September 2010
IMF Country Report No. 10/300

Republic of Yemen: Request for a Three-Year Arrangement Under the Extended Credit Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Yemen.

In the context of the request for a three-year arrangement under the extended credit facility, the following documents have been released and are included in this package:

- The staff report for the Request for a Three-Year Arrangement Under the Extended Credit Facility, prepared by a staff team of the IMF, following discussions that ended on July 7, 2010, with the officials of Yemen on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 20, 2010. 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 Press Release summarizing the views of the Executive Board as expressed during its July 30, 2010 discussion of the staff report that completed the request and/or review.

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

Letter of Intent sent to the IMF by the authorities of Yemen*
Memorandum of Economic and Financial Policies by the authorities of Yemen*

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF YEMEN

Request for a Three-Year Arrangement Under the Extended Credit Facility

Prepared by the Middle East and Central Asia Department
(In consultation with other departments)

Approved by Alan MacArthur and David Marston

July 20, 2010

- **Background**. Yemen has been facing mounting pressures on its fiscal and external accounts that have contributed to the depreciation of the rial and a notable reduction in foreign exchange reserves.

  Request for Extended Credit Facility. The authorities have requested a three-year arrangement under the Extended Credit Facility in the amount of SDR 243.50 million (100 percent of quota). Yemen's macroeconomic reforms are intended to put fiscal and external finances on a sustainable path, and restructure spending toward investment and social outlays to promote growth and reduce poverty.

- **Discussions.** Missions visited Sana'a during February 23–March 6, May 24–June 2, and June 28–July 7, 2010. The team met with the prime minister, deputy prime minister, the ministers of finance, oil and minerals, and trade and industry, the governor of the central bank, and other government officials. The team also met with representatives of the private sector and the donor community.

- **Mission.** The team comprised Messrs. Al-Atrash (head), Schneider, Naseer, Poghosyan, and Ms. Ostojic (all MCD). Mr. Geadah (OED) joined the policy discussions in March.

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Attachments

EXECUTIVE SUMMARY

Yemen suffers from high poverty and poor security. Risks to macroeconomic and financial stability could make the situation worse. These risks have been present for some time, but have been masked by high oil prices in recent years. The sharp drop in oil production in 2007 and weak oil prices in late 2008 and 2009 have brought these risks to center stage.

The fiscal and external imbalances have deteriorated. The 2009 fiscal deficit reached a record high due in large part to lower oil production and prices as well as difficulties in sufficiently containing spending or boosting revenues. In the meantime, lower oil exports and strong import demand have led to a steady decline in foreign exchange reserves and considerable pressures on the exchange rate. Security concerns have added to these pressures.

The program to be supported under the Extended Credit Facility (ECF) aims over the medium-term to achieve high and sustained growth and reduce poverty. To this end, it will reinforce macroeconomic stability in the face of a difficult global environment and declining oil production; and put public finances on a medium-term footing, by combining fiscal consolidation with a restructuring of expenditures more toward capital and social outlays.

The centerpiece of the 2010 program is the full implementation of the General Sales Tax and a package of laws that abolishes almost all exemptions on tax and customs duties. The major measure on the expenditure side is the phased adjustment in domestic fuel prices to achieve a net fiscal savings of nearly 1 percent of GDP. These measures should create fiscal space for higher social spending and largely safeguard the level of capital spending.

There are several risks to the program. The security situation clouds not only the economic outlook, but the authorities' ability to meet commitments on socially sensitive reforms. Weak institutional capacity is another source of risk, and is only likely to change over the medium- term and on the basis of a sustained technical assistance effort.

Strong communication will be key. Adjustments to domestic petroleum pricing to reduce smuggling and contain fiscal pressures will be an important challenge. To support this core element of the program, public outreach will be important.

The role of donors is critical. Yemen's developmental and social needs are enormous. Budgetary support is critical to making headway toward meeting the MDGs. In the absence of significant and predictable budgetary support, it may be difficult to create and maintain public support for the authorities' program.

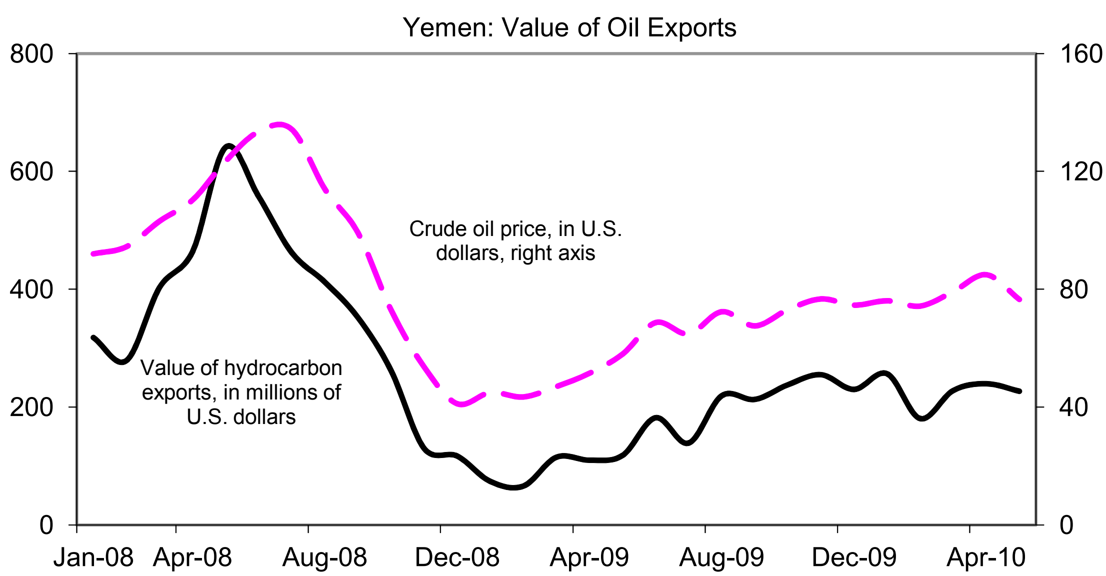
I. Background and Context

1. **Yemen, one of the poorest countries in the region, is confronted with a range of difficult economic challenges**. As highlighted in recent Article IV consultation reports, the economic weaknesses of the country are related to heavy dependence on declining oil revenues that have contributed to growing macroeconomic imbalances, an underdeveloped non-hydrocarbon sector, widespread poverty, and a shortage of water resources. These pressures are likely to continue in the medium-term as oil reserves dwindle.

2. **In the past year, the government's efforts to improve the economy have been complicated by a difficult security situation and civil unrest.** The ceasefire with Houthi rebels is periodically breached, keeping tensions high and contributing to a humanitarian crisis in the north. Further pressure has come from increasing protests and civil unrest in the south. Moreover, Al Qaeda has an active presence in the country, and the recent crackdown by the authorities has led to a number of incidents and casualties.

II. Recent Economic Developments

3. **The reduction in oil revenues in the past year has affected the Yemeni economy through a set of direct and indirect channels**. Average oil prices dropped from US$97 per barrel in 2008 to US$62 in 2009, while production fell marginally from 284 thousand barrels per day (bpd) in 2008 to 274 thousand bpd in 2009. The start of Yemen liquefied natural gas (LNG) production in November 2009 marginally offsets for lower oil output. The slowdown in hydrocarbon sector affected non-hydrocarbon economic growth through spillover effects, with the latter weakening from 4.8 percent in 2008 to an estimated 4.1 percent in 2009. Inflation was relatively subdued in 2009 (8.8 percent), largely owing to the decline in international food prices.



Source: Yemeni authorities.

Box 1. Poverty and Human Development Indicators in Yemen

The incidence of poverty in Yemen is significantly higher than that of the MENA region. According to the World Bank Poverty Assessment Report of 2007, Yemen achieved an overall decline in poverty in the first half of this decade. However, the 2007–09 food, fuel and financial crises reversed the gains. As a result, the overall level of poverty in 2009 was broadly similar to the level in 1998. The high rate of population growth in Yemen further complicates the poverty situation. The ratio of the population that lives below US$ 2 per day in Yemen is 47 percent compared to the MENA average of 17 percent in 2005.

Poverty in Yemen
(in percent of total population)

	1998		2006		2009 (prel.)	
	food/extreme	overall	food/extreme	overall	food/extreme	overall
Urban	n.a	32.3	n.a.	20.7	17.7	29.9
Rural	n.a	42.5	n.a.	40.1	37.3	47.6
Overall	n.a	40.1	12.5	34.8	32.1	42.8

Source: World Bank, International Food Policy Research Institute (est. based on 2006 Household Survey).

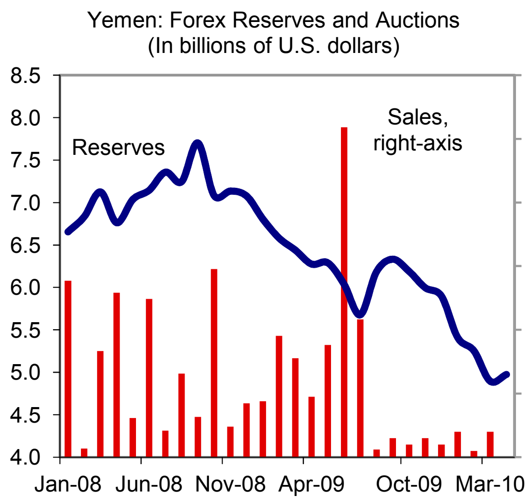
Poverty is heavily concentrated in rural areas (72 percent of the population and 84 percent of the poor). The initial drop in poverty was largely in the urban areas, as rural poor did not benefit from oil growth. Indeed, rural poverty has increased over the past decade.

According to the World Bank, Yemen also has one of the highest malnutrition rates in the world, as of the most recent estimates of 2010. About 55 percent of children under the age of five have chronic malnutrition, 35 percent are underweight, and 13 percent have acute malnutrition. In addition, 27 percent of pregnant and 35 percent of lactating women are malnourished. Moreover, maternal mortality at 365 per 100,000 live births is amongst the highest in the world. Mortality of children under five is at 102 per 1,000 births.

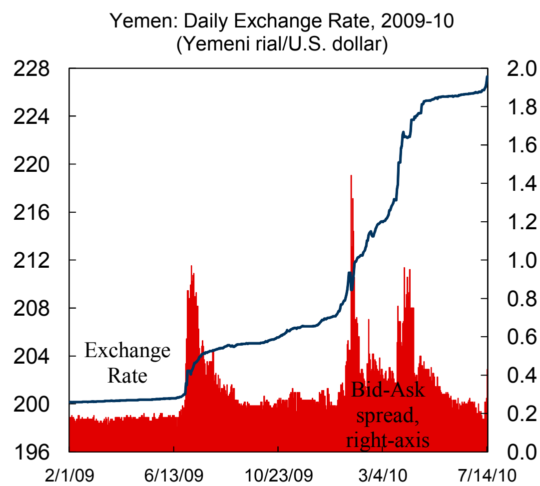
4. **The loss of oil revenue contributed to a record fiscal deficit of about 10 percent of GDP in 2009, financed in large part by the central bank.** The increase in the deficit took place notwithstanding the government's attempts to cut the civil service wage bill through reducing hiring, freezing wages, and suspending bonuses. Non-essential expenditures were also curtailed, including on goods and services, and operation and maintenance. However, the full implementation of the General Sales Tax (GST) and the reform of fuel subsidies were further postponed. In the absence of sufficient sources of other domestic financing, a large part of the deficit was monetized, resulting in an increase in the Central Bank of Yemen (CBY) credit to the government by Yrls 223.7 billion (over 4 percent of GDP).

5. **The balance of payments was also put under considerable strain.** The current account deficit widened to 10.7 percent of GDP in 2009, largely owing to the sharp decline in hydrocarbon exports. Other factors include strong import demand (especially for food and fuel, which together account for 60 percent of total imports) and—on the capital account—a slowdown in foreign direct investment and a marked increase in commercial bank deposits abroad in response to exchange rate pressures.

6. **The adverse fiscal and external sector developments put pressure on the exchange rate—leading to higher interest rates and a loss of foreign exchange reserves**. The Yemeni rial depreciated by 3 percent against the U.S. dollar in 2009 and by a further 8 percent in the first quarter of 2010. Two factors explain the stress on the exchange rate: (i) a fundamental deterioration in the macroeconomic situation associated with lower oil revenues and record fiscal and external deficits; and (ii) loss of public confidence associated in part with the difficult security situation. In response, the CBY raised the benchmark deposit rate three times in the first quarter of 2010 while the government significantly tightened fiscal policy by raising domestic fuel prices in February 2010 (by 0.4 percent of GDP) and cutting expenditures. The CBY was successful in stabilizing foreign exchange reserves in the second quarter of 2010, which dropped by only US$290 million, in comparison with a fall of US$1.1 billion in 2009 and by a further US$1 billion in the first quarter of 2010.

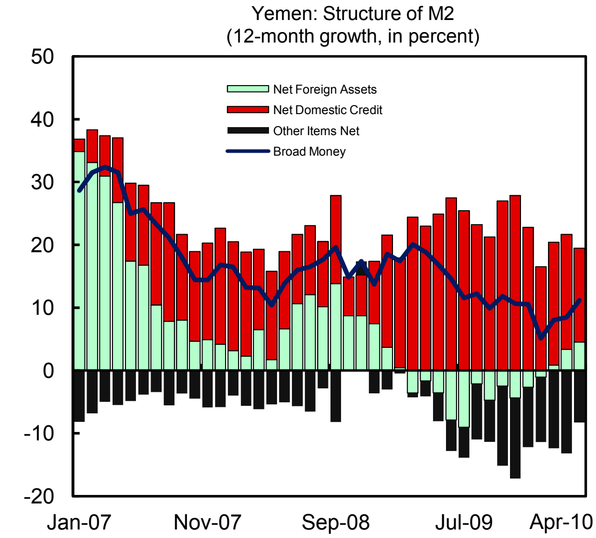


Sources: Yemeni authorities.

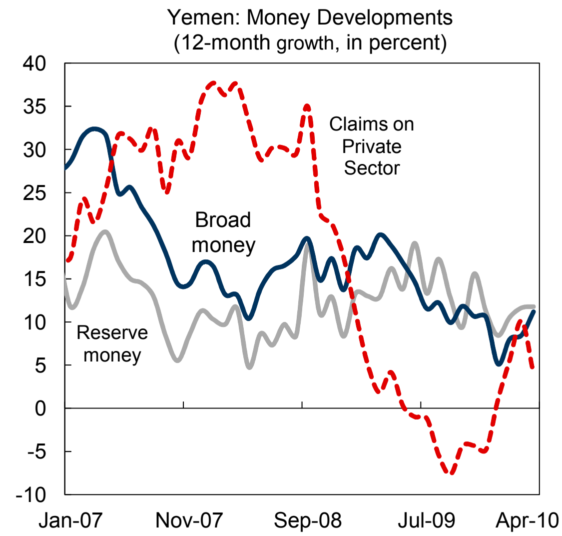


Sources: Yemeni authorities.

7. **While monetary policy accommodated the expansion of credit in 2009, the stance was tightened more recently to smooth exchange rate fluctuations**. In an attempt to foster demand for rial denominated deposits, the CBY increased the benchmark deposit rate from 12 percent to 15 percent and subsequently to 20 percent during March 2010, which reduced the pressures on the exchange rate.

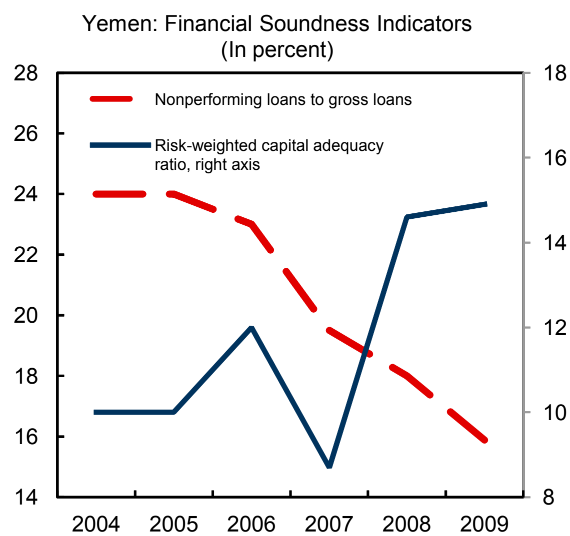


Sources: Yemeni authorities.

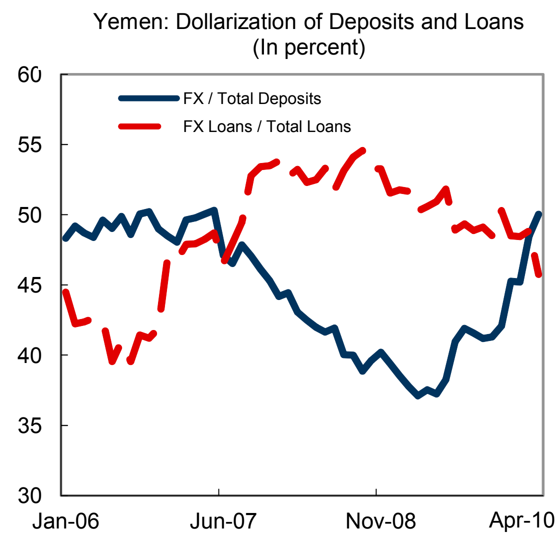


Sources: Yemeni authorities.

8. **Financial sector soundness indicators suggest the risks are contained**. This reflects the risk aversion of Yemeni banks, who mostly invest in government securities. While nonperforming loans remain high as a share of total loans, they are declining. Capital adequacy ratios have also been improving, in line with the legislative time limit to meet capital requirements by end-2009. The increased fluctuation in the foreign exchange market has, however, affected dollarization (measured as a share of foreign exchange deposits to total deposits), which started rising following the CBY's decision to allow moderate depreciation of the rial in June 2009. More recently, this trend was reversed as evidenced by the decline in the share of foreign currency deposits from 50 percent in April to 48.7 percent in May.



Sources: Yemeni authorities.



Sources: Yemeni authorities.

III. MEDIUM-TERM ECONOMIC POLICY FRAMEWORK

9. **Yemen needs sustained growth to reduce poverty in the face of a rapidly growing population.** The set of recent unfavorable economic and security developments, coupled with the projected decline in hydrocarbon output, pose challenges for macroeconomic stability and growth. Oil production is on a declining trend. In the absence of new oil discoveries, it is estimated that Yemen may become a net importer as soon as 2016. This will have a significant impact on the economy given that oil revenues account for 60 percent of government receipts and over 90 percent of exports. Central bank financing of the fiscal deficit was already starting to create a vicious circle magnifying the repercussions of the existing twin imbalances.

10. **The medium-term adjustment strategy will need to address the prospect of lower oil revenues while boosting public investment and social spending**. To ensure sustainability, the fiscal anchor centers on an adjustment path consistent with keeping overall public debt below 50 percent of GDP and reducing the non-hydrocarbon primary deficit by about 1 percent of GDP annually to achieve fiscal sustainability. A second objective is to shift the balance between current vs. capital spending/social transfers from 70 percent and 30 percent, respectively, to approximately 65 percent and 35 percent—engendering a stronger social safety net and sustained higher levels of public investment needed to achieve the growth objectives.

11. **The focus of the authorities' medium-term strategy** is on (i) accelerating non-hydrocarbon economic growth while maintaining inflation within moderate levels; (ii) putting public finances on a medium-term footing, by combining fiscal consolidation with a restructuring of expenditures more toward capital and social outlay, including by gradually reducing the fuel subsidies and limiting non-essential operating expenditures; (iii) boosting non-hydrocarbon revenues through tax policy and administration measures, such as a significant reduction in tax and customs exemptions and the full implementation of the General Sales Tax; (iv) maintaining adequate foreign exchange reserve cover and exchange rate flexibility to promote external competitiveness; and (v) creating a more attractive and market oriented business climate.

12. **The macroeconomic framework** targets real GDP growth of 5 percent annually—supported by robust investment. Inflation is expected to hover around 10 percent annually. While relatively high, the projected inflation rate reflects the likely adjustment in domestic fuel prices and greater exchange rate flexibility. The fiscal deficit is projected to gradually decline to 3.5 percent of GDP consistent with a sustainable level of domestic financing and a reduction in the outstanding balance of central bank credit to the government, while allowing for enhanced social safety and sustained higher level of public investment needed to achieve the growth objective. The external current account deficit is projected to remain at around 5 percent of GDP (given the structure of the economy and its import dependence) and external debt ratios to decline to around 39 percent of GDP in present value terms by 2013. The tighter

fiscal position and reduction in debt are critical pillars in safeguarding foreign exchange reserves to about three months of imports over the medium term.

IV. Policies for 2010

Fiscal Policy and Reforms

13. **Fiscal targets are aimed at realigning expenditures with actual revenues and available domestic and foreign financing** (see MEFP, ¶20). The authorities have set the fiscal deficit target for 2010 at 5.6 percent of GDP. This means a reduction of the deficit by 2.2 percent of GDP relative to budget adjusted for higher oil prices and the February 2010 change of domestic fuel prices, implying an overall reduction of the fiscal deficit by about 4.6 percent of GDP relative to 2009. Such an adjustment was necessary to reduce domestic central bank financing of the government and consequently stem pressures on the exchange rate and foreign exchange reserves. The adjustment is feasible because the authorities had already taken measures in the first half of 2010 to reduce the budget deficit, including by raising domestic fuel prices and cutting non-essential operating expenditures. The adjustment is to be achieved through a mix of revenue and expenditure measures while largely safeguarding capital expenditures and increasing social spending. The fiscal deficit is expected to further narrow in 2011 to about 5.0 percent of GDP. Specific measures for 2011 will be outlined at the time of the first review.

14. **The identified measures are home-grown and designed to have a long-lasting impact on the structure of the budget**. The centerpiece of tax reforms is the full implementation of the General Sales Tax, which was implemented on July 1, 2010 (see Box 2) (prior action) and the promulgation of a package of tax reform laws (income, customs, and investment) that abolish all new income tax and most customs (except for fixed assets and 50 percent of raw materials for industrial use) exemptions under the Investment Law (structural measure for September 2010, see MEFP, ¶20). These measures will bring about 0.7 percent of GDP of additional revenues in 2010 and provide a strong signal of the authorities' commitment to tax reforms. The expected revenue impact will increase over time with better enforcement of tax collection.

Box 2. The General Sales Tax and Other Tax Reforms

Tax revenues in Yemen (7 percent of GDP; 10.5 percent of non-oil GDP) are about half of the region's average (14 percent of GDP; 17 percent of non-oil GDP). Yemen's sales tax revenues of 2.5 percent of GDP are half the average for the region. Most of the countries in the Middle East (except some in the GCC) have implemented a GST.

Yemen has been working to implement the General Sales Tax (GST) for about a decade. The original law was adopted in early 2001, but due to serious weaknesses it was suspended in January 2002 pending amendments that were adopted by Parliament in July 2005. The law was then intended to be implemented in January 2007. However, due to pressures from the business community, it was not fully implemented until July 2010. The GST sets a tax rate of 5 percent to be applied across the board to importers, manufacturers, wholesalers, retailers, service providers, etc.

A temporary arrangement was in place till July 2010. Under this arrangement, the compliant taxpayers (200 out of 6500 taxpayers) paid 5 percent (importers at customs or manufacturers at the factory gate), and the non-compliant pay 10 percent at customs.

The tax compliance culture is low in Yemen, while enforcement power of the tax authority is weak due to a propensity to challenge and reverse the decisions of the tax authority by different courts and tribunals. The decision to fully implement GST will resolve most of the issues related to challenging and reversing the decisions of the tax authority. Moreover, there is a long list of exempted goods and services, as well as exemptions granted by individual ministers and by the customs and investment laws. The majority of these exemptions will be eliminated in the context of the income tax/investment/customs reform package expected in September 2010.

The tax authority has organized workshops and education campaigns to raise awareness and strengthen self-assessment and voluntary compliance. Moreover, with extensive technical assistance from the Fund and the World Bank, the tax authority has reorganized along the functional lines, consolidated the Large Taxpayers Office (LTO) activities in one place, made the LTO fully operational, simplified procedures, and shortened the time for filing tax returns.

15. **The tax reform laws reduce the income tax rates, but eliminate new income tax and most customs exemptions under the investment law.** Specifically, parliament is expected to approve a package of laws by end-September that decrease corporate tax rates from 35 to 20 percent (and 15 percent for investment) and personal income tax rates from 20 to 15 percent. These laws have already been approved by the Parliament's Finance Committee. In order to maintain revenue neutrality, the authorities agreed to delay the implementation of the reduction in personal income tax until December 31, 2010. This postponement should save about 0.3 percent of GDP in comparison with the budget. In addition, these laws will eliminate new income and most customs exemptions. Existing exemptions will be grand-fathered. Moreover, the authorities are undertaking administrative reforms at the Customs Authority aimed at simplifying and streamlining procedures with a view of improving both the business climate and government revenues (see MEFP, ¶20).

16. **The major measure on the expenditure side is a phased adjustment in the prices of domestic fuel products to reduce the fuel subsidy.**[1] Specifically, the authorities increased fuel prices by 5 rials per liter in February 2010 and will make a similar adjustment quarterly in 2010. The May/June increase (prior action) generated savings of 0.4 percent of GDP while the overall adjustment through end-2010 (including the February increase) will be 1.2 percent GDP. In addition, the authorities intend to create a cash management unit to more tightly control government spending should the need arise (structural benchmark for September) (see MEFP, ¶20). Expenditures on goods and services, as well as on operation and maintenance will be kept unchanged in nominal terms from 2009.

17. **These measures will create the fiscal space for higher social spending and largely safeguard capital spending**. The fuel price increase will be accompanied by an augmentation of social transfers by 0.1 percent of GDP, all of which will be allocated to the Social Welfare Fund (see Box 3). The program envisages capital expenditures to increase by 0.2 percent relative to the 2009 outturn, but to fall relative to budgeted amounts reflecting, in part, overly optimistic estimates in the budget that were contingent on unrealized foreign financing. Sustaining growth will require sizeable investments as well as more rigorous selection of projects to be financed.

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[1] The objective is to bring the prices of domestic fuel derivatives closer to international prices, as Yemen imports most of its refined fuel products. The authorities have announced their intention to further reduce the subsidies over the medium term,

Box 3. Social Safety Nets

Yemen has a three-tiered safety net, namely: (i) the *Social Welfare Fund* (SWF), which provides limited cash transfers to the poorest segments of society; (ii) the *Social Fund for Development* (SFD), which is community driven and functions similar to a public works program; and (iii) *fuel price subsidies*.

The *SWF*, as a main pillar of social safety net, covers about 1 million families with monthly transfers ranging from Yrls 2000 to 4000 (US$ 9 to 18), depending on the poverty category. These transfers do not cover the poverty gap, as the 2006 national poverty line is around Yrls 5,000 per capita, and about Yrls 19,500 for families with two children. Furthermore, the recent household survey has newly identified 500,000 eligible families that should be included in the monthly scheme of social transfers. The initial budget allocation for the SWF in 2010 is about Yrls 43 billion, unchanged from the 2009 budget allocation. The authorities' program targets an increase in these transfers to 59 Yrls billion. According to the World Bank, a perfect targeting of the poor would require about 4 percent of GDP per year to close the gap between actual spending of the poor and the poverty line spending. In addition, the World Bank estimates that an increase in fuel prices by 30 percent will increase poverty (number of poor) by 1 percent. The planned increase in transfers is sufficient to offset the impact on increasing oil prices on existing poor as well as the new ones to be taken into SWF.

The *SFD* is another channel for helping the poor but less vulnerable via a "cash for work" program, that hires poor but able nationals. The main focus of SDF is village-level infrastructure projects.

Finally, the *fuel price subsidies* are substantial and poorly designed. They have encouraged smuggling of petroleum products to neighboring countries. At the same time, the fuel subsidy bill is about 8 to 10 percent of GDP, accounting for about 28 percent of total and 36 percent of current expenditures, endangering fiscal sustainability. Reforming the subsidy system, will free up resources for other social expenditures.

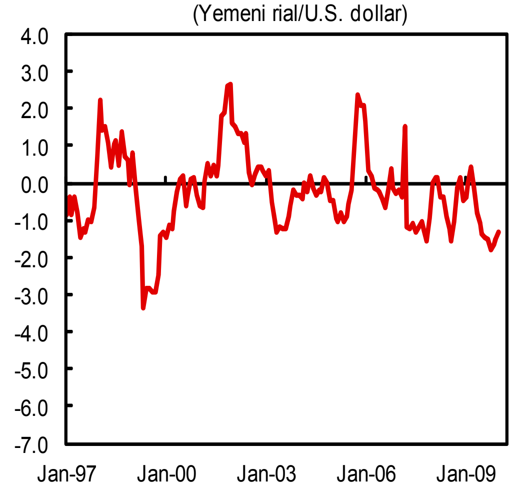
18. **The deficit will be mainly financed by domestic borrowing, which could usefully be complemented by additional donor financing.** The available domestic financing for 2010 is about 4.9 percent of GDP, including 3.5 percent of GDP in securities (T-bill, T-bonds, Sukuk), 1.2 percent of CBY financing, and 0.2 percent in deposit drawdown. The external financing will provide 0.7 percent of GDP. The use of additional donor financing, either project grants or direct budget support, could relieve pressures on the underperforming T-bills market.

Monetary and Exchange Rate Policies

19. **The ceiling on central bank financing should further ease exchange rate and inflationary pressures.** The monetary program for 2010 projects reserve and broad money growth of 14 percent and 15 percent, respectively, consistent with government borrowing from the central bank and 10 percent inflation. For 2011, broad and reserve money are programmed to grow at 16 percent and 15 percent, respectively. The CBY will continue to maintain a close watch on excess rial liquidity in the banking system, and will seek to enforce prudential norms within a context of encouraging banks to devote the necessary resources to risk management to allow for a broader extension of private sector credit. To the extent possible, and consistent with inflation and balance of payments developments, the CBY will also seek to reduce, and ultimately liberalize interest rates in an effort to encourage economic activity.

20. **Exchange rate flexibility will be an important element in safeguarding foreign exchange reserves, but must be balanced against price stability**. Yemen is highly dependent on imports, and changes in the exchange rate are quickly reflected in the price of tradables—particularly food, which constitutes more than 40 percent of the CPI basket. Allowing greater flexibility is a necessary component of medium-term adjustment toward a non-oil economy, along with a reduction of the government fiscal deficit and measures to boost Yemen's competitiveness and investment environment. In this context, continued interventions to calm short-term fluctuations in the exchange rate will likely be necessary, and the program allows for a total decumulation of about US$1.5 billion in the central bank's net international reserves as part of the adjustment process in 2010. While substantial in nominal terms, the decumulation in the second half of 2010 is roughly 17 percent of the loss in the first half of the year (MEFP, ¶24).

Yemen: Deviation of REER from equilibrium (%), January 1997 to present (Yemeni rial/U.S. dollar)



Sources: Yemeni authorities; staff projections.

21. **The issuance of Islamic bonds (Sukuk) will provide a new investment opportunity, an additional instrument for monetary policy, and diversify budget financing** (see MEFP, ¶25). The Sukuk will enable the central bank to manage the liquidity in Islamic banks while certificates of deposits and treasury bills control liquidity in commercial banks. With the legal underpinnings in place, the authorities have formed a working group to prepare for the issuance and an entity has been established, initially affiliated with the CBY, to manage the issuance. The entity will select investment projects and prepare the relevant documentation. The issuance of Sukuks is expected in the fourth quarter of 2010.

Structural Policies

22. **Public financial management (PFM) reforms will be advanced to underpin the fiscal adjustment**. The government has already begun to accelerate implementation of the Automated Financial Management and Information System (AFMIS). In the remainder of 2010, the system will be rolled out beyond the pilot ministries to five additional ministries as a first step to improving budget execution. With the same goal, the government will create a cash management unit in the ministry of finance to more tightly control government spending by end-September. The unit will produce monthly reports on cash outturns by December 2010 and develop a cash management plan for the coming months during 2011 as a base for developing a commitment control system (see MEFP, ¶26).

23. **A reinvigoration of the civil service reforms will be necessary to meet the program's objectives**. The overall goal is to streamline the wage bill, while providing proper compensation to civil servants. Essential steps in this area—such as completion of biometric identification for all public employees and processing of early retirements and redundancies through the Civil Service Fund—will be necessary to realize envisaged savings over the medium-term. The authorities intend to complete these essential steps by end-2011 (see MEFP, ¶27).

24. **Further progress in improving the business climate and deepening financial sector intermediation will be essential to promote sustained growth**. The government's efforts will focus on simplifying business regulation, improving property rights protection, and clarifying and simplifying bankruptcy procedures. These measures should simultaneously encourage deeper financial intermediation along with the improvement of a national credit registry and intra-bank market, and development of secondary market for government securities (see MEFP, ¶28).

25. **The Poverty Reduction Strategy Paper (PRSP) will be updated in the context the fourth Development and Poverty Reduction Plan (2011–15) that is under preparation and is expected to be finalized by September 2010** (see MEFP, ¶31). The plan outlines the main directions for the institutional, economic, financial, administrative, judicial, educational and cultural reforms. The PRS goals are integrated in the general objectives of the plan to generate economic growth, poverty reduction, create job opportunities and ensure economic and social stability thus providing a more systematic approach to monitor the progress in Yemen's fight against poverty.

V. Program Modalities and Capacity to Repay

26. **The proposed arrangement under the ECF will cover the three-year period from Board approval**. Proposed access is 100 percent of quota (SDR 243.5 million), reflecting balance of payments need and the strength of the program, in particular, the sizeable fiscal adjustment. While Yemen's reserve cushion is substantial, Fund resources are justified given

entrenched macroeconomic imbalances, the sharp drop in central bank reserves, recent pressure on the exchange rate, and the prospective decline in the reserve cushion over the medium term as Yemen transitions to a non-oil economy. The arrangement has 7 disbursements (Table 9) of equal size. Program implementation will be monitored semi-annually. The first two reviews would assess developments relative to performance criteria for end-December 2010 and end-June 2011, respectively. The quantitative performance criteria for end-December 2010 and end-June 2011 and indicative targets for end-December 2011 are included in Table A of the MEFP, while the structural measures are in Table B. The 2010 program has two prior actions, namely (i) the full implementation of the GST law and (ii) an increase in domestic fuel prices by Yrls 5 per liter on petroleum derivatives. Both of these prior actions have been met.

27. **Yemen's capacity to repay the Fund is good**. Purchases under the proposed ECF would not have a significant impact on the external debt outlook. They would raise the total external debt from 21.2 percent in 2010 to 22.9 percent level by 2015. Given the concessional nature of the ECF, the arrangement will have a limited effect on debt indicators. Nevertheless, the 2009 joint World Bank-Fund debt sustainability analysis, which has been updated in view of Yemen's request for access to Fund resources (see Appendix I), found that dwindling oil production presented risks over the medium and long term. This underscores the importance of implementing measures to improve the debt outlook in the medium- and long-term, as well as the need for continued external assistance on concessional terms. There is a zero ceiling in the program on the contracting or guaranteeing of external nonconcessional debt by the public sector, which is prudent given the risks to Yemen's debt position.

28. **A safeguards assessment of the CBY has been initiated and will be completed prior to the first review**. The last safeguards assessment was done in 2001.

Box 4. Technical Assistance Needs

Weak institutional capacity is generating sizeable TA needs. Given the program's requirements, the following areas are critical to address:

Monetary

- *Monetary and Exchange Rate Regimes*. Defining a proper monetary policy framework and instruments will provide guidance to monetary policy. Challenges related to the foreign exchange auction and liquidity management framework are being addressed—an MCM TA mission visited Sana'a in June 2010.
- *Capital Markets Development.* TA on the development of Islamic bonds could expand investment opportunities for banks, provide additional instrument for monetary policy, and become a source of budget financing. There is also the need to integrate *Sukuk* in a more comprehensive sovereign liability management strategy.
- *Supervision and Regulation.* An ongoing TA project would benefit from an advisor permanently based in Sana'a to improve knowledge transfer. In addition, assistance is needed in the implementation of credit registry.
- *Other.* There is a need to review a deposit insurance scheme and national payment system. An FSAP update would also be useful.

Fiscal

- *Public Financial Management*. In conjunction with the World Bank, TA should support the development and implementation of Automated Financial Management System, in particular cash and commitment control management. Gradually this could evolve into the introduction of treasury system.
- *Revenue Administration*. Implementation of the GST together with FIAS could be supported by developing medium- and small-taxpayers' offices.
- *Tax Policy.* A review of national tax system has been requested in the light of alignment of local and national tax systems, but introduction of new taxes and revision of existing tax rates could also be considered.
- *Expenditure Policy.* TA in this area would complement the Bank Public Expenditure Review.
- *Other.* TA in the area of budget formulation and execution could contribute to the development of a medium-term expenditure framework.

Statistics

- *Balance of Payments.* Continuation of ongoing TA is necessary to improve recording of balance of payments transactions and estimations, and eventually start publishing quarterly balance of payments.
- *National Accounts and Prices.* The ongoing METAC TA enabled Yemen to produce a set of consistent national account at the annual level, as well as consumer price indicator. Further assistance is needed to start producing a quarterly NA and producer price indicators.
- *Government Statistic*s. TA to help the transition to *GFSM 2001* would be useful.

Other

- *Business Environment* (outside of Fund's mandate). TA to improve business environment and make it conducive for private-led growth.
- *Energy/Extractive Industry* **(**outside of Fund's mandate). TA to develop a modern and flexible legislative framework and procedures for extractive industries in order to make it more flexible for new discoveries and investment.

VI. The Role of the Donor Community

29. **The role of donors is critical.** The donor community has reinvigorated its activities in 2010 through the Friends of Yemen forum. The process started with the high-level meeting in London in January 2010 that recognized the magnitude of the challenges that Yemen is facing and the need to react quickly. It will be important for donors to support Yemen's economic and social reforms and provide predictable budgetary support to meet its needs and build support for its reform program.

30. **Donor assistance has a direct bearing on the design of the macroeconomic framework and program targets**. The program is based on identified external financing of 0.7 percent of GDP—the "bird in hand". Past experience argues for a cautious approach in programming donor support.[2] However, in the event that new pledges are made with a commitment to rapid adjustment, the 2010 program would allow for higher capital expenditures and social transfers. On this basis, the program would allow for a combination of (i) lower domestic financing (a reduction in central bank budgetary support); (ii) an increase in the programmed level of public investment;[3] and (iii) an increase in social transfers through the Social Welfare Fund. The centerpiece fiscal adjustment measures identified in Table B of the MEFP would remain as key requirements.

VII. Staff Appraisal

31. **Yemen faces considerable short- and medium-term risks to macroeconomic and financial stability**. These risks have been present for some time, but have been masked by high oil prices in recent years. The sharp drop in oil production in 2007 and weak oil prices in late 2008 and 2009 have brought these risks to center stage.

32. **The fiscal and external imbalances have worsened**. The 2009 fiscal deficit reached a record high due in large part to lower oil production and prices as well as difficulties in containing spending or boosting revenues. In the meantime, lower oil exports and strong import demand have led to a steady decline in foreign exchange reserves and considerable pressures on the exchange rate. Recent security concerns have added to these pressures.

33. **The authorities' medium-term program aims to sustain economic growth and improve living standards**. It seeks to set public and external finances on a sustainable path

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[2] Total pledges at the 2006 Consultative Group meeting were US$5 billion, which were to be disbursed over three years. To date, total disbursements have been about US$400 million.

[3] Opportunities for higher public investment abound. About 75 percent of Yemenis are isolated due to the poor rural roads network, which also hinders tourism development. Yemen is one of the least electrified countries in the region, with only 42 percent of total population having access to electricity. And the low productivity of agriculture and fisheries implies a large scope for investment and capacity building.

and to restructure public spending to place a heavier emphasis on capital expenditures and social transfers. These will require a set of complementary policies to boost non-hydrocarbon revenues, rationalize and prioritize expenditures, and structural reforms to underpin growth in the non-hydrocarbon sector.

34. **The 2010 program is ambitious**. It includes a sizeable fiscal adjustment consistent with available domestic and external financing; strong prior actions to attain the deficit target; and policies designed to sustain non-hydrocarbon growth. The strength of the program is even more remarkable given the daunting social and security situation.

35. **The prior actions send a powerful signal of the government's commitment to addressing emerging imbalances**. On the revenue side, the full implementation of the GST is key. The reform was long overdue, technically feasible, and critical to attain the program's objectives. On the expenditure side, a phased reduction in the fuel subsidy is similarly important. The subsidy is large (8 to 10 percent of GDP), a source of smuggling, and inefficient. Simply put, these reforms are critical to the success of the program, and will need to be complemented by a better targeted social safety net to protect the most vulnerable. It is noteworthy that the program envisages an increase in social welfare fund transfers by nearly 0.3 percent of GDP relative to budgeted amounts.

36. **Monetary policy will need to balance inflation objectives with a resumption of private sector credit and an orderly adjustment of the rial.** A substantial part of inflation control and exchange rate stability will rest on fiscal consolidation. However, the central bank also has an important role to play through maintaining a close watch on signs of excess liquidity, maintaining an efficient and transparent system for foreign exchange auctions, and establishing an effective communication strategy vis-à-vis banks.

37. **A comprehensive structural reform agenda will be needed to meeting the macroeconomic objectives of the program**. A concerted effort, backed at the highest levels, will be necessary to reinvigorate the reform agenda, and ensure sufficient follow-through. The reforms in the first year focus largely on tax policy and expenditure control. Priority reforms going forward should also include public financial management and financial sector development.

38. **The role of donors is crucial for the success of the authorities program**. Yemen's developmental and social needs are enormous. In the absence of significant and predictable donor financial assistance for the budget, it may be difficult to create and maintain public support for the authorities' reform effort.

39. **Risks to the program are numerous**. Continued fragility in the security situation clouds not only the economic outlook, but the authorities' ability to meet commitments on socially sensitive reforms. Weak institutional capacity is another source of risk, and is only likely to change over the medium- to long-term and on the basis of a sustained technical assistance effort. Finally, Yemen's high import dependence and reliance on hydrocarbons for

the bulk of government revenues and foreign exchange receipts also leaves the economy subject to considerable volatility. These risks underline the need for vigilance and to ensure that contingency plans can easily be implemented to safeguard the fiscal position. The prior actions already implemented should mitigate these risks.

40. **Strong communication will be key.** Adjustments to domestic petroleum pricing to reduce smuggling and contain fiscal pressures will be a major challenge. To support this core element of the program, public outreach will be important. It will also be necessary to convince interest groups that GST implementation is critical to reduce dependence on dwindling oil revenues.

41. **Staff supports the authorities' request for a three-year ECF arrangement**. The focus of the program on fiscal consolidation and supporting fiscal reforms is appropriate. The prior actions and fiscal consolidation already implemented reflect the seriousness and commitment to undertake necessary reforms, and bode well for the program's successful implementation. An active communication strategy and donor support will be critical to sustaining the reform momentum.

Table 1. Republic of Yemen: Selected Economic Indicators, 2006–13

				Est.	Proj.			
	2006	2007	2008	2009	2010	2011	2012	2013
				(Change in percent)				
Production and prices								
Real GDP at market prices	3.2	3.3	3.6	3.9	8.0	4.1	4.1	4.4
Real nonhydrocarbon GDP	4.7	5.3	4.8	4.1	4.4	4.8	5.0	5.3
Real hydrocarbon GDP	-8.3	-13.1	-8.1	1.6	51.0	-1.4	-4.2	-4.6
Consumer price index (annual average)	10.8	7.9	19.0	3.7	9.8	8.9	10.2	10.8
Core consumer price index (annual average) 1/	10.9	9.2	20.3	3.8	8.9	12.7	14.0	10.8
Core consumer price index (12-month) 1/	9.3	12.2	13.1	7.3	10.6	14.7	13.4	8.2
Hydrocarbon production (1,000 barrels/day)	357	310	284	290	438	431	412	394
Crude oil	357	310	284	274	275	269	250	232
LNG (oil equivalent)	...	...	...	16	162	162	162	162
				(In percent of GDP)				
Investment and savings								
Gross domestic investment	16.4	17.2	15.4	13.5	13.7	15.0	17.4	18.8
Government	7.3	7.2	5.9	6.5	6.7	7.2	8.0	8.3
Other	9.1	10.0	9.5	7.0	7.0	7.8	9.4	10.5
Gross national savings	17.4	10.2	10.8	2.9	8.5	10.2	12.8	14.3
Government	10.3	1.8	2.3	-3.7	1.0	2.3	3.3	4.8
Other	7.1	8.5	8.5	6.5	7.5	8.0	9.6	9.5
Government finance								
Total revenue and grants	38.6	33.2	36.7	25.0	26.8	25.2	23.9	23.2
Total expenditure and net lending	37.4	40.3	41.2	34.6	32.4	30.1	28.6	26.7
Overall balance (cash basis) 2/	-0.7	-5.8	-3.2	-10.2	-5.6	-5.0	-4.7	-3.5
Nonhydrocarbon primary fiscal balance (cash)	-27.2	-26.1	-28.6	-22.3	-19.5	-17.1	-15.1	-12.7
Gross Public Sector Debt	40.8	40.4	36.4	51.0	46.3	46.3	46.0	45.2
External debt	28.7	26.9	21.9	24.2	21.3	21.2	21.4	21.4
Domestic debt	12.1	13.5	14.5	26.8	25.0	25.1	24.6	23.9
				(Twelve-month change in percent)				
Monetary data								
Broad money	27.7	16.8	13.7	10.6	15.5	16.0	…	…
Reserve money	17.1	11.3	8.3	11.2	14.3	15.0	…	…
Credit to private sector	16.7	35.7	17.5	-4.8	18.0	20.0	…	…
Benchmark deposit interest rate (percent p.a.)	13.0	13.0	13.0	10.0	…	…	…	…
Velocity (non-oil GDP/M2)	1.9	1.9	2.1	2.0	2.1	2.1	…	…
				(In millions of U.S. dollars, unless otherwise indicated)				
External sector								
Exports, f.o.b.	7,316	7,050	8,977	5,855	7,940	8,293	8,173	7,910
Of which: hydrocarbon (oil and gas)	6,733	6,264	7,895	4,532	6,456	6,715	6,453	6,014
Of which: nonhydrocarbon	583	785	1,082	1,323	1,484	1,578	1,720	1,896
Imports, f.o.b.	-5,926	-7,490	-9,334	-8,056	-8,566	-9,015	-9,531	-10,075
Current account (in percent of GDP)	1.1	-7.0	-4.6	-10.7	-5.2	-4.8	-4.6	-4.5
Memorandum items								
Crude export oil price (U.S. dollar/barrel) 3/	62.8	72.3	95.5	60.3	73.5	76.0	78.8	80.5
Central Bank own gross foreign reserves 4/	6,798	6,969	7,323	6,213	4,631	4,113	3,332	2,638
In months of imports 4/	10.2	8.0	9.3	7.5	5.3	4.5	3.4	2.6
Real effective exchange rate (2000 = 100)	123.3	122.2	132.8	140.9	...	...	...	...
Nominal GDP at market prices								
In billions of Yemeni rials	3,760	4,309	5,376	5,098	6,737	7,711	8,878	10,016
In millions of U.S. dollars	19,063	21,651	26,909	25,131	30,170	32,979	36,162	38,856
Per capita GDP (in U.S. dollars)	882	971	1,171	1,061	1,237	1,312	1,397	1,457
Population (in thousands)	21,622	22,290	22,978	23,687	24,398	25,130	25,884	26,660

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

1/ The core CPI is defined as the CPI excluding qat.

2/ Includes statistical discrepancy.

3/ The price of Yemeni oil differs from the WEO price because it trades at a discount.

4/ Gross reserves minus commercial bank and pension fund foreign exchange deposits held with the Central Bank of Yemen.

Table 2. Republic of Yemen: General Government Finances, 2006-10
(In billions of Yemeni rials)

	2006	2007	2008	2009		2010			
			Prel.	Budget	Prel.	Approved Budget (at $55)	Budget at $75.00	Budget at $75.00 adjus. 4/	Program
Total revenue and grants	1,450	1,429	1,974	1,467	1,275	1,457	1,791	1,758	1,802
Hydrocarbon revenue	1,085	973	1,494	833	745	755	1,089	1,089	1,089
Of which:									
Crude oil exports	612	510	853	399	378	330	514	514	514
LNG exports	0	0	0	3	0	80	80	80	32
Nonhydrocarbon revenue	349	442	466	552	509	620	620	587	631
Tax revenue	266	315	367	457	406	455	455	422	466
Income taxes	123	144	155	203	201	219	219	198	219
Taxes on goods and services	101	118	121	139	139	166	166	154	170
Custom taxes	36	44	46	55	57	58	58	58	65
Other taxes	6	8	45	60	10	12	12	12	12
Nontax	83	126	99	95	103	165	165	165	165
Grants	15	15	14	81	21	82	82	82	82
Total expenditure and net lending	1,405	1,739	2,217	1,944	1,795	1,980	2,284	2,281	2,182
Current expenditure	1,062	1,352	1,852	1,549	1,461	1,451	1,755	1,752	1,734
Wages and salaries	373	470	540	567	559	585	585	585	597
Goods and services	128	167	161	177	168	167	167	167	167
Operations and maintenance	19	35	25	31	24	29	29	29	29
Interest obligations	87	97	129	106	127	116	116	140	156
Domestic	76	87	115	90	114	100	100	123	140
External	11	10	14	16	13	16	16	17	16
Subsidies and transfers	418	534	938	639	554	522	826	799	752
Subsidies	309	408	750	429	420	371	675	648	585
Of which:									
Petroleum products (including LPG)	303	402	744	423	391	337	640	613	550
Electricity	6	6	6	6	6	6	6	6	6
Other	...	...	...	...	...	29	29	29	29
Transfers	109	126	188	210	133	151	151	151	167
Of which: social welfare fund	18	23	34	64	43	43	43	43	59
Other	37	50	58	29	29	32	32	32	32
Capital expenditure	274	310	318	364	334	529	529	529	448
Of which: foreign financed	...	46	189	111	0	145	145	145	145
Net lending	69	76	47	31	0	0	0	0	0
Overall balance (commitment)	45	-309	-244	-478	-521	-523	-493	-523	-380
Discrepancy	-71	60	69	0	74	…	…	…	0
Financing	26	250	174	478	447	…	…	…	380
External	53	47	21	15	7		…	…	49
Domestic	-26	203	153	463	440	…	…	…	331
Memorandum items:									
Overall balance (cash), excluding grants and foreign-financed capital expenditure 1/	...	-219	1	...	-541	…		…	-317
Primary balance (cash) 1/	61	-153	-46	...	-393	…		…	-224
Nonhydrocarbon primary balance (cash) 1/	-1,025	-1,125	-1,539	...	-1,138	…		…	-1,313
Nonhydrocarbon primary balance (cash), excluding grants and foreign-financed capital expenditure 1/	...	-1,079	-1,351	...	-1,138	…		…	-1,168
Social spending 2/	270	317	406	...	387	…		…	517
Gross public debt 3/	1,535	1,741	1,956	...	2,602	…		…	3,120
Net public debt 3/	1,240	1,518	1,687	...	2,286	…		…	2,820

Sources: Ministry of Finance; Ministry of Planning; and Fund staff estimates.

1/ Based on overall (cash) balance and statistical discrepancy.
2/ Consists of education, health, social assistance, and social welfare fund transfers; covers central and local government.
3/ Refers to central and local governments.
4/ Adjustments take into account (i)implementation of income tax law as of July 1; and (ii) petroleum derivatives price increase as of Feb 1, 2010.

Table 3. Republic of Yemen: General Government Finances, 2006-10
(In percent of GDP)

	2006	2007	2008	2009		2010			
				Budget.	Prelim.	Approved Budget (at $55)	Budget at $75.00	Budget at $75.00 adjus. 4/	Program
Total revenue and grants	38.6	33.2	36.7	28.8	25.0	21.6	26.6	26.1	26.8
Hydrocarbon revenue	28.9	22.6	27.8	16.3	14.6	11.2	16.2	16.2	16.2
Of which:									
Crude oil exports	16.3	11.8	15.9	7.8	7.4	4.9	7.6	7.6	7.6
LNG exports	0.0	0.0	0.0	0.1	0.0	1.2	1.2	1.2	0.5
Nonhydrocarbon revenue	9.3	10.3	8.7	10.8	10.0	9.2	9.2	8.7	9.4
Tax revenue	7.1	7.3	6.8	9.0	8.0	6.8	6.8	6.3	6.9
Income taxes	3.3	3.4	2.9	4.0	3.9	3.3	3.3	2.9	3.3
Taxes on goods and services	2.7	2.7	2.2	2.7	2.7	2.5	2.5	2.3	2.5
Custom taxes	1.0	1.0	0.9	1.1	1.1	0.9	0.9	0.9	1.0
Other taxes	0.2	0.2	0.8	1.2	0.2	0.2	0.2	0.2	0.2
Nontax	2.2	2.9	1.9	1.9	2.0	2.4	2.4	2.4	2.4
Grants	0.4	0.3	0.3	1.6	0.4	1.2	1.2	1.2	1.2
Total expenditure and net lending	37.4	40.3	41.2	38.1	35.2	29.4	33.9	33.9	32.4
Current expenditure	28.2	31.4	34.5	30.4	28.7	21.5	26.1	26.0	25.7
Wages and salaries	9.9	10.9	10.0	11.1	11.0	8.7	8.7	8.7	8.9
Goods and services	3.4	3.9	3.0	3.5	3.3	2.5	2.5	2.5	2.5
Operations and maintenance	0.5	0.8	0.5	0.6	0.5	0.4	0.4	0.4	0.4
Interest obligations	2.3	2.3	2.4	2.1	2.5	1.7	1.7	2.1	2.3
Domestic	2.0	2.0	2.1	1.8	2.2	1.5	1.5	1.8	2.1
External	0.3	0.2	0.3	0.3	0.3	0.2	0.2	0.3	0.2
Subsidies and transfers	11.1	12.4	17.5	12.5	10.9	7.7	12.3	11.9	11.2
Subsidies	8.2	9.5	14.0	8.4	8.2	5.5	10.0	9.6	8.7
Of which:									
Petroleum products (including LPG)	8.1	9.3	13.8	8.3	7.7	5.0	9.5	9.1	8.2
Electricity	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other	...	...	...	…	...	0.4	0.4	0.4	0.4
Transfers	2.9	2.9	3.5	4.1	2.6	2.2	2.2	2.2	2.5
Of which: social welfare fund	0.5	0.5	0.6	…	0.8	0.6	0.6	0.6	0.9
Other	1.0	1.2	1.1	0.6	0.6	0.5	0.5	0.5	0.5
Capital expenditure	7.3	7.2	5.9	7.1	6.5	7.9	7.9	7.9	6.7
Of which: foreign financed	...	1.1	3.5	2.2	0.0	2.2	2.2	2.2	2.1
Net lending	1.8	1.8	0.9	0.6	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment)	1.2	-7.2	-4.5	-9.4	-10.2	-7.8	-7.3	-7.8	-5.6
Discrepancy	-1.9	1.4	1.3	0.0	1.4	…	…	…	0.0
Financing	0.7	5.8	3.2	9.4	8.8	…	…	…	5.6
External	1.4	1.1	0.4	0.3	0.1	…	…	…	0.7
Domestic	-0.7	4.7	2.8	9.1	8.6	…	…	…	4.9
Memorandum items:									
Overall balance (cash), excluding grants and foreign-financed capital expenditure 1/	...	-5.1	0.0	...	-10.6	…	…	…	-4.7
Primary balance (cash) 1/	1.6	-3.5	-0.8	...	-7.7	…	…	…	-3.3
Nonhydrocarbon primary balance (cash) 1/	-27.2	-26.1	-28.6	...	-22.3	…	…	…	-19.5
Nonhydrocarbon primary balance (cash), excluding grants and foreign-financed capital expenditure 1	...	-25.0	-25.1	...	-22.3	…	…	…	-17.3
Social spending 2/	7.2	...	...	...	7.6	…	…	…	7.7
Gross public debt 3/	40.8	40.4	36.4	...	51.0	…	…	…	46.3
Net public debt 3/	33.0	35.2	31.4	...	44.8	…	…	…	41.9

Sources: Ministry of Finance; Ministry of Planning; and Fund staff estimates.

1/ Based on overall (cash) balance and statistical discrepancy.
2/ Consists of education, health, social assistance, and social welfare fund transfers; covers central and local government.
3/ Refers to central and local governments.
4/ Adjustments take into account (i)implementation of income tax law as of July 1; and (ii) petroleum derivatives price increase as of Feb 1, 2010.

Table 4. Republic of Yemen: Monetary Survey, 2006–10
(In millions of Yemeni rials)

	2007 Dec.	2008 Dec.	2009 Dec.	2010 Dec. Proj.
Net foreign assets	1,733,844	1,856,988	1,807,289	1,585,138
Central Bank of Yemen	1,483,230	1,579,988	1,405,181	1,142,820
Commercial banks	250,614	277,000	402,108	442,319
Net domestic assets	-82,507	20,931	268,864	812,819
Net domestic credit	441,634	605,253	1,032,673	1,346,612
Net claims on central government	66,936	94,090	533,044	746,396
Central Bank of Yemen	-222,191	-162,580	13,483	109,610
Commercial banks	289,128	256,669	519,561	636,786
Net claims on nongovernment enterprises	374,698	511,164	499,630	600,215
Claims on private sector by commercial banks	352,622	414,203	394,323	465,301
Claims on public enterprises 1/	15,220	87,351	95,509	122,547
Claims on mixed enterprises	6,855	9,609	9,798	12,368
Pension fund deposits in CBY	-65,116	-67,113	-76,030	-53,221
CBY certificates of deposit held in nonbanks.	0	-488	0	0
Other Items (net)	-524,141	-584,322	-763,809	-533,792
Valuation adjustment	-234,442	-180,675	-254,644	-154,644
Capital and reserves	-112,896	-153,801	-183,006	-83,006
Other (net)	-176,803	-249,846	-326,159	-296,143
Broad money	1,651,337	1,877,919	2,076,154	2,397,958
Money	613,748	680,600	758,561	887,244
Currency outside banks	425,840	472,667	532,372	605,097
Demand deposits	187,908	207,933	226,189	282,148
Quasimoney	456,190	595,234	611,403	743,367
Foreign currency deposits	516,284	534,971	630,161	714,126
Memorandum items:				
Broad money (annual percentage change)	16.8	13.7	10.6	15.5
Reserve money (annual percentage change)	11.3	8.3	11.2	14.3
Credit to private sector (annual percentage change)	35.7	17.5	-4.8	18.0
Currency to broad money (in percent)	25.8	25.2	25.6	25.2
Foreign currency deposits to total deposits	42.1	38.1	40.8	39.8
Non-oil GDP velocity (average)	1.9	2.1	2.0	2.1
Central Bank own gross foreign assets (US$ millions) 2/	6,969	7,323	6,213	4,631

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

1/ The increase in credit to public enterprises since 2008 reflects primarily a new revolving credit line to finance the import of refined fuel products.

2/ Gross reserves minus commercial-bank and pension-fund foreign exchange deposits held with the Central Bank.

Table 5. Republic of Yemen: Summary Accounts of the Central Bank of Yemen, 2006-10
(In millions of Yemeni rials)

	2006 Dec.	2007 Dec.	2008 Dec.	2009 Dec.	2010 Dec Proj.
Net Foreign Assets	1,419,174	1,483,230	1,579,988	1,405,181	1,142,820
Assets	1,497,760	1,548,639	1,632,135	1,450,952	1,189,287
Liabilities	-78,586	-65,410	-52,147	-45,770	-46,467
Net Domestic Assets	-848,409	-848,042	-891,813	-639,997	-268,059
Net claims on government	-291,442	-222,191	-162,580	13,483	109,610
Claims	3,386	418	105,921	329,668	409,670
Budget financing	3,386	418	105,921	329,668	409,670
Deposits	-294,828	-222,609	-268,501	-316,185	-300,060
Net claims on non-government/non-bank entities	-150,791	-166,631	-89,879	-122,035	-65,782
Claims on public sector enterprises	0	8,148	83,487	79,614	100,496
Deposits and CDs	-150,791	-174,780	-173,366	-201,649	-166,278
Pension Fund Deposits	-62,349	-65,116	-67,113	-76,030	-53,221
Local Currency	-3,394	-4,108	-9,946	-24,817	-17,372
Foreign Currency	-58,955	-61,008	-57,167	-51,212	-35,849
Net claims on commercial banks	-97,040	-97,045	-256,531	0	0
Claims	0	0	0	0	0
Certificates of deposits held by banks	-97,040	-97,045	-256,531	0	0
Other Items (net)	-309,136	-362,174	-382,823	-531,445	-531,445
Valuation adjustment	203,746	234,442	180,675	254,644	254,644
Other	-512,882	-596,616	-563,498	-786,089	-786,089
Reserve Money	570,765	635,188	688,175	765,184	874,761
Currency outside banks	412,520	425,840	472,667	532,372	605,097
Currency with banks	6,825	18,133	17,835	19,346	75,633
Commercial bank deposits (reserves)	151,420	191,215	197,673	213,466	194,031
Local Currency	62,035	94,040	87,834	102,107	97,015
Foreign Currency	89,385	97,175	109,839	111,359	97,015
Memorandum Items					
Central Bank credit to government (annual change)	2,404	-2,968	105,503	223,747	80,002
Central Bank own gross foreign assets	1,349,419	1,390,457	1,465,128	1,288,380	1,056,422
US$ million	6,798	6,969	7,323	6,213	4,631

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

Table 6. Republic of Yemen: Balance of Payments, 2006–13
(In millions of U.S. dollars)

					Proj.			
	2006	2007	2008	2009	2010	2011	2012	2013
Current account	206	-1,508	-1,251	-2,685	-1,565	-1,572	-1,648	-1,764
Nonhydrocarbon current account 1/	-3,721	-4,489	-6,276	-5,864	-6,083	-6,290	-6,158	-5,823
Goods and services	84	-1,584	-1,499	-3,029	-1,432	-1,469	-1,946	-2,583
Trade balance	1,390	-441	-357	-2,201	-626	-722	-1,358	-2,165
Exports, f.o.b.	7,316	7,050	8,977	5,855	7,940	8,293	8,173	7,910
Hydrocarbon exports	6,733	6,264	7,895	4,532	6,456	6,715	6,453	6,014
Nonhydrocarbon exports	583	785	1,082	1,323	1,484	1,578	1,720	1,896
Imports, f.o.b.	5,926	7,490	9,334	8,056	8,566	9,015	9,531	10,075
Hydrocarbon sector imports	3,375	3,918	3,578	1,966	2,168	2,347	2,504	2,634
Other imports, f.o.b.	2,551	3,573	5,756	6,090	6,398	6,669	7,027	7,441
Services, net	-1,306	-1,143	-1,142	-828	-806	-747	-588	-417
Income	-1,234	-1,350	-1,915	-1,171	-1,913	-1,973	-1,868	-1,787
Of which: Hydrocarbon company profits	-1,365	-1,362	-1,882	-941	-1,687	-1,743	-1,701	-1,738
Current transfers	1,356	1,426	2,163	1,515	1,781	1,870	2,166	2,606
Workers' remittances, net	1,242	1,281	1,362	1,112	1,269	1,444	1,639	2,001
Capital and financial account	710	1,220	567	-252	-255	916	760	1,005
Direct investment, net, *of which 2/*	1,121	1,148	470	-171	-724	-381	-660	-479
LNG sector	1,200	1,785	875	223	-225	-291	-308	-311
Medium- and long-term loans, net	236	238	108	247	350	599	722	586
New disbursements	349	355	273	386	520	787	928	817
Amortization	113	117	165	139	169	188	205	230
Commercial banks, net	-475	33	-128	-555	0	0	0	0
Others, net	-172	-199	118	228	119	698	698	898
Errors and omissions	536	584	1,124	1,815	0	0	0	0
Overall balance	1,452	296	440	-1,122	-1,820	-656	-888	-759
Financing								
Central bank net foreign assets (- increase)	-1,462	-304	-467	1,117	1,756	528	759	694
Exceptional Financing	10	8	27	6	2	2	2	2
Financing gap (+ deficit)	0	0	0	0	62	126	127	62
Memorandum items:								
Current account including grants (percent of GDP)	1.1	-7.0	-4.6	-10.7	-5.2	-4.8	-4.6	-4.5
Nonhydrocarbon current account (percent of GDP)	-19.5	-20.7	-23.3	-23.3	-20.2	-19.1	-17.0	-15.0
Central bank own gross foreign reserves 3/	6,798	6,969	7,323	6,213	4,631	4,113	3,332	2,638
(months of imports) 4/	10.2	8.0	9.3	7.5	5.3	4.5	3.4	2.6
Total External Debt (percent of GDP) 5/	28.7	26.9	21.9	24.2	21.3	21.2	21.4	21.4
Export oil price (U.S.$/barrel)	63.0	72.3	95.5	60.3	73.5	76.0	78.8	80.5
Nonhydrocarbon export (growth)	26.4	34.7	37.8	22.3	12.2	6.3	9.0	10.2
Imports (growth)	25.7	26.4	24.6	-13.7	6.3	5.2	5.7	5.7

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

1/ Hydrocarbon sector includes oil and LNG exports less corresponding imports, expenses, and repatriation.
2/ The negative direct investment numbers reported in the table reflect repatriation of profits by foreign gas and oil companies.
3/ Includes central bank SDR holdings (as well as new allocations of $281.6 million at end-August and $36.3 million at end-september 2009), 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 reserves.
4/ Imports are c.i.f. for next year and exclude oil sector imports.
5/ Public external debt, including central bank foreign liabilities. There is limited information on private external debt, which is deemed to be modest.

Table 7. Republic of Yemen: Indicators of Banking System Financial Soundness, 2001–09 1/

(In percent; unless otherwise indicated)

	2001	2002	2003	2004	2005	2006	2007	2008*	2009** March	2009** June	2009** Sep	2009** Dec
Capital adequacy:												
Risk-weighted capital adequacy ratio	13.0	10.0	11.0	10.0	10.0	12.0	8.7	14.6	14.6	14.9	14.6	14.6
Capital (net worth) to assets	7.0	6.3	5.0	5.0	5.0	6.5	4.9	8.7	8.8	8.3	8.2	8.2
Portfolio quality:												
Nonperforming loans to total assets	8.0	8.0	7.3	6.8	7.1	5.7	5.4	5.2	5.1	4.4	3.7	3.5
Nonperforming loans to gross loans	31.0	33.0	29.0	24.0	24.0	23.0	19.5	18.0	19.2	15.9	13.9	13.9
Nonperforming loans net of provisions to capital	39.0	40.0	38.0	43.0	23.0	28.0	16.9	25.3	30.2	21.6	14.5	11.8
Provisions against problem loans/problem loans	68.0	69.0	60.0	60.3	75.0	66.0	44.0	62.3	47.6	59.0	68.2	70.3
Total capital and reserves/problem loans	82.0	78.0	79.0	83.5	109.0	120.0	123.4	168.2	173.8	189.8	218.8	251.4
Portfolio performance:												
Average return on assets	...	1.0	0.8	0.8	1.1	1.2	1.6	1.0	...	...	...	0.9
Average return on equity	...	13.5	14.0	15.1	17.8	17.3	19.7	11.4	...	...	...	9.6
Interest margin to gross income	...	...	30.0	30.3	33.5	36.1	33.7	33.9	...	...	...	33.4
Noninterest expenses to gross income	...	...	25.9	21.5	20.5	19.6	19.8	22.5	...	...	...	26.4
Trading and fee income to gross income	...	...	12.2	11.0	10.0	8.6	7.7	7.8	...	...	...	7.7
Exposure to exchange rate risk												
Total foreign currency assets (in billions of rials)	188.1	228.9	279.5	309.1	379.3	469.3	576.3	646.4	635.3	668.8	714.4	754.4
Total foreign currency liabilities (in billions of rials)	175.9	213.0	256.5	288.9	354.8	458.1	520.1	557.1	532.5	558.4	615.1	635.2
Net exposure/total capital and reserves	48.0	55.0	76.5	0.0	24.5	38.2	65.1	75.1	77.3	86.0	77.2	83.2
Forex credits/forex deposits	25.4	22.5	26.8	31.1	32.2	30.5	42.3	45.1	43.8	45.9	39.3	37.4

Source: Central Bank of Yemen.

1/ Data refers to all banks except the Housing Bank and CACbank. 2006 data included CAC.

* Audited financial statements.

** Monthly data received from the banks.

Table 8. Republic of Yemen: Quantitative Performance Criteria and Indicative Targets 1/ 2/

(In billions of Yemeni rials unless otherwise indicated)

	2009	2010		2011			
	Dec.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
		I.T.	P.C.	I.T.	P.C.	I.T.	I.T.
Ceiling on domestic financing of the central government	440	83	79	66	66	66	66
Ceiling on domestic financing of the central government (cumulative change)		*252*	*331*	*66*	*133*	*199*	*265*
Of which, the central bank		20	-57	5	4	3	9
Central bank (cumulative change)		*137*	*80*	*5*	*9*	*12*	*20*
Ceiling on net domestic assets of the central bank (Stock)	-759	-360	-252	-188	-119	-54	2
Net domestic assets of the central bank (cumulative change)		*399*	*507*	*65*	*134*	*199*	*254*
Floor on net international reserves of the central bank (stock, US$ millions)	5,677	4,244	4,170	4,070	3,970	3,870	3,770
Net international reserves of the central bank (cumulative change, US$ millions)		*-1,433*	*-1,507*	*-100*	*-200*	*-300*	*-400*
Ceiling on contracting or guaranteeing of external nonconcessional by the government or the central bank (stock, US$ millions)	0	0	0	0	0	0	0
Floor on social spending (cumulative) (indicative target)	387	388	517	158	315	473	631
Memorandum Items							
Reserve Money	765	832	875	883	890	948	1,006
External Financing (cumulative)		37	49	35	70	105	140
Government oil and LNG export revenues (US$ millions) 1/	1,890	661	661	559	559	559	559
Cumulative Government oil and LNG export revenues (US$ millions)		1,983	2,645	559	1,118	1,677	2,235

1/ The performance criteria (P.C.) (on cumulative changes from the beginning of the year) are: (i) domestic financing of the central government; (ii) net domestic assets of the central bank; (iii) net international reserves of the central bank; and (iv) ceiling on contracting or guaranteeing of external nonconcessional debt by the government or the central bank (continuous). End-December 2010 and end-June 2011 targets are P.Cs., while others are indicative targets (I.T.).

2/ The PCs on NIR and NDA of the central bank, and on domestic financing of the budget have adjustors which are defined in the attached Technical Memorandum of Understanding (TMU).

Table 9. Republic of Yemen: Extended Credit Facility—Prior Actions and Structural Benchmarks

Measures Under the ECF	Objective	Timing
Increase domestic fuel prices by Yrls 5 per liter on petroleum derivatives.	Expenditure Control	Prior Action (Done)
Full implementation of the General Sales Tax (GST) law.	Broaden Tax Base and Improve Revenue	Prior Action (Done)
Reduce corporate income tax rate from 35 percent to 20 percent (15 percent for investment projects), while simultaneously eliminating tax and customs (except for fixed assets and 50 percent of raw materials for industrial use) exemptions under the Investment Law.	Broaden Tax Base and Improve Revenue	Structural Benchmark, September 30, 2010
Create a cash management unit in the ministry of finance in order to better control government spending.	Expenditure control/Budget Execution	Structural Benchmark, September 30, 2010
Gradual adjustment of fuel prices to achieve net fiscal savings of Yrls 56 bln (0.8 percent of GDP).	Expenditure Control	Structural Benchmark, December 31, 2010

Table 10. Republic of Yemen: Fund Disbursements and Timing of Reviews Under the Prospective Three-Year ECF Arrangement, 2010-2013

Date of Availability	Conditions	Amount (in million SDR)
July 30, 2010	Board approval of the ECF arrangement	34.79
March 15, 2011	Completion of the first review (end-December 2010 quantitative performance criteria and relevant structural benchmarks)	34.79
September 15, 2011	Completion of the second review (end-June 2011 quantitative performance criteria and relevant structural benchmarks)	34.79
March 15, 2012	Completion of the third review (end-December 2011 quantitative performance criteria and relevant structural benchmarks)	34.79
September 15, 2012	Completion of the fourth review (end-June 2012 quantitative performance criteria and relevant structural benchmarks)	34.78
March 15, 2013	Completion of the fifth review (end-December 2012 quantitative performance criteria and relevant structural benchmarks)	34.78
June 15, 2013	Completion of the sixth review (end-March 2013 quantitative performance criteria and relevant structural benchmarks)	34.78
Total		243.50
(as percent of quota)		100.00

Sources: Fund staff estimates.

Table 11. Yemen: Indicators of Capacity to Repay the Fund, 2009-2023 1/

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	Actual	Projections													
Fund obligations based on existing credit (in millions of SDRs)															
Principal	28.4	8.9	15.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.7	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Fund obligations based on prospective credit (in millions of SDRs)															
Principal	0.0	0.0	0.0	0.0	0.0	0.0	0.0	10.4	24.4	38.3	48.7	48.7	38.3	24.4	10.4
Charges and interest	0.0	0.0	0.0	0.4	0.5	0.6	0.6	0.6	0.6	0.5	0.4	0.2	0.1	0.1	0.0
Fund obligations based on existing and prospective credit (in millions of SDRs)															
Principal	28.4	8.9	15.8	0.0	0.0	0.0	0.0	10.4	24.4	38.3	48.7	48.7	38.3	24.4	10.4
Charges and interest	0.7	0.1	0.1	0.5	0.6	0.7	0.7	0.7	0.7	0.6	0.5	0.4	0.2	0.2	0.1
Total obligations based on existing and prospective credit															
In millions of SDRs	28.1	8.9	15.9	0.5	0.6	0.7	0.7	11.1	25.0	38.9	49.2	49.1	38.5	24.5	10.6
In millions of US$	44.9	13.8	23.6	0.7	1.0	1.1	1.1	16.7	37.4	58.1	73.5	73.3	57.6	36.6	15.8
In percent of Gross International Reserves	0.7	0.3	0.6	0.0	0.0	0.0	0.0	0.5	0.8	1.1	1.2	1.1	0.8	0.9	0.6
In percent of exports of goods and services	0.6	0.2	0.2	0.0	0.0	0.0	0.0	0.1	0.3	0.4	0.5	0.5	0.4	0.4	0.2
In percent of debt service	17.7	5.0	7.9	0.2	0.3	0.3	0.3	4.2	9.3	14.1	17.6	16.3	11.6	6.7	2.6
In percent of GDP	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0
In percent of quota	11.5	3.7	6.5	0.2	0.3	0.3	0.3	4.6	10.3	16.0	20.2	20.1	15.8	10.1	4.3
Outstanding Fund credit															
In millions of SDRs	33.5	50.5	104.4	174.0	243.5	243.5	243.5	233.1	208.7	170.5	121.8	73.1	34.8	10.4	0.0
In millions of US$	53.5	78.2	155.5	259.5	363.7	363.9	364.1	348.5	312.1	254.8	182.0	109.2	52.0	15.6	0.0
In percent of Gross International Reserves	0.9	1.7	3.8	7.8	13.8	15.4	16.3	10.5	7.0	4.8	3.0	1.6	0.7	0.4	0.0
In percent of exports of goods and services	0.8	0.9	1.6	2.7	3.8	3.8	3.8	2.8	2.4	1.9	1.3	0.8	0.4	0.2	0.0
In percent of debt service	21.1	28.1	51.7	85.6	108.4	100.4	98.1	88.8	77.8	61.8	43.5	24.3	10.5	2.9	0.0
In percent of GDP	0.2	0.3	0.5	0.7	0.9	0.9	0.8	0.8	0.6	0.5	0.3	0.2	0.1	0.0	0.0
In percent of quota	13.8	20.8	42.9	71.4	100.0	100.0	100.0	95.7	85.7	70.0	50.0	30.0	14.3	4.3	0.0
Net use of Fund credit															
Disbursements	0.0	34.8	69.6	69.6	69.6	…	…	…	…	…	…	…	…	…	…
Repayments and Repurchases	28.4	8.9	15.8	0.0	0.0	0.0	0.0	10.4	24.4	38.3	48.7	48.7	38.3	24.4	10.4
Memorandum items:															
Nominal GDP (in millions of US$)	25,131	30,170	32,979	36,162	38,856	41,061	43,219	45,663	48,199	50,624	52,966	55,425	57,839	54,979	58,061
Exports of goods and services (in millions of US$)	7,097	9,080	9,552	9,685	9,669	9,576	9,531	12,448	13,104	13,481	13,845	14,221	14,012	9,195	9,752
Gross International Reserves (in millions of US$)	6,213	4,631	4,113	3,332	2,638	2,366	2,237	3,306	4,440	5,339	6,040	6,750	6,987	3,955	2,630
Debt service (in millions of US$)	253	278	301	303	336	362	371	393	401	412	419	449	496	545	610
Quota (millions of SDRs)	244	244	244	244	244	244	244	244	244	244	244	244	244	244	244

Sources: Fund staff estimates and projections.

1/ Assumes a new ECF arrangement of 100 percent of quota (SDR 243.50 million).

APPENDIX I. REPUBLIC OF YEMEN: DEBT SUSTAINABILITY—UPDATE

1. **In view of Yemen's request for access to Fund resources under the Extended Credit Facility, Fund staff has updated the assessment of Yemen's debt sustainability**. The last joint Bank-Fund debt sustainability analysis found that, although Yemen's debt ratios were below most of the indicative policy-dependent thresholds, dwindling oil production presented significant risks over the medium and long term as the present value of debt-to-exports threshold was breached over the long term. This assessment builds on the previous exercise. It incorporates the previous projections of debt service on the stock of outstanding external and domestic debt and includes debt service projections on new domestic and external debt obligations, including the proposed use of Fund resources. The macroeconomic assumptions underlying the assessment have also been revised in line with program parameters.

2. **Yemen's risk of debt distress is broadly unchanged relative to last year's assessment**. Yemen's external debt and debt service are projected to slightly increase as a share of GDP, exports, and revenues during 2010 and beyond, mostly because of lower export receipts. The use of Fund resources will have only a modest impact on these ratios. With the proposed use of Fund resource, the debt indicators remain below their thresholds, except the present value of debt-to-exports ratio in the baseline scenario.

Table 1.Yemen: Public Sector Debt Sustainability Framework, Baseline Scenario, 2007-2030
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2007	2008	2009	Average	Standard Deviation	2010	2011	2012	2013	2014	2015	2010-15 Average	2020	2030	2016-30 Average
Public sector debt 1/	40.4	36.4	51.0			46.3	46.3	46.0	45.2	45.0	45.7		39.3	48.8	
o/w foreign-currency denominated	26.9	21.9	24.2			21.3	21.2	21.4	21.4	22.1	22.9		24.0	20.9	
Change in public sector debt	-0.4	-4.0	14.6			-4.7	0.0	-0.3	-0.8	-0.2	0.7		-1.8	-1.6	
Identified debt-creating flows	2.1	-3.4	13.0			-4.8	0.1	-0.4	-0.7	-0.3	0.6		-1.6	-1.3	
Primary deficit	4.9	2.1	7.7	-0.2	4.8	3.3	2.6	2.3	0.9	1.0	1.8	2.0	-0.4	0.6	1.5
Revenue and grants	33.2	36.7	25.0			26.8	25.2	23.9	23.2	22.6	21.8		23.0	18.9	
of which: grants	0.3	0.3	0.4			1.2	1.5	1.5	1.5	1.4	1.3		0.5	0.5	
Primary (noninterest) expenditure	38.0	38.8	32.7			30.1	27.8	26.1	24.2	23.7	23.6		22.6	19.5	
Automatic debt dynamics	-2.7	-5.6	5.3			-8.1	-2.5	-2.7	-1.7	-1.3	-1.2		-1.2	-1.8	
Contribution from interest rate/growth differential	-0.8	-1.7	2.1			-6.3	-2.0	-2.1	-1.5	-1.5	-1.5		-1.7	-1.8	
of which: contribution from average real interest rate	0.5	-0.2	3.5			-2.5	-0.2	-0.3	0.4	0.4	0.5		0.2	0.4	
of which: contribution from real GDP growth	-1.3	-1.4	-1.4			-3.8	-1.8	-1.8	-1.9	-1.9	-2.0		-1.8	-2.2	
Contribution from real exchange rate depreciation	-1.9	-3.9	3.2			-1.8	-0.5	-0.6	-0.2	0.2	0.3		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	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	
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	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	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	
Residual, including asset changes	-2.5	-0.6	1.5			0.1	0.0	0.1	-0.1	0.1	0.1		-0.2	-0.4	
Other Sustainability Indicators															
PV of public sector debt	13.5	14.5	42.5			40.0	40.4	40.2	39.7	39.2	39.6		32.8	43.7	
o/w foreign-currency denominated	0.0	0.0	17.2			15.4	15.8	16.1	16.3	16.8	17.4		17.5	15.8	
o/w external	...	...	17.2			15.4	15.8	16.1	16.3	16.8	17.4		17.5	15.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	8.1	5.3	10.9			6.2	5.6	5.3	4.1	3.8	4.5		1.9	3.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	40.6	39.5	169.9			149.4	160.2	168.5	170.8	173.2	182.2		142.7	230.9	
PV of public sector debt-to-revenue ratio (in percent)	41.0	39.7	172.7			156.5	170.3	179.5	182.6	185.0	194.1		145.6	236.5	
o/w external 3/	…	…	69.8			60.4	66.5	72.0	75.2	79.3	85.3		77.7	85.5	
Debt service-to-revenue and grants ratio (in percent) 4/	9.9	8.6	12.9			11.0	12.1	12.6	13.5	12.2	12.3		10.2	14.8	
Debt service-to-revenue ratio (in percent) 4/	10.0	8.7	13.1			11.5	12.8	13.4	14.5	13.0	13.1		10.4	15.2	
Primary deficit that stabilizes the debt-to-GDP ratio	5.3	6.1	-6.9			8.0	2.5	2.6	1.7	1.2	1.1		1.4	2.2	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	3.3	3.6	3.9	4.1	1.0	8.0	4.1	4.1	4.4	4.5	4.5	4.9	4.7	4.5	4.4
Average nominal interest rate on forex debt (in percent)	1.2	1.2	1.1	1.2	0.3	1.3	1.2	1.2	1.2	1.2	1.1	1.2	1.0	6.5	1.4
Average real interest rate on domestic debt (in percent)	7.7	-0.5	25.6	5.4	9.4	-9.4	0.1	-0.4	2.5	2.7	3.1	-0.2	2.6	-1.8	2.5
Real exchange rate depreciation (in percent, + indicates depreciation)	-6.9	-15.1	15.2	-5.0	9.2	-8.3	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	10.9	20.4	-8.7	11.4	9.3	22.4	9.9	10.6	8.1	6.2	5.7	10.5	6.0	4.4	4.8
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.1	-0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant element of new external borrowing (in percent)	...	...	...	…	…	34.9	34.7	34.9	34.8	35.8	35.8	35.1	35.8	35.8	...

Sources: Country authorities; and staff estimates and projections.
1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]
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 excluding 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.

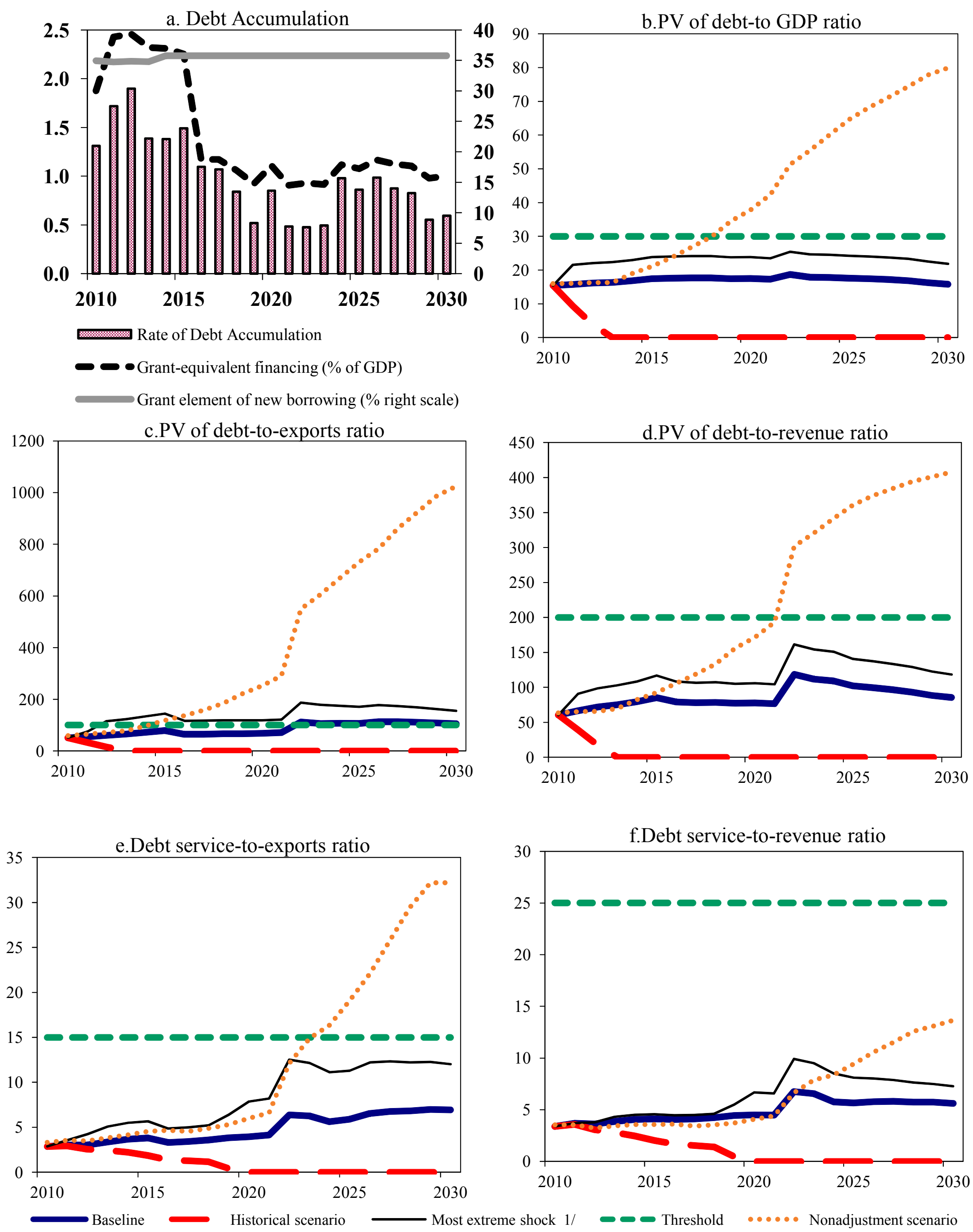
Table 2.: External Debt Sustainability Framework, Baseline Scenario, 2007-2030 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical 0 Average 0	Standard Deviation	Projections									
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-2015 Average	2020	2030	2016-2030 Average
External debt (nominal) 1/	**26.9**	**21.9**	**24.2**			**21.7**	**23.4**	**23.3**	**23.7**	**24.8**	**26.2**		**25.6**	**23.8**	
o/w public and publicly guaranteed (PPG)	26.9	21.9	24.2			21.3	21.2	21.4	21.4	22.1	22.9		24.0	20.9	
Change in external debt	0.0	-5.0	2.2			-2.4	1.6	0.0	0.3	1.1	1.4		-0.4	-0.9	
Identified net debt-creating flows	-1.6	-2.4	12.9			6.0	5.1	5.5	4.8	4.2	4.4		0.4	-0.2	
Non-interest current account deficit	**6.7**	**4.4**	**10.4**	**-1.5**	**7.2**	**4.9**	**4.5**	**4.3**	**4.3**	**4.5**	**4.6**		**1.6**	**2.5**	4.4
Deficit in balance of goods and services	7.3	5.6	12.1			4.7	4.5	5.4	6.6	7.9	9.3		4.0	10.0	
Exports	35.9	37.8	28.2			30.1	29.0	26.8	24.9	23.3	22.1		25.7	15.0	
Imports	43.2	43.4	40.3			34.8	33.4	32.2	31.5	31.2	31.3		29.6	24.9	
Net current transfers (negative = inflow)	-6.6	-8.0	-6.0	-9.8	3.0	-5.9	-5.7	-6.0	-6.7	-7.4	-7.6		-6.7	-9.1	-7.9
o/w official	-0.7	-3.0	-1.6			-1.7	-1.3	-1.5	-1.6	-1.5	-1.5		-0.5	-0.5	
Other current account flows (negative = net inflow)	5.9	6.9	4.4			6.1	5.7	4.9	4.4	4.1	3.0		4.3	1.6	
Net FDI (negative = inflow)	**-5.3**	**-1.7**	**0.7**	**-1.4**	**2.5**	**2.4**	**1.2**	**1.8**	**1.2**	**0.4**	**0.6**		**-0.2**	**-1.8**	-1.3
Endogenous debt dynamics 2/	**-2.9**	**-5.0**	**1.8**			**-1.4**	**-0.6**	**-0.6**	**-0.7**	**-0.8**	**-0.8**		**-0.9**	**-0.8**	
Contribution from nominal interest rate	0.3	0.3	0.3			0.2	0.2	0.2	0.2	0.2	0.2		0.2	0.2	
Contribution from real GDP growth	-0.8	-0.8	-0.9			-1.6	-0.8	-0.9	-0.9	-1.0	-1.1		-1.2	-1.0	
Contribution from price and exchange rate changes	-2.4	-4.5	2.5			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**1.5**	**-2.7**	**-10.7**			**-8.4**	**-3.5**	**-5.5**	**-4.5**	**-3.1**	**-3.0**		**-0.9**	**-0.7**	
o/w exceptional financing	0.0	-0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	18.4			15.8	17.9	18.1	18.7	19.5	20.7		19.1	18.7	
In percent of exports	...	...	65.1			52.6	61.7	67.5	75.0	83.5	93.7		74.5	125.2	
PV of PPG external debt	**...**	**...**	**17.2**			**15.4**	**15.8**	**16.1**	**16.3**	**16.8**	**17.4**		**17.5**	**15.8**	
In percent of exports	**...**	**...**	**60.8**			**51.2**	**54.4**	**60.3**	**65.7**	**72.1**	**79.0**		**68.3**	**105.4**	
In percent of government revenues	**...**	**...**	**69.8**			**60.4**	**66.5**	**72.0**	**75.2**	**79.3**	**85.3**		**77.7**	**85.5**	
Debt service-to-exports ratio (in percent)	**3.5**	**2.7**	**3.5**			**2.9**	**3.0**	**3.0**	**3.4**	**3.7**	**3.8**		**3.9**	**6.9**	
PPG debt service-to-exports ratio (in percent)	**3.5**	**2.7**	**3.5**			**2.9**	**3.0**	**3.0**	**3.4**	**3.7**	**3.8**		**3.9**	**6.9**	
PPG debt service-to-revenue ratio (in percent)	**3.8**	**2.8**	**4.1**			**3.4**	**3.7**	**3.6**	**3.9**	**4.1**	**4.1**		**4.5**	**5.6**	
Total gross financing need (Billions of U.S. dollars)	0.6	1.0	3.0			2.5	2.2	2.5	2.5	2.4	2.6		1.3	1.5	
Non-interest current account deficit that stabilizes debt ratio	6.7	9.4	8.2			7.4	2.9	4.3	4.0	3.4	3.2		2.0	3.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	3.3	3.6	3.9	4.1	1.0	8.0	4.1	4.1	4.4	4.5	4.5	4.9	4.7	4.5	4.4
GDP deflator in US dollar terms (change in percent)	9.9	19.9	-10.1	8.6	9.3	11.1	5.0	5.4	3.0	1.2	0.7	4.4	0.0	2.4	0.7
Effective interest rate (percent) 5/	1.3	1.3	1.2	1.2	0.3	1.2	1.2	1.1	1.1	1.1	1.0	1.1	1.0	0.9	0.9
Growth of exports of G&S (US dollar terms, in percent)	-1.2	31.0	-30.3	12.7	23.5	27.9	5.2	1.4	-0.2	-1.0	-0.5	5.5	2.7	6.2	3.2
Growth of imports of G&S (US dollar terms, in percent)	20.3	24.8	-13.3	14.2	12.2	3.8	4.8	5.5	5.3	4.5	5.6	5.0	3.7	3.0	3.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	34.9	34.7	34.9	34.8	35.8	35.8	35.1	35.8	35.8	35.8
Government revenues (excluding grants, in percent of GDP)	32.8	36.5	24.6			25.5	23.7	22.4	21.7	21.2	20.4		22.5	18.5	19.4
Aid flows (in Billions of US dollars) 7/	0.4	0.3	0.5			0.9	1.3	1.5	1.4	1.6	1.7		1.3	1.8	
o/w Grants	0.1	0.1	0.1			0.4	0.5	0.5	0.6	0.6	0.6		0.2	0.4	
o/w Concessional loans	0.4	0.3	0.4			0.5	0.8	0.9	0.8	1.0	1.1		1.0	1.4	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.9	2.4	2.5	2.3	2.3	2.3		1.1	1.0	1.1
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			60.3	58.0	57.0	60.0	59.6	58.0		48.4	50.3	49.6
Memorandum items:															
Nominal GDP (Billions of US dollars)	21.7	26.9	25.1			30.2	33.0	36.2	38.9	41.1	43.2		55.4	90.7	
Nominal dollar GDP growth	13.6	24.3	-6.6			20.0	9.3	9.6	7.5	5.7	5.3	9.6	4.6	7.0	5.1
PV of PPG external debt (in Billions of US dollars)			4.2			4.6	5.1	5.7	6.2	6.7	7.3		9.4	14.2	
(PVt-PVt-1)/GDPt-1 (in percent)						1.3	1.7	1.9	1.4	1.4	1.5	1.5	0.9	0.6	0.8
Gross workers' remittances (Billions of US dollars)	1.3	1.4	1.2			1.3	1.5	1.7	2.1	2.5	2.8		3.6	8.2	
PV of PPG external debt (in percent of GDP + remittances)	...	...	16.4			14.8	15.1	15.4	15.5	15.8	16.4		16.5	14.5	
PV of PPG external debt (in percent of exports + remittances)	...	...	52.1			44.6	46.9	51.2	54.0	57.2	61.3		54.6	65.7	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	3.0			2.5	2.6	2.6	2.8	2.9	3.0		3.2	4.3	

Sources: Country authorities; and staff estimates and projections.

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 PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Figure 1. Yemen: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2010-2030 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2020. In figure b. it corresponds to a Nonadjustment scenario shock; in c. to a Nonadjustment scenario shock; in d. to a Nonadjustment scenario shock; in e. to a Nonadjustment scenario shock and in figure f. to a Nonadjustment scenario shock

ATTACHMENT I. REPUBLIC OF YEMEN: LETTER OF INTENT

July 14, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

Yemen has maintained close cooperation with the IMF over the past many years. In the mid- and late-1990s, the government undertook efforts aimed at strengthening the foundations of a market-based and private sector-driven economy, and more closely integrating Yemen into world markets. These programs, supported by the IMF, were successful in lowering inflation, improving the state of public finances, and bolstering economic prospects. The cooperative relationship with the IMF also paved the way for successive debt rescheduling operations with the Paris Club. Since then, our relationship continued in the context of the annual consultations.

The past few years have been difficult for Yemen. Oil production—the mainstay of government revenues and the external accounts—dropped substantially in 2007. The collapse of international oil prices in late 2008–09 aggravated these pressures. Moreover, the impact of the global crisis was also felt on the external balance of payments—mainly via lower export receipts and weaker inward investment and remittance flows. These developments made the fiscal and external positions more difficult, contributing to the recent pressures on the exchange rate.

The government is committed to addressing the economic imbalances, re-stabilizing the economy, and placing it on a path of sustained high growth in order to accelerate the pace of progress toward the Millennium Development Goals. Specifically, our objectives are to (i) put public finances on a sustained footing in the medium-term, by combining fiscal consolidation with a restructuring of expenditures more toward capital and social outlay; (ii) boost non-hydrocarbon revenues through improvement in tax policy and administration to allow higher capital and social outlays over the medium-term; and (iii) contain inflation and exchange rate pressures.

The attached Memorandum of Economic Policies (MEFP) sets forth our policy intentions and measures we intend to implement to attain our objectives. In support of the policies in the MEFP, the government requests that the Executive Board of the IMF approve a three-year Extended Credit Facility (ECF) arrangement with access in the amount of SDR 243.50 million (100 percent of quota) and disburse the first tranche upon approval of the arrangement.

The government of Yemen will provide the information the Fund may request in connection with progress in implementing its economic and financial policies. It believes that the policies set out in the attached MEFP are adequate to achieve the objectives of the program, but will take any further measures that may be appropriate for this purpose. The government will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultations.

The Yemeni authorities consent to the release to the public of this Letter of Intent, the attached MEFP, and the attached Technical Memorandum of Understanding, as well as the IMF staff report relating to the request for an ECF arrangement. We hereby authorize their publication and inclusion on the IMF website, following approval of the IMF Executive Board.

Sincerely yours,

/s/
Mr. Noman Taher Alsuhaibi
Minister
Ministry of Finance

/s/
Mr. Mohamed Bin Humam
Governor
Central Bank of Yemen

ATTACHMENT II. REPUBLIC OF YEMEN: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

JULY 14, 2010

I. INTRODUCTION

1. This memorandum outlines the economic and financial policies of the government of Yemen for 2010–13. Our program aims at achieving high and sustained levels of economic growth, reducing poverty, and maintaining macroeconomic stability in the face of a difficult global environment and declining oil production. These policies are also intended to form the basis for a three-year IMF-supported program under the Extended Credit Facility (ECF), which we hope will be facilitated by an expansion of donor budgetary support.

II. BACKGROUND

2. Yemen has had a long and productive relationship with the IMF. In the mid- and late-1990s, the government undertook efforts aimed at strengthening the foundations of a market-based and private sector-driven economy, and more closely integrating Yemen into world markets. The programs, supported by the IMF, aimed at restoring macroeconomic and financial stability and included strong fiscal adjustment measures, liberalization of most interest rates, and simplification of the exchange rate system. The programs were successful in lowering inflation, improving the state of public finances, and bolstering economic prospects. The cooperative relationship with the IMF also paved the way for successive debt rescheduling operations with the Paris Club.

3. We have continued to make macroeconomic and financial progress since the end of the last IMF-supported program in 2001. During 2001–07, non-hydrocarbon sector growth averaged over 5 percent per year, while core inflation remained under 11 percent per year. The LNG project is now operational, and will provide a steady source of government revenue and export earnings over the long-term. With relatively high oil prices and associated foreign exchange earnings, the government used the opportunity to further reduce external debt and to build a substantial cushion of foreign exchange reserves. Total government and government-guaranteed external debt fell from roughly 49 percent of GDP in 2001 to the current level of some 24 percent of GDP. Gross own foreign exchange reserves of the central bank climbed from $3.6 billion in 2001 to $7.3 billion in 2008, amounting to an average reserve cover of over 9-months of imports—a marked achievement for any country.

4. Financial intermediation, market orientation, and integration with world markets have also improved over the past decade. Private sector credit as a share of GDP rose from just under 6 percent of GDP in 2001 to 8 percent of GDP in 2008, while the level of dollarization (foreign currency deposits as a share of total banking deposits) dropped sharply from 52 percent to 38 percent—signaling greater confidence in the rial. Yemen has maintained

one of the more open trade regimes in the region. Total trade (imports plus exports) rose from 61 to 66 percent of GDP during this period, denoting a greater degree of openness and integration with world markets. After many years of hard work, Yemen is also on the cusp of accession to the World Trade Organization (WTO). Continued progress on improving the investment environment is also evident, with Yemen's standing on the World Bank's Doing Business Index rising progressively over the years.

5. The government has consistently sought to maintain a sound and sustainable fiscal position over the last decade. Despite a secular decline in oil production, progressively higher international oil prices during 2001-08 allowed for the overall fiscal deficit (cash basis) to average under 2 percent of GDP. Overall capital expenditure also registered an impressive 7 percent of GDP on average during this period—reflecting government efforts to meet many pressing public investment needs. On the less positive side, however, and like many countries, the relative balance between current expenditure (wages and salaries, government operations and maintenance, subsidies, and transfers) and capital expenditure remained heavily weighted in favor of the former. Further, progress has been relatively slow in building non-hydrocarbon revenues. Total tax revenue as a share of non-hydrocarbon GDP has been essentially flat at just under 11 percent of GDP since 2001—reflecting continued difficulties which caused delays in implementing key measures in the area of tax policy and administration. Progress on improving public financial management—particularly commitment control and cash management—has also been mixed.

III. Recent Economic Developments

6. The past few years have been exceptionally difficult for Yemen. Oil production—the mainstay of government revenues and the external accounts—dropped substantially in 2007. Fast increases in international commodity prices brought benefits in terms of higher oil export revenues in 2008, but also resulted in record inflation—particularly for food. Given Yemen's heavy reliance on imports and low level of per capita income, this was particularly difficult for the most vulnerable segments of the population. Despite the recent decline in food prices, the government recognizes food insecurity as a serious potential risk and has taken steps to address it.

7. With the onset of the global financial crisis, we have encountered a new set of challenges. Economic activity has slowed, but inflation has been modest. Non-hydrocarbon sector growth fell from about 4.8 percent in 2008 to an estimated 4.1 percent in 2009—reflecting somewhat slower activity in construction, manufacturing, and real estate. Oil production continued to fall in 2009 (by 3.8 percent), and the start of LNG production was delayed until mid-November. Overall investment (foreign and domestic) was substantially lower than in 2008. Inflation hit record lows in 2009, largely due to the sharp decline in international food prices. Twelve-month core inflation fell to 1.9 percent by August 2009 in the wake of lower international commodity prices, but rose to 7.3 percent by year-end as commodities recovered.

8. The collapse of international oil prices in late 2008-09 had a strongly negative impact on our public finances. The sharp drop in average prices ($60 per barrel in 2009 versus $98 per barrel in 2008), combined with lower oil production and declining government share led to a substantial drop in government oil exports. The government realized early on the potential risks associated with the rising gap between planned expenditures and likely revenues, and moved to immediately curtail non-essential current spending. In the event, however, the magnitude of adjustment proved insufficient, and resulted in a record fiscal deficit of 10.2 percent of GDP on a cash basis in 2009. Critically, because of relatively limited external financing, the government was forced to draw heavily on the domestic debt market, place lower-yielding bonds with public pension funds, and resort to a high level of central bank financing. Net credit of the banking system to the government rose, overall public debt increased by 13 percent of GDP, and private sector credit ended the year with negative growth. While the 2010 budget is an improvement over the 2009 outturn, the gap between expenditures and likely revenues remains large—posing risks to macroeconomic stability.

9. The impact of the global crisis was also felt on the external balance of payments—mainly via lower export receipts and weaker inward investment and remittance flows. Total hydrocarbon exports fell by about US$3.4 billion in 2009—fundamentally shifting the balance of supply and demand for foreign exchange. Weaker inward remittances and a slowdown in investment inflows also contributed to external pressures. Gross own reserves of the Central Bank of Yemen (CBY) declined by US$1.1 billion over the course of the year, and would have fallen even further were it not for some US$300 million from the IMF as part of a general SDR allocation. Given these pressures and the need to limit the amount of foreign exchange reserve loss, the CBY opted to allow greater flexibility in the exchange rate. As a result, the rial depreciated by 3 percent against the U.S. dollar in 2009. Exchange rate pressures intensified in the first quarter of 2010. The CBY responded by increasing foreign exchange intervention, resulting in the loss of net international reserves (NIR) of US$995 million in the first three months of 2010.

10. The focus of monetary policy in 2009 was on providing liquidity to the economy. With single-digit inflation, declining private sector credit, and a surge in government borrowing, the CBY lowered the benchmark interest rate (from 13 percent to 10 percent in two steps during January-May 2009). The CBY redeemed Yrls 256 billion in CDs from commercial banks—re-injecting liquidity into the banking system, which in turn purchased government T-bills. Lower yielding, longer maturity Treasury Bonds (T-bonds) were also created and placed with public pension funds—replacing their holdings of T-bills. The impact of these policies on money supply was muted by the large decline in net foreign assets and (possibly due to crowding out by government borrowing) negative private sector credit growth.

11. Renewed pressure on the exchange rate in early 2010 led to a decision to raise the benchmark deposit rate to 12 percent in January, and subsequently to 20 percent in March

and to institute intra-auction limits on the amount of foreign exchange that could be purchased by a single bank or foreign exchange dealer. These measures appear to have calmed the market, but foreign exchange reserves are on a declining trend given the fundamental shift in the supply and demand for foreign currency associated with declining oil production and exports.

IV. Medium-Term Economic Policy Framework

12. Yemen's medium-term prospects remain closely tied to the hydrocarbon sector. The government will continue to make every effort to extend the life of oil reserves. The production and export of LNG via the Yemen LNG project and other natural gas opportunities will offer some cushion. Nevertheless, new resources coming on-stream will likely be insufficient to compensate for the loss of oil. The government recognizes the need for a prudent approach going forward, and to plan on the basis of continued decline in hydrocarbon production. Given rising domestic consumption, the predominant trend suggests that Yemen will shift from being a net fuel exporter to a net fuel importer within the medium-term horizon.

13. Our main medium-term challenge is to facilitate a smooth adjustment to declining oil production, while bolstering prospects for non-hydrocarbon growth and poverty reduction. The government is committed to a strategy of achieving high and sustained level of economic growth within a framework of financial and external stability. Toward this end, our medium-term strategy will focus on (i) accelerating non-hydrocarbon economic growth while maintaining inflation within moderate levels; (ii) putting public finances on a medium-term footing, by combining fiscal consolidation with a restructuring of public spending to place a heavier emphasis on capital expenditures and social transfers; (iii) boosting non-hydrocarbon revenues through tax policy and administration measures; (iv) maintaining adequate foreign exchange reserve cover; and (v) creating a more attractive and market oriented business climate, and strengthening the ability of the banking system to support development of the real sector.

14. Our objective is to achieve average non-hydrocarbon sector growth of at least 5 percent through the program period (2010–13). Emphasis will be placed on promising sectors such as agriculture, manufacturing, fisheries, tourism, and transport. The government will, in cooperation with its development partners, map out a strategy to address these issues in the context of the new five-year development and poverty reduction plan, which is expected to be completed by the end of 2010. Essential to this endeavor will be sufficient levels of public investment to remove infrastructural bottlenecks and pave the way for private-sector led growth.

15. The government is committed to putting public finances on a sustainable path before the end of the program period (2013). Given the anticipated steady decline in oil production, it is clear that difficult but essential efforts must be undertaken to realign expenditures with a

shrinking revenue base and to ensure a higher degree of efficiency in government spending. To this end, the program will endeavor for a reduction in the overall fiscal deficit to about 3.5 percent of GDP by the end of the program period, consistent with a sustainable level of domestic financing and a significant reduction in the outstanding balance of central bank credit to the government. Central pillars underlying this strategy will include: (i) a reduction and the gradual removal of domestic fuel subsidies (ii) a notable reduction of the subsidy on electricity generation; (iii) civil service wage and salary restraint; and (iv) containment of nonessential current expenditures (goods and services, operations and maintenance) while allowing for an increase in social and capital spending. By the end of the program period, our hope is that the relative weight of current expenditures versus capital/social spending in total government expenditures will have shifted from the present around 70/30 balance to about 65/35—engendering a stronger social safety net and sustained higher levels of public investment needed to achieve the aforementioned growth objectives.

16. Increasing non-hydrocarbon revenues is the second essential element in ensuring sustainable public finances over the medium- and long-term. Government efforts in this area will be intensified, and tax policy and administration measures will be implemented, with a view to raising the tax-to-GDP ratio to at least 7.5 percent of GDP by the end of the program period. The government will be careful to balance revenue objectives with the need to maintain a fair, transparent, and efficient tax system. Key measures will likely include (i) full implementation of the General Sales Tax (GST); (ii) maintaining a policy of no new tax or customs (except for fixed assets and 50 percent of raw materials for industrial use) exemptions—offering instead non-distortionary incentives such as accelerated depreciation; (iii) greater efficiency in customs and tax administration; and (iv) consideration of new tax policy measures, as needed.

17. Monetary policy will focus primarily on price stability, while ensuring a sufficient level of private sector credit to support economic growth. The CBY will continue to target reserve money growth in line with non-hydrocarbon sector economic activity, while keeping a close watch on excess liquidity in the banking system or signs of upward pressure on prices from domestic sources. To enhance the efficacy of monetary policy, the CBY will move to enhance both liquidity forecasting (in conjunction with the Ministry of Finance), and will explore the possibility of phasing out the administered benchmark deposit rate in favor of greater use of indirect instruments of monetary policy. The objective is to minimize central bank financing of the budget to avoid inflationary pressures.

18. With regard to exchange rate policy, the CBY will seek to strike a balance between enhancing external competitiveness and limiting inflation. Yemen's heavy reliance on imports makes domestic prices sensitive to movements in the exchange rate. At the same time, the expected decline in oil exports makes exchange rate flexibility necessary to ensure external competitiveness and a sustainable external position. The CBY will continue to auction sufficient foreign exchange to meet market needs and smooth short-term volatility—

balanced against the necessity of maintaining a sufficient cushion of foreign exchange reserves.

V. Policies for 2010–11

19. Within the context of the medium-term framework noted above, the government is committed to implementing critical measures in 2010 to address growing current macroeconomic and financial imbalances. Specifically, measures will be implemented to (i) reduce the size of the overall fiscal deficit to a level consistent with available domestic and external financing; (ii) stem the recent pressures on foreign exchange reserves; and (iii) adopt a monetary framework that can help facilitate a recovery of private sector credit while protecting price stability, and facilitating lending to small and medium sized enterprises via expansion of microfinance institutions.

A. Fiscal Policy

20. With a view to realigning expenditures with actual revenues and reducing pressures on the external accounts and the exchange rate, the government is committed to reducing the overall size of the fiscal deficit to approximately Yrls 380 billion in 2010. The adjustment (approximately Yrls 143 billion relative to the budget adjusted for higher oil prices and the February increase in domestic fuel prices) will be accomplished through the following measures:

- Gradual adjustment of domestic fuel prices. Given the heavy burden that fuel subsidies place upon public finances and their low level of efficiency in assisting the poor, the government will seek to gradually reduce the subsidy on gasoline, diesel, kerosene, and LPG over the course of 2010 to achieve a net fiscal savings of about Yrls 56 billion (0.8 percent of GDP) (structural measure for December 31, 2010). An adjustment in domestic fuel prices of Yrls 5 per litter (0.5 percent of GDP) on derivative products (gasoline, diesel, kerosene) was implemented in May/June 2010 (prior action). This comes on the back of the adjustment implemented in February 2010. Our efforts to bring domestic fuel prices closer to world prices will be complemented by instituting a social safety net to help protect the most vulnerable segments of the population against the price increases. In this context, we plan to increase social transfers by Yrls 16 billion (0.24 percent of GDP) above budgeted amounts. We hope that donors will provide financial assistance for the Social Welfare Fund. We intend to review this in the context of the first review under the program.

- Full implementation of the General Sales Tax (GST). Building non-hydrocarbon revenues has consistently been an objective of the government over the years, but progress in this area had not proceeded as quickly as had been hoped. Full implementation of the GST offers the greatest prospect for increasing tax revenues in the short-term. Implementation of the law was enacted on July 1, 2010 (prior action).

Moreover, the government will not defer payments under the GST law for its own transactions beyond the fiscal year and will not grant new exemptions under the law.

- Reduction in the corporate income tax rate (from 35 percent to 20 percent and to 15 percent for investment projects)) while simultaneously eliminating all income tax and most customs (except for fixed assets) exemptions under the Investment Law (structural benchmark for end-September).[1] Existing exemptions will be grand-fathered. Moreover, procedural improvements will be undertaken to ensure that no new exemptions can be introduced by individual line ministries or agencies. Given the need to maintain revenue neutrality, the reduction in the rate on the personal income tax (the tax on public sector wages and salaries) will become effective on December 31, 2010.

- Implement administrative reforms at the Customs Authority focused on improving both the business climate and government revenues. Specifically, we intend to simplify and streamline customs procedures to encourage investment, particularly in the oil sector, and reduce processing time. We are proceeding with efforts to fully automate work procedures, including by upgrading ASCUDA software system. Moreover, we have created a unit at the Customs Authority to gather data on international commodity prices to address under-invoicing and reduce an area of friction with the business community. We will undertake a review of customs valuation and activate the Anti-Smuggling Committee with a view to addressing smuggling and under-invoicing.

- Create a cash management unit in the ministry of finance to more tightly control government spending should the need arise (structural benchmark for September 30, 2010). The unit will produce a first monthly report on cash outturns of the targeted units by December 2010, and start developing a cash management plan for the coming months.

21. The government will seek to create additional fiscal space through identification of inefficient practices and procedures. In this regard, we intend to utilize domestic natural gas for power generation instead of costly diesel fuel by 2013, with potential savings yet to be quantified. The rental power generators fueled by diesel will be replaced by generators fueled by natural gas during 2010.

22. Preparation for the 2011 budget has not started. Our preliminary thinking is that the overall fiscal deficit would be about 5.0 percent of GDP. We expect tax revenues to improve in the context of tax policy and administrative reforms to reduce reliance on the hydrocarbon sector. We intend to further streamline non-priority expenditures. The 2011 budget

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[1] The only other exemption will be payment of 50 percent of customs duty on raw materials for industrial use.

parameters will be reviewed later in 2010, as the preparation of the 2011 budget advances. Specific measures for 2011 will be outlined at the time of the first review.

B. Monetary and Exchange Rate Policies

23. The CBY will seek to ensure price stability. Critical to this effort will be the process of fiscal consolidation noted above and the associated reduction of central bank financing of the government budget. The program envisages broad money growth of 15.5 percent, consistent with non-hydrocarbon GDP and inflation objectives, allowing for a notable growth of credit to the private sector. Reserve money is targeted to increase by 14.3 by limiting budget financing from the central bank to no more than Yrls 80 billion. Similarly, in 2011, broad and reserve money are programmed to grow at 16 percent and 15 percent, respectively. The CBY will continue to maintain a close watch on excess rial liquidity, and will seek to enforce prudential norms within a context of encouraging banks to devote the necessary resources to risk management to allow for a broader extension of private sector credit. To the extent possible, and consistent with inflation and balance of payments developments, the CBY will also seek to liberalize interest rates in an effort to encourage economic activity.

24. In the context of continued exchange rate flexibility, the CBY will act to maintain net international reserves (NIR) of no less than US$4.17 billion by end-2010 and US$3.77 billion by end-2011. While the CBY will continue to provide foreign exchange sufficient to meet market needs and smooth short-term volatility in the rial, the exchange rate will be allowed to adjust to fundamental shifts in the supply and demand for foreign exchange, consistent with the medium-term objective of ensuring an orderly adjustment of the balance of payments. To help meet these objectives, the CBY will enhance efforts to collect timely balance of payments and liquidity data. We have recently received technical assistance from the IMF to enhance the efficiency of liquidity management and the foreign exchange auction process.

25. We plan to issue *Sukuk* in the last quarter of 2010 to diversify budget financing, provide an additional monetary policy instrument, and give Islamic banks and other investors an opportunity to invest in securities that are compliant with Islamic finance principles. We have formed an entity, initially affiliated with the CBY, to set up the basic infrastructure and manage the *Sukuk* issuance. The entity will select investment projects and prepare the relevant documentation for *Sukuk* issuance. We will have contingency plans in the event that *Sukuk* issuance is lower than programmed and other forms of non-inflationary financing are not available.

C. Structural Reforms

26. Strengthening government capacity in the area of public financial management will be a linchpin in meeting fiscal targets in 2010 and beyond. Particularly in the current environment of volatile hydrocarbon revenues, there is the need to generate timely fiscal data, adjust expenditures, and/or enact cash control measures. In this context, the government

has already begun to accelerate implementation of the Automated Financial Management and Information System (AFMIS). In the remaining months of 2010, the system will be rolled out beyond the pilot ministries to five additional ministries. The government will start implementing the second phase of PFM strategy by end-year within the framework of the Public Finance Modernization Project, and with the technical support of the World Bank. The objective of the PFM is to improve budget formulation and execution, including enhancing commitment controls and cash management, and fully implement the classification and methodology of the *Government Finance Statistics Manual 2001 (GFSM 2001)*, and supporting the AFMIS system rollout plans to the central and local government as a whole. We are also fully committed to timely publication of fiscal data—via the government financial statistics bulletin. Finally, to further protect public finances and eliminate current and future drains on the budget, the government will undertake reform of the public pension scheme, and devise a strategy to deal with moribund public enterprises.

27. A renewed effort to reform the civil service will be needed to meet the aforementioned objectives with respect to lowering expenditure on the public sector wage bill. Essential steps in this area—such as completion of biometric identification for all public employees (including military and police), and processing of early retirements and redundancies through the Civil Service Fund—will be necessary to realize envisioned savings over the medium-term, and the government commits itself to complete these essential steps by end-2011.

28. Further progress in improving the business climate and deepening financial intermediation will be essential to achieving the growth objectives noted above. Over the medium-term, we will strive to eliminate the most serious deficiencies in the business environment. Efforts will focus on, among other issues, measures to clarify property rights, improve the functioning of commercial courts, and the judicial processes for recovery of bank and other debts (including legal procedures for executing judgments and repossessing and disposing collateral) would enhance prospects for growth and investment over the medium-term. These measures will, inter alia, encourage deeper financial intermediation. But in addition, the CBY will seek to enhance financial sector development through enforcement of prudential criteria, improving the functioning of national credit registry, encouraging the establishment of an active intra-bank market, and proceeding with the issuance of Islamic financial instruments.

D. Data Issues

29. Broad access to timely macroeconomic data will be an essential pillar in improving macroeconomic management and policy coordination. Progress in data collection and dissemination has improved considerably in recent years, but there remain a number of priority areas where greater efforts are needed. In particular, we intend to complete work on a revised national accounts series by end-2010, proceed with the establishment of a producer price index, establish monthly reporting on the trade balance and quarterly reporting on the

balance of payments, release official fiscal data via the government financial bulletin with a lag of no more than two months, and complete the transition to *GFSM 2001* for the government fiscal accounts over the medium term. We look to the IMF and the donor community for assistance in reaching these objectives.

VI. Other

30. We would like to emphasize that Yemen's development and poverty reduction needs are enormous. In the absence of significant and predictable donor budgetary support, we will not be able to make a significant dent in fighting poverty and meeting Millennium Development Goals. We request that donors move quickly in helping Yemen meet these goals and provide significant and predictable budgetary support.

31. We will update our Poverty Reduction Strategy Paper (PRSP) in the context of drafting the new Development and Poverty Reduction Plan (DPPR) covering 2011–15, which is now under preparation and expected to be completed by end-2010. The expected shift towards more capital and social spending, as envisaged in our program, should contribute to a reduction in poverty.

VII. Program Monitoring

32. The program will cover a three year period beginning July 28, 2010, with semi-annual disbursements from the IMF contingent upon successful completion of reviews. The proposed semi-annual targets for end-December 2010 and end-June 2011 (performance criteria) and end-December 2011 (indicative targets) are set forth in Table A. These include (i) a ceiling on domestic financing of the central government; (ii) a sub-ceiling on financing by the CBY; (iii) a ceiling on net domestic assets of the CBY; (iv) a floor on net international reserves of the CBY; and (v) a continuous ceiling on the contracting or guaranteeing of nonconcessional external debt. A number of structural benchmarks are detailed in Table B. We will closely monitor financial and economic developments in coming months and will implement any measures that may be needed to safeguard macroeconomic stability in consultation with IMF staff.

33. The attached Technical Memorandum of Understanding (TMU) sets out the modalities of program monitoring. These include definitions of performance criteria and indicative targets; application of adjustors for deviations from oil revenues and external financing; and data sources and frequency of data reporting.

Table A. Republic of Yemen: Quantitative Performance Criteria and Indicative Targets 1/ 2/

(In billions of Yemeni rials unless otherwise indicated)

	2009	2010		2011			
	Dec.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
		I.T.	P.C.	I.T.	P.C.	I.T.	I.T.
Ceiling on domestic financing of the central government	440	83	79	66	66	66	66
Ceiling on domestic financing of the central government (cumulative change)		*252*	*331*	*66*	*133*	*199*	*265*
Of which, the central bank		20	-57	5	4	3	9
Central bank (cumulative change)		*137*	*80*	*5*	*9*	*12*	*20*
Ceiling on net domestic assets of the central bank (Stock)	-759	-360	-252	-188	-119	-54	2
Net domestic assets of the central bank (cumulative change)		*399*	*507*	*65*	*134*	*199*	*254*
Floor on net international reserves of the central bank (stock, US$ millions)	5,677	4,244	4,170	4,070	3,970	3,870	3,770
Net international reserves of the central bank (cumulative change, US$ millions)		*-1,433*	*-1,507*	*-100*	*-200*	*-300*	*-400*
Ceiling on contracting or guaranteeing of external nonconcessional by the government or the central bank (stock, US$ millions)	0	0	0	0	0	0	0
Floor on social spending (cumulative) (indicative target)	387	388	517	158	315	473	631
Memorandum Items							
Reserve Money	765	832	875	883	890	948	1,006
External Financing (cumulative)		37	49	35	70	105	140
Government oil and LNG export revenues (US$ millions) 1/	1,890	661	661	559	559	559	559
Cumulative Government oil and LNG export revenues (US$ millions)		1,983	2,645	559	1,118	1,677	2,235

1/ The performance criteria (P.C.) (on cumulative changes from the beginning of the year) are: (i) domestic financing of the central government; (ii) net domestic assets of the central bank; (iii) net international reserves of the central bank; and (iv) ceiling on contracting or guaranteeing of external nonconcessional debt by the government or the central bank (continuous). End-December 2010 and end-June 2011 targets are P.Cs., while others are indicative targets (I.T.).

2/ The PCs on NIR and NDA of the central bank, and on domestic financing of the budget have adjustors which are defined in the attached Technical Memorandum of Understanding (TMU).

Table B. Republic of Yemen: Extended Credit Facility—Prior Actions and Structural Benchmarks

Measures Under the ECF	Objective	Timing
Increase domestic fuel prices by Yrls 5 per liter on petroleum derivatives.	Expenditure Control	Prior Action (Done)
Full implementation of the General Sales Tax (GST) law.	Broaden Tax Base and Improve Revenue	Prior Action (Done)
Reduce corporate income tax rate from 35 percent to 20 percent (15 percent for investment projects), while simultaneously eliminating tax and customs (except for fixed assets and 50 percent of raw materials for industrial use) exemptions under the Investment Law.	Broaden Tax Base and Improve Revenue	Structural Benchmark, September 30, 2010
Create a cash management unit in the ministry of finance in order to better control government spending.	Expenditure control/Budget Execution	Structural Benchmark, September 30, 2010
Gradual adjustment of fuel prices to achieve net fiscal savings of Yrls 56 bln (0.8 percent of GDP).	Expenditure Control	Structural Benchmark, December 31, 2010

ATTACHMENT III. REPUBLIC OF YEMEN: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This Memorandum sets out the understanding reached between the Yemeni authorities and the Fund staff regarding the definitions of performance criteria and indicative targets, as well as data reporting requirements for the 2010–13 Extended Credit Facility (ECF) Arrangement (Table 1).

2. The ECF Arrangement is built upon four performance criteria for the end of semi-annual intervals (test dates) during December 2010–June 2013 period. Performance criteria and indicative targets are set out in Table A of Memorandum of Economic and Financial Policies. Performance criteria and indicative targets are set subject to adjustors, which will be monitored as memorandum items along with broad, reserve money and social spending.

3. The exchange rate of Yemeni rial to the U.S. dollar for the purposes of the program is set at Yrls 225 = US$ 1.

I. PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Reserve Money

4. Reserve Money is defined as the sum of currency in circulation (outside banks), banks' domestic cash in vaults, and banks' required and excess deposits with the Central Bank of Yemen (CBY). It includes commercial banks' required and excess reserves on foreign currency deposits valued at the program exchange rate. It excludes deposits held in the CBY by the central government and local councils, pension funds, public enterprises, and counterpart funds. The term "banks" relates to all commercial and Islamic banks. The term "public enterprises" relates to all enterprises where government has stake of 50 percent and above. The term "counterpart funds" refers to, but is not limited to, all other extrabudgetary funds related to the government or public enterprises.

B. Floor on Net International Reserves of Central Bank of Yemen

5. For purposes of this criterion, net international reserves (NIR) of the CBY are defined consistent with the definition of the Balance of Payment Manual 6, as external assets readily available to, and controlled by, the CBY, net of external liabilities of the CBY. Pledged and otherwise encumbered assets, including, but not limited to reserve assets used as collateral (or guarantees for third party external liabilities), are excluded.

6. NIR of the CBY are defined for this purpose as readily available external assets of the CBY (this includes following categories: monetary gold, foreign exchange deposits held with non-resident financial institutions; foreign securities; SDR holdings; and reserve position in the International Monetary Fund) minus (i) CBY external liabilities (this includes liabilities to the Arab Monetary Fund (AMF), the International Monetary Fund (IMF), and other

liabilities to non-residents) and (ii) external assets not controlled by the CBY (foreign currency deposits at CBY of banks', pension funds' and public enterprises'). For program monitoring purposes, NIR of the CBY as of the test dates are measured as the change in millions of US dollars from the beginning of the calendar year.

C. Ceiling on Net Domestic Assets of Central Bank of Yemen

7. Net domestic assets (NDA) of the CBY are defined as reserve money minus net foreign assets of CBY. Net foreign assets are external assets of the CBY as defined under paragraph 5 and 6 minus external liabilities of the CBY.

D. Ceiling on Domestic Financing of the Budget

8. Budget refers to the budget of the central government of the Republic of Yemen and local councils. It does not include extrabudgetary funds and public enterprises.

9. Domestic financing of the budget is defined as the sum of net claims of the CBY and commercial banks' on the central government and net holdings of government securities by non-banks. Net claims of the CBY and banks are defined as central bank and banks' advances and credits to the central government plus government paper held by the central bank and banks minus the central government's deposits at the central bank and banks. Government paper includes but is not limited to T-bills, T-bonds, Islamic bonds (sukuk and other), and repurchases of government securities of various maturities.

E. Floor on Social Spending

10. Social spending is defined as a total of budget current and capital social spending including spending on the Social Welfare Fund, health, education and social protection, as recorded in the government's Financial Statistics Bulletin.

F. Ceiling on Contracting of Non-concessional External Public Sector or Publicly-Guaranteed Debt

11. For program purposes, the definition of debt is set out in Executive Board Decision No. 12274, Point 9, as revised on August 31, 2009 (Decision No. 14416-(09/91)). This performance criterion refers to the contracting or guaranteeing of new non-concessional external debt with an original maturity of over one year. External debt is defined as debt contracted from non-residents. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. The term "public sector" relates to the government and public enterprises as defined in paragraph 4. Non-concessional loans are defined as having a grant element equivalent to less than 35 percent calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt

service due on this debt. The discount rates used for this purpose are the currency-specific commercial interest reference rates (CIRRs), published by the Organization for Economic Cooperation and Development (OECD). The ceiling excludes the use of IMF resources..

II. ADJUSTORS

A. External Financing of Budget

12. Net external financing of the budget consists of cash disbursements of loans, less cash amortization payments. External financing transactions are to be valued at the program exchange rate.

13. The floor on NIR will be adjusted downward, while the ceilings on NDA and domestic financing of the budget will be adjusted upward by the full cumulative amount of any shortfall in net external financing. In case of excess net external financing, ceilings on NDA and domestic financing of the budget will be adjusted downward for the portion of net external financing that is not spent on capital and social expenditures, while the floor on NIR will be adjusted upward for the portion of net external financing that is not spent on capital expenditures financed through import.

B. Crude Oil and LNG Export Revenue of Government

14. The programmed quarterly crude oil and LNG export revenue of government shown in the Table A of the MEFP under memorandum item for the end of the quarter are compared to the actual government crude oil and LNG revenue reported by the CBY/ Ministry of Oil in order to determine the excess or shortfall in cumulative government crude oil and LNG receipts. LNG revenues are defined as LNG export revenues net of the amount of loan service. The data on government crude oil and LNG revenue will be converted to rials at the program exchange rate.

15. The data on crude oil and LNG export revenues of the government for the end of the quarters are applied as adjustors to the floor on net international reserves and to the ceilings on net domestic assets and domestic financing of budget. The floor on NIR will be adjusted upward, while ceilings on NDA and domestic financing of budget will be adjusted downward by the full cumulative amount of any excess in cumulative government crude oil revenue and LNG export receipts vis-à-vis the programmed level. In the case of shortfall of cumulative government crude oil revenue and LNG export receipts, the floor on NIR will be adjusted downward by the full cumulative amount of any shortfall, while ceilings on NDA and domestic financing of budget will be adjusted upward for the 50 percent of any shortfall in cumulative government crude oil revenue and LNG export receipts vis-à-vis the programmed level.

Table 1. Reporting Standards

Reporting Agency	Type of Data	Description of data	Frequency	Timing within specified period
Central Bank of Yemen	Flash report	Weekly data for movement in main indicators of CBY balance sheet, own net international reserves, foreign assets, foreign liabilities, sale and purchases of foreign exchange, and exchange rate.	Weekly	Five working days of the end of each week (Wednesday).
	CBY balance sheet	Detailed balance sheet of Central bank of Yemen	Monthly	3 weeks after the end of each month
	Monetary survey	Banking system balance sheet and consolidated balance sheet of commercial and Islamic banks	Monthly	3 weeks after the end of each month
	Securities	Data of outstanding and redemption amount and interest rates on T-bills, T-bonds, CDS rates by maturity.	Monthly	3 weeks after the end of each month
	Bank and non-bank financing	Data on T-bills, T-bonds and repurchases	Monthly	1 month after the end of each month
	Domestic debt	Stock of central government domestic debt broken down into T-bills, T-bonds, repurchases, and loans that are owned to each of the following: CBY, commercial banks, pension funds, public enterprises, and other private sector	Monthly	1 month after the end of each month
	Banking indicators	Capital adequacy, portfolio quality, portfolio performance, exposure to exchange rate risk.	Quarterly	2 months after the end of each quarter
	Balance of payments	Detailed composition of exports, imports, services, transfers and capital account transactions.	Quarterly	4 months after the end of each quarter
Ministry of Finance	Central government	Revenues, grants, expenditures (current and development), financing – standard presentation	Quarterly	2 months after the end of each quarter
	Central government	Revenues, grants, expenditures, and financing as in GFSM 2001	Quarterly	2 months after the end of each quarter
	Short term debt	Data on all new borrowing and guarantees by central government, local governments and CBY	Monthly	1 month after the end of each month
	External financing	External debt service and payments	Monthly	1 month after the end of each month
	Crude oil and LNG	Crude oil and LNG export revenue received by the government	Monthly	3 weeks after the end of each

	exports			month
Central Statistical Office	CPI	Disaggregated consumer price index	Monthly	5 weeks after the end of each month
	National accounts	National accounts data	Annual	Within 4 months after the end of each year.
Ministry of Oil	Crude oil and LNG production	Data on crude oil and LNG production by field	Monthly	1 month after the end of each month
	Consumption of refined fuel product	Data on domestic consumption of refined fuel product by category	Monthly	1 month after the end of each month
	Production of refined fuel products	Data on domestic production of refined fuel products by category	Monthly	1 month after the end of each month
	Imports of refined oil products	Data on imports of refined oil products by category	Monthly	1 month after the end of each month

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$ 369.8 Million Extended Credit Facility Arrangement for Yemen

The Executive Board of the International Monetary Fund (IMF) approved on July 30, 2010 a three-year Extended Credit Facility Arrangement for the Republic of Yemen in the amount of SDR 243.5 million (about US$ 369.8 million) in support of the country's economic reform program. An initial disbursement equivalent to SDR 34.79 million (US$ 52.8 million) is available to the Yemeni authorities immediately, with subsequent disbursements subject to semi-annual reviews. The goal of the authorities' economic program is to achieve high and sustained growth and reduce poverty.

Following the Executive Board's decision, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, issued the following statement:

"Yemen is confronted with a range of difficult economic challenges related to its heavy dependence on declining oil revenues, widespread poverty, and water shortages. The global financial crisis has aggravated these challenges through a reduction in world oil prices, resulting in mounting macroeconomic imbalances.

"The government is embarking on a three-year economic program that aims to achieve high and sustained growth and durable poverty reduction over the medium term. The program reinforces macroeconomic stability in the face of a difficult global environment and declining oil production. It puts public finances on a strengthened medium-term footing by combining fiscal consolidation with a restructuring of expenditures more toward capital and social outlays.

"The centerpiece of the 2010 program is a reorientation of fiscal policy that reins in unsustainable deficits, while allowing for higher social spending and safeguarding capital outlays. This will be complemented by tax policy reforms to increase the revenue base, including the full implementation of the general sales tax and adoption of a package of laws that abolishes most exemptions on tax and customs duties.

"Going forward, a comprehensive structural reform agenda will be needed to meet the objectives of the program. The reforms in the first year focus largely on tax policy. Priority reforms also include a strengthening of public financial management and financial sector development.

"The role of the donors is crucial for meeting the government's objectives. Yemen's developmental and social needs are considerable. In the absence of significant donor financial assistance, it would be difficult for Yemen to make tangible progress toward meeting its Millennium Development Goals."

ANNEX

Program summary

Yemen needs sustained growth to reduce poverty in the face of a rapidly growing population. The set of recent unfavorable economic and security developments, coupled with the projected decline in hydrocarbon output, pose challenges for macroeconomic stability and growth. Oil production is on a declining trend. .

The medium-term adjustment strategy will need to address the prospect of lower oil revenues while boosting public investment and social spending. The focus of the authorities' medium-term strategy is on:

- Accelerating non-hydrocarbon economic growth while maintaining inflation within moderate levels;
- Combine fiscal consolidation with a restructuring of expenditures more toward capital and social outlay;
- Boosting non-hydrocarbon revenues through tax policy and administration measures to finance needed infrastructure and social spending;
- Maintaining adequate foreign exchange reserve cover;
- Creating a more attractive and market oriented business climate.

The macroeconomic framework targets real GDP growth of 5 percent annually— supported by robust investment. Inflation is expected to hover around 10 percent annually. . The fiscal deficit is projected to gradually decline to 3.5 percent of GDP, while the external current account deficit is projected to remain at around 5 percent of GDP (given the structure of the economy and its import dependence) and external debt ratios to decline to around 39 percent of GDP in present value terms by 2013.

The Republic of Yemen joined the IMF as a member in 1992. Its quota is SDR 243.50 million (about US$369.8 million).

Republic of Yemen: Selected Economic Indicators, 2006–13

	2006	2007	2008	Est. 2009	Proj. 2010	2011	2012	2013
	(Change in percent)							
Production and prices								
Real GDP at market prices	3.2	3.3	3.6	3.9	8.0	4.1	4.1	4.4
Real nonhydrocarbon GDP	4.7	5.3	4.8	4.1	4.4	4.8	5.0	5.3
Real hydrocarbon GDP	-8.3	-13.1	-8.1	1.6	51.0	-1.4	-4.2	-4.6
Consumer price index (annual average)	10.8	7.9	19.0	3.7	9.8	8.9	10.2	10.8
Core consumer price index (annual average)	10.9	9.2	20.3	3.8	8.9	12.7	14.0	10.8
Core consumer price index (12-month)	9.3	12.2	13.1	7.3	10.6	14.7	13.4	8.2
Hydrocarbon production (1,000 barrels/day)	357	310	284	290	438	431	412	394
	(In percent of GDP)							
Investment and savings								
Gross domestic investment	16.4	17.2	15.4	13.5	13.6	15.0	17.4	19.0
Government	7.3	7.2	5.9	6.5	6.6	7.2	8.0	8.5
Other	9.1	10.0	9.5	7.0	7.0	7.8	9.4	10.5
Gross national savings	17.4	10.2	10.8	2.9	8.6	10.6	13.5	15.0
Government	10.3	1.8	2.3	-3.7	1.1	2.3	3.3	5.0
Other	7.1	8.5	8.5	6.5	7.5	8.3	10.3	10.0
Government finance								
Total revenue and grants	38.6	33.2	36.7	25.0	27.0	25.5	24.1	23.4
Total expenditure and net lending	37.4	40.3	41.2	34.6	32.5	30.4	28.8	26.9
Overall balance (cash basis)	-0.7	-5.8	-3.2	-10.2	-5.5	-5.0	-4.7	-3.5
Nonhydrocarbon primary fiscal balance (cash)	-27.2	-26.1	-28.6	-22.3	-19.7	-17.5	-15.4	-12.9
Gross Public Sector Debt	40.8	40.4	36.4	51.0	45.8	45.9	45.6	45.0
External debt	28.7	26.9	21.9	24.2	21.1	21.0	21.2	21.3
Domestic debt	12.1	13.5	14.5	26.8	24.7	24.8	24.4	23.7
	(Twelve-month change in percent)							
Monetary data								
Broad money	27.7	16.8	13.7	10.6	15.5	16.0	…	…
Reserve money	17.1	11.3	8.3	11.2	14.3	15.0	…	…
Credit to private sector	16.7	35.7	17.5	-4.8	18.0	20.0	…	…
Benchmark deposit interest rate (percent p.a.)	13.0	13.0	13.0	10.0	…	…	…	…
Velocity (non-oil GDP/M2)	1.9	1.9	2.1	2.0	2.1	2.1	…	…
	(In millions of U.S. dollars, unless otherwise indicated)							
External sector								
Exports, f.o.b.	7,316	7,050	8,977	5,855	8,099	8,473	8,336	8,026
Of which: hydrocarbon (oil and gas)	6,733	6,264	7,895	4,532	6,615	6,895	6,617	6,131
Of which: nonhydrocarbon	583	785	1,082	1,323	1,484	1,578	1,720	1,896
Imports, f.o.b.	-5,926	-7,490	-9,334	-8,056	-8,637	-9,058	-9,462	-9,979
Current account (in percent of GDP)	1.1	-7.0	-4.6	-10.7	-5.0	-4.4	-3.8	-4.0

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

Statement by Mr. Shakour A. Shaalan, Executive Director for the Republic of Yemen
July 30, 2010

1. The Yemeni authorities would like to convey to staff their appreciation for the collaborative engagement and constructive policy dialogue. They are particularly grateful for the valuable technical assistance from the Fund in support of their reform efforts. They are in general agreement with the staff analysis on the broad challenges facing the country, and look forward to continued close collaboration.

Background

2. Yemen is the lowest income country in the Middle East, at the same time it faces daunting economic and acute poverty challenges. The country has to deal with significant development needs, chronic water shortages, and dwindling oil reserves which are currently a major source of fiscal and external receipts. These factors, coupled with security concerns and a humanitarian crisis in the North, weigh on the economic outlook. Indeed, Yemen has been facing mounting pressures on its fiscal and external accounts that have contributed to the depreciation of the rial and to a sizeable reduction in foreign exchange reserves during the past year.

3. The authorities are committed to stabilizing the economy and placing it on a path of sustained growth toward the Millennium Development Goals. They aim to (i) put public finances on a sustained footing in the medium-term, while increasing pressing capital and social outlays; (ii) boost non-hydrocarbon revenues by improving tax policy and administration; and (iii) contain inflation and exchange rate pressures. In support of their economic program, the authorities are requesting an Extended Credit Facility (ECF). They are fully committed to the implementation of the program, as evidenced by the significant fiscal measures that have already been implemented in challenging domestic conditions. These measures represent the bulk of the adjustment needed for 2010 and augur well for a successful program implementation.

Recent Economic Developments and Outlook

4. Economic performance deteriorated in the past year due to difficult security conditions and a sharp fall in oil revenues which was almost halved in 2009, partly reflecting lower production. The current account deficit widened by 6 percentage points to 11 percent of GDP. The collapse of international oil prices impinged heavily on Yemen's public finances, as oil revenues represent more than 60 percent of government receipts. As a result, the government initiated a major fiscal adjustment—through containment of the civil service wage bill and non-essential current expenditures—which did not fully prevent the fiscal deficit from widening to a record level of 10 percent of GDP.

5. The significant pressures on the fiscal and external accounts since the last Article IV consultation in January 2010 have contributed to the depreciation of the rial and to a large reduction in foreign exchange reserves. The need to smoothen abrupt movements in the

exchange rate underpinned interventions in the foreign exchange market. The Central Bank of Yemen (CBY) raised the policy interest rate from 12 percent to 20 percent in an effort to reduce the pressures on the exchange rate.

6. Going forward, Yemen's economic conditions are expected to improve, as economic growth is projected to double to about 8 percent in 2010, largely reflecting the start of Liquefied Natural Gas (LNG) production. However, growth in the non-oil sector is expected to remain relatively modest, and the government does not expect significant receipts from LNG production for several years.

Program Objectives and Reform Agenda

Fiscal Policy and Reforms

7. The authorities' fiscal strategy aims at putting public finances on a sustainable path while creating the space for higher social and development spending. Starting with the 2010 budget, the authorities plan to reduce the fiscal deficit to almost half the level of 2009. This frontloaded adjustment is necessary to stem pressures on the external position and reduce domestic central bank financing.

8. Notwithstanding strong domestic opposition, two major fiscal measures that are critical to the success of the adjustment have already been implemented. The General Sales Tax (GST) was introduced after years of preparation, and domestic fuel prices were increased for the first time since 2005. To boost non-hydrocarbon revenues, the authorities also intend to significantly reduce customs exemptions and to streamline customs procedures. Moreover, a planned reduction in the personal income tax will be delayed, which would generate additional savings.

9. Considerable effort is also being made on the expenditures side and the authorities have already taken measures to cut non-essential current expenditures. Reforming the fuel subsidy system is expected to generate savings of 1.2 percent of GDP in 2010. These measures will allow for a modest increase in social and capital expenditures. Transfers to the Social Welfare Fund will be increased to help reduce poverty and offset the impact of increasing oil prices. The authorities are planning to create a cash management unit to control government spending more efficiently. Public financial management reforms will also be crucial to achieve the fiscal consolidation targets by improving budget formulation and execution.

10. The fiscal deficit will be financed mainly through domestic borrowing, and the authorities are planning to issue Islamic bonds (Sukuks) to diversify the sources of budget financing. Continued donor budgetary support[1] will be critical to meet

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[1] Out of the $5.7 billion pledged in international aid in 2006 only 10 percent were disbursed so far.

development and poverty reduction needs. The authorities hope that the ECF arrangement will serve as a catalyst to expedite the flow of donor's funds that were pledged in 2006 and to attract additional donor support.

Monetary and Exchange Rate Policies

11. Monetary policy will strike a balance between inflation control and exchange rate stability. The program's targets for central bank net domestic assets should allow for an expansion of credit to the private sector. To enhance the effectiveness of monetary policy, the CBY will continue to develop its indirect monetary policy instruments. The CBY plans to intervene in the foreign exchange market to reduce short-term fluctuations in the rial if necessary, while maintaining a sufficient cushion of foreign reserves.

Other Structural Reforms

12. With oil production on a declining trend, the Yemeni authorities are cognizant of the need to bolster non-hydrocarbon activity by promoting sectors with promising prospects for generating growth and employment. The authorities' structural reform agenda will focus on improving the business climate through the simplification of business regulation, removal of infrastructure bottlenecks, and strengthening property rights.

13. The authorities will introduce a series of reform measures under their Top 10-Priority Plan, which cover civil service reforms and oil exploration among other development issues. They are committed to completing the Civil Service Reform by 2011 with the objective of streamlining the wage bill and lowering pressures on the public sector wage. They will also adhere to international best practices in the management of natural resources, including compliance with the EITI requirements. The fourth Development and Poverty Reduction Plan for 2011-15 is under preparation and expected to be completed by September 2010.

Conclusion

14. The Yemeni authorities are fully committed to the implementation of the policies that are being supported by a Fund arrangement. They have demonstrated their commitment to strong macroeconomic policies and economic reforms by undertaking upfront fiscal adjustment measures. In view of the challenges ahead, continued support from development partners remains essential to help Yemen stabilize its economy, promote growth, and reduce poverty.