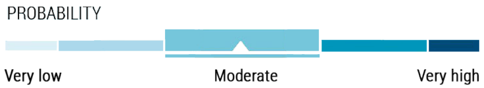
THE END OF SAUDI FINANCIAL SUPPORT TO YEMEN: SCENARIOS

Possible impact on the economy and humanitarian outcomes in Yemen due to the end of Saudi financial support

June 2020

Scenarios

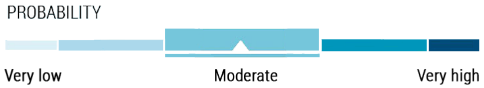
Scenario 1 Cessation of Saudi/external financial support: sharp devaluation of Yemeni Riyal



An increase in conflict throughout Yemen, domestic troubles at home, and a failure in any meaningful implementation of the Riyadh Agreement results in the cessation of financial aid from Saudi Arabia with no one else stepping in to fill the gap. The Letter of Credit (LC) system, which supports imports of essential food (wheat, rice, sugar, milk, cooking oil) ceases, forcing importers to turn to commercial lenders for finance, increasing costs. Unprecedented rapid depreciation of the Yemeni riyal increases food, fuel, and other essential commodity prices – disrupting electricity services to schools, water networks and health facilities.

Rapid inflation sees the value of state salaries decrease and local taxes rise. Corruption and criminality increases. Overall poverty rates rise significantly as households spend an increased proportion of income on food forcing the adoption of additional negative coping strategies. The spread, and impact, of COVID-19 is fuelled by the reduced capacity, and increased cost, of healthcare services increasing morbidity and mortality.

Scenario 2 Partial reduction in Saudi/external financial support: moderate devaluation of the Yemeni Riyal



Reduction and delays in financial support from Saudi Arabia forces a suspension of the LC system. Saudi Arabia or external financers then revert to providing short term reactive interventions. Continued fragmentation between the Central Bank of Yemen in Sana'a (CBY – Sana'a) and Central Bank of Yemen Aden (CBY – Aden) and a lowered public confidence in the ability of CBY – Aden to intervene in the market with foreign exchange results in moderate devaluation of the Yemeni riyal.

Food, water, and fuel prices rise in the short-term forcing the poorest households to adopt further negative coping strategies, driving increasing poverty. The capacity of health services is slightly reduced as costs of essential medicines and equipment increase. The COVID-19 response continues to be inadequate.

Scenario 3 Sustained Saudi/external financial support; exchange rate stability

A renewed commitment to the Riyadh Agreement results in Saudi Arabia, or another donor, providing **timely, robust**, **coordinated**, **sustained**, and **wide-ranging** support to CBY – Aden. Such support enhances the ability of CBY – Aden to contain any further depreciation of the Yemeni riyal and boosts its capacity to intervene in the market to respond to any signs of currency speculation or depreciation.

Prices of essential items stabilise and fuel supply is largely uninterrupted. Poverty rates stabilise and increased support is provided to healthcare services to cope with the COVID-19 caseload.

Introduction

Saudi financial support to Yemen's economy, worth over $2.2 billion since March 2018, has been crucial in helping Yemen to escape economic collapse. With this financial support coming to an end, and no alternative financing in place, Yemen could see the riyal lose almost half its value over the coming six months (reaching YER 1000 to the USD). This would cause food prices to almost double again, increasing food insecurity and pushing Yemenis into a heavier reliance on humanitarian aid, regional patronage and negative coping mechanisms, including criminality and informal taxation.

Yemen, one of the poorest Arab countries, is highly dependent on revenues from its relatively small oil and gas reserves, remittances from expatriates working mainly in the Gulf states, and bi-lateral support from Saudi Arabia. The crash in oil prices and global spread of COVID-19 has reduced Yemeni income from oil exports and severely reduced remittances leaving direct support as Yemen's economic lifeline. Saudi Arabia provided a $2 billion deposit to the GoY in March 2018 to help stabilise currency and food prices. This funding is all but exhausted, with less than $200 million remaining in May 2020.

Neither Saudi Arabia nor any other donor has yet indicated a willingness to provide ongoing funding to Yemen. Thus Yemen is looking increasingly economically vulnerable. The global crash in oil prices has reduced GoY hydrocarbon revenue by, on average half that seen in 2019 (USD 60 per barrel to under USD 30). Concurrently, worldwide COVID-19 restrictions have significantly reduced Yemeni expatriates' earnings and remittances have fallen while transfer costs increased. Any decision by the GoY put in circulation any new banknotes without sufficient foreign exchange cover will fuel inflation.

Humanitarian activities continue to fall due to the restrictive environment, exacerbated by the COVID-19 outbreak. A donor pledging conference in Riyadh on 2 June 2020 secured little over half its target ($1.35 billion pledged against an ask of $2.4 billion).

Current situation

The Riyadh Agreement, brokered by Saudi Arabia in November 2019 to end several months of fighting between the GoY and Southern Transition Council (STC), is on hold and in danger of collapsing completely. The context in southern Yemen is probably at its most uncertain since the near Houthi takeover of Aden in 2015.

While the agreement, or its failure, has little direct significance on events in the north, it is important to Ansar Allah (more commonly known as the Houthis) as they (along with the General People's Congress party and Islah) hold to a vision of a unified Yemen under their control. The complete failure of the agreement would have a greater impact on the GoY, weakening their position further still and potentially increasing conflict along existing frontlines as the Houthis seek to expand territorial control. Although unlikely, it may also contribute to a possible agreement between the Houthis and the STC.

Despite a partial ceasefire, conflict continues between the Houthis and GoY, although so do airstrikes by the Saudis. The Houthis are reported to control Al Jawf in Yemen's north west. This slightly increases the probability that the Houthis will make a move on resource rich Marib, especially if the GoY were to move forces to the south, although many local tribes in Al Bayda and Marib would opposed them.

Following the GoY's decision to move forces into Abyan and failure to implement the Riyadh Agreement, the STC announced the unilateral abrogation of the Agreement and declared self-rule seeking to wrest control of the local Aden economy from the GoY. This move broke a power-sharing agreement that existed in name only. Six of the southern governors reacted negatively to the self-rule announcement, surprising even some STC supporters. The reluctance of the governors of Hadramawt, Shabwa, and Lahj to lend their support was a major blow as they preside over some of the most resource-rich and strategic areas of southern Yemen.

At present Saudi Arabia appears to be adopting a peacekeeping role, preventing the tensions between the GoY and the STC from escalating militarily. Saudi has significant domestic issues to address including the global oil price crash and COVID-19. Thus it may soon tire of waiting for the GoY and STC to resolve their differences and decide to back the GoY or withdraw its focus. The UAE, however, continues to provide direct financial and logistical support to the STC and STC-allied forces. UAE patronage has been critical to STC endeavours, not least for the comparatively timelier payment and higher salaries on offer than that provided by the GoY. However STC funds are currently low and they lack sufficient funds to pay salaries and provide essential services.

Increased COVID-19 cases, amid serious concerns about underreporting and anecdotal reports of increased death rates, indicate that the virus has spread significantly throughout Yemen. Containment measures, including a 14-day quarantine for people entering the country, may result in delays to the import and movement of commercial goods across the country adding to costs and increasing prices. However, with the exception of some temporary delays at Aden Port at the end of April beginning of May, the total amount of fuel and food shipments that arrived at the relevant seaports and land border crossings in April and May were comparable to previous months and thus suggest that goods are entering the country at a steady rate despite the enforcement of COVID-19 measures.

See page 8 for more detail of the background to the current economic situation.

Geographic areas of most concern

The anticipated impacts of these scenarios cover the entire country. Most population groups will be heavily affected, notably by falling purchasing power, the inflation of basic commodity prices, and restricted economic activity. Certain areas, notably eastern governorates with low population density and higher natural resources will likely suffer the least, but the fragmentation of the country and the economy will give rise to the strengthening of patron-client ties and the deepening of the rentier economy.

Methodology

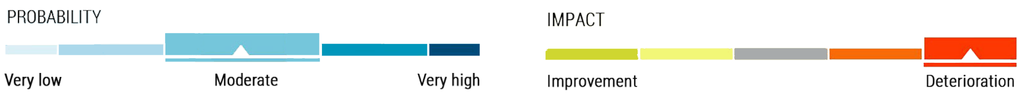
These scenarios were developed in January 2020 through team mapping and analysis exercises by four Yemen researchers, validated through interviews with key stakeholders. The draft report was further developed and revised on the basis of a literature review, rounds of extensive revision and input from ACAPS economists. Subsequently, as the Saudi deposit to CBY Aden depleted, the report was updated in May 2020 to reflect the impact of COVID-19 both on Yemen and developments in south Yemen.

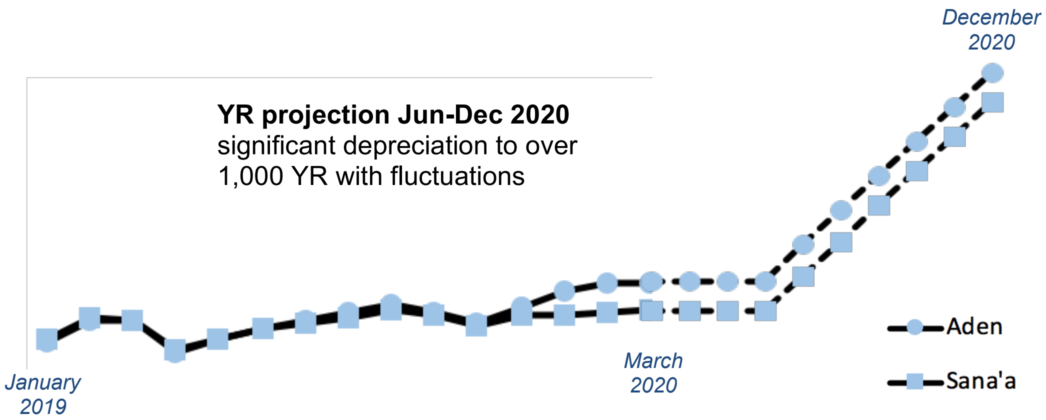
Limitations

Considering the institutional divisions, rivalries and sensitivity of the subject, it was hard to access recent statistics. Also, key informants were reluctant to provide in-depth input in developing the scenarios. Further, the situation in Yemen keeps continually changing making it difficult to judge determining factors and triggers.

Scenarios

1. Cessation of Saudi/external financial support: sharp devaluation of the Yemeni Riyal





Saudi Arabia, dissatisfied by the inability (or perceived unwillingness) of GoY to meet specific benchmarks outlined in the Riyadh Agreement, as well as the lack of progress made in regard to the enhancement of GoY and CBY – Aden internal capacity to manage and implement Saudi investments in the economy, and rising tensions between the GoY and STC chooses to cease all financial support to GoY and CBY – Aden. No other donor steps in to fill the gap. Facing a growing domestic crisis due to COVID-19 and decreased hydrocarbon revenues, Saudi Arabia also decreases the level of military and logistical support it provides to the GoY, reducing its presence in Aden and instead focusing on bolstering its presence and support networks in Marib and Al Mahrah governorates, as well as securing the Saudi-Yemeni border.

The reduction of Saudi financial support for the GoY and CBY – Aden weakens their economic leverage, which ultimately hinges on continued international recognition (and the accompanying benefits, such as access to SWIFT), and the backing it receives from Saudi Arabia. The Houthis and the Southern Transitional Council (STC), seek to capitalise on the GoY's increased fragility to pursue their own political and economic objectives.

Unprecedented rapid depreciation of the Yemeni riyal results with, the value of riyal halving to 1000 Yemeni riyals to 1 US dollar.

Possible triggers/assumptions

- The GoY and STC fail to meet the benchmarks set by the Riyadh Agreement
- The GoY fails to improve its internal capacity to manage and implement Saudi financial support
- Saudi Arabia ceases all financial and logistical support to CBY - Aden, perhaps with the exception of the payment of GoY military salaries
- No other donor steps in to fill the gap
- The Houthis and STC look to capitalise on increased vulnerability of the GoY and GoY-run institutions.
- The Houthis try to further maintain their existing regulations and monetary, fiscal, and economic policies designed to limit engagement with the GoY, CBY – Aden, and the food and fuel import mechanisms that the GoY is trying to enforce.

Impact

Reduced confidence in the ability of GoY-run economic institutions, namely CBY – Aden, to manage the economy, and specifically in regard to the management of foreign and local currency reserves and the Yemeni riyal exchange rate and continued implementation of GoY food and fuel import mechanisms.

Food importers and banks lose the associated benefits tied to GoY/CBY – Aden LCs system currently tied to the Saudi deposit, such as permanent access to foreign currency at a below market exchange rate.

CBY – Aden starts to rely more on negative interventions such as the injection of additional (newly-printed) Yemeni riyal banknotes to fund the budget deficit, increasing inflation and currency depreciation. CBY–Aden implements increasingly politicised policies aimed at reducing Houthi control over financial institutions and the economy. CBY – Aden may threaten to have certain banks and money exchange companies blacklisted, and subsequently increase their isolation from regional and international financial networks.

CBY – Aden and CBY – Sana'a intensify their competition for control over Yemen's economy. Conflicting monetary, fiscal, and economic regulations reduce the space in which banks, businesses and money exchangers can operate free of political interference. Leading international banks and financial institutions impose further restrictive de-risking measures on Yemeni banks due to the increased concerns over money laundering and terrorism financing risks in Yemen.

World Bank and International Monetary Fund (IMF) suspend CBY – Aden capacity building endeavours.

OSESGY mediation over the implementation of the Decree 49 Al Hodeidah fuel import mechanism stalls, leading to fuel shortages, disruptions to electricity, water, sanitation and health services which increase the spread of communicable diseases, including

COVID-19 and cholera. The Houthis extract and start disbursing the outstanding balance currently deposited in the CBY – Al Hodeidah branch.

Importers face increased difficulties in securing foreign currency to import essential commodities (food, medicine, and fuel derivatives. Increased shortages result in increased commodity). Food importers will revert to money exchange companies in order to access foreign currency to facilitate imports. The increased exchanged rate they now face (no longer YR 440 to USD 1) will be passed on to the ordinary citizen via increased commodity prices.

There is an expansion of parallel or black-market activity and the smuggling of goods and YR currency notes. Compliance and risk concerns over financial flows, money laundering and terrorism financing raise the cost and difficulty of future attempts to revitalise the formal finance sector and reign in illicit business and financial brokers. The Yemeni riyal loses its importance as means of exchange while the use of Saudi riyals and US dollars increases, with foreign currencies becoming the primary mode of exchange.

The Houthis continue to implement, and start to introduce further, prohibitive economic, monetary, and fiscal policies that seek to limit engagement with GoY economic institutions and regulations and protect Houthi economic interests. One such measure is the continued ban on the newly-printed banknotes circulating in Houthi-controlled territories – i.e. Yemeni riyal banknotes that GoY printed after September 2016 issued by CBY – Aden.

UAE-backed, STC-aligned forces stationed in southern Yemen may seek to secure key economic facilities, access routes, and oil and gas pipelines and halt oil exports. Mobilisation of UAE-backed, STC-aligned forces is met with strong resistance from many local political authorities, GoY-aligned forces, and other armed groups.

The Houthis continue their attempts to consolidate recent gains in Al Jawf as its looks to advance on Marib, and subsequently increase its leverage for any future peace talks under the UN framework or any bilateral talks, namely with Saudi Arabia and the United States.

Although limited Saudi financial support may continue to be provided, such as for the payment of GoY military salaries, the level of this support (over 300 million Saudi riyals per month) would be insufficient to prevent the expected rapid devaluation of the Yemeni riyal. This would compound the ongoing capital outflow and continued fragmentation of the country, the economy, and economic institutions. The reduction in foreign currency resources for GoY and CBY – Aden would weaken their ability to regulate the import of food, fuel, and other essential commodities. CBY may revert to increasingly reactive economic interventions driven by political objectives rather than effective economic policy.

The amount of foreign exchange available in the market will be limited to aid, remittances, and limited oil export revenues. All three sources of foreign currency have been in a state of decline since March 2020. Any disruption caused to the LC system the GoY introduced in November 2018 would also lead to a reduction in foreign currency in the market. Food importers would need to access foreign currency directly from the market (e.g. from banks, money exchange companies or hawala agents) in order to facilitate their imports and at a higher exchange rate (as opposed to the 440 Yemeni riyals per US dollar rate that is used as part of the LC system tied to the Saudi deposit). Higher financing costs would be passed on to the consumer. In this scenario, inflated food prices will be further compounded by a depreciation of the value of the riyal due to the downward pressure that food importers place on the local currency. We will likely see a continued divergence in the value of the riyal between Houthi and non-Houthi controlled areas as the Houthis continue to introduce policies to protect their own economic spheres, such as the ban on the use and circulation of newly-printed Yemeni riyal banknotes in Houthi-controlled territories. After CBY – Sana'a announced the extension of its ban on the newly-printed banknotes on December 18, 2019 to include Yemeni citizens, the divergence between the value of the riyal in Houthi and GoY-controlled areas has widened.[1]

The inevitable decline in effective economic policy will drive fragmentation, creating a vacuum for external states, such as Qatar, Turkey, or Iran, to leverage their resources to empower political actors or specific geographic areas. This would result in an increased dependence on a patronage driven economy exacerbated by political and military fragmentation, with increasingly unequal economic spaces developing throughout the country.

Humanitarian consequences

Food and basic commodity prices double again, in line with the inflation of the riyal. Overall poverty rates rise significantly as households spend an increased proportion of income on food, forcing the adoption of additional negative coping strategies.

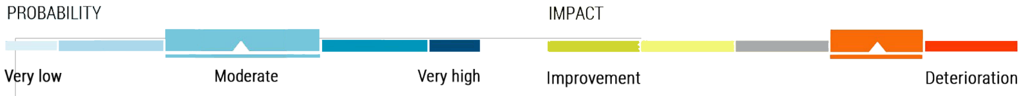
Rapid inflation sees the value of state salaries decrease and the cost of food, fuel, water, and other essential items rise significantly. Furthermore, local authorities seek to raise additional funds to compensate for the inflation and raise taxes. As a result increasing numbers of Yemeni are forced into poverty.

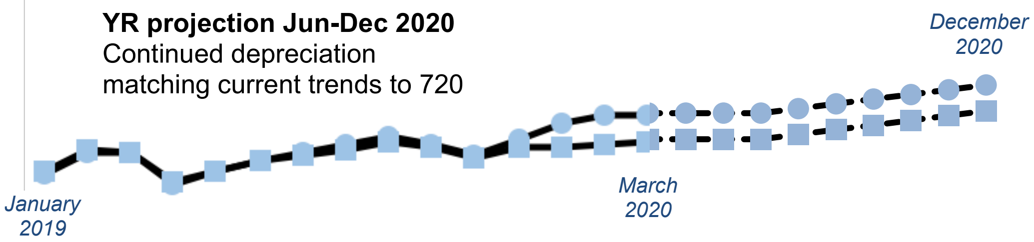
The spread, and impact, of COVID-19 is fuelled by the reduced capacity, and increased cost, of healthcare services increasing morbidity and mortality.

Corruption and criminality increase with significant negative consequences for the most vulnerable and for humanitarian operations.

[1] https://sanaacenter.org/publications/analysis/8674

2. Partial reduction in Saudi/external financial support: moderate devaluation of Yemeni Riyal





Conflict between the Houthis and GoY-aligned forces continues at the present level, with no significant progress or deterioration in UN-led or bilateral peace talks. In parallel to this, simmering tensions between southern separatist groups – namely the UAE-backed STC and STC-aligned forces – and GoY spreads across different southern governorates. Meanwhile the humanitarian situation continues to deteriorate across the country prompting increased international pressure on Saudi Arabia and GoY allies to take emergency action to avert Yemen's deepening economic and humanitarian crises.

Despite its apparent reluctance to relent on its stance that additional financial support is conditional on GoY (and STC) implementing the Riyadh Agreement and the specific benchmarks contained therein, Saudi Arabia decides to intervene to shore up the Yemen economy to prevent a complete collapse of the Yemeni economy.

While remaining dissatisfied with GoY efforts to improve its internal capacity to manage the economy, Saudi Arabia limits the nature and extent of its support, due largely to domestic economic issues, deciding to provide limited, conditional assistance to the GoY.

Possible triggers/assumptions

- Houthi authorities continue economic warfare introducing new measures designed to limit the GoY's ability to implement effective economic policy countrywide.
- International concern over the GoY's ability to manage the economy and reduce corruption prevents any effective engagement between international actors and GoY, thus external support continues to depend on Gulf States, primarily Saudi Arabia.
- Delays in the provision of additional support from Saudi Arabia, causes decreased trust and confidence among Yemeni citizens and economic actors, which in turn contributes to a depreciation of the value of the Yemeni riyal. This delay reduces the effectiveness of the aid, despite the slight immediate rebound of the riyal.
- The Riyadh Agreement is amended/updated after extensive mediation efforts.

Impact

Reduced and limited international support, along with increased political and economic fragmentation, in Yemen continues to negatively impact the economy causing both moderate depreciation of the value of the riyal and inflation of stable food and fuel commodities in the local market. The disparity in local exchange rates continues to grow.

The reduction and delays in financial support from Saudi Arabia forces a suspension of the LC system. As noted in the first scenario, the suspension of the LC system prompts food importers to revert to the market to access foreign currency at a higher exchange rate. Additional costs are passed on to the consumer. State employees' salary payments are delayed.

GoY continues, in a more unstable ad hoc fashion, to provide critical services such as the payment of public sector salaries, controlling the exchange rate (as much as possible), and the continued implementation of GoY food and fuel import mechanisms. A significant reduction in confidence in the long-term capacity of CBY – Aden and a contrary higher perception of risk (and risk aversion), among ordinary citizens, banks, businesses, and money exchange companies places more downward pressure on the riyal as well as increasing the opportunity costs associated with monetary interventions.

Fragmentation between CBY – Sana'a and CBY – Aden contributes to market distortions. The Houthis and CBY – Sana'a continue to implement reactionary policies in opposition to those implemented by CBY – Aden. The Yemen economy continues to be an arena of significant political competition, as CBY – Aden continues to face challenges in extending its economic control throughout both GoY and Houthi-controlled areas.

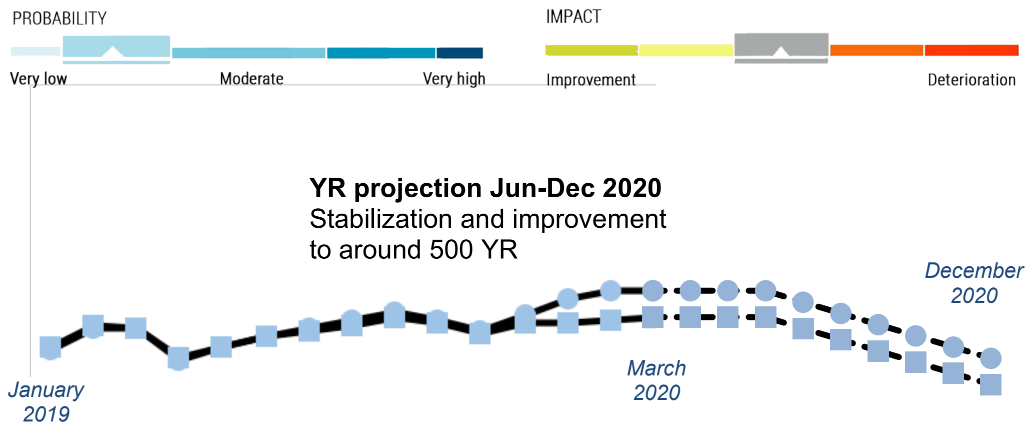
Public confidence in the ability of CBY – Aden to intervene in the market with foreign currency that is largely derived from Saudi support subsequently declines. Continued fragmentation between CBY – Sana'a and CBY – Aden distorts the foreign exchange market and negatively impacts the potential of the UN-mediated agreement in Al Hodeidah to extend the pay out of public payroll beyond Al Hodeidah.

Inflow of foreign currency from oil exports, remittances, and humanitarian aid continues at roughly the current level which is insufficient to arrest the slow but steady decline in the value of the riyal we have seen over the past few years. CBY – Aden attempts to utilise other sources of foreign currency, notably the money Saudi Arabia provides for the payment of GoY military salaries to continue implementing the existing LC food import mechanism. The consequent partial suspension of military salary payments leads to increased unrest among GoY fighters. Alternatively, The GoY uses newly printed banknotes to make such payments resulting in inflation.

Humanitarian consequences

Inflation continues which, combined with temporary shortages of fuel and some other essential items, results in increasing prices for the Yemeni population forcing the poorest households to adopt further negative coping strategies, driving increasing poverty. The capacity of health services is temporarily reduced as the cost of essential medicines and equipment increase.

3. Sustained Saudi/external financial support; exchange rate stability



This scenario involves robust, complex and sustained support from Saudi Arabia or other external actors to GoY economic institutions, namely the CBY – Aden, in tandem with, at least the appearance of, major political progress, possibly including the implementation of the benchmarks outlined in the Riyadh agreement.

Saudi Arabia successfully contains the conflict between the GoY and STC who agree to re-engage with the Riyadh Agreement. Saudi Arabia, possibly enabled by an improving economic situation, attempts to re-invigorate the peace process by providing timely, robust, coordinated, sustained, and wide-ranging support to CBY – Aden. Such support enhances the ability of CBY – Aden to arrest any further depreciation of the Yemeni riyal through the provision of continued support to food importers, as well as the continued ability of CBY – Aden to intervene in the market to respond to any signs of currency speculation or depreciation. Saudi Arabia encourages GoY and CBY – Aden to increase the level of transparency over the implementation of its LC food import mechanism to increase the level of outsider confidence in GoY and CBY – Aden economic management, and address concerns of potential favouritism given to certain importers. CBY – Aden continues to utilise Saudi financial support to reduce the impact and frequency of exchange market instability, further reducing the need for rushed, expensive and inefficient interventions (such as the 200 million USD granted to CBY – Aden in 2018).

Possible triggers/ assumptions

- Significant improvements in the capacity of GoY and CBY – Aden to effectively manage Saudi financial support to the economy, and the level of transparency regarding the disbursement of funds for the approval of LCs and food import applications.
- The Riyadh Agreement is amended/updated after extensive mediation efforts.
- Prime Minister Maeen Abdulmalik Saeed builds on reactivation of Supreme National Anti-Corruption Commission (SNACC) and the Supreme Economic Council to try and increase the level of efficiency and accountability of the GoY's handling of the economy and financial and logistical support provided by external actors.
- Demonstration of capacity by the GoY to implement budgetary reform, increase revenues and reduce its level of dependence on external support.
- GoY efforts to address concerns over wastage and corruption are well received by Saudi Arabia and other international actors. Saudi Arabia and other members of the international community examine ways of increasing the level of economic support after seeing signs of: (a) increased currency and economic stability; (b) GoY efforts to increase revenues and reduce dependence on external financial support; (c) promoting good governance, transparency, and accountability; and, (d) progress in reducing wastage, corruption and politicised interventions.

Impact

GoY economic policy with effective international support brings significant benefits to the entire country, through supporting the private sector, stabilising the riyal at around 500 YR to the USD and reviving the financial sector.

A reduction in politically targeted economic policies significantly lowers the counterproductive and reactionary policies instated in Houthi-controlled areas and widens the space within which banks, businesses, money exchange companies, and ordinary citizens can operate free of excessive political interference.

Divergent currency rates begin to recede in severity. Shared economic gain becomes an incentive towards a wider political solution and a rolling back of the current trends of political and economic fragmentation.

CBY - Aden is able to get access to additional sources of foreign currency through increased effectiveness and a broader political mandate.

Revenue from oil exports increase as political and economic recovery grows in GoY areas facilitating increased extraction and export.

International donors focused on humanitarian aid and development deposit money in CBY – Aden, a process they had been reluctant to engage with due to concerns over accountability and the potential further politicisation of the economy. These deposits would improve the ability of the CBY – Aden to engage in effective monetary policy and reduce the level of dependency on external financial support provided by Saudi Arabia and others.

International actors, such as the World Bank, the IMF, and various states, begin to see sustained support for GoY and CBY – Aden as less risky, and increase their level of engagement with GoY through a range of mechanisms further stabilising the economy.

Food, fuel, and water prices stabilise and even reduce. Poverty rates stabilise. The economic stability allows the GoY to concentrate on supporting the healthcare system to cope with the increased caseload from COVID-19.

Background

Saudi Arabia has been a crucial actor in helping Yemen to escape economic collapse. Saudi has provided financial support through four modalities (in addition to humanitarian and development support).

1. Letters of Credit $2 billion USD (March 2018)
2. Fuel subsidy of $180 million USD (October, December 2018 and January 2019)
3. $200 million USD un-earmarked funding (November 2018)
4. Saudi Riyal deposits for military salaries (Since July 2019)

Following the escalation and regionalisation of the conflict in March 2015 with the military intervention of the Saudi-led coalition, Yemen's hydrocarbon production and exports were suspended. As a result, Yemen was deprived of its main source of foreign currency and exchange rate stability. In 2014, oil and gas exports and investment contributed a combined $6.8 billion in foreign currency, underpinning public finance and foreign currency reserves. Yemen's economy lacks diversity and relies heavily on imports, including for around 90 percent of its essential food commodities.

Yemeni banks and traders face major challenges accessing their correspondent accounts in the United States, Canada, and Europe as a result of additional "de-risking" measures brought in from 2010. Yemeni importers, who represent some of the biggest clients and indeed shareholders for a number of Yemeni banks, had to find alternative ways of accessing foreign currency and connecting to regional financial and trade networks in order to bring goods into the country.

This saw the Central Bank of Yemen (CBY) take on an even more active role in managing reserves and supply of foreign currency. Under the stewardship of then-Governor of the CBY Mohamed bin Humam, from March 2015 until August 2016, the CBY sought to: (a) cover imports through the issuing of letters of credit (LC); and (b) pay state employees' salaries. In the absence of foreign currency inflows from hydrocarbon exports, Bin Humam and the CBY had little option but to use CBY foreign currency reserves to ensure YER liquidity, facilitate essential imports, and stabilise prices. CBY foreign currency reserves fell from $4.8 billion in December 2014 to around $700 million in August 2016. The official foreign exchange rates depreciated from 215 to 280 Yemeni riyals per US dollar between February and March 2015 as Operation Decisive Storm began, compared to a slightly higher parallel market rate of about 300 Yemeni riyals per US dollar. The CBY exhausted local currency liquidity[2] as it sought to cover monthly public expenditures, namely public sector employee salaries, by over drafting the Government of Yemen (GoY) account from 688 billion YER end of 2014 to about 1.9 trillion YER by mid-2016.

In the wake of claims that the Houthis were plundering state coffers, President Abdrabbu Mansour Hadi ordered the transfer of CBY headquarters from Sana'a to Aden in September 2016. The newly appointed CBY Governor Monassar al-Quaiti sought to resolve the issue of salary payments by simply printing more money. A total of 1.7 trillion was printed and subsequently fed into the market in 2017 and 2018 imposing huge downward pressure on the Yemeni riyal. The CBY – Sana'a, responded by formally prohibiting the use and circulation of the newly-printed banknotes (i.e. those printed after September 2016 and issued by CBY – Aden) among Yemeni banks and businesses in Houthi-controlled areas.

Saudi financial support to stem Yemen's continued economic decline

In January 2018 Saudi Arabia announced that it would provide a $2 billion deposit to the Government of Yemen (GoY). The deposit came to represent a huge stabilising force that offset downward pressure on the Yemeni riyal and facilitated the import of essential food commodities – specifically wheat, rice, sugar, milk, and cooking oil. The $2 billion Saudi deposit was delivered in March 2018 and the GoY started using funds allocated from the Saudi deposit in June 2018, although early implementation was hindered by delays in processing food import applications.

Based on extensive consultations with Yemeni food importers and other economic stakeholders, CBY – Aden introduced a new financial mechanism for food imports underwritten by the Saudi deposit. Food importers could apply to banks to receive Letters of Credit (LCs) which, upon approval from CBY - Aden and Saudi Arabia, granted importers access to funds allocated from the Saudi deposit at a below market exchange rate of 440 Yemeni riyals per US dollar.

Since November 2018, the Saudi deposit has been one of the major stabilising forces for the Yemeni riyal. The implementation of the LC system contributed to the immediate appreciation of the Yemeni riyal in November 2018 following an unprecedented period of rapid depreciation from July till October 2018. Other factors that contributed to the rebounding and subsequent stabilisation of the riyal included: (a) the introduction and implementation of Decree 75 in October 2018; and (b) additional financial and logistical support from Saudi Arabia. Over the past six months, as the remaining funds from the Saudi deposit continued to deplete and became closer to the point of exhaustion, with less than $200 million left at the time of writing, concerns have risen over the negative impact that the depletion of the Saudi deposit would have on the Yemen economy in the absence of further external financial aid.

The Saudi deposit essentially provided GoY with a vital injection of foreign currency that GoY was not in a position to raise on its own – not least due to decreased levels of crude oil exports and the ongoing suspension of liquified natural gas (LNG) exports since the escalation of the conflict in March 2015. The same problem remains; as despite the withdrawal and reduction of funds from the Saudi deposit over time GoY is still not yet in a position to meet the country's foreign currency demands. As of May 2020, the situation is much more precarious as the Saudi deposit nears depletion. Crude oil export revenues have been slashed due to the drop in global oil prices. Remittances and humanitarian

[2] Liquidity is the ability to exchange an asset for another item of value. A lack of cash flow in the economy result in economic downturn.

funding, respectively the first and second largest sources of foreign currency for Yemen, are also declining.

In addition to the $2 billion deposit, Saudi Arabia offered further financial and logistical support to try and tilt the balance in the GoY's favour. The Saudi Development and Reconstruction Program for Yemen (SDRPY) provided the GoY with a $180 million fuel for electricity grant that helped cover three separate diesel and fuel oil shipments made in October 2018, December 2018, and January 2019. The subsidised diesel and fuel oil was intended to power 64 electricity power stations located in 10 different governorates under GoY control. The $180 million provided was part of a $60 million per month fuel for electricity grant announced in August 2018 that was originally slated to run for 12 months. However, the Saudis ended the program after a six-month period, allegedly due to concerns over GoY handling of the grant.

Saudi Arabia also gave CBY - Aden $200 million in November 2018 to help restore the value of the YER after it crashed to almost YER900 to the USD in October 2018. This collapse was largely caused by speculation among fuel importers competing to secure the estimated USD 200 million per month they need to maintain fuel imports from local money markets. CBY - Aden used the $200 million provided by Saudi Arabia to intervene in the market in order to stabilise the rial, helping to bring prices back to around YER550 to YER600 for most of 2020. The GoY also introduced Decree 75, which requires fuel importers to submit applications to the Economic Committee in Aden and work with the formal banking sector, to help regulate demand from fuel importers. The $200 million Saudi Arabia gave GoY in November 2018 was dovetailed with the implementation of the LC financial mechanism for food imports underwritten by the Saudi deposit. Both financial support mechanisms instilled greater market confidence and contributed to a rebounding of the value of the Yemeni riyal.

Finally, in July 2019 Saudi Arabia started depositing over 300 million Saudi riyals per month for GoY military salaries in a GoY account held at the National Commercial Bank (NCB) in Riyadh, Saudi Arabia, also known as Al Ahli Bank. The deposit for military salaries is not transferred directly to CBY – Aden foreign exchange reserves accounts with its correspondent banks but is held in a separate GoY account at Al Ahli Bank in Jeddah.

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Saudi Arabia's Financial Support to Yemen 2018-2019

	Letters of Credit March 2018	**Fuel Subsidy** October 2018	**Un-earmarked Funding** November 2018	**Saudi deposit for military salaries** April 2019	**Humanitarian Funding** 2018 to 2019
Amount (USD)	$2 billion	$180 million	$200 million	$100 million per month	$ 2.03 Billion[3] (paid contribution only)
Rationale	Designed to offset downward pressure of YER and facilitate the flow of imported food at stable prices. Consisted of letters for traders wishing to import specific basic commodities, such as wheat, rice, sugar, milk, and cooking oil.	Designed to maintain stable electricity supply for 64 electricity power stations across 10 GoY governorates. Meant to cover three separate diesel and fuel oil shipments totalling 277,000 tons of fuel derivatives for distribution by Aden Refinery.	Designed to assist GoY with buying and selling of Yemini Riyal. CBY Aden used the funds to enter the market in order to stabilise the Riyal when the market exchange rate increased.	In April 2019, Saudi Arabia began paying the monthly Saudi Riyal salaries for the GoY military to offset economic challenges to fulfil payroll.	Support to Humanitarian agencies and Government of Yemen for responding to the Yemen humanitarian crisis based on HRP 2018 and 2019 (FTS UNOCHA). This funding included USD 0.255 billion dispersed through the Saudi Development and Reconstruction Program for Yemen.
Impact	Imported basic food goods remained available in the market at slightly higher prices	Originally designed to run for 12 months, the fuel grant was discontinued after 6 months (and only three instalments of X) due to alleged corruption. It was estimated that the fuel grants would benefit up to 8.5 million Yemenis.	Played a significant role in rebounding the exchange rate from YER800/ US dollar to YER700 USD early October 2018. It was the emergency injection that limited speculation	Created space for CBY Aden to further foreign exchange resources for coverage of imports. The extra support helped to alleviate pressure on the YER.	Provided basic services with wide range of activities in multiple sectors. Also provided hard currency liquidity to the Yemeni financial system. UN humanitarian funding deposits are usually transferred via IBY, who in turn lends this liquidity to importers
Pro	• Stabilizing force for YER • Facilitated the flow of imported food at stable prices.	• Stable supply of electricity power provided during summer season when temperatures rise significantly. • Without the L/C for imported basic food covered at subsidised exchange rate 440 , people will have to buy it at the market rate around 600 YER per 1 USD meaning with 26% higher food excluding the additional effects of the supporting services cost at higher exchange rate like transportation and fuel with higher pressured exchange rate	• Timely disbursement of funds directly following the rapid depreciation of the YER in July-October 2018 when there was a huge demand for foreign currency among fuel importers. • Contributed to immediate appreciation of the YER in Nov 2018	• Contributed to exchange rate stability • CBY Aden is able to allocate resources for the supply market demand of fuel, medicines, and other commodities.	• Lifesaving assistance to people in need. • Continuation of provision of basic services to people in need.

[3] Out of total humanitarian funding reported in FTS; 0.255 Billion USD through "The Saudi Development and Reconstruction Program for Yemen" (UNOCHA FTS 2018 & 2019)

Con	• Significant Delay (announced in January 2018 and delivered I March 2018) • CBY- Aden not granted direct access to the fund • Limited banks whose HQs in Aden and have political affiliation with GoY • Banks in Sana'a Are not allowed to transfer YER cash to Aden by the Houthis • Monopoly of the L/Cs by single to few importers	• Alleged corruption resulted in discontinuation of fuel subsidies after three instalments. • Limited to GoY controlled territories	• Corruption within the CBY and among specific banks furthered mistrust between Saudi government and GoY	• Delay in military staff pay led to resistance and cut of the roads by the beneficiaries • Payments were contrary to the people's preference of receiving salary in in foreign exchange which creates a net gain from the market rate differences. • The unstable security situation in Aden and south likely to place constraints on the CBY's ability to disburse the salaries • Corruption involving "ghost soldier" or fake identities to illicitly gain salary • The FX benefits businesses affiliated with the political elites within the GoY	• Delays in aid will disrupt basic services to people in need. • Heavy reliance on humanitarian aid may create or increase dependency and is not sustainable in the long run. • High profile scandals around aid diversion or misuse could see share reductions in humanitarian funding