March 2005
IMF Country Report No. 05/111

Republic of Yemen: 2004 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Yemen

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with the Republic of Yemen, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 15, 2004, with the officials of the Republic of Yemen on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 28, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 14, 2005 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for the Republic of Yemen.

The document listed below have been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF YEMEN

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for the 2004 Consultation
with the Republic of Yemen

Approved by Lorenzo Pérez and Martin Fetherston

February 28, 2005

The 2004 Article IV consultation discussions were held in Sana'a from December 1 to 15, 2004. The mission met with the ministers of finance, planning and development, oil and mineral resources, civil service, labor and social affairs, and electricity, the governor of the central bank, and other government officials. The mission also met with managers of several oil companies in Yemen as well as with heads of commercial banks, representatives of the labor unions, and donors.

The staff team comprised Messrs. Chami (head), Ben Ltaifa, Abdih, Ms. Ivanova, and Ms. Kargbo (all MCD), Ms. Jacobs (FAD), and Mr. Ahmed (PDR). The mission was assisted by Mr. Benon, the Middle East Technical Assistance Center (METAC) revenue administration advisor, who joined the mission for about one week.

At the conclusion of the 2003 Article IV consultation, Directors noted that while short- and medium-term fiscal and external sector positions are likely to remain manageable, strong reforms will be needed to deal with long-term challenges. Directors welcomed the authorities' reform package announced in October 2003 as a first step toward ensuring long-term sustainability. They expressed concern, however, about the re-emergence of inflation and recommended some tightening of monetary policy.

The last Fund arrangements (supported by the Poverty Reduction and Growth Facility (PRGF) and the Extended Fund Facility (EFF)) expired in October 2001. Performance under a Staff Monitored Program (SMP) during 2002 was mixed. A higher-than-expected decline in oil production during 2003–04 raised concerns about oil prospects, putting additional strains on the economy, and requiring even more rapid fiscal and external sector adjustments than previously envisaged.

Yemen accepted the obligations of Article VIII, Sections 2, 3, and 4 in 1996, and maintains a system free of restrictions on the making of payments and transfers for current international transactions.

Yemen has consented to the publication of the staff report.

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EXECUTIVE SUMMARY

Recent Developments—Macroeconomic performance weakened in 2004. Oil production declined by 5.9 percent, reducing overall growth to 2.7 percent. Core inflation increased to 14.5 percent by year-end because of expansionary macroeconomic policies and the impact of adverse weather conditions on food prices. A supplementary budget authorized increased spending, leading to a fiscal deficit of 4.5 percent of GDP. An increase in import demand mitigated most of the export gains resulting from higher oil prices, leaving the current account balance broadly unchanged. Because of higher oil exports, international reserves increased to about $5.1 billion or 16.4 months of imports.

The Economic Outlook—While the near-term outlook remains manageable, the expected rapid decline in oil production raises serious concerns about long-term sustainability. Unless new and large discoveries are made, oil reserves are expected to be depleted in about 12–14 years. Using a target debt-to-GDP ratio of 50 percent as an anchor to fiscal policy, staff's analysis suggests that a cumulative adjustment in the non-oil primary deficit of about 22.5 percent of GDP is needed by 2016 to bring Yemen closer to a sustainable long-term path. This requires a comprehensive and credible fiscal strategy supported by policies that can stimulate economic growth and diversify production away from oil.

Macroeconomic Policies—If adhered to, the 2005 budget appears broadly appropriate. However, staff projected that the deficit may end up higher, mainly because of larger subsidy and development spending. Staff stressed the need for a stricter budgetary discipline in 2005 than in previous budgets to avoid overspending by line ministries. Staff welcomed the authorities' decision to raise petroleum prices beginning in 2005, and called for eliminating the subsidy within two years according to an automatic price adjustment formula, and for strengthening social protection mechanisms to mitigate any possible impact on the poor. Central bank officials did not see a need to raise interest rates, as suggested by the staff, arguing that the increase in inflation was mainly supply driven. Given the expected deterioration in the current account and the need to develop non-oil sectors, staff called for greater exchange rate flexibility to maintain external competitiveness.

Structural Reforms—The government submitted an improved general sales tax (GST) law to parliament, which is expected to be introduced in July 2005. In view of the slow progress in public expenditure management and its importance for achieving fiscal sustainability, staff discussed with the authorities the prioritization and sequencing of the remaining measures that should be completed over the next 18 months. Staff also stressed the need to improve Yemen's business environment, which is important for investment and growth. Staff welcomed the continued civil service reform efforts but stressed that such efforts may be compromised by any ad hoc wage increases that are not part of the national wage strategy.

Staff Appraisal—In view of the expected decline in oil production, staff believes that strong and sustained reform efforts must be undertaken soon to maintain macroeconomic stability in the medium and long term. The fiscal strategy should be based on raising non-oil revenue, including through the implementation of the GST, removing subsidies, reducing the wage bill and defense spending, and improving public expenditure management and tax administration. Staff calls for a stricter budgetary discipline in 2005 and for a tighter monetary policy to curb continuing inflationary pressures. In view of the expected decline in oil production, staff is of the view that a truly flexible exchange rate would lead to a depreciation of the rial over time and avoid large and disruptive depreciations in the future.

I. Introduction

1. ***Yemen's strong adjustment efforts that began in the mid-1990s have stalled in recent years.*** Achievements under Fund-supported programs from 1996 to 2001 included macroeconomic stabilization, price liberalization, exchange rate unification, trade liberalization, and the reduction in external debt. Recently, the reform process has been held back by mounting opposition as the remainder of the reform agenda began to encroach on the interests of very powerful groups. The lack of broad-based political consensus for reform, fueled in part by a perception of rampant corruption, has not helped.

2. ***With oil depletion looming closer on the horizon, the government unveiled in October 2003 a reform package aimed at pushing the reform process forward and breaking the political deadlock.*** The package, which was designed to be adopted or rejected in its entirety, contained some popular measures, such as wage increases for civil servants and tariff reduction, in the hope of winning parliamentary support. However, in 2004, under political pressure, the government granted a public sector wage increase without any tangible progress in civil service reform; delayed the introduction of an amended GST Law by one year to July 2005; and postponed the adjustment in petroleum prices.

3. ***Strong commitment at the highest political level is needed to reignite and sustain reforms in the coming years.*** With the approaching presidential elections in 2006, it is critical that reforms be implemented soon. Otherwise, the adjustment process may be significantly delayed, putting at risk the achievements of the past.

II. Background

4. ***A steeper-than-expected decline in oil production in 2004 and a downward revision of the long-term production path raise serious concerns about sustainability***. Oil production was estimated to have declined by 5.9 percent last year and is projected to decline by 4.7 percent in 2005 as the recovery from aging large fields diminishes. The prevailing opinion, within government and oil company circles, is that, while small discoveries are possible, they will not be sufficient to replace the loss from large oil fields. At current production levels, proven oil reserves could be depleted in five years. With more realistic lower production rates, the depletion horizon can be extended by 12–14 years (Box 1).

5. ***Recent developments point generally to a deterioration in macroeconomic indicators.***

- ***Real GDP*** growth was estimated to have declined to 2.7 percent in 2004, mainly because of the slowdown in oil production. Non-oil GDP growth is expected to have reached 4.1 percent, supported by stronger activity in the construction, transportation, and trade

Box 1. Oil Sector: Recent Developments and Prospects

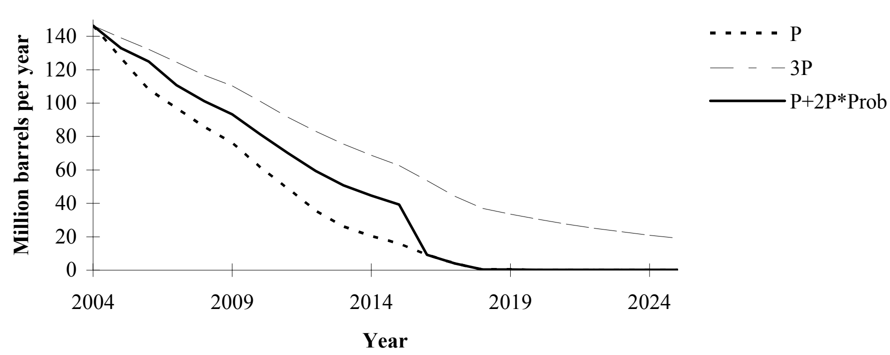
A sharp decline in production in two maturing large fields in 2004 is feared irrevocable. There are nine producing blocks in Yemen, the largest of which are Marib and Masila—together contributing about three-fourths of total production. Production in these two blocks is now expected to drop sharply in the next decade.

The authorities and oil companies feel that there is a possibility of discovering new small fields, but they do not believe that this will be sufficient to replace the loss from the existing large fields. They conjecture that, based on geological data, they are unlikely to find large new oil fields in the near future. However, there is a general optimism about discovering small fields with about 50 million barrels in reserves.

In the absence of major new discoveries, reserves would be depleted in about 12–14 years. According to the Production and Exploration Authority (PEPA) estimates, proven (and fully recoverable) oil reserves are at 750 million barrels. However, if we add the estimates of recoverable probable and possible reserves, the level of reserves could almost double to 1.4 billion barrels.

The reserves-to-production ratio—which indicates how long reserves would last if production were to continue at the current pace of 146 million barrels per year—is only 5 years for proven; and 10 years for proven, probable, and possible. Under more realistic declining production schedules, reserves could be extended, but not for long. The figure below shows the production paths under three different assumptions: (a) only proven reserves are considered (P); (b) proven, probable, and possible (3P); and (c) a more realistic assumption consistent with other countries' experiences under which we assume that there is a 50 percent chance that the probable and possible reserves become proven (P+2P*Prob). Under the first and third scenarios, production will drop by more than 90 percent and under the second scenario, by about 60 percent by 2016. Under the third scenario, which is used in our projections, oil revenue and exports will be virtually depleted by 2018.

Oil Production under Different Assumptions on Reserves



sectors, and fueled by domestic demand stemming from continued fiscal expansion and higher public sector wages. However, over the long term, non-oil growth is likely to taper off as oil production declines, and with it government spending, unless important reforms reverse the tide and boost private investment (Table 1).

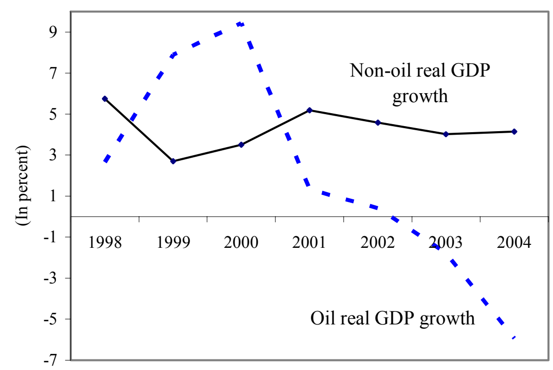
- ***The fiscal deficit*** was estimated at about 4.5 percent of GDP in 2004, about 1 percent higher than the original budget target due to higher development spending and the petroleum subsidy as authorized by the supplementary budget that was adopted late in the year (Table 2).

- ***Broad money*** grew at a rapid pace during the better part of 2004 until it was reined in during November-December—ending the year with a growth rate of 15 percent. Money growth was driven largely by a buildup in net foreign assets (on account of high oil exports) and an expansion of credit to the private sector (33 percent) mainly to finance trade (Table 3).

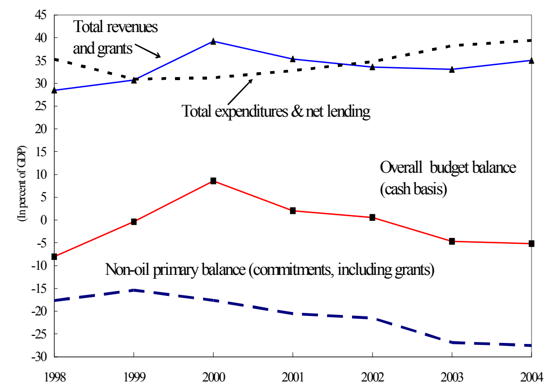
- ***Core inflation*** (excluding qat) picked up partly as a result of expansionary macroeconomic policies and partly because of the impact of adverse weather conditions on food prices. The end-year core CPI inflation rate reached 14.5 percent compared with 12.1 percent in 2003, while the headline inflation rate was at 10 percent.

- ***The external current account deficit remained broadly unchanged in 2004.*** A pickup in the demand for imports mitigated most of the export gains resulting from higher oil prices (oil export volumes were actually lower than expected). International reserves increased to reach about $5.1 billion, or 16.4 months of imports, despite record sales of foreign exchange ($740 million) by the

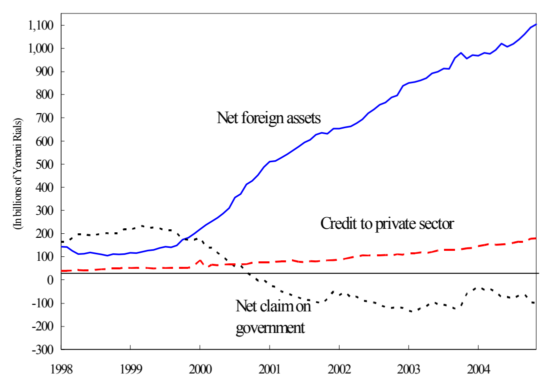
Non-Oil and Oil Real GDP Growth, 1998–2004



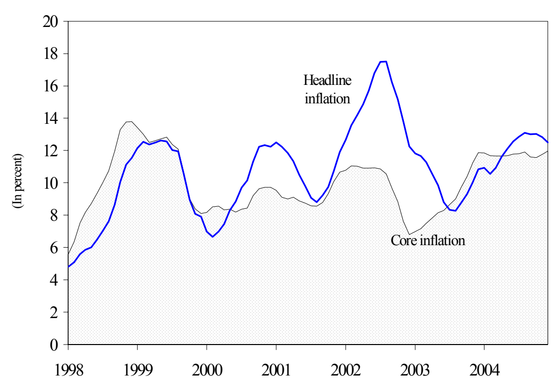
Budgetary Indicators



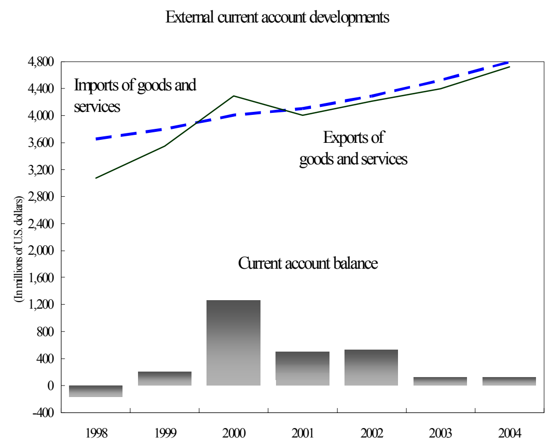
Monetary Aggregates



Measures of Inflation

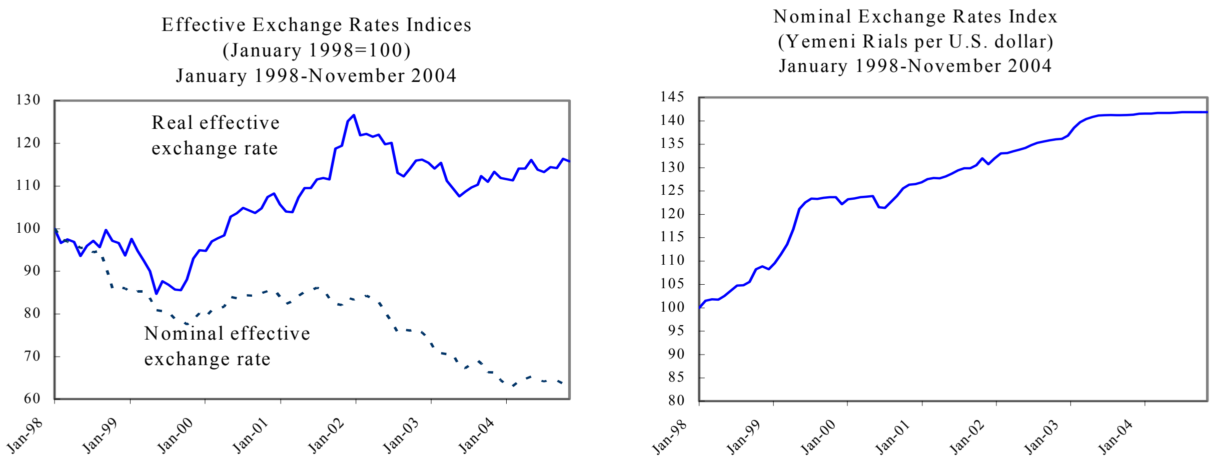


Central Bank of Yemen (CBY) to respond to increased demand for import financing (Table 4).



• ***The nominal exchange rate*** remained fairly stable vis-à-vis the U.S. dollar in 2004 and depreciated against other currencies (by 9 percent against the euro). This depreciation was not sufficient to make up for inflation differentials with Yemen's trading partners, leading to an appreciation of the real effective exchange rate by 3.5 percent over the 11 months through November 2004.

Nominal and Effective Exchange Rate Indices
January 1998=100



Sources: Yemeni authorities; and Fund staff estimates.

6. ***In early January, parliament approved the 2005 budget conditional on the government adopting a set of wide-ranging measures.*** These include: (a) submitting to parliament a national wage strategy to be implemented fully by 2007; (b) providing additional resources for social safety nets to reduce the impact of higher petroleum prices; (c) reducing customs duties to the levels of neighboring countries; (d) fighting smuggling through better border control; and (e) adopting policies that would encourage growth in non-oil sectors such as fisheries and tourism.

III. Policy Discussions

7. ***The 2004 Article IV discussions revisited almost all the themes raised in recent consultations—in particular the need for strong fiscal and structural reforms to address long-term challenges—but with particular emphasis on the additional challenges created by the downward revision of the oil production path.*** The mission stressed that the shorter

time horizon for oil production will require even stronger adjustment to preempt serious fiscal and external imbalances that could threaten macroeconomic stability. Policies to spur non-oil sector growth would also be critical.

8. ***While the near-term outlook is manageable, staff suggested that macroeconomic policies for 2005 and the immediate future be guided by the serious longer-term concerns.*** Staff stressed the benefits of casting macroeconomic policies in a coherent framework that focuses on these long-term prospects.

9. ***The authorities indicated that they had launched a public information campaign to highlight the long-term risks of declining oil production and the benefits of reforms***. They hoped that these efforts would lessen the strong opposition to reform that has so far prevented the government from taking action. They also noted that the package of reforms that was originally proposed in October 2003 is an integral part of the 2005 budget, which was under discussion in parliament during the mission and which has since been approved.[1]

A. The Economic Outlook

10. ***To illustrate the medium- and long-term outcomes under different policy choices, staff prepared two scenarios: a nonadjustment scenario and an adjustment scenario.*** The first is based on unchanged policies and the second aims at deriving the fiscal adjustment required to maintain the debt-to-GDP ratio at a sustainable level (below).

A nonadjustment scenario

11. ***A nonadjustment medium-term scenario shows clearly that Yemen's fiscal and external positions are unsustainable (Table 5).*** Without policy adjustments, the share of budgetary oil revenue to GDP drops from 25 percent in 2004 to 8.5 percent by 2009; the petroleum subsidy remains at about 6 percent of GDP; and the budget deficit increases to about 21.9 percent of GDP by 2009. If imports continue to grow modestly to sustain domestic demand, the current account deficit could exceed 13 percent of GDP in 2009, and gross international reserves are likely to be virtually depleted in about five years. Extending this scenario beyond the medium term, the debt-to-GDP ratio is projected to increase to 181 percent of GDP by 2014 and to 289 percent of GDP by 2025 (Table 6).

An adjustment scenario

12. ***With the expected decline in oil production, it would be preferable to have a long-term anchor to the fiscal framework that would sustain the economy beyond oil***. Staff

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[1] The main elements of this package are: adjusting petroleum product prices, introducing the GST; adopting a national wage strategy in the context of the ongoing civil service reform; and reducing customs tariff rates on vehicles and other easily smuggled goods.

assumed that maintaining the debt-to-GDP ratio at 50 percent (which is about the current level) could provide such an anchor and would be an important element in preparing Yemen to face the long-term challenges posed by the expected depletion of oil resources.

13. ***Staff's analysis suggests that a cumulative adjustment of about 22.5 percent of GDP in the non-oil primary budget deficit is needed by 2016 (when oil is virtually depleted) to bring Yemen closer to a sustainable long-term path (Box 2).*** This estimate is derived by comparing the sustainable primary balance path required to maintain the debt-to-GDP ratio at 50 percent with the primary balance under the nonadjustment scenario.[2] The comparison shows that a significant fiscal adjustment is needed upfront to maintain sustainability and help smooth the transition to a non-oil economy.

14. ***To realize such a large adjustment over the long term, a comprehensive fiscal strategy would be required.*** Given Yemen's very low tax-to-GDP ratio (7.5 percent of GDP), raising tax revenue and strengthening tax administration at first are essential.[3] Experience in other countries suggests that an expenditure cutting strategy would also tend to offer a great likelihood of effecting an enduring change in the budget, and is perceived as more durable and credible.

15. ***Staff identified several fiscal measures to compensate for some of the loss in oil revenue (Box 3).*** The set of measures could realistically generate about 12–15 percent of GDP. The authorities agreed with these measures, but noted that some of them would probably not be implemented in the period envisaged by the staff. In particular, officials pointed out that imposing an excise tax on petroleum products soon after the elimination of the subsidy is likely to be very difficult.

16. ***Fiscal measures should be supported by policies that stimulate economic growth and diversify the production base away from oil, easing the pains of adjustment.*** Particular attention should be given to the fishery sector, which has great potential for creating large employment and remains largely unexploited.[4] While the recent adoption of a new strategy for fisheries (which divides territorial water into different zones and determines the size of

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[2] While not a panacea, the 50 percent of debt-to-GDP target allows one to evaluate the size of adjustment required over the medium and long term, although it may be considered high for a low-income country like Yemen, with weak institutional capacity. Under the current debt structure, a debt-to-GDP ratio of 50 percent is roughly equivalent to a net present value of debt-to-GDP of 30 percent.

[3] Experience has shown that countries with relatively low initial revenue-to-GDP ratios were more successful in their adjustment efforts.

[4] Yemen possesses a long coast of more than 2,500 kilometers with access to some 700,000 squared kilometers of territorial water.

Box 2. Required Fiscal Adjustment for Long-Term Sustainability

In theory, the government is deemed solvent if it can generate future primary surpluses sufficient to service its outstanding debt. This definition does not preclude protracted large budget deficits provided that primary surpluses can be generated in the future. In practice, such an approach may require large future adjustments, which may not be feasible or desirable, economically and politically. A more operational definition (WEO 2003) suggests that a given debt level is sustainable if it implies that the government's budget constraint (in NPV terms) is satisfied without unrealistically large future corrections in the primary balance.

We use different target debt-to-GDP ratios to assess debt sustainability and determine the required adjustment needed to achieve this target. According to recent studies, a sustainable debt level for emerging markets ranges between 15 percent to 50 percent of GDP. The poor quality of institutions in Yemen militates for a debt ratio closer to the lower bound of this range. However, given that Yemen is a poor country that is facing a rapid decline in oil production, a 50 percent target seems more realistic.

The difference between sustainable and nonadjustment primary balance is the cumulative adjustment required in any given year. The results are then tested against staff's estimates of fiscal adjustment in terms of revenue and expenditure measures. Results are summarized in Table 6.

In the nonadjustment scenario, the debt-to-GDP ratio is projected to rise to 181 percent of GDP by 2014, at which time oil production and revenue drop by 94 percent. During the next 10 years, the non-oil primary deficit is projected to average 25 percent of GDP (equivalent to 29 percent of non-oil GDP).

For debt-to-GDP ratios between 15 and 50 percent of GDP, sustainable non-oil primary deficits over the next 12 years would have to average between 15 and 12 percent of GDP (17 percent and 14 percent of non-oil GDP, respectively). This is significantly lower than the current non-oil primary deficit of 27.5 percent of GDP (39 percent of non-oil GDP).

We assume that the deficit is financed by domestic and foreign borrowing or by seignorage. Evolution of debt in this case can be described as follows:

$$D_t^d + D_t^{fUSD} S_t - D_{t-1}^d - D_{t-1}^{fUSD} S_t + H_t - H_{t-1} = i_t^d D_{t-1}^d + i_t^f D_{t-1}^{fUSD} S_t - PB_t \qquad (1)$$

where D_t^{fUSD} is foreign debt expressed in U.S. dollars, S_t is exchange rate (units of domestic currency per one unit of foreign currency), H_t is the stock of base money, i_t^d is nominal interest rate charged on domestic debt, i_t^f is the interest rate on foreign debt denominated in foreign currency, and PB is the primary balance.

Denoting by lower case letters ratios of variables to current nominal GDP, (1) becomes:

$$pb_t = \frac{d_{t-1}^d}{(1+g_{Y_t})}\left[1+i_t^d\right] + \frac{d_{t-1}^f(1+g_{S_t})}{(1+g_{Y_t})}\left[1+i_t^f\right] - d_t^d - d_t^f - h_t + \frac{h_{t-1}}{(1+g_{Y_t})} \qquad (2)$$

If the government wants to reduce its total debt-to-GDP ratio from d_0 to d_n in n years with equal reduction per year, debt-to-GDP ratio at time t (d_t) can be written as debt-to-GDP ratio at time t-1 (d_{t-1}) plus a constant reduction, namely, $d_t = d_t^d + d_t^f = d_{t-1} + c = d_{t-1}^d + d_{t-1}^f + c$ where c satisfies $c = (d_n - d_0)/n$. Assuming that reserve money stock is growing at the same rate as nominal GDP, we obtain the following expression for primary balance in period t:

$$pb_t = \frac{d_{t-1}^d}{(1+g_{Y_t})}\left[i_t^d - g_{Y_t}\right] + \frac{d_{t-1}^f\left[\left(1+i_t^f\right)(1+g_{S_t}) - (1+g_{Y_t})\right]}{(1+g_{Y_t})} - \frac{h_{t-1}g_{Y_t}}{(1+g_{Y_t})} - c \qquad (3)$$

The first three terms of equation (3) give the primary balance necessary to maintain the debt-to-GDP ratio constant at the level of the previous period, and the constant c is the additional adjustment needed every year to bring the debt ratio to the desired level in n years.

Achieving sustainability would require a total adjustment of 22.5 percent of GDP in the non-oil primary deficit over the next 12 years. Fiscal adjustment per year would have to average about 1.9 percent of GDP and postponing adjustment would require large primary surpluses at the time of reserves depletion, thereby increasing the adjustment costs. Staff identified fiscal measures that can be implemented over the long run that could amount to 12–15 percent of GDP (Box 3).

Box 3. Fiscal Reforms Toward Long-Term Sustainability

Yemen needs to embark on a large fiscal adjustment path to move to a post-oil economy within 15 years. To be successful, the adjustment needs to be comprehensive and front-loaded. Experience has shown that adjustment could be achieved with growth friendly policies that have a high social rate of return. A comprehensive fiscal strategy, based on both revenue and expenditure measures, as well as a substantial improvement in tax administration and public expenditure management are needed. An ill-designed adjustment that lacks credibility would likely lead to policy reversal. Priority reforms include:

Tax policy and administration. Given Yemen's development needs and the low tax revenue in Yemen (about 10 percent of non-oil GDP), the fiscal adjustment will require a substantial increase in non-oil revenue:

- **Introducing the General Sales Tax (GST)**. Based on international experience, a 10 percent GST rate should generate between 3 and 5 percent of GDP. If the draft GST law is approved as recently amended by the government—simple to administer and with limited exemptions—it could generate between 3 percent to 3.5 percent of GDP in a few years, some 1–1.5 percent of GDP over the existing TCPS.

- **Eliminating custom exemptions and fighting smuggling**. Customs exemptions and other exemptions under the investment code should be reduced to a minimum. The low collection rate—less than half of the simple average tariff rate—suggests that customs revenue could potentially increase by at least 1 percent of GDP, if supported by better border enforcement to fight smuggling—estimated at 20 percent of total imports.

- **Applying an excise tax on petroleum products**. This will have to wait until the elimination of the petroleum subsidy. An excise tax of 5 percent introduced in 2007—raised to 10 percent beginning in 2010—is projected to generate up to 1.5-2 percent of GDP in revenue. While politically difficult, excises are potentially an important source of revenue in the long term. Higher excises, by reflecting the social costs, would also lead to a more efficient use of energy.

- **Strengthening the tax and customs administrations**. Initial efforts should focus on the Large Taxpayer Office (LTO). However, the LTO will have to be supported by further strengthening and coordination with the customs administration. This could generate about 0.5 percent to 1 percent of GDP over the long term.

Expenditure policy and public expenditure management. Reforms should focus on:

- **Eliminating petroleum product subsidies.** This will save the budget about 6 percent of GDP, which could be used in part to mitigate the impact of removing the subsidy on the poor and the rest to finance priority pro-growth spending as well as social expenditures, such as health and education.

- **Reducing the civil service wage bill.** At more than 7 percent of GDP, the civilian wage bill is 1–2 percentage points higher than in comparator countries. The reduction in the bill should be achieved through retrenchment rather than a wage freeze. This reform should go hand in hand with a comprehensive review of the wage strategy.

- **Containing defense spending**. Even taking into account domestic security needs, defense outlays could gradually decline to a level of about 3–4 percent of GDP (slightly above the average in countries outside the Middle East), realizing a saving of 1–2 percent of GDP.

The above measures could generate about 12–15 percent of GDP. If these measures are supported by a strong supply response, this adjustment would likely be sufficient to ensure sustainability in the long run. However, if the reform process slows down and the above measures do not generate the needed savings, then there will be no choice but to take some extraordinary measures, including cutting development spending and raising taxes.

boats in each of these zones) is a step in the right direction, it should be followed by a complete survey of fish resources and by strengthening monitoring mechanisms to reduce reported corruption and piracy. Transshipment activities (especially in the port of Aden) and tourism are potentially other important sources of growth. However, developing non-oil sectors requires, above all, improvement in the security situation and in the business environment.

17. ***Fiscal adjustment should be accompanied by institutional and structural measures.*** First, improving public expenditure management is an important step in the consolidation of the fiscal strategy. Second, designing and carrying out fiscal policy in a medium-term framework would enhance the credibility of the government and reduce public opposition to reforms. Third, core allocation of critical and poverty-related expenditures should be protected from ad hoc cuts and should be tracked over time to assess progress. Fourth, measures to strengthen revenue administration should be accelerated.

18. ***While the adjustment scenario could generate a cumulative adjustment of 17.6 percent of GDP in the non-oil primary balance (by 2016), this would not be sufficient for debt sustainability (Table 6), suggesting a need for additional corrective measures.*** Under the adjustment scenario, a cumulative adjustment gap of some 5 percent of GDP in the non-oil primary deficit would remain by 2016. To close this gap, some difficult measures are needed including reducing development spending (say by some 1–2 percent of GDP), cutting the wage bill by 1–2 percentage points of GDP, increasing the GST rate (from the current proposed rate of 10 percent), and introducing new taxes (which could generate about 1 percent of GDP). Because of the potentially adverse impact on growth and poverty reduction, reduction of pro-poor spending should be resisted until all other possible avenues are explored. The possible negative impact of raising taxes on growth will also need to be assessed. External assistance, preferably in the form of grants, would make the adjustment process less painful.

19. ***There are several risks to the long-term scenario and the outcome will depend on how these risks play out.*** The most important downside risks are the political economy obstacles that cast doubt on the feasibility of implementing such a large fiscal adjustment. It is possible that powerful vested interest groups, who have been successful in blocking reforms—since they reduce rent-seeking activities— could still hold back reform efforts. Other downside risks include lower oil prices, slower growth that could result in part from the proposed fiscal adjustment, and faster depletion of oil resources. On the upside, new oil discoveries, high oil prices, and potential exploitation of natural gas (which is now being discussed with foreign investors) could improve economic prospects.

20. ***Yemen's external debt indicators are expected to deteriorate over the long term with the depletion of oil exports unless sufficient additional efforts are made to diversify and increase non-oil exports.*** Debt sustainability in Yemen is primarily driven by the projected path of oil production, which accounted for 94 percent of export revenue and nearly 70 percent of fiscal revenue in 2004. Even under optimistic growth rates in non-oil exports and non-oil budgetary revenue, the projected decline in oil production for the outer

years sharply reduces export and budgetary revenue, casting doubt on long-term debt sustainability (Appendix II).

B. Fiscal Policy

21. ***Staff expressed concern about the deterioration in the fiscal position in 2004 at a time when more fiscal discipline was clearly needed.*** While the increase in petroleum subsidy—which was not reduced as originally planned—explains in large part the increase in the fiscal deficit, it was unfortunate that the supplementary budget was used also to increase other expenditure categories, including defense, wages, and development. The authorities explained that these were necessitated by the precarious security situation, the political decision to increase public sector wages, and overspending by some line ministries.

22. ***While the 2005 budget represents a strong adjustment effort, it is questionable whether the fiscal target can be attained given some of the budget's unrealistic allocations and the risk of a further delay in implementing the required measures.*** The budget targets a deficit of 3 percent of GDP, representing a drop of 9 percent of GDP in the non-oil primary balance (Table 2). However, even if petroleum prices are adjusted in early 2005, the staff projected the deficit to end up close to 5 percent of GDP, mainly because of higher subsidy and development spending. Moreover, in view of the conditions imposed by parliament, which may not be fulfilled soon, there is a risk that the reform package would be caught again in a political stalemate, with a possible surge in the deficit to more than 8 percent of GDP. Under all circumstances, staff stressed that if a supplementary budget is needed, it should be subject to stringent budgetary discipline and be contained to respond only to the budgetary impact of unforeseen developments or external shocks.

23. ***The authorities renewed their commitment to the phasing out of the petroleum product subsidy beginning in 2005.*** The proposed price adjustment in 2005 consists of almost doubling the diesel price (to Yrls 33) and increasing the prices of gasoline and liquefied petroleum gas by 45 percent and 40 percent, respectively—in line with the government's proposal of last year.[5] The impact of this measure is to reduce the subsidy by about 3 percent of GDP if fully implemented at the beginning of the year. However, the authorities noted that these price adjustments could be lower if there is a need for a compromise with political partners and parliament.

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[5] This would bring most domestic prices very close to international prices especially for gasoline, while the price of diesel fuel would still be at 85 percent of the international price.

The 2005 Budget

The 2005 budget is based on the following measures and assumptions: (a) significant reduction in petroleum subsidy; (b) an increase in the wage rate by 10-15 percent; (c) reduction in customs rates on cars and some other goods that can easily be smuggled; (d) a $30 per barrel oil price, more realistic price assumption than in previous budgets; (d) implementation of an amended GST law beginning July 2005 although no revenue impact is assumed; (e) lower development spending compared to recent years (about 1.8 percent of GDP); and (f) a decline in oil revenue by 7.6 percent of GDP.

Yemen: Fiscal Aggregates
(as share of GDP)

	2000	2001	2002	2003	Proj. 2004	Budget 2005	Proj. 2005
Total revenue and grants	39.2	35.3	33.6	33.1	35.0	27.0	30.6
Oil revenue	27.9	25.3	22.3	23.6	25.2	17.6	20.1
Total expenditure	31.2	32.8	34.8	38.2	39.4	30.0	35.3
Petroleum subsidies	5.7	3.8	3.0	5.0	6.4	1.6	3.3
Development expenditure	5.4	7.5	7.1	9.7	8.8	7.0	8.1
Primary non-oil fiscal balance (commitment basis)	-17.6	-20.5	-21.5	-26.9	-27.5	-18.7	-22.2

Source: Ministry of Finance, and Fund staff projections.

24. ***Staff suggested that the remaining gap between domestic and international petroleum product prices be phased out during the 2005–06 period, according to a well-defined automatic price adjustment formula***. This formula would have two components: the first consists of quarterly price adjustments, and the second would pass through the absolute change in the international price to domestic prices.[6] If oil prices fall over the next two years, this would mitigate the required adjustment in the price. However, the authorities argued against setting a formula for fear of increased smuggling ahead of future price increases. While there is merit to this argument, staff considered that with the substantial increase planned for 2005, the incentive for smuggling will be significantly reduced.

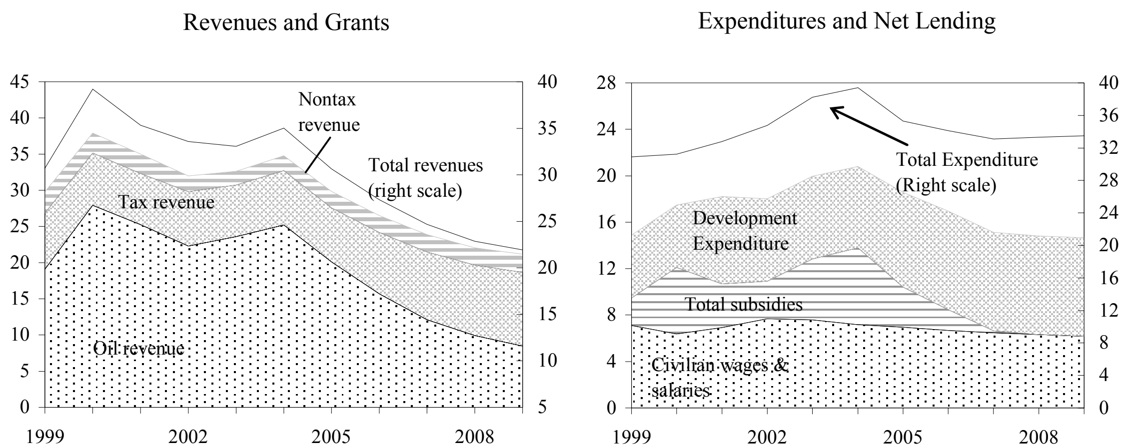
25. ***The electricity subsidy, which has been small so far, could become a heavy burden on the budget if not addressed soon***. According to an agreement with the World Bank and the Fund, the budget pays a subsidy of Yrls 6 billion a year until 2007 to the electricity company until it builds more efficient power plants. Anecdotal evidence suggests that the actual subsidy may be higher than budgeted and could grow further in the next few years.

[6] If the subsidy is to be eliminated over the next two years, each quarterly adjustment would eliminate one eighth of the gap until it is fully eliminated. The domestic price should not be reduced until the subsidy is fully eliminated.

Staff expressed concerns and suggested that, among other things, serious consideration be given to revising the tariff structure to protect only the poorest segment of the population.[7] The authorities agreed with this assessment, but noted that, in view of the heavy reform agenda, this particular issue was not one of their top priorities at this time.

Revenues and Expenditures 1999–2009

(In percent of GDP)



Source: Yemeni authorities; and Fund staff estimates.

26. ***The planned increase in petroleum product prices requires strengthening of social protection mechanisms to mitigate any possible impact on the poor***. A poverty and social impact analysis conducted by the World Bank and DFID indicates that less than 2 percent of the subsidy reaches the poor. However, the study suggested that removing the subsidy would have an impact on food and transport prices and, thus, may have a regressive impact given the large proportion of income that the poor spend on food. In order to ease such an impact, the targeting and the coverage of the Social Welfare Fund (SWF), which distributes a cash subsidy to very poor families, should be improved. More generally, further efforts should be made to protect the most vulnerable groups from the long-term adjustment required for achieving sustainability (Box 4).

[7] The first segment of Yemen's tariff structure, which is targeted at the poor, is too generous compared to other countries and imposes a large cost burden on the budget.

Box 4. Social Protection and Adjustment Efforts

The success of fiscal adjustment will largely depend on how well it protects the most vulnerable groups and how it is perceived by the public at large. About 42 percent of Yemen's population live below the poverty line, with an estimated 33 percent unable to meet the minimum daily calorie intake requirement. Protection mechanisms that are fair, transparent, and well targeted will mitigate the possible adverse impact of adjustment on the poor and facilitate the political acceptance of reforms.

The elimination of petroleum subsidy and the subsequent fiscal adjustment measures are expected to have an adverse impact on the poor. For example, although a large portion of the petroleum subsidy benefits the rich, its removal will likely be felt more by the poor through, inter alia, higher transportation costs and food prices—the latter representing a disproportionately much higher portion of the poor's household budget.

According to a World Bank study, **about 60 percent of the direct diesel subsidy used by households is captured by the two top (income) deciles, while less than 2 percent goes to the two lowest deciles**. At the same time, **the aggregate impact of eliminating subsidies is regressive because of the dominance of the indirect impact.** It is estimated that, for households using diesel as fuel, the impact of bringing diesel price to its economic price in percent of their expenditure would reach about 14 percent and 5 percent for the lowest and highest deciles, respectively. Similarly, for those using LPG (used more widely by the poor), the impact is about 13 percent and 2 percent for the lowest and highest deciles, respectively.

The authorities should focus mainly on strengthening the existing social safety nets (see below) while exploring with NGOs and representatives of the poor other mechanisms to respond to the potential impact of other adjustment measures. Additional efforts should aim at strengthening capacity at the subnational level, essential in the delivery of social safety net programs. Delivery instruments should take into account administrative and financial constraints, and could include: targeted cash transfers, public works programs, social funds, and microfinance.

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The Social Welfare Fund (SWF) is the government's primary safety net and provides direct cash assistance (with a limit of Yrls 2,000 or about $11 per family per month) to 650,000 beneficiaries. While at its inception it suffered from ill targeting and poor governance, according to the ministry of labor and social welfare targeting has improved and 80 percent of the most recent 200,000 beneficiaries are indeed poor, according to the formula used. The main delivery mechanism for the SWF, covering 58 percent of the total benefit transfer, is the postal system.

The Social Development Fund (SDF) provides assistance for long-term development projects. These are aimed at providing social and economic services—including education, health care, water supply, and microfinance—creating jobs and enhancing the capacity of local communities. Recently, the SDF has developed a five-year $137 million National Small and Micro-Enterprises Development Strategy focusing on poverty alleviation in both rural and urban areas. The SDF's involvement with SME development has been met with limited success owing to the reluctance of banks to extend credit to SMEs.

C. Monetary and Exchange Rate Policies

27. ***Central bank officials did not see a need to raise interest rates, arguing that the pick up in inflation was mainly supply driven.*** They claimed that most of the increase in the inflation rate was due to the rise in food prices, which were affected by adverse weather conditions, and, hence, raising interest rates—as suggested by staff—would not help in combating inflation. They were also concerned about the impact of higher interest rates on investment and growth. They assured the mission though that they would monitor the situation very closely and intervene when necessary, including by raising the benchmark minimum rate on savings deposits.

28. ***Staff expressed concerns about inflation running at double digits, and indicated that the surge in prices during the past year reflected more than the transient effect of adverse weather conditions. Staff stressed the need for monetary policy to focus primarily on price stability and for interest rates to reflect market forces.*** Staff indicated that the rise in food prices did not explain fully recent inflationary trends, which were influenced to a large extent by expansionary fiscal and monetary policies. While at times there may be a need for the central bank to balance multiple and conflicting objectives, now that core inflation is running at close to 15 percent and macroeconomic stability is in jeopardy, more focus should be placed on price stability.[8] Staff suggested that mopping up excess liquidity by issuing a large amount of treasury bills should push their interest rate sufficiently high to encourage banks to compete by paying higher interest rates on deposits. At this time, the minimum rate should become nonbinding and should then be liberalized.[9] Until the benchmark is eliminated, the CBY should use it more actively to signal the stance of monetary policy and maintain a positive real interest rate. Officials at the central bank maintained that removing the benchmark rate would lead to a sharp drop in the interest rate on deposits, because of lack of competition between banks, and would encourage speculative behavior including against the domestic currency.

29. ***While a flexible exchange rate is the declared official policy, discussions with the central bank and its recent policy choices suggested a revealed preference for more exchange rate stability than is warranted by a free float***. Officials at the central bank reaffirmed their adherence to an independently floating exchange rate and strongly contested

[8] A tighter monetary policy in 2005 is needed to contain the trend inflation at 12 percent—inflation that excludes the impact of higher fuel prices on the CPI, which is estimated at a one-off increase of 6 percent. This is consistent with the monetary program that targets broad money growth of 13.5 percent and credit to the privates sector of 25 percent.

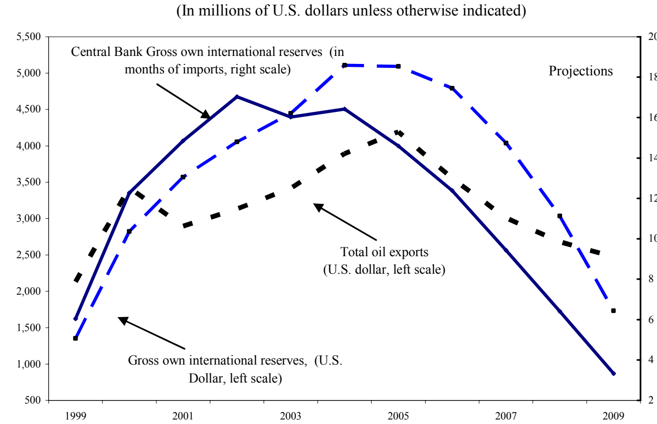
[9] In the staff's view, the minimum interest rate on savings deposits—which has been fixed at 13 percent since 2001—has distorted market signals and has outlived its usefulness, since it was originally intended to mobilize deposits in the mid-1990s, when inflation was running very high and sharp exchange rate depreciations were all too frequent.

any suggestion that they were pursuing a managed float. They asserted that interventions have been aimed primarily at dampening exchange rate volatility and at supporting to some extent the objective of price stability particularly given the rapid and strong pass through from exchange rate depreciations to prices. Officials, however, seemed to be content with the stability of the rial against the U.S. dollar, which, in their view, is the main anchor for public expectations. While staff supports the occasional need for the CBY to intervene in the foreign exchange market to minimize large speculative swings, the CBY should not resist strong and persistent pressures indicative of underlying fundamental changes. Notwithstanding the depreciation of the dollar in 2004, the value of the rial failed to fall sufficiently against other currencies to compensate for inflation rate differentials with Yemen's key trading partners, leading to a real exchange rate appreciation of the rial by 3.5 percent. Although this appreciation does not suggest serious competitiveness problems at this time—especially in view of the very narrow non-oil export base—if it continues, it will undermine the development of non-oil sectors.

30. ***Staff argued that, in a longer-term context, greater exchange rate flexibility will serve Yemen well because of the expected deterioration in the external current account and the need to develop non-oil sectors.*** External competitiveness should be maintained, including through low inflation and appropriate exchange rate policy, to develop the non-oil sectors and diversify the production base away from oil. With declining oil exports and consequently international reserves, the exchange rate is expected to depreciate. The CBY should not resist such a potential movement in the rate to avoid sharp disruptive depreciations in the future.[10] Although reserves seem comfortable now, seen in a longer-term context, they may not be sufficient to meet future demand if imports are to be sustained at a level that is commensurate with poverty-reducing growth. A managed gradual depreciation of the rial could be an option in the future to achieve the required depreciation.

Gross Own International Reserves and Oil Exports 1999-2009

(In millions of U.S. dollars unless otherwise indicated)



Sources: Yemeni authorities and Fund staff estimates and projections.

31. ***The discussion on a possible change in the monetary policy framework did not go too far.*** The discretionary nature of the existing framework—reacting to developments after they

[10] While a large real exchange rate depreciation could help in developing non-oil sectors, it would have adverse balance sheet effects and worsen external debt indicators.

occur—has proved to be ineffective in maintaining low inflation. Staff suggested that, in view of the instability of money demand, it would be useful for the CBY to adopt a framework based on a clear inflation objective, a monetary rule (perhaps interest-based), market-determined interest rates, and a flexible exchange rate. Recognizing the limited technical capacity at the CBY, moving to such an approach should be gradual and extend over three to five years. The authorities were reluctant to engage in a discussion on this issue, citing the lack of skills and the shallow nature of the financial markets, as well as the negligible role that interest rates play in the conduct of monetary policy in Yemen.[11] They suggested that the forthcoming MFD mission on liquidity forecasting and management could look into these issues.[12]

D. Key Structural Reforms

Tax reform

32. ***Staff welcomed the speedy revision of the draft GST law and hoped that it will be adopted soon by parliament***. The revised draft includes several improvements: (a) reduction of exemptions; (b) elimination of the tax on production and consumption; (c) unification of the GST registration threshold; and (d) development of special refund procedures. At the same time, the mission pointed out the case for: (a) eliminating the few remaining unnecessary exemptions (e.g., electricity); (b) converting higher GST rates on specific goods (cigarettes, cigars, and qat) into a uniform GST rate of 10 percent plus an excise; and (c) shortening the time for processing refunds to one month. The authorities took note of these observations and indicated that these would be addressed at a later stage. They were hopeful that the current draft would be approved by parliament without amendments. Since major improvements were made in the draft, staff agreed that there was no need to reopen the discussions on the draft GST law at this stage, but warned that delays in adopting the proposed amendments are likely to result in further delays in the implementation of the GST and reduce the effectiveness of the METAC assistance.[13]

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[11] The role of interest rates, according to the CBY, is also limited by the fact that Islamic banks, which are growing in importance, do not accept interest and do not deal with treasury bills.

[12] At the request of the authorities, a Monetary and Financial Systems Department (MFD) mission on liquidity forecasting and management and on developing technical capacity at the central bank will visit Yemen in early April of 2005.

[13] The mission was assisted by Mr. Benon, the METAC revenue administration advisor, who prepared a comprehensive assessment of the new draft GST Law, which was shared and discussed with the authorities during the mission.

33. ***Staff emphasized the importance of strengthening the large taxpayers' office and preparing customs administration for the implementation of the GST, which is expected in July.*** The METAC could provide some technical assistance to help strengthen the LTO organization and procedures, and finalize the preparation of GST administration once it is adopted. The apparent lack of awareness of customs officials of GST procedures should be quickly addressed. There is also a need to undertake a public relations campaign to explain the nature and impact of the GST to minimize its exploitation by businesses toward raising prices.

Public expenditure management

34. ***There was agreement on the need to improve public expenditure management as a condition for achieving a sustainable fiscal adjustment over the long term.*** Staff was encouraged by the use of macroeconomic indicators and indicative ceilings in the preparation of the 2005 budget. However, it underscored the importance of strengthening internal expenditure control mechanisms, including by developing a commitment control system and adhering strictly to budgetary allocations. The authorities acknowledged the difficulties they face in controlling some line ministries and executing agencies from exceeding their allocations. In view of the large number of remaining reforms in this area, staff discussed the prioritization and sequencing of these measures as suggested in Box 5.[14]

Civil service reform, labor market, and business environment

35. ***The ministry of civil service continued to set forth strong foundations for civil service reform, but the pace must be accelerated before the momentum is lost.*** Staff was encouraged by the completion of the civil service database and by the voluntary self declaration of multi-dippers (those who receive more than one salary) in light of the amnesty granted by the ministry.[15] It reiterated that reform efforts should concentrate on pilot agencies and ministries that could be showcased to generate political and public support for this reform. The retrenchment effort should be scaled up soon before mounting political opposition curtails the government program.

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[14] The mission shared with the authorities tables comparing Yemen to other countries in the region. The comparison clearly shows that Yemen is lagging behind in terms of nearly all public expenditure management areas (Appendix VI).

[15] Due to technical delays, the issuing of biometric cards (used to identify public sector employees) should begin in early 2005.

Box 5. Public Expenditure Management (PEM) and Reforms

Progress in public expenditure management and reforms has been slow in spite of extensive technical assistance (TA) provided by the Fund and donors. Recent reforms include, in particular, the adoption of a macroeconomic framework in the preparation of the 2005 Budget, and the subsequent use of indicative expenditure ceilings in negotiations with line ministries and spending agencies.

There remains a set of priority measures aimed at streamlining the budget presentation, strengthening expenditure controls, and improving fiscal transparency. The authorities indicated their intention to gradually dissolve a number of extra-budgetary funds and other "special accounts" in a move to create a fully-fledged Treasury Single Account. The adoption of a functional classification of expenditures according to GFS2001, while important for budgetary planning purposes and tracking poverty-related expenditures, is not one of the top priorities of the government at this time.

The project of creating an integrated and computerized financial management information system (AFMIS), with the assistance of the World Bank, is seriously lagging behind. Efforts are being made by the World Bank to put this project back on track.

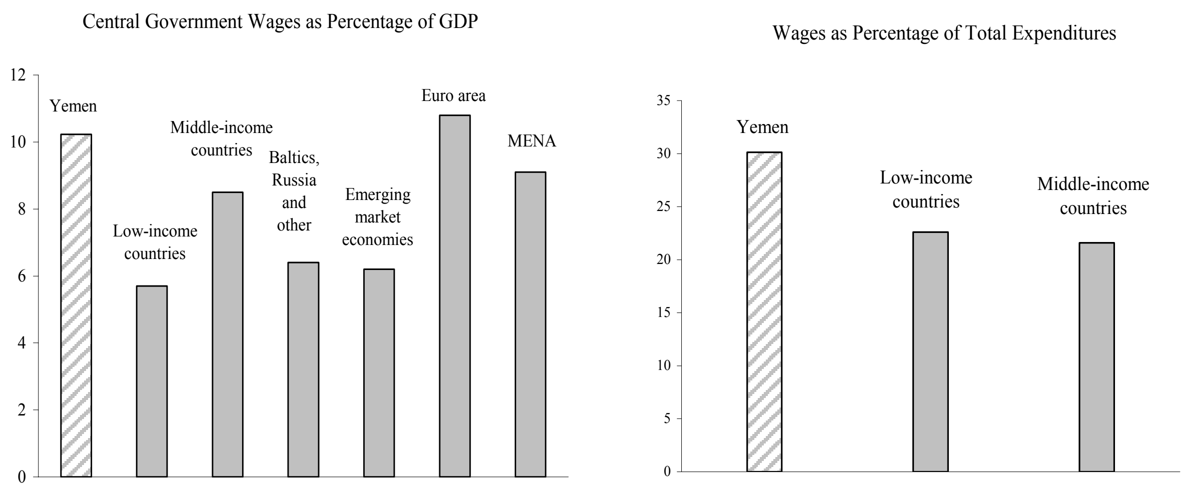
Staff stressed that a prioritized and sustained progress in PEM reform is crucial to fiscal adjustment. Several reforms are yet to be undertaken, including the development of a commitment control system (CCS) and further strengthening of internal expenditure control mechanisms. Compared to countries in the region, Yemen lags behind in nearly all PEM reform areas (see Appendix VI). Given the large number of reform measures, there is a need for prioritization and sequencing, as proposed in the table below (a ranking of 1 has the highest priority).

PEM Reforms

Reform Areas	Reform Objectives	Ranking	Time Frame
A. Budget execution and audit	1. Strengthening internal expenditure control mechanisms, including the development of a commitment control system (CCS).	**1**	12-18 months
	2. Introducing a fully functional treasury single account (TSA).	**2**	6–12 months
	3. Strengthening the external audit function.	**3**	1–2 years
B. Budget preparation and coverage of the budget	1. Expanding budget coverage, while limiting the number of extra-budgetary funds.	**1**	6–12 months
	2. Developing an adequate functional classification of the budget.	**2**	6–12 months
	3. Improving the macroeconomic foundations of the budget.	**2**	Ongoing
	4. Allowing for a "top-down" and "bottom-up" approach to preparing the budget.	**2**	Ongoing
C. Fiscal reporting and publication of fiscal data	1. Improving reporting on fiscal performance.	**2**	3–6 months
	2. Expanding the comprehensiveness of fiscal reports.	**4**	6–12 months

36. ***Staff stressed that ad hoc wage increases which are not part of the national wage strategy will undermine the ongoing civil service reform.*** While the proposed wage increase of 10–15 percent in 2005 aims at garnering the political support for the petroleum price increase, it reduces the incentives for employees to leave the public sector, and makes it more expensive for the Civil Service Fund to absorb excess labor and finance either their retirement or their severance packages. Given the need to reduce the wage bill by 1–2 percent of GDP over the long term—to help in the adjustment efforts and to bring it in line with other low-income countries—retrenchment and close monitoring of hiring and promotion policies are critical steps.

A Comparison of Public Sector Wage Bill with that of Selected Country Groups



Sources: Yemeni authorities, and Fund staff estimates.

37. ***Greater attention should be given to labor market issues and unemployment.*** While there are no official statistics on unemployment, it is reported to be very high. Staff and the authorities agreed on the need to redesign the education curricula and enhance vocational training to reduce the severe mismatch in existing skills and better cater to market demand. This is all the more important in view of the adverse impact of national employment programs in the region, especially the Saudization program, on unemployment in Yemen.[16] Staff expressed hope that the revision to the labor code, which introduces more flexibility in hiring foreign labor by private investors when local skills are lacking, could be adopted soon.

38. ***Strong efforts are needed to improve Yemen's business environment, which, as confirmed by recent studies, is plagued with several problems.*** A recent study by the

[16] National employment programs aim at replacing foreign labor by nationals over time according to specific employment targets in various job categories. Given the large number of Yemenis working in Saudi Arabia, this could exacerbate the unemployment problem in Yemen.

World Bank ranks Yemen as one of the world's ten most expensive countries in terms of business startups. Staff called for streamlining procedures and reducing costs to encourage private sector investment, growth, and bring more businesses into the formal sector.[17]

Yemen. The Cost of Starting a Business in Yemen and Selected Middle Eastern Countries, as of January 2004

Country	Number of Procedures	Time it Takes (days)	Official Fees (percent of income per capita)	Minimum Capital Requirement (percent of income per capita)
Yemen	12	63	269	1561
Lebanon	6	46	131	82
Saudi Arabia	12	64	69	1549
Egypt	13	43	63	815
Jordan	11	36	52	1147
Morocco	5	11	12	718
Oman	9	34	4	100

Source: *Doing Business in 2005: Removing Obstacles to Growth*, The World Bank, 2005.

39. ***Staff suggested that the government appoint a high-level committee of highly respected statesmen to look into governance and corruption issues.*** Discussions with different parties, including parliamentarians, business leaders, and labor unions, pointed clearly to an urgent need to fight corruption. Dealing with this issue would in all likelihood facilitate the political acceptance of reforms, contributing to improving the business environment. A weak judiciary and inefficient public service are also serious impediments to private sector development.[18]

[17] Yemen could follow the path of a number of countries that reformed business start-up procedures in the recent past. For example, Ethiopia reduced official registration fees from five times its per capita income to 0.7 and new registrations went up by 48 percent. Morocco and Slovakia implemented similar reforms, resulting in new registrations increasing by 21 percent and 12 percent, respectively.

[18] In the context of a general plan for reforming the commercial judiciary process and upgrade its performance, the government has adopted a project to modernize and develop the commercial courts in Sana'a and in four other governorates: Aden, Hadramout, Taiz, and Hudeaida.

Financial sector issues

40. ***Officials at the CBY felt that the quality of its banking supervision and its enforcement of prudential regulations are sound***. They indicated that banks are adequately monitored (both through off-site and on-site inspections), especially with the recent strengthening of personnel in the banking supervision unit. However, staff considered that the quality of bank assets remained low, characterized by high concentration and dollarization of credit.

41. ***Progress in implementing the recommendations of the 2001 Financial Sector Assessment Program (FSAP) has been limited***. In 2003, the CBY amended its accounting standards to conform to the latest international standards. In early 2005, the authorities launched a new initiative to modernize commercial courts. However, a project to adopt a new central bank law has been deferred indefinitely.[19] In addition, there were no changes to report on the existing framework for anti-money laundering (AML) and the combating of financing of terrorism (CFT) since the last consultation.

External sector issues

42. ***The CBY should improve further its reserve and external debt management.*** Reserves are currently invested mainly in short-term liquid U.S. dollar dominated assets. While this is a sensible strategy, it may be worthwhile exploring, with the help of a reputable investment firm, the possibility of investing part of Yemen's large reserves in longer-term assets with a higher rate of return, taking into account the risks stemming from the longer-term outlook. Staff welcomed the progress made in using the debt management system (DMFAS) within the CBY and recommended that it should be shared with other ministries and agencies that deal with external debt.

43. ***Yemen's trade regime remains relatively open.*** Negotiations on World Trade Organization (WTO) accession are proceeding well. It is expected that Yemen would join the WTO in four to five years. While accession to the WTO is not expected to lead to higher market access or significantly increased trade in the near term, the authorities saw important potential gains from this upcoming accession, including increased investor confidence and an improved business environment.[20] The authorities did not see that an agreement could be reached any time soon in joining the Gulf Cooperation Council (GCC). They confirmed that Yemen would begin reducing its tariffs in 2005 toward their full elimination by 2010 for the countries of the Greater Arab Free Trade Area (GAFTA). As for the diagnostic trade

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[19] The monetary authorities fear that submitting this piece of legislation to parliament may lead to changes in the banking law that would reduce the independence of the central bank.

[20] For example, the dispute settlement mechanism within the WTO provides additional security to foreign investors.

integration study that was prepared in 2003 under the Integrated Framework for Trade-Related Technical Assistance, the authorities indicated that they had prepared a detailed work plan to implement its recommendations.

Other issues

44. ***The final draft of the first PRSP progress report covering 2003 has recently been approved by the cabinet.*** Given the delay in producing this report, and the preparation for the combined new PRSP, which has already started, and the five-year development plan covering 2006–10, staff suggested, after consultation with the World Bank, producing only one progress report covering both 2003 and 2004, with the expectation that the new PRSP would be produced by the end of 2005. The authorities agreed to this suggestion. The mission stressed that the progress report be focused and candid, accounting for both accomplishments and setbacks. It should also be more forward looking, drawing lessons from the first year of implementation and assessing whether any changes in the strategy are needed. More important, the mission recommended that the new PRSP set realistic and well-prioritized targets, taking into account resource limitations including foreign financing.

45. ***While Yemen's data are satisfactory for conducting surveillance, there are several areas where improvements are needed to enhance the quality of economic analysis.*** This is true for fiscal, national accounts and prices, and balance of payments data, in particular. Staff also underscored the importance of coordination and the flow of information among different government agencies. The authorities agreed with this assessment and requested further technical assistance on national accounts and balance of payments statistics.

IV. Staff Appraisal

46. ***Yemen's long-term prospects are clouded by the expected rapid decline in oil production and the continued delays in undertaking needed reforms.*** Unless significant discoveries are made, oil reserves could be depleted in about 12–15 years, leading to serious long-term sustainability problems. While the near-term outlook remains manageable—supported by a high level of international reserves—Yemen's high dependency on oil dictates that short-term policies need to be cast in a longer-term coherent framework. Decisive actions now could go some way in redressing policy credibility, following a few years of inaction, including on the package that was announced in October 2003, and of which almost none of the measures has yet been implemented.

47. ***Failure to undertake strong reform efforts soon will put at risk the achievements of the past and lead to macroeconomic instability.*** A strong and orderly adjustment now will obviate the need for a drastic and disorderly adjustment in the future. Sustained efforts, however, will need to be supported by strong commitment to reforms at the highest political level. The fact that the ruling party has an overwhelming majority in parliament and that there is still some time—although not much of it—before the presidential elections of 2006, provides a window of opportunity for taking actions now. Otherwise, staff is apprehensive

that the political landscape will worsen, putting off the reform process and adding to the burden of adjustment.

48. ***It is encouraging that the authorities have taken the reform process one notch forward by launching a public information campaign to highlight the risks of inaction and by making the reform package an integral part of the 2005 budget. But significant risks remain.*** These risks stem mainly from political economy considerations and from the conditions imposed by parliament for the approval of the 2005 budget, which may take some time to address and may be used to block the reform process. Staff hopes that the adjustment process can be reignited in a way that will maintain social cohesion and avoid a further polarization of the political climate. Initiating actions to improve governance and enhance transparency should facilitate public acceptance of reforms.

49. ***At this critical juncture, there is a need to have a long-term anchor to guide fiscal policy and bring Yemen closer to a sustainable path.*** Maintaining a debt-to-GDP ratio of 50 percent can provide such an anchor. This requires a cumulative adjustment of at least 15 percent of GDP in the non-oil primary deficit over the next 12 years. This assessment provides a useful guide—but certainly not the only one—for policymaking in the difficult period ahead.

50. ***The sheer magnitude of the necessary fiscal adjustment requires a comprehensive and credible fiscal strategy.*** While in the first instance the strategy should rely on mobilizing non-oil revenues—in view of Yemen's low tax revenue—expenditure cuts should lend support to the strategy and enhance its chances of success. The main elements of the strategy are raising tax revenue, adopting the GST Law, removing subsidies, reducing the wage bill and defense spending, improving public expenditure management, and strengthening tax and customs administration.

51. ***Demand management policies should be supported by policies aimed at improving the supply response of the economy.*** Developing some promising sectors such as fisheries, transshipments, and tourism will boost non-oil growth and ease the pain of adjustment. In addition to developing strategies to promote these sectors, the authorities should adopt structural policies that can improve the business climate and encourage investment and growth. Particular efforts should be devoted to reducing the high cost of starting a business in Yemen and removing impediments to the development of the private sector.

52. ***Staff welcomes the authorities' intention to significantly reduce the non-oil primary deficit in 2005, although this may be difficult to achieve.*** In view of the expected sharp decline in oil revenue (7.5 percent of GDP), and the difficulty of fully compensating for it in one year, staff is of the view that the original fiscal target for 2005 seems unrealistic and achieving it will likely pose serious challenges. Staff also considers that the proposed increase in the wage rate in the budget—while desirable to improve governance and fight corruption—is premature as it undermines the ongoing civil service reform. Should a supplementary budget be adopted, staff recommends that it be contained to respond to

unexpected developments and exogenous shocks and not to be used to increase spending in a manner that undermines the integrity of the budgetary process.

53. ***The authorities' decision to raise petroleum prices beginning in 2005 should be followed by a clear plan to remove the subsidy within two years.*** After the initial increase in 2005, staff recommends that Yemen adopt an automatic price adjustment formula to adjust prices on a quarterly basis until the full elimination of the subsidy. This formula will insulate price adjustments from constant political bargaining and will mitigate these adjustments if the oil prices fall over the next two years.

54. ***The planned adjustment in petroleum prices and the sheer magnitude of the long-term adjustment more generally require strong social protection mechanisms.*** Social and poverty impact analysis shows that, while the petroleum subsidy is not benefiting the poor, its elimination may lead to increases in food prices and disproportionably hurt the most vulnerable groups. Because of this, and the potential impact on the most vulnerable groups from the longer-term adjustment required for sustainability, the coverage and targeting of the SWF should be improved and the Social Development Fund should be supported.

55. ***Staff is concerned about the surge in inflation and calls for a tighter monetary policy to curb continuing inflationary pressures.*** While the central bank may need at times to strike a delicate balance between conflicting objectives, price stability should take precedence, especially when inflation is running close to 15 percent and macroeconomic stability is in the balance. To enhance the role of interest rates in the conduct of monetary policy, the central bank should liberalize the minimum benchmark rate on savings accounts so that interest rates reflect market forces.

56. ***In the staff's view, greater exchange rate flexibility should help in achieving long-term sustainability.*** With the expected rapid decline in oil exports and foreign reserves, the CBY should not resist pressures on the exchange rate to depreciate over time so as to avoid large and disruptive depreciations in the future. A flexible exchange rate policy should be supported by other structural reforms that enhance competitiveness and boost growth in non-oil sectors

57. It is proposed that the next Article IV consultation discussions take place on the standard 12-month cycle.

Table 1. Republic of Yemen: Selected Economic Indicators, 2000–05

	2000	Est. 2001	Est. 2002	Est. 2003	Proj. 2004	Proj. 2005
			(Change in percent)			
Production and prices						
Nominal GDP at market prices	31.3	4.5	9.0	16.1	17.5	16.6
Real GDP at market prices	4.4	4.6	3.9	3.1	2.7	2.9
Real non-oil GDP	3.5	5.2	4.6	4.0	4.1	4.0
Real oil GDP	9.4	1.3	0.4	-1.8	-5.9	-4.7
GDP deflator	25.7	-0.1	4.9	12.5	14.4	13.4
Core consumer price index (annual average) 1/	10.0	10.7	6.8	11.9	12.0	16.4
Core consumer price index (12-month) 1/	7.6	14.6	4.5	12.1	14.5	18.0
Crude oil production (1,000 barrels/day)	434	434	433	425	400	381
Crude export oil price (weighted average, U.S. dollar/barrel) 2/	28.2	23.0	24.6	27.9	34.76	37.5
			(In percent of GDP)			
Government finance						
Total revenue and grants	39.2	35.3	33.6	33.1	35.0	30.6
Oil revenue	27.9	25.3	22.3	23.6	25.2	20.1
Non-oil revenue	10.0	9.8	9.7	9.1	9.6	9.7
Grants	1.3	0.3	1.6	0.4	0.2	0.8
Total expenditure	31.2	32.8	34.8	38.2	39.4	35.3
Current	25.8	25.2	27.7	28.6	29.6	26.5
Development	5.4	7.5	7.1	9.7	8.8	8.1
Overall balance including grants (commitment basis)	8.0	2.6	-1.2	-5.2	-4.4	-4.7
Primary non-oil fiscal balance (commitment, including grants, excluding oil and gas revenues)	-17.6	-20.5	-21.5	-26.9	-27.5	-22.2
			(12-month change in percent)			
Monetary data						
Broad money	25.1	18.7	18.0	20.0	15.0	13.5
Credit to private sector	21.3	25.8	14.3	26.3	33.5	25.0
Benchmark deposit interest rate (percent per annum.)	13.0	13.0	13.0	13.0	13.0	...
Velocity (Non-oil GDP/M2)	2.4	2.2	2.1	2.0	2.1	2.1
			(In millions of U.S. dollars)			
External sector						
Exports, f.o.b.	3,805	3,302	3,584	3,923	4,510	4,864
Of which : Crude oil	3,423	2,895	3,134	3,417	3,893	4,192
Imports, f.o.b.	-2,635	-2,771	-3,083	-3,422	-3,884	-4,556
Services, income, and transfers (net)	96	-24	33	-374	-499	-356
Services (net)	-630	-718	-633	-748	-757	-762
Interest obligations	-51	-52	-48	-57	-57	-57
Current transfers (net)	1,400	1,273	1,384	1,201	1,280	1,231
Of which : Workers remittances	1,223	1,228	1,230	1,137	1,168	1,114
Official transfers	72	42	148	64	112	117
Net factor income	-610	-763	-867	-1,067	-875	-633
Current account	1,265	507	535	128	126	-47
Own current account (excluding oil companies)	1,026	394	453	-2	36	-567
Capital and financial accounts, including errors and omissions	103	255	217	455	559	59
Overall balance	1,368	761	752	583	685	12
Memorandum items:						
Central bank gross foreign reserves	2,915	3,677	4,428	5,011	5,772	5,820
Central bank own gross foreign reserves 3/	2,822	3,569	4,056	4,445	5,108	5,091
In months of imports 3/	12.3	14.9	17.0	16.0	16.4	14.6
Current account, including grants (in percent of GDP)	13.2	5.3	5.4	1.1	1.0	-0.3
Debt service ratio (obligation basis), after rescheduling	6.0	6.3	4.6	3.9	3.9	4.2
Official external debt, after rescheduling 4/	4,832	4,870	4,852	4,978	5,075	5,178
Terms of trade (1996 = 100)	167.2	133.0	138.1	141.2	164.1	176.5
Exchange rate (e.o.p.) (Yrls per U.S. dollar)	164.0	173.3	178.9	184.3	185.8	...
Real effective exchange rate (1995 = 100) 5/	164.6	182.0	189.4	178.8	183.4	...
Nominal GDP at market prices						
In billions of Yemeni rials	1,539.4	1,608.1	1,753.5	2,035.5	2,390.8	2,788.7
In millions of U.S. dollars	9,561	9,533	9,985	11,211	12,904	14,566
Per capita GDP (in U.S. dollars)	546	528	537	585	653	715
Population (in thousands)	17,507	18,046	18,601	19,173	19,763	20,370

Sources: Yemeni authorities; staff estimates and projections.

1/ Core CPI is defined as CPI excluding qat.
2/ Oil price is different from the WEO price because Yemeni oil is traded at a discount.
3/ Gross reserves minus commercial bank and pension fund foreign exchange deposits held with the central bank. Imports are for the current year and exclude oil and gas sector imports.
4/ Public and publicly guaranteed debt including central bank foreign liabilities. Debt service ratio is measured as a percent of exports of goods and services.
5/ The real effective exchange rate for 2004 is the average over eleven months through end-November.

Table 2. Republic of Yemen: Central Government Finance, 2003–09

	Actual 2003	Actual Jan.– Oct. 04	Proj. 2004	Budget 2005	Proj. 2005	Proj. 2006	Proj. 2007	Proj. 2008	Proj. 2009
	(In billions of rials)								
Total current revenue and grants	672.9	665.4	836.9	754.3	854.2	846.6	844.5	877.8	947.0
Total current revenue	664.5	660.6	831.2	735.8	831.7	821.8	817.4	847.6	913.2
Oil and gas revenue	480.2	474.8	602.8	490.6	560.2	486.0	415.3	381.3	365.0
Of which : Crude oil exports	316.4	301.7	360.7	284.6	340.3	291.9	246.3	219.2	204.4
Non-oil revenue	184.3	185.8	228.4	245.1	271.5	335.8	402.0	466.4	548.2
Tax	145.3	145.5	179.5	191.7	208.9	263.2	320.4	374.1	440.3
Direct	68.3	...	74.6	85.6	90.1	110.5	127.0	144.6	158.8
Indirect	77.0	...	104.9	106.1	118.9	152.7	193.4	229.5	281.5
Of which : Customs revenues	42.4	43.0	51.6	51.1	57.5	69.4	80.7	96.9	116.1
Nontax	39.0	40.3	48.9	56.7	62.5	72.6	81.7	92.2	107.9
Grants	8.3	4.8	5.7	18.5	22.5	24.8	27.2	30.2	33.8
Total expenditure and net lending	778.2	717.6	942.7	836.4	984.5	1,057.8	1,133.3	1,280.0	1,445.5
Current expenditure	581.2	526.8	707.7	621.3	738.4	784.3	832.2	943.3	1,068.7
Civilian wages and salaries	143.2	111.6	171.6	193.5	193.5	207.2	221.7	242.7	265.7
Materials and services	51.7	42.4	60.0	84.5	84.5	101.3	118.4	137.0	156.6
Operation and maintenance	9.3	3.8	10.1	11.5	11.5	24.8	41.1	46.1	51.8
Defense	148.1	127.8	155.0	111.5	162.3	179.8	195.2	215.2	232.3
Interest obligations	38.0	41.2	50.8	52.2	71.5	88.9	111.8	146.5	190.0
Domestic	29.2	33.7	40.1	42.7	60.5	77.1	99.1	130.9	173.9
External	8.8	7.5	10.6	9.5	10.9	11.8	12.7	15.5	16.1
Transfers and subsidies	177.1	188.7	243.4	149.1	196.1	164.7	124.4	131.8	145.4
Subsidies	106.9	127.9	158.5	50.2	97.2	55.1	6.0	0.0	0.0
Petroleum cash subsidies	100.9	123.4	152.5	44.2	91.2	49.1	0.0	0.0	0.0
Financial support electricity	6.0	4.5	6.0	6.0	6.0	6.0	6.0	0.0	0.0
Current transfers	70.3	60.7	84.9	98.9	98.9	109.6	118.4	131.8	145.4
Development capital expenditure	197.1	167.0	210.0	196.0	227.0	263.5	291.1	326.6	366.8
Net lending	0.0	23.7	25.0	19.1	19.1	10.0	10.0	10.0	10.0
Overall balance (commitment)	-105.3	-52.2	-105.7	-82.2	-130.3	-211.2	-288.7	-402.2	-498.5
Pending obligations 1/	0.0	0.0	-18.0	0.0	0.0	0.0	0.0	0.0	0.0
External interest paid	10.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash)	-95.0	-52.2	-123.7	-82.2	-130.3	-211.2	-288.7	-402.2	-498.5
Financing	80.3	30.0	50.9	82.2	130.3	211.2	288.7	402.2	498.5
Privatization	-36.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External (net)	15.8	48.2	27.2	31.1	31.1	60.4	70.7	87.3	93.0
Bilateral and multilateral loans (net)	15.5	48.2	21.9	35.3	35.3	60.4	70.7	87.3	93.0
Disbursements	31.1	27.9	41.3	50.8	50.8	83.0	97.6	119.4	127.6
Amortization obligations	-15.6	20.3	-19.5	-15.4	-15.4	-22.7	-26.8	-32.2	-34.6
Exceptional financing	0.0	-4.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	101.5	-18.2	23.8	51.1	99.2	150.9	218.0	314.9	405.5
Bank	83.9	-54.5	-20.0	1.1	49.2	90.7	131.2	189.5	244.3
Nonbank	17.5	36.3	43.8	50.0	50.0	60.2	86.8	125.4	161.2
Pension funds	0.0	0.0	0.0	44.0	44.0	35.0	50.0	50.0	60.0
Public enterprises	0.0	0.0	0.0	6.0	6.0	5.0	10.0	10.0	10.0
Others	0.0	0.0	0.0	0.0	0.0	20.2	26.8	65.4	91.2
Discrepancy 1/	-14.7	-22.2	-72.8	0.0	0.0	0.0	0.0	0.0	0.0
	(In percent of GDP)								
Total revenue and grants	33.1	27.8	35.0	27.0	30.6	27.3	24.7	22.8	21.9
Total revenue	32.6	27.6	34.8	26.4	29.8	26.5	23.9	22.1	21.2
Oil and gas revenue	23.6	19.9	25.2	17.6	20.1	15.7	12.1	9.9	8.5
Of which : Crude oil exports	15.5	12.6	15.1	10.2	12.2	9.4	7.2	5.7	4.7
Non-oil revenue	9.1	7.8	9.6	8.8	9.7	10.8	11.7	12.1	12.7
Tax revenue	7.1	6.1	7.5	6.9	7.5	8.5	9.4	9.7	10.2
Direct	3.4	...	3.1	3.1	3.2	3.6	3.7	3.8	3.7
Indirect	3.8	...	4.4	3.8	4.3	4.9	5.6	6.0	6.5
Of which : Customs revenues	2.1	1.8	2.2	1.8	2.1	2.2	2.4	2.5	2.7

Table 2. Republic of Yemen: Central Government Finance, 2003–09

	Actual 2003	Actual Jan.– Oct. 04	Proj. 2004	Budget 2005	Proj. 2005	Proj. 2006	Proj. 2007	Proj. 2008	Proj. 2009
Nontax revenue	1.9	1.7	2.0	2.0	2.2	2.3	2.4	2.4	2.5
Grants (cash)	0.4	0.2	0.2	0.7	0.8	0.8	0.8	0.8	0.8
Total expenditure and net lending	38.2	30.0	39.4	30.0	35.3	34.1	33.1	33.3	33.5
Current expenditure	28.6	22.0	29.6	22.3	26.5	25.3	24.3	24.5	24.8
Civilian wages and salaries	7.0	4.7	7.2	6.9	6.9	6.7	6.5	6.3	6.2
Materials and services	2.5	1.8	2.5	3.0	3.0	3.3	3.5	3.6	3.6
Operation and maintenance	0.5	0.2	0.4	0.4	0.4	0.8	1.2	1.2	1.2
Defense	7.3	5.3	6.5	4.0	5.8	5.8	5.7	5.6	5.4
Of which : MIG purchase	...	...	0.7	...	...	...	...	...	...
Interest obligations	1.9	1.7	2.1	1.9	2.6	2.9	3.3	3.8	4.4
Transfers and subsidies	8.7	7.9	10.2	5.3	7.0	5.3	3.6	3.4	3.4
Subsidies	5.2	5.4	6.6	1.8	3.5	1.8	0.2	0.0	0.0
Petroleum cash subsidies	5.0	5.2	6.4	1.6	3.3	1.6	0.0	0.0	0.0
Financial support electricity	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.0	0.0
Current transfers	3.5	2.5	3.6	3.5	3.5	3.5	3.5	3.4	3.4
Other current expenditure	0.7	0.5	0.7	0.7	0.7	0.6	0.6	0.6	0.6
Development expenditure	9.7	7.0	8.8	7.0	8.1	8.5	8.5	8.5	8.5
Net lending	0.0	1.0	1.0	0.7	0.7	0.3	0.3	0.3	0.2
Overall balance (commitment)	-5.2	-2.2	-4.4	-2.9	-4.7	-6.8	-8.4	-10.5	-11.6
Overall balance (commitment, excluding grants)	-5.6	-2.4	-4.7	-3.6	-5.5	-7.6	-9.2	-11.3	-12.3
Pending obligations 1/	0.0	0.0	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
External interest paid (arrears) 1/	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash)	-4.7	-2.2	-5.2	-2.9	-4.7	-6.8	-8.4	-10.5	-11.6
Financing 7/	3.9	1.3	2.1	2.9	4.7	6.8	8.4	10.5	11.6
External (net)	0.8	2.0	1.1	1.1	1.1	1.9	2.1	2.3	2.2
Domestic (net)	5.0	-0.8	1.0	1.8	3.6	4.9	6.4	8.2	9.4
Bank	4.1	-2.3	-0.8	0.0	1.8	2.9	3.8	4.9	5.7
Nonbank	0.9	1.5	1.8	1.8	1.8	1.9	2.5	3.3	3.7
Discrepancy 1/	-0.7	-0.9	-3.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Primary balance (commitment) 2/	-3.7	-0.7	-2.5	-1.7	-2.9	-4.7	-6.0	-7.4	-7.9
Primary non-oil balance (commitment, including grants) 3/	-26.9	-20.3	-27.5	-18.7	-22.2	-19.6	-17.3	-16.6	-15.6
Non-oil balance (commitment, excluding grants)	-29.2	-22.2	-29.9	-21.2	-25.6	-23.3	-21.4	-21.2	-20.8
Non-oil balance (commitment, excluding grants and crude oil exports)	-21.1	-15.0	-19.8	-13.8	-17.7	-17.0	-16.4	-17.0	-17.1
Tax revenue, as percent of non-oil GDP	10.1	8.7	10.7	9.5	10.3	10.8	11.3	11.3	11.6
Net domestic oil revenue 4/	-5.0	-5.2	-6.4	-1.6	-3.3	-1.6	0.0	0.0	0.0
Public and publicly guaranteed debt 5/	56.1	...	45.1	45.8	47.5	50.4	56.0	62.5	69.9
GDP (at market prices in billions of Yrls)	2,035.5	2,391	2,391	2,789	2,789	3,100	3,425	3,843	4,315
Social expenditures (in percent of GDP) 6/	9.2	...	10.0	...	10.3	10.7	10.8	10.8	10.8
				(In percent of non-oil GDP)					
Non-oil revenue	12.9	11.1	13.7	12.1	13.4	13.8	14.2	14.1	14.5
Tax revenue	10.1	8.7	10.7	9.5	10.3	10.8	11.3	11.3	11.6
Nontax revenue	2.7	2.4	2.9	2.8	3.1	3.0	2.9	2.8	2.8
Grants (cash)	0.6	0.3	0.3	0.9	1.1	1.0	1.0	0.9	0.9
Total expenditure and net lending	54.2	42.9	56.4	41.3	48.6	43.5	39.9	38.8	38.2
Primary non-oil balance (commitment including grants)	-38.2	-29.0	-39.3	-25.7	-30.6	-25.0	-20.9	-19.3	-17.8
Total revenue and grants	46.9	39.8	50.0	37.2	42.2	34.9	29.8	26.6	25.0
Total revenue	46.3	39.5	49.7	36.3	41.0	33.8	28.8	25.7	24.1
Oil and gas revenue	33.5	28.4	36.0	24.2	27.7	20.0	14.6	11.6	9.6
Crude oil exports	22.1	18.0	21.6	14.0	16.8	12.0	8.7	6.6	5.4

Table 2. Republic of Yemen: Central Government Finance, 2003–09

	Actual 2003	Actual Jan.– Oct. 04	Proj. 2004	Budget 2005	Proj. 2005	Proj. 2006	Proj. 2007	Proj. 2008	Proj. 2009
	(In percent of non-oil GDP)								
Non-oil revenue	12.9	11.1	13.7	12.1	13.4	13.8	14.2	14.1	14.5
Tax revenue	10.1	8.7	10.7	9.5	10.3	10.8	11.3	11.3	11.6
Direct	4.8	...	4.5	4.2	4.4	4.6	4.5	4.4	4.2
Indirect	5.4	...	6.3	5.2	5.9	6.3	6.8	7.0	7.4
Of which : Customs revenues	3.0	2.6	3.1	2.5	2.8	2.9	2.8	2.9	3.1
Nontax revenue	2.7	2.4	2.9	2.8	3.1	3.0	2.9	2.8	2.8
Grants (cash)	0.6	0.3	0.3	0.9	1.1	1.0	1.0	0.9	0.9
Total expenditure and net lending	54.2	42.9	56.4	41.3	48.6	43.5	39.9	38.8	38.2
Current expenditure	40.5	31.5	42.3	30.7	36.4	32.3	29.3	28.6	28.2
Civilian wages and salaries	10.0	6.7	10.3	9.5	9.5	8.5	7.8	7.4	7.0
Materials and services	3.6	2.5	3.6	4.2	4.2	4.2	4.2	4.2	4.1
Operation and maintenance	0.6	0.2	0.6	0.6	0.6	1.0	1.4	1.4	1.4
Civil Service Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Defense	10.3	7.6	9.3	...	8.0	7.4	6.9	6.5	6.1
Of which : MIG purchase	...	...	1.0	...	...	...	...	...	...
Interest obligations	2.6	2.5	3.0	2.6	3.5	3.7	3.9	4.4	5.0
Transfers and subsidies	12.3	11.3	14.6	7.4	9.7	6.8	4.4	4.0	3.8
Subsidies	7.4	7.6	9.5	2.5	4.8	2.3	0.2	0.0	0.0
Petroleum cash subsidies	7.0	7.4	9.1	2.2	4.5	2.0	0.0	0.0	0.0
Financial support electricity	0.4	0.3	0.4	0.3	0.3	0.2	0.2	0.0	0.0
Current transfers	4.9	3.6	5.1	4.9	4.9	4.5	4.2	4.0	3.8
Other current expenditure	1.0	0.7	1.0	0.9	0.9	0.7	0.7	0.7	0.6
Development expenditure	13.7	10.0	12.6	9.7	11.2	10.8	10.3	9.9	9.7
Net lending	0.0	1.4	1.5	0.9	0.9	0.4	0.4	0.3	0.3
Overall balance (commitment)	-7.3	-3.1	-6.3	-4.1	-6.4	-8.7	-10.2	-12.2	-13.2
Overall balance (commitment, excluding grants)	-7.9	-3.4	-6.7	-5.0	-7.5	-9.7	-11.1	-13.1	-14.0
Overall balance (cash)	-6.6	-3.1	-7.4	-4.1	-6.4	-8.7	-10.2	-12.2	-13.2
Financing	5.6	1.8	3.0	4.1	6.4	8.7	10.2	12.2	13.2
External (net)	1.1	2.9	1.6	1.5	1.5	2.5	2.5	2.6	2.5
Domestic (net)	7.1	-1.1	1.4	2.5	4.9	6.2	7.7	9.5	10.7
Bank	5.8	-3.3	-1.2	0.1	2.4	3.7	4.6	5.7	6.4
Nonbank	1.2	2.2	2.6	2.5	2.5	2.5	3.1	3.8	4.3
Discrepancy 1/	-1.0	-1.3	-4.4	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Primary balance (commitment) 4/	-5.3	-0.9	-3.6	-2.4	-4.0	-6.1	-7.2	-8.7	-9.0
Primary non-oil balance (commitment, including grants)	-38.2	-29.0	-39.3	-25.7	-30.6	-25.0	-20.9	-19.3	-17.8
Non-oil GDP (at market prices in billions of Yrls)	1,435	1,673	1,673	2,026	2,026	2,429	2,839	3,299	3,788
Social expenditures (in percent of non-oil GDP) 8/	13.0	…	14.3	…	14.2	13.7	13.0	12.6	12.3
Memorandum item:									
Expenditure, excluding interest, subsidy, and MIGs	44.2	31.8	42.9	36.2	40.2	37.6	35.8	34.4	33.1
adjustment	2.1	-10.1	11.0	-6.7	4.0	-2.6	-1.8	-1.4	-1.2
Non-oil balance plus domestic oil revenue	-29.4	-19.6	-27.9	-18.1	-23.2	-20.7	-18.8	-18.8	-18.6
Modified fiscal adjustment in percent of non-oil GDP	-29.4	5.2	-27.9	-18.1	-18.3	2.5	1.9	0.0	0.3

Sources: Ministry of finance; ministry of planning; and staff estimates.

1/ In 2003–04 the increase reflects pending payments associated with project accounts.

2/ Revenue excluding grants minus expenditures excluding interest obligations.

3/ Overall balance (commitment including grants) excluding interest obligations and oil and gas revenue.

4/ Domestic oil revenue net of cash petroleum subsidies.

5/ External debt includes expected debt relief and projected stock-of-debt operations as well as expected future disbursements. Domestic debt includes net outstanding lending to government by the central bank and commercial banks, and treasury bills and repurchases held by the bank and nonbank sector.

6/ Classification based on the ministry of finance bulletin (it may not include all expenditures in health or education).

7/ Includes an acquisition of equity in Aden Container Facility of an amount of $200 million.

Table 3. Republic of Yemen: Monetary Aggregates, 2000–05

	Dec. 2000	Actual Dec. 2001	Actual Dec. 2002	Actual Dec. 2003	Actual Oct. 2004	Actual 1/ Dec. 2004	Proj. 3/ Dec. 2005
	(End-of-period stock; in billions of Yemeni rials)						
Broad money (M2)	474.5	563.0	664.7	797.4	879.5	917.3	1,041.5
Money	247.2	282.7	306.4	347.5	364.5	390.5	469.2
Currency	197.1	212.8	239.3	268.8	279.1	297.9	334.5
Demand deposits	50.1	69.9	67.1	78.7	85.4	92.6	134.7
Quasi-money	81.1	96.3	139.1	179.4	228.0	239.5	241.9
Foreign currency deposits	146.2	184.0	219.1	270.5	287.0	287.2	330.4
Net foreign assets	487.3	652.1	838.2	971.5	1090.1	1,117.6	1,204.9
Central bank	393.3	536.2	689.6	816.6	929.3	962.2	1,030.4
Commercial banks	94.0	115.9	148.6	154.9	160.7	155.4	174.5
Net domestic assets	-12.8	-89.0	-173.6	-174.1	-210.5	-200.3	-163.5
Credit to government (net)	1.3	-49.7	-119.4	-45.6	-96.2	-64.8	-24.2
Total budget financing (net)	-1.9	-47.8	-71.8	12.1	-42.4	-7.9	41.3
Central bank	-65.1	-102.6	-147.0	-100.3	-192.0	-166.4	-167.2
Commercial banks	63.1	54.8	75.2	112.366	149.642	158.5	208.5
Credit to nongovernment (net) 1/	76.2	85.8	109.4	138.2	179.1	183.5	231.5
Private sector	75.7	95.3	108.9	137.6	176.9	183.6	229.6
Other items (net) 1/	-90.3	-125.2	-163.6	-266.7	-293.4	-319.0	-370.8
Valuation adjustment	-17.4	-38.0	-74.0	-124.4	-133.2	-151.8	-203.6
Other items (net)	-73.0	-87.2	-89.6	-142.3	-160.3	-167.2	-167.2
Capital and reserves	-20.5	-26.9	-30.7	-34.7	-43.8	-47.9	-47.9
Other (net)	-52.5	-60.4	-58.9	-107.6	-116.5	-119.3	-119.3
	(Change in percent of initial M2)						
Net foreign assets	75.7	34.7	33.1	20.0	14.9	18.3	9.5
Net domestic assets	-50.6	-16.1	-15.0	-0.1	-4.6	-3.3	4.0
Total budget financing (net) 5/	-45.2	-9.7	-4.3	12.6	-6.8	-2.5	5.4
Credit to private sector	3.5	4.1	2.4	4.3	4.9	5.8	5.0
	(Twelve-month change in percent)						
Broad money (M2)	25.1	18.7	18.0	20.0	16.3	15.0	13.5
Of which : Rial broad money	22.7	15.4	17.6	18.3	20.1	19.6	12.9
Credit to private sector	21.3	25.8	14.3	26.3	33.7	33.5	25.0
Memorandum items:							
Velocity of M2 (GDP/M2)	3.7	3.2	2.9	2.8	...	2.8	2.8
Non-oil velocity (ratio non-oil GDP/M2)	2.4	2.2	2.1	2.0	...	2.0	2.1
Credit to private sector/GDP	4.9	5.9	6.2	6.8	7.4	7.7	8.2
Currency/deposits	71.1	60.8	56.3	50.9	46.5	48.1	47.3
Dollarization 1 (foreign currency deposits as percent of total deposits)	52.7	52.5	51.5	51.2	47.8	46.4	46.7
Dollarization 2 (private sector credit in U.S. dollars as percent of total private sector credit)	41.9	43.1	41.0	46.5	44.8	44.7	44.8
Official gross reserves/reserve money	197.6	237.9	266.0	249.7	271.9	255.6	253.9
Stock of treasury bills/GDP	11.1	11.4	11.6	12.9	14.5	15.2	18.2

Sources: Central Bank of Yemen; and Fund staff estimates.

1/ Includes valuation adjustment.

Table 4. Republic of Yemen: Balance of Payments, 2003–09

(In million of U.S. dollars)

	Est.	Projections					
	2003	2004	2005	2006	2007	2008	2009
Current account	128	126	-47	-644	-1,183	-1,625	-1,951
Current account excluding oil company transactions 1/	-2	36	-567	-1,149	-1,876	-2,579	-3,120
Goods and services	-246	-132	-453	-1,324	-2,095	-2,715	-3,181
Trade balance	502	625	308	-676	-1,569	-2,305	-2,835
Exports, f.o.b.	3,923	4,510	4,864	4,255	3,731	3,438	3,372
Of which: Crude oil	3,417	3,893	4,192	3,553	3,007	2,680	2,471
Government share	1,741	1,969	1,766	1,432	1,155	984	865
Oil companies' share	1,677	1,924	2,426	2,122	1,852	1,696	1,605
Non-oil exports	234	260	290	344	384	428	476
Imports, f.o.b.	-3,422	-3,884	-4,556	-4,932	-5,300	-5,743	-6,208
Services, net	-748	-757	-762	-648	-525	-410	-345
Income	-827	-1,022	-825	-578	-363	-202	-92
Of which: Oil company profits	-872	-1,072	-902	-765	-549	-351	-207
Interest income, net	44	50	77	187	185	148	115
Current transfers	1,201	1,280	1,231	1,259	1,275	1,293	1,322
Of which: Workers' remittances, net	1,137	1,168	1,114	1,135	1,145	1,156	1,178
Capital and financial account	299	559	59	179	246	385	421
Financial account excluding oil company transactions	430	366	295	379	389	477	475
Direct investment, net	-131	193	-236	-200	-143	-92	-54
Outflow	-881	-711	-1,345	-1,140	-818	-523	-308
Inflow	750	904	1,109	940	675	431	254
Trade credits, net	-19	0	0	0	0	0	0
Medium- and long-term loans, net	126	96	103	80	58	73	82
Disbursements	171	223	265	253	266	282	299
Amortization paid	-46	-127	-163	-173	-208	-209	-208
Commercial banks	14	-26	-50	-45	-47	-49	-52
Other private capital, net	309	296	242	344	378	453	444
Errors and omissions	156	0	0	0	0	0	0
Overall balance	583	685	12	-464	-938	-1,240	-1,531
Financing	-583	-685	-12	464	938	1,240	1,531
Central bank gross foreign assets (- increase)	-583	-761	-48	306	742	984	1,291
Debt relief 2/	0	75	0	0	0	0	0
Change in overdue obligations (increase +)	0	0	0	0	0	0	0
Financing gap (+ deficit)	0	0	36	158	196	255	240
Memorandum items:							
Current account including grants (percent of GDP)	1.1	1.0	-0.3	-4.2	-7.3	-9.3	-10.6
Of which : Official grants (percent of GDP)	0.6	0.9	0.8	0.8	0.8	0.8	0.8
Capital account	2.2	4.9	1.2	1.8	2.3	2.9	2.9
Central bank gross foreign assets	5,011	5,772	5,820	5,514	4,772	3,788	2,497
Central bank own gross foreign reserves 3/	4,445	5,108	5,091	4,794	4,037	3,037	1,731
(months of imports) 4/	16.0	16.4	14.6	12.4	9.4	6.4	3.3
Official external debt (after rescheduling) 5/	4,978	5,075	5,178	5,258	5,316	5,389	5,472
Official external debt (percent of GDP) 5/	44.4	39.3	35.5	34.1	32.6	30.9	29.8
Debt service (percent of exports of goods and services) 5/	3.9	3.9	4.2	4.6	5.3	5.2	4.8
Change in outstanding Fund credit (US$ millions), increase (+)	29.1	-38.8	-55.4	-60.8	-84.9	-68.1	-65.5

Sources: Central Bank of Yemen, and Fund staff estimates and projections.

1/ Oil sector includes oil companies share of exports less oil sector imports, expenses and repatriation.

2/ Debt relief in 2004 from Bulgaria and Japan.

3/ Includes central bank SDR holdings, foreign exchange held abroad, foreign securities, gold, silver and foreign currencies; excludes commercial bank required foreign exchange reserves with the central bank against their foreign currency deposits and pension fund reser

4/ Imports are c.i.f. for current year and exclude oil sector imports. Include high grade oil imports for the refineries beginning 2005.

5/ Public and publicly guaranteed debt including central bank foreign liabilities.

Table 5. Republic of Yemen: Macroeconomic Summary Indicators, 2000–09

Non-adjustment Scenario

	Actual	Actual	Actual	Est.	Projections					
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Economic growth and prices										
Real GDP (percentage change)	4.4	4.6	3.9	3.1	2.7	2.9	2.7	2.7	3.0	3.0
Real non-oil GDP (percentage change)	3.5	5.2	4.6	4.0	4.1	4.0	4.5	4.4	4.3	4.0
Core consumer price index (in percent, e.o.p.) 1/	7.6	14.6	4.5	12.1	14.5	18.0	12.0	12.0	11.0	10.0
Crude oil production (1,000 barrels/day)	434	434	433	425	400	381	342	303	277	255
Crude export oil price (U.S. dollar/barrel) 2/	28.2	23.0	24.6	27.9	34.8	37.5	35.0	33.0	32.0	31.5
	(In percent of GDP, unless otherwise indicated)									
Fiscal indicators										
Overall government balance (commitment basis)	8.0	2.6	-1.2	-5.2	-4.4	-4.7	-12.0	-16.0	-18.9	-21.9
Non-oil primary balance (commitment basis)	-17.6	-20.5	-21.5	-26.9	-27.5	-22.2	-24.6	-24.2	-23.9	-24.2
Oil revenue	27.9	25.3	22.3	23.6	25.2	20.1	15.7	12.1	9.9	8.5
Petroleum product subsidy	5.7	3.8	3.0	5.0	5.8	3.3	6.1	5.9	5.9	6.1
External sector										
Current account (including official transfers)	13.2	5.3	5.4	1.1	1.0	-0.3	-5.0	-9.1	-11.6	-13.4
Government oil-exports (in millions of U.S. dollars)	1,944	1,531	1,562	1,741	1,969	1,766	1,432	1,155	984	865
Central bank own gross reserves (in millions of U.S. dollars)	2,822	3,569	4,056	4,445	5,108	5,091	4,794	4,037	3,037	1,731
Central bank own gross reserves (in months of imports)	12.3	14.9	17.0	16.0	16.4	14.6	12.2	9.0	6.1	3.1
External sector financing gap (in millions of U.S. dollars)	0	0	0	0	0	36	378	616	849	933
Memorandum items										
Nominal GDP (in billions of Yrls)	1,539	1,608	1,754	2,035	2,391	2,789	3,100	3,425	3,843	4,315
Nominal GDP (in millions of U.S. dollars)	9,561	9,533	9,985	11,211	12,904	14,566	15,428	16,310	17,431	18,378

Source: Yemeni authorities and staff estimates.

1/ Core CPI is defined as the overall CPI less the CPI for qat.

2/ Oil price is different from the WEO price because Yemeni oil is traded at a discount.

Table 6. Republic of Yemen: Required Fiscal Adjustment and Long-Term Sustainability

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Assumptions for nonadjustment scenario 1/	(Percentage change unless indicated otherwise)												
Nominal GDP growth rate	17.5	16.6	11.2	10.5	12.2	12.3	11.7	16.3	16.4	21.9	22.3	27.6	23.8
Real GDP growth rate	2.7	2.9	2.7	2.7	3.0	3.0	1.8	1.9	2.0	2.2	2.4	2.5	0.8
Core CPI Inflation (e.o.p.)	14.5	18.0	12.0	12.0	11.0	10.0	10.0	15.0	15.0	20.0	20.0	25.0	25.0
Depreciation (e.o.p.)	0.8	5.9	4.0	5.0	5.0	8.0	15.0	15.0	15.0	20.0	20.0	25.0	25.0
Domestic debt share	12.4	15.0	26.6	36.8	43.8	48.9	51.0	50.5	48.4	46.0	44.5	42.3	39.2
Foreign debt share	87.6	85.0	73.4	63.2	56.2	51.1	49.0	49.5	51.6	54.0	55.5	57.7	60.8
Average interest rate	2.9	3.3	4.9	6.3	7.3	8.0	8.2	8.1	7.8	7.4	7.1	6.8	6.3
Interest rate on foreign debt	1.1	1.2	1.2	1.2	1.3	1.2	1.1	1.0	1.0	0.9	0.9	0.8	0.8
Interest rate on domestic debt	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
	(In percent of GDP)												
Nonadjustment scenario													
Projected debt-to-GDP ratio	**45**	**41**	**50**	**62**	**76**	**93**	**115**	**133**	**153**	**167**	**181**	**192**	**211**
Projected primary balance	-2.3	-2.1	-8.9	-12.1	-14.0	-15.8	-17.5	-18.8	-20.5	-21.2	-22.5	-23.0	-26.6
Projected oil revenue	25.2	20.1	15.7	12.1	9.9	8.5	7.3	6.3	5.3	4.5	3.9	3.4	1.3
Non-oil primary balance (1)	-27.5	-22.2	-24.6	-24.2	-23.9	-24.2	-24.8	-25.0	-25.9	-25.6	-26.4	-26.4	-27.9
Benchmark scenario: debt-to-GDP ratio is stabilized at 50 percent													
Projected debt-to-GDP ratio	**45**	**50**	**50**	**50**	**50**	**50**	**50**	**50**	**50**	**50**	**50**	**50**	**50**
Required primary balance		-5.9	-3.6	-2.4	-2.9	-2.0	0.1	-2.5	-2.6	-4.4	-4.6	-6.0	-4.1
Required non-oil primary balance (2)		-26.0	-19.3	-14.5	-12.9	-10.4	-7.2	-8.8	-7.9	-8.9	-8.5	-9.4	-5.4
Required cumulative fiscal effort (3) = (2) - (1)		-3.8	5.3	9.7	11.0	13.8	17.6	16.2	17.9	16.7	17.9	17.0	22.5
Required fiscal adjustment per year		-3.9	9.2	4.4	1.3	2.8	3.8	-1.4	1.7	-1.2	1.1	-0.9	5.5
Adjustment scenario 2/													
Projected debt-to-GDP ratio	**45**	**41**	**46**	**52**	**58**	**66**	**77**	**88**	**100**	**112**	**124**	**136**	**155**
Projected primary balance	-2.3	-2.1	-3.9	-5.2	-6.7	-7.1	-7.6	-7.6	-8.3	-8.1	-8.6	-8.3	-8.6
Adjustment non-oil primary balance (4)	-27.5	-22.2	-19.6	-17.3	-16.6	-15.6	-14.9	-14.1	-14.0	-13.2	-13.2	-12.5	-10.3
Cumulative adjustment (5) = (4) - (1)		**0.0**	**5.0**	**6.9**	**7.3**	**8.6**	**9.9**	**10.9**	**11.8**	**12.4**	**13.2**	**13.9**	**17.6**
Adjustment per year		0.0	5.0	2.0	0.4	1.3	1.2	1.0	0.9	0.6	0.7	0.7	3.8
Financing gap to maintain the 50 percent debt-to-GDP target (7) = (2) -(4)		-3.8	0.4	2.8	3.7	5.2	7.7	5.3	6.1	4.3	4.7	3.1	4.9
Required additional adjustment per year to maintain the 50 percent debt-to-GDP target					3.7	1.5	2.5	-2.4	0.8	-1.8	0.4	-1.6	1.8

1/ Inflation is assumed to be lower under the adjustment scenario.
2/ Assumes the fiscal reforms described in the text.

Table 7. Republic of Yemen: Macroeconomic Summary Indicators, 2000–09

Adjustment Scenario

	Actual	Actual	Actual	Est.	Projections					
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Economic growth and prices										
Real GDP (percentage change)	4.4	4.6	3.9	3.1	2.7	2.9	2.7	2.7	3.0	3.0
Real non-oil GDP (percentage change)	3.5	5.2	4.6	4.0	4.1	4.0	4.5	4.4	4.3	4.0
Core consumer price index (percent, e.o.p.) 1/	7.6	14.6	4.5	12.1	14.5	18.0	12.0	12.0	11.0	10.0
Crude oil production (1,000 barrels/day)	434	434	433	425	400	381	342	303	277	255
Crude export oil price (U.S. dollar/barrel) 2/	28.2	23.0	24.6	27.9	34.8	37.5	35.0	33.0	32.0	31.5
	(In percent of GDP, unless otherwise indicated)									
Fiscal indicators										
Overall government balance (commitment basis)	8.0	2.6	-1.2	-5.2	-4.4	-4.7	-6.8	-8.4	-10.5	-11.6
Non-oil primary balance (commitment basis)	-17.6	-20.5	-21.5	-26.9	-27.5	-22.2	-19.6	-17.3	-16.6	-15.6
Oil revenue	27.9	25.3	22.3	23.6	25.2	20.1	15.7	12.1	9.9	8.5
Petroleum product subsidy	5.7	3.8	3.0	5.0	5.8	3.3	1.6	0.0	0.0	0.0
External sector										
Current account (including official transfers)	13.2	5.3	5.4	1.1	1.0	-0.3	-4.2	-7.3	-9.3	-10.6
Government oil-exports (in millions of U.S. dollars)	1,944	1,531	1,562	1,741	1,969	1,766	1,432	1,155	984	865
Central bank own gross reserves (in millions of U.S. dollars)	2,822	3,569	4,056	4,445	5,108	5,091	4,794	4,037	3,037	1,731
Central bank own gross reserves (in months of imports)	12.3	14.9	17.0	16.0	16.4	14.6	12.4	9.4	6.4	3.3
External sector financing gap (in millions of U.S. dollars)	0	0	0	0	0	36	158	196	255	240
Memorandum items										
Nominal GDP (in billions of Yrls)	1,539	1,608	1,754	2,035	2,391	2,789	3,100	3,425	3,843	4,315
Nominal GDP (in millions of U.S. dollars)	9,561	9,533	9,985	11,211	12,904	14,566	15,428	16,310	17,431	18,378

Source: Yemeni authorities and staff estimates.

1/ Core CPI is defined as the overall CPI less the CPI for qat.
2/ Oil price is different from the WEO price because Yemeni oil is traded at a discount.

Table 8. Republic of Yemen: Macroeconomic Framework, 2000–09

(In percent of GDP, unless otherwise indicated)

						Projections				
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Economic growth and prices										
Real GDP (percentage change)	4.4	4.6	3.9	3.1	2.7	2.9	2.7	2.7	3.0	3.0
Real non-oil GDP (percentage change)	3.5	5.2	4.6	4.0	4.1	4.0	4.5	4.4	4.3	4.0
Nominal GDP (percentage change)	31.3	4.5	9.0	16.1	17.5	16.6	11.2	10.5	12.2	12.3
GDP deflator (annual percentage change)	25.7	-0.1	4.9	12.5	14.4	13.4	8.3	7.6	8.9	9.0
Core consumer price index (percent, p.a.) 1/	9.7	10.7	6.8	11.9	12.0	16.4	14.8	12.0	11.5	10.5
Core consumer price index (percent, e.o.p.)	7.6	14.6	4.5	12.1	14.5	18.0	12.0	12.0	11.0	10.0
Crude oil production (1,000 barrels/day)	434	434	433	425	400	381	342	303	277	255
Crude export oil price (weighted average, U.S. dollar/barrel) 2/	28.2	23.0	24.6	27.9	34.8	37.5	35.0	33.0	32.0	31.5
Gross domestic expenditures	94.4	102.0	101.3	102.2	101.0	103.1	108.6	112.8	115.6	117.3
Consumption	75.8	81.0	80.9	79.1	78.9	81.2	84.6	87.8	89.6	90.3
Public sector	14.1	15.7	16.7	16.7	16.2	16.4	16.3	16.2	16.0	15.7
Private sector	61.7	65.3	64.1	62.4	62.8	64.8	68.2	71.6	73.5	74.6
Gross fixed investment	18.6	20.9	20.5	23.1	22.1	21.9	24.0	25.0	26.0	27.0
Public sector	5.4	7.5	7.1	9.7	8.8	8.1	8.5	8.5	8.5	8.5
Private sector	13.2	13.4	13.4	13.4	13.3	13.8	15.5	16.5	17.5	18.5
Gross national savings from disposable income	31.8	26.2	25.8	24.2	23.1	21.6	19.8	17.7	16.7	16.4
Public sector	13.4	10.1	7.5	5.3	5.0	3.5	1.7	0.1	-2.0	-3.1
Private sector	18.4	16.1	18.3	18.9	18.0	18.1	18.2	17.7	18.7	19.5
Current account (including official transfers)	13.2	5.3	5.4	1.1	1.0	-0.3	-4.2	-7.3	-9.3	-10.6
Net exports of goods and services	5.6	-2.0	-1.3	-2.2	-1.0	-3.1	-8.6	-12.8	-15.6	-17.3
Exports of goods and services	42.0	36.4	38.7	37.7	37.6	36.0	30.2	25.5	22.3	20.9
Imports of goods and services	-36.4	-38.4	-40.2	-39.9	-38.6	-39.1	-38.8	-38.3	-37.9	-38.2
Net factor income	-7.0	-6.1	-7.2	-7.4	-7.9	-5.7	-3.7	-2.2	-1.2	-0.5
Net current transfers	14.6	13.4	13.9	10.7	9.9	8.5	8.2	7.8	7.4	7.2
Memorandum items										
Nominal GDP (billions of Yrls)	1,539.4	1,608.1	1,753.5	2,035.5	2,390.8	2,788.7	3,099.7	3,424.5	3,842.8	4,315.1
Nominal non-oil GDP (billions of Yrls)	980.6	1,105.1	1,232.7	1,434.5	1,672.7	2,026.2	2,429.0	2,838.8	3,298.9	3,788.4
Government revenue, excluding grants	37.9	35.0	32.0	32.6	34.8	29.8	26.5	23.9	22.1	21.2
Government expenditures, net lending	31.2	32.8	34.8	38.2	39.4	35.3	34.1	33.1	33.3	33.5
Overall government balance (commitment)	8.0	2.6	-1.2	-5.2	-4.4	-4.7	-6.8	-8.4	-10.5	-11.6
Overall non-oil government balance (commitment)	-19.9	-22.7	-23.5	-28.8	-29.6	-24.8	-22.5	-20.6	-20.4	-20.0
Non-oil exports (millions of U.S. dollar)	146.0	178.3	214.9	233.5	260.2	289.7	343.8	383.9	428.2	476.3
Government oil-exports (millions of U.S. dollar)	1,943.5	1,531.1	1,561.9	1,740.7	1,968.9	1,765.8	1,431.8	1,155.0	984.5	865.4
Central bank own gross reserves (in U.S. dollars)	2,822.3	3,569.0	4,055.5	4,445.3	5,107.8	5,091.3	4,793.5	4,037.0	3,037.4	1,730.8
Central bank own gross reserves (in months of imports)	12.3	14.9	17.0	16.0	16.4	14.6	12.4	9.4	6.4	3.3

Source: Yemeni authorities and staff estimates.

1/ Core CPI is defined as the overall CPI less the CPI for qat.

2/ Oil price is different from the WEO price because Yemeni oil is traded at a discount.

Table 9. Republic of Yemen: Millennium Development Goals, 1990–02

	1990	1995	1998	2000	2002
1. Eradicate extreme poverty and hunger					
Population below $1 a day (percent)			10.0		
Poverty gap ratio at $1 a day (percent)			2.3		
Percentage share of income or consumption held by poorest 20 percent			7.4 1/		
Prevalence of child malnutrition (percent of children under 5)					
Population below minimum level of dietary energy consumption (percent)				33.0 5/	
2. Achieve universal primary education					
Net primary enrollment ratio (percent of relevant age group) 2/	51.7		57.4	67.1	
Percentage of cohort reaching grade 5 (percent)					
Youth literacy rate (percent ages 15–24)	50.0				67.9 6/7/
3. Promote gender equality					
Ratio of girls to boys in primary education (percent)	0.4		0.6	0.6	
Ratio of girls to boys in secondary education (percent)			0.4	0.4	
Women to men parity index, as ratio of literacy rates (percent ages 15–24)	0.3				
Share of women employed in the nonagricultural sector (percent) 8/	8.9	7.6	6.8	6.3	5.8
Proportion of seats held by women in national parliament (percent)	4.0	1.0	1.0	1.0	1.0
4. Reduce child mortality					
Under 5 mortality rate (per 1,000)	142.0	126.0		117.0	114.0
Infant mortality rate 0–1 year (per 1,000 live births)	98.0	89.0		84.0	83.0
Immunization, measles (percent of children under 1 year old)	69.0	46.0	66.0	71.0	65.0
5. Improve maternal health					
Maternal mortality ratio (per 100,000 live births)	1400.0 9/	1471.0		570.0	
Births attended by skilled health staff (data from most recent year available from 1995–2002)					22.0 10/
6. Combat HIV/AIDS, malaria and other diseases					
Prevalence of HIV (percent ages 15–49) 1/					
Contraceptive prevalence rate (percent of women ages 15–49)					
Number of children orphaned by HIV/AIDS					
Tuberculosis prevalence rate (per 100,000 people)				178.0	145.0
Tuberculosis cases detected under DOTS (percent)			36.0	56.0	49.0
7. Ensure environmental sustainability					
Forest area (percent of total land area)	1.0			0.9	
Nationally protected areas (percent of total land area)					
GDP per unit of energy use (PPP $ per kg oil equivalent)	332.0	308.0	270.0	263.0	
CO2 emissions (metric tons per capita)		0.7	0.8	0.5	
Access to an improved water source (percent of population)	69.0				69.0
Access to improved sanitation (percent of population)	21.0				30.0
Access to secure tenure (percent of population)					
8. Develop a global partnership for development					
Youth unemployment rate (percent of total labor force ages 15–24)					
Fixed line and mobile telephones (per 100 people)	1.1	1.3	1.6	2.1	4.9
Personal computers (per 100 people)			0.2	0.2	0.7
General indicators					
Adult literacy rate (percent of people ages 15 and over)		40.0		46.0	
Total fertility rate (births per woman)		6.7		5.8	6.2
Life expectancy at birth (years)		53.0		57.0	58.0
Aid (percent of GNI)					

Source: World Bank, Statistics Yemen

1/ Survey year: 1998. Refers to consumption shares by percentiles of population. Ranked by per capita consumption
2/ Unesco Institute for Statistics (UIS) estimation.
3/ 1990–92 average.
4/ 1995–97 average.
5/ 1999–2001 average.
6/ UNESCO Institute of Statistics estimates.
7/ Data for 2000–04.
8/ ILO estimate.
9/ No national data on maternal mortality available. Estimates derived from model.
10/ Data refer to the most recent year available during the period 1995–2002.

Republic of Yemen: Fund Relations
As of December 31, 2004

I. Membership Status: Joined May 22,1990; Article VIII

II. General Resources Account	**SDR million**	**Percent Quota**
Quota	243.50	100.00
Fund holdings of currency	276.99	113.75
Reserve position in Fund	0.01	0.01
Holdings exchange rate		

III. SDR Department	**SDR million**	**Percent Allocation**
Net cumulative allocation	28.74	100.00
Holdings	33.03	114.91

IV. Outstanding Purchases and Loans	**SDR million**	**Percent Quota**
Extended arrangements	35.50	13.76
PRGF arrangements	208.75	85.73

V. Latest Financial Arrangements

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
EFF	10/29/97	10/28/01	72.90[21]	46.50
ESAF/PRGF	10/29/97	10/28/01	264.75[22]	238.75
Stand-By	3/20/96	6/19/97	132.38	132.38

VI. Projected Obligations to Fund Under the Repurchase Expectations Assumptions

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	37.75	40.83	56.58	45.20	28.38
Charges/Interest	1.95	1.54	1.06	0.58	0.26
Total	39.70	42.37	57.64	45.78	28.65

[21] Amount available after reduction in access by SDR 33 million in February 2001.

[22] Amount available after reduction in access by SDR 26 million in February 2001.

VII. Safeguards Assessment

Under the Fund's safeguards assessment policy, the Central Bank of Yemen (CBY) was subject to the transitional procedures with respect to the EFF arrangement which expired on October 28, 2001. The assessment, which was completed on May 23, 2001, concluded that CBY's external audit mechanism was not fully adequate at the time, and recommendations to address the shortcomings were reported. A review of information necessary to conduct a full safeguards assessment of the CBY has been initiated, with a view to completing the assessment prior to approval of a new PRGF arrangement.

VIII. Exchange Arrangements

The currency of Yemen is the Yemeni rial. Yemen maintains an independently floating exchange rate system.

Yemen has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions.

IX. Article IV Consultation

The latest Article IV consultation was concluded on December 22, 2003. Yemen is on the standard 12-month consultation cycle.

X. FSAP Participation

FSAP (with the World Bank), October–November 2000.

XI. Technical Assistance

(See ANNEX I)

XIII. Resident Representatives

None.

REPUBLIC OF YEMEN: EXTERNAL AND PUBLIC DEBT SUSTAINABILITY ANALYSIS (DSA)

1. This note examines the sensitivity of Yemen's external and public debt dynamics under the staff's baseline scenario to a number of standardized shocks in the debt sustainability framework for low-income countries. The baseline scenario assumes that the government implements reform measures such as the elimination of the fuel subsidy, the introduction of GST, or undertakes structural measures to improve the business environment and enhance non-oil sector growth the medium and long term.

A. The Current Situation

2. Yemen's total external public debt was \$5.1 billion at end-2004 (39 percent of GDP), of which \$1.3 billion is owed to the Russian Federation. Other external debts (46 percent of total external debt) are mostly from multilateral creditors, primarily the World Bank, at highly concessional terms. Domestic public debt, all denominated in local currency, accounted for about 5.6 percent of GDP at end-2004.

3. The baseline scenario underlying the DSA is based on the medium-term framework under the adjustment scenario in the staff report. It assumes that future borrowings to meet the external financing requirements are made at a highly concessional rate given the impending vulnerabilities of the economy.

B. Public Debt Sustainability

4. Under the baseline scenario, although the total public sector debt starts at acceptable levels in 2004 (45 percent of GDP, see Table 1), it increases over the medium term to reach 69.9 percent in 2009. This is mainly due (as discussed before) to the tapering of revenues and grants with more than 10 percent of GDP from 2004 to 2009. Public sector debt stocks in NPV terms start at 27.4 percent in 2004, but rise rapidly to 51.1 percent of GDP in 2009. The NPV of the debt-to-revenue ratio is projected to rise from 78.2 percent in 2004 to 232 percent in 2009 and to 804 percent in 2023.

5. Stress tests (Table 2 and Figure 1) show that Yemen's fiscal sustainability will depend on the implementation of actions to sustain and improve fiscal adjustment and growth, particularly in the non-oil economy. The main results are the following:

6. Given the fact that Yemen was able to substantially improve its fiscal position during the second half of the 1990s,[23] it is possible under scenario (1), that assumes real GDP growth and the primary balance at historical (low) averages, to improve the NPV of debt-to-

[23] Improvement as measured in the change in the primary balance from a deficit of 11.4 percent of GDP in 1994 to a primary surplus of 4.4 percent in 2001.

GDP to 36 percent in 2009,[24] compared to 51 percent in the baseline scenario. However, in 2009 the debt service-to-revenue ratio would be almost 10 percent lower than in the baseline scenario. Under scenario (2), where the primary balance is kept unchanged from 2003 onwards to "historic averages" scenario mentioned above, the NPV of debt-to-GDP would increase to 49 percent and the debt-to-revenue ratio to 222 percent in 2009.

7. Scenarios (1) and (2) discussed above are however not feasible given: (a) the dependency of public finances on oil revenues; and (b) the expected depletion of oil reserves by 2016.

8. A more realistic stress would be to impose a shock to real growth (lowering it permanently by reducing it to the historical average minus one standard deviation). Under this scenario a significant deterioration in all debt ratios would take place. In 2009, the NPV of debt-to-GDP would reach 55 percent; the NPV of debt-to-revenue would increase to 251 percent; and debt service would absorb 25 percent of revenue.

C. External Debt Sustainability

9. Under the baseline scenario, although the external debt stock in NPV terms starts at a modest level (22 percent of GDP in 2004) and remains there over the medium term (35 percent in 2013), debt indicators measuring Yemen's ability to service external debt deteriorate significantly over the long term as Yemen runs out of oil. The NPV of the debt-to-exports would increase to about 340 percent, and the debt service-to-exports ratio to 20 percent by 2023. The risks to the debt dynamics primarily stem from the fact that oil, the largest source of export earnings for Yemen, is expected to virtually run out by 2016, generating a spike in sustainability indicators. Subsequently, debt indicators improve with the growth in non-oil exports.

10. External debt dynamics are most vulnerable to the decline in exports. A shock to export growth equal to the size of one standard deviation under the stress tests (B2) raises the NPV of debt-to-exports ratio to about 560, and debt service would absorb 36 percent of exports in 2013. This scenario clearly demonstrates that, without a strong commitment to export diversification, Yemen's external debt would be unsustainable.

11. A lack of concessional new borrowing will also aggravate the external sustainability by pushing up the NPV-to-export ratio to over 270 by 2013.[25]

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[24] The public debt-to-GDP ratio in 2009 would be at 69.9 percent of GDP under the baseline scenario (see Table 1).

[25] Given that growth and capital account surplus were high in the past, primarily reflecting the performance of the oil-economy, the scenario with historical averages delivers implausible debt ratios.

Table 1. Republic of Yemen: Public Sector Debt Sustainability Framework, Baseline Scenario, 2000–23

(In percent of GDP, unless otherwise indicated)

	Actual				Historical	Standard	Projections									
													2004–09			2009–23
	2000	2001	2002	2003	Average 5/	Deviation 5/	2004	2005	2006	2007	2008	2009	Average	2013	2023	Average
Public sector debt 1/	**58.8**	**57.8**	**52.8**	**53.1**	**103.0**	**50.5**	**45.1**	**45.8**	**50.4**	**56.0**	**62.5**	**69.9**	**54.9**	**120.2**	**258.4**	**161.8**
Of which: Foreign-currency denominated	51.5	52.5	49.5	45.1			39.5	37.4	38.0	38.4	38.6	39.2		75.6	187.8	
Change in public sector debt	-37.9	-1.0	-5.0	0.3			-8.0	0.7	4.6	5.6	6.4	7.4		10.6	16.1	
Identified debt-creating flows	-34.0	-2.9	-2.0	-0.8			-4.8	-0.4	3.3	5.1	5.8	7.3		11.4	16.1	
Primary deficit	**-10.3**	**-4.7**	**-0.8**	**3.3**	**1.4**	**6.7**	**1.3**	**1.4**	**3.6**	**4.9**	**6.4**	**6.9**	**4.1**	**8.1**	**9.2**	**8.4**
Revenue and grants	39.2	35.3	33.6	33.1			35.0	30.6	27.3	24.7	22.8	21.9		19.9	19.0	
Of which: Grants	1.3	0.3	1.6	0.4			0.2	0.8	0.8	0.8	0.8	0.8		1.0	2.2	
Primary (noninterest) expenditure	28.9	30.6	32.8	36.4			36.3	32.1	30.9	29.5	29.2	28.9		28.0	28.3	
Automatic debt dynamics	-19.2	2.4	-1.2	-4.1			-5.5	-1.8	-0.4	0.2	-0.6	0.3		3.3	6.9	
Contribution from interest rate/growth differential	-18.8	2.0	-0.8	-4.0			-5.0	-2.7	0.0	0.1	-0.6	-0.2		3.3	6.9	
Of which: Contribution from average real interest rate	-14.7	4.6	1.4	-2.4			-3.6	-1.5	1.1	1.4	1.1	1.6		6.7	16.1	
Of which: Contribution from real GDP growth	-4.1	-2.6	-2.2	-1.6			-1.4	-1.3	-1.2	-1.3	-1.7	-1.8		-3.4	-9.2	
Contribution from real exchange rate depreciation	-0.4	0.4	-0.4	-0.1			-0.5	0.9	-0.3	0.2	0.0	0.5		...	...	
Denominator = 1+g	1.0	1.0	1.0	1.0			1.0	1.0	1.0	1.0	1.0	1.0		1.0	1.0	
Other identified debt-creating flows	-4.5	-0.6	0.0	0.0			-0.6	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-4.5	-0.6	0.0	0.0			-0.6	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-3.9	1.8	-3.0	1.1			-3.2	1.1	1.4	0.5	0.6	0.2		-0.9	0.0	
NPV of public sector debt	**32.2**	**30.8**	**29.0**	**31.7**			**27.4**	**28.4**	**32.8**	**38.1**	**44.4**	**51.1**		**77.7**	**153.0**	
Of which: Foreign-currency denominated	24.9	25.5	25.7	23.7			21.8	20.1	20.4	20.5	20.5	20.4		33.1	82.3	
Of which: External	24.9	25.5	25.7	23.7			21.8	20.1	20.4	20.5	20.5	20.4		33.1	82.3	
NPV of contingent liabilities (not included in public sector debt)	...	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	73.2	46.8	51.8	48.7			51.7	42.2	48.2	54.2	60.5	67.2		113.8	237.2	
NPV of public sector debt-to-revenue ratio (in percent) 3/	82.2	87.1	86.4	95.8			78.2	92.8	120.1	154.5	194.3	232.7		390.4	804.1	
Of which: External	63.5	72.1	76.6	71.8			62.2	65.6	74.7	83.3	89.9	93.0		166.3	432.8	
Debt service-to-revenue ratio (in percent) 3/ 4/	35.0	15.9	13.5	8.0			11.7	10.2	13.2	16.4	20.4	23.7		35.5	67.7	
Primary deficit that stabilizes the debt-to-GDP ratio	27.6	-3.7	4.2	3.0			9.3	0.7	-1.0	-0.8	-0.1	-0.5		-2.5	-6.8	
Key macroeconomic and fiscal assumptions																
Real GDP growth (in percent)	4.4	4.6	3.9	3.1	5.6	2.7	2.7	2.9	2.7	2.7	3.0	3.0	2.8	3.2	3.9	3.4
Average nominal interest rate on forex debt (in percent)	0.9	1.1	1.0	1.2	1.6	1.1	1.2	1.2	1.1	1.1	1.2	1.1	1.1	0.5	0.1	0.5
Average real interest rate on domestic currency debt (in percent)	-12.0	22.8	24.7	31.7	-1.5	22.1	9.1	28.1	22.9	16.9	11.8	9.1	16.3	7.3	7.4	7.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-0.7	0.8	-0.8	-0.2	26.9	70.2	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	25.7	-0.1	4.9	12.5	18.4	16.6	14.4	13.4	8.3	7.6	8.9	9.0	10.3	6.6	7.0	7.0
Growth of real primary spending (deflated by GDP deflator, in percent)	19.1	10.8	11.2	14.4	10.3	20.0	2.4	-9.0	-0.9	-2.0	2.0	1.7	-1.0	2.7	7.4	3.2
Grant element of new external borrowing (in percent)	0.6	0.6	0.6	0.6	0.6	0.0	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	...

Sources: Country authorities; and Fund staff estimates and projections.

1/ Central government debt (net).

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues including grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2. Republic of Yemen: Sensitivity Analyses for Key Indicators of Public Sector Debt , 2003–2023

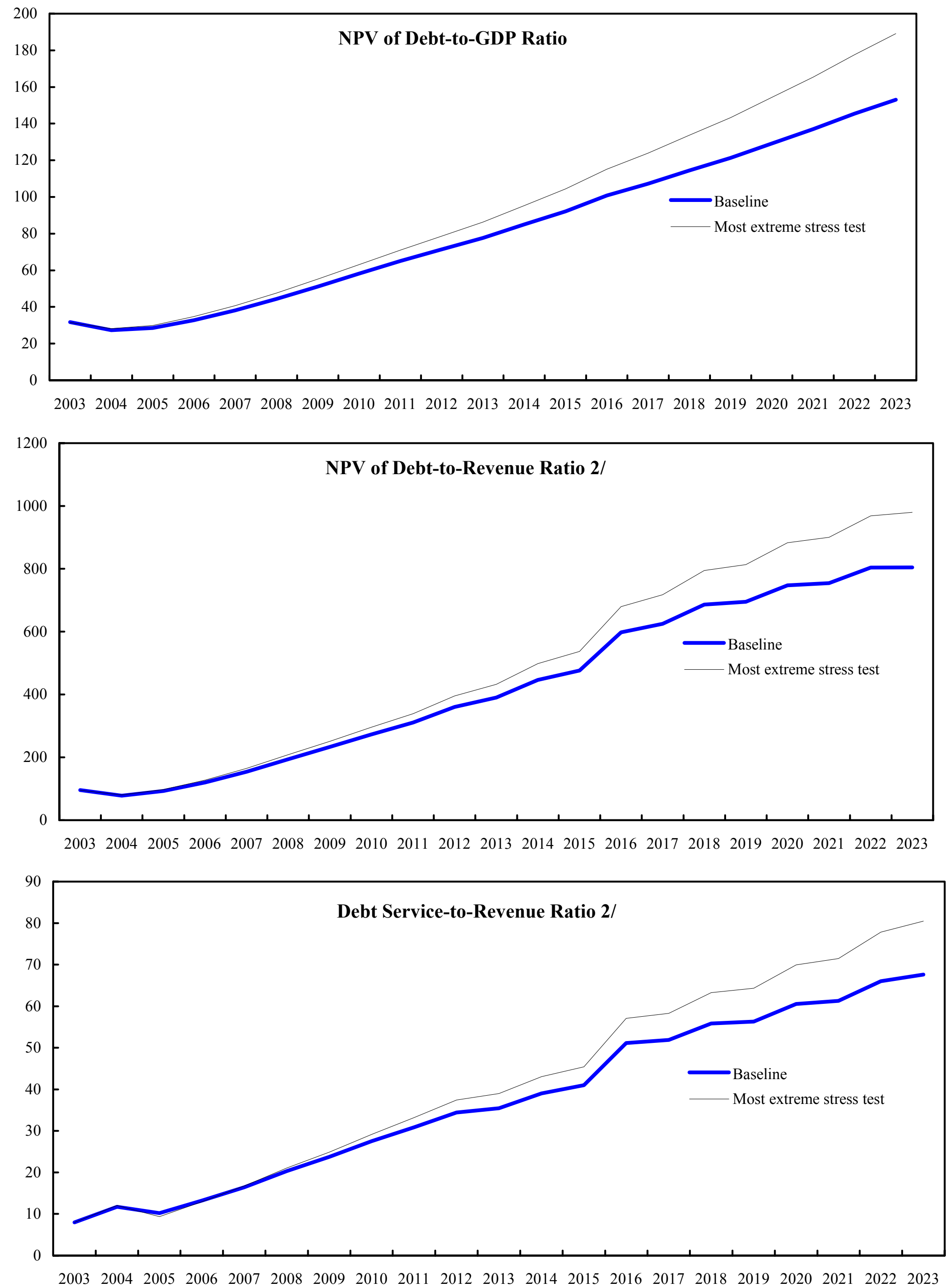
								hide	hide	hide		
	Actual	Projections										
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2023
NPV of Debt-to-GDP Ratio												
Baseline	**32**	**27**	**28**	**33**	**38**	**44**	**51**	**58**	**65**	**71**	**78**	**153**
A. Alternative scenarios												
A1. Real GDP growth and primary balance are at historical averages	31	27	27	29	31	34	36	37	38	38	38	31
A2. Primary balance is unchanged from 2003	31	29	31	35	40	44	49	53	57	60	63	84
A3. Permanently lower GDP growth 1/	31	28	30	35	41	48	55	63	71	79	86	189
B. Bound tests												
B1. Real GDP growth is at historical average minus one standard deviations in 2004–05	31	28	29	33	38	44	51	57	64	70	76	146
B2. Primary balance is at historical average minus one standard deviations in 2004–05	31	32	37	41	46	52	58	65	72	79	86	164
B3. Combination of B1-B2 using one half standard deviation shocks	31	30	32	36	41	47	54	61	67	74	80	157
B4. One time 30 percent real depreciation in 2004	31	38	37	41	45	51	57	63	67	71	77	161
B5. 10 percent of GDP increase in other debt-creating flows in 2004	31	34	34	39	44	50	56	63	70	77	83	160
NPV of Debt-to-Revenue Ratio 2/												
Baseline	**96**	**78**	**93**	**120**	**155**	**194**	**233**	**273**	**311**	**360**	**390**	**804**
A. Alternative scenarios												
A1. Real GDP growth and primary balance are at historical averages	95	77	90	107	127	147	163	175	184	195	195	169
A2. Primary balance is unchanged from 2003	95	83	102	130	161	193	222	249	273	304	317	440
A3. Permanently lower GDP growth 1/	95	80	97	127	165	208	251	296	339	396	432	980
B. Bound tests												
B1. Real GDP growth is at historical average minus one standard deviations in 2004–05	95	79	94	121	155	194	231	269	305	352	380	771
B2. Primary balance is at historical average minus one standard deviations in 2004–05	95	92	120	148	185	226	265	307	346	399	430	862
B3. Combination of B1-B2 using one half standard deviation shocks	95	84	104	132	167	207	245	285	322	373	403	827
B4. One time 30 percent real depreciation in 2004	95	107	122	150	184	223	259	294	323	361	389	848
B5. 10 percent of GDP increase in other debt-creating flows in 2004	95	97	112	141	177	218	257	298	336	388	418	841
Debt Service-to-Revenue Ratio 2/												
Baseline	**8**	**12**	**10**	**13**	**16**	**20**	**24**	**28**	**31**	**34**	**35**	**68**
A. Alternative scenarios												
A1. Real GDP growth and primary balance are at historical averages	8	12	9	11	12	14	15	17	18	19	19	21
A2. Primary balance is unchanged from 2003	8	12	10	14	16	19	20	23	25	28	28	44
A3. Permanently lower GDP growth 1/	8	12	9	13	17	21	25	29	33	37	39	80
B. Bound tests												
B1. Real GDP growth is at historical average minus one standard deviations in 2004–05	8	12	9	12	16	20	23	27	30	34	35	65
B2. Primary balance is at historical average minus one standard deviations in 2004–05	8	12	13	18	18	21	24	28	32	35	36	72
B3. Combination of B1-B2 using one half standard deviation shocks	8	12	11	15	16	20	23	27	30	34	35	69
B4. One time 30 percent real depreciation in 2004	8	12	10	13	17	21	24	28	32	35	36	68
B5. 10 percent of GDP increase in other debt-creating flows in 2004	8	12	15	14	17	21	24	28	31	35	36	70

Sources: Country authorities; and Fund staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

2/ Revenues are defined inclusive of grants.

Figure 1. Repblic of Yemen: Indicators of Public Debt Under Alternative Scenarios, 2003–2023 1/
(In percent)



Source: Staff projections and simulations.

1/ Most extreme stress test is test that yields highest ratio in 2013.
2/ Revenue including grants.

Table 3. Republic of Yemen: External Debt Sustainability Framework, Baseline Scenario, 2000–2023 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical	Standard	Est.	Projections									
													2003–09			2010–23
	2000	2001	2002	Average 6/	Deviation 6/	2003	2004	2005	2006	2007	2008	2009	Average	2013	2023	Average
External debt (nominal) 1/	**50.5**	**51.1**	**48.6**			**44.4**	**39.3**	**36.4**	**36.3**	**36.4**	**36.3**	**36.5**	**37.9**	**64.9**	**168.1**	**101.0**
Of which: Public and publicly guaranteed (PPG)	50.5	51.1	48.6			44.4	39.3	36.4	36.3	36.4	36.3	36.5	37.9	64.9	168.1	101.0
Change in external debt	-22.4	0.5	-2.5			-4.2	-5.1	-3.0	-0.1	0.1	-0.1	0.3	-1.7	8.6	11.4	9.4
Identified net debt-creating flows	-30.3	-7.8	-10.7			-4.1	-5.8	-0.7	2.3	4.9	6.2	7.5	1.5	5.7	0.3	4.3
Non-interest current account deficit	**-13.8**	**-5.9**	**-5.8**	**-5.0**	**4.3**	**-1.6**	**-1.4**	**-0.1**	**3.7**	**6.8**	**8.8**	**10.1**	**3.7**	**10.5**	**12.1**	**11.7**
Deficit in balance of goods and services	-6.4	1.1	0.7			1.5	0.3	2.4	7.9	12.2	14.9	16.6	8.0	19.9	31.1	24.3
Exports	41.6	36.0	38.4			37.3	37.3	35.7	29.9	25.2	22.0	20.7	29.7	17.6	26.2	18.9
Imports	35.2	37.2	39.1			38.8	37.6	38.1	37.8	37.4	37.0	37.3	37.7	37.5	57.3	43.3
Net current transfers (negative = inflow)	-14.6	-13.4	-13.9	-17.9	4.0	-10.7	-9.9	-8.5	-8.2	-7.8	-7.4	-7.2	-8.5	-9.0	-17.9	-12.0
Other current account flows (negative = net inflow)	7.2	6.3	7.3			7.6	8.2	5.9	4.0	2.4	1.3	0.6	4.3	-0.4	-1.0	-0.6
Net FDI (negative = inflow)	**-1.5**	**-2.7**	**-3.0**	**-0.6**	**2.5**	**-1.6**	**-3.8**	**0.0**	**-0.9**	**-1.4**	**-2.1**	**-2.1**	**-1.7**	**-3.8**	**-7.2**	**-5.3**
Endogenous debt dynamics 2/	**-15.0**	**0.7**	**-1.8**			**-0.9**	**-0.6**	**-0.6**	**-0.5**	**-0.4**	**-0.5**	**-0.5**	**-0.5**	**-1.0**	**-4.6**	**-2.2**
Contribution from nominal interest rate	0.5	0.6	0.5			0.5	0.4	0.4	0.5	0.5	0.6	0.6	0.5	0.9	1.7	1.2
Contribution from real GDP growth	-2.5	-2.3	-1.9			-1.4	-1.0	-1.0	-0.9	-0.9	-1.0	-1.0	-1.0	-1.8	-6.3	-3.4
Contribution from price and exchange rate changes	-13.0	2.5	-0.4			…	…	…	…	…	…	…	…	…	…	…
Residual (3-4) 3/	**7.9**	**8.4**	**8.2**			**-0.1**	**0.7**	**-2.2**	**-2.4**	**-4.8**	**-6.3**	**-7.2**	**-3.2**	**2.9**	**11.0**	5.1
Of which: Exceptional financing	-0.6	0.0	0.0			0.0	-0.6	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0
NPV of external debt 4/	...	...	26.1			24.1	21.9	20.7	20.8	21.0	21.0	21.2	21.5	35.1	88.1	53.6
In percent of exports	...	...	68.0			64.5	58.6	57.9	69.6	83.4	95.4	102.6	76.0	199.4	335.8	282.7
NPV of PPG external debt	**...**	**...**	**26.1**			**24.1**	**21.9**	**20.7**	**20.8**	**21.0**	**21.0**	**21.2**	**21.5**	**35.1**	**88.1**	**53.6**
In percent of exports	...	...	68.0			64.5	58.6	57.9	69.6	83.4	95.4	102.6	76.0	199.4	335.8	282.7
Debt service-to-exports ratio (in percent)	6.1	6.4	3.8			3.4	3.4	2.8	4.0	5.0	6.3	6.6	4.5	11.6	19.7	16.2
PPG debt service-to-exports ratio (in percent)	6.1	6.4	3.8			3.4	3.4	2.8	4.0	5.0	6.3	6.6	4.5	11.6	19.7	16.2
Total gross financing need (billions of U.S. dollars)	-1.2	-0.6	-0.7			-0.2	-0.5	0.1	0.6	1.1	1.4	1.7	0.6	1.5	1.3	1.5
Non-interest current account deficit that stabilizes debt ratio	8.6	-6.4	-3.3			2.5	3.7	2.9	3.8	6.7	8.9	9.8	5.5	1.9	0.8	2.3
Key macroeconomic assumptions																
Real GDP growth (in percent)	4.4	4.6	3.9	5.1	1.4	3.1	2.7	2.9	2.7	2.7	3.0	3.0	2.8	3.2	3.9	3.4
GDP deflator in US dollar terms (change in percent)	21.6	-4.6	0.8	8.1	16.9	8.9	12.1	9.7	3.2	3.0	3.7	2.4	6.8	-4.8	-6.1	-5.1
Effective interest rate (percent) 5/	0.9	1.1	1.0	1.1	0.2	1.2	1.2	1.2	1.3	1.4	1.7	1.6	1.3	1.5	1.1	1.3
Growth of exports of G&S (U.S. dollar terms, in percent)	53.4	-13.7	11.5	13.1	32.0	9.2	15.1	8.1	-11.3	-10.9	-6.6	-1.1	0.6	-3.7	6.8	-0.2
Growth of imports of G&S (U.S. dollar terms, in percent)	9.6	5.2	10.1	6.7	6.6	11.4	11.5	14.6	5.0	4.5	5.7	6.5	8.8	-1.6	3.2	1.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	36.4	31.6	35.5	42.6	42.1	43.4	42.6	38.6	51.8	51.5	50.5
Memorandym item:																
Nominal GDP (billions of U.S. dollars)	9.6	9.5	10.0			11.2	12.9	14.6	15.4	16.3	17.4	18.4		17.2	13.1	

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments devided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4. Republic of Yemen: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2003-23

(In percent)

	Est.	Projections						
	2003	2004	2005	2006	2007	2008	2013	2023
NPV of debt-to-GDP ratio								
Baseline	24	22	21	21	21	21	35	88
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2004-23 1/	24	22	18	12	6	0	0	0
A2. New public sector loans on less favorable terms in 2004-23 2/	24	22	22	22	23	24	48	146
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2004–05	24	22	20	20	21	21	34	87
B2. Export value growth at historical average minus one standard deviation in 2004–05 3/	24	28	36	35	35	35	51	105
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004–05	24	27	31	31	31	31	52	130
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004–05 4/	24	23	20	20	20	20	34	87
B5. Combination of B1-B4 using one-half standard deviation shocks	24	25	28	28	29	28	46	110
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	24	30	28	28	29	29	48	120
NPV of debt-to-exports ratio								
Baseline	65	59	58	70	83	95	199	336
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2004-23 1/	65	59	49	40	22	0	0	0
A2. New public sector loans on less favorable terms in 2004-23 2/	65	60	60	75	92	109	274	558
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2004–05	65	59	58	70	83	95	199	336
B2. Export value growth at historical average minus one standard deviation in 2004–05 3/	65	106	188	224	265	300	549	758
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004–05	65	59	58	70	83	95	199	336
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004–05 4/	65	61	55	66	79	91	192	331
B5. Combination of B1-B4 using one-half standard deviation shocks	65	72	87	104	124	142	286	460
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	65	59	58	70	83	95	199	336
Debt service ratio								
Baseline	3	3	3	4	5	6	12	20
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2004-23 1/	3	3	3	4	4	4	1	0
A2. New public sector loans on less favorable terms in 2004-23 2/	3	3	3	4	5	7	15	36
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2004–05	3	3	3	4	5	6	12	23
B2. Export value growth at historical average minus one standard deviation in 2004–05 3/	3	5	6	10	12	14	36	54
B3. US dollar GDP deflator at historical average minus one standard deviation in 2004–05	3	3	3	4	5	6	12	23
B4. Net non-debt creating flows at historical average minus one standard deviation in 2004–05 4/	3	3	3	4	5	6	12	22
B5. Combination of B1-B4 using one-half standard deviation shocks	3	4	4	6	7	9	18	31
B6. One-time 30 percent nominal depreciation relative to the baseline in 2004 5/	3	3	3	4	5	6	12	23
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	45	45	45	45	45	45	45	45

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

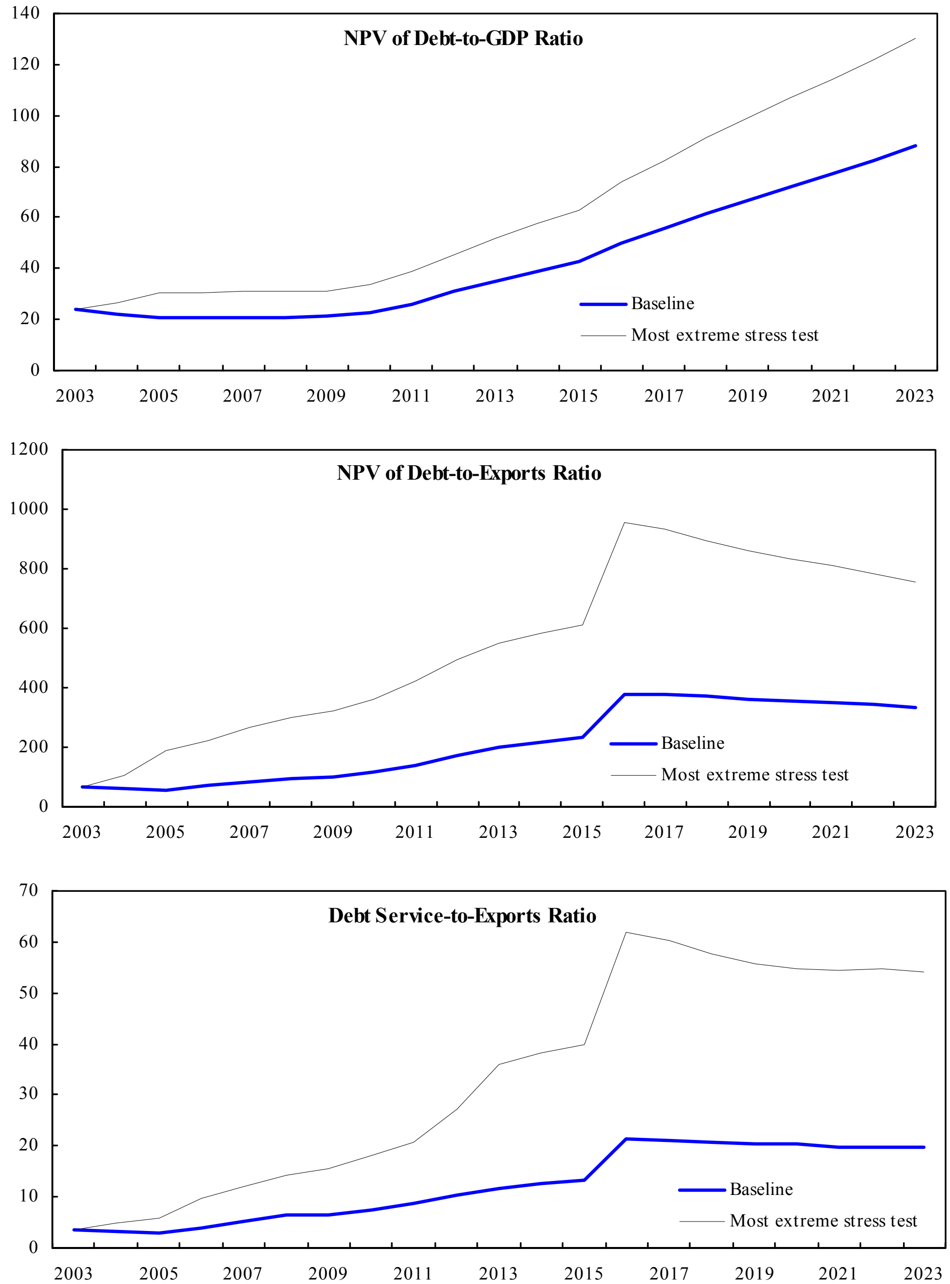
4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 2. Republic of Yemen: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2003–2023

(In percent)



Source: Staff projections and simulations.

REPUBLIC OF YEMEN: WORLD BANK RELATIONS

A. Partnership in Yemen's Development Strategy

1. World Bank assistance to the implementation of Yemen's Poverty Reduction Strategy Paper (PRSP) has progressed, and the Country Assistance Strategy (CAS) for FY03–06 program of lending and policy dialogue is being implemented as envisaged.

2. The four main objectives of the CAS are: (a) better public sector governance; (b) an attractive environment for private investment; (c) building and protecting human capital; and (d) ensuring environmental stability, particularly in the critical area of water. The implementation of the CAS is progressing well with $387.4 million committed between FY03 and the second quarter of FY05 for seven credits. These include two credits for agriculture/rural development, two for infrastructure/urban development, one for water, one for the innovative and successful social funds for development, and one for basic education development program. Two additional projects (*Second Rural Access Program,* and *Second Vocational Training*) are expected to be approved this Fiscal Year (FY05).

3. The Bank's key non-lending support included completion of analysis of public expenditure management, civil service modernization, and country financial accountability assessment, petroleum price policy reform, household energy supply and use, development of national gender strategy, environmental safeguard requirements, and strategic plans for long-term development of coastal aquifers. The Bank is also assisting Yemen in preparing a progress report on PRSP by providing early comments as the draft is being prepared. Coordination among donors has become more regular and has elaborated into subgroups dealing with specific sectors (civil service, water, education, etc.). Collaboration with, and support for, civil society organizations has also deepened, both directly (e.g., NGO capacity building grants) and indirectly (e.g., credits for projects employing NGOs).

B. Status of the Portfolio

4. As of December 31, 2004, the International Development Association (IDA) had approved 132 credits for Yemen for a commitment value of $2.2 billion (net of cancellations), of which about $1.7 billion have been disbursed. The current portfolio has 19 projects with total commitments of $816 million (net of cancellations), of which $648.5 million are undisbursed. About 26 percent of the portfolio, by value, is dedicated to the water sector, 19 percent to education, almost 15 percent to health and other social sectors, over 16 percent to public administration, 9 percent to agriculture, 8 percent to transportation, 6 percent to energy, and 1 percent to financial sector.

5. Overall portfolio performance and management remain satisfactory. Out of 19 projects in the portfolio, only two (*Civil Service Modernization and Health Reform Support*) are rated unsatisfactory/problem projects. The Bank and the government are making efforts to address issues affecting the implementation of these projects. A Country Portfolio Performance Review (CPPR) was held in Sana'a in May 2004. Disbursements in FY04 was

about $91 million; this, however, translated into a lower disbursement ratio (about 16.5 percent) than in FY03 that was 20 percent. The disbursement ratio is expect to improve by end of FY05.

6. The International Finance Corporation (IFC) has three active investments in grain processing, ceramic tile manufacturing, and bottled water, totaling $11 million. Problems with the investment environment limit IFC activities in Yemen and (as in the case of the grain processing project) impede implementation and profitability. However, the IFC has a very clear developmental role to play in the country and has devoted considerable resources to promote business there. Several large projects are currently under consideration. In addition, the IFC received approval for a new regional facility that will provide technical assistance in Yemen to help improve the business environment, strengthen the financial sector, and stimulate the growth of SMEs.

C. Bank-Fund Collaboration in Specific Areas

7. Bank and Fund staffs consult regularly and coordinate their activities. A major activity over the past year was assistance to the Yemeni experts who produced the PRSP and subsequently collaboration on a Joint Staff Assessment of the PRSP. In addition, the staffs have worked closely together on civil service reform and government financial management, and in particular, budgeting and public expenditure modernization. Collaboration on these issues is expected to intensify. Bank and Fund staffs have also collaborated on financial sector development issues, with the aim of restoring financial stability (by now largely achieved) and removing constraints on economic development.

Contact Persons:

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REPUBLIC OF YEMEN: STATISTICAL ISSUES

1. In view of wide-ranging statistical deficiencies, the authorities are making an effort to improve data compilation with technical assistance from the Fund and other donors. The Republic of Yemen has participated in the General Data Dissemination System since April 26, 2001. While some progress has been made, significant work remains to be done before major improvements can be seen.

2. The most reliable and timely data are those on the **monetary sector** produced by the Central Bank of Yemen (CBY). To strengthen monetary statistics further, the multisector mission in August 2000 recommended that (a) repurchase agreements be treated as collateralized loans; (b) all nonstandard loans be reclassified as claims on the relevant sector; (c) counterparty for several monetary accounts need to be accurately identified; and (d) a number of monetary accounts should be disaggregated so as to enable the CBY to present the position for each financial instrument. In June 2003, the authorities began reporting to STA a more disaggregated set of data that allowed for their improved sectoral and instrument classification in monetary statistics. Based on this more detailed data reporting, a revised series of monetary statistics starting December 1999 was published beginning with the August 2003 issue of *IFS*.

3. The CBY disseminates data on total official reserve assets with a lag of one week and is in the process of compiling the reserve template with data on reserve and foreign currency liquidity. The authorities should aim to disseminate the reserve template with a monthly periodicity and a lag not exceeding one month.

4. Although important progress have been achieved in terms of coverage, classification, and compilation methods of **national accounts** in accordance with the *System of National Accounts 1993*, significant work remains to be done to further improve data quality and compilation methods. Based on technical assistance provided by STA in real sector statistics from September 2001 to June 2004, the Central Statistics Office (CSO) has compiled national accounts statistics for the years 1999–2002 that include: current accounts and the capital account by institutional sector; goods and services account and the integrated economic accounts for the total economy; supply and use tables (SUT). The compilation of the SUT for 2003 is well underway, but the sectoral accounts have not been completed due to delays experienced with the surveys. Unlike previous estimates, most of the production and expenditure estimates are now based on direct methods that mainly use the results of recently conducted surveys. Looking ahead, quarterly establishment sample surveys are planned for late 2004 to provide short-term indicators for moving annual benchmark series, and a household expenditure and income survey is scheduled for 2005. Additional work is still needed to (i) ensure the accuracy and the speed of collecting and processing survey results; (ii) to conduct new surveys to cover additional activities; (iii) better identify the informal sector; and (iv) cover unorganized units and update survey samples to improve coverage.

5. With regard to **price statistics**, some improvements have been made in the CPI compilation and the production of foreign trade indices starting with the 2001–03 series.

However, development of a producer price index had to be postponed due to the limited human and financial resources. With the assistance of the real sector mission by STA, the CSO has constructed a CPI that is consistent with international standards. The weights were derived from the 1998 Households Budget Survey. The CPI has a broad geographic coverage and a sufficient number of consumption items, although some deficiencies remain in data collection practices. The real sector mission recommended further improving the sources of data in general, expanding the price statistics to cover different areas, and enhancing training and internal coordination within the CSO.

6. Regarding the **fiscal accounts**, data reliability is uncertain, and timeliness is weak, particularly for detailed revenue and expenditure items. There are also discrepancies between reported budget data and below-the-line financing data obtained from the monetary statistics. Since the beginning of 2000, fiscal data have been prepared according to the GFS economic classification, and monthly reports are available, albeit irregularly, at the subchapter level. Further progress, particularly in providing expenditure data based on GFS functional classification on a chapter and subchapter level, as recommended by FAD technical missions, is expected to be made following the installation of the proposed integrated information system (AFMIS). The authorities have not reported data for publication in the Government Finance Statistics Yearbook (GFSY) from 2000 onwards. The latest data are estimates for 1999 published in the 1999 GFSY. A GFS mission visited Sana'a in January 2004.

7. The CBY, which compiles **balance of payments** statistics, is responsible for data collection from various sources, implementation of the proper methodology, and dissemination of the data. More recently, the CBY has started preparing the international investment position (IIP) statement in the framework of the Balance of Payments Manual, fifth edition (BPM5). The tasks are performed on a rather ad hoc basis, mostly relying on survey-based questionnaires whose response rate is generally poor. Also, the quality of the questionnaires themselves is poor due to the limited expertise and experience in developing such material. Further compounding the weak quality of the statistics are inadequacies in documented sources and methods, and financial and material resources dedicated to balance of payments compilation. The CBY publishes quarterly external debt statistics within one quarter of the reference period for the banking sector, general government, and monetary authority.

8. A STA mission on balance of payment statistics in January 2003 found that little progress had been made in implementing the recommendations of either the IMF's resident advisor on balance of payments statistics (1998–2000) or the 2002 multisector statistics mission. The coverage of the oil industry transactions remains weak. The quality of the questionnaires is poor, with questionnaires on FDI and selected items in services being either discontinued or not followed up. The shortage of qualified staff dedicated to data compilation as well as weak coordination between the CBY and other government agencies (such as the customs authority, the CSO, and the ministry of oil and mining resources) were also responsible for the slow progress. The mission recommended that a new work program be

carried out over a period of 22 months. The plan calls for, among other things, better coordination between the CBY and other government agencies for more timely and effective data collection and compilation, improved staffing and training, and the reinstitution of discontinued surveys. Further technical assistance may be required for designing and implementing surveys aimed at improving data collection on workers' remittances. Yemen recently began submitting quarterly BOP and IIP data (for 2003) for publication in *IFS* and the Balance of Payments Statistics Yearbook.

Republic of Yemen: Table of Common Indicators Required for Surveillance
(as of January 31, 2005)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	12/31/04	1/18/05	D	W	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/31/04	1/18/05	W	W	W
Reserve/Base Money	12/31/04	1/18/05	M	M	M
Broad Money	12/31/04	1/18/05	M	M	M
Central Bank Balance Sheet	12/31/04	1/18/05	M	M	A
Consolidated Balance Sheet of the Banking System	12/31/04	1/18/05	M	M	A
Interest Rates[2]	12/04	12/04	M	M	M
Consumer Price Index	12/31/04	1/18/05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	10/04	12/04	M	M	A
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	10/04	12/04	M	M	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	10/04	12/04	M	M	A
External Current Account Balance	2004	12/04	A	A	A
Exports and Imports of Goods and Services	2004	12/04	A	A	A
GDP/GNP	2003	12/04	A	A	A
Gross External Debt	12/04	1/06/05	M	M	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

REPUBLIC OF YEMEN: TECHNICAL ASSISTANCE PROGRAM[26]

a. UNDP/IMF Program:

BCS—Computerization needs of the ministry of finance, April 1995
FAD—Long-term expert (LTE) on customs and administration reform since August 1996
FAD—General sales tax and tax administration, June 1997
FAD—Short-term expert (STE) on budget management, February–March and November–December 1997
FAD—STE on tax identification number system and computerization, February and July–August 1997
FAD—STE on input tax credit mechanism, July–August 1997
MED—STE on dept management, November 1996–June 1997

b. IMF

FAD—Tax policy and customs administration, April 1995
FAD—Budget control and reporting, July–August 1995
FAD—Personal income tax reform and preparations for general sales tax, June 1996
FAD—Social safety net: food subsidies, Social Welfare Fund, and pension funds, July 1996
FAD—Modernization of tax administration, August 1997
FAD—Customs and tax reform, March 1999
FAD—Budget management reform, April 1999
FAD—Pension reform, May 1999
FAD—Introduction of GST, September 1999
FAD—Pension Reform, January 2000
FAD—Introduction of GST, February 2000
FAD—Pension Reform, April 2000
FAD—Pension Reform, August 2001
FAD—Reform of the Budgetary Process, April 2002
FAD—Public expenditure management expert installation, September 2002
FAD—Tax policy, tax administration and customs reform, October–November 2002
INS—Techniques of financial analysis and programming, March 1996
INS—Techniques of financial analysis and programming, October 1997
MAE—Financial sector reform, May 1995
MAE—STE on Treasury bill issuance, November–December 1995
MAE—Operation of a floating exchange rate system, December 1995

[26] Mission; unless otherwise indicated.

MAE—LTE on monetary policy, January 1996–July 1999
MAE—STE on monetary policy, November 1997 and February 1998
MAE—STE on central bank information technology, March and August 1996
MAE—Monetary and financial market overview, February–March 1998
MAE—LTE on central bank accounting and computerization, November 1995–January 1998
MAE—Central bank legislation, banking supervision, and monetary operations, February 1998
MAE—Monetary operations, foreign reserves management, and organization and management April 1999
MAE—Monetary operations, October–November 2000
MAE—FSAP (with World Bank), October–November 2000
MAE—Foreign reserves management, February–March 2001
STA—STE on national accounts and price statistics, March 1996
STA—Balance of payments statistics, July–August 1997
STA—STE on balance of payments statistics, November 1997
STA—National accounts and prices, September 1998
STA—National accounts and prices, April 1999
STA—National accounts and prices, October 1999
STA—National accounts and prices, April 2000
STA—Multisector statistics, August 2000
STA—Balance of payments statistics, January 2003
STA—Government Finance Statistics, January 2004

c. UNDP/IMF/DFID Program:

FAD—LTE on general sales tax, January 1998–December 2000.
FAD—LTE on tax administration, January 1998–December 2000.
FAD—LTE on budget management, March 1998–June 2001, and September 2002–January 2004.
MAE—LTE on bank supervision, May 1997–May 2001.
MED—LTE on debt management, July 1997–March 2001.
STA—LTE on balance of payments statistics, February 1998–February 2000.
FAD—Peripatetic experts on customs reform, July 1999–July 2001.
STA—Peripatetic expert on national accounts, September 2001–August 2002.
MAE—Peripatetic expert on foreign reserves management since April 2002.

REPUBLIC OF YEMEN: PRIORITY PEM REFORM AREAS[27]

Budget Preparation and Coverage of the Budget

Reform Areas	Budget preparation follows top-down & bottom-up approach	MT macro and fiscal forecasts are used as basis for planning budgeting (with thorough analysis)	Budget classification includes adequate functional classification	Comprehensive coverage of central government budget	Some coverage of general government in budget or fiscal reports
YMN					√
DZA		√	√	√	√
EGY			√		√
IRN	√	√	√		
JOR					
MAR	√		√	√	
OMN	√	√	√	√	√
SND	√	√		√	
SYR					
Number of countries	**4**	**4**	**5**	**5**	**4**

Budget Execution Control and Audit

Reform Areas	Control of central government over local governments is strong	Government operates a Treasury Single Account (TSA)	Adequate mechanisms of accounting & control (internal audit) exists	Existence of a national independent external audit body
YMN	√			
DZA		√		
EGY	√			
JOR		√	√	
MAR		√		√
OMN			√	
SDN			√	√
Number of countries	**2**	**3**	**3**	**2**

Fiscal Reporting and Publication of Fiscal Data

Reform Areas	Regular reporting on fiscal performance	Timeliness and public availability of fiscal reports	Comprehensiveness of fiscal reports
YMN			
DZA			√
EGY	√	√	√
IRN	√	√	
JOR	√	√	
LBN	√	√	√
MAR	√	√	√
OMN	√	√	√
SND	√		√
Number of countries	**7**	**6**	**6**

Note: (X equals yes or "moderately well") and YMN = Yemen; JOR = Jordan; EGY = Egypt; OMN = Oman; SYR = Syria; DZA = Algeria; IRN = Iran; MAR = Morocco; SND = Sudan; and LBN = Lebanon.

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[27] These results are taken from the study done by Ahmad, Calcoen, Danninger, and Sabharwal, 2004, "Institutions and the Public Sector in Reforming the Public Finances in Middle Eastern and North African Countries" (draft) for the 2004 MENA Conference in Washington, DC and the Regional Conference on Fiscal Reforms in the Arab Countries, Beirut.

Statement by A. Shakour Shaalan, Executive Director for the Republic of Yemen March 14, 2005

1- At the outset, I would like to convey the Yemeni authorities' appreciation to the staff and management for their continuing candid and constructive engagement in Yemen. They view the consultation process as well as the provision of technical assistance as being of great value to the country. The authorities are in broad agreement with the analysis and the thrust of the policy recommendations contained in the comprehensive staff report.

Background

2- Yemen undertook ambitious macroeconomic and structural reform efforts since the mid 1990s, bringing about major improvements in the economy. Accomplishments under Fund-supported programs, in the form of Stand-By and Extended Arrangements and subsequently the PRGF over the period 1996-2001, included macroeconomic stabilization, exchange rate unification, trade liberalization, and the reduction in external debt. Further significant advances in structural reforms included the fiscal area, the civil service, the banking sector, and public enterprise privatization. Yemen, still a developing democracy often confronted with precarious security situations, continues to muster strong public and political support to the wide-ranging reform program pursued. Looking ahead, the authorities are determined to maintain this consensus building approach to reform, which, sometimes, might have led to inevitable compromises, but which, they strongly believe, has served the country well.

Recent Developments

3- Following the favorable economic performance supported by the completion of the PRGF program in 2001, a number of weaknesses emerged, including a slowdown in economic growth and reemerging inflationary pressures. Unexpected adverse circumstances, namely a steeper than expected decline in oil production in 2004 accounted for the former, while the latter was largely due to the impact of adverse weather conditions on food prices. In spite of these factors, the overall fiscal deficit narrowed by 0.8 percent in 2004, although it was still 1 percent above its target. The external current account deficit remained broadly unchanged as increasing export revenues resulting from higher oil prices offset an increase in import demand. Higher oil exports boosted the central bank's own gross foreign reserves to about U.S. dollars 5.1 billion (16.4 months of imports), despite a drop in oil production. Moreover, the non-oil GDP grew by 4.1 percent and is expected to further rise in the medium term. Given the internal circumstances and regional uncertainty, this is a commendable achievement.

4- The short-term outlook for the economy is broadly manageable. While the downward revision of Yemen's long-term oil production path introduces new challenges, the prospect of natural gas exploitation could improve the economic outlook. To address these challenges, the authorities are already planning a comprehensive economic strategy supported by policies aimed at promoting growth and diversifying the economy's production base. In a move to muster public support for these efforts, they have launched a public communication campaign aimed at explaining the benefits of these reforms in light of the long-term risks stemming from declining oil production. They are hopeful that they will mobilize the necessary effort to gradually implement the reform agenda.

Fiscal Policy and Reform

5- The authorities fully integrated an ambitious reform package in the 2005 budget, which was approved by parliament in early January, pending the adoption by the government of the following measures in order to ensure effective implementation: submitting to parliament a national wage strategy to be implemented fully by 2007, reducing customs duties to the level of neighboring countries, providing additional resources for social safety nets to reduce the impact of higher petroleum prices, fighting smuggling through better border control, and adopting policies that would encourage growth in non-oil sectors such as fisheries and tourism. I am pleased to report that the two major conditions related to the wage strategy and customs duties' reduction are currently being finalized and on the way to be implemented. The government is hopeful that the remaining conditions will soon be fulfilled. In an effort to reverse the recent deterioration in the fiscal trend relative to end of year budget targets, the 2005 budget is targeting a 9 percent decline in the non-oil primary deficit, which will reduce the overall deficit to 3 percent of GDP.

6- The centerpiece of the reform effort consists in phasing out the petroleum product subsidy beginning in 2005. The price adjustment aims at bringing most domestic prices, especially gasoline, in line with international prices, while the price of diesel fuel would increase to 85 percent of the international price. In line with a proposal the government made last year, diesel prices would almost double to reach Yrls 33, and gasoline and liquefied petroleum gas prices would increase by 45 percent and 40 percent, respectively. Swift and full implementation of these measures would result in halving the fuel subsidy to about 3 percent of GDP, and improving the fiscal stance. In addition, the authorities are determined to eliminate fuel price subsidies totally, with a view to reducing their distortionary effect and their heavy burden on the budget. In view of the adverse impact the removal of the fuel subsidy is expected to have on the most vulnerable groups of society, the authorities recognize the need to strengthen existing social safety nets, including improving the targeting and coverage of the Social Welfare Fund and supporting the Social Development Fund, while enhancing capacity at the national level.

7- The Yemeni authorities are thankful for the staff's elaborate medium and long-term fiscal scenario and the fiscal adjustment measures put forward. The adjustment will reduce the non-oil primary budget deficit by 12-15 percent of GDP over the next 12 years. While the authorities agree with the proposed measures, they note the difficulty of ensuring the timely implementation of some of them. In particular, they are concerned about the imposition of an excise tax on petroleum products as early as 2007, immediately after the elimination of the subsidy.

8- Major components of the fiscal adjustment effort, namely the GST and public expenditure management measures, have already received the government's attention. The authorities are of the view that a broad-based and simple tax is key to improving revenue performance. In this respect, the government completed a revision of the draft GST law, which is now with parliament for approval. It is hoped that the draft law will be approved without amendments. Major improvements included in the draft comprise a streamlining of exemptions, the elimination of the tax on production and consumption, the unification of the GST registration threshold, and the development of special refund procedures. In addition, the authorities took note of further enhancing measures suggested by staff, such as the elimination of the few remaining exemptions, lowering higher GST rates while imposing an excise on specific goods, and shortening the time for processing refunds to one month. They intend to address those measures at a later stage.

9- The Yemeni authorities agreed with staff on the need to improve public expenditure management as a condition for achieving a sustainable fiscal adjustment over the long term. In this respect, the 2005 budget preparation process was significantly improved by the use of macroeconomic indicators and indicative ceilings. However, as the authorities recognize the importance of further strengthening internal expenditure control mechanisms, including by developing a commitment control system and strictly adhering to budgetary allocations, they discussed with staff the prioritization and sequencing of the remaining reform measures. Continuous technical assistance provided by the Fund and donors has been very helpful, particularly in streamlining the budget presentation and improving fiscal transparency. The authorities indicated their intention to gradually consolidate a number of extra-budgetary funds and other special accounts into the budget, in a move to create a Treasury Single Account.

Monetary and Exchange Rate Policies

10- The authorities are committed to a monetary targeting framework to achieve price stability. In light of the recent increase in inflation, they confirm their close monitoring of the situation and their intention to intervene when necessary. In this respect, they are open to increasing the benchmark deposit rate. However, they see no immediate need for such an action, given that they deem the recent pick-up in inflation mainly supply driven. Moreover, they are concerned over the effect of higher interest rates on investment and growth.

11- With regard to intervention in foreign exchange markets, the authorities remain of the view that such interventions should be limited to smoothing short-term fluctuations, especially that they concur with staff that a flexible exchange rate that reflects real market forces would serve the economy well as the non-oil export base expands.

Financial Sector and Other Structural reforms

12- The authorities recognize the importance of implementing the 2001 FSAP recommendations. While acknowledging that further steps should be adopted, the Central Bank of Yemen upgraded its accounting practice to the latest international standards and a new initiative to modernize commercial courts was launched recently.

13- The authorities are committed to supporting the necessary fiscal effort by adopting policies aimed at promoting economic growth and diversifying the production base. They have recently adopted a strategy for fisheries as they agree with staff on the serious employment opportunities provided in the sector. Transshipments activities and tourism are potentially other important sources of growth. In this context, the World Bank port cities project aims, at encouraging growth and creating jobs in the port cities of Aden, Honeidah and Mukalla. The development of non-oil sector activities remain, however, dependent on the improvement in the security situation and the business climate, which I will discuss below. The Yemeni authorities intend to adopt structural measures to accompany the fiscal adjustment and other pro-growth policies. These include preserving a core allocation of critical and poverty-related expenditures.

14- The authorities remain committed to removing impediments to private sector activity. Plans to reform the civil service are progressing steadily with the completion of the civil service database and the amnesty law resulting in a voluntary self declaration of multi-salary recipients. Moreover, Yemen remains committed to maintaining an open trade regime. It is expected to join the WTO in four to five years as negotiations on accession are steadily progressing. In a move to combat unemployment, the authorities are hopeful that the improved labor code, aimed at introducing flexibility in the market, would soon be adopted. They agreed with staff on the need to redesign the education curricula and enhance vocational training to better respond to market demand.

Conclusion

15- Yemen's near-term outlook remains broadly manageable. However, the authorities recognize that there is no room for complacency in view of the medium- and long-term challenges posed by a rapid decline in oil production and the continuous need to undertake necessary reforms. I would like to reiterate the commitment of the Yemeni authorities to pursuing fiscal reforms and accompanying policies aimed at improving the supply response of the economy. They very much appreciate staff's valuable advice and technical assistance, and look forward to continuous intensive support from the Fund in the period ahead.

INTERNATIONAL MONETARY FUND
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March 24, 2005

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2004 Article IV Consultation with the Republic of Yemen

On March 14, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Yemen.[1]

Background

An expected rapid decline in oil production poses serious long-term economic challenges for Yemen. The authorities have carried out a public information campaign to highlight the risks of inaction and to facilitate the political and public acceptance of reform measures, some of which are now part of the 2005 budget.

Economic growth slowed in 2004 due to a sharp contraction in the oil sector. Oil production declined by 5.9 percent, reflecting diminishing recovery from aging large oil fields as well as the absence of significant new discoveries. Given the slowdown in oil production, real GDP growth is estimated to have declined to 2.7 percent in 2004 compared with 3.1 percent in 2003. Non-oil GDP growth is estimated to have reached 4.1 percent in 2004, supported by stronger activity in the construction, transportation, and trade sectors, and fueled by domestic demand stemming from continued fiscal expansion and higher public sector wages.

The end-year core CPI inflation (excluding qat) increased from 12.1 percent in 2003 to 14.5 percent in 2004, owing largely to expansionary fiscal and monetary policies, as well as higher food prices caused by adverse weather conditions. The nominal exchange rate remained stable vis-à-vis the U.S. dollar in 2004, and the real effective exchange rate appreciated by 3.5 percent over the 11 months ending November 2004.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The 2004 fiscal deficit was estimated at 4.5 percent of GDP, about 1 percent higher than the original budget. The larger than expected deficit was due to higher development spending and larger petroleum subsidy due mainly to higher oil prices and the postponement of the envisaged increase in petroleum prices. An increase in imports and strong capital inflows mitigated most of the export gains resulting from higher oil prices, leaving the current account balance broadly unchanged. Because of higher oil exports and strong capital inflows, international reserves increased to about $5.1 billion or 16.4 months of imports at end-2004.

Money grew by 15 percent in 2004. It was largely driven by the accumulation of net foreign assets as well as a sharp rise in private sector credit (33.5 percent mainly to finance trade). The benchmark interest rate on saving deposits, the anchor of other interest rates, has remained constant since 2001 at 13 percent.

Some progress has been made in structural reforms. The revised General Sales Tax (GST) law submitted to parliament in late 2004 included several improvements designed to protect the integrity and simplicity of this tax. On public expenditure management, the authorities used, for the first time, macroeconomic indicators and indicative ceilings in the preparation of the 2005 budget, but very little has been done to improve internal expenditure control mechanisms, or to improve budget execution or fiscal reporting. The ministry of civil service continued to lay strong foundations for civil service reform and completed the civil service database. In light of the amnesty granted to multi-dippers (those collecting more than one salary) several hundreds of those came forward voluntarily.

Executive Board Assessment

Executive Directors considered that Yemen is at a crucial crossroads, facing the long-term challenges arising from the expected rapid decline in oil production. While noting the slow pace of reform in recent years, Directors welcomed the authorities' plans to develop a comprehensive strategy aimed at promoting growth and diversifying the productive base. They also welcomed the authorities' renewed efforts to mobilize public support for reforms—including through a public information campaign—and to make the reform package part of the 2005 budget. Directors underscored the importance of strengthening fiscal adjustment and deepening structural reforms to ensure fiscal and external sustainability, with macroeconomic policies guided by long-term considerations, as well as to strengthen the non-oil sector.

Directors noted that, while the short-term outlook remains manageable, without policy adjustments, the long term fiscal and external positions are clearly unsustainable. They observed that an indicative target for debt-to-GDP could provide a useful long-term anchor for fiscal policy. Several Directors took note of the staff's estimate that, to maintain the debt-to-GDP ratio at its current level, a fiscal adjustment of more than 20 percent of GDP in the non-oil primary fiscal deficit will be required over the next 12 years. Directors concurred that, to achieve an adjustment of such magnitude, there will be a need for strong and front-loaded fiscal adjustment, along with a range of structural reforms to facilitate Yemen's smooth transition to a non-oil economy. They welcomed the authorities' recognition of the challenges ahead and their commitment to undertake the necessary policy response, which is also important for attracting additional donor assistance and foreign investment. Some Directors also encouraged the authorities to further explore the country's natural gas reserves as part of their efforts to meet the challenges posed by the declining oil sector.

Directors underscored the need for a strong, credible, and comprehensive fiscal strategy, and recommended the implementation, without delay, of critical measures, such as the General Sales Tax, the removal of the petroleum product subsidy, and the reduction in the wage bill through retrenchment rather than a wage freeze. They also emphasized the importance of improving public expenditure management and strengthening tax and customs administration for the success of the reform effort.

Directors emphasized that public expenditure management reforms should aim mainly at strengthening expenditure controls and enhancing fiscal transparency. Recognizing the large number of needed measures, Directors expressed strong support for clear prioritization and sequencing. They underscored that policies to dissolve extra budgetary accounts and "special funds" leading to the creation of a fully-fledged Treasury Single Account (STA) will be essential. Directors also emphasized the importance of enhancing expenditure discipline by developing a commitment control system to help contain budgetary overcommitments. Poverty reduction strategy priorities should be reflected in the national budget to ensure that the envisaged sectoral plans can be implemented. Efforts should also be made to adopt a functional classification of expenditures and to improve tracking of poverty-related spending.

Directors welcomed the latest amendments to the GST law—now in parliament—intended mainly to limit exemptions and to simplify the GST structure, and expressed hope that it will be adopted soon. Directors called for strengthening the Large Tax Payers Office (LTO) as an important step in mobilizing more tax revenue. They also welcomed the authorities' intention to phase out the petroleum product subsidy and suggested that this be done on the basis of an automatic price adjustment formula. Some Directors noted that the introduction of the excise tax on petroleum products following the elimination of the subsidy might need to be phased in gradually.

In view of the planned adjustment in petroleum prices, Directors underscored the importance of strengthening social protection mechanisms to mitigate the impact on the poor. They supported policies that would improve the targeting and the coverage of the Social Welfare Fund (SWF), which distributes cash subsidies directly to poor families. They also called for further efforts to protect the most vulnerable groups from the long term adjustment required for achieving sustainability. An explicit link between the dividend of oil price reform and increased pro-poor spending was considered beneficial in this connection.

Directors noted that fiscal adjustment alone will not be sufficient to achieve long-term sustainability. Complementary macroeconomic and structural policies to stimulate growth and diversify the production base away from oil will also be required. Particular attention should be given to sectors with a strong potential comparative advantage and large job creation prospects, including fisheries, transshipment activities, and tourism.

In this context, Directors called on the authorities to adopt policies that would improve the business environment, including reducing costs of business startups and streamlining procedures to encourage private sector investment. They also considered that addressing governance issues and tackling corruption should enhance the climate for both domestic and foreign investment. Directors welcomed the continued civil service reform efforts, but stressed that ad hoc wage increases, which are not part of the national wage strategy, may undermine these efforts.

Regarding recent macroeconomic and policy developments, Directors expressed support for the authorities' fiscal policy in the context of the 2005 budget. Directors particularly welcomed the planned significant reduction in the petroleum product subsidy and the improvement in tax revenue expected from the introduction of the GST by mid-year. However, they noted that the adjustment target under the 2005 budget, equivalent to about 9 percent of GDP in the non-oil primary deficit, may be ambitious. They stressed that, under all circumstances, if a supplementary budget is to be adopted later in the year, it should be subject to stringent budgetary discipline and be designed to respond only to unforeseen developments or external shocks.

Directors expressed concern about the surge in prices and considered that monetary policy should be geared to containing inflationary pressures. They called for a tightening of monetary policy, and took note of the authorities' readiness to closely monitor the situation and intervene when necessary. While recognizing the occasional need for the central bank to balance multiple objectives, Directors emphasized that price stability should remain the primary focus of the monetary authorities, especially when macroeconomic stability is in the balance. To enhance the role and effectiveness of monetary policy, they called on the monetary authorities to liberalize the minimum benchmark rate on saving deposits. Directors encouraged the authorities to make further progress in implementing the recommendations of the 2001 Financial Sector Assessment Program, and in strengthening the AML/CFT framework.

Directors emphasized the importance of exchange rate flexibility to achieve long-term sustainability. With the expected decline in oil production and international reserves, the central bank should not resist signals in the foreign exchange market emanating from changes in underlying economic fundamentals. A flexible exchange rate policy, supported by structural reforms, should improve external competitiveness and boost growth in non-oil sectors, easing the transition to a post-oil economy.

Directors took note of the efforts under way to improve the quality and availability of statistics. However, they emphasized the need for further improvements in national accounts and price statistics, balance of payments data, and government finance statistics, to enhance the quality of economic analysis.

Republic of Yemen: Basic Economic and Financial Indicators, 2000–2004
(Quota = SDR 243.5 million)
Population: 19.8 million (2004)
Per Capita GDP: US$653 (2004)

	2000	2001	2002	2003	Proj. 2004
	(Change in percent)				
National income and prices					
Real GDP	4.4	4.6	3.9	3.1	2.7
Real non-oil GDP	3.5	5.2	4.6	4.0	4.1
Real oil GDP	9.4	1.3	0.4	-1.8	-5.9
Core consumer price index (end-of-period) 1/	7.6	14.6	4.5	12.1	14.5
	(In millions of U.S. dollars)				
External sector					
Exports, f.o.b.	3,805	3,302	3,584	3,923	4,510
Of which: crude oil	3,423	2,895	3,134	3,417	3,893
Imports, f.o.b.	-2,635	-2,771	-3,083	-3,422	-3,884
Current account, incl. grants (in percent of GDP)	13.2	5.3	5.4	1.1	1.0
Overall balance (deficit -)	1,368	761	752	583	685
	(In percent of GDP)				
Financial variables					
Overall fiscal balance, commitment basis (deficit -)	8.0	2.6	-1.2	-5.2	-4.4
Primary non-oil fiscal balance, commitment basis (deficit -)	-17.6	-20.5	-21.5	-26.9	-27.5
	(12-month change in percent)				
Broad money	25.1	18.7	18.0	20.0	15.0
Credit to private sector	21.3	25.8	14.3	26.3	33.5
Benchmark deposit interest rate (percent per annum)	13.0	13.0	13.0	13.0	13.0
Central bank own gross foreign reserves 2/					
In millions of U.S. dollars	2,822	3,569	4,056	4,445	5,108
In months of imports	12.3	14.9	17.0	16.0	16.4

Sources: Yemeni authorities; and IMF Staff estimates and projections.

1/ Core CPI is defined as CPI excluding qat.

2/ Gross reserves minus commercial bank and pension fund foreign exchange deposits held with the central bank. Imports are for the current year and exclude oil and gas sector imports.