

Central Bank of Iraq

Statistics & Research Dept.

Financial Stability Division

Summary: Annual Report on Financial Stability in Iraq for 2015

The Central bank of Iraq performs its regulatory, supervisory and control role on banks and intermediary financial institutions to maintain a financial system based on market competition, achieving domestic price stability, avail job opportunities, maintain low inflation rates, and ensure a smooth and active payment system, in addition the central bank compile and classify statistics in order to follow up developments in the banking system and the Iraqi economy for analytical and prudential purposes, the Central Bank also acts as the financial advisor to the government, apart from supporting and coordinating efforts for , anti-money laundry and combating terrorism financing, those activities aim at enhancing sustainable development and realizing prosperity in Iraq.

Accordingly, this report reviewed the most important developments occurring in the financial sector and its stability in Iraq during 2015 through two main objectives:

First: continue the supervisory control on banks and non- banking financial institutions aiming at early diagnoses of weaknesses in performance, risks and treat problems and violations faced.

Second: provide a remedial system that strives to contain different types of crisis and accelerate procedures to prevent their spread over the financial and banking fields.

The Central bank operates according to the legislative environment represented in the laws and regulations posted on the official website of the Central bank.

In order to maintain the soundness and solidity of the financial position of banks operating in Iraq, the Central Bank consistently used legal and standardized ratios.

We indicate below the most important indicators for financial stability for banks and the supportive institutions of the banking system operating in Iraq along with the related departments in the Central Bank of Iraq.

– The assets side in the balance sheet indicates how funds are being invested in assets in order to carry out the banks or companies operations; assets are divided into fixed and current (liquid) assets according to their use and nature; Where total assets recorded 222.9 trillion IQD at year end 2015 at a reduction rate of 1.7% compared with their stock of 226.8 trillion IQD for the year end 2014 which represent 115.8 of GDP.

State-owned banks assets stock continued to maintain its lead at a rate of 90% of total assets for all banks, for the relative importance of private banks amounted to 10% in 2015, also government assets stock dropped to 200.5 trillion IQD at a decline of 4 trillion IQD at a rate of decrease 2% compared with 2014 at a balance of 204.5 trillion IQD, whereas the

assets stock for private banks rose to 22.4 trillion IQD at a rate of increase 0.4% compared with 2014 at a balance of 22.3 trillion IQD.

Internal and external challenges facing banking institutions represented in legal procedures posed by monetary Authorities and the high competition among banks inside and outside, also the increase in doubtful debts amounting to 3,079.7 billion has represented a burden on financial stability of 2015, for the ratio of credit bottlenecks for governmental banks was 67.1% amounting to 2,067.5 billion IQD, whereas this ratio was 32.9% for private banks amounting to 1,012.2 billion IQD this led to increase the interest of banking activity towards assets management and work on enhancing their efficiency.

Monetary credit extended by banks achieved an increase of 7.9% in 2015 to reach 36.8 trillion IQD (including centrally funded credit) after being 34.1 trillion IQD in 2014, distributed at a rate of 38.9% for social services sector, 22.86% for building and construction sector, 14.27% for retail and wholesale sector, restaurants and hotels 6.3% for transportation, storage and communications, 2.22% for Water, Electricity and Gas, 3.61% for insurance and finance, 0.11% for Mining and External World, though this ratio is considered of little impact on the desired economic growth financing against big development projects that Iraq needs at the present and near future.

Investment stock of commercial banks for 2015 amounted to 13 trillion IQD distributed among Iraqi investment instruments at an amount of 10.1 trillion IQD and 2.9 trillion IQD for foreign investments which

contributed as a whole by 6.8% of GDP which is a small contribution of banks in the economic development of the country.

Iraqi Investments of government banks accounted for 90.7% of Iraqi government treasury bills and 9.3% for shares and other investments whereas private banks share were 76.1% of Iraqi government treasury bills and 23.9% shares and other investments , foreign investment amount was 2.9 trillion IQD for government banks and about 0.3 trillion IQD for private banks.

Deposits are considered the most important source of finance for banks their stock amounted to 64.3 trillion IQD at a rate of 28.9 % of total liabilities for 2015 against 74.1 trillion IQD in 2014 at a decrease of 9.7 trillion IQD at a rate of 13.3%.

The total stock of current deposits with all banks amounted to 46.3 trillion IQD of which 39.6 trillion IQD with government banks 6.7 trillion IQD with private banks, saving deposits amounted to 9.6 trillion IQD, of which 7.7 trillion IQD with government banks and 1.9 trillion IQD with private banks, whereas fixed deposits stock amounted to 8.4 trillion IQD of which 7.8 trillion IQD with government banks and 556.9 billion IQD with private banks.

Although fixed and saving interest rates rose for periods of one to two or more than two years in both Iraqi and foreign currency during 2015 compared with 2014, but there was deterioration in the economic situation of the country due to Daesh control over western governorates along with Mousel and Deyala, the decrease in oil prices, the increased

number of withdrawal of public deposits, high citizens migration abroad, the decreased number of bank branches to reach 840 branch in different Iraqi governorates a decrease of 194 bank branch of 2014 which amounted to 1034, the matter that led to decrease in the monetary bloc to 65.4 trillion at year end 2015 compared with the monetary bloc of amounting to 72.7 trillion IQD at year end 2014 in addition to the reduction in dollar sales for the central bank of Iraq for different economic purposes local and external to 44.3 billion USD by a reduction of 10.2 billion USD compared with 2014, government deposits continued to maintain its first rank at a rate of 63.3% of total deposits, whereas private sector deposits amounted to 36.7% for 2015.

Although capital adequacy ratio declined with both Raffidain & Rashid banks amounting to 4 %–11% respectively, this ratio was high with private banks between 15%–536% but the high ratio of deposits stock with government banks indicates how confident the public are in those banks ,because they are 100% guaranteed by the government.

Private sector deposits (with both governmental and private banks) accounted for 10.3% of GDP as in year end 2015 which amount to 19.9 trillion IQD which indicates the continued weakness of financial depth which does not help in building a strong and solid financial sector. Banks capital grew in Iraq from 9.1 trillion IQD in 2014 to 10.1 trillion IQD in 2015 rising for the comparison period at an amount of 1 trillion IQD recording a ratio of 5.2% of GDP, but this increase is considered slight against big development projects , Raffidain bank capital did not reach 400 billion IQD , Rashid Bank to 300 billion IQD and specialized

banks to 200 billion IQD implementing the economic committee resolution in its letter No.341 dated 31/3/2008, where Raffidain bank capital is still 126 billion IQD , Rashid Bank 50 billion IQD, and specialized banks 325 billion IQD, whereas 3 private banks continued to increase their capital to reach the minimum of 250 billion IQD, so the number of banks became 26 at year end 2015 most of which have met the minimum capital requirement prescribed by the Central bank of Iraq whereas 27 banks failed to achieve the required increase due to the inability of some banks to implement CBI circulation concerning the increase in their capital according to the related directives issued by the Central bank of Iraq, so this increase represent the first pillar of Basel II pillars.

Total (private banks) capital ratio and market value of their traded stocks in Iraq securities market to GDP, amounted to (2.8%)¹ , (1.8%)*respectively, this ratio is still low, those indicators show the deep financial weakness of the Iraqi banking system.

Joint – stock banks capital ratio (private banks) to GDP 4.1% which represent a low ratio, whereas this ratio amounted to 1.1% for governmental banks which is most minimal when compared with private banks ratio; that is a total ratio of banks' capital 5.2% of GDP for 2015 CBI struggles to raise this ratio and develop the banking system contribution in GDP components.

Iraqi Securities Market Annual report 2015 (p.77, p.78) issued by Iraq Stock Exchange ¹

With respect to capital adequacy ratio with governmental banks especially Raffidain bank, the ratio is less than 12% where it amounted to 60% in most of the private banks due to the reservation of the latter from granting credit which resulted high liquidity exceeding the standardized ratio of 30%, this refers to the existence of disabled financial resources with no safe and sound credit and investment opportunities .Accordingly government banks, are considered licensed banking institutions by granting credit according to the standardized ratios mentioned above and exposed to moral hazards.

2015 witnessed, the establishment of the first Islamic government bank in Iraq coinciding with the issuance of Islamic banks Law No. 43 of 2015.

The structure of the Islamic banking system in Iraq consist of one government bank which is Al Nahrain Islamic Bank with 8 private banks in addition to two banks Arab and foreign, whereas total Islamic bank branches operating in Iraq amounted to 94 branch at year end 2015distributed as 31 branch in Badghdad,63branch in Governorates , and Islamic bank branches were distributed as 4 branches of state – owned banks ,86 private bank branches and 4 Arab and foreign bank branches .

The Central Bank hoped through foreign partnerships, that banks that made partnerships would use technical and modern banking systems such as issue credit cards , use automated cash Machines , points of sale and develop other payment means, but partnership banks activities are still limited in this field and does not meet the level of ambition, also

their partnership with Iraqi banks capitals is still simple and does not correspond to the efforts and expectations of the CBI desired out of these partnerships in order to develop the Iraqi Banking Sector.

The entry of Foreign Banks with the operating Iraqi banks now came to meet the country's needs of Banking Institutions to cover all parts of Iraq after a study prepared in this Department indicated that banking intensity in 2007 amounted to one bank for each (75000) person and improved in 2013 to be one bank for each (32000) person at a rate of improvement of (50%) due to the increasing number of branches opened by all banks, including foreign bank partnership, noting that the standard intensity is (one bank branch) for (10000) person.

In a step to catch up with the global technology developments, the private banks after 2003 including participating banks introduced professional banking system in their work such as (BANKS) system, (ORIENT) system as well as (SWIFT) system, (Western Union) system to ensure the confidentiality of the transfer and to avoid global hacking. In addition Banks participated in the unified system which is Automated Clearing House (ACH) for checks settlement in order to serve business sector as well as Automated Teller Machine (ATM) & Points-of -Sale (POS).

Monetary Policy is concerned with efficiency & safety of those systems in addition to their role as a user of payment system to settle open market operations or buying & selling operations of government bonds & treasury bills or any other payment operations.

Iraq owns one of the most advanced electronic payment systems in the world and is responsible for exchange of payment orders among banks electronically via an efficient and secure network. The Central Bank of Iraq (CBI) is the dominating party & operational manager of the system, as the owner of the system, CBI manages settlement accounts of the participants to ensure the safety and efficiency of payment systems and clearing operations. The CBI aims to reduce the use of cash in the country.

In this context the Central Bank of Iraq undertakes the formulation of policies, setting standards and on-site surveillance for payment and settlement systems, perform assessing instruction and regulations implementation operations and organize payment and settlement systems and supervise them (whether state-owned or managed by the central bank or by another party), also the central bank adopted clear performance measuring indicators and is working on developing quantitative statistical reports on clearing and settlement systems.

The Central bank of Iraq achieved through the Iraqi payment Department during 2015 the following achievements:

First: Retail payment project (IRPSI)

1-finalizing examination and testing operation for the system of Iraqi retail payment project with the cooperation of the technical staff from BPC company executing the project and work on solving problems in order to start with the final testing and examination operation in preparation for the actual execution of the project.

2- Two companies (both Taif and Iraqi for financial transfer) were licensed to participate in the retail payment project and issue prepaid cards ,also two companies were licensed (Asia Hawala and Iraq Mahfazat)to work as payment service providers through the mobile phone .

3-start integration testing with both Baghdad bank and the Iraqi Company.

4- Completion of preparation and connection operations of data production and crisis recovery center in Basrah.

5- Set time schedules to work with banks (commercial, International Development, Middle east, Elaf, Gulf ,Ahli and Credit bank) weith number of Lebanese banks to initialize their connection with the National Switch.

6-Activate bank branches in the updated electronic clearing system(C-ACH) on the onset of the actual operation of the system .

7- add 14 bank branch to the electronic clearing system(C-ACH) so the total number becomes 643 bank branch.

The Central bank of Iraq continued to monitor the determined ratios and standards to reduce potential risks on the CBI foreign reserves through the annual, quarterly, monthly weekly observance to the developments in the international financial markets and the changes of exchange rates, gold, oil, international interest rates and stock market indicators, also the

extent of influence those changes have on the market value of foreign reserves and their deviation of the acknowledged limits and standards in the guidelines of investment and exchange rates risks with other market risks in addition to monitoring concentrations in the geographical location of those reserves.

In the area of monitoring interest rates and their effect on the market value of the bonds invested by the central bank of Iraq , the central bank ,through the investment department , observed and clarified the period limits and the adjusted period of investment portfolio ,compared with what was determined in the investment guidelines to identify the deviation of those limits.

Based on the cooperation and information exchange principal between the central bank and other governmental institutions to transact with foreign banks and mitigate credit risks , the central bank of Iraq provided those institutions with the credit ratings of foreign banks which was prepared by acknowledged international ratings agencies S&P, Moody's and Fitch .

In recent years ,Iraq has given an increasing importance to the development and improvement of financial market by preparing and reforming legal environment ,Capital movement liberation , the implementation of disclosure and transparency principal , and according to the role played by this market in mobilizing savings and channeling it to available investment areas , provide financing and different services that help in developing financial market in particular and national

economy in general . The financial market includes the following institutions:

- 1–Banks and their branches
- 2– Iraq Stock Exchange
- 3– Association of Iraqi private Banks
- 4– Iraqi Insurance companies both governmental and private
- 5– Postal saving Fund
- 6–Intermedaition companies for buying and selling foreign currencies (Exchange Companies)
- 7–Financial transfer Companies
- 8– Intermediation Companies for buying & selling securities
- 9– Financial Investment Companies
- 10– Pension Funds
- 11–there are smaller size institutions includes Al Zakat Fund , Minority Care Fund and Iraqi company for currency transfer
- 12– Iraqi Company for Small & Medium Loans, the Iraqi Company for Bank Guarantees, and this company guarantees loans extended by the Iraqi Company.
- 13– Iraq Depositary Center
- 14– Global Smart Card Company

15– Electronic Banking Funds Services Company

16– Iraqi Center for banking and financial consultations

17–Banking Training Center in the Commercial Gulf Bank

The Central bank of Iraq developed the Anti–Money Laundry reporting office in order to promote a practical reality to the level of sophistication in the Arab peer neighboring countries through:

–the issuance of the administrative order No.6263/10/3260 dated 2/12/2014 related to granting the office the financial and administrative independence according to which the office gained the CBI board of Directors approval to allocate a budget from the central bank of Iraq budget also allocate an independent location for the office, addressing it officially in addition to administering the employees files by this office.

In the area of implementing Anti Money Laundry Law No.93 of 2004 The Central Bank of Iraq through the Anti– Money Laundry Reporting Office, addressed letters and circulations to Banks and financial Companies urging them to comply with all instructions issued from this Bank according to its Law No.65 of 2004 and submit a bimonthly analytical statements concerning transfers operations.