

REPUBLIC OF YEMEN

Key conditions and challenges

Population, million	29.8
GDP, current US\$ billion	18.8
GDP per capita, current US\$	630.9
School enrollment, primary (% gross) ^a	93.6
Life expectancy at birth, years ^a	66.1

Source: WDI, Macro Poverty Outlook, and official data.
(a) WDI for School enrollment (2016); Life expectancy (2019).

With the conflict continuing in 2021, the value of the Yemeni riyal continues to depreciate to new historic lows, driving large increases in food prices and pushing more people into extreme poverty. Socio-economic conditions are deteriorating rapidly, further affected by declining remittances, trade disruptions, severe fuel supply shortages, and the disruption and declining humanitarian operations. Intensifying violence and the fragmentation of macroeconomic policies add further strains on the fragile economic conditions. An unprecedented humanitarian crisis persists, further aggravated by COVID-19, leaving many Yemenis dependent on relief and remittances.

The economic fallout of currency depreciation and COVID-19 continue to hit hard the people and the economy, after more than seven years of armed violence and the unprecedented humanitarian crisis in Yemen. Socioeconomic conditions are deteriorating rapidly in 2021, driven by currency devaluation and the ensuing increase in food and fuel prices, as well as by the adverse climate conditions and depleted coping capacity.

The macroeconomic policy environment remains complicated by the ongoing conflict. 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. Debt service to external creditors (except for IDA) have been halted since 2015. Regular salary payments to public sector workers continue to experience re-occurring delays and uneven geographical coverage.

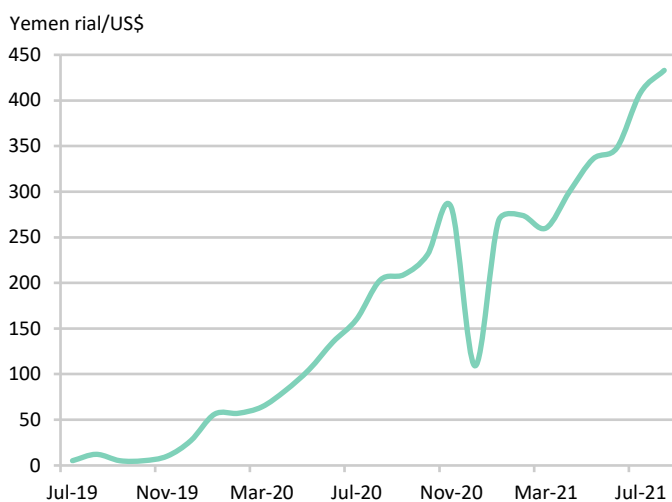
The overarching socioeconomic risks derive from perpetuating violence and subsequent competition over resource transfers. In the South, continued monetization of the fiscal deficit, including for public salary payments, remains a major driver for macroeconomic instability. In the North, lack of liquidity and compressed inflow of commercial imports remain key challenge activities. At the same time, the private sector faces enormous challenges

due to an arbitrary - and sometimes coercive - business environment in both sides of the country.

Recent developments

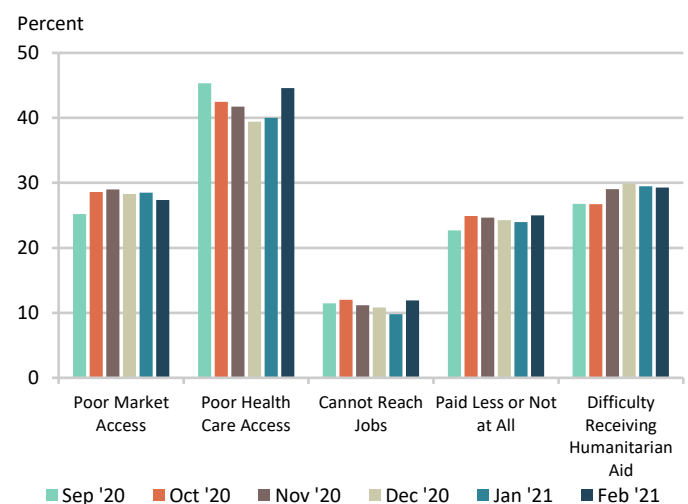
Preliminary estimates suggest that the economy had shrunk by 8.5 percent in 2020. Non-oil economic activity was affected by the COVID-19-induced slowdown in trade, dual taxation systems in the north and south, scarcity of inputs, and commodity price hikes. The negative impact of recent tightening of immigration to Saudi Arabia and the Saudization policies is not clear yet on Yemeni overseas workers and their associated remittances, although trends in workers remittance inflows since 2020 were already affected by the COVID-19 crisis. Shortages in foreign exchange have further intensified in 2021, due to the slow recovery in oil production and export capacity and the declining humanitarian funding and operations. The IMF general SDR allocation to Yemen of US\$665 million, approved in August 2021, should ease pressures on the balance of payments and foreign exchange markets. Fiscal policy of the internationally recognized government (IRG) continues to rely on money printing to cover the bulk of government expenditures, which focuses on salaries (to recipients under IRG's controlled territories), goods and services, and social transfers (mostly related to COVID-19 spending). Public revenue is underperforming, constrained by the slow recovery in oil production and

FIGURE 1 Republic of Yemen / Divergence between dual exchange rates (eom, daily average)



Source: World Bank staff estimates.

FIGURE 2 Republic of Yemen / Share of respondents with access to food, health care, and employment during pandemic



Sources: WFP Mobile Vulnerability Analysis and Mapping Survey.

exports and the weak non-hydrocarbon revenue, while the fiscal deficit continues to be monetized. It is not clear how previously projected recovery in oil export capacity could translate into improved government's finances in 2021, since any progress in the oil industry remains tightly connected to political stability and security (beside international prices).

Inflation has accelerated in 2021. The average cost of the Minimum/Survivable Food Basket increased in June 2021 (y-o-y) by 52 percent and 19 percent in the southern and northern governorates, respectively.¹ Besides currency devaluation, fuel shortages and dual taxation contribute to domestic price increases and disruptions in basic services delivery. The monthly average of imported fuel products discharged through the Hodeidah port in January-August 2021 have declined by an estimated 72 percent compared to the same period of last year. The divergence in dual exchange rates between Sana'a and Aden have widened considerably in 2021, reaching nearly YR 433 (approximately 72 percent) at the end of the August 2021. The divergence between exchange rates, the increasing demand for foreign currency, and the tightening of exchange controls and payment networks have increasingly fragmented local financial markets, impeding domestic transfer services. Therefore, the cost of financial transfers and associated fees through commercial banks and exchange bureaus from the South to the North (i.e.,

from new to old banknotes) increased sharply in recent months, reaching more than 70 percent by early September 2021. The humanitarian response that supported households through years of conflict was significantly scaled back since 2020. Consequently, the risk for a potential famine increases without progress in socioeconomic conditions and scaled up humanitarian assistance. The already difficult situation for the people of Yemen has been exacerbated by both the COVID-19 pandemic and rising food and fuel prices over the first half of 2021. New estimates from the WFP mobile phone survey corroborates the worsening food security situation with at least 40 percent of households reported having inadequate food consumption in 12 of 22 governorates. Moreover, repeated food and fuel price spikes are eroding real incomes, further limiting access to other basic needs and services (e.g., education and healthcare).

Outlook

Economic prospects in 2021 and beyond will critically depend on rapid improvements in the political and security situation, and ultimately whether a cessation of hostilities and eventual political reconciliation will allow for rebuilding the economy and Yemen's social fabric. Without additional external financing and with a continuation of the pandemic,

output is expected to further contract by 2 percent in 2021. Improved monetary supervision and policy controls could reduce currency exchange volatility and temporarily limit speculative activities, with possible moderate gains in the relative value of the US dollar in the south. A more durable stabilization of the exchange regime will require solutions to tackle the root causes of volatility.

In the absence of stable sources of foreign currency, expansionary monetary policy risks accelerating the depreciation of the Yemeni rial. Yet, increasing oil production and export capacity could ease the strain on public finances in the IRG-controlled areas and reduce the recourse to central bank financing, while also requiring military de-escalation and relative security stability around the production sites. Inflation is anticipated to accelerate rapidly in 2021, to an estimated 45 percent compared to 35 percent in 2020. Progress in implementing past agreements on access to supplies and fuel imports through the Hodeidah port, as well as the scaling up of humanitarian funding, would, *ceteris paribus*, improve prices and access to food. It should also enhance the provision of public services and the operational environment for humanitarian operations.

1/ FAO-FSIS & MoPIC-FSTS Quarterly Food Security Report, April-June 2021.

TABLE 2 Republic of Yemen / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2018 e	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	0.8	1.4	-8.5	-2.0
Inflation (Consumer Price Index, eop)	14.3	10.0	35.0	45.0
Current Account Balance (% of GDP)	-0.8	-3.9	-5.9	-8.8
Fiscal Balance, cash basis (% of GDP)	-7.8	-5.6	-5.2	-5.2

Source: IMF, World Bank, Macroeconomics, Trade & Investment Global Practice.

Notes: e = estimate, f = forecast.