

Iraq: A new opportunity set

Florence Eid-Oakden, Ph.D, Chief Economist
Ghalia Al Bajali & Leila Lajvardi, Analysts

- Although Iraq has approved a smaller deficit for 2021 than initially budgeted, it could still fall short of meeting deficit reduction targets in the face of public sector spending needs.
- Challenging fiscal reform and difficulties in curbing the bloated public sector bill place pressure on foreign reserves.
- With the October elections drawing closer, Iraq's security situation will be put to the test as political factions (and their proxies) jockey for power.

Growth gathering pace

Iraq's economic outlook augurs well amid rising oil prices and easing OPEC+ production quotas. Recovery, however, continues to rely on global oil market prospects and the pace of public sector reform. Political stability and governance are also key factors.

- In its latest economic update, the IMF revised its forecast for Iraq. It expects GDP to rebound by 1.1% this year down from the forecast of 2.2% made in October 2020. Growth in 2022 is expected at 4.4% in 2022 compared with a 10.9% contraction in 2020.
 - This year's downward revision is mainly due to Iraq's slow vaccine inoculation programme and subdued oil production, but could be revised upward again if oil prices rise further.
- On the back of higher public and private investment in reconstruction, the non-oil economy is projected to bounce back by an average of 3.5% between this year and next.
 - While oil GDP is forecast to improve, the quantum will depend on both price and quantity. Iraq is the only oil-exporting country in the MENA region besides Kuwait with an oil GDP forecast to remain in negative percentile figures.
- Following the absence of a formal budget last year and a year-long financial crisis emerging from the COVID-19 pandemic, the cabinet approved a USD 89B budget for 2021.
 - After four months of political wrangling, the approved budget envisages a deficit of USD 20B, half of the USD 40B deficit passed by the government in December 2020, and down 19% from 2019.
 - This represents a deficit of 9.2% of GDP, down from the estimated 19.8% for 2020.
- Current expenditure - mostly public sector wages - continues to dominate around 77% of government spending at USD 69B, with USD 20B left for capital spending.
 - This year's budget, however, will impose a freeze on hiring as the government attempts to shift employees to the private sector.
 - If maintained, current spending is set to narrow by 18% from the USD 85B figure in 2019.
- Oil will remain key to government finances.
 - The 2021 budget is banking on USD 60B in oil revenue based on a highly conservative oil price of USD 45 pb. This represents 80% of total government revenues, down from the usual 90% in previous budgets, leading

Table 1 - Iraq Macroeconomic Indicators¹

	2018	2019	2020	2021f	2022f
Real GDP Growth (%)	0.8	4.5	-10.9	1.1	4.4
Crude Oil Production (M bpd)	4.4	4.6	4.0	3.9	4.2
Oil GDP Growth (%)	-1.3	3.8	-12.6	-1.3	5.9
Non-oil GDP Growth (%)	4.7	5.7	-8.0	5.0	2.1
CPI Inflation (%)	0.4	-0.2	0.6	9.4	7.5
Fiscal Balance (% of GDP)	8.2	0.9	-19.8	-9.2	-7.7
C/A Balance (% of GDP)	4.5	0.5	-14.8	0.0	-0.6
Total Gov't. Gross Debt (% of GDP)	50.0	47.7	81.2	69.7	73.3
Total Gross Extn'l Debt (% of GDP)	30.8	30.6	47.9	34.0	29.8
Gross Official Reserves (Mos. of Imports)	8.4	10.8	8.9	8.4	7.5
Nominal GDP (USD B)	216.9	222.4	172.1	190.7	203.3
Population (Millions)	38.4	39.3	39.5	41.2	42.2

us to believe that this year's budget outturn will surprise on the upside.

- The 23% devaluation of the Iraqi Dinar in December 2020 further ease the pressure on Iraq's weak fiscal position.
 - Devaluation should allow the government to generate more dinars from dollar-denominated oil sales and boost the local currency value of oil exports by 5% of GDP.
 - However, devaluation is likely to increase inflation and the cost of living, negatively impacting contractors awaiting payments in dinars.
- Despite the easing of OPEC+ production cuts, Iraq's oil production could decline again this year.
 - This is because the country needs to compensate for last year's overproduction, when it pumped 707K bpd over its OPEC+ cap.
- Based on IMF figures, the country is set to produce an average of around 3.94M bpd this year, a 2.5% drop from last year. If fully adhered to, this cut will form a drag on growth.
 - This year, oil exports are estimated to remain steady at an average of around 3.25M bpd. This includes the mandated revenue transfer of 250K bpd of crude by the Kurdistan Regional Government (KRG) to the State Organisation for Marketing of Oil (SOMO) in order to receive its 12.7% share of the budget.
 - If the KRG refuses to (or cannot) transfer its share of exports, the federal government will deduct its value from the KRG's budget share, along with the monies owed by the KRG to the Trade Bank of Iraq.
- In April, Iraqi crude exports held steady, edging up by 10K bpd MoM to 2.94M bpd. But as pressure on oil prices eased, revenues dipped by 4.5% to USD 5.5B.
 - Despite last month's dip, oil revenues have been stabilising since April 2020.
 - Q1 2021 revenues posted USD 15.5B, a 40% QoQ increase from Q4 2020, and a YoY USD 1.5B increase.
 - Oil tends to exceed 95% of Iraq's total exports. Last year, oil accounted for 99.7% of exports, resulting in a 43% decline in total export receipts.
- For now, key challenges facing Iraqi government officials include enacting the bill ahead of the general election and moving ahead with 'White Paper' reforms which were drafted in October 2020.
 - Even if oil revenue improves, Iraq desperately needs to rebuild its fiscal space, mainly by cutting inefficient spending.
 - Some articles from the initial budget were removed from the approved budget. These include proposals for income tax, as well as salary cuts to the three presidencies (40%), and also to ministries and their employees (30%).

¹ Arabia Monitor; IMF.

- Consequently, we do not exclude the possibility that the cabinet could propose new budget amendments in the coming months.

Factions need no further fuel

With the October elections fast approaching, Iraq's prime minister Mustafa al-Kadhimi is scrambling to leave an impact on his political legacy.

- Prime Minister al-Kadhimi has not formally announced his candidacy. However, he is likely to run independently, abstaining from aligning himself with a specific political party (at least for now).
- Iraqi politics are characterised by factions. These have caused several political gridlocks in the past year, making reforms difficult to enact.
- Yet these factions have strong support bases that show no sign of abating.
 - The Independent High Electoral Commission (IHEC) has issued 267 licenses for political parties. Of these, only 122 have so far expressed an explicit interest in running in the election.
 - Only about a dozen parties and alliances have enough significance and governmental backing to have an impact on proceedings.
 - Saairun (an alliance between the Sadrist Integrity Party, the Iraqi Communist Party, the Youth Movement for Change Party, the Party of Progress and Reform, the Iraqi Republican Group and the State of Justice Party) currently has the most seats (54 out of 329) in the Council of Representatives of Iraq. It is aligned with the popular Shia cleric, Muqtada al-Sadr.
 - The Fatah Alliance, a group aligned with the Iran-backed Popular Mobilisation Forces (PMF), trails closely behind with 48 of 329 seats.
 - Both alliances are closely affiliated with the Islamic Republic of Iran.
 - Of the 3,500 candidates who have registered to run, the majority are party-affiliated. Of those registered, 887 have classified themselves as independent.
- The UN is ready to support the Iraqi electoral commission in monitoring the elections in October.
- The US administration, which has supported al-Kadhimi during his time in power, says it will provide additional support during the elections to ensure a smooth democratic transition.
- As the election date approaches, we are likely to see an uptick in activity from rogue groups which have splintered from the PMF.
 - The PMF was an Iraqi state-sponsored military unit deployed to fight Islamic State (IS). However, after the assassination of its former commander Abu Mahdi al-Muhandis in 2020, the group has become increasingly decentralised.
 - The PMF is funded largely by Iran and backed by Muqtada al-Sadr.
 - These groups have maintained their presence during al-Kadhimi's premiership; he has struggled to clamp down on their activity.
 - As many Iraqi communities are divided along ethnic and sectarian lines, this presents an opportunity for Shia-aligned groups to expand their support base.

Figure 1 - Iraq Oil Exports (M/bpd)²

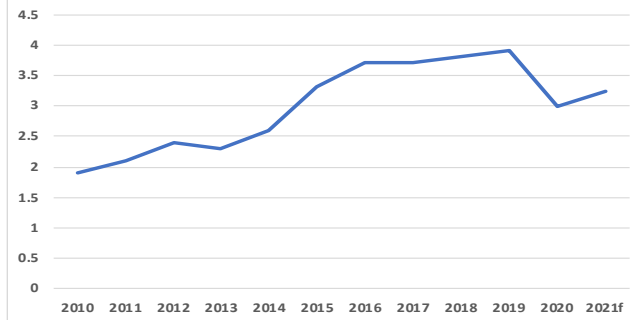
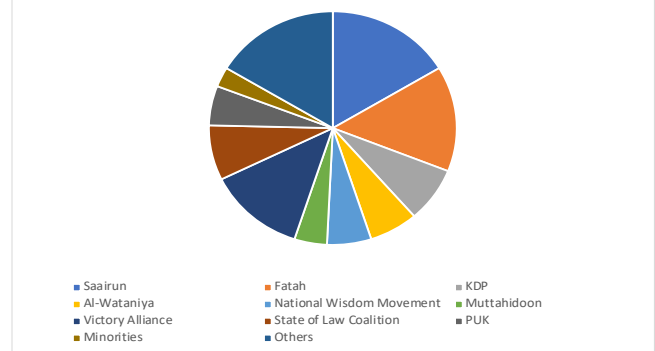


Figure 2 - Iraq's Council of Representatives³



Toward a new *entente*?

There are opportunities for regional dynamics to shift, and al-Kadhimi could secure a reputation as a mediator between regional rivals Iran and Saudi Arabia.

- The first talks occurred in Baghdad in early April and were leaked by an Iraqi government official. Such negotiations could be a huge foreign policy victory for al-Kadhimi, gaining him prestige on the international stage.
 - The initial meeting took place between the Saudi intelligence chief Khalid al-Humaidan and Saeed Iravani, the deputy secretary of Iran's Supreme National Security Council (SNSC).
 - Al-Kadhimi cultivated personal relationships with both men during his tenure as head of the Iraqi National Intelligence Service (INIS).
 - However, any such dialogue is unlikely to have much of an impact on al-Kadhimi's popularity with Iraqi voters ahead of the elections.
 - While the negotiations in Iraq's capital Baghdad have supposedly focused heavily on Yemen, a new Iranian nuclear deal which considers its Arab neighbours is also likely to be a key topic.
 - A rapprochement between Riyadh and Tehran, facilitated by Baghdad, would be good for Iraq and the broader region.
- Regional dialogue in parallel to the JCPOA, such as the one between Saudi Arabia and Iran, could advance some of the thorny regional security issues that remained outside the scope of the JCPOA in 2015. For Iraq, the role played in forging some form of *entente*, would have security, economic and political benefits. For the GCC states and Iran the same sets of benefits also apply.

² Arabia Monitor; OPEC.

³ Arabia Monitor.

Disclaimer

© Arabia Monitor 2021

This is a publication of Arabia Monitor Limited (AM Ltd) and is protected by international copyright laws and is for the subscriber's use only. This publication may not be distributed or reproduced in any form without written permission.

The information contained herein does not constitute an offer or solicitation to sell any security or fund to or by anyone in any jurisdictions, nor should it be regarded as a contractual document. Under no circumstances should the information provided on this publication be considered as investment advice, or as a sufficient basis on which to make investment decisions. The information contained herein has been gathered by AM Ltd from sources deemed reliable as of the date of publication, but no warranty of accuracy or completeness is given. AM Ltd is not responsible for and provides no guarantee with respect to any of the information provided herein or through the use of any hypertext link.

Arabia Monitor is an independent research firm specialising in economic and market studies on the Middle East & North African region, which we view as the new emerging market. Our forward-looking perspective allows us to place recent developments in the region within a broader context and a long-term view. Our analysis is based on the macroeconomic and financial balance sheet of Arab countries to deliver unique strategy insights and forecasts to businesses across a wide range of sectors.

Arabia Advisors specialises in portfolio strategy and private placements. It works with firms, family offices and government related organisations that are looking to streamline, re-balance or diversify their asset portfolios. Based in the UAE as an offshore company, Arabia Advisors services a regional and international client base with interest in the Arab countries.

Arabia Monitor
Aston House | Cornwall Avenue | London N3 1LF
Tel +44 203 239 4518
info@arabiamonitor.com
www.arabiamonitor.com