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International Monetary Fund
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IMF Executive Board Approves First Ever Stand-By Arrangement for Iraq

The Executive Board of the International Monetary Fund (IMF) today approved the institution's first-ever Stand-By Arrangement for Iraq, which is designed to support the nation's economic program over the next 15 months. The IMF arrangement, for an amount equivalent to SDR 475.4 million (about US\$685 million), is being treated as precautionary by the Iraqi authorities.

Iraq, a founding member country of the IMF, received its first-ever loan from the Fund in September 2004 through Emergency Post Conflict Assistance ([see Press Release No. 04/206](#)). The initial credit was designed to facilitate Iraq's negotiations with its Paris Club creditors over a debt-restructuring agreement that is now in place, and to support the nation's economic programs through 2005. Approval of the Stand-By Arrangement is a condition for the second stage of debt reduction agreed with Iraq's Paris Club creditors.

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

“The Iraqi authorities were successful in promoting macroeconomic stability in 2005, despite the extremely difficult security environment. Economic growth was modest, following the strong rebound recorded in 2004, and inflationary pressures moderated, although prices remained volatile. The Central Bank of Iraq built up reserves and the exchange rate remained stable. The projected fiscal deficit is much lower than expected under the EPCA-supported program, mainly due to higher than projected export prices for crude oil. On the other hand, because of security concerns and capacity constraints, the implementation of structural benchmarks specified in the EPCA-supported program was slower than envisaged.

“The authorities' program for 2006 aims to allocate resources towards the planned expansion of the oil sector, redirect expenditures away from general subsidies towards providing improved public services, and strengthen administrative capacity. The program, which envisages an increase in economic growth, a reduction in inflation, and an increase in net international reserves, maintains a focus on macroeconomic stability, while improving governance and advancing Iraq's transition to a market economy.

“A critical component of the overall strategy is to contain expenditures within revenues and available financing, by prioritizing expenditures, controlling the wage and pensions bill, reducing subsidies on

petroleum products, and expanding the participation of the private sector in the domestic market for petroleum products, while strengthening the social safety net.

“The authorities have recently increased prices of refined petroleum products and will need to press ahead with other structural reforms, including measures to enhance the efficiency and transparency of public financial management and the development of a comprehensive restructuring strategy for the state-owned banks. At the same time, the Central Bank of Iraq aims to establish a modern payments system, implement modern supervisory frameworks, facilitate the proper functioning of foreign exchange and money markets, and conduct a monetary policy geared to ensuring financial stability.

“The medium term outlook for Iraq is favorable, but subject to many risks. A strengthening of the security situation will help the authorities to implement the program. Moreover, Iraq remains vulnerable to shocks, particularly those relating to oil production development and oil export price movements,” Mr. Kato said.

Background and 2006 Program Summary

The Stand-By Arrangement is intended to support Iraq’s economic program for 2006. The authorities’ policies under the Emergency Post Conflict Assistance (EPCA) have succeeded in promoting overall macroeconomic stability despite the extremely difficult security environment. Economic growth in 2005 is estimated at 2.6 percent, following a rebound of almost 50 percent in 2004. Inflationary pressures have moderated in 2005, though prices remain volatile.

Iraq’s projected fiscal deficit in 2005 is much lower than expected under the EPCA-supported program, which is mainly due to higher than projected export prices for crude oil. The Iraqi dinar’s exchange rate has remained stable at about ID 1460-1480 to the U.S. dollar, and the international reserves of the Central Bank of Iraq (CBI) have continued to increase.

Implementation of structural benchmarks specified in the EPCA-supported program was slower than scheduled, and Iraq’s commitment to increase domestic fuel prices of refined petroleum products was not implemented.

For 2006, the authorities aim to strengthen administrative capacity, allocate resources towards the planned expansion of Iraq’s oil sector, and to redirect expenditures away from general subsidies towards providing improved public services. The IMF-supported program envisages an acceleration of economic growth to 10 percent in 2006, and a reduction in the rate of inflation to around 15 percent. Net international reserves of the CBI, which stood at about US\$8.7 billion at the end of September 2005, are expected under the program to increase further in 2006

Iraq’s fiscal stance in the near term will be driven by reconstruction needs, subject to constraints on financing. The primary fiscal deficit in 2006 is projected to be about 8 percent of GDP, following a deficit of nearly 11 percent of GDP in 2005. Over the medium term, and as reconstruction needs subside, the government’s fiscal deficit should gradually decline to zero. To begin the process of appropriate fiscal adjustment and to meet previous commitments to the Fund, the Iraqi authorities have increased domestic prices of all refined petroleum products.

In addition, an audit of the Central Bank of Iraq has reached an advanced stage, which was another pre-condition for the IMF Executive Board’s consideration of the Stand-By Arrangement.

Iraq joined the IMF on December 27, 1945. Its quota is SDR 1.188 billion (about US\$1.71 billion), and its outstanding obligations to the Fund as of November 30, 2005 is SDR297.1 million (about US\$428.12 million).

Table 1. Iraq: Selected Macroeconomic Indicators, 2004–06
(Quota: SDR 1188.4 million)
(Population: 27.1 million)
(Per capita GDP, 2004: US\$ 942)
(Poverty rate: 7 percent; 2004) 1/

	2004		2005		2006
	EPCA	Actual	EPCA	Est.	Proj. 2/
Oil and gas sector					
Total exports of oil and gas (in billions of U.S. dollars)	16.5	17.8	17.6	22.8	28.7
Average crude oil export price (in U.S. dollars/barrel)	30.4	31.6	26.0	43.1	46.6
Crude oil production (in millions of barrels/day)	2.1	2.0	2.4	2.0	2.3
	(Annual percentage change)				
Output and prices					
Real GDP	51.7	46.5	16.7	2.6	10.4
Consumer price inflation (end-of-period)	7	32	15	20	15
	(In percent of GDP)				
Investment and saving					
Gross domestic investment	34.9	26.5	44.8	29.1	29.0
<i>Of which: non-government</i>	8.5	4.3	7.4	3.5	2.4
Gross national savings	17	-10.2	26.6	14.7	26.1
<i>Of which: non-government</i>	33.4	28.9	16.9	0.1	8.5
	(In percent of GDP)				
Public Finances					
Government revenue (including grants)	90.6	80.0	97.7	93.6	96.2
Oil revenue	76.7	69.6	74.6	67.8	72.9
Expenditure	133.5	120.6	125.4	104.5	105.3
Current	107.1	98.3	88.0	78.9	76.2
Capital	26.4	22.3	37.4	25.6	25.3
Budget balance (including grants)	-42.9	-40.5	-27.7	-10.9	-9.0
Primary fiscal balance	-41.9	-39.6	-27.3	-10.8	-8.2
Non-oil primary fiscal balance	-103.7	-88.4	-80.5	-57.1	-62.8
	(Annual percentage change unless otherwise indicated)				
Monetary sector					
Gross central bank foreign exchange assets/base money (in percent)	68.0	94.4	75.0	98.8	99.2
Claims on banks/base money (in percent)	6.5	0.1	5.7	0.1	0.1
Base money	117.0	116.9	32.8	12.9	20.6
Currency issued	118.4	74.9	32.8	20.7	24.2
	(In percent of GDP, unless otherwise indicated)				
External sector					
Imports of goods	-102.6	-76.2	-104.9	-73.6	-67.7
Merchandise trade balance	-24.3	-7.0	-32.4	-4.9	1.1
Overall external balance	-4.8	6.1	-14.9	4.2	4.0
Foreign Direct Investment 3/	0.9	0.8	1.2	0.9	0.7
Total external debt 4/	588.2	308.6	541.3	154.3	125.2
Current account (in percent of GDP)	-17.8	-36.8	-18.2	-14.4	-2.7
Central banks gross reserves (in millions of U.S. dollars)	5,691	7,902	8,353	9,311	11,013
In months of imports of goods and services	2.6	3.2	3.7	3.1	3.6
Memorandum Items					
Nominal GDP (in billions of U.S. dollars)	21.1	25.7	24.3	33.2	41.7
Unemployment rate 1/,5/	...	11
Local currency per U.S. dollar (period average)	1,500	1,460	1,500

Source: Staff estimates and projections.

1/ Iraq Living conditions survey 2004, UNDP, and ministry of planning and development cooperation. However, the survey notes that 96 percent of households receive food rations.

2/ Tentative projection, based on SBA medium-term framework.

3/ Estimate for 2004.

4/ Data for EPCA are prior to Paris Club agreement of November 21, 2004.

5/ Other estimates range from 28 percent (ministry of planning) to 70 percent (Baghdad University).

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**Statement by A. Shakour Shaalan, Executive Director for Iraq
December 23, 2005**

1. On behalf of the Iraqi authorities, I would like to thank the Fund's Executive Board, Management and Staff, for the support provided to Iraq throughout these difficult times, in assisting the initiation of the process of overhauling the country's economic institutions and promoting the transition to a modern market economy. Under very trying conditions, and with the support of the Emergency Post Conflict Assistance (EPCA), Iraq has achieved strong advances in macroeconomic stabilization. However, **in order to anchor the progress achieved so far and to support the continuation of economic and institutional reforms, the authorities are requesting a fifteen months Stand-By Arrangement from the Fund.** Such an arrangement will also be helpful in ensuring external debt sustainability, as Iraq would face a solvency problem unless its debt is broadly restructured¹. With an SDR 475.4 million (40 percent of quota) access, the program will be treated as precautionary, in view of the authorities' expectation that they will be able to secure adequate financing for their program within the available resource envelope, barring severe unanticipated shocks. In this regard, I would like to convey the authorities' continued commitment to sound policies and to the needed structural reforms as outlined in the excellent staff report. I am pleased to confirm that the two prior actions on the audit of the Central Bank of Iraq (CBI), and the increases in the prices of domestic petroleum products, according to the agreed upon schedule, have been met, as the staff supplement states.

2. **A major landmark in the political reconstruction of Iraq was reached on December 15, as the first parliamentary elections under the framework of the new constitution—endorsed through a public referendum in October 2005—was successfully held that day.** More than 10 million people, representing over two thirds of the registered voters participated, and, importantly, the elections witnessed an active involvement of all major factions of the populations. These elections, which come after more than two years of transitional administration of the country since the onset of the war in 2003, open the way for a representative government with broader legitimacy to take the helm in Iraq. It is hoped that the successful representation of all segments of the population in an active and open political process will contribute to the reduction of violence and to an environment more conducive to economic prosperity.

3. **The violent conflict that has marked the difficult and complex restructuring of the political and economic landscape in Iraq since 2003 has been of longer duration and greater intensity than was expected.** It is hard to overstate the adverse implications that this open conflict has had on the pace of reconstruction and economic restructuring, and the ability to implement policy and reform measures. Whether directly or indirectly, the conflict has undermined the reform of the public sector, the functioning of institutions, investment in oil capacity and the rebuilding of infrastructure. Clearly, the ability of the government to

¹ The Paris Club agreement on Iraq's debt restructuring is conditional on an SBA by end-2005.