

Potential Impacts of the Banking Sector Crisis on Household Vulnerability to Food Insecurity in Yemen



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Main Highlights

- **The various directives issued by the Central Banks in Aden and Sana'a, resulting in notable disruptions in the financial and banking sectors, pose a substantial risk of heightened food insecurity and hunger for the average Yemeni population:** the economic and financial fallout of the measures between the Government of Yemen (GoY) and Sanaa Based Authorities (SBA) peaked in May 2024 after both issued reactive regulatory measures to financial sector actors.
- **Accelerated local currency depreciation:** in the last one year leading up to June 2024, the YER in the GoY areas lost value against the US Dollar (US\$) by *38 percent*, equivalent to an average monthly depreciation of 3 percent. The YER is projected to depreciate further at much faster rate in GoY areas, *at least by 5 percent per month* over the next four months. The trajectory of the YER in SBA areas remains uncertain in the short-term owing to tight exchange rate controls.
- **Increased risk of food, and fuel prices and anticipated decline in imports:** The Minimum Food Basket (MFB) is projected to reach between US\$87 and US\$107 in August 2024, increasing by a minimum of 6 percent in GoY areas at a time when casual labour rates are not expected to grow in tandem with increased minimum cost of living. Similarly, the projected currency depreciation in GoY areas poses a heightened risk of diesel price hikes. Consequently, this is expected to lead to an increase in food prices due to transportation costs, representing approximately *30 percent of food inflation*. The food and fuel price risks in SBA areas remain unpredictable because of economically unresponsive price controls but the inflation risks linger. This comes at a time when humanitarian assistance has decreased. In addition, the inability of traders and importers to access adequate dollars, transfer funds, and secure credit lines, combined with currency depreciation and increased transaction costs, is anticipated to decelerate commercial import flows, impacting Southern Ports disproportionately.
- **Internal and external remittance flows to slow down:** remittances, which exceed US\$4.2 billion per year, play an important role in meeting food needs of millions of people in Yemen, translating equivalent to US\$270 on average monthly per household of the estimated [27 percent](#) of the population receiving remittance. The financial sector disruptions are expected to worsen the already declining domestic and external remittance flows since 2022, resulting in accelerated currency depreciation, widened import financing gap and worsened household food insecurity.
- **Deepening economic downturn:** the ensuing financial sector crisis is expected to further impede Yemen's economy amidst a delayed peace settlement. [IMF](#) had projected a negative growth for the second consecutive year in 2024. The deepening economic crisis has the potential to adversely affect economic and trade activities, increase unemployment rates, and reduce household incomes.
- **In Yemen, the reliance on essential food items from the market is substantial, and households allocating more than 65% of their income to food expenses.** With a [significant percentage of the population \(82%\)](#) living in multidimensional poverty, highly dependent on market resources, coupled with a consistent decline in real income, families are increasingly at risk due to *the currency crisis, depreciating YER, and subsequently rising food costs*. The situation leaves them susceptible to economic and market instabilities and many households are turning to food borrowing and aid for support. This dependency may hinder their financial recovery, worsen their nutritional status, and deepen their poverty.
- **A combination of mitigating and preventive actions is essential in managing the current banking/financial crisis and reducing its potential negative consequences:** The heightened vulnerability underscores the urgent need for humanitarian and development assistance to address the growing food insecurity among households in Yemen. Furthermore, fostering negotiation and dialogue among conflicting parties to establish mutual understanding and agreements is crucial. International mediation and support for financial institutions can assist in stabilizing the financial sector and ensuring the efficient delivery of essential services to meet basic needs and safeguard vulnerable communities.

Background

The banking and financial crisis in Yemen is dire and is poised to have profound impacts on the nation's economic and social landscape. If left unresolved, it has the potential to reignite conflicts after a period of relative calm following the official truce expiration and exacerbate food insecurity. The current crisis originated in 2015, as depicted in the timeline graphics below when the De Facto Authorities (DFA)/SBA froze commercial bank assets, primarily Treasury Bills in CBY Sana'a, amounting to approximately YER 1.78 trillion. Subsequently, in September 2016, the Government of Yemen (GoY) made the decision to relocate the Central Bank of Yemen (CBY) from Sana'a to Aden, resulting in the establishment of two conflicting central banks—one in Sana'a and the other in Aden.

An important development was the March 2023 enactment of the DFA law prohibiting Usurious Transactions, which significantly impacted IBY Bank as depositors began to withdraw their funds, drying up liquidity and interest rates on deposits.

Following a series of Red Sea attacks since November 2023, the United States unilaterally imposed sanctions on Ansar Allah (AA) on January 17, 2024, which took effect 30 days later. This has led to the disruption or cessation of numerous international transactions in regions where these sanctions apply, potentially impacting the economy and financial activities in SBA areas. It is crucial to recognize the interconnected nature of military, political, and economic challenges in the country. The economic pressures are likely to influence the dynamics of the conflict in Yemen.

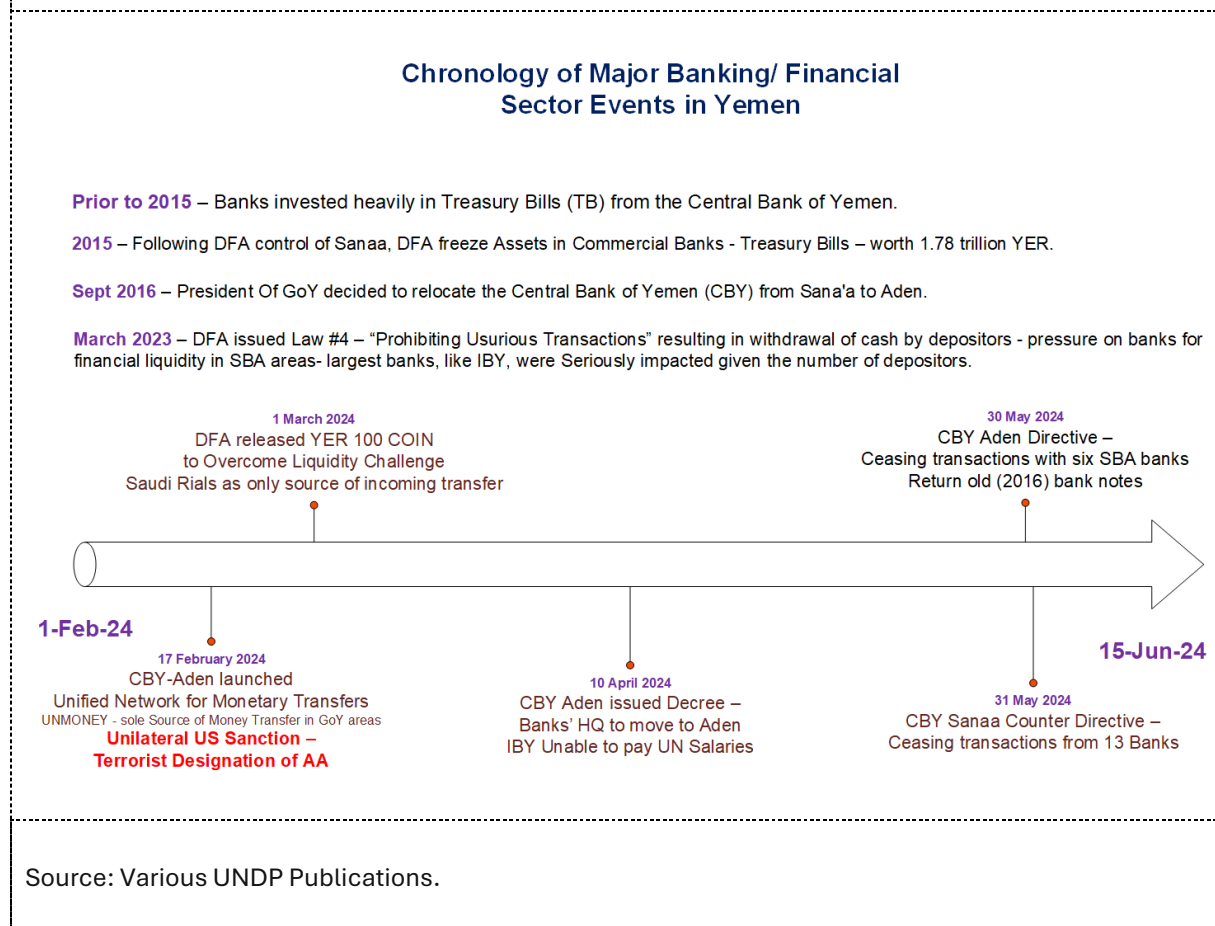
In February 2024, tensions heightened with the launch of a new network, the Unified Network for Monetary Transfers (UNMONEY), by CBY-Aden as the exclusive money transfer platform in government-controlled areas. In response, CBY-Sana'a prohibited exchange houses and local money transfer networks in SBA areas from engaging with UNMONEY.

The situation escalated in March 2024 as the SBA introduced YER 100 coins to replace the outdated and barely functional YER 100 banknotes. Additionally, it required money transfer agents not to dispense US dollars for incoming transfers or remittances irrespective of the original currency. In April 2024, CBY-Aden worsened the crisis by directing all commercial, Islamic, and microfinance banks to transfer their headquarters to Aden. Non-compliance with this directive would potentially impact their ability to utilize SWIFT for foreign transactions with correspondent banks.

In May 2024, CBY Aden issued a directive requesting six major banks to cease operations in SBA-controlled areas and instructed the public to return old currency notes printed before 2016 to the CBY Aden. Following suit, major money transfer companies like MoneyGram and Al Rajhi Bank (KSA) issued compliance statements, with Western Union also preparing to comply. The most recent action occurred when CBY Sanaa banned thirteen financial and non-financial institutions on May 31st, 2024, from conducting transactions in SBA-controlled areas.

These escalations occur against a backdrop of dwindling foreign currency reserves in Yemen due to decreased earnings from oil exports. This has triggered public anxiety and significantly disrupted the financial, banking, and money transfer sectors in the country. Customers, traders, importers, and UN contractors are facing challenges in accessing their funds held in sanctioned banks, causing disruptions in remittance pathways, and resulting in a severe shortage of US dollars.

Figure A: Timeline of major financial sector events in Yemen

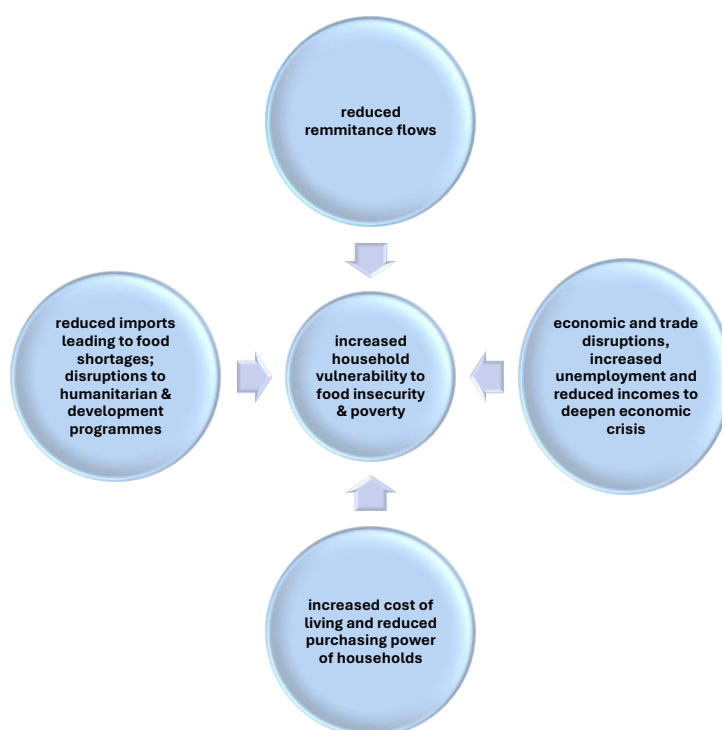


This paper posits that these actions will not only disrupt livelihoods but also aggravate vulnerability to food insecurity among the ordinary Yemeni people by diminishing household purchasing power. The continued dollar shortage, currency depreciation and repercussions of the banking and financial sector disruptions are anticipated to lead to the following outcomes:

- i. Currency depreciation and destabilization.
- ii. Increased food prices and hence escalated cost of living
- iii. Reduced imports and shortages of goods as businesses encounter challenges in obtaining dollars for international transactions and payments to suppliers.
- iv. Reduced remittance flows
- v. Disruption of humanitarian and development programmes
- vi. General economic disruptions causing a decline in economic activity, a rise in unemployment, and decrease in household incomes.
- vii. Increased household vulnerability to food insecurity

These impact pathways are illustrated in Figure B below.

Figure B. Potential impacts of the banking crisis on household vulnerability to food insecurity in Yemen.



Currency depreciation risks

The exchange rate between the YER and the US Dollar has remained relatively stable in the SBA areas since June 2022 due to stringent exchange rate controls. However, in GoY controlled areas the YER has been steadily depreciating over the same period due to diminished foreign exchange earnings following stoppage of oil exports. In the last one year leading up to June 2024, the YER in the GoY areas lost value against the USD by 38 percent, equivalent to an average monthly depreciation of more than 3 percent.

Given the current circumstances and in the absence of a quick resolution to the economic measures, which is unlikely based on historical trends, it is anticipated a more rapid depreciation of the YER in GoY areas, projected to be at least by 5 percent monthly over the next four months. Consequently, three currency depreciation scenarios are established (5%- most likely, 7.5% and 10%- worst case) and assess their potential impacts on the Minimum Food Basket. The YER in SBA areas is however projected to remain generally unchanged because of controls although currency risks are high and unpredictable.

Risk of increased cost of living and reduced household purchasing power

In contrast to the SBA areas where exchange rate and food prices are strictly regulated and do not align to market dynamics, basic food prices in GoY areas, are to a large extent, determined by exchange rate fluctuations, as most foods are imported (Figure 1 & 2). While domestic food prices in Yemen have historically shown a strong correlation with global food prices and exchange rates (refer to Figure 2), recent evidence from mid last one year (2023) indicates a rise in domestic food prices

even when global food prices were declining, underscoring the growing impact of exchange rate shifts on food price fluctuations (Figure 3). This trend is particularly significant considering that Yemen normally imports over 90 percent of its annual food needs, this ratio has increased since the onset of conflict in 2015 with local wheat production declining.

There is, therefore, a very strong and significant positive correlation between exchange rates and food prices, with 87 percent of the variation in MFB in GoY areas on average being determined by the exchange rate changes. A simple regression analysis has shown that depreciation of the YER by one unit in GoY areas corresponds to 102 unit rise in the average cost of the MFB in the same areas. The assumption is that as the YER depreciates, traders automatically adjust their selling prices in local currency for future imports. The IMF's, [empirical econometric analysis](#) revealed that international food prices and domestic factors, such as variations in money supply and demand (exchange rate) increasingly impact food prices in Yemen. The estimated MFB in GoY controlled areas under the three scenarios are presented in Table 1 below:

Table 1: Depreciation scenarios

Scenarios	MFB monthly increase in GoY areas
Scenario 1: 5 percent (most likely)	6%
Scenario 2: 7.5 percent	10%
Scenario 3: 10 percent (worst case)	13%

In the most likely scenario (5 percent monthly depreciation), the monthly MFB increase is anticipated to be 6 percent in GoY areas. In the worst-case scenario (10 percent depreciation), the MFB is expected increase in GoY by 13 percent.

Fig. 1: Long-run co-movement between exchange rate & MFB in GoY areas

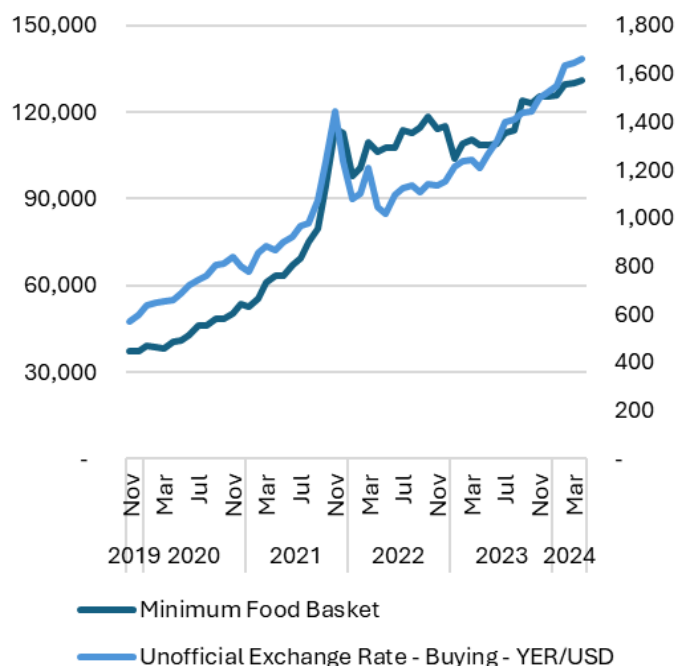
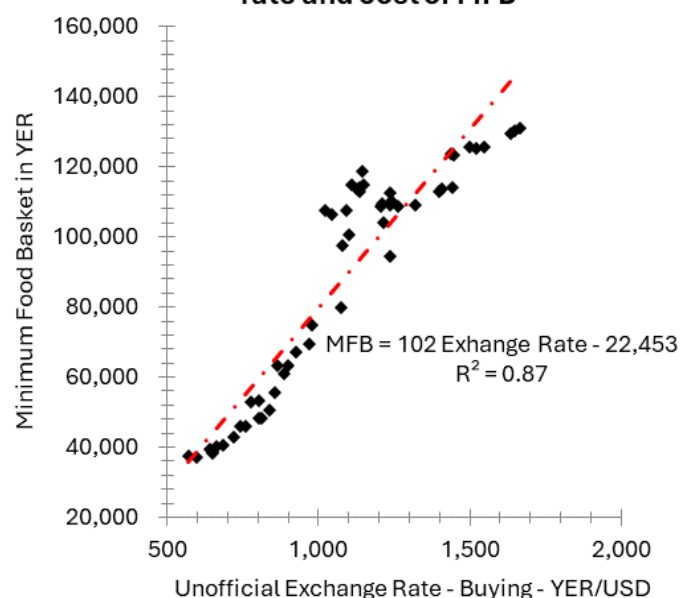


Fig. 2: Relationship between exchange rate and cost of MFB



The projected MFB over the next four months under these different scenarios are adjusted after applying triple exponential smoothing forecasting as presented in Figure 4. Had it not been for the current currency shock, MFB would have mostly likely reached 137,500 YER by August 2024 in GoY areas. However, with a 5 percent YER depreciation, MFB is forecasted to most likely reach 144,483 YER in GoY areas and in the worst case scenario (10 percent currency depreciation), the MFB is projected to hit 159,103 in GoY areas. The MFB is expected to remain relatively stable or increase slightly in SBA areas in line with previous trends because of punitive price controls that do not reflect the real economic fundamental changes. It is, however, still unclear on the likely ramifications on food prices in SBA areas as this will depend on how effectively price controls are enforced even though the prospects of widespread commodity hoarding, traders collusion and incrsaed food prices remain high.

The expected rise in MFB is likely to further diminish the purchasing power of most Yemeni households, leading to constraints in accessing essential food and non-food items in the markets and exacerbating food insecurity.

Fig. 3: Long-run co-movement between global and domestic (GoY) food prices

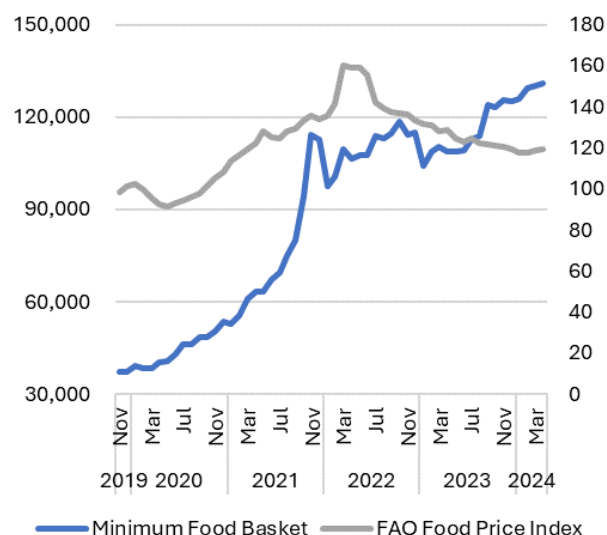


Fig. 4: MFB historic and projected trends

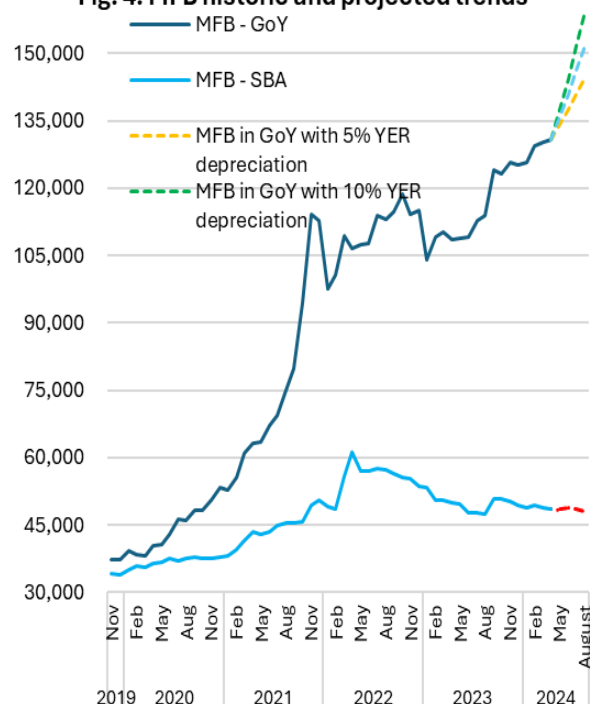
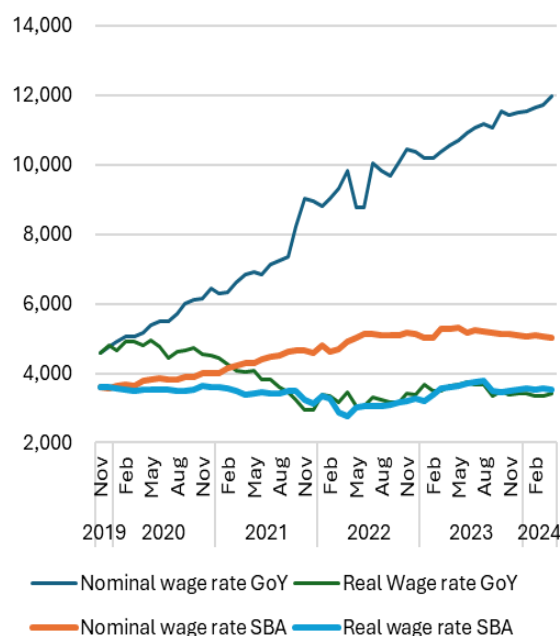


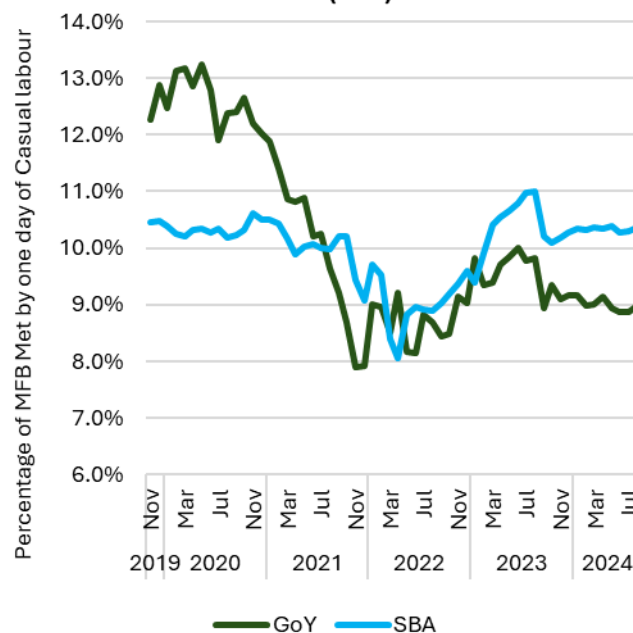
Fig. 5: Nominal and Real Casual Labour Wage Rates- GoY



This comes at a time when most families are not able to generate sufficient income to feed their families due to a general economic downturn following nearly 10 years of conflict. Employment and livelihood opportunities are limited, especially with irregular payment of civil servants' salaries in GoY areas and complete non-payment in SBA areas. Furthermore, the real daily wages earned from agricultural, and off-farm casual jobs have declined since November 2019 (see figures 4 & 5) and are not expected to keep pace with increase in the MFB.

Accordingly, and given the ever-rising cost of the MFB and stable or decreasing availability of casual labour, the terms of trade (purchasing power) for casual wage earners are predicted to slightly drop between April and August 2024 in both SBA and GoY areas (see figure 6).

Fig. 6: Casual Labour to MFB Terms of Trade (ToT)



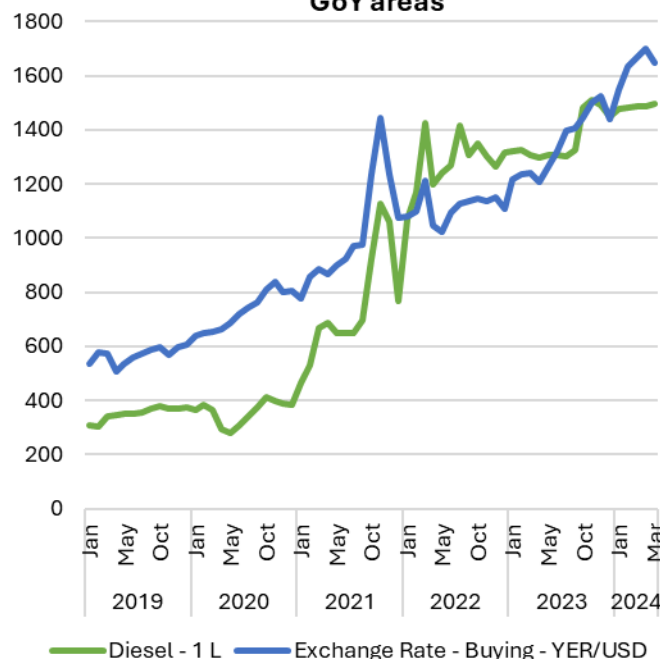
Risk of increased fuel prices and cost of transportation

Similar to food prices, there is a strong positive co-movement between exchange rate and diesel prices in GoY areas (as depicted in Figure 7). The projected currency depreciation in GoY areas poses a heightened risk of diesel price hikes. Consequently, this is expected to lead to an increase in food prices due to higher transportation costs, representing approximately 30 percent of food inflation.

Risk of reduced food and fuel imports leading to commodity shortages in the markets

Traders and importers are already facing serious challenges in obtaining adequate dollars, transfer money and establish secure credit lines. Currency depreciation coupled with increased marine insurance costs due to the ongoing Red Sea crisis are not only inflating transaction costs and imports bills but also diminishing the overall availability of hard US dollars for traders, all disincentives for imports.

Fig. 7: Exchange rate and diesel prices in GoY areas

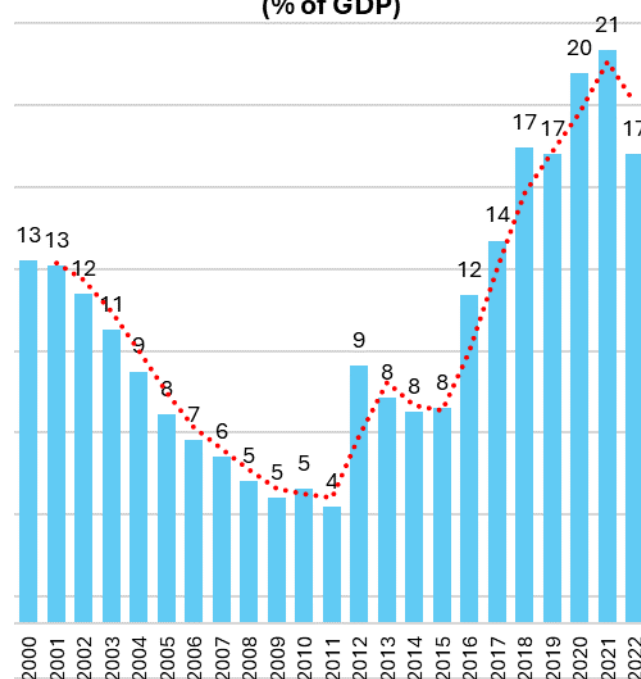


Despite Yemen's imports maintaining a degree of relative stability since the onset of the Red Sea disruptions in November 2023, there are increasing risks that prolonged dollar shortage could lead to the reduction in the volume of commercial food and fuel imports and potentially result in food shortages and consequently lead to increased food prices. The reduction in imports is expected to be notably more pronounced in Southern Ports, which have witnessed a decrease over the past year compared to Northern Ports.

Risk of reduced remittance flows

Of significant concern is the impact on cash transfers in SBA areas, home to more than two-thirds of the Yemeni population. The majority of the population in these regions heavily rely on remittances, with 64% originating from KSA and the remaining 36% from other countries, totaling approximately US\$ 4.2 billion in 2022. According to [ACAPS](#), remittances have emerged as principal source of foreign currency supporting import financing and strengthening balance of payments. This has been particularly crucial due to dwindling earnings from oil exports and depleted foreign currency reserves since 2022. At the household level, remittances are a key lifeline for millions of Yemenis, covering basic food and non-food requirements and helping alleviate food insecurity. [World Bank](#) posits that domestic and external private remittances remain critical for household living standards in the country, reaching 27 percent of the population and equaling 27 percent of recipients' living standards.

Figure 8: Personal remittances, received (% of GDP)



As depicted by Figure 8, remittance flows to Yemen increased from 2016 after the conflict began until 2021 only with a slight decline in 2019 due to the impacts of COVID-19. However, these flows have since resumed a decreasing trend since 2022. The recent banking/financial sector disruptions such as bank closures, restrictions on money transfers, possible severance of SWIFT connection with Sana'a headquartered banks/ isolation from global financial system, SBA ban on dollars, and expected currency depreciation are all deterrents for remittance transfers. These factors are likely to exacerbate the existing decline in remittance flows to Yemen, leading to accelerated currency depreciation, a widened gap in import financing, increased household food insecurity, and additional strain on the economy.

Risk of deepening the economic crisis

As per [UNDP analysis](#), the banking system is anticipated to face escalating dysfunctionality, with numerous banks teetering on the brink of insolvency due to the unstable economic climate, liquidity shortages, and challenges in accessing international financial markets. This situation will lead to a

heightened constraint on access to banking services, preventing many Yemenis from reaching their savings, engaging in transactions, or securing credit, thereby further impeding economic activities.

Previously, [IMF](#) had projected that Yemen's fragile economy was poised for negative growth for the second consecutive year, with a 1 percent real GDP decrease expected for 2024. The economic forecast suggests a gloomy outlook, with further deterioration anticipated due to delayed peace agreements, elevated domestic prices, ongoing financial regulations, and rising Red Sea tensions. These factors have the potential to negatively impact economic and trade activities, leading to increased unemployment, reduced household incomes, weakened purchasing power, and restricted food access for a large segment of the Yemeni population. The IMF's [2024 Yemen Economic Outlook](#) warned that additional disruptions to essential imports, remittances, and livelihoods could exacerbate the nation's socio-economic challenges.

Risk of increased household vulnerability to food insecurity and deepening poverty

The compounding impacts of ongoing banking/ financial disruptions are expected to increase household's vulnerability to food insecurity and increase humanitarian food needs and disproportionately impact the impoverished. In the face of escalating poverty levels, with a [significant percentage of the population \(82%\)](#) living in multidimensional poverty due to years of conflict that have ravaged the economy, displaced millions, destroyed livelihoods, public infrastructure and markets, and reduced employment opportunities, the current crisis is projected to push more people below the poverty threshold. The unfolding crisis follows a recent [World Bank report](#) that placed Yemen among the poorest 15 percent of countries globally.

In Yemen, majority of the households depend on markets as the main source of staple food, as evidenced by the recent food security assessments (Figure 9 & 10), particularly disproportionately higher in GoY areas compared to SBA areas. With decreased incomes, most households resorted to extensive and high level of borrowing to access food across the country, comprising their potential future ability to recover from indebtedness. Given the ongoing crisis aligning with significant decline in humanitarian assistance in the country, especially of in SBA areas, households' reliance on markets-based food borrowing is likely to increase further.

Figure 9: Sources of staple cereal, GoY controlled governorates

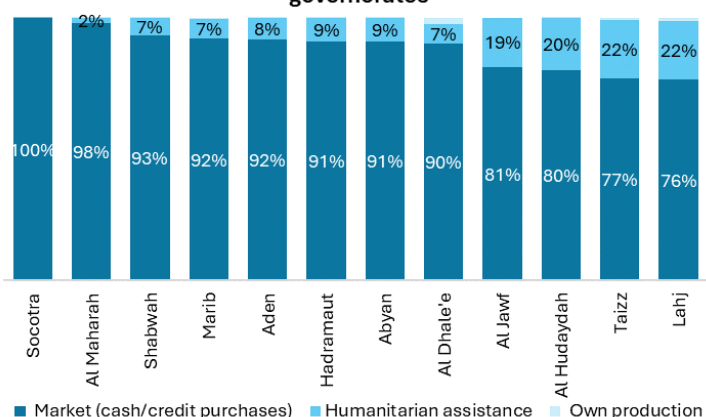
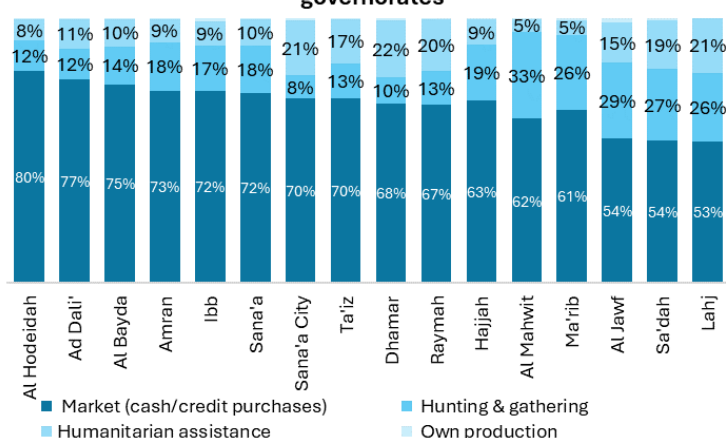


Figure 10: Sources of staple cereal, SBA controlled governorates



Households that allocate significant portion of their income towards food, as high (65-75%) and very high (>75%) are vulnerable to economic and market shocks such as the ongoing currency crisis and depreciation of the YER and resultant food prices. In areas under GoY control, such as Socotra and Al Jawf Governorates, overall half of the population expends a large share of their income on food (>65%), a trend also the same in SBA areas, like Sa'adah, Al Jawf and Raymah governorates. Moreover, in most Governorates like Lahj, Hodeidah, Hajah, Marib, Taiz Al Mawhit, nearly or more than 4 in 10 households have high and very high expenditures on food (See figures 11 & 12).

Consequently, the looming MFB pressures are expected to reduce households' ability to access food through markets and increase their vulnerability to food insecurity. This scenario is exacerbated by the fact that during emergencies, such as this, higher portions of constrained household budgets are channeled towards food purchases, further diminishing their ability to access food, and decreasing their capacity to afford nutritious diet and plunging them into poverty.

Figure 11: Food Expenditure Share/FES (%), GoY controlled governorates

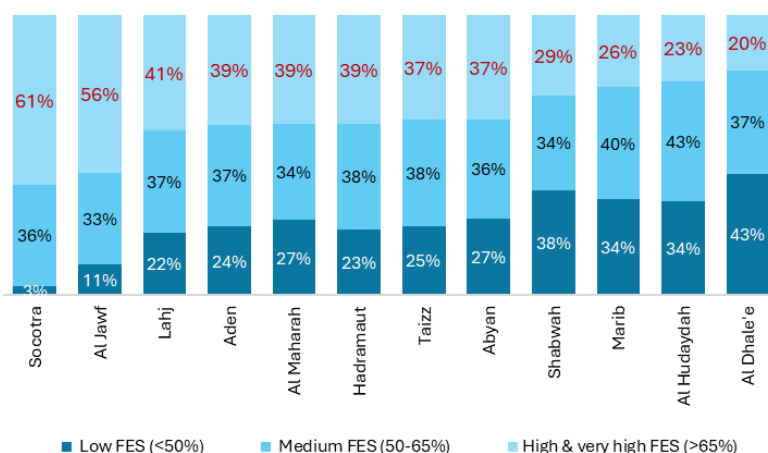
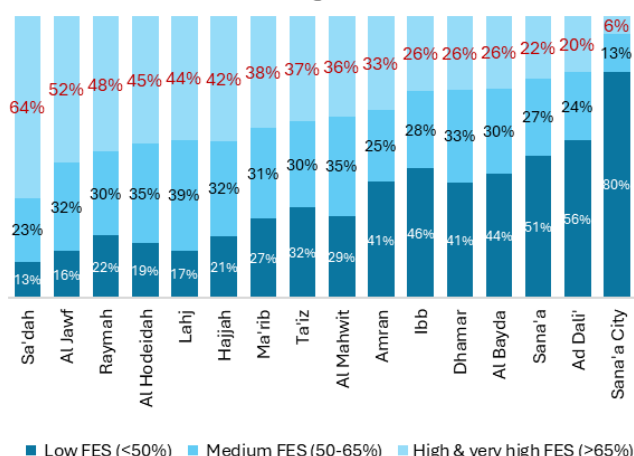


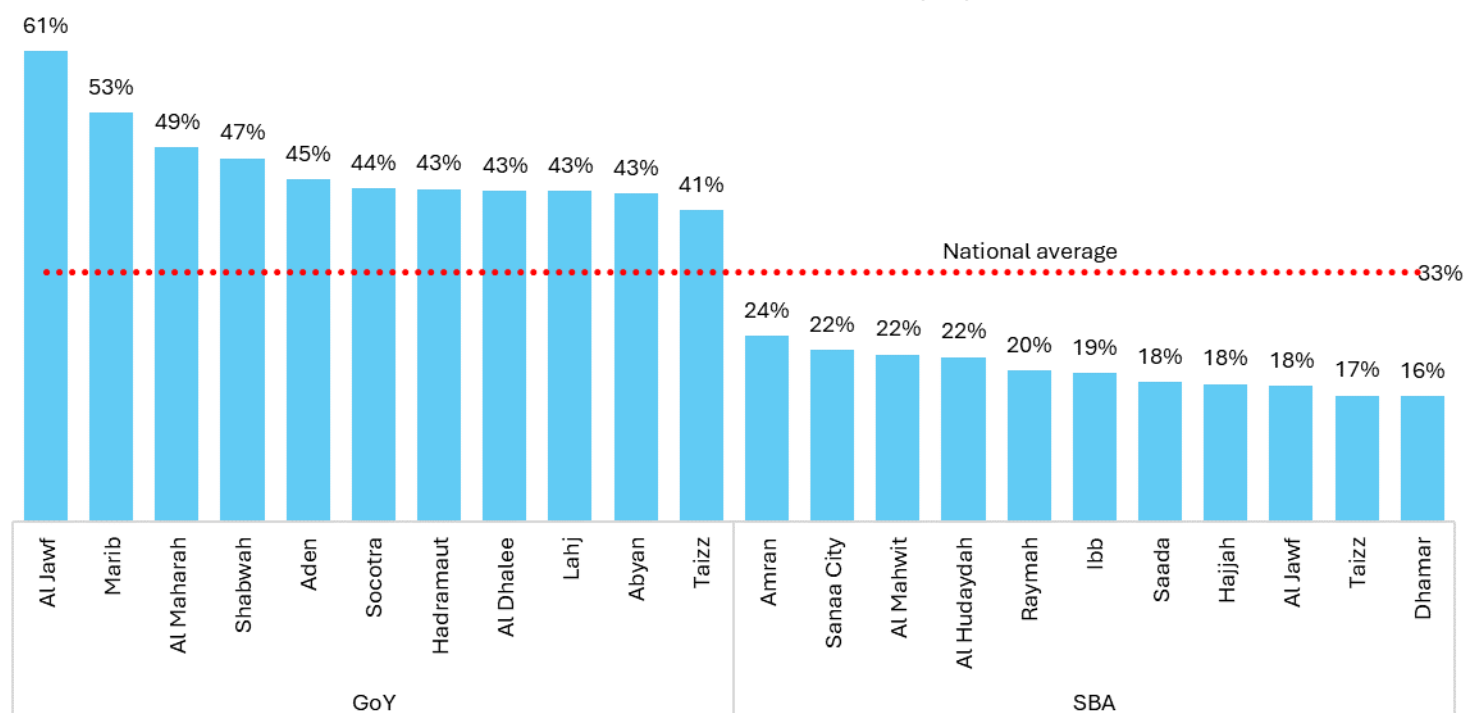
Figure 12: Food Expenditure Share/FES (%), SBA controlled governorates



Moreover, the volatile and unstable food prices in the GoY controlled areas (see Figure 13¹) limits the ability to foresee market dynamics, creating a sense of ambiguity and heightens uncertainty among market players including cash transfer safety nets. Consequently, this leads to persistent upward trend in food prices, detrimentally impacting the purchasing power of impoverished households. A vast majority of the Yemeni population will therefore be affected by the current crisis given very high poverty levels and depleted livelihood assets and exhausted coping capacities after nearly ten years of conflict. As a result, an increased number of households are anticipated to requiring humanitarian food assistance, at a time when donor funding for Yemen Humanitarian Response has been dwindling.

¹ The coefficient of variation is a measure of dispersion of data points around the mean in a series. The higher the coefficient of variation, the greater the level of dispersion around the mean. It is generally expressed as a percentage.

Fig. 13: Coefficient of Variation (CV)



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