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