MERCY CORPS
Humanitarian Access Team

ECONOMIC PERILS DEEPEN FOR DAMSCUS

Situation Report

September 2022

Contents

The Syrian pound has depreciated again to a low not seen since March 2021. As a result, compounded by restricted imports, depleted foreign currency reserves and supply-chain iterruptions, prices of food and fuel are on the rise. At the same time, Damascus' continued attempt to stabilize the currency, and preserve foreign currency reserves have failed to have a significant impact.

Key points

- Depreciation of the Syrian pound, which reached a low of over 4,500 SYP to the dollar in August 2022, combined with a rise in global inflation, restricted supply of imported items and reduced government spending have disproportionatley affected Syrian communities in government-controlled areas.
- Years of conflict and sanctions have depleted foreign currency reserves, restricted imports, reduced domestic supply and, by extension, increased prices for food and other basic commodities.
- Fuel imports have also been affected; much of the oil in Syria is located outside Damascus' jurisdiction, and reliant on crossline imports from the northeast. Imports from allies have been curtailed by international sanctions – both means are unreliable and dependent on the government's ability to pay.
- Problems with supply have inflated the price of fuel – higher diesel prices are quickly passed onto many food items, mainly locally-produced vegetables.
- As a way to cut spending and preserve foreign currency reserves, Damascus has cut back subsidies and increased rationing, while reducing its funding for imports of specific items.
- The recent currency depreciation, and Damascus' money-saving policies, have inflicted price increases on imported goods in Syrian government areas, particularly cooking oil, sugar, and chickpeas.
- The Central Bank has tried to reduce its budget deficit through various means, including selling treasury bonds. Although bonds have been sold, and money is coming in, the amounts raised have been insufficient to significantly reduce the deficit.
- With fuel price increases leading to cost of living increases, most noticeably for food, Syrian communities in government-held areas face continuing hardship – a situation which the government is struggling to keep stable, and seemingly unable to improve.

Current situation

The economic situation of government-held areas continues to worsen, indicated by further depreciation of the Syrian pound, subsidy removals and increasing prices of fuel, food and other basic commodities. The Syrian pound depreciated 14% in the last two months alone, dropping to a low of below 4,500 SYP on 20 August for the second time since March 2021. The recent depreciation highlights the continued erosion of the government's economic and financial fundamentals following a decade of conflict, mounting economic pressures, and limited options to mitigate the decline.

The depreciation is compounded by import difficulties, with sanctions preventing foreign trade with Damascus, and low foreign currency reserves limiting procurement funding. Additionally, along with a reduction in import expenditure, the government has sought to reduce its budget deficit through a gradual subsidy removal policy that ranges from excluding large segments of the population from receiving essential items at a subsidized price.

For Syrians, the depreciating value of the pound, coupled with a reduction in subsidies, shortages of basic items and increasing prices, particularly for fuel and food, are unlikely to be resolved in the short-term, putting pressure on households struggling to make ends meet.

Figure 1. *SYP/USD rates from January 2022 to September 2022.*

Fuel prices

The fuel crisis continues to intensify in government-controlled areas, amid the government's lack of import options due to sanctions and its inability to fund imports due to foreign currency reserve deficits. Domestically, this has been reflected in shortages of fuel and its derivatives, an increase in fuel, gas, and diesel prices, and increasingly austere measures by the government, including reducing subsidies and rationing. High fuel prices have exerted further pressure on domestic economic activity, by increasing the cost of basic commodities, and disrupting transportation and service provision (particularly electricity).

GPS devices installed on public transportation vehicles

The Syrian government has begun implementing a long-planned project to install GPS devices on public transportation vehicles. Several governorates such as Damascus, Lattakia, Tartous, Aleppo, and Homs issued a mandatory decision in August requiring their registered public transportation vehicle owners to conduct the necessary paperwork to install GPS devices. The device that the owners are asked to purchase reportedly costs 350,000 SYP and has an additional monthly service subscription of 2,500 SYP. Mazen Dabbas, member of the Damascus governorate executive council, told pro-government media that 4,000 vehicle owners have paid and registered for the GPS device installation and expects the number to increase up to 8,500. Additionally, Malek al-Kheir, member of the Lattakia executive transportation council, stated that 600 vehicle owners have paid and registered for the device.

Minister of oil and mineral resources, Bassam Tohmen, inspecting the installation of GPS devices on vehicles Soumariyyeh (Source: Syrian Prime Minister's Facebook page)

This measure follows the prolonged and intense fuel crisis throughout government-held areas and the government's growing inability to provide sufficient amounts of subsidized petrol for its citizens and public transportation sector. Moreover, the decision to install GPS devices was reportedly taken to ensure that public transportation vehicles stay on their designated routes and monitor their fuel consumption to assess the amount of subsidized fuel they should be provided with accordingly. Moreover, those who refuse to install GPS devices on their vehicles risk losing their subsidized fuel allocations and potentially their license.

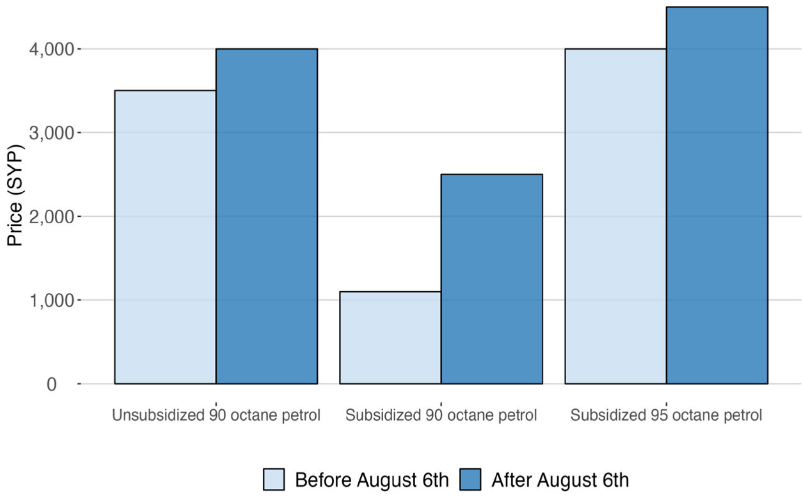

Figure 2. *Price of unsubsidized and subsidized petrol in Syrian government areas.*

On 6 August, the Ministry of Domestic Trade and Consumer Protection raised the price of subsidized fuel by 127%, from 1,100 SYP to 2,500 SYP per liter. Simultaneously, it also raised the prices of unsubsidized petrol from 3,500 to 4,000 SYP per liter and high-octane gasoline from 4,000 to 4,500 SYP per liter. Meanwhile, local sources stated that the black-market prices of diesel and gasoline currently range between 7,000–7,500 and 7,000–8,000 SYP respectively. Justification for this upward adjustment, the third of its kind this year, was on the basis of reducing expenses on the state budget.

This new increase of 127% for the price of subsidized fuel, to 2,500 SYP per liter, comes at a time when the average monthly salary of public sector employees hovers around 150,000 SYP, or approximately $33 at the 4,500 SYP exchange rate. It is also significantly higher when compared with the last reported increase in May 2022 a 47% increase from 750 to 1,100. Delays in the delivery of subsidized fuel within south and central governorates have reduced the ability of fuel providers to meet local demand. Sources have stated that subsidized fuel deliveries are increasingly delayed, with subsidized petrol being delivered every two weeks on average instead of one week; subsidized gas canisters have also been delayed, increasing from 21 days to 130 days. Media sources attributed the delay to a 30% reduction in fuel allocations to gas stations.

Fuel rationing and removal of subsidies are similar to developments of June 2022, when an 18-day delay in the delivery of subsidized petrol raised the black-market price to 8,000 SYP per liter, with consumers able to receive their allocations of subsidized petrol only once a month as a result of consecutive delays.[1] Additionally, recipients in Homs city experienced a 15-day delay during the same month, with Governor Samir al-Droubi explaining that the governorate received only 11 deliveries of gasoline, of the 17 which were requested. The interruption of fuel supply to the local market has not only been a consequence of allocation shortages, but also as an anticipatory measure by gas stations when rumors of new

1 Citizens commonly receive SMS text messages informing them when their subsidized petrol allocation has arrived and which gas station to purchase it from.

price adjustments begin to circulate. For instance, media sources argued that the closing down of gas stations supplying high-octane gasoline in the capital Damascus came as a precursor to an anticipated announcement by the Ministry of Domestic Trade concerning new price listings, which proved accurate.

Diesel, for which subsidized prices have not increased, has however become difficult to even procure on the black market. The cost for a liter stands at 7,000 SYP per liter, and individuals and households willing to buy at this inflated price are finding it difficult to purchase enough.

Diesel is required for transportation, and agricultural and industrial production, meaning price increases impact both logistics and production costs, which likely impact consumer prices (Figure 3). With the winter season approaching, the delays in allocation of subsidized diesel (set at 700 SYP per liter), coupled with the soaring prices of firewood, have increased local concerns about securing sources for heating.

Locals from Dar'a indicated that the government has yet to start distributing diesel vouchers in the governorate, voicing their distrust in the Fuel Directorate, which managed to distribute only one batch of diesel (50 liters) out of a planned 200 liters last winter. Given the delays in diesel distribution and its high price on the black market, a significant number of families in the governorate will be able to purchase only a few liters of diesel at once.

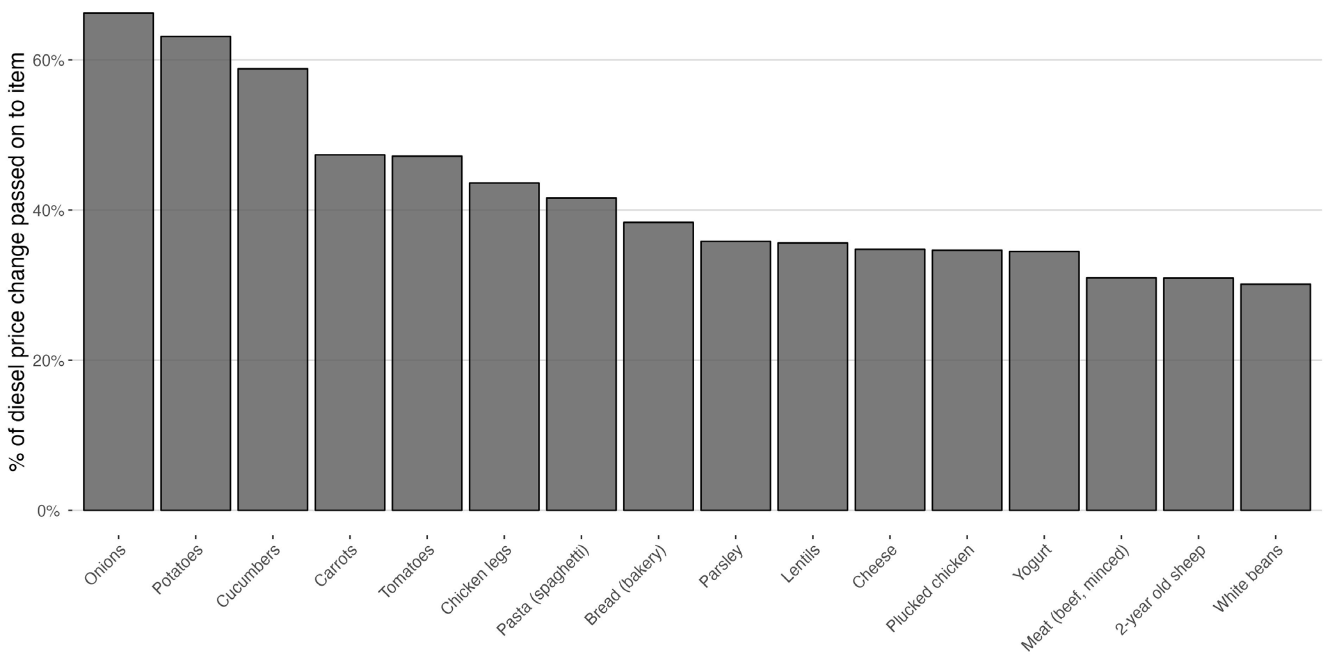

Figure 3. *Diesel pass-through effect on food prices in government-held areas.*

Import disruption, depreciation and subsidy removal

The increase in fuel prices is mostly attributed to three variables: import difficulties, the depreciation of the Syrian pound, and the Syrian government's policy of gradual subsidy removal. These variables are in turn symptoms of the economic crisis in government-controlled areas, brought about through the severe conflict-induced damage to productive economic infrastructure, loss of access to strategic territories and natural resources now claimed by the Syrian opposition and the Autonomous Administration in Northeast Syria, sanctions, and the loss of significant financial assets due to the economic breakdown in neighboring Lebanon, and the onset of the Russian–Ukrainian conflict.

Importing fuel and other basic commodities has become an increasingly daunting task for the Syrian government, both in terms of securing import options due to sanctions as well as harnessing the foreign currency reserves sufficient to carry out import transactions. The sanctions have placed the Syrian government in a state of economic isolation, leaving the latter with very few options to secure the import of strategic commodities such as fuel and wheat. While the Syrian government has been able to bear the brunt of sanctions through support from Russia, it has been finding it increasingly difficult to import oil from abroad, particularly with Russian economic assistance being scaled back following the onset of the Russian–Ukrainian conflict and consequent sanctions targeting Moscow. Even if the Syrian government manages to land a new fuel trade partner, funding the import process is practically impossible, given the extremely low foreign currency reserves, not to mention large current-account and budgetary deficits, a status-quo unlikely to change in the foreseeable future in the absence of significant foreign direct investment.

As for fuel transported from Administration-held areas, media sources claimed that crude oil shipments from northeast Syria resumed in June 2022, following an understanding between Syrian government and Syrian Democratic Forces (SDF) officials over their stance towards Turkey and the anticipated military offensive. The volume of crude oil shipments, which is regularly transported to the Homs refinery by the pro-government Qaterji Company, has reportedly increased to an estimated 20,000 barrels per day (bpd) since June 2022, compared to 10,000 bpd before the period of interruption in early April.

Yet, the oil supply from the northeast only serves as an auxiliary source for government-controlled areas; its reliability and consistency cannot be guaranteed. That said, the Syrian government's relationship with Iran has gained an even more strategic dimension, with Tehran providing Damascus with fuel and its derivatives through what is known as the Iranian credit line. Within the conflict's setting, the first credit line between the two states, dating back to 2013 and reportedly valued at $1bn, allowed the Syrian government to fund the purchase of basic goods, fuel included. Further credit line agreements were signed in the period between 2013 and 2019, with economic cooperation expanding from the finance of basic commodities towards that of projects related to energy and infrastructure; this mechanism reportedly ended in 2019 for unknown reasons.

Only recently in May 2022, and particularly following Assad's second visit to Tehran since the onset of the conflict, has the Iranian credit line been revived. Indeed, media sources reported that four oil tankers arrived in June 2022, a month after the line's reactivation, delivering a total of 3.3 million barrels of crude oil to the Banyas port; the port has also seen the unloading of gas tankers in parallel with shipments to filling units in the governorates, in an attempt to alleviate the domestic gas shortages in recent months.

Also, two oil tankers arrived at Banyas port during the second half of August; the first carrying 31,000 tonnes of diesel, and the second carrying 5,000 tonnes, bringing the total number of gas and oil tankers that Iran sent to Syria during August to five, in addition to one that arrived last July carrying one million barrels of crude oil.

However, unconfirmed reports have indicated that the new line differs from its predecessors, as the value of Iran's crude shipments are to be paid back with interest, making it more costly for the government. Given the vagueness surrounding the May 2022 credit line, it remains unclear whether it will be sufficient to resolve the government's fuel shortage.

Moreover, even if the credit line is sufficient, the stability of the supply chain is not guaranteed; a Russian-flagged oil tanker, called Pegas, carrying 115,000 tonnes of Iranian oil was intercepted by the Greek coast guard on 19 April while en route Marmara in Turkey and its contents were later confiscated and transferred to the US government. The incident highlights that interception and confiscation continues to be a valid threat for Iranian oil shipments as the US and its allies enforce sanctions.

Additionally, it is not unlikely that the unexplained 2019 credit line suspension would take place again some time in the future, especially as Iran is well-aware that the Syrian government does not have the capacity to repay its debt obligations. In fact, Iran itself is suffering from economic pressure and financial difficulties due to sanctions imposed on it. Indeed, the Iranian economy itself is unstable, characterized by high inflation, high taxes, and low purchasing power which is likely to limit the Iranian government's ability to extend credit.

Food prices

Food prices have also increased in the past few months, due to an amalgamation of contributing factors. In addition to the above-mentioned fuel price increases, the pound's depreciation and low supply caused by import difficulties have been contributing factors. The pound's depreciation is likely to push traders to adjust their prices and increase them accordingly while low supply caused by import logistics and funding issues are likely to push up prices further, particularly for items with high demand.

The pass-through effect, the change in domestic prices as a result of changes in a foreign currency exchange rate, is useful for measuring the impact of the pound's depreciation on the price of food items in Syria. The increase in food prices due to depreciation among items with statistically significant pass-through effects are found in Figure 4.[2,3]

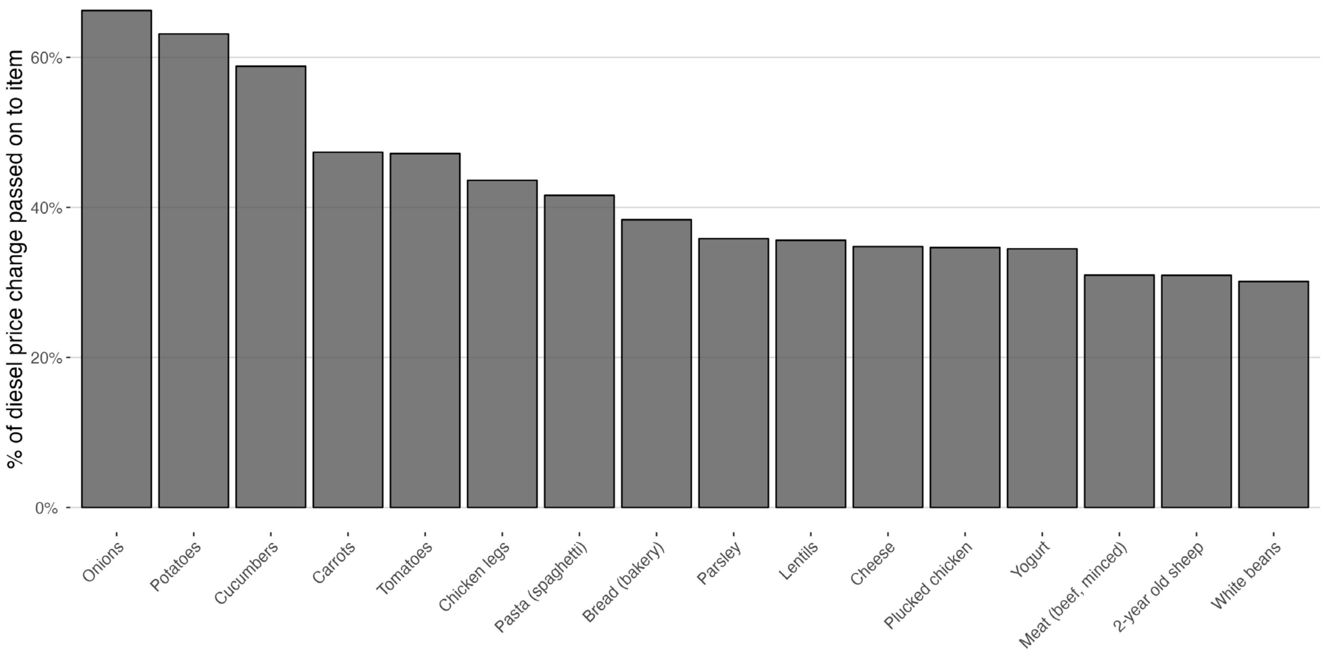

Figure 4. *Projected food price increases due to SYP/USD depreciation in Syrian government areas. The red dotted line represents the change in average monthly SYP/USD exchange rate from July 2022 to September 2022 (11.1% as of 15 September).*

2 Food items recorded by WFP in all markets in Syrian government areas with price data every month from February 2022 to July 2022.

3 Price projections are calculated by multiplying the estimated pass-through effect by growth in SYP/USD in August and September and then by the most recent price (July 2022 is the latest from WFP). One month projections are accurate within 6% and two month projections are accurate within 9%, on average among all projected items. Error rates are measured using mean absolute percentage deviation.

Unsurprisingly, imported items produced the greatest pass-through effect because importation directly involves foreign currency exchanges; specifically, the price of bananas, cooking oil, canned tuna, and chickpeas increased nearly or more than the rate of depreciation. Further, when calculated for time periods with higher and lower changes in exchange rate, pass-through rates are on average 16% higher when the change in the average monthly exchange rate exceeds 5%, compared to when the change in the average monthly exchange rate is less than 5%. In other words, merchants raise prices closer to matching the change in exchange rate in times of rapid depreciation.

Import disruption and reduced government expenditure

Price increases for food items can also be attributed to increased scarcity and shortages of certain items; many sources have stated that for several months, there have been sustained shortages of sugar, rice, and sunflower oil in government-held areas. Residents reportedly complained about significant delays in the delivery of subsidized sugar and rice with media sources claiming that the last delivery took place in March.

The Ministry of Domestic Trade and Consumer Protection attributed the sugar shortage to import difficulties due to increased shipping costs and the stoppage of sugar production by certain exporting Arab countries. The Minister of Domestic Trade, Amro Salem stated only 8,000 tonnes of sugar were imported in the past three months, an amount insufficient to meet local demand. This has reportedly compelled opportunistic traders to hoard the commodity to then sell it for higher profits later, leading its black market price to increase 15% since mid-July reaching 5,500 SYP per kg in south Damascus; some media sources reported prices as high as 6,000 SYP. Moreover, Salem also attributed the rice shortage to import difficulties, stating on 1 August that sanctions have discouraged the direct import of rice from China, forcing them to receive these imports through an unidentified third-party. Furthermore, Salem added that sunflower oil imports have also faced difficulties with only 26,000 tonnes of the product being imported since the beginning of the year.

According to media sources, the government has been actively working to resolve import issues. On 4 August, the Ministry reportedly reduced the price of unsubsidized sugars sold at the Syria Trade Establishment (STE) sale points from 4,400 SYP to 3,900 SYP per kg after the arrival of sugar imports and a reduction in global sugar prices, shipping costs, and insurance costs. Additionally, STE General Manager, Ziad Haza‘ stated that sugar and rice distribution will take place from 1 September. Moreover, Salem later stated on 8 September that the government is working on facilitating imports; the Ministry submitted proposals to the Prime Minister’s office to remove import taxes and reduce the cost of importing essential items. However, sources stated that while subsidized rice has become available, the sugar shortage continues; unsubsidized sugar is largely missing from STE sale points as the ministry requested that citizens wanting to purchase sugar at the unsubsidized price order the desired amount through the 'way-in' smart card mobile application.[4]

While government officials cited import difficulties, mostly attributing them to sanctions, import operations were restricted further by the Central Bank's decision to stop funding imports. The Central Bank usually provides foreign currency for importers at the platform exchange rate, an exchange rate specific for those who wish to purchase foreign currency to pay for their imports. Moreover, this exchange rate is only used to fund the import of a specific list consisting of essential food items in addition to agricultural and industrial raw materials.

The Syrian Central Bank stated on 21 August that "it will be providing foreign currency at a reduced exchange rate for wheat, medicine, and baby formula imports." The term 'reduced exchange rate' is notable, considering that the Central Bank usually uses the term 'platform exchange rate' when referring to import funding. Local sources have noted that the underlying meaning of this statement could be that funding imports will now be limited to the three above-mentioned items. While this interpretation was uncertain, Mohamad Hallak, of the Damascus Chamber of Commerce blamed the government for the market price increases, stating that the Central Bank's decision to stop funding imports to save foreign currency resulted in a shortage of many items. Hallak added that "only ten to fifteen importers are active at a time when hundreds should be" and that "five rice shipments are imported at a time when it should have fifty."

Analysis and Forecasting

The Syrian pound's recent depreciation and the subsequent price increases in both fuel and food are not particularly surprising, as the Syrian economy has been stuck in a downward spiral. Ten years of protracted conflict have devastated the Syrian economy and financial structures: poor monetary policy, corruption, sanctions on Damascus and its supporters, and the Lebanese financial crisis have accelerated the pound's depreciation.

4 The 'Way-in' mobile application was made by the Takamol company which manages the smart card system. Through the application, a citizen can see how much of his allocations he/she has left, the date and location of delivery of allocations, and can now order certain unsubsidized items, particularly sugar, through the app to purchase them.

However, the recent depreciation follows several notable indications, explored below, that the Central Bank's much-needed foreign currency reserves have depleted further to dangerously low-levels in parallel to the continued deterioration of socio-economic conditions in Syria.

The Syrian Central Bank's decision to seemingly halt funding for most imports was apparently motivated by its need to save foreign currency. Additionally, the government has instigated a cost-saving reduction in subsidies (those newly exempt from the subsidy program in August are shown in Figure 5), and rations for many citizens; bread rations for households of two people or less have been reduced,[5] and the price of subsidized petrol, as mentioned above, was increased up to 127%. Subsidy removal for raw commodities and inputs such as fertilizer, which increased its price up to 92%, is likely to further increase production costs, and by extension, consumer prices.

There are also indications that there are foreign currency shortages on the black market which aren't being replenished. Traders requesting foreign currency from the Central Bank to fund their imports, excluding the above-mentioned items, have been turned down, forcing them to purchase the necessary foreign currency from the black market.

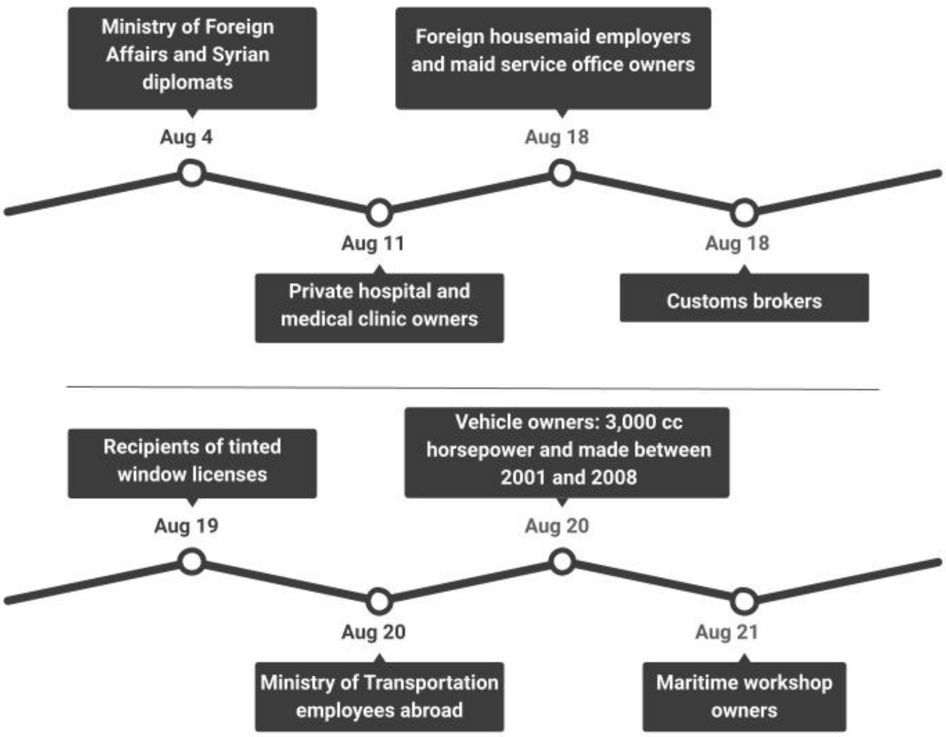

***Figure 5.** Individuals exempt from the Syrian government's subsidy program, by employment type.*

5 The weekly rations of a one person family have been reduced from 4 to 3 packets per week and a two-person family from 6 to 5 packets per week.

Sources also noted a reduction in remittances from Syrian expats due to global inflation, further reducing the amount of foreign currency entering the country. Both factors have reportedly contributed to the foreign currency shortages; and its continuation could indicate that the Central Bank has yet to intervene and pump foreign currency in the market.

Finally, the Syrian government has been increasingly resorting to SYP-denominated treasury bonds to finance its budget deficit; treasury bonds financed 29% of its deficit in 2021 and increased to 31% during the first eight months of 2022. In parallel, the government continues to fail to reduce its budget deficit, which increased from SYP 3,484 tn in 2021 to SYP 4,118 tn in 2022. However, this has not deterred the Syrian government from selling its bonds. The Syrian Central Bank announced a bid on 1 August for treasury bonds amounting to SYP 300 bn; the bid later saw 8 out of the 17 licensed banks participate and purchase more than SYP 227 bn worth of bonds. Additionally, the government is planning on increasing treasury bond sales further; the Ministry of Finance issued a treasury bond calendar for 2022 which shows that it plans on selling an additional SYP 1.1 tn worth of bonds by the end of the year, bringing the total amount of debt sold to SYP 1.6 tn.

The government also expanded the pool of eligible bidders beyond banks and insurance companies and facilitate the purchase of bonds. The Syrian Commission of Financial Markets and Securities issued decision 151 on 7 September allowing individuals to purchase and sell treasury bonds in the market. Moreover, the Syrian Minister of Finance, Kinan Yaghi, stated that the government is working on allowing individuals to purchase and sell treasury bonds through mobile apps. Yaghi added that this could be considered an investment opportunity for citizens and a way to fund the state's coffers.

***Table 1**. Syrian government's treasury bond sales since 2020 (Source: Syrian Central Bank)*

Date	Purchase rate	Banks involved	Bid value (in SYP)	Bid value (in USD)
3 February 2020	99%	7/17	150 bn	145 m
10 August 2020	100%	5/17	150 bn	72 m
15 November 2020	87%	8/17	116 bn	40 m
31 January 2022	79%	6/17	188 bn	62 m
8 August 2022	85%	8/17	300 bn	70 m

Economic deterioration expected to continue

The economic situation in government-held areas is expected to deteriorate in the absence of effective economic tools which can stabilize the currency in the long-term. With the absence of sufficient foreign currency reserves to pump into the market, the Central Bank is currently planning on dealing with inflation through implementing contractionary monetary policies; Iyad Bilal, the Central Bank's treasury manager, stated that the bank is conducting liquidity management through controlling the money supply and facilitating the circulation of existing currency in the market through the introduction of electronic payments. Sources stated that, in the absence of sufficient foreign currency to inject into the market, the government is opting for limiting or reducing its money supply instead.

The planned SYP 1.6 tn in treasury bond sales enable the government to put money out of circulation; approximately SYP 500 bn have, in theory, been removed from the market this year so far. Additionally, the Central Bank introduced an electronic payment system in January to ease financial transactions, increase the efficiency of tax collection, and facilitate currency circulation (as there are no daily restrictions on amounts for electronic payments).[6] Sources have stated, however, that the system faces technical difficulties at times and isn't being widely used for conducting tax payments yet, making it an ineffective tool so far.

In addition to its seeming contractionary monetary policies, the government has also used a heavy-handed (raiding and seizing companies, and confiscating foreign currency bank notes) approach to deal with the depreciation. The Central Bank stated on 14 August that it "continues to follow and monitor SYP transactions in the foreign currency market and will intervene by taking the necessary measures to stop the individuals engaging in currency speculation and manipulating the exchange rate." However, past events have shown that such solutions have been ineffective. Given the Central Bank's inability to effectively intervene to stop the pound's depreciation, it is likely that the Syrian economy and financial sector will continue to deteriorate, consequently making the cost of living for already cash-strapped families more unaffordable.

6 The system was initially connected to four banks enabling their 575,000 clients to conduct electronic payments through more than 1,000 P.O.S (Point of sale) devices spread across different sectors. Syrian Central Bank governor, Issam Hazimeh, later stated on 24 August that the number of banks connected to it electronically increased to eight.

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The Humanitarian Access Team (HAT) was established in Beirut in March 2015 in response to the collective challenges facing the remote humanitarian response in Syria. HAT's most important function is to collect and analyze disparate data and information. Since 2015, HAT analysis has provided a forward-looking template for international interventions in Syria, and facilitated an increasingly adaptive, integrated, and ultimately impactful international response to the conflict.