

# Syria Economic Report

## COMPLEMENTING THE IMPROVEMENT IN POLITICAL CONDITIONS BY WIDE-RANGING ECONOMIC REFORMS

- ▶ Syria's economic performance in 2010 indicates a relative strengthening in economic conditions, with real GDP growth projected at 5% this year according to the International Monetary Fund. The improvement in Syria's foreign political relations with regional countries and the Western World created an upside potential to its investment framework and business environment.
- ▶ The oil sector is estimated to grow, in real terms, by only 0.2% in 2010, as per the IMF and the overall oil balance is estimated to reach an annual deficit of US\$ 1.2 billion. Yet, Syria's average production of crude oil rose by a yearly 3.1% to 387,357 barrels per day (b/d) in the first nine months of 2010.
- ▶ The real estate sector in Syria has witnessed a good performance in 2010, on the back of demand for both commercial and residential space and few reforms aimed at stimulating investment in that sector. Real estate ventures scheduled for completion in the next few years amount to more than US\$ 2 billion.
- ▶ Syria's tertiary sector is continuing to grow, with the tourism related sectors recording a strong activity so far this year. The number of visitors to Syria in the first nine months of 2010 reached 6.6 million, up by 46% year-on-year.
- ▶ Syria's external sector has seen a relative recovery in 2010. The revival in commodities prices provided a push to exports, which remain to a minor extent adversely affected by the recent droughts that affected agricultural production. Indeed, average oil prices witnessed an average increase of 31.6% in the first ten months of 2010.
- ▶ At the monetary level, the year 2010 was marked by a low single-digit inflation rate, moderate annual growth in money supply, and mild change in official reserves. The Central Bank of Syria continued to adopt monetary easing to spur economic growth through cuts in reserves requirement and indicative interest rates.
- ▶ The Syrian banking sector has witnessed a satisfactory performance so far this year, in line with the overall improving economic activity. Total deposits continued to be a major driver of sector activity in 2010, posting a 10.1% rise in this year's first seven months (7.6% in US Dollar terms). Banks' lending to the private sector registered a healthy 12.2% increase (+9.7% when accounting for FX fluctuation effects).
- ▶ The Damascus Securities Exchange saw a tangible increase in prices and attracted new listings during the first ten months of 2010 that translated into a significant rise in the DSE's market capitalization. Measures have been taken to increase the number of listed firms on the DSE and to incite family businesses to go public.
- ▶ Forecasts for 2011 revolve around a 5.5% real GDP growth and a 5% inflation rate as recently established by the IMF. Syria's near term economic outlook actually depends on the pace of global and regional recovery but also on domestic factors such as the extension of new waves of loans by banks operating in Syria, the launch or continuation of projects under the auspices of both private and public sectors and the impact of further reforms on the country's business infrastructure at large.
- ▶ Although there are risks that represent serious challenges to the outlook, the country's large opportunities outpace such risks at the horizon. The real challenge today is to complement the improvement in political risk by drastic structural economic reforms that would speed up the transition to a market based and more open Syrian economy.

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Syria's economic performance in 2010 indicates a relative strengthening in economic conditions, with real GDP growth projected at 5% this year according to the International Monetary Fund. The economy had experienced a relative slowdown in 2009 but performance remained satisfactory amid global sluggishness, with GDP growing in real terms by close to 4%. The improvement in Syria's foreign political relations with regional countries and the Western World created an upside potential to its investment framework and business environment. The consolidation of public finances over the past few years provided room for the authorities to take counter-cyclical measures to mitigate the effects of the global economic crisis. Unemployment yet remains an issue and is estimated to have increased to almost 11% last year.

The government is making efforts to diversify the economy away from oil and develop an export-oriented private sector. The authorities simplified investment procedures to stimulate private sector investment. Investments in Syria are gradually rising this year, on the back of the ongoing global recovery and underpinned by the fact that the economy is opened up and international relations improve. The Syrian Investment Commission said in mid-October that 305 investment projects, with an estimated cost of US\$ 1.23 billion (SP 56.9 billion), have been included since the beginning of 2010, of which 37 foreign investment projects. Industry accounts for the largest portion of the projects, followed by transport and agriculture. Most of the projects are centered in Damascus, Aleppo, Raqqa, Deir Ezzor and the North Eastern region of the country.

Henceforth, government efforts seem to be directed towards building strong public-private partnerships, particularly in the oil industry. It is worth mentioning that crude oil production increased by about 3% in the first nine months of 2010, while natural gas production rose by around 29% over the same period. Average crude oil production totaled 387 thousand barrels per day in the first nine months of 2010 in the wake of several new joint ventures beginning production. Recently, the country's imports of refined products became about equal in value to its exports of crude oil.

At the public finance level, Syria which does not share the fiscal problems of its neighboring fiscally challenged economies, reported a further improvement in 2010. The overall fiscal deficit is expected to narrow to US\$ 2.6 billion in 2010, according to the IMF, accounting for 4.3% of GDP, compared to 5.4% of GDP in 2009, on the back of higher oil revenues and a reduction in fuel subsidies. On October 12, the draft 2011 budget was approved by the Syrian Cabinet and transferred to Parliament. The budget expects spending of SP 835 billion (US\$ 17.8 billion) next year, an annual rise of 12%, with investment expenditures representing most of the increase.

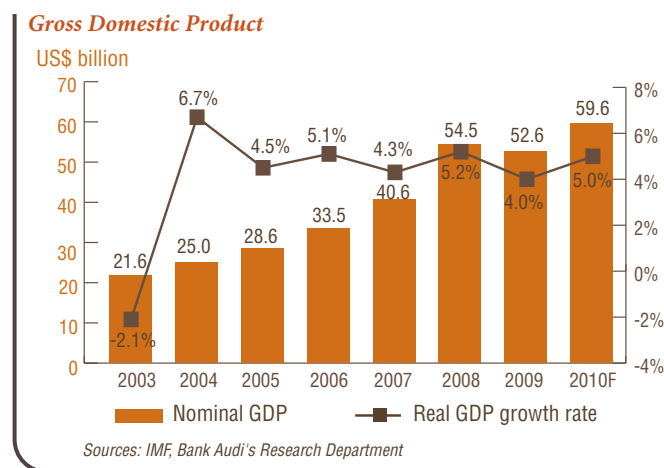
At the external sector level, a number of favorable developments were reported this year. Export earnings are set to increase considerably, as exports of cotton and textiles increasingly recover. The relaxation of foreign-exchange controls led to more non-oil exports moving out of the black economy and being officially recorded. Also, the pick-up in economic activity in the Middle East and North Africa region, which gathers an important portion of Syrian expatriates, is set to contribute to a gradual rise in remittances. The World Bank projects US\$ 1.4 billion of remittances to Syria in 2010. In parallel, the number of tourists visiting Syria in the first nine months of 2010 reached 6.6 million, up by 46% year-on-year, mainly due to improvement in relations with the West in addition to the elimination of visas for

Iranian and Turkish nationals.

At the monetary level, inflation is not a concern with the continuation of low single digit rates. As a matter of fact, consumer prices are forecast to rise by 5.0% in 2010, as per the IMF. This reflects a rise in inflation from 2009 when the slowdown in Syria and the fall in global prices of basic commodities reduced inflation to 2.8%. The Syrian Pound fluctuation against the US\$ remains non-erratic within the context of a managed exchange rate regime reflecting largely market forces. The Central Bank of Syria adopted measures to ease the monetary stance and support lending to investment projects. These included reducing the indicative deposit interest rates from 7-9% to around 6-8% and increasing the credit exposure limit for development projects from 25% to 35% for a single project.

Within the context of an improving economic situation, banking activity flourished. Customer deposits grew by 10.1% in the first seven months of 2010. The growth in customer deposits was mainly fostered by SP deposits which grew by 13.0% over the first seven months of 2010, while FX deposits contracted by 5.0% over the same period. On the lending front, Syrian banks posted 12.2% growth in loans to the private sector over the same period. Bottom lines of private banks were on the upside, driven by quantity effects. Figures released by 10 listed private banks for the first nine months of 2010 show an average earnings growth of 21% year-on-year. More importantly, authorities established a Lender of Last Resort facility and increased minimum capital requirement for banks. In parallel, the Central Bank increased the ceiling for foreign ownership stakes in local banks from 49% to 60%. It is also worth noting that in July 2010, the government has passed a law allowing the establishment of investment banks in Syria for the first time.

Following are the detailed developments in the real sector, external sector, public sector, monetary sector, and financial sector of the Syrian economy.



## 1. ECONOMIC CONDITIONS

### 1.1. REAL SECTOR

#### 1.1.1. Oil Sector

The Syrian economy is still partly dependent on the oil sector although the government is putting efforts to develop other sectors of the economy, particularly those than can boost export earnings, in order to counterbalance the impact of the decline in oil production.

The oil sector, which was a pillar of the Syrian economy, started to post negative and nil growth rates over the past five years. Indeed, the oil sector contracted, due to a decline in oil production, which kept oil GDP real growth at an average of -4.1% per annum over the period 2004-2009, according to the International Monetary Fund (IMF) figures. The oil sector is estimated to grow, in real terms, by only 0.2% in 2010, as per the IMF. The overall oil balance (defined as the oil trade balance less profit of foreign oil companies) is estimated to reach a deficit of US\$ 1.2 billion in 2010, according to the IMF. Oil revenues that used to represent a substantial proportion of public revenues account for only 20-25% of government receipts today.

However, the oil sector is still receiving much government efforts to attract foreign investments for new exploration and production techniques, especially gas production and oil refining. Syria's average production of crude oil rose by a yearly 3.1% to 387,357 barrels per day (b/d) in the first nine months of 2010, according to the Ministry of Petroleum. Light crude oil represented 40.6% of the total production while heavy crude accounted for the remaining 59.4%. Fields developed directly by the Syrian Petroleum Company (SPC) produced around 50% of the total, while production by the eight joint-venture firms established between SPC and foreign operators accounted for the other 50% as at end-September 2010. The latter increased by a yearly 3.6% over the first nine months of 2010, mainly driven by the entry of two new oil producers, Abu Kamal Petroleum (a joint-venture between Tatneft and the General Petroleum Corporation (GPC)) and Ebla Petroleum Company (a joint-venture firm established between Petro-Canada Palmyra and GPC).

The modest increase registered in crude oil production is attributable to rising output at new fields which outweighs the continued decline in output at larger and mature fields. As a matter of fact, this slight rise in oil production would probably be temporary, as the new fields are relatively small. According to the Ministry of Petroleum, Syria's production of crude oil would decline by around 7% in the next five years.

Syria and Iraq have agreed in August 2010 to build three pipelines that would carry Iraqi crude and gas to the Mediterranean, of which two oil pipelines with capacities of 1.5 million barrels per day and 1.25 million barrels per day respectively, in addition to a complementary gas pipeline. The bigger pipeline would be used to export heavy crude oil, while the smaller pipeline would export light crude. The pipelines would carry oil from fields near Kirkuk in northern Iraq and terminate in Baniyas on the Mediterranean Sea. The Syrian government proposed to build the new pipelines alongside the existing ones within the Syrian network.

On the other hand, natural gas production has been rising steadily and is also being viewed as a key opportunity at the horizon. The government has begun to work with international energy companies in the hopes of eventually becoming a gas exporter, even though, at present, all gas currently produced is consumed domestically.

The country's average production of natural gas increased by a yearly 29.1% to reach 27.5 million cubic meters a day over the first nine months of 2010, according to the Ministry of Petroleum. This production comprises 18.7 million cubic meters of non-associated natural gas and 8.8 million cubic meters of associated gas. The increase in the production of natural gas is partly justified by the additional production of four new firms, Syro-Kawkab Oil Company (a joint company between GPC and

China National Petroleum Corporation), Oudeh Petroleum Company (a joint-venture between Sinopec and GPC), Ebla Petroleum Company and Abu Kamal Petroleum.

The government is importing gas from Egypt and is considering importing gas from additional other sources, including Azerbaijan and Iran. Works on the 62 kilometers Arab Gas Pipeline (AGP) between Aleppo and the Turkish border should be completed before the end of the year, according to the Minister of Petroleum. Syria would be able to start imports of Iranian and Azeri gas when the Turks complete their part of the works linking the AGP with the Turkish network, which is set for March 2011. This year, Syria and Azerbaijan began negotiations for a purchase and sale contract of some 1 to 1.5 billion cubic meters of Azeri natural gas per year starting mid-2011.

It is worth noting that the Hayyan gas factory is set to enter actual service early next year, with a capacity of 650,000 cubic meters of clean gas per day. In addition, the Ebla gas plant was inaugurated in April 2010 and has a daily production capacity of 2.5 million cubic meters of clean gas.

Syria has been altering regulations governing the sector to facilitate the entry of the private sector and to promote the switch to more oil efficient usage, gas production and usage, in addition to benefitting from strategic location to transport imports from nearby countries. Throughout the course of 2010, several investments were made in the country's gas sector following the approval by the council of ministers of a proposal that allows the private sector to participate in investments in such sectors in 2009.

It is worth noting that a number of Chinese companies have entered the Syrian oil market lately, with the most active being China National Petroleum Corporation (CNPC), which currently develops oil fields owned by the Syrian Petroleum Company in the northeast of Syria. In September 2010, CNPC, a state-owned owned entity, gained the approval of Chinese state authorities to purchase a 35% stake in Syria Shell Petroleum Development (SSPD), until then a fully-owned subsidiary of Royal Dutch Shell. SSPD has interests in three production licenses which cover some 40 oil fields in Deir-ez-Zor. Also, CNPC will begin construction of a US\$ 2 billion refinery in Syria in the second quarter of next year, according to press reports. The refinery, which is expected to refine some 100,000 barrels of crude oil per day, will be located in the Governorate of Deir-ez-Zor, next to the country's largest oil fields.

On the overall, the decline witnessed in the Syrian oil sector led the authorities to intensify efforts to attract foreign investments for new exploration and production techniques, especially gas production and oil refining. There are still untapped gas reserves in Syria, conferring to the country an underexploited potential. The government increased its focus on gas and has put efforts to develop the regulatory environment in order to facilitate the entry of the private sector and encourage new investment in the broad sector.

### 1.1.2. Agriculture and Manufacturing

The agricultural sector in Syria is still considered a major sector of activity for its importance in trade, its provision of primary materials for food and manufacturing industries, and its contribution to employment. Indeed, it is estimated to employ

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around 30% of the country's workforce and agrarian products constitute from 16% to 22% of total exports.

It is worth noting that the government has granted around US\$ 1.5 billion worth of subsidies to the agricultural sector in 2010, with half of this amount coming in the form of direct support that includes compensations for fuel expenses in strategic crops projects and compensations for rising fertilizer prices in basic crops projects. Further, the authorities had adopted financial incentives to stimulate investment, such as an exemption of all taxes and fees for a period of ten years for projects in the eastern area as well as a debt rescheduling plan for farmers in that region. In addition, in 2009, the Syrian government re-drew the agriculture strategic plans through a study on the competitiveness of the Syrian goods.

Syria's wheat output is expected to reach 3.3 million tons in 2010-2011 as an epidemic of yellow rust has hit the soft wheat crop. The US Department of Agriculture projected this year's wheat crop close to last year's level, but a third below the record crop of 5 million tons that was expected following this year's excellent weather conditions.

On the other hand, cotton is still considered a strategic crop by the government as it employs up to one fifth of Syria's active population. Syria's cotton crop is estimated at 660,000 metric tons of raw (seed) cotton this year, about 25% below planned production. This cotton production remains in line with the country's recent production levels, but well below the highs of a few years ago, when the crop regularly crossed the one million ton mark. In fact, reduced water availability and low international prices, which in turn reduce the procurement prices paid by the government to farmers, concurred to reduce the long-term levels of the areas planted with cotton and of the cotton crop.

It is worth noting that the Syrian President has issued in June 2010 two new decrees to speed up the transfer into modern irrigation techniques and organize the overall cotton industry and market. The first decree lays down the rules to implement a national plan for the transfer of irrigated lands across the country from a dependence on traditional irrigation methods into modern irrigation systems. The aim of this policy is to rationalize the consumption of water used for irrigation. The second decree sets a detailed framework that organizes the cultivation, ginning and marketing of cotton, as well as the production and development of cotton seeds. The aim of this policy is to organize the overall cotton industry and to stop the illegal trade of cotton inputs such as seeds, which are exclusively produced and developed locally.

Syria's sugar beet crop is expected to reach 1.4 million tons in 2010, according to a report released by the Ministry of Agriculture, which means an increase of 27% compared to last year's crop, attributable to good rain falls. The country's entire crop is purchased by state-owned refineries that are affiliated to the General Organization of Sugar.

In parallel, the government introduced a wide range of incentives to modernize the ailing manufacturing industries, create new opportunities for businesses and attract foreign direct investment. These include the issuance of laws on income tax and combating tax evasion, the establishment of administratively-independent cities, in terms of the swift issuing of licenses through a one-stop-shop in all governorates as well as import permits necessary for investment ventures.

It is worth noting that the establishment of industrial cities in a number of Syrian cities was one of the most important incentives for foreign investments in addition to the entry of a number of

investors into industries that were limited to the public sector. The total value of the investments in the four Syrian industrial cities reached SP 441.7 billion at end-June 2010, up by 69% year-on-year. The total number of operating factories stood at 860 at end-June 2010, while the number of factories under construction stood at 3,466.

Another measure to support the manufacturing sector was the issuance of a decree in June 2010 to protect the country's "emerging industries" against competing imports. The decree provides a protection of up to five years for industries, products or services deemed emerging. Measures to protect a specific emerging industry include an increase in customs tariffs on imported products that can compete with it or a decrease in customs tariffs for the input needed by this industry, noting that the measures adopted must not be in violation of the commitments included in the various trade agreements signed by Syria.

Various new plants have been established this year. The Middle East Sugar Refinery, which is the second sugar refinery operated by the private sector in the country, has recently begun production, while construction works of the first lime plant in Syria and the region, located in Lattakia, have been completed.

Further, the governments of Syria and India have signed an agreement in October 2010 to establish a joint venture company that will produce phosphoric acid; this follows an agreement signed in August 2010 between Gecopham, Syria's state-owned organization in charge of the phosphate sector, and Oswal, an Indian manufacturer of phosphatic fertilizers and diammonium phosphate, for the establishment of a diammonium phosphate plant with a capacity of 1 million tons per annum. Syria has the 11th largest deposit of phosphate with reserves totaling 1.8 billion tons, increasingly attracting the attention from regional and international investors. As a matter of fact, the Syrian-Qatari holding company has also signed a series of agreements to establish a phosphate-based fertilizer plant with an annual capacity of 500,000 tons.

### 1.1.3. Construction and Real Estate

The real estate sector in Syria has witnessed a good performance in 2010, on the back of demand for both commercial and residential space and few reforms aimed at stimulating investment in that sector. The market has attracted regional investors in the past few years, and has benefited from the excess liquidity at hand in the region following the sharp rise in global oil prices, which concurred with the gradual liberalization of Syria's centrally planned economy. Gulf developers unveiled plans to launch major residential, commercial and office compounds in an undersupplied market, with a focus on the areas surrounding the capital city.

The real estate sector has also managed to entice a large amount of funds from local investors, within the context of growing demand from Iraqi immigrants and cash surpluses in the hands of locals and Syrian expatriates in the region.

The lack of supply, low real interest rates, the lack of proper investment opportunities, the rising cash flows from the Gulf and the inflow of Iraqi immigrants have all contributed to a significant increase in the price of real estate properties in recent years across the country and mainly in the large city centers. This trend was reversed in the last eighteen months as prices somewhat went down. According to Colliers International, Damascus real estate

prices stabilized in the first quarter of this year.

The regulatory framework has improved, with several laws and regulations introduced in an aim to facilitate and attract investments in construction and real estate. New laws have been adopted this year. For instance, a new law was enacted in June 2010 to organize land-use planning, protect environment-sensitive and cultural areas and put a limit on informal settlements around Syria's largest cities. Another decree passed in October 2010 establishes a number of new rules on the real estate sectors in a bid to provide new supplies. The decree obliges developers that own a land located in the capital cities of the fourteen Governorates as well as in property developments to seek a building license for their land within a year from acquiring it and to finish construction works within three years from acquiring the license.

Many real estate projects are either underway or scheduled to start next year. Ground works at the large scale US\$ 1 billion Majid Al Futtaim project (Khams Shammat) in Damascus have started, the project comprising two hotels, office buildings, serviced apartments and around 120,000 square meters of retail space. Emaar Syria will launch works on Eighth Gate shopping mall early next year, which is part of the Eighth Gate project, a 300,000 square meter mixed-used development located 22 kilometers from downtown Damascus and including a hotel and office space.

Majid Al Futtaim Properties also announced in May 2010 that it would invest in the proposed Mall of Syria, to be located on the outskirts of Damascus. The Mall of Syria is expected to have a gross leasable area of 200,000 square meters and is due to open in 2014. In addition, Construction Products Holding Company (CPC)-Syria will build a US\$ 75 million commercial mall in Homs, the latter spreading over 110,000 square meters, and including a 9,000 square meter hypermarket to be managed by Carrefour, the French hypermarket chain.

The retail property market in Syria has remained relatively stable, despite the global economic slowdown, according to the latest retail property survey from Cushman & Wakefield, with Damascus ranked as the fourth most expensive retail location among ten regional countries surveyed, with annual rents of €980 per square meter in 2009.

As for the residential segment, a real estate development, Sama City, with a total land area of 350,000 square meters, is under construction in the north of Aleppo. The project, whose investment cost is estimated at above US\$ 100 million, will feature 323 residential villas, a community center, restaurants, an entertainment area and a number of parks and playgrounds. Palmyra-SODIC, the new venture between the Egyptian developer, Sixth of October Development & Investment Company (SODIC), and Palmyra Real Estate Development Company, a subsidiary of the MAS Group, plans a 500,000 square meter mixed-used commercial and residential development to be established in Yaafour in the first half of 2011. Ongoing projects of Palmyra-SODIC also include Tilal Yasmeeen, a residential compound with 169 villas in Kafar Qouq, near Yaafour, which is expected to be completed in early 2012.

The office market in Damascus is characterized by a rising demand outstripping an inadequate supply, compounded by the supply constraints and costs involved in converting residential space into office units, which have led to an increase in prices in that segment. The latest office space survey conducted by global consultancy firm Cushman and Wakefield ranked Damascus as the fifth most expensive city for office space among regional cities

with an annual rental cost in the capital's Central Business District standing at €374 per square meter in 2009. However, prices of office space in Damascus have been leveling out in the first quarter of this year, as per Colliers International. New supply of office space is planned outside of the Old City as the commercial center of Damascus is expected to move west to the "New Damascus" in the Yaafour area, according to Cushman and Wakefield.

In parallel, the construction industry is continuing to grow, driven by interest from foreign investors and the private sector. Lafarge Cement Syria, which is the first private company to manufacture cement in Syria since the government ended the state monopoly on the sector a few years ago, has started production recently and will seek, in a first stage, to meet the demands of the local market. Also, Al-Badia Cement, the second private sector manufacturer of cement in the country, announced that it would start production from its plant before the end of the year.

Overall, the real estate sector benefited from the implementation of new laws and witnessed continued activity this year. Ongoing ventures started in 2009 or earlier and scheduled for completion in the next few years amount to more than US\$ 2 billion, and would tackle the needs of the sector in residential but also commercial and office space. As such, prospects for the real estate sector in Syria, and the corollary cement industry, remain rather strong, while the main challenge remains that of enhancing further the regulatory planning of real estate projects in a way that ensures a more balanced development of the property market across the country at large.

#### 1.1.4. Trade and Services

Syria's tertiary sector is continuing to grow, with the tourism related sectors recording a strong activity so far this year. The number of visitors to Syria in the first nine months of 2010 reached 6.6 million, up by 46% year-on-year, mainly due to improvement in relations with the West in addition to the elimination of visas for Iranian and Turkish nationals. Arab visitors who represent the largest proportion of tourists rose by a yearly 35% to reach 3.7 million over the first nine months of 2010, while expatriates grew by 46%, totaling 1.2 million. It is worth noting the significant growth of 158% for Turkish visitors whose number reached 618,221 over the said period. Also, tourist expenditures reached SP 303 billion in the first nine months of the year.

Syria's travel and tourism industry is expected to contribute 5.2% of the country's GDP in 2010, according to a report from the World Travel & Tourism Council. Along with the strong growth in tourist figures, the tourism sector continues to witness investments. According to the Ministry of Tourism, 42 hotels and 180 restaurants opened across Syria in the first nine months of 2010 at an investment cost of SP 14.5 billion. About 1,000 new branded hotel rooms are expected to be added by 2013, as per the hospitality consultancy services firm HVS. Indeed, several international operators have announced their entry in the market, including Holiday Inn and Intercontinental that are opening in Damascus in the next couple of years.

Construction works at various hotels started this year. For instance, excavation works at Taj Halab, a 200,000 square meters mixed-used project located in Aleppo comprising two hotels, a 150-room Novotel and a 129-room Ibis, have recently started. The

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project is developed by Bena Properties, the real estate development arm of Cham Holding, Syria's second largest holding company. The construction of the Yasmeen Rotana hotel in the Mezzeh area in Damascus started in April of this year, the project also being carried out by Bena Properties. The hotel would comprise 338 rooms, 6 meeting rooms, 3 restaurants, and a 600-seat banquet hall. In addition, excavation works began this year on Abraj Souria, a mixed-use project, comprising a 5-star hotel featuring 350 rooms and 250 serviced apartments that will be managed by the UAE-based group, Jumeirah. On the other hand, Loftus, a French company specialized in the construction and management of entertainment infrastructures, has signed an agreement to build a US\$ 22 million amusement center in Homs.

Another sector of interest is the telecom sector, a quite profitable industry in Syria. The important progress was the enactment of a new law in June 2010. The latter reorganizes the whole sector by assigning to a newly-established institution, the Telecoms Supervisory Authority (TSA), the power to regulate the telecoms sector. The importance of the new law pertains to the fact that it empowers the TSA with the full authority to grant new licenses in the telecommunications sector. In August 2010, the Syrian government approved plans to issue the country's third mobile operator license and would convert the two existing networks into full licenses networks. Five companies have prequalified for the award of the third mobile phone license, namely Etisalat of the UAE, STC of Saudi Arabia, Qtel of Qatar, Turkcell of Turkey, and France Telecom, according to the Telecommunications Ministry. These companies had to fit a number of requirements including having a minimum of 1.5 million active subscribers in at least two countries.

Until now, two large private sector companies, Syriatel and MTN-Syria, operated the two GSM network licenses. The number of subscribers to Syria's two mobile phone networks increased by 42% to reach 9.98 million at the end of last year, according to the Syrian Telecommunications Establishment. Also, the number of subscribers to the landline network increased by 6.6% to 3.87 million at the end of 2009.

In sum, Syria's tertiary sector is continuing to expand, boosted by strong activity in its tourism sector. Tourism revenues are an important source of foreign exchange receipts for the country, but still remain below their potential and could ultimately pick up amidst efforts to stimulate this sector. The telecoms sector is also growing, supported by the introduction of a telecoms regulatory body along with the potential entry of a third operator in the mobile sector in the coming months.

## 1.2. EXTERNAL SECTOR

Syria's external sector has seen a relative recovery in 2010, following a somewhat tough year in 2009, during which both imports and exports fell, adversely impacted by the global economic meltdown. This year, the revival in commodities prices, stimulated by the global recovery from the crisis, with its corollary positive spillovers on economic prospects of Syria's foreign trade partners, provided a push to exports, which remain to a minor extent adversely affected by the recent droughts that affected agricultural production. On the other side, the resurgence in oil prices enhanced the import bill while other non-oil imports went up due to higher domestic demand.

Indeed, aggregate merchandise trade activity saw a revival in 2010. According to the latest estimates recently released by the EIU, the overall foreign trade volume would reach US\$ 26.4 billion in 2010, registering a yearly increase of 8.3%. This increase bodes well for Syria, especially that it follows a drop of 22.7% in 2009. It is worth noting however that neither the overall trade volume nor the growth in trade activity have resumed pre-crisis levels.

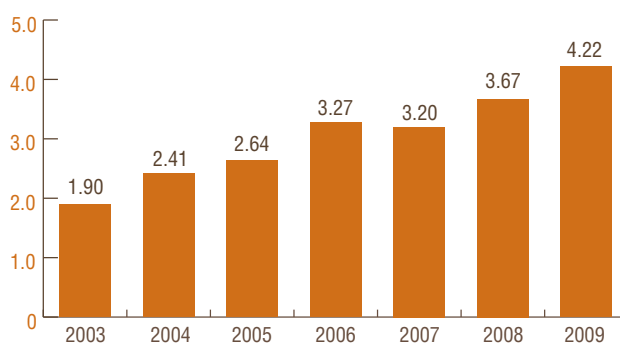
In previous years prior to the crisis, the progression in trade activity was more triggered by a growth in imports that surpassed that of exports, resulting in a continuous deterioration in the trade balance. In 2010, however, it seems that the formula has reversed, and export growth exceeded import growth, thereby resulting in a contraction of 21.3% in the trade deficit, for it to reach a four-year low of US\$ 601 million, the equivalent of 1.0% of GDP. It is worth noting that although Syria still suffers from a trade imbalance, the improvement in its trade deficit is deemed significant, especially that it comes within the context of an overall amelioration in the country's export performance. Furthermore, this progress is set to gradually continue over the coming years as exports would continue to grow, affected by positive structural reforms in the country.

Syria's exports in 2010 were driven up by a rise in both oil exports and non-oil exports. The former benefitted from rising oil prices and from increased oil production in Syria. Indeed, average oil prices witnessed an increase of 31.6% in the first ten months of 2010, as per the latest figures available, whereas estimates by the EIU indicated that oil production in Syria would increase by 5.6% in 2010. In fact, oil production is increasing at a number of small fields but declining at the larger, mature fields, with the net effect being a pick up in output in the short term to an average of 382,000 barrels/day in 2010-11. In the longer-term however, as oil reserves in the small fields deplete over time, oil production is forecasted to spiral downwards, re-emphasizing the importance of diversifying exports in Syria.

As a matter of fact, it is non-oil exports in Syria that cause an improvement in the country's trade balance, since the net impact of changes in oil exports in the country remains limited on account of the fact that Syria's imports of refined products are about equal in value to its exports of crude oil. Non-oil exports went up in 2010 gaining advantage from the fact that the drought has now eased, which positively affected production of cotton and textiles. Meanwhile, the relaxation of foreign-exchange has led to more non-oil exports moving out of the black economy and being officially recorded. The combined effect is an anticipated yearly expansion of 9.1% in Syria's overall exports in 2010.

On the other side, the resurgence in oil prices also enhanced the import bill in 2010 while other non-oil imports went up due to

**Number of Tourist Arrivals to Syria (all nationalities except Syrian expatriates, Iraqis and one-day visitors from neighboring countries, in millions)**



Sources: Central Bureau for Statistics - Syria, Bank Audi's Research Department

higher domestic demand, increased trade liberalization measures and markets' opening to the private sector, as well as the recovery in prices of non-oil imports. The bulk of Syrian non-oil imports are raw materials essential for industry, vehicles, agricultural equipment, and heavy machinery, and all those items underwent a price increase in 2010, following a decline in 2009. Syria's total imports are estimated to increase by 7.7% in 2010.

It is worth noting that preliminary estimates by the EIU suggest that the rise in imports was to a large part due to a quantity effect, while the price effect had a smaller contribution to the growth in imports. This is explained by the fact that Syria's private consumption is estimated to grow by 4.5% in 2010 and is projected to grow by a further 5.1% in 2011. Here, it is worth noting that private consumption in Syria continues to benefit from the 25% wage increase implemented in 2008, as prior to the latter year, increases in private consumption were quite feeble.

In 2010, the country pressed ahead with trade liberalization measures as part of its effort to gradually become a market economy and in order for its external sector to benefit from the global recovery as it occurs. Such liberalization measures were mainly in the form of Free Trade Agreements (FTA), but also included the creation of several investment zones, and the abolition of several customs and income tax levies for companies investing in the country. Syria signed several FTAs with Venezuela in June 2010 to boost bilateral exchange between the two countries. Also, in August 2010, Syria, Lebanon, Turkey, and Jordan signed a quadripartite free trade agreement, as a first step to establishing a free trade zone among the four countries, aimed at creating a regional economic bloc that would guarantee increasing trade exchange and investment flow among the said countries.

Moreover, Syria's external sector also benefitted from improved relations with the West, and as such, the EU announced this year that it is now ready to sign its long-delayed Association Agreement with Syria, and talks to resolve some outstanding issues with the agreement are ongoing.

The contraction in Syria's merchandise trade deficit was also accompanied by an improvement in the country's services balance and transfers balance, which is apt to result in an expansion in the country's current account surplus in 2010 to US\$ 672 million (1.2% of GDP), up from US\$ 362 million in 2009. The services surplus was buoyed by the strong spending of tourists in Syria, which went up in line with the growth in tourism.

Further, the country profited from the growth in its current-

transfers surplus to an estimated US\$ 1.1 billion in 2010. The main source of income in this balance is remittances of Syrians working abroad, which slightly advanced on account of the pick-up in economic activity in the Middle East and North Africa region that gathers an important portion of Syrian expatriates. The World Bank projects US\$ 1.4 billion of remittances to Syria in 2010, compared to US\$ 1.3 billion in 2009.

This current account surplus was met by positive developments in the capital account in 2010 driven by a rise in foreign direct investment (FDI). After a 32% decline in FDI into Syria in 2009, it seems that the country captured a good share from the global and regional recovery underway, as the Arab Investment and Export Credit Guarantee corporation estimated a 29% increase in FDI to US\$ 1.9 billion in 2010.

Finally, Syria's improved relations with countries in the region and across the western world, as well as the market openness and reforms adopted in the country have left it in a good position to benefit from the global recovery at the level of its external sector. In order to further improve its external sector activity, Syria needs to undertake measures targeted at bolstering its capital account by attracting capital investments, a trend which started three years ago but needs to be strengthened further, as the country still has significant potential to attract further capital. Syrian authorities do acknowledge the importance of FDI in triggering growth and are thus apt to continue and intensify plans to attract FDI and motivate private sector participation.

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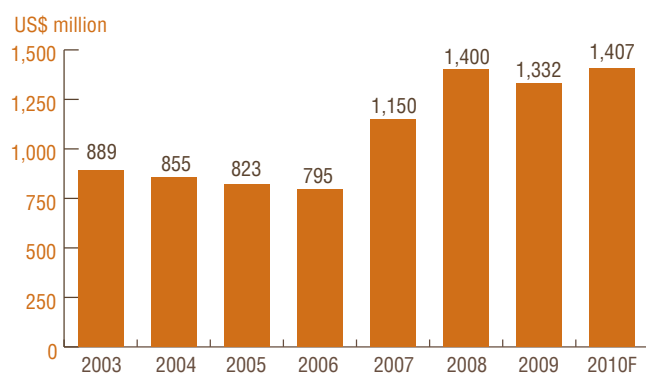
### 1.3. PUBLIC SECTOR

The public sector performance in Syria in 2010 was shaped by two factors, the first being the expansionary fiscal stance that the Syrian government continued to adopt since 2009 to support the economy during the past two particular years, and the second being Syria's continuous and gradual transition from a centrally planned economy to a market economy. The consolidation of public finances in Syria in the preceding few years prior to the crisis and the fact that Syria does not share the fiscal woes of neighboring Arab countries, have come in handy for the country during those two past years as it provided room for the authorities to undertake counter-cyclical measures that were crucial to mitigate the effects of the global economic crisis, that are still partially being felt in several countries across the globe till now.

In turn, this has taken a significant toll on the overall fiscal deficit, which as per recently released IMF estimates is likely to reach US\$ 2.6 billion, or 4.3% of GDP in 2010. Although this denotes an improvement from a deficit of US\$ 2.9 billion in 2009, the equivalent of 5.4% of GDP, it still significantly exceeds the average deficit of the previous six years, which hovered around US\$ 1.1 billion.

Syria's overall fiscal deficit improved in 2010, in spite of the continued expansionary fiscal stance, owing to higher oil revenues and a reduction in fuel subsidies. Indeed, total revenues are estimated to go up by 11.3%, driven by a rise of 34.1% in oil revenues, as well as an increase of 5.1% in non-oil revenues. The former went up in line with the increase in average worldwide oil prices and rising oil production in Syria to reach an expected US\$ 3.2 billion. On the other hand, the latter rose due to strong tax collection, which reflected improved administration and

Remittances to Syria



Sources: World Bank, Bank Audi's Research Department

incentives to settle arrears. In 2009, the authorities raised the minimum thresholds for wage taxes. However, as a compensatory measure, the top income tax rate for individuals with income of SP 75,000 and higher was increased to 22% (from 20%).

Furthermore, non-tax revenues benefitted from higher telecom revenues. Indeed, Syria's two mobile-phone operators have reported healthy increases in their turnover in the first half of 2010, which has translated into similar growth in revenue streams to the state. In August 2010, the government approved the conversion of existing mobile-phone contracts into licenses and awarding a license for a third operator. This should boost telecom revenues further upward in 2011.

In parallel, total expenditures are estimated to grow by 6.9% in 2010, driven by a rise of 8.5% in current expenditures as well as an increase of 5.2% in capital expenditures. Within current expenditures, salaries and wages are estimated to grow by 6.4%, whereas transfers public enterprises as well as pensions and social assistance are projected to increase by 18.8%. Meanwhile, although fuel subsidies were slashed significantly, other subsidies went up in 2010, thereby resulting in an estimated increase of 15% in overall subsidies. The only drop within current expenditures was observable at the level of interest payments, which are estimated to undergo a reduction of 19.1% by end-2010, on account of the fact that public debt remained somewhat contained during the year. In parallel, capital expenditures moved up, in line with rising public investments, highlighting ongoing efforts exerted by the Syrian government to promote economic activity.

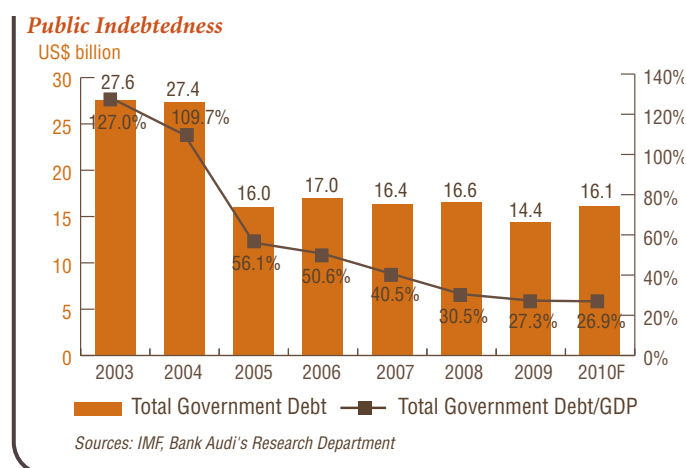
Furthermore, it is worth noting that increased public investments have been part of Syria's plan to liberalize and diversify the economy, even before the eruption of global financial crisis. Such projects are still at their earlier stage, and the continuous implementation of public investment is contingent on further rationalization of appropriations in the budget and an implementation ratio that is in the same order as in 2009.

The aggravation of fiscal imbalances in 2009 did not result in an aggravation of the public debt in Syria. On the contrary, IMF estimates indicate that public debt went down by 13.4% to US\$ 14.4 billion in 2009. Nonetheless, ongoing spending through into 2010 resulted in a projected rise of 11.7% in Syria's public debt in 2010 to reach US\$ 16.1 billion. However, in absolute terms, public debt in Syria remains very low and contained, well below that of neighboring Arab countries, and as such does not pose any threat on the country's public finances. In spite of the projected increase in public debt in 2010, the debt-to-GDP ratio is estimated to drop from 27.3% in 2009 to 26.9% in 2010, triggered by a relatively higher growth in nominal output. One should note that currently, the debt-to-GDP level is extremely comfortable, especially when compared to the highs of around 127% registered in 2003.

It is worth noting that most of Syria's debt remains domestic. Syria has been redeeming most of its external debt especially that related to the Soviet era. Yet it is worth highlighting that concerns from the growing domestic debt, which has been, so far, in the form of direct borrowing from the Central Bank, are rising, especially as the budget deficits increases. Within this context, the IMF recently recommended a shift in the financing of the budget deficit from Central Bank borrowing to issuing Treasury bills, with market determined interest rates. At the same time, it would be important to ensure that public investment projects yield high economic and social return in order to justify the cost of their financing.

On October 12, the draft 2011 budget was approved by the Syrian Cabinet and transferred to Parliament. The budget expects spending of US\$ 17.8 billion next year, an annual rise of 12%, with investment expenditures representing most of the increase. Still, by 2011, further fiscal improvement is foreseen, as adjustments and reforms continue along the same line of the past few years. The government has a number of resources to boost public revenues that might be introduced within a couple of years time, if economic conditions permit. The value added tax is being considered to offset the decline in oil revenues. Reforms of customs administration and modernization of budget processes are proceeding as well. In addition, the government can expect to reap good revenues from the privatization or restructuring of the many state-owned companies. Indeed, expanding revenues should enable the government to maintain relatively high investment spending while reducing the budget deficit.

On the overall, Syria has recently made several improvements on the fiscal front, but the near-term outlook requires further fiscal consolidation as it can be subjected to downside risks with the coming few years considered to be a challenging phase. Pursuing strictly the implementation of structural reforms should keep public finance conditions under control and maintain an overall positive outlook of the Syrian economy in the near term.



### Selected Public Finance Indicators

US\$ billion	2003	2004	2005	2006	2007	2008	2009	2010F
Central government revenues	6.2	6.8	6.9	8.5	9.2	10.6	11.5	12.8
Central government revenues/GDP	28.8%	27.2%	24.0%	25.5%	22.7%	19.4%	21.9%	21.4%
Central government expenditures	6.8	7.9	8.1	8.9	10.8	12.1	14.4	15.4
Central government expenditures/GDP	31.4%	31.4%	28.5%	26.6%	26.6%	22.1%	27.3%	25.8%
Central government fiscal balance	-0.6	-1.1	-1.3	-0.4	-1.6	-1.5	-2.9	-2.6
Central government fiscal balance/GDP	-2.6%	-4.2%	-4.5%	-1.1%	-4.0%	-2.8%	-5.4%	-4.3%

Sources: IMF, Bank Audi's Research Department

## 1.4. FINANCIAL SECTOR

### 1.4.1. Monetary Situation

The first seven months of 2010 were marked by a low single-digit inflation rate, moderate annual growth in money supply, and mild change in official reserves. In this context, the Central Bank of Syria continued to adopt monetary easing to spur economic growth through cuts in reserves requirement and indicative interest rates.

The inflation rate averaged 3.87% during the first seven months of 2010 as compared to an average of 4.19% during the corresponding period of the previous year. The breakdown of the Consumer Price Index by category shows that the education category posted the highest average year-on-year increase in prices of 28.7% during the first seven months of 2010, followed by the hotels and restaurants category with 14.0%, the health category with 6.3%, the house equipments and regular maintenance category with 5.6%, the clothes and shoes category with 5.6%, and the housing, water, electricity, gas and other kind of fuel category with 4.1%. Consumer price inflation is expected to average 5.0% in 2010, up from 2.8% in 2009, according to the IMF estimates, as global commodity prices recover slightly, and government subsidies on fuel are reduced.

In view of sustained low single-digit inflation rates, the Central Bank of Syria (CBS) continued to adopt measures to ease its monetary policy. In fact, after reducing the compulsory reserves requirement by up to 5% for banks that increase their lending for investment projects in the industrial sector in May 2009, the CBS implemented a similar regulation governing lending to small and medium-sized enterprises starting July 2010. Under this decision, banks will be offered a discount in their reserve requirements on a sliding scale dependent on increased lending to SMEs up to a discount level of 5% of reserves for a lending ratio of more than 45% to SMEs. Within this context, it is worth mentioning that

the IMF recommended the Central Bank of Syria to end its policy of reducing reserve requirements for banks that increased their loan portfolio towards the manufacturing sector, highlighting that the legitimate intended objectives of differentiated reserve requirements or increased credit exposure limits for development projects can be achieved through other means that are more effective and entail lower risks for banks and lesser burden for the supervision department.

In addition to the cut in the reserves requirement, reference interest rates for deposits were lowered further by 50 basis points in August 2010 following a cut of 1% in January 2009, with indicative deposit interest rates currently varying between 5.5% and 7.5%.

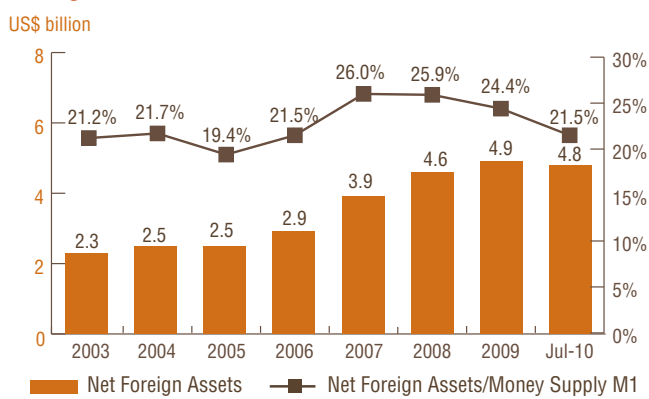
The net foreign assets of the Central Bank of Syria declined from US\$ 4.9 billion at year-end 2009 to US\$ 4.8 billion at end-July 2010, down by 1.2%, under the impact of depreciation in the Syrian Pound. This compared to a growth of 5.9% in 2009 and a compounded average growth rate of 13.7% over the 2003-2009 period. The net foreign assets covered 21.5% of money supply in Syrian pound at end-July 2010, as compared to a coverage ratio of 24.4% at year-end 2009.

Money supply in its broad sense (M2) expanded by 12.0% year-on-year in July 2010, moving up from US\$ 37.4 billion at end-July 2009 to US\$ 41.9 billion at end-July 2010, in line with GDP growth, driven by growth of credit to the private sector owing to the expanding financial intermediation and stronger bank penetration in the economy. In fact, the growth in money supply is mainly explained by a growth in net domestic assets of 18.3% year-on-year that resulted from a staggering surge of 24.3% in claims to the resident private sector and an 18.9% increase in claims on non-financial public enterprises.

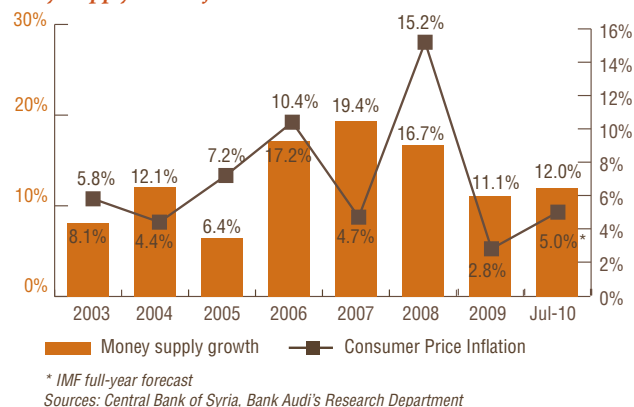
The Syrian Pound that has been pegged to the IMF's special drawing rights since October 2007, slightly depreciated against

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#### Exchange Market Indicators



#### Money Supply and Inflation



#### Monetary Situation

Flows in US\$ million	2003	2004	2005	2006	2007	2008	2009	Jul-10
Net foreign assets (monetary system)	498	997	18	-307	-511	-2,522	304	-219
Claims on public sector	352	519	1,354	1,044	1,113	1,969	1,666	1,786
Claims on private sector	494	735	1,363	631	1,056	1,847	2,337	1,302
<b>Total</b>	<b>1,344</b>	<b>2,251</b>	<b>2,736</b>	<b>1,367</b>	<b>1,658</b>	<b>1,294</b>	<b>4,307</b>	<b>2,869</b>
Money supply (M2)	1,382	2,429	2,318	2,153	3,366	3,959	3,391	3,119
Other items (net)	-39	-178	418	-786	-1,708	-2,665	916	-250

Sources: Central Bank of Syria, Bank Audi's Research Department

the US Dollar during the first seven months of 2010, moving from SP/US\$ 45.60 at end-2009 to SP/US\$ 46.65 at end-July 2010, on the back of weakness in the Euro zone.

Despite the achievements made so far to improve financial intermediation, considerable challenges remain, including establishing indirect monetary instruments, reducing the role of the government in credit allocation, and removing the large excess liquidity in the financial system. The authorities are considering replacing administrative tools for conducting monetary policy, including controls on banks' domestic currency deposit rates with issuance of treasury bills. In fact, the CBS has current plans to issue Treasury bills by the end of 2010, with no plans to issue Certificates of Deposits. Within this context, it is important, according to the IMF, that interest rates are fully liberalized to allow for full transmission of policy signals. Also, reserve requirements, which introduce distortions and complicate monetary management as the CBS moves forward with its plan to introduce indirect monetary instruments, will need to be unified. Finally, considerations can also be given to securitizing government debt to CBS in order to remove excess liquidity.

### 1.4.2. Banking Activity

The Syrian banking sector has witnessed a satisfactory performance so far this year, in line with the overall improving economic activity the country has been recording. Measured by consolidated assets of banks operating in Syria, total sector activity grew by 5.3% in local currency terms -and by a lower 2.9% when accounting for FX fluctuation effects- over the first seven months of 2010, as per latest available Central Bank data, to reach SP 2,057 billion at end-July 2010, the equivalent of US\$ 44.1 billion.

Total deposits, accounting for nearly two thirds of banks' balance sheets, continued to be a major driver of sector activity in 2010, posting a 10.1% rise in local currency terms in this year's first seven months (7.6% in US Dollar terms), moving from SP 1,202 billion (US\$ 26.4 billion) at end-December 2009 to SP 1,323 billion at end-July 2010 (US\$ 28.4 billion) practically through steady growth month after month. This reflects domestic players' continued ability to attract deposits into a steadily developing banking industry, noting that such a growth actually proved nearly twice higher (in local currency terms) than that achieved during the corresponding period of 2009.

The breakdown of sector deposits shows that such growth in this year's first seven months is equally attributed to the private and public sectors, and driven by Syrian Pound denominated deposits, which rose by 13.0% in local currency terms during the covered period. Those denominated in foreign currencies actually retreated slightly over the covered period, bearing in mind that banks in Syria currently have relatively limited options

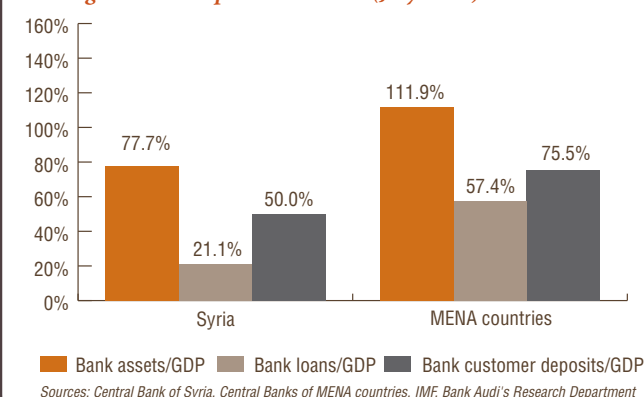
for utilizing foreign currency deposits in a lucrative manner. Within this context, the deposit dollarization rate in Syria continued its downward trajectory, reaching 14.1% at end-July 2010, against 16.3% at year-end 2009 and levels hovering around the 20% mark in the previous couple of years.

In parallel, banks' lending to the private sector, an increasingly important driver of sector activity in Syria, registered a healthy 12.2% increase in local currency terms in the first seven months of 2010 (+9.7% when accounting for FX fluctuation effects), moving from SP 498 billion at end-December 2009 (US\$ 10.9 billion) to SP 558 billion at end-July 2010 (US\$ 12.0 billion), a performance nearly matching that of the corresponding period of the previous year.

Such continued growth in lending volumes is actually noticeable as it comes at a time when most peer banking sectors across the globe are still witnessing subdued lending activity within the context of continued deleveraging across the board in the aftermath of one of the most severe financial crises in recent history. Banks in Syria were actually more or less shielded from the global crisis spillovers, owing to prudential and conservative regulations on behalf of local authorities and relatively limited integration with international financial markets, and which allowed Syrian banks to continue being able to match the steadily growing needs of the domestic economy.

In a recent step to enhance further banks' lending activity, Syrian authorities lately reduced compulsory reserve requirements for commercial banks on the basis of lending volumes provided to small and medium size enterprises (SMEs), industrial and touristic projects and micro-finance institutions. Reserve requirement discounts range from a minimum of 1% (for banks whose lending to SMEs and aforementioned productive sectors accounts for 16%-25% of their total loan portfolio) to 5% (for banks with a similar ratio exceeding 45%), according to The Syria Report. Syrian officials asserted SMEs would be an area of focus of the upcoming five-year plan starting 2011, noting that the Ministry of Economy, together with the EU-funded SME

**Banking Sector Comparative Ratios (July 2010)**



### Banking Activity

US\$ million	2003	2004	2005	2006	2007	2008	2009	Jul-10
Total assets	22,933	23,951	24,484	27,602	33,123	37,027	42,835	44,091
% yearly change in assets	-	4.4%	2.2%	12.7%	20.0%	11.8%	15.7%	12.0%
Total deposits	11,981	12,829	13,368	15,743	19,219	23,072	26,369	28,367
% yearly change in deposits	-	7.1%	4.2%	17.8%	22.1%	20.0%	14.3%	16.6%
Total loans to the private sector	2,120	2,831	4,057	4,985	6,352	8,439	10,914	11,971
% yearly change in loans to the private sector	-	33.5%	43.3%	22.9%	27.4%	32.9%	29.3%	24.0%

Sources: Central Bank of Syria, Bank Audi's Research Department

Support Program, recently set up an SME development strategy. Furthermore, this year has seen Syrian private banks provide funds to the public sector for the first time to finance grain purchases, following the introduction of a new mechanism for securing funding to public sector owned entities. The Central Bank Governor said there are more projects involving public sector entities that would be funded by public and private banks.

Such measures complement authorities' earlier steps aimed at supporting bank lending at large. Beyond the reserve requirement ratio reduction of up to 5% for banks increasing their loans aimed at financing investment projects, the regulator raised the lending exposure limit for development projects from 25% to up to 35% for a single project, and required selected banks to write-off penalty on overdue debts while extending reimbursement time, in addition to establishing a lender of last resort facility.

At the level of profitability, while consolidated sector statistics are not available, the results of the ten listed banks on the Damascus Stock Exchange, which give some indication on recent performance trends, show that banks' increasing lending activity so far this year actually triggered a positive quantity-effect which favored their core revenues, and led to a 21% yearly rise in net profits in the first nine months of 2010.

But while financial intermediation has indeed developed remarkably in recent years, banking dimension in the Syrian economy remains narrow in absolute and relative terms. Customer deposits and loans to the private sector continue to account for a comparatively narrow portion of the country's GDP, with such ratios at 50% and 21% respectively, comparing to much higher regional benchmarks of close to 75% for deposits and nearly 60% for loans.

In this respect, Syrian authorities continued to adopt measures prone to open up the sector further and increase the private sector's contribution to economic development at large. The government recently passed a law in July 2010 to allow the establishment of investment banks in the country, with a minimum capital requirement of SP 20 billion (around US\$ 426 million) twice higher than that of conventional private banks (lately raised from SP 1.5 billion) and stipulating that the capital must be fully paid prior to commencing activities. While such levels are deemed rather high by emerging market standards and might have been set bearing in mind risks associated with investment banks' activities at large in the aftermath of the latest global crisis, this move comes at a time when Syrian authorities adopted a new five-year plan requiring some SP 2.3 trillion (about US\$ 50 billion) in investments from the private sector. According to the Central Bank Governor, investment banks would help secure sources of funding needed to finance large scale projects. It is worth noting that the law also stipulates that following approval of the Council of Ministers, foreign stakes in investment banks could be increased in line with the provisions of Law 28 of 2001 (and its amendments) governing the establishment of private banks in the country. The latter law was modified at the start of 2010 to entice foreign players into the Syrian banking arena by enabling such investors to retain up to 60% in local commercial banks (against a previous ceiling of 49%).

All in all, the well-performing Syrian banking sector looks set to expand further and benefit from substantial opportunities ahead to increase its participation in the development of an economy with an unquestionable pent-up growth potential.

### 1.4.3. Capital Markets

The Damascus Securities Exchange saw a tangible increase in prices and attracted new listings during the first ten months of 2010 that translated into a significant rise in the DSE's market capitalization. In addition, many measures have been taken to increase the number of listed firms on the DSE and to incite family businesses to go public.

Eighteen firms are actually listed on the DSE, up from twelve at end-2009, and they are distributed by sector as follows: ten in the banking sector, two in the services sector, one in the industrial sector, four in the insurance sector and one in the agricultural sector. The six additional firms listed so far this year are: Qatar National Bank-Syria, Bank of Jordan-Syria, Syria Gulf Bank, Syria International Insurance-Arope, National Insurance Company, and Al-Aqeelah Takaful Insurance.

The total trading value on the DSE amounted to US\$ 129.5 million during the first ten months of 2010, as compared to US\$ 36.5 million over the March-December 2009 period. The average daily trading value stood at US\$ 919 thousand during the first ten months of 2010 against US\$ 392 thousand over the March-December 2009 period. The total number of traded shares reached 4,473,236 during the first ten months of 2010 against a total number of 1,704,379 in 2009.

DSE share prices improved significantly during the first ten months of 2010, as reflected by a tangible growth of 74.6% in the Audi Price Index. As a result of the hike in prices that was coupled with an increased number of listed firms, the DSE's market capitalization surged by 111.6% over the first ten months of 2010 to reach US\$ 2.9 billion.

Several measures have been taken by the government and the DSE authorities to attract additional and new listings. In fact, a presidential decree (decree 3/2010) has been enacted early 2010 that lifted the combined share of moral persons, whether they are local or foreign, in banks operating in Syria from 49% to 60%, and to 75% provided the additional 15% is held by state affiliated companies and institutions. In addition, the decree gave conventional and Islamic banks until the end of 2012 to raise their capital to SP 10 billion and SP 15 billion respectively. Within this context, the Damascus Securities Exchange has allowed companies and other moral persons to buy shares of private sector banks through the stock exchange provided that the combined shares they hold don't exceed 60%. The DSE's decision would help banks to reach the new capital target by enabling companies to buy additional shares through the securities exchange.

Furthermore, the government provided incentives for privately held family companies to go public. In fact, family companies can get taxed at a rate of 14% as compared to previous rates that often reached as high as 65%, if they restructure their ownership in a way that more than 51% is held by multiple shareholders.

In addition, the Syrian Commission on Financial Markets and Securities (SCFMS) issued a decision on March 14, 2010 that obliged joint-stock firms to apply within a maximum period of one month – extended to three months for recently established companies - for their stocks to be listed in the DSE.

After newly established banks and insurance companies that are subsidiaries of international financial service institutions have been listed on the DSE, the challenge now lies in listing older

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established Syrian companies that have for many years been working under local accounting and auditing standards. Around 65 publicly held companies have been identified and classified by the DSE authorities as eligible in terms of revenues and capital for listing on the exchange, nine of which have been listed so far. Another challenge arises in inciting the country's family businesses to go public. After all, the establishment of the Damascus Securities Exchange and the attraction of new listings are expected to leave a positive impact on the financial sector as a whole, as they play a major role in raising corporate transparency, increasing tax compliance and boosting local borrowing.

As to the debt market, the development of a government bond market is currently considered among priorities in Syria. Syria's financial institutions still lack a benchmark by which to price other types of financial products, the most notable of which are corporate bonds. The absence of a yield curve remains the biggest remaining barrier to raise funding at large.

## 2. CONCLUSION

In summary, economic performance in Syria was on the upside in 2010, favored by a rise in economic growth, strengthening capital inflows, growing consumption and investment demand and corollary growth in monetary and financial aggregates. Forecasts for 2011 revolve around a 5.5% real GDP growth and a 5% inflation rate as recently established by the IMF in its Global Economic Outlook released last October. Syria's near term economic outlook actually depends on the pace of global and regional recovery but also on domestic factors such as the extension of new waves of loans by banks operating in Syria, the launch or continuation of projects under the auspices of both private and public sectors and the impact of further reforms on the country's business infrastructure at large.

As a matter of fact, Syria is still lagging behind in competitiveness and business environment indicators. According to the Doing Business report, the annual survey on the ease of doing business produced by the World Bank, Syria ranked 144th in the World, and among the weakest ranks in the MENA region. Likewise, according to the Global Competitiveness Index ranking by the World Economic Forum, Syria ranked 97th in the World, lagging behind most MENA countries. As to the index of economic freedom released by Fraser Institute, Syria ranked 15th out of the 22 MENA countries covered by the index.

It is within this context that the Syrian Government adopted a 5-year Plan governing the country's economic policy for the next five years and aiming at improving the overall investment framework. The Plan targets an annual real GDP growth of 5.7% per annum over the next five years, hinging over SP 4.3 trillion in cumulative investments, of which SP 2 trillion by the public

sector and SP 2.3 trillion by the private sector. An area of strategic importance is infrastructure, with significant government investments in power and water sectors, in addition to roads, airports and ports. The reduction in population growth rises among top priorities as well, aiming to reach an annual growth rate of 2.1% from the current 2.5% rate. Notwithstanding the targeted improvement in the quality of human resources to increase labor productivity at large.

While such ambitious government targets require massive capital spending on behalf of the government, the public finance outlook remains sustainable in Syria. According to the IMF, debt is expected to increase only moderately, and reach about 25% of GDP by 2014, despite the substantial decline in oil revenues as per the Fund's baseline scenario. When addressing alternative scenarios, debt to GDP at the horizon 2014 ranges from a best case scenario of 14% and a worst case scenario of 32%, which is considered still manageable by international standards and benchmarks. It is worth mentioning that Syria's public sector is in a net external creditor position, with official foreign assets estimated at US\$ 17 billion at end-2009 against gross external debt of US\$ 5.8 billion.

As a reflection of such a creditworthiness, Capital Intelligence, the international credit rating agency, assigned last September somehow favorable sovereign ratings for Syria. The long term foreign currency rating, assigned for the first time for Syria, stood at BB- with a stable outlook, underpinned by comparatively strong solvency and liquidity indicators and a growing commitment to gradual economic reform. On the downside however, Capital Intelligence mentioned weakness in the country's economic infrastructure, the relatively undiversified production base, the declining oil production, the high levels of state ownership, bureaucracy and corruption, the deficient legal and regulatory regimes and the inadequate physical and technological infrastructure.

Although all those weaknesses represent serious challenges to the outlook, the country's large opportunities outpace such challenges at the horizon. Those opportunities anchor over the important infrastructural projects underway or in the pipeline, the fiscal improvement with expected VAT introduction and subsidies reform, the increasing financial liberalization and the recent quasi-normalization of political relations with western countries. The latter lead to a drastic amelioration in the Euromoney country risk ranking from the 149th rank worldwide in September 2009 to 128th in September 2010, i.e improving by 21 ranks over the past year. The challenge now is to complement the improvement in political risk by drastic structural economic reforms that would speed up the transition to a market based and more open Syrian economy.

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