A diagnosis of the banking risk profile in the macroeconomic environment in Syria

Abstract. This paper reviews some aspects of risks in the banking industry in Syria in terms of Macroeconomic during the current ongoing crisis, with a consideration of the impact of various factors on the banking industry.

Prior to the crisis, Syria had a stable economy with a positive GDP growth rate. GDP increased 545% from USD 11.1 billion to USD 60.5 billion during the period 1999-2010, but as the crisis began in 2011, GDP declined sharply to USD 23 billion. Syrian financial sector does not contribute significantly to the gross domestic product. This contribution is estimated to represent from 2.1% to 6.2% of GDP.

The banking industry in Syria is taking too many risks in too many areas. Basically, in addition to credit risk and interest rate risk, banks in Syria are subject to the economic sanctions and the volatile of exchange rates in the market.

The paper concludes with a few recommendations to mitigate risk in the banking industry, and boost the banking performance through a robust and effective risk management practices.

Keywords: banking industry; risk management; credit risk; interest rate risk; economic sanctions

Syria suffers the current ongoing crisis for 6 years now (from 2011 to the present time). This led to a deterioration in the macroeconomic environment in the country, and hence, in the financial system and banking industry.

There are some fears that vast risk positions in the banking industry can be accumulated under the nose of the regulators and investors during the current ongoing crisis and the deteriorating macroeconomic environment. Therefore, one will need to identify the macroeconomic profile of the
market in Syria before to review and assess the risk inherent in the banking industry that will be most affected by adverse market conditions.

**Macroeconomic indicators**

Gross domestic product (GDP) is the main indicator that reflects the state of the macroeconomic profile in Syria (figure 1).

![Figure 1. dynamics of Syria's GDP in the period 1990 - 2014 in bn. of US dollars (source: compiled by the author based on data from UN data http://data.un.org/ access mode and evaluation of the Syrian Center for Political Studies)](image)

Syria has had a stable economy with a positive GDP growth rate. Prior to the crisis, during the years from 1990 to 2010, GDP has increased 545% from USD 11.1 billion to USD 60.5 billion. As the crisis began in 2011, and since the economy had become more fragile, GDP has declined sharply to USD 23 billion. [2, page 60]

Syrian financial sector does not contribute significantly to the gross domestic product. This contribution is estimated to represent from 2.1% to 6.2% of GDP. The structure of Syrian GDP (figure 2).
Figure 2. Structure of GDP by industry for the period 2001 - 2014 (source: Calculated by the author based on UN data, world factbook CIA USA, GWB, Syrian Centre of Statistics, Syrian Investment Agency SIA, SCPR - Syrian Center for Policy Research)

The figure illustrates that the financial sector does not contribute significantly to the gross domestic product. This contribution is illustrated to represent from 2.1% to 6.2% of GDP.

In order to be able to manage risk effectively, one will need to consider and identify all aspects of risk that the banking industry in Syria is facing nowadays, before to start analyzing and managing the risk. Moreover, a resilient and robust regulatory framework would itself ensure a sound banking system.

From our point of view, and due to the current ongoing crisis, the factors of risk in the banking industry in Syria can be divided into three main factors: internal, external and international factors. The following figure illustrates each of these factors (figure 3).
International risks are there due to the American, European and Arab economic sanctions imposed on the economy of Syria, and the sharp decline in oil prices.

External risks are imposed by the decline in bank reserves, the volatile of exchange rate and the adverse conditions of the current ongoing crisis. While internal risks are basically Interest rate risk and credit risk.

**Western and Arab economic sanctions**

In 2011, the act № 7442 of the Arab League imposed economic sanctions against Syria. These sanctions include:

- stop all types of financial relationships with the Central Bank of Syria.
- stop all types of financial relationships with the Syrian government.
- freeze any financial asset or any stake of the Syrian government in foreign countries.
- stop businesses, financial transactions and operations with the Syrian government.
- Stop all types of relationships with all state-owned banks including the Commercial Bank of Syria.
stop funding any commercial or financial activity in Syria and cancel any foreign direct investment (FDI).

monitoring any banking operation and cash outflow to Syria with the exception of bank transfers sent from Syrian workers abroad to their families in Syria.

In other words, foreign trade is suffering financing and credit problems due to the economic sanctions that are mentioned above.

In addition to the economic sanctions, the decline in banks’ reserves represents another factor of risk to the banking industry in Syria.¹

Risk is an integral part of the banking business, especially with regard to the increasing in competition, technological development, the increasing in the volume of bank operations and the need for large banks in terms of scale, size, reserves and capital.

Banks in Syria are faced today with a variety of banking risks. These risks vary in severity from one bank to another. A robust risk management is needed to ensure that banks have more and better financial resources with which to operate and to improve the banking’s sector ability to absorb shocks arising from financial and economic stress.

**Exchange & Interest rates**

The volatility of the Syrian pound’s exchange rate has a significant influence on economic relations and trade transactions with foreign countries. Moreover, direct foreign investments have declined as the volatility and inflation rate discourage foreign investors, and put a heavy weight on the banking industry to fill the gap between supply and demand of fund.

On the other hand, sanctions and isolation imposed on the Syrian economy would minimize the fluctuation in exchange rate. This would indirectly protect the Syrian economy in the conditions of rapid changes in the foreign exchange markets, and also, reduces inflation by reducing import costs.

Reducing volatility and stabilizing the exchange rate between the Syrian pound and the US dollar play an important role in rebalancing the Syria’s foreign trade and foreign investment, because volatility will have a negative impact on businesses, and consequently will results in macroeconomic instability in the country.

Prior to the current ongoing crisis, Syrian Pound had a strong value in foreign exchange markets. The exchange rate between Syrian Pound and US Dollar reached 46.25 to 53.13 Syrian Pound for one US Dollar. Ever since the crisis has begun, the exchange rate of Syrian Pound has decreased sharply to 225 Syrian pounds in 2014. The current ongoing crisis has significantly increased losses in Banks’ reserves (see figure 4).

On the black market the dollar in 2014 already sold for 225 Syrian pounds, despite the constant intervention of the Central Bank of Syria in supporting the national currency, a further fall of the Syrian pound has continued. At the end of October 2015, the dollar was worth more than 341 Syrian pounds. Syrian Pound declined as a result of the increase in global demand for the US dollar and the decline in world oil prices below 50 dollars. [2, page 87]

In the current conditions, Syrian banks face multiple risks in regard to the current conditions. The fundamental role of risk management is to avoid the negative effects of these risks in order to ensure the achievement of stability in the Syrian financial market and its links with the global financial markets.

Interest rate risk is the purchase of foreign currency futures contracts or futures or options in order to hedge the risk of an increase or decrease in interest rates for deposits in foreign currency rate.

In order to avoid risks, resulting from changes in the interest rate on deposits in foreign currency suggest the following solutions:

- Purchase of foreign currency futures contracts or future;
- Ensure the financing bank foreign currency exchange rates accepted by the use of - option contracts (purchase and sale rights);
- The formation of a variety of foreign currencies portfolio;
- Forming a portfolio of derivatives for a variety of foreign currencies.

**Credit Risks**

The Syrian war has caused in 2014 bad loans Syrian public banks stood at record levels (figure 5).
Figure 3. Bad loans in the Syrian public banks 2014 in bn. of SYP
(source: http://thawra.sy/_print_veiw.asp?FileName=87101241020140203214147)

This is in order to ensure payment has been issuing a series of decrees that provided for: the exemption or partial reimbursement or re-scheduling for a few years (can be up to 10 years).

To avoid the risks of non-payment of debtors we propose regarding credit loans suggest options contracts (buying and selling rights) to the insurance companies or institutions, insurance and other.

Conclusion

Events develop rapidly during the current ongoing crisis. Syria's economy is under economic sanctions. It suffers from lack of investment and high risk profile. Moreover, the country is experiencing a large outflow of funds from Syria. Hence, the state is required to put in place a robust financial system with resilient banks to tackle all aspects of any potential failure. Such a financial system will be able to finance, fund and invest in development program and sustain economic growth with an increased contribution in GDP in Syria.

Under the fragile macroeconomic profile, the banking industry in Syria is taking too many risks in too many areas and may suffer the consequences if risk were not managed effectively. Risk management needs to be regulated more closely. The first priority of regulatory reform in Syria needs to improve the resilience of the financial system in terms of solvency, capital standard, funding resources and liquidity structure to detect, tackle and prevent any potential failure and imbalances in the banking industry in Syria.

A robust financial system ensures that banks will be able to carry out a more effective foreign trade transactions, develop mechanisms and approaches to provide credit facilities and guarantees to businesses, attract investment, create an innovative products and instruments to fund development program, boost economic growth and invest in infrastructure projects.
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Диагноз рисков банковской индустрии
в макроэкономической среде в Сирии

Аннотация. В данной работе рассматриваются некоторые аспекты рисков в банковской отрасли Сирии с точки зрения макроэкономики в современных условиях кризиса в стране, с учетом влияния различных факторов на банковскую отрасль.

До кризиса, Сирия имела стабильную экономику с положительным темпом роста ВВП. В период 1999-2010 годов ВВП постепенно вырос с 11,1 млрд долларов США до 60,5 млрд долларов США или на 545%. В условиях кризиса с 2011 году по 2014 гг. ВВП резко снизился до 23 млрд долларов США. Сирийский финансовый сектор существенно не вносит вклад в валовой внутренний продукт, поскольку его доля в ВВП переделах 2,1% - 6,2%.

В современных условиях барьеры развития банковской индустрии в Сирии представляют слишком много рисков для разных областей экономики. Что дополнение к кредитному риску и риску изменения процентных ставок, банки в Сирии подлежат экономические санкции и острые колебания валютных курсов на отечественном рынке иностранных валют.

В данной работе разработаны некоторые рекомендации для снижения рисков в банковской сфере, а также повышения производительности за счет банковской надежной и эффективной практики управления рисками.

Ключевые слова: банковская индустрия; управление рисками; кредитный риск; риск изменения процентных ставок; экономические санкции
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