REPUBLIC OF YEMEN

Table 1	2019
Population, million	29.6
GDP, current US$ billion	22.6
GDP per capita, current US$	761.9
School enrollment, primary (% gross)[a]	93.6
Life expectancy at birth, years[a]	66.1

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) WDI for School enrollment (2016); Life expectancy (2018).

An unprecedented humanitarian crisis, now aggravated by COVID-19, persists, leaving many Yemenis dependent on relief and remittances. Economic conditions are deteriorating rapidly, driven by a drop in oil exports, downsizing of humanitarian support, and devastating torrential rains and flash floods. Fragmentation of macroeconomic policies add further strains on the fragile economic conditions, with serious humanitarian consequences.

Recent developments

Violent conflict has entered its sixth year, and Yemen continues to face an unprecedented humanitarian, social and economic crisis. Socio-economic conditions deteriorated further in 2020, affected by low global oil prices, the economic fallout of COVID-19, and weak public infrastructure and coping capacity to deal with extreme climate events/natural disasters. Distortions created by the fragmentation of institutional capacity (especially of the Central Bank of Yemen, CBY) and the divergent policy decisions between the areas of control, have further compounded the economic and humanitarian crisis, from protracted conflict, interruption of basic services, and acute shortages of basic inputs, including fuel.

Anecdotal evidence indicates a likely contraction of the economy from an already low base in the first half of 2020. The oil sector—the only large export earner—was hard-hit by low global oil prices. Non-oil economic activity suffered significantly from COVID-19 related trade slowdown and exceptionally heavy rainfalls, which caused intense flooding, infrastructure damage and human casualties. Foreign exchange shortages deepened further with the near depletion of Saudi Arabia's basic import finance facility, reduced oil exports, and downsizing of humanitarian assistance. In April, some breathing space was provided through the IMF Catastrophe Containment and Relief Trust (CCRT). Trends in remittances are not clear, but were already troubling before Covid-19 due to the impact of weak oil prices on the GCC economies and the increased emphasis on employment nationalization programs in these economies.

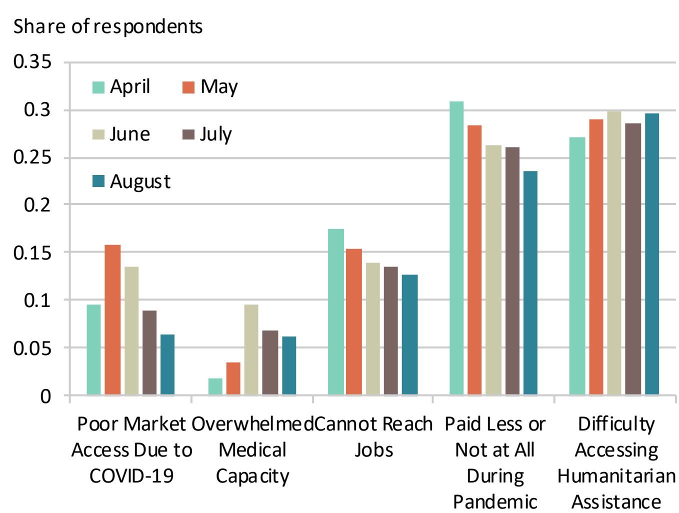
The macroeconomic policy environment differs spatially due to the bifurcation of administration between areas of control. In the areas controlled by the internationally recognized government (IRG), significant revenue underperformance and continued monetization of the fiscal deficit have undermined macroeconomic stability. Oil prices remain low, eroding government hydrocarbon revenue, the main revenue source. Collection of non-hydrocarbon revenue has been compromised by contested control of key institutions in Aden, due to the associated fragmentation of revenue administration functions. The severe revenue shortfall has led to expenditure compression. The expected formation of a new government within the framework of the Riyadh Agreement will strengthen the ability of the IRG to tackle the huge economic challenges facing the country.

Since early 2020, salary payments to public sector workers have seen frequent delays and uneven geographical coverage in the IRG-controlled areas. Payables to suppliers (mostly to energy suppliers) have continued to build up, disrupting fuel imports and the supply of electricity. Debt service to external creditors (except for IDA and IMF) have been halted since 2015. While official data remain unavailable, growing evidence suggests that the widening government deficit has been financed by the CBY overdraft facility.

FIGURE 1 Republic of Yemen / Parallel market exchange rate in IRG controlled areas, daily average

Source: World Bank.

FIGURE 2 Republic of Yemen / Access to food, health care, and employment over the course of COVID-19[1]



Source: World Food Program. Data obtained from a mobile phone survey using random digit dialing that reaches approximately 4200 households each month.

Without stable sources of foreign exchange, expansionary monetary policy has accelerated the depreciation of the Yemeni rial. Given Yemen's high dependence on imports, the weakening of the currency has passed through to domestic prices, eroding purchasing power of households and businesses.

The *de facto* authorities (DFA) in Sana'a, the country's main commercial and financial center, apply a different policy framework reflecting constraints and conditions in their area of control. The complete ban on the use of new banknotes since December 2019 (notes printed after September 2016 when the CBY headquarters was moved to Aden) has effectively segmented the DFA-controlled areas from the impact of macroeconomic policy implemented by the IRG and CBY (Aden).

Fiscal policy of the DFA operates under a cash-constrained balanced budget. The structure of DFA's budget reflects the absence of hydrocarbon revenue. Collection of corporate profit and sales taxes and customs revenue, the three largest revenue sources, was affected negatively by COVID-19 related trade slowdown and movement restrictions, and administrative disruption caused by flooding. So far in 2020, the DFA has disbursed half-month salaries to public sector workers under its controlled areas every other month. Since late 2019, the value of the rial circulating in the governorates under the DFA (old banknotes) has been broadly stable on the parallel market, and significant inflation has not been observed.

Deteriorating economic conditions have likely translated into widespread poverty. Accurate projections are unable to be produced in the current environment. The last national poverty rate was estimated using data prior to the conflict, and is a difficult base from which to estimate how poverty has changed given the profound impacts the conflict has had on the country. Despite the lack of a precise projection of poverty, it is clear that the conflict has placed an extraordinary stress on households. This stress cannot be exclusively captured by monetary poverty alone. Observation suggests that households lack access to food and many basic and essential services, such as health and education, and are experiencing a widespread forced displacement crisis. Approximately 80 percent of respondents of a monthly mobile phone survey conducted by the WFP had difficulty accessing either food or basic services. All of these difficulties have been exacerbated by COVID-19, with increasing households having trouble accessing food markets, receiving pay due to difficulties in reaching jobs, and accessing medical care due to local capacity being overwhelmed. The worsening conditions peaked by June 2020 and, as of September 2020, remain significantly worse than at the beginning of the pandemic.

Outlook

Economic and social prospects for the remainder of 2020 and beyond are highly uncertain. A gradual recovery of global oil prices would help ease the strain on public finances governorates under the IRG and reduce the recourse to central bank financing. However, with ongoing political and security situations, socio-economic conditions will remain difficult. Urgent progress to address the current restrictions of access to supplies and fuel imports through Hodeidah would improve the provision of public services and the operational environment for humanitarian operations. A cessation of hostilities and eventual political reconciliation, including the return of unitary macroeconomic policy implementation, are prerequisites for the reconstruction of the economy and rebuilding of social fabric.

Risks and challenges

The overarching risks derive from fragility and conflict. Near-term macroeconomic risks are closely tied to improving external and fiscal accounts. In the governorates under the IRG, there is a difficult trade-off between salary payments and macroeconomic stability, in the absence of other financing sources. In the governorates under the DFA, the trade-off relates more to the predictability of the private sector business environment, given the reliance of the DFA on such revenue sources. Increasing fragmentation of institutional capacity and the lack of policy coordination would further deepen the divisions in the financial sector and aggravate market distortions which are already evident (e.g., in smuggling activity and arbitrage of goods and assets between different areas of control).

TABLE 2 Republic of Yemen / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2017	2018	2019 e
Real GDP growth, at constant market prices	-5.1	0.8	2.1
Real GDP growth, at constant factor prices	-5.8	-2.7	2.1
Inflation (Consumer Price Index)	30.4	27.6	10.0
Current Account Balance (% of GDP)	0.1	-2.2	-4.4
Fiscal Balance, cash basis (% of GDP)	-5.1	-6.7	-4.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.