

REPUBLIC OF IRAQ

Key conditions and challenges

Table 1 **2021**

Population, million	41.2
GDP, current US\$ billion	204.8
GDP per capita, current US\$	4973.4
School enrollment, primary (% gross) ^a	108.7
Life expectancy at birth, years ^a	70.6
Total GHG Emissions (mtCO ₂ e)	246.2

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2019).

Iraq's economy is gradually recovering from the twin shocks of the pandemic and collapse in oil prices in 2020. Both oil and non-oil growth are on track to reach their pre-pandemic levels as oil production increases and the easing of COVID-19 restrictions restores domestic economic activity. Fiscal and external deficits are back to surpluses as oil prices continue to surge. Growth in the medium term is projected to be driven by the oil sector as OPEC+ production cuts are phased out. The outlook remains subject to significant risks including uncertainties relating to the impact of geopolitical tensions, the ongoing pandemic, security challenges, and climate change.

Iraq's economy is gradually emerging from the pandemic, driven by a recovery in non-oil economic activity and more favorable oil market dynamics. Non-oil economic activity is recovering to the pre-pandemic level as COVID-19 restrictions are eased. Oil production has also gradually increased as per the OPEC+ production quota tapering, which is scheduled to be fully phased out by September 2022. Higher oil prices have also bolstered government revenues and strengthened reserves.

However, Iraq's economic recovery remains fraught by significant volatility and long-standing structural challenges. Due to overdependence on oil, exports and government revenues remain highly volatile and pro-cyclical in line with oil price dynamics. Government spending is beset by rigid wage and transfer expenditures. The pandemic also amplified Iraq's pre-existing fragilities in the health care system, public administration, and digital and physical infrastructure, compounding low productivity growth. The disproportional impacts of the crisis on the pre-pandemic poor and vulnerable population exacerbated the pre-existing poverty trends and inequality. While the overall unemployment rate increased during the pandemic, unemployment among the displaced, returnees and women jobseekers, and those pre-pandemic self-employed and informal workers, in particular, is pronounced significantly. Record

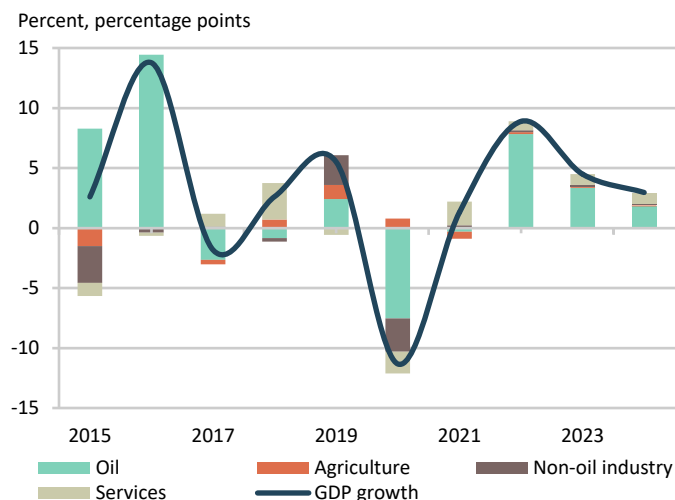
high temperatures and severe droughts have impacted agricultural production, making Iraq more reliant on imports as commodity prices rise, with implications for food security and poverty, especially in rural areas. High dependence on gas and electricity imports have increased the magnitude of impact from disruptions to these imports. This while Iraq is the world's second largest gas flaring country failing to capture over half of the associated gas in oil production.

A protracted government formation process and a resurgence of security challenges cloud the prospects of Iraq's economy. A political dead lock has stalled the government formation process since the October 2021 parliamentary elections and led to postponing of the 2022 budget, adding to pre-existing social grievances regarding corruption, poor public service delivery and lack of economic opportunities. The oil windfall presents a crucial opportunity for implementation of a comprehensive package of economic reforms to achieve sustainable economic growth and cushion the impact of future economic shocks.

Recent developments

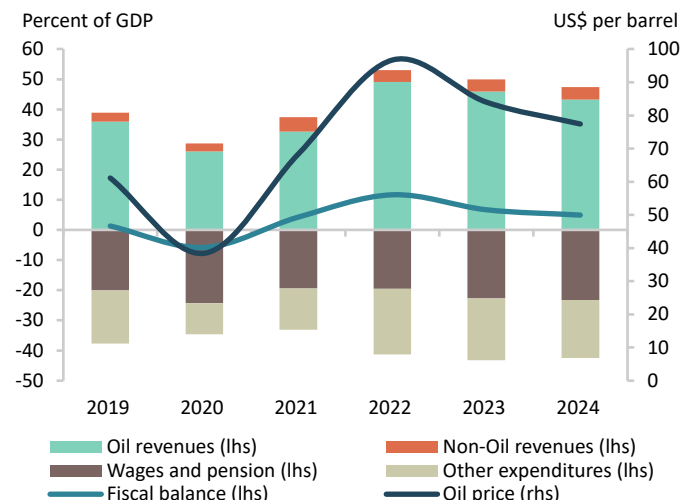
Iraq's economy is gradually rebounding following the deep economic strains of the COVID-19 pandemic. Real GDP is estimated to have edged up by 1.3 percent in 2021, after a sharp contraction of 11.3 percent in 2020. The rebound was mainly driven by the non-oil sector which grew by 6 percent in 9M-2021 year-on-year (y/y), underpinned

FIGURE 1 Republic of Iraq / GDP growth and supply side decomposition



Sources: Iraq's COSIT and World Bank staff calculations.

FIGURE 2 Republic of Iraq / Fiscal account outlook



Sources: Iraq MoF, MoO, and World Bank staff calculations.

by a strong performance of the high contact sectors including transport, accommodation, and retail sectors. However, agricultural and construction contracted by 17.5 percent and 36.8 percent respectively, following severe droughts, energy outages, and the rising global price of inputs. In 9M-2021, oil GDP contracted by 4 percent (y/y) as Iraq adjusted its oil production as per the OPEC+ agreement. Headline and core inflation edged up to an average of 6 and 6.6 percent (y/y) in 2021, respectively, following the 23 percent devaluation in Dec-2020 and the gradual recovery in domestic demand.

Government revenues surged by 73 percent (y/y) in 2021 spurred by higher oil prices which averaged at US\$68.3/barrel in 2021 (78 percent increase y/y). These budgetary gains were in part boosted by the currency devaluation and measures to mobilize non-oil domestic revenues mainly from customs. While recurrent expenditures – including the wage bill – remained high at 29 percent of GDP, improved oil receipts turned the overall fiscal balance to a surplus of 5.3 percent of GDP in 2021. The improved fiscal situation together with a denominator effect from the high nominal GDP growth (33 percent y/y) is estimated to have reduced the debt-to-GDP ratio to 54.8 percent in 2021, down from 64.7 percent in 2020.

Higher oil prices and exports also improved Iraq's external accounts. The current account balance turned into a surplus of 8.3 percent of GDP in 9M-2021 as exports surged by 46 percent and imports declined

by 25 percent (y/y). The latter was driven by private imports' downward adjustment following the devaluation. The stronger trade balance pushed official reserves up from US\$54 billion in Dec-2020 to US\$61.9 billion in Dec-2021, strengthening buffers to external shocks.

Outlook

The turnaround in oil markets has significantly improved Iraq's economic outlook in the medium term. Overall growth in 2022 is now forecast at 8.9 percent as OPEC+ quotas end and Iraq's production surpasses its pre-pandemic level of 4.6 mbpd. Growth in the outer years is projected to remain modest at 3.7 percent on average as oil production moderates. Non-oil GDP growth is projected to converge to its long-term potential growth trend in part aided by higher investments that would be financed through the oil windfall. However, growth is forecast to remain constrained by the economy's limited absorptive capacity and other inefficiencies. Higher projected oil prices in 2022-2024 are forecast to significantly improve Iraq's fiscal and external outlook. Due to their high dependence on oil, government revenues are likely to grow significantly through both price and volume channels. In the absence of a fiscal rule, part of the new fiscal space is likely to be absorbed by higher investment expenditures along with other procyclical discretionary spending. As

such, Iraq's overall fiscal surplus is projected to moderate from an initial high of 11.7 percent of GDP in 2022 to 4.9 percent of GDP in 2024, while the debt-to-GDP ratio gradually improves to an annual average of 43 percent in 2022-24.

Iraq's economic outlook remains subject to significant risks. The recent geopolitical tensions related to the Russian war and invasion highlight risks for Iraq economy both on the up and downside. While any further oil price hikes would further improve Iraq's fiscal balance, rising food prices and disruption to agriculture imports will exacerbate pre-existing poverty trends and increase food security risks. The conflict also poses risks to Iraq's crude oil production if operations of Russian oil companies in Iraq are impacted by international sanctions on Russia. Higher oil prices could hurt the long-standing need to reform thereby deepening Iraq's structural economic challenges. Further intensified climate change effects and water shortages will decrease agricultural production. Additionally, COVID-19 vaccination in Iraq remains very low, among the lowest in the region and well below the global rate, and poses additional risks. It remains low even among the most vulnerable group, the elderly, and among those with high risk of exposure to the virus – poorer households and informal workers that are less likely to work from home and more likely to live in large households in cramped conditions. Other risks include the decline in oil prices, and a deterioration of the security situation.

TABLE 2 Republic of Iraq / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices	4.8	-8.6	1.3	8.9	4.5	3.0
Private Consumption	1.5	3.1	2.3	3.2	3.1	3.0
Government Consumption	25.2	-9.5	5.6	6.0	4.0	3.4
Gross Fixed Capital Investment	496.1	-67.0	10.0	13.3	9.5	8.3
Exports, Goods and Services	4.6	-10.1	-0.5	13.5	5.5	2.9
Imports, Goods and Services	28.4	-23.9	4.2	8.7	5.7	5.0
Real GDP growth, at constant factor prices	5.5	-11.3	1.3	8.9	4.5	3.0
Agriculture	46.2	22.5	-12.0	4.0	2.0	2.0
Industry	7.4	-15.2	-0.1	12.5	5.3	2.9
Services	-1.8	-6.3	6.5	2.3	3.0	3.1
Inflation (Consumer Price Index)	-0.2	0.6	6.0	3.3	3.0	2.5
Current Account Balance (% of GDP)^a	5.6	-5.2	8.2	10.6	7.4	5.2
Net Foreign Direct Investment (% of GDP)^a	1.4	1.6	1.5	1.6	1.6	1.7
Fiscal Balance (% of GDP)^a	1.3	-5.8	4.3	11.7	6.7	4.9
Debt (% of GDP)^a	44.7	64.7	54.8	43.3	42.8	41.7
Primary Balance (% of GDP)^a	2.4	-4.8	5.3	12.5	7.6	6.0
GHG emissions growth (mtCO₂e)	11.4	-2.6	7.3	18.1	13.8	11.6
Energy related GHG emissions (% of total)	72.5	73.8	76.4	79.3	81.2	82.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

a/ Share of factor cost GDP.