International Monetary Fund

Iraq and the IMF

Press Release: IMF Managing Director Approves a Staff-Monitored Program for Iraq
January 12, 2016

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Iraq: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

December 22, 2015

The following item is a Letter of Intent and a Memorandum of Economic Policies of the government of Iraq. It is being made available on the IMF website by agreement with the member as a service to users of the IMF website. This memorandum describes the policies that Iraq is implementing in the framework of a staff-monitored program. A members's staff-monitored program is an informal and flexible instrument for dialogue between the IMF staff and a member on its economic policies. A staff-monitored program is not supported by the use of the Fund's financial resources; nor is it subject to the endorsement of the Executive Board of the IMF.

Letter of Intent

Baghdad, December 22, 2015

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, DC 20431, USA

Dear Ms. Lagarde,

1. The attacks by the so-called Islamic State in Iraq and Syria (ISIS) have put Iraq in great danger. Iraqi security forces have made notable progress in the fight against ISIS, with the help of our international partners. In fact, a significant portion of the territory captured by ISIS after its invasion has already been retaken. However, the war is not likely to end soon and will continue to affect the lives of Iraqis as well as the national economy.

2. The attacks has resulted in the loss of thousands of lives and caused a dramatic humanitarian crisis. More than 4 million people have been displaced in the northern regions since June 2014, in addition to 250 thousand Syrian refugees whom Iraq has been sheltering since the civil war in neighboring Syria. Nearly half of the internally displaced persons are children, forced to live in difficult conditions and to face serious health risks. The refugee crisis is also putting great pressure on Iraq's infrastructure system and public services. Furthermore, the war has destroyed public and private assets and infrastructure, is seriously hampering economic activity in the non-oil sector, and has undermined domestic and external trade.

3. As the ISIS threat expanded, world oil prices fell by 50 percent in the space of a few months, causing a huge external shock to our balance of payments and our budget revenue, which depends predominantly on oil export receipts. The shock has caused a strong deterioration of the current account balance, drained our international foreign exchange reserves, and boosted the Iraqi government budget deficit.

4. Against this background, the government commits to implement the economic and financial policies described in the attached Memorandum on Economic and Financial Policies (MEFP) as part of a Staff-Monitored Program, in order to demonstrate good performance and move to a possible IMF financing arrangement as soon as possible. The MEFP describes the large fiscal consolidation that the government has already implemented in 2015 and plans to continue to implement in 2016. The MEFP describes also the foreign exchange policy, public financial management and banking

supervision reforms that the government commits to implement during the remainder of 2015 and in 2016.

5. The government believes that the measures and policies set out in the attached MEFP are appropriate for attaining the objectives of this program and will take any further steps that might be necessary to that end. It will consult with the IMF staff on the adoption of such measures prior to any revision of the policies described in the attached MEFP.

6. The government will provide IMF staff with any relevant information referred to in the attached Technical Memorandum of Understanding (TMU) concerning progress made under the program.

7. The government intends to make public the content of the IMF staff report, including this letter, the attached MEFP, the TMU, and the informational annex of the staff report. It therefore authorizes the IMF staff to publish these documents on its website once you have approved this Staff-Monitored Program.

Sincerely yours,

/s/	/s/
Hoshyar Mahmoud Zebari	Ali Mohsen Ismail Al Allaq
Minister of Finance of Iraq	Acting Governor of the Central Bank of Iraq

Attachments:

1. Memorandum of Economic and Financial Policies
2. Technical Memorandum of Understanding

Attachment I. Memorandum on Economic and Financial Policies

1. This Memorandum on Economic and Financial Policies (MEFP) sets out recent economic developments, outlook and economic and financial policies in 2015-16 in regard to Iraq's Staff-Monitored-Program with the International Monetary Fund (IMF).

Background and Recent Economic Developments

A. Background

2. The attacks by the so-called Islamic State in Iraq and Syria (ISIS) have put Iraq in great danger. The Iraqi security forces have made notable progress in the fight against ISIS, with the help of our international partners. In fact, a significant portion of the territory captured by ISIS after its invasion has already been retaken. However, the war is not likely to end soon and will continue to affect the lives of Iraqis as well as the national economy.

3. The ISIS attacks has boosted the number of internally displaced persons—estimated at 4 million people at end June 2015. Close to 10 million Iraqis (or almost one third of the population) need humanitarian assistance. With 250,000 Syrian refugees, Iraq is the fourth largest hosting country in the region for people fleeing Syria. Refugees—60 percent of whom are women and children—mostly reside in the north, including the Kurdistan Regional Government (KRG) where they have been granted residency status including rights to work. This refugee inflow is adding to the already difficult internal humanitarian situation faced by the Iraqi government.

4. In response to escalating protests across the country fueled by massive electricity outages, the Prime Minister proposed a series of significant administrative reforms in August. Parliament approved a number of these measures, including reducing cabinet from 33 to 22 members, eliminating three vice-president and three deputy prime minister positions, addressing tax evasion, implementing customs at border points including within KRG, reducing security budgets and lowering pension ceilings and salaries for officials.

B. Recent Economic Developments

5. *Oil production*, located in areas under control of the Iraqi government and the KRG, is holding well: for the first 11 months of 2015, it increased by 14 percent compared to last year and oil exports increased by 23 percent. Northern oil exports accelerated in line with the oil revenue sharing agreement between the Iraqi government and KRG until June, when the KRG drastically reduced oil supply to the State Oil Marketing Organization (SOMO) and increased its independent sales to repay the debt to oil companies incurred in 2014 as the oil and budget agreement with Baghdad stumbled.

6. *Non-oil activity in the part of the country that is not occupied by ISIS* dropped by 8 percent year-on-year during the first semester of 2015. The government has no information on economic activity in the ISIS-controlled territories.

7. At end-October 2015, y-o-y consumer price *inflation* (CPI) was low at 1.6 percent, but is likely underestimated because CPI coverage excludes areas occupied by ISIS.

8. *Broad money* stayed flat at end June year-on-year and *reserve money* contracted by 13 percent at end-September likely reflecting lower government spending and weakening non-oil economic activity.

9. *Gross foreign exchange reserves* of the Central Bank of Iraq (CBI) stood at $59 billion at end-October compared to $67 billion at end-2014.

10. As part of the preparation to issue *Eurobonds* to help finance the large fiscal deficit, the Fitch Ratings agency gave a sovereign rating of B- to Iraq. In light of the adverse market conditions, the government has decided to postpone the issuance of $2 billion in Eurobonds from 2015 to 2016 (¶26).

11. The Iraqi *stock exchange* index lost about 16 percent between June and September.

12. The *spread between the official and the parallel foreign exchange market rate* receded to around 2 percentage points since August from as high as 16 percentage points in June, as a result of the elimination of the obligation to prove custom duty and income tax payments before buying foreign exchange.

13. During the first eight months of the year, *public expenditures were compressed owing to the tight financing constraints*. Oil revenue amounted to ID 39 trillion, non-oil revenue amounted to ID 5 trillion, and total spending amounted to ID 54 trillion, out of which ID 41 trillion in current expenditures and ID 13 trillion in investment expenditure. Total spending was about ID 23 trillion lower than the path assumed in the budget. The resulting deficit of ID 11 trillion, or 5 percent of GDP, was financed mostly by the issuance of T-bills subscribed by the state-owned banks Rasheed and Rafidain, of which 4 trillion was refinanced at the discount window of the Central Bank of Iraq (CBI). The deficit was also financed by the accumulation of domestic arrears estimated at ID 5 trillion at end-April 2015. The government paid all the arrears it owed to the international companies (IOCs) in an amount of $3.5 billion. The deficit was also financed by a loan of $1.2 billion by the IMF under the Rapid Financing Instrument (RFI) approved by the IMF Executive Board on July 29, 2015.

Economic and Financial Policies for the End of 2015 and 2016

14. The external outlook has worsened since the latest Article IV consultation assessment (May-June)[1] mainly owing to a further weakening of global oil prices. Lower capital spending on the back of falling oil revenue is expected to contract non-oil economic activity by 8 percent in 2015, after a contraction of close to 9 percent in 2014. Overall real GDP should nonetheless grow by 1.5 percent thanks to an increase of oil production by 10 percent. In 2016, real GDP growth should increase to 10.6 percent thanks to the projected 20 percent increase in oil production, despite flat non-oil GDP.

15. The fall in oil prices since mid-2014 is expected to shift the current account balance from a surplus of 1 percent of GDP in 2014 to a deficit of 7 percent of GDP in 2015 and 6 percent of GDP in 2016. The overall balance of payments deficit will reach $14 billion in 2015 and $11 billion in 2016, which will be financed mostly by a large drawdown of official foreign exchange reserves. Official gross foreign exchange reserves held by the CBI would fall from $67 billion (13 months of imports of goods and services) in 2014 to $51 billion (9 months) in 2015, and $43 billion (7 months) in 2016. Reserves should resume their rising trend in 2017 and beyond owing to rising oil revenue: they should gradually increase from $48 billion (7 months) in 2017 to $88 billion (10 months) in 2020.

16. The fall in oil prices is also causing a sharp deterioration of the fiscal position with the budget deficit increasing from 6 percent of GDP in 2014 to 15 percent of GDP in 2015 and 10 percent of GDP in 2016 (provided measures discussed below are taken), and the total public debt increasing from 39 percent of GDP in 2014 to 62 percent of GDP in 2015 and 66 percent of GDP in 2016 as result of a sharp increase of mostly domestic borrowing to finance the deficit.

17. In the medium term, the outlook should improve as oil production expands further, oil prices recover somewhat, structural reforms are implemented, and progress is made to retake territories controlled by ISIS.

C. Foreign Exchange Policy

18. The government will maintain the peg with the U.S. dollar. The peg provides a key nominal anchor in a highly uncertain environment with policy capacity weakened by the conflict with ISIS.

19. The government will gradually remove remaining exchange restrictions and multiple currency practice (MCP) with a view to eliminating exchange rate distortions. Such a move towards acceptance of the obligations under Article VIII of the IMF's Articles of Agreement will send a positive signal to the investment community that Iraq is committed to maintain an

[1] See Country Report No. 15/235. Iraq: 2015 Article IV Consultation and Request for Purchase under the Rapid Financing Instrument.

exchange system that is free of restrictions and MCPs for current international transactions and thus facilitate creation of a favorable business climate. As a first step, the government will, by end-February 2016, amend the Investment Law, or issue clarifying implementing regulations, to remove the limitation on transfer of investment proceeds that gives rise to an exchange restriction, as recommended by a recent technical assistance mission of the IMF.

20. The government will implement reforms on anti-money laundering and combating the financing of terrorism (AML/CFT). This will improve the integration of the domestic financial system into the global economy and lower transaction costs, improve governance, and reduce the size of the informal sector. As a first step, the government will, by end-February 2016, draft, with the help of IMF technical assistance, and adopt a by-law to set up a mechanism to comply with the relevant United Nations Security Council resolutions related to terrorism financing and Recommendation 6 of the Financial Action Task Force on Money Laundering (FATF).

D. Fiscal Policy

21. In order to maintain macroeconomic stability, the government commits to implement a large fiscal consolidation to bring spending into line with available resources in 2015 and 2016. This will require: (i) a sizable reduction in the non-oil primary balance[2] (quantitative targets, Table 1), of about 12 percent of non-oil GDP (ID 24 trillion, or $20 billion) over 2013–16;[3] and (ii) a large increase in mostly domestic but also external financing over the short run that will remain compatible with debt sustainability in the medium run. In order to minimize the impact of the fiscal consolidation on the population, the government will protect social spending, i.e. spending on health, education, and transfers in support of the social safety net, the internally displaced and the refugees (quantitative targets, Tables 1 and 3).

Fiscal Program in 2015

22. In 2015, the government commits to contain the non-oil primary deficit to no more than ID 69 trillion (52 percent of non-oil GDP), compared to ID 84 trillion (60 percent of non-oil GDP) in 2014. This will be achieved through the implementation of the following measures:

- collect at least ID 6.5 trillion (4.9 percent of non-oil GDP) in non-oil revenue, compared to ID 5.9 trillion (4.2 percent of non-oil GDP) in 2014; and

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[2] The non-oil primary fiscal balance is defined as the difference between non-oil revenue and non-oil primary expenditure, i.e. excluding interest payment, see Technical Memorandum of Understanding (TMU), ¶7.

[3] 2013 is the appropriate reference year to measure the fiscal consolidation since it is the last year that fully included revenue and expenditure of KRG in the federal government fiscal tables; 2014 includes only 2 months of KRG's revenue and expenditure and 2015 only 6 months owing to disagreements between KRG and the federal government over their oil revenue sharing agreement. The 2016 budget fully incorporate oil revenue exported by KRG and transfers of the federal government to KRG.

- contain non-oil primary expenditure to ID 75 trillion (57 percent of non-oil GDP) compared to ID 90 trillion (64 percent of non-oil GDP) in 2014; this reduction will be borne mostly by a reduction of non-oil investment expenditure (by ID 15 trillion, or 10 percent of non-oil GDP), goods and services (ID 3.7 trillion, or 2.4 percent of non-oil GDP) and transfers (by ID 1.3 trillion, or 0.5 percent of non-oil GDP), making room for higher wages for security forces fighting ISIS and for higher pensions; the reduction in non-oil investment expenditure has been achieved by cancelling non-priority projects and delaying other ones to outer years.

23. In order to finance the non-oil primary fiscal deficit, the oil investment expenditure and the debt service, the government will have recourse to oil revenue (ID 55 trillion), domestic financing (ID 33 trillion) and external financing (ID 2 trillion). The domestic financing will be covered by the issuance of Treasury bills, out of which up to ID 15 trillion will be refinanced by commercial banks at the discount window of the CBI. The external financing will be covered by the loan from the IMF under the RFI ($1.2 billion, ¶13), a Development Policy Loan by the World Bank ($1.2 billion) to be disbursed in December 2015, and project loans by the World Bank ($35 million), the Japan International Corporation Agency (JICA, $307 million), and Italy ($40 million).

24. To ease the cash constraint in 2015-16, the government of Kuwait has agreed to the postponement of the payment of the balance of war reparations ($4.6 billion, or 4 percent of non-oil GDP) by the Iraqi government to 2017.

Fiscal Program in 2016

25. On October 18, 2015, the government approved a draft budget for 2016 with a non-oil primary deficit of ID 78 trillion (57 percent of non-oil GDP) with a large amount of foreign financing. In light of the adverse market conditions (¶10), the government decided to reduce its foreign financing forecast and introduced amendments to the 2016 draft budget to parliament on December 2, 2015 that target a slightly lower non-oil primary fiscal deficit of up to ID 77 trillion (56 percent of non-oil GDP; prior action for management approval, Table 2) with financing tilted towards domestic sources. This will be achieved through the implementation of the following measures:

- collect at least ID 8.8 trillion (6.5 percent of non-oil GDP) in non-oil revenue, out of which ID 1 trillion from an increase in wage taxation; and

- contain non-oil primary expenditure to ID 86 trillion (63 percent of non-oil GDP). This containment of non-oil primary expenditure at a level slightly higher than the low level programmed in 2015 will be obtained again mostly by the postponement of lower-priority non-oil investment projects to later years.

26. In order to finance the non-oil primary fiscal deficit, oil investment expenditure and debt service, the government will have recourse to oil revenue (ID 73 trillion), domestic financing (ID 20 trillion) and external financing (ID 4 trillion). The domestic financing will be covered by the issuance of Treasury bills, out of which up to ID 7 trillion will be refinanced by commercial banks

at the discount window of the CBI, the issuance of national bonds for the general public in an amount of ID 5 trillion, and the drawdown of government deposits in the banking sector in an amount of ID 4 trillion. The amount of central bank indirect monetary financing will be revisited on the occasion of the first review in light of the inventory of government cash holdings in bank accounts to be completed by end-February 2016 (¶27). The external financing will be covered by the planned issuance of Eurobonds ($2 billion), a loan from the Islamic Development Bank ($500 million) and project loans by the World Bank ($50 million), JICA ($502 million), and Italy ($40 million). The government will not resort to the accumulation of arrears to finance the deficit. It commits to a zero ceiling on external arrears (continuous quantitative target, Table 1) and regular inventories of domestic arrears with a view to ensuring that new arrears do not accumulate and to paying them down after proper audit, as will be done for the existing stock of domestic arrears (¶27, second bullet).

E. Public Financial Management Reforms

27. In order to strengthen fiscal discipline, the government will implement the following measures:

- *The Minister of Finance will approve a new draft of the Financial Management law in line with World Bank and IMF comments on the last draft submitted to the Shura Council* (structural benchmark for the second review, Table 2).

- *Survey, audit and pay domestic arrears*. As a first step, the Ministry of Planning will complete, by end-February 2016, a survey of domestic arrears on investment spending accumulated by all ministries as of end-September 2015 (structural benchmark, Table 2) and the Ministry of Finance will complete a survey, also by end-February, on current spending arrears accumulated by the same units as of end-September; in addition, similar surveys of arrears as of end-December 2015 by end-March 2016, and as of end-March 2016 by end-May 2016 will be completed. On the basis of each of these surveys, the government will prepare plans for the orderly payment of the arrears, which will include an independent audit of the arrears and a repayment schedule in line with the government's financing capacity. As of end-April 2015, the government identified ID 7.3 trillion in domestic arrears, out of which ID 5 trillion accumulated in 2015 (¶13); the Board of Supreme Audit will audit these arrears to check their validity by end-February 2016. So far, the government has included ID 2.4 trillion for the repayment of domestic arrears in its revised 2016 budget (¶25).

- *Take steps to move to a Treasury Single Account (TSA)*; as a first step, the Ministry of Finance and the CBI will, by end-February 2016, compile a list of all bank accounts controlled by the Ministry of Finance and all spending units and sub spending units of the federal government, in CBI, state-owned and commercial banks; details should include balances at end-December 2015, account number, title, location, purpose, authority, and signatories (structural benchmark, Table 2).

- *Design and implement, with the IMF technical assistance, a commitment control system for budget execution* that is based on a comprehensive financial plan for budget execution.

- *Design and implement an Integrated Financial Management Information System (IFMIS) with the assistance of the World Bank*; as a first step, adopt, by end-April 2016, a road map detailing its core functional requirements, such as: the chart of accounts, multi-year expenditure tracking; carry-over of resources from one year to the next; and management of advances and cash management arrangements.

- *Implement Public Investment Management (PIM) reform with the assistance of the World Bank*. On October 18, 2015, the Prime Minister issued a decree endorsing the Public Investment Management Decision Process Framework in line with World Bank recommendations covering investment selection, implementation, and ex-post evaluation. By end-April 2016, the federal Ministry of Planning will set up a central PIM unit that will screen projects based on feasibility studies and develop and manage the Integrated Bank of Projects (IBP) to be operated as a sub-system of the existing Iraq Development Management System (IDMS).

- *Implement the existing asset declaration procedures for high-level officials* in order to improve governance and enhance anti-corruption efforts; the Public Integrity Commission will continue to publish the names of those who fail to submit their annual declaration.

F. Banking Supervision

28. As of June 30, 2015, there were 56 banks operating in Iraq including 7 state-owned banks (SOB) of which one is an Islamic bank, 32 Iraqi private banks, of which 6 Islamic banks, and 17 foreign branches, of which 5 are Islamic banks. The SOBs dominate the financial sector and account for the bulk of assets and credits. Three of the SOBs, Rafidain Bank, Rasheed Bank and Trade Bank of Iraq (TBI), cluster around 89 percent of the banking system's assets. The financial positions of Rasheed Bank and Rafidain Bank are fragile following years of quasi-fiscal operations. As a first step to restructure these banks, the Ministry of Finance will, by end-February 2016, appoint international auditors to audit the latest financial statements of Rasheed Bank and Rafidain Bank according to international standards (structural benchmark, Table 2), in cooperation with the Executive Committee for the restructuring of these banks and the World Bank.

29. The CBI will continue to implement reform measures to enhance the stability of the banking sector in Iraq which includes inter alia:

- Introducing the international bank account number (IBAN) system in Iraq;

- Increasing the capital requirement of banks to ID 250 billion ($214 million), a level to which all private banks except one have increased their capital;

- Contracting a consultant to assist the CBI in rating banks, whereby they rated 17 banks: three banks were rated "*satisfactory*", eight banks rated "*fair*" and six banks "*marginal*";
- Contacting a consultant to assist the CBI in upgrading the prudential regulations on "*Liquidity*" and "*Capital Adequacy Ratio*";
- Working on reviewing and assessing CBI prudential regulations with the assistance of the IMF Middle East Technical Assistance Center (METAC);
- Preparing a Deposit Insurance Scheme which stipulates the establishment of a corporation to be licensed by the CBI, of which banks will have the opportunity to take a share in the capital;
- Contracting a private firm to provide the CBI with a credit registry system for sharing information among banks on their common existing and potential borrowers;
- Issuing a banking law for financial institutions offering Islamic services; and
- Penalizing financially and administratively banks and non-banks financial institutions for any non-compliance with laws and regulations in force.

Program Monitoring

30. The program will have quarterly reviews and set quarterly quantitative targets on the non-oil primary balance, the stock of net domestic assets of the CBI, official foreign exchange reserves, social spending, and the absence of new external arrears, starting in December 2015 (Table 1). Each program review will set a few structural benchmarks in areas that are essential for the success of the program (Table 2 contains the list for the first review). The first review should be completed by end-May 2016. The government intends to demonstrate good performance under this Staff-Monitored Program to move to a possible IMF financing arrangement as soon as possible.

Table 1. Iraq: Quantitative Targets Under the Staff-Monitored Program, 2015–16 [1/]

(In billions of Iraqi dinars, unless otherwise indicated)

	Targets				
	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Stock of gross international reserves of the CBI (floor; eop stock, in millions of U.S. dollars)	51,100	43,064	38,945	37,849	42,517
Net domestic assets of the CBI [2/] (ceiling; eop stock)	12,956	22,029	27,186	28,912	23,677
Cumulative flow from beginning of calendar year					
Central government non-oil primary balance (floor) [3/]	(68,801)	(20,949)	(39,365)	(58,621)	(76,705)
Social spending (floor) [3/4/]	17,456	4,355	8,710	13,829	18,949
New external arrears on existing / rescheduled debt and new borrowing (in millions of U.S. dollars; ceiling) [5/]	0	0	0	0	0

1/ The Technical Memorandum of Understanding (TMU) provides for precise definitions of all quantitative targets.

2/ Excluding other items net.

3/ End-March, end-June, end-September and end-December targets are cumulative from January 1.

4/ Quarterly targets assume spending of at least 90 percent of the budget allocation on health, education, and transfers in support of the social safety net, the internally displaced and refugees (see Table 3).

5/ To be monitored on a continuous basis. The December 2015 target is cumulative from November 10, 2015.

Table 2. Iraq: Prior Action and Structural Benchmarks, 2016

Measures	Scheduled review by which the measure will be completed	Macroeconomic justification	Status
Prior action for Management approval			
Approval by the Council of Ministers and introduction to Parliament of amendments to the draft 2016 budget to bring it into line with the macroeconomic framework agreed under the Staff-Monitored Program.		Preserve macroeconomic stability.	Met
Structural benchmark			
Completion by the Ministry of Planning of a survey of domestic arrears on investment spending accumulated by all ministries of the federal government at end-September 2015. Details should include the amount of the arrear, the identity of the creditor, the bill, the identification of the goods or the services delivered, and the credit line in the budget authorizing such spending.	1rst review	Strengthen cash management.	
Compilation by the Ministry of Finance and the Central Bank of Iraq (CBI) of a list of all bank accounts controlled by the Ministry of Finance and all spending and sub-spending units of the central government in CBI, state-owned and commercial banks. Details should include balances at end-December 2015, account number, title, location, purpose, authority, signatories.	1rst review	Strengthen cash management.	
Appointment of one or several international auditors to audit the latest financial statements of Rasheed Bank and Rafidain Bank according to international standards.	1rst review	Strengthen financial sector stability.	
Approval by the Minister of Finance of a draft of the Financial Management law in line with World Bank and IMF comments on the last draft submitted to the Shura Council.	2nd review	Strengthen public financial management.	

Source: Iraqi authorities.

Table 3. Iraq: Social Spending

(In billions of Iraqi dinars, cumulative from the beginning of the year)

		Targets			
	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Total Social spending	17,456	4,355	8,710	13,829	18,949
Social Safety Net	1,215	496	991	1,487	1,982
Public Distribution System (PDS - food subsidies)	2,250	556	1,112	1,667	2,223
Wheat and rice subsidy	1,604	396	792	1,188	1,585
Assistance and subsidy to Iraqi refugees	192	0	0	95	189
Assistance and subsidy to internally displaced persons	900	0	0	445	889
Farmer subsidies	457	0	0	226	452
Health Ministry and Environment Ministry- wages	2,546	668	1,335	2,003	2,671
Higher Education Ministry - wages	2,035	564	1,128	1,691	2,255
Lower Education Ministry - wages	6,258	1,676	3,352	5,027	6,703

Table 4. Iraq: Central Government Fiscal Accounts, 2016

(In trillions of Iraqi dinars; unless otherwise indicated. Cumulative from the beginning of the fiscal year)

	2016			
	Mar. Prog.	Jun. Prog.	Sep. Prog.	Dec. Prog.
Revenues and grants	15.5	34.5	56.2	81.7
Revenues	15.5	34.5	56.2	81.7
Oil	13.7	30.1	49.7	72.8
Non-oil	1.8	4.3	6.5	8.8
Grants	0.0	0.0	0.0	0.0
Expenditures	27.4	52.7	78.5	103.1
Current expenditures	20.3	39.7	59.0	77.4
Salary and pension	13.4	26.1	38.8	50.9
Salary	10.3	20.1	29.8	39.1
Pension	3.1	6.0	9.0	11.8
Goods and services	2.1	4.1	6.2	8.1
Transfers	4.1	8.0	11.9	15.6
Social safety net (including PDS)	2.0	3.9	5.8	7.6
Transfers to SOEs 1/	0.6	1.2	1.8	2.4
Other transfers	1.5	2.9	4.2	5.6
Interest payments	0.8	1.5	2.2	2.9
War reparations 2/	0.0	0.0	0.0	0.0
Investment expenditures	7.0	13.0	19.5	25.7
Non-oil investment expenditures	3.2	5.5	8.2	11.0
Oil investment expenditures	3.9	7.5	11.2	14.7
Balance (including grants)	-11.9	-18.3	-22.3	-21.4
Balance (excluding grants)	-11.9	-18.3	-22.3	-21.4
Financing	11.9	18.3	22.3	21.4
External financing	-0.5	-1.1	-0.5	1.8
Assets held abroad				
Project financing	0.0	0.0	0.5	0.9
World Bank (budget support, other)	0.0	0.0	0.0	0.0
Regional and foreign national banks	0.0	0.0	0.6	0.6
Loan guarantees by export credit agencies	0.0	0.0	0.0	0.0
Eurobond	0.0	0.0	0.0	2.4
Amortization	-0.5	-1.1	-1.6	-2.1
Arrears	0.0	0.0	0.0	0.0
Domestic financing	12.4	19.3	22.8	19.7
SDR Allocation	0.0	0.0	0.0	0.0
IMF (RFI)	0.0	0.0	0.0	0.0
Commercial bank loans	0.0	2.4	2.4	6.4
T-bills and bonds	12.7	18.8	22.7	17.1
o/w CBI purchases	3.8	4.6	6.2	7.0
Arrears	0.0	-1.2	-1.2	-2.4
Amortization	-0.4	-0.7	-1.1	-1.4
Financing gap:	0.0	0.0	0.0	0.0
Memorandum items:				
Security-related expenditure (military and police equipment and salaries)	4.7	9.2	13.6	17.9
Non-oil primary expenditure	22.8	43.7	65.1	85.5
Non-oil primary fiscal balance	-20.9	-39.4	-58.6	-76.7

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

1/ Includes off-budget transfers to SOEs financed by Bank Rafidain.

2/ Five percent of oil exports as mandated by U.N. Security Council Resolution 1483 to finance war reparations to Kuwait until 2016.

Table 5. Iraq: Balance of Payments, 2016

(In billions of U.S. dollars; unless otherwise indicated. Cumulative from the beginning of the fiscal year.)

	2016			
	Mar. Prog.	Jun. Prog.	Sep. Prog.	Dec. Prog.
Trade balance	-3.9	-4.3	-2.4	2.8
(In percent of GDP)				
Exports	11.0	24.4	40.4	59.4
Crude oil 1/	11.0	24.3	40.2	59.1
Other exports	0.1	0.1	0.2	0.3
Imports	-15.0	-28.7	-42.8	-56.6
Private sector imports	-8.7	-16.7	-24.9	-32.9
Government imports	-6.3	-12.0	-17.9	-23.7
Services, net	-3.2	-6.2	-9.2	-12.2
Receipts	1.1	2.0	3.0	4.0
Payments	-4.3	-8.2	-12.2	-16.1
Income, net	-0.1	-0.2	-0.3	-0.4
Transfers, net	0.0	0.0	0.0	0.0
Private, net	0.0	0.0	0.0	0.0
Official, net	0.0	0.0	0.0	0.0
Current account	-7.2	-10.6	-11.9	-9.8
(In percent of GDP)				
Capital account	0.0	0.0	0.0	0.0
Financial account	-0.7	-1.5	-1.8	-1.3
Direct and portfolio investment (net) 2/	0.5	1.0	1.5	2.0
Other capital, net	-1.2	-2.5	-3.3	-3.3
Official, net	-0.4	-0.9	-0.9	-0.1
Assets	0.0	0.0	0.0	0.0
Liabilities	-0.4	-0.9	-0.9	-0.1
Disbursements 3/	0.0	0.0	0.4	0.8
Amortization	-0.4	-0.9	-1.3	-0.9
Private, net	-0.8	-1.6	-2.4	-3.2
Errors and omissions	0.0	0.0	0.0	0.0
Overall balance	-8.0	-12.1	-13.7	-11.0
(In percent of GDP)				
Financing	8.0	12.1	13.7	11.0
Development Fund for Iraq (increase -) 4/	0.0	0.0	0.0	0.0
Gross International Reserves (increase -)	8.0	12.2	13.3	8.6
Fund credit (net)	-0.1	-0.1	-0.1	-0.1
World bank	0.0	0.0	0.0	0.0
Eurobond	0.0	0.0	0.0	2.0
Islamic Development Bank	0.0	0.0	0.5	0.5
Qatar National Bank	0.0	0.0	0.0	0.0
Loan securitized by future oil revenue	0.0	0.0	0.0	0.0
Change in arrears (negative = decrease)	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0
Memorandum items:				
GIR (end of period) 5/	43.1	38.9	37.8	42.5

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

1/ Reflects KRG exports through the State Oil Marketing Company of Iraq.

2/ Excludes planned issuances of Eurobonds in 2016, which are reflected under the financing gap.

3/ Excludes prospective disbursements from the IMF and the WB in 2015 and 2016, which are reflected under the financing gap.

4/ Reflects the transfer of the Development Fund for Iraq from the Federal Reserve Bank of New York to the CBI in May 2014.

5/ Starting 2014 includes US$ balances from oil revenues.

Table 6. Iraq: Monetary Survey, 2016

(In trillions of Iraqi dinars; unless otherwise indicated)

	2016			
	Mar. Prog.	Jun. Prog.	Sep. Prog.	Dec. Prog.
Net foreign assets	80,982	79,085	77,820	75,291
Of which: CBI	48,970	44,110	42,816	48,325
Net domestic assets	22,915	26,948	31,257	38,153
Domestic claims	43,694	47,603	51,755	50,715
Net claims on general government	15,890	19,386	23,263	21,671
Claims on general government	55,545	58,042	60,918	58,326
less: Liabilities to general government	-39,656	-38,656	-37,656	-36,656
Claims on other sectors	27,804	28,217	28,493	29,044
Other Item Net (OIN)	-20,779	-20,655	-20,499	-12,562
Broad money	103,897	106,033	109,077	113,444
Currency outside banks	42,506	43,467	44,137	44,706
Transferable deposits	44,875	45,734	47,469	50,245
Other deposits	16,516	16,832	17,471	18,492

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

Table 7. Iraq: Central Bank Balance Sheet, 2016
(In trillions of Iraqi dinars; unless otherwise indicated)

	2016			
	Mar. Prog.	Jun. Prog.	Sep. Prog.	Dec. Prog.
Net foreign assets	48,970	44,110	42,816	48,325
Foreign assets	52,368	47,508	46,215	51,723
Official reserve assets	50,815	45,955	44,662	50,170
Gold	4,488	4,562	4,636	4,710
Other	45,923	41,027	39,698	45,171
SDR holdings and reserve position in the Fund	405	366	328	289
Other foreign assets	1,553	1,553	1,553	1,553
Foreign liabilities	-3,398	-3,398	-3,398	-3,398
Net domestic assets	17,686	22,843	24,569	19,333
Domestic assets	20,867	21,752	23,321	24,198
Net claims on general government	20,780	21,665	23,234	24,111
Loans to central government	3,677	3,648	3,620	3,592
Holdings of discounted treasury bills	19,000	19,870	21,435	22,227
Other claims	0	0	0	0
Domestic currency deposits	-717	-673	-640	-542
Foreign currency deposits	-1,180	-1,180	-1,180	-1,166
Monetary policy instruments 1/	1,162	5,434	5,591	-521
Other items net	-4,343	-4,343	-4,343	-4,343
Reserve money	66,656	66,952	67,385	67,658
Currency in circulation	44,882	45,667	46,498	47,064
Bank reserves	21,774	21,285	20,887	20,595
Memorandum items				
Gross foreign exchange assets (in millions of U.S. dollars) 2/	43,064	38,945	37,849	42,517

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

1/ This mainly represents the ID standing overnight facilities, US$ deposits of commercial banks, domestic currency deposits, and CBI bills.

2/ Starting 2014 reflects the balances of the Development Fund of Iraq were moved from the Federal Reserve Bank of New York to the CBI as a US$ account (US$ balances from oil revenues) in May 2014.

Attachment II. Technical Memorandum of Understanding

1. This memorandum defines the quantitative targets for the economic program of the Iraqi authorities during the period November 10, 2015–December 31, 2016 under the Staff-Monitored Program (SMP). These indicators, presented in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated December 22, 2015 reflect the understandings reached between the Iraqi authorities and the staff of the IMF. It also specifies the periodicity and deadlines for transmission of data to the staff of the IMF for monitoring purposes.

A. Quantitative Targets

2. The quantitative targets are the following:

(i) a floor on the stock of gross international reserves of the Central Bank of Iraq (CBI);

(ii) a ceiling on net domestic assets of the CBI;

(iii) a floor on the central government non-oil primary balance;

(iv) a floor on the central government social spending;

(v) a continuous ceiling on new external payments arrears on any existing, rescheduled and new debt of the central government and/or the CBI.

B. Definitions

3. An exchange rate set at ID 1,180 per U.S. dollar will be used for monitoring purposes. This exchange rate will be used to convert into Iraqi dinars the U.S. dollar value of all CBI foreign assets and liabilities denominated in U.S. dollars, as required. For CBI assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar, they will be converted in U.S. dollars at their respective SDR-exchange rates prevailing as of November 10, 2015, as published on the IMF's website. The same rules will be used to convert external debt related parameters.

4. For the monitoring purposes, central government is defined to include the central administration, the Kurdish regional government, as well as agencies included under Section 6 (the local boards, Iraqi media network, Iraqi national Olympic committee, Bait-Al-Hikma, Ammant Baghdad, Municipality institutions, as well as the General directorates of sewage and water).

5. Gross international reserves (GIR) of the CBI are claims of the CBI on nonresidents that are controlled by the CBI, denominated in foreign convertible currencies, and are immediately and unconditionally available to the CBI for meeting balance of payments needs or for intervention in foreign exchange markets, and are not earmarked by the CBI for meeting specific

payments. They include CBI holdings of monetary gold, SDR holdings, Iraq's reserve position in the IMF, foreign currency cash, holdings of non-resident equity and debt securities, and deposits in foreign currency abroad, including foreign exchange account of the government (300/600). Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options). For program monitoring purposes, the stock of foreign assets of the CBI shall be valued at program exchange rates (¶3).

6. Net domestic assets (NDA) of the CBI include: (i) net claims on the general government, comprising of gross claims on the general government minus general government domestic and foreign currency deposits at the CBI; (ii) gross claims on other depository corporations; (iii) monetary policy instruments, including dinar and foreign currency denominated term deposits and CBI bills held by other depository corporations; (iv) net claims on public nonfinancial corporations; and (v) claims on private sector. For the purpose of this SMP, net domestic assets of the CBI exclude other items net (OIN). OIN is the net value of nonfinancial assets, capital and reserve accounts, IMF account adjustments (differences between national record and IMF record), and provisions.

7. The central government non-oil primary balance is defined as the difference between non-oil revenue and non-oil primary expenditure. Non-oil revenue is defined as total revenue and grants excluding oil-related receipts (exports of crude oil and refined products, and transfers from oil-related state-owned enterprises). Non-oil primary expenditure is defined as total expenditure, including off-budget spending approved by government decree, excluding (i) interest payments on domestic and external debt; and (ii) oil-related spending (including war reparations).

8. Social spending will be defined as the sum of expenditure on the social safety net, the public distribution system, wheat and rice subsidies, assistance subsidies to Iraqi refugees and the internally displaced, farmer subsidies, and wage expenditure of the health, environment and the higher and lower education ministries. The annual targets will be set at 90 percent of the expenditure in the budget. Expenditure will be measured at the time the Ministry of Finance transfers the money to the spending units.

9. A continuous ceiling applies to the non-accumulation of new external payments arrears on rescheduled debt and new external debt contracted or guaranteed by the central government and/or by the CBI. External payment arrears consist of external debt service obligations (principal and interest) falling due after November 10, 2015 and that have not been paid within the grace period specified in the contractual agreements. The SMP monitoring ceilings of the external payments arrears are reported in Table 1.

10. As set out in Executive Board Decision 15688-(14/107), paragraph 8, adopted December 5, 2014) the term "debt" will be understood to mean a current, i.e., not contingent, liability,

created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

- Loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements).

- Suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided.

- Leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

- Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation within the contractual grace period are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

11. For program purposes, external debt is defined based on the residency of the creditor.

C. ADJUSTORS

12. The floor on the central government non-oil primary balance in December 2015 will be adjusted downwards/upwards in case domestic arrears incurred in 2015 exceed/are less than ID 5 trillion of domestic arrears identified at the end of April 2015. The size of the adjuster will be equal to the difference between the value of domestic arrears and ID 5 trillion.

13. The ceiling on the stock of net domestic assets (NDA) of the CBI will be adjusted upwards in case foreign financing is lower than programmed to a limit of ID 1.4 trillion in December 2015, zero in March and June 2016, ID 1.1 trillion September 2016, and 3.9 trillion in December 16. The size of the adjuster will be equal to the difference between the observed and programmed value of foreign financing and capped at the values enumerated in the previous sentence.

14. The ceiling on the stock of net domestic assets (NDA) of the CBI will be adjusted downward in case foreign financing is higher than programmed. The size of the adjustment will be equal to the difference between the observed and programmed value of foreign financing.

15. The floor on the stock of gross international reserves of the CBI will be adjusted downwards in case foreign financing is lower than programmed to a limit of $1.2 billion in December 2015 zero in March and June 2016, $0.9 billion in September 2016, and $3.3 billion in December 16.

16. The floor on the stock of gross international reserves of the CBI will be adjusted upward in case foreign financing is higher than programmed. The size of the adjustment will be equal to the difference between the observed and programmed value of foreign financing.

D. Provision of Information to the Fund Staff

Data

17. To monitor developments under the SMP, the authorities agree to provide the Fund, the information specified below after the approval of the SMP. The economic adjustment program of the Iraqi authorities is designed with quarterly quantitative targets and the actual outcome should be provided within six weeks following the end of the quarter. However, in order to facilitate regular monitoring, many indicators should be provided with higher frequencies, as indicated below.

Key Financial Indicators

- Weekly preliminary monetary and financial aggregates as in "*Key Financial Indicators*" including exchange rate data (daily), currency in circulation, transferable and other deposits held at commercial banks, balances on government accounts at the CBI, interest rates on loans and on deposits at commercial banks, holdings of government securities, and credit outstanding to the public and private sectors. The data, excluding exchange rates, should be reported no longer than three weeks after the end of the reference period.

Real Sector

- Oil GDP and indicators of oil activity on crude oil and gas production and use, production and sales (export and domestic) of refined petroleum products, including heavy residuals, and associated prices (monthly). These data should be reported no longer than six weeks after the end of the reference quarter.

- Non-oil GDP and indicators of non-oil real economic activity (quarterly), including production of cement, fertilizers, and electricity, reported no longer than six weeks after the end of the reference quarter.

- Total GDP, reported no longer than six weeks after the end of the reference quarter.

- Consumer price index (CPI), including indices for main cities (monthly). These should be reported no longer than a month after the end of the relevant month.

Monetary and Financial Sector

- CBI gross foreign exchange reserves (weekly) and balances of the foreign exchange account of the government (300/600). This should be reported no longer than 2 weeks after the end of the reference week.

- The monthly balance sheet of the CBI, with a month lag.

- The monthly consolidated balance sheet of the other depository corporations (commercial banks), with an eight-week lag.

- The assets and liabilities of the central government (ministry of finance and line ministries) in the banking sector with an eight-week lag.

- The depository corporations (monetary) survey of all commercial banks and the CBI (quarterly), with an eight-week lag.

- The latest balance sheet of the Trade Bank of Iraq as well as data on issued, implemented and outstanding Letters of Credit, with no more than a six-week lag.

- The latest balance sheet of the Rasheed and Rafidain Banks.

- Quarterly financial stability indicators of the banking system, distinguishing the state-owned banks and the private banks, with an eight-week lag.

Fiscal Sector

- Detailed revenues, operating and capital expenditure, and financing items of consolidated fiscal and oil operations, and overall fiscal balance. These data should include:

    a) the execution of the Iraqi budget, comprising the incremental revenue from the impact of revenue (tax) measures stipulated in the 2015 Budget Law (sales taxes on mobile phone cards, internet usage, car sales, and on tobacco and alcohol, in addition to incremental receipts from the entry into force of the amended Customs Law for 2010), and savings realized via (a) any cuts in investment projects or financing for investments through public-private partnership schemes; (b) cuts in operating (current) expenditure, such as the enactment of compulsory or voluntary national savings schemes (including as a result of changes in legislation governing the wage ladder for public sector or civil service employees), and removal/streamlining of subsidies on electricity and gasoline or other products;

    b) transfers to and from the Kurdistan Regional Government;

c) social spending as defined in ¶8 and total transfers (including in support of the social safety net—public distribution system—the internally displaced, and on refugees;

d) operations and deposits of the oil-related state-owned enterprises;

e) payments and/or arrears in payments to international oil companies;

f) disbursements of external assistance and loans including issuance of Eurobonds and loans from the Trade Bank of Iraq (TBI);

g) execution of letters of credit financed through the TBI or by other means;

h) all operations of account 300/600 and its sub-accounts;

i) amounts drawn from Iraq's 2009 SDR allocation;

j) other forms of multilateral and bilateral assistance and exceptional financing resources (such as issuance of domestic bonds, loans securitized by futures oil revenue, etc);

k) balances of all government accounts held at the CBI and the commercial banks (including government and/or line ministry deposits);

l) amounts related to all off-budget and on-budget advances; and

m) outstanding stock of government securities (including treasury bills) held at/by commercial banks, the CBI, and pension funds. These data should be reported on a monthly basis and no later than six weeks after the end of the reference month.

Balance of Payments

- Foreign trade statistics (imports, exports, re-exports) (quarterly). This should be reported no later than six weeks after the end of the reference quarter.

- Amount of total imports of petroleum products financed from the budget on a quarterly basis starting with the first quarter of 2015. These data should be reported no later than six weeks after the end of the reference quarter.

- Detailed data on disbursement of external assistance (both project and budget financing) from the U.S. and other donors, including by recipient sector; foreign debt amortization and interest payments made; and total outstanding domestic and external debt. These data should be reported on a monthly basis no more than six weeks after the end of the reference month.

- The amount and terms of concessional loans contracted and their grant element, on a quarterly basis, with no more than six weeks lag.

- The balance sheet of the Trade Bank of Iraq (TBI) as well as data on issued, implemented and outstanding Letters of Credit, with no more than a six weeks lag.

External Debt

- List of short, medium, and long-term government or government-guaranteed external loans contracted during each quarter, identifying for each loan: the creditor, the borrower (ultimate obligor), the amount and currency, the maturity and grace period, repayment terms, and interest rate (monthly).

- Details on new debt rescheduling and debt relief agreements with bilateral, multilateral, and commercial creditors, including new outstanding amount and currency, schedule of payments (principal and interest), terms of agreement, repayment terms, and interest rate arrangements (quarterly).

Structural Reforms

18. Structural benchmarks comprise a critical component of the SMP. In accordance with agreed benchmarks (Table 2 of the MEFP), the authorities will prepare and send to the IMF staff reports, with appropriate documentation, documenting completion.

Other Information

19. Other details on major economic and social measures taken by the government that are expected to have an impact on program sequencing (such as changes in legislation, regulations, or any other pertinent document) will be sent in a timely manner to IMF staff, for consultation or information.