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Unification of CBY Policies Opportunities and Obstacles to Success

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Introduction

Central banks derive their success in monetary policy and their contribution to achieving the overall economic objectives of the state from their independent determination and implementation of monetary policies which are integrated into fiscal policy and government instructions, away from any political influences. This is crucial in a stable state of affairs, and necessarily the more so let in war and instability circumstances.

Since the beginning of the war, the Central Bank of Yemen (CBY) has gone through two phases. The year 2015 was marked by a truce and a relative agreement by the parties to keep the CBY away from the ongoing conflict in light of its limited capabilities with the aim of preserving financial and economic stability, and giving priority to the people's interest. However, this reality did not last long, and signs of disagreement appeared soon. In mid-2016, interventions to steer financial and monetary policy to serve the interests of some parties emerged. Here the second phase began in conjunction with the imminent depletion of cash reserves, the liquidity crisis, the depreciation of the national currency, and the suspension of payment of public servants' wages and salaries.

The Yemeni government decided to move the CBY headquarters to the provisional capital, Aden, abiding by its right to run the central CBY office, since it is the most important sovereign institution of the state in the midst of opposition by the Houthi group. Soon after, division came to the surface. Economic and financial activity deteriorated as a result of those repercussions and the negative impacts of the still ongoing war.

These divisions were reflected in the living standards and economic well-being of the people, in light of the suspension of salaries, wages and the most important sources of income for millions of Yemenis. They also led to the stagnation of commercial activity and paralysis of the financial and banking sector.

Hence, it is imperative for all parties to reconsider those unilateral measures.

In this file, we will address the opportunities and challenges for the parties to reach a unification of the monetary policy in a way that contributes to preserving the remainder of the economic and financial structure in the country, and to spare the people the scourge of those consequences. There are possible opportunities for success once all parties show goodwill and determination to overcome the challenges that will face this process.

Functions and Tasks of the CBY and Monetary Policy

CBY is one of the sovereign institutions of the country, indeed the most important one. It plays a leading and key role in managing the monetary policy of the state and maintaining stable market rates and commodity prices through the application of a set of tools and means. Central banks usually determine those tools on the basis of the general economic objectives of the state.

Monetary policy is defined as “the measures taken by the state, represented by the central bank, to manage money and credit and regulate the liquidity required for the national economy in order to achieve certain objectives.”[i] The main tasks can be summarized as follows:

- Determining interest rates and national and foreign currency reserve ratios.
- Determining the quantity of the proper money supply, and the factors affecting it.
- Utilizing the open market policy to influence the supply and demand of foreign currency to serve price stability.
- Supervising the performance of banks, exchange enterprises, and financial institutions, in line with approved policies and procedures.
- Carrying out specific services to the government, lending money to it, depositing revenues, disbursing public expenditures according to its terms, issuing government bonds, and granting and managing credit.
- Issuing the currency (banknotes and coins) based on the needs of the economy in coordination with the fiscal policy and the government.
- Managing foreign currency reserves in coordination with the government.

CBY Monetary Policy Prior to Moving its Headquarters

Despite the state of confusion that prevailed during the first months of the war, the CBY continued to perform its duties, applying some policies and procedures in support of the banking sector to ensure non-interruption of provision of its services, and preserving market stability. The main contours of its performance are detailed below.

The bank adhered to pre-war interest indicators of (15%), and to the legal reserve ratios of national and foreign currency without any changes. It also took some measures to regulate withdrawal and circulation of foreign currency, and imposed some control measures on exchange companies, etc. Some of those measures succeeded while others failed.[ii]

The CBY facilitated the importation of fuel derivatives through the Yemeni Oil Company at the official exchange rate before the de facto authority announced floating the importation of fuel derivatives in July 2015 and opened the door for the private sector to import oil. The CBY had dedicated the sum of 970 million dollars for oil imports in 2015.[iii]

The decision to float oil imports had affected foreign exchange rates, as the exchange rate of 1 US dollar against the national currency rose to 303 rials in August 2016, compared to 215 rials in April 2015.[iv]

The CBY also facilitated basic commodity imports and provided foreign exchange to banks at the official price for the same purpose. Its total intervention reached 2.5 billion dollars[v] in 2015 before adopting the policy of 'substitution' and gradually diminished facilitating the import of food commodities through local banks until the list became ultimately restricted to five basic commodities.

The CBY continued to pay wages and salaries according to the general 2014 budget, which amounted to 75 billion rials per month, throughout the country until August 2016. A total number of 1.2 million employees employed in various sectors were paid, including employees of the Ministry of Defense. It got 244.6 billion rials printed during only one year.[vi] The total public expenditures amounted to 3,648 billion rials during the years 2015-2016, while public revenues amounted to only 2,086 billion rials. The deficit reached 1,562 billion rials and was covered by borrowing from the CBY (overdraft).[vii]

However, cash reserves soon began to run out in light of the interruption of oil and gas exports and the widening of the trade balance deficit, in conjunction with decrease in the volume of public revenues by 60%,[viii] compared to 2014 and the increase of levies outside the revenue channels of the state.

In early 2016, CBY governor warned the parties of the imminent depletion of foreign currency reserves, and the shortage of local currency liquidity. A crisis of confidence in the banking sector resulted. This crisis prompted many customers to withdraw their bank deposits. Subsequently, the banking sector faced a suffocating local currency liquidity crisis by mid-2016. The value of the Yemeni rial began to fall with the increasing demand for foreign currency purchases by individuals and companies alike for fear of the depreciation of the national currency.

In light of the endless interventions and their impact on the independence of CBY, the legitimate government accused the Houthi group of imposing an agenda and policies such as supporting the popular committees and the war effort and spending from government institutions accounts at the CBY. The sum of 1.8 billion dollars was withdrawn, according to the CBY governor statement in a press interview.[ix] In September 2016, the government took a decision to move the CBY headquarters to the provisional capital, Aden.[x]

CBY Monetary Policy After Moving its Headquarters

This stage coincided with the liquidity crisis in the banking sector, the decline of foreign exchange reserves, and the CBY suspension of facilitations of basic commodity and fuel imports, according to World Bank reports.[xi]

The Houthi group rejected the decision, prevented the transfer of some employees and managers to Aden, and seized everything that could be transferred to Aden. It also appointed new managers at all administrative levels of the bank, capping those changes with appointing a new CBY governor.

The CBY in Aden began exercising its functions independently despite the obstacles it faced at the beginning, such as the cash liquidity crisis, shortage of human resources, and lack of experience, in addition to material components such as systems and networking due to the continued control of the Houthi group in Sana'a of all these technical means.

Many of those obstacles were solved. Banknotes were printed in coordination with the government to cover the deficit in the money supply, and to re-facilitate payment of the wages and salaries of public servants. Wages were estimated according to the 2014 budget at about 200 million dollars, which is equivalent to 75 billion rials per month at an exchange rate of 375 rials to 1 US dollar. The wages of civil servants amounted to 48.7 billion rials per month, and 585 billion rials annually.[xii] Some public and operational expenditures of government institutions were also covered by the budget.

The bank adhered to all international standards and regulatory banking norms, obligated the banking sector to conform to regulations and laws to combat money laundering and financing of terrorism. It coordinated with international financial authorities and institutions in order to facilitate procedures for communicating and disposing of balances of the state’s cash reserves and running the banking sector. It managed to connect the SWIFT code and exchange codes with banks.

The CBY raised the interest rates on deposit certificates to 27%, but kept the cash reserve ratios unchanged. It employed the open market policy by interfering in the foreign exchange market, and regulating the supply and demand for it. It also issued government bonds and instruments.

In the wake of the move, the CBY also boosted the foreign currency reserve assets from various sources, the most important of which were exports of fuel derivatives at the minimum limits and Saudi deposits of 2 billion dollars.[xiii] This latter fund was allocated to cover the trade balance deficit, and to facilitate the import of basic commodities and fuel derivatives. Moreover, the bank also utilized some grants and aid. Over the last period, the bank governors persuaded the supporting bodies to transfer these funds via CBY and used the funds in paying the salaries of some military sectors, which were paid in Saudi Arabian Riyals. However, some of that money still passes through local banks that the Houthi group controls the decisions of their management in Sana'a.

At the same time, the corresponding and irresponsible measures of the CBY in Sana'a began to affect the monetary policy. The Houthi group sought to prevent the banks and exchange companies under its control from dealing with the CBY in Aden, taking repressive measures against the managements of those banks.[xiv] Those measures further complicated the scene and pushed the rial in a downward trend, causing it to hit an all times low of 800 + rials to one US dollar in September 2018.

In a short period of time, CBY governor was changed more than once. The Yemeni rial partly recovered against foreign currencies, recording an upward trend of 520 rials to one US dollar, compared to its all-time low of September 2018. Yet, it soon fell again after the legitimate government was forced by the so-called Southern Transitional Council (STC) to leave Aden by force of arms last April, which coincided with the irresponsible measures taken by the CBY in Sana'a.

The last of those most disastrous measures on the banking sector and society as a whole was the ban imposed by the Houthis on dealing in the newly printed banknotes in December 2019.[xv] This decision caused a second wave of depreciation of the national currency, bringing the exchange rate to 850 Rials to one US dollar as in September 2020, compared to 582 rials to one US dollar in December 2019.[xvi]

The extent of the various parties influence on the economic issue

The various parties enjoy some strengths in the economic file through which they can influence the political aspect and the course of the war in general. The most important of these factors can be identified in the following:

The De Facto Authority: (The Houthis)

The Houthi group practices blackmail by taking unilateral measures. It takes advantage of the size of the economic and commercial activity of the private sector concentrated in Sana'a, and the vital institutions controlled by the group such as telecommunications companies, head offices of major commercial companies and banks to impose the group's agenda, even if such measures are at the expense of the public interest.

Hodeidah ports still receive oil shipments and some major commodities, which constitutes a significant source of revenues to the Houthis. Revenues from imported oil shipments amounted to 12.8 billion rials during the period from August to November 2019, representing 40% of the total revenues through seaports and other ports.[xvii] The legitimate government had signed a UN-sponsored agreement with the Houthi group to deposit the revenues of the Hodeidah port into a special account at the CBY, Hodeidah branch, for the purpose of disbursing the deposited funds as wages and salaries of civil servants who had gone unpaid since late 2016.

The Houthi group seizes all public revenues in its areas of control, and imposes additional customs on all goods entering through its ports, specifically at the entrances to Sana'a. There are no accurate statistics on the size of the revenues obtained from these sources, but according to the estimated budget of the not-recognized salvation government for the year 2018, the volume of public revenues was 377 billion Rials.[xviii]

The Houthi group imposes repressive measures on the activity of the banking and economic sector. Those measures have reached the point of detaining and kidnapping some of the general managers of banks and their assistants, and closing exchange companies, as the management and head offices of the majority of local banks and exchange companies are still operating from Sana'a. The Houthi group forces chief executive officers of banks to sign undertakings that are unfair to the institutions they manage. Some institutions are even subjected to forced closure.[xix]

It is noteworthy that a large proportion of expatriate remittances and funds of some relief and humanitarian organizations received in foreign currency is mediated by these banks and companies. This allows the Houthi group to dispose of an important resource of foreign exchange by imposing its policies on these companies, financial networks and banks, and on their financial inter-governorate transfers.

The CBY in Sana'a is isolated from the outside world, and has no authority to correspond and exchange information and codes with foreign banks. The de facto authority in Sana'a does not have any sources or resources to boost its foreign currency reserves. The stability of exchange rates in Houthi-dominated areas is a byproduct of the scarcity of cash liquidity and low purchasing power due to the group's refusal to pay salaries and wages since August 2016.

The Houthi group resorted to imposing a ban on dealing in the newly printed banknotes in order to create an exchange rate difference between the North and the South. The aim is to prove to the international community that it has influence and strengths in the economic file, even if that comes at the expense of millions of affected people. The Houthi group does not care about the consequences, and employs suffering as a collective punishment.

The Legitimate Government

The legitimate government has great strengths and capabilities to influence the economic aspect positively in the event that these capabilities are exploited away from the pressures that are exerted on it. It has the capacity to control the monetary and financial policy even if the CBY in Sana'a continues to intervene.

The legitimate government controls large areas of the country, estimated at 80%, including the areas and sources of oil and gas, which constituted 70% of the state's public revenues during the pre-war period. If production and export are resumed, oil and gas will constitute significant additional resources for the government, noting that the total production of those oil fields reached 17.5 million barrels in 2019, which is much less than the volume of production in the pre-war period.[xx]

The legitimate government controls the gas facilities of Safer, which supplies all governorates, including those that are still under the control of the Houthi group, with gas derivatives, and household gas. Oil and gas derivatives account for the largest proportion of the local and foreign currency money supply.

The government collects customs and tax revenues in the areas under its control, except for the areas that fall under the control of the so-called Transitional Council, which announced the autonomous administration of those areas in April 2020. It also controls all revenues of those areas, the most important of which is the seaport and airport of Aden. Those customs and other revenues are deposited to private bank accounts at local banks, rather than to government accounts at the CBY.

According to the estimated budget of 2019, the volume of public revenues was estimated at 2,159 billion rials, while expenditures were estimated at 3,111 billion rials with a 30% deficit.[xxi] The legitimate government paid the salaries and wages of public employees in most governorates through the CBY, in addition to paying some operating expenses of government institutions in the capital, Aden and the governorates under its control.

The CBY in Aden regulates the operation of the banking sector. Some banks the head offices of which are based in Aden and money exchange companies are subjected to its supervision. These companies and networks are less in number than those based in Sana'a. The government-controlled areas witnessed a significant commercial and banking activity, compared to the previous period before the moving the CBY headquarters to Aden.

The Saudi-led Arab Coalition

The Coalition possesses a military, political, and economic decision in the country and controls many developments, particularly in the economic aspect as it militarily controls the most important oil production area and export ports. It is accused of thwarting the government's efforts to benefit from the public revenues of those areas. One of the Yemeni President’s advisers has recently accused the coalition of obstructing the resumption of the production and export of oil, disrupting state resources, and supporting armed groups that do not recognize the legitimate government and are outside of its control.[xxii]

The Coalition also possesses great capacities to support the economic aspect, especially in the midst of international community circles, with regard to humanitarian aid and donor conferences that it mobilizes almost annually, in addition to its ability to support an early reconstruction process and depositing foreign currency funds at the CBY. The estimated volume of aid obtained through donor conferences during the war period is 5.05 billion dollars.[xxiii]

Opportunities of and Challenges to Successful Unification of Monetary Policy

Through the previous data, the size of control and the influence of the parties on the economic and banking file, in addition to the data of the current economic situation, it can be said that there are some opportunities of success for the unification of the monetary policy. On the other hand, there are major challenges that require the various parties to make concessions to overcome.

Opportunities of Success

Opportunities from a technical point of view, based on the nature of the functions of the monetary policy of central banks, are as follows:

- There are some monetary policy tools that can be implemented by a unified management, such as interest rates, legal limit of national and foreign exchange reserves, the volume of credit, and deposits of various types.
- Supervising and controlling the performance of banks and exchange companies from an administrative point of view, and issuing licenses to them. These may not constitute essential points of contention and will have positive impact on maintaining the stability of the exchange rates and commodity prices. A joint mechanism can be worked out for the implementation of these points.
- The open market policy and intervention in regulating the foreign exchange supply and demand in the from of market interactions may be used provided that there is full coordination with the banking sector to unify the channels of foreign exchange sources through one company that brings together banks and exchange companies. Inbound remittances, humanitarian aid flows and grants shall be supervised by the unified management of the bank.
- The money supply and the volume of cash liquidity required for the smooth functioning of the economic activity in the country may be managed by the unified administration through the branches of the CBY in the governorates.
- The public debt policy can be restricted to financing the wages and salaries section if necessary, provided that the costs of paying and servicing it are charged from the private resources that the parties will agree upon to finance that section, after the public debt service costs for the previous period are settled.

Other Opportunities

- The desire of the parties to settle this issue - even if it has not yet high - in order to escape from the internal pressures of popular, societal and international discontent with the catastrophic humanitarian crisis in Yemen. The Saudi-led Coalition is facing major criticism in the international human rights community as a result.
- The relative importance of the economic file which is evidenced by its introduction in the Stockholm negotiations in December 2018 between the two sides, and the subsequent meetings that ensued and reaching understandings such as an agreement

on the revenues of Hodeiah ports.[xxiv]

- The two parties possess sufficient resources to pay the wages and salaries for the civil sector. This can be the starting point of the solution as much as it is also a major challenge to unifying the monetary policy, due to its connection to the general revenues of the parties, as the parties can finance it at certain rates determined through negotiations.
- The success of the Riyadh negotiations between the government and the STC may represent a catalyst in unifying the internal front of the government and strengthening its position in order to pressurize the Houthi group to accept the unification of the monetary policy.

Challenges

On the other hand, there are some challenges that may hinder the agreement, including the following:

- The monetary policy is linked to the overall objectives of the state and overlaps with the fiscal policy in many factors that contribute to its success. In light of the complete division in the financial policy between the parties, chances of unifying monetary policy will not be easy.

The political file represents a major challenge as it is interlocked with the economic file, especially since the STC continues to confuse the government in the south, while the Saudi-led Arab coalition is busy forming a government fitting its own requirements. In the meanwhile, the Houthi group pursues its unilateral financial measures that deepen the division and exacerbate the existing humanitarian crisis to achieve some advantages on the political aspect. The success of unification of monetary policy in light of this disparity of goals may not be reached.

The failure of the Riyadh Accords will be a major challenge to unifying the monetary policy. The internal government front will continue to be divided, and hence the difficulty of reaching understanding in light of the presence of a third party that assumes its powers in the capital, Aden.

There is a greater challenge represented by the sources of the cash reserves, as it is the most important factor affecting the success of CBY objectives of achieving stability of prices and preserving the value of the local currency.

Conclusion

By analyzing the reality of the monetary policy before and after moving CBY headquarters to Aden, it can be said that the legitimate government saved the CBY by moving its head office to Aden. The Houthi group had no capabilities to keep the bank activities uninterrupted such as cash liquidity, foreign exchange reserves, and the confidence of financial institutions. It found solutions to most of those problems.

However, the government performance soon relapsed after entering into conflict with the so-called Transitional Council, the coup it orchestrated against the government and its control of public institutions in the provisional capital of Aden, which led to the disruption of CBY functions.

The Houthi group took this retrogression as an opportunity to impose its policies and agenda in the economic and financial aspect and pressurize the government through a series of measures in the banking sector that deepened the division, harmed the sector, and exacerbated the suffering of the people.

In light of this overlap between the parties' files and agendas, the existing opportunities and challenges, the size of control and the forces of influence on the economic file of each party, we can summarize the possibilities of success and failure of unifying monetary policy under one management in the following potential scenarios:

Scenario # 1: failure to reach a unified management as the current situation is comfortable for the Houthi group in the near future at least. The Houthis will impose conditions for negotiations that may affect the sovereignty of the government, which will reject those conditions. Thus, the state of division will continue along with the measures that harm the economic and banking sector. The national currency will depreciate further. This state of affairs will not serve the interests of any party. Moreover, it will deepen the humanitarian crisis, and expose the economy to the risk of total collapse.

Scenario # 2: a unified management of monetary policy either through negotiations with the Houthi group, or the imposition of a successful monetary policy that nullifies the effectiveness of the Houthi group’s actions. Yet, this depends on the success of the Riyadh negotiations and the formation of a government operating from the capital, Aden, that supports the independence of the CBY and strengthens its foreign currency reserves, and activates monetary policy tools. This scenario may be the most likely to take place by virtue of its popularity at present.

Scenario # 3: reaching partial understanding or a truce in this file that mitigates its negative impact, as the various parties will be obliged to make concessions under popular pressure, and the pressure of the various components of the private sector, the international community and the countries sponsoring the Yemeni file. However, this will occur only after the economy and the Yemeni people have paid the price for these divisions. As a result of the unremitting depreciation of the national currency and the decline of economic activity.

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[ii] *CBY Annual Report,* 2015
[iii] *Ibid.*
[iv] *Bulletin of Economic Developments,* Ministry of Planning and International Cooperation, 2018, No.34
[v] *CBY Annual Report, 2015*
[vi] *Bulletin of Economic Developments,* Ministry of Planning and International Cooperation, No.34, 2018
[vii] Studies and Economic Media Center, *Economic Indicators,* 2018
[viii] *Bulletin of Economic Developments,* Ministry of Planning and International Cooperation, No.34, 2018
[ix] The Press Conference of the CBY Governor, Munassar al-Qua’iti, as quoted in *Al-Sharq Al-Awsat* newspaper, September 20, 2016
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[xi] *Yemen: Economic Outlook report,* The World Bank Spring, 2016
[xii] Khaled Al-Abadi, CBY Deputy governor, *Al-Sharq Al-Awsat* Newspaper, No. 14214, October 28, 2017
[xiii] Mohammad Zimam, Governor of the CBY, *Al-Sharq Al-Awsat* Newspaper, No. 14647, January 4, 2019
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[xv] Statement by the CBY of Sana'a, December 19, 2019
[xvi] *Economic Developments Bulletin,* Studies and Economic Media Center, September 2020
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[xviii] *Economic Indicators,* Studies and Economic Media Center, 2018
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[xxiii] *Economic Developments Bulletin,* Studies and Economic Media Center, September 2020
[xxiv] Yemeni government statement, Saba News Agency, (@sabanew_), October 14, 2019