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IMF Executive Board Concludes 2008 Article IV Consultation with the Syrian Arab Republic

On January 9, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Syrian Arab Republic.[1]

Background

Syria's overall macroeconomic performance has been strong. Non-oil real GDP is estimated to have been about 6 percent in 2007, despite unfavorable weather conditions affecting agriculture. Virtually all other non-oil sectors continued to grow strongly. Oil output, however, remained on a downward trend. As a result, overall growth registered only about 4 percent. Preliminary data for 2008 indicate a rate of non-oil growth similar to 2007, despite a further decline in agricultural output, as construction and services maintained their rapid expansion. Overall growth is expected to be about 5 percent in 2008. Inflation accelerated to 17-20 percent by mid-2008, up from a reported 5 percent in 2007. However, it started to decline in the fourth quarter of 2008 in line with international food prices, and is projected to average about 15 percent for the year.

While the overall fiscal deficit increased to about 3.5 percent of GDP in 2007, the non-oil deficit improved slightly. Oil revenue decreased by about 2 percent of GDP. Non-oil receipts also declined, partly reflecting the reduction in customs tariffs. Current and capital outlays were reduced by about 1 percent of GDP in total.

[1]Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The fiscal deficit is expected to stabilize in 2008, mainly as a result of the reduction in fuel subsidies. The authorities launched a program to phase out these subsidies in May 2008 by increasing the prices of gasoline and diesel. These price increases and an overall expenditure restraint led to a further small narrowing of the non-oil deficit, despite the continued decline in customs revenue resulting from the full year effect of the 2007 reduction in tariffs.

The external current account deficit is expected to widen to about 4 percent of GDP in 2008, from 3.3 percent in 2007. The net oil balance (after subtracting the share of foreign partners) turned negative due to declining output and rising domestic consumption. However, non-oil exports, tourism, and remittances grew rapidly as a result of strong regional demand and the relaxation of foreign exchange controls. Net official foreign assets have been stable at about $17 billion (10 months of imports). The real effective exchange rate of the Syrian pound appreciated by 4 percent in 2007, and about 9 percent in the first three quarters of 2008 due to the combined effect of rising inflation and the pound’s nominal appreciation against the dollar.

Broad money has been growing in line with nominal GDP. This growth mainly reflected domestic credit expansion. Credit to public enterprises grew by about 40 percent in 2007 and by 60 percent in the first half of 2008 (year-on-year), reflecting the rising financing needs of enterprises providing fuel and other subsidies. Growth of credit to the private sector was about 20 percent in 2007 and is expected to register 25 percent in 2008. Interest rates remained low, and became largely negative in real terms with the rise in inflation in 2008.

The impact of adverse global and regional developments on the Syrian economy is expected to be relatively mild in the short term. The effects are likely to be through weakening foreign direct investment (FDI), remittances, and demand for Syrian exports from the Gulf region. The medium-term outlook is then expected to improve as the global and regional economies begin to recover. The fiscal and current account deficits are expected to stabilize as a result of the fiscal reforms currently in the pipeline and a resumption in the strong growth of exports of goods and services. This generally positive outlook is contingent on perseverance in advancing fiscal and structural reforms and a gradual global recovery over the next two years.

Significant progress has been made on the structural front over the last two years, but the reform agenda remains substantial. Important progress toward exchange rate unification has been achieved; a dynamic private banking sector is growing; the investment regime is being liberalized; and trade liberalization has also continued.

Executive Board Assessment

Executive Directors welcomed Syria's strong macroeconomic performance in recent years, as manifested in the rapid non-oil GDP growth, comfortable level of foreign reserves, and low and declining government debt. This performance reflected both robust regional demand and the authorities' reform efforts to shift toward a more market-based economy.

At the same time, Directors observed that oil production and exports are declining, and Syria has already become a net oil importer. Inflation has declined in recent months as a result of falling international food and fuel prices, but remains high. Directors also noted the downside risks to growth arising from the current adverse global and regional developments—although many Directors considered these risks to be relatively mild because of Syria's still limited integration into the international financial system and the significant potential for raising foreign direct investment and tourism exports. Directors were encouraged by the authorities' efforts to address these challenges, and urged steadfast implementation of fiscal and structural reforms to support economic growth and diversification.

Directors encouraged the authorities to continue to reduce the non-oil fiscal deficit through mobilization of non-oil revenue, restraint on current expenditure—notably wages and subsidies—and prioritization of investment projects. They underscored the importance of the authorities' adherence to plans to introduce the value added tax by the new target date of 2010, and supported the adoption of a single rate with limited exemptions. They commended the steps taken to reduce fuel subsidies, and encouraged the authorities to eliminate such subsidies by 2010 as planned—while developing a well-targeted compensation scheme to mitigate the impact on the poor.

Directors emphasized the importance of strengthening public expenditure management, including by reforming the budget process, improving the monitoring of expenditures at the regional level, establishing a single treasury account, and reducing extra-budgetary and quasi-fiscal operations through the banking system and bringing them on budget. They welcomed the authorities' intention to issue treasury bills in 2009, observing that this will also help develop the domestic capital market and strengthen the conduct of monetary policy.

Directors welcomed the authorities' commitment to maintain a cautious monetary policy stance. They urged the authorities to strictly limit directed lending by public banks, develop indirect monetary policy instruments, further liberalize interest rates, and modernize the role and responsibilities of the central bank.

Directors welcomed the 2008 Financial Sector Assessment Program (FSAP) finding that banks are well-capitalized and liquid, while noting the vulnerabilities in state-owned banks. They noted that enhancing the availability of reliable financial sector indicators would facilitate a more precise assessment and monitoring of the banking sector. They commended the authorities' quick response to the FSAP recommendations, and encouraged them to continue their efforts in this regard. Directors stressed that bank supervision should be strengthened, and that all banks should be subject to annual independent audits and should provide timely information to the central bank. They urged the authorities to give priority to restructuring and commercializing the operations of state-owned banks. Directors noted the authority's efforts to enhance the framework for combating money laundering and terrorism financing, and encouraged further work in this area.

Executive Directors agreed that the Syrian pound's peg to the SDR remains appropriate, as it provides a strong monetary anchor while allowing some flexibility in the pound's rate vis-à-vis major currencies. While acknowledging available estimates of the real effective exchange rate that show moderate over-valuation, Directors noted that these estimates are not reliable. Accordingly, Directors did not recommend any change in the exchange rate level in the present context. Directors encouraged the authorities to prepare the ground for a gradual move toward greater exchange rate flexibility over the medium term. They called on the authorities to remove the existing exchange restrictions and multiple currency practice.

Directors emphasized that vigorous implementation of the authorities' substantial structural reform agenda will be crucial to accelerate the shift to a more market-oriented and non-oil-based economy. They commended the reduction in import duties, and encouraged the authorities to continue to liberalize foreign trade and to improve the business environment.

Directors underscored that shortcomings in Syria's economic and financial statistics continue to hamper effective Fund surveillance and national policy formulation. They urged the authorities to improve the quality and timeliness of economic data.

Syrian Arab Republic: Selected Economic Indicators, 2004–08

	2004	2005	2006	Prel. 2007	Proj 2008
	(Change in percent, unless otherwise indicated)				
National income and prices					
Real GDP	6.7	4.5	5.1	4.2	5.2
Oil	-6.1	-8.6	-7.1	-5.0	-0.1
Non-oil	10.2	7.5	6.9	5.8	6.0
Nominal GDP (LS billions)	1,263	1,491	1,709	2,025	2,567
Of which: Non-oil	986	1,134	1,305	1,558	1,886
Nominal GDP ($ billions)	25.0	28.6	33.5	40.6	55.2
Crude oil production (‘000 barrels/day)	462	431	400	380	380
GDP deflator	10.9	12.9	9.1	13.7	20.6
Oil export rice ($ per barrel)	33.5	48.1	57.6	65.3	90.0
CPI period average	4.4	7.2	10.4	4.7	14.5
Total population (millions)	18.8	19.3	20.4	20.8	21.3
Of which: Iraqi Immigrants (millions)	0.8	0.9	1.5	1.5	1.5
	(In percent of GDP, unless otherwise indicated)				
Government finances					
Revenue	27.2	24.0	25.5	22.3	21.4
Oil- related revenue	11.2	7.1	7.3	4.9	4.7
Non-oil revenue	16.1	16.9	18.2	17.3	16.7
Expenditure	31.4	28.5	26.6	25.7	24.9
Current expenditure	19.0	18.1	16.3	16.1	15.4
Development expenditure	12.4	10.4	10.3	9.6	9.5
Overall balance	-4.2	-4.5	-1.2	-3.4	-3.5
Non-oil budget balance	-15.4	-11.6	-8.5	-8.4	-8.2
	(Changes in percent of initial stock of money)				
Broad money	11.1	11.5	9.4	9.8	19.0
Net foreign assets	5.4	0.7	-2.3	-2.0	3.7
Net domestic assets	5.8	10.8	11.7	11.9	15.3
Credit to government	2.8	6.1	0.3	-3.1	-0.7
Credit to public enterprises	0.5	1.7	3.4	7.6	9.2
Credit to private sector	4.3	6.9	3.5	4.3	6.0
Credit to private sector (change in percent)	35.0	45.9	17.9	20.2	25.8
Credit to private sector (in percent of GDP)	11.7	14.5	14.9	15.1	15.0
	(In billions of U.S. dollars, unless otherwise indicated)				
Balance of payments					
Current account balance	-0.4	-0.6	-0.9	-1.4	-2.3
(in percent of GDP)	-1.6	-2.2	-2.8	-3.3	-4.1
Overall oil balance 1/	1.3	0.7	0.0	-1.0	-2.1
(in percent of GDP)	5.3	2.1	0.0	-2.4	-2.6
Non-oil exports of goods and services	6.4	7.7	9.1	11.2	13.5
(change in percent)	99.2	20.4	18.6	23.5	20.2
Non-oil imports of goods and services	-9.3	-10.4	-11.9	-13.8	-15.6
(change in percent)	20.8	12.5	13.9	16.2	13.2
Overall balance	0.2	0.0	-0.8	0.7	-0.4
Official net foreign assets	17.6	17.6	16.8	17.5	17.1
(in months of imports of GNFS)	20.2	16.4	13.7	11.6	9.4
Weighted average nominal exchange rate LS/$2/	50.5	52.2	51.0	49.9	46.5
Real effective exchange rate (in percent, + appreciation) 3/	0.0	1.7	10.7	4.9	9.0

Sources: Syrian authorities, and IMF staff estimates and projections.
1/ Oil trade balance less profit of foreign oil companies.
2/ Trade-weighted average of official and parallel market rates before 2007. For 2008 data are for July.
3/ For 2008 data are for the first three quarters.