

**FOR
AGENDA**

EBS/07/138
Supplement 2

December 17, 2007

To: Members of the Executive Board

From: The Secretary

Subject: **Iraq—Request for Stand-By Arrangement and Cancellation of Current Arrangement**

The attached supplement to the paper on a request for a Stand-By Arrangement for Iraq and the cancellation of the current arrangement (EBS/07/138, 12/5/07) has been prepared on the basis of additional information and is tentatively scheduled for discussion on **Wednesday, December 19, 2007**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of Iraq indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. De Vrijer (ext. 36259), Mr. Grigorian (ext. 38605), and Mr. Kock (ext. 36299) in MCD.

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INTERNATIONAL MONETARY FUND

IRAQ

Request for Stand-By Arrangement and Cancellation of Current Arrangement—Supplementary Information

Prepared by the Middle East and Central Asia Department

Approved by Adam Bennett and Adnan Mazarei

December 17, 2007

1. This supplement provides an update on developments since the issuance of the staff report (EBS/07/138). The thrust of the staff appraisal remains unchanged.
2. **All September quantitative performance criteria under the current Stand-By Arrangement (SBA) have been met** (Table 1).
3. **Inflation continued its downward path in November.** Consumer prices declined by 0.4 percent in November, largely because of lower fuel and transportation prices, bringing annual consumer price inflation down to 15.4 percent from 20.4 percent in October. Core inflation (excluding fuel and transportation) also declined to 15.2 percent in November from 16.2 percent in October. Annual inflation is expected to remain considerably below the target of 25 percent for the year 2007 as consumer prices increased by only 4 percent during January-November (core inflation during January-November was just under 12 percent).
4. **The Central Bank of Iraq (CBI) continued to gradually appreciate the exchange rate of the dinar**, in line with the policy described in the staff report. On December 13, 2007, the exchange rate of the Iraqi dinar stood at ID 1,216 per U.S. dollar, compared to ID 1,232 per U.S. dollar on October 31, 2007. The dinar has appreciated by 17.3 percent since November 2006, when the CBI started to appreciate the exchange rate to counter dollarization and reduce inflation.
5. **Oil exports have increased in recent months, including through the northern pipeline.** Staff have not yet received official data on oil exports for November but there are indications these exceeded the level of 1.7 million barrels per day (mbpd) recorded in October. On average, crude oil exports during January-October 2007 stood at 1.53 mbpd, close to the projected level of 1.55 mbpd for the year as a whole.
6. **Preliminary fiscal data through September indicate a surplus of ID 2.5 trillion or about 3 percent of projected 2007 GDP.** With revenues broadly on target, the surplus is largely due to underspending in non-oil investment, as well as on goods and services, and pensions. However, non-oil investment has picked up in the third quarter, in part reflecting improvements in security. Reporting has improved since the beginning of the year, but differences between above-the-line and below-the-line fiscal outcomes remain. Mirroring the

overall fiscal performance and sizable oil export revenues, the balance in the Development Fund for Iraq increased from \$12.1 billion at end-October to \$13.1 billion at end-November.

7. **On December 2, 2007, the President signed into law the amendments to the pension law**, making the government's pension liabilities fiscally sustainable. The enactment took place ahead of the test date of December 31, 2007, for the relevant structural performance criterion under the proposed SBA.

8. **The United Nations Security Council will likely extend the mandate of the International Advisory and Monitoring Board (IAMB) through 2008.** The IAMB has exercised audit oversight over the Development Fund for Iraq (DFI) since December 2003, and its mandate is due to expire by end-2007. During 2008, the IAMB will transfer its responsibilities to the Iraqi Committee of Financial Experts (COFE) while performing high-level oversight of the COFE and providing technical assistance.

9. **Staff recently completed a workshop in Amman to help the Iraqi authorities advance preparations for the restructuring of the banking sector.** In addition to the appointment of an international auditor to conduct the operational and financial audits of Rafidain and Rasheed banks (a prior action for the proposed SBA), some progress has been made in preparing for the cleaning up of these banks' books and in creating accounts for identification and subsequent disposal of their inherited losses.

10. **Staff has recently completed a technical assistance mission to assist Iraq's statistical agency in developing the new consumer price index (CPI).** Iraqi officials (including from the Kurdish region) attended the training that focused on extracting new CPI weights from the recently completed 2007 household expenditure survey and in rebasing the CPI. Final results of the survey are expected to be available by end-February 2008.

11. **On December 12, Iraq made an early repurchase of the full amount outstanding under the Emergency Post-Conflict Assistance (EPCA).** The EPCA was approved by the Board on September 24, 2004, in an amount of SDR 297.1 million (25 percent of quota). The original terms of the EPCA envisaged a repayment of half of this amount in 2008, with the balance due in 2009. The authorities have kept the total purchased amount in their SDR account at the Fund. The early repurchase was made in light of Iraq's strong international reserves position.

Table 1. Iraq: Quantitative Performance Criteria and Indicative Targets
Under the Stand-By Arrangement, 2005–07 1/
(In billions of Iraqi dinars, unless otherwise indicated)

	2005	Performance Criteria							
	9/30/05	12/31/05	3/31/06	6/30/06	9/30/06	12/31/06	3/31/07	6/30/07	9/30/07
<i>Cumulative change from September 2005</i>									
Net international reserves of the CBI (floor; in millions of U.S. dollars) (Actual)	8,500 2/	-1,000 +3,041	-1,000 +3,635	-1,000 +3,554	-1,000 +5,252	-1,000 +9,770	0 +8,503	0 +12,545	0 +15,592
Lending to the government and the private sector by the CBI (ceiling) 3/ (Actual)	5,100 2/	0 0	0 0	0 0	0 0	0 0	0 0	0 0	0 0
<i>Cumulative flow from beginning of calendar year</i>									
Government primary fiscal deficit (ceiling; deficit [+]/surplus[-]) 4/ 5/ (Actual)	...	5,400 -5,102	1,950 -819	3,600 -4,752	4,850 -11,220	5,300 -8,947
Central government total financing (ceiling) 4/ 5/ (Actual)	3,000 -1,688	5,350 492	5,700 -2,534
Government wage and pension bill (ceiling) 4/ 6/ (Actual)	...	6,650 7,069	2,400 2,051	4,750 3,898	7,100 5,875	9,500 7,792	2,525 1,644	5,050 3,770	7,575 5,842
Revenue of oil related enterprises, including those remitted to the budget (floor) 4/ (Actual)	...	900 1,456	700 509	1,500 1,454	2,100 2,651	2,800 3,611	750 1,144	1,500 2,501	2,850 3,888
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/ 7/ (Actual)	...	500 0	500 0	500 0	500 0	500 0	500 0	500 0	500 0
External arrears on new borrowing (in millions of U.S. dollars; ceiling) 8/ (Actual)	...	0 653	0 0	0 0	0 0	0 0	0 0	0 0	0 0
<i>Indicative targets</i>									
Government imports of petroleum products (ceiling) 4/ 9/ (Actual)	...	6,000 4,128	1,700 1,045	3,400 1,884	4,000 3,120	4,200 4,082	100 104	200 110	300 116
Revolving government credit to the State Oil Marketing Organization (ceiling) (Actual)	300 400	400 400	400 370

1/ See Technical Memorandum of Understanding for precise definitions of all performance variables.

2/ Estimated.

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

4/ Flows for 12/31/05 are cumulative for 2005. Flows for 2006 and 2007 are cumulative starting 1/1/2006 and 1/1/2007, respectively.

5/ Starting in 2007, the budget deficit will be monitored from below the line (i.e., from the financing side).

6/ Excluding salaries paid by ministries of defense and interior (see Technical Memorandum of Understanding for precise definition).

7/ This ceiling excludes loans with a grant element of 35 percent or more of up to Yen 350 billion for reconstruction projects to be contracted with the government of Japan in 2007.

8/ This will be monitored on a continuous basis.

9/ Starting in 2007, this no longer comprises all imports of petroleum products made directly by the government of Iraq but instead comprise of imports of petroleum products financed from the budget.