

MONETARY POLICY IN IRAQ
Current Developments

CENTRAL BANK OF IRAQ

January 2010

1- Monetary Policy from dependence to independence

- Development of Central Banking in Iraq
 - The original Iraqi National Bank was established in 1947 with a capital of ID 5.0 million
 - It was the nucleus of the Iraqi Central Bank established according to law 72 of 1956

- Monetary policy was constricted by two factors in the past five decades:
 - ❑ The rentier nature of the Iraqi economy
 - ❑ The effect of fiscal policy

- ❑ Thus money supply was linked to government expenditures.
- ❑ But coordination between monetary and fiscal policy remained weak.

- In 1964 the authorities reduced the role of the private sector, commercial, industrial and banking.
- Commercial bank transactions were concentrated, till 1980's in one government bank, Rafidain. Later on another government bank was established, Alrasheed
- In 1991 licenses were given to establish private banks

- During this period, the 1990's, narrow money supply increased from ID 24.6 billion to **ID 20.7 Trillion in March 2008.**
- The rate of exchange declined from 4 ID to the dollar **to 1216 ID in April 2008.**

- Inflation increased from 6.3 in 1990 (1993=100) to approach hyper-inflation during the 1990's which is the period of sanctions
- Government expenditures increased from ID 17.5 billion to **33.5 Trillion in Dec. 2007.**

2- Monetary Policy in Iraq: Current trends and challenges

Annual inflation **rate** was about **5.5% in April 2008**. Unemployment reached about 50% during recent years.

The real sector experienced a decline in productivity.

- Negative interest rate incited people to hold foreign currency giving rise to monetary substitution (dollarization).
- Industrial and agricultural production have experienced a serious decline.

3- The Iraqi financial sector: some salient features:

- Monetary Policy aims at deepening the monetary sector given that:
- The percentage of the lent credit to GDP was only **about 7% during 2007**.
- Private sector contribution to lending does not exceed **24%** and the rest is extended by government banks.
- Spread is **8 percent** signifying weakness in intermediation.

Central Bank independence and tendency for modernization

- The new law No. 56 of 2004 gave the bank its independence. CBI does not receive instructions from government
- For the Iraqi Banking sector to perform its functions, the monetary authority undertook the following tasks:

- A new currency was put into circulation, end of 2003
- Liberalization of financial sector especially interest rate.
- Foreign Banks were allowed to operate in Iraq.
- Rescheduling of domestic debt owed by the MOF, around ID 5.4 Trillion
- DMFAS has been used (Debt Management and Financial analysis system).
- Modernization of the payment system (RTGS)
- Reserve management

4 - Monetary Policy employed the following rules to generate stability in the financial market.

1. Daily foreign Currency Auctions. CBI built respectable level of reserves **\$44 Billion December 2009**.
2. Standing Facilities. This is to control liquidity in two ways,
 - Lending: Primary, Secondary and the last resort.
 - Deposits in Dinar and Dollars.
3. Legal reserve requirements: **25% deposits for the private sector and 75% for Government sector since July 2007** to be modified as required.
- 4 – Surplus banking reserves. To monitor and control liquidity.

Payment Systems :

- This is done in cooperation with the IMF and WB.
- A separate department was created.

Liquidity Management – Policy Option

- Treasury Bill Auctions for 91 days, 63 days and 28 days.
- Inter – Bank lending

4 – Current Trends in Monetary Policy

- Exchange rate appreciation because of inflation.
- Adjusting the policy rate.
 - Raising the rate because of inflation
 - Reducing the rate because of decline in inflation

5 - New developments in policy

- Inflation declined to 7% after being 50%
- Policy rate was lowered to 9%
- Funds moved from CB to market
- Having moved from market to CB under inflation

Now more attention is paid to growth policy and watching closely development in inflation