SANA'A
CENTER FOR STRATEGIC STUDIES
مركز صنعاء للدراسات الاستراتيجية

REVITALIZING YEMEN'S BANKING SECTOR:

NECESSARY STEPS FOR RESTARTING FORMAL FINANCIAL CYCLES AND BASIC ECONOMIC STABILIZATION

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February 2019

Yemen’s banking sector faces a litany of challenges stemming from the county’s ongoing economic collapse and the warring parties’ competition for financial control.

Challenges Facing Yemen's Banking Sector

A Divided Central Bank

Since September 2016, there have been two central banks in Yemen – in Sana'a and Aden – claiming national jurisdiction yet neither has the capacity to fulfill the role. With the two central banks operating independently of and often in opposition to each other, the country has suffered from divergent fiscal and monetary policies.

Liquidity Crisis

After oil exports ceased in 2015, the central bank took action to shore up foreign currency supplies in the country through limiting local market access, while commercial banks began limiting customer withdrawals. At the same time, public cash withdrawals increased. With little cash liquidity themselves, banks could not make deposits at the central bank. Later, the CYB in Aden denied the Sana'a branch access to the foreign printers necessary to print new banknotes.

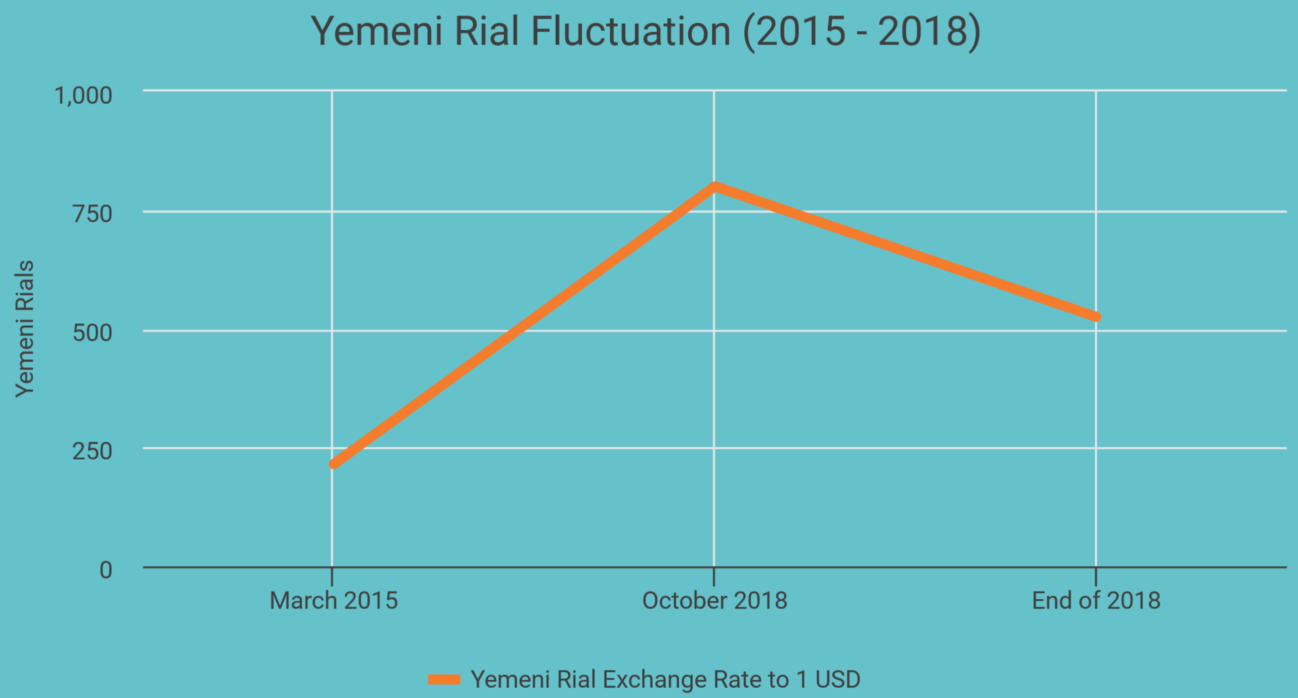
Frozen Assets

Since the division in 2016, CBY branches in Sana'a and Aden have applied similar mechanisms to handle the balances of commercial banks in their accounting systems and to restrict cash withdrawals. This has led to the separation of cash transactions from non-cash transactions and undermined non-cash payment instruments, like checks. It has also discouraged the public from conducting financial transactions within the banking sector.

Frozen Public Debt Repayments

Commercial banks have come under further strain due to the central bank's suspension of payments on domestic debt. Commercial banks hold 72 percent of all treasury bills. Meanwhile, Islamic banks have invested heavily in Islamic *sukuk* bonds.

Deterioration of the Yemeni Rial



As of this writing the Yemeni rial had lost, relative to the US$, almost two thirds of its purchasing power since March 2015, when it was trading at YR215 per US$1. The rial reached a record low of more than YR800 per US$1 in October 2018, before rebounding to YR525 per US$1 by the end of the year.

Fight for Financial Control

The CBY in Aden instructed traders to issue letters of credit (LCs) at commercial banks in Aden to guarantee imports. However, these were counter-acted by Houthi authorities who issued orders for banks to use checks to cover LCs, so as to prevent the transfer of banknotes outside their territory.

Obstruction of New Liquidity Circulation

In December 2018, Houthi authorities imposed new restrictions to prevent the transfer of cash out of their territory. Houthi authorities banned banks from transferring amounts exceeding YR450,000 (equivalent to roughly US$900 in December 2018) from Sana’a to Aden without prior approval from the Sana’a-based central bank

Detaining Senior Banking Staff

Houthi authorities, through their affiliated national security agency and central bank in Sana’a, have intensified measures to punish commercial banks by applying physically coercive tactics to try and force the banking sector to abide by their decrees and, more often, to prohibit them from following directives issued from Aden.

Restrictions and Compliance Challenges (1)

As of this writing, most American and European banks continue to refuse to interact with Yemeni banks. However, in April 2017, the central bank in Aden resumed some functions of the SWIFT network, which was deactivated in September 2016. By the time the central bank in Aden resumed full operations, it had been disconnected from the global transaction system for more than a year.

Restrictions and Compliance Challenges (2)

The withdrawal of international recognition of the Sana’a-based Financial Information Unit (FIU) means that it and the national anti-money laundering committee in Yemen have since been largely disconnected from global anti-money laundering agencies. This leaves Yemen vulnerable to money laundering and terrorism-financing risks.

Restrictions and Compliance Challenges (3)

Furthermore, the Saudi-led military coalition imposed restrictions preventing Yemeni banks from transferring their surplus foreign currency to feed their accounts held abroad. Due these restrictions, Yemeni banks were unable to use their foreign currency holdings to finance imports of goods to meet the population’s needs.

RECOMMENDATIONS FOR REVITALIZING THE YEMENI BANKING SECTOR

1. Reunify the Central Bank of Yemen
2. Reactivate Anti-Money Laundering and Counterterrorism Financing Mechanisms
3. Release Banks' Retained Balances
4. Facilitate Secure Transfers of Cash Holdings
5. Ease Import Financing Requirements, Establish Cash Clearing System
6. Replace Damaged Banknotes
7. Restart Partial Public Debt Servicing