ECONOMIC BULLETIN

DEPRECIATION OF THE YEMENI RIAL THE UGLIEST FACE OF THE WAR IN YEMEN

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Introduction

Depreciation of the Yemeni riyal continues unabated in light of the government's inability to address the problem and reduce its effects. As a result of this persistently accelerating depreciation, the inflation index rises and income rates decline, foretelling more humanitarian suffering in Yemen, which is the most severe in the history of the modern world.

Depreciation of the Yemeni riyal, which lost nearly a third of its value in a short time, reflects the depth of the Yemeni crisis and its economic and administrative ramifications. It represents one of the key manifestations of the incompetent monetary and financial policy in Yemen and the lack of a clear vision in this respect. This situation is further intensified by the ongoing war and the negative impacts of the Coronavirus on the situation in Yemen, besides the state of fragmentation and fragility in the management of political and economic affairs in Yemen.

With the depreciation of the Yemeni riyal, the economic crisis in Yemen enters a more complex phase, especially as we are facing a new variable represented by two different denominations of the Yemeni currency: old and new, with each category has a different market value. This is by far the most grievous manifestation of the economic crisis. It is an expression of the level of conflict in the economic sphere between the internationally recognized Yemeni government and the Houthi group that controls large parts of the northern governorates in Yemen.

In addition to the factors related to supply and demand that stand in the way of this depreciation of the Yemeni riyal, the danger now is to fling the economic file into the depth of the political crisis in Yemen, as a consequence, any partial solutions seem almost impossible.

It can be said that the key to the solution to the humanitarian crisis begins with putting an end to the depreciation of the local currency. It is impossible for humanitarian relief efforts to make a fundamental difference in people's lives in light of this ongoing escalation of prices resulting from the depreciation of the local currency.

In light of such a complex situation, everyone is required to come up with solutions that would unify the financial and monetary policy in the country. All parties shall agree on a fiscal and monetary policy that would put the economic process on its right track, especially as other scenarios would definitely lead us to more economic and financial instability, and more poverty and unemployment.

The war will continue as long as the factors feeding it survive. The most important of these factors are the financial resources of the state that are divided among the parties to the conflict, while such resources are inaccessible to 24.1 million Yemenis who are at risk of starvation. About 19.7 million Yemenis do not have access to health care services, and 40% of families lost their income sources, according to estimates by UN organizations. [1]

Another dimension in the economic crisis; namely, the nebulous relationship between the Yemeni government and the Saudi-led Arab Coalition and its implications for the economic file cannot be overemphasized. It has become clear that major problems hinder the resumption of oil and gas exports and restrict the freedom of commercial movement in Yemeni ports. There are several other restrictions that represent a heavy burden on economic and commercial activity in Yemen.

The internationally-recognized government was allowed to export oil and gas derivatives, export ports were evacuated by the coalition forces, and the flow of public resources was again channeled through CBY after it was given its full independence under a unified management away from the conflict.

Stopping the sharp decline in economic growth, and reducing inflation rates, depreciation of the national currency and the trade deficit, and alleviating the most tragic humanitarian crisis in the world will be possible if all Yemeni parties reach a comprehensive and just peace that restores state control over all Yemeni soil. A rational administration, characterized by efficiency and integrity, shall take charge of affairs.

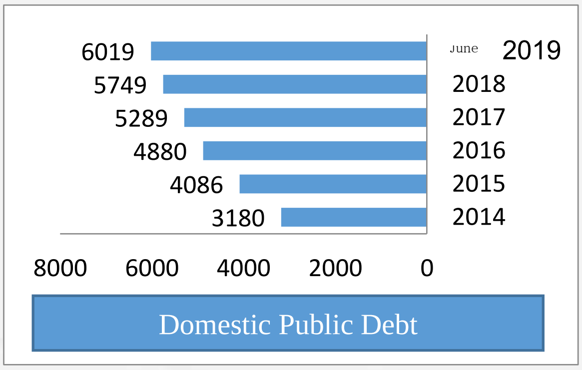
Factors of Currency Depreciation

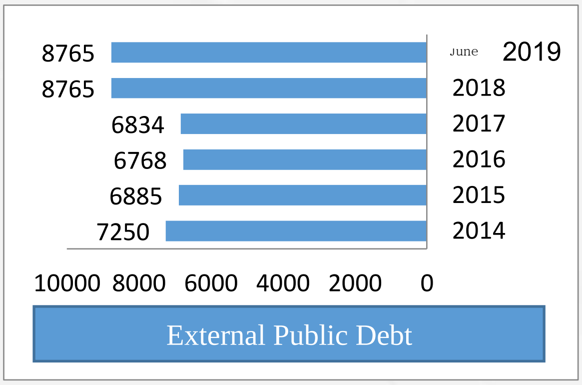
The national currency has been undergoing a decline in its value for decades, but depreciation in the context of the ongoing war is the worst at least over the past two decades. Value of the Yemeni riyal has rapidly declined in September 2020 as the US dollar exceeded the barrier of 820 riyals, which is the highest rise ever against the Yemeni riyal, which suffered a loss of its value by 233% compared to 2014.

Economic Indicators

The war has imposed a new reality on the economic scene characterized by the devastation and destruction of public and private institutions, disruption of production, and economic and financial decline. Public and private institutions were destroyed and all economic indicators of government performance declined.

All exports, including oil and gas, stopped and affected the trade balance and reserve ratios in an unprecedented way. The volume of foreign exchange reserves fell from 8.3 billion dollars in 2008 to USD 4.6 billion in 2014.[2] During the war, it further fell to USD 700 million before the CBY was moved to Aden in September 2016, including the Saudi deposit of USD 1 billion.





Source: Economic Developments Newsletter, June 2019, No. 44)

Prior to moving CBY headquarters to Aden, CBY management adopted some monetary policies. Those policies were only partially successful, and CBY continued to be driven by de facto power using inflationary tools to cover public expenditures. Before moving CBY headquarters to Aden in 2016, the volume of domestic public debt increased by 53.4%, compared to 3176.5 billion riyals in 2014,[3] while an increase of 23.3% was recorded following the movement of CBY headquarters to Aden in 2016. This means that the CBY pursued a policy of domestic borrowing before being moved which is larger in scale than in the post-movement phase. This is an inflationary policy that relies on printing banknotes.

CBY headquarters was moved to Aden in September 2016, after depleting USD 4.5 billion, representing 86.5% of the total reserves amounting to USD 4.6 billion.[4] Led by four different governors in the duration of 4 years, the new CBY administration in Aden was able to overcome many obstacles. It adopted some monetary policies such as raising interest rates, injecting foreign currency into the local market, taking procedures for organizing the activities of exchange enterprises and issuing licenses, making contacts with international bodies, providing liquidity through printing banknotes, and obtaining a USD 2 billion deposit devoted to supporting import of basic commodities and oil derivatives. Some of these policies were effective while others simply failed.

Manifestations of failure are more evident in the failure to adopt a clear monetary policy that is binding on all banks and exchange enterprises. The market has witnessed many cases of currency speculation in recent years, and the CBY in Sana'a gained the upper hand and had the greater influence on the policies of banks and exchange enterprises. Moreover, the CBY in Aden failed to develop close relations and open prospects for cooperation with international banks. Consequently, the banking sector still suffers a state of isolation.

The authorities of the CBY in Aden have been negatively affected after the recent conflict in Aden between the internationally-recognized government and the Southern Transitional Council (STC), as the latter has controlled the levers of power in Aden and declared the so-called autonomous rule. Accordingly, many resources were transferred to the National Bank, and newly printed money arriving in Aden was confiscated.

The CBY in Aden was subjected to numerous harassments that it in many cases paralyzed its capacity to control the exchange market, and the market became subject to multiple players.

These developments coincided with the repercussions of the Coronavirus. Oil prices and expatriates remittance also decreased in conjunction with the depletion of the Saudi deposit. CBY in Aden continued to cover salaries from the newly printed money, and all these repercussions combined to lead to a serious depreciation of the Yemeni riyal.

The value of the national currency declined sharply, as the riyal lost 25% of its value. Its value fell from YER 661 in April 2020 to YER 825 to USD 1 in September 2020

Impact of Parties to the Conflict

The economy and the CBY were used as tools of pressure by some of the parties to the conflict. The banking sector was flung into the conflict, and the suffering of the Yemeni people was exploited as a means to impose a political or military agenda in an unethical manner and in violation of all international laws and conventions. This state of affairs resulted in the worst humanitarian crisis in the world.

Restrictions on the internationally recognized government are imposed by exploiting its financial resources, so that it is forced to accept hard currency deposits through the CBY (as obligations on its part) or aid through UN organizations while its ports, airports, and oil and gas sectors are under the control of the Arab Coalition.

The process of exporting oil and gas from oil and gas facilities is being hindered and production is stopped in most fields, with the exception of limited quantities amounting to 12.7 million barrels during 2018, compared to 17.5 million barrels in 2019. The government seeks to increase the volume of production in 2020 by 71% compared to 2019. The volume of exports reached 16.5 million barrels in 2019, while Yemen was producing 45.7 million barrels in 2014.[5] According CBY state budget data, oil and gas revenues amounted to 1039.2

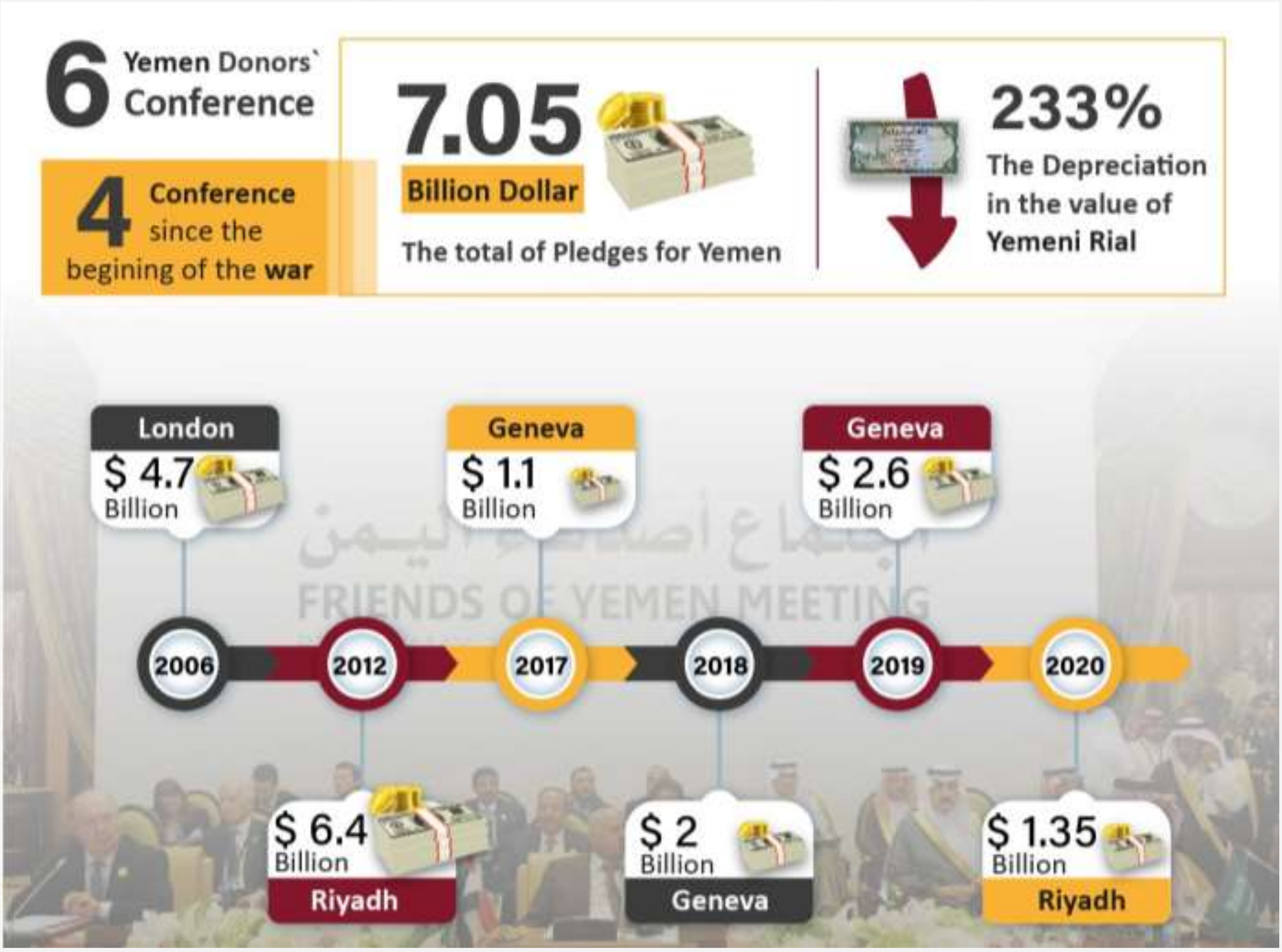
billion riyals in 2014.[6]

Public revenues of the state are divided among the parties to the conflict, and the Yemeni people are deprived from those resources, which are instead channeled to private accounts in local banks. All resources of government institutions in Aden go to the National Bank according to the commands of the Autonomous Administration (the STC), and all revenues of Hodeidah port and the de-facto authority areas go to the CBY in Sana'a.

Government institutions are disrupted and prevented from collecting revenues. Three main regions are under the control of the internationally-recognized government and the Arab Coalition; namely, the eastern, western and southern regions. These regions contribute more than 75% of the total public state revenues according to pre-war public budget statistics, but the disruption of the work of these institutions deprived the public treasury of its revenues.

As war is prolonged, a state of uncertainty and ambiguity surrounds the military operations which have been stalled during the past three years without any progress in terms of the real military targets that led to the intervention of the Arab Coalition. This situation has resulted in a complete paralysis of various economic activities and halted the process of production.

The volume of humanitarian and financial aid provided by donors decreased by 100%, compared to 2019, when USD 2.6 billion were raised during the Geneva Conference in February 2019, while only USD 1.3 billion was raised in the fifth conference held in Riyadh in June 2020.[7]



CBY Independence

The effect of the parties to the conflict on CBY independence, obstructing its functions and procedures, and thwarting its efforts to perform its duties as an independent body managing the monetary process lead to currency depreciation and expose the economy in general to the risk of collapse.

Violations of Conflict Parties to CBY Independence

The CBY is exposed to some violations that threaten its independence and undermine its position. Such violations include the flowing:

- Seizure of shipments of newly-printed banknotes in the port of Aden in 2017. Those shipments were held for months, in flagrant violation of the CBY and internationally-recognized government sovereignty.
- Seizure of currency shipments belonging to the CBY by the STC forces last June. The confiscated shipments were restored by the CBY after negotiations. During the same period, five other currency containers were seized, according to an official in the Ministry of Information. This shipment was destined for the CBY in Mukalla, and it was restored.
- Banning the circulation of the newly-printed banknotes by the Sana'a authorities in areas under their control, and confiscating and burning some of it according to press reports and media news during the past year.
- CBY in Aden is prevented by the STC from moving any cash shipments to its branches for the purpose of paying salaries. CBY domestic and external movements are also closely monitored by the STC, according to some CBY leaders.
- Transferring governmental public resources accounts, such as seaport and Aden Airport revenues, from the CBY to other local banks, such as the National Bank of Yemen (NBY). This is an intervention and rejection of all CBY circulars and instructions restricting the opening of any public accounts with local banks unless CBY approval is obtained, if necessary.
- Seizure of YER 44 billion by the Houthi group from customs revenues of oil shipments arriving at the port of Hodeidah and deposited in private accounts at the CBY, Hodeidah, in violation of the Stockholm Agreement, which stipulated the neutralization of those assets and allocating them as salaries only.

Dual Policies and Procedures

Monitoring the contradictory policies and procedures of CBY in Aden and Sana'a, we find that in the wake of each procedure, the value of the currency subsequently declines. The negative effects are also reflected in economic activity in general:

- The de facto authority in Sana'a formed the so-called Payments Committee to manage the foreign exchange supply and demand away from the CBY, while the Supreme Economic Committee was formed by the Riyadh-based internationally-recognized government.
- Tens of millions of dollars have been pumped over the past years by the CBY in Aden and the so-called Payments Committee in Sana'a, but these conflicting policies play into the hands of speculators and lead to depreciation because such policies are arbitrary and lack the uniformity of policies adopted by a single central authority.
- Billions of printed banknotes were pumped out, as the CBY in Aden did not disclose the volume of the printed money in circulation. On the other hand, circulation of that newly-printed money was gradually banned by the CBY in Sana'a, pursuant to the decisions of the de facto authority in Sana'a, ultimately leading to the final ban by the end of 2019. Compensations were offered to holders of newly-printed money in the form of the electronic riyal.

The contradictory procedures regarding the issuing of licenses to exchange enterprises. The CBY in Sana'a imposes the sum of YER 10 million as a security deposited at the CBY for an individual company, and YER 500 million for a joint liability company as capital. On the other hand, CBY in Aden demands the sum of YER 300 million for an individual company as capital, And YER 500 million for a joint liability company.[8]

- Pressure is being exerted by the CBY in Sana'a on exchange companies by suspending their transfer networks by virtue of its control over the Yemen Telecom Company, as (6) companies and large networks were suspended under the pretext of violations before the suspension was reconsidered in September 2019.[9]
- Failure to invest the incoming financial flows in foreign currency, especially expatriate remittances, which are the second most important source of foreign exchange, next only to oil derivatives, which are channeled through unmonitored exchange networks away from approved banking channels such as banks. This is the result of lack of coordination between the CBY in Aden and Sana’a in controlling that important source. Some unofficial estimates indicate that the volume of annual remittances that do not pass through the formal banking sector is USD 8 billion.
- Imposing customs duties at the entrances to the capital, Sana'a, on all inbound goods. Companies and businesses are forced to pay fees twice, a procedure which raises the costs of goods and increases inflation rates.
- Banning the circulation of the newly-printed money in December 2019 and the imposition of electronic currency by the CBY in Sana'a and rejection of these policies by the CBY in Aden. The decision of the CBY in Sana’a caused depreciation of the

riyal as it gave way to two conflicting rates of the national currency in Sana'a and Aden. The gap between the two prices increased dramatically, soaring to more than 30% of the local currency value.

- Against the local currency sums it printed, the CBY in Aden obtained a USD 2-billion Saudi deposit, and transfer of salaries of the military personnel in Yemen in Saudi Arabian rials, besides some other sources. These foreign exchange revenues were used to finance the imports of basic commodities and oil derivatives through local banks. These moves were rejected by the Sana'a CBY, which pressurized banks to reject dealing with these developments. Pressure escalated to such an extent that general managers and assistant general managers of some banks were arrested.

Effects of Currency Depreciation

- The banking sector and the private sector were further thrown into the conflict, exposing economic activity to deterioration and helping the black market to penetrate the formal economy.
- Disruption of economic activity, production, stalling development, continued decline in GDP growth and depreciation of the national currency. Cumulative losses in GDP are estimated at USD 66 billion at a rate of USD 13.2 billion annually during the past five years.[10] According to a report issued by the UN Development Program, losses may reach USD 89 billion until the year 2019. In the event that the war ends in 2022, the cumulative losses will reach USD 180 billion.[11]
- Erosion of employees' salaries outside the internationally-recognized government dominions, deduction of up to 30% of the salary in commissions, and the increase in suffering resulting from the exchange rate divergences.
- The sharp depreciation of the national currency has led to the persistent high rates of inflation and the exacerbation of the humanitarian crisis, as reports indicate that the rate of inflation in commodity prices has reached 4.1% since the beginning of the current year.[12]
- The widening gap in exchange rates between Sana'a and Aden, exacerbating the suffering of people in both regions, and the suspension of supply chains of some basic commodities between the high and low rate regions.
- Continuation of the war will exacerbate the recession and slow the recovery in the future. According to experts, the Yemeni economy, already exhausted, has received additional blows this year, with the depreciation of the national currency by 33% since December 2019, and a decline in expatriate remittances by 20%. The economic recession is expected to reach 4.3% this year.[13]
- The spread of the black market and the increase in the number of unlicensed exchange businesses, and the expansion of currency speculation and smuggling, taking advantage of the difference in exchange rates between the high and low rate areas.
- The continued involvement of CBY in the conflict, which means more unilateral and dual measures. This negatively affects the performance of the banking and financial sector.

Recommendations and Proposals

The uncurbed collapse of the value of the local currency will inevitably lead to disastrous economic effects, especially in view of the ongoing conflict in the country. Therefore, we recommend the following:

- ❖ The monetary authority is responsible for the task of preserving the value of the currency and achieving monetary stability. Therefore, any policies or measures taken in order to achieve this point will have no positive effect unless division is ended and unilateral measures canceled. The economic and financial aspect must occupy the top of the list of any forthcoming negotiations.
- ❖ Rearranging the current administrative schema of the CBY may take one of the following two options, depending on the agreements that may be reached on this issue:
  - One: achieving CBY independence and restoring its vital role in managing the monetary policy and monitoring the financial and banking sector by unifying its management under one leadership and ensuring that it carries out all its functions independently without any interference that may hinder the effectiveness of its administrative performance.
  - Two: in the event that no agreement on unifying CBY management is reached, it is crucial under the supervision of an international party, such as the International Monetary Fund (IMF), provided that full coordination is made between the Central Bank management in both Sana'a and Aden in a manner that ensures the recovery of the role of the CBY in managing monetary policy and effectively monitoring the financial and banking sector.
- ❖ Activating the supervisory role of the CBY by providing the material and human capabilities, training and necessary qualification to ensure that all exchange facilities that currently represent the informal banking sector are subjected to full control and their activities are regulated in a way that limits their role in igniting waves of foreign exchange speculations. The process of reducing the activities of the informal financial sector will not make any progress unless it an agreement is reached with the Saudi government to facilitate the procedures of expatriate remittances through the official channels represented by banks and authorized exchange companies.
- ❖ Stopping the deficit financing policy represented by printing money, and activating non-inflationary sources of revenues.
- ❖ The oil and gas sector is the most important source of foreign exchange revenues, on which the CBY relies a lot for the stability of exchange rates. Therefore, it is necessary to create a friendly investment milieu as an initial step to encourage the return of oil companies to work and evacuating their sites from military barracks to facilitate the resumption of production and export operations.
- ❖ Enhancing transparency of CBY reports and actions, as they affect all economic aspects.

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