

# Yemen's Banking Problems Could Have Dire Humanitarian Implications

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Brief Analysis

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## Clarifying the Central Bank's authority, resuming the payment of public salaries nationwide, and addressing currency shortages could help the Hadi government avert a looming famine.

**F**ollowing a visit to Yemen earlier this month, the head of the United Nations World Food Programme (WFP) declared that it was "a race against time" to avoid famine in the country. Her assessment was echoed in a subsequently released multiagency report on the crisis, which found that 17 million Yemenis are food insecure, up by more than 2.5 million since June 2016. Given the difficulty of moving material humanitarian aid across battle lines and conflict zones, the WFP and other international organizations often provide cash assistance to needy families where markets continue to function, allowing them to purchase basic commodities themselves. Thus, maintaining the flow of food available for commercial purchase and ensuring buying power are urgent priorities in a situation like Yemen's.

Last year, the internationally recognized government of President Abdu Rabu Mansour Hadi relocated the Central Bank of Yemen from the Houthi-controlled capital of Sana to Aden. Yet questions about the CBY's authority persist, hindering its access to Yemen's limited reserves. Likewise, the bank has struggled to pay public salaries countrywide, putting government workers and their dependents, over 8 million people in total, at risk.

## BACKGROUND

**A**fter the Hadi government was forced out of Sana in February 2015, the CBY continued to play a monetary and fiscal role from the capital, paying salaries throughout the country based on allocations made in the prewar 2014 budget. Yet officials soon began to question the bank's neutrality, fearing that payments made to line ministries in order to cover salaries were enabling the Houthis to pay their loyalists and fund their war effort.

Last August, the Hadi government sought to change the CBY leadership when the terms of sitting board members expired. And in mid-September, amid the UN General Assembly meetings in New York, President Hadi issued orders to move the bank's headquarters to Aden.

## DWINDLING FOREIGN RESERVES

**A**t the time of its relocation, the CBY was already facing formidable challenges. Without regular oil exports, it had been unable to replenish its foreign reserves. A \$1 billion Saudi deposit made in 2012 had provided some stability to the bank and the Yemeni rial, but Riyadh was unwilling to provide additional funds to an institution perceived to be financing its opponents in the conflict.

Since moving to Aden, the CBY has struggled to take on many of the duties of a central bank. Several of its foreign accounts reportedly remain out of reach due to continuing uncertainty over its claim to Yemen's foreign exchange reserves. While the IMF lists the bank's new governor, Munasar Saleh al-Quaiti, as Yemen's primary representative to the fund, former governor Muhammad bin Humam continues to be listed as the alternate.

Yemeni officials also note that the CBY's recent challenges have complicated the receipt of payments for the country's limited oil exports. Last summer, proceeds from an oil sale to the multinational firm Glencore were deposited into an account held by the Yemeni Finance Ministry in Saudi Arabia rather than existing CBY accounts. And while the Yemeni government reported in late February that it was finalizing negotiations with Riyadh to put \$2 billion on deposit with the CBY, these funds cannot be fully utilized without access to U.S. dollar accounts, and it is not clear that the CBY has such access in practice.

## BANKNOTE SHORTAGES

**T**he CBY and other Yemeni banks have also faced shortages of physical currency since well before the Aden relocation. Over the course of the two-year war, such shortfalls have become more frequent, even when funds were available electronically to effectuate salary payments. CBY branches were forced to postpone the planned destruction of deteriorating banknotes in order to ensure that the banking sector had sufficient physical cash. The CBY had also negotiated a deal with the Russian currency printer Goznak to print 400 billion Yemeni rials last year, but once the Hadi government became unhappy with the bank's leadership, it took steps to prevent delivery of the new cash to Sana in order to prevent the Houthi alliance from accessing it.

Once the CBY was relocated, it finalized arrangements for the new currency to be delivered exclusively to Aden. Goznak recently made its first delivery there, and the bank is dispersing the cash in Hadi-controlled territory through its branches and post offices. To help with salary payments in rebel-controlled areas, the CBY is relying on select private banks and exchange houses that have been able to retain adequate levels of physical currency. These outlier institutions likely obtained their cash from merchants bringing them local currency to pay for imports from abroad. Such foreign transactions are probably offset abroad by foreign currency remittances from Yemeni expatriates. In this way, some Yemeni institutions seem able to continue cross-border payments without going through traditional CBY clearing channels. The existence of this parallel system could also explain how prices for basic goods have not spiraled completely out of control.

Nevertheless, the salaries of many public employees have gone unpaid since the Hadi government decided to stop

providing ministries with lump sums for distribution. Officials now seek to confirm the payrolls in each ministry and district in the hope of ensuring that no money is paid to personnel hired after the Houthi coup or otherwise diverted to the rebels.

The CBY has also struggled with other basic duties since moving to Aden. These include financial institution oversight and anti-money laundering and counter-terrorist financing controls -- duties that are especially important in a country where al-Qaeda in the Arabian Peninsula has periodically controlled territory and taken advantage of the security vacuum created by the civil war. Further deterioration of the formal financial sector carries the risk of pushing more transactions into informal networks outside the CBY's regulatory reach.

## POLICY RECOMMENDATIONS

Yemeni officials have repeatedly sought U.S. and international support for the relocated CBY, in part to support their wider claim that they are capable of governing the country and stabilizing the economy. Given the country's crisis-level economic and humanitarian conditions, Washington should urge the Hadi government to live up to its promises and pay public salaries countrywide. Its slow approach of confirming each ministry payroll district-by-district has significantly hobbled this effort, thereby undermining the government's credibility. More important, it has left many households without the ability to purchase food.

Washington should also urge the government to address liquidity problems throughout the country, including outside its areas of control. This could mean offering liquidity to Houthi areas in exchange for verifiable assurances that the money will not be diverted for military purposes, as well as recognition of the CBY's independence throughout the entire country. Similarly, the U.S. government should press the Yemenis to ensure that hard-currency allocations for purchasing food and medicine enable imports into both Hodeida and Aden ports.

Ultimately, addressing the CBY's capacity will only go part of the way toward mitigating Yemen's humanitarian problems. The government also needs to secure additional foreign currency and ensure that the funds serve all of the country's needs. Such funds could come from renewed oil exports, a Saudi-coalition-backed loan/deposit, or international humanitarian assistance. Although these economic decisions may not make the front pages of newspapers, they will likely have an enormous impact on the ground, perhaps even determining whether Yemen is able to avoid a famine.

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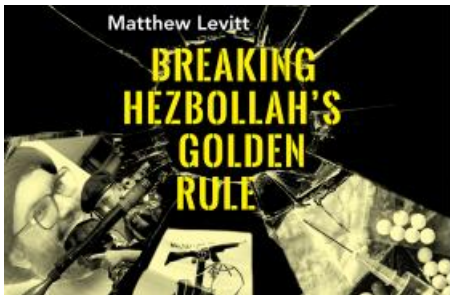
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