Economist: Syrian Economic Outlook for 2008-09

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SYRIA COUNTRY VIEW: OUTLOOK FOR 2008-09
THE ECONOMIST INTELLIGENCE UNIT
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* The president, Bashar al-Assad, is expected to remain in power in 2008-09. He will continue to rely on the strength and loyalty of the security services, which will keep opposition forces weak and ineffective.
* Mr Assad will devote considerable effort to ending Syria's political isolation, but it is questionable whether he is willing to make any concessions on Syria's strategic alliance with Iran or its desire to influence events in Lebanon.
* Economic policy in 2008-09 will focus on the need to diversify the economy and on encouraging investment, but structural fiscal reform will be constrained by the fear of alienating public opinion.
* Syrian oil output is expected to fall markedly over the outlook period, which will reduce export volumes and government spending (which is heavily dependent on the level of oil revenue) and thereby curb economic growth.
* The Syrian pound will appreciate against the US dollar in 2008 (largely because of dollar weakness) but will depreciate in 2009 owing to concerns about export competitiveness.
* The trade account will fall into deficit in 2009, as the negative impact of falling oil production and exports is compounded by a modest decline in global oil prices.

DOMESTIC POLITICS: Power remains firmly in the hands of the president, who is supported by key elements in the security services and by the ruling Baath party. There appears little prospect that any serious challenge to Mr Assad's regime will emerge in the outlook period. Since assuming power following the death of his father in 2000, Mr. Assad has stepped up repression of local opposition groups and activists, and has appointed his own close allies to key posts. This has increased his control, albeit at the cost of narrowing his power base. Importantly, the core of the elite is drawn from Mr Assad's minority Alawi sect, and is acutely conscious that to move against him would risk endangering the Alawi hold on power.

INTERNATIONAL RELATIONS: Although Mr Assad may have secured his domestic position, he faces a number of challenges in the international arena (which will have a profound bearing on his popularity at home). Efforts to emerge from international isolation have been ongoing for much of the year, but in November, Syria received recognition from both Europe (in particular, France) and Arab countries. The new French president, Nicolas Sarkozy, opened channels of dialogue, culminating in a large, high-profile team of diplomats being sent to the capital, Damascus. The diplomatic initiative was ostensibly aimed at reaching an accommodation between pro- and anti-

Syrian forces in Lebanon, but was probably also part of Mr Sarkozy's wider ambitions to create a "Mediterranean union", involving Europe and the southern and eastern littoral states. From the Syrian perspective, it seemed to confirm that Syria had the right to be consulted about the next Lebanese president.

POLICY TRENDS: The soaring cost of the fuel subsidy bill, which is placing an unsustainable burden on the fiscal account, has led to heated economic debate between the government's more reformist, technocratic elements, led by the deputy prime minister for economic affairs, Abdullah al-Dardari, and the more conservative Baath party members. Mr Dardari is pushing for structural fiscal reform, including cuts in fuel subsidies and the introduction of a value-added tax (VAT). However, some Baath party members oppose these reforms, in part because of concern about their negative impact on disposable incomes. As a result, the proposed introduction of VAT has now been delayed until 2009. Fuel subsidy cuts also appear to be on hold. Indeed, in late November the Ministry of Petroleum issued a tender invitation for the development of a smartcard system to administer fuel rationing. The Economist Intelligence Unit expects any cuts in fuel price subsidies to be piecemeal and to be offset by compensatory payments to low-income families.

INTERNATIONAL ASSUMPTIONS: We forecast that world GDP growth will average 4.6% in 2008-09 (at purchasing powerparity exchange rates), down from an estimated 5.1% in 2007, largely as a result of a sharp slowdown in the US economy in 2008. International oil prices are expected to remain high, however, as buoyant demand in emerging markets offsets any slowdown in OECD oil demand. The benchmark dated Brent Blend is expected to rise to an average of US$78/barrel in 2008, before easing slightly to US$72/b in 2009, but risks are weighted on the upside.

ECONOMIC GROWTH: The Syrian economy is expected to grow steadily over the outlook period, at an annual average rate of 4.5%, as falling oil production is offset by persistent expansion in the services sector, boosted by solid growth in tourism and demand for goods and services, in part from the large Iraqi refugee population. Our growth forecast is also underpinned by the expected recovery in the agricultural sector (after drought conditions in parts of the country depressed growth in 2007).

INFLATION: We estimate that inflation will have eased in 2007 to an average of 7.4%, down from 10% in 2006. However, holiday-related demand for foodstuffs will have compounded the impact of higher global food costs, and the increase in petrol prices in November will feed through into distribution costs; as a result, we estimate that the end-2007 inflation rate will have risen to 8.9%. Although we expect average inflation to rise to 8.7% in 2008, it will fall over the year as the new exchange-rate regime helps to contain imported inflation and domestic demand pressure ebbs. In 2009 lower global oil and non-oil commodity prices will help to reduce the inflation rate to 5.9%. Moreover, a significant return of Iraqi nationals to Iraq would also lower inflationary demand pressures in 2008-09. However, if the government were to enact more phased cuts in fuel price subsidies in 2008-09, this would lead to a significant upward revision to our inflation forecast.

EXCHANGE RATES: Since the beginning of October 2007 there has been a marked appreciation of the pound against the US dollar, suggesting that the new exchange-rate regime–a peg to a basket of currencies based on the IMF's special drawing rights–has finally been implemented. The currency will not be allowed to float freely, however, with the government continuing to prioritise stability. The regime is well placed to protect the value of the pound, because of the dominant position of the state-owned banks and the control that the Central Bank of Syria retains over foreign-currency transactions, even as some laws are relaxed. Consequently, we forecast that the pound will remain relatively stable in 2008 (partly as a result of dollar weakness), before depreciating modestly in 2009 owing to concerns about the competitiveness of Syria's non-oil exports (and some strengthening of the dollar against the euro).

EXTERNAL SECTOR: We estimate that the value of merchandise exports will have risen in 2007, with strong growth in non-oil exports more than offsetting the decline in the value of oil exports. The estimated fall in oil export revenue is the result of lower Syrian oil production. Non-oil exports are continuing to benefit from the relaxation of foreign-exchange controls, which has led to more exports being officially recorded, and strong regional demand. We have raised our forecast for export earnings in 2008 following an upward revision to our global oil price assumption for that year. The higher price will offset the negative impact of falling oil production, and we expect still strong growth in non-oil export revenue. Import spending growth will also remain strong in 2008-09, partly as a result of the ongoing process of tariff liberalisation. As a result of these trends, the trade account will register a surplus of US$377m (0.8% of GDP) in 2008, slightly larger than in 2007, and a deficit of US$257m (0.5% of GDP) in 2009, as oil production falls and international oil prices ease.

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