

Iraq's Rock-Steady Currency

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Central bank builds confidence in the dinar by intervening to maintain the exchange rate.

If Iraqis have one solid economic achievement to hold on to amid their many problems, it is the strength of their currency, which some feared would be devalued out of existence in the months that followed the fall of Saddam Hussein in March 2003.

The dinar's current nominal value of 1,465 to the benchmark US dollar is virtually unchanged from January 2004, when the introduction of new banknotes to replace the Saddam-era denominations was completed.

Sadoon Hamoud Kathir, professor of economics and administration at the University of Baghdad, attributes this remarkable level of stability to sound government policies – specifically the transformation of the Central Bank of Iraq, CBI, into an independent body, which took place at the same time the new banknotes were issued.

“The most important move the cabinet made was to separate the authority responsible for monetary emission from the government and to make it independent,” said Kathir.

Under Saddam Hussein, the CBI was simply an arm of the executive authority, churning out more banknotes or extending unlimited credit to the government whenever the latter needed money.

The dinar, too, enjoyed less and less credibility because of Saddam's policy of printing it like Monopoly money coupled with hyperinflation in the economy. An added problem for Iraq's post-Saddam administrators was that the Kurdish region, which was effectively autonomous from the rest of Iraq after 1991, had been using its own separate version of the dinar.

With the change to new banknotes, which took place between October 2004 and January 2004, the government had to put its own house in order and start making the bulk of domestic expenditure in dinars rather than US dollars.

Establishing a stable currency was central to creating confidence in the CBI as an independent and credible institution, and remains so.

“The CBI's goal is to restore the stability of the Iraqi dinar against other currencies,” said an official from the bank speaking on condition of anonymity.

In theory, the exchange rate is free floating, dependent on supply and demand on the foreign currency market. But as Firas Jabbar, a financial analyst with the Romata Investment Company, explained, dinar stability has been achieved through some robust intervention by the CBI, buying and selling dollars to keep the rate steady.

Jabbar has confidence both in this proactive approach to monetary policy and in the stability of the Iraqi money market.

“I'm very optimistic about the current situation,” he said. “And I have confidence in the economic policy of the new government.”

Apart from the fact that Iraqis are generally comfortable using their national currency because they can reasonably assume the exchange rate is not going to suddenly rocket out of control, dinar stability brings other economic benefits.

Businessmen are happy because the price they pay for imported goods remains steady. As Ali Hussein, who sells footwear wholesale to traders at the al-Shorja market in Baghdad, says he does well out of exchange-rate stability.

“The current exchange rate is OK compared with Iraqis' income,” he said. “In the coming period, I expect the currency to appreciate to 1,000 dinars to the dollar.”

Hussein's optimism about the dinar's potential to appreciate in value is shared by economist Kathir, who said if the government continues to pursue prudent policies, the exchange rate could shift to 500 dinars to the dollar.

But it is important to note that such nominal values are less important as a measure than the real exchange rate, which takes price rises into account. Dinar stability against the dollar will mean little to consumers if inflation makes shop prices unaffordable.

Curbing inflation, therefore, remains a central plank of monetary policy. In May, CBI governor Sinan al-Shabibi was quoted by Reuters as forecasting that the inflation rate, estimated at 30 per cent in 2004, could fall to 20 per cent this year. The CBI currently estimates annual inflation at around 17 per cent.

Mustafa al-Azawi, who describes himself as an average consumer, said currency stability was unimportant because inflation still made things costly.

“Although the dinar has appreciated [since 1993], everything is still expensive,” he said.

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