

REPUBLIC OF IRAQ

Recent developments

Faced with this multifaceted crisis, Iraq's growth is expected to contract by 9.5 percent in 2020, the worst annual performance since 2003. Oil-GDP is contracting by 12 percent, capped by the OPEC+ production agreement, while non-oil-GDP is contracting by 5 percent as services sectors are affected by COVID-19 mitigation measures especially the all-important religious tourism. Subdued domestic demand and the depreciation of the Iran and Turkey's currencies vis-à-vis the Dinar have kept inflation checked. Headline and core inflation registered only 0.4 and 0.7 percent rise in first 7 months 2020 (y/y).

Cuts in oil production and prices have seen budgetary revenues drop by 39 percent in the first half of 2020 (H1-20) (y/y). Gol's response was to stop discretionary spending and public investment including growth-critical human capital and service delivery programs. Nevertheless, given the wage bill and pension rigidities, which require a US\$58 per-oil-barrel to be fully covered, the budget surplus in H1-19 turned into a 0.7 percent of GDP deficit in H1-20. With no access to international markets, the deficit is being primarily monetized with secured through the central bank (CBI) and to lesser extent by state-owned-banks, adding pressure on the exchange rate. Moreover, public debt is expected to reach 66 percent of GDP in 2020, up from 45 percent in 2019.

Less favorable terms of trade have also turned the current account surplus into a

0.9 percent of GDP deficit in Q1-20 (most recent data). With little financing available - foreign borrowing has dropped by 3.1 percent of GDP - such large swing is taking a toll on CBI reserves.

Outlook

The outlook for Iraq's is highly uncertain and will depend on the evolution of global oil markets, the capacity of the Iraqi healthcare system to respond to the pandemic, and the reform process.

If conditions ease, growth is projected to gradually return to 2.0-7.3 percent in 2021-2022 with non-oil economy projected to bouncing back to an average of 4 percent in 2021-22. The recovery in domestic demand is expected to increase inflation in 2021-22, to an annual average of 2 percent. In the absence of public wage bill and pension reforms, the fiscal deficit is projected to remain sizeable averaging 12 percent of GDP in 2021-22 amidst modest recovery in oil prices. Consequently, debt to-GDP ratio is projected to remain elevated over the forecast period. Securing budget financing will be challenging. Reliance on domestic financing would increase Iraq's debt service and repayment risks, and crowd out private sector.

Iraq is also expected to face a persistent current account deficit. However, low public spending outside of the wage bill and pension is expected to ease the impact on the CBI reserves as imports are contained. Reserves are projected to reach seven months of imports by 2022.

Table 1 **2019**

Population, million	40.1
GDP, current US\$ billion	234.1
GDP per capita, current US\$	5840.5
Lower middle-income poverty rate (\$3.2) ^a	14.8
Upper middle-income poverty rate (\$5.5) ^a	52.4
National poverty rate ^a	22.5
Gini index ^a	29.5
School enrollment, primary (%gross) ^b	108.7
Life expectancy at birth, years ^b	70.5

Source: WDI, Macro Poverty Outlook, and official data.

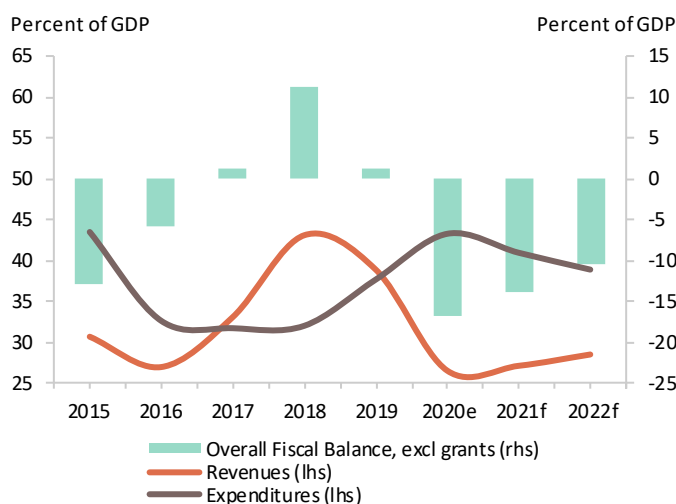
Notes:

(a) Most recent value (2012), 2011 PPPs.

(b) WDI for School enrollment (2007); Life expectancy (2018).

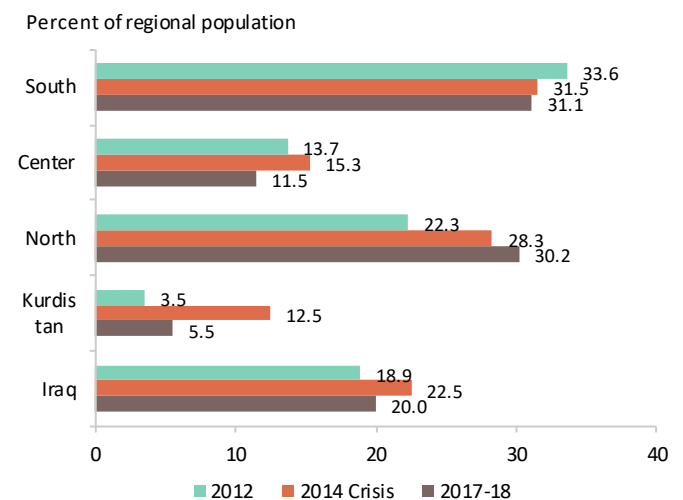
Iraq's economy is expected to contract in 2020 due to lower oil prices and the spread of COVID-19. The twin deficits are mounting as a result, reversing the declining trend on public debt and adding pressure on the exchange rate and central bank reserves. Weaker oil prices, budget rigidities as well as cuts to pro-growth program and the slow implementation of structural reforms are all upstream risks to the economic outlook that will hinder advancing human capital formation and job creation.

FIGURE 1 Republic of Iraq / Fiscal accounts



Sources: Ministry of Finance; and World Bank staff projections.

FIGURE 2 Republic of Iraq / Regional poverty head-count rates



Sources: World Bank staff estimates.

Pre-existing conditions of rising unemployment and underemployment particularly among youth and IDPs are likely to worsen with the current crises. Projections suggest that poverty would increase by 7 to 14 percentage points. This means 2.7 to 5.5 million Iraqis would become poor due to the pandemic in addition to the existing 6.9 million pre-crisis poor.

Risks and challenges

The drop in oil prices and the COVID-19 pandemic are placing unprecedented strain on Iraq's economy. These fragilities are amplified by an already precarious political situation, a significant weak healthcare system, an ineffective social safety nets systems, rampant corruption, and dilapidated service delivery which continue to fuel large scale protests across the country.

While the new Government of Iraq (GoI) has been affirming its grip on security and

illegal arms as well as announcing a date for new parliamentary election in response to popular protests, it has been struggling in dealing with economic challenges. The country's pre-existing conditions of heavy oil dependence, dominant presence of the state in economic activities, as well as budget rigidities limit GoI's capacity to respond to the Covid-19 and offer a stimulus package to restart the economy.

The key challenges for Iraq will be to navigate this multi-dimensional crisis amidst unfavorable conditions for international oil markets. The implementation of the OPEC+ agreement and a global recession means that growth prospects for Iraq are on the downside. It also underscores the importance of creating fiscal space for advancing the human capital, diversification, and job creation agendas. Even with a recovery in oil prices, Iraq will need to undertake many reforms to rebuild fiscal space by cutting distortionary and strengthening the orientation of macroeconomic policies. A failure to narrow the

twin deficits and a rapid build-up in government debt would divert more resources away from productive investment and further reduce foreign exchange reserves and the economy's resilience to shocks.

These crises are also likely to worsen the welfare of Iraqi households. After years of conflict and displacement, many Iraqis were already vulnerable, and the pandemic will test their resilience further. While disruption in supply chains will increase basic prices, households' labor and non-labor incomes are likely to decrease due to the economic slowdown and reduced remittances. Tightening fiscal space could affect food and public cash transfers. Many households may lose all of their incomes, especially those in the informal private sector, compelling them to exhaust savings and employ negative coping strategies. In the absence of a significant government response, these short-term effects coupled with the reduced access to education, healthcare, and other services will have lasting impacts on households' ability to escape poverty or remain above it.

TABLE 2 Republic of Iraq / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2017	2018	2019	2020 e	2021 f	2022 f
Real GDP growth, at constant market prices	-2.5	-0.6	4.4	-9.5	2.0	7.3
Private Consumption	-1.2	0.3	2.0	-4.2	2.2	2.4
Government Consumption	4.4	15.2	14.3	14.3	10.4	7.3
Gross Fixed Capital Investment	-13.0	-9.1	-13.9	-13.6	2.1	2.3
Exports, Goods and Services	-0.1	1.4	3.9	-22.6	17.4	8.2
Imports, Goods and Services	-1.7	13.1	12.0	3.2	2.0	2.4
Real GDP growth, at constant factor prices	-2.5	-0.6	4.4	-9.5	2.0	7.3
Agriculture	-16.0	-26.1	5.0	3.0	5.5	5.0
Industry	-3.5	-2.3	4.2	-6.2	2.1	5.0
Services	0.9	4.6	4.8	-17.5	1.7	13.5
Inflation (Consumer Price Index)	0.1	0.4	-0.2	0.9	2.0	2.0
Current Account Balance (% of GDP)	1.8	6.9	2.7	-12.2	-8.0	-4.5
Fiscal Balance (% of GDP)	1.3	11.2	1.3	-16.8	-13.9	-10.4
Debt (% of GDP)	58.9	46.0	46.8	65.7	66.0	64.3
Primary Balance (% of GDP)	2.3	12.3	2.4	-14.9	-12.2	-9.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate. f = forecast.