

Yemen Monthly Economic Update¹



March 2020

Yemen's conflict entered the sixth year in March. Despite generally difficult operating environment, some entrepreneurs seized opportunities to spur new business sectors. Declining food stocks, sharply rising food prices, and draining foreign reserves point to a looming food crisis in Yemen. COVID-19 could potentially exacerbate Yemen's already difficult socio-economic conditions.

March 26, 2020 marked five years of violent conflict, which has devastated the economy and social fabric in Yemen. Despite a gradual recovery, hydrocarbon exports remain significantly below the pre-conflict levels. As a result, acute foreign exchange shortages persist and significant pressure on public finances continue with disruptions in civil service pension and salary payments. Business environment has deteriorated through protracted conflict, significant damage to infrastructure, a widespread suspension of essential public services (water, electricity, waste management), and lack of imported inputs (fuel, equipment), disrupting economic activity and leaving many Yemenis without a regular source of income. The bifurcation of national capacity, including the capacity of Central Bank of Yemen (CBY), between the conflicting parties, and ad hoc policy decisions by them further compound the economic crisis and humanitarian suffering from violence.

Amid these difficult times, some businesses have adapted and are thriving. Solar energy is one booming sector, spurred by the lack of public electricity supply and limited fuel availability for generators. The rapidly falling cost of renewable technology and financial support from donors have also helped the private sector to seize the opportunity and grow (Annex 1).² A recently conducted survey by the World Bank finds that solar penetration is particularly high in the northern governorates compared with those in the south, which tend to rely more on public and private grids.³ While armed conflict continues, the commercial solar market may represent the fastest and most resilient solution to overcome the severe electricity shortages in the country and provide electricity to small-scale users such as households and critical services, such as irrigation, water system, and healthcare. Construction and real estate are additional sectors that are also growing solidly, as excess liquidity created by large-scale money printing has fueled speculative activity on tangible assets (and currency).

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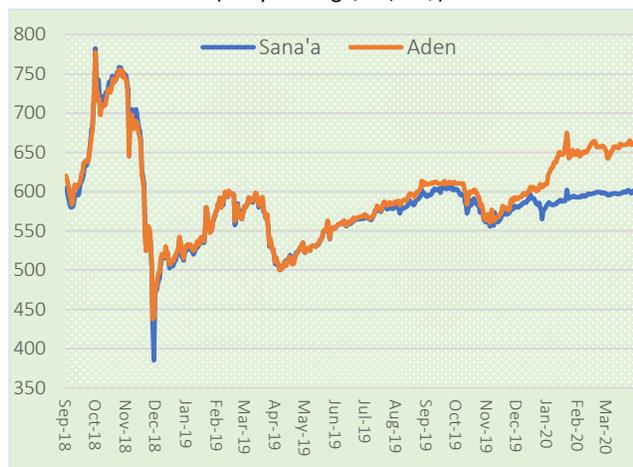
² A report with a comprehensive analysis of the energy sector and recommendations is currently under preparation and forthcoming in summer 2020.

³ Faced with difficulties of importing food and fuel, the *de facto* authorities in Sana'a position the renewable sector as key to reviving agriculture (which has been affected negatively by fuel scarcity) and improve food supply in areas under their control. In 2020, renewable energy is one of the sectors receiving a tax break from the authorities.

The exchange rate of the rial was broadly stable during March 2020.

Despite continued shortages of foreign exchange, the exchange rate of the rial remained unchanged in March, at YR 657-660 per US dollar on average in areas under control of the Government in Aden (“south”). This may be explained by reduced demand for foreign currency, reflecting the COVID-19 related decline in imports from China, one of the most important trade partners for Yemen (see below). In areas controlled by the *de facto* authorities in Sana’a (“north”), the exchange rate of the rial also remained stable at YR 600 per US dollar on average.⁴ The exchange rate gaps between the two areas has persisted, as arbitrage opportunities between the two rates have been contained by financial surveillance by the Sana’a authorities and COVID-19 related restrictions on movements. As a result, fees for financial transfers from the south to the north via banks and exchange houses remained high (up to 15 percent of the transfer value), imposing additional costs to businesses and households. On March 26, the CBY in Aden announced the revision of the exchange rate for imports of foods not covered by the Saudi Arabia import financing facility from YR 570 per US dollar to an average market exchange rate minus YR 30, but did not clarify how the average market exchange rate is determined.

Figure 1. Parallel Market Exchange Rates (Daily Average, YR/US\$)



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

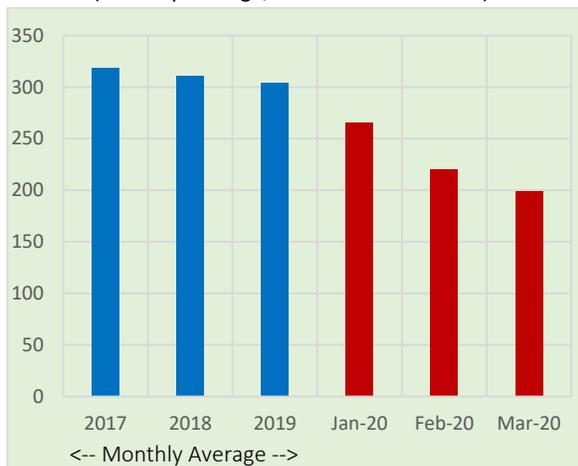
In March, the Government in Aden resumed the disbursement of public pension payments to recipients in the north, enabled by the Sana’a authorities’ intervention.

Payments to pensioners in the north were suspended in in late December 2019, in response to the illegalization of new banknotes by the *de facto* authorities in Sana’a. While the Government in Aden lifted the suspension and processed payment transfer via Al Kuraimi Bank in late January 2020, actual disbursements to the pensioners in the north (about 38 thousand people, or a third of those who are on the public pension scheme) had been delayed due to disagreements over the payment of high financial transfer fees.⁵ The disbursement of pensions in March signals that the issue of who should cover the full financial transfer fees (including payments in old banknotes) has been resolved, at least temporarily. Between November 2018 and November 2019, the Government in Aden made regular pension payments to the recipients in the north. As of end-March, there have been no confirmed reports of salary disbursement in the north by the Government in Aden.

⁴ In mid-December 2019, the CBY in Sana’a announced a complete ban on the use of the new edition of banknotes, printed after September 2016 when the CBY headquarters was moved to Aden, deepening the divisions in the financial sector and economic distortion. Market reaction to the banknote ban has seen increased speculation on the price of the old banknotes against the new, which led to diverging exchange rates between the areas controlled by two different authorities. For further information, see *Yemen Monthly Economic Update, January 2020*.

⁵ In March, the Government in Aden paid a one percent fee to Al Kuraimi Bank for pension payments in the north. Sources suggest that the rest of the fees were covered by the Pension Authorities in Sana’a.

Figure 2. Volume of Food Imports Discharged via UNVIM*
(monthly average, thousand metric tons)



* Imports via Hodeidah and Saleef ports.

Source: UNVIM.

The volume of imports has fallen in recent months despite forthcoming Ramadan, and imported food stocks are declining. In Aden, issues with port access appears to be largely limited to fuel importation, leading to frequent electricity outages, fuel shortages, and a decline in government revenue from fuel imports. Importation through Hodeidah and Saleef ports (servicing more than two thirds of the population in Yemen) has also been depressed. This is due to delayed import processing and discharge from Hodeidah, a COVID-19 related slowdown in trade with China, and more importantly, the near depletion of the Saudi Arabia’s deposit, which bolstered food imports in 2019 (Figure 2).⁶ According to the United Nations Verification and Inspection Mechanism (UNVIM) for

Yemen, the volume of monthly food imports via Hodeidah and Saleef ports—which includes food imports by international agencies—has fallen since October 2019, raising concerns about declining food stocks in Yemen. The decline in food importation was more dramatic during the first quarter of 2020, a trend unobserved previously during a period in which many traders fill inventories in the run up to Ramadan. The volume of food imports in March accounted for only 66 percent of the monthly average volume of food imports in 2019.

Food prices continued to surge in February 2020. Price hikes in January were observed mainly in the southern governorates that were affected by the rapid rial depreciation resulting from the banknote ban in the north. However, in February, prices of imported food surged across all the governorates, as the declining import food stocks and lagged impact of rising global food prices began to bite (Figure 3). Although locally produced food prices were broadly stable across the country, the national average cost of Minimum Food Basket (MFB) increased by around 3 percent in February 2020, compared with a month earlier, reaching YR 38,758 (about US\$58 at YR 660/US\$) per month (Figure 4).⁷ Thus far, the rising prices do not appear to have translated into significantly worsening food deprivation. A recently released report by the World Food Programme (WFP) and World Bank suggests that the share of households experiencing food deprivation remained unchanged at 30 percent during the period November 2019 - February 2020, although it is difficult to precisely identify why the impact on deprivations has been small.⁸

⁶ Reportedly, more than 10 ships loaded with imported goods have been unable to discharge goods despite having obtained clearance to access the Hodeidah port.

⁷ *FAO-FSIS & MoPIC-FSTS Market Bulletin February 2020 (#55)*. The highest MFB was recorded in October 2018 (YR 43,911) when the rial plummeted to almost YR 750/US\$.

⁸ The finding is based on monthly mobile phone surveys conducted in November, December, January, and February. Since July 2015, the WFP has been performing remote phone-based data collection and food security monitoring in Yemen through the mVAM (mobile Vulnerability Analysis and Mapping) approach. Survey respondents

Figure 3. FAO Food Price Indices (2002-2004 = 100)



Source: FAO.

Figure 4. Average Monthly Cost of Minimum Food Basket (7 persons/in Yemeni rial)



Source: FAO-FSIS & MoPIC-FSTS Market Bulletin February 2020 (#55).

Sources point to accelerating inflation since mid-March. As fears about COVID-19 unfold and movement restrictions are put in place, globally, people have begun to stockpile food, medicine and hygiene products as well as other basic goods, exacerbating the price hike and shortages resulting from reduced imports and rising global food prices (see below). Moreover, the recent wave of desert locust attacks can potentially reduce domestic food production and exacerbate Yemen’s dire food security situation (Box 1). Reportedly, in Lahj and Hodeida governorates, most farmers cropping areas have been affected, leading to higher prices and accentuated shortages. Flash flood that hit the southern parts of Yemen in late March also destroyed food crops and drowned livestock.⁹

Box 1. Desert Locust Plague

The worst desert locust infestation in decades, fueled by extreme weather and institutions weakened by conflict, is threatening the food supply and livelihoods of tens of millions a cross East Africa, the Middle East, and South Asia. As of mid-March 2020, 23 countries from Yemen to Pakistan to Tanzania have been affected, and the locust swarms are expected to continue spreading. The situation is extremely alarming and deteriorating rapidly, with widespread breeding in the region in progress and new swarms starting to form, representing an unprecedented threat to food security at the beginning of the region’s



are contacted through a call center and asked to respond to a short series of questions on household food consumption, coping and access to food assistance. The surveys cover approximately 2,400 respondents each month, and each survey reaches just under 100 respondents each day of the month until the required sample size is reached. For the latest analysis of the collected data, see https://analytics.wfp.org/t/Public/views/Yemen_mvAM51Jan-Feb2020/Yemenmvbulletin51?iframeSizedToWindow=true&:embed=y&:showAppBanner=false&:display_count=no&:showVizHome=no&:origin=viz_share_link.

⁹ OCHA Yemen Flash Floods in Southern Governorates, Flash Update 1.

upcoming cropping season.¹⁰ Yemen is one of the key breeding grounds of the locust swarms and thus is an important frontline country for locust response. Before the conflict, Yemen had an adequate capacity, both in terms of equipment and human power to deal with the locust crisis, and Yemen was a key part of the locust monitoring network. However, the ongoing conflict has resulted in loss of necessary assets and capacities to monitor and control the developing locust swarms. The government (Aden) has requested the Bank's support in dealing with the locust crisis. Yemen is expected to benefit from a "Fast Track Locust Response Program" to improve its capacity to prepare for, control, and respond to the locust invasion, deliver safety net support and livelihood restoration to affected households, and improve the early warning and response systems.

As of April 10, 2020, there has been one confirmed case of COVID-19 infection in Yemen, and concerns mount over the potential impact of the pandemic. The low case load is surprising given an increasing number of cases in the neighboring countries. About 40 suspected cases were reported in March, but only one of them has been confirmed positive after official testing facilities. Various precautionary measures have been put in place by the two authorities, including the suspension of all international flights to Yemen, reduced staffing of public offices, closure of schools and public gathering. Some local authorities have imposed a limited curfew in major urban centers and released low-risk prisoners to help protect prisons from an outbreak of COVID-19.

Yemen's ability to deal with COVID-19 is limited, given the already weakened public health system, limited state capacity, and no fiscal space. Supply of medicine, equipment, and personal protection equipment is scarce. Since the conflict started, millions of Yemenis have migrated from their home to packed encampments that house the internally displaced. Overcrowding and poor health conditions (malnutrition, diarrhea, and lack of access to clean water and basic sanitation) have allowed the outbreak of infectious diseases, such as cholera. Due to the fragmentation of capacities, harmonized responses to COVID-19 is absent and a strict enforcement of protective measures could be difficult in some areas, adding further challenges to the country's preparedness, containment and mitigation of the virus. Implications are serious if the global outbreak severely disrupts humanitarian aid flows into and within Yemen.¹¹ The country's capacity to fight COVID-19 will be further constrained as Yemen has to confront the outbreak of desert locusts at the same time.

COVID-19 could exacerbate Yemen's already difficult socio-economic situations. With nearly depleting international reserve and without external financial support, there is elevated risk of a collapse in the rial with a knock-on effect on the prices of imported commodities, eroding households' purchasing power and increasing operating cost for businesses. The strengthening of the US dollar due to a flight to safety would further add downward pressure on the rial. Tumbling global oil prices would benefit Yemen, a net

¹⁰ The *FAO Desert Locust situation update* (April 4, 2020) warns that widespread rains that fell in late March could allow a dramatic increase in locust numbers in East Africa, eastern Yemen and southern Iran during the coming months. During May, the eggs will hatch into hopper bands that will form new swarms in late June and July, which coincides with the start of the harvest.

¹¹ International relief teams reduced their numbers to essential staff. During March, no significant disruptions to humanitarian operation were reported. For instance, the WFP program (consisting of cash and in-kind transfers and vouchers) was still operational and was able to secure a certain level of food stocks within the country. However, the *Yemen Food Security Alert* (April 8, 2020) by FEWS Net warns that beginning in April, an estimated 8.5 million beneficiaries in the north, who have been receiving nearly full rations of food assistance monthly, will face a 50 percent reduction in assistance.

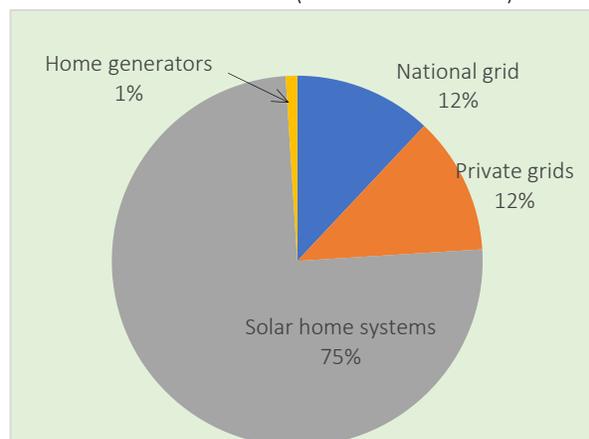
oil importer, and ease downward pressure on the currency. However, the country could suffer from reduced remittances, an important source of foreign currency, if economic downturns in the GCC hit the employment opportunities and wages of the Yemeni migrant workers there, affecting households that depend on their incomes. This, together with marked increases in global food prices, could partially or fully offset the favorable impact of low oil prices on the fragile currency. Reduced earnings from crude exportation (in US dollar terms) would lower the Government's hydrocarbon revenue, but the impact on the budget (in rial terms) is clouded by the multiple exchange rate practices. Disruptions in international trade and domestic economic activity would lower tax and customs revenue collections, the main sources of government revenue for the *de facto* authorities in Sana'a. All in all, the net impact of COVID-19 on Yemen's trade is ambiguous, but humanitarian conditions would deteriorate, affected by high food prices and potential shortages of basic necessities from supply disruptions (see Annex 2 for further discussion on the potential economic impact of COVID-19).

Annex 1. Growing Use of Solar Power System

Armed conflict has severely damaged public electricity infrastructure. The collapse of public electricity, coupled with pervasive fuel shortages, has disrupted provision of other public services such as healthcare and water management, while affecting millions of households and a wide range of economic activity (agriculture, manufacturing, banking).

According to a phone survey commissioned by the World Bank, the reliance on solar energy has increased significantly in recent years. The survey finds that, as of end-2019, 75 percent of Yemenis used small-scale solar-powered systems as a primary source of electricity, due to unreliable public electricity services and fuel availability. Only around 12 percent of the population relied solely on public electricity due to extensive damage to the national grid and fuel shortages across the country, with a similar share using private grids, which typically run on diesel generators (Figure A1).

Figure A1. Primary Sources of Electricity among Yemeni Households (as of December 2019)



Source: World Bank.

The solar market in Yemen is operating commercially and is driven by the private sector. The booming solar energy sector has had a cascading impact on the supply chain, from trading houses that import panels, charge controllers, and batteries, to small-scale retailers, who have expanded their business to solar panels. These small-scale systems are connected with photovoltaic panels that can be easily installed by households themselves and are often paired with solar lamps for basic lighting. They typically serve those who cannot access (or afford) a connection to a grid, including farmers and small and medium enterprises (SMEs). At present, this solar market represents the fastest and most resilient solution to overcome the severe electricity shortages in the country, providing electricity to households and serving agriculture, water management, and healthcare facilities, whose demand can be met by small-scale systems.

A report with a comprehensive assessment of the survey results and an analysis of electricity services in Yemen is currently under preparation and is expected in summer 2020.

Annex 2. Potential Impact of COVID-19 on Yemen's Socio-economic Conditions

A COVID-19 related global and regional economic downturn is expected to affect Yemen's economy mainly through the trade and remittance and channels, but the net impact is uncertain.

The collapse of global oil prices would benefit Yemen's external account. Yemen is a net oil importer. In 2019, it exported about US\$1 billion of crude oil and imported US\$3 billion of refined oil products. The sharp fall in global oil prices would therefore lower Yemen's fuel importation costs, curbing significant demand for foreign exchange and easing pressure on the rial.

Remittance inflows to Yemen are likely to fall, offsetting the benefit from low oil prices while affecting households that depend on financial transfers. As observed during the global financial crisis of 2009, the economic downturn in the GCC—the largest source of remittance inflows for Yemen—would negatively affect employment opportunities or payment of wages for the Yemeni migrant workers there, reducing financial transfers to Yemen and affecting household that depend on remittances at a time when the cost of the basic food basket is increasing and there are concerns about disrupted distribution of humanitarian aid.¹² Policy response packages recently announced in Saudi Arabia and the UAE have been favorable in terms of impact on expatriate employment by exempting firms from various fees including those associated with renewal of work permits and providing extensions to permits that otherwise would have lapsed. Nevertheless, with the closure of most sectors, many migrant workers are forced to sit at home without pay. There are also concerns that GCC firms that are experiencing sharply reduced cashflows may use the government compensation to cover their losses and withhold salary payments to migrant workers (whether by building up arrears or stopping payments outright).

Sharp increases in global food prices would compound pressures on Yemen's external account and exacerbate food insecurity. During the last two months, global prices of wheat and rice—the two main food commodities Yemen imports—rose markedly, affected by supply disruptions and surging demand.¹³ As a growing number of countries impose movement restrictions across and within national borders, the supply chain of grains have been disrupted. Some countries, such as Russia, the world's largest exporter of wheat, is curtailing exports to build up their in-country stock. Meanwhile, countries that rely on imported grains began to scale up purchases, all exacerbating the COVID-19 impact on global food prices. As Yemen depends heavily on imported food to meet 80-90 percent of national food requirements, elevated prices of essential food commodities would weigh heavily on its import bill and food access for millions of Yemenis.

The fiscal position may worsen, but payroll remains the dominant budget challenge with or without COVID-19. The slump in oil prices would reduce government revenue from oil exports, but also lower the cost of electricity generation from imported fuel. The net impact on the State Budget is likely to be negative. Non-hydrocarbon revenue would suffer from reduced economic activity (flight suspension, school and business closure, movement restrictions), but this effect would be small given the limited significance of hydrocarbon revenue in the State Budget. Disruptions to international trade and reduced economic activity from movement restrictions could lower tax and customs revenue, major revenue sources for the *de facto* authorities in Sana'a. Overall, for the Government in Aden and the *de facto*

¹² During the global financial crisis of 2009, 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.

¹³ Wheat and rice together accounted for 43 percent of the total value of imports (south) and 68 percent (north) in 2019.

authorities in Sana'a, the ability to maintain payroll obligations is their major intervention and as in previous years they will be under particular pressure in April to disburse such payments before Ramadan. From this perspective, there is zero fiscal space available for COVID-19 response.