https://eiu.bvdep.com/version-201056/EIU/images/cobanner.gif

**Country Outlook: Syria**

***June 2010***

DOMESTIC POLITICS: The Syrian president, Bashar al-Assad, and his ruling Baath party are expected to retain a secure grip on the country, supported by key elements in the security services. The core of the elite is drawn largely from Mr Assad's Alawi sect, and any move against him would risk endangering its hold on power. However, tensions within the regime persist, accentuated by external pressures such as the UN inquiry into the killing of Rafiq Hariri, a former Lebanese prime minister, which is likely to issue an indictment in the autumn. A number of leading Syrian figures could be implicated in the assassination, and demands for them to be handed over to an international tribunal could bring domestic rivalries to the fore. Tensions could also arise from the ongoing investigation by the International Atomic Energy Agency into allegations that Syria has a nuclear programme. Syria has denied officials access to re-examine a site that was bombed by Israel in 2007--a new report is due at the end of May.

INTERNATIONAL RELATIONS: After a period of considerable diplomatic isolation in 2005-07, Syria has been developing steadily better relations with many Western and regional states--notably France, Turkey, Saudi Arabia and Lebanon. One consequence is that the EU is now ready to sign its long-delayed Association Agreement with Syria, and talks to resolve some outstanding issues with the agreement are expected to be resumed soon. The catalysts for the improvement in relations include the more constructive role that Syria is playing in Lebanon and a desire by Western and other Arab countries to weaken Syria's alliance with Iran. Relations with the US have also improved and although US sanctions on Syria were renewed in May, the US has withdrawn its objections to Syria's accession to the World Trade Organisation.

POLICY TRENDS: Syria is expected to continue the gradual liberalisation of its centrally planned economy, a process that has been led by the deputy prime minister for economic affairs, Abdullah al-Dardari. However, there remain influential officials who argue instead that socialist and protectionist policies should be retained, and these conflicting interests will inhibit the formulation and implementation of policy. There are also powerful members of the business elite who benefit from the status quo and might resist certain changes that would threaten their advantages. The recent removal of Tayseer al-Reddawi as head of the State Planning Commission, apparently over public criticisms he made about policy implementation, indicates that the economic debate remains highly charged. The overriding policy challenge will be to offset the impact of the decline in oil production by developing other sectors of the economy, particularly those that can boost export earnings in the medium term, such as tourism. This will require making established state-owned and family businesses more dynamic and encouraging entrepreneurship and investment. Moves intended to increase domestic and foreign investment include expanding the Damascus Securities Exchange, relaxing foreign-currency restrictions and boosting bank lending. There are also plans to cut government subsidies, which are burdensome and inefficient, particularly fuel subsidies.

INTERNATIONAL ASSUMPTIONS: The Economist Intelligence Unit forecasts that world real GDP growth (at purchasing power parity exchange rates) will be 4.1% in 2010, declining to 3.5% in 2011, as the effect of government stimulus packages fades. We have revised our currency outlook owing to concerns in the euro zone, and the US dollar is forecast to be substantially stronger against the euro than previously expected. The benchmark dated Brent Blend is forecast to average US$79/barrel in 2010-11. Syrian crude, most of which is heavy, will trade at a discount to this, averaging about US$70/b.

ECONOMIC GROWTH: We forecast that real GDP growth will pick up from an estimated rate of 3.6% in 2009--when the effect of the global recession was mitigated by strong government spending--to an average of 4.1% in 2010-11. Foreign investment into Syria is likely to rise because of Syria's increasing economic openness and improving international relations, although it will be held back in the short term by the ongoing global squeeze on credit. This will support stronger fixed investment in 2010-11. Government consumption growth will be steady in 2010-11 as the fiscal stimulus is sustained but will slow slightly. Private consumption growth will pick up in both years. However, if there is a significant improvement in security in Iraq (not our core scenario) once the new government is formed and US troops are withdrawn--planned by late 2010--a sizeable number of the 1m or so Iraqi refugees in Syria may return home, thereby depressing consumption. Imports will pick up after contracting in 2009.

INFLATION: Consumer price inflation is expected to increase over the forecast period, as global commodity prices recover slightly, government subsidies on fuel are reduced and VAT is finally introduced. We forecast that annual average inflation will be 6.7% in 2010-11, up from just 2.6% in 2009, but well below the peak of 15.7% in 2008. Rental prices are already falling as Iraqi nationals return home. This trend could accelerate, which would hold back inflation, but this would require a significant improvement in security conditions in Iraq.

EXCHANGE RATES: Owing to our expectations for a weaker euro than previously forecast in 2010-11, the Syrian pound is now projected to depreciate slightly against the US dollar to an average of SP48.2:US$1. The depreciation will be checked by Syria's narrowing current-account deficit. The pound has been pegged to a basket of currencies based on the IMF's special drawing rights since October 2007 and, although this new regime is less rigid than the previous peg to the dollar, the authorities are unlikely to let the pound float freely, because they place a high priority on exchange-rate stability. The dominant position of the state-owned banks and the Central Bank's control over foreign-currency transactions (even as some laws are relaxed) mean that the regime is well placed to control the value of the currency. The Central Bank's foreign-exchange reserves are relatively healthy, at US$4.9bn (around four months of import cover) at end-2009. (The Commercial Bank of Syria also holds some foreign reserves.)

EXTERNAL SECTOR: Data released for 2008 showed a better current-account outturn than was expected, and this has had a knock-on impact on our forecasts. We expect that export earnings will recover in 2010-11, to an average of US$13.4bn, below the oil-price-related peak of 2008. In recent years, drought has seriously constrained production and therefore exports of cotton and textiles. The drought has now eased but the 2009/10 wheat crop is expected to be disappointing, although Syria is not expected to need imports as it did in 2008/09. Oil production is increasing at a number of small fields but declining at the larger, mature fields, with the net effect that total production may pick up in the short term to an average of 384,000 barrels/day in 2010-11. The net impact of changes in oil prices on the trade balance is limited, because Syria's imports of refined products are about equal in value to its exports of crude oil. A domestic factor affecting the trade figures is the relaxation of foreign-exchange controls, which has led to more non-oil exports moving out of the black economy and being officially recorded. Overall, the trade deficit will widen slightly to an average of US$1.6bn in 2010-11, although as a proportion of GDP it will fall to an average of 2.8%.

(c) 2010 The Economist Intelligence Unit Limited