



# IRAQ OIL REPORT

*As a client of Insider's View, you are receiving an Insider's View Bulletin. These bulletins are intended to provide real-time situational awareness and updates of events that are of key interest to our clients. This bulletin, and any updates, will be included in this month's report.*

**Insider's View Bulletin:** IMF loan conditions spell more spending cuts, put pressure on GoI not to slip on TSC payments

June 1, 2016

**Key points:**

- Senior International Monetary Fund (IMF)'s official explains conditions of proposed loan agreement worth \$5.4 billion
- Timely TSC payments "close to" a requirement
- IMF targets will focus on fiscal discipline for non-oil revenues
- As per the agreement, accumulation of further debt to be frozen
- Drawing down from sovereign reserves to be limited
- More spending cuts
- Senior Iraqi politicians "confident" necessary steps will be taken to secure IMF loan agreement
- Official believes further international loans will follow IMF loan
- KRG allocations contingent on budget law

**Potential IOC impact:** The prospect of TSC payments being more regularized and timely will improve if and when the IMF loan is realized.

**EXECUTIVE SUMMARY:** An IMF official explained the fiscal discipline measures enshrined in the proposed loan agreement with the Government of Iraq (GoI). The official also expects that if and when the IMF loan is finalized, there will be fairly rapid movement from other international lenders to provide their own assistance to Iraq. Though the KRG participated in IMF-Iraq meetings, its receiving a share of the loan is predicated on the implementation of the 2016 budget law, something that has not yet occurred in 2016.

This BULLETIN draws from a separate interview than the one covered in the BULLETIN titled, "IMF official discussed terms of Iraq loan deal," from May 26.

-- -- -- -- -- -- -- -- -- -- -- -- -- --

**Details:** In an exclusive interview, a senior IMF official said that GoI payments to IOCs were "close to" being a prerequisite for receiving IMF loan monies. He said that all arrears outstanding for 90 days or more at the time of the loan "would be paid by the end of the year," and that when the IMF's program begins there must be "zero new accumulation of external arrears."

Conditions like this will be enforced by the IMF through quarterly reviews of five quantitative performance criteria and two indicative targets, said the official.

**Iraq's international reserves set to shrink to \$40 billion:** The loan agreement, yet to obtain the approval of the IMF board and Iraqi cabinet to make it binding, imposes other requirements on the

Gol. The official explained that there is a target for the Gol to achieve a non-oil primary balance, whereby non-oil revenues and expenditures match, not including interest payments on past debt. The IMF will also encourage the Central Bank of Iraq (CBI) to lend to the government by placing a ceiling on net domestic assets, preventing it from accumulating capital. But it will also steer the Gol from exhausting its overseas currency reserves by putting a floor on gross international reserves. The official said that the Gol had burned through \$13 billion in international reserves in 2015, bringing their total down to \$53 billion. "It will probably do the same by the end of this year," he added, with the caveat that specific numbers were not yet available. Heavy use of savings to make ends meet was acceptable, said The official, because of the fall in oil prices.

**Debt freezes, spending cuts:** There are several performance criteria included in the loan, including two "indicative" targets. One is a ceiling on arrears to domestic suppliers, a debt that currently totals 7.5 trillion Iraqi dinars. Limited to debts for non-oil investment, the official said arrears would be frozen at this level.

The second indicative target is a floor on social spending, which includes government employee salaries, goods and services for ministries of health and education, aid to IDPs, and subsidies on food and agriculture. The Gol already made significant spending cuts in 2015, reducing the budget by around 30% as compared to 2014, and these budget lines were more or less followed again in 2016.

So to hit IMF targets, 90% of the allocations already in the 2016 federal budget can still be protected because savings are already legislated. But the official said the aim was to continue to reduce spending, and the IMF's fiscal program would require an agreement to cut 2016 budget spending by 13%. He said there would be "big cuts" in non-oil spending, in order to protect social services and programs. "They still have a spending package in the budget that is calibrated to oil prices to \$100 plus," said the official. "This is not the situation any more. Nobody sees oil prices coming back to that."

The official added that the IMF's main target is the non-oil primary balance because "oil revenue is too much out of control of authorities," i.e. is too subject to global oil price shifts.

**Analysis:** *This first target implies that arrears on oil investment could breach the ceiling set by the IMF – its messaging to the Gol, in line with the US', appears focused on maintaining the health of the oil sector at all costs.*

*While the IMF is focusing on non-oil revenues and expenditure, this actually represents a small portion of Iraq's spending. The admission that Iraq is essentially unable to control its oil revenues suggests that the IMF's fiscal program probably will not make sweeping changes to Iraq's spending. Iraq's public services are already in tatters, with healthcare and education having been especially badly hit by over a decade of severe instability – spending cuts are unlikely to improve their performance, and may be resented by ordinary Iraqis. It is worth noting that the IMF conditions for receiving loan monies are supported by other potential lenders, including the G7 and World Bank.*

**Next steps:** Before the agreement is presented to the IMF board to be put into action, the Gol must take three steps. First, the revised fiscal program has to be approved by the Iraqi cabinet and presented to parliament (this can be in writing if parliament isn't meeting). Second, the Gol must agree to curb wage exemptions so that tax on civil servants (non-military personnel) can be calculated. Third, the Finance Ministry needs to send revised spending plans to the ministries.

If this is implemented, and the official says senior Iraqi ministers are confident it will be, the IMF loan of \$5.4 billion can be approved around the end of June.

Approval of the IMF loan will likely trigger implementation of loans from other international lenders, including the G-7 and potentially JICA, said the official.

**Analysis:** *Although ministers may be confident of securing consensus on the IMF loan, Baghdad is still politically volatile. While there is every indication the loan will be finalized, it should not yet be taken for granted.*

**KRG:** Regarding the KRG receiving a share of the allocation, the official said, "We support the budget of the government," meaning the central government. "In the budget there is an oil sharing agreement. When we set the target, we assumed that at some point they (the Iraqi government) will implement the agreement with the KRG. During our mission, the ministry of planning of KRG participated in all of the meetings. The way we set our targets, we have included transfers to KRG. If when we check whether the targets are met, we are going to adjust the targets," said the official.

**Analysis:** *The implication appears to be that the extent to which the IMF is willing to go to ensure the KRG receives an allocation is hoping that the incentive posed by the available funds may be sufficient to get the KRG and Gol to adhere to the 2016 budget law (which calls for the KRG to turn 550,000 bpd over to SOMO at Ceyhan in exchange for 17% minus sovereign expenses from the monthly budgetary allocation). However, there are multiple reasons to be skeptical that either side is capable of adhering to the deal. The KRG has already committed cargoes as part of forward oil sales with a number of traders under terms that the Gol is unlikely to readily take on. The upshot is the KRG is unlikely to be able to commit 550,000 bpd to SOMO, even if it was inclined to do so. Meanwhile, the Gol has a poor track record – particularly in the low oil price environment – of adhering to the budget law when it comes to ministerial spending, instead operating on what effectively amounts to a "squeakiest wheel" policy. Given this track record, there is limited reason to think that the Gol would treat transfers to the KRG as sacrosanct.*

-- END --

**This bulletin will be included in the monthly Insider's View Report. The content herein is for the original recipient of this email, and should not be forwarded outside of the predetermined subscriber list.**

DISCLAIMER AND RESTRICTED USE: Insider's View report and Insider's View Bulletin emails (herein, collectively, the "Report" or "Reports") produced by the Company who registered and is using the domain iraqcustomresearch.com ("Company") reflect the analysis and opinions, not the advice, of Company. Reports, the copyright and all intellectual property rights of which are reserved exclusively to Company, are produced for the eyes only of Reports subscribers, and are for informational purposes only. The opinions and analysis reflected in Reports are based on information obtained from sources Company considers reliable, but Company neither guarantees nor represents the completeness or accuracy of such information, nor its analysis and opinions based thereon. Company's opinions and analysis do not constitute a warranty of future results. ALL INFORMATION IN A REPORT IS PROVIDED "AS IS" AND ALL IMPLIED WARRANTIES, INCLUDING WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE, ARE HEREBY DISCLAIMED. TO THE FULLEST EXTENT PERMITTED BY LAW COMPANY WILL NOT BE LIABLE FOR THE QUALITY, ACCURACY, COMPLETENESS, RELIABILITY OR TIMELINESS OF INFORMATION IN A REPORT, OR FOR DAMAGES OR COSTS OF ANY KIND AND NATURE WHICH MAY ARISE OUT OF THE AUTHORIZED OR UNAUTHORIZED USE OF ANY REPORT (INCLUDING BUT NOT LIMITED TO, LOST PROFITS OR OPPORTUNITIES THAT MAY RESULT FROM ANY INACCURACY OR INCOMPLETENESS OF INFORMATION IN A REPORT), WHETHER IN TORT, CONTRACT OR OTHERWISE. In no event shall Company's liability to any subscriber or third party exceed the amount paid by subscriber, if any, for the specific Report from which a claim may derive. Copyright to the content of all Reports is either owned by Company, or is licensed thereto. Reports are generated for the benefit of Report subscribers only; no Report content may be copied, reproduced, published, republished, uploaded, posted, displayed, transmitted, modified, used to prepare derivative works, distributed or redistributed in any way or in any medium whatsoever now known or later invented except pursuant to separate written authorization given by an officer of Company as to the specific content. In the event of a subscriber's breach of the immediately preceding provision, the subscriber shall: (i) indemnify, defend and hold harmless Company, its officers, directors, agents, shareholders and

representatives, from any and all claims (whether or not a lawsuit or formal claim is filed), damages and costs of any kind and nature, whether in tort, contract or otherwise, which are directly or indirectly related to the subscriber's breach, whether or not such breach was intended by the subscriber, and (ii) otherwise be liable to Company for all damages and losses Company may prove (which the subscriber agrees shall be, at a minimum, equal to the then-current fee typically charged by Company for a Report, multiplied by the number of unauthorized disclosures made, or other breaches, by the subscriber), plus all costs of collection, including actual attorney fees (whether or not a lawsuit or formal claim is filed). Subscriber's accessing the Reports, including pursuant to any free or reduced-cost trial period, constitutes its acceptance of these terms. Subscriber's access to the Reports, and any dispute arising out of or relating to the Reports, will be governed by the laws of the State in which Company filed its Articles of Incorporation in the U.S.A., irrespective of its conflicts of laws provisions. Subscriber, for itself and for any party attempting to make a claim through subscriber, irrevocably agrees that any dispute regarding the Reports or any services provided by Company shall be submitted to a court of competent jurisdiction selected by Company, provided however that Company may pursue injunctive relief in any court having jurisdiction for such actions. Subscriber, for itself and for any party attempting to make a claim through subscriber, further agrees to submit to the exclusive personal jurisdiction and venue of the federal and state courts selected by Company.

CONFIDENTIALITY NOTICE: This email and any attachments are confidential and intended solely for the use of the intended recipient. If you are not the intended recipient, please do not read, disclose, copy, or distribute this message or any attachment. Please notify the sender immediately by e-mail if you believe you received this e-mail in error; please delete this e-mail from your system, and please refrain from opening any attachment. Intended and unintended recipients of this email and any attachments are hereby notified that copying, disclosing, distributing or taking any action in reliance on the contents of this email, or any attachments, is strictly prohibited unless separate specific written authorization to do so is given by an officer of Company. Recipients of this email who copy, disclose, distribute or take action (or refrain from taking action) in reliance on the contents of this email or any attachments, or who cause or influence another party to so take action (or refrain from taking action), without such reliance being specifically authorized in writing by an officer of Company, shall indemnify, defend and hold harmless Company, its officers, directors, agents, shareholders and representatives, from any and all claims (whether or not a lawsuit or formal claim is filed), damages and costs of any kind and nature, whether in tort, contract or otherwise. The information in this email and any attachments is provided "as is" and all implied warranties, including warranties of merchantability and fitness for a particular purpose, are hereby disclaimed.