Central Bank of Yemen

Quarterly Bulletin
Economic and Monetary Developments

Issue No.2 (March 2021)

Quarterly Bulletin – March 2021

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Foreword

The Central Bank of Yemen (CBY) has the pleasure of announcing the issue of its Quarterly Economic Bulletin (March 2021). The Bulletin provides readers and researchers interested in the Republic of Yemen's economic and monetary developments with insights on major developments across all sectors. It also directly enhances financial regulatory oversight processes in alignment with Basle II and Basle III pillars.

The Bulletin reviews the most important economic and monetary developments in the Yemeni economy during 2020. It covers key developments across four areas and explains their implications for the Yemeni economy. The first chapter discusses global and local macro-economic developments, while the second discusses recent monetary and banking sector developments. The third and fourth chapters are devoted to public finances and external sector developments, respectively.

Despite the war, which has been ongoing since 2015, and has resulted in a prolonged contractionary phase, the Yemeni economy witnessed positive growth rates in 2018 and 2019 due to a significant surge in oil production before plunging into recession in 2020 due to the proliferation of the pandemic. The outbreak of the Covid-19 pandemic in early 2020 and the subsequent lockdowns and oil price collapse affected economic activities across the globe, causing massive losses of both lives and livelihoods as the global economy entered a recessionary phase. Oil price drops and the spread of the pandemic are expected to have significant adverse effects on Yemen's economic activity, with real GDP estimated to have contracted by 8.5% in 2020. In addition to these shocks, the January 2020 ban on newly printed banknotes in the region under Houthi's control has limited the government's ability to pay salaries in this area and complicated monetary policy operations. This has increased the cost of financial transactions, reduced market transparency, and resulted in widening exchange rate gaps between Aden and Sanaa— as much as 30% in some instances.

Inflationary pressures triggered primarily by inflation on imports remained strong; around 90% of Yemen's basic consumable goods come from overseas. This continues to pose a macroeconomic challenge and hence requires a concerted and sustained monetary policy response directed towards stabilizing prices and providing sufficient liquidity in order to maintain adequate funding of public and private sector needs; in line with the CBY legal mandate as stated in Article 5 of the Central Bank Law.

Yemen's fiscal position also improved during the last years as a result of an increase in oil exports, although these still remain far below pre-war levels. Expenditure rationalization and fiscal deficit financing, however, are still critical issues to be addressed through close coordination between all government entities. Indeed, the fiscal deficit was funded largely through monetary emissions by the central bank, while a small portion of the fiscal deficit was financed through domestic market borrowing, with the intended objective of alleviating the pressure on debt monetization. Stronger public finance management, development of domestic debt capital markets, and financial deepening are all top reform priorities anticipated in the coming years.

The external position continued to deteriorate since the outset of the war, which led to significant weakening of the value of the local currency. The only exception to this trend was in 2019, when drawdowns from a June 2018 Saudi US$2.0 billion deposit helped stabilize the Rial exchange rate. Reviving economic activity, boosting export earnings, building up a buffer of foreign reserves, and limiting debt monetization are the main pillars of our macro-financial policy over the upcoming period.

The high level of commitment and quality output from the management and staff of the Bank, which facilitated smooth and efficient functioning of the CBY, merit deep appreciation. We could not have been published this Bulletin if other departments had not contributed their efforts and data.

It is also acknowledged with great appreciation that the CBY has since June 2019 received expert technical support from the USAID, and UKAID-financed Pragma advisory team in helping improve core functions and building institutional capacity through implementation of a detailed time-framed action plan covering core functional areas of central bank operations.

God bless,

Ahmed Obaid Al-Fadhli

Governor

Executive Summary

The Yemeni economy witnessed improvements in 2019 after a deep contraction since the start of the war in 2015. This contraction was primarily attributed to declines in the hydrocarbon sector, which makes up a significant share of domestic output. In CY2020, economic activity has been severely affected by the dual shocks of the Covid-19 pandemic and a steep decline in oil prices. Since the world economy will take time to return to normality, oil prices will continue to remain low, affecting hydrocarbon sector activities in the Republic.

In wake of the pandemic spread, the IMF reported in April 2021 that the world economy was estimated to have contracted by 3.3%, a figure that may have increased after the pandemic intensified in the final months of the year.

Inflationary conditions worsened in 2020 after relative stability in 2019. Significant devaluation of the Rial, the lack of foreign reserve buffers at the CBY, growing uncertainty, and increased dollarization all contributed to inflationary pressures. Market surveys indicate that average food price inflation exceeded 30% in 2020, while the annual rate of inflation was estimated at around 25%, up from an estimated average rate of 10% in 2019. Inflation is projected to remain slightly above 20% in 2021.

As stated in the Central Bank of Yemen (CBY) Law No. (14) of 2000, achieving price stability is the primary objective of monetary policy. In this regard, the CBY is proactively steering monetary policy in a manner designed to maintain macro-financial stability while providing adequate financing to ensure critical public financing needs are met, operating, in concert with relevant government institutions and with the assistance of the international community.

The principal objective of monetary policy is to attain low and stable inflation. To this end, the central bank attaches great importance to control the money supply. This is being achieved through the construction of a robust framework for monetary targeting and moving towards the adoption of a comprehensive toolkit of indirect and market-based instruments for liquidity management.

Against this backdrop, monetary aggregates expanded reasonably during the last two years. Broad money grew by 15% in 2020 and 8.5% in 2019, down from a growth rate of 28.5% in 2018. Reserve money (base money) increased by 13.3% in 2020 and 11.5% in 2019, down from a growth rate of 28.3% in 2018. M1 increased by 15% and 10.6% in 2020 and 2019, respectively, as compared with a 33.1% growth rate for the previous year. Currency in circulation, which accounted for more than 80% of narrow money and constitutes the main driver of M1 growth, grew by 15.1% in 2020 and 12.4% in 2019, down from a growth rate of 36.6% during the prior year. From the CBY balance sheet perspective, monetary expansion was contained through a 50,6% decline in net foreign assets in 2020. With respect to domestic assets, the overall net growth rate declined from 26.8% in 2019 to 18.8% in 2020. Net claims on government grew by 18.3% in 2020 and 19.6% in 2019, against 27.3% in 2018. This constituted the major source of overall monetary growth.

The CBY managed to design robust monetary program for 2020 and 2021, the first following its relocation to Aden. This helped rationalize money supply parameters, and limited high inflationary pressures stemming from monetary creation. Within this overall framework, broad money (M2) increased by 15.0% in 2020, significantly outperforming the annual target of 22.2%. Base money grew by 13.3% during the same period, also significantly outperforming the annual target of 20.6%. Currency issuance increased by 15.1% in 2020, far below the annual target of 25.5%. The program has proved to be highly effective and to have out-performed all benchmarks set in the annual monetary program. For CY2021, the annual monetary plan projected broad and base money to grow by 18.3% and 19.1%, respectively.

The deterioration of macroeconomic conditions since 2015 has severely affected the government's fiscal position. In consequence, fiscal consolidation through further expenditure rationalization and boosting of the revenue base (from both hydrocarbon and non-hydrocarbon activities) remains a key macro-economic policy priority.

Overall, the fiscal deficit is estimated to have registered 782 billion Rials in 2020, growing at an annual rate of 11,2%, partly reflecting the impact of the pandemic on overall economic activities. The share of investment expenditures remained marginal, with the majority of expenditures utilized to cover current spending needs. Expenditure containment efforts have been intensified in 2020, the importance of which has been further underscored by weakened oil revenues due to the pandemic crisis.

Due to weak public revenues, Yemen's government has relied heavily on direct borrowing from the CBY to finance a major share of the fiscal deficit over the last five years. This constitutes an important driver of inflationary pressures and local currency depreciation.

Fiscal discipline, rationalizing public expenditures, improving efficiency, and identifying non-inflationary means through which to finance government expenditures are all urgently important for purposes of promoting sustainable fiscal consolidation and macroeconomic stability.

The external sector has continued to deteriorate due to the aforementioned fall in oil exports and declines in remittances, while dependence on humanitarian aid has continued to increase significantly. The balance of goods and services registered a deficit of USD7.2 billion in 2020, down from USD8.6 billion in 2019. The current account deficit represented -3.4% of GDP, against -3.6% of GDP in 2019. Moreover, volatility recently experienced in international oil prices dramatically underscores the importance of reducing Yemen's dependence on the petroleum sector.

The current account deficit continues to require significant levels of external financing. In 2020 the balance of payments deficit was estimated to approximately USD465 billion. This trend is being driven largely by the negative impact of Covid-19 on remittances, which are estimated to have declined by more than 20% in 2020. This underscores the contractionary impact of the crisis on economic activity and employment in the region. The impact on remittances is felt particularly hard in the case of KSA, which accounts for around 60% of Yemeni diaspora remittances. This has dramatically reinforced the deleterious economic impact of the ongoing oil crisis and the recent dampening of foreign aid inflows.

To restore macroeconomic stability, external imbalances will need to be addressed through increased export earnings, and progress towards economic diversification. In addition, it is hoped that recent improvements in political economy and security stability conditions may help attract additional capital inflows.

CHAPTER I: Current Situation and Economic Prospects

I.1- World Economic Growth

According to the April 2021 issue of the IMF's World Economic Outlook (WEO) report, global growth is expected to fall by 3.3% in 2020, largely due to the effects of the Covid-19 pandemic.

Global growth is expected to reach 6% in 2021 thanks to the anticipated recovery from the Covid-19 pandemic. The projections for 2021 are stronger than in the October 2020 WEO. The upward revision reflects additional fiscal support in a few large economies, the anticipated vaccine-powered recovery in the second half of 2021, and continued adaptation of economic activity to subdued mobility. High uncertainty surrounds this outlook, related to the path of the pandemic, the effectiveness of policy support to provide a bridge to vaccine-powered normalization, and the evolution of financial conditions.

Nonetheless, global prospects remain highly uncertain one year into the pandemic. New virus mutations and the accumulating human toll raise concerns. Economic recoveries are diverging across countries and sectors, reflecting variation in pandemic-induced disruptions and the extent of policy support. The outlook depends not just on the outcome of the battle between the virus and vaccines—it also hinges on how effectively economic policies deployed under high uncertainty can limit lasting damage from this unprecedented crisis.

The economic disruptions caused by the pandemic were reflected in a slump in demand that led to weak price growth and deflation across the globe. The average inflation rate in advanced economies decreased from 2% in 2018 to 1.5% in 2019, while emerging markets and developing economies saw a narrow decrease from 4.8% in 2018 to 4.7% in 2019. While considerable uncertainty surrounds future inflation projections, inflation is expected to remain low due to relatively weak aggregate demand.

Table I.1- Global Growth Forecast

		Projections	
	2019	**2020**	**2021**
Global Growth Rate, %	2.8	-3.3	6.0
Growth Rate (Advanced Economies), %	1.7	-4.7	5.1
Growth Rate (Emerging and Developing Economies), %	3.7	-2.2	6.7
Growth Rate (Middle East and Central Asia), %	1.4	-2.9	3.7
Growth Rate (Middle East and North Africa), %	0.8	-3.4	4.0
Growth Rate (Low-Income Developing Countries), %	5.3	0.0	4.3

Source: IMF, WEO, October 2020

I.2- Growth and Price Developments in Yemen

After recording an estimated total contraction of about 45% from 2014 to 2017, economic activity in Yemen began improving in 2018; growth that was sparked primarily by the hydrocarbon industry. Real GDP increased by an estimated 2.1% in 2019, up from 0.8% in 2018, despite slowing global growth and tightening financial conditions.

Yemen's 2019 growth was accompanied by a decrease in the inflation rate from the 20% to 30% range recorded from 2015 to 2018 to approximately 10%. Inflation in Yemen has traditionally been the result of both imported inflation (increases in import prices due to currency depreciation) and local factors, but monetary policy adopted in 2019 has thus far been successful in controlling the money supply in a manner consistent with the pace of economic activity. In addition, the Rial exchange rate was stabilized after an exchange rate crisis in the fall of 2018 that sent the Rial's depreciation to unprecedented levels. International and domestic economic conditions placed further downward pressure on Yemen's 2019 inflation; slow growth in international prices for non-oil commodities and modest domestic demand both played a role in cutting inflation by more than half.

As with the rest of the world, 2020 brings a different economic picture for Yemen. As an oil dependent state, declining oil prices and the COVID-19 pandemic have combined to have a significant negative impact on the country; Yemen's GDP is expected to contract by 8.5% in 2020 then by 2% in 2021.

This deterioration in economic conditions also cut short any positive movement in the inflation rate, which during 2020 reached levels not seen since the 2018 crisis. Expectations indicate that inflation increased to about 25% in 2020, and the annual rate of inflation is expected to reach 25-30% level in 2021. This brings direct and immediate costs for consumers, since roughly 90% of Yemen's total consumable goods are imported. The Market survey indicated that the national average cost of the Minimum/Survivable Food Basket increased by 4 percent in December 2020 (m-o-m) and by 30 percent (y-o-y).

CHAPTER II: Monetary Developments

The following focuses on analyzing the development of base money and broad money aggregates in Yemen during 2020/2019 in order to investigate the linkages between money and other macroeconomic variables. To this end, we review the details of the central bank balance sheet, the commercial and Islamic banking survey, and the overall monetary survey.

This monetary survey was developed in 2019 as part of technical assistance, capacity building, and institutional strengthening support provided by USAID to the Central Bank of Yemen (CBY). Having this tool at the disposal of the CBY is an important accomplishment. CBY needs accurate reporting to create proper monetary decisions; the monetary survey, by providing a thorough picture of the financial system, will help CBY to formulate and implement effective monetary policy.

2020 brought positive news regarding Yemen's monetary policy. Money supply growth was contained in 2019 and 2020 following the CBY's adoption of a more appropriate monetary policy based on a monetary programming framework designed to ensure adequate economic absorptive capacity and money creation. The impact of this ongoing reform has become evident in the significant decline of the currency issuance growth rate, which fell to 12.4% in 2019 and 15.1% in 2020, down from 35.8% and 37.6% in 2018 and 2017, respectively. In the same vein, the money supply (M2) rose by 8.5% and 15% in 2019 and 2020, respectively.

II.1- Central Bank Balance Sheet

CBY's balance sheet rose in 2020 by 727.5 billion Rials or 11.1% year-over-year (YoY) to reach 7286.3 billion Rials. The following analyzes the key balance sheet components (see Table II.1).

- **Assets**

The central bank's net foreign assets decreased in 2020 by 240.6 billion Rials or 50.6% YoY compared to the previous year, to record a negative value of 907.5 billion Rials, equal to USD2269 billion. This decrease has two main causes. First, Yemen's ongoing political instability has slowed oil exports. Secondly, the steep decline in international oil prices lessened the value of Yemen's exports and deprived the country of its primary source of foreign assets.

- As a result, total external assets as a share of total assets fell from 9.6% in 2019 to 5.3% in 2020., Net claims on the government increased by 767.4 billion Rials (18.3% YoY) and 689.4 billion Rials (19.6% YoY) in 2020 and 2019, respectively.

- **Liabilities**

Base money grew by 13.3 percent over the entire CY 2020 against a target of 20.6 percent. Recall that base money is the sum of currency issued and bank reserves held with CBY. Currency issued and bank reserves grew over the same period by 15.1 and 4.4 percent, respectively.

This trend is mainly attributed to the net effect of the increase in credit to the government in form of direct financing of the budget deficit from one hand and the decrease of foreign assets as result of the disbursement of the remaining balance of the Saudi deposit.

Table II.1- CBY Balance Sheet (in billion Rials)

	Dec-18	Dec-19	Dec-20
Foreign Assets	**1,133.6**	**628.4**	**387.8**
Domestic assets	**4,616.7**	**5,930.4**	**6898.5**
Government	3,756.3	4,532.3	5398.9
Public Enterprises	309.5	309.5	309.5
Banks			
Fixed and other assets	550.9	1,088.6	1190.1
Assets=Liabilities	**5,750.3**	**6,558.8**	**7286.3**
Base money	**3,125.9**	**3,484.7**	**3948.2**
Banknotes Issued	2,571.6	2,890.5	3327.5
Banks	554.3	594.2	620.6
Government	243.6	330.6	429.7
Public Enterprises	105.4	48.5	60.3
Social Security Fund	58.7	58.7	58.7
Certificate of deposits			
Foreign liabilities	**1,230.9**	**1,230.9**	**1295.3**
Other Liabilities	**985.9**	**1,405.4**	**1494.1**
Capital & Reserves	110.9	517.5	623.0
Revaluation Account	164.6	214.4	259.8
’DR's	83.8	83.8	93.5
Other Liabilities	626.6	589.7	517.8

Source: CBY

II.2- Consolidated Balance Sheet of Commercial and Islamic Banks

The consolidated balance sheet of commercial and Islamic banks totaled 4,408.9 billion Rials in 2019, an increase of 374.7 billion Rials or 9.3% over 2018 (see Table II.2).

- **Assets**

Net foreign assets of commercial and Islamic banks increased by 113.4 billion Rials or 14.9% in 2019, rising to 873.2 billion Rials, an increase primarily due to a 56.7 billion Rial (13.7% YoY) rise in correspondent accounts and a 30.6 billion Rial (45.8% YoY) rise in foreign exchange. Total foreign assets rose 87.2 billion Rials or 10.6% YoY to 909.8 billion Rials, equal to 20.6% of total assets in 2019.

2019 saw bank reserves (cash in vaults and account balances at CBY) increase by 60.9 billion Rials (8.5% YoY) to equal 774.5 billion Rials. This resulted from a 61.5 billion Rial (85.6% YoY) increase in local currency held and a 0.6 billion Rial (0.1% YoY) decrease in reserves held with the central bank. Bank reserves as a share of total deposits equaled 23.8% in 2019.

Bank loans and advances increased by 161.6 billion Rials or 7.5% in 2019 to reach 2,319.4 billion Rials. The bulk of this increase came from loans provided to the government (primarily represented in treasury bills and Islamic Sukuk), which increased by 166 billion Rials (10.7% YoY). Slight increases were also observed in advances for public institutions, which experienced a moderate rise of 0.6 billion Rials (3% YoY). In contrast, the private sector advanced decreased by 5 billion Rials (0.9% YoY) in 2019.

- **Liabilities**

2019 saw total deposits increase by 222 billion Rials (7.3% YoY) to reach 3,249.3 billion Rials. This increase reflected growth across several types of deposit categories: demand deposits rose by 11.9% YoY, earmarked deposits by 8% YoY, savings deposits by 7.8% YoY, and time deposits by 5.4% YoY.

The net amount of other liabilities rose by 113.9 billion Rials (18.8%) during 2019 to reach 718.8 billion Rials. This rise was partly due to an increase in the capital and reserves of commercial and Islamic banks, which increased by 42.6 billion Rials (14.6% YoY) in 2019, reaching 333.7 billion Rials.

- **Deposits**

2019 CBY data demonstrated increases in deposits across the board. Time deposits rose by 41.7 billion Rials (5.4% YoY) to reach 815.7 billion Rials, which represented 25.1% of total deposits; demand deposits went up by 69.7 billion Rials (11.9% YoY), reaching 653.9 billion Rials and accounting for 20.1% of total deposits; saving accounts increased by 18.9 billion Rials (7.8% YoY) to reach 260.9 billion Rials, equal to 8% of total deposits; and earmarked deposits increased by 3.7 billion Rials (8%, YoY) reaching 1.5% of total deposits. Finally, government deposits increased by 9.8 billion Rials or 43%, equaling 1% of total 2019 deposits.

Likewise, deposits denominated in foreign currency recorded an increase of 78.1 billion Rials, or 5.8%, in 2019, totaling 1,436.1 billion Rials and 44.2% as a share of total deposits. This, in turn, reflects 2019's stronger overall economic performance.

- **Loans and advances**

The total amount of credit granted to the private sector by the banking sector in 2019 equaled 578.2 billion Rials in 2019, a decline of 5 billion Rials or 0.9% from 2018 levels.

The distribution of credit to the private sector in 2019 as follows:

- Short-term loans and advances accounted for 18% of total non-government credit;
- Medium and long-term loans accounted for 3% of total non-government credit;
- Investments from Islamic banks in 2019 represented 26% of total non-government credit; and
- Non-performing loans represented 53% of total non-government credit in 2019.

Table II.2- Commercial and Islamic Banks Balance Sheet (in billion rials)

	Dec-18	Dec-19
Assets	**4,034.2**	**4,408.9**
Foreign Assets	**822.6**	**909.8**
Foreign Currency	66.8	97.4
Banks Abroad	414.3	470.9
Non-residents	0.0	0.0
Foreign Investment	341.5	341.5
Reserves	**713.6**	**774.5**
Local Currency	71.8	133.3
Deposits with CBY	641.8	641.2
Gross Loans & Advances	**2,157.8**	**2,319.4**
Government	1,554.8	1,720.8
Public Enterprises	19.8	20.4
Private Sector	583.2	578.2
Certificate of Deposits	**1.0**	**1.0**
Treasury bills purchased from CBY	**0.0**	**0.0**
Other Assets	**339.2**	**404.2**
Liabilities	**4,034.2**	**4,408.9**
Deposits	**3,027.3**	**3,249.3**
Government	23.0	32.8
Demand	584.1	653.9
Time	774.0	815.7
Saving	242.0	260.9
Foreign Currency	1,358.0	1,436.1
Earmarked	46.2	49.9
Foreign Liabilities	**62.7**	**36.6**
Banks Abroad	59.8	33.6
Non-residents	2.9	3.0
Borrowing from banks	0.0	0.0
Other Liabilities	**944.1**	**1,123.0**
Loans from CBY	5.6	13.5
Other Liabilities	647.4	775.8
Capital		
Capital & Reserves	291.1	333.7

Source: CBY

II.3- Monetary Survey

A rise in net domestic assets combined with a decline of net foreign assets led to an overall rise in the money supply (M2) to 6869.8 billion Rials in 2020, an increase of 896.1 billion Rials (15% YoY).

When analyzing the dynamics of money supply components in 2020, it is worth noting that narrow money (M1) increased by 511.6 billion Rials (15% YoY), while quasi-money rose by 384.6 billion Rials (15% YoY). This represents an increase in money across all sectors of the financial system; the rise in narrow money (M1) reflected an increase in both currency in circulation and demand deposits, while the upward trend in quasi-money was due to the increase in time and foreign deposits.

The predominance of currency in circulation, which accounted for 46.5% of the total money supply in 2020, is evidence that Yemen continues to rely heavily on cash as its primary means of financial intermediation. This reflects the ongoing institutional and access constraints characterizing the nation's financial system, and generates heavy costs at both the consumer and institutional levels. In this regard, the overreliance on cash limits intermediation capacity and prevents access to sophisticated payment systems. The overall composition of Yemen's money supply can be seen in Table II.3.

Table II.3- Decomposition of Broad Money (in billion Rials unless otherwise indicated)

	Dec-18	Dec-19	Dec-20
Broad money (M2)	**5504.2**	**5973.7**	**6869.8**
Broad money, annual change in %	28.5	8.5	15.0
Quasi-money	**2420.2**	**2562.6**	**2947.2**
Quasi-money, annual change in %	23.1	5.9	15.0
Quasi-money/Broad money, in %	44.0	42.9	42.9
Foreign currency deposits	**1358.0**	**1436.1**	**1820.6**
Foreign currency deposits, annual change in %	52.5	5.8	26.8
Foreign currency deposits/Total deposits, in %	45.2	44.6	49.5
Narrow money (M1)	**3084.0**	**3411.1**	**3922.7**
Narrow money, annual change in %	33.1	10.6	15.0
Narrow money/Broad money, in %	56.0	57.1	57.1
Demand deposits	**584.2**	**653.9**	**728.4**
Demand deposits, annual change in %	20.1	11.9	11.4
Demand deposits/Broad money, in %	10.6	10.9	10.6
Currency in circulation	**2499.8**	**2757.2**	**3194.3**
Currency in circulation, annual change in %	36.6	10.3	15.9
Currency in circulation/Broad money, in %	45.4	46.2	46.5

Source: CBY

A significant fraction of Yemen's net monetary emissions has been utilized to finance the government deficit. This has spiked in recent years due to the deterioration of oil export revenues, while public wages remain high and continue to represent the bulk of government expenditures. It should be noted that drawdowns from the Saudi Letter of Credit deposit - utilized to help finance urgently needed imports - helped CBY bring broad money growth down from 28.5% in 2018 to 8.5% in 2019 and 15% in 2020. CBY's initial monetary plan for 2021 projected base and broad money to grow by 19.1% and 18.3%, respectively, consistent with an inflation rate of around 20%. Designed with technical assistance framework provided by USAID, CBY's 2020 plan was its first since relocation to Aden. The plan focused on controlling the money supply in a manner consistent with the real economic needs emanating from both public and private sectors. Though economic conditions have shifted since its implementation, the plan remains a core part of CBY's strategy moving forward. In the absence of a foreign reserve buffer, strong commitment to the annual monetary plan targets remains the only tool at CBY's disposal to attempt to contain inflationary pressures and stabilize exchange rate movements, and CBY remains committed to its effective implementation.

II.4- Exchange Rate Policy Developments

The exchange rate of the US dollar against the Yemeni Rial reached 700 Rials per dollar at the end of 2020, up from 591 Rials per dollar at the end of 2019. Worth to note that exchange rate of the Rial crossed the threshold of 900 Rials per dollar many times during 2020. This, in turn, led to a substantial shortage of foreign currency needed in the local FX market to cover essential goods. The Rial's depreciation was caused by multiple shocks hitting the economy in early 2020. These included the fall in oil prices, the decline in remittances due to the Covid-19 pandemic, and the depletion of the 2018 Saudi deposit -- all of which placed serious downward pressure on the exchange rate, rolling back progress made over the previous year.

In response to these downward pressures and the accelerating depreciation of the Rial, CBY approved the following set of short-term measures to help further limit the demand for foreign exchange in the market.:

- Adoption of a new mechanism for oil derivatives imports financing, which requires importers to obtain the approval of the CBY to access foreign exchange resources. Under the new arrangement, importers are required to deposit their daily cash sales in local currency to their accounts in commercial banks, while the CBY provides foreign currency to be utilized to cover imports;
- A ceiling of 500,000 Yemeni Rial (or its equivalent in foreign currency) for every financial transfer per day, per individual. Additionally, CBY prohibited the use of foreign currency for payments in the domestic market.
- Intensified periodic inspection campaigns, in cooperation with security agencies and the Public Funds Prosecution, of all exchange companies and facilities in the liberated governorates.

Nonetheless, these downward pressures on the exchange rate are expected to persist into 2021 due to a projected lack of foreign reserves available to cover the widening gap in the balance of payments. This will continue to affect Yemeni purchasing power, placing stress on consumers and institutions. Due to these challenging economic conditions, additional international aid in the form of balance of payments assistance is likely to prove vital to Yemen's economic health.

II.5- Building a Robust Framework for Conducting Monetary Policy

The main objective of the Central Bank of Yemen (CBY), as stated in its Law No. (14) of 2000, is to maintain prices by achieving low inflation rates; in doing so, it plays a critical role in regulating the country's economic health.

In pursuing its legal mandate of price stability, the central bank began targeting the growth rate of the money supply (broad money) as an intermediate target, while base money, controllable by the central bank, is used as an operational target. There is a strong analytical foundation for this framework; based on empirical estimations conducted by CBY with the assistance of USAID/Pragma specialists; it determined that base money is positively and significantly correlated with inflation, which underscores the strong relationship between that monetization of the government deficit and high inflation. It also suggests that an increase in the money supply has a persistent positive effect on inflation rates. With this in mind, the central bank's mission looking ahead will be to smooth variability in the money supply; in order to achieve price stability and provide an adequate volume of monetary resources to support inclusive growth.

The central bank places great importance on adherence to the designed monetary targeting framework for monetary policy operations to achieve macroeconomic objectives. CBY initiated specification of quantitative targets for broad money and base money in CY2020 using the monetary planning framework established with the assistance of USAID/Pragma and is closely monitoring their trajectory to keep inflation in check.

Under this framework, the exchange rate will be allowed to gradually adjust, while the current system of multiple exchange rates will be gradually abandoned. High exchange rate volatility will be smoothened through formalized interventions in the FX market using a transparent and rules-based auctioning system. In addition, nominal and real exchange rate movements will be considered in designing monetary policies. The exchange rate channel works via through the impact of changes in monetary flows on exchange rates and aggregate demand and supply; any excessive increase in the money supply will normally lead to a depreciation of the exchange rate, which increases the price of imported goods and services and thereby raises domestic prices and inflationary pressures.

Under the current macroeconomic conditions and given the soaring prices present since 2014, tightening monetary policy and improving monetary impulse transmission to the real sector, along with efforts to address external imbalances by promoting private sector exports, competitive import substitution activities, and allowing greater exchange rate flexibility while building foreign reserves, are all indispensable elements of the central bank's plan to restore macro-financial stability.

To achieve its monetary policy objectives, CBY is working to set up a combination of well-coordinated monetary policy instruments. The market-based toolkit of monetary control instruments will be designed to include open market operations, standing facilities, and a structured reserve requirement system as the main pillars of the monetary policy operational framework.

CHAPTER III: Public Finance

At the end of 2020, Yemen had a public deficit of 782 billion Rials, equal to 5.5% of GDP, against a deficit of 703 billion Rials or 5.6% of GDP at the end of 2019. Though economic conditions worsened in 2020 in wake of the pandemic outbreak, greater care made to public finance management avoided running excessive expenditures and limited the fiscal deficit close to its previous year level.

Yemen's persistently high fiscal deficit must be addressed in the near term by maintaining tight control on spending given the limited availability of public resources. Moreover, it is critically important to do so in a manner designed to bring down inflation and contain additional depreciation pressures.

To accomplish these objectives, public expenditures should be effectively aligned with available revenues by promoting a clear focus on fiscal consolidation. This should include cutting non-essential expenses, reshuffling and prioritizing public spending (in a way that frees funds to be allocated to healthcare spending), and minimizing tax evasion and fraud. Though under the purview of the Ministry of Finance, this process requires coordination across the government; careful coordination with the CBY will be required in order to avoid excessive monetary emission-based financing of the public deficit.

III.1- Public Revenues

Total revenues and grants slightly increased by 8 billion Rials (0.9% YoY) in 2020, reaching 930 billion Rials. This resulted from the decrease in oil revenues by 23.7 billion Rials from one hand and the increase of non-oil revenues (tax and customs), by 31.7 billion Rials from another. Public revenues totaled 6.6% of GDP in 2020.

- **Oil revenues**

Oil revenues fell to 330.1 billion Rials in 2020, a decrease of 23.9 billion Rials or 6.7% YoY. It contributed 35.5% of total public revenues and accounted for 2.4% of GDP.

- **Non-oil revenues**

Non-oil revenues rose to 551.7 billion Rials in 2020, an increase of 31.7 billion Rials (6.1% YoY). This equaled 59.3% of total public revenues and 3.9% of GDP.

The composition of non-oil revenues is as follows:

- Tax revenues (including customs duties) increased by 7.5 billion Rials in 2020, to 345.5 billion Rials (2.2% YoY). Tax receipts represented 37.2% of total public revenues and 2.5% of GDP.
- Non-tax revenues (which include fees and profit transfers) increased in 2020 by 24.2 billion Rials (13.3% YoY) and totaled 206.2 billion Rials, representing 22.2% of total public revenues and 1.5% of GDP.

Table III.1- Public Revenues and Grants (in billion Rials)

	Dec-18	Sep-19	Dec-19	Sep-20	Dec-20
Total revenues and grants	**743.0**	**465.2**	**922.0**	**446.0**	**930**
Oil revenues	**342.0**	**237.2**	**354.0**	**172.8**	**330.3**
Non-oil revenues	**377.0**	**228.0**	**520.0**	**265.2**	**551.7**
Tax revenues	224.0	150.2	338.0	203.4	345.5
Other revenues	153.0	77.8	182.0	61.8	206.2
Grants	**24.0**	**0**	**48.0**	**8.0**	**48**

Source: MOF

III.2- Public Expenditures

Public expenditures reached 1712 billion Rials in 2020, increasing by 87 billion Rials or 5.4% YoY; and accounting for 12.2% of GDP.

Current expenditures

Current expenditures totaled 1,663 billion Rials in 2020, increasing by 128 billion Rials or 8.3% YoY.

Capital expenditures

Capital expenditures totaled 49 billion Rials in 2020, decreasing by 41 billion Rials or 45.6% YoY. This remained a fairly marginal component of public spending, accounting for only 2.9% of 2020's overall budget expenditures.

Table III.2- Public Expenditures (in billion rials)

	Dec-18	Sep-19	Dec-19	Sep-20	Dec-20
Total expenditures	**1652.0**	**1218.8**	**1625.0**	**926.8**	**1712**
Current Expenditures	**1555.0**	**1151.3**	**1535.0**	**880.5**	**1663**
Wages and salaries	821.0	640.5	854.0	389.3	878
Goods and services	308.0	90.0	120.0	159.9	199
Interest payments	8.0	22.5	30.0	53.3	255
Subsidies and transfers	389.0	369.0	492.0	259.5	281
Other expenditures	29.0	29.3	39.0	18.5	50
Capital Expenditures	**97.0**	**67.5**	**90.0**	**46.3**	**49**

Source: MOF, CBY

- **Overall balance**

The overall budgetary balance displayed a public deficit of 782 billion Rials in 2020 (5.6% of GDP), down from a deficit of 703 billion Rials in 2019 (5.6% of GDP). The ratio of total revenues and grants to public expenditures was at 54.3% in 2020.

Table III.3- Overall Balance (in billion Rials)

	Dec-18	Dec-19	Dec-20
Total public revenues and grants	**743.0**	**922.0**	**930**
Total public expenditures	**1652.0**	**1625.0**	**1712**
Overall balance	**-909.0**	**-703.0**	**-782**
Overall balance, in % of GDP	**-7.9**	**-5.6**	**-5.5**

Source: MOF, CBY

III.3- Public Domestic Debt

Due to the ongoing decline in public revenues, net internal public debt (stock of internal debt since CBY's temporary relocation to Aden in fall 2016) soared by 632 billion Rials (26.6% YoY) in 2020; reaching a value of 3009 billion Rials at the end of December 2020.

Direct borrowing from the central bank represented the primary source of domestic public financing, amounting to 2909 billion Rials in 2020. This was equal to 97% of total public internal debt. Wakala Sukuks and certificates of deposit constituted the second-largest source of domestic public financing, with 100 billion Rials representing a share of 3% of the total internal public debt.

Table III.3- Public Internal Debt (in billion Rials)

	Dec-19	Dec-20
Internal public debt	**2377**	**3009**
Central bank financing of the government (overdraft)	**2277**	**2909**
Commercial and Islamic bank financing of the government	**100**	**100**

Source: MOF, CBY

While the current situation poses major challenges from a stable public financial management perspective, the Ministry of Finance is committed to achieving fiscal balance in the medium term, strengthening its institutional and governance structures, and enhancing its operational capacity; in order to promote effective planning and timely implementation of a sound fiscal policy framework.

CHAPTER IV: External Sector

The improvement of Yemen's political and security situation during 2019 played a fundamental role in boosting the performance of the national economy and, more specifically, the external sector; this, in turn, was reflected in the status of the balance of payments, as exports increased and foreign earnings rose.

In contrast, the widening balance of payments deficit witnessed during CY 2020 reflects a rapid and radical deterioration of economic fundamentals due to the adverse effects of the Covid-19 pandemic and the fall in oil prices. The sharp drop in foreign export earnings led to extensive utilization of available foreign reserves, which fell precipitously, reflecting economic headwinds and leading to further depreciation of the national currency.

IV.1- Balance of Payments

Preliminary data indicate that Yemen experienced a deficit in the overall balance of payments of about USD465 million in 2020. This deficit was reflected in a decrease in the total foreign reserves of the CBY in 2020, falling to 937 million dollars—only enough to cover 1.3 months of imports. The deficit in the balance of payments is primarily due to the twin deficits of the current account and the capital and financial accounts.

Table IV.1- Balance of Payments Key Indicators

	2018	2019	2020
Current deficit, as % of GDP	-2.1	-3.6	-3.4
(Exports + Imports), as % of GDP	43.2	52.4	50.7
Exports, as % of GDP	5.6	6.9	6.2
Oil Exports, as % of GDP	16.6	4.9	3.8
Remittances, as % of GDP	13.5	18.8	18.5
Imports, as % of GDP	37.7	45.4	44.4
Oil imports, as % of GDP	11.0	12.0	10.9
Food imports, as % of GDP	9.1	12.9	16.5
Gross international reserves (USD million)	2,292	1402.0	936.9
Foreign reserves coverage in months of imports	3.1	1.6	1.3

Source: IMF.

All balance of payment indicators reflected Yemen's challenging economic position heading into 2020. The deficit in the current account amounted to USD644 million in 2020, equal to 3.4% of GDP; the capital and financial account recorded a surplus of USD20 million dollars in 2020. The deficit of the total balance of payments at the end of 2020 was estimated to USD465 million.

The following is a detailed presentation of the primary indicators of the balance of payments.

- **Current account**

The current account, which represents transactions related to goods and services, income, and current transfers, recorded a deficit of USD644 million in 2020, equal to 3.4% of GDP.

The trade deficit has improved significantly in 2020, to about USD7.225 billion against USD8.694 billion in 2019.

Overall, the total value of exports decreased by USD384 million (24.6% YoY) in 2020 to USD1.178 billion, equal to 6.2% of GDP. The decrease of exports in 2020 reflected significantly lower growth in the global economy in light of the pandemic adverse effects.

- ***Exports of crude oil and gas***

Crude oil and gas exports declined in CY2020 to USD711 million due to political instability and worsening international economic conditions, a decrease of USD390 million (35.4% YoY).

- ***Non-oil exports***

The value of non-oil exports increased in 2020 by 1.5%, to USD468 million, a bright spot for Yemen and a reflection of early stage work underway to diversify the country's exports.

Yemen's dependence on imported goods is reflected in the sector's share of GDP, which is well above global averages. The value of imports reached around USD8.4 billion in 2020, a decrease of USD1.9 billion in 2020 or 18.4%.

- ***Imports of oil products***

Oil derivative imports decreased by USD0.7 billion or (25.9% YoY), to reach USD2.0 billion in 2020 against USD2.7 billion in 2019.

- ***Food imports***

Food imports reflect a core part of Yemen's consumer spending; the bulk of basic goods are imported, which means that worsening global conditions place significant demands on consumers. Food import bill increased in 2020 by 6.9% to reach USD3.1 billion.

- ***Balance of income and transfers***

The net balance of income and transfers dropped to USD6,5 billion in 2020, down by 16.6% or USD1.3 billion YoY. The decrease in the net income and transfers balance in 2020 mainly reflected the decrease in humanitarian aid and worker remittances. Decline in remittances appeared to reflect regional instability and the economic difficulties faced by the Yemeni diaspora.

- **Capital and financial account**

Yemen's capital account recorded a surplus of USD20 million in 2020 while the financial account recorded a deficit of USD13 million. The net balance was USD7 million.

Overall balance

The overall balance recorded a deficit of USD465 billion in 2020 (2.5% of GDP) down by USD425 million or 47.8% on a year-over-year basis. This was chiefly due to the decrease of goods and services importation bill. The balance of payments deficit was also exacerbated by the transformation of the capital account surplus into a deficit, a result of the increase in direct investment flows abroad and the decrease in other investments. This, in turn, affected the central bank's gross foreign reserves, which decreased by USD549.1 million during 2020. The deficit of the total balance of payments for 2021 is projected to increase by USD901 million to reach USD1.366 billion.

Table IV.2- Balance of Payments, Actual and Projection (in million dollars)

	2019	**2020**
Exports of goods and services	**1,561.8**	**1,178.2**
Hydrocarbon	1,101.0	710.5
Other exports	460.8	467.7
Imports of goods and services	**10,255.6**	**8,403.5**
Hydrocarbon	2,700.0	2,070.0
Food	2,901.5	3,114.1
Other imports	4,654.1	3,219.4
Balance of goods and services	**-8,693.9**	**-7,225.3**
Incomes	-17.9	-19.0
Transfers	7,900.0	6,600.0
Remittances	4,250.0	3,500.0
Use of donor grants	3,650.0	3,100.0
Balance of incomes and transfers	**7,882.1**	**6,581.0**
Current account	**-811.7**	**-644.3**
Capital inflows net	**-78.3**	**179.2**
Financial inflows net	-740.0	6.8
Errors and omissions	661.7	172.4
Overall balance	**-890.0**	**-465.1**

Source: IMF

Both the balance of payments deficit and the fiscal deficit are expected to continue widening over the coming months as the effects of the Covid-19 pandemic continue to be felt, which will lead to further weakening of the local currency - unless the main causes are addressed in the short-term. To combat this downward pressure and help stabilize the economy, macroeconomic and structural policies which help revive private sector activity, boost export earnings, help up a buffer of foreign reserves, and limit debt monetization should be pillars of economic policy moving forward.

IV.2- Public External Debt

The lack of accurate data from public authorities and lending and donor countries on the size of the Republic of Yemen's external debt represents a significant ongoing barrier to managing the nation's finances. To combat this, a working group that consists of representatives from the Central Bank, the Ministry of Finance, and the Ministry of Planning and International Cooperation, supported by USAID/UKAID-financed Pragma experts, has been formed to collect data; by communicating with lenders and helping to restart the Debt Management and Financial Analysis System (DMFAS).

The latest estimates made by the International Monetary Fund (IMF) on the position of the external public debt of Yemen indicate that the outstanding balance of the external public debt has decreased by USD52 million (0.8% YoY) to a total of USD6.665 billion, equal to 35.2% of 2020 GDP. The balance of the debt of the International Development Agency (IDA) decreased in 2020 by USD83.3 million - or 5.5% - due to installments and interest paid, reaching USD1.421 billion dollars. IDA debt's share of the balance of the outstanding external public debt amounted to 21.3% in 2020.

Appendix: Statistical Concepts and Methodology

The Quarterly Economic and Monetary Bulletin issued by the Central Bank of Yemen focuses on developments in global economic conditions and their expected prospects, in addition to local economic and monetary developments. The Bulletin highlights the following:

I- Current situation and economic prospects

The World Economic Outlook report issued by the International Monetary Fund represents the most reliable source for diagnosing the development of global economic conditions and their prospects. We rely on data from the Central Statistical Organization (CSO), if/as available, to diagnose the conditions of the national economy.

II- Money aggregates and monetary policy developments

The Central Bank of Yemen is the main source of the country's monetary and banking statistics. The General Department of Central Accounts provides the General Department for Research and Statistics with the balance sheet of the central bank, while the General Department for Banking Supervision provides the consolidated balance sheet of commercial and Islamic banks, as well as its various activities.

The General Department for Research and Statistics collects this data and periodically prepares it for publication, in accordance with the 2000 Monetary and Financial Statistics Manual issued by the International Monetary Fund. The central bank treats the data it collected separately on the concerned institutions with strict confidentiality. The monetary data should be published in its final form, and these data are reviewed when any amendment is made related to the methodology used and the classification of the monetary data. The following is an introduction to the content of the most prominent terms included in the monetary tables:

- Banks: All commercial and Islamic banks operating in the Republic of Yemen that accept deposits.
- Banking system: The Central Bank of Yemen and the commercial and Islamic banks operating in Yemen.
- Government: The central government and the local councils.
- Social Security Institutions: The General Authority for Insurance and Pensions, the General Organization for Insurance and Pensions, and the Security and Military Retirement Institutions.
- Public Institutions: Public (non-financial) institutions and companies in which the government has an interest and/or voting power.
- Non-Governmental Sector: All local sectors except the government and social security institutions.

- Resident: A natural or legal person who usually resides in Yemen or has been in Yemen for a year or more, regardless of the nationality of this person, with the exception of international bodies and institutions and foreign students who reside for more than one year.
- Non-resident: A natural or legal person who usually resides outside Yemen and/or who has not completed one year of residency inside Yemen, regardless of the nationality of this person, except for families and individuals who have an economic center or interest in Yemen and have permanent housing even if he resides there intermittently.
- Net foreign assets: The external assets of the banking system minus the external liabilities on the banking system, based on the concept of residency. It is calculated for each of the central bank and banks from the external assets and liabilities included in their balance sheets.
- Net government borrowing: The sum of the claims on the central government and local councils of the banking system, minus the total government deposits with the banking system.
- Claims on the non-governmental sector: The total claims on public institutions and the local private sector.
- Other items net: The sum of the other assets of the banking system minus the sum of other liabilities of the banking system, representing items that are not included in the definition of net foreign assets, net of government borrowing, and claims on the non-governmental sector from the central bank balance sheet and the consolidated balance sheet of commercial and Islamic banks.
- Currency issued: The cash issued by the central bank, consisting of cash circulating outside banks plus cash in banks’ vaults.
- Money: Currency in circulation plus demand deposits in rials with the banking system for both the (local) private sector and public institutions.
- Quasi-money: Both savings and time deposits in Yemeni rials and deposits in foreign currencies for all sectors mentioned in the definition of money with the banking system, in addition to deposits of social security institutions.
- Money supply: Equals money plus quasi-money, and also equates to the sum of net foreign assets, net government borrowing, claims on the non-governmental sector, and other items net.
- Banks' deposits with the central bank include the following:

    1) Reserve Requirement: The minimum value that banks must keep with the Central Bank of Yemen in exchange for meeting the mandatory reserve ratio imposed on deposits with banks.

    2) Current Accounts: These are the current accounts opened with the Central Bank of Yemen in local and foreign currencies by banks. Certificates of deposit in rials are not considered within these accounts.

- Bank advances: Credit granted by commercial banks in the form of loans, facilities, and discounted securities, in addition to financing Islamic banks for their investment operations.
- Loans and advances granted to the private sector by banks: This item includes direct loans and facilities granted by banks to the private sector, as well as to banks' investments in companies' shares.
- Loans and advances granted to the government by banks: This represents agency deposits (alternative to Islamic bonds) and certificates of deposit, in addition to government bonds.
- Exchange rate and monetary policy: The national currency exchange rate against the major foreign currencies is a monetary anchor point that the central bank is striving to stabilize through effective monetary policy measures, in order to achieve a macroeconomic balance between supply and demand and curb price inflation. The General Department of Foreign Exchange and Exchange Affairs is the source of these data and procedures.

III- Public finance

The Ministry of Finance is the source of the state's general budget data. We rely as well on data from the General Budget Department of the Central Bank of Yemen, which includes budget data on the following:

- Public revenues: This includes oil and gas revenues, direct and indirect tax revenues, including customs duties, and non-tax revenues.
- Grants: This includes all sums obtained as donations free of charge from allies and friendly countries.
- Public expenditures: This includes current expenditures and includes chapters one, two, and three according to economic classification, while development and capital expenditures contain chapters four and five.
- Total balance: This represents the state's general budget and indicates the relationship between public revenues and overall public spending.

IV- External sector

- Balance of Payments: According to the Central Bank of Yemen Law No. (14), for the year 2000, the central bank is responsible for collecting the balance of payments statistics. The Balance of Payments Department of the General Department for Research and Statistics is tasked with collecting the balance of payments data from various ministries and government agencies, as well as via investment company surveys.
- External public debt: The Department of Foreign Loans and Aid at the Central Bank of Yemen is the source of external public debt data. In this regard, please note that the outstanding balance of the external debt represents the amounts withdrawn from external loans minus the installments paid, plus the arrears on installments and interest.

Disclaimer

Beginning in August 2008, monetary and banking data were amended and updated in accordance with the 2000 Monetary and Financial Statistics Manual issued by the International Monetary Fund.

According to Article (45) of the Central Bank Law No. (14) of 2000, all information and individual data provided to the central bank is strictly confidential information to be used only for statistical purposes, and no information is published that reveals the financial conditions of any bank or financial institution.

The data contained in the Bulletin received from sources such as ministries and government agencies are preliminary data, subject to change.

We use projections made by the International Monetary Fund when/if no relevant national sources of data/information are available.

This Bulletin is issued by the Department of Research and Statistics at the Central Bank of Yemen – Aden.

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