Economic conditions remain highly fragile in Yemen. Humanitarian needs have worsened due to compounding crises, including the recent Ukrainian war. Glimmers of hope are offered by a combination of extraordinary financial support announced by bilateral partners, geopolitical conditions that may be conducive to redeveloping the hydrocarbon sector, and some timid progress on the de-escalation process, as demonstrated by an extended truce. However, the already dire socio-economic conditions of the country keep being challenged by poor institutional capacity, uncoordinated policy decisions, and administrative bifurcation.

Key conditions and challenges

After eight years of military conflict, which prompted an unprecedented economic and humanitarian crisis, several developments during 2022 have generated cautious optimism about Yemen’s peace and growth prospects. On the domestic front, an UN-sponsored truce has been extended since April 2022. Days after announcing the truce, President Hadi transferred authority to a “Presidential Leadership Council” on the last day of GCC-sponsored peace consultations. Only hours later, the KSA and UAE announced a US$3.3b financing package. These positive developments were supplemented by an almost complete halt of monetary financing, which significantly curbed inflationary trends. Moreover, oil exports recently recovered to around 2014 levels, in terms of GDP, due to both quantity and price effects.

Despite encouraging developments, Yemen’s external financing challenges remain substantially unaltered. While the announced CBY deposit can meaningfully mitigate risks, the timeline associated with its implementation remains unclear. On the other hand, oil sector growth remains heavily contingent on Yemen’s capability to attract foreign investment, which – in turn – is tightly dependent on security and peace conditions. Non-oil activity continues to suffer from essential services interruptions and acute input shortages, compounded by double taxation, pervasive corruption practices, market distortions triggered by uncoordinated policy approaches, and the multiplicity of Yemen’s institutions.

Despite cautious optimism for growth, any trickle-down effects on Yemeni households remain doubtful. Yemen’s economy is mainly informal; households cannot meet basic needs without external support, and recent food assistance reductions are likely to affect living conditions severely. A large portion of Yemenis is currently reliant on (decreasing) remittances and aid flows. Recent floods have further compounded the precarity of socio-economic conditions, particularly for those living in and around displacement sites. Additionally, Yemen is one of the countries with the lowest COVID-19 vaccination rates: as of July 2022, the rollout reached only 1.4% of the population. After the collapse of the oil sector and inconsistent payments to public sector employees (the largest source of employment pre-conflict), agriculture – primarily of subsistence nature – dominates the real economy while being highly exposed to increasing climate, environmental and pest-related disruptive events.

Recent developments

Yemen’s GDP is expected to grow, in real terms, by 2 percent in 2022, after a 2-year-long recession. The rebound has been preliminarily driven by the oil sector: real oil GDP is predicted to expand...
by 15.5 percent due to an uptick in output and higher oil prices. On the other hand, a relatively more stable currency, slower inflation, and a drastic decline in hostile activities support private sector activity; thus, non-oil GDP is estimated to grow by 0.6 percent.

On the fiscal side, the Internationally Recognized Government’s (IRG) total public revenues are expected to increase, supported by a rise in hydrocarbon revenues, which not only reflects rising fuel exports but also MoF’s decision to account for hydrocarbon revenues at the markets exchange rate. Total public expenditure has also recently grown, relative to 2021. The expansion is mainly caused by inflationary pressures, the resumption of debt servicing payments (following the suspension of DSSI and CCRT), and a sizable real increase in government consumption – concentrated on current expenditures. Overall, the IRG’s fiscal deficit is moving on a declining trend for the 4th year in a row, and we expect it to close the year at -1.9 percent of GDP. Fiscal deficit financing sources are assumed to include elements of monetization – albeit significantly less than in the past – and some degree of arrears on lower-priority expenses.

Monetary conditions have tightened during 2022, as CBY drastically reduced fiscal deficit monetization to levels complying with its stated money supply growth targets. Moreover, CBY’s hard currency auction mechanism proved relevant in supporting exchange rate stability. As a result, inflation declined from the double-digits of 2021, despite specific commodity prices still registering an inflation rate of around 30 percent (particularly in the food sector), negatively impacting households’ purchasing power and consumption capacity. In a context where the macroeconomic fundamentals, the political context, and other structural factors affecting exchange rate dynamics have remained substantially unaltered, the exchange rate fluctuations appear to be highly responsive to sentiment and psychological factors. For instance, the exchange rate spread between Aden and Sanaa drastically shrank at the announcement of foreign assistance packages, to then gradually return to hovering around 600 pp as of September 2022.

Yemen’s current account deficit has been widening and is expected to grow 3-fold in nominal US$ terms by the end of 2022 (or 2-fold relative to GDP). Declining official development assistance and remittance receipts – as neighboring countries apply more protectionist labor policies – have offset the predicted increase in oil exports. Considering CBY’s reserve position, Yemen’s difficulties in financing its external deficit remain significant; to date, the country has relied on successfully liquidating previously frozen foreign currency deposits. However, should the announced foreign-financed assistance fail to materialize (or materialize with delay), the level of foreign currency reserves could slip under one month worth of imports.

Economic conditions in 2023 and beyond remain highly uncertain and continue to be a function of three major factors: conflict resolution, commodity market developments, and the availability of external financing options. Economic expansion over the medium term is conditional on prudent policy-making and a robust reform effort. Assuming the conflict is resolved, hydrocarbon prices remain at current levels, and the announced financial assistance initiatives materialize, Yemen’s economy could – from a macroeconomic standpoint – register more sustained growth. Nevertheless, economic stability will remain dependent on predictable and sustainable hard currency inflows and – further upstream – from a resolution of the conflict. Other risks to the outlook include unexpected terms of trade shocks, as well as a resurgence in hostile activities caused by regional or domestic tensions. Policy inaction is also one of the most significant risks to Yemen’s outlook. While favorable energy commodity price conditions and CBY’s prudence lay the ground for potentially more pronounced economic optimism, there is no substitute for structural reforms, which are a condition-sine-qua-non to maximize the inclusiveness of any growth outturns, and to reinforce the resilience, private initiative, and resourcefulness for which the Yemenis are renowned.

### Table 2: Republic of Yemen / Macro poverty outlook indicators

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022e</th>
<th>2023f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth, at constant market prices</td>
<td>1.4</td>
<td>-8.5</td>
<td>-1.0</td>
<td>2.0</td>
<td>3.3</td>
</tr>
<tr>
<td>Inflation (Consumer Price Index)*</td>
<td>10.0</td>
<td>35.0</td>
<td>58.5</td>
<td>29.2</td>
<td>7.7</td>
</tr>
<tr>
<td>Current Account Balance (% of GDP)</td>
<td>-3.8</td>
<td>-5.9</td>
<td>-5.1</td>
<td>-11.5</td>
<td>-7.3</td>
</tr>
<tr>
<td>Fiscal Balance (% of GDP)</td>
<td>-5.9</td>
<td>-4.8</td>
<td>-2.2</td>
<td>-1.9</td>
<td>-1.2</td>
</tr>
</tbody>
</table>


Notes: e = estimate, f = forecast.

a/ Inflation rates refer to end-of-period figures.