

REPUBLIC OF IRAQ

Recent developments

Table 1 **2018**

Population, million	39.8
GDP, current US\$ billion	224.1
GDP per capita, current US\$	5639
Lower middle-income poverty rate (\$3.2) ^a	17.9
Upper middle-income poverty rate (\$5.5) ^a	57.3
National poverty rate ^b	22.5
Gini index ^a	29.5
Life expectancy at birth, years ^c	70.0

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

Notes:

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

(b) Most recent WDI value (2017).

(c) Most recent WDI value (2017).

Higher oil prices entering 2019, improved security conditions, better rainfall and fiscal loosening have contributed to a noticeable pick-up in economic activity. However, in the absence of structural reforms and accelerated reconstruction, growth recovery in Iraq may be short-lived especially with an unfavorable outlook for oil prices given global trade tensions. The poverty rate was 22.5 percent in 2014 and is likely to have declined since then. Almost 5 percent of Iraqis remain displaced.

Iraq's economy is gradually rebounding, after the contraction in the last two years. GDP grew at 4.8 percent year on year (y/y) in the first half of 2019, reversing the contraction of 2017-18. Growth can be mainly attributed to a rise in crude oil production (up 6.3 percent) and a rebound in non-oil economic activity (up 5.6 percent in H1-19, y/y). Crude oil production is a significant success story for Iraq; prior to 2014, there had been doubts as to whether production could be sustained above 3 million barrels per day (mbpd), whereas it currently is within striking distance of 5 mbpd. The non-oil sector improvement is underpinned by better rainfall, an improvement in electricity production, and an expansionary fiscal policy linked to higher oil prices in 2018 which persisted into the early part of this year. Repeating past patterns of "windfall" spending, higher oil revenues have resulted in a rising wage bill and public consumption. Overall real GDP growth is estimated to be 4.8 percent at end-2019, with the non-oil economy likely to accelerate over 5 percent.

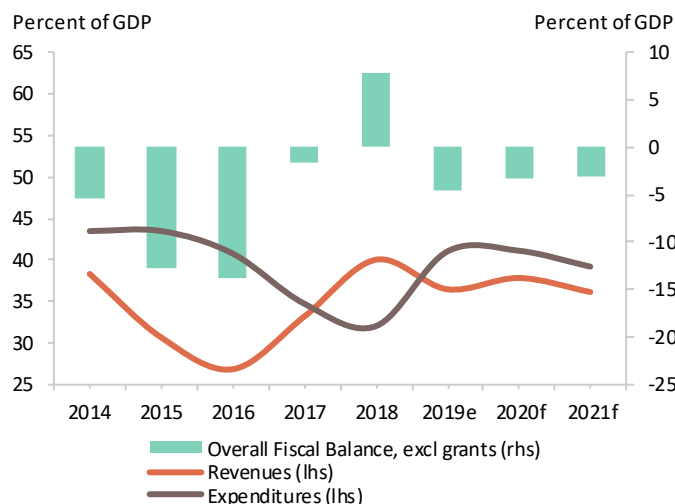
Inflationary pressures remain muted. This is largely due to cheaper imported consumption goods following the depreciation of both Turkish and Iranian currencies, the two main trading partners for Iraq.

The fiscal policy stance is expansionary based on a higher wage bill and subsidies to lessen social pressures amidst weak private sector job creation. This is evident

from the latest decision to absorb militias into the security forces and employ large numbers of graduates into ministries and SOEs. As a result, recurrent spending has increased by 28.8 percent in H1-19 (y/y), only partially offset by a 1.1 percent decline in capital spending over the same period. Such a decline reflects serious public investment management constraints. Despite large allocations made for public investments (12.5 percent of GDP in the 2019 budget law), the execution rate remains below 5 percent in H1-2019. This puts a drag on growth and increases social tensions as reconstruction, notably in Mosul, is further delayed. Furthermore, domestic revenue mobilization remains weak with non-oil revenues representing only 8 percent of total government receipts. Customs exemptions and weak growth in 2018 have led to a 33.5 percent decline in tax receipts, partially offsetting the 6.3 percent rise in oil budgetary revenues. As a result, the fiscal surplus in 2018 (7.9 percent of GDP) is expected to turn into 4.6 percent deficit by end-2019 pushing debt-to-GDP to 49.7 percent (up from 49.3 percent a year ago).

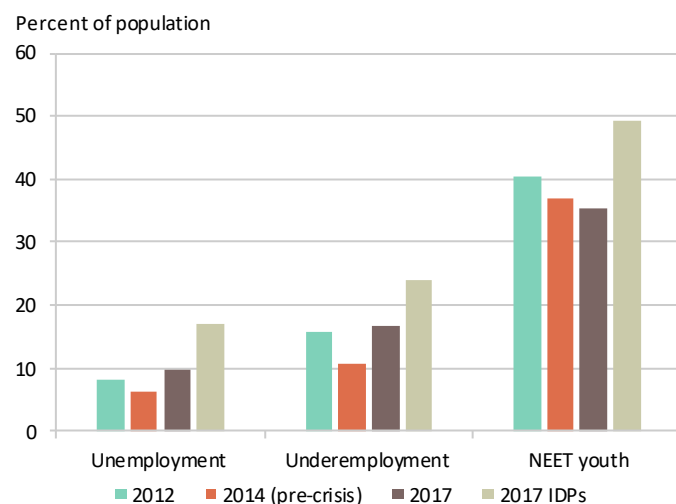
The external position has weakened. The 2018 current account surplus (6.9 percent of GDP) is expected to turn into a deficit of 4.6 percent of GDP in 2019. This is due to less favorable terms of trade as Iraq's oil export price average fell from US\$66/barrel in 2018 to US\$62/barrel in the first 8 months of 2019, and to an expansionary fiscal policy, which has resulted so far in a 12 percent rise in imports. The central bank's reserves are at US\$68 billion at end-August 2019, a 5.3 percent increase compared to 2018 (y/y)

FIGURE 1 Republic of Iraq / Fiscal accounts



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

FIGURE 2 Republic of Iraq / Selected labor market indicators



Sources: World Bank staff calculations using IHSES 2012, CHS 2014, SWIFT 2017-18.

supported by oil export volumes. However, the situation is expected to reverse due to a projected dip in international oil price coupled with a more stringent implementation of the OPEC+ quota for Iraq. Reserves are projected to decline to an estimated US\$60 billion at end-2019 (or 6.7 months of imports), from over US\$64 billion in 2018 (8 months of imports), increasing the vulnerability of the country to external shocks.

While updated official poverty data is not yet available, the monetary poverty rate is expected to have declined from 2014 (22.5 percent) due to the recent economic growth and improved security situation. Several non-income dimensions of welfare have improved, including increases in school enrollment, and expansion of drinking water provision. At the same time, employment conditions have worsened since 2012. The unemployment rate, which was falling before the ISIS crisis, has increased beyond the 2012 level to 9.9 percent in 2017/18. Underemployment is particularly high among internally displaced persons (IDPs), with almost 24 percent of IDPs unemployed or underemployed (compared to 17 percent for the national average). Also, more than a fifth of the economically active youth do not have a job, and more than a fifth is neither

in employment nor in education or training (NEET). In conflict afflicted areas, the standard of living is likely below the 2014 level because of disruptions in the labor market and general economic activity.

Outlook

In the absence of structural reforms and accelerated reconstruction, growth recovery may be short-lived (Table 2). Growth is projected at 5.1 percent in 2020 and down to 2.7 percent in 2021. This is mostly due to the oil markets outlook where both prices and exports are expected to weaken given lower global demand and the uncertainty of the OPEC+ agreement renewal. Non-oil growth is expected to remain positive on the back of improved security conditions and higher investment to rebuild the country's damaged infrastructure – which is nonetheless likely to remain far short of needs. Higher spending together with lower oil prices will result in a fiscal deficit projected at 3.3 percent of GDP in 2020 and remain in a similar range in 2021. Lower oil prices and increased imports will cause the current account balance to remain into

deficit, and international reserves to decline during the forecast period.

Risks and challenges

Volatility in oil prices remains the main risk exposure, reflecting the lack of diversification and budget rigidities linked with irreversible spending measures on the wage bill. These factors reduce Iraq's financial buffers and increase its vulnerability to external shocks. They also threaten to further delay reconstruction and the addressing of legacy development deficits. Volatility could also swamp the recent positive government reforms efforts especially in the electricity and agriculture sectors. Labor market outcomes continue to be a concern, especially for women and youth. Creating the adequate fiscal space for growth-enhancing programs in human and physical capital will be key for diversification and job creation, without which the impressive increases in oil production will mean little for most Iraqis. With IDPs returning to their homes, there will be an increasing need to open economic opportunities and maintain flexible social assistance in these parts of the country.

TABLE 2 Republic of Iraq / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2016	2017	2018	2019 e	2020 f	2021 f
Real GDP growth, at constant market prices	15.2	-2.5	-0.6	4.8	5.1	2.7
Private Consumption	14.6	-1.2	0.3	1.6	5.2	3.6
Government Consumption	3.7	4.4	15.2	5.5	3.2	1.4
Gross Fixed Capital Investment	-13.2	-13.0	-9.1	23.6	-7.7	-3.0
Exports, Goods and Services	13.2	-0.1	1.4	4.7	5.9	1.7
Imports, Goods and Services	-5.7	-1.7	13.1	18.3	1.4	0.5
Real GDP growth, at constant factor prices	15.3	-2.5	-0.6	4.8	5.1	2.7
Agriculture	-30.9	-16.0	-26.1	5.0	6.6	5.6
Industry	23.5	-3.5	-2.3	4.5	5.6	2.0
Services	1.7	0.9	4.7	5.5	3.9	4.2
Inflation (Consumer Price Index)	0.5	0.1	0.4	0.0	2.0	2.0
Current Account Balance (% of GDP)	-8.3	1.8	6.9	-4.6	-4.0	-4.0
Fiscal Balance (% of GDP)	-13.9	-1.6	7.9	-4.6	-3.3	-3.1
Debt (% of GDP)	64.2	58.9	49.3	49.7	48.6	48.6
Primary Balance (% of GDP)	-13.2	-0.4	9.4	-3.3	-2.2	-2.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.