

Iraq: Second Review Under the Stand-By Arrangement and Financing Assurances Review—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Iraq

In the context of the second review under the Stand-By Arrangement and the financing assurances review, the following documents have been released and are included in this package:

- The staff report for the Second Review Under the Stand-By Arrangement and the Financing Assurances Review, prepared by a staff team of the IMF, following discussions that ended on October 30, 2008, with the officials of Iraq on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 3, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement of December 15, 2008 updating information on recent economic developments.
- A Press Release summarizing the views of the Executive Board as expressed during its December 17, 2008 discussion of the staff report that completed the review.
- A statement by the Executive Director for Iraq.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: <http://www.imf.org>

Price: \$18.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

IRAQ

**Second Review Under the Stand-By Arrangement
and Financing Assurances Review**

Prepared by the Middle East and Central Asia Department
(In consultation with other departments)

Approved by Adam Bennett and David Marston

December 3, 2008

- This report is based on discussions held during October 25–30, 2008 in Amman. Staff met with Minister of Finance Al-Zubaydi, Minister of Oil Al-Shahristani, Governor of the Central Bank of Iraq (CBI), Al-Shabibi, other senior officials, and parliamentarians. The staff team comprised Messrs. De Vrijer (head), Grigorian, Kock, and Ms. George (all MCD), Ms. Oliva-Armengol (SPR), Mrs. Kokenyne (MCM), and Mr. Bergthaler (LEG). Mr. Ibrahim, the Fund’s resident representative for Iraq, assisted the mission.
- The Executive Board approved a 15-month Stand-By Arrangement (SBA) on December 19, 2007, in an amount equivalent to SDR 475.36 million (40 percent of quota). The main objectives of the program are to maintain macroeconomic stability, facilitate higher investment and growth, and move forward with key structural reforms.
- The first review under the SBA was completed on September 3, 2008. The authorities continue to treat the arrangement as precautionary.

Contents	Page
Executive Summary	4
I. Introduction.....	5
II. Recent Economic and Political Developments.....	5
III. Policy Discussions.....	9
A. Macroeconomic Outlook and Risks.....	9
B. Fiscal Policy and Related Measures.....	10
C. Monetary and Exchange Rate Policies.....	11
D. Public Finance Reform.....	13
E. Banking Reform	15
F. Other Issues.....	15
IV. Program Monitoring, Financing Assurances, and Future Relations	15
V. Staff Appraisal	17
 Boxes	
1. Pricing of Fuel Products in Iraq	12
2. Public Financial Management Reform	14
3. Key Findings of the Financial and Operational Audits of Rafidain and Rasheed Banks	16
 Figures	
1. Violence Indicators, June 2003–September 2008.....	5
2. Output and Inflation	7
3. External and Fiscal Indicators.....	8
4. Official Fuel Prices in Iraq, 2004–08.....	11
5. Real and Nominal Exchange Rates, January 2004–September 2008	13
 Tables	
1. Selected Economic and Financial Indicators, 2006–13	19
2. Fiscal and Oil Sector Accounts (in billions of Iraqi dinars), 2006–13.....	20
3. Fiscal and Oil Sector Accounts (in percent of GDP), 2006–13	21
4. Central Bank Balance Sheet, 2006–13.....	22
5. Summary Balance Sheet of Deposit Money Banks, 2006–13	23
6. Monetary Survey, 2006–13	24
7. Balance of Payments, 2006–13	25
8. Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2007–08.....	26

Tables (Concluded)

9. Structural Performance Criteria, and Structural Benchmarks Under the Stand-By Arrangement.....	27
10. Availability of Purchases Under the Stand-By Arrangement, 2008–09	28
11. Indicators of Fund Credit, 2004–14	28

Appendix

External Debt Outlook	29
-----------------------------	----

Attachments

I. Letter of Intent.....	32
II. Second Supplementary Memorandum of Economic and Financial Policies for 2008–09.....	34

EXECUTIVE SUMMARY

Economic activity is picking up in 2008, and growth for the year is expected to be robust. Improved security and the reopening of the northern pipeline to Turkey have contributed to higher oil production and exports. Non-oil activity has also started to recover, albeit from a low base.

Inflation has remained subdued thus far in 2008 as exchange rate policy was adjusted in anticipation of price pressures expected from increased spending in the 2008 supplementary budget. The civil service wage increase that came into effect in June has had a limited impact on inflation thus far, and annual consumer price inflation in October was 7½ percent. Core inflation (excluding fuel and transportation), however, remained at about 13½ percent in October, in part because of higher food prices. The Central Bank of Iraq (CBI) increased the pace of appreciation of the dinar during July–October. In view of the limited price pressures, the CBI lowered its policy interest rate to 15 percent as of early November.

The draft 2009 budget is based on much lower oil revenue projections but allows for an increase in investment spending and security outlays. Current spending will be strictly contained, in particular on the wage bill and transfers. Efforts are underway to reform the in-kind Public Distribution System.

The CBI will maintain its tight policy stance by gradually appreciating the exchange rate of the dinar in the coming months, and by keeping the policy interest rate positive in real terms to keep inflation under control.

The authorities will consider adjusting domestic fuel prices after the provincial elections scheduled for early 2009. With lower world oil prices, the indirect subsidies on fuel products are projected to decline in 2009.

Structural reforms will continue. Priority reforms in public financial management will be based on the recently adopted action plan in this area. The CBI will continue to improve its accounting and reporting framework, and an external auditor will be appointed to conduct the audit of its 2008 financial statements. Restructuring plans for Rafidain and Rasheed banks will be developed with assistance of the World Bank and other international partners. The remaining prudential regulations for banks are being finalized. Governance in the oil sector will be strengthened by further extending metering systems and by implementing the Extractive Industries Transparency Initiative (EITI) procedures.

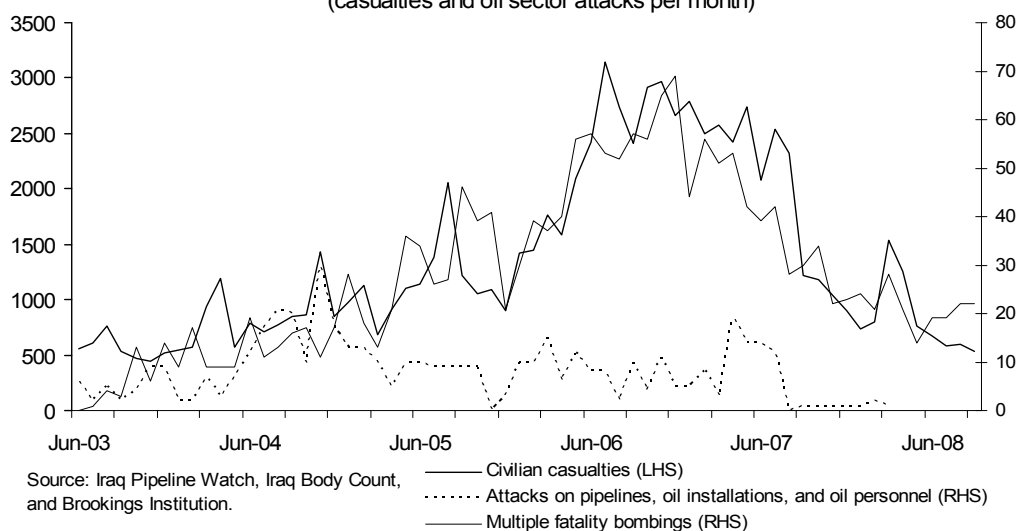
I. INTRODUCTION

1. **This is the second and final review under Iraq's second Stand-by Arrangement (SBA).** The (precautionary) arrangement expires on March 18, 2009, at which point Iraq will have completed over three years of programs continuously supported by upper credit tranche arrangements with the Fund. Iraq's first SBA was approved on December 23, 2005, and was extended twice before being cancelled just prior to approval of the present arrangement on December 19, 2007. Completion of this review (by end-December 2008) will trigger the third and final stage of Iraq's Paris Club debt reduction agreement, for a total debt reduction of 80 percent (in net present value (NPV) terms).¹

II. RECENT ECONOMIC AND POLITICAL DEVELOPMENTS

2. **The security situation in Iraq continues to improve and some progress has been made toward political reconciliation.** The rejoining of the Cabinet by ministers belonging to Sunni and other political parties in July 2008 has strengthened the position of the government. The provincial elections law was enacted on October 3, allowing the elections to be held in early 2009. A draft agreement on the future status of foreign forces in Iraq has been approved by the Council of Representatives (CoR), ahead of the expiration of the United Nations mandate on December 31, 2008. The turnaround in the security situation achieved in 2007 has been sustained. Indicators of violence show an improving trend in 2008 despite intermittent flare-ups.

Figure 1: Violence Indicators, June 2003–September 2008
(casualties and oil sector attacks per month)



¹ The Paris Club agreed on November 21, 2004 to a debt reduction for Iraq, equivalent to 80 percent in NPV terms, to be achieved in three stages. The first and second stages, each comprising a 30 percent debt reduction in NPV terms, went into effect in November 2004 and in December 2005 (following approval of the first SBA), respectively. The final stage will comprise an additional 20 percent debt reduction in NPV terms, and depends on completion by end-2008 of the second and last review under the current SBA.

3. **Economic activity has picked up in 2008, underpinned by improving security.**

Following the reopening of the northern pipeline to Turkey, crude oil production in the first eight months of 2008 rose to 2.3 million barrels per day (mbpd), compared with 1.9 mbpd in the same period of 2007. Oil exports in the first nine months of 2008 were running slightly ahead of the target average for the year of 1.8 mbpd. Preliminary indications, including from the industrial production index, are that non-oil activity also picked up, albeit from a low base. On this basis, real GDP growth is expected to increase to almost 10 percent in 2008 from 1½ percent in 2007.

4. **Inflation has been subdued thus far in 2008.** Annual consumer price inflation in October was 7½ percent, reflecting declining black-market fuel prices. Core inflation (which excludes fuel and transportation costs) has remained somewhat higher (running at about 13½ percent in the year to October), in part because food price inflation has not yet come down. The 2008 civil service salary increase that came into effect in June has had a limited impact on inflation thus far because of the high import content of consumption spending.² Inflation for the year as a whole is likely to remain somewhat below the target of 14 percent.

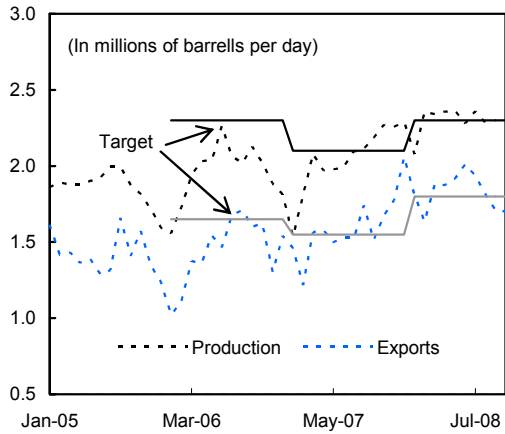
5. **The fiscal balance through July 2008 was in surplus, mainly on account of larger-than-expected oil revenues,** reflecting both higher export prices and volumes. While still below budget, capital expenditures during the first seven months of 2008 were twice the level recorded for the same period in 2007. The balance in the Development Fund for Iraq (DFI) increased from \$12.6 billion at end-2007 to \$23.5 billion at end-September 2008, and government deposits in the banking system rose by ID 4½ trillion to ID 18 trillion over the same period. Notwithstanding the recent drop in world oil prices and the increased spending in the supplementary budget for 2008, an overall budget surplus of close to 8 percent of GDP is projected for 2008.

6. **Exchange rate policy was adjusted in anticipation of price pressures resulting from the fiscal expansion in 2008.** During July–October 2008, the appreciation of the dinar increased to ½ percent per month from ¼ percent per month during the first half of the year. The dinar has appreciated by 20 percent since November 2006, when the CBI started to appreciate the currency to counter dollarization and reduce inflation. Gross international reserves of the CBI increased from \$31.5 billion at end-2007 to \$44.3 billion at end-September 2008. In light of the subdued price pressures in 2008, the CBI reduced its policy interest rate from 16 percent to 15 percent as of November 3.

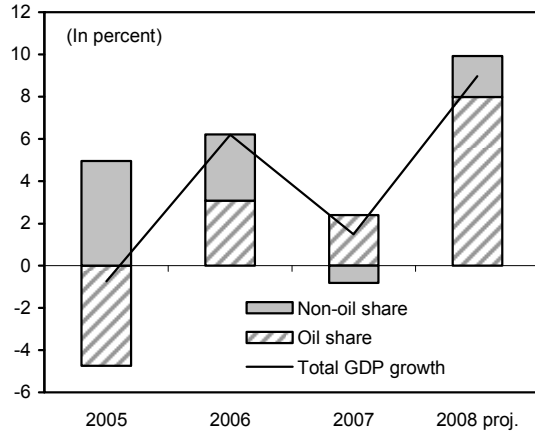
² The salary increase would increase the civil service wage bill by some 57 percent. The effective salary increase in 2008 has been limited to 40 percent and the remainder will be paid in 2009.

Figure 2. Iraq: Output and Inflation

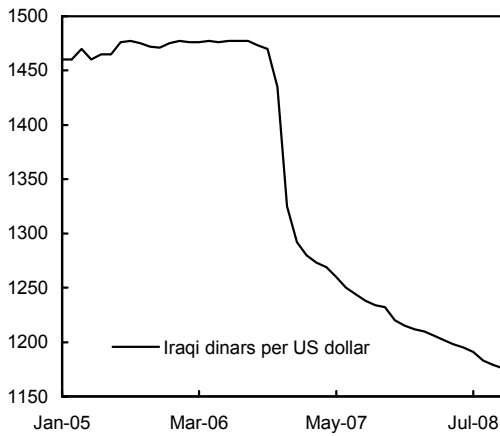
Oil production and exports have gradually increased...



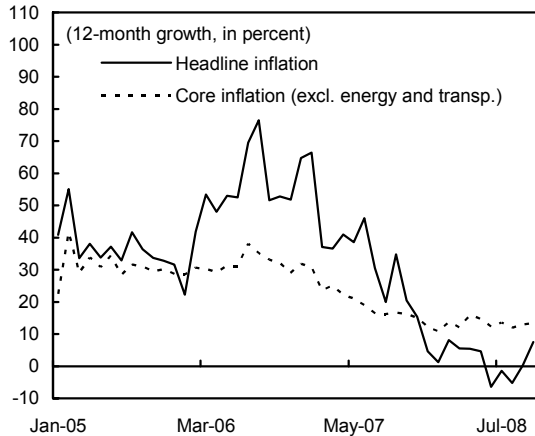
...but overall output growth remained volatile



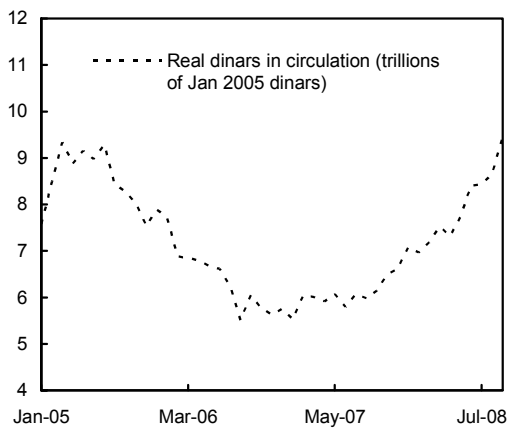
Appreciation of the dinar...



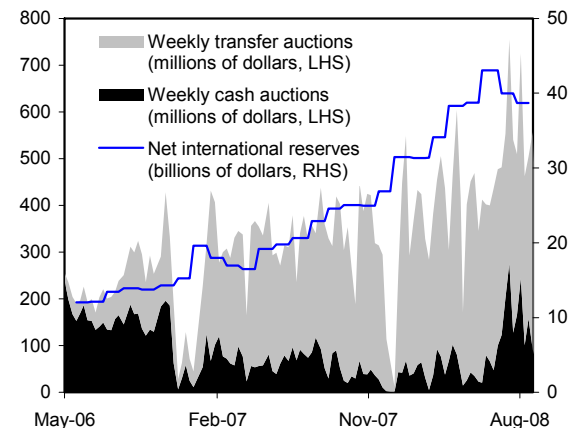
...has helped bring down consumer price inflation...



...and reduce cash dollarization...



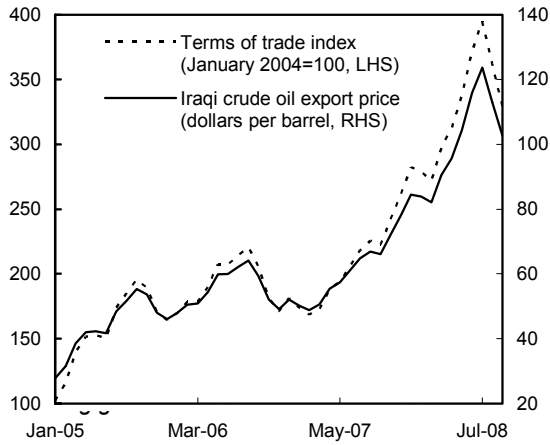
...while the CBI was able to satisfy market demand for dollars and build up reserves.



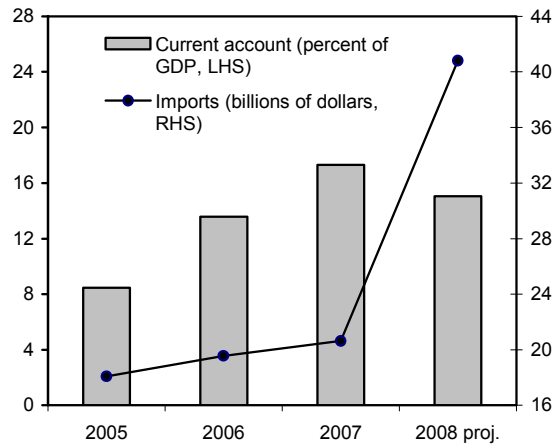
Source: Iraqi authorities; and Fund staff calculations.

Figure 3. Iraq: External and Fiscal Indicators

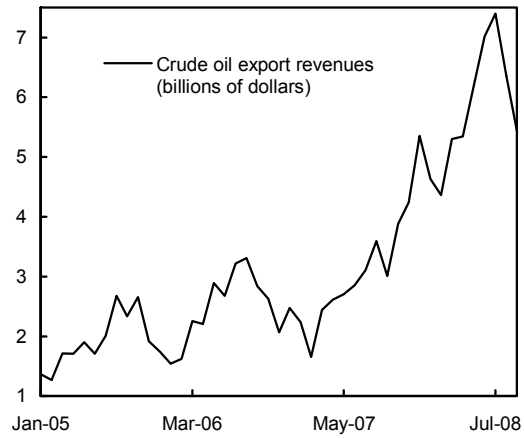
Rising export commodity prices...



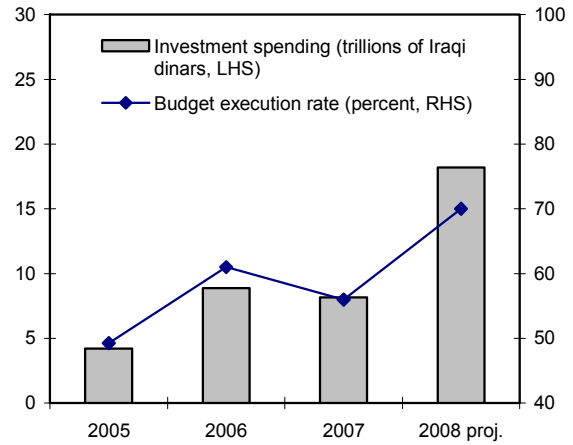
...improved the current account, while financing rising imports.



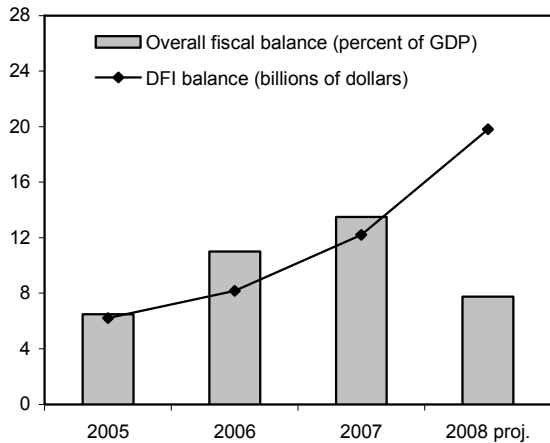
Rising government oil revenues...



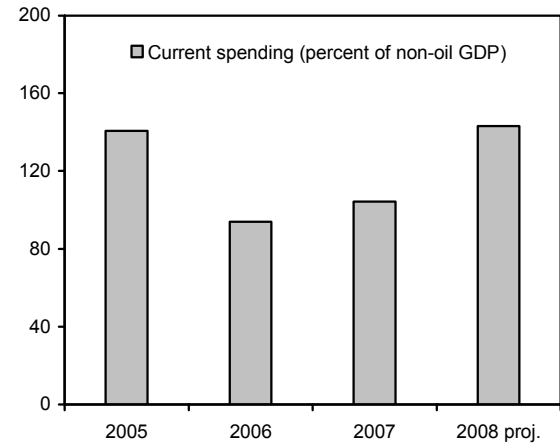
...combined with low investment execution...



...improved the fiscal position...



...despite increasing current spending.



Source: Iraqi authorities; and Fund staff calculations.

7. **Iraq has continued to make progress toward resolving outstanding external claims.** As at end-October 2008, bilateral debt arrangements with eleven non-Paris Club official creditors had been signed on terms comparable to the Paris Club agreement, restructuring a debt stock of \$9.4 billion. Negotiations with Greece, Morocco, Tunisia, and the United Arab Emirates have been concluded, and debt agreements are expected to be signed in the near future; this would bring the resolved share of total non-Paris Club debt (excluding the other Gulf countries) to 46 percent of the initial debt by value. Debt negotiations continue with several other non-Paris Club official creditors, including China and some Gulf countries. In August 2008, a cash settlement was completed with private creditors on terms comparable to the 2004 Paris Club agreement, resulting in a cash payment of \$48.3 million and the cancellation of \$470 million of outstanding commercial debt.

8. **Some progress was made in structural reforms.** The CBI Board approved the new reserves management guidelines, the final fiscal accounts for 2007 have been submitted to the Board of Supreme Audit (BSA), and an action plan for modernizing the government's public financial management system was adopted in November. Some progress was also made in banking reform, but the census of public service employees is still not completed.

III. POLICY DISCUSSIONS

9. **The discussions focused on 2009 budget in the context of lower oil prices and revenues, on the conduct of monetary policy, and on the outstanding structural reform agenda.** With the average Iraqi oil export price at \$95.4 per barrel in the first half of 2008, spending pressures mounted and a supplementary budget was passed that provided for significant increases in current and capital spending. The steep decline in oil prices beginning in September has worsened Iraq's external outlook for the period ahead. The draft 2009 budget is based on an oil export price of \$62.5 per barrel, a third lower than the average price expected for 2008.³ The authorities and staff agreed that the 2009 draft budget needs to allow for adequate security and investment spending, while limiting other current spending to preserve fiscal sustainability. The discussions also covered the authorities' plans regarding adjustment of official fuel prices next year, the appropriate monetary and exchange rate policy stance, and the implementation of the structural reform agenda.

10. **The authorities remain strongly committed to the program supported by the SBA.** The attached second Supplementary Memorandum of Economic and Financial Policies (SMEFP-2) outlines their plans for the remainder of the program period through March 2009.

A. Macroeconomic Outlook and Risks

11. **The direct impact of the global financial crisis on Iraq has been limited but the decline in oil prices prompted by the global slowdown has adverse implications for**

³ The budget oil export price is in line with the latest WEO forecast (October 20, 2008) for 2009 of \$68 per barrel, less a quality discount of \$5.50 per barrel.

Iraq's budget and balance of payments. Financial spillovers are small because private capital flows and foreign direct investment are low, and Iraq's banking sector is relatively underdeveloped and primarily focused on the domestic market.

12. **Real GDP growth is projected to continue at about 7½ percent in 2009**, provided the reduction in violence is sustained. Oil production and exports are projected to increase to 2.5 mbpd and 2.0 mbpd, respectively, and the non-oil sector is expected to further recover as improved security would allow private commerce to expand. Assuming no further declines in black-market fuel prices, the gap between headline and core inflation would likely be reduced; annual inflation is targeted to be contained at 10 percent in 2009. The external current account surplus of 15 percent of GDP in 2008 is projected to disappear in 2009, mainly due to lower oil export revenues. From 2010 onwards, the current account balance is projected to improve again, assuming a continuing rise in oil export volumes and a gradual recovery in oil prices over the medium term.

13. **The economic outlook remains subject to considerable risks.** A reversal of the still fragile security gains and a resumption of political instability could lower economic growth, add to inflationary pressures, and hamper the timely implementation of the structural reform agenda. A slowing world economy could further depress international oil prices, which would pose a major risk for public finances and the balance of payments.⁴ Iraq's external debt situation remains vulnerable to oil shocks, even after the completion of the debt reduction (Appendix).

B. Fiscal Policy and Related Measures

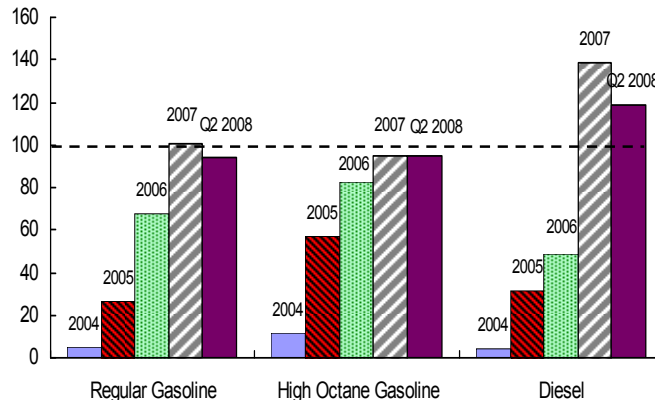
14. **The draft 2009 budget provides for an increase in security and capital spending, while strictly containing other current outlays to preserve fiscal sustainability** (SMEFP-2, ¶¶ 9 and 10). The draft budget was approved by Cabinet on November 10, 2008. Faced with declining oil revenues, the government significantly reduced its initial spending plans (by 14 percent of GDP) by cutting current spending and bringing investment in line with implementation capacity. Oil revenues are expected to be about a quarter lower than the projected outturn in 2008. The carry-over from the 2008 civil service salary increase will be fully funded but there will be no additional wage increases and zero net hiring of nonsecurity personnel. As a first step to reform the costly and untargeted in-kind Public Distribution System, eligibility of better-off families will be restricted as of mid-2009. Transfers to public enterprises will be contained and include transfers to the electricity sector (fuel imports) and a limited wage increase. Investment spending, including in the oil sector and at the provincial level, will be increased compared to the expected 2008 outturn, but the practice of carrying over unspent investment allocations from previous years will be ended.

⁴ As Iraq's oil exports account for a relatively small share in the world market (about 2½ percent), a downturn in global or regional demand should have only a minor impact on export volumes. In addition, Iraq continues to be exempt from OPEC's production ceilings.

15. **On this basis, an overall fiscal deficit of about 17 percent of GDP is projected for 2009, which under current policies would turn into a surplus by 2012.** The swing in the fiscal balance between 2008 and 2009 is mostly due to the fall in oil revenues and, with expenditures only rising moderately, is unlikely to be inflationary. The deficit will be financed by drawing down part of the balance in the DFI and by using some of the bank deposits accumulated during 2006–08. In the event that oil export revenues are substantially lower than budgeted and fiscal sustainability is at risk, the authorities have stated their readiness to prepare a supplementary budget to reduce government spending.

16. **The authorities will consider adjusting official fuel prices after the provincial elections early next year (SMEFP-2, ¶11).** Although official retail prices of jet fuel and LPG were increased in mid-2008, the total indirect subsidy on fuel products resulting from underpricing of crude oil used for domestic consumption is projected to increase by ½ percent to 6.3 percent of GDP in 2008 (Box 1). While recognizing that the indirect fuel subsidy remains high, the authorities were hesitant to increase domestic fuel prices now as world oil prices are falling and the indirect subsidy is projected to decline again to about 4 percent of GDP in 2009. They agreed to continue working on developing a periodic adjustment mechanism for fuel prices based on the recommendations of a recent Fund technical assistance mission.

Figure 4: Official Fuel Prices in Iraq, 2004–08
(In percent of average fuel prices in other oil-exporting countries in the Middle East and North Africa region)



Sources: Iraqi authorities and Fund staff calculations.

C. Monetary and Exchange Rate Policies

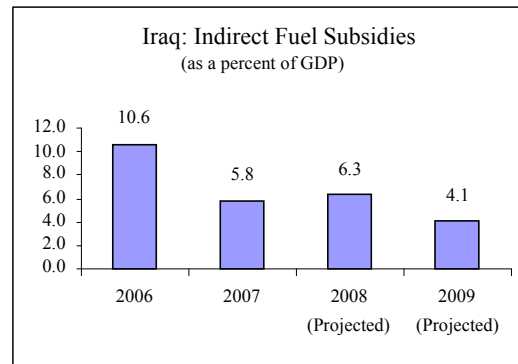
17. **The CBI will continue to manage the exchange rate and maintain its tight monetary policy stance with a view to keeping inflation under control (SMEFP-2, ¶15).** The fiscal adjustment planned for 2009 should alleviate the burden on the central bank in this regard. In the absence of an effective monetary transmission mechanism, given the weak state of the banking system, the exchange rate remains the CBI's main policy instrument. It was agreed that the CBI will continue to gradually appreciate the exchange rate of the dinar in the coming months. Once core inflation has come down to near single digit levels, the CBI should return to its previous policy of maintaining a stable exchange rate. The CBI also agreed to keep its policy interest rate positive in real terms (as measured against core inflation), in order to signal its continued commitment to fighting inflation.

Box 1. Pricing of Fuel Products in Iraq

Prices of domestic fuel products in Iraq have been raised significantly since 2005, but pass-through remains limited. While direct budgetary subsidies were eliminated in 2007 (except for a small subsidy on kerosene which will be abolished in 2009), indirect subsidies remained sizable at almost 6 percent of GDP as domestic refineries receive crude oil for a fraction of the export price (currently \$2 per barrel). Indirect fuel subsidies are expected to increase by ½ percent of GDP in 2008, reflecting the significant increase in world market prices in the first part of the year. The indirect fuel subsidies are expected to fall in 2009 because of falling world oil prices.

Iraq: Domestic Fuel Prices (In U.S. dollars per liter/per cylinder for LPG, end of period)				
	High Octane Gasoline	Diesel	Kerosene	LPG
2004	0.03	0.01	0.003	...
2005	0.17	0.06	0.017	0.41
2006	0.26	0.11	0.06	0.75
2007	0.37	0.33	0.12	2.47
2008 1/	0.38	0.33	0.13	3.35
2008 2/	0.75	0.91	0.94	11.60

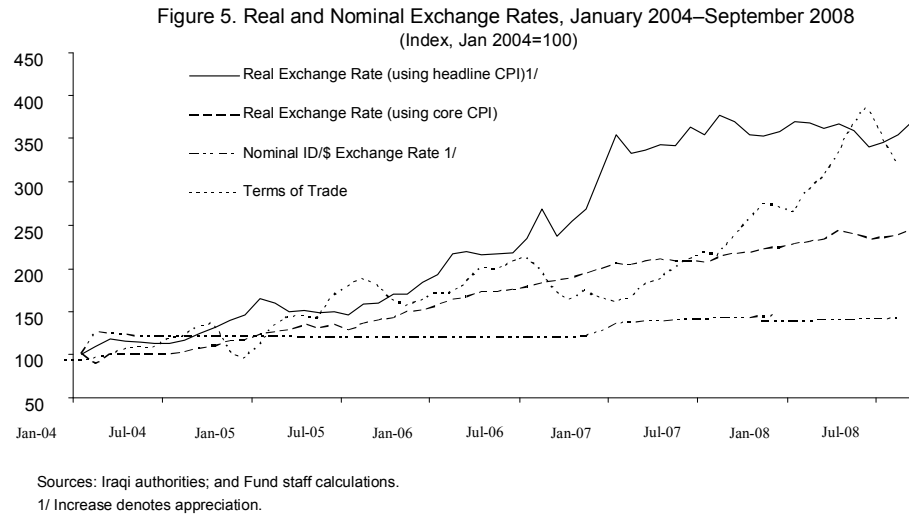
1/ Q2 prices reported. LPG price was raised on July 1, which is the price reported.
2/ Average import prices for the period January-July, 2008.



To preserve the cost recovery gains made in 2005–07, the government intends to develop a periodic price adjustment mechanism for fuel prices based on changes in domestic production costs and import costs. To assist the authorities in this undertaking, FAD conducted a seminar on petroleum product prices and sector financial flows in Beirut during August 10–14, 2008.¹ Key recommendations of the seminar included to:

- Gradually move toward export parity pricing whereby domestic fuel prices are based on a pre-determined fraction of the Iraqi export price of crude oil plus a margin for refining and distribution costs;
- Implement price adjustments on a quarterly or semi-annual basis to avoid large price jumps and discourage hoarding; and
- Smooth price changes by basing adjustments on a moving average of production and import costs.

^{1/} The seminar was originally scheduled for May but had to be postponed for security reasons.



18. **Some progress has been made in the implementation of outstanding safeguards measures (SMEFP-2, ¶16).** An independent audit committee, including one external expert, has been set up to make recommendations regarding external and internal audit oversight, financial reporting, and controls consistent with the requirements of the central bank law. The CBI has started implementing the new reserves management guidelines that were adopted in early August. Finally, the CBI will appoint an international external auditor before year-end to conduct the audit of the CBI 2008 financial statements.

19. **Iraq is making progress to accept the obligations of Article VIII, Sections 2(a), 3, and 4, of the Fund's Articles of Agreement (SMEFP-2, ¶17).** The staff's review of exchange laws and regulations has almost been completed, and the authorities intend to implement staff's recommendations in this area to complete the process.

D. Public Finance Reform

20. **The authorities continue to give high priority to improving public financial management.** The government has adopted an action plan for modernizing its financial management system (Box 2 and SMEFP-2, ¶13), with the assistance of the Fund and the World Bank. The action plan includes a timetable for priority reforms in this area and specifies technical assistance needs.

21. **Progress is also being made in other public finance-related areas:**

- While completion of the census of public service employees has been delayed due to technical problems, 25 percent of the data collection was completed by end-October, and half of this work is expected to be achieved by end-November (SMEFP-2, ¶14). The census is now expected to be completed by end-January 2009;
- The 2005 final fiscal accounts have been audited by the BSA, and the audits of the 2006 and 2007 final accounts are underway (SMEFP-2, ¶13);

- The Committee of Financial Experts (COFE) has published on its website the audit report covering DFI operations in the first half of 2008 (SMEFP-2, ¶18). The COFE has also presented its first semi-annual report to the Council of Ministers.⁵
- Some progress was made in developing a medium-term tax reform strategy. A draft law on import tariffs has been prepared that will be reviewed by the Fund and envisages establishing a transparent and efficient system of tariffs with fewer exemptions (SMEFP-2, ¶12). Efforts to develop a sales tax (as precursor for a VAT) and to reduce the number of brackets for the personal income tax are also underway.

Box 2. Public Financial Management Reform

The Iraqi authorities have actively engaged with the Fund, the World Bank, and other international partners in recent years with a view to modernizing public financial management (PFM). A new budget classification based on the IMF *Government Finance Statistics Manual* (GFSM) 2001, within a cash accounting framework, was adopted in 2007. Progress is also being made, in cooperation with USAID, on the Iraq Financial Management Information System (IFMIS), which is expected to become fully operational in 2009.

However, the PFM framework continues to have shortcomings in a number of critical areas. Recent Fund technical assistance has focused on budget execution, cash management, commitment control, and the accounting framework. The authorities are also working with the World Bank on a new project covering budget preparation, public procurement, and fiscal reporting.

To set these efforts in a unified framework, the authorities have adopted—in close consultation with the Fund and the World Bank—a comprehensive PFM action plan. Its main pillars are:

- **budget preparation**, including strengthening the link between government policy and resource allocation, achieving a better coordination between the current and capital budgets, and incorporating information on donor-financed projects;
- **budget execution, cash management, and reporting**, including introduction of effective cash release and commitment control systems, establishment of additional monthly reporting requirements for spending units, and expansion of the application of the IFMIS; and
- **public procurement**, including ratification of the draft Public Procurement Law and introduction of standard bidding documents for all procurement entities.

⁵ The COFE is scheduled to take over the responsibilities of the International Advisory and Monitoring Board (IAMB) as the audit oversight body for the DFI by end-2008.

E. Banking Reform

22. **The financial and operational audits of Rafidain and Rasheed banks have been completed, but work on the restructuring plans for both banks has been delayed** (Box 3 and SMEFP-2, ¶19). The authorities have requested assistance from the World Bank and other international partners to develop the restructuring plans for Rafidain and Rasheed banks as soon as possible. The BSA will undertake diagnostic reviews for the three smaller specialized state banks in the coming months with a view of developing restructuring plans for them.

23. **The authorities completed half of the prudential regulations for commercial banks**, including key regulations on licensing, capital adequacy, credit risk, large exposures, and liquidity risk (SMEFP-2, ¶20). Work is ongoing, with Fund technical assistance, to finalize the remaining regulations, including those related to minimum capital requirements, liquidity risk, and anti-money laundering.

F. Other Issues

24. **Further efforts are being undertaken to strengthen governance**, in particular in the hydrocarbon sector (SMEFP-2, ¶18). Oil-metering systems are being extended to the northern pipeline and export terminals, and all domestic oil sector activities. Work on the implementation procedures under the Extractive Industries Transparency Initiative (EITI) has started, with technical assistance from the World Bank. Discussions on a new legislative framework for the hydrocarbon sector are ongoing.

25. **The authorities are continuing their efforts to improve the statistical database** (SMEFP-2, ¶22). The publication of monetary and balance of payments data in the IMF's *International Financial Statistics* is a welcome development. While the Socio-Economic Household Survey has been completed, the updating of the weights in the CPI, with technical assistance of the World Bank, is still underway. A new national coordinator for the General Data Dissemination System (GDDS) has been appointed and GDDS participation is expected next year.

IV. PROGRAM MONITORING, FINANCING ASSURANCES, AND FUTURE RELATIONS

26. **Iraq has met the quantitative performance criteria set for end-September on the net international reserves of the CBI and on CBI lending to the government and the private sector** (Table 8). Based on the available information, the other end-September quantitative performance criteria are expected to have been met as well. All structural performance criteria have been met. Staff will inform the IMF Executive Board on compliance with the other end-September quantitative performance criteria and on progress made in meeting the structural benchmarks through November before Board consideration of the second review. The program will continue to be monitored through quarterly quantitative performance criteria set for end-December 2008, as specified in Table 8.

Box 3. Key Findings of the Financial and Operational Audits of Rafidain and Rasheed Banks

The financial and operational audits of Iraq's two large state-owned banks provide the basis for restructuring plans that the Iraqi authorities are committed to develop in the coming months. The analysis of assets and liabilities points to a recapitalization need of ID 15.7 trillion, which is higher than staff's previous estimate of roughly ID 10 trillion. This amount is an approximation of the minimum amount of additional capital required in order to bring the banks into compliance with Basel II guidelines. The estimate is based on a partial analysis of the loan portfolio and may increase when all loans are taken into account and accounting errors have been resolved. The bulk of the recapitalization needs stem from losses arising from the revaluation of foreign currency assets and liabilities that appear as a claim on the government on the balance sheet of Rafidain bank. Recapitalization needs arising from non-performing loans are relatively modest despite the high share of non-performing loans (56 percent in value terms), because both banks' loan portfolios are very small.

From an operational point of view, the audits show that the banks' weaknesses are serious, and restructuring will be time-consuming and challenging. Some key operational shortcomings are:

- The banks have no documented strategy and business plan, and no documented objectives;
- Operational rules and regulations are not clear for all employees, and reporting requirements and responsibilities are not clearly allocated;
- Information technology and other infrastructure is inadequate and outdated;
- Risk management is inadequate: there is no formally recognized risk management function, no active asset-liability management function, and no centralized treasury department;
- Product offering is limited: the banks do not offer letters of credit and other key banking products, and insufficient importance is given to customer relations, sales, and marketing; and
- The internal audit function's methodology follows a compliance-based and not a risk-based approach.

Rafidain and Rasheed Banks: Selected Indicators
(In billion Iraqi dinar, unless indicated otherwise)

	Rafidain	Rasheed
Year founded	1941	1988
Number of branches	147	142
Of which in Baghdad	...	69
Loans and advances	402	219
Of which non-performing ^{1/}	209	139
Assets on balance sheet	21,295	6,019
Liabilities on balance sheet	20,934	5,222
Equity	361	797
Estimated capital shortfall after risk and valuation adjustments	15,370	359

^{1/} Based on assessment of 80 percent (Rafidain) and 74 percent (Rasheed) of the loan portfolio.

27. **The Iraqi authorities continue to make good faith efforts to reach collaborative agreements with remaining commercial creditors.** The settlement process of outstanding private claims as part of the liquidation of the London branch of Rafidain Bank is well under way and the process to liquidate fixed assets has begun. The settlement is expected to conclude before end-2009 under terms consistent with the Fund's policy on lending into arrears.

28. **The authorities have expressed interest in a follow-up program with the Fund after the current SBA expires on March 18, 2009.** The Fund stands ready to discuss such an arrangement that would build on the progress made under the current SBA.

V. STAFF APPRAISAL

29. **Iraq continues to make encouraging progress in recovering from the very difficult economic situation of the past several years.** With the reduction in violence, growth prospects have improved as oil production and exports are beginning to increase and non-oil activity is starting to rebound. At the same time, macroeconomic stability has been maintained.

30. **The authorities remain committed to rebuilding the economy, while preserving fiscal sustainability over the medium term.** This objective has become more challenging in the context of the sharp fall in oil prices in recent months. Staff welcomes the scaling down of the initial spending plans for 2009 and the readiness of the government to take further measures should oil revenues fall substantially more than currently projected. Although the draft budget implies a large fiscal deficit in 2009, this outcome is acceptable because under current policies the deficit should disappear again over the next few years. It is important to strictly contain current spending, especially the wage bill and transfers. The decision to begin streamlining the costly and untargeted Public Distribution System in mid-2009 is timely. However, the census of public service employees is long overdue, and staff urges its completion as soon as possible. Staff welcomes the increased investment allocation.

31. **The decision to delay further adjustments of domestic fuel product prices until the first part of 2009 is reasonable.** The explicit subsidy (on imported fuels) has already been eliminated and the implicit subsidy (on domestic production) will go down automatically as a result of lower world oil prices. Staff encourages the government to develop a fuel price adjustment mechanism in the coming months to help put future fuel price adjustments on a sound footing.

32. **Staff welcomes the intention of the CBI to continue managing the exchange rate with a view to keeping inflation under control.** Once core inflation has come down to near single digit levels, the CBI should revert to maintaining a stable exchange rate. It is important to keep the central bank's policy interest rate positive in real terms.

33. **It is important to speed up the rather slow pace of implementation of key structural reforms.** The recently adopted action plan provides a good basis for modernizing public financial management. In order to strengthen financial intermediation in Iraq, restructuring programs for Rafidain and Rasheed banks should be adopted without further delay. It is also important to continue improving the accounting and reporting framework of the CBI and to complete the set of prudential regulations for commercial banks. The recent drop in world oil prices underscores Iraq's vulnerability to lower oil revenues. Therefore, there is a need to significantly expand its oil and gas production, including by establishing a new legislative framework for the hydrocarbon sector to attract the large investments needed to develop capacity.

34. **Efforts must continue to strengthen governance and fight corruption,** especially in the oil sector. The ongoing extension of oil metering systems is encouraging and staff looks forward to further progress in this area. Staff encourages the authorities to complete the work on the implementation procedures under the EITI soon.

35. **Staff encourages Iraq to accept the obligations of Article VIII, Sections 2(a), 3, and 4, of the Fund's Articles of Agreement in the near future.**

36. **Staff recommends that the second review under the SBA be completed in view of Iraq's overall good performance under the program.** Staff believes that Iraq is making best efforts to reach bilateral debt agreements with official non-Paris Club creditors and that the authorities have been negotiating in good faith to resolve the remaining arrears to private creditors, consistent with the Fund's policy on lending into arrears, and supports the completion of the financing assurances review.

Table 1. Iraq: Selected Economic and Financial Indicators, 2006–13

	2006	2007		2008		2009	2010	2011	2012	2013
	Est.	SBA	Prel.	Rev.	SBA	Proj.		Proj.		
Economic growth and prices										
Real GDP (percentage change)	6.2	1.3	1.5	9.0	9.8	7.7	7.2	7.3	6.9	6.7
Non-oil real GDP (percentage change)	7.5	0.0	-2.0	3.0	5.0	6.0	6.0	7.0	7.0	7.0
GDP per capita (US\$)	1,720	2,115	2,109	3,198	3,085	2,673	2,957	3,292	3,609	3,823
GDP (US\$ billion)	49.5	62.6	62.4	97.2	93.8	83.5	94.8	108.1	121.4	131.6
Oil production (In mbpd)	2.0	2.0	2.04	2.3	2.3	2.5	2.7	2.9	3.1	3.3
Oil exports (In mbpd)	1.4	1.55	1.59	1.8	1.8	2.0	2.1	2.3	2.5	2.7
Iraq oil export prices (US\$ pb)	55.6	58.8	63.0	98.4	93.3	62.5	68.5	72.8	75.5	76.5
Consumer price inflation (percentage change; end of period)	64.8	25.0	4.7	14.0	12.0	10.0	8.0	7.0	5.0	5.0
Exchange rate (dinar per US\$; period average) 1/	1,467	1,264	1,255	...	1,176	...	...	...	...	...
Total government debt (in billions of US\$)	97.9	101.4	101.9	43.0	40.4	42.1	43.8	43.0	42.0	40.7
(In percent of GDP)										
National Accounts										
Gross domestic investment	18.4	13.9	16.1	29.0	21.1	26.9	26.6	25.8	25.4	24.3
Of which: public	17.0	12.3	11.9	25.9	17.3	22.1	20.5	19.0	17.7	17.0
Gross domestic consumption	71.0	80.5	63.0	53.4	61.8	74.3	68.9	67.0	65.2	66.3
Of which: public	38.4	35.6	34.0	32.2	33.4	43.1	38.3	34.8	32.6	31.8
Gross national savings	32.0	15.9	33.4	46.4	36.2	26.9	31.5	33.1	34.9	34.1
Of which: public	28.1	13.8	25.5	28.3	24.6	4.3	10.9	16.5	23.8	27.4
(In percent of GDP, unless otherwise indicated)										
Public Finance										
Government revenue and grants	80.4	64.7	75.0	79.0	77.5	67.4	68.0	68.5	68.1	69.4
Government oil revenue	65.2	58.9	67.6	71.5	70.9	61.9	62.5	63.4	63.8	64.8
Government non-oil revenue	2.7	2.9	3.8	6.0	5.0	5.2	5.3	4.9	4.3	4.5
Grants	12.5	2.9	3.7	1.5	1.6	0.2	0.2	0.2	0.0	0.0
Expenditure, Of which:	69.4	63.2	61.5	76.2	69.8	84.6	76.8	69.8	64.8	62.8
Current expenditure	52.4	49.4	49.0	50.1	52.3	61.8	55.7	50.3	46.6	45.4
Capital expenditure	17.0	12.3	11.9	25.9	17.3	22.1	20.5	19.0	17.7	17.0
Overall fiscal balance (including grants)	11.0	1.5	13.5	2.8	7.8	-17.3	-8.9	-1.3	3.3	6.6
Primary fiscal balance	11.6	2.2	14.3	3.5	8.2	-16.6	-7.2	0.6	5.0	8.8
Gross borrowing/use of external assets	-2.3	-1.0	-3.1	-3.4	-7.1	14.6	7.4	2.0	-0.4	-3.9
Amortization	3.1	0.3	0.1	0.5	0.7	1.4	0.0	1.6	1.8	1.7
Residual or financing gap/surplus	1.3	0.0	-1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Tax revenue/non oil GDP (In percent)	1.9	2.0	3.6	3.8	3.1	4.2	4.8	5.0	5.1	5.4
External assets held abroad (In US\$ million)	8,624	10,367	12,584	16,463	19,803	8,455	2,041	1,329	3,212	9,273
(In percent, unless otherwise indicated)										
Monetary Indicators										
Growth in reserve money 2/	29.0	33.0	73.9	39.0	41.2	18.9	14.3	13.7	11.8	11.5
Gross CBI foreign exchange assets/Reserve money	150.3	137.5	124.4	136.8	125.2	147.0	171.4	182.3	193.4	197.5
Gross reserves (In US\$ billion)	20.0	26.9	31.5	50.4	46.8	64.3	81.0	93.5	107.7	119.1
In months of imports of goods and services	9.3	8.0	8.0	13.5	11.6	15.3	17.5	18.8	19.7	24.4
Policy interest rate (end of period) 3/	16.0	20.0	20.0	16.0	15.0	...	...	...	...	...
(In percent of GDP)										
Balance of payments										
Current account	13.6	2.0	17.3	17.4	15.1	0.0	4.8	7.3	9.6	9.8
Trade balance	20.9	12.3	27.6	23.6	22.6	2.0	7.3	10.0	12.1	12.2
Exports of goods	60.5	54.5	60.6	67.3	66.1	55.6	56.2	57.2	57.4	57.9
Imports of goods	-39.5	-42.3	-33.1	-43.8	-43.5	-53.6	-48.9	-47.2	-45.2	-45.8
Income and services	-17.7	-11.8	-12.0	-9.4	-8.6	-1.8	-1.5	-1.4	-1.2	-0.9
Transfers	10.3	1.5	1.7	3.2	1.1	-0.2	-1.0	-1.2	-1.3	-1.4
Financial account	1.4	4.3	1.3	1.2	0.5	20.3	12.4	4.1	2.1	-1.2
Direct investment	0.2	0.9	1.5	0.5	2.3	2.7	2.7	2.9	3.1	3.2
Gross borrowing/use of external assets	5.1	5.8	1.6	1.1	-2.4	15.9	8.1	1.8	-0.6	-4.0
Amortization	-3.1	-0.3	-0.1	-0.5	-0.7	-1.4	0.0	-1.6	-1.8	-1.7
Overall external balance	16.3	9.9	17.2	18.6	15.6	20.3	17.2	11.5	11.7	8.7
Central bank reserves (increase -)	-16.2	-11.0	-18.3	-19.4	-16.4	-20.9	-17.7	-11.5	-11.7	-8.7
Change in arrears	-31.2	-1.6	-0.1	-65.1	-70.1	-0.2	0.0	0.0	0.0	0.0
Errors and omissions	1.3	3.6	-1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ 2008 at end-October.

2/ Reserve money growth in 2007 reflects the impact of the increase in the required reserves ratio on government deposits from 25 percent to 75 percent per September 2007.

3/ 2008 as of November 3.

Table 2. Iraq: Fiscal and Oil Sector Accounts, 2006–13
(In billions of ID; unless otherwise indicated)

	2006		2007		2008		2009		2010	2011	2012	2013
	Act.	SBA	Prel.	Rev. SBA	Proj.	Prop. Budg.	Proj.			Proj.		
Revenues and Grants	58,347	50,753	58,714	91,231	86,351	81,496	66,358	80,386	96,975	111,430	126,644	
Revenues	49,282	48,448	55,823	89,454	84,544	81,251	66,113	80,147	96,751	111,349	126,574	
Crude oil export revenues	43,736	41,725	47,149	76,733	72,775	69,558	53,838	65,536	79,968	92,861	104,701	
Revenues of oil-related public enterprises	3,611	4,465	5,729	5,842	6,225	7,173	7,173	8,377	9,825	11,500	13,654	
Tax revenues	593	768	1,228	1,505	1,220	1,378	1,978	2,581	3,035	3,482	4,126	
Direct taxes	353	428	886	1,040	780	870	970	1,133	1,323	1,516	1,737	
Indirect taxes	240	340	343	465	440	508	1,008	1,449	1,713	1,967	2,389	
Non-tax revenues 1/	1,342	1,490	1,716	5,374	4,324	3,143	3,126	3,652	3,923	3,506	4,093	
Grants	9,065	2,304	2,892	1,777	1,807	245	245	240	224	81	69	
Expenditures	50,353	49,566	48,153	87,953	77,709	97,437	83,374	90,876	98,779	106,036	114,663	
Current expenditures	38,026	38,774	38,332	57,871	58,285	65,806	60,853	65,880	71,150	76,216	82,861	
Salary and pension	11,034	14,098	12,815	20,556	20,556	26,270	24,950	26,320	28,651	30,749	32,763	
Salary	8,427	10,706	10,446	16,177	16,177	21,522	20,352	20,900	22,363	23,481	24,655	
Salary (Defense/Interior)	3,177	5,169	4,491	6,171	6,171	7,471	7,471	8,069	8,634	9,065	9,519	
Salary (others) 2/	5,249	5,537	5,955	10,005	10,005	14,051	12,881	12,831	13,729	14,416	15,137	
Pension	2,608	3,392	2,368	4,379	4,379	4,748	4,598	5,420	6,288	7,268	8,108	
Goods and Services (non-oil sector) 3/	10,226	8,709	7,704	11,438	11,438	12,054	11,554	11,997	12,229	12,764	13,337	
Budgeted goods and services	3,853	7,210	5,797	10,340	10,340	12,054	11,554	11,997	12,229	12,764	13,337	
Overhead costs for donors' financed projects	2,588	156	776	439	439	0	0	0	0	0	0	
Other goods and services financed by donors 4/	3,566	913	1,132	658	658	0	0	0	0	0	0	
Goods and Services (oil sector)	6,610	4,005	5,628	5,031	5,107	5,555	5,173	6,227	7,525	9,050	11,054	
Oil derivative imports	4,133	400	210	382	382	382	0	0	0	0	0	
Operating expenditures of oil-related public enterprises	2,477	3,605	5,418	4,649	4,725	5,173	5,173	6,227	7,525	9,050	11,054	
Transfers	7,482	9,336	9,183	16,250	17,050	17,678	15,796	16,088	16,089	16,207	16,421	
Social safety net	5,019	4,848	5,450	7,379	7,379	7,826	7,614	8,015	8,351	8,530	8,704	
Transfers to SOEs 5/	1,300	1,726	1,132	3,083	3,883	5,401	4,231	4,019	3,618	3,437	3,265	
Other transfers 6/	1,163	2,762	2,601	5,788	5,788	4,451	3,951	4,054	4,121	4,240	4,452	
Interest payments	438	540	623	760	495	772	689	1,971	2,657	2,804	4,051	
War reparations 7/	2,235	2,086	2,380	3,837	3,639	3,478	2,692	3,277	3,998	4,643	5,235	
Investment expenditures	12,317	9,655	9,337	29,959	19,301	28,930	21,720	24,196	26,829	29,020	31,002	
Non-oil investment expenditures	8,989	7,773	7,796	27,196	16,539	25,863	18,653	20,754	23,062	24,953	26,660	
Domestic financed reconstruction expenditure	5,980	6,941	6,726	26,218	15,531	24,733	17,523	19,184	20,808	22,953	25,222	
Grant financed reconstruction expenditure	2,562	725	874	633	662	245	245	240	224	81	69	
Loan financed reconstruction expenditure	0	0	0	346	346	886	886	1,330	2,029	1,919	1,368	
Oil investment expenditures (including on refineries)	3,328	1,882	1,540	2,762	2,762	3,067	3,067	3,442	3,767	4,067	4,342	
Contingency	9	1,137	484	123	123	2,700	800	800	800	800	800	
Balance (including grants)	7,994	1,186	10,561	3,278	8,642	-15,941	-17,016	-10,490	-1,803	5,394	11,981	
Balance (excluding grants)	-1,071	-1,118	7,670	1,501	8,635	-16,185	-17,260	-10,729	-2,027	5,313	11,911	
Change in outstanding Letters of Credit [+ increase] 8/	2,226	...	1,905	...	...	...	...	...	...	...	...
Financing, of which:	-6,741	-1,186	-7,529	-3,278	-8,642	15,941	17,016	10,490	1,803	-5,394	-11,981	
External financing	-3,923	-1,001	-2,524	-4,478	-8,642	11,941	13,016	8,760	573	-3,624	-10,211	
Assets held abroad	-2,147	-1,001	-2,430	-4,235	-8,201	12,464	13,539	7,430	807	-2,589	-8,536	
Project financing	0	0	0	346	346	886	886	1,330	2,029	1,919	1,368	
Other financing 9/	458	0	0	0	0	0	0	0	0	0	0	
Amortization	2,235	222	95	588	787	1,409	1,409	0	2,263	2,954	3,043	
Domestic financing	-2,818	-185	-5,005	1,200	0	4,000	4,000	1,730	1,230	-1,770	-1,770	
Bank financing	-1,869	534	-5,272	1,200	0	4,000	4,000	3,500	3,000	0	0	
T-bills	-949	-719	268	0	0	0	0	-1,770	-1,770	-1,770	-1,770	
Residual or Financing gap[+]/surplus [-]	973	0	-1,128	0	0	0	0	0	0	0	0	
Memorandum items:												
Security-related expenditure	4,130	9,673	6,804	13,055	13,055	14,369	14,369	15,940	17,613	19,122	20,498	
Primary fiscal balance	8,432	1,726	11,184	4,038	9,137	-15,169	-16,327	-8,519	854	8,198	16,031	
Non-oil primary fiscal balance	-28,977	-38,577	-34,526	-68,427	-59,345	-81,344	-67,784	-73,428	-78,963	-84,010	-89,794	
External assets held abroad	11,996	15,101	15,314	19,550	23,516	11,052	9,977	2,547	1,740	4,330	12,866	

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ For 2008 and 2009–11, includes \$1.875 and \$0.625 billion mobile operator license fees, respectively.

2/ The 2008 wage bill includes an allocation of ID216 billion for salaries of provincial councils and personnel contingent upon the enactment of the draft Provinces Law.

3/ Include goods and services financed by donors, including overhead costs for reconstruction projects.

4/ Includes security spending associated with the implementation of reconstruction projects.

5/ 2008 data excludes an amount of ID636 billion included in the Supplementary Budget to settle arrears of the electricity sector to the state-owned oil companies; this cross-settlement is expected to have no net impact on the budget.

6/ 2006 data includes ID270 billion allocated toward government's share of capital in new regional commercial banks. ID1,500 formerly recorded under this item were reclassified as non-oil investment expenditures in the 2006 budget presentation. Finally, ID265 billion were reclassified as debt repayment.

7/ Calculated as 5 percent of oil exports as per UN Security Council Resolution 1483 to finance war reparations to Kuwait.

8/ LCs in the Trade Bank of Iraq, for which full down-payment is customarily required.

9/ Includes financing from LCs previously issued under the UN oil-for-food program.

Table 3. Iraq: Fiscal and Oil Sector Accounts, 2006–13
(In percent of GDP)

	2006	2007		2008		2009		2010	2011	2012	2013
	Act.	SBA	Prel.	Rev. SBA	Proj.	Prop. Budg.	Proj.		Proj.		
Revenues and Grants	80.4	64.7	75.0	79.0	77.5	82.7	67.4	68.0	68.5	68.1	69.4
Revenues	67.9	61.8	71.3	77.5	75.9	82.5	67.1	67.8	68.3	68.1	69.3
Crude oil export revenues	60.3	53.2	60.2	66.4	65.3	70.6	54.7	55.4	56.5	56.8	57.4
Revenues of oil-related public enterprises	5.0	5.7	7.3	5.1	5.6	7.3	7.3	7.1	6.9	7.0	7.5
Tax revenues	0.8	1.0	1.6	1.3	1.1	1.4	2.0	2.2	2.1	2.1	2.3
Direct taxes	0.5	0.5	1.1	0.9	0.7	0.9	1.0	1.0	0.9	0.9	1.0
Indirect taxes	0.3	0.4	0.4	0.4	0.4	0.5	1.0	1.2	1.2	1.2	1.3
Non-tax revenues 1/	1.8	1.9	2.2	4.7	3.9	3.2	3.2	3.1	2.8	2.1	2.2
Grants	12.5	2.9	3.7	1.5	1.6	0.2	0.2	0.2	0.2	0.0	0.0
Expenditures	69.4	63.2	61.5	76.2	69.8	98.9	84.6	76.8	69.8	64.8	62.8
Current expenditures	52.4	49.4	49.0	50.1	52.3	66.8	61.8	55.7	50.3	46.6	45.4
Salary and pension	15.2	18.0	16.4	17.8	18.5	26.7	25.3	22.3	20.2	18.8	17.9
Salary	11.6	13.6	13.3	14.0	14.5	21.8	20.7	17.7	15.8	14.4	13.5
Salary (Defense/Interior)	4.4	6.6	5.7	5.3	5.5	7.6	7.6	6.8	6.1	5.5	5.2
Salary (others) 2/	7.2	7.1	7.6	8.7	9.0	14.3	13.1	10.8	9.7	8.8	8.3
Pension	3.6	4.3	3.0	3.8	3.9	4.8	4.7	4.6	4.4	4.4	4.4
Goods and services (non-oil sector) 3/	14.1	11.1	9.8	9.9	10.3	12.2	11.7	10.1	8.6	7.8	7.3
Budgeted goods and services	5.3	9.2	7.4	9.0	9.3	12.2	11.7	10.1	8.6	7.8	7.3
Overhead costs for donors' financed projects	3.6	0.7	1.0	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Other goods and services financed by donors 4/	4.9	1.2	1.4	0.6	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Goods and services (oil sector)	9.1	5.1	7.2	4.4	4.6	5.6	5.3	5.3	5.3	5.5	6.1
Oil derivative imports	5.7	0.5	0.3	0.3	0.3	0.4	0.0	0.0	0.0	0.0	0.0
Operating expenditures of oil-related public enterprises	3.4	4.6	6.9	4.0	4.2	5.3	5.3	5.3	5.3	5.5	6.1
Transfers	10.3	11.9	11.7	14.1	15.3	17.9	16.0	13.6	11.4	9.9	9.0
Social safety net	6.9	6.2	7.0	6.4	6.6	7.9	7.7	6.8	5.9	5.2	4.8
Transfers to SOEs 5/	1.8	2.2	1.4	2.7	3.5	5.5	4.3	3.4	2.6	2.1	1.8
Other transfers 6/	1.6	3.5	3.3	5.0	5.2	4.5	4.0	3.4	2.9	2.6	2.4
Interest payments	0.6	0.7	0.8	0.7	0.4	0.8	0.7	1.7	1.9	1.7	2.2
War reparations 7/	3.1	2.7	3.0	3.3	3.3	3.5	2.7	2.8	2.8	2.8	2.9
Investment expenditures	17.0	12.3	11.9	25.9	17.3	29.4	22.1	20.5	19.0	17.7	17.0
Non-oil investment expenditures	12.4	9.9	10.0	23.6	14.8	26.3	18.9	17.5	16.3	15.3	14.6
Domestic financed reconstruction expenditure	8.2	8.8	8.6	22.7	13.9	25.1	17.8	16.2	14.7	14.0	13.8
OFFP financed reconstruction expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant financed reconstruction expenditure	3.5	0.9	1.1	0.5	0.6	0.2	0.2	0.2	0.2	0.0	0.0
Loan financed reconstruction expenditure	0.0	0.0	0.0	0.3	0.3	0.9	0.9	1.1	1.4	1.2	0.7
Oil investment expenditures (including on refineries)	4.6	2.3	1.8	2.4	2.4	3.1	3.1	2.9	2.7	2.5	2.4
Contingency	0.0	1.4	0.6	0.1	0.1	2.7	0.8	0.7	0.6	0.5	0.4
Balance (including grants)	11.0	1.5	13.5	2.8	7.8	-16.2	-17.3	-8.9	-1.3	3.3	6.6
Balance (excluding grants)	-1.5	-1.4	9.8	1.3	6.1	-16.4	-17.5	-9.1	-1.4	3.2	6.5
Change in outstanding Letters of Credit [+ increase] 8/	3.1	...	2.4	...	...	...	...	...	...	...	...
Financing, Of which:	-9.3	-1.5	-9.6	-2.8	-7.8	16.2	17.3	8.9	1.3	-3.3	-6.6
External financing	-5.4	-1.3	-3.2	-3.9	-7.8	12.1	13.2	7.4	0.4	-2.2	-5.6
Assets held abroad	-3.0	-1.3	-3.1	-3.7	-7.4	12.7	13.7	6.3	0.6	-1.6	-4.7
Project financing	0.0	0.0	0.0	0.3	0.3	0.9	0.9	1.1	1.4	1.2	0.7
Other financing 9/	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	3.1	0.3	0.1	0.5	0.7	1.4	1.4	0.0	1.6	1.8	1.7
Domestic financing	-3.9	-0.2	-6.4	1.0	0.0	4.1	4.1	1.5	0.9	-1.1	-1.0
Bank financing	-2.6	0.7	-6.7	1.0	0.0	4.1	4.1	3.0	2.1	0.0	0.0
T-bills	-1.3	-0.9	0.3	0.0	0.0	0.0	0.0	-1.5	-1.3	-1.1	-1.0
Residual or financing gap[+]/surplus [-]	1.3	0.0	-1.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Security-related expenditure	5.7	12.3	8.7	11.3	11.7	14.6	14.6	13.5	12.4	11.7	11.2
Primary fiscal balance	11.6	2.2	14.3	3.5	8.2	-15.4	-16.6	-7.2	0.6	5.0	8.8
Current expenditures (percent of non-oil GDP)	123.2	100.5	112.9	145.2	146.0	141.4	130.7	123.6	116.6	111.2	107.6

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ For 2008 and 2009–11, includes \$1.875 and \$0.625 billion mobile operator license fees, respectively.

2/ The 2008 wage bill includes an allocation of ID216 billion for salaries of provincial councils and personnel contingent upon the enactment of the draft Provinces Law.

3/ Include goods and services financed by donors, including overhead costs for reconstruction projects.

4/ Includes security spending associated with the implementation of reconstruction projects.

5/ 2008 data excludes an amount of ID636 billion included in the Supplementary Budget to settle arrears of the electricity sector to the state-owned oil companies; this cross-settlement is expected to have no net impact on the budget.

6/ 2006 data includes ID270 billion allocated toward government's share of capital in new regional commercial banks. ID1,500 formerly recorded under this item were reclassified as non-oil investment expenditures in the 2006 budget presentation. Finally, ID265 billion were reclassified as debt repayment.

7/ Calculated as 5 percent of oil exports as per UN Security Council Resolution 1483 to finance war reparations to Kuwait.

8/ LCs in the Trade Bank of Iraq, for which full down-payment is customarily required.

9/ Includes financing from LCs previously issued under the UN oil-for-food program.

Table 4. Iraq: Central Bank Balance Sheet 2006–13
(In billions of Iraqi dinars, unless otherwise indicated)

	2006		2007			2008				2009	2010	2011	2012	2013
	Dec. Act.	Dec. Act.	Dec. SBA	Mar. Prel.	Jun. Prel.	Sept. Prel.	Dec. Proj.	Dec. Rev. SBA	Dec. Proj.	Dec. Proj.	Dec. Proj.	Dec. Proj.	Dec. Proj.	
Net foreign exchange assets 1/	25,954	38,219	31,695	41,151	51,428	52,182	54,322	58,459	75,858	101,112	122,286	145,022	165,099	
Foreign exchange assets	26,549	38,219	32,291	41,151	51,428	52,182	54,322	58,459	75,858	101,112	122,286	145,022	165,099	
Gold	159	192	150	212	210	197	192	192	192	192	192	192	192	
Other	26,391	38,027	32,141	40,939	51,219	51,986	54,130	58,268	75,666	100,920	122,095	144,830	164,908	
Foreign exchange liabilities	-596	0	-596	0	0	0	0	0	0	0	0	0	0	
Of which: Borrowing from the IMF	-578	0	-523	0	0	0	0	0	0	0	0	0	0	
Net domestic assets	-8,288	-7,492	-8,203	-4,494	-11,061	-10,842	-10,922	-15,737	-24,241	-42,134	-55,219	-70,030	-81,495	
Domestic assets	-297	-2,449	1,318	-4,189	-2,803	-7,363	-4,768	-3,469	-5,487	-5,206	-4,925	-5,145	-5,304	
Net claims on general government	-309	-2,456	1,307	-4,196	-2,810	-7,369	-4,774	-3,476	-5,493	-5,212	-4,932	-5,151	-5,310	
Holdings of treasury bills	4,675	3,956	3,956	3,776	3,596	3,596	3,236	3,236	2,517	1,798	1,079	360	0	
Holdings of discounted treasury bills	733	733	719	719	719	719	719	719	719	719	719	719	719	
Overdrafts	0	0	0	0	0	0	0	0	0	0	0	0	0	
Domestic currency deposits	-5,170	-3,583	-2,156	-3,652	-1,433	-6,538	-3,583	-2,393	-3,583	-2,583	-1,583	-1,083	-883	
Foreign currency deposits	-546	-3,561	-1,212	-5,038	-5,693	-5,146	-5,146	-5,038	-5,146	-5,146	-5,146	-5,146	-5,146	
Claims on commercial banks	12	7	11	7	7	6	6	7	6	6	6	6	6	
Monetary policy instruments 2/	-8,088	-7,146	-12,930	-3,319	-6,026	-7,639	-11,155	-16,852	-23,755	-36,260	-44,669	-55,664	-62,705	
Of which: CBI bills	-1,632	-2,746	...	-1,663	-1,951	-2,627	...	...	...	...	...	...	...
Other items net	97	2,104	3,408	3,014	-2,231	4,160	5,001	4,584	5,001	-668	-5,624	-9,221	-13,486	
Reserve money	17,665	30,726	23,492	36,657	40,366	41,341	43,400	42,722	51,617	58,978	67,067	74,992	83,604	
Currency issued	11,917	15,632	14,970	17,242	18,619	19,641	20,882	20,662	24,836	28,858	33,453	38,054	43,185	
Currency outside banks	10,968	14,232	13,779	15,257	16,272	18,176	19,362	17,724	23,027	26,757	31,017	35,283	40,041	
Cash in vaults of commercial banks	948	1,401	1,191	1,985	2,347	1,465	1,521	2,938	1,808	2,101	2,436	2,771	3,145	
Banks reserves	5,749	15,094	8,522	19,415	21,747	21,700	22,518	22,061	26,782	30,119	33,615	36,938	40,419	
Required	3,572	11,805	7,487	15,273	16,539	18,174	18,860	17,354	22,430	26,063	29,813	33,413	37,118	
Excess	2,177	3,289	1,035	4,142	5,208	3,526	3,659	4,706	4,352	4,056	3,802	3,525	3,300	
Memorandum items														
Reserve money (annual growth, in percent) 3/	29.0	73.9	33.0	92.3	102.2	45.1	41.2	39.0	18.9	14.3	13.7	11.8	11.5	
Currency issued (annual growth, in percent)	16.2	31.2	25.6	33.4	37.6	35.8	33.6	32.2	18.9	16.2	15.9	13.8	13.5	
Gross foreign exchange assets (in millions of U.S. dollars)	20,037	31,455	26,909	34,122	43,035	44,260	46,829	50,396	64,286	81,007	93,393	107,592	118,988	
Foreign exchange liabilities (in millions of U.S. dollars)	-449	0	-496	0	0	0	0	0	0	0	0	0	0	
Net foreign exchange assets (in millions of U.S. dollars)	19,588	31,455	26,413	34,122	43,035	44,260	46,829	50,396	64,286	81,007	93,393	107,592	118,988	
Exchange rate (end of period)	1,325	1,215	...	1,206	1,195	1,179	...	...	...	...	...	...	...
Gross foreign exchange assets/reserve money (in percent)	150.3	124.4	137.5	112.3	127.4	126.2	125.2	136.8	147.0	171.4	182.3	193.4	197.5	
Reserve money coverage (NFA/reserve money, in percent)	146.9	124.4	134.9	112.3	127.4	126.2	125.2	136.8	147.0	171.4	182.3	193.4	197.5	
Currency outside banks/Reserve money (in percent)	62.1	46.3	58.7	41.6	40.3	44.0	44.6	41.5	44.6	45.4	46.2	47.0	47.9	
Currency outside banks/Non-oil GDP (in percent)	35.5	41.9	35.7	44.9	44.1	47.3	48.5	44.5	49.5	50.2	50.8	51.5	52.0	
Ratio of Reserve money to GDP	24.3	39.3	29.9	42.4	42.6	40.1	39.0	37.0	52.4	49.9	47.4	45.8	45.8	
Policy interest rate	16.0	20.0	...	17.0	17.0	16.0	...	...	...	...	...	...	...

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ Valued at market exchange rates.

2/ This mainly represents the ID and US\$ overnight standing deposit facilities and CBI bills.

3/ Reserve money growth in 2007 reflects the impact of the increase in the required reserves ratio on government deposits from 25 percent to 75 percent per September 2007.

Table 5. Iraq: Summary Balance Sheet of Deposit Money Banks, 2006–13
(In billions of Iraqi dinars, unless otherwise indicated)

	2006	2007		2008				2009	2010	2011	2012	2013
	Dec.	Dec.	Dec. SBA	Mar. Prel.	Jun Prel.	Dec. Proj.	Dec. Rev. SBA	Dec. Proj.	Dec. Proj.	Dec. Proj.	Dec. Proj.	Dec. Proj.
Net foreign assets	-3,215	-1,493	-3,215	-2,490	-51	-49	-2,395	-50	-53	-56	-57	-59
Assets	7,763	9,150	7,763	6,271	8,468	8,220	6,031	8,362	8,845	9,278	9,551	9,832
Liabilities	-10,978	-10,643	-10,978	-8,761	-8,519	-8,269	-8,426	-8,412	-8,898	-9,334	-9,608	-9,891
Net Domestic Assets	12,087	14,494	20,202	14,331	14,013	26,931	34,233	50,151	71,454	88,729	106,285	120,310
Domestic credit	-6,919	-12,836	-7,644	-11,781	-17,031	-9,404	-10,306	-3,336	1,687	6,717	9,611	12,734
Credit to the general government (net)	-9,771	-15,678	-11,572	-15,588	-20,378	-13,360	-14,763	-8,641	-5,422	-2,703	-2,483	-2,324
Credit to the economy	2,851	2,842	3,928	3,807	3,348	3,956	4,457	5,305	7,109	9,419	12,094	15,057
Monetary policy instruments	8,088	7,146	12,930	3,319	6,026	11,155	16,852	23,755	36,260	44,669	55,664	62,705
Reserves	6,697	16,494	9,714	21,554	23,874	24,039	24,998	28,590	32,221	36,051	39,709	43,563
Cash in vault	948	1,401	1,191	2,139	2,128	1,521	2,938	1,808	2,101	2,436	2,771	3,145
Deposits at the CBI	5,749	15,094	8,522	19,415	21,747	22,518	22,061	26,782	30,119	33,615	36,938	40,419
Of which: required reserves	3,572	11,805	7,487	15,273	16,539	18,860	17,354	22,430	26,063	29,813	33,413	37,118
Other Items Net	4,221	3,689	5,203	1,239	1,143	1,142	2,689	1,143	1,287	1,293	1,300	1,308
Demand deposits	6,682	9,733	12,740	8,325	10,038	20,162	23,879	37,576	53,551	66,505	79,670	90,188
Time deposits	2,190	3,268	4,247	3,516	3,925	6,721	7,960	12,525	17,850	22,168	26,557	30,063
Memorandum items												
Net foreign assets (percentage growth)	43.6	53.6	0.0	23.1	99.2	96.7	-60.5	-1.7	-5.8	-4.9	-2.9	-2.9
Domestic credit (percentage growth)	-88.0	-85.5	-10.5	-121.4	-211.6	26.7	19.7	64.5	150.6	298.1	43.1	32.5
Credit to the economy (percentage growth)	66.6	-0.3	37.8	27.4	27.1	39.2	56.4	34.1	34.0	32.5	28.4	24.5
Demand deposits (percentage growth)	76.0	45.7	90.7	19.5	53.7	107.2	111.3	86.4	42.5	24.2	19.8	13.2

Sources: Iraqi authorities; and Fund staff estimates and projections.

Table 6. Iraq: Monetary Survey, 2006–13
(In billions of Iraqi dinars, unless otherwise indicated)

	2006	2007		2008				2009	2010	2011	2012	2013
	Dec.	Dec. Prel.	Dec. SBA	Mar. Prel.	Jun. Prel.	Dec. Proj.	Dec. Rev. SBA	Dec. Proj.	Dec. Proj.	Dec. Proj.	Dec. Proj.	Dec. Proj.
Net foreign assets	22,739	36,726	28,480	38,661	51,378	54,273	56,064	75,808	101,059	122,231	144,965	165,040
Of which: CBI	25,954	38,219	31,695	41,151	51,428	54,322	58,459	75,858	101,112	122,286	145,022	165,099
Net domestic assets	-2,892	-9,490	2,286	-11,716	-20,920	-8,028	-6,502	-2,679	-2,900	-2,540	-3,454	-4,749
Domestic claims	-7,224	-15,292	-6,337	-15,977	-19,841	-14,178	-13,782	-8,829	-3,525	1,785	4,460	7,423
Net claims on general government	-10,080	-18,134	-10,265	-19,784	-23,188	-18,134	-18,239	-14,134	-10,634	-7,634	-7,634	-7,634
Claims on general government	7,549	8,194	...	6,511	7,030	...	...	...	...	...	...	...
less: Liabilities to general government	-17,629	-26,329	...	-26,295	-30,219	...	...	...	...	...	...	...
Claims on other sectors	2,856	2,842	3,928	3,807	3,348	3,956	4,457	5,305	7,109	9,419	12,094	15,057
Other Item Net (OIN)	4,332	5,802	8,623	4,261	-1,079	6,150	7,280	6,150	625	-4,325	-7,915	-12,172
Broad money	19,842	27,235	30,766	26,946	30,456	46,245	49,562	73,128	98,158	119,690	141,510	160,291
Currency outside banks	10,968	14,232	13,779	15,103	16,491	19,362	17,724	23,027	26,757	31,017	35,283	40,041
Transferable deposits	6,684	9,735	12,740	8,327	10,040	20,162	23,879	37,576	53,551	66,505	79,670	90,188
Other deposits	2,190	3,268	4,247	3,516	3,925	6,721	7,960	12,525	17,850	22,168	26,557	30,063
Memorandum items												
Net foreign assets (percentage growth)	99.8	61.5	25.2	117.5	162.2	47.8	52.7	39.7	33.3	21.0	18.6	13.8
Net domestic assets (percentage growth)	-185.9	-228.1	178.9	-478.3	-1,731.7	15.4	17.9	66.6	-8.3	12.4	-36.0	37.5
Net claims on general government (percentage growth)	-91.5	-79.9	-1.8	-242.4	-275.4	0.0	-0.4	22.1	24.8	28.2	0.0	0.0
Claims on other sectors (percentage growth)	66.9	-0.5	37.8	27.4	27.1	39.2	56.4	34.1	34.0	32.5	28.4	24.5
Broad money (percentage growth)	34.6	37.3	55.1	29.1	45.9	69.8	72.1	58.1	34.2	21.9	18.2	13.3
M2 velocity (ratio)	3.7	2.9	2.5	...	...	2.4	2.3	1.3	1.2	1.2	1.2	1.1
Credit to the economy (as a percentage of non-oil GDP)	9.3	8.4	10.2	...	...	9.9	10.4	11.4	13.3	15.4	17.6	19.5

Sources: Iraqi authorities; and Fund staff estimates and projections.

Table 7. Iraq: Balance of Payments, 2006–13 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2006	2007	2008		2009	2010	2011	2012	2013
	Prel.	Prel.	Rev. SBA	Proj.			Proj.		
Trade balance	10,360	17,207	22,908	21,188	1,645	6,937	10,783	14,745	15,994
(In percent of GDP)	20.9	27.6	23.8	22.6	2.0	7.3	10.0	12.1	12.2
Exports	29,914	37,835	65,487	61,998	46,396	53,249	61,812	69,628	76,229
Crude oil	29,190	37,137	64,617	61,284	45,625	52,505	61,074	68,894	75,459
Other exports	725	698	869	714	771	744	739	734	771
Imports	-19,555	-20,628	-42,578	-40,810	-44,751	-46,313	-51,029	-54,883	-60,236
Government imports	-12,145	-9,752	-24,762	-23,170	-25,228	-24,948	-26,888	-27,684	-29,170
UN Oil for Food Program (OFFP)	-272	-110	0	-80	0	0	0	0	0
Other consumption imports (non-OFFP)	-3,834	-2,597	-8,570	-10,412	-10,970	-10,999	-11,325	-11,938	-13,048
Other non-oil related capital imports (non-OFFP)	-3,746	-2,231	-9,962	-6,407	-7,999	-8,676	-10,326	-11,049	-11,823
Oil-related capital imports	-1,843	-2,154	-2,531	-2,741	-3,348	-3,558	-4,050	-4,103	-4,299
Refined oil products	-2,450	-2,660	-3,699	-3,530	-2,912	-1,716	-1,188	-594	0
Private sector imports	-7,410	-10,876	-17,816	-17,641	-19,522	-21,365	-24,140	-27,199	-31,065
Of which: refined oil products	0	-1,777	-3,699	-3,530	-3,559	-4,003	-4,750	-5,344	-7,274
Income, net 2/	-3,570	-3,322	-3,366	-2,893	1,177	1,294	1,497	1,758	2,409
Services, net	-5,164	-4,175	-5,746	-5,170	-2,664	-2,711	-3,028	-3,265	-3,625
Transfers, net	5,086	1,084	3,139	1,006	-147	-935	-1,324	-1,590	-1,834
Private, net (incl. NGOs) 3/	368	637	4,873	2,549	1,927	1,498	1,558	1,683	1,767
Official	4,718	448	-1,734	-1,543	-2,074	-2,433	-2,882	-3,273	-3,602
Receipts	6,178	2,305	1,497	1,522	207	192	171	171	171
Payments	-1,459	-1,857	-3,231	-3,064	-2,281	-2,625	-3,054	-3,445	-3,773
Current account	6,712	10,794	16,935	14,130	12	4,585	7,928	11,648	12,943
(In percent of GDP)	13.6	17.3	17.4	15.1	0.0	4.8	7.3	9.6	9.8
Capital account	0	0	0	0	0	0	0	0	0
Financial account	683	806	1,144	496	16,962	11,746	4,485	2,566	-1,533
Direct investment	78	964	519	2,121	2,269	2,587	3,112	3,751	4,153
Other capital, net	605	-158	625	-1,624	14,693	9,159	1,373	-1,185	-5,686
Official, net	2,215	1,014	425	-2,949	13,302	7,671	-220	-2,889	-7,509
Assets 4/	-1,796	-3,536	-3,567	-6,819	11,474	5,952	616	-1,921	-6,152
Liabilities	4,011	4,550	3,992	3,870	1,828	1,718	-836	-968	-1,357
Loan disbursements	0	0	241	241	550	866	1,350	1,224	836
Amortization 5/ 6/ 10/	-329	0	-614	-662	0	0	-2,186	-2,191	-2,193
Capitalized interest payment 6/	4,340	4,550	4,365	4,291	1,278	853	0	0	0
Financial corporations, net 7/	-1,517	-1,518	0	0	0	0	0	0	0
Private, net	-94	346	199	1,325	1,391	1,488	1,593	1,704	1,823
Errors and omissions	663	-899	0	0	0	0	0	0	0
Overall balance	8,057	10,702	18,079	14,627	16,974	16,331	12,412	14,214	11,410
(In percent of GDP)	16.3	17.2	18.6	15.6	20.3	17.2	11.5	11.7	8.7
Financing	-8,057	-10,702	-18,079	-14,627	-16,974	-16,331	-12,412	-14,214	-11,410
Central bank (increase -)	-8,021	-11,418	-18,914	-15,374	-17,467	-16,752	-12,412	-14,214	-11,410
Reserves (net; increase -)	-8,021	-11,869	-18,914	-15,674	-17,467	-16,752	-12,412	-14,214	-11,410
Liabilities (increase +)	0	-451	0	0	0	0	0	0	0
Fund credit (net)	0	-451	0	0	0	0	0	0	0
Disbursement	0	0	0	0	0	0	0	0	0
Repayments	0	-451	0	0	0	0	0	0	0
Deferred accrued interest 8/	754	791	835	748	632	422	0	0	0
Change in arrears (net, decrease -) 9/	-15,457	-75	-63,319	-65,793	-139	0	0	0	0
Debt forgiveness 10/	14,667	0	63,319	65,793	0	0	0	0	0
Memorandum items:									
Central bank reserves	20,037	31,455	50,369	46,829	64,296	81,049	93,461	107,675	119,085
Central bank reserves (in months of imports of goods and services)	9.3	8.0	13.5	11.6	15.3	17.5	18.8	19.7	24.4
External assets held abroad (In US\$ million)	8,624	12,584	16,463	19,803	8,455	2,041	1,329	3,212	9,273
GDP	49,465	62,383	97,246	93,817	83,477	94,751	108,121	121,393	131,552
Non-oil GDP	21,027	27,060	33,571	33,622	39,453	42,698	46,601	50,860	55,514

Sources: Iraqi authorities; and Fund staff estimates and projections.

1/ Excludes U.S. military spending in Iraq.

2/ Includes interest accrued, deferred, and capitalized.

3/ 2008 data include \$3.75 billion obtained from telecoms licensing fees.

4/ Includes the use/accumulation of the DFI resources and the UN Oil for Food letters of credit.

5/ Includes the estimates of cash payments to settle the debt owed to small private creditors through cash exchange offer.

6/ Based on Paris Club agreement, the payments of principal and most interest during 2006–10 are deferred and capitalized.

7/ Reflects advance transfers for the execution of letters of credit (L/C).

8/ Estimates of accrued interest on existing stock of debt prior to the implementation of the Paris Club agreement.

9/ Includes debt forgiveness and clearance of arrears on multilateral debt and arrears related to fuel imports from Turkey.

10/ The notional debt forgiveness reflects: (i) the first stage of debt reduction (30 percent) at end 2004; (ii) the second stage reduction (30 percent) at end-2005; and (iii) the settlement of debt owed to private creditors through cash and debt exchanges. Assumes debt reduction comparable to the Paris Club agreement on other debt to official creditors.

Table 8. Iraq: Quantitative Performance Criteria and Indicative Targets
Under the Stand-By Arrangement, 2007–08 1/
(In billions of Iraqi dinars, unless otherwise indicated)

	Amount at 6/30/07	Performance Criteria				
		12/31/07	3/31/08	6/30/08	9/30/08	12/31/08
<i>Cumulative change from June 2007</i>						
Net international reserves of the CBI (floor; in millions of U.S. dollars) 2/ (Actual)	20,635	0 10,820	0 13,487	0 22,400	0 23,625	0 ...
Lending to the government and the private sector by the CBI (ceiling) 3/ (Actual)	5,230	0 0	0 0	0 0	0 0	0 ...
<i>Cumulative flow from beginning of calendar year</i>						
Central government total financing (ceiling) 4/ (Actual)	...	7,600 -7,894	2,200 -9,024	3,750 -6,879	-2,400 ...	-3,200 ...
Government wage and pension bill (ceiling) 4/ 5/ (Actual)	...	10,100 8,324	2,750 2,385	5,500 6,579	11,650 ...	14,400 ...
Government imports of petroleum products (ceiling) 4/ (Actual)	...	400 195	100 108	200 172	300 ...	400 ...
Direct government subsidies to the fuel sector (Actual)	...	0 0	0 0	0 0	0 ...	0 ...
New medium-and long-term nonconcessional external debt (with original maturities of one year or more) contracted or guaranteed by the government (in millions of U.S. dollars; ceiling) 4/ 6/ (Actual)	...	500 0	500 0	500 0	500 0	500 ...
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 7/ (Actual)	...	0 0	0 0	0 0	0 ...	0 ...
<i>Indicative target</i>						
Revolving government credit to the State Oil Marketing Organization (ceiling) (Actual)	...	400 400	400 400	400 400	400 ...	400 ...

1/ The Technical Memorandum of Understanding will provide for precise definitions of all performance variables.

2/ Amount at 6/30/07 has been revised from 21,045 at the time of the Board meeting in light of updated data.

3/ Rolling over t-bills does not constitute new lending.

4/ Flows for 2007 and 2008 are cumulative starting 1/1/2007 and 1/1/2008, respectively.

5/ Excluding salaries paid by ministries of defense and interior.

6/ Concessionality is defined as loans with a grant element of 35 percent or higher.

7/ To be monitored on a continuous basis.

Table 9. Structural Performance Criteria, and Structural Benchmarks
Under the Stand-By Arrangement

I. Structural Performance Criteria		
Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.	Continuous	Met
Enact the amendments to the pension law to make it fiscally sustainable.	December 31, 2007	Met
Completion by an external auditor of an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	March 31, 2008	Met
Completion by an external auditor of the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	June 30, 2008	Met
II. Structural Benchmarks		
Implementation of regular reconciliation in the CBI accounts of (i) local banks' current accounts; (ii) intra-branch accounts; and (iii) suspense accounts.	March 31, 2008	Partially met 1/
Adoption of reserves management guidelines by the CBI.	March 31, 2008	Met on August 4
Completion of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	May 31, 2008	Met on July 10
Incorporate new weights in the CPI based on the 2007 household expenditure survey.	May 31, 2008	Underway
Submission to the Board of Supreme Audit of the final accounts of the Federal Budget for the year ending December 31, 2007.	June 30, 2008	Met on October 19
Completion of census of all public service employees (central government and military)	June 30, 2008	Delayed 2/
Adoption of an action plan for modernizing the government's financial management system.	July 31, 2008	Met on November 10
Completion of the set of prudential regulations for commercial banks.	July 31, 2008	Partially met 3/
Publication of audit reports mandated by the Committee of Financial Experts (COFE) and presentation of the first semi-annual COFE report, covering the period January–June 2008 and including recommendations, to the Council of Ministers.	September 15, 2008	Met on December 2
Development of a periodic adjustment mechanism for fuel prices based on changes in domestic production costs and import costs to prevent re-emergence of direct budget subsidies on fuel products.	September 30, 2008	Underway
Adoption of an operational restructuring program for Rafidain bank based on the findings of the audits.	September 30, 2008	Delayed 4/
Adoption of operational and financial restructuring programs for Rasheed bank based on the findings of the audits.	September 30, 2008	Delayed 4/
Submission to the Council of Representatives and publication of the audited accounts of the Federal Budget for the year ending December 2007, in accordance with the Financial Management Law of 2004.	November 15, 2008	Underway

1/ Reconciliation of local banks' current account has improved after the CBI tightened its reporting requirements from the banks. No progress has been made with respect to the reconciliation of suspense accounts (mainly with the Ministry of Finance), and of CBI intra-branch accounts.

2/ Expected in January 2009.

3/ Nine key regulations have been finalized.

4/ Preparation of the restructuring programs will start before end-2008.

Table 10. Iraq: Availability of Purchases Under the Stand-By Arrangement, 2008–09

Availability Date	Amount of Purchase		Condition
	SDR	% quota	
Proposed schedule new SBA			
November 15, 2008	439,708,000	37.00	Completion of second review and observance of end-September 2008 performance criteria
February 15, 2009	35,652,000	3.00	
Total access	475,360,000	40.00	

Source: Fund staff projections.

Table 11. Iraq: Indicators of Fund Credit, 2004–14 1/
(In millions of SDRs, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Disbursements of Fund credit											
EPCA	297.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SBA	0.0	0.0	0.0	0.0	439.7	35.7	0.0	0.0	0.0	0.0	0.0
In percent of IMF quota	0.0	0.0	0.0	0.0	37.0	3.0	0.0	0.0	0.0	0.0	0.0
Obligations											
Clearance of arrears	55.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments of EPCA	0.0	0.0	0.0	297.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments of SBA 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	233.2	237.7	4.5	0.0
Total charges and interest	0.7	10.5	14.4	16.1	1.6	18.2	19.2	16.0	6.5	0.1	0.0
Total obligations	56.0	10.5	14.4	313.2	1.6	18.2	19.2	249.2	244.2	4.6	0.0
Total obligations, in percent of:											
Exports of goods and services	0.6	0.1	0.1	1.5	0.0	0.1	0.1	0.7	0.6	0.0	0.0
External public debt	0.1	0.0	0.0	0.5	0.0	0.1	0.1	0.9	0.9	0.0	0.0
Gross reserves	1.0	0.1	0.1	1.5	0.0	0.0	0.0	0.4	0.4	0.0	0.0
GDP	0.3	0.0	0.0	0.8	0.0	0.0	0.0	0.4	0.3	0.0	0.0
IMF Quota	4.7	0.9	1.2	26.4	0.1	1.5	1.6	21.0	20.5	0.4	0.0
Outstanding Fund credit											
EPCA	297.1	297.1	297.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SBA	0.0	0.0	0.0	0.0	439.7	475.4	475.4	242.1	4.5	0.0	0.0
Total outstanding Fund credit	297.1	297.1	297.1	0.0	439.7	475.4	475.4	242.1	4.5	0.0	0.0
Total outstanding Fund credit, in percent of											
Exports of goods and services	3.3	2.6	1.8	0.0	1.5	1.5	1.3	0.7	0.0	0.0	0.0
External public debt	0.4	0.4	0.4	0.0	1.7	1.7	1.7	0.9	0.0	0.0	0.0
Gross reserves	5.5	3.7	2.2	0.0	1.4	1.1	0.9	0.4	0.0	0.0	0.0
GDP	1.7	1.4	0.9	0.0	0.7	0.9	0.8	0.3	0.0	0.0	0.0
IMF Quota	25.0	25.0	25.0	0.0	37.0	40.0	40.0	20.4	0.4	0.0	0.0

Sources: Fund staff estimates and projections.

1/ Including the hypothetical purchases under the current precautionary SBA, not shown in the balance of payments projections.

2/ The SBA repayments are on a expectations basis.

APPENDIX. IRAQ—EXTERNAL DEBT OUTLOOK

1. Iraq has received substantial debt reduction from official and private creditors, but the amount of external debt remains large. Assuming that debt reduction comparable to the terms of the 2004 Paris Club agreement is applied to non-Paris Club creditors' claims in 2008, the latest estimates of external debt indicate that the stock of debt was \$98 billion (198 percent of GDP) at end-2006 and \$102 billion (163 percent of GDP) at end-2007. Without the third stage of debt reduction, external debt would amount to \$41 billion (31 percent of GDP) by 2013. The third stage reduction (expected in 2008) would further reduce Iraq's external debt to about \$33 billion (25 percent of GDP) by 2013 (Appendix, Table 1).¹ The medium-term projections assume that new debt disbursements are mostly from multilateral creditors, Italy and Japan.

2. Iraq's external debt remains vulnerable to a further negative oil shock, particularly when Iraq will start repaying the debt to official creditors. Based on the Paris Club agreement, the repayment of the remaining debt stock would start in 2011; the interest payments accrued during 2005–10 are mostly capitalized. The debt service remains moderately large through 2008, when those non-Paris Club creditors that have not yet provided debt relief are assumed to provide 80 percent debt reduction in net present value terms. Debt service is projected to increase in 2011 because of Paris Club debt repayments. Simulations include two oil shocks (a production shock that keeps oil production constant at 2.2 mbpd in 2008–13, and a price shock that lowers the oil export price by 10 percent per barrel during 2008–13), as well as a combined shock in view of the considerable level of uncertainty under the baseline scenario. Under all three scenarios, the oil production shock, oil price shock and the combined shock scenarios, Iraq would need to use resources from the Development Fund for Iraq and possibly to borrow from international markets to close the financing gaps (Appendix, Table 2).

¹ The third stage of debt reduction would be contingent on Iraq completing the second and final review under the current Stand-By Arrangement.

Table 1. Iraq: Estimated External Debt Stock, 2004–13
(In billions of US\$) 1/

	2004 before debt reduction	2004 after debt reduction	2005	2006	2007	2008	2009	2010	2011	2012	2013
Without the third stage of debt reduction in 2008 (baseline) 2/											
Paris Club official creditors	51.6	31.7	17.1	17.8	18.6	18.6	19.2	19.6	18.5	17.5	16.4
Non-Paris Club official creditors 3/	69.6	69.6	71.5	75.0	78.7	17.5	18.1	18.5	17.4	16.4	15.3
Private creditors 4/	20.2	20.2	18.9	4.1	4.1	3.6	3.6	3.6	3.6	3.6	3.6
Multilateral creditors and others 2/	0.9	1.2	1.8	1.0	0.5	0.7	1.1	2.0	3.4	4.6	5.4
Total debt	142.4	122.7	109.3	97.9	101.9	40.4	42.1	43.8	43.0	42.0	40.7
In percent of GDP	552.6	476.2	348.4	197.9	163.4	43.1	50.4	46.3	39.8	34.6	30.9
Total debt service 5/	...	0.2	0.2	1.2	0.7	0.9	0.6	0.7	3.4	3.4	4.1
With the third stage of debt reduction in 2008 6/											
Total debt	142.4	122.7	109.3	97.9	101.9	31.8	33.2	34.7	34.4	33.9	33.1
In percent of GDP	552.6	476.2	348.4	197.9	163.4	33.9	39.7	36.6	31.8	28.0	25.2
Total debt service 5/	...	0.2	0.2	1.2	0.7	0.9	0.5	0.5	2.4	2.4	3.2

Sources: Iraqi authorities and staff estimates.

1/ The assumptions made in this table are for purposes of illustration and discussion only. While the process of Iraq's debt reconciliation is ongoing, the IMF has had to base its analysis on information that may include as yet unreconciled data. Such use of data by the IMF does not amount to a recognition or denial of any particular claims. The estimates of the debt stock may differ from those in IMF Country Report No. 08/303 to incorporate the latest results of debt reconciliation and settlement.

2/ Includes new debt and arrears related to fuel imports from Turkey in 2006. The projections assume that new debt disbursement is mostly from multilateral creditors and Japan.

3/ Assumes debt reduction comparable to the 2004 Paris Club agreement for creditors with whom a debt agreement has been signed. For the remaining non-Paris Club creditors, such debt reduction is assumed to take place by end-2008.

4/ Assumes that by end-2009 all debt to private creditors would be settled by debt and cash exchanges.

5/ Debt service is actual amount paid, including repayment of arrears to Turkey.

6/ Assumes precautionary SBA during 2005–09.

Table 2. Iraq: External Debt Sustainability Framework, 2004–13
(In percent of GDP, unless otherwise indicated)

	Estimates				Projections					
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
External debt	476.2	348.4	197.9	163.4	43.1	50.4	46.3	39.8	34.6	30.9
Change in external debt (1)	-641.4	-127.8	-150.5	-34.5	-120.3	7.4	-4.2	-6.5	-5.1	-3.7
Identified external debt-creating flows (2)	-569.7	-75.5	-135.5	-50.8	-66.2	-12.8	-21.4	-18.0	-16.9	-12.4
Current account deficit, excluding interest payments	17.2	-24.6	-22.5	-24.9	-20.3	-2.4	-7.0	-9.3	-11.3	-11.3
Deficit in balance of goods and services	25.2	2.3	-10.5	-20.9	-17.1	1.2	-4.5	-7.2	-9.5	-9.4
Exports	69.0	74.8	61.2	62.3	67.3	57.1	57.6	58.5	58.6	59.2
Imports	94.2	77.0	50.7	41.4	50.2	58.3	53.1	51.3	49.1	49.8
Net non-debt creating capital inflows (negative) 1/	-44.3	18.2	5.4	7.4	3.6	-18.1	-10.6	-4.9	-2.9	0.1
Automatic debt dynamics 2/	-542.6	-69.0	-118.4	-33.4	-49.5	7.7	-3.8	-3.8	-2.7	-1.2
Contribution from nominal interest rate	22.4	16.2	9.0	7.6	5.3	2.3	2.2	2.0	1.7	1.5
Contribution from real GDP growth	-257.1	2.8	-13.7	-2.3	-10.6	-3.7	-3.2	-2.9	-2.5	-2.1
Contribution from price and exchange rate changes 3/	-307.9	-88.1	-113.6	-38.6	-44.1	9.0	-2.8	-2.8	-1.9	-0.5
Residual, incl. change in gross foreign assets (1-2)	-71.7	-52.3	-14.9	16.3	-54.1	20.2	17.2	11.5	11.7	8.7
Of which: change in official reserves (increase = positive)	26.4	13.0	16.2	18.3	16.4	20.9	17.7	11.5	11.7	8.7
External debt-to-exports ratio (in percent)	689.9	466.0	323.4	262.2	64.0	88.4	80.3	68.0	59.1	52.2
Gross external financing need (in billions of US dollars) 4/ in percent of GDP	14.4	-1.1	-4.5	-11.6	-13.5	1.2	-4.6	-6.2	-9.5	-10.8
External debt service in percent of exports 5/	32.5	22.3	19.7	12.4	8.9	6.6	3.7	6.1	5.9	5.3
Debt-stabilizing non-interest current account (positive = surplus) 6/	-658.6	-103.1	-127.9	-9.6	-100.0	9.7	2.8	2.8	6.1	7.6
Key Macroeconomic Assumptions										
Real GDP growth (in percent)	46.5	-0.7	6.2	1.5	9.8	7.7	7.2	7.3	6.9	6.7
GDP deflator in U.S. dollars (change in percent)	38.0	22.7	48.4	24.3	37.0	-17.3	5.8	6.4	5.0	1.6
Nominal external interest rate (in percent)	4.1	4.1	4.1	4.8	4.9	4.8	4.9	4.8	4.7	4.6
Growth of exports (U.S. dollar terms, in percent)	91.7	31.9	29.0	28.4	62.4	-24.6	14.6	15.9	12.5	9.4
Growth of imports (U.S. dollar terms, in percent)	203.7	-0.5	3.8	3.1	82.4	3.2	3.5	10.2	7.6	9.8
Stress Tests for External Debt Ratio										
Limited oil production 7/		348.4	197.9	163.4	44.7	54.9	53.1	47.9	43.3	40.1
Lower oil price in 2008-13 8/		348.4	197.9	163.4	46.0	54.3	49.4	42.6	37.1	33.2
Combined shock--Lower production and lower oil price in 2008-13 9/		348.4	197.9	163.4	47.6	58.7	56.4	50.8	45.9	42.5
Stress Tests for External Debt Service-to-Exports Ratio 5/										
Limited oil production 7/		22.3	19.7	12.4	9.4	7.7	4.9	8.6	9.1	8.8
Lower oil price in 2008-13 8/		22.3	19.7	12.4	9.8	7.5	4.2	6.8	6.6	5.9
Combined shock--Lower production and lower oil price in 2008-13 9/		22.3	19.7	12.4	10.3	8.8	5.4	9.6	10.1	9.8
Memorandum items:										
Real GDP growth under stress scenarios (in percent)										
Limited oil production 7/		-0.7	6.2	1.5	6.8	2.4	2.5	3.0	3.1	3.2
Lower oil price in 2008-13 8/		-0.7	6.2	1.5	9.8	7.7	7.2	7.3	6.9	6.7
Combined shock--Lower production and lower oil price in 2008-13 9/		-0.7	6.2	1.5	6.8	2.4	2.5	3.0	3.1	3.2
Non-interest current account deficit under stress scenarios (in percent of GDP)										
Limited oil production 7/		-24.6	-22.5	-24.9	-18.1	4.2	3.0	4.1	5.6	9.2
Lower oil price in 2008-13 8/		-24.6	-22.5	-24.9	-16.4	3.4	-1.8	-3.9	-5.8	-6.3
Combined shock--Lower production and lower oil price in 2008-13 9/		-24.6	-22.5	-24.9	-14.1	10.0	8.3	9.6	11.2	14.3

1/ Includes net FDI, other net private sector inflows (all assumed to be equity), and use of official assets held abroad (Development Fund for Iraq). Projections do not assume the third stage of debt reduction by the Paris Club in 2008, but assume the remaining non-Paris Club claims are settled in 2008.

2/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g + r + gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation. (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ Debt service is total accrued amount.

6/ Balance that stabilizes the debt ratio at its previous year's level, given assumptions on real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP.

7/ Assumes that oil production remains constant at 2.2 mbpd from 2008 onward.

8/ Assumes that the oil price in 2008-13 is 10 percent lower than the WEO price before adjusting by the quality discount factor.

9/ Assumes that oil production remains at 2.2 mbpd and the oil price is 10 percent lower than WEO price before adjusting by the quality discount factor.

Attachment I. Iraq—Letter of Intent

Baghdad, November 29, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

The Executive Board of the IMF approved a request for a Stand-By Arrangement (SBA) for Iraq on December 19, 2007, in support of our economic program for 2008. The first review was completed on September 3, 2008. The security situation has improved in recent months but remains precarious. Nevertheless, we continue to make progress in the implementation of our program. In particular, growth prospects have improved as crude oil production and exports have increased compared to previous years while inflation has remained subdued, despite a large increase in government spending provided for in the 2008 supplementary budget and higher food prices. We have also advanced with the implementation of structural reforms.

Iraq has met all quantitative performance criteria set for end-June 2008, except for the quantitative performance criterion on the government wage and pension bill because payment of the civil service salary increase included in the 2008 supplementary budget started earlier than anticipated. In completing the first review under the SBA, the Fund has granted a waiver for the nonobservance of this performance criterion. All structural performance criteria have been met. We request completion of the second and final review under the SBA.

In the period ahead, we will strive to maintain macroeconomic stability and take measures that will enable Iraq to move toward a path of high and sustainable growth as proposed in the attached second Supplementary Memorandum of Economic and Financial Policies (SMEFP). The sharp drop in world oil prices triggered by the current international financial and economic crisis is having a serious adverse impact on Iraq's fiscal and external positions. We have based the draft budget for 2009 on a crude oil export price of \$62.5 per barrel, which is much lower than the average crude oil export price of \$101.3 per barrel realized during January-September 2008. In order to maintain a sustainable fiscal stance, we have significantly scaled down our initial spending plans for 2009. At the same time, we have maintained a sizable allocation for government investment, including in the oil sector, to further step up our reconstruction efforts. In the event that the average export price of Iraqi oil

in 2009 would fall below \$62.5 per barrel and fiscal sustainability is at risk, we will prepare a supplementary budget to further cut current spending and adjust investment. We will also continue the appropriate management of the exchange rate of the dinar and maintain a tight monetary policy stance, in order to keep inflation under control.

The attached memorandum updates our economic program for 2008 and outlines the main elements of our program for 2009. We believe that the policies and measures set forth in the second SMEFP are adequate to achieve the objectives of the program that is supported by the SBA through March 2009. However, we will take any additional measures that may be needed to ensure that the program remains on track. We will consult with the Fund on the adoption of such measures, and in advance of revisions to the policies contained in the second SMEFP, in accordance with the Fund's policies on such consultation. We will provide the Fund with such information as it requests on policy implementation and achievement of the program objectives.

We intend to continue to treat the SBA as precautionary and consent to the publication of this letter and the second SMEFP. Finally, we would like to thank the Fund for its support to Iraq's economic programs over the last four years under very difficult circumstances, and hope that we can count on the continued support of the Fund for the implementation of Iraq's economic policy agenda.

Sincerely yours,

/s/

Dr. Sinan Al-Shabibi
Governor of the Central Bank of Iraq

/s/

Mr. Baqir S. Jabr Al-Zubaydi
Minister of Finance of Iraq

Attachment II. Iraq—Second Supplementary Memorandum of Economic and Financial Policies for 2008–09

November 29, 2008

I. INTRODUCTION

1. This memorandum supplements the Memorandum of Economic and Financial Policies for 2008 (MEFP) and the first supplement thereto, annexed to our letters dated December 4, 2007 and August 10, 2008, respectively. It describes additional economic objectives and policies agreed in the context of the second review under the Stand-By Arrangement (SBA). Policies and unfulfilled commitments specified in the MEFP and the first supplement thereto continue to be part of the program.

II. RECENT DEVELOPMENTS UNDER THE STAND-BY ARRANGEMENT

2. Economic developments have been encouraging so far in 2008. Oil production in January–August 2008 rose on average to 2.3 million barrels per day (mbpd), compared to 1.9 mbpd in the same period of 2007, and is expected to remain at that level for the year as a whole. Oil exports in January–September 2008 were running slightly ahead of the target average for the year of 1.8 mbpd. Indications are that the improved security situation is also starting to benefit the non-oil sector. Preliminary estimates by the Central Organization for Statistics and Information Technology (COSIT) show that real non-oil GDP increased by about 8 percent, year-on-year, in the first half of 2008. Total real GDP growth is projected to increase to close to 10 percent in 2008, from 1½ percent in 2007. Headline inflation has remained subdued thus far in 2008, mainly because of a further decline in (black-) market fuel prices and the limited initial price effect of the civil service salary increase that came into effect in June. On this basis, it seems likely that inflation in 2008 will be kept below the target of 14 percent. Annual core inflation (excluding fuel and transportation costs), however, remained at 13½ percent in October, in part because of increasing food prices.

3. The fiscal outturn through July 2008 showed a surplus, mainly on account of higher-than-expected oil revenues resulting from both higher export prices and volumes of crude oil. Underspending on investment also contributed to the surplus, although our efforts to improve investment execution have resulted in a doubling of recorded capital expenditures in January–July 2008 compared to the same period last year. The balance in the Development Fund for Iraq (DFI) increased by almost \$11 billion to \$23.5 billion at end-September 2008. The salary increase for civil servants granted this year is being phased in gradually, in line with the program ceilings for the government wage and pension bill. Taking account of the increased spending included in the 2008 supplementary budget and the sharp drop in oil

export prices since the summer, an overall budget surplus of almost 8 percent of GDP is expected for 2008 (compared to a surplus of 2.8 percent in the revised program).

4. The Central bank of Iraq (CBI) has stepped up the rate of appreciation of the dinar vis-à-vis the U.S. dollar to about ½ percent per month since mid-2008 to keep inflation under control and counter dollarization. Since November 2006, the dinar has appreciated by 20 percent to ID 1,176 per dollar at end-October 2008. Net international reserves increased to a level of \$44.3 billion at end-September. In light of the subdued inflation thus far in 2008, the CBI has reduced its policy interest rate from 16 percent to 15 percent as of November 3, 2008, while keeping the real interest rate in positive territory (as measured against core inflation).

5. All quantitative performance criteria for end-June 2008 were met, except for the performance criterion on the government wage and pension bill, which was missed because the implementation of the civil service salary increase granted in 2008 started earlier than anticipated (Table 1). All structural performance criteria were met (Table 2).

6. We have also continued to make progress toward resolving external claims. Bilateral agreements with eleven non-Paris Club official creditors have already been signed. The United Arab Emirates has announced the full cancellation of Iraq's debt and we have finalized the debt negotiations with Greece, Morocco and Tunisia; we hope to sign the relevant debt agreements in the near future. Also, debt negotiations are underway with several other non-Paris Club official creditors, notably some Gulf countries and China. Regarding private creditors, we have completed a cash settlement of about \$470 million of commercial debt in August. The process to resolve most of the remaining private claims as part of the liquidation of the London branch of Rafidain Bank has also begun.

III. ECONOMIC AND FINANCIAL POLICIES IN THE REMAINDER OF 2008 AND IN 2009

7. The serious international financial and economic crisis, notably the recent precipitous fall in world oil prices, has significantly worsened Iraq's external outlook for the period ahead. The projected drop in oil export revenues in 2009, in particular, presents a challenge in view of strong spending pressures fueled by the high oil revenues and fiscal surpluses of recent years. We are determined to strengthen spending discipline to better ensure that the reduced public resources are put to productive use and preserve fiscal sustainability. Therefore, we have revised our spending plans for 2009 downwards by reducing non-priority current outlays and by better aligning the investment budget with our implementation capacity. Appropriate management of the exchange rate and a positive real policy interest rate remain instrumental to keep inflation under control. We will also continue with structural reforms to achieve high growth over the medium term and to strengthen governance and administrative capacity in the public sector.

8. Provided violence continues to decline, real GDP growth is expected to remain strong at about 7½ percent in 2009. Growth would be driven by the ongoing expansion of oil output and a further recovery of non-oil activity. We will strive to further increase average crude oil production and exports to 2.5 mpbd and 2.0 mbpd, respectively, in 2009. We aim to contain inflation at 10 percent in 2009. With average oil export prices projected to fall from \$93 per barrel in 2008 to \$62.5 per barrel in 2009, oil export earnings would drop by about one-quarter. As a result, the surplus in the external current account of 15 percent of GDP in 2008 is projected to disappear in 2009. The net international reserves of the CBI are expected to further increase to about \$64 billion by end-2009.

A. Fiscal Policy and Reforms

9. The 2009 draft budget adopted by Cabinet is designed to preserve fiscal sustainability over the medium term in light of sharply lower expected oil revenues, while continuing to support a sizable investment program. The draft budget provides for sizable security outlays while strictly limiting other current spending. The 2008 civil service salary increase will be fully funded, including the carry-over of the part that was postponed in 2008. We will not grant any additional wage increases and there will be no net hiring of non-security personnel in 2009. In order to limit its costs, we have initiated a reform of the in-kind Public Distribution System aimed at restricting eligibility of well-off beneficiaries as of mid-2009. Other transfers, including to state-owned enterprises, will be strictly limited. In view of the improved investment execution, we have somewhat increased next year's investment budget for the oil, electricity, water and sanitation, education, health, and agricultural sectors. The practice of carrying over unspent investment allocations from the previous year will be stopped, and we will step up our efforts to safeguard the quality of investment spending.

10. Despite this significant fiscal adjustment, a sizable fiscal deficit is foreseen for 2009, which we intend to eliminate over the next two years. The draft budget aims to limit the overall deficit to ID 17 trillion or 17.3 percent of GDP in 2009. The deficit will be financed by drawing down part of the balance in the DFI and by using some of the bank deposits accumulated during 2006-08. In order to maintain a benchmark for market interest rates and help develop a secondary market for treasury bills, we will continue our regular bi-weekly issuance in the order of ID 150-200 billion.

11. We are considering to increase official fuel prices for regular and blended gasoline, diesel, and kerosene in the first part of 2009. The adjustment will depend on developments in international oil and fuel prices, and aim to reduce the still sizable indirect subsidies and to counter smuggling. At the same time, we will continue to work on the development of a periodic adjustment mechanism for fuel prices, based on the recommendations of a recent Fund technical assistance mission.

12. We have made some progress in developing a medium-term tax reform strategy with the objective to streamline the tax system while broadening the tax base and increasing revenue collection. A draft law on import tariffs has been prepared and will be discussed with the Fund before submission to the Council of Ministers. The objective of the draft law is to establish a transparent and efficient tariff system with fewer exemptions. We are working on the development of a sales tax as a precursor for a value-added tax. As a first step, we intend to introduce a mobile phone tax in 2008. We are also considering to reduce the number of income tax brackets. We will seek technical assistance from the Fund and other international partners to support our tax reform efforts.

13. We are making progress in modernizing public financial management (PFM). The Board of Supreme Audit (BSA) has completed the audit of the final accounts of the federal budget for 2005 and the audit of the final accounts for 2006 is underway. We have submitted the final accounts of the federal budget for 2007 to the BSA in October. The audit reports will be submitted to the Council of Representatives and published. We have also adopted, in consultation with the Fund and the World Bank, a three-year action plan that identifies priority measures to modernize PFM, notably as regards budget preparation, execution and reporting; cash management; public procurement; cash management; and the accounting framework. We will step up our efforts to put in place, in cooperation with USAID, the renewed Iraq Financial Management Information System (IFMIS), in order to make this system fully operational in 2009.

14. We have completed about 25 percent of the data collection for the census of public service employees at end-October, but finalization of the project is being delayed due to technical problems. We will make all efforts to have the census completed by end-January 2009. After completion of the census we will move swiftly to eliminate ghost workers and adopt an action plan to computerize the payroll, as a first step for a comprehensive civil service reform. In parallel, the BSA has begun a project to verify the personnel records in line ministries, in order to clean up the existing payroll.

B. Monetary and Exchange Rate Policies

15. The policy stance of the CBI will continue to be geared to keeping inflation under control. The subdued inflationary pressures thus far in 2008 and the fiscal adjustment envisaged for 2009 would help in this regard. The current policy to appreciate the exchange rate of the dinar will be continued at least until end-2008. Once annual core inflation is brought down to single digits, we intend to maintain a stable exchange rate as the nominal anchor for the economy. The CBI will keep its policy interest rate positive in real terms (measured against core inflation) to signal our firm commitment to continue fighting inflation. Any downward adjustments of the policy interest rate that would be made possible by lower inflation, will be implemented gradually.

16. We continue to strengthen the accounting and reporting framework of the CBI. The CBI has appointed a control committee, which is responsible for developing control procedures and manuals, and for establishing a modern internal audit function with the assistance of external consultants. An independent audit committee has also been set up, which will be made operational shortly. The audit committee includes one external expert and is tasked with making recommendations regarding external and internal audit oversight, financial reporting, and controls. Efforts will be stepped up to reconcile suspense accounts and CBI intra-branch accounts, and to establish a register of outstanding off-balance sheet commitments (letters of credit and guarantees). We will also appoint shortly an external auditor to undertake the audit of the CBI 2008 financial statements in accordance with International Standards on Auditing. The CBI will work with the Ministry of Finance to adopt an audit selection and rotation policy for future audits. To facilitate implementation of International Financial Reporting Standards (IFRS) by end-2009, we will engage an external expert to assist the CBI in the conversion process. We are also moving ahead in implementing our new reserves management guidelines that were adopted in early August.

17. We have made progress in moving towards accepting the obligations of Article VIII, Sections 2(a), 3, and 4, of the Fund's Articles of Agreement. The review of exchange laws and regulations is nearing completion. We will work with Fund staff to complete the review as soon as possible and are ready to implement the Fund staff's recommendations once we receive them. In the meantime, we are committed to not impose any restrictions on the making of payments and transfers for current international transactions nor to introduce any multiple currency practices.

C. Other Structural Policies

18. Transparency and good governance in the oil sector remain a top priority. The metering system for the Al-Basra oil export terminal has been installed. The second phase of the installation of metering systems for the northern pipeline and the Khor Al-Amyah export terminal has started and will be completed by October 2009. Also, a comprehensive custody-transfer metering system is largely installed and will be completed by September 2009, while a computerized tracking system for oil transports by road and rail is up and running. Since joining the Extractive Industries Transparency Initiative (EITI), implementation procedures are underway, especially with regards to informing the public about oil production, exports and domestic consumption. The Iraqi Committee of Financial Experts (COFE) is set to take over the responsibilities of the International Advisory and Monitoring Board (IAMB) as the audit and oversight body for the DFI by the end of this year. The COFE has published the audit report, which covers DFI operations in the first half of 2008, on its website. The COFE has also presented its first semi-annual report to the Council of Ministers.

19. We will accelerate the further implementation of our reform strategy for the banking sector. Before the end of the year, we will start, with assistance from the World Bank and

other international partners, to develop restructuring plans for Rafidain and Rasheed banks, based on their completed financial and operational audits. The BSA will begin the reconciliation of the foreign debt held by Rasheed and Rafidain and the cleaning up of their large suspense accounts before year-end. The Restructuring Oversight Committee (ROC) will complete its preparation of individual strategies for the three specialized state-owned banks by March 2009. In the meantime, the BSA will start its diagnostic review of these banks. Based on these strategies and the results of the diagnostic reviews, we will develop restructuring plans for these three banks.

20. We have partially completed the set of prudential regulations for commercial banks. Nine key regulations have already been finalized. Work on the relevant reporting tables for the banks will be completed soon. We will make every effort to draw up the remaining regulations as soon as possible, including those related to minimum capital requirements, liquidity risk, and anti-money laundering. This work will be carried out in consultation with the Fund and other providers of technical assistance. At the same time, we are pursuing our efforts to further develop banking supervision practices in line with international standards and best practices. In addition, we will continue to work toward changing the commercial banks' accounting norms in line with IFRS, and prepare a set of financial soundness indicators for commercial banks.

III. OTHER ISSUES AND PROGRAM MONITORING

21. We will continue our efforts to resolve outstanding external claims under terms that are consistent with the 2004 Paris Club agreement. We are working to finalize the negotiations on a number of debt agreements with non-Paris Club creditors, including China, in the near future. We will continue our best efforts to reach bilateral debt agreements with other remaining non-Paris Club creditor countries with a view to an early conclusion of debt agreements. We will also make every effort to complete the settlement phase of commercial claims as part of the liquidation of the London branch of Rafidain Bank as soon as possible.

22. We will continue our efforts to improve Iraq's statistical database. Monetary and balance of payments data are now being published in the IMF's *International Financial Statistics* regularly. Annual national accounts data has been compiled up to 2007. We will now focus on improving the quality of these annual data before turning our attention to further developing quarterly national accounts data. While the Socio-Economic Household Survey has been completed, the updating of the CPI weights has been delayed because of difficulties with the start-up of the software for processing the new CPI. We will step up our efforts to resolve these problems and update the CPI weights as soon as possible. We have appointed a new national coordinator for the General Data Dissemination System (GDDS). Once we have finalized the remaining meta data, we intend to start participating in the GDDS in the course of next year.

23. Macroeconomic policy performance will continue to be monitored through quarterly quantitative performance criteria and an indicative target (Table 1). Progress in structural reform will be monitored through benchmarks (Table 2).

Table 1. Iraq: Quantitative Performance Criteria and Indicative Targets
Under the Stand-By Arrangement, 2007–08 1/
(In billions of Iraqi dinars, unless otherwise indicated)

	Amount at 6/30/07	Performance Criteria				
		12/31/07	3/31/08	6/30/08	9/30/08	12/31/08
<i>Cumulative change from June 2007</i>						
Net international reserves of the CBI (floor; in millions of U.S. dollars) 2/ (Actual)	20,635	0	0	0	0	0
		10,820	13,487	22,400	23,625	...
Lending to the government and the private sector by the CBI (ceiling) 3/ (Actual)	5,230	0	0	0	0	0
		0	0	0	0	...
<i>Cumulative flow from beginning of calendar year</i>						
Central government total financing (ceiling) 4/ (Actual)	...	7,600	2,200	3,750	-2,400	-3,200
		-7,894	-9,024	-6,879	...	...
Government wage and pension bill (ceiling) 4/ 5/ (Actual)	...	10,100	2,750	5,500	11,650	14,400
		8,324	2,385	6,579	...	...
Government imports of petroleum products (ceiling) 4/ (Actual)	...	400	100	200	300	400
		195	108	172	...	...
Direct government subsidies to the fuel sector (Actual)	...	0	0	0	0	0
		0	0	0	...	...
New medium-and long-term nonconcessional external debt (with original maturities of one year or more) contracted or guaranteed by the government (in millions of U.S. dollars; ceiling) 4/ 6/ (Actual)	...	500	500	500	500	500
		0	0	0	0	...
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 7/ (Actual)	...	0	0	0	0	0
		0	0	0	...	...
<i>Indicative target</i>						
Revolving government credit to the State Oil Marketing Organization (ceiling) (Actual)	...	400	400	400	400	400
		400	400	400	...	...

1/ The Technical Memorandum of Understanding will provide for precise definitions of all performance variables.

2/ Amount at 6/30/07 has been revised from 21,045 at the time of the Board meeting in light of updated data.

3/ Rolling over t-bills does not constitute new lending.

4/ Flows for 2007 and 2008 are cumulative starting 1/1/2007 and 1/1/2008, respectively.

5/ Excluding salaries paid by ministries of defense and interior.

6/ Concessionality is defined as loans with a grant element of 35 percent or higher.

7/ To be monitored on a continuous basis.

Table 2. Structural Performance Criteria, and Structural Benchmarks
Under the Stand-By Arrangement

I. Structural Performance Criteria		
Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.	Continuous	Met
Enact the amendments to the pension law to make it fiscally sustainable.	December 31, 2007	Met
Completion by an external auditor of an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	March 31, 2008	Met
Completion by an external auditor of the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	June 30, 2008	Met
II. Structural Benchmarks		
Implementation of regular reconciliation in the CBI accounts of (i) local banks' current accounts; (ii) intra-branch accounts; and (iii) suspense accounts.	March 31, 2008	Partially met 1/
Adoption of reserves management guidelines by the CBI.	March 31, 2008	Met on August 4
Completion of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	May 31, 2008	Met on July 10
Incorporate new weights in the CPI based on the 2007 household expenditure survey.	May 31, 2008	Underway
Submission to the Board of Supreme Audit of the final accounts of the Federal Budget for the year ending December 31, 2007.	June 30, 2008	Met on October 19
Completion of census of all public service employees (central government and military)	June 30, 2008	Delayed 2/
Adoption of an action plan for modernizing the government's financial management system.	July 31, 2008	Met on November 10
Completion of the set of prudential regulations for commercial banks.	July 31, 2008	Partially met 3/
Publication of audit reports mandated by the Committee of Financial Experts (COFE) and presentation of the first semi-annual COFE report, covering the period January–June 2008 and including recommendations, to the Council of Ministers.	September 15, 2008	Met on December 2
Development of a periodic adjustment mechanism for fuel prices based on changes in domestic production costs and import costs to prevent re-emergence of direct budget subsidies on fuel products.	September 30, 2008	Underway
Adoption of an operational restructuring program for Rafidain bank based on the findings of the audits.	September 30, 2008	Delayed 4/
Adoption of operational and financial restructuring programs for Rasheed bank based on the findings of the audits.	September 30, 2008	Delayed 4/
Submission to the Council of Representatives and publication of the audited accounts of the Federal Budget for the year ending December 2007, in accordance with the Financial Management Law of 2004.	November 15, 2008	Underway

1/ Reconciliation of local banks' current account has improved after the CBI tightened its reporting requirements from the banks. No progress has been made with respect to the reconciliation of suspense accounts (mainly with the Ministry of Finance), and of CBI intra-branch accounts.

2/ Expected in January 2009.

3/ Nine key regulations have been finalized.

4/ Preparation of the restructuring programs will start before end-2008.

INTERNATIONAL MONETARY FUND

IRAQ

**Second Review Under the Stand-By Arrangement and Financing Assurances
Review—Supplementary Information**

Prepared by the Middle East and Central Asia Department

Approved by Lorenzo Pérez and David Marston

December 15, 2008

1. This supplement provides an update on developments since the issuance of the staff report. The thrust of the staff appraisal remains unchanged.
2. **All quantitative performance criteria set for end-September under the Stand-By Arrangement have been met** (Table 1).
3. **In response to the continued decline in world oil prices since the submission of the draft 2009 budget to the Council of Representatives on November 18, 2008, the government has started to prepare measures to preserve fiscal sustainability.** Based on the latest WEO oil price projections (of December 2, 2008), Iraq's average crude oil export price is projected at \$48.8 per barrel in 2009, considerably below the current budget reference price of \$62.5 per barrel. This would result in about 20 percent lower government revenue as compared to the draft 2009 budget. The Minister of Finance has issued a public statement on December 12, in which he calls upon government ministries to rationalize their spending programs and announces that the government will decide early next year on further cuts in nonpriority current spending and a revision of the 2009 budget in light of the expected drop in oil revenues. In the meantime, the Ministry of Finance has already begun working on specific expenditure reducing measures for next year.
4. **Oil production and exports have slowed down somewhat in October–November but exports in January–November remained just above the target average of 1.8 million barrels per day for 2008.** Exports were affected by technical and weather-related interruptions. The average crude oil export price in January–November was \$95.85 per barrel, still above the program projection of \$93.3 for the year as a whole.
5. **Preliminary fiscal data through September indicate a surplus of ID 16.6 trillion or about 15 percent of projected 2008 GDP.** While investment expenditures picked up significantly compared to 2007, they remained below budget, contributing—along with the higher-than-expected oil export revenues—to the surplus. Consistent with this outcome, the

balance in the Development Fund for Iraq increased from \$12.6 billion at end-2007 to \$24 billion at end-October 2008.

6. **To counter inflationary pressures, the Central Bank of Iraq (CBI) continued to gradually appreciate the dinar.** At end-November, the exchange rate of Iraqi dinar stood at ID 1,173 per U.S. dollar, compared to ID 1,179 per U.S. dollar at end-September. The dinar has appreciated by 20¼ percent since November 2006, when the CBI started to appreciate the currency to counter dollarization and reduce inflation.

7. **Progress has been made in preparing restructuring programs for Rafidain and Rasheed banks** (structural benchmarks; Table 2). The authorities have developed, with assistance of the World Bank and other donors, a comprehensive and detailed *Banking Reform Strategy Action Plan* for the two banks. Once this action plan has been officially adopted, the authorities will assign specific responsibilities and timelines for each of the two banks, including their financial restructuring and recapitalization. The World Bank stands ready to support the implementation of the restructuring plans as part of its envisaged bank restructuring project.

Table 1. Iraq: Quantitative Performance Criteria and Indicative Targets
Under the Stand-By Arrangement, 2007–08 1/
(In billions of Iraqi dinars, unless otherwise indicated)

	Amount at 6/30/07	Performance Criteria				
		12/31/07	3/31/08	6/30/08	9/30/08	12/31/08
<i>Cumulative change from June 2007</i>						
Net international reserves of the CBI (floor; in millions of U.S. dollars) 2/ (Actual)	20,635	0 10,820	0 13,487	0 22,400	0 23,625	0 ...
Lending to the government and the private sector by the CBI (ceiling) 3/ (Actual)	5,230	0 0	0 0	0 0	0 0	0 ...
<i>Cumulative flow from beginning of calendar year</i>						
Central government total financing (ceiling) 4/ (Actual)	...	7,600 -7,894	2,200 -9,024	3,750 -6,879	-2,400 -16,949	-3,200 ...
Government wage and pension bill (ceiling) 4/ 5/ (Actual)	...	10,100 8,324	2,750 2,385	5,500 6,579	11,650 10,824	14,400 ...
Government imports of petroleum products (ceiling) 4/ (Actual)	...	400 195	100 108	200 172	300 238	400 ...
Direct government subsidies to the fuel sector (Actual)	...	0 0	0 0	0 0	0 0	0 ...
New medium-and long-term nonconcessional external debt (with original maturities of one year or more) contracted or guaranteed by the government (in millions of U.S. dollars; ceiling) 4/ 6/ (Actual)	...	500 0	500 0	500 0	500 0	500 ...
External arrears on existing/rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) 7/ (Actual)	...	0 0	0 0	0 0	0 0	0 ...
<i>Indicative target</i>						
Revolving government credit to the State Oil Marketing Organization (ceiling) (Actual)	...	400 400	400 400	400 400	400 400	400 ...

1/ The Technical Memorandum of Understanding will provide for precise definitions of all performance variables.

2/ Amount at 6/30/07 has been revised from 21,045 at the time of the Board meeting in light of updated data.

3/ Rolling over t-bills does not constitute new lending.

4/ Flows for 2007 and 2008 are cumulative starting 1/1/2007 and 1/1/2008, respectively.

5/ Excluding salaries paid by ministries of defense and interior.

6/ Concessionality is defined as loans with a grant element of 35 percent or higher.

7/ To be monitored on a continuous basis.

Table 2. Structural Performance Criteria, and Structural Benchmarks
Under the Stand-By Arrangement

I. Structural Performance Criteria		
Avoid administrative measures limiting participation or bids in the CBI's regular auction of foreign exchange other than screening related to anti-money laundering or counter-terrorism.	Continuous	Met
Enact the amendments to the pension law to make it fiscally sustainable.	December 31, 2007	Met
Completion by an external auditor of an audit of the CBI net international reserves data reported to the IMF as at December 31, 2007, including a full count of gold and foreign exchange holdings at the CBI.	March 31, 2008	Met
Completion by an external auditor of the audit of the CBI 2007 financial statements in accordance with International Standards on Auditing.	June 30, 2008	Met
II. Structural Benchmarks		
Implementation of regular reconciliation in the CBI accounts of (i) local banks' current accounts; (ii) intra-branch accounts; and (iii) suspense accounts.	March 31, 2008	Partially met 1/
Adoption of reserves management guidelines by the CBI.	March 31, 2008	Met on August 4
Completion of the operational and financial audits of Rasheed and Rafidain banks based on their 2006 financial accounts.	May 31, 2008	Met on July 10
Incorporate new weights in the CPI based on the 2007 household expenditure survey.	May 31, 2008	Underway
Submission to the Board of Supreme Audit of the final accounts of the Federal Budget for the year ending December 31, 2007.	June 30, 2008	Met on October 19
Completion of census of all public service employees (central government and military)	June 30, 2008	Delayed 2/
Adoption of an action plan for modernizing the government's financial management system.	July 31, 2008	Met on November 10
Completion of the set of prudential regulations for commercial banks.	July 31, 2008	Partially met 3/
Publication of audit reports mandated by the Committee of Financial Experts (COFE) and presentation of the first semi-annual COFE report, covering the period January–June 2008 and including recommendations, to the Council of Ministers.	September 15, 2008	Met on December 2
Development of a periodic adjustment mechanism for fuel prices based on changes in domestic production costs and import costs to prevent re-emergence of direct budget subsidies on fuel products.	September 30, 2008	Underway
Adoption of an operational restructuring program for Rafidain bank based on the findings of the audits.	September 30, 2008	Underway
Adoption of operational and financial restructuring programs for Rasheed bank based on the findings of the audits.	September 30, 2008	Underway
Submission to the Council of Representatives and publication of the audited accounts of the Federal Budget for the year ending December 2007, in accordance with the Financial Management Law of 2004.	November 15, 2008	Underway

1/ Reconciliation of local banks' current account has improved after the CBI tightened its reporting requirements from the banks. No progress has been made with respect to the reconciliation of suspense accounts (mainly with the Ministry of Finance), and of CBI intra-branch accounts.

2/ Expected in January 2009.

3/ Nine key regulations have been finalized.



Press Release No. 08/330
FOR IMMEDIATE RELEASE
December 17, 2008

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review of Iraq's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Iraq's economic performance under the Stand-By Arrangement (SBA), which is designed to support the country's economic program through March 2009. The Board also completed a financing assurances review under the SBA.

The SDR 475.36 million (about US\$729.3 million) arrangement was approved in December 2007. It is being treated as precautionary by the authorities (see [Press Release No. 07/301](#)), and no disbursements are planned.

Following the Executive Board's discussion of Iraq's economic performance, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, said:

“Economic developments in Iraq have been encouraging in 2008 and the authorities have kept their economic program on track. With the improvements in the security and political situation, economic activity has picked up as oil production and exports have increased and non-oil activity has started to recover, while inflation has remained subdued. The recent sharp drop in world oil prices, however, has worsened Iraq's external and fiscal outlook for the period ahead. Iraq's continued efforts to rebuild its infrastructure and institutions and to achieve higher economic growth depend critically on continued improvements in the security situation, prioritization in the use of lower oil revenues, and the implementation of key structural reforms.

“The draft 2009 budget is based on much lower oil revenue projections than realized in 2008 and contains current spending, including by streamlining the in-kind Public Distribution System, while allowing for increases in investment and security spending. In this connection, it is important to ensure the quality of public investment. In response to the further decline in world oil prices since the submission of the draft budget to parliament, the government has begun preparing additional measures to reduce non-priority spending in 2009, in order to preserve fiscal sustainability. The Central Bank of Iraq (CBI) will continue to keep its policy

interest rate positive in real terms and to manage the exchange rate with a view to keeping inflation under control.

“With lower world oil prices, the indirect subsidies on fuel products are expected to decline in 2009. To establish a transparent framework for future fuel price adjustments, the authorities are developing a periodic adjustment mechanism for domestic fuel prices with assistance from the Fund.

“It is important to step up the pace of structural reforms. The recently adopted action plan to modernize public financial management provides a good basis to make significant progress in this area. The census of public service employees needs to be completed urgently, in order to clean-up and computerize the payroll. In the financial sector, it is crucial to adopt restructuring programs for Rafidain and Rasheed banks based on their financial and operational audits, and to complete the set of prudential regulations for commercial banks. It is also important for the CBI to continue implementing the recommendations of the IMF Safeguards Assessment Report to further improve its accounting and reporting framework.

“Further efforts are required to strengthen governance and fight corruption, in particular in the hydrocarbon sector. While progress has been made recently in oil metering, the metering systems should be extended to all oil sector activities, and the implementation procedures under the Extractive Industries Transparency Initiative should be stepped up. A new legislative framework for the hydrocarbon sector needs to be put in place to facilitate investments in the sector.

“The authorities’ efforts to conclude debt agreements with Iraq’s official and private creditors are commendable. However, further progress is needed to resolve the outstanding claims of official non-Paris Club creditors on terms comparable to those of the 2004 Paris Club Agreement,” Mr. Kato stated.

**Statement by A. Shakour Shaalan, Executive Director for Iraq
December 17, 2008**

Background

1. Notwithstanding the improved but still fragile security and political environment that continued to prevail in 2008, the Iraqi authorities have made considerable progress in implementing their economic program under the Fund-supported Stand-By Arrangement (SBA). Oil production and exports have considerably increased compared to previous years, strongly enhancing growth prospects. The fiscal balance through July 2008 was in surplus, while capital expenditures have doubled in January–July 2008 compared to the same period last year, as a result of measures to enhance investment execution rates. Inflation has been kept under control at around 7½ percent for October, through effective exchange rate policy and by reducing fuel shortages, with little impact from the wage increases introduced in the 2008 Supplementary budget. Notwithstanding continued capacity constraints, the authorities have advanced their structural agenda in several key areas, including the approval of the central bank’s new reserves management guidelines, and the adoption of an action plan for modernizing the government’s public financial management system. They have also continued to make progress toward reaching bilateral agreements on arrears to official non-Paris Club creditors, and toward resolving the remaining arrears to private creditors.

Economic Policies and Reforms for the Remainder of 2008 and for 2009

2. The authorities continue to see the improvement in security conditions, and the related recovery of oil and non-oil activity, as a window of opportunity to move toward a path of high and sustainable growth, in the context of continued macroeconomic stability. They acknowledge, however, the challenge for their public finances and balance of payments stemming from the sharp decline in oil prices in recent months.

3. The authorities’ **fiscal strategy** aims at rebuilding Iraq’s economy and institutions, restoring adequate public services, and enhancing the standard of living of the population, while maintaining fiscal sustainability. In this regard, the draft 2009 budget provides for an increase in security and capital spending, while strictly containing other current outlays. It comprises a 14 percent of GDP reduction in the government’s initial spending plans in response to declining oil revenues. In particular, the 2008 civil service salary increase will be fully funded, no additional wage increases will be granted nor will there be net hiring of non-security personnel in 2009. A reform of the in-kind Public Distribution System, aimed at restricting eligibility of well-off beneficiaries as of mid-2009, has also been initiated. Moreover, other transfers, including to state-owned enterprises, will be strictly limited and the practice of carrying over unspent investment allocations from the previous year will be discontinued. Although a fiscal deficit of about 17 percent of GDP is foreseen for 2009, such deficit would be eliminated over the next three years. More importantly, while the budget is based on an average oil price of \$62.50 for 2009, the authorities stand ready to prepare a supplementary budget to further cut current spending and adjust investment in line with future oil price developments, should declining oil prices put fiscal sustainability at risk.

4. Further to increases in the official retail prices of jet fuel and LPG last June and July, the government is considering raising official fuel prices for regular and blended gasoline, diesel, and kerosene in the first part of 2009, to help reduce the still sizable indirect subsidies and to counter smuggling. It will continue to work on the development of a periodic adjustment mechanism for fuel prices, based on the recommendations of a recent Fund technical assistance mission.

5. Considerable effort is being devoted to advancing **fiscal reforms**. The authorities have made progress in developing a medium-term tax reform strategy with the objective of streamlining the tax system while broadening the tax base and increasing revenue collection. They have prepared a draft law on import tariffs, which they plan to discuss with staff before submitting it to the Council of Ministers. They are working on the development of a sales tax as a precursor for a value-added tax. The authorities have also adopted, in consultation with the Fund and the World Bank, a three-year action plan that identifies priority measures to modernize public financial management. Notwithstanding the progress made with the data collection for the census of public service employees, completion of the project was delayed until end-January 2009, due to technical reasons. Once the project is completed, the authorities plan on adopting an action plan to eliminate ghost workers and computerize the payroll, as a first step for a comprehensive civil service reform.

6. The Central Bank of Iraq (CBI) is committed to maintaining its tight **monetary stance**, including through its exchange rate policy, with a view to keeping inflation under control. The CBI intends to maintain the gradual appreciation of the dinar until core inflation has come down from 13½ percent to near single digit levels, and to keep the policy interest rate positive in real terms to signal its firm commitment to containing inflation.

7. The CBI has made progress in implementing the outstanding recommendations of the IMF safeguards assessment report. It has appointed a control committee for establishing a modern internal audit function. It has also set up an independent audit committee, including one external expert, to make recommendations regarding external and internal audit oversight, financial reporting, and controls. In addition, the CBI has started implementing the new reserves management guidelines that were adopted last August.

8. **Other structural issues.** Increased transparency and good governance in the oil sector continue to rank high on the authorities' agenda. Important progress has been achieved in installing and operationalizing oil-metering systems. Moreover, since joining the Extractive Industries Transparency Initiative, implementation procedures are underway, especially with regards to informing the public about oil production, exports, and domestic consumption. Finally, discussions on a new legislative framework for the hydrocarbon sector are ongoing.

9. Bank restructuring will pave the way to strengthening financial intermediation. In close collaboration with the World Bank, the authorities have made good progress in the development of a restructuring plan for the two largest state-owned banks, Rafidain and Rasheed, based on their financial and operational audits. Moreover, while significant progress was achieved in finalizing key prudential regulations for commercial banks, the

authorities are committed to completing the remaining regulations, and to further improve the accounting and reporting framework of the CBI.

Performance Under the SBA and Financing Assurances

10. The Iraqi authorities have demonstrated a strong commitment to undertaking significant macroeconomic policies and structural reforms, which has enabled them to meet the program's quantitative and structural criteria. They also continue to make best efforts to reach bilateral agreements on arrears to official non-Paris Club creditors and have been negotiating in good faith to resolve the remaining arrears to private creditors, consistent with the Fund's policy on lending into arrears. Against this background, the authorities request the completion of the second review under the SBA and the financing assurances review. They remain fully committed to the objectives of the program, which provides cohesion to their policy framework while anchoring progress towards macroeconomic stability and structural reforms.

11. The Iraqi authorities are grateful for the valuable policy advice and technical assistance they are receiving from staff in support of their stabilization and reform efforts, as well as for the continued support provided by the Fund and its membership.