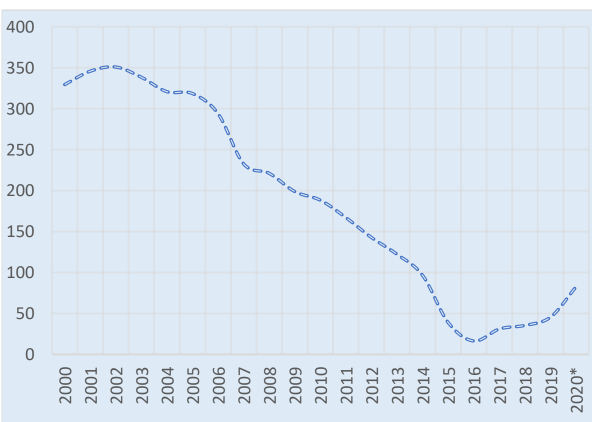
Yemen Monthly Economic Update[1]

February 2020

Economic conditions remained relatively calm in February and internet connectivity was restored. Risks of monetary disruption continue, and indirect global crisis impacts through oil prices and trade are emerging. Humanitarian conditions remain dire.

On February 13, TeleYemen, the country's sole operator of international gateway, announced the restoration of the FALCON submarine cable and the return of the internet services. The restoration came after more than a month-long severe outage nationwide caused by damage to the cable. The sudden internet outage forced a vast majority of Yemenis offline and paralyzed commercial and financial transactions, including remittances, causing widespread socio-economic disruptions and exposing the vulnerability of internet infrastructure's dependence on a single cable.[2] Despite owning a large capacity in other international submarine cables (AAE1, SMW-5), TeleYemen has been unable to use the capacity due to constraints imposed by the current conflict.[3] For the past months, the company has made several calls to the international community for urgent support to prevent the sector from politicized fragmentation and a complete collapse. Continued political divides and fragmentation in the sector pose serious risks for the loss of national coverage in the telecom market, which would negatively affect economic activity and coping mechanisms, as seen during the recent outage.

Figure 1. Yemen Crude Oil Exports
(thousand barrels per day)



Source: Ministry of Oil and Minerals.
** Forecast.*

Crude oil production continued to grow in 2019. According to the Ministry of Oil and Minerals, the country's total oil production increased to 17.5 million barrels in 2019 from 12.7 million barrels in 2018 (Figure 1). Although this represents growth of about 38 percent, the actual production volume was significantly lower than the target, of 27 million barrels, caused by delays in the construction of a pipeline in Marib, which was expected to boost exports from the Marib-Shabowa basin. Of the total production of 17.5 million barrels in 2019, 16.7 million barrels were exported (compared with 14.2 million barrels in 2018) and the remaining 0.8 million barrels were allocated for domestic refining. Despite

[1] Prepared by Naoko Kojo (nkojo@worldbank.org) and Amir Althibah (aalthibah@worldbank.org) based on information available up to February 29, 2020.

[2] On January 9, 2020, the country's main submarine cable (so-called Falcon cable) on the seabed of the Suez Canal suffered two major cuts (most likely by an anchor), which deprived the country from 80 percent of its limited internet capacity. For further information, see the *Yemen Monthly Economic Update January 2020*.

[3] Specifically, TeleYemen needs to complete construction of the branch and its landing station in Hudaydah to use submarine cable SMW5 and have access to the landing station in Aden to use submarine cable AAE1.

the increase in volume, export proceeds from crude oil exports declined in 2019 as a result of lower global oil prices. The Ministry of Oil and Minerals forecasts a further rise in oil production in 2020 to 30 million barrels. However, reaching this volume depends critically on the completion of the pipeline as well as the security situation on the ground, and these barrels will face a much less favorable oil price environment.

Businesses in areas controlled by the *de facto* Sana'a authorities ("north") appear to be coping relatively well for now with the monetary environment created by the illegalization of new banknotes.[4] As the restriction on the use of new prints had been in place for some time, businesses were already aware of the position held by the Sana'a authorities, before the tightening of the ban was announced in December 2019, and the circulation of new banknotes was limited in the areas controlled in the north. This may have helped to minimize the negative impact on the real sector in the north. Banks in Sana'a continue to allow cash disbursements in old banknotes, which are in short supply, although as before larger withdrawals tend to be constrained and take more time to process. Similarly, cash transfer programs by donor agencies in the north have thus far not been disrupted by the limited availability of old banknotes, as humanitarian agencies are liaising with partner banks to ensure sufficient availability of appropriate notes for each region to minimize inconvenience to the beneficiaries.[5] The major challenge is the shifting lines of control between the two authorities in certain areas, although this concern is limited to a couple of districts.

The acceptance of e-rial remains limited and there is currently no mechanism for using e-rial for normal daily economic activities. Since January 2020, the operators of the three e-wallets promoted in the context of the banknote ban—AL Kuraimi Bank, Yemen Kuwait Bank and CAC Bank—have made efforts to develop services (such as offering visa and ATM cards) and expanded business network to include a few supermarkets and business outlets. However, their acceptance and potential remain limited in scope and geopolitical coverage. The e-rial can still only be used to pay limited expenses such as water and electricity bills and mobile phone services.[6] The Central Bank of Yemen (CBY) based in Sana'a is currently developing a mechanism to widen the acceptance and use of e-rial further in 2020.

The exchange rate of the Yemeni rial stayed broadly stable during February 2020. After a steep fall triggered by the *de facto* authorities in Sana'a, the rial regained strength in areas controlled by the Aden authorities ("south"), supported by the approval of withdrawals from Saudi Arabia's deposit for import financing for essential commodities in late January (Figure 2). During February, the rial remained broadly stable in the south, trading at YR 650 - 665 per US dollar, as the coronavirus-related slow-down in trade

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[4] On December 18, 2019, the *de facto* authorities in Sana'a tightened the ban on the use of new edition of banknotes printed since the CBY headquarters moved to Aden in 2016. Holders of new banknotes were required to surrender "illegal" cash within 30 days from the date of announcement for an exchange into an electric currency ("e-rial") or cash reimbursement in old banknotes, if available, for up to YR 100,000 per person. The *de facto* authorities reiterated that large-scale monetization of the fiscal deficits over the past years had caused a collapse in the Yemeni rial, and that the new measure was necessary to stop currency speculation and protect the value of the currency. For further information, see the *Yemen Monthly Economic Update December 2019*.

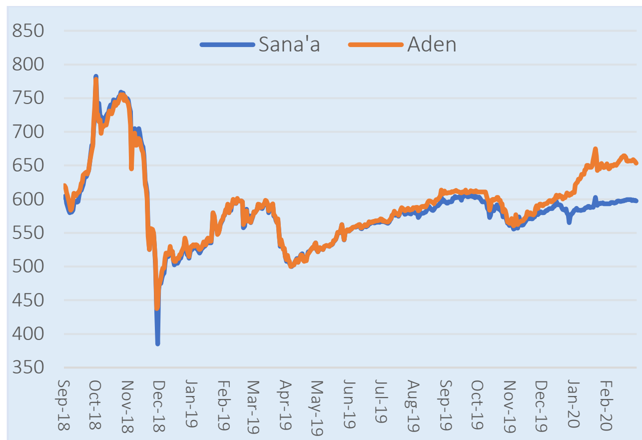
[5] While the direct impact of the monetary measure appears limited so far, humanitarian agencies continue to face a challenging operating environment due to bureaucratic requirements to access project sites and deliver relief.

[6] According to the CBY (Sana'a), the number of e-rial accounts currently stands about 700, with a total balance of YR 25 billion.

with China (one of Yemen's biggest trade partner) has led to lower demand for foreign exchange and the initial panic to the monetary measure has subsided. The rial also remained stable in the north at YR 597 per US dollar on average during February, as stronger oversight of exchange houses by the CBY (Sana'a) contributed to containing currency speculation and declining demand for hard currency. Driven by the wide wedge between the value of the rial between the north and south, commercial banks and exchange houses continued to charge high fees—sometimes by up to 20 percent—for processing cash transfers from the south (where the rial is valued less) to the north (where the rial is valued higher), imposing additional costs on businesses and households.

The Yemeni rial remains vulnerable to downward pressures in view of dwindling foreign reserves and the lack of stable source of foreign currency. Prospects of significantly increased proceeds from crude oil exports are uncertain, depending crucially on the development of global oil markets and the anticipated production increase following the completion of the pipeline. Preliminary estimates suggest that the bulk of the US$2 billion Saudi Arabia's deposit with the CBY (Aden) has been exhausted by end-January 2020. The near-term risk of a new collapse of the rial remains high, with uncertain scope of the renewal of Saudi Arabian deposit and a fast-approaching Ramadan month, which raises demand for imports and pressure to find any means to pay salaries.

Figure 2. Parallel Market Exchange Rates
(Daily Average, YR/US$)



Source: Data collected from Informal exchange rate markets and staff estimates.

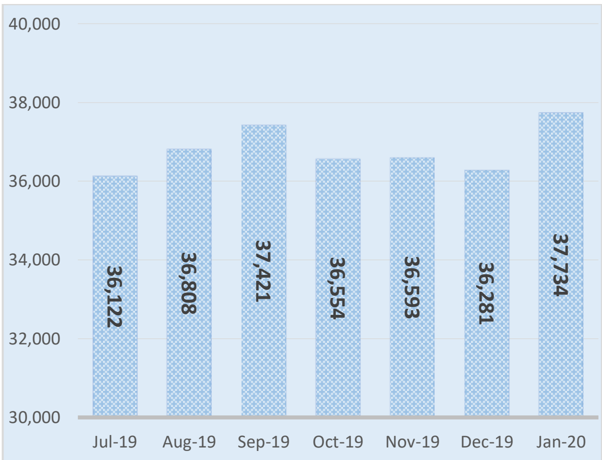
By end-February 2020, there had been no confirmed cases of COVID-19 infection in Yemen, although concerns mount over the potential impact of the pandemic. Yemen's ability to fight the spread of COVID is likely limited, given the already weakened public health system and limited fiscal space. With the prevalence of diseases such as cholera, dengue fever, and swine flu (H1N1) and poor health conditions, such as malnutrition and diarrhea, the Yemeni population is vulnerable to the pandemic. On the economic front, the net impact of a COVID-affected global and regional economic slowdown would be uncertain. On one hand, as Yemen is a net importer of oil products, a slump in global oil prices would likely contribute to improved fiscal position and trade balance, especially if lower oil prices are accompanied by synchronized declines in global commodity prices.[7] On the other hand, Yemen would likely suffer from reduced remittance receipts, if Saudi Arabia's economic downturn constrains employment opportunities for Yemeni migrant workers there, affecting households that depend on foreign transfers.[8] In the event

[7] Even with an increased volume of oil production in 2020, Yemen's status as a net oil importer will remain. Yemen was a net oil exporter until 2015, when crude oil exports came to a near halt. Preliminary estimates suggest that Yemen's net imports of oil products amounted to US$1.5 billion in 2019.

[8] During the global financial crisis of 2019, remittance inflows to Yemen declined sharply. It is estimated that about Saudi Arabia is the source of 60 percent of remittance inflows to Yemen through the formal financial system.

the fall in remittances more than offset the gains in the trade balance, Yemen's external position could weaken, adding further strains to the exchange rate with a knock on impact on the price of imported commodities.

Figure 3. Average Monthly Cost of Minimum Food Basket (7 persons/Yemeni rials)



Source: FAO-MOPIC Market Monitoring Bulletin, January 2020 (#54).

The weakening of the rial in January led to soaring prices of imported food commodities in the south. Data by governorate suggest that the increase in retail prices of imported food commodities was more acute in Abyan, Aden, Shabwah and Al Maharah, which are under the control of the Aden government and thus affected by the sharp depreciation of the rial for the past months. The price hikes in the south contributed to the increase in the national average cost of Minimum Food Basket by 4 percent in January 2020, compared with December 2019 (Figure 3).[9] It is noteworthy that the national average retail price of all locally produced grains increased significantly in line with imported grains, while prices of locally produced vegetables dropped sharply in the same month.

[9] FAO-FSIS & MoPIC-FSTS Market Bulletin January 2020 (#54).