

YEMEN

Economic Monitoring Brief



2019
Winter



Photo credit: The Social Fund for Development – Yemen

Macroeconomics, Trade & Investment
Global Practice
Middle East & North Africa



WORLD BANK GROUP
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OVERVIEW OF SOCIAL AND POLITICAL CONTEXT

Yemen's economic and social fabric continues to suffer from disintegration as the conflict enters its fourth year. While official statistics remain unavailable, partial information and anecdotal evidence suggests that Yemen's GDP contracted by an accumulated 39 percent since end of 2014. The conflict has caused widespread disruptions of economic activities, with substantial reduction in jobs, private sector operations and business opportunities. Operating costs rose severely due to insecurity and lack of supplies and inputs, leading to massive layoffs to the country's workforce in both formal and informal sectors. Oil and gas production and exports have come to a near halt since 2015, except for some limited production at the SAFER field and the MASILA basin. Remittances fell as a result of restrictions imposed on transfers and immigration policies in the GCC since 2016 but also because of uncertainties and high costs of money transfers. Imports have contracted sharply amongst dwindling foreign reserves while foreign debt obligations have not been served since May 2016, except for obligations to the IMF and to IDA.

The fragmentation of existing central economic institutions like the Central Bank of Yemen in combination with the conflict condition have repeatedly impaired normal distribution of food imports and aid, essential to Yemenis. Operations of the country's largest seaports (Hodeidah and Saleef) were adversely affected by escalating conflict and destruction of infrastructure (roads, facilities, etc.) during the 2nd half of 2018. Since August, local markets have therefore witnessed several waves of increasing shortages of essential commodities with many importers and trading outlets temporarily suspending or postponing business operations due to lack of supplies and prevailing uncertainties. Essential central bank functions remained until recently largely fragmented and disrupted, adding to the economic and humanitarian challenges

The dramatic deterioration of country conditions has translated into a significant worsening of the incidence of poverty. The headcount poverty rate defined using the World Bank's International Poverty Line of a daily per capita consumption of \$US1.90 PPP is projected to have increased since 2014 by 33 percentage points, to approximately 52 percent of the population in 2019. Furthermore, the commensurate dramatic decrease in government revenues, especially due to the much-reduced oil and gas production, have further contributed to the implosion of the formal social safety nets for poor households. Repeated waves of exchange rate devaluations, most recently in October 2018, have further undermined household income, although recent currency revaluations compensated somewhat for earlier losses. For many, joining a militia or other conflict-related economic activities remains the only gainful opportunity in a "war economy."

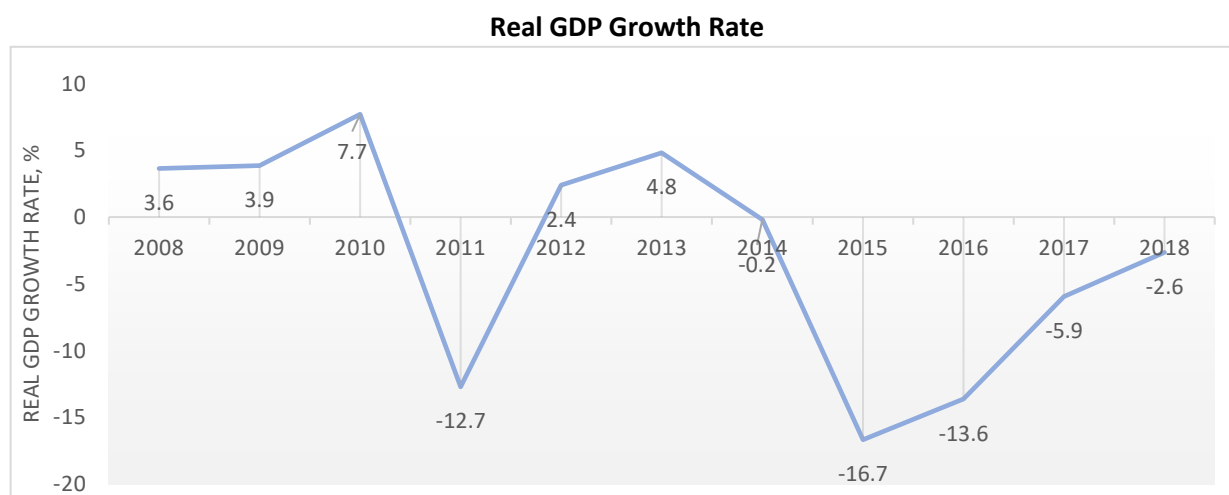
The conflict and the ensuing economic crisis are among the main drivers for Yemen's deepened food insecurity. According to latest Integrated Food Security Phase Classification (IPC) of December 2018, approximately 20.1 million people in Yemen, 67 percent of the population, are facing severe and acute food insecurity in the absence of humanitarian food assistance (HFA). The analysis estimates that a total of 15.9 million (53 percent of the population) will be severely and acute food insecure despite of ongoing humanitarian food assistance, including nearly 5 million people on the brink of famine under IPC Phase-4 ('People in Emergency') and 63,500 that are qualified as suffering from a famine catastrophe (IPC phase-5). According to the 2018 Global Hunger Index (GHI), Yemen is among the top three most food insecure countries in the world.

The recent momentum for peace coming from the consultations in Sweden last December are promising but require continuous constructive attention by all parties to bring peace. While the consultations are a step in the right direction there is still a longer way to go to bring peace. The first 4 weeks post the Sweden consultations demonstrated the challenges for the mediation process keeping the conflict parties engaged and peace focused (see also: <https://www.un.org/press/en/2019/sc13659.doc.htm>).

Economic prospects in 2019 and beyond depend on rapid improvements of the political and security situation, and ultimately whether an end to the on-going conflict will allow for rebuilding the economy and Yemen's social fabric. If cessation of hostilities can be agreed upon soon, GDP could see gradual recovery in 2019, but three quarters of the population will remain in poverty by standards of lower middle income countries (WB line of US\$3.20 per day) and nearly half below the low income poverty line (WB line of US\$1.90 per day). Given the bleak outlook for Yemenis, massive foreign assistance would continue to be required for recovery and reconstruction in a post-conflict period. In particular, foreign assistance would be needed to help restore basic services and help rebuild confidence in Yemen's institutions.

REAL SECTOR

Deterioration of the macroeconomic situation continued in 2018 in the absence of peace. The conflict related adverse economic impact and distortions, have depressed or constrained the supply side of the economy as much as the demand side, which is much driven by reduced household income. Given the depressed economic situation, employment opportunities have significantly diminished. In addition, much of the public-sector employment failed to provide relief as salaries for public employees have been only partly or intermittently paid since late 2016. However, the decline in GDP growth appears to be bottoming out in 2018 with an estimated reduction of 2.6 percent. Yet, growth requires economic recovery and fundamentally the restoration of basic security.



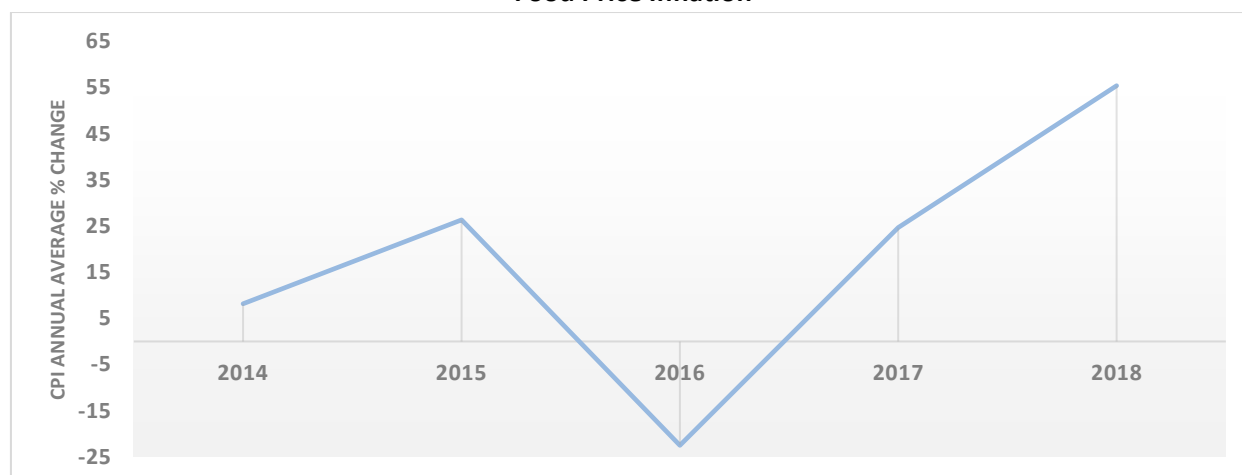
Source: MoF, IMF and staff estimates.

Sharp exchange rate depreciation and volatility have driven up commodity prices and annual inflation in 2018, exacerbating an already catastrophic humanitarian crisis. Prices of essential food have increased considerably during the second half of 2018. According to UN estimates, the national average monthly per capita cost of minimum food basket has surged by nearly 28 percent between June and October and by approximately 112 percent since pre-crisis level in February 2015. Furthermore, the monthly cost of the survival minimum expenditure food basket (SMEB) for one household, rose to average of YR42,489 in November, an approximately 145 percent increase since February 2015.

Inflation in 2018 was driven up by the mid-year currency depreciation and by the fiscal deficit. Preliminary estimates indicate an annual increase in the food price inflation to around 55 percent in 2018 compared to around 25 percent increase previous year. Measures adopted by the Central Bank of Yemen (CBY) since early September, using proactively the large foreign exchange deposits made available to CBY by the Kingdom of Saudi Arabia, helped to stabilize and stop the sharp decline of the currency value for the time being, bringing the exchange rate value back to around 500 Yemeni Riyal per dollar towards the end of 2018. The currency revaluation and subsequent relative stabilization since late October contained

somewhat rising inflation as prices for essential food imports lowered. Nonetheless, annual inflation is likely to remain high in 2018, given also the large fiscal deficit accumulated earlier during the year that was among others financed through the issuance of fresh money.

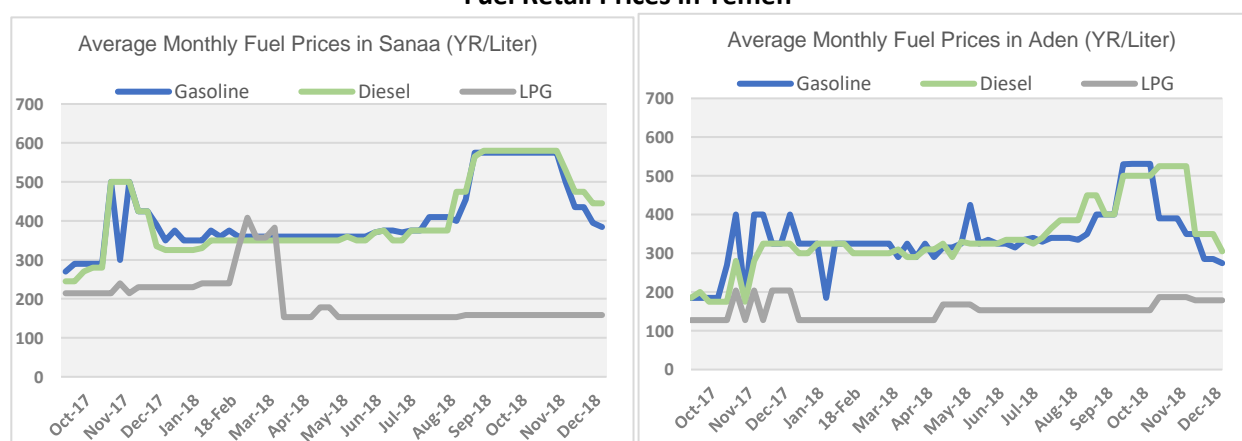
Food Price Inflation



Source: GoY, IMF and Staff estimates.

Domestic fuel prices and market supply appear to have improved since mid-November. Despite reductions of international oil prices during the second half of 2018, recurring supply shortages and large currency devaluations since September, have increased prices for fuel during the last quarter. Gasoline and diesel pump prices in Sanaa and most of the northern areas hit an all-time high during the last quarter of 2018 with up to 50 percent increases compared to previous quarter and the last quarter of 2017. While prices in the south of Yemen saw equally a relative increase in general, limited supply meant sourcing fuel products would often be subjected to the informal markets, usually at twice or more the official price. However, since late November, prices have witnessed gradual but widespread price reductions across all markets, in line with the relative exchange rate stabilization.

Fuel Retail Prices in Yemen



Source: GoY and Staff estimates.

LPG (cooking gas) remains in short domestic supply and witnessed volatile prices during the last quarter. Since 2015, the domestic LPG sector (bottled gas) has seen a considerable expansion and a rising interest by the domestic private sector to meet increasing demand as the fueling of cars or generating electricity got increasingly substituted by LPG as an energy source because gasoline became very scarce and expensive. Scarcity of gas supply for cooking purposes hampered, however, the positive welfare effect. The domestic supplies in cooking gas come mostly from state owned company SAFER and have been

increasingly insufficient to meet national demand. The prevailing security weaknesses have also contributed to shortages and volatile gas prices in some parts of the country.

Improving the security situation could speed up the recovery in oil and gas production in 2019. Oil and gas production and exports collapsed soon after the conflict erupted in March 2015, except for limited production dominated by the state-owned operators (PetroMasila). In 2018, however, gradual recovery in the Masila field, which contains a number of oil producing sites, appears to have stepped up the country's oil production, following also the return in 2018 of the foreign oil company OMV in Block S2 of the Masila field. In November 2018, local authorities announced that the daily production from Block S2 has increased from around 5 thousand barrels per day to around 17 thousand barrels a day. As a result, the overall oil export revenues from the Masila field is estimated to have reached a total of \$900 million in 2018.

Restoring oil production in the immediate post-conflict phase would have to heavily rely on the state-owned operational capacity. As of 2014, the state operated two of the twelve active blocks, Block 18 (SAFER) and Block 14 (PetroMasila), which jointly produced nearly 42 percent of the country's total output in 2014. In addition, following the expiration of the production sharing agreement (PSA) with TOTAL for Block 10 in 2015, and its consequent handover to the state-owned company PetroMasila, the total share of the state-owned companies in the total oil output has increased to around 65 percent, if measured in terms of to the 2014 production level of 156,000 barrels per day.

Yemen Oil Production Sector

Basin	Block	Operator	Output ('000 b/year) *	GoY Share (%) **	Current Production Status
Marib-Shabwa	5	Jannah Hunt	9,660	64	Halted
	43	Jannah Hunt	440	36	Halted
	S-1	Occidental/TransGlobe	310	3.6	Halted
	S-2	OMV	5,740	33	Active
	4	YICOM	60	26	Halted
	18	SAFER	13,720	100	Halted
Masila	14	PetroMasila	10,040	100	Active
	10	TOTAL	13,240	45	Conceded to PetroMasila in 2016
	32	DNO	560	49	Halted
	53	DOVE	1,450	50	Halted
	9	Calvalley	1,120	50	Halted
	51	Nexen	680	55	Halted

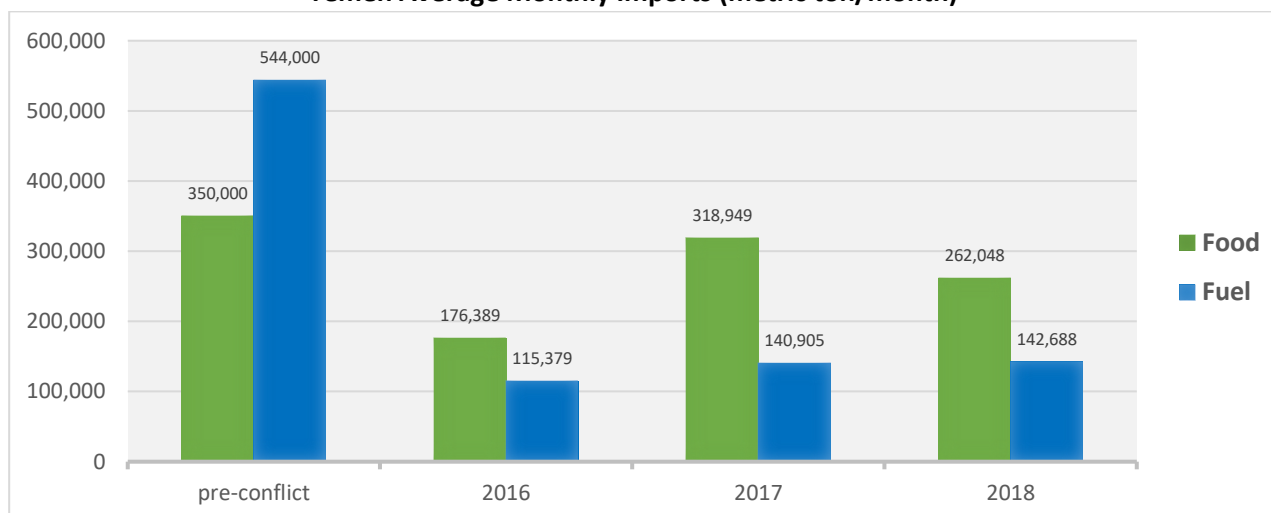
* Output is based on estimated net state's share in 2014 (=production share+ taxes+ royalties)

** based on 2014 estimates and shares

The conflict has since 2015 frequently disrupted markets and supply chains for essential food and non-food commodities causing local supply shortages, increased transaction costs, and consequent price rises and volatility. Before the 2015 conflict, Yemen used to import around 350,000 metric tons of food and 544,000 metric tons of fuel on a monthly basis. However, much of this import volume have been subjected to several reductions especially since November 2017 when the tensions deepened around the country's largest seaports (HODAIDAH AND SALEEF), which serve about 70 percent of the population. Latest UN data for imports cleared by the United Nations Verification and Inspection Mechanism for Yemen (UNVIM), estimate the average monthly import volume for food to have declined to 262,048 metric ton in 2018, or by around 18 percent compared to previous year and nearly 25 percent from the

pre-conflict level. In addition, average monthly fuel imports in 2018 were compressed to around 142,688 metric ton, which represents almost 74 percent decline compared to the pre-conflict level¹.

Yemen Average Monthly Imports (metric ton/month)



Source: UNOCHA COMMODITY TRACKER – December 2018.

Public electricity supplies have seen an unprecedented deterioration and widespread disruption since conflict escalation in 2015. Since late March 2015, several governorates have been exposed to round-the-clock black-outs as the already weak sector suffered from serious generation constraints caused by infrastructure damages and lack of fuel supply. A few southern governorates began recently to benefit from the KSA oil grants that helped to supply public power generation needs. The remaining parts of the country have zero hours of publicly supplied electricity per day, also due to damaged and suspended electricity infrastructure and facilities.

PUBLIC FINANCE

Fiscal policy has been dominated by the conflict conditions. Prior to the conflict, public spending on wages of both civil and military sectors, amounted to around 42 percent of the total public revenues in 2010-2014, or nearly 10 percent of GDP. In 2018, actual expenditures for salaries and wages were consuming about 2/3 of total expenditures while revenues covered only 2/3 of the actual civil service wage bill: revenues cannot even cover core recurrent costs, which in turn dominate overall expenditure. The conflict averted so far a normal budget preparation, or applying fiscal controls in line with public financial management (PFM) regulations. Public expenditures executed by the government since 2015 were mostly based on the lines offered by the 2014 budget, the last one that has been approved by Parliament and which served as a reference. Going forward, the government announced a return to a normal budget process for 2019 (Prime Minister decree number 165 of 2018; see below).

In November, the Cabinet endorsed measures which promise to restore fiscal policy transparency and improve PFM. The Cabinet of President Hadi's Government approved the formation of the High Committee for State Budgets and its technical secretariat. The mandate of the new committee is to oversee the preparation process for the 2019 budget framework in accordance to the constitution and prevailing economic conditions and anticipated resources. The budget framework will also aim to ensure deficit reduction to safe limits through rationalizing current expenditures, enhancing public revenues, and non-inflationary deficit financing. Other endorsed measures focus on improving the efficiency of state's

¹ Averages per the monthly imports cleared via UNVIM, estimated from the UN-OCHA data from June to December 2018.

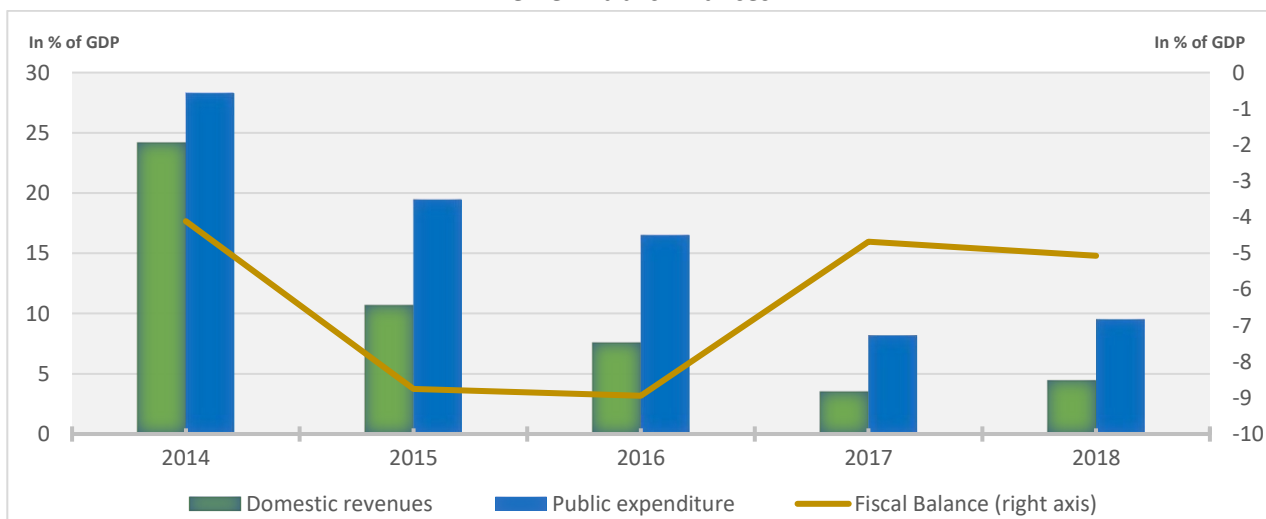
revenue collection capacity, including through enhancing central tax and custom collections from imported and domestic oil products.

Salary payments continue to suffer from limited geographical coverage. In the northern part of Yemen, the indication is that only one month of salaries were paid in 2018 (or half of a monthly salary was paid during the last quarter), whereas in the south salary payments reach a broader coverage, albeit payment is not yet regular throughout. The resumption of public salary payments throughout the country appears to have received a consensus by the warring parties during the recent UN-sponsored consultations in Sweden, although implementation has yet to take place.

While the raising of public revenues appears to have improved in 2018, the fiscal deficit is estimated to remain large. Although official statistics are still unavailable, the latest Central Bank of Yemen (CBY) estimates suggest that the current fiscal deficit for 2018 is projected at around YR550 billion, mostly improved by the rise in oil export revenues and grants during the second half of the year. Preliminary estimates indicate public revenues to reach about 4.4 percent of GDP in 2018 (from nearly 24 percent of GDP prior to the conflict), while hydrocarbon revenue collection is expected to amount to around 3 percent of GDP. Revenues were also boosted in 2018 by an in-kind oil grant and a \$200 million grant by KSA to CBY in early October. Public expenditures in 2018 are expected to increase from nearly 8 percent of GDP in 2017 to approximately 10 percent of GDP, reflecting largely a nominal increase in the wage bill spending. The overall resulting fiscal deficit in 2018 is projected to reach around 5.1 percent of GDP. This deficit has been financed by an expansion of the Central Bank overdraft to the Government, including by printing money, and by accumulating arrears.

The Cabinet approved a YR100 billion domestic borrowing plan to finance the fiscal deficit. The approved government borrowing from the CBY will be limited to domestic non-inflationary financing sources, including offering investment certificates for banks and pension funds whose state financing had come to a halt earlier. To unlock these sources for financing, CBY in October increased interest rates on certificate deposits (CDs) by 10 percentage points to 27 percent, while adjusting the interest rate for government bonds and 'Wakala' Islamic contracts to 17 percentage points and 25 percentage points, respectively.

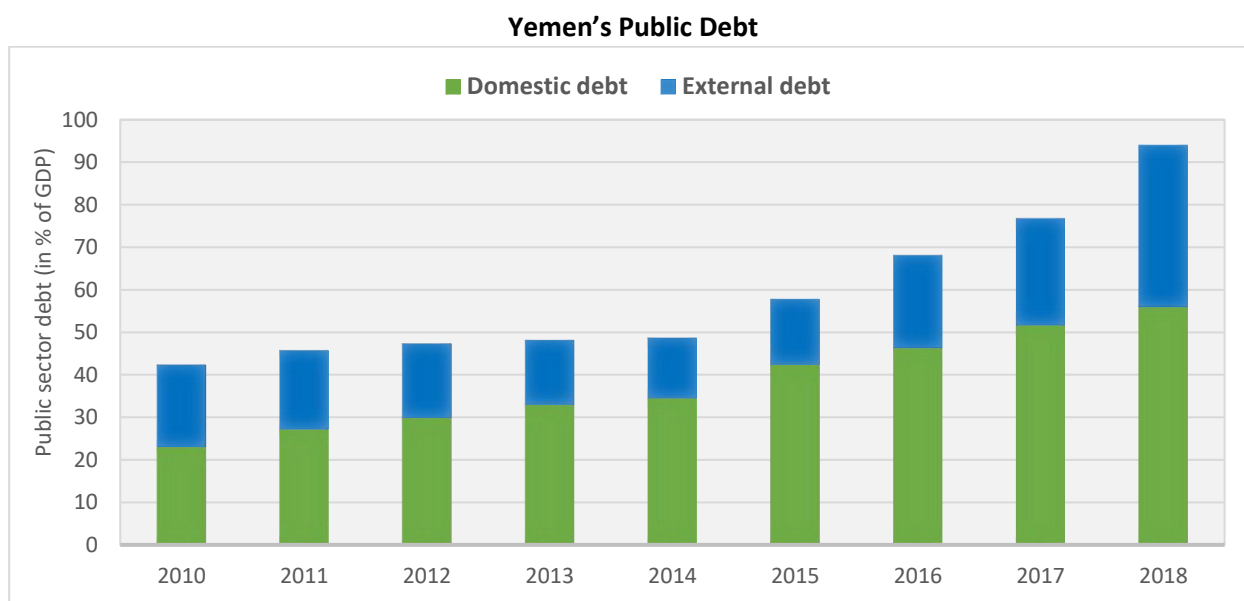
Yemen Public Finances



Source: GoY, IMF and Staff estimates.

Yemen's total public debt in 2018 is increasing as a result of rising domestic debt, rising external arrears and new external debt obligations. Total public debt had been relatively low in pre-conflict years but the financing of the rising fiscal deficit with the Central Bank overdraft has propelled the public debt ratio to an estimated 94 percent of GDP in 2018 of which 38 percent of GDP is domestic public debt. While official

data are unavailable, external public debt is projected to have increased to 55.9 percent of GDP, taking also into account new debt taken on by CBY. In addition, arrears have been accumulated since 2015, including for unpaid goods and services, salaries and debt payment arrears.



Source: Central Bank of Yemen, IMF and staff estimates.

MONEY AND BANKING

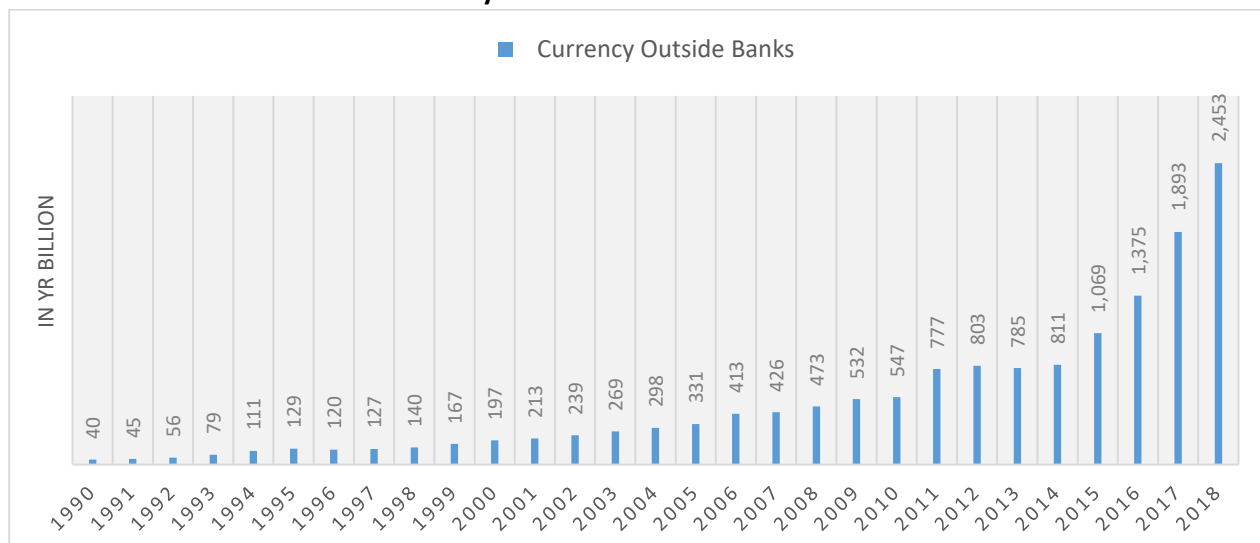
Money supply growth accelerated in 2018. Total money supply is estimated to have grown to around 53 percent in 2018, compared to 1.3 percent in 2017, reflecting massive issuance of new bank notes since 2017 and the corresponding steep increase of currency circulation outside banks, which has increased by more than 100 percent since 2014, from YR811 billion in 2014 to YR2,453 billion by the end of 2018. By contrast, private sector credit which contracted by 14 percent in 2017, is estimated to show a gradual recovery in 2018. In early September, in an effort to regain better control over monetary policies, the Government issued three carefully calibrated decrees (no. 75, 76, and 77) accompanied by guidance letters from the Central Bank of Yemen, Aden, which aim collectively to re-establish the Central Banking System in Yemen led by the Central Bank in Aden by (1) raising the interest rates for various products up to 27 percent, and (2) by offering a limited exchange convertibility through the financing of petroleum products and food imports, and for medical treatment abroad (limited to \$2000 per case). The offer is conditional to commercial banks that work with the CBY in Aden and operate under its supervision. Decree no 75 on oil and food imports has been in the meantime simplified in early January by circular no. 1 (via the Economic Committee) offering a less restrictive import regime for oil importers. While the decrees are a step into the right direction to restore the integrity of the financial system in Yemen, it needs to be seen whether they can do so in the given fragmented financial market context in Yemen. These measures could be more effective, if also accompanied by appropriate fiscal policy measures, which are promised for 2019 (see above).



Photo credit: The Social Fund for Development – Yemen

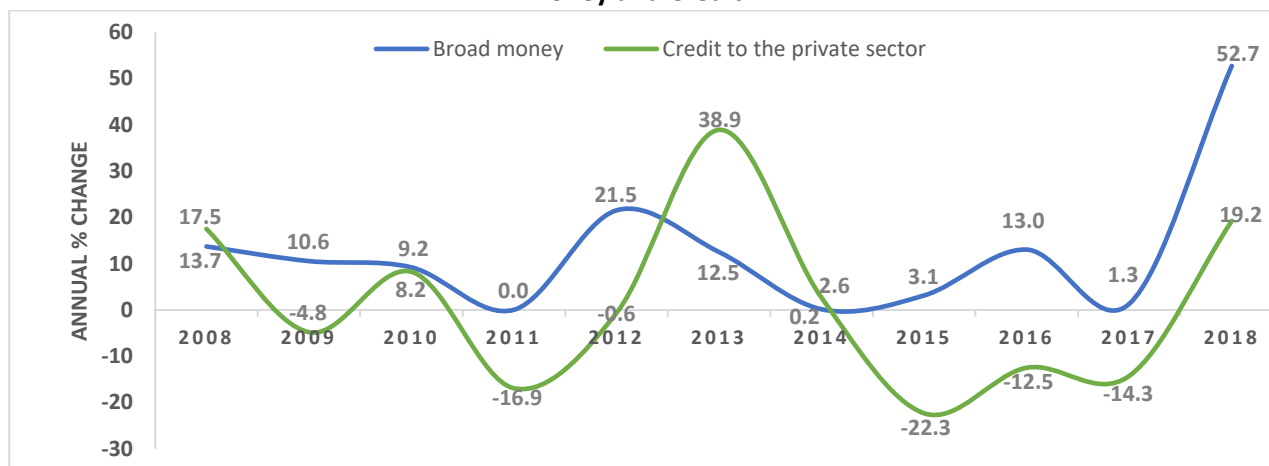


Currency outside Banks - Annual Growth



Source: Central Bank of Yemen, IMF and staff estimates.

Money and Credit



Source: Central Bank of Yemen and IMF staff estimates.

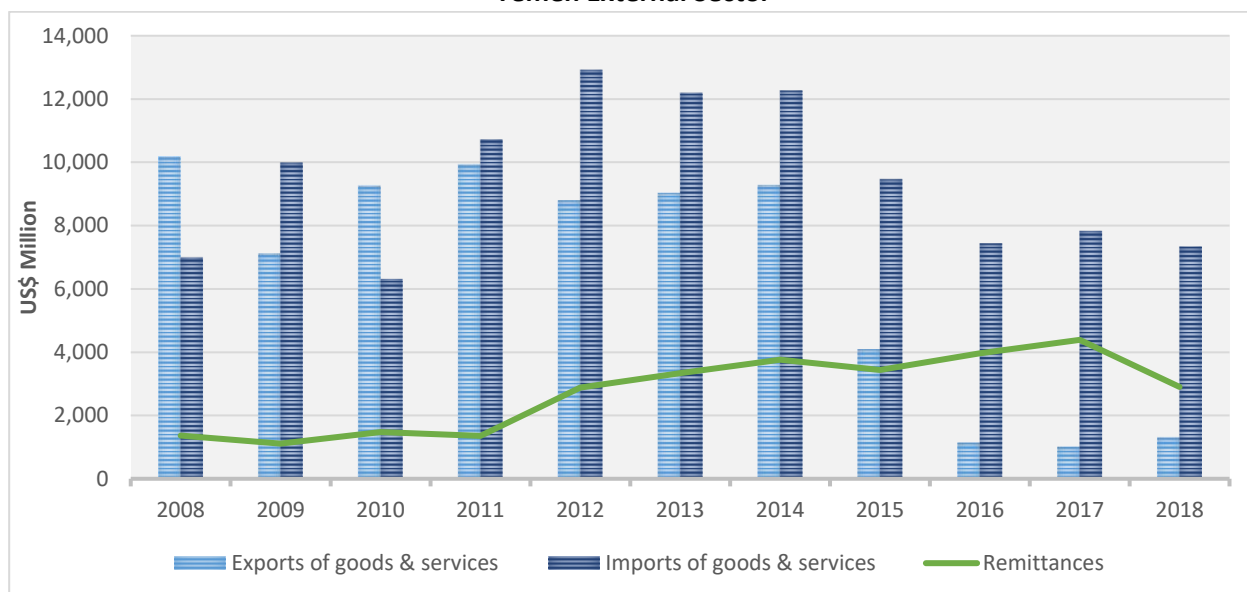
During the last quarter, the Government in Aden headed by President Hadi has endorsed several fiscal measures in support of more effective monetary policies. These measures included suspension of the government overdraft financing from the CBY starting from 2019 while preparing a restructuring plan for the overdraft debt stock. Furthermore, CBY will restore its reserves in local currency to 500 billion and issue new banknotes only going forward, within the confinements of the above referred to fiscal parameters and if not contradicting a prudent monetary policy. Any financing of the remaining deficit through CBY should be done by using the newly introduced securities which offer better investment returns (i.e., CDs, Islamic 'Wakala' Contracts) than in the past.

EXTERNAL POSITION

Given the secular decline in export revenues since 2014, the current account deficit is likely to have remained wide in 2018. Pressure on the balance of payments was high during 2018 owing to the relative loss of oil revenues, dwindling remittances, and the continued strong demand for imports (food and fuel imports). Yet, exports are projected to grow by 29 percent in 2018 to around \$1.3 billion compared to 2017, although remaining 86 percent below the pre-conflict level of 2014. The projected annual export growth is attributed to a relative increase in oil exports from the Masila field, which are reported to reach \$894 million in 2018. Imports on the other hand, are projected to decline by 6 percent in 2018,

cumulatively by nearly 40 percent since 2014. Remittances, which represented the main source for financing the country's import followed by the aid inflows, are estimated at \$2.9 billion in 2018, declining by 34 percent compared to 2017.

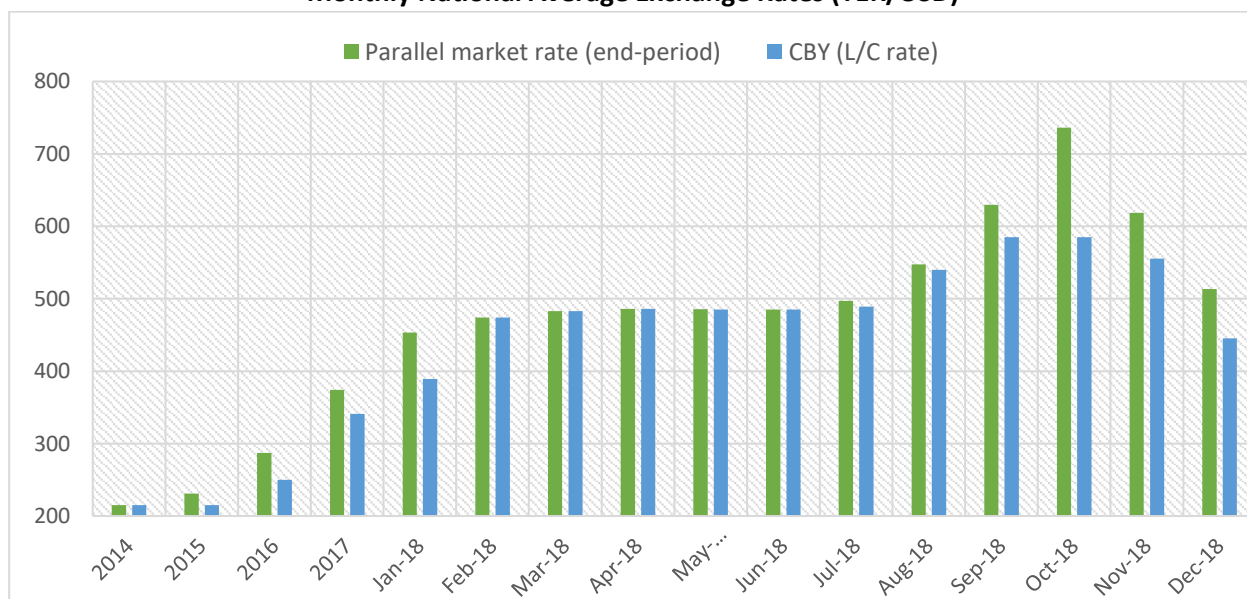
Yemen External Sector



Source: Central Bank of Yemen and IMF staff estimates.

The value of the Yemeni Riyal saw wide fluctuations since September 2018 but stabilized towards the end of the year. The nominal exchange rate during the fourth quarter has appreciated on average by approximately 12 percent compared to the previous quarter and by almost 49 percent compared with same period last year. The preceding gradual depreciation path of the Yemeni Riyal began in 2016 and reached its highest levels in October 2018 with a monthly average estimated at about YR736 per one US dollar, before recovering to an approximate monthly average of YR513 in December. Pressure on the exchange rate seems to have eased with a more active role being exercised by CBY which made foreign exchange available (see also below), by addressing some vulnerabilities and uncertainties stemming from a large informal money exchange market, and by using effectively the deposits made available by the Kingdom of Saudi Arabia (KSA) to guide and stabilize market expectations.

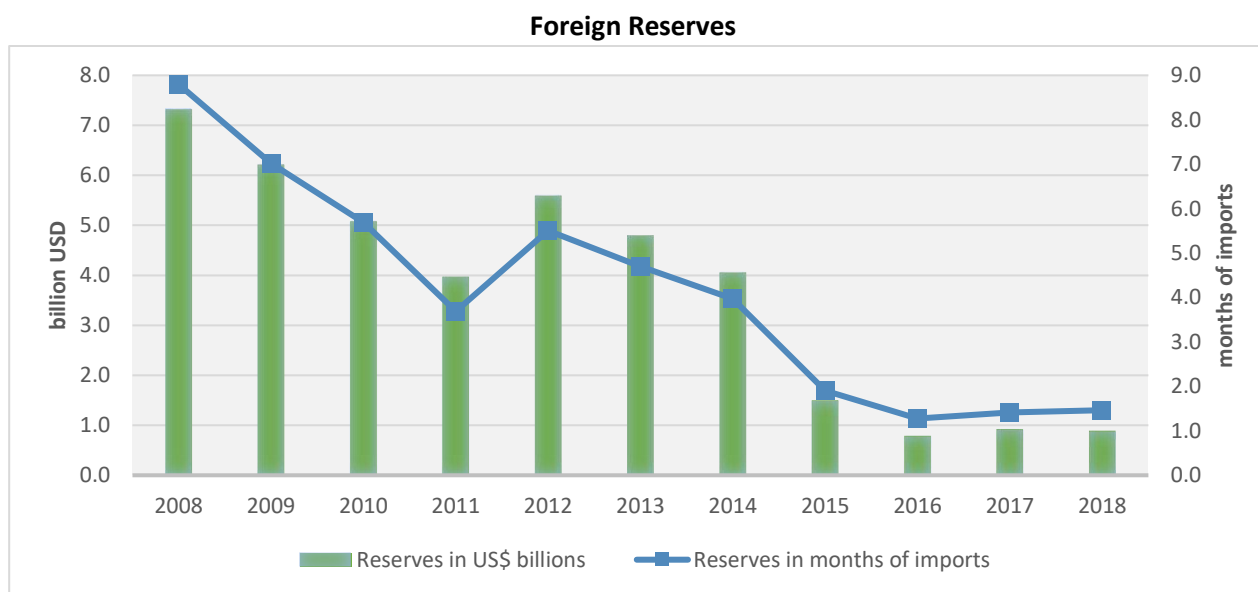
Monthly National Average Exchange Rates (YER/USD)



Source: CBY and staff estimates.

CBY could access successfully its enlarged deposits in foreign reserves holdings during the last 2018.

According to CBY, foreign reserves holdings increased to approximately \$3 billion during the 2nd half of 2018, with the majority originating from a \$2 billion deposit and a \$0.2 billion grant from the Kingdom of Saudi Arabia (KSA) in total. At the same time, remittances have decreased partially due to KSA labor market reforms ('Saudization policy') to reduce reliance on foreign labor, including Yemeni labor. Going forward, the reserve rebuilding hinges on (1) that the CBY led official financial system offers improved services and conditions – as outlined above – and therefore captures more of the financial flows that previously were channeled through informal and parallel system, and (2) on rising oil exports, currently estimated running at \$80-\$100 million per month.



Source: Central Bank of Yemen, IMF and Staff estimates.

OUTLOOK

In the current conflict situation and the given political and economic uncertainties, it is not possible to provide a detailed sound outlook. However, Yemen's medium-term outlook will depend ultimately on whether an end to the on-going conflict can be found and the rebuilding of the Yemen economy and social fabric is facilitated. In the short-term, there is no substitute for external financial support for initial macroeconomic stabilization given the interdependency of external financing, early stabilization requirements, and the fiscal expenditure program. Finally, if violence can be contained beginning with 2019, GDP is predicted to begin gradual recovery via the gradual resumption of hydrocarbon exports. However, little of the economic recovery will initially translate into a meaningful reduction of the high headcount poverty.

Yemen: Key Economic Indicators

	2014	2015 Prel.	2016 Prel.	2017 Prel.	2018 Est.
National Income and Prices	(Change in percent, unless otherwise indicated)				
Nominal GDP, market prices (billions of YR)	9,289	9,798	8,891	10,006	12,445
Real GDP growth	-0.2	-16.7	-13.6	-5.9	-2.6
Food Price Inflation (period average)	...	26.3	-22.5	24.7	55.4
Yemeni Oil Price	94.7	49.3	41.3	51.3	68.8
Hydrocarbon production (in million barrels per year)	71.5	49.5	6.0	11.7	13.0
Central Government Finances	(In percent of GDP)				
Revenue	24.2	10.7	7.6	3.5	4.4
of which hydrocarbon revenue	10.3	2.4	1.3	1.9	2.7
Expenditure	28.3	19.4	16.5	8.2	9.5
wages and salaries	10.5	9.4	8.3	5.6	6.0
Fiscal Balance	-4.1	-8.8	-8.9	-4.7	-5.1
Gross Public Sector Debt	48.7	57.8	68.1	76.8	94.0
Domestic debt	34.5	42.3	46.3	51.6	55.9
External debt	14.3	15.5	21.8	25.2	38.1
Monetary data	(End-of-period annual growth rate)				
Broad money	0.2	3.1	13.0	1.3	52.7
Reserve money	1.4	27.4	23.8	18.2	...
Credit to private sector	2.6	-22.3	-12.5	-14.3	...
Benchmark deposit interest rate (percent)	15.0	15.0	15.0	15.0	27.0
Velocity (non-oil GDP/M2)	2.4	2.4	2.4
External Sector	(In millions of U.S. dollars, unless otherwise indicated)				
Exports (goods & services)	9,287	4,097	1,141	1,011	1,305
of which hydrocarbon (oil and gas)	6,774	2,440	248	599	894
of which nonhydrocarbon	2,513	1,657	893	412	411
Imports (goods & services)	12,257	9,460	7,433	7,826	7,331
of which food	2,529	1,475	1,400	1,519	1,480
of which fuel	3,094	1,993	1,706	1,979	1,524
Current account balance (in percent of GDP)	-1.7	-6.2	-5.1
Reserves					
Central Bank own gross reserves (billions US\$ end-period)	4.1	1.5	0.8	0.9	0.9
Central Bank own gross reserves (in months of imports)	4.0	1.9	1.3	1.4	1.5
External Debt					
External debt (in billions YR)	1,325	1,519	1,938	2,522	4,742
External debt (in percent of GDP)	14.3	15.5	21.8	25.2	38.1
Exchange Rate					
Average Exchange rate per US\$	214.9	231.0	287.0	374.0	542.0
Memo Items					
Nominal GDP in billion US\$	43.2	42.4	31.0	26.8	23.0
Population (in millions)	27.5	28.3	29.1	30.0	30.8
Nominal per capita GDP (US\$)	1,574	1,500	1,063	892	745

Source: Ministry of Finance, Central Bank of Yemen, IMF and staff estimates.