Iraq: Growth recovery despite structural woes

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- **Higher oil output should boost growth, but structural vulnerabilities, particularly high unemployment and a growing population, are being left unattended by the absence of any major legislative action.**
- **The faltering of the Southern Iraq Integrated Project (SIIP) with US energy giant ExxonMobil reflects some of Iraq's problems that need to be addressed.**
- **Leaders in Baghdad and the Kurdistan regional capital Erbil have opened a fresh round of talks to resolve disputes over oil and territory, as new administrations in both cities look to reset their relationship.**

Higher oil output to boost growth

Iraq's economy is overly reliant on exports of crude oil, which account for more than 90% of the country's revenues. This does mean, however, that the recovery of the industry is having a beneficial effect on growth.

- The IMF expects real GDP to rebound strongly to 6.5% this year from 1.5% in 2018 and a 0.4% contraction in 2017, based on oil exports rising and reconstruction picking up, the latter boosted by the largest budget ever passed.
  - The forecast sees Iraq producing 4.7 Mb/d this year, up from 4.4 Mb/d in 2018.
- On the back of higher investment, both public and private, in reconstruction, the IMF also estimates that non-oil growth will increase to 5.4% in 2019 from 4.4% in 2018,
- The 2019 budget of USD 113B (52.7% of GDP) is 27% higher than last year. The deficit, however, is projected at USD 23B (10.6% of GDP), double that of 2018.
  - The budget forecasts oil exports to average 3.9 Mb/d at USD 56 pb, up from 3.8 Mb/d at USD 46 pb in 2018.
  - Capital spending is 1.1% higher in the 2019 budget while state salaries were up 15% from 2018 including those of the northern Kurdish region.
  - Iraqi Kurdistan's share of the federal budget declined to 12% from the 17% in previous budgets since 2005. As with prior budget provisions in Iraq, the Sunni and Kurdish regions are receiving smaller shares than mainly Shi'a areas.
- Iraq's oil production stood at 4.85 Mb/d in July, down slightly from 4.88 Mb/d in June.
  - Fields operated by the federal government through the Iraq National Oil Company (INOC) produced 4.36 Mb/d, while the Kurdistan Regional Government (KRG) produced the rest.
  - Iraq is planning production increases from IOC-operated fields by 250 Kb/d this year and another 59 Kb/d from Kurdistan to increase oil capacity to 5.12 Mb/d.
  - This means it is not meeting its pledged OPEC cuts: it has an average compliance of minus 7% so far this year.

Table 1 - Iraq Macroeconomic Indicators[1]

	2015	2016	2017	2018	2019f
Real GDP Growth (%)	2.5	13.1	-0.4	1.5	6.5
Crude Oil Production (M bpd)	3.7	4.6	4.4	4.4	4.7
Oil GDP Growth (%)	18.4	24.6	-3.5	0.0	6.9
Non-oil GDP Growth (%)	-14.4	-4.0	0.8	4.4	5.9
CPI Inflation (%)	1.4	0.5	0.1	2.0	2.0
Fiscal Balance (% of GDP)	-12.8	-14.3	-1.6	-5.2	-10.6
C/A Balance (% of GDP)	-6.5	-7.8	2.3	6.9	3.1
Total Gov't. Gross Debt (% of GDP)	56.9	66.0	59.7	51.8	48.9
Total Gross Extrn'l Debt (% of GDP)	37.2	38.1	36.2	32.5	32.4
Gross Official Reserves (Mos. of Imports)	9.4	7.9	7.0	8.6	9.5
Nominal GDP (USD B)	177.7	170.7	192.4	230.9	250.1
Population (Millions)	36.1	37.2	38.2	39.3	40.8

- Minister of Oil Jabbar Alluaibi has said that Iraq has enough capacity to increase production to 6 Mb/d if needed. We see this as an overstatement.
  - The State Organization for Marketing of Oil calculates current capacity to be comparable to current production.
    - It says capacity will only reach 6.5 Mb/d between 2024-29, which is closer to the International Energy Agency's view that it will take until 2030 for Iraq to reach 6 Mb/d.
  - Lukoil's newly discovered Eridu field on Block 10, west of Basra, is expected to produce 300 Kb/d, with commercial production in 2022 starting at 50 Kb/d.
    - The Russian company plans to complete exploration on Block 10 in 2020.

Preparations are complete for the new oil pipeline project signed in 2013 to export Iraqi crude oil from Basra to the Jordanian port of Aqaba on the Red Sea.

- The Basra-Aqaba pipeline capacity is expected to be 1 Mb/d. Construction costs are set at USD 18B.
- The pipeline should help Iraq promote oil exports via integrated infrastructure, which has not been the case to date.
- The deal will also help meet Jordan's demand for crude oil.
  - The kingdom currently imports oil from Saudi Arabia at international prices by ship and then transports it by land tankers from Aqaba to the oil refinery in Zarqa, east of Amman.

A "welfare state" under population strain

Iraqi President Barham Salih, on a trip to Britain at the end of June, outlined many of the problems facing his country, notably dealing with an exploding population with no jobs.

- Salih said the Council of Representatives would begin work in autumn to create a legislative environment for FDI.
  - Since 2013, net FDI in Iraq has been negative, with outflows exceeding inflows by USD 4.8B in 2018, compared with a net peak inflow of USD 3.4B in 2012.
  - As a result, total FDI stock fell to USD 10.1B, accounting for nearly 4.3% of GDP.

[1] Arabia Monitor; IMF.

- The United States and the European Union are the leading investors in Iraq.
- Foreign investment and expertise are crucial for Iraq to meet its goal of increasing oil production and overcoming decades of conflict and sanctions.

➢ Salih also said he was expecting the introduction of major legislation on reconstruction and investment at the Council's autumn session. It was necessary, he said, because Iraq was "essentially a welfare state" facing huge population growth, viz:
  - Iraq's population is growing at the rate of one million people a year.
  - Some 12,000 new school buildings are needed now (as opposed to renovating old ones).

➢ Unemployment is a major security issue for Iraq and the region.
  - The World Bank estimates the Iraqi labour force participation rate at only 48.7%, one of the lowest rates in the world.
  - Only 26% of young people and 12% of women participate in the work force.

Legislative delays hampering projects

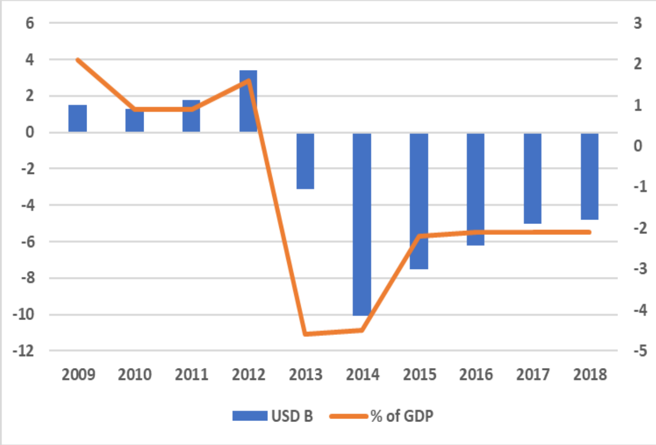
The faltering of the Southern Iraq Integrated Project (SIIP) with ExxonMobil reflects some of Iraq's as-yet-unaddressed problems.

➢ The USD 53B deal with ExxonMobil was for a water treatment facility and pipelines needed to boost oil output capacity. The US energy giant would have also been granted the rights to develop at least two southern oilfields - Nahr Bin Umar and Artawi.
  - But negotiations subsequently became long-drawn-out over contract conditions and escalating tensions between Iran and the US, Baghdad's two main allies.
  - Talks were also delayed by two separate evacuations of Exxon's foreign staff from Iraq, the first after Washington warned of Iranian threats to US interests there, and the second prompted by a rocket attack that appeared to target the company.

➢ In June, government officials also announced that South Korea's Hyundai Engineering & Construction Co Ltd had been selected to build a USD 2.4B seawater injection facility, part of the deal with ExxonMobil.
  - However, the contract has not actually been, awarded to Hyundai yet, and appears to have been announced as a negotiating tactic to put pressure on ExxonMobil.

➢ During negotiations with the Ministry of Oil (MoO), it has been decided that ExxonMobil and PetroChina will pay for the SIIP infrastructure by selling Ratawi and Nahr bin Omar production to the MoO.
  - This agreement needs parliamentary approval and is facing some backlash because a portion of revenues will come to the state budget until a certain threshold of payment is reached, some years away.

Figure 1 – Iraq FDI Inflow[2]



Baghdad-Erbil relations reset?

In a positive move, the Kurdistan Regional Government's (KRG) new prime minister, Masrour Barzani, met Adel Abdel Mahdi, now premier of Iraq, in July to form technical committees to tackle disputes.

➢ The two sides agreed on a series of mechanisms to resolve outstanding disputes, including issues related to territory and the oil-for-salary controversy, which remains the most contentious matter between them.

➢ The Baghdad-KRG oil dispute picked up in May when Finance Minister Fuad Hussein and Oil Minister Thamir Ghadhban were called in by the Council to explain why budget payments were being made to the KRG despite non-receipt of the contractual 250 Kb/d from the KRG for export through the State Organization for Marketing of Oil (SOMO).
  - The 2019 budget law seems to be unclear regarding the oil deal. It is vague in interpretation but unlike prior budgets, appears to guarantee certain financial transfers regardless of the KRG's adherence to its oil obligations.
  - The KRG has transferred some amounts to Baghdad, but not the full contractual 250 Kb/d.
    - In April, for example, the KRG transferred 107 Kb/d to SOMO. That was the largest monthly transfer in 2019.

➢ Discussions will focus on KRG oil exports, its share of the federal budget and control of disputed, oil-rich Kirkuk.

➢ Stakeholders include global energy companies, OPEC, and allied states such as the US, whose officials have urged Baghdad and Erbil to reconcile.

➢ The discussions are a positive step, but in our view, even if a deal were to be negotiated, Abdel Mahdi will struggle to convince his parliamentary opponents to endorse it.
  - Many MPs have previously criticised Abdel Mahdi for being too lenient towards the KRG.
  - The region voted for independence in 2017 in a referendum deemed illegal by Baghdad.

[2] Arabia Monitor; UNCTAD World Investment Report, 2018.

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