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## **Country Report**

# **Syria**

**September 2013**

Economist Intelligence Unit  
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"0 or 0.0" means nil or negligible; "n/a" means not available; "-" means not applicable

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# Highlights

Editor: **Robert Powell**

Forecast Closing Date: **September 19, 2013**

## Outlook for 2013-17

- The regime will battle for its survival against a deepening insurgency, on the one hand, and the risk of US-led air strikes (in retaliation for its alleged use of chemical weapons) on the other.
- Having lost control over large areas of territory and many of the country's oilfields, the presidency of Bashar al-Assad is expected to weaken and eventually be replaced. However, we do not expect this to occur until mid-2014.
- Even assuming Mr Assad's ouster, restoring stability will be a protracted and messy affair, reflecting the bitter divisions within the rebel groups, worsening sectarian frictions, and the massive economic damage wrought by the war.
- Although the prospect of US-led military intervention has receded, the military option would be revived in the likely event of major problems in implementing Syria's chemical weapons handover.
- The fiscal deficit will remain high in 2013, as tax revenue from businesses will be depressed owing to fighting between the regime and the opposition. The deficit is forecast to average 7.8% of GDP in 2013-17.
- We have adjusted lower our forecast for GDP in 2013, in light of the ongoing collapse in oil output and the acceleration in Syrian refugees leaving the country. The economy should recover from mid-2014 as the violence eases.
- We have revised higher our forecast for average inflation in 2013, to 59.1%, following the release of updated consumer price growth data. Inflation should fall in 2014, however, as security improves.
- The Syrian pound will depreciate in the remainder of 2013, owing to the collapse in export revenue. We now expect that a major devaluation of the pound will be necessary, but this will probably be delayed until 2014.

## Review

- A major diplomatic initiative led by Russia has overtaken plans for a US-led military intervention in Syria. Under the plan, the Syrian regime will place its chemical arsenal under full international control within a year.
- The prospect of a US attack came on the back of deaths of hundreds of people, many of them children, on August 21st as a result of a chemical weapons bombardment of several areas on the outskirts of Damascus.
- Mr Assad has reshuffled his cabinet, including creating a separate portfolio for internal trade and consumer protection. The appointment may reflect the government's concerns about shortages of goods and rising prices.
- Year-on-year inflation reached 61.3% in April, according to official data. Price growth will have accelerated since, as the exchange rate has depreciated, and the official price of petroleum products and electricity has been lifted.

# Outlook for 2013-17

## Political stability

The regime of the president, Bashar al-Assad, will continue to battle for its survival against a deepening insurgency, on the one hand, and the ongoing risk of US-led air strikes (in retaliation for its alleged use of chemical weapons) on the other. Prospects for the latter have faded in the near term following the regime's acceptance of a Russian proposal to place its chemical arsenal under international control. However, The Economist Intelligence Unit judges that the plan is likely to prove unworkable—reflecting, among other things, the difficulty of implementation amid a civil war, and the likelihood of regime obfuscation—and thus the US military option will be revived before long. Meanwhile, on the domestic front, a hotchpotch of rebel groups have secured a swathe of territory running from Idlib province in the north-west, along the northern border with Turkey, and down the eastern border with Iraq. In response, the regime has hunkered down in a corridor running between Damascus and the Alawi areas in the north-west (an area viewed as the regime's heartland). However, this has resulted in the de facto partition of the country and, ostensibly, a military stalemate. Nevertheless, with the rebels' numerical and military strength gradually growing, and the regime having lost control of most of the country's oilfields, we expect the president to be removed by mid-2014. The fallout from Syria's civil war is likely to be protracted and messy, however, particularly in light of the bitter divisions already evident between the rebel groups, worsening sectarian frictions, and the massive economic damage and population displacement wrought by the conflict.

With the civil war approaching a stalemate and threatening to draw in international intervention, diplomatic efforts have been stepped up, led by Russia and the US. This not only includes the hastily-drawn-up chemical disarmament proposal, but also long-stated plans for another peace conference in Geneva. However, the likelihood of a peace deal remains exceptionally low. Notably, the opposition Syrian National Coalition (SNC) has firmly rejected talks with the regime, and, in any case, the Assad regime has shown no sign of offering meaningful concessions. Instead, we continue to expect that a military resolution to the war will be required, with the SNC—and its military wing, the Free Syrian Army (FSA), headed by Salim Idris—likely to grow in strength owing to a build-up in the supply of military equipment from sympathetic states.

However, unifying the movement is proving a considerable challenge. The SNC's president, Moaz al-Khatib, resigned in March, and his replacement, Ahmed al-Jarba, was only narrowly elected ahead of a rival from the Muslim Brotherhood. Meanwhile, the rebels' military wings remain divided between more secular, grassroots groupings and the increasingly confident (and well-financed) militant Islamist factions. This split has become increasingly embittered lately, in light of the aggressiveness of the Islamic State of Iraq and al-Sham (ISIS)—composed of the Syrian and Iraqi wings of al-Qaida—which has sought to infiltrate areas held by other rebel forces. This has led to fierce fighting at times between the FSA and ISIS, as well as ISIS and Kurdish rebel groups. In response, the Iraqi Kurdistan president, Massoud Barzani, in August threatened to intervene to defend his fellow Kurds. The growing presence of ISIS and other jihadi groups will prove a growing headache for both the SNC and its foreign backers. In addition, it also complicates foreign governments' task of supplying the rebels, with most Western-supplied weapons now reportedly funnelled into the south of Syria, in order to keep them away from al-Qaida-aligned groups (which are largely concentrated in the north).

Meanwhile, despite recent territorial gains, the army has been weakened by defections, which has increased the regime's propensity to use irregular forces, including the shabiha militias and Hizbullah, a Lebanese Shia militia, to subdue areas. However, by resorting to more punitive measures against its own population (including, allegedly, a large chemical weapons attack on the Ghouta suburbs of Damascus on August 21st), the regime is merely strengthening the will of the rebels to prolong the fight, and thus, in turn, draining its own financial resources and further exhausting the army. As the props of the regime steadily weaken, towns and potentially entire regions will become in effect self-governing (a major stumbling block in reuniting the country once peace is restored). As a result, the SNC, or some future incarnation, will struggle to impose its authority once Mr Assad and his cohorts are removed, compelling the FSA to play a pivotal role in maintaining order in the immediate post-Assad era. This may well entail not only substantial foreign donor backing, but also potentially US military support in nullifying the al-Qaida threat.

## Election watch

Following a referendum on the new constitution in February 2012, a parliamentary election was held in May 2012, which led to a consolidation of power in the hands of the Baath party. The election was boycotted by the bulk of the opposition. Even though the new draft constitution does not contain Article 8, which stated that the Baath party was the leading force in the state and society, the president retains substantial powers. The constitution imposes a two-term limit on holders of the presidency but does not do so retrospectively, thereby theoretically allowing Mr Assad to remain in power until 2028. (The presidential term is seven years, and the next presidential and parliamentary elections are due in 2014 and 2016 respectively.) The reshuffle at the top of the Baath party in July appears part of the preliminary process of nominating Mr Assad as its candidate in the next presidential election, if his regime survives.

## International relations

Syria will continue to rely on Russia and China to veto any resolution authorising force or further sanctions against it at the UN Security Council. However, the potential for more forceful direct action has risen markedly since the chemical weapons attack on August 21st—now confirmed by a UN inspection team—which had threatened to prompt a US-led military intervention. Although this prospect has receded following Russia's diplomatic intervention, the military option remains on the table, and would be revived in the likely event of major problems in implementing Syria's chemical weapons handover. It could also potentially be triggered by an unforeseen Syrian regime provocation—such as another chemical weapons attack, or a crossborder incident (as occurred on September 17th, when Turkey shot down a Syrian military helicopter for violating Turkish airspace).

The approach of the Arab states will remain divided, with Qatar and, increasingly, Saudi Arabia (which backed the new SNC head during his candidature) continuing to supply weaponry to the opposition. However, Iraq's Shia-led government, which is wary of the Sunni-dominated SNC and the implications of the merger of al-Qaida's Iraqi and Syrian wings, will remain on the sidelines. The growing involvement of Hizbullah also threatens to prompt a spillover of the conflict over Syria's borders, with a number of attacks taking place against Assad allies in July. This leaves only Russia and Iran, as well as Hizbullah, as Mr Assad's allies.

## Policy trends

Both the current government and its successors will struggle to deal with the fallout from the country's civil war. Government income will continue to be diminished by the EU embargo on imports of Syrian oil and the loss of many of its oilfields, forcing it to rely heavily on financial support from Iran (including a US\$4bn credit line) and, to a lesser extent, Russia. With the country's balance-of-payments position deteriorating, the Central Bank of Syria will intervene in the market and deepen capital controls to manage the depreciation of the Syrian pound. After the war, a major economic reconstruction plan will be required. This will entail, among other things, ramping up capital spending, attracting international oil operators back to the country and aligning the official exchange rate with the black-market rate. This will no doubt require considerable donor support (as well as the lifting of the EU's embargo), with the oil-rich Gulf Arab states expected to be leaned on especially—assuming the SNC is victorious.

## Fiscal policy

The main sources of budget revenue have been badly affected by the civil war. Syria is no longer exporting oil, which prior to the war generated about 25% of total revenue, and customs receipts are down on the back of lower trade. Exacerbating the situation, the government is spending some US\$500m a month on fuel imports (financed by Iranian loans). The only main revenue source to have been sustained is the state's share of the income of Syria's two mobile-phone companies, both of which reported higher revenue in 2012. Although the government has been able to reduce its welfare spending outlays by in effect increasingly ceding responsibility to international donor agencies, we still forecast that the fiscal deficit will remain large in 2013, at 13.6% of GDP.

The deficit is forecast to narrow gradually over the remainder of the outlook period. Revenue should recover from mid-2014 onwards as economic activity revives slightly and oil production recovers. The government has been forced to scale back subsidies on gasoil and electricity in order to ease pressure on the public finances. In spite of this and the expected increase in foreign donor assistance after the end of the war, the huge cost of reconstruction and the shallowness of the banking sector could well mean post-war governments periodically turning to the Central Bank to monetise the deficit.

## Monetary policy

Domestic unrest has prompted occasional runs on the Syrian pound, causing the Central Bank to bring back restrictions on foreign-currency transactions and prompting a reshuffle in July in the Credit and Monetary Council, which is in charge of monetary policy and the financial sector). In June private-sector importers were obliged to secure licences for each transaction, and in August a decree was issued banning the use of foreign currency or precious metals for commercial transactions within Syria. However, such measures have been insufficient to prevent a substantial widening in the gap between the black-market and official rates—a factor that raises the likelihood of a major exchange-rate devaluation (although the current government appears unwilling to sanction such a move). After the war, it is highly likely that a major audit of all Syrian banks' operations will be required, delaying the resumption of regular banking activities.

## International assumptions

	2012	2013	2014	2015	2016	2017
<b>Economic growth (%)</b>						
US GDP	2.8	1.6	2.6	2.3	2.5	2.3
OECD GDP	1.6	1.1	2.1	2.2	2.2	2.2
World GDP	2.2	2.0	2.7	2.8	2.8	2.8
World trade	2.4	3.3	5.2	5.4	5.5	5.6
<b>Inflation indicators (% unless otherwise indicated)</b>						
US CPI	2.1	1.5	2.2	2.2	2.3	2.3
OECD CPI	2.2	1.6	2.1	2.2	2.3	2.1
Manufactures (measured in US\$)	-0.6	-3.6	-0.1	1.1	1.9	2.0
Oil (Brent; US\$/b)	112.0	108.7	104.8	107.3	103.8	97.5
Non-oil commodities (measured in US\$)	-10.7	-6.6	-1.0	-0.1	-1.5	3.1
<b>Financial variables</b>						
US\$ 3-month commercial paper rate (av; %)	0.2	0.1	0.2	0.3	1.2	2.2
US\$:€ (av)	1.29	1.31	1.27	1.26	1.26	1.27
¥:US\$ (av)	79.79	97.27	101.21	103.00	102.00	101.00

## Economic growth

We have adjusted our forecast for real GDP in 2013 once again, in light of the ongoing collapse in oil output and the acceleration in Syrian refugees leaving the country. Damage to the economy caused by the unrest and subsequent civil war has been broad-based, with rural incomes (and thus private consumption) hit by poor harvests, oil production depressed by sanctions and damage to fields, and domestic demand dampened by the continued fleeing of Syrian refugees to neighbouring countries. In an indication of the country's problems, the wheat harvest is expected to be only 2.4m tonnes, compared with an annual average of 4m tonnes over the past decade, while oil output is now down to just 20,000 barrels/day (b/d), compared with 380,000 b/d in 2010. Although natural gas output has remained relatively buoyant, an attack on a gas pipeline in August highlighted the sector's vulnerability.

With violence worsening, we now expect real GDP in 2013 to contract by 18%. Economic activity will be restrained as long as Mr Assad stays in power, and, even once he goes, uncertainty surrounding the transition will deter investment, at least initially. Business activity and investment will also remain affected by the uncertainty, although we expect oil output to recover relatively rapidly once a new administration is in place.

Private consumption should recover in 2014, but will grow only modestly over the remainder of the forecast period as civilians struggle to pay for basic goods in the face of high inflation and a continued decline in the Syrian pound. We forecast that growth will pick up in 2014-15 as violence on the ground eases, although with a less helpful base effect the pace of growth will slow in 2016. We forecast that growth will average 4.4% a year in 2014-17. We therefore expect that by 2017 the economy will still be substantially smaller in real terms than it was in 2011.

### Economic growth

%	2012 <sup>a</sup>	2013 <sup>b</sup>	2014 <sup>b</sup>	2015 <sup>b</sup>	2016 <sup>b</sup>	2017 <sup>b</sup>
GDP	-18.8	-18.0	4.2	6.2	3.6	3.8
Private consumption	-15.0	-14.0	5.9	6.0	3.2	3.5
Government consumption	-7.0	0.5	4.0	3.0	4.2	4.8
Gross fixed investment	-27.0	-14.5	6.0	7.0	7.6	8.0
Exports of goods & services	-29.0	-40.0	10.0	12.4	5.5	5.8
Imports of goods & services	-18.0	-10.0	11.0	7.0	6.5	7.4
Domestic demand	-16.2	-11.3	5.5	5.6	4.3	4.7
Agriculture	-21.0	-13.0	3.9	5.4	2.5	2.6
Industry	-32.8	-20.6	5.8	12.6	3.5	4.0
Services	-12.0	-19.0	5.1	5.1	3.8	4.0

<sup>a</sup> Economist Intelligence Unit estimates. <sup>b</sup> Economist Intelligence Unit forecasts.

## Inflation

We have revised higher our forecast for average inflation in 2013, to 59.1%, following the release of data showing that inflation averaged 55.6% in the first four months of the year. With further subsidy reductions implemented and shortages worsening (despite the introduction of ration cards), we expect inflation to increase further during the remainder of 2013. However, inflation is forecast to fall to 17.8% in 2014 as security improves and the rate of depreciation of the pound slows. With shortages easing and the currency stabilising, we expect inflation to slow further in 2015-16. However, assuming further subsidy reductions and a less helpful base effect, consumer price growth is forecast to rise once again in 2017.

## Exchange rates

The Syrian pound will continue to decline against the US dollar and other major currencies in 2013, owing to the collapse in export revenue, sanctions and a resultant shortage of foreign exchange. Reliable, updated information on the present level of foreign-exchange reserves is not available. Although the Central Bank in June and July authorised renewed sales of foreign exchange to banks and money changers to stabilise the market, we judge that Syria's foreign reserves are close to being exhausted—as demonstrated by the recent pick-up in the pace of depreciation of the official rate. The black-market rate has recovered recently, having plummeted to S£300:US\$1 at the start of July (compared with the official rate of S£105:US\$1), but the gap between it and the official rate remains extremely wide. As a result, a major readjustment of the official rate is becoming increasingly necessary (although this will probably not occur until after the war), and thus we are expecting a further marked depreciation of the official rate in 2014, to an average of S£163.6:US\$1. This should be sufficient, alongside recovering oil production, to eliminate much of the gap between the official and black-market rates. Subsequently, we expect the rate of depreciation to slow markedly, with the official rate averaging S£189.2:US\$1 in 2017.

## External sector

The current-account deficit is expected to remain extremely wide in 2013 as the near-halting of oil sales depresses export earnings. However, we forecast a relatively rapid rise in oil production from mid-2014 onwards, based on the assumption that the conflict on the ground will ease and sanctions will at least be partly lifted. (At present we are not counting any oil sales from areas under the control of the opposition.) Non-oil exports are also set to remain far below their 2010-11 levels, although earnings will recover slowly from 2015 onwards as business activity revives. However, the current-account deficit will remain sizeable as export earnings stay depressed.

In contrast, the non-merchandise account is likely to strengthen from 2014 onwards as rising current transfers inflows offset rising income debts (as profit repatriation by oil companies restarts). Nonetheless, we expect the current-account deficit to remain large, at an annual average of 11.5% of GDP in 2013-17.

## Forecast summary

### Forecast summary

(% unless otherwise indicated)

	2012 <sup>a</sup>	2013 <sup>b</sup>	2014 <sup>b</sup>	2015 <sup>b</sup>	2016 <sup>b</sup>	2017 <sup>b</sup>
Real GDP growth	-18.8	-18.0	4.2	6.2	3.6	3.8
Oil production ('000 b/d)	163.0 <sup>c</sup>	72.5	135.0	223.8	230.0	240.0
Gross agricultural production growth	-21.0	-13.0	3.9	5.4	2.5	2.6
Consumer price inflation (av)	36.9 <sup>c</sup>	59.1	17.8	14.2	11.7	12.7
Government balance (% of GDP)	-16.5	-13.6	-9.9	-6.0	-5.1	-4.4
Exports of goods fob (US\$ bn)	3.9	2.7	3.9	6.0	7.1	7.9
Imports of goods fob (US\$ bn)	10.8	8.9	9.8	11.1	12.2	13.2
Current-account balance (US\$ bn)	-6.7	-5.9	-5.0	-3.7	-3.3	-3.2
Current-account balance (% of GDP)	-15.0	-15.4	-16.8	-10.2	-7.9	-7.0
External debt (year-end; US\$ bn)	8.4	9.8	11.3	12.3	13.5	14.5
Exchange rate S£:US\$ (av)	64.4 <sup>c</sup>	105.3	163.6	173.4	182.8	189.2
Exchange rate S£:US\$ (end-period)	77.3 <sup>c</sup>	140.1	187.6	169.5	194.8	189.0
Exchange rate S£:¥100 (av)	80.7 <sup>c</sup>	108.3	161.7	168.3	179.2	187.4
Exchange rate S£:€ (av)	82.8 <sup>c</sup>	138.1	207.8	218.4	230.3	240.3

<sup>a</sup> Economist Intelligence Unit estimates. <sup>b</sup> Economist Intelligence Unit forecasts. <sup>c</sup> Actual.

# Data and charts

## Annual data and forecast

	2008 <sup>a</sup>	2009 <sup>a</sup>	2010 <sup>a</sup>	2011 <sup>b</sup>	2012 <sup>b</sup>	2013 <sup>c</sup>	2014 <sup>c</sup>
<b>GDP</b>							
Nominal GDP (US\$ m)	52,159	53,967	60,185	54,479	44,727	38,068	29,866
Nominal GDP (£ bn)	2,430	2,521	2,792	2,635	2,880	4,008	4,887
Real GDP growth (%)	4.5	6.0	3.2	-3.4	-18.8	-18.0	4.2
<b>Expenditure on GDP (% real change)</b>							
Private consumption	2.3	4.6	7.6	-3.0	-15.0	-14.0	5.9
Government consumption	-0.5	17.3	10.8	7.2	-7.0	0.5	4.0
Gross fixed investment	-5.9	11.5	13.6	-2.5	-27.0	-14.5	6.0
Exports of goods & services	-2.3	-19.0	11.2	-12.0	-29.0	-40.0	10.0
Imports of goods & services	7.6	-23.0	15.1	-3.2	-18.0	-10.0	11.0
<b>Origin of GDP (% real change)</b>							
Agriculture	-7.1	12.8	-9.6	0.0	-21.0	-13.0	3.9
Industry	2.1	3.7	7.8	-3.3	-32.8	-20.6	5.8
Services	10.2	5.4	5.6	-5.0	-12.0	-19.0	5.1
<b>Population and income</b>							
Population (m)	19.7	20.1	20.4	20.8 <sup>a</sup>	20.4	19.6	19.9
GDP per head (US\$ at PPP)	4,859 <sup>b</sup>	5,097 <sup>b</sup>	5,230 <sup>b</sup>	5,062	4,258	3,694	3,850
Recorded unemployment (av; %)	10.9	8.1	8.6	14.9	18.0	17.8	14.5
<b>Fiscal indicators (% of GDP)</b>							
Central government revenue	20.2	21.5	23.5 <sup>b</sup>	21.8	11.7	6.3	8.9
Central government expenditure	22.6	24.4	24.9 <sup>b</sup>	32.8	28.1	19.9	18.8
Central government balance	-2.4	-2.9	-1.4 <sup>b</sup>	-11.0	-16.5	-13.6	-9.9
Net public debt	22.0 <sup>b</sup>	23.9 <sup>b</sup>	22.7 <sup>b</sup>	35.4	52.4	58.9	70.8
<b>Prices and financial indicators</b>							
Exchange rate £:US\$ (end-period)	46.45	45.70	46.76	55.89 <sup>a</sup>	77.27 <sup>a</sup>	140.06	187.59
Consumer prices (av; % change)	15.7	2.6	4.4	4.8 <sup>a</sup>	36.9 <sup>a</sup>	59.1	17.8
Stock of money M1 (% change)	20.5	9.2	17.6	15.0	6.0	-12.5	10.0
Stock of money M2 (% change)	26.4	8.6	13.5	5.4	-2.6	-14.6	7.5
Lending interest rate (av; %)	10.0	10.0	10.0	10.5	11.7	10.5	10.0
<b>Current account (US\$ m)</b>							
Trade balance	-791	-3,064	-3,663	-7,310	-6,901	-6,242	-5,925
Goods: exports fob	15,334	10,884	12,273	10,288	3,876	2,675	3,899
Goods: imports fob	-16,125	-13,948	-15,936	-17,598	-10,777	-8,917	-9,824
Services balance	1,262	2,079	3,860	429	32	-456	-377
Income balance	-1,149	-1,107	-1,514	-1,682	-872	-501	-465
Current transfers balance	1,150	1,062	950	837	1,035	1,320	1,741
Current-account balance	472	-1,030	-367	-7,726	-6,706	-5,879	-5,026
<b>External debt (US\$ m)</b>							
Debt stock	7,155 <sup>b</sup>	7,323 <sup>b</sup>	7,442 <sup>b</sup>	8,269	8,394	9,796	11,264
Debt service paid	172 <sup>b</sup>	162 <sup>b</sup>	160 <sup>b</sup>	152	119	102	63
Principal repayments	117 <sup>b</sup>	110 <sup>b</sup>	108 <sup>b</sup>	102	91	78	45
Interest	55 <sup>b</sup>	51 <sup>b</sup>	52 <sup>b</sup>	50	27	24	18
<b>International reserves (US\$ m)</b>							
Total international reserves	17,100	17,436	19,519	14,833	4,774	1,887	2,143

<sup>a</sup> Actual. <sup>b</sup> Economist Intelligence Unit estimates. <sup>c</sup> Economist Intelligence Unit forecasts.

Source: Central Bank of Syria; IMF, International Financial Statistics; World Bank, Global Development Finance.

## Quarterly data

	2011	3 Qtr	4 Qtr	2012	2 Qtr	3 Qtr	4 Qtr	2013
	2 Qtr			1 Qtr				1 Qtr
<b>Prices</b>								
Consumer prices (2005=100)	144.6	146.9	157.0	180.6	192.8	207.5	233.5	253.2
Consumer prices (% change, year on year)	3.3	4.2	6.7	22.5	33.3	41.3	48.8	40.2
<b>Financial indicators</b>								
Exchange rate S£:US\$ (av)	47.5	47.8	51.4	58.2	62.6	65.8	71.0	81.1
<b>Sectoral trends</b>								
Crude oil production (m barrels/day)	0.37	0.32	0.22	0.17	0.16	0.16	0.16	0.11
Crude oil production (% change, year on year)	-2.6	-17.9	-43.6	-54.7	-56.8	-50.0	-27.3	-36.0
<b>Foreign trade (US\$ m)<sup>a</sup></b>								
Exports fob	4,821	4,461	2,631	2,579	3,209	2,922	2,470	2,500
Imports cif	6,463	6,990	6,426	4,513	4,856	4,325	4,186	3,564
Trade balance	-1,642	-2,528	-3,795	-1,934	-1,647	-1,403	-1,716	-1,064

<sup>a</sup> IMF, Direction of Trade Statistics estimates.

Sources: Central Bank of Syria; International Energy Agency, Oil Market Report; IMF, International Financial Statistics, Direction of Trade Statistics.

## Monthly data

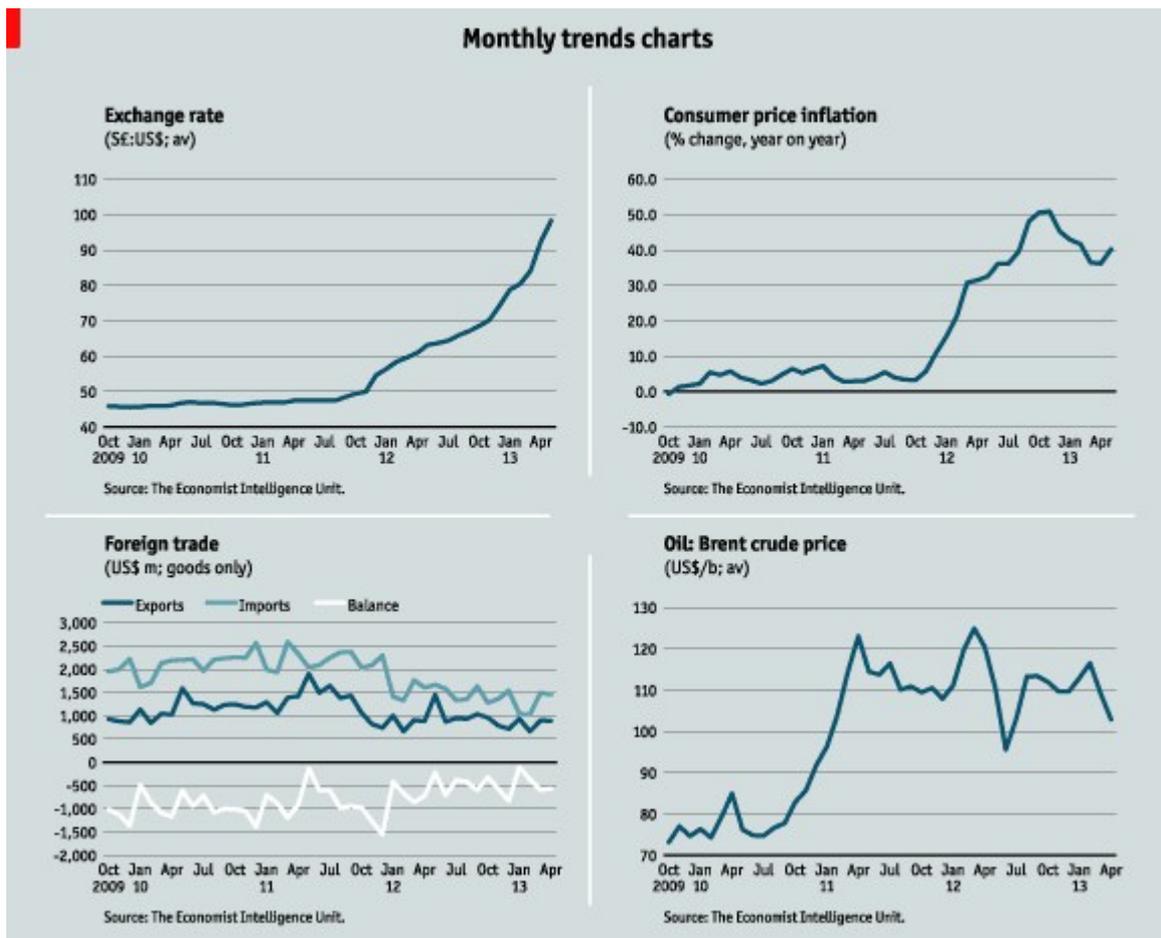
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<b>Exchange rate S£:US\$ (av)</b>												
2010	45.7	46.0	45.9	46.0	46.8	47.0	46.7	46.8	46.5	46.2	46.3	46.7
2011	46.9	46.9	46.9	47.5	47.5	47.5	47.5	47.5	48.5	49.4	50.0	54.7
2012	56.4	58.5	59.6	61.0	63.2	63.7	64.4	65.9	67.0	68.5	70.2	74.3
<b>M1 (% change, year on year)</b>												
2010	12.8	14.4	16.0	16.5	17.1	18.7	14.9	13.6	12.3	15.8	13.2	17.6
2011	13.9	13.1	15.9	15.5	12.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2012	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>M2 (% change, year on year)</b>												
2010	11.3	11.3	11.5	11.1	11.2	13.1	10.9	11.5	10.6	12.6	11.1	13.5
2011	12.2	11.5	10.5	8.9	8.0	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2012	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Consumer prices (av; % change, year on year)</b>												
2010	2.2	5.4	4.7	5.7	3.9	3.2	2.2	3.0	4.8	6.4	5.2	6.4
2011	7.2	4.3	2.8	2.9	3.0	4.0	5.5	3.9	3.4	3.3	5.8	11.0
2012	15.7	21.3	30.8	31.5	32.5	36.1	36.1	39.5	48.1	50.6	50.9	45.2
<b>Deposit rate (av; %)</b>												
2010	7.0	7.0	7.0	7.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
2011	6.0	6.0	6.0	6.0	7.0	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2012	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Lending rate (av; %)</b>												
2010	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
2011	10.0	10.0	10.0	10.0	10.0	n/a	n/a	n/a	n/a	n/a	n/a	n/a
2012	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Total exports fob (US\$ m)</b>												
2010	1,136	846	1,043	1,028	1,591	1,269	1,250	1,132	1,236	1,249	1,193	1,180
2011	1,292	1,060	1,392	1,421	1,904	1,495	1,645	1,382	1,434	1,067	822	742
2012	1,005	666	908	886	1,450	873	952	934	1,036	961	790	719
<b>Total imports cif (US\$ m)</b>												
2010	1,616	1,707	2,130	2,192	2,200	2,218	1,966	2,211	2,236	2,257	2,246	2,568
2011	1,993	1,937	2,587	2,333	2,037	2,093	2,249	2,364	2,378	2,040	2,089	2,296
2012	1,418	1,329	1,766	1,606	1,670	1,581	1,335	1,354	1,636	1,282	1,362	1,542
<b>Trade balance fob-cif (US\$ m)</b>												
2010	-480.8	-861.1	-1087.5	-1163.5	-609.4	-949.7	-715.5	-1078.6	-999.7	-1008.3	-1053.8	-1388.2
2011	-701.1	-877.0	-1194.4	-912.1	-132.9	-597.4	-603.6	-981.2	-943.6	-973.4	-1267.2	-1554.2
2012	-413.6	-663.1	-857.2	-720.0	-219.2	-707.4	-383.3	-420.5	-599.1	-321.1	-571.9	-823.4

Sources: Central Bank of Syria; IMF, International Financial Statistics, Direction of Trade Statistics; Haver Analytics.

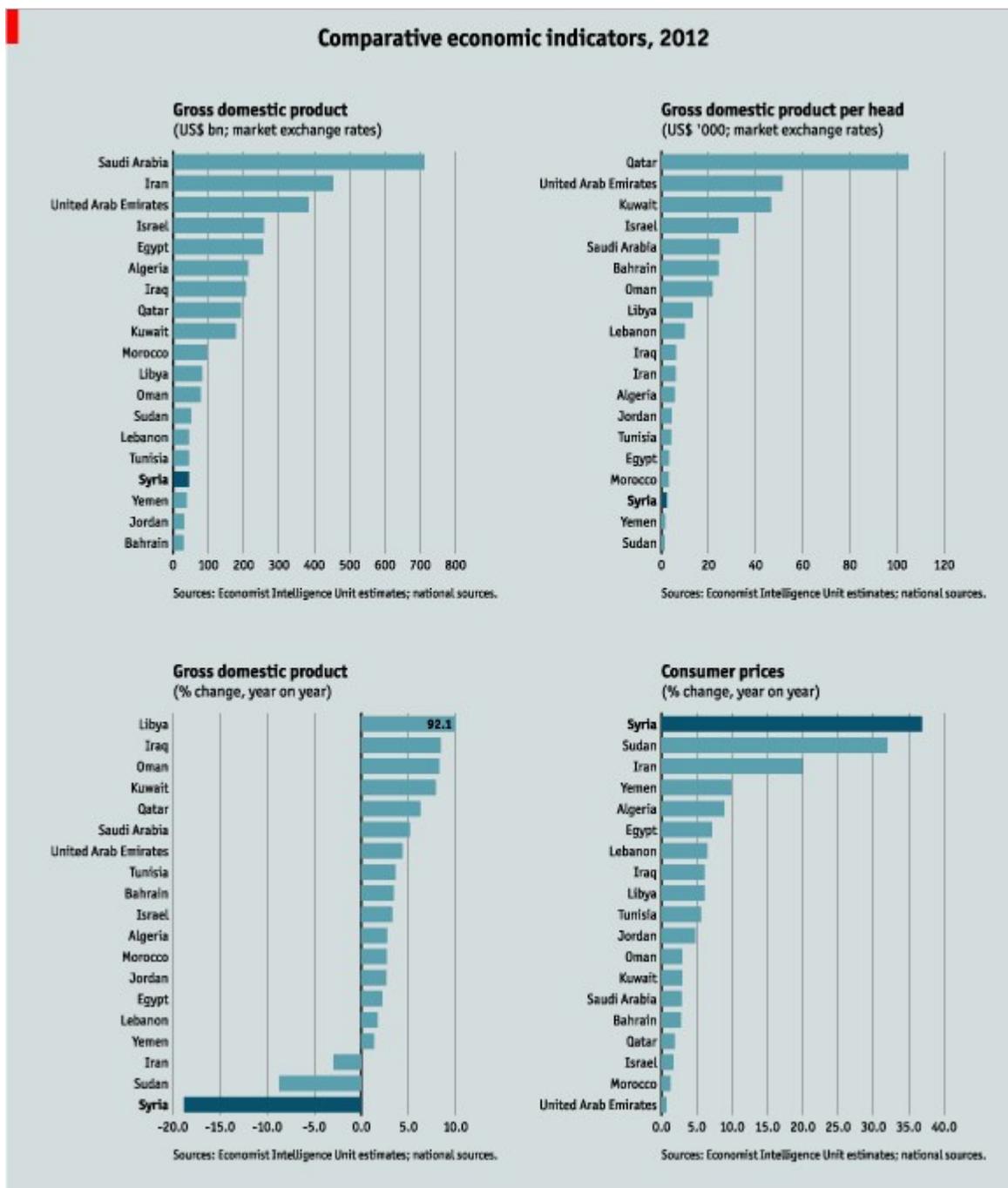
# Annual trends charts



# Monthly trends charts



# Comparative economic indicators



## Basic data

### Land area

185,180 sq km

### Population

22.9m (2010 estimate)

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## Main provinces

Population in millions, 2010

Damascus (capital) area: 4.48

Aleppo: 4.74

Homs: 1.76

Hama: 1.59

Hassakah: 1.47

Idlib: 1.46

## Climate

Subtropical on coast, arid in the centre, cold winters in the highlands

## Weather in Damascus

Hottest month, August, 18-37°C (average daily minimum and maximum); coldest month, January, 2-12°C; driest month, August, zero average rainfall; wettest month, January, 43 mm average rainfall

## Languages

Arabic, French, some English

## Religion

Sunni Muslim (72%); Alawi Muslim (14%); Christian (12%); Shia Muslim and Druze minorities

## Measures

Metric system

## Currency

Syrian pound (S£) = 100 piastres

## Time

GMT plus two hours

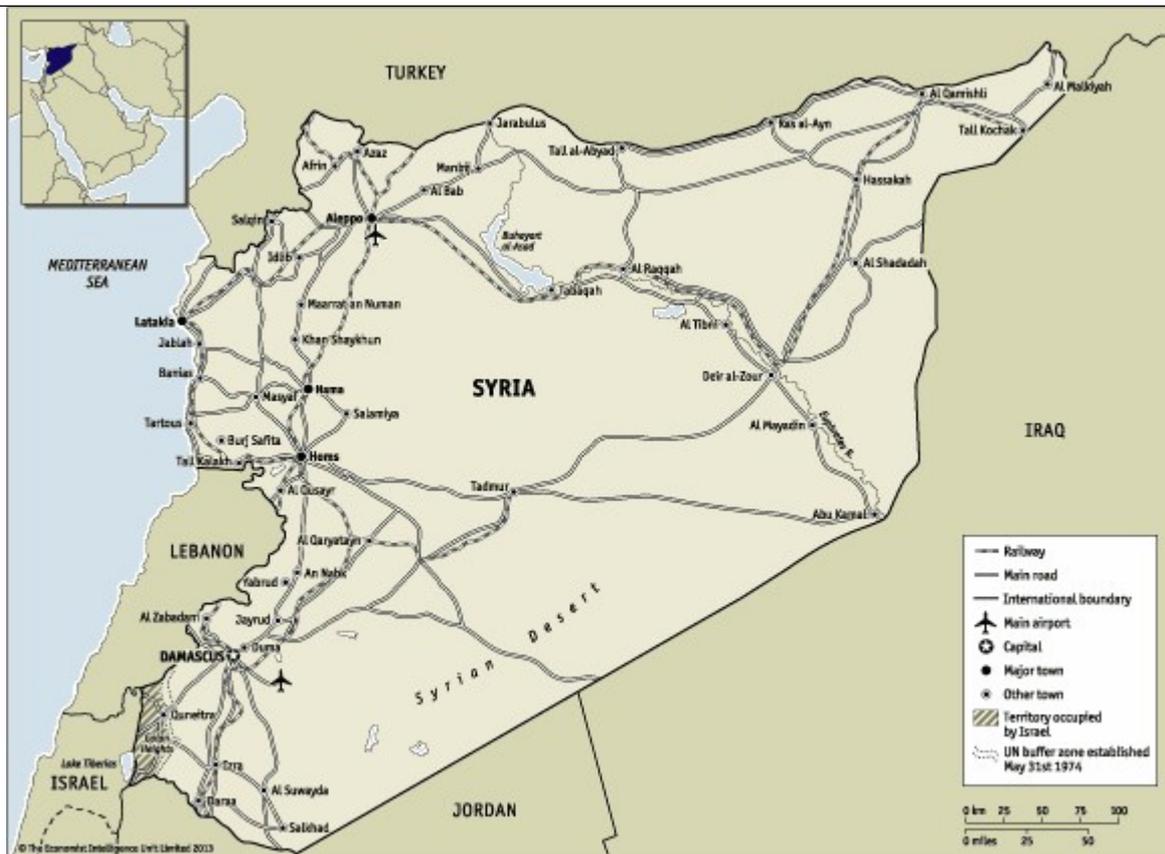
## Fiscal year

January 1st-December 31st

## Public holidays

The dates of Islamic holidays are based on the lunar calendar and are therefore approximate. Mawlid al-Nabi (the birthday of the Prophet, January 24th 2013); Eid al-Fitr (August 8th); Eid al-Adha (Feast of the Sacrifice, October 15th); Islamic New Year (November 4th)

New Year's Day (January 1st); Revolution Day (March 8th); Mother's Day (March 21st); Easter (March 31st); Orthodox Easter (May 5th); Independence Day (April 17th); Labour Day (May 1st); Martyrs' Day (May 6th); October Liberation War Day (October 6th); Christmas Day (December 25th)



## Political structure

### Official name

Syrian Arab Republic

### Form of state

Republic

### Legal system

Based on the constitution of 1973

### Legislature

250-member Majlis al-Shaab (People's Assembly) directly elected for a four-year term

### Electoral system

Universal adult suffrage

### National elections

Next presidential and legislative elections due in 2014 and 2016 respectively

### Head of state

President, elected for a seven-year term. The president appoints the vice-president, the prime minister and the Council of Ministers. Bashar al-Assad, the current president, is also the commander-in-chief of the armed forces and the secretary-general of the Baath party

### Executive

The prime minister heads the Council of Ministers, a large number of whom are drawn from the ruling Baath party and its partners

## **Main political parties**

The ruling National Progressive Front includes the Arab Socialist Baath Party; Arab Socialist Party; Arab Socialist Unionist Party; Communist parties; Syrian Arab Socialist Union Party; Unionist Socialist Democratic Party; Union Socialist Party

## **Key ministers**

Prime minister: Wael Nader al-Halqi

Deputy prime minister & defence: Fahad Jassim al-Frej

Deputy prime minister & foreign affairs: Walid al-Muallim

Deputy prime minister & local government: Omar Ibrahim Ghalawanji

Deputy prime minister & economic affairs: Qadri Jamil

Awqaf (Islamic endowments): Mohammed Abdel-Sattar al-Sayed

Communications & technology: Imad Abdel-Ghani Sabbouni

Culture: Lubana Mashouh

Economy & foreign trade: Mohammed Zafar Mahbak

Education: Hazwan Alos

Electricity: Imad Mohammed Deeb Khamis

Environment (minister of state): Nazira Sarkis

Finance: Mohammed al-Jleilati

Health: Said Abdel-Salam Nayef

Higher education: Malek Ali

Housing & construction: Safwan al-Assaf

Industry: Adnan Salakho

Information: Omar Zuabi

Interior: Mohammed Ibrahim al-Shaar

Internal trade & consumer protection: Samir Ezzat Qadri Amin

Irrigation: Bassam Hanna

Justice: Najim Hamad al-Ahmed

Labour & social affairs: Jasem Zakariya

Petroleum & mineral resources: Suleiman al-Abbas

Presidential affairs: Mansour Azzam

Tourism: Bishr Yazigi

Transport: Mohammed Ibrahim al-Said

## **Central Bank governor**

Adib al-Mayaleh

## **Head of State Planning Commission**

Amer Lufti

# Recent analysis

Generated on October 8th 2013

The following articles were published on our website in the period between our previous forecast and this one, and serve here as a review of the developments that shaped our outlook.

## Politics

### Forecast updates

#### August 2, 2013: International relations

### Syria signs US\$3.6bn oil-for-investment deal with Iran

#### Event

Iran has signed an agreement to provide a US\$3.6bn line of credit to cover supplies of oil and petroleum products to Syria, according to the official Syrian Arab News Agency (SANA).

#### Analysis

Few details have been provided about the deal, which is reported to have been signed during a late July visit to Tehran, the Iranian capital, by Adib al-Mayaleh, the governor of the Central Bank of Syria, and Suleiman al-Abbas, the oil minister. The SANA report noted that the credit would be repaid through Iranian investments in various sectors of the Syrian economy, which suggests some form of debt-to-equity swap is envisaged.

Mr Mayaleh announced in May that Iran was providing US\$7bn in financing to assist Syria in meeting its import needs, mostly for petroleum products. It is not clear whether the new credit line is part of this pledge. There has also been no information provided of the volumes and types of fuel to be supplied, or of the timing. According to a statement by Mr Abbas to parliament in May, Syria's crude oil production has dwindled to about 20,000 barrels/day, and the government requires about US\$500m a month to import most of its fuel requirements. Prior to the uprising against the Assad regime, Syria consumed about 16m tonnes/year of petroleum products, including about 7.5m tonnes of gasoil, 5m tonnes of fuel oil and 2.5m tonnes of petrol. About half of the gasoil was imported, while most of Syria's petrol and fuel oil needs were met from local production and refining. As a result of the conflict the government's fuel requirements have declined significantly, but the loss of oil output means that the import bill has increased. Assuming the figure of US\$500m is accurate, the government would be importing 6m-7m tonnes of fuel a year. Most of this is likely to be gasoil and petrol, supplemented by some crude oil that will be processed by the Baniyas refinery, which recently restarted operations after a revamp, according to the Ministry of Petroleum. The Homs refinery is barely functioning as it has limited access to crude oil.

#### Impact on the forecast

The credit line from Iran reinforces our forecast that the Syrian regime, in the face of the collapse in oil and tax revenue, will increasingly rely on financial assistance from its few remaining allies (namely Iran and, to a lesser extent, Russia).

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## August 6, 2013: Political stability

### Rebels advance into regime's heartland

#### Event

The Syrian rebels have announced the capture of an air base in Aleppo province and a number of villages in Latakia province.

#### Analysis

The latest rebel victories come after a string of regime gains in the west and north of the country, and a confident speech by the president, Bashar al-Assad, on August 1st in which he expressed that he was "confident of victory". In reality, however, the regime's advances were limited to areas viewed as being part of its heartland, namely those in a corridor running between Damascus and the Alawi areas in the northwest, and the regime had failed to advance into the rebel strongholds in the north and east of the country.

The rebels' capture of the Minakh air base in Aleppo province should also not be viewed as especially significant, given that it was deep in rebel-held territory. However, the tactics used to capture the base may cause some alarm among the Western and Arab backers of the rebel Free Syrian Army (FSA). In particular, according to press reports, FSA and al-Qaida soldiers (including a number of foreigners) fought together, and a large suicide bomb was deployed to break the base's defences.

Arguably of more significance for the outcome of the war, however, were reports that the rebels had taken a handful of rural villages in Latakia province—the bastion of the Assad regime and the location for the bulk of the country's Alawi community (to which the Assad family and many of the regime's leaders belong). Reports of a rebel offensive in the area had circulated for some time, but it was not known if it had been derailed after a bloody battle between a senior leader in the opposition Supreme Military Command (which includes the FSA), Kamal Hamami, and fighters linked to al-Qaida, in which Mr Hamami was killed. However, it appears that the various sides have managed to overcome their differences, and the opposition alliance, the Syrian National Coalition, lauded the success of the FSA in a statement (although it did not acknowledge the role of Islamist fighters, who it was reported provided the bulk of the forces).

#### Impact on the forecast

The latest advances by the rebels reinforce our forecast that the regime will eventually be toppled, albeit probably not until next year.

## August 9, 2013: International relations

### Russia rebuffs Saudi proposal to break with Assad

#### Event

The Russian government has reportedly turned down efforts by the Saudi intelligence chief, Bandar bin Sultan, to use lucrative arms purchases to persuade Russia to stop backing the Syrian president, Bashar al-Assad.

#### Analysis

Prince Bandar's meeting with the Russian president, Vladimir Putin, took place on July 31st, during which, according to the Reuters news agency, he promised to buy US\$15bn worth of Russian arms. As part of a quid pro quo, Prince Bandar suggested that the Russian government end its support for the Assad regime and, it was claimed, also drop its veto of repeated UN Security Council resolutions on Syria that could be used to threaten Mr Assad with Western-led military intervention. More improbably, reports also suggested that Prince Bandar pledged that Saudi Arabia would ensure that future Gulf gas deals would not undermine Russian gas sales in Europe—a promise that frankly Prince Bandar would be in no position to keep, given that Saudi Arabia's gas is consumed domestically, and Qatar is by a distance the Gulf's biggest gas exporter (and its ties with Saudi Arabia are tetchy).

Speaking to reporters on August 9th, Mr Putin's foreign policy adviser, Yuri Ushakov, stated that no specific talks on an arms agreement had taken place, although he failed to deny the broad outlines of the story. However, the Russian leadership's ambivalence appears to indicate a lack of interest in the proposal. Nonetheless, the visit seems in-keeping with the Saudi government's increasingly strident approach to Syria's war. Prince Bandar is reputed to have said that the upcoming planned Syrian peace conference, dubbed "Geneva 2", should be forgotten as the opposition will not be attending. As a result, he appeared to be suggesting to Mr Putin that, without an understanding on the terms he was seeking, the conflict will be resolved by military means alone. This argument at least seems plausible. The Saudi-backed new leader of the Syrian political opposition, Ahmed Al-Jarba, is claiming that he has been promised more advanced weaponry by Saudi Arabia, and, given the recent military gains by the rebels, this may now be happening.

#### Impact on the forecast

The visit to Russia by Prince Bandar reinforces our forecast that Saudi Arabia will maintain a proactive involvement in providing support to the Syrian opposition, including by supplying arms and finance.

## August 13, 2013: International relations

# Iraqi Kurdish president threatens to intervene in Syria

## Event

The president of Iraq's Kurdistan Regional Government (KRG), Massoud Barzani, has announced that he is assembling a team to investigate the reported killings of Kurdish civilians in Syria by Islamist militants.

## Analysis

Tensions between the Syrian rebels and Syria's Kurdish minority have risen markedly of late, as the Kurdish militias gradually carve out an autonomous region in the north-east of the country. This has brought the Kurdish groups increasingly into conflict with Islamist extremists, such as Jabhat al-Nusra, who stridently oppose the Kurds' secessionist tendencies and resent the backseat role taken by the Kurdish militias in the fight against the regime of Bashar al-Assad.

As far back as October 2012 there were reports of clashes between the opposition Free Syrian Army (FSA) and the Kurdish Democratic Union (PYD, which is affiliated to Turkey's Kurdistan Workers' Party) in northern Aleppo. However, the recent heightening of tensions was prompted by the PYD's ejection of jihadists from Ras al-Ain on the Turkish border in July. In reprisal, several hundred Kurds have reportedly been taken hostage by jihadi groups.

The escalating situation seems to have prompted Mr Barzani's intervention. The KRG president has in the past admitted that the Syrian rebels have received training from the *peshmerga* (the military forces of the KRG), although he has distanced himself from the PYD. However, on August 10th, citing the killing of Kurdish civilians in Syria by "al-Qaida terrorists", Mr Barzani pledged to "make use of all of its [the KRG's] capabilities to defend ... innocent citizens".

Should he dispatch *peshmerga* units to Syria, it will further internationalise the conflict. The prospect of a greater Kurdistan, incorporating both Iraqi and Syrian Kurds (and potentially some of Syria's oilfields), would call into question the substantial improvement in relations that the KRG has enjoyed with Turkey in recent years, and could also mean *peshmerga* forces coming into conflict with Saudi- and Qatari-armed Syrian rebel groups. As a result, international pressure will probably be applied on Mr Barzani to row back from his comments, or to at least to avoid co-operating with the PYD (whose affiliate, the PKK, is listed as a terrorist organisation by Turkey, the US and EU).

## Impact on the forecast

Mr Barzani's comments reinforce our forecast that, once the Syrian civil war is over, reuniting the country will prove a major challenge, especially with regard to areas that have fallen under the sway of Kurdish groups.

## August 21, 2013: Political stability

# Hundreds reported killed in chemical weapons attack

### Event

Hundreds of people, many of them children, were killed on August 21st as a result of chemical weapons bombardments of several areas on the outskirts of Damascus, according to opposition accounts.

### Analysis

Reuters quoted a nurse at a medical facility in Douma, to the north-east of the capital, as saying that the death toll in this area had reached 213. Attacks were also reported in other areas to the south-west of Damascus. The opposition Syrian National Coalition said that more than 650 people had been killed as a result of the chemical weapons attacks. The official Syrian Arab News Agency said that the reports were baseless, and were an attempt by rebels to divert a visiting UN chemical weapons inspection team from "doing its duties". The team was preparing to inspect three sites, approved by the government, where chemical weapons incidents have been reported in recent months. The team's mandate is restricted to verifying whether chemical weapons have been used; it does not extend to certifying which party used them.

Reports from opposition sources indicated that the victims of the attacks had died of suffocation, and many had foam around their mouths. The attacks took place in the small hours of the morning. Some reports indicated that many people in the areas under attack took refuge in basements, assuming that they were being hit by artillery bombardments, which had the effect of amplifying the attack because of the confined space.

If the opposition reports are correct, it raises the question of why the regime should decide to launch a chemical attack on this scale within 48 hours of the arrival in Damascus of the UN inspection team. One possible explanation is that the attack will make it difficult for the mission to accomplish its task. The government had approved a visit to Khan alAssal, outside Aleppo, where the regime claims that rebels used chemical weapons, as well as to two other undisclosed locations. There have now been calls from the opposition and its supporters in the West and the Arab world for the mission to inspect the sites of the most recent incidents. However, the regime of Bashar alAssad and its supporters in the UN are most unlikely to approve this. If the team goes ahead with its agreed programme in such circumstances its credibility risks being fatally undermined.

### Impact on the forecast

The most recent attack reinforces our view that the Assad regime will take advantage of international deliberations over the crisis in Syria to try to crush opposition groups.

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## August 27, 2013: Political stability

### Assad adjusts his cabinet

#### Event

Syria's president, Bashar al-Assad, has made several changes to his cabinet.

#### Analysis

On August 22nd the president issued a decree setting out changes to the government, focused on strengthening the management of economic policy. The ministreshuffle included creating a separate portfolio for internal trade and consumer protection, which had previously been under the control of Qadri Jamil, the deputy prime minister for economic affairs. The appointment may reflect the government's concerns about shortages of goods in the marketplace and about rising prices. The new minister is Samir Ezzat Qadri Amin. The section of the decree providing biographical details of new ministers listed his experience in the Damascus governorate's housing office.

Other new appointees include Khodr Orfali as economy and foreign trade minister, replacing Mohammed Zafar Mahbak. Mr Orfali was a professor at Aleppo University, and obtained his doctorate in the former Soviet Union. Mr Assad also appointed Kamaleddin Toameh, a former head of a statelowned chemicals corporation, as the new industry minister, and Malek Ali, an academic and recent appointee to the regional command of the Baath party, as higher education minister. The reshuffle also included the appointment of Bishr Yazigi as tourism minister, and Hussein Shammaas as a minister of state. The prospect of Western military intervention in Syria will hang over the country, meaning the adjustments to the cabinet will have little impact in the near term.

#### Impact on the forecast

We are unlikely to change our economic forecast as a result of the changes to the cabinet as we believe that much of the damage to Syria's economy, caused by the civil war, is beyond the government's ability to redress. We will incorporate the reshuffle into our analysis.

## August 29, 2013: International relations

### Hizbullah considers response to an attack on Syria

#### Event

With a US and allied military strike on targets of the regime of the Syrian president, Bashar al-Assad, appearing likely by the end of August, a Hizbullah member of parliament has said that the Shia militia would "deal seriously" with an attack on its main ally.

#### Analysis

Hizbullah forces have actively participated in the Syrian civil war on behalf of the Assad regime, but the group has little ability to deter cruise missile strikes launched from US warships in the Mediterranean Sea.

The clearest form of reprisal Hizbullah could take would be to launch its own missiles against targets in Israel, the US's main regional ally. Israel's armed forces have mobilised reserve forces and moved an anti-missile defence system, Iron Dome, to the northern regions of the country. A Hizbullah attack on Israel could do substantial damage to the country, but would mean that the Shia group was risking serious return damage, as the US and its allies would be unlikely to hold Israel back from retaliating. Hizbullah did manage to resist and fend off an Israeli assault in 2006, but at that time its main ally was not engaged in a life-or-death conflict against rebel groups nor facing the prospect of Western bombardment.

If a Western assault on Syria was of limited scope and specifically targeted positions or units associated with the suspected use of chemical weapons, Hizbullah may respond only in a limited fashion, perhaps by sending further forces against Syrian rebels. The group's leaders would be well aware that the involvement of the Israeli military against it at a time when being resupplied is a challenge would weaken it sharply. Hizbullah has extended its influence over domestic politics since 2011 (when its cabinet members resigned, prompting the collapse of the Lebanese government and beginning over two years of political uncertainty) and if it were severely weakened militarily in a clash with Israel, its opponents in Lebanon might seek to press their advantage and reduce the group's presence in state institutions (such as internal security services).

There is a risk, however, that Hizbullah's leaders may decide that the destruction of the Assad regime may mean that there is nothing left to lose and retaliate by launching large-scale missile attacks against Israel, although this is not part of our central scenario.

#### Impact on the forecast

At present we maintain our forecast that Lebanon will experience political violence across the country. Should the US and its allies engage in a sustained campaign against the Assad regime, we would alter our forecast to take into account much greater political disarray in Lebanon, with negative consequences for economic performance as well.

## September 2, 2013: International relations

### UAE backs international action on Syria

#### Event

The UAE is politically backing international action against Syria but is likely to keep a low profile in any military campaign.

#### Analysis

At the Arab League meeting this weekend in Cairo the UAE backed Saudi Arabia in urging an international response to the alleged use of chemical weapons in Syria. The meeting passed a resolution calling for "international action" to "deter the ugly crime of using chemical weapons". There were disagreements, though, with Egypt speaking against foreign military intervention. In the end, Egypt did not vote against the resolution, presumably because it did not explicitly mention military action. Egypt may also have been mindful that it would have been voting against its main financial supporters since the military ousting of former president, Mohammed Morsi.

Despite supporting action against Syria, the UAE is keen to maintain a low profile over the issue, and the UAE's role in the Arab League meeting was almost entirely absent from the English-language Emirati press. This low profile is in keeping with the UAE's approach to regionally controversial issues that it does not feel a direct exposure to. However, it is in marked contrast to the UAE's participation in air strikes against the Qadhafi regime in Libya in 2011. In that case the West appeared clear and confident in its objectives and the UAE was not really taking a risk with its involvement either militarily or in terms of jeopardising alliances. In the case of Syria, though, the conflict is dividing Arab state and popular opinion. Moreover, the West is also divided on how to respond. The UAE is also keen to rebuild stronger ties with Egypt after a deterioration in relations during the Muslim Brotherhood's political ascendancy following the Arab Spring and the removal of the former president, Hosni Mubarak.

#### Impact on the forecast

The UAE will lend support for the position of Saudi Arabia on Syria but will aim to keep apart from a controversial conflict. This does not affect our forecast, and we expect that the UAE will continue to strengthen bilateral relations with Egypt.

## September 2, 2013: Political stability

### Assad boosted by Western hesitation

#### Event

The decision of the US president, Barack Obama, to seek congressional authorisation for the use of force against Syria has given Syrian forces more time to make preparations for a possible attack.

#### Analysis

Mr Obama announced on August 31st that the military forces required to carry out an operation in response to Syria's alleged use of chemical weapons against its own population were in place, but that he would seek approval from Congress before giving the orders for the attack to start. Congress will remain in summer recess until September 9th. In the meantime, Mr Obama is scheduled to travel to St Petersburg on September 4th to take part in a G20 summit hosted by the Russian president, Vladimir Putin, who is firmly opposed to any attack on Syria and whose government has dismissed as not credible the evidence presented by the US that the Assad regime was responsible for an August 21st chemical weapons attack on several outlying areas of Damascus.

Mr Obama was not required to secure clearance from Congress, but his decision appears to have been influenced both by his own reservations about intervening in the Syrian conflict and by the failure of the UK government to secure parliamentary approval for the involvement of British forces in any such operation. The French government has indicated that it is committed to taking part in any operation in response to the Assad regime's use of chemical weapons. The president, François Hollande, has called for a parliamentary debate on the issue, but as yet has not opted to put it to a vote.

Prior to Mr Obama's announcement it had appeared that an attack was imminent, and there were widespread reports from Damascus of potential targets such as barracks and missile bases being evacuated, and of soldiers and equipment being moved to schools and universities. The delay in any attack will give the regime more time to work on its defences. Mr Assad can also take heart from the apparent political weakness of the Western governments that have lent support to opponents of his regime.

#### Impact on the forecast

Our forecast will be revised in line with the outcome of the US vote.

## September 9, 2013: International relations

# Iran reportedly threatens reprisals for a US strike on Syria

### Event

According to a report in a US newspaper, *The Wall Street Journal*, Iran is threatening retaliation against US interests in Iraq in the event that the US attacks Syria (Iran's closest state ally in the region).

### Analysis

*The Wall Street Journal* cited unnamed US intelligence sources, who revealed that they had intercepted the instruction from Iran's Quds Force—an elite unit within the Islamic Revolutionary Guards Corps. Although the target of the attack was not revealed, a US official was quoted on CNN, a US news channel, as saying that Iran might target the embassy in Baghdad. As far back as August 28th Iran's supreme leader, Ayatollah Ali Khamenei, had warned of "dire consequences" if the US launched a strike on Syria.

Prior to its withdrawal from Iraq in 2011, the US had repeatedly blamed Iran for arming and financing militias within Iraq—many of which were responsible for attacking US military units, especially in the south of the country. As a result, the US and Iraqi governments will no doubt be taking the news of potential Iranian intervention seriously. These concerns will only have been heightened by a subsequent report from AP, which quoted the head of an Iranian-backed militia, the Mukhtar Army, saying that hundreds of targets were under consideration (including companies "associated with the Americans").

Aside from Iraq, there are also concerns that Lebanon could be dragged into the conflict, with Hizbullah (a Shia group that is backed by both Iran and Syria) the most likely candidate to conduct reprisals against the US and its allies (notably Israel). Probably with this in mind, on September 6th it was announced that all "nonessential" US diplomatic staff would be withdrawn from Lebanon.

However, despite the concerns, current fears appear overblown. Iran's foreign minister, Mohammed Javad Zarif, denied the US press reports, and some leading Iranian officials (including Akbar Hashemi Rafsanjani, a former president and the current head of the Expediency Council) have even begun to question Iran's firm backing for the Syrian regime led by Bashar al-Assad. In addition, Iran is likely to be cautious about provoking the US (or Israel), out of fear of potential major reprisals. Finally, it is worth noting that a US attack is not inevitable, in light of the considerable opposition within the US Congress and the public towards such action.

### Impact on the forecast

Despite the latest threats, we continue to believe that a major regional escalation following a US strike on Syria is unlikely.

## September 9, 2013: International relations

### Syria to put chemical weapons under international control?

#### Event

The Syrian foreign minister has "welcomed" a Russian plan to put the regime's chemical weapons under international control, casting doubt on a US plan to launch air strikes on the country.

#### Analysis

The president, Barack Obama, unexpectedly announced on August 31st that he would seek authorisation from Congress for the use of force against Syria in response to the alleged chemical weapons attacks against its own population, despite insisting that his administration did not need Congressional approval for a short, targeted strike. This gamble looked set to fail as the White House appeared unable to garner sufficient votes as a strong libertarian and anti-interventionist wing of Republicans joined with anti-war Democrats to oppose military action. The implications of such a loss would be significant for Mr Obama, weakening his bargaining power on the international stage. It would have fewer implications domestically where he already faces a stiff challenge trying to pass legislation through the Republican majority in the House of Representatives.

However, on September 9th the Syrian foreign minister, Walid al-Muallim, "welcomed" a proposal from the Russian foreign minister, Sergey Lavrov, that Syria place its chemical weapons under international control—handing Mr Obama a chance to avoid a vote that he was increasingly likely to lose. This followed an apparently offhand comment from the US secretary of state, John Kerry, that Syria could avoid a US attack if it handed over its chemical weapons. While the initial US response to Mr Muallim's comments was cautious—a government official said it would take a "hard look"—the likelihood of a US attack appears to have fallen. If Mr Obama decides that this is a delaying tactic from Syria and seeks congressional approval for military action, it will prove even more difficult to get the required votes as a possible non-military solution is available. More likely is that the US will explore the diplomatic route offered, possibly supporting a plan to bring in international inspectors. If the move by Syria turns out to be a ploy and it refuses to give international inspectors free and unfettered access, US air strikes could be back in consideration within weeks or months. This could give the administration more time to provide evidence of the regime's alleged chemical weapons use, as well as allowing it to portray itself as having exhausted all diplomatic options; however, by leaving the issue to fester, the administration would be in danger of losing momentum for action.

#### Impact on the forecast

We will change our forecast to reduce the likelihood that the US will begin air strikes, although this is subject to change as details of the Syrian government's commitment to this new stance emerge in the coming days.

## September 12, 2013: Political stability

# Free Syrian Army rejects chemical weapons deal

### Event

Leading figures in Syria's opposition have rejected the diplomatic deal designed to put Syria's chemical weapons arsenal beyond use.

### Analysis

The chemical weapons handover, proposed by Russia on September 9th, has continued to gain diplomatic traction, with, most conspicuously, the Syrian president, Bashar al-Assad, appearing on a Russian television station, Rossiya 24, on September 12th voicing his support for the plan. Meanwhile, despite widespread scepticism about the workability of a disarmament programme in the midst of a civil war, an unnamed US State Department official, travelling to a meeting in Geneva, Switzerland, involving the US secretary of state, John Kerry, and his Russian counterpart, Sergei Lavrov, described the proposal as "doable but difficult".

However, less encouragingly, senior elements within the Syrian opposition have rejected the scheme, with the head of the rebel Free Syrian Army (FSA), Salim Idriss (who has close ties to Saudi Arabia and the US), announcing that the FSA "categorically rejects the Russian initiative". Other statements from senior FSA commanders were even more outspoken, with the head of the Aleppo Military Council, quoted as saying that the deal "would serve Israel, not the Syrian people"—referring to the long-held assessment that Syria's chemical weapons are a strategic deterrent amassed in response to Israel's clandestine nuclear programme. Intriguingly, however, thus far the political arm of the opposition, the Syrian National Coalition, has remained largely quiet about the plan.

Although not a show stopper, the denunciation of the Russian plan by the Syrian opposition could have serious practical implications in the longer term. Assuming UN technical teams are eventually sent to Syria to enforce the plan, they will require a measure of security to conduct their work—an impossibility if the rebels are unwilling to agree to a ceasefire. Similarly, the rejection of the proposal by the opposition could potentially be used as a justification by the Assad regime not to cooperate with the UN inspectors. Mr Assad has repeatedly blamed the rebels for the chemical attack on August 21st in the Ghouta suburbs of Damascus (which prompted the US threat of force), and, as such, his cooperation may be dependent upon the rebels also joining the disarmament process.

### Impact on the forecast

Despite the general positivity of the US and Russia towards the chemical weapons handover plan, the rejection of the initiative by the FSA reinforces our assessment that the proposal will prove unworkable and that the US military option will therefore eventually return to the table.

## September 16, 2013: International relations

# US-Russian deal sets tight deadlines for chemical weapons

### Event

On September 14th the US and Russia announced the framework of an agreement aimed at removing or destroying Syria's entire stock of chemicals weapons and related equipment and materials by end-June 2014.

### Analysis

The deal comes after Syria lodged a formal application with the Organisation for the Prohibition of Chemical Weapons (OPCW), an autonomous body based in The Hague with a working relationship with the UN, to join the Chemical Weapons Convention (CWC). According to the US-Russian agreement, Syria has committed itself to applying the provisions of the Convention before it has formally come into force, owing to "the extraordinary character of the situation with the Syrian chemical weapons"—a reference to the international crisis prompted by the death of hundreds of civilians on the outskirts of Damascus after a heavy bombardment by chemical weapons. The first step will be the provision by Syria within one week of a comprehensive list of its chemical weapons stocks and agents and of their location. By the end of October an OPCW inspection team should have visited all declared chemical weapons sites and destroyed all mixing and filling equipment. The destruction or removal of all chemical weapons should be accomplished by mid-2014.

The agreement states that the US and Russia agree that the implementation of Syria's commitments under the CWC should be monitored and reviewed according to the provisions of the UN Security Council, and that "in the event of non-compliance ... the UN Security Council should impose measures under Chapter VII of the UN Charter". This leaves the door open for the eventual use of force against Syria if it fails to comply. However, Russia has already objected to suggestions that the initial resolution should be placed under Chapter VII, arguing that this should only happen later in the event of Syrian obstructionism.

The deal has spared the regime of Bashar al-Assad from the threat of being hit by US air strikes, and enabled his forces to focus once more on prosecuting the war. However, Mr Assad does have cause for concern. By agreeing to relinquish Syria's chemical weapons arsenal, Mr Assad has made a major strategic concession. It is not clear whether there was any significant dissent within the core of the regime about this step. Moreover, the prospect of Russia—and, potentially, Iran—co-operating with the US in efforts to resolve the Syrian crisis means that he may no longer be able to count on the divisions between the major international powers helping to ensure the survival of his regime.

### Impact on the forecast

Despite agreement between the US and Russia, we continue to assess that the deal will prove unworkable.

## September 17, 2013: International relations

# Downing of Syrian helicopter will keep tension high

### Event

On September 16th, Turkish Air Force jets shot down a Syrian military helicopter for violating Turkish airspace. Tension between the two countries remains high despite the halting of planned international military action against the regime of the Syrian president, Bashar al-Assad.

### Analysis

Although Turkey's shooting down of a Syrian helicopter is unlikely to prompt a military response or a significant worsening of the already awful relations between the two countries, it highlights the continuing volatility along the 900-km border between the two countries.

Syria has accused Turkey of acting hastily and trying to ratchet up tension; Turkish officials have made it clear that they see it as a perfectly legitimate protection of the country's borders. Turkey's deputy prime minister, Bulent Arinc, noted that the helicopter had been warned repeatedly before being fired on, and the minister of foreign affairs, Ahmet Davutoglu, pointed to the deterrent effect on any possible further crossborder incursions.

The downing of the helicopter follows a change in the rules of engagement announced by the Turkish government after Syrian forces shot down a Turkish jet in June 2012. Under these rules, Turkey said that it could fire on any Syrian forces approaching the border. Syria has acknowledged that its helicopter was in Turkish airspace while tracking rebels, but claims that it had mistakenly crossed the border and was shot down while returning to Syrian airspace.

The border between Turkey and Syria has increasingly posed a threat to Turkish security. Turkey now hosts an estimated 500,000 Syrian refugees as well as the opposition Syrian National Coalition. Many supplies to Syria's rebels are routed through Turkish territory. In May 2013 the Turkish government accused Syrian intelligence of involvement in a car bomb attack in the Turkish border town of Reyhanli, in which over 50 people died. The Turkish military regularly engages large groups of Syrian smugglers and has repeatedly responded to stray gunfire from the Syrian side of the border.

The conflict in Syria has become a major political headache for the Turkish government. Its fierce hostility to Mr Assad and its call for military action against him have frequently left Turkey isolated internationally. It appeared for a while that international intervention would take place following Mr Assad's alleged use of chemical weapons on August 21st. However, those plans have been put on hold since September 14th, when the US and Russia, one of Mr Assad's closest allies, announced a framework agreement designed to remove or destroy Syria's entire stock of chemical weapons.

### Impact on the forecast

Although we maintain our view that both Turkey and Syria will seek to avoid major military confrontation, the downing of the helicopter has increased the risk of retaliatory attacks against Turkish interests.

## September 17, 2013: International relations

### UN inspectors confirm chemical weapons usage

#### Event

A UN inspection team has reported that it has found "clear and convincing evidence" that a poison, sarin, was used in an attack in the Ghouta suburbs of Damascus on August 21st.

#### Analysis

The release of the inspectors' report on September 16th was seized upon by the US, France and the UK. They have argued that a resolution being drawn up at the UN Security Council outlining a plan for Syria's surrender of its chemical weapons should be incorporated under Chapter VII of the UN charter—in effect giving the resolution military backing to ensure its enforcement. However, China and, in particular, Russia have refused to countenance such a move, arguing that the threat of force should be reserved for a later date, in the event that Syria fails to comply with the resolution.

Although the UN inspection team was restricted from apportioning blame, the report included the trajectory of the missiles used and the nature of the munitions. The report commented that the missiles had come from the north-west of the suburbs—an area that is not only under regime control, but also is the location of a government military base. Similarly, it included pictures of the projectiles (which in one case appeared to have Russian letters inscribed on its casing). Television footage has shown these being fired by Syrian government forces during the war, but there is no evidence that these missiles have ever been used by the rebels (or that the rebels have the equipment needed to fire them).

However, although the US, UK and France said the evidence implicating the Syrian government was overwhelming, Russia has remained reticent, with its foreign minister, Sergei Lavrov, instead maintaining that the chemical attack may have been a rebel "provocation". As a result, the resolution, if it goes ahead, is unlikely to be included under Chapter VII, as such a move would be vetoed by Russia and/or China. However, the UN report may have a bigger impact in the US and the EU, where the public has largely been opposed to any sort of military intervention in Syria. With the UN confirming chemical weapons use, and the secretary-general, Ban Ki-moon, describing the attack as a "war crime", the US administration and its allies' should at least have an easier time persuading their skeptical publics that the Syrian regime is indeed using chemical weapons.

#### Impact on the forecast

The inspectors' report will have little bearing on our forecast that the likelihood of a US-led attack on Syria has receded in the near term, but it could become a key justification for any future military intervention in Syria.

## Analysis

August 23, 2013

### Chemical attack pushes West towards intervention

**The reported death of more than 1,000 people on the outskirts of the Syrian capital, Damascus, as a result of bombardments by missiles filled with toxic chemicals has put the issue of whether the West should intervene militarily in the Syrian conflict back on the political agenda. In response, the US president, Barack Obama, and other Western leaders have indicated that there should be resolute action taken against those found to be responsible. One of the difficulties that they face, however, is in proving conclusively that the regime of Bashar al-Assad was responsible. Others include the considerable political opposition within the US and Europe to any form of military intervention, and the operational challenges of any such intervention.**

The attack on August 21st came only two days after the arrival in Damascus of a team of UN inspectors who were preparing to visit three sites where previous suspected chemical weapons incidents had been reported. The agreement on the terms of the UN inspection had taken several months to conclude. The mission had been cleared by the Syrian government to visit Khan al-Assal, near Aleppo, where one of the first chemical incidents had been reported in March (and blamed by the government on rebels), as well as two other undisclosed sites. The inspectors would not be permitted to enter areas where the Syrian army was conducting operations, and its mandate would be restricted to certifying if chemical agents had been used and identifying what type of chemicals were involved; it

would not be authorised to state which party might have used them.

## Assad regime points finger at the rebels

The Assad regime has claimed that the chemical attacks in rebel-held areas surrounding Damascus had been carried out by the rebel groups themselves, with the intention of disrupting the work of the UN inspectors and undermining efforts to conclude a peace conference in Geneva—a view endorsed in several statements by Russian officials, including Aleksandr Lukashевич, a spokesman for the Russian Ministry of Foreign Affairs. Such claims carry little credibility, given the weight of evidence provided from people in the areas attacked, but they do serve the purpose of slowing down the processes of international diplomacy. As long as Russia continues to insist that there is room for reasonable doubt about the Assad regime's culpability, the UN Security Council is obliged to maintain a degree of circumspection. The council's statement issued on August 21st expressed serious concern about the "allegations" and referred to a "general sense that there must be clarity on what happened".

In a statement that was similarly cautious, the US president said on August 23rd that the attacks were a grave incident that demanded the administration's close attention, but he was careful to avoid directly blaming the Assad regime, noting that the US was still gathering information.

Russia has publicly called on Syria to allow the UN inspectors to go to the areas where the attacks occurred, and for the rebel forces to guarantee them safe passage. However, the Syrian government is likely to insist on a new protocol to be drawn up to set out the terms for any such inspections, and in the meantime it has continued to bombard these areas heavily.

The chemical attacks came after rebel forces had made advances in the region between the Jordanian border and the outskirts of Damascus, thanks largely to increased logistical support provided by Saudi Arabia and, possibly, the US via Jordan. One message that could be drawn from the attacks is that the Assad regime considers that the limited military support being provided by the West to the southern rebels is a form of external aggression. The government indicated in mid-2012 in a statement by Jihad Makdissi, a foreign ministry spokesman (who has since left the country), that it would only resort to using chemical weapons if it faced external aggression.

## Empty threats

Mr Obama's threat, first made in August 2012, to take serious action against Syria if the Assad regime were to use chemical weapons, was shown to be hollow when the first evidence of such use emerged earlier this year. The US indicated that it would do nothing as long as the incidents were of a relatively small scale. Now that the regime appears to have committed the worst chemical weapons attack on civilians since the bombing of Halabja by Iraq in 1988, the credibility of Mr Obama's threat is once more on the line.

The US has made contingency plans, in coordination with Jordan and other allies, to seize control of Syria's main chemical weapons sites under various scenarios, including its own intervention. The attacks outside Damascus can be seen as a statement of intent from the Assad regime to use chemicals on a much larger scale in the event of any such intervention. The existence of such a threat has been one of the factors that have prevented the US from taking military action against the Syria regime, and, in light of Mr Obama's continued caution, this deterrent may well continue to be an effective tool in Mr Assad's hands.

**August 27, 2013**

## US and allies debate scale of military intervention

**The US and its principal allies in Europe and the Middle East have indicated their resolve to take military action against the Assad regime in response to the death of more than 1,000 people around Damascus after bombardments by missiles containing toxic chemicals. Briefings from US officials suggest that the Obama administration aims to carry out a limited military intervention, aimed at registering international condemnation of the use of chemical weapons against civilians and at deterring any future use of such weapons.**

The clearest signal that the US has taken the decision to attack Syria came in a speech by the US secretary of state, John Kerry, on August 26th. Mr Kerry said that the "meaning" of the chemical weapons attack went far beyond Syria itself. His words implied that the US administration considers it vital that there should be a strong international response, not only because of the situation in Syria but also because of the wider implications of letting such attacks go unpunished. He said that the US president, Barack Obama, "believes there must be accountability for those who would use the world's most heinous weapons against the world's most vulnerable people".

Mr Kerry has been a leading proponent within the administration of an interventionist line on Syria, in the face of a

more cautious approach argued by US military commanders. Mr Obama has thus far lined up with the military, despite the evidence that emerged earlier this year that the Assad regime had started to use chemical weapons, in defiance of warnings from the US president that there would be serious consequences for any such action.

## UK and France support military action

The case for military action against the Assad regime has been advocated strongly by the UK and French governments, whose forces are likely to play a role in any operation. The other principal supporters of the US position include Turkey, Jordan, Saudi Arabia and Qatar, all of which are likely to be involved directly or indirectly.

The legal basis that the US will present for its military strikes is likely to consist of the argument that the Assad regime has committed a flagrant violation of international law and that the use of force is legitimate in such circumstances according to the responsibility to protect civilians and under the provisions of international protocols on chemical weapons (despite Syria not having signed any such protocols). The UK government is likely to seek parliamentary approval for its contribution to any operation—the British parliament was recalled on August 26th to discuss the issue—but Mr Obama is thought to have the discretion to approve an attack on Syria without needing to secure the backing of Congress. The UN has an inspection team in Damascus, but its mandate has been severely limited by the need for it to operate with the approval of the Syrian government. It has been able to gain brief access to one of the sites attacked, but was not permitted to gather any parts from the rockets that local residents claimed were used in the attacks. The UN team has also been barred from investigating which party was responsible for the chemical attacks and has come under sniper fire. The firm opposition of Russia and China to any outside military intervention in Syria means that there is no chance of passing a resolution through the UN Security Council endorsing military strikes.

## Military intervention will be limited and quick

The US administration has signalled through media briefings that the operation is likely to be limited and of relatively short duration. This would imply that it would involve attacks using naval vessels and aircraft from outside Syrian airspace on military and security installations. The main weapons used would be cruise missiles or guided bombs from aircraft. Based on the pattern of similar operations against Iraq and Libya, the targets would include air defence systems and control centres, military bases and buildings housing security agencies. Direct attacks on chemical weapons storage sites are unlikely because of the risk of the dispersal of toxic agents. Particular targets could include bases of the Fourth Armoured Division, commanded by Maher al-Assad, the president's younger brother, and the specific brigade reported to have been responsible for the firing of chemical missiles.

Even if the operation is presented as being purely a response to the regime's perceived large-scale use of chemical weapons against civilians, the military intervention of itself would open up a new phase in the conflict. This would be perceived as being aimed at bringing down the Assad regime, or at least forcing it to negotiate its own replacement. This would require enhanced support for rebel fighters, possibly including the establishment of a no-fly zone, and more determined external engagement in the process of charting a viable political and economic future for Syria.

## Risk of regional consequences

The US and its allies will have to assess the risk of retaliation by the regime and its allies. One option that the Assad regime has is to draw Israel into the conflict. This could entail firing missiles from Syria into Israel, or else activating the front in southern Lebanon between Israel and Hizbullah, a Lebanese Shia movement allied to Syria and Iran. Syria could also launch missile attacks against Turkey and Jordan, although the US has sought to protect these two states through the deployment of Patriot anti-missile batteries. The reaction of Iran and Russia would also have to be weighed up. Both countries have military advisers in Syria, and have warned the US that there would be serious consequences if Syria were attacked.

**August 27, 2013**

## Iran faces grim choices if the West intervenes in Syria

**Iran's new government will face its first major diplomatic challenge in managing the increasing discussion of a Western military intervention into its main Arab ally, Syria. Iran has limited options for response should the West attack Syria, and any escalation in the war is likely to foster further Sunni-Shia enmity in the region. Moreover, it would all but scupper any chance that the US and Iran could engage in negotiations over the Islamic Republic's disputed nuclear programme. The new president of Iran, Hassan Rowhani, will be forced to maintain support for the regime of Syria's president, Bashar al-Assad, lest he risk provoking a harsh response from hardline conservatives at home.**

The tone from the US administration following a meeting between the president, Barack Obama, and his national security team has increased the expectation that the US and its allies will attack Syria after the alleged use of chemical weapons by Mr Assad's forces. The likely means would be missiles from warships or submarines in the eastern Mediterranean or Persian Gulf, or via combat aircraft. Targets could include Syria's air-defence system, command bunkers, communications hubs, government buildings, missile sites or, perhaps, the units thought responsible for chemical attacks.

Syria's government has warned that any US military action would "create a ball of fire that will inflame the Middle East", and many in the US government may be reluctant to reengage in a conflict in the region. Any intervention carries substantial risks. Syria has relatively sophisticated Russian air-defence systems, which were close to locking on Israeli jets during the 2007 attack on the alleged nuclear site at Dayr al-Zawr. There are also particular problems with trying to neutralise a chemical weapons target. Although such weapons are generally delivered through conventional systems—aircraft, artillery or missiles—that could be targeted, any attack on chemical plants risks contamination and the chance of unguarded nerve agents and other substances falling into the hands of Sunni militants.

## Iranian reaction: violence or diplomacy?

Throughout the two-year conflict in Syria, Iran has given logistical support to the Assad regime, with Syria a long-term ally as far back as the 1980–88 Iran-Iraq war. As part of the fallout from the Arab Spring and war in Syria, the Middle East has been increasingly polarised between Sunnis (especially the Sunni-led Gulf states) and Shia (primarily the Iranians, plus Iraq and Hizbullah in Lebanon). Sustaining an alliance with at least one friendly Arab state has been vital for Iran to exert influence over the region.

Iran is well aware of the reluctance within the US towards intervention, and its response to the prospect has been to talk up the dangers of such an attack. Massoud Jazayeri, deputy chief of staff of the armed forces, warned the US of "severe consequences" if it crossed "the red line of the Syrian front". The director of parliament's international affairs committee, Hossein Sheikholeslam, said that the first victim of any attack would be "the Zionist regime [Israel], because the army in Damascus has the ability to attack with severity the occupied territories"; he added that he did not expect Russia to repeat "the same mistake" it made in Libya by tolerating Western intervention. A more sober assessment in a reforming newspaper, *Shargh*, referred to "a swordplay opportunity for the two superpowers", but warned that despite "the high cost" of previous US interventions, "force" remained an option.

The official Iranian response during Syria's civil war has generally favoured diplomacy. The foreign minister, Mohammed Javad Zarif, has reiterated Iran's long-standing opposition to chemical weapons, which were employed by Iraqi forces during the 1980–88 war. Mr Zarif and Abbas Araghchi, a foreign ministry spokesman, have suggested that it was the rebels and not the Assad regime who used the chemicals.

Mr Araghchi has also stressed Iran's co-operation with Russia and their shared preference for negotiations over Syria. However, the diplomatic process over Syria appears deadlocked, with the regional Sunni powers—led by Saudi Arabia and Turkey—and the US insisting that Mr Assad should leave power as soon as possible, while Russia and Iran argue that this should not be a precondition for talks.

Lakhdar Brahimi, the UN and Arab League envoy for Syria, reiterated earlier this month his belief that Iran should be included in Geneva-2, the international conference on Syria scheduled for July but postponed by the US. No details have emerged from the visit to the Iranian capital, Tehran, on August 26th by Jeffrey Feltman, the UN undersecretary-general and a former senior US diplomat with experience of the Middle East: while Mr Feltman's agenda was the UN's interest in Syria, Egypt and Lebanon, he may also represent a back-channel to the US (this was his second visit in a year: in September 2012 he accompanied the UN secretary-general, Ban Ki-moon, to a summit of the Non-Aligned Movement in Tehran).

## Possible Iranian retaliatory options

Iran's options for retaliation against US attacks on Syria are limited. Western defence analysts have flagged up the possibility that it might encourage Palestinian or Sunni Islamist attacks on Israel, or attempts to foment a "third intifada" in the Israeli-occupied Palestinian Territories; however, these are groups with whom Iranian influence is diminishing, given the Sunni-Shia polarisation that the Syrian war is encouraging. Among vulnerable Western targets could be the NATO base at Incirlik in south-east Turkey, or even the British bases in Cyprus (where a member of Hizbullah was jailed in May for surveying Israeli tourists).

However, an overt attack on a NATO or allied facility would invite reprisal from the US and its allies—a dynamic that the Iranian leadership will seek to avoid at all costs. Whatever response Iran makes, the Israeli leadership seems fixed on its enmity with the country. After evidence of chemical attacks emerged, Israel's prime minister, Binyamin

Netanyahu, described Syria as "the test field of Iran."

## Rowhani in a corner

While the effect of US strikes on Syria is uncertain, they would be likely, in the short term at least, to undermine prospects for negotiations between the US and Iran over the latter's disputed nuclear programme. It seems likely that any inflammation of the war in Syria would domestically weaken Mr Rowhani, who stressed the need for dialogue both during his election campaign and following his inauguration at the start of August. In the aftermath of the chemical weapons attack, Mr Rowhani called for the international community to prevent the use of such materials in Syria, but he stopped short of saying who he thought had used the arms.

Likewise, military strikes on Syria would be likely to strengthen those in Iran who are most sceptical over—or even opposed to—talks with the US. During the two years of the Syrian conflict, Iran has given no indication that it would abandon its Syrian ally. Mr Rowhani will be pressed into a corner by hardline conservatives in Iran to maintain support for Mr Assad.

September 4, 2013

## Syria prepares for US air strikes

**A US military strike on Syria is imminent, as the US seeks to punish the regime of President Bashar al-Assad for its use of chemical weapons. However, the fallout for Syria and the region remains highly uncertain. Although figures close to the Syrian leadership have threatened reprisal attacks on US warships, in reality the prospect of an overwhelming military response from the US and its allies almost certainly preclude such an escalation. However, even after US air strikes, the regime would unquestionably still be able to inflict considerable pain on its own population, as well as potentially on some of its near neighbours such as Israel and Lebanon (either through its own weapons, or via its Lebanese Shia ally, Hizbullah). In such an event, the US would be faced with the unenviable task of having to either intervene once again, and probably on a larger scale, to subdue the Syrian regime, or be criticized globally for worsening the already tense and deepening crisis.**

Although the US administration has faced considerable political headwinds in gaining support for a military attack on Syria (not least following the UK parliament's vote on joining such an attack), it appears that momentum in Washington DC is moving in favour of military intervention, with a number of senior Republican figures giving their support on September 3rd. As for the US strategy, the US president has signaled that the approach will be to degrade Syria's military capabilities, while upgrading the capabilities of the moderate Syrian opposition. In terms of the former, the US is faced with a dilemma: it has ruled out regime change, but it will be highly unwilling to launch large-scale attacks on Syria's chemical weapons stocks (ostensibly the *casus belli* for the US's intervention). Although the US has weapons specifically designed for hitting chemical weapon sites (including ones that contain large quantities of white phosphorous, designed to burn the chemical agents), and it hit a number of such sites during the 1990-91 Gulf war with Iraq, the bombs would be highly unlikely to destroy all the chemical weapons. The resulting release of a "chemical cloud" from the damaged stockpile would cause massive civilian casualties.

## Chemical weapons sites may not be the US's primary target

With this in mind, the US is likely to use Tomahawk missiles, both naval- and air-launched, at key regime targets, in order to punish the regime for its use of non-conventional weapons. France may also join the attacks, probably using air-launched stand-off missiles. The targets will most likely range from military units associated with the alleged chemical weapons attack on the Ghouta suburbs of Damascus on August 21st (notably the Republican Guard and the Fourth Armoured Brigade, both of which are controlled by the president's younger brother, Maher al-Assad), to Syrian air force hangars—Syria's air force has provided the regime a considerable military advantage during the civil war. In addition, Syria's Scud missiles may also be in the US's sights (especially given their potential use as a long-range retaliatory weapon), and reports have indicated that the regime has already begun to hide its Scuds to pre-empt such a move. The US campaign will probably be relatively short, with its military unlikely to need the full 60 days (with one 30-day extension) that is reportedly set to be authorised by the US Congress.

However, the US's pledge to step-up supplies to the Syrian opposition appears to be largely rhetoric at this stage. In fact, the US agreed to start weapons supplies to the Syrian opposition back in mid-June, but little has thus far been delivered. The US's caution reflects the fragmented state of the rebel forces, with the US keen to keep its weapons out of the hands of extremists (notably units associated with al-Qaida). If anything, this situation has worsened since June, as the Islamic State of Iraq and the Levant (comprising the Syrian and Iraqi arms of al-Qaida) has grown in prominence.

## Syria may call on its allies

In response, there is little the Syrian military can do to defend itself against a Tomahawk attack, other than seek to hide its most-prized weaponry. However, a retaliatory attack on US warships in the Mediterranean is at least militarily realistic, even if we do not envisage such an outcome. Syria has a number of Yakhont anti-ship missiles, with a range of up to 300 km, stationed on its coastline, and it is believed that Israel has already launched air strikes on several missile batteries in recent months. Equally, Syria could call on its ally, Hizbullah, to attack shipping close to the coast, and it was notable that the Lebanese group succeeded in damaging an Israeli warship during the two sides' war in 2006. Alternatively, Syria could pressure Hizbullah to fire missiles into Israel—a scenario that will have been behind the Israeli-US anti-missile test on September 3rd. Israel's armed forces have already mobilised reserve forces and moved an anti-missile defence system, Iron Dome, to the northern regions of the country. A Hizbullah attack on Israel could do substantial damage to the country, but would mean that the Shia group was risking serious harm in the event of Israeli reprisals.

Beyond Hizbullah, however, little if any military support would be forthcoming from Syria's international allies, with Iran set to remain primarily a provider of financial support and fuel (its military is no match for the US's). Russia will also not risk any sort of military intervention, although the Russian president, Vladimir Putin, has hinted he may step up the supply of air defence weaponry to Syria and other regional players unfriendly to the US.

## Syrians will probably suffer the most

In all, however, with the US unlikely to deal a knock-out blow to Mr Assad and his government, the most likely to suffer from any regime backlash will be the population itself. The regime will use the US attack to burnish its nationalist credentials, and the frightening possibility remains that it may even seek to step up its use of chemical weapons, in order to deter further US action (and, potentially, to offset the degradation to its conventional capabilities). Meanwhile, the US will have created a precedent, and will come under instant pressure to attack again if further reports of regime chemical weapons usage emerge. Further US attacks will probably only hasten the flood of refugees leaving the country, with more than 2m Syrians already having crossed the country's borders.

For the US, however, arguably the greatest risk would be if its military intervention proves too effective, and prompts a sudden collapse of the regime (an outcome that at present we do not expect—the regime has proven resilient, and we expect it to survive until at least mid-2014). Although the US lacks the stomach to knit Syria back together again, the fragmented state of the rebels probably precludes an orderly transition—a situation not helped by the oil-rich Arab states' backing for differing opposition leaders and units. Indeed, an internecine conflict has already broken out among rebel groups, especially between elements of the more secular and tribal Free Syrian Army and the Kurds on the one hand, and groups affiliated to al-Qaida on the other. Should the regime begin to implode, the US may be required to intervene once again, at the minimum to disrupt the spread of jihadi groups—a role that it already undertakes in Afghanistan and, to a lesser extent, Pakistan and Yemen. Although the US administration is currently confining itself to a single, time-limited attack, by intervening directly, and against one side, returning to the sidelines may well not be an option.

September 10, 2013

## Syria accepts Russian proposal

**A major diplomatic initiative led by Russia has derailed plans for a US-led military intervention in Syria. Seeing a chance to halt US air strikes, Syria has welcomed a proposal calling for it to place its chemical weapons arsenal "under international control", with the eventual aim of destroying the weapons. Meanwhile, the US and its allies have also cautiously welcomed the plan. However, in reality, the latest diplomatic move may well prove unworkable: Syria is unlikely to give UN weapons inspectors free and unfettered access to its chemical weapons arsenal, and therefore the US military option could be back on the table before long.**

Nonetheless, at least for now, the momentum behind US military action has been halted. The proposal itself seemingly stemmed from an offhand comment by the US secretary of state, John Kerry, on September 9th that Syria could avoid an attack if it destroyed its chemical weapons—although the US administration has since "clarified" that the idea had originally been floated during talks between the US president, Barack Obama, and the Russian president, Vladimir Putin, a week earlier. Whatever the case, soon after Mr Kerry's comments, Russia (a strong backer of the Syrian regime) put forward the plan for Syria to place its chemical weapons under international control.

Seizing his chance after meeting his counterpart in Moscow, the Syrian foreign minister, Walid al-Muallim, announced that the Syrian government welcomed the Russian leadership's proposal, "arising from the concern of the Syrian leadership for the lives of our citizens and the security of our country". Reinforcing the message, the prime minister, Wael Nader al-Halqi, was quoted on Syrian state television accepting the proposal on September 10th—although no Syrian official has yet stated explicitly that Syria will destroy its chemical weapons arsenal. The US, for its part, has been more cautious, but Mr Obama still described the move as a "positive development", and, with support for military action within the US Congress ebbing, a procedural motion in the Senate to begin debating a resolution backing military air strikes was postponed on September 10th.

## UN route is resurrected

Having previously been unwilling to put forward a resolution on military intervention to the UN Security Council, given the certainty of a Chinese and Russian veto, the latest diplomatic twist has handed the US and its allies an opportunity to reexplore the UN route. On September 10th the French foreign minister, Laurent Fabius, announced that France would be putting forward a resolution demanding that Syria's chemical weapons stocks be put under international control and dismantled. Crucially, the resolution would be framed under Chapter VII, which in effect gives the resolution military backing for its enforcement.

The obvious concern to those countries aligned against the regime of Bashar al-Assad is that Syria's acceptance of the Russian proposal is a ploy, designed merely to forestall a US attack. Even if it accepts the terms of any disarmament proposal, the regime could arguably still delay the work of the inspectors indefinitely, citing overweening security concerns—clearly, the weapons inspectors would require a ceasefire to be in place if they were to be able to work unhindered. Meanwhile, the sincerity of the Assad regime is also questionable, given their previous record of obfuscation and secrecy. For example, the UN chemical weapons investigative team that was dispatched to Syria in August was repeatedly delayed owing to objections from the Syrian government over its scope. Equally, the regime also succeeded in delaying the team's mission to explore the alleged chemical weapons attack on the Ghouta suburbs of Damascus on August 21st by five days—long enough for much of the evidence of the attack to either fade or be corrupted.

## Force still on the table

Although early reports indicate that Russia is unwilling to pass a resolution framed under Chapter VII, it is feasible that an alternative resolution could be agreed that includes verifiable confidence-building steps, against which Syrian compliance, or lack of it, can be measured. In the event that the US and its allies judge that the Syrian regime is not complying, the US administration could take the case for military action back to Congress, and military preparations would recommence. However, whether such a scenario would succeed in winning over a sceptical public (popular opinion in both the US and the EU is against intervention) remains to be seen. On the one hand, by exploring the diplomatic route, the US and French governments would at least be able to contend that they have exhausted all options before launching military operations. On the other hand, the momentum behind a military intervention will be lost as the outrage over the chemical weapons attack of August 21st recedes.

# Economy

## Forecast updates

August 6, 2013: Monetary policy outlook

### Government outlaws foreign-exchange transactions

#### Event

The president, Bashar al-Assad, issued a decree on August 4th banning the use of foreign currency or precious metals for commercial transactions within Syria.

#### Analysis

Adib Mayaleh, the governor of the Central Bank of Syria, said that the measure had been introduced in order to prevent the dollarisation of the Syrian economy and to support the local currency, which briefly fell below S£300:US\$1 on the black market in early July, before rallying in response to intervention by the Central Bank. Since mid-July the black-market rate has averaged about S£190:US\$1, compared with the official rate of S£105:US\$1.

The decree states that all commercial transactions in goods and services must be conducted in Syrian pounds, unless a specific licence to use foreign currency is granted by the prime minister. The penalty for any transgression is six months to three years in jail, with a fine of double the value of the transaction, or a minimum of S£100,000 (US\$945). For transactions of US\$5,000 and over, the penalty is three to ten years in jail, with hard labour, and a fine of double the deal's value. Mr Mayaleh said that advertising a product or service with a price listed in foreign currency would amount to a transgression of the law.

The measure is comparable to a law introduced in the early 1980s, which outlawed even the possession of foreign currency. The law was finally repealed in 2003.

Meanwhile, the depreciation of the Syrian pound has yielded windfall profits to private banks as a result of the revaluation of their capital base. The capital invested in these banks by non-Syrian institutions (mainly banks from Lebanon, Jordan and the Gulf) is denominated in foreign exchange, and the banks are permitted periodically to book the revaluation of this capital base as profits. Bank Audi Syria has been the first listed bank to announce results for the first half of 2013, and has booked a net profit of S£2.2bn (US\$20m) as a result of a capital base revaluation. The bank's assets have increased by 26% to S£62.6bn since the start of the year, partly owing to the revaluation of its holdings of bonds issued by an unnamed foreign bank.

#### Impact on the forecast

The latest announcement banning the use of foreign currency for commercial transactions reinforces our forecast that foreign-currency restrictions will steadily be tightened in an effort to support the pound.

## August 21, 2013: Economic growth

### Attack on gas pipeline hits power supplies

#### Event

On August 18th the petroleum minister, Suleiman al-Abbas, said that supplies of natural gas to three major power stations had been disrupted by an attack on a pipeline in the main gas-producing region between Homs and Palmyra, in central Syria.

#### Analysis

Mr Abbas said that repair work was ongoing, but that fuel supplies to the Nasiriya and Tishreen power stations had been restored within a few hours, according to the official Syrian Arab News Agency. The two plants are located between Homs and Damascus. Nasiriya is a 750mw combined cycle plant, with 505 mw of gas turbine capacity; Tishreen has a 450mw gas turbine extension that came on stream in 2009, according to the Public Establishment for Electricity Generation (PEEG). Mr Abbas did not specify the third power station or elaborate on whether its supplies had been restored.

Mr Abbas said that the attack had been on a stretch of pipeline linking the Shaar gasfield to the Ebla processing plant, which started up in April 2010 with capacity of about 900m cu metres/year of sales gas. Syria's total gas production was 7.6bn cu metres in 2012, according to BP's *Statistical Review of World Energy*, compared with 8.4bn cu metres in 2011 and 8bn cu metres in 2010. In the first half of 2013 Syria produced 2.9bn cu metres, according to Mr Abbas.

#### Thermal power generation, by type

(gwh)

	2007	2008	2009	2010	2011	2012
Combined cycle (gas)	5,263	10,404	11,599	18,493	17,273	18,651
Steam turbine	22,551	23,986	22,833	21,153	20,979	16,621
Gas turbine	7,302	3,756	6,946	4,146	4,183	3,262
Gas turbine (diesel)	0	5	5	17	23	0
<b>Total<sup>a</sup></b>	<b>35,116</b>	<b>38,151</b>	<b>41,383</b>	<b>43,809</b>	<b>42,458</b>	<b>38,534</b>

<sup>a</sup> Does not sum in source.

Source: Public Establishment for Electricity Generation.

The relatively resilient performance of the gas industry has helped to minimise losses of power generation, although local supplies have been hit by damage to the distribution networks. The PEEG's most recent annual report states that Syria's total power generation from thermal plants (excluding a relatively small amount of supply from hydroelectric plants) was 38,534 gwh in 2012, compared with 42,458 gwh in 2011 and 43,809 gwh in 2010. Total installed capacity is 7,675 mw, of which about 58% is either gas turbine or combined cycle.

#### Impact on the forecast

Thus far the gas sector has provided some support for the ailing economy, which we forecast will contract by 13.2% in 2013. However, if the interruption to supplies is repeated, we may be required to downgrade Syria's real GDP forecast.

## September 2, 2013: Exchange rates

### Private banks prosper on exchange-rate weakness

#### Event

Syria's 12 privately owned commercial banks completed their reporting of their halfyear financial results on September 1st.

#### Analysis

The aggregate assets of the banks rose sharply in the second quarter in local currency terms, mainly because of the impact of the depreciation of the Syrian pound. Much of the equity of the banks is dollar-denominated, and a large portion of their deposits are also in foreign currency. Many of the banks booked large profits on unrealised gains on their capital base, thanks to the fall in the value of the Syrian pound. The aggregate return on assets on an annualised basis was 9.2%, which, on paper, makes the Syrian banks among the most profitable in the world by this criterion. However, most banks also made heavy provisions for loan losses, and at most of the banks the loan portfolio shrank.

The total assets and liabilities of the 12 banks, based on disclosures to the Damascus Securities Exchange, which The Economist Intelligence Unit has aggregated, rose by 47.8% during the second quarter to reach S£807bn. This is equivalent to US\$7.8bn according to the official exchange rate of the Central Bank of Syria on June 30th, of S£102.5:US\$1. The rate was S£86.7:US\$1 on March 30th, and was S£128:US\$1 on September 2nd. However, since May a new rate for foreign exchange quotations has been quoted daily by the state-owned Commercial Bank of Syria (CBS), and it appears that this rate, which was S£128:US\$1 on June 30th, is the appropriate one to use for the listed banks' balance sheets. If the Central Bank rate is applied it gives the impression that the balance sheets have grown in dollar terms, which is improbable. Using the CBS rate, the dollar value of the 12 banks' assets is now about US\$6.3bn, compared with US\$13.4bn at end-2010.

The highest profits booked in the first half were those of Qatar National Bank Syria, but this is mainly because its paid-up capital is about three times higher than the average of the other banks. Its capital is S£15bn, compared with total assets/liabilities of S£42bn and a loan portfolio of only S£1.9bn. The controlling shareholders of the banks are all non-Syrian institutions: six Lebanese banks, three from Jordan, two from Qatar and one based in Bahrain.

#### Impact on the forecast

We will maintain our existing forecast that the banking sector will continue to suffer as a result of the country's deepening civil war.

## September 10, 2013: Inflation

### Official inflation rate reached 61.3% in April

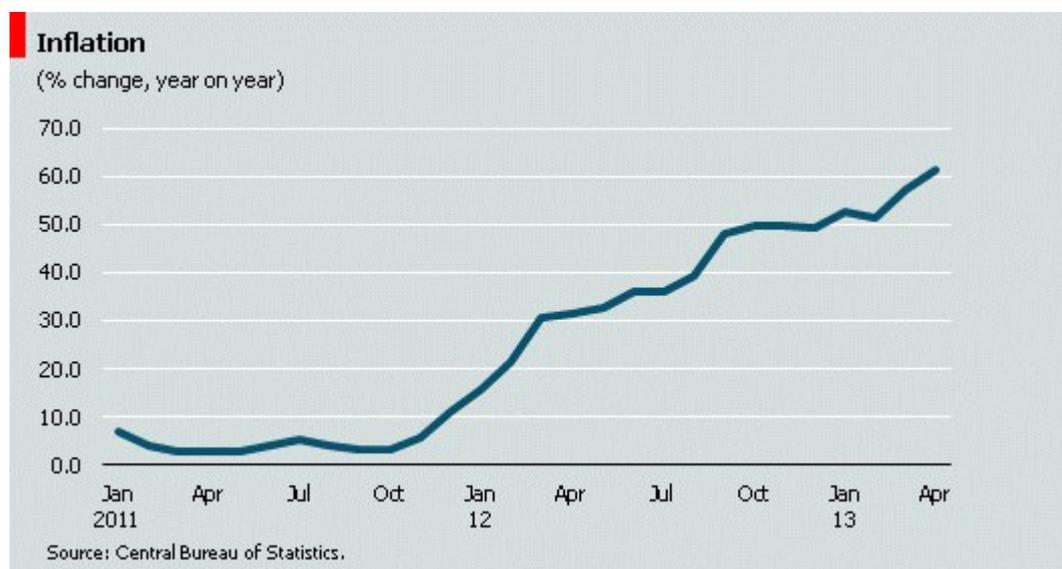
#### Event

The year-on-year inflation rate reached 61.3% in April, based on analysis of data reported by *Al Watan* on September 8th and sourced to the Central Bureau of Statistics.

#### Analysis

The most recent data available online from the statistics agency were issued in March 2013 and included the consumer price index (CPI) for the period up to November 2012. Since that time the agency's website has not been accessible, but the newspaper report suggests that it is issuing some data to the local media.

The newspaper report stated in its headline that the inflation rate had reached 309.01% in April, but it is evident from the subsequent text that this number was the general index, and was not a percentage increase. It also indicated that the index had risen by 9.46 points since March. By relating these figures to the indices published for the corresponding months of 2012, it appears that the year-on-year increase in the CPI was 61.3% in April and 57.3% in March, marking a relatively gradual rise since November, when the rate was 49.5%. The average rate of inflation in the 12 months to April 2013 was 47%.



The official inflation data are likely to understate the extent of the price increases experienced by households, as many goods are in short supply and can only be procured at a high premium from the black market. Since April the rate of inflation is likely to have accelerated as the exchange rate has depreciated sharply. The government has also carried out several increases in the official prices of petroleum products and electricity. In an effort to control inflation, the government has set administered prices for a wider range of goods, available in set quantities through a ration card. The system previously only applied to sugar and rice, but it now extends to tea, cooking oil, tomato paste and washing powder.

#### Impact on the forecast

We had expected an elevated rate of inflation this year, at an average of 43%. However, in light of the latest data, we are likely to revise this higher.

## Analysis

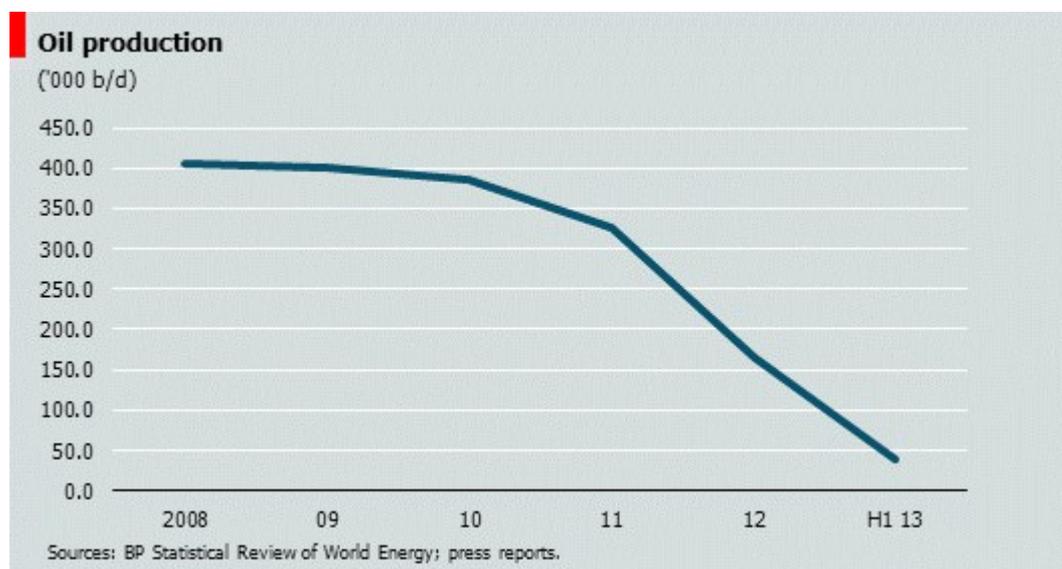
August 9, 2013

### Oil minister reveals extent of oil output collapse

The petroleum minister, Suleiman al-Abbas, has announced figures for the performance of the oil and gas sector in the first half of 2013. The briefing confirmed earlier indications that production of crude oil and refined products

has dwindled to a small fraction of pre-uprising levels, owing to the impact of EU sanctions (where the vast bulk of Syria's oil was exported) and the capture of many areas by the rebels. However, natural gas output has been less severely affected, as most of the major gasfields are in government-controlled areas.

Mr Abbas revealed the figures in a briefing to the local media on August 6th. According to an account of the briefing provided by the Champress web news agency, crude oil production in the first half of the year averaged 39,389 barrels/day (b/d), compared with 163,062 b/d in January-June 2012. This is consistent with statements by Mr Abbas during May: at the start of that month he said that oil output was 70,000 b/d, but later he said that it was only 20,000 b/d. According to the *BP Statistical Review of World Energy*, Syria produced 164,000 b/d on average in 2012, compared with 327,000 b/d in 2011. At the time of the March 2011 uprising against the Assad regime, production was about 385,000 b/d.



The Champress report said that the Homs and Baniyas refineries had received about 4m barrels of oil each during the first half of 2013, which works out at a total of about 43,000 b/d on average. The combined capacity of the two refineries is about 240,000 b/d. The minister's figures imply that part of the refineries' throughput was accounted for by imported crude, which is likely to have been supplied by Iran (with which Syria has agreed a US\$7bn credit line to assist the country in meeting its import needs, mostly for petroleum products).

## Gas output remains resilient

Mr Abbas said that raw gas production totalled 16.7m cu metres/day, or just over 3bn cu metres in total over the six months. Processed sales gas production during the first half of the year totalled 2.93bn cu metres, of which 2.61bn cu metres was used for electricity generation. According to BP, Syria's sales gas production in 2012 was 7.6bn cu metres, compared with 8.4bn cu metres in 2011 and 8bn cu metres in 2010. Production had increased sharply in the two years before the uprising owing to the start-up of two new projects in central Syria, Ebla and Hayan. The figures issued by the minister indicate that gas output is still slightly higher than its average of 5.5bn cu metres/year in the mid-2000s.

The minister said that Mahrukat, the state oil distribution company, had earned S£133bn (US\$1.3bn, at official exchange rates) from the sale of petroleum products during the first half of the year and had spent S£245bn on purchasing oil and products, including S£97bn in imports. This implies a total subsidy of S£112bn. Although the paucity of data makes direct comparisons difficult, this would still seem to be a considerable increase compared with before the crisis, with the 2010 budget, for example, projecting total subsidy outlays of just S£88bn for that entire year. State spending on fuel subsidies will no doubt have been inflated by the considerable weakening of the Syrian pound (which will have pushed up the local-currency costs of buying oil on the international markets), although it will have been offset to a degree by lower domestic demand. Indeed, so concerned has the regime become about the depreciation of the exchange rate that it recently banned the use of foreign currency or precious metals for commercial transactions.

## Abbas more gloomy than IEA

The latest figures from Mr Abbas differ substantially from the oil output data from the Paris-based International Energy Agency (IEA). The IEA recorded Syrian output at a little over 100,000 b/d in the first half of the year; we had thus forecast average output at 85,000 b/d this year. However, we are now likely to revise down our forecast in line

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with Mr Abbas's comments, which will have a knock-on impact on the current forecast of a GDP contraction of 13.2%. In his briefing, Mr Abbas discussed the need to rehabilitate the country's oil and gas fields, after repeated attacks by "terrorists". The full level of damage to the sector is as yet unclear, although there have been a plethora of reports about sabotage of pipelines. Whatever the case, however, assuming the regime of Bashar al-Assad is eventually toppled, it will be up to the next government to revive the sector, a task that will not only necessitate a considerable levels of investment, but will also require the next government to guarantee sufficient security for the international oil companies to return.