



OFFICE OF THE UNDER SECRETARY OF DEFENSE  
FOR POLICY

IRAG

26 October 2004

NOTE FOR: Secretary of Defense  
Deputy Secretary of Defense

FROM: Douglas J. Feith

DJF by LA 10/26/04

SUBJECT: Iraq: Update on Economic Developments

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OSD 21073-05

26 OCT 04

from  
Treasury  
Department  
(John Taylor)

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# Iraq: Update on Economic Developments

October 26, 2004





# Macroeconomic Developments

- The overall macroeconomic setting is generally favorable -- stable exchange rate, moderate increase in consumer prices, and a fairly substantial level of foreign reserves.

# Economic Activity

- Projections for economic growth in 2004 are around 50%, led primarily by the oil sector, which accounts for over three quarters of Iraq's GDP.
- Oil production and exports have been fairly stable in recent weeks, averaging around 2.5mbpd and 1.5mbpd, respectively.
- IIG officials report that retail commercial activity continues to be robust and agricultural activity is recovering.
  - Information on economic activity outside of the oil sector is limited, but suggests the non-oil economy is recovering, led primarily by reconstruction and commercial activities.



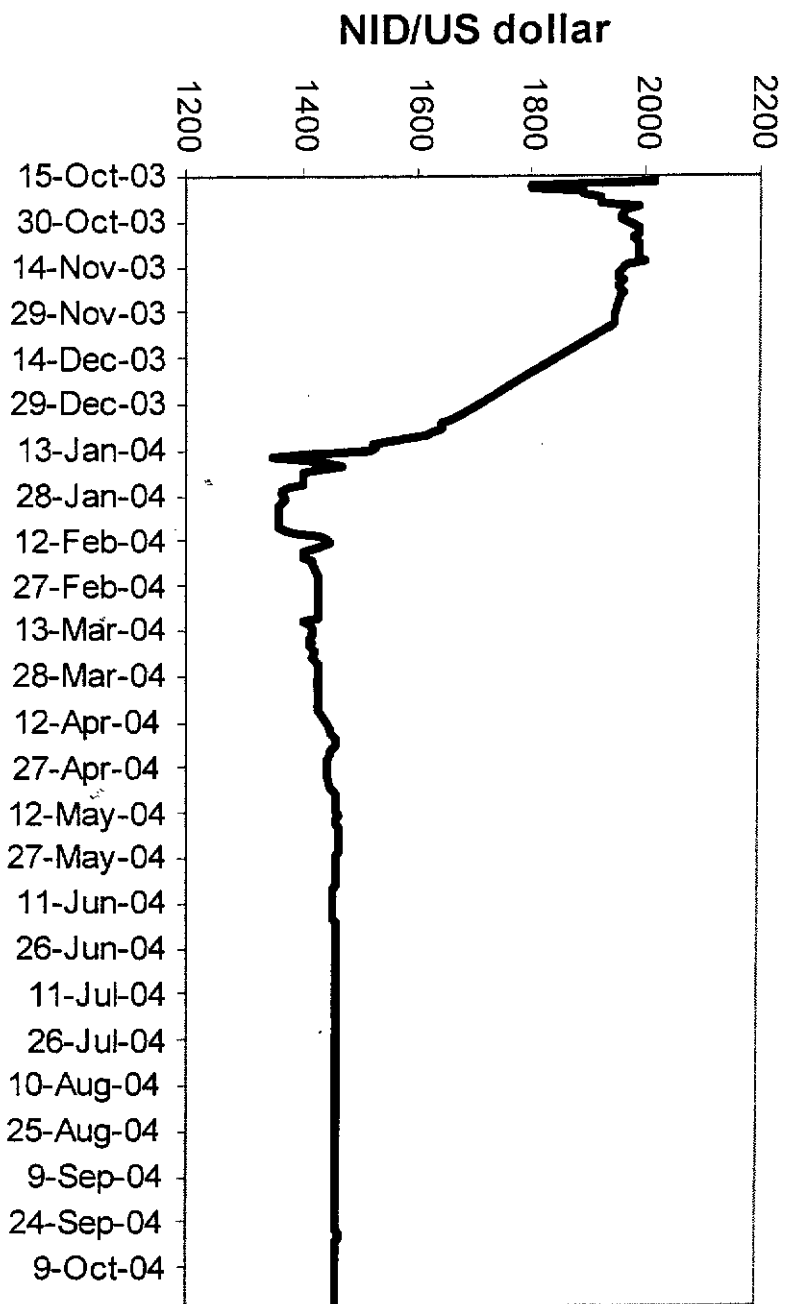
# Exchange Rate

- The New Iraqi Dinar (NID) remains stable following the one year anniversary of its introduction.
- U.S. dollar sales by the CBI in daily auctions, however, have increased in recent weeks, suggesting a modest amount of selling pressure on the dinar. Dollar sales are now averaging around \$28 million, up from around \$15 million over the summer.



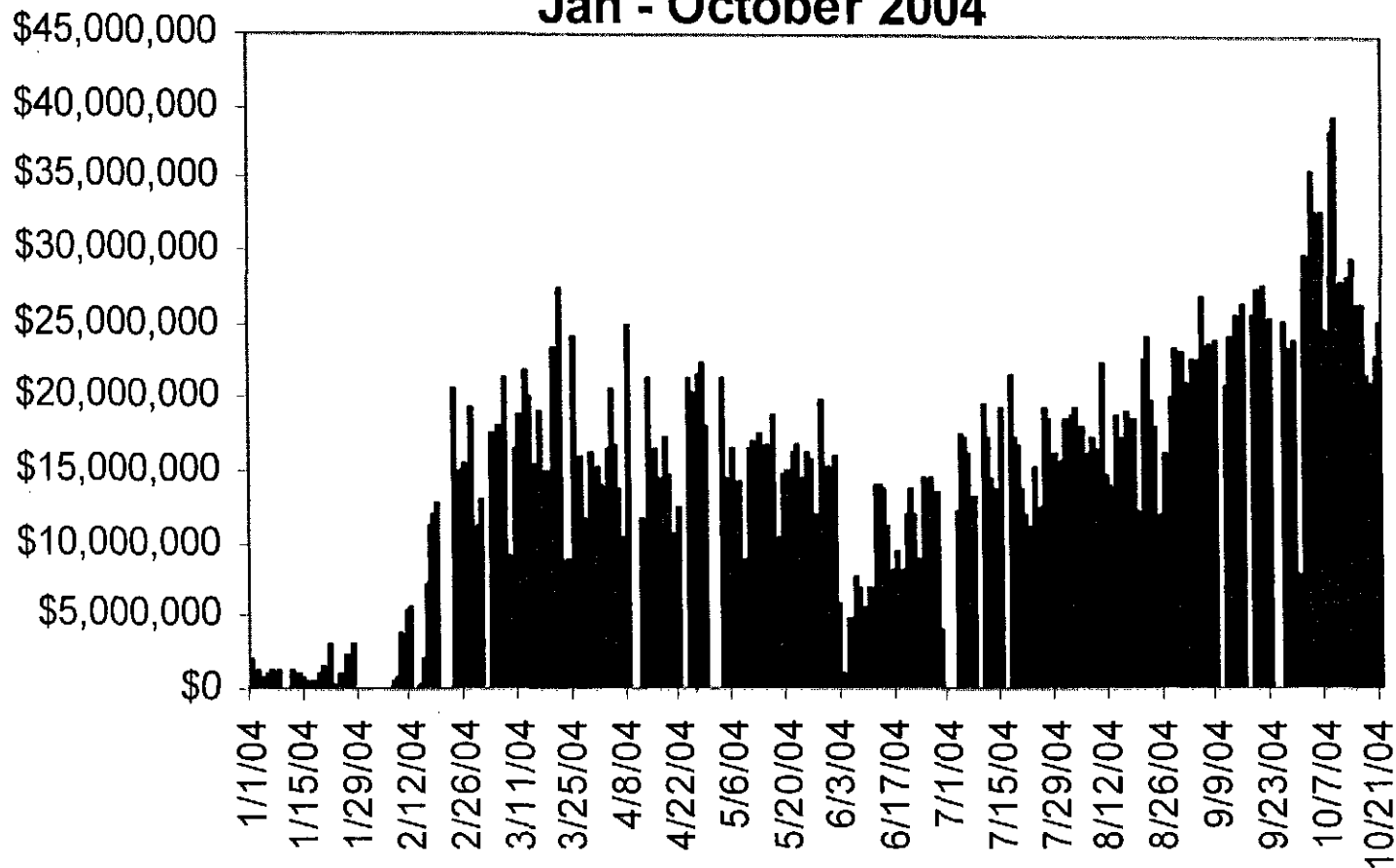
# Exchange Rate Performance

## New Iraq Dinar Exchange Rate October 2003 - October 2004



# Foreign Exchange Auction Volume

CBI Auction - Volume of Dollars Sold  
Jan - October 2004



# Central Bank Reserves

- It is estimated that the CBI now has over \$5 billion in reserves, up from \$3 billion at mid-year, and has been able to continue to build reserves even as dollar sales have grown of late.
- This amount would enable the CBI to withstand more intensified selling pressure, if it chooses to, at least for a while.





# Consumer Prices

- Consumer price increases have been moderate in 2004.
  - It appears that Iraq has gone from a period of mild deflation earlier in the year, associated with appreciation of its currency around year-end, to mild inflation more recently.
  - In August, the Central Statistical Office (CSO) reported that consumer prices rose 3.6 percent.
- At this point, it appears that inflation for 2004 will be in the single digits versus 18-35 percent of recent years.



# Budget/Fiscal Policy

- 2004 budget revenues are expected to be \$1-2 billion higher than originally estimated, as a result of higher oil prices. IIG, with Ministry of Finance lead, will need to determine how to allocate this money.
- Important to take an integrated approach to determining the appropriate allocation of additional revenues.

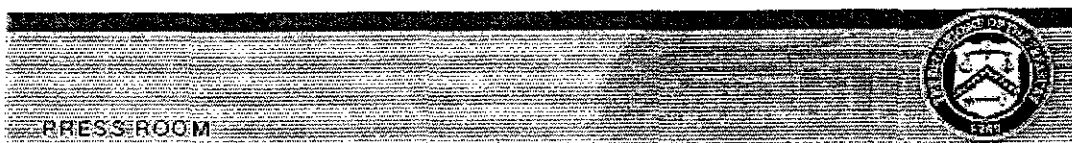


# Key Economic Indicators

<b>Est. GDP</b>	\$21bn	<b>Exchange Rate (ID/\$1)</b>	1460
<b>Est. GDP/Capita</b>	\$780	<b>M-o-M change</b>	0
<b>Est. 2004</b>		<b>FX Auction volume</b> (USD sold)	
<b>real GDP growth</b>	50%	October est. average	\$28m
<b>Est. Debt Stock</b>	\$125bn	<b>Approx. M-o-M change</b>	20%
<b>Est. Debt/GDP</b>	600%	<b>Interest Rates</b>	
<b>Inflation</b>		<b>Policy Rate</b>	6%
August 2004	3.6%	<b>CBI overnight deposit</b>	4%
Est. year-to-date (Jan-Aug)	5.8%	<b>CBI overnight lending</b>	8%
<b>Est. Foreign Reserves</b>	\$5bn	<b>T-Bill Rate</b>	3.2%
<b>Base Money</b>		<b>Bank lending rate</b>	
(ID, trillion, as of July)	10.5	(ID, 1-5 years)	13%

Sources: IMF EPCA documents, Central Bank of Iraq, Iraq Central Statistical Office





FROM THE OFFICE OF PUBLIC AFFAIRS

October 22, 2004  
JS-2056

Remarks on the Occasion of the One-Year Anniversary of the Iraq Currency  
Exchange  
John B. Taylor  
Under Secretary of the Treasury for International Affairs  
October 22, 2004

One year ago this week the Iraqi people, working with the United States and our coalition partners, embarked on a difficult economic mission: to replace completely Iraq's deteriorating and easily counterfeited currency and to restore economic and financial stability to their ravaged economy. After years of hyper-inflation and falling incomes under Saddam's regime, everyone knew this was an essential reconstruction task. But many doubted that a nation-wide currency exchange could be accomplished – What if the Iraqis didn't accept a new currency? How would the new currency be distributed to millions of people in hundreds of cities and towns? What if terrorists sabotaged the distribution?

Now, one year later, a new currency is circulating throughout Iraq and the Iraqi currency exchange is hailed as a success. The exchange rate is steady, price stability has been restored, and economic growth this year is 50 percent, one of the highest rates in the world. The new Iraqi dinar is a sturdy and secure currency, imprinted with traditional Iraqi symbols – altogether a great improvement over the flimsy bills with Saddam's face. Demand for the new currency has been so strong that the Iraqi government has earned an amazing \$5 billion in seignorage during the past year just supplying it. And Iraqis are using the newly-minted dinars to purchase goods— fresh bananas from the Americas, chickens from around the world, new and used cars—at stable competitive prices in markets in Basra, Baghdad, Irbil and Mosul.

The Iraqis are building upon these successes as they take responsibility for their economic future. Iraqi officials in the newly constituted Central Bank now conduct monetary policy, supervise the banking system, and review the growing number of applications for banking licenses. At the Finance Ministry, Iraqis are developing next year's budget according to international best practices as laid out in their new Financial Management Law. Iraq has re-engaged with the international financial community; it just entered into a strong agreement with the International Monetary Fund, approved and welcomed by the all the G7 countries. Earlier this month, Iraq's Finance Minister was in Washington at the annual meetings of the IMF and World Bank to engage with the world's economic leaders and make the case for erasing a large part of the crippling international debt run up by Saddam. As President Bush mentioned in the St. Louis debate, the Finance Minister was amazed that the U.S. press coverage missed all this good economic news about his country.

The successful introduction of a new currency—one of the crucial first steps in the stabilization of Iraq's economy—did not occur by accident. It was the outcome of extensive and careful advance planning and close international cooperation begun in 2002 and culminating in the final approval by President Bush in the spring of 2003. I remember putting the plan forward in the White House situation room with the President asking tough questions of all of us—Treasury, Defense and State—about the economic significance, market acceptance, security, and logistics. Only after all his questions were fully answered did he give the go ahead.

Then the plans were put into operation with the Iraqis and the Coalition Provisional



Authority working together. To make this all happen, twenty-seven 747 plane loads of the new currency were printed in record time at seven different locations around the world. The currency was then flown into Baghdad, and distributed to over 250 distribution points all over the country. Millions of Iraqis came with bags full of old currency, and lined up to get the new currency. Finally, the old currency was destroyed. A retired U.S. general, who had been running a bank in the United States, volunteered to oversee logistical operations. He sent situation reports from Baghdad to Washington and other coalition capitals everyday. Each report concluded with his motto "Teamwork That Works!" And it did work.

