses. The authorities also anticipate further efficiency gains from the LMTO and ongoing customs administration reforms (not incorporated in staff estimates yet). The yields from these revenue measures will be sustained in subsequent budget years. Once the parliament passes the Revenue Bill, tax measures will

be rolled out beyond Mogadishu, further enhancing the country's tax revenues (the impact of this is not yet factored into the 2019 budget) (MEFP ¶8). Staff encouraged the authorities to build on progress achieved by the LMTO, by continuing to increase the number of registered large and medium taxpayers and assigning unique taxpayer identification numbers. The mission also discussed the authorities' progress in implementing the customs reform roadmap, with assistance from the U.K.'s Department for International Development (DFID), which focuses on developing front-end declaration and auditing processes to improve revenue collection. Continued improvements in revenue and customs administration will also help reduce governance weaknesses and fight corruption. The mission urged the authorities to start reporting on revenue mobilization for the whole country to capture the country's comprehensive tax-to-GDP ratio.²

15. Expenditure policy and PFM reforms. The budget plans for a large increase in employee compensation, capital investment, and transfers to sub-national governments financed by the expected increase in grants. Given the past uncertainty regarding grant disbursements, staff and the authorities agreed to maintain tight expenditure control, especially on non-priority spending in the

Text Table 2. Somalia: Projected Yields from Fiscal Measures, 2018–19 1/
(Million of U.S. Dollars)

	2018	2019
	Proj.	Proj.
Total projected yields from fiscal measures	43.6	68.4
Revenue measures previously implemented 2/	43.6	44.6
Tax policy, increase in excise tax rate on:	18.0	18.0
Khat from \$2 to \$2.50 per kg	13.0	12.0
Airlines sales tax and fees	3.3	3.3
Higher and increased progressivity rate of rental income tax (from 5% to 15–22%)	0.5	0.5
Corporate income tax	1.2	2.2
Tax administration measures:	25.6	26.6
Personal income tax (hotels, electricity, telecoms, foreign workers and NGOs) 3/	5.5	6.4
In-housing revenue collection 4/	1.4	-
Sales tax on Telecommunication companies	6.5	6.5
Sales tax on hotels	0.2	0.2
Collect sales tax on imported goods by value at the port	12.0	13.0
Sales tax on consumer electricity companies	-	0.5
New revenue measures in SMPIII		23.8
Annual tuna licence fees		3.0
Airspace fees collected by ICAO 5/		12.0
Telecommunication licensing and spectrum fees		2.0
Visa charges		4.8
Aiport fees-Favori		2.0

Sources: Somali authorities; and Fund staff estimates and projections.

1/ As outlined in IMF Country Report No. 17/204 (Box 2, page 15).

2/ These are the ongoing yields from measures introduced in 2017 and 2018.

3/ The majority of Somalis working in the private sector earn less than the minimum tax threshold.

4/ The 2018 projection includes full-year annual fees and taxes and clearance of fees and taxes arrears.

5/ Approximately 150-200 flights fly over Somali airspace daily, generating ICAO fees of about US\$1.5 million per month.

² Domestic revenue of the FGS is collected mainly in Mogadishu. However, the GDP series covers the entire country (i.e., the Federal state, the Federal Member States, as well as Somaliland).

coming months. In the event of domestic revenue or grant shortfalls, the authorities will cut spending in line with the rules for sequestration (prioritizing) expenditures. Any revenue windfalls will be first used to paydown domestic arrears and then to build up a fiscal buffer (MEFP 18). The fiscal buffer will only be used to cover wages and salaries, while non-salary spending will follow the sequestration rule. Staff also recommended swift progress on PFM reforms, including: (1) implementing the Treasury Single Account (TSA) by stepping up efforts to close unnecessary MDAs bank accounts and mapping them to the SFMIS; (2) urgently implementing a proper cash-forecasting framework and fully-adopting the commitment control system; (3) further reducing the use of cash advances; (4) effecting direct bank payments for employees, vendors and contractors while eliminating cash payments; (5) requiring more accountability from FMS by reporting on the uses of transfers; (6) speeding up progress on biometric registration of national army forces and on the civil servant database; and, (7) reinforcing the monitoring activities of the Domestic Arrears Management Committee's (DAMC) and Debt Management Unit (DMU). Authorities also need to implement the national procurement policy and speed up the establishment of a procurement authority. Combined, the above measures will help address governance vulnerabilities and reduce the scope for corruption.

16. Fiscal federalism. Given the importance of fiscal relationships between the FGS and FMS to the overall health of the fiscal framework, the mission urged the authorities to continue using the Fiscal Federalism Forum to foster strong country-wide fiscal administration and policies, including for tax, customs, and natural resource management. The authorities indicated they are in the process of concluding discussions at the Forum's technical level on a draft policy paper on intergovernmental fiscal transfers that will inform policies related to the budgeting timetable, reporting, and disbursement conditions. In parallel, progress has been made in implementing quarterly reporting by the FMS on the use of FGS budgetary transfers.

B. Enhancing Financial and Monetary Policies Through Reform

The underdeveloped financial sector faces several structural constraints that limit its support for growth and poverty reduction. The central bank structure, governance, and operations need improvement. Basic supervisory and AML/CFT frameworks are in place but gaps remain. Meanwhile, preparations for currency reform are advancing.

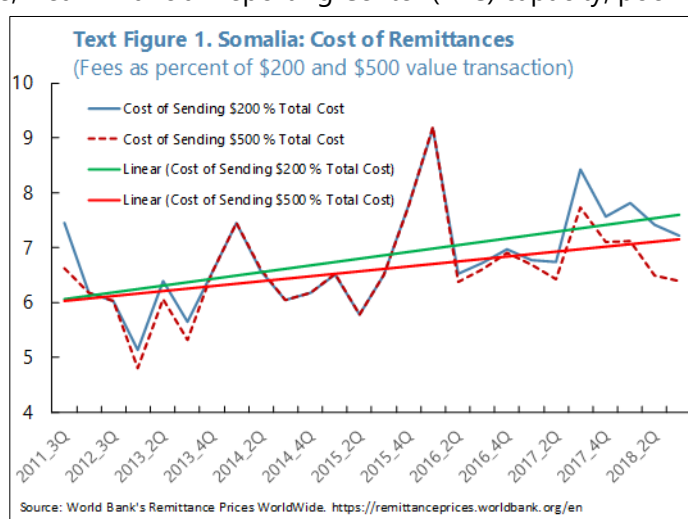
17. Further development of the financial sector is critical to effectively support economic growth and poverty reduction. The financial sector is composed of six banks, 11 money transfer businesses (MTBs), and numerous mobile money operators (MNOs). Total banking sector assets amount to just over 5 percent of GDP and financial inflows through the MTBs amount to well over \$2 billion per year (see Figure 3); however, the mobile money sector dominates.³ Capacity at the central bank, while improving, remains relatively weak, with constraints in both personnel and information technology. This has translated into a financial sector supervisory regime that is still

³ A World Bank report estimates monthly transaction value at about \$2.7 billion per month, and over 70 percent of Somali households use mobile money regularly.

basic, despite recent progress. Additionally, there is a lack of financial infrastructure, including a central payments system.

18. Implementation of a Financial Sector Reform Roadmap (FSR) that prioritizes and sequences key reforms to support financial sector development is underway.⁴ This will help strengthen financial stability, enhance intermediation, and improve governance in the sector. In line with this, the authorities have focused on two urgent near-term priorities: reshaping the current CBS organizational and governance structure, based on IMF TA and approved by the CBS Board on November 25, and action to introduce supervisory oversight over MNOs. The authorities are expected to finalize mobile money regulations in early 2019 and will seek World Bank assistance to implement these regulations and to operationalize the central bank reorganization plan. Finally, the CBS appears to be on track to make its balance sheet compliant with International Financial Reporting Standards (IFRS) by the end of 2019.

19. In addition, a basic AML/CFT legal and operational framework is in place, but addressing critical gaps is a key priority. The LSD is conducting on- and off-site inspections of MTBs, and annual relicensing helps provide AML/CFT regulations some traction. Staff welcomed the submission to Parliament of the Targeted Financial Sanctions Bill, consistent with United Nations Security Council Resolutions 1267 and 1373 and Financial Action Task Force recommendation 6, and urged its rapid enactment and implementation via regulation. Key gaps in the AML/CFT framework include poor MTB reporting and compliance, weak Financial Reporting Center (FRC) capacity, poor coordination between operational agencies, and lack of a national identification card. These factors contribute to the challenge of normalizing correspondent banking relationships and to the rising costs of Somali remittance inflows (Text Figure 1), a life-line for the economy. To take stock of the legal and operational gaps, and outline a sequence of key reforms, staff and the authorities, in conjunction with other donors, agreed to develop an AML/CFT action plan.



20. While the preparatory work for the currency reform is advancing, staff highlighted that a number of key items for Phase I of the reform remain outstanding.⁵ These include: (1) finalizing a communication strategy between the CBS and key stakeholders; (2) preparing the Phase I project timeline; (3) setting up the project management framework, as well as the project fund administration; and (4) operationalizing the accountability framework. While some donors have

⁴ See Annex II of IMF Country Report No. 18/212.

⁵ Phase I of the currency reform will be limited to exchanging the counterfeit Somali shilling notes currently in circulation with new currency.

already indicated their willingness to support Phase I, further work is still needed to secure the full \$41 million.

C. Other SMP Related Policy Issues

21. The authorities continue to address key macroeconomic and financial data gaps. With assistance from the IMF and other donors, the estimation of expenditure-based GDP is nearly complete, and CPI is reported monthly. Financial sector data is being reported regularly, and data quality is steadily improving. A monetary survey is under construction. Statistics on external debt, international trade, and remittances from MTBs have also advanced, while preliminary steps to improve data on other current transfers and income, as well as foreign direct investment, have been taken. Fiscal data reporting for the central government is complete.

22. Capacity building activities are intensifying. The priorities include: (1) budget preparation, execution, and control; (2) PFM, including treasury, arrears, and debt management; (3) tax policy and administration; (4) national accounts and government financial statistics; (5) AML/CFT and correspondent banking relationships; (6) banking licensing and supervision (7) central bank accounting and audit; and, (8) central bank organization and currency reform.

23. Fighting corruption and improving governance in Somalia is essential for improving institutions and promoting inclusive growth. Staff explained to the authorities the new IMF framework for assessing governance and corruption risks, which will be conducted during the Article IV. Staff has started to engage the authorities and development partners, including the World Bank, on some of the issues that will be covered. Additionally, staff urged the passing of an audit bill that ensures the independence of the Auditor General and is consistent with both international best practices and the prevailing Somali constitution.

24. Efforts are being made to pave the way for an IMF upper credit tranche (UCT) arrangement and for the Heavily Indebted Poor Countries (HIPC) initiative decision point (DP). The authorities are establishing a track record of implementing economic policies via the successive completions of SMP I and II. Satisfactory completion of SMP III could support the design of a successor SMP that would meet the standard associated with UCT and eventually pave the way for arrears clearance and debt reduction under the HIPC Initiative.

25. In addition to the challenge of establishing a track record under a UCT-quality SMP, reaching the HIPC DP requires some other demanding steps. The HIPC process is complex and requires substantial coordination of the international community. Authorities must secure commitments from donors to finance debt relief, and complete at least an iPRSP. In addition, Somalia's external debt data will need to be reconciled, a full debt sustainability analysis (DSA) prepared, and an arrears clearance strategy put in place.

- **Work on building the external debt database is well advanced.** Twenty out of the 21 bilateral creditors have validated their claims, enabling progress in determining key inputs for the DSA. Somalia's external debt is high (about \$4.7 billion or 66 percent of GDP as of end-2017)

and nearly 94 percent is in arrears. The government does not have the capacity to service its debt, rendering the situation unsustainable.

- **The topic of Somalia's debt relief has been raised in international fora.** This includes the Paris Club meeting and the Fourth Arab Economic and Social Development Summit, both held in January 2019. This should help start the process of mobilizing resources to finance HIPC debt relief, including the IMF portion for Somalia, the cost of which was not included in the original estimates of the HIPC initiative.
- **The concept note for NDP9 has been approved by the Cabinet.** Donors are supporting the authorities in its preparation, and TA is planned by the World Bank and IMF. The note was circulated to a variety of stakeholders, and the plan is to undertake broad-based and multiple rounds of consultations.

26. The authorities reaffirmed that they are fully committed to meeting the objectives of this SMP and indicated that upon its satisfactory completion they plan to request a successor SMP that is of UCT-quality. They would like the next SMP (SMP IV) to pave the way for arrears clearance and HIPC DP. They also emphasized that they intend NDP9 to be iPRSP compliant. They want the plan to reflect Somalia's development priorities, based on broad consultations across the country, and be fully costed. They agreed to staff's recommendation to seek early support for developing the macro-fiscal framework of NDP9. They also emphasized the need to continue to address poor governance and corruption (MEFP ¶13), and highlighted recent efforts, particularly some high-profile investigations and arrests.

STAFF APPRAISAL

27. Staff supports the completion of the first review under SMP III. Thanks to the authorities' strong commitment, program implementation has been satisfactory, and capacity continues to strengthen, despite a challenging environment.

28. Somalia's economy is recovering but further efforts are needed to secure economic resilience and reduce poverty. Since 2017, growth has rebounded, inflation has slowed, and the trade deficit has narrowed. The exchange rate has remained stable. But further efforts are needed to improve economic conditions, increase employment and make a significant reduction in poverty. Development and humanitarian partners are working with the authorities on enhancing the country's resilience. Nevertheless, risks to the outlook and program remain.

29. The authorities' efforts to improve domestic revenue mobilization has strengthened revenue performance. This reflects efforts to broaden the tax base, and to develop the tax policy framework and administrative capacity to collect taxes. New budget support grants from the EU and the World Bank are increasing grant revenues and providing further support for reforms and social transfers. Staff commends the authorities for their concerted efforts to improve domestic revenue mobilization.

30. Bold steps to strengthen PFM need to continue. Reforms to improve the fiscal framework are ongoing, and the authorities continue to exhibit greater fiscal discipline and are implementing regular monthly fiscal operations reporting.

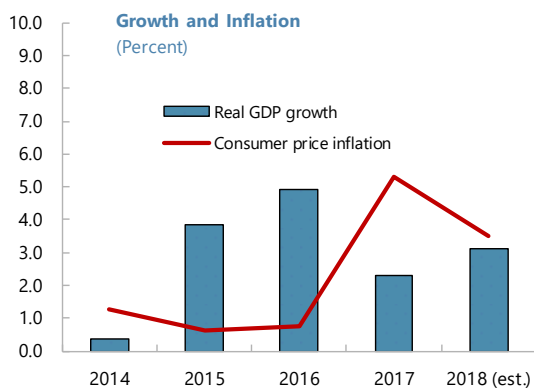
31. The authorities' stepped-up efforts to develop the financial sector are welcome. Staff encourages continued progress on implementing the FSR. Staff urges the rapid implementation of planned changes to the organizational and governance structure of the CBS. Staff urges the authorities to bring the mobile money sector under its supervisory and regulatory umbrella as soon as possible. Finally, compliance with AML/CFT regulations must be improved, and identified gaps in the framework addressed.

32. The authorities need to complete the final preparatory steps before launching Phase I of the currency reform. These include securing the needed funds and operational support; operationalizing the accountability framework; and completing the detailed project timeline and communications strategy.

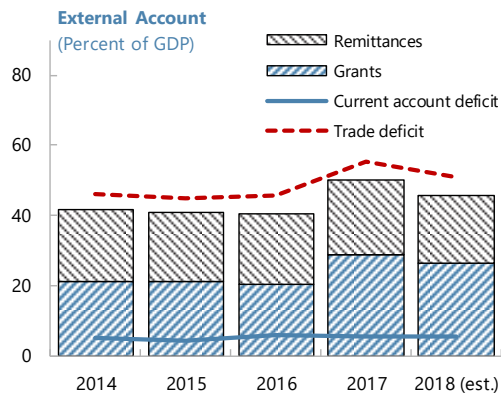
33. Staff encourages the Somali authorities to sustain their reform momentum. The successful completion of the first two 12-month SMPs (from May 2016 to April 2018), as well as satisfactory performance under the third (current) SMP, reflects the authorities' strong policy and reform commitment. This continued commitment will help pave the way towards securing the necessary support, including from donors, for eventual debt relief and arrears clearance under the HIPC Initiative. Staff urges the authorities to begin the process of securing the necessary financial assurances for both HIPC and clearing arrears to the international financial institutions.

Figure 1. Somalia: Macroeconomic Developments, 2013–18

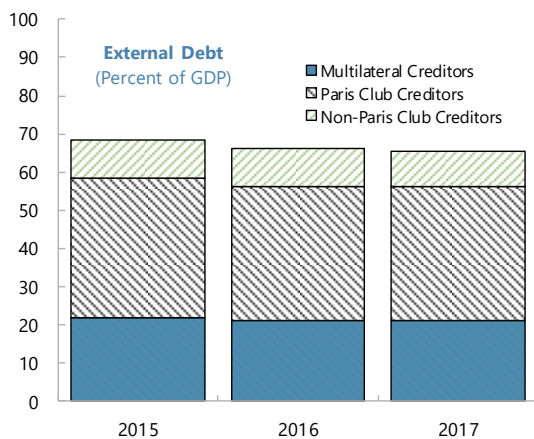
With the return of the rains, growth is expected to recover and inflation to ease in 2018.



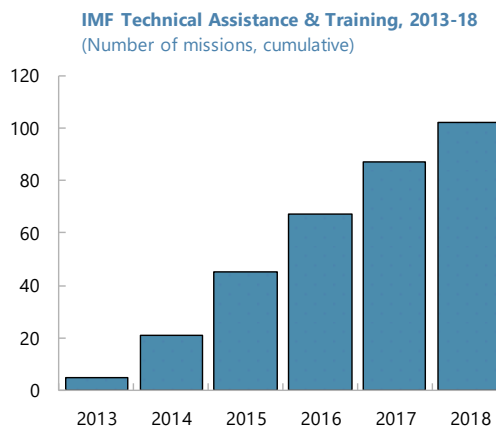
Remittances and grants finance a large trade deficit.



Somalia's external public debt burden is high and virtually all in arrears.



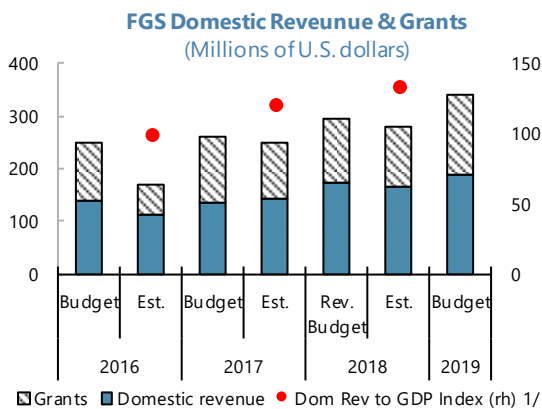
Somalia is among the largest beneficiaries of IMF TA, which underpins the broad reform agenda. 1/



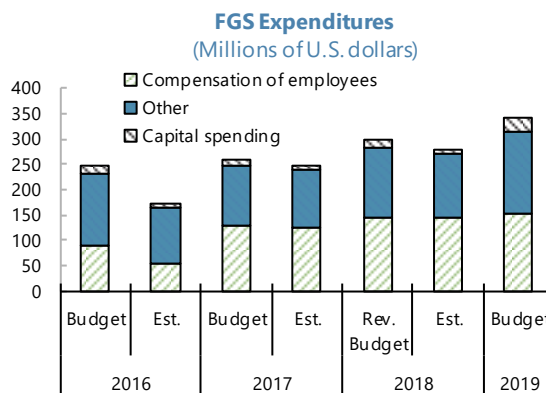
Sources: Somali authorities; and IMF staff estimates.
1/ Through end-December 2018.

Figure 2. Somalia: Fiscal Developments, 2016–19

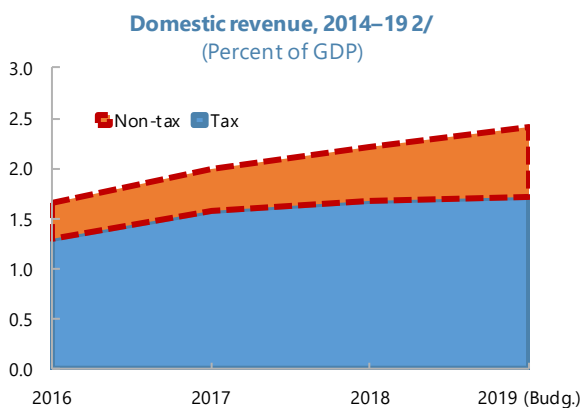
With a small tax base, the government relies heavily on volatile grants...



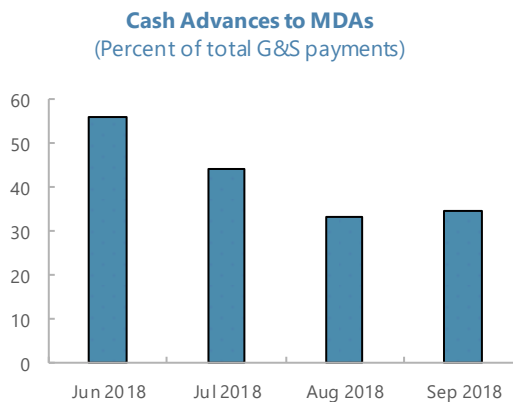
...making budget execution difficult, but improvements are evident more recently.



Domestic revenue remains very low but progress is being made.



Cash advances to MDAs are still large, but have declined recently.



Sources: Somali authorities and IMF staff estimates.

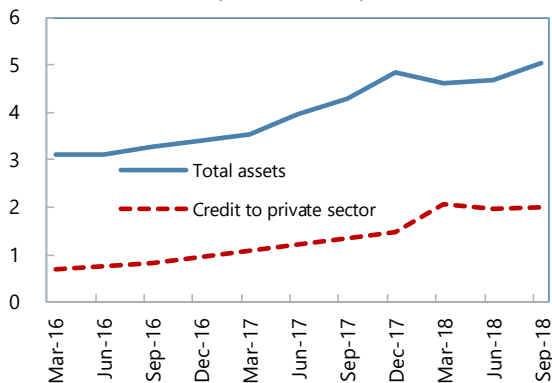
1/Index, 2016=100

2/ Reflects only tax revenue of the Federal Government of Somalia (collected mainly in Mogadishu). The GDP series cover the entire country (i.e., the Federal state, the Federal Member States, as well as Somaliland).

Figure 3. Somalia: Financial Sector Developments 1/

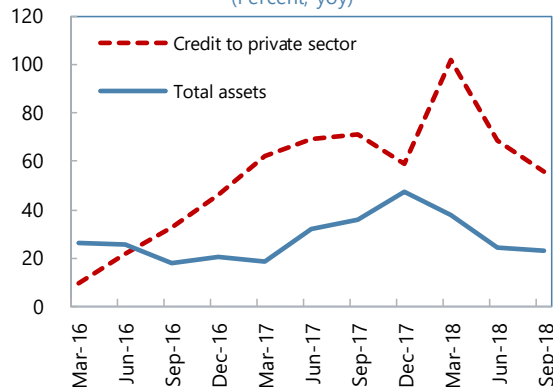
The banking sector is relatively small...

Commercial banks: total assets & credit to the private sector
(Percent of GDP)



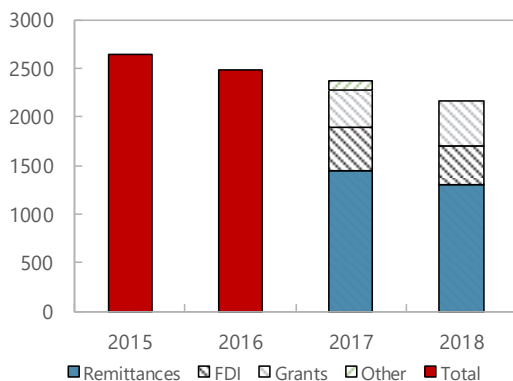
...but activity is increasing rapidly, especially credit to the private sector...

Commercial banks: total assets & credit to the private sector
(Percent, yoy)



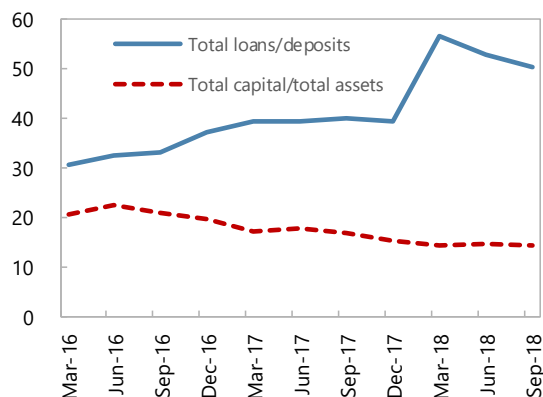
...and inflows via MTBs are large and remain stable.

Financial Inflows via MTBs 2/
(million of USD)



The sector is highly liquid and is adequately capitalized.

Financial Soundness Indicators
(Percent)



Sources: Somali authorities and IMF staff estimates.

1/ Through end-September 2018.

2/ 2017 and 2018 are estimated based on 2017 (Q2-Q4) and 2018 (Q1-Q3) data, respectively.

Table 1. Somalia: Selected Economic and Financial Indicators, 2015–20

(Main Export: Livestock)

	Est.			Proj.		
	2015	2016	2017	2018	2019	2020
National income and prices						
Nominal GDP in millions of U.S. dollars	6,669	6,840	7,128	7,484	7,907	8,345
Real GDP, annual percentage change	3.9	4.9	2.3	3.1	3.5	3.5
Per capita GDP in U.S. dollars	511	510	516	527	541	555
Consumer prices (e.o.p., percent change)	0.6	0.7	5.3	3.5	3.0	2.8
(Percent of GDP)						
Central government finances 1/						
Revenue and grants	2.1	2.5	3.5	3.7	4.3	4.4
<i>of which:</i>						
Grants	0.4	0.9	1.5	1.5	1.8	1.7
Expenditure, <i>of which:</i>	2.0	2.5	3.4	3.7	4.1	4.3
Compensation of employees 2/	0.8	0.8	1.8	1.9	2.0	2.0
Purchase of non-financial assets	0.0	0.1	0.1	0.1	0.3	0.3
Overall balance	0.1	0.0	0.0	0.0	0.1	0.1
Stock of domestic arrears	1.0	1.1	1.0	0.9	0.6	0.4
(Millions of U.S. Dollars)						
Central bank summary balances						
Foreign assets (gross)	68.6	60.9	89.2	...	...	...
Net foreign assets, excl. IMF 3/	21.6	21.6	24.0	...	...	...
CBS liabilities to govt 4/	7.2	5.4	29.3	...	...	...
(Percent of GDP)						
Balance of payments						
Current account balance	-4.4	-5.9	-5.6	-5.6	-5.3	-5.2
Trade balance	-45.0	-45.9	-55.3	-50.9	-49.2	-47.8
Exports of goods and services	15.6	15.5	13.3	16.1	16.6	16.4
Imports of goods and services	60.5	61.3	68.6	67.1	65.7	64.1
Remittances	19.9	20.0	21.4	19.1	19.3	19.5
Grants	21.2	20.4	28.7	26.6	25.0	23.6
Foreign Direct Investment	4.5	4.8	5.2	5.5	5.7	5.6
External debt	68.2	66.0	65.5	...	...	...
Market exchange rate (SOS/USD, e.o.p.)	22,285	24,005	23,605	...	...	...

Sources: Somali authorities; and Fund staff estimates and projections.

1/ Budget data for the Federal Government of Somalia. Fiscal operations are recorded on a cash basis. GDP data cover the entire territory of Somalia.

2/ Increase in compensation of employees in 2017 reflects the bringing onto budget military spending related to the loss of an off-budget grant.

3/ Program definition. Excludes position in the SDR Department and obligations to the IMF.

4/ Includes grants and other Treasury deposits.

Table 2a. Somalia: Federal Government Operations, 2016–20 1/

(Millions of U.S. dollars)

	2016		2017		2018					2019				2020	
	Dec.	Nov	Dec	Sept.	Nov	Dec.			March		Dec.		Dec.		
	Est.	Prel.	Est.	Prog.	Prel.	Prel.	Budg.	Rev. Budg.	Prog.	Rev. Proj.	Prog.	Rev. Proj.	Budg.	Prog.	Proj.
Revenue and grants	171.1	209.4	248.5	183.7	186.9	227.7	274.6	297.1	261.9	279.9	72.1	84.2	340.1	288.3	368.6
Revenue	112.7	123.3	142.6	116.1	127.2	161.2	156.0	172.5	165.0	165.0	47.0	49.1	189.9	188.1	223.6
Tax revenue	88.6	96.6	112.0	89.9	96.5	122.9	127.2	127.9	124.6	124.6	35.5	36.8	135.2	142.0	167.8
Tax on income, profit, and capital gains	2.4	2.8	3.4	4.2	5.7	7.2	6.9	7.2	5.4	5.4	1.5	2.0	9.1	6.1	9.3
Taxes on goods and services	2.9	3.3	8.9	13.2	14.1	18.7	17.6	19.4	18.5	18.5	5.3	5.5	22.0	21.1	25.2
Taxes on international trade and transactions	76.3	84.8	92.8	67.3	71.5	90.3	97.0	94.5	94.0	94.0	26.8	27.2	97.0	107.2	124.0
Other taxes	7.0	5.8	6.9	5.1	5.2	6.7	5.7	6.8	6.7	6.7	1.9	2.1	7.1	7.6	9.3
Non-tax revenue	24.1	26.7	30.6	26.2	30.7	38.3	28.8	44.7	40.4	40.4	11.5	12.2	54.7	46.1	55.8
Grants 2/	58.4	86.1	105.9	67.7	59.7	66.6	118.6	124.6	96.9	114.9	25.0	35.1	150.2	100.2	145.0
Bilateral	31.3	51.8	61.8	30.7	28.5	28.6	61.1	43.5	44.1	43.5	11.4	7.5	30.0	45.6	31.0
Multilateral	27.1	34.3	44.1	36.9	31.2	38.0	57.5	81.1	52.8	71.4	13.6	27.6	120.2	54.6	114.0
Total expenditure 3/	171.1	206.8	245.4	179.0	178.3	219.5	274.6	297.1	261.9	279.9	69.0	77.7	340.1	285.6	356.4
Current	165.1	201.9	239.1	171.7	173.1	213.7	259.1	281.6	250.9	272.3	66.1	72.2	313.7	273.9	332.9
Compensation of employees 4/	55.1	103.8	125.4	94.7	96.0	121.1	131.2	145.3	131.2	145.5	35.0	38.8	154.1	140.0	167.9
Use of goods and services	64.4	66.7	79.0	58.6	54.4	65.6	93.3	96.7	93.3	96.6	24.9	25.8	117.3	99.5	111.5
Transfers to sub-national governments & Banadir Region	9.4	19.7	22.9	16.1	19.0	23.2	23.7	33.3	20.6	23.1	5.5	6.2	37.9	22.0	26.7
Contingency	2.1	3.8	4.0	1.8	3.7	3.8	2.5	4.4	2.5	4.4	0.7	1.3	2.5	2.7	5.8
Repayment of arrears and advances	34.1	7.8	7.8	0.4	0.0	0.0	8.4	1.5	3.3	2.7	0.1	0.1	1.5	9.7	20.5
Purchase of non-financial assets	5.9	4.9	6.3	7.3	5.2	5.8	15.6	15.5	11.0	7.6	2.9	5.4	26.4	11.7	23.5
Overall fiscal balance	0.0	2.6	3.1	4.8	8.6	8.2	0.0	0.0	0.0	0.0	3.0	6.5	0.0	2.6	12.2
Memorandum items															
Accumulation of domestic arrears	42.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock of domestic arrears 5/	76.5	68.8	68.8	68.4	68.8	68.8	60.4	67.2	65.4	66.0	65.4	66.0	65.7	55.7	30.5

Sources: Somali authorities; and Fund staff estimates and projections.

1/ The fiscal operations are recorded on a cash basis. Positions shown are cumulative year to date.

2/ Includes only donor support provided to the federal government through treasury accounts at the Central Bank of Somalia.

3/ Advances to MDA and grants to other organizations are not included.

4/ Increase in compensation of employees in 2017 reflects the bringing onto budget military spending related to the loss of an off-budget grant.

5/ The figure includes only wages, salaries, and allowances.

Table 2b. Somalia: Federal Government Operations, 2016–20 1/

(Percent of GDP)

	2016		2017		2018			2019		2020
	Est.	Prog.	Est.	Budg.	Rev. Budg.	Prog. 2/	Proj.	Budg.	Prog.	Proj.
Revenue and grants	2.5	3.3	3.5	3.7	4.0	3.4	3.7	4.3	3.6	4.4
Revenue	1.6	1.9	2.0	2.1	2.3	2.1	2.2	2.4	2.4	2.7
Tax revenue	1.3	1.5	1.6	1.7	1.7	1.7	1.7	1.7	1.8	2.0
Tax on income, profit, and capital gains	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Taxes on goods and services	0.0	0.1	0.1	0.2	0.3	0.3	0.2	0.3	0.3	0.3
Taxes on international trade and transactions	1.1	1.3	1.3	1.3	1.3	1.2	1.3	1.2	1.4	1.5
Other taxes	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Non-tax revenue	0.4	0.4	0.4	0.4	0.6	0.4	0.5	0.7	0.6	0.7
Grants 2/	0.9	1.3	1.5	1.6	1.7	1.2	1.5	1.9	1.3	1.7
Bilateral	0.5	0.8	0.9	0.8	0.6	0.6	0.6	0.4	0.6	0.4
Multilateral	0.4	0.5	0.6	0.8	1.1	0.6	1.0	1.5	0.7	1.4
Total expenditure 3/	2.5	3.2	3.4	3.7	4.0	3.4	3.7	4.3	3.6	4.3
Current	2.4	3.2	3.4	3.5	3.8	3.2	3.6	4.0	3.5	4.0
Compensation of employees 4/	0.8	1.7	1.8	1.8	1.9	1.7	1.9	1.9	1.8	2.0
Use of goods and services	0.9	1.0	1.1	1.2	1.3	1.1	1.3	1.5	1.3	1.3
Transfers to sub-national governments & Banadir Region	0.1	0.3	0.3	0.3	0.4	0.3	0.3	0.5	0.3	0.3
Contingency	0.0	0.1	0.1	0.0	0.1	0.0	0.1	0.0	0.0	0.1
Repayment of arrears and advances	0.5	0.1	0.1	0.1	0.0	0.1	0.0	0.0	0.1	0.2
Purchase of non-financial assets	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.3	0.1	0.3
Overall fiscal balance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Memorandum items										
Accumulation of domestic arrears 5/	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock of domestic arrears 5/	1.1	1.0	1.0	0.8	0.9	0.9	0.9	0.8	0.7	0.4

Sources: Somali authorities; and Fund staff estimates and projections.

1/ The fiscal operations are recorded on a cash basis. All ratios are calculated based on current GDP estimates and projections. GDP data are for the entire territory of Somalia while fiscal data are for the central government alone.

2/ Includes only donors' support provided to the Federal government through treasury accounts at the Central Bank of Somalia.

3/ Advances to MDA and grants to other organizations are not included.

4/ Increase in compensation of employees in 2017 reflects the bringing onto budget military spending related to the loss of an off-budget grant.

5/ The figure includes only wages, salaries, and allowances.

Table 3. Somalia: Summary of the Accounts of the Central Bank, 2014–2018 1/

(Millions of U.S. dollars)

	2014	2015	2016	2017	2018		
	Dec.	Dec.	Dec.	Dec.	March	June	Sept.
	Est.	Est.	Est.	Est.	Est.	Est.	Prel.
Net Foreign Assets (NFA)	(345.3)	(323.5)	(321.0)	(317.4)	(305.7)	(301.7)	(297.0)
Foreign assets	63.2	68.6	60.9	89.2	110.0	101.2	103.3
SDR holdings	26.5	25.3	24.6	25.8	26.3	25.4	25.1
Gold 2/	19.6	17.2	17.3	18.8	21.2	21.2	21.2
Foreign exchange	10.9	12.7	10.8	33.9	32.3	35.4	38.8
<i>of which:</i>							
Grants	5.4	5.4	3.5	28.2	26.5	30.3	29.3
Cash and cash equivalent (US\$)	6.2	13.3	8.2	10.7	28.1	19.2	18.3
Foreign liabilities	408.4	392.1	381.9	406.6	415.8	402.9	400.3
IMF obligations	341.1	327.7	319.4	340.4	348.2	337.6	335.5
SDR allocations	67.3	64.4	62.5	66.2	67.6	65.4	64.8
Net Domestic Assets	391.5	377.3	367.8	385.6	393.3	377.8	376.9
Domestic assets	402.5	388.7	379.2	424.1	433.3	421.5	419.7
<i>of which:</i>							
Claims on government (net IMF position) 3/	381.9	366.7	357.3	380.8	389.5	377.5	375.3
Domestic liabilities	11.0	11.5	11.4	38.5	39.9	43.6	42.8
Government	7.2	7.2	5.4	29.3	27.6	31.3	30.4
<i>of which:</i>							
Grants	5.4	5.4	3.5	28.2	26.5	30.3	29.3
Other Treasury deposits	4.5	11.9	6.7	4.3	21.6	13.7	16.8
Other domestic liabilities	3.1	3.7	5.6	8.7	11.9	11.9	12.0
<i>of which:</i>							
Commercial bank reserves 4/	...	...	...	...	6.5	9.5	9.5
Commercial bank deposits	...	...	0.0	1.3	1.1	1.6	1.7
MTB deposits	0.1	0.7	0.7	0.8	0.8	0.8	0.8
Equity and reserves	46.2	53.8	46.8	68.2	87.6	76.1	79.9
<i>of which:</i>							
Property and equipment	20.6	21.4	21.7	42.9	43.1	43.6	44.0
Memorandum items:							
NFA (program definition) 5/	16.4	21.6	21.6	24.0	27.8	27.7	29.0
Somali shillings per US dollar (eop)	20,265	22,285	24,005	23,605	23,405	24,305	24,455

Sources: Central Bank of Somalia (CBS); and Fund staff estimates.

1/ Based on incomplete financial data.

2/ Gold price as defined in the TMU ¶10.

3/ Assumes a claim on the Somali treasury composed of (1) the IMF obligations and (2) the net negative SDR position.

4/ Prudential regulations require that commercial banks hold \$1.5 of the minimum \$7 million capital requirement at the CBS; MTBs must hold \$60,000 each at the CBS.

5/ Program definition per TMU ¶19. Excludes position in the SDR Department and obligations to the IMF.

Table 4. Somalia: Consolidated Commercial Banks Balance Sheet, 2015–2018 1/

(Millions of U.S. dollars)

	2015				2016				2017				2018		
	March	June	Sept.	Dec.	March	June	Sept.	Dec.	March	June	Sept.	Dec.	March	June	Sept.
	Est.	Est.	Est.	Est.	Est.	Est.	Est.	Est.	Prel.	Prel.	Prel.	Prel.	Prel.	Prel.	Prel.
Total assets	168.1	169.9	190.8	194.4	212.5	214.0	225.1	234.2	252.1	282.4	305.8	345.0	347.0	351.3	377.3
Cash on Hand	52.9	56.6	72.9	63.9	100.6	64.4	60.7	62.8	65.2	70.5	71.2	71.0	82.4	81.4	108.4
Balances with Central Bank	0.0	0.0	0.1	0.4	1.3	1.2	1.1	1.5	3.1	3.1	5.4	6.7	9.8	10.7	12.5
Deposits with other banks 2/	12.0	13.5	16.1	32.8	9.7	24.1	47.6	41.5	20.5	24.7	44.4	58.4	25.3	19.9	16.3
Credit to private sector	43.0	42.2	42.0	45.2	47.3	51.4	55.8	66.1	76.6	86.9	95.5	105.2	154.5	146.8	149.0
Investment 3/	15.6	15.8	15.7	9.6	8.9	9.5	9.4	12.7	14.7	15.9	8.8	8.8	34.9	49.7	46.6
Other Assets 4/	44.7	41.8	44.0	42.3	44.8	63.4	50.5	49.7	72.0	81.3	80.5	94.9	40.1	42.9	44.5
Total liability	120.2	122.3	144.6	147.8	165.9	163.4	172.2	182.4	202.7	232.2	254.0	292.4	297.0	300.2	323.2
Customer Deposits	115.5	117.3	139.7	142.8	153.8	158.1	167.6	177.1	194.6	219.7	238.3	267.2	272.6	276.9	296.0
Financing Liabilities	0.4	0.1	0.2	0.1	2.0	0.9	1.0	0.9	1.6	1.6	6.3	9.9	1.0	1.0	1.5
Other Liabilities	4.2	4.8	4.7	4.9	5.9	4.4	3.6	4.4	6.5	10.9	9.4	15.2	23.4	21.4	24.6
Equity	48.0	47.6	46.2	46.6	46.6	50.6	52.9	51.8	49.4	50.2	51.8	52.7	50.0	51.1	54.1
Memorandum items:															
Credit to private sector															
share of total assets (percent)	...	...	...	...	22.2	24.0	24.8	28.2	30.4	30.8	31.2	30.5	44.5	41.8	39.5
share of GDP (percent)	...	...	...	...	0.7	0.8	0.8	1.0	1.1	1.2	1.3	1.5	2.1	2.0	2.0
y-o-y changes (percent)	...	...	...	...	9.9	21.9	33.0	46.1	61.9	69.1	71.2	59.3	101.9	68.9	56.0
Total capital to assets (percent)	...	...	...	...	22	24	24	22	20	18	17	15	14.7	15.1	14.9
Loan to deposits (percent)	...	...	...	...	30.7	32.5	33.3	37.3	39.3	39.5	40.1	39.4	56.7	53.0	50.3

Sources: Central Bank of Somalia; and Fund staff estimates.

1/ Quarterly financial data has been reported since March 2015 and is incomplete.

2/ Primarily deposits and placements with non-resident banks and other financial institutions.

3/ Securities, associations and joint ventures, and property.

4/ Fixed, intangible and other assets.

Table 5a. Somalia: Balance of Payments, 2015–20

(Millions of U.S. dollars)

	Prel.			Proj.		
	2015	2016	2017	2018	2019	2020
Current account balance	-290	-403	-400	-421	-419	-430
Overall trade balance	-3,000	-3,139	-3,938	-3,813	-3,888	-3,986
Goods balance	-2,026	-2,216	-3,006	-2,806	-2,817	-2,854
Exports of goods, f.o.b.	683	647	418	675	764	803
Imports of goods, f.o.b.	-2,710	-2,863	-3,424	-3,481	-3,581	-3,658
Services, net	-974	-923	-932	-1,007	-1,071	-1,132
Service credits	355	410	532	530	546	562
Service debit	-1,328	-1,333	-1,464	-1,538	-1,617	-1,693
Income (net)	-29	-30	-31	-33	-35	-37
Receipts	38	39	40	42	45	47
Payments	-67	-69	-72	-75	-79	-84
Current transfers (net)	2,739	2,766	3,569	3,425	3,504	3,592
Private (net), including remittances	1,325	1,369	1,523	1,432	1,527	1,626
Official	1,414	1,397	2,046	1,993	1,977	1,966
Capital account and financial account	299	396	426	421	419	430
<i>of which:</i>						
Foreign direct investment	300	330	369	408	447	464
Overall balance and error and omissions	9	-7	25	0	0	0
Change in central bank reserves (- = increase)	-9	7	-25	0	0	0
Memorandum items:						
Nominal GDP	6,669	6,840	7,128	7,484	7,907	8,345
External public debt	4,551	4,513	4,671	...	...	...

Sources: Authorities, Direction of Trade Statistics, UN Comtrade, and Fund staff estimates and projections.

Table 5b. Somalia: Balance of Payments, 2015–20

(Percent of GDP, unless otherwise indicated)

	Prel.			Proj.		
	2015	2016	2017	2018	2019	2020
Current account balance	-4.4	-5.9	-5.6	-5.6	-5.3	-5.2
Overall trade balance	-45.0	-45.9	-55.3	-50.9	-49.2	-47.8
Goods balance	-30.4	-32.4	-42.2	-37.5	-35.6	-34.2
Exports of goods, f.o.b.	10.2	9.5	5.9	9.0	9.7	9.6
Imports of goods, f.o.b.	-40.6	-41.9	-48.0	-46.5	-45.3	-43.8
Services, net	-14.6	-13.5	-13.1	-13.5	-13.5	-13.6
Service credits	5.3	6.0	7.5	7.1	6.9	6.7
Service debit	-19.9	-19.5	-20.5	-20.5	-20.5	-20.3
Income (net)	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Receipts	0.6	0.6	0.6	0.6	0.6	0.6
Payments	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Current transfers (net)	41.1	40.4	50.1	45.8	44.3	43.0
Private (net), including remittances	19.9	20.0	21.4	19.1	19.3	19.5
Official	21.2	20.4	28.7	26.6	25.0	23.6
Capital account and financial account	4.4	5.9	5.6	5.6	5.3	5.2
<i>of which:</i>						
Foreign direct investment	4.5	4.8	5.2	5.5	5.7	5.6
Overall balance and error and omissions	0.1	-0.1	0.4	0.0	0.0	0.0
Change in central bank reserves (- = increase)	-0.1	0.1	-0.4	0.0	0.0	0.0
Memorandum items:						
Nominal GDP (Million of U.S. dollars)	6,669	6,840	7,128	7,484	7,907	8,345
External public debt	68.2	66.0	65.5	...	...	...

Sources: Authorities, Direction of Trade Statistics, UN Comtrade, and Fund staff estimates and projections.

Table 6a. Somalia: External Public Debt, 2014–17 1/

(Millions of U.S. dollars)

	Prel.			
	2014	2015	2016	2017
Total stock outstanding	4,520	4,551	4,513	4,671
<i>of which: in arrears 2/</i>	4,214	4,255	4,253	4,370
Multilateral creditors	1,493	1,456	1,441	1,522
AfDB Group	133	130	131	138
AfDB	21	22	22	24
African Development Fund (AfDF)	111	106	108	111
Nigerian Trust Fund	2	3	3	3
Arab Fund for Economic and Social Development	175	172	173	179
Arab Monetary Fund	270	265	263	286
International Fund for Agricultural Development	24	24	24	26
International Monetary Fund	341	328	319	340
Islamic Development Bank	14	13	13	13
OPEC Fund for International Development	35	35	35	35
World Bank	501	489	482	505
Bilateral creditors	3,028	3,095	3,072	3,149
Paris Club creditors	2,361	2,434	2,405	2,472
Denmark	8	8	8	9
France	424	476	425	411
Italy	615	600	593	639
Japan	106	109	113	116
Netherlands	6	6	6	7
Norway	2	2	2	2
Russia	141	144	145	149
Spain	38	39	39	40
United Kingdom	82	82	82	83
United States	936	969	992	1,017
Non-Paris Club creditors	667	660	668	677
Algeria	2	2	2	2
Bulgaria	10	10	10	10
Iraq	176	176	176	176
Kuwait Fund and Central Bank	117	115	115	118
Libya	21	22	23	24
Romania	3	3	3	3
Saudi Arabia	103	105	106	108
Serbia	2	2	2	2
United Arab Emirates	233	227	231	235

Sources: Somalia Debt Management Unit; IMF; World Bank; and AfDB.

1/ All non-US dollar claims are converted at period-end exchange rates. The external debt database is under construction and undergoing a reconciliation process.

2/ Based on current data from the authorities and creditors, a portion of Somalia's external debt is not in arrears.

Table 6b. Somalia: External Public Debt, 2014–17 1/

(Percent of GDP, unless otherwise indicated)

	Prel.			
	2014	2015	2016	2017
Total stock outstanding	70.4	68.2	66.0	65.5
<i>of which: in arrears 2/</i>	65.6	63.8	62.2	61.3
Multilateral creditors	23.3	21.8	21.1	21.4
AfDB Group	2.1	2.0	1.9	1.9
Arab Fund for Economic and Social Development	2.7	2.6	2.5	2.5
Arab Monetary Fund	4.2	4.0	3.9	4.0
International Fund for Agricultural Development	0.4	0.4	0.3	0.4
International Monetary Fund	5.3	4.9	4.7	4.8
Islamic Development Bank	0.2	0.2	0.2	0.2
OPEC Fund for International Development	0.5	0.5	0.5	0.5
World Bank	7.8	7.3	7.1	7.1
Bilateral creditors	47.2	46.4	44.9	44.2
Paris Club creditors	36.8	36.5	35.2	34.7
Denmark	0.13	0.12	0.12	0.12
France	6.6	7.1	6.2	5.8
Italy	9.6	9.0	8.7	9.0
Japan	1.7	1.6	1.6	1.6
Netherlands	0.1	0.1	0.1	0.1
Norway	0.0	0.0	0.0	0.0
Russia	2.2	2.2	2.1	2.1
Spain	0.6	0.6	0.6	0.6
United Kingdom	1.3	1.2	1.2	1.2
United States	14.6	14.5	14.5	14.3
Non-Paris Club creditors	10.4	9.9	9.8	9.5
Algeria	0.02	0.02	0.02	0.02
Bulgaria	0.2	0.2	0.1	0.1
Iraq	2.7	2.6	2.6	2.5
Kuwait Fund and Central Bank	1.8	1.7	1.7	1.7
Libya	0.3	0.3	0.3	0.3
Romania	0.0	0.0	0.0	0.0
Saudi Arabia	1.6	1.6	1.6	1.5
Serbia	0.03	0.03	0.03	0.03
United Arab Emirates	3.6	3.4	3.4	3.3

Sources: Somalia Debt Management Unit; IMF; World Bank; and AfDB.

1/ All non-US dollar claims are converted at period-end exchange rates. The external debt database is under construction and undergoing a reconciliation process.

2/ Based on current data from the authorities and creditors, a portion of Somalia's external debt is not in arrears.

Table 7. Somalia: Off-Budget Aid, 2014–18

(Millions of U.S. dollars)

	2014	2015	2016	2017	2018
	Act.	Act.	Act.	Act.	Prel.
Total estimated grants	1,685	1,741	1,688	2,452	2,492
Total Official Development Assistance (ODA) aid 1/	1,218	1,172	1,186	1,908	1,914
Humanitarian aid	672	588	563	1,313	1,087
Developmental aid	546	584	623	595	827
Support for peacekeeping 2/	467	569	502	544	578
Memorandum items:					
FGS budgetary grants 3/	61.0	26.9	58.4	105.9	114.9
FGS budgetary grants, as percent of ODA	5.0	2.3	4.9	5.5	6.0

Sources: Authorities and UN-WB Aid Coordination Unit.

1/ Excludes on-budget grants.

2/ Bilateral military aid is not captured in the table.

3/ Federal Government of Somalia budgetary grants.

Appendix I. Letter of Intent

Mogadishu, Somalia

February 6, 2019

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, N.W.,
Washington, D.C. 20431, U.S.A.

Dear Ms. Lagarde:

The IMF support under the Staff-Monitored Programs (SMPs) since May 2016 is helping us strengthen the Somali economy. Our economy has withstood the 2016–17 severe drought and sporadic terrorist attacks. With sustained support from the international community, we have avoided a humanitarian crisis in 2017. The Federal Government of Somalia (FGS) has developed a Somalia Recovery and Resilience Framework (RRF) as a long-term economic and social response to vulnerability and humanitarian crisis caused by natural disasters. Thanks to decisive reforms under the successive 12-month SMPs since May 2016, our fiscal and monetary institutions, as well as our capacity, are improving. Reform efforts are strengthening budget preparation and execution, broadening the revenue base, and improving tax collection and public financial management (PFM). Despite some delay in the fund-raising efforts to finance the currency reform, progress toward the preparatory work to launch the new national currency is satisfactory.

We are taking bold steps to re-enforce peace and security in Somalia and the region. We believe that achieving our long-term economic and social goals will require sustained efforts to restore peace and security in Somalia as well as in the region. With continued support from the international community, progress on peace and state-building is becoming apparent. Among other efforts, the United Nations Security Council has re-authorized the deployment of the African Union peacekeeping mission in Somalia and delayed the date for Somali forces to take over the lead in the country's security by one year to December 2021. The Horn of Africa has seen strengthening partnership recently and Somalia is playing a significant role in the enhanced cooperation in the region.

We remain determined on achieving our long-term recovery and growth objectives. We are preparing the ninth National Development Plan (NDP9) since 1960. It is built on the 2017–19 NDP (NDP8) and we intend it to serve as an interim PRSP document which lays out our development

goals, challenges, and financing requirements. Achieving our development goals will require obtaining debt relief and access to substantial development financing. Financial sector remains the backbone of the economy, and we are committed to its further development. Our fiscal priority is to increase domestic revenue to enable us to increase budgetary allocations on social spending, including education, health, and humanitarian support. It is in this context that we remain committed to maintaining our reform momentum under the SMP.

Despite milestones achieved thus far under the SMPs, challenges ahead remain significant. The external public debt is high, and we do not have the capacity to service our debt obligations. Growth is too low to make a significant dent in our country's widespread poverty and large social needs. The economy is vulnerable to weather conditions. While the security situation has improved, it remains fragile and aggravated by high youth unemployment. We envisage that following the satisfactory completion of SMP III, which will expire in Spring 2019, the successor IMF program will meet the standard of an Upper Credit Tranche arrangement and would pave the way to move Somalia towards the Decision Point under the HIPC Initiative as soon as possible.

We are requesting the completion of the first review of the current SMP (SMP III). Despite the difficult environment, our performance under SMP III is strong. We have met all end-June and end-September indicative targets (ITs) and structural benchmarks (SBs). We have also exceeded the IT floors for fiscal balance, domestic revenue, and net foreign assets for June and September. Moreover, preliminary assessment suggests that we are well on track on seven out of ten SBs for December 2018 and March 2019 and two were already completed.

The FGS remains convinced that the policies and measures set in the June 2018 Memorandum of Economic and Financial Policies (MEFP) remain appropriate for attaining the objectives of SMP III. The attached supplement to the MEFP describes the progress made under the economic and financial program supported by the SMP and lays out specific government policies for the remainder of 2018 and for 2019 to strengthen program implementation. We remain committed to implementing these policies and reforms and stand ready to adopt any additional measures that may become necessary to keep the SMP on track. We will remain in close consultation with IMF staff on the adoption of such measures and in advance of any revisions to the policies contained in the MEFP. To that end, we seek continued and accelerated support from the IMF and our international partners. To facilitate the monitoring of the performance of the program, the FGS will regularly provide IMF staff with all necessary information within the deadlines specified in the attached Technical Memorandum of Understanding (TMU, Attachment II).

Considering the recent improvement in security in Somalia, and the opportunity cost involved in having many key officials traveling outside Somalia, several times a year, to hold discussions with IMF missions, we urge the IMF to revisit its policy regarding travel to Mogadishu. This continues to seriously impact the work of several ministries and agencies when their staff are outside the country. We would be grateful if the IMF considers the possibility of conducting missions at the UN compound at the Mogadishu International Airport.

In line with our commitment to transparency, the FGS authorizes the IMF to publish this letter, the attached MEFP, TMU, and the related staff report, including the placement of these documents on the IMF website, subject to the removal of market-sensitive information.

Sincerely yours,

/s/

Abdirahman Duale Beileh
Minister of Finance of Somalia

/s/

Bashir Issa Ali
Governor of the Central Bank of Somalia

Attachments (2)

Attachment I. Supplemental Memorandum of Economic and Financial Policies for 2018–20

This Memorandum of Economic and Financial Policies (MEFP) updates the one outlined the request for the third 12-month Staff-Monitored Program (SMP III, May 2018–April 2019, approved by the Managing Director on June 20, 2018). It updates recent economic developments, assesses performance under SMP III, and describes policies that the Federal Government of Somalia (FGS) plans to implement in 2018–20.

A. Background and Context

1. **Aided by favorable rains and sustained remittance inflows, economic activity is recovering from the 2016–17 drought.** In 2018, better weather is supporting the economic recovery, particularly in the agricultural and livestock sectors. Increased activities in the construction, communication, commerce, and service sectors are expected to be sustained. As a result, real GDP growth and inflation are projected at 3.1 and 3.5 percent (from 2.3 and 5.3 percent in 2017), respectively. The trade deficit is expected to narrow to 50.9 percent of GDP (from 55.3 percent of GDP in 2017). Exports are recovering, with increased agricultural production, while imports are expected to decelerate as drought-related relief returns to pre-drought levels.
2. **Fiscal performance through September 2018 has been strong.** Fiscal balance at end of September recorded a surplus of \$8.6 million (up from \$2.3 million in June) largely because of continued strong domestic revenue collection. Moving away from previously negotiated taxes, our tax reform measures initiated as of the fourth quarter of 2017 are bearing fruit. Despite disappointed budgetary grants (lower than budgeted), we expect improved grant disbursements by end-December coming from the E.U and the World Bank. At the same time, expenditure has remained under control, in part due to PFM reform measures, including improved cash management.
3. **Despite recent advances in reform and policy implementation, the development challenges ahead are daunting.** Somalia’s economic institutions are still weak, and poverty remains widespread. While the security situation has improved, it remains fragile and aggravated by high youth unemployment. Our external debt burden is heavy, and we have no capacity to service debt obligations falling due nor to clear overdue obligations. Nonetheless, we are determined to maintain our reform implementation momentum under SMP III. We are hopeful that following satisfactory completion of SMP III; which will expire in Spring 2019, a successor IMF program would meet the standard of an Upper Credit Tranche (UCT) arrangement and pave the way to move Somalia towards the Decision Point under the HIPC Initiative as soon as possible.

B. Program Performance

4. Performance under SMP III is satisfactory (see MEFP Tables 1 and 2).

- All the structural benchmarks (SBs) through September were met.** The Minister of Finance has issued orders to fulfill SB1, SB2, and SB9. We have started recording cash advances in SFMIS in accordance with agreed accounting treatments, with some payments in August recorded in the correct manner, while a smaller proportion followed the old practice (SB 3). We are strongly committed to ensuring continuous improvement in the recording of cash advances until all comply with the agreed accounting treatment. Regarding SB 4, we intend to undertake minor adjustments to the database records to remove three years of records that are outside the agreed timeframe for arrears and to identify the debtor in a small number of records. We have shared the staffing and structure of the fully-operational LMTO with IMF staff (SB8). It has increased the number of registered large and medium taxpayers to more than 50 (SB10). We have also submitted the draft Targeted Financial Sanctions Bill to parliament (SB17).
- As well as all the indicative targets (ITs).** We have also exceeded the targeted floors for fiscal balance, domestic revenue, and net foreign assets by increasing margins from June to September. For September, the overall fiscal balance at end-September stood at \$8 million (up from \$2.3 million in June), against a zero-cash-balance floor. The domestic revenue collection totaled \$127.2 million as compared to a program floor of \$116.1 million. Net foreign assets of the CBS exceeded the program floor by \$5 million. The zero ceilings on domestic expenditure arrears, contracting of new domestic debt, and contracting or guaranteeing of new nominal external non-concessional borrowing were met.
- A forward-looking preliminary assessment suggests that we are well on track on seven out of ten SBs for December 2018 and March 2019 with two already completed.** In particular, the Ministry of Finance has taken over all non-tax revenue collections from 10 of the MDAs which were collecting these revenues (SB 13). On the financial sector, the CBS has already issued a regulation on credit classification and provision, and review reporting requirement for banks (SB18). We also made significant progress toward a timely completion of seven out of the remaining eight SBs set for December 2018 and March 2019. However, we are experiencing an unexpected delay on the two contract renegotiations targeted for the end of December 2018 (SB 6). The latter has proven to be more difficult than expected, mainly reflecting the lengthy and complex legal discussions with other parties.

C. Economic and Financial Policies for 2018–20

5. **Our recovery and growth agenda and progress toward achieving the Sustainable Development Goals will be supported by our ninth National Development Plan for 2020–24 (NDP9).** The NDP9 is being built on the 2017–19 NDP8 and is intended to serve as an interim PRSP document. It will lay out our development goals and the challenges, and the financing requirements.

Our development partners have expressed strong interest in supporting the process and are encouraged to align their support with the 2020–24 NDP9.

6. Our Economic and Financial Program for 2018–20 will support NDP9 and aims at reaching the SDGs. To that end, the program will focus on (1) consolidating the improvement of the macroeconomic framework and the fiscal position, and (2) starting to reduce vulnerability with steadfast implementation of the Somalia Recovery and Resilience Framework (RRF), as well as a budgetary social safety net program. Alongside this, we will continue to improve capacity and institutions, and build ownership for the program, including by (1) continuing efforts to improve macroeconomic statistics, and (2) developing a debt sustainability framework for Somalia, together with the appropriate debt management capacity.

7. The Economic and Financial Program for 2018–20 will continue to be aligned with the policies under SMP III and will build on the achievements over the past two years. Hence,

- **Our broad fiscal policy** will continue to be anchored on (1) maintaining a zerocash-based fiscal balance; (2) avoiding any new domestic arrears accumulation; and (3) continuing to improve domestic revenue mobilization.
- **On the monetary policy side**, we will not allow the net foreign assets of the Central Bank of Somalia (CBS), as defined in the Technical Memorandum of Understanding (TMU) to fall below a continuous floor.
- **On structural reform policies and measures, we will continue to focus on:**
 - Deepening progress on public financial management (PFM) reform, including expenditure control and minimizing the use of cash advances, arrears, cash, and treasury management; and revenue mobilization;
 - Accelerating the completion of Phase I of the currency reform by, mainly, reaching out to donors to confirm pledged grants to finance the reform;
 - Accelerating the implementing the financial sector roadmap, focusing on CBS reorganization and implementing mobile money regulations in the short-term, while strengthening compliance with the anti-money laundering and combating the financing of terrorism (AML/CFT) standards; and
 - Upgrading our macroeconomic and financial data production and reporting system.

Fiscal Policy and Reforms

8. The FGS is taking bold steps to implement reform measures and improve the fiscal framework overtime.

- **Overall fiscal strategy for the remainder of 2018 and during 2019.** We are committed to greater fiscal discipline and to improving the fiscal framework with prudent budget planning and management. To that end, we will (1) refrain from any expenditures that are not fully covered by realistic domestic revenue and conservative, pledged grants projections; (2) remain current on our obligations, and in the event of domestic revenue or grant shortfalls, we will cut spending in line with the rules for sequestering (prioritizing) expenditures; and, (3) ensure that, where possible, revenue windfalls (including additional grants for budgetary support) are used to pay down domestic arrears first and then to build up fiscal buffers. Given the volatility in grants thus far in 2018, we will keep expenditure under control, particularly on non-priority goods and services.
- **Fiscal strategy for 2018.** We will remain committed to expanding domestic revenue mobilization including gains from the new tax measures.
- **Fiscal strategy for 2019.** We will issue a supplementary budget in 2019 that would reflect some revisions in domestic revenue to reach \$196.3 million (compared with \$189.9 million in the budget). We are confident that we will receive the \$150.2 million in budgetary and project grants. In case of a shortfall in budgetary grants (for project grants a shortfall in revenues is budget neutral as it is matched by a corresponding fall in expenditures), we will cut discretionary expenditures and apply the \$15 million buffer we have in deposits. Should grant disbursements be lower than projected, the supplementary budget will also include downward revision in budgeted grants.
- **Revenue measures.**
 - **For the remainder of 2018,** we intend to reach our revenue targets by improving efficiencies in collection and we will focus on maintaining revenue collection from: (1) sales tax on imports of goods; (2) sales taxes and license fees from telecommunication companies; (3) tax rate on khat; and (4) transferring the collection of certain fees from the few remaining Ministries, Departments and Agencies (MDAs) to the Ministry of Finance.
 - **For 2019,** we will undertake an upward revision in domestic revenue to better reflect revenue yields from new and on-going tax measures (as outlined above) and additional measures including on hotels, telecommunication and electricity companies to broaden the tax base. The new measures will include (1) expanding the coverage of large and medium taxpayers beyond 80 currently registered and follow-up on all potential tax arrears in Mogadishu; and (2) assessing income taxes, sales taxes from telecommunications companies. In addition, following the takeover of the management of Somali Airspace from the International Civil Aviation Authority (ICAO) last October, we expect to generate new revenue from collecting airspace fees, once pending legal issues with ICAO and technical issues with IATA are resolved.
 - **Other revenue measures.** With the adoption of the Revenue Bill, we intend to roll out tax measures beyond Mogadishu. We will also follow-up on progress toward the

implementation of the Customs Roadmap and on the submission of an amended National Customs Act to Parliament (SB 15). We intend to reactivate Somalia's membership in the World Customs Organization to further support a broad range of customs functions.

- **Expenditure measures.**
 - **Civil service productivity and database.** With assistance from the World Bank and in coordination with the National Civil Service Commission, we are making steady progress on the preparatory work to restructure our civil service and build its database to ensure an increase in staff productivity and to contain the public wage bill.
 - **Domestic expenditure arrears.** Following the stocktaking of domestic expenditure arrears and their recording into the SFMIS, we intend to update the database through end-December 2018 and maintain the database on monthly basis. As we develop our capacity to repay our obligation, a coherent and transparent domestic arrears clearance program will be set.
- **Public Financial Management (PFM) measures.**
 - **Fiscal governance and accountability.** We will ensure that all FMS continue reporting back to FGS on the utilization of budgetary transfer on a semi-annual basis. Despite security challenges in some areas, we are continuing to make good progress on biometric registration of SNA personnel (as of the end of September 2018, 4,950 have been registered, all in Mogadishu, Banadir region, and are being paid through SFMIS directly into personal bank accounts. We are aiming to register all SNA (Somalia National Army) personnel and complete the entire process by June 2019 despite recent setbacks outside of our control.
 - **Treasury Single Account (TSA).** Progress toward the Treasury Single Account (TSA) by stepping up efforts to close unnecessary MDAs bank accounts and mapping them to the SFMIS is advancing well (SB 7).
 - **Cash advances.** We have achieved a milestone in August by commencing to record cash advances in the SFMIS under agreed accounting procedures to ensure transparent fiscal reporting and improve budget credibility. We will keep up this momentum and ensure all cash advances are properly recorded and acquitted.
 - **Cash-forecasting framework.** We have updated the monthly cash-forecast for 2018 and completed a preliminary forecast for 2019 based on the draft budget. We remain committed to implementing the cash forecasting framework that informs the monthly allotments in SFMIS.
 - **Domestic arrears management institutions and capacity.** We are taking bold steps to improve our domestic arrears management capacity. To that end, we are reinforcing and monitoring activities of the Domestic Arrears Management Committee's (DAMC).

- **Fiscal federalism.** Progress on fiscal federalism remains strong despite some recent tensions with the FMS resulting mainly from the beginning of the states' presidential elections periods over the next twelve months starting in November 2018. Nonetheless, fiscal federalism is a critical political and economic objective for the FGS which will help foster higher and more inclusive growth. We continue to hold fiscal federalism meetings with the FMS and have agreed to implement the Revenue and PFM Bills once approved by the parliament. Following that, we will implement the petroleum and fisheries revenue sharing agreements. We are also in the process of concluding a discussion on a draft policy paper on intergovernmental transfers at a technical level that will guide our policies related to budgeting timetable, reporting and disbursement conditions.
- **Budgetary and off-budget grants.** To improve the FGS oversight of budgetary and off-budget grants to Somalia, we will write, by end-March 2019, to donors and recommend that all grants to Somalia be reported to the CBS, the Ministry of Finance (MoF), and the Ministry of Planning.
- **Procurement and concessions.** We are aware of the need to implement the national procurement policy and to speed up the process to establish a proper procurement authority and guidelines to enhance the effectiveness of procurement and contract concessions process. This is critical as we are reviewing government contracts (that value exceed \$5 million each). We will empower the Interim Procurement Requirement in line with the Procurement Act to review these contracts and enforce current regulations and complete the procurement framework. Meanwhile, we are working to propose adjustments to the Procurement Law, to enable the possibility of third party approval of high-value contracts and non-standard bidding procedures.

Financial Sector Reforms

9. We plan to launch Phase I of currency reform as soon as preparations are completed.

Following the endorsement letter received from the IMF in early March 2018, we have stepped up efforts to reach out to donors to raise the needed funds (\$41 million) for this project. We have also reached out the World Bank for assistance on the project fund's administration. With IMF's assistance good progress is being made on key preparatory documents which include: (1) communication strategy framework between the central bank and key stakeholders; (2) currency reform project timeline; and (3) the tender document. The accountability framework committee associated with Phase I was endorsed by the CBS Board of Directors, and the committee members were identified in June 2018 to support the final preparatory work for the launch of the new currency. As soon as the administrative framework for the project fund is set up and the project funding is fully covered, we expect the IMF to assist us with a currency expert based in Nairobi to provide direct support to the CBS and the currency reform project manager.

10. We will continue implementing the updated financial sector development roadmap.

The roadmap highlights key bottlenecks for financial development and inclusion and outlines reforms to improve financial intermediation and stability. Our priorities over the next twelve months are outlined below:

- **CBS organization.** With the CBS Board approval of the CBS reorganization recommendations, based on IMF technical assistance, we will take steps to implement the recommendations as soon as possible. As a next step, we will reach out to the World Bank for assistance on the operationalization and financing (including of staffing needs) of the proposed CBS organization framework.
- **Prudential supervision.** We will continue to improve the capacity of the Licensing and Supervision Department (LSD):
 - **For commercial banks,** we will expand and improve financial reporting requirements, continue strengthening the on-site inspection and supervision manuals, expand the scope of on-site inspections, finalize an off-site inspection manual, and develop a plan for dealing with problem institutions. In addition, we will develop a plan to address the staffing and organizational needs of LSD, as well as providing adequate IT resources, conduct a validation exercise of financial data submitted by banks, and give supervisors the needed time to conduct on-site inspections.
 - **On money transfer businesses (MTBs),** we will improve the MTBs licensing process and enhance compliance with existing regulations. This will be done by increasing enforcement via the annual relicensing process. We will also further enhance standards for disclosing Inspection Reports to MTBs and improve communication and address gaps in the AML/CFT framework.
 - **Mobile money** has grown rapidly in the past years and is also an important element in Somalia's payment system. We will prioritize the proper regulation and supervision of the mobile money services by end-March 2019. We will accelerate the process to issue the necessary regulations to license and supervise mobile money providers under the current legal framework. In the context of CBS reorganization and ongoing capacity building, we will build these operational requirements into the LSD structure. At the same time, the National Communications Authority (NCA) will build licensing and reporting requirements necessary for proper regulation of the telecommunications sector and mobile network operators (MNOs). Importantly, these future regulations will require MNOs, that provide mobile money services, to fulfill reporting requirements – and cooperate with – the CBS to receive and maintain a license to operate telecommunications and mobile money services in Somalia. In coordination with international partners, we will look to update the Financial Institutions Act to address legal gaps.
- **CBS accounting and audit.** With the appointment of a Director of Internal Audit, we will issue an exit report and recommendations from the recent external audit, develop a multi-year audit plan, and draft an annual audit report for the Audit Committee. On accounting, we will finalize the draft accounting manual, agree on the recognition of IMF positions on the CBS balance sheet and on treatment of investment properties, and clarify the process to achieve full IFRS compliance. We will start accrual accounting for the 2018 financial statement and aim to begin implementing IFRS in 2019.

- **Financial infrastructure.** With assistance from the World Bank, we are developing a plan to introduce a digital identification for Somalis to support collateral based lending and Know Your Client (KYC) objectives. To support the payment system, we are developing an automated transfer system and national switch, which are tentatively planned to be operational in 2019. In addition, we are starting to explore options for developing a collateral registry and credit bureau.

11. Improving the AML/CFT framework and increasing compliance with regulations is a priority. With the assistance of our external partners, we will develop an AML/CFT roadmap to identify specific gaps and reforms to support correspondent banking relationships and remittance flows to Somalia. Following the recent submission of the Targeted Financial Sanctions Regulation Bill to Parliament, we will now move quickly to finalize – with IMF TA assistance – and issue regulations to implement these targeted sanctions. We will also improve the MTBs’ compliance with the AML/CFT regulations and the reporting of suspicious transactions to the Financial Reporting Center (FRC) by implementing the MTB plan to improve compliance and licensing. We will expand the capacity of the FRC, in cooperation with international partners, by addressing personnel and IT gaps. Finally, while preparing for a comprehensive review of the AML/CFT Act and associated regulations, we will clarify the roles and responsibilities of agencies in the National Anti-Money Laundering and Countering the Financing of Terrorism Committee (NAMLC) to improve operationalization of the AML/CFT framework.

Policies for Accelerating Economic Recovery and Social Inclusion

12. We are advancing a broad-based reform agenda to strengthen economic resilience and bolster the foundations for sustained inclusive growth. The development challenges for Somalia, after decades of civil war, are significant. We have recently developed the Somalia Recovery and Resilience Framework (RRF) as a long-term economic and social response to the vulnerability and humanitarian crises caused by natural disasters. This is also well integrated into the ongoing preparation of the 2020–24 NDP9 which, in turn, is strongly supported by the international community.

13. We have identified several priority areas for accelerating economic recovery and social inclusion.

- **Combating corruption and improving governance will remain essential for the FGS.** Our ongoing efforts to combat corruption and improve governance include (1) the passage in the lower house of the Anti-Corruption Bill which is in line with international best practices; (2) the on-going operations of a Reform Implementation Unit (“Delivery Unit”) to monitor the performance of all government reform priorities; (3) issuing of orders by all ministers to fight against civil servant workers’ absenteeism and running a pilot program using biometric technology to track attendance; (4) improving transparency on monetary and fiscal reporting, including, where possible, on the off-budget support; and, (5) strengthening the MoF website including Budget information. We have recently prepared and submitted to the Parliament an Audit Bill that ensures the independence of the Auditor General function in a manner that is

consistent with the Constitution of Somalia and aligned with international best practice. The anti-corruption bill was approved by the House of the People and is awaiting the approval of the Senate. Once the Bill is approved by the Parliament and signed by the President, we will quickly move to the formation of the Anti-Corruption Commission.

- **We will continue to improve the business environment.** We have already stepped up efforts to increase the private sector's role in the economy. We passed a foreign direct investment (FDI) law and adopted a procurement bill. We will continue to enhance the business environment through public-private sector dialogue, improved financial governance and intermediation, and new business regulations, as well as to improve access to finance. Access to financial services will be achieved by following through with the Financial Sector Development Roadmap, including better AML/CFT compliance. We were pleased that Somalia entered the Global Doing Business Survey for the first time in 2017. We believe that the continued low ranking of Somalia in the Doing Business report for 2018 does not fully reflect the broad-based progress we are currently making. Nonetheless, we will continue to work on areas identified in the report to raise the position of Somalia in subsequent surveys.
- **We will prepare a draft 9th NDP for 2020-2024 and have started the process.** Our intention is to make the plan compliant with an interim Poverty Reduction Strategy Paper (PRSP) document, which lays out our development goals, challenges, priorities, and financing requirements. The plan will be developed through a consultative process with participation from all stakeholders across the country. We will start preparing a medium-term fiscal framework and link it to the NDP. Special attention will be given to the social program targets, including poverty reduction, job creation, and capacity and resilience program in response to drought, flooding, and other social safety net programs. Finally, we will seek adequate financing of the NDP.
- **Increasing social spending will remain critical for developing resilience and supporting poverty reduction.** We are pleased to have started allocating more resources to our social sectors in our annual budget starting in 2019 and the aim is to increase this allocation in our subsequent annual budgets. We will increase budgetary allocations on social spending, including education, health, and humanitarian support. We have also made progress on managing and facilitating the return of refugees to Somalia. Also, under the United Nations Refugee Return and Reintegration project, an increasing number of refugees are being placed in training institutions (mainly in Kenya), where they are trained in peace-building and conflict-resolution.

D. Institutions and Statistics

14. Our efforts to empower the government and institutions will be essential for sustained growth and social cohesion.

- **Natural resource management and transparency.** We remain committed to transparent and equitable management of natural resources. The draft PFM Bill includes a clause that sets out the principles of governing the PFM of natural resource revenues. Also, discussions with the FMS

in the Fiscal Federalism Finance Ministers Forum meetings are well advanced on natural resource revenue sharing. Many of these issues are addressed in the Revenue Bill which is being finalized.

- **Statistical data.** Despite important progress to reconstitute our economic data in the past three years, the challenges ahead are significant. We will press on the Parliament to adopt the long-awaited Statistical Law which was submitted in September 2017. The MOPIED, Ministry of Finance, and CBS will strengthen the existing roadmap for statistical data production and dissemination by end of March 2019. In this regard, we have identified the following critical tasks: (1) complete the reconstitution of the public debt database; (2) update, on a regular basis, the statistical business register across FGS and FMS; (3) launch a capital expenditure survey based on the existing one and strengthen Somalia's export and import data by collecting trade in goods data by value and volume; (4) implement IFRS-based accounting at the CBS; (5) improve remittance data mainly with the MTB survey; (6) start conducting surveys on travel, and primary current transfers related to embassies and NGOs; (7) finalize the survey form for foreign direct investment and coordinate with the Ministry of Trade and Commerce to begin surveying the 20 largest companies; and (8) complete a civil service database. Meanwhile, we have compiled and applied GFSM2014 to the federal government for the period of 2013–18 and the draft 2019 budget. Building on technical work to develop a consolidated COA/GFS and budget harmonization, we will aim to prepare a consolidated government budget for the FGS and FMS during 2019 using the 2019 budgets as a pilot exercise. Separately, the CBS will implement the action plan for improving source data for the CBS and for collecting financial and non-financial data.

E. Relations with International Creditors and Debt Relief

15. Normalization of relations with international creditors is underway. We expect budget support and debt relief from our bilateral creditors following the Fourth Arab Economic and Social Development Summit on January 2019. In the period ahead, we will intensify our effort to reach out to multilateral and Paris Club creditors. This should, in due course, help address the burden of external debt and arrears, and facilitate access to concessional financing. We understand that qualifying for the HIPC Initiative requires (1) establishing a satisfactory track record of cooperation with the Fund on policies; (2) normalizing relations with creditors, including to mobilize donor agreement and resources to finance debt relief; and, (3) preparing a poverty reduction strategy. We expect, following the satisfactory completion of the current SMP, that SMP IV would be developed to meet the standard associated with IMF financing support. To our understanding, that would imply that staff would seek the endorsement of the IMF's Board to move Somalia towards the Decision Point under the HIPC Initiative in due course.

16. Meanwhile, we will step up efforts to complete our debt database and improve capacity at the Debt Management Unit (DMU). Reconciling external debt and confirming that debt sustainability indicators are above the relevant HIPC initiative thresholds is a technical prerequisite for HIPC. Hence, we have reached out to 21 bilateral creditors, representing nearly 70 percent of Somalia's external debt, to confirm the loan-by-loan terms, principals, interest and

outstanding penalties (the remaining 30 percent of external debt are primarily with multilateral creditors). As of today, 20 out of 21 bilateral creditors have responded to the validation exercises, so nearly all of Somalia's external debt has been confirmed, which is about \$4.7 billion or 66 percent of GDP as of end 2017, with nearly 94 percent is in arrears. We are also supporting the IMF and World Bank in developing Somalia's first debt sustainability analysis (DSA). In this regard, we expect the IMF and World Bank to support our request for training the DMU staff on the LIC-DSF as soon as possible.

Technical Assistance

17. During the program period, we are requesting IMF TA in: (1) tax policy, revenue, and customs administration; (2) budget preparation and execution; (3) reforms in cash forecasting, and the TSA; (4) planning and implementing Treasury management and reforms; (5) internal controls; (6) natural resources revenue sharing; (7) licensing, supervision, and regulation of banks; (8) currency reform; (9) central banking operations and governance structure; (10) CBS accounting and internal audit; (11) macroeconomic statistics; (12) debt sustainability analysis; and (13) preparing a medium-term fiscal framework for the NDP.

F. Program Monitoring

18. Our standing SMP Monitoring Committee will continue to monitor the implementation of our program by preparing and assessing the indicative targets (Table 1) and SBs (Table 2). The program will have one more review to assess its performance based on the test date of March 31, 2019. We welcome further clarifications that emerged from the discussions on the SB2, SB3 and SB16. The SB 2 will be monitored every six months. Hence, it will be assessed at end-March 2019 (following its first completion in September 2018). The SB3 will be monitored monthly starting from its first completion date in September 2018. On SB3, while the Appropriations Act was not passed by September 2018, we had been processing the cash advances in accordance with this prescribed process, and the appropriate language has been included in the Supplemental Appropriations Act, passed in October. Moving forward, we intend to follow this practice, which is also envisioned in the PFM Bill awaiting Parliamentary approval. For the SB16, we have agreed to update the language of the benchmark from "Prepare an update of National Development Plan (NDP) 2020-24" to now read "Prepare a draft National Development Plan (NDP) for 2020–24". The above updates will be reflected in the TMU. Also, ITs and SBs are defined in the TMU (Attachment II).

Table 1. Somalia: Indicative Targets under the Staff-Monitored Program, 2018–19^{1/}

(Millions of U.S. dollars)

	2018						2019		
	June			Sept. 2/			Dec.	March 3/	
	Prog.	Prel.	Status	Prog.	Prel.	Status	Prog.	Prog.	Proj.
Fiscal									
Fiscal balance (cash basis; floor)	0.0	2.3	Met	0.0	8.6	Met	0.0	0.0	0.0
Domestic revenue floor	75.7	82.9	Met	116.1	127.2	Met	165.0	47.0	49.1
Accumulation of new domestic expenditure arrears (ceiling) 4/	0.0	0.0	Met	0.0	0.0	Met	0.0	0.0	0.0
Contracting of new domestic debt (ceiling) 4/	0.0	0.0	Met	0.0	0.0	Met	0.0	0.0	0.0
Contracting or guaranteeing of new nominal external non-concessional borrowing (ceiling) 4/	0.0	0.0	Met	0.0	0.0	Met	0.0	0.0	0.0
Central Bank of Somalia (CBS)									
Net foreign assets of the CBS (floor) 4/ 5/	24.0	27.7	Met	24.0	29.0	Met	24.0	24.0	
Memorandum item									
Debt contracting or guaranteeing of nominal external concessional borrowing (ceiling).	0.0	0.0		0.0	0.0		0.0	0.0	

Sources: Somali authorities; and Fund staff estimates and projections.

1/ Based on preliminary data. Cumulative from the beginning of the year.

2/ Test date for the first review of the SMP.

3/ Test date for the second review of the SMP.

4/ Continuous indicative target.

5/ Calculated using program exchange rates. See Technical Memorandum of Understanding (Attachment II) for definitions of the program targets.

Table 2. Somalia: Structural Benchmarks Under the Staff-Monitored Program, May 2018–April 2019

Benchmarks	Target dates	Rationale and Monitoring	Status
Public Financial Management			
1 A Minister of Finance order to require that all salaries provided in cash be paid directly to individuals' bank accounts and record/register all Somali National Army payroll and non-payroll into the SFMIS payroll module.	Jun-18	Improve PFM and fiscal reporting.	Met
2 A Minister of Finance order to require all Federal Member States (FMS) and the Banadir region to report at end-Q1 and end-Q3 on the utilization of any FGS budgetary transfer.	Sep-18	Improve fiscal transparency, accountability, FGS leadership and oversight over the FMS.	Met
3 Record cash advances in SFMIS and process them in accordance with the Appropriations Act.	Sep-18	Improve cash management and payment processes.	Met
4 Complete the stocktaking and recording of all payroll and goods & services vouchers to December 31, 2017 which are in arrears into SFMIS.	Sep-18	Create an accurate and verified compilation of domestic arrears, to improve governance, and to allow a transparent process of repayment to begin.	Met
5 Design and implement a cash-forecasting system to inform allotments which are issued prior to commitment, in accordance with the Appropriations Act.	Dec-18	Provide effective use of the purchasing module in SFMIS, improve cash management, and limits/avoid new arrears.	on-track
6 Conclude the renegotiation of the Mogadishu port and airport fee-collection contracts.	Dec-18	Strengthen PFM and broaden FGS revenue base. Provide concluded and signed Mogadishu port and airport fee-collection contracts.	
7 The Minister of Finance to issue an order: (1) to identify Ministries, Departments, and Agencies (MDAs) accounts at commercial banks and the CBS, close unnecessary accounts, and move active accounts to CBS; and, (2) to require that all active MDA accounts be mapped to the SFMIS.	Mar-19	Make progress towards developing the Treasury Single Account. Will require that: (1) the ministry will establish a list of all MDA bank accounts respective signatories and operating mandates; (2) all MDA bank accounts be opened upon express issuance of formal authorization by the Accountant General; and, (3) CBS will report monthly bank balances of Treasury accounts.	on-track
Tax Administration and Tax Policy			
8 Ensure that the large-and-medium-taxpayer office (LMTO) is fully operational and share its organizational structure and staffing status.	Jun-18	Enhance the Inland Revenue Department, expand the revenue base and increase domestic tax collection.	Met
9 Minister of Finance to issue order to make the renewal of all licenses by Ministries, Departments, and Agencies (MDAs) conditional on presenting a tax clearance certificate (TCC) from the Ministry of Finance.	Jun-18	Expand the revenue base and increase domestic tax collection.	Met
10 The LMTO to increase the number of registered large and medium taxpayers from 25 to at least 50, evaluate all potential tax arrears for 2017 in Mogadishu, and collect the corresponding tax obligations due.	Sep-18	Expand the revenue base and increase domestic tax collection. This follows the establishment of the LMTO. LMTO staff will determine which of these arrears are considered potentially recoverable and record needed information. Provide new registration list of large- and medium taxpayers.	Met

Table 2. Somalia: Structural Benchmarks Under the Staff-Monitored Program, May 2018–April 2019 (concluded)

Benchmarks	Target dates	Rationale and Monitoring	Status
Tax Administration and Tax Policy (continued)			
11 Submit the Revenue Bill to Parliament.	Dec-18	Update the tax law by also correcting deficiencies of the old tax laws	Met
12 The Minister of Post and Telecommunication (MPT) and the Minister of Finance to develop a plan to enforce regulations-associated with the fees to be levied (licensing, spectrum, etc.).	Dec-18	Improve revenue collection. Communications Act, which would provide considerably broader powers to MPT to regulate the sector, including the ability to set appropriate fees and regulatory requirements. Provide the agreed fee structure and the plan for collection.	on-track
13 The Ministry of Finance to take over all non-tax revenue collections from at least 5 of the remaining MDAs which are currently collecting these revenues.	Dec-18	Improve revenue collection. FGS to provide SFMIS report showing non-tax revenue collections from the regulatory and operational activities of all MDAs.	Met
14 Finalize petroleum and fisheries operational revenue-sharing mechanisms between the FGS and FMS.	Mar-19	Operational step toward fiscal federalism. Adopting a petroleum and fisheries revenue sharing mechanisms will advance the tax harmonization process, contribute to national unity, and promote equity and accountability.	on-track
15 Submit an amended National Customs Act to Parliament, and the Ministry of Finance to implement a common classification of goods based on HS codes and a front-end customs declaration process.	Mar-19	It will provide the foundation for a new tariff while improving coordination and efficiency. It will focus on HS classifications of goods. Provide common nomenclature of goods by HS code and a report detailing the progress of implementing the customs declaration process.	on-track
MOPIED–National Development Plan			
16 Prepare a draft of the National Development Plan 2020-24.	Mar-19	The NDP 2020-24 is intended to serve as the interim PRSP document. Provide Draft 1 as specified in the NDP 9 Concept Note, which includes the first round of consultations at the national and FMS/BRA levels.	on-track
CBS–Financial Sector Development			
17 Submit to Parliament the draft Targeted Financial Sanctions Act.	Sep-18	Strengthen the AML/CFT framework to address terrorist financing risks and correspondent banking relationships (CBR) pressures.	Met
18 CBS to issue regulation on credit classification and provision, and review reporting requirement for banks.	Mar-19	Improve financial intermediation, banking supervision, legislation, and supervision. This action will include update on reporting requirements for banks to include data relevant to the classification of credit and extent of provisioning. It will also include identification of gaps that would be filed by reporting requirement.	on-track

Attachment II. Technical Memorandum of Understanding

This technical memorandum of understanding (TMU) sets out the understanding between the Somali authorities and the International Monetary Fund (IMF) regarding the definitions of the indicative targets for the 12-month Staff-Monitored Program (SMP) spanning May 2018–April 2019. It specifies the indicative targets on which the implementation of the SMP will be monitored. In addition, the TMU establishes the terms and timeframe for transmitting the data that will enable IMF staff to assess program implementation and performance. The definitions are valid at the start of the program but may need to be revisited during the program reviews to ensure that the memorandum continues to reflect the best understanding of the Somali authorities and IMF staff in monitoring the program.

A. Indicative Targets

1. The indicative targets have been set for the end of June 2018, end of September 2018, end of December 2018, and end of March 2019. Unless otherwise specified, all indicative targets will be evaluated in terms of cumulative flows from the beginning of each calendar year. Indicative targets are specified in Table 1 of the Memorandum of Economic Financial and Policies and they are:

- a) Floor on the fiscal balance (on a cash basis).
- b) Ceiling on accumulation of new domestic expenditure arrears of the Federal Government of Somalia (FGS).
- c) Floor on FGS revenue.
- d) Ceiling on new domestic debt contracted by the FGS.
- e) Ceiling on new external debt contracted or guaranteed by the FGS or the Central Bank of Somalia (CBS).
- f) Floor on CBS's net foreign assets.

Definitions and Computation

2. For the purposes of the SMP, the government is defined as the FGS. This definition excludes public entities with autonomous legal personalities whose budgets are not included in the federal government budget. The general government includes the FGS and the federal member states (Galmudug, Hirsabelle, Jubaland, Puntland, and South West State).

3. Government revenue includes all tax and nontax receipts transferred into the FGS general accounts at the CBS and excludes grants. It is measured on a cash basis, and cumulative from the beginning of the fiscal year (which coincides with the calendar year). Revenues of the government, which are defined in line with the Government Financial Statistics Manual (GFSM 2014) on a cash accounting basis, excluding grants.

- Revenues of the federal government include taxes and other compulsory transfers imposed by the government, property income derived from the ownership of assets, sales of goods and services, penalties and forfeits and voluntary transfers received from nongovernment other than

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grants. The definition for program monitoring excludes grants and other noncompulsory contributions received from foreign governments and international organizations; such transfers between the government units would be eliminated in the consolidation of the fiscal reports and not recorded as revenue. Receipts from the sale of nonfinancial assets (for example, the sale of physical assets) and future signing bonuses from natural resource contracts, transactions in financial assets and liabilities, such as borrowing but excepting interest payments, are also excluded from the definition of revenue.

- Revenues should be recognized on a cash basis and flows should be recorded when cash is received. The Government SFMIS reports will be used as the basis for program monitoring of revenues and expenditures; supplemented by the monthly financial statements prepared by the Minister of Finance.

4. The fiscal balance, on a cash basis, is defined as the difference between (1) the sum of government revenue (as defined in paragraph 3) and budget grants; and (2) total current expenditure plus capital expenditure (excluding foreign-financed off budget investment).

5. New domestic expenditure arrears of the government are defined as budgeted federal government payments to residents determined by contractual obligations that remain unpaid 90 days after the due date. Under this definition, the due date refers to the date in which payments are due according to the relevant contractual agreement, considering any contractual grace periods. Government payment include all expenditure for which vouchers have been approved by the Budget Department/Accountant General Office, expenditures that are automatically approved by legislation, debt payments to CBS and commercial banks, and transfers to regional governments.

6. Debt is defined for program purposes in accordance with Executive Board Decision No. 15688 (14/107), Point 8(a) and 8(b), adopted on December 5, 2014.

- For program monitoring purpose, the term “debt” will be understood to mean a current (that is, not contingent) liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take several forms; the primary ones being as follows:
 - Loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

- Suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and
 - Leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair, or maintenance of the property.
- Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (for example, payment on delivery) will not give rise to debt.

7. Domestic debt is defined as short-term and medium-to-long-term borrowing from residents of Somalia, including the CBS. The definition of domestic debt excludes temporary advances for liquidity management from the CBS, and domestic expenditure arrears as defined in paragraph 6. Temporary advances will be fully repaid within 90 days.

8. Benchmarks for external debt are cumulative ceilings on contracting or guaranteeing of new nominal external non-concessional borrowing by the government from the beginning of the calendar year. External debt is defined by the residency of the creditor.

9. The CBS's net foreign assets are defined as the difference between the CBS's gross foreign assets and gross foreign liabilities. Gross foreign assets are defined as (1) gold valued, over the program period, at the market price of December 31, 2017 (\$1,302.80 per ounce); plus (2) foreign exchange (including recovered CBS assets, non-earmarked budget, and earmarked donor grants); minus (3) government budget grant deposits at the CBS in foreign currency; minus (4) other earmarked foreign currency deposits by residents of Somalia. Somalia's net position to the IMF is excluded from the definition of net foreign assets. Relevant exchange rates against the U.S. dollar at December 31, 2017 will be used to convert foreign assets and liabilities denominated in currencies other than U.S. dollars.

B. Program Monitoring

Program-Monitoring Committee

10. The Somali authorities shall maintain a program-monitoring committee composed of senior officials from the Ministry of Finance, the Central Bank of Somalia, and the Ministry of Planning, Investment and Economic Development. The IMF Resident Representative will have observer status on this committee. The committee shall be responsible for monitoring the performance of the program, recommending policy responses, informing the Fund regularly on

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program performance, and transmitting the supporting materials necessary for the evaluation of benchmarks. The committee shall provide the Fund with a monthly progress report on the program within four weeks of the end of each month, using the latest available data.

Data Reporting to the Fund

11. To allow monitoring of developments under the program, the Ministry of Finance, the CBS and the Ministry of Planning, Investment, and Economic Development will provide to the Resident Representative's office of the IMF the following information contained in the data reporting table below.

Somalia: SMP Data Reporting, May 2018–April 2019				
Reporting Agency	Type of Data	Description of Data	Frequency	Timing (within period specified)
Central Bank of Somalia	Monetary survey	Detailed balance sheet data of the CBS submitted in the reporting template.	Quarterly	3 weeks after the end of each quarter
		Consolidated commercial banks' balance sheet data by residency submitted in the reporting template.	Quarterly	4 weeks after the end of each quarter
	Other financial indicators	Prudential data as per associated CBS regulations (total capital, core capital, total net assets, high quality liquid assets, and 30-day funding requirement), and average interest and maturity information for private sector loans.	Quarterly	4 weeks after the end of each quarter
	Balance of payments	Trade in goods data by value for the port of Mogadishu; petroleum imports to Mogadishu; travel data from the Immigration Department; and MTB survey on cross-border transfers.	Quarterly	4 weeks after the end of each quarter
	CBS temporary advances to the FGS	Provide monthly amounts and terms of the temporary advances to the Ministry of Finance.	Monthly	1 week after the end of each month
	Budget grants	Provide data on the amounts of on-budget grants, including transfers to the government's accounts from the government's external accounts at the CBS.	Monthly	3 weeks after the end of each month
Ministry of Finance	FGS budget operations	The detailed revenue and expenditure by budget line and a comprehensive table summarizing Government operations including TSA balances.	Monthly	4 weeks after the end of each month
		The outstanding appropriation, allotment, commitment, vendor purchasing/payments, cash advances, and bank balances (including for all MDA accounts) since the beginning of the calendar year.	Monthly	4 weeks after the end of the month
		Monitoring Agent reports for Recurrent Cost and Reform Financing non-salary reimbursement eligibility.	Monthly	4 weeks after the end of the month
		SFMIS audit report recording use of the allotment "allow to exceed" control override function.	Monthly	4 weeks after the end of the month

Somalia: SMP Data Reporting, May 2018–April 2019 (concluded)

		The monthly cash plan.	Monthly	4 weeks after the end of each month
		A report of all payment requests by MDAs awaiting payment since the beginning of the calendar year where the commitments exceed the agreed payment terms (in SFMIS/Excel).	Monthly	4 weeks after the end of the month
		Payroll and non-payroll salary and allowance payments made by MDAs and individual embassies (in Excel).	Monthly	4 weeks after the end of the month
	Regional Member States' budget operations	Reports from all Federal Member States (FMS) and the Banadir region on the utilization of any FGS budgetary transfers.	Semi-annually	4 weeks after the end of Q1 (March) and Q3 (September)
	Domestic arrears	A table providing the end-of-period stock of domestic arrears accumulated during the year by MDA and 4-digit Object Code.	Annually	4 weeks after the end of the year
	Domestic debt	The amount of new domestic debt contracted by Government.	Monthly	4 weeks after the end of the month
	External debt	End of year external debt in U.S. dollars, by creditor, and origination currency. The amount of new external debt contracted or guaranteed by Government.	Monthly	4 weeks after the end of the month
		Disbursements and repayments: (1) scheduled; and (2) actual interest and principal on debt of the Government and the CBS, by creditor.	Monthly	30 days after the end of each month
	Structural benchmarks	A table with a description of the status of implementation of the structural benchmarks in Table 2 of the MEFP.	Monthly	4 weeks after the end of the month
National Statistics Bureau	CPI and other economic indicators	Indicators to assess overall economic trends, such as the consumer price index.	Monthly	6 weeks after the end of each month
		Production data	Annually	6 months after the end of each year