

### Economic

#### Credit Agencies

Moody's: --

S&P: --

Fitch: --

#### Nominal GDP (2005)

US\$15.2bn

#### Population (2005):

20.4 million

#### Total Trade / GDP:

63%

#### Currency:

Yemeni rial

#### Exchange regime:

floating

#### Merchandise exports from Canada: 20054

CAD\$37.6mn

#### Main sources of Foreign Exchange (excl. FDI):

Oil (95%)

#### Largest Merchandise Trading Partner:

Thailand (19%)

UAE (16%)

#### Main imports:

Petroleum products for refinery (16%)

#### Risks to the Outlook



Sustained oil prices; reforms and new discoveries.



Low oil prices; No new discoveries; No reforms

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**Market Spotlight:** Yemen is currently benefiting from high world oil prices & steady oil output due to further successful drilling to existing wells. Nevertheless, the country struggles to retain output at mature fields. The fiscal position depends on the authorities' ability to increase non-oil revenues and reducing subsidies. The external position is manageable today, but its future depends on domestic and world oil conditions. Yemen has still a strong dependence on the international community for aid and workers' remittances. Business environment remains high risks.

**Macroeconomic performance:** In the face of depleting oil reserves, oil output has been maintained due to further drilling of existing wells. GDP growth accelerated due to stronger activity in agriculture, construction and transport. Nevertheless, little progress has been made toward meeting the Millennium Development Goals. In the face of concerns about security and falling oil output, the government is drafting a five-year development plan. Yemen is dependent on agriculture, oil revenues, workers' remittances, tourism receipts and grants. Social fabric is a challenge for reforms, obtaining donor support and attracting tourists and foreign investors. Recent growth has been insufficient to reduce poverty and unemployment. The outlook for 2006 is for a GDP growth rate broadly unchanged. The authorities are hopeful about the over-spilling effects on Yemen of the booming economies of the Gulf Cooperation Countries (GCC) in terms of portfolio investment and workers' remittances.

**Fiscal position:** While the size of the fiscal deficit is not disturbing for now, the trend is. Larger oil revenues and tighter fiscal discipline would allow greater expenditures on priority expenditures if efforts are made to contain wages and defense spending even. The IFIs urge fiscal reform, in tightening oil subsidies and in implementing a general tax system, but the authorities are hoping for new oil discoveries. While the authorities have announced an increase in petroleum prices, a large adjustment to the non-oil primary deficit is necessary for longer-term sustainability. Based on current policies, the budgetary deficit could widen to 17% of GDP by 2010!

**Inflation:** Extra-budgets contribute to corruption, inconsistencies and lack of transparency. Excessive spending fuelled demand and inflationary pressures. Inflation (CPI) increased markedly in 2005. Monetary policy in 2006 will focus on maintaining price stability rather than focusing on the exchange rate. But, eventually real effective depreciation of the Yemeni rial will be required.

**Banking sector:** The banking sector is underdeveloped and falls short of Bank for International Settlement (BIS) standards with high levels of non-performing loans and heavy concentration of credit. The failure of Watani bank shows the need for reviewing the supervisory framework of the banking sector.

**The external sector:** External accounts have recorded strong performances, with trade, current account and overall surpluses since 2000. Much larger imports due to investment in the LNG initiative, Yemen may register external current account deficits as early as this year. Production is scheduled to start only in 2009. Worker remittances and donor support have played a key role in financing the balance of payments. The liquidity position is comfortable. Yemen has obtained on stock of debt treatment from the Paris Club in June 2001, on Naples terms (which included 67% debt reduction). The debt servicing has been lowered to manageable levels.

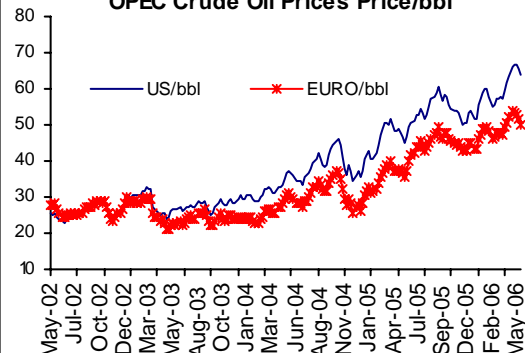
*The short-term outlook is positive. The medium-term outlook is clouded by falling oil reserves and slow reforms.*

#### Economic Indicators

|                             | 00-04 avg. | 2005(e) | 2006(f) | 2007(f) |
|-----------------------------|------------|---------|---------|---------|
| GDP (% growth, real)        | 4.1        | 3.8     | 3.9     | 2.5     |
| Inflation (%) (End-year)    | 10.4       | 14.6    | 15.7    | 13.1    |
| Fiscal Balance (% GDP)*     | 0.1        | -2.4    | -3.0    | -5.0    |
| Exports (US\$bn)            | 13.5       | 6.6     | 7.0     | 6.5     |
| Imports (US\$bn)            | 12.7       | -4.5    | -6.2    | -6.6    |
| Current Account (US\$bn)    | 5.8        | 0.7     | -0.8    | -1.5    |
| Reserves (month of imports) | 10.0       | 9.6     | 9.8     | 8.5     |
| External Debt (US\$bn)      | 48.3       | 5.2     | 5.3     | 5.4     |
| Debt Service Ratio          | 4.3        | 3.2     | 2.9     | 3.2     |
| Currency (Y rial: US\$1)    | 177.6      | 183.98  | 192.5   | 195.5   |

Source: EIU, EDC Economics\* with grants

#### OPEC Crude Oil Prices Price/bbl



Source: Bloomberg, EDC Economics

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### Political

#### Political Structure

Republic

**President**  
Ali Abdullah Saleh (GPC)

**Vice-President** (appointed by the President)  
Abdel-Rabbuh Mansour Hadi

**Prime Minister**  
Abdel-Qader Ba-Jammal

**Legislative Body**  
**Bicameral legislature**  
Majlis al-Nowab (elected – 301 seats) and Majlis al-Shura (appointed – 111 seats)

**Major Parties (seats in Assembly)**

- General People's Congress – 238; Islah – 46; Yemeni Socialist Party (YSP) – 8

**Last Elections**

- Presidential: September 23, 1999
- Legislative: April 27, 2003

**Next Elections**

- Presidential: September 20, 2006
- Legislative: 2009

**Press Freedom Survey:**

- 2005 Score: 76 (Not Free)

[freedomhouse.org](http://freedomhouse.org)

**Control of Corruption Index:**

- 2004 Score: -0.84 (-2.5: Worst; +2.5: Best)

[worldbank.org](http://worldbank.org)

**September 2006**  
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#### General Political Environment:

The Yemen Arab Republic (North Yemen) and People's Democratic Republic of Yemen (South Yemen) united to form the Republic of Yemen in May 1990. Political infighting between the country's two leading parties – the northern General People's Congress (GPC) and the southern Yemeni Socialist Party (YSP) – as well as southern Yemen's political marginalization however, propelled the country into civil war in April 1994. Northern forces ultimately proved victorious. Since that time, the political system has continued to reflect the north's domination through repeated GPC majority-wins at the polls (1997, 2003) and a marginalized YSP presence in parliament.

While President Saleh and his ruling GPC have solidified their position since the time of unification, political stability is being challenged by popular opposition to Yemen's increasing cooperation with the US "war on terror". Co-operation with the US, however, did not cost the government in voter support the country's April 2003 parliamentary elections in which the GPC won a solid majority of seats. The elections were marked by strong voter turnout and comparatively lower levels of violence in contrast to past elections. This bodes well for the ability of the ruling GPC party to continue to strengthen its position in a state where tribal groups dominate rural areas.

After 27 years in power, President Saleh shocked observers with his mid-2005 announcement that he would not stand for re-election in 2006. However, the President reversed his position in late 2005 by accepting his party's presidential nomination. Saleh faces four other candidates in upcoming September 20 presidential elections, including key challenger, leading opposition candidate Faisal Bin Shamlan. Nonetheless, another Saleh victory remains highly likely.

The government is expected to continue to follow through on US counter-terrorism efforts while being careful to not upset the country's delicate political balance. Efforts to improve the investment climate, implement economic and civil service reforms and strengthen the social safety net are also expected to remain important government priorities.

#### Investment Environment:

Yemen strongly encourages foreign investment and is considered to have one of the most liberal trading environments in the region. In July 2002, Yemen updated its foreign investment law to include the guarantee of national treatment for foreign investors.

An inefficient bureaucracy and endemic corruption remain Yemen's most serious obstacles to attracting increased foreign direct investment.

#### Political Violence:

Yemen's security environment is considered poor. Despite the government's ongoing crackdown on extremist groups, foreigners and foreign installations continue to remain vulnerable to the risk of isolated terrorist attacks.

Incidents of tribal kidnapping declined substantially since the 1990s due in large part to the government's decision to make kidnapping a capital offence.

Government efforts to regulate the use of the high number of small arms in Yemen have led to clashes between tribal groups and government security forces.

The Believing Youth led three uprisings in the northern Sa'ada province against the government since 2004. The uprisings were first triggered by the authorities' attempt to arrest the movement's former leader on charges of inciting sectarian and anti-Western violence. Further violence from this group remains highly likely.

#### Outlook

Stepped-up security operations, alongside efforts to encourage dialogue between suspected terrorists and Islamic clerics, has thus far proven an effective strategy and over the longer-term, is expected to improve Yemen's security environment.

Weak central government control in rural areas, endemic poverty, terrorism, high illiteracy and unemployment rates will continue to foster instability in both the political and security environment. However, President Saleh has proven himself adept at governing and courting the donor assistance needed to keep the economy going. As such, Yemen's short term outlook favours a continuation of the status quo with President Saleh and his ruling GPC firmly at the helm.