

of the budget transfer to the KRG. Arrears to the international oil companies were also accumulated. The deficit has been mostly financed by domestic borrowing from state-owned banks.

"The 2015 budget, assuming exports of 3.3 mbpd and a price of \$56 per barrel, includes increases in non-oil taxation and strives to contain spending, for example through compulsory savings on wages of civil servants. Nevertheless, due to the large fall in oil revenues, it still envisages a deficit of about 12 percent of GDP. Under more conservative oil revenue assumptions, and taking into account unbudgeted payments to international oil companies, the deficit may well reach much higher levels. To address this downside risk, the government is committed to under-execute budget spending as needed through rigorous cash management, the rationalization of capital investment, and the postponement of some investment projects.

"However, further fiscal consolidation through revenue and spending measures will be needed to contain the 2015 deficit to a level consistent with financing constraints, alleviate pressure on the domestic banking system and tighten domestic demand to contain the decline in international reserves. Consolidation measures should be permanent to underpin medium-term fiscal and external sustainability, which would be particularly important because of the weak oil price outlook.

"The foreign exchange market has remained stable in 2014 following steps taken by the CBI to liberalize it, and the parallel market spread had declined to 3.5 percent at the end of the year. However, the authorities should reconsider the caps on CBI foreign exchange sales and the collection of custom duties through commercial banks. These measures are effectively restricting the supply of foreign exchange to the Iraqi economy and have boosted the parallel market rates to record levels in the past weeks.

"Aware of the importance of the financial system for development of the private sector and growth, the authorities are pressing ahead with the restructuring of state-owned banks Rasheed and Rafidain. They are also taking steps to open government business to private banks, and introduce key elements of the financial system infrastructure, such as a deposit guarantee scheme and a credit bureau.

"Achieving inclusive and diversified economic growth over the medium term will also depend on a wide set of reforms, encompassing state-owned enterprises, the energy sector, and the labor markets, and improvements in the business environment and governance.

"The mission indicated that the IMF stands ready to support the Iraqi authorities through stepped up policy engagement, technical assistance, and, if needed, financial support.

"The mission met with Minister of Finance Hoshyar Zebari, Minister of Oil Adil Abdul Mehdi, Acting Governor of the Central Bank (CBI) of Iraq Ali Allaq and officers from the