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Syria

Features

Syrians feeling the pinch

December 2011

The deteriorating political situation in Syria and reality of Arab League sanctions promises to further hurt a financial system which is running out of options to stem the flow of money to calmer shores

by James Gavin
thegulf@trade Arabia.net



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Syria's economy is starting to feel the impact of eight months of violence that has killed an estimated 3,500 people, as former allies issue stark warnings to Damascus' leadership that the country has passed the point of no return.

Last month the Arab League approved a raft of sanctions aimed at hitting Syria's substantial regional trade. Among measures agreed by the Arab states was the suspension of all dealings with the Syrian central bank and the state-owned Commercial Bank of Syria.

European Union (EU) governments are also mulling sanctions aimed at stopping president Bashar al Assad from accessing cash via the banking sector. This is likely to intensify pressure on the wider financial system in Syria.

Syrians have been pulling money out of banks in growing numbers and looking for alternative safe havens.

In October, the country's largest lender, the Commercial Bank of Syria, was hit by fresh EU sanctions preventing it from being able to finance transactions through letters of credit issued by the bank.

Up to now, Syrian commercial banks have masked much of the crisis' impact on the bottom line thanks to the Syrian pound's four to five per cent depreciation against major currencies. This has enabled most banks to translate foreign currency positions into Syrian pounds at a gain, thereby boosting operating revenues by nearly 50 per cent, despite growth of only 10 per cent in recurring income in the third quarter of this year.

Syrian banks' foreign currency assets are being placed abroad and reported at a certain exchange rate on their balance sheet. This year, because of the depreciation of the Syrian exchange rate, they are reported at a higher value.

Banks have made gains out of the revaluation of foreign currency assets and concealed their actual performance. But, warns Joude Badra, deputy head of investment banking at Bemo Saudi Fransi Finance in Damascus, if this gain is taken out of the equation, the banks would show a loss of 700 million Syrian pounds (about \$14 million) in pre-tax profits for the third quarter of this year. "The banks aren't coping, but their income figures are concealing the impact," he says.

Private banks' profitability has also increased partly as a result of the withdrawal of deposits lowering interest expenses.

This situation is unlikely to sustain if customers continue to pull deposits out of banks at the rate they have been, in a slow-motion run on banks that has boosted the unofficial cash economy. The aggregate deposits of the 12 banks fell by 21 per cent in the first nine months, representing a combined outflow of \$2.2 billion.

A closer look shows smaller balance sheets, weaker lending growth, lower cost efficiency, and a deteriorating asset quality across the Syrian banking community.

Many Syrians are pulling out funds from banks in order to buy US dollars, the traditional safe haven of first resort. "A lot of Syrians are scared primarily of currency depreciation and in turn inflation, so are withdrawing their money to buy forex, and this is not getting back into the banks," says Badra.

However, banks are forbidden from selling dollars to customers except for specific export or other reasons, under capital controls introduced in August. People cannot buy more than \$2,000 a year in Syria without adequate justification. The central bank's decision to hike interest rates by two per cent in June is also helping to slow down customer withdrawals.

Banks are limiting the amount that customers can withdraw per month by charging extra fees on each dollar withdrawn, making it even harder for customers to take out cash. However, the effect of this is ultimately to further erode trust in banks, giving a fillip to the cash economy and other safe havens such as real estate.

Some Lebanese estate agents have noted an increase in interest in Beirut real estate from Syrians, notably in the Christian Ashrafieh area of the city.

Reports of large hauls of cash being smuggled into neighbouring Lebanon have prompted fears that wealthy Syrians are ploughing their holdings across the border. The Bekaa town of Chtoura once served as an offshore banking centre for Syrians, before reforms created a commercial banking system in the country in the mid-2000s. Chtoura may once again become the repository for Syrian funds if the uprising continues.

Much of the flow across the border is in the form of cash, as some wealthy Syrians attempt to escape an impending asset freeze. In October, Syria's state news agency reported the interception of \$100,000-worth of Syrian pounds being smuggled across the Lebanese border under a car seat.

Yet if growing amounts of money are being transferred across the ante-Lebanon range, it is not registering in official bank figures in Beirut. Despite an increase in Lebanese commercial bank deposits of 4.4 per cent in the first nine months of 2011 to \$113.4 billion, the Banque du Liban (central bank) says its strict fund deposit protocols have stymied non-resident deposits. Governor Riad Salameh indicated that deposit growth in 2011 had been slower than in 2010.



"It's possible more money is going out through Lebanon but it's difficult to quantify as it is illegal to take cash out of the country and as such there are no official figures," says Badra.

The Syrian central bank is doing what it can to stimulate the official dollar market by holding an auction of \$15- \$20 million every four to five days to bring in the currency dealers, but this is not helping the situation. Demand for the greenback exceeds this level.

Syria's respected central bank governor Adib Mayaleh claims that the country's \$18 billion stock of foreign currency reserves affords ample protection against a run on the Syrian pound. He has reportedly spent up to \$5 billion of a "rainy day" fund to protect against a run on the currency this year.

Mayaleh nonetheless faces an uphill task in defending the pound in the face of worsening government finances, with tax revenues feeling the pinch from the decline in economic activity.

Syrian banks are looking at a tough 2012. If the situation continues there will be provisions, more defaults on loans and less lending. Deposit withdrawals may have slackened recently with the restrictions, but haven't stopped and will continue unless the political situation improves.

"The banks are coping on paper because of the revaluation and it is possible that, should the pound depreciate further next year, they will also report gains on paper," says Badra. "That said, the longer this crisis continues, the less likely banks are to extend new loans and facilities, meaning less new business. And more debtors will default on payments causing higher provision expenses. This will in turn increase their loss from core banking activities," he adds.

Banks have few lending options and even the retail market looks too risky in times of crisis. Sanctions are now limiting trade activity, so trade finance will also take a hit.

Other indicators paint a dismal picture of economic activity across the board. The stock market index has fallen by about 50 per cent since the start of the year.

The bad news for president Assad is that the business community has been one of his few props of support in the gathering crisis. Liberalisation measures introduced in the past five years have benefited the well-connected business communities of Damascus and Aleppo, and this has played a role in ensuring the relative calms in its two biggest cities.

If the business community really starts to feel the pinch, these remaining bonds of loyalty could fray. A historical example serves as a grim portent for the Assad regime: it was the growing resentment of Iran's Bazaari merchant class toward the Shah of Iran that helped to tip the balance against him in the 1979 Islamic Revolution.

Bashar's ability to ride out the financial storm could be circumscribed if a political resolution is not found soon. And with enemies on all sides joining forces against Damascus, this looks an increasingly distant prospect. <

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