Foreign Exchange Crisis and Currency Forecasts

INTRODUCTION

Foreign exchange resources are the arteries that give life to the heart of every economy. They are necessary to finance the development process, build up the level of foreign exchange reserves to protect the national currency, finance imports, repay external debt, promote the creditworthiness of the economy and improve people’s wellbeing.

Unfortunately, several of Yemen’s sources of foreign exchange dried up during the ongoing conflict, including oil and Liquified Natural Gas (LNG) exports, which have been the main source of funding for Yemen’s economy since the early 1990s. Additionally, tourism revenues have been disrupted, foreign direct investments have been suspended and external loans have been frozen, leaving nothing for Yemen’s economy except the Yemeni expatriates’ remittances and the external support for the humanitarian response and war purposes. Thus, there has been a severe crisis in the foreign exchange and the foreign exchange reserves have depleted. Thus, the Yemeni riyal lost more than 55% of its value against the US dollar.

Of course, the economic factors are not a sufficient condition to illustrate the rapid depreciation in the value of the Yemeni riyal. The war atmosphere, the political and psychological factors and absence of an effective monetary authority also explain clearly the rapid devaluation of the national currency.

Despite all of the above, donor support is expected to amount to about $5 billion in 2018. This makes us hopeful about the possibility to calm the exchange rate fluctuations. In order to sustain the positive impact of this support, this edition highlights a set of immediate priorities, including covering the funding requirements for the fuel and basic goods imports at a realistic official exchange rate, reaching an economic settlement to resume oil and LNG exports and operating Aden refinery.

First: Foreign Exchange Sources:

Yemen’s national economy suffers from chronic structural imbalances in the productive base and lack of diversification of national income sources. As of 2014, returns of oil and LNG exports, Yemeni expatriates’ remittances, external loans and grants and foreign aid were the most important foreign exchange sources flowing from abroad to Yemen. Since April 2015, the Yemeni economy has been facing a severe crisis in all the foreign exchange sources, except the remittances made by the Yemeni expatriates and the donor support for the humanitarian response (Table 1).

Table (1) The Inflow of Foreign Exchange Resources to Yemen during 2014-2018 ($billion)

<table>
<thead>
<tr>
<th>Description/Year</th>
<th>2014</th>
<th>Structure %</th>
<th>2017</th>
<th>2018****</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export of Goods of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Oil and gas</td>
<td>7.9</td>
<td>44%</td>
<td>0.40*</td>
<td>Limited improvement</td>
</tr>
<tr>
<td>Services Exports of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Tourism returns</td>
<td>0.9</td>
<td>5%</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Expatriates’ remittances</td>
<td>3.3</td>
<td>18%</td>
<td>3.4**</td>
<td>Decline</td>
</tr>
<tr>
<td>External grants</td>
<td>1.7</td>
<td>10%</td>
<td>2.3***</td>
<td>Twofold increase</td>
</tr>
<tr>
<td>External Loans</td>
<td>0.5</td>
<td>3%</td>
<td>0.003</td>
<td></td>
</tr>
<tr>
<td>Investment of oil companies</td>
<td>2.5</td>
<td>14%</td>
<td>NA</td>
<td>Unknown</td>
</tr>
<tr>
<td>Others</td>
<td>0.3</td>
<td>2%</td>
<td>Support for the war</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>18.0</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Therefore, the foreign exchange reserves have run out rapidly and Yemen’s economy has been unable to finance imports of fuel and basic commodities at the official exchange rate since the second half of 2016. Thus, the US dollar exchange rate witnessed unprecedented consecutive increases. Below is a detailed analysis on the status of oil and LNG exports, Yemeni expatriates’ remittances and external support:

First: Foreign Exchange Sources.
Oil export revenues:

Although Yemen is a small crude oil producer compared with other countries in the region, the oil sector (oil and liquefied natural gas) played a major role in financing the state public budget and the development process in Yemen since the early nineties of the last century. As of 2014, this sector remained the most important source of foreign currency needed to finance capital goods and food imports, strengthen the foreign exchange reserves and stabilize the exchange rate. The oil sector played a vital role in economic activity and the macroeconomic balances, contributing about 22.8% of GDP, and 83.3% of the total merchandise exports and 45.3% of the total state budget revenues in 2014.

Since early April 2015, foreign oil and gas companies announced force majeure and departed from Yemen. As a result, crude oil and LNG exports have been totally suspended and declined from $6.4 billion (of which $2.4 billion is the government’s share) in 2014 to $984.9 million (of which $525.3 million is government’s share) in 2015. Oil exports during 2016 were limited to oil quantities that have been stored in Al-Dhaba Port in Hadramout governorate, estimated at $54 million, while oil exports from Al-Masila oilfield in Hadramout reached $190 million in 2017 (Figure 1). In addition, about one million barrels of crude oil are still stored in Ras Issa Port up to this date without being exported.

The disruption of oil and LNG exports contributed to worsening the public budget deficit, deepening the economic downturn, depleting the foreign exchange reserves, devaluing the national currency value and soaring prices during the war period. The lost opportunity cost in the government’s share of crude oil exports and quantities refined at the Aden Refinery was estimated at about $5 billion during 2015-2017. This had a major direct and indirect impact on the living conditions of millions of Yemenis.

Recently, some sources have indicated that crude oil exports will be resumed from Hadramout while LNG exports will be resumed through Balhaf Port in Shabwa governorate. To ease the foreign exchange crisis, it is also important to operate the Aden Refinery. Yemen has two operating refineries in Aden and Marib: the Aden Refinery with a total capacity of more than 60,000 barrels/day and the Marib Refinery with a total capacity of 10,000 barrels/day. The Aden refinery alone covered 44% of domestic fuel consumption in 2013. However, it has been suspended since 2015 due to the lack of light crude oil supply from Marib. This makes it necessary to import most of the fuel needs from abroad, thereby putting more pressure on the exchange rate.
Taking into consideration the deteriorating economic and humanitarian situation in the country, an economic settlement, even unwritten, must be reached to supply the Aden Refinery with light crude oil from Marib to be locally refined instead of depleting billions of US dollars in importing fuel from abroad and use the revenues of the locally-refined fuel to cover monthly salaries of state employees.

**Yemeni Expatriates’ Remittances:**

Remittance transfers made by Yemenis working abroad played a major role in providing the living needs of millions of Yemenis and supporting the external exchange reserves and the exchange rate. During 2012-2016, these transfers were estimated at $3.4 billion on average per year (Figure 2).

Remittance transfers made by Yemenis working abroad are least affected by the war and successive cycles of conflicts in Yemen compared with other foreign exchange resources. Thus, the remittances have recently come at the forefront among the resources of external financing, exceeding the oil and LNG exports that have been halted during the war. While the foreign currency sources have dried up and foreign exchange reserves have been on an accelerating downward glide path since the conflict outbreak in Yemen three years ago, the Yemeni expatriates’ remittances have maintained their absolute value at $3.3 billion in 2015 and increased slightly to $3.7 billion in 2016(1).

Thus, if we put aside the external funding for the humanitarian response and war purposes, we will find out that the Yemeni expatriates’ remittances represented the last resort to cover the bill of imports and saved Yemen’s economy from the most dangerous scenarios, where the percentage of remittances to imports increased from 29.2% in 2012 to 58.9% in 2016. In parallel, the percentage of remittances to GDP increased from 10.3% in 2012 to 19.9% in 2016 due to the contraction in imports and economic activity as a result of the ongoing war.

**Yemeni Expatriates’ Remittances and Currency Crisis**

Prior to the conflict, Yemeni banks used to collect their balances in Saudi Riyal and send them to Bahrain on a monthly basis. This money was then being sent to Dammam to be transferred into US dollars in the Saudi Arabian Monetary Agency. After that, these US dollar funds were deposited to the Yemeni banks’ accounts in international banks to enable the Yemeni banks to finance and provide letters of credit to traders to import goods.

Currently, the Yemeni banks are unable to transport their accumulated funds to banks abroad due to the ongoing war in the country. As a result, the balances of banks and exchange companies in Saudi Riyal have accumulated against US dollar shortage. The Saudi Riyal exchange rate has devaluated slightly against the Yemeni Riyal (even by a minor difference) and banks became unable to cover the letters of credit of imports, thereby contributing to a further deterioration in the exchange rate crisis. This requires allowing the Yemeni banks and exchange companies throughout Yemen, especially in Sana’a, to transport their accumulated balances to banks outside Yemen.

(1) There are no accurate figures for the Yemeni expatriates’ remittances into Yemen. These remittances range between $3.3 billion- $10 billion per year. Whatever the estimates are, the official figures of remittances ($3.3 billion) were more than the government’s share of oil and LNG exports even prior to the suspension of the oil and LNG exports due to the war in the country.
The Gulf countries, especially Saudi Arabia, are the main source of remittances for Yemen. However, the recent measures by Saudi Arabia, including the imposition of an “expat levy” on all foreign workers and their dependents, will affect not only millions of Yemenis who depend directly on remittances, but also Yemen’s economy as a whole. Without exempting Yemeni workers from these measures, they will lead to further exacerbation of the humanitarian crisis in the country.(2)

**External Loans and Grants:**

External loans and grants are among the main sources of financing for the development process in several countries, including Yemen. They represent one of the channels that translate the level of economic and political relations between countries nowadays. The total donor support to Yemen totaled about $7.1 billion ($2.37 billion per year on average) during 2012-2014, including grants and loans allocated for the development and humanitarian programs and strengthening the national currency value and oil grants to support the public budget. Thus, the donor support has been a major source of foreign currency and has strongly contributed to the stability of the national currency exchange rate at about YR 215 / USD during the transition period 2012-2014.

Unfortunately, donor support for the development process in Yemen has been mainly limited to humanitarian support during the war period. External loan disbursement for development projects has dropped to the lowest level. There is no comprehensive and reliable database of external grants for the past three years 2015-2017. Below is a more detailed review of the data available in this regard:

**With regard to loans,** external loan disbursement fell from $545.3 million in 2014 to $63.3 million, $27.7 million and $3.2 million in 2015, 2016 and 2017, respectively. This is attributed mainly to the suspension of most of the donor support disbursement, barriers to project implementation such as lack of security in some areas and the government’s inability to pay the external debt service, where the accumulated arrears and interests on external debt amounted to about $1 billion as of 31 December 2017. In 2017, the government did not pay the external debt service to all but three creditors: The International Development Association ($77.6 million), the International Monetary Fund ($18 million) and the European Economic Community ($0.284 million).

Due to the ongoing war, Yemen has lost the opportunity for external debt inflow, the disbursement of which has significantly reduced despite the fact that the amount of external loans available for disbursement was $2.37 billion as of 31 December 2015. This has hindered the implementation of vital projects in sectors such as electricity, primary education, reproductive health and the social safety nets. Moreover, the external debt service payments exceeded loan disbursements during the war period (table 2). This has contributed to the depletion of a part of Yemen’s foreign exchange reserves.

### Table (2): Net flow of external loans to Yemen and loan arrears (US $, million)

<table>
<thead>
<tr>
<th>Description/Year</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan disbursements</td>
<td>284</td>
<td>332</td>
<td>352</td>
<td>103</td>
<td>1366</td>
<td>230</td>
<td>544</td>
<td>63</td>
<td>28</td>
<td>3.2</td>
</tr>
<tr>
<td>Paid principal and interests</td>
<td>278</td>
<td>257</td>
<td>255</td>
<td>275</td>
<td>254</td>
<td>268</td>
<td>358</td>
<td>355</td>
<td>140</td>
<td>96</td>
</tr>
<tr>
<td>Net inflow</td>
<td>6</td>
<td>75</td>
<td>97</td>
<td>-172</td>
<td>1112</td>
<td>-38</td>
<td>186</td>
<td>-292</td>
<td>-112</td>
<td>-92.8</td>
</tr>
<tr>
<td>Arrears of principal and interests</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>361</td>
<td>653</td>
</tr>
</tbody>
</table>

*Source: Central Bank of Yemen, 2017.*

(2) Given the importance of the Yemeni expatriates’ remittances, it will be tackled in more details in a separate edition.
Basically, Yemen is still relatively safe from the external debt burden, as the outstanding external debt has declined from $7.3 billion in 2014 to $6.8 billion in 2017 (Figure 3). External loans are soft loans at low interest rates (not more than 1.5% on average), with extended repayment periods and large grants. Despite the increase in the percentage of the external debt to GDP during the war period from 22% in 2014 to 48% in 2017 due to the contraction of economic activity, it is still acceptable in comparison to some regional countries such as Tunisia and Djibouti, where the external debt has exceeded 60% (Figure 4). In case peace is achieved, Yemen will be able to overcome the current problem of inability to pay the external debt service, which has affected the creditworthiness of the national economy.

On the other hand, the official development assistance and official aid is an important source of development and humanitarian relief in developing economies and war-torn countries. According to the World Bank’s database, the net official development assistance and official aid received by Yemen rose slightly from $1.2 billion in 2014 to $1.7 billion on average during 2015-2016. However, *Yemen’s share of assistance and aid did not exceed 25% of the assistance and aid provided to Syria, which is experiencing a war and conflict similar to Yemen* (figure 5). In the same context, Yemen’s net official development assistance (ODA) per capita, which was $63 on average during 2015-2016, is low compared to $73 in fragile and war-torn countries (figure 6). This requires the donor community to fulfill their obligations towards Yemen, just like other countries undergoing war and conflict, in order to alleviate the humanitarian crisis and the exchange rate crisis.

Figure (3): Outstanding of External Debt (billion USD)


Figure (4): Outstanding of External Debt as % of GDP


Figure (5): Net Official Development Assistance and Official Aid flows (Average 2015-2016, Billion USD)

Source: WB, World Development Indicators, February 2018.

Figure (6): Per Capita of Net Official Development Assistance flows (Average 2015-2016, USD)

Source: WB, World Development Indicators, February 2018.
In 2017, the Financial Tracking Service shows that donors provided $2,262.8 million to Yemen: $596.8 million out of the Humanitarian Response Plan and $1,666 million for the Yemen Humanitarian Response Plan 2017, covering 71.2% of the funding requirements for the Humanitarian Response Plan.

The funding requirements for the Humanitarian Response Plan 2018 amount to about $2.96 billion, through which the plan aims to provide humanitarian assistance to some 13.1 million people. The donor development and humanitarian support is expected to increase in 2018, and a sign of this support was depositing $2 billion at the Central Bank of Yemen in Aden on March 16, 2018. Recently, International donors pledged more than US$2 billion to support the delivery of urgently needed humanitarian aid during a pledging event in Geneva on April 3, 2018, co-chaired by the United Nations, Sweden and Switzerland. Bridging the financing gap of the plan and providing adequate cash and in-kind assistance is undoubtedly an urgent need to face the exchange rate crisis and alleviate the severity of one of the world’s largest humanitarian crises.

Second: Exchange Rate (Trends & Driving Factors):

The exchange rate of US dollar in the parallel market increased significantly from about YR 215/USD in March 2015 to YR 476/USD in February 2018, with a cumulative change rate of 121.4%. The largest change in the exchange rate was (39.3%) in 2017 (Figure 7). Recently (January - February 2018), the parallel exchange rate faced more severe shocks and reached in some weeks to YR 500/USD, mainly due to the depletion of foreign exchange reserves and limited flow of foreign exchange resources to Yemen. This increases the consumer prices of food and non-food items, weakens the purchasing power of the national currency and leads to more people slipping below the poverty line, especially since Yemen is a net importer of food, medicine, clothes and fuel.


Regrettably, the absence of a unified and effective monetary authority over the banking system throughout the country has, among other factors, made the monetary policy instruments out of control and confused the exchange rate policy. This creates confusion among exchange dealers in the foreign exchange market and makes them take pessimistic economic decisions that exacerbates the exchange rate crisis. The Central Bank of Yemen (CBY) in Aden decided to float the exchange rate in August 2017, thereby reducing the funds that some banks were receiving from humanitarian aid, but this policy contributed to the intensification of speculation and was followed by rapid exchange rate increases. In recognition of this, the CBY set the official exchange rate at YR 380/USD at the beginning of 2018. However, banks and foreign exchange companies did not abide by this price, nor was the CBY able to provide foreign exchange to import commodities at this price. In contrast, the official exchange rate announced by the CBY in Sana’a remained the same since 2016 at YR 250 USD but this rate is no longer realistic and is only used as a customs exchange rate at some land and sea customs outlets.

On the other hand, the daily fluctuations in the exchange rate make it difficult for international humanitarian organizations to make accurate budgets for their programs and the number of beneficiaries. The higher exchange rate means more beneficiaries and vice versa. In general, local operations implemented by international humanitarian organizations in local currency in Yemen, including the cash transfer programs, are carried out at a negotiable exchange rate with banks (often 5% less than the parallel exchange rate). This means that the higher the exchange rate of US dollar the bigger revenues of banks. Moreover, INGOs can use the amounts in US dollar to cover a higher number of beneficiaries who receive cash transfers in Yemeni Riyal. Banks have been competing to carry out INGOs activities at higher exchange rates. This seems to be one of the factors that contributed to the recent increase in the exchange rate. This requires considering the appropriate policy options, including the option of making the banks’ share an absolute number instead of a percentage.

Driving Factors of the exchange rate:

The real roots of the exchange rate crisis are attributed to several political, security, psychological and economic factors, as follows:

2-1. The political, security and psychological causes have resulted in:

- The absence of a unified and effective monetary authority over the banking system throughout the country, which led to:
  - Waning the residents’ confidence in the national currency and the banking system and, consequently, preference for foreign currency acquisition and withdrawing it outside the banking system. In addition to the fragmentation of the money supply in several areas (Sana’a, Aden, Marib, Hadramout). At the same time, large cash remittances in Yemeni Riyal and USD have been banned to areas controlled by the warring parties. Recently, there has been a slight variation in the exchange rate between Sana’a and Aden.
  - Confusing banks with the instructions given by two inconsistent and ineffective monetary authorities. For example, the SWIFT system was suspended following the relocation of the CBY from Sana’a to Aden. Thus, banks were unable to transfer funds from their balances at the CBY in Sana’a to their accounts abroad. These balances were frozen, which impacted negatively on banks’ confidence in the monetary authorities. Banks are no longer depositing their funds in the CBY.
  - Inability to use the appropriate monetary policy instruments to mitigate the exchange rate crisis such as the interest rate and required reserve ratio.

- Deterioration of the investment environment, which made cash surpluses owners and perhaps banks resort to currency speculation in the exchange market.

- Suspension of some production facilities, such as the Aden Refinery, which used to cover 44% of the domestic fuel market needs. This has resulted in greater demand for foreign currency to import fuel from abroad.
● Destruction of some infrastructure projects such as airports and ports, and the decline in travel and trade activities with other countries worldwide. This has reduced the foreign currency revenues of seaports and airports services.

● Positive and negative rumors about the chances of reaching a political settlement, placing deposits in the CBY or printing new banknotes, which affect the behaviors of exchange dealers in the foreign exchange market. For example, the exchange rate fell during the second half of January 2018 from YR 500/USD to YR 430/USD immediately following the news in media outlets about placing the $2 billion Saudi deposit in the CBY in Aden. The exchange rate increased gradually again to about YR 490/USD on 15 March 2018 (prior to the actual approval of the Saudi deposit).

2-2. Economic Factors of the Exchange Rate Crisis:

2-2-1. International Economic Factors:

● Precipitous decline in the flow of foreign exchange resources from abroad to Yemen due to the suspension of exports, disruption of tourism and foreign investments, suspension of the disbursement of most of the external loans, limitation of grants and aid to the humanitarian aspect and departure of embassies and some INGOs from Yemen.

● Reluctance of foreign banks to open accounts for Yemeni banks or deal with them in USD remittances due to Yemen’s failure to comply with international regulations related to money laundering and terrorism financing and classification of Yemen as a high-risk area.

● Inability of Yemeni banks to transfer their accumulated foreign currency amounts to their accounts in correspondent banks abroad. This has created unique problems such as reluctance of exchange companies to accept the earlier types or series of U.S. banknotes (1996-2001-2001) or accept them for a lower price than the exchange rate in the foreign exchange market. This distinction represents a kind of extortion by exchange dealers. Ironically, banks also do not accept to deposit earlier series of U.S. banknotes (1996 and 1999) while they often pay customers only series of U.S. banknotes (2001-2003)(3). As a result, customers are reluctant to deposit new series of U.S. banknotes (2006 and beyond) in banks. This will keep the US dollar out of the banking system.

● Remittances made by Yemeni expatriates in Saudi Arabia are expected to be affected in the coming period due to the imposition of an “expat levy” on all foreign workers and their dependents, unless Yemeni expatriates and their dependents are exempted from these measures.

2-2-2. Local Economic Factors:

● Excessive issuance of new banknotes in a manner that is inconsistent with the movement of real economic activity and without adequate foreign exchange. The total issued banknotes amounted to YR 855 billion as of late 2014. After that, the CBY in Sana’a issued YR 521 billion and used it during 2015-2016. The CBY in Aden printed YR 600 billion in 2017 but there is no available data on the cash disbursed from this amount. This increases the money supply and affects the value of the national currency.

● Dominance of exchange offices and companies over the activities of external remittances and imports financing in an attempt to fill the vacuum left by the banking sector. Thus, exchange companies and offices spread widely and their number increased in 2017 to more than 1,350 offices and companies (including 800 unlicensed companies and offices) compared to 606 companies and offices in 2014. This means that informal entities are being empowered at the expense of the official banking sector and, hence, the growing activity of speculators in foreign currencies, especially in light of the weak control over the activities of exchange dealers. According to some sources, there are five main players in the exchange market in Yemen.

(3) Except the INGOs’ staff who receive their monthly salaries in series of U.S. banknotes 2006 and beyond
- Depletion of the CBY’s foreign exchange reserves (total foreign reserves without bank deposits) from $4.2 billion in December 2014 to $245 million in December 2017, which is enough to cover the imports of less than one month only\(^4\). Figure (8) shows an inverse relationship between foreign reserves and the exchange rate. The lower the external reserves, the weaker the CBY in terms of protecting the national currency and further appreciation of the US dollar. Therefore, placing the recent deposit of $2 billion in the CBY in Aden will ease the exchange rate fluctuations.

\[\text{Source: CBY, 2017.}\]

\[\text{Source: CBY, 2017.}\]

\[\text{Source: IMF, 2018.}\]

**Third: Funding Requirements for the Exchange Rate Stability:**

The CBY’s used of the foreign exchange amounted to about $4.7 billion on average per year during 2012-2014, of which about 75% (or $3.5 billion per year) is used to finance the fuel and basic commodity (wheat, rice, sugar) imports. The policy of financing the fuel and basic commodity imports at the official exchange rate during 2012-2014 transition period resulted in preventing the exchange rate fluctuations and maintaining the stability of exchange rate at about YR 214.9/ USD, thereby reducing inflationary pressures.

During the war period, the CBY’s exchange reserves depleted gradually, reaching the lowest levels of $245 million in 2017, covering the imports of less than one month.

\[^4\] The external exchange reserves are the most important factors that give or undermine the creditworthiness of the economy and the national currency. For example, in war-torn Syria, the Syrian pound collapsed against the US dollar due to the depletion of external exchange reserves, where the change rate in the official exchange rate reached 994% during March 2011-March 2017. However, in Libya that is undergoing conflict and division in the state institutions, the Libyan dinar remained relatively stable due to the large external reserves, where the change rate in the official exchange rate was only 13.5% during 2011-2016.
Therefore, the CBY was not able to provide more foreign currency to the exchange market to protect the exchange rate. It also failed to continue the policy of financing the fuel and basic commodity (wheat, rice, sugar) imports at the official exchange rate (see the annex). Fuel was the first thing abandoned by the CBY because it’s the largest of all imported goods and exhausts the foreign currency. Given the high returns of fuel imports, fuel importers have been endeavoring to secure their needs of the US dollar, even at high prices. This has created an additional demand for foreign currency that exceeds 30% of the dealings in the foreign exchange market. Due to the scarcity of foreign exchange and the large amounts demanded by fuel importers within a limited time, this encourages exchange companies to increase the US dollar exchange rate. No matter how high the exchange rate, the exchange companies will endeavor to prevent any decline in the exchange rate to avoid any losses that may be incurred.

The lack of the single-window system or an effective mechanism to harmonize between the available foreign exchange resources and the funding requirements for the fuel and basic commodity imports stimulates speculation in the foreign exchange market. Requesting a large sum of US dollar to import a fuel or wheat cargo, for example, must be repeated several times. In the first time, the exchange company is not able to provide the full requested amount. It start searching for US dollar from other companies, which in return request US dollar from other companies. The same request may be repeated for several times at the same exchange company. Requesting $10 million may be repeated by exchange companies just like requesting $100 million. This inflates the demand for foreign exchange and creates panic, thereby, exacerbating the exchange rate crisis.

In general, to ease the exchange rate fluctuations, the CBY must regain its previous role in covering the funding requirements for fuel and basic commodity imports, which are currently estimated at about $3.0 billion per year. This is less than the funding requirements prior to the war period due to the decline in world prices of fuel and food as well as covering a part of the domestic demand for these goods through the humanitarian support. In addition to the importance of harmonizing the resources and uses of foreign exchange, rationalizing imports, resuming exports and reaching an economic settlement to supply light crude oil from Marib to Aden Refinery.
Fourth: Currency Forecasts 2018:

The exchange rate is a sensitive indicator that measures macroeconomic situation and reflects the overall health of the national economy. The continuous rise in the exchange rate (devaluation of the national currency) reflects the imbalances in the national economy due to the fragmentation of economic, financial and monetary institutions, political conflicts and consequences of the ongoing war.

Naturally, the scarcity of foreign exchange resources, depletion of foreign exchange reserves, excessive printing new banknotes and active speculation in the foreign exchange market are the main economic factors behind the current devaluation of the Yemeni Riyal. However, economic factors alone are not a sufficient condition to explain the rapid deterioration in the national currency value or forecast its future trends. The war atmosphere, political and psychological factors and the absence of an effective monetary authority also explain to a large extent the rapid fluctuations in the value of the Yemeni riyal.

Whatever the case is, based on the expectations that the donor support to Yemen may exceed $5 billion in 2018 in the form of a deposit in the CBY, support for humanitarian response and development purposes and improved exports and a better government vision for the management of foreign exchange resources and uses, it’s expected that the exchange rate will be relatively stable and will experience less severe changes during the remaining period of 2018 compared with 2017. Based on the past experiences, the seasonal demand on commodities rises remarkably before and during Ramadhan, resulting in high demand on USD and rise in the exchange rate. Thus, early precautionary measures should be taken to avoid such crisis including the provision of enough foreign exchange for importers and controlling the imports.

Due to the exchange rate sensitivity, it may not be appropriate to provide forecasts about specific exchange rate values or to go into detailed scenarios to forecast its trends in 2018 and beyond. In all cases, the restoration of full confidence in the national currency and strengthening it cannot be guaranteed by palliatives. This requires achieving sustainable peace and shifting from consumption to production in the mid and long terms.

Fifth: Immediate Priorities:

<table>
<thead>
<tr>
<th>Key issues</th>
<th>Immediate priorities to reduce the foreign exchange/ exchange rate crisis</th>
</tr>
</thead>
</table>
| Neutralization of the monetary authority | 1. Adhering to the full independence of the CBY and ensuring that it is fully dedicated to monetary and banking issues.  
2. Abandoning any obstacles that complicate the situation of monetary policy and exchange rate policy such as adopting a fixed exchange rate and restricting currency movement throughout the country.  
3. Guaranteeing the safety of bank balances in the CBY to maintain the integrity of the banking sector.  
4. Providing enough space in media outlets to address economic issues and enhance confidence in the banking sector by all parties. |
### Immediate Priorities: (cont.)

<table>
<thead>
<tr>
<th>Key issues</th>
<th>Immediate priorities to reduce the foreign exchange/ exchange rate crisis</th>
</tr>
</thead>
</table>
| **Improvement of the flow of foreign exchange sources and accumulation of foreign exchange reserves** | 1. Giving priority to the resumption of oil and LNG exports as well as supplying Aden refinery with light crude oil from Marib, through an economic settlement, to refine it locally instead of importing fuel for billions of US dollar.  
2. Depositing the foreign currency revenues of all state institutions in the CBY.  
3. Exempting Yemeni expatriates (even temporarily during the war period) of the recent measures imposed by Saudi Arabia on foreign workers and their dependents.  
4. Trying to obtain concessional or interest-free external loans and searching for in-kind grants of oil derivatives.  
5. Starting dialogue with the World Bank to continue its support for the Cash Transfers Program for the beneficiaries of the Social Welfare Fund in a sustainable manner.  
6. Contacting the regional funds to resume funding the projects that have been suspended before completion or to give their consent to finalize these projects by other donors. This applies to the suspended projects of the Social Fund for Development.  
7. Coordinating with the CBY and the United Nations to facilitate the periodic transfer of accumulated foreign currencies of Yemeni banks wherever they are, especially in Sana’a, to correspondent banks abroad.  
8. Trying to attract capital inflows such as issuing a new license for the mobile. |
| **Management of the economic and exchange rate policies** | 1. Forming a team to manage the economic crisis and the exchange rate crisis. This team should include the main players in the foreign exchange market and those concerned with the formulation of macroeconomic policies (CBY, public and private banks, Foreign Exchange Dealers Association, Chamber of Commerce and major Importers, Ministry of Planning and International Cooperation, Ministry of Finance and Ministry of Industry and Trade).  
2. Strengthening the supervision and monitoring mechanisms on the exchange companies and obligating them to obtain and renew their licenses regularly, comply with the law of exchange and the law of the Central Bank and link them automatically with the CBY.  
3. Monitoring the financing movement of banks to ensure that they finance real economic activities and not speculations on US dollar.  
4. Conducting a feasibility study on the possibility to raise the required reserve ratio on foreign currency deposits and raise the interest rate on deposits in Yemeni riyal and US dollar to 20% and 5%, respectively.  
5. Thinking of paying interests on current deposits in banks and current deposits of banks in the CBY in order to attract more deposits to the banking system.  
6. Controlling the liquidity growth rate in consistence with the requirements of the real economic activity and the need for liquidity.  
7. Obligating Yemeni banks and exchange companies, by the CBY, to deal with all series of US dollar banknotes (old and new) without distinction, and to exchange them with the same exchange rate.  
8. Adopting a reasonable official exchange rate and operating the SWIFT system. |
Immediate Priorities: (cont.)

<table>
<thead>
<tr>
<th>Key issues</th>
<th>Immediate priorities to reduce the foreign exchange/ exchange rate crisis</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. Developing a budget for foreign exchange resources and uses in order to estimate the available resources and the funding requirements to import fuel and basic commodities (wheat, rice, sugar, medicine) for every two or three months.</td>
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<tr>
<td></td>
<td>2. Obligating fuel and basic goods importers to deposit their money in banks in exchange for using them to purchase the foreign exchange needed to cover the importers’ credits as follows:</td>
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<tr>
<td></td>
<td>- Determining the contribution of the CBY in covering the funding requirements for importing fuel and basic goods.</td>
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<tr>
<td></td>
<td>- Then, determining the size of foreign exchange deposits of INGOs that are spent on their local activities in Yemeni riyal, such as the cash transfers provided to beneficiaries of Cash Transfers Program, and using them to finance imports of fuel and basic goods at the exchange rate agreed between the CBY, commercial banks and INGOs.</td>
</tr>
<tr>
<td></td>
<td>- If necessary, obligating the other banks and exchange companies to provide the rest of the funding requirements in accordance with thematic criteria such as the accumulation of foreign exchange at each bank and exchange company.</td>
</tr>
<tr>
<td></td>
<td>As a result, banks will get cash amounts in local currency while importers get foreign currency and avoid resorting to the foreign exchange market to purchase US dollar individually and putting further pressure on the exchange rate.</td>
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<td></td>
<td>3. Activating the proposal of the World Bank regarding the allocation of $500 million by donors as credit facilities for imports of wheat, rice and medicine at the official exchange rate, as well as granting a certain period until the repayment of documentary credits.</td>
</tr>
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<td></td>
<td>4. Rationalizing unnecessary and luxurious imports that consume the foreign exchange and have a good local alternative.</td>
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<tr>
<td></td>
<td>5. Taking Precautionary measures to avoid the exchange rate deterioration before and during Ramadhan by providing the importers with enough foreign exchange and controlling the imports.</td>
</tr>
</tbody>
</table>
Immediate Priorities: (cont.)

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. Getting the CBY to obligate banks that dominate the deposits of INGOs to use the parallel exchange rate to pay any amounts needed by INGOs to be disbursed to beneficiaries in local currency. If necessary, the margin obtained by the banks shall be a reasonable absolute number and not a percentage of the parallel exchange rate.</td>
</tr>
<tr>
<td></td>
<td>2. Getting OCHA, on behalf of all the UN humanitarian agencies operating in Yemen, to negotiate with Yemeni banks that dominate the deposits of INGOs to put pressure on them to accept the parallel exchange rate without any margins.</td>
</tr>
<tr>
<td></td>
<td>3. Getting OCHA to coordinate between the CBY branches in Sana’a and Aden and the Yemeni Banks Association to approve a special exchange rate for the resources of INGOs that are transferred into Yemeni riyal, as well as calculating the exchange rate as a moving average of the parallel exchange rate in the last three months. The foreign currency amounts disbursed at the aforementioned exchange rate shall be deposited in a separate bank account used to cover the imports of fuel and basic goods at the same exchange rate as in the previous three months. This will contribute to reducing speculation and will result in stabilizing the basic goods prices. This bank account shall be managed under the supervision of the CBY, OCHA and the Yemeni Banks Association.</td>
</tr>
</tbody>
</table>

Exchange rate options on the operations of INGOs

Annex:

Table (3): CBY’s uses of foreign exchange during 2012-2016 ($ million)

<table>
<thead>
<tr>
<th>Description/ Year</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>Average</th>
<th>2015</th>
<th>2016</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic goods</td>
<td>1092</td>
<td>825</td>
<td>869</td>
<td>928.7</td>
<td>933</td>
<td>584</td>
<td>758</td>
</tr>
<tr>
<td>Oil derivatives (Fuel)</td>
<td>2564</td>
<td>2931</td>
<td>2188</td>
<td>2561.0</td>
<td>970</td>
<td>49</td>
<td>510</td>
</tr>
<tr>
<td>Sales to banks and exchange companies</td>
<td>16</td>
<td>125</td>
<td>404</td>
<td>181.7</td>
<td>667</td>
<td>284</td>
<td>476</td>
</tr>
<tr>
<td>Interests and principal of loans</td>
<td>254</td>
<td>267</td>
<td>348</td>
<td>289.9</td>
<td>356</td>
<td>140</td>
<td>248</td>
</tr>
<tr>
<td>Others</td>
<td>829</td>
<td>703</td>
<td>562</td>
<td>698.0</td>
<td>241</td>
<td>92</td>
<td>167</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4755</strong></td>
<td><strong>4851</strong></td>
<td><strong>4372</strong></td>
<td><strong>4659.3</strong></td>
<td><strong>3167</strong></td>
<td><strong>1149</strong></td>
<td><strong>2158</strong></td>
</tr>
</tbody>
</table>

Source: CBY, 2016