

THE ROLE OF MONETARY POLICY IN CONTROLLING INFLATION RATES IN LIGHT OF THE DECLINE IN THE VALUE OF THE IRAQI DINAR

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Abstract

Inflation represents a fundamental problem in various developing and developed countries, as it negatively affects all macro variables of the economy, as these countries always seek to control its rates within moderate limits with which the economy can coexist and develop. In this aspect, the monetary administration in Iraq sought independence by... Law 56 of 2004, and its use of modern monetary tools as a currency selling window, is one of the primary and most appropriate methods in achieving stability in the general level of prices by achieving stability in the exchange rate of the local currency, especially in light of the economic conditions prevailing in the Iraqi economy, but the problem lies in its own recent decisions. By adjusting the value of the local currency towards the dollar, which created a state of increasing price levels, it came once again to use its tools to control it. The research concluded that the monetary policy followed by the Central Bank with its various tools contributed significantly to improving the currency's value and reducing inflation rates in the country.

Keywords: Monetary policy, inflation, exchange rate, monetary policy and its effect on inflation.

Introduction

Inflation is regarded as one of the world's most challenging economic issues for many developed and developing nations Due to its detrimental effects on overall economic activity. Global economies struggle immensely to keep inflation rates within reasonable and acceptable bounds by international standards, particularly in Its aggravating factors have kept becoming worse, which are first and foremost represented by the spending policy and, second, by the exchange rates in developing nations that have a single peg (in the dollar), such as Iraq. The decline in the value of the Iraqi dinar and the ambiguity surrounding the monetary policy's assessment significantly contribute to the rising inflation rates, which impact economic activity. Monetary stability in the economy, particularly because of the production system's limited flexibility and the prevalent lack of financial discipline, leads to a rise in the money supply and higher consumption levels. Because the economy cannot keep up with this growth, aggregate demand will be represented in higher inflation and import levels. The rise in the value of Iraq's imports and consequently the rise in prices and inflation rates can be attributed to the change in exchange rates, given the monetary authority's attempts to sterilize the monetary mass and maintain stable exchange rate levels by defending it during the window for selling foreign currency.

Research problem

The Iraqi economy suffers from the ambiguity of monetary policy in light of the change of administrations, which was directly reflected in the value of the local currency and then its impact on inflation levels, not to mention the effects of international regulatory authorities on the financial sector and reform attempts that led to a decline in the value of the dinar in light of Iraq's dependence on imports, which made it Those concerned with monetary policy are following a series of measures to control inflation rates.

Research hypothesis

The research is based on the hypothesis that “monetary policy, through its tools, has a significant influence on controlling inflation levels.”

Research aims

The research aims to achieve the following objectives:

- 1 - Study and analyze the reality of the inflation rate in the Iraqi economy
- 2- Analyzing the development of currency value changes and their repercussions in Iraq
- 3 - Explain the role of monetary policy in controlling inflation rates

Research Methodology

The researcher combined inductive and deductive analysis methods to achieve the research's goals and prove or disprove his hypothesis. First, he tracked the development of the data under study to analyze its effects and extrapolate the economic reality. Next, he used the available economic tools to deduce the effects and results to reach specific conclusions.

Monetary policy

Monetary policy is one of the macroeconomic policies established and implemented by the monetary authority, represented by the central bank, and through the banking system and in coordination with the financial system, whose institutions (the stock market, insurance companies, investment banks... and others) play an important role in monetary policy, as No matter how wide or narrow the definitions of monetary policy vary, they revolve in one context, represented by the money supply (Al-aqaili 2022: 22), so it is defined as “all the procedures, rules, measures and tools adopted by the monetary authority to influence the money supply, interest rates and the volume of credit to achieve economic goals.” “as price stability and full employment” (Hubbard & Glenn, 2013: 456). The economist Mishkin also defined it as “the art of managing the money supply and interest rates” (Mishkin, 2004: 12).

It is clear from the above that the monetary authority seeks to achieve many goals through the use of specific tools, and for it to be able to achieve those goals, there must be a channel transmitting the impact of the use of tools in achieving the goals, and therefore we can explain the mechanism of monetary policy in the figure (1).

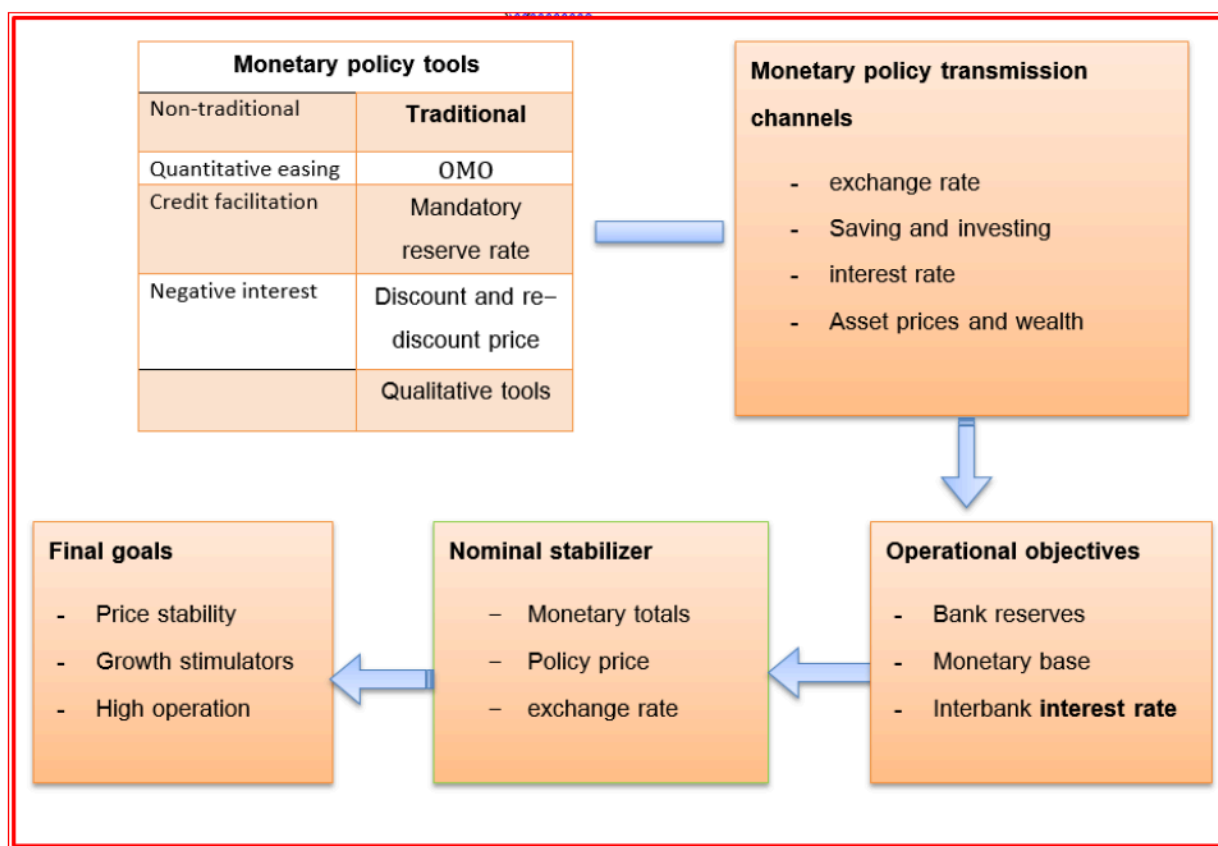


Figure (1) How monetary policy works

Source : Barbara Casu, Claudia Girardone and Philip Molyneux: INTRODUCTION TO BANKING , prentice Hall, Financial Times ,England, 2006, p 117 .

Inflation and the theories explaining it

Because inflation has a detrimental impact on economic activity, it poses a persistent challenge to the economies of most industrialised and emerging nations. Economists disagree on the meaning of inflation despite the phrase being widely used. Some think that inflation results from an increase in the money supply by a more significant percentage than the supply of commodities, which raises prices overall. Others think that inflation results from increased government spending that isn't accompanied by increased production. Still, others think that inflation results from rising production costs. Still, others think that inflation results from structural changes that take place. The economy must be accompanied by a rise in the general level of prices (Al-Assaf and Al-Wadi, 2009: 179).

According to the information above, inflation is the phenomenon of a persistent increase in the general level of prices over a considerable amount of time, along with a persistent decrease in the value of money or the monetary unit's purchasing power in exchange for the creation of goods and services (Al-aqaili, 2018: 19).

It may be the result of Demand-Pull Inflation, that is, the growth of aggregate demand at a faster pace than aggregate supply occurs when the economy approaches its maximum capacity,

affecting the price level at a rate higher than its effect on the production level. The classic confirms that demand inflation occurs due to the rapid increase in the money supply or Push Inflation. Cost: This occurs when a supply shock occurs, a decrease or disturbance in the total supply resulting from the deterioration of external or uncontrolled variables, such as a shortage or increase in the prices of imported production inputs or a deterioration in climatic conditions, causing an increase in the level of costs.

The inflation problem has gained the attention of many economists, to the point that it has become one of the topics of intellectual debate in economic theory. This results from the multiple interpretations that economic schools have developed throughout history. Some attribute the problem of inflation to the imbalance between the supply of money and its demand, and some attribute the reason. Inflation is attributed to the imbalance between aggregate demand and aggregate supply, and some attribute it to imbalances in the structure of the capitalist system. In explaining the inflation problem, the classical analysis was based on the quantity of money in the economy, relying on Fisher's equation of exchange. The classical belief is that inflation is a monetary phenomenon caused by an increase in the money supply in the economy (Shendi, 2010: 55-56).

As for the Keynesian analysis, in explaining the inflation problem, it was based on the imbalance between aggregate demand and aggregate supply, indicating the incorrectness of the classical assumption regarding the exchange equation and that it is only valid in the case of total use. Based on this, Keynes distinguished between two cases to explain the inflation problem. The first case is before full employment (the economy in the short term), which is represented by the presence of unemployed workers and unutilized productive capacities, so the increase in aggregate demand will not lead to an increase in the general level of prices, but instead what happens is an increase in aggregate supply, by The way to increase production, and then sales, which prompts producers to increase their demand for production factors to keep pace with the increase in aggregate demand, which leads to an increase in their prices, so inflationary pressures begin to appear as a result, and this means that Keynes did not believe in the neutrality of money in the short term. (Keynes, 2010: 332).

As for the second case, it is the case when the economy reaches the level of full employment (the economy in the long run), and here Keynes agrees with the classics in explaining the problem of inflation, and accepting their assumption about the neutrality of money on economic activity, so the increase in aggregate demand leads directly to an increase in the general level of prices. Due to the failure of the aggregate supply (because the economy is at the level of full employment) to the increase in the aggregate demand (Rajab, 2011: 118).

Supporters of Keynes' theory believe that restrictive fiscal and monetary policy can reduce inflation rates, but they also believe that it will take a very long time to perform its role successfully and that employment and output will be below their long-run equilibrium levels during this period. They conclude that reducing inflation through the use of... Flexible fiscal and monetary policy is costly, and because of the high costs associated with reducing inflation through restrictive fiscal and monetary policy, many, if not most, Keynesians support the use of other policies that are combined with less expansive fiscal and monetary policies, such as the price-wage rationalization programs that were implemented in the United States. The American

government during the Carter era is part of an attempt to achieve a lower inflation rate and reduce the costs associated with the use of flexible fiscal and monetary policy alone, as well as wage and price control programs and various programs that work through the tax system to support price and wage stability (Michael, 1999:425).

While the monetarist school confirmed that there is no long-term relationship between inflation and unemployment, as there is no connection between the average unemployment rate and the average wage rate, inflation is a monetary phenomenon that has no connection to the stability of wages and trade unions, and its main reason is the increase in the quantity of money more quickly than the increase in production, as The main variable that should be taken into account to understand price changes is the quantity of money per unit of production and not the total quantity of money (AL-aqaili, 2018: 21).

As a result, money can affect both production and prices in the short run, but within a few years, as the economy tends to operate close to the full employment level, the main impact of money is on the price level. On the other hand, fiscal policy slightly affects both production and prices. In the short and long term, this is the essence of monetary thought. More precisely, if fiscal policy is not accompanied by a change in the money supply, it will be ineffective, at least in the long term.

Another opinion also appeared in explaining the problem of inflation, represented by the view of the structural school led by John Kenneth Calbraith (J.K. Galbraith), which attributes the problem of inflation to the structural imbalances that occur in the structure of the capitalist system. The structural imbalance means the presence of sectors that are more developed than other sectors, that is, there is a developed sector. (Industry, for example), and another backward (agriculture, for example). This leads to high wages and profits in the developed sector, which is reflected in increased demand for goods and services (for workers) and increased demand for factors of production (for producers) to achieve the maximum possible profit, which It leads to a rise in prices in this sector, while wages, profits, and prices remain low in the backward sector. Therefore, the development of one sector and the backwardness of the other creates different prices between them, and this is called structural inflation (Kanaan, 2011: 253).

Historical development of inflation rates in Iraq after 2003

Many of Iraq's economic infrastructures were disrupted during the government change, and the country's prices steadily increased throughout the early years of the transition. There were two instances of rising inflation in the nation: the first saw rates that rose from 2004 and 2007; the second saw rates fall till... All years were ranked as one, with the exception of 2008, which was represented by the period (2008-2020).

Table (1) makes this evident: from approximately (10,148,626) million dinars in 2004 to about (103,353,556) million dinars in 2020, the money supply has grown at a positive growth rate. This is a result of the security situation getting worse and the Iraqi economy becoming more accessible to the outside world following the removal of the economic blockade. Imports rose in tandem with the shift in the structure of domestic demand brought about by the better living conditions of Iraqi families, the rise in the marginal propensity for consumer spending, and the end of production of many regional industrial and agricultural goods, It caused the food index to

increase, which in turn caused all of this. From around 36.4% in 2004 to roughly 76.4% in 2006, the consumer price index increased. In 2006, the annual inflation rate hit 53.1%, which is thought to be the greatest amount of inflation during this time. While preserving price stability was the Central Bank's primary purpose, as indicated by Law No. 56 of 2004 enacted by the Coalition Provisional Authority, the Central Bank's authority was restricted from 2004 to 2007.

In contrast, we observe a decrease in the annual inflation rate in the second case, which peaked at 12.7% in 2008. This was attributed to the Central Bank's policy, which helped to strengthen the Iraqi dinar's exchange rate against the US dollar. The inflation rate decline persisted until the end of the study period, reaching (0.6%) in 2020. The effectiveness of monetary policy in aiming for the stability of the overall level of prices—one of its main objectives—through the currency sale window is shown in the decline in yearly inflation rates.

Table (1) The development of inflation rates and money supply in the Iraqi economy for the period (2004-2020)

Years	cpi	inflation	msl	G%
2004	36,4	-	10148626	-
2005	49,9	37,1	11399125	12,3
2006	76,4	53,1	15460060	35,6
2007	100,0	30,9	21721167	40,5
2008	112,7	12,7	28189934	29,8
2009	122,1	8,3	37300030	32,3
2010	125,1	2,5	51743489	38,7
2011	132,1	5,6	62473929	20,7
2012	140,1	6,1	63738571	2,02
2013	142,7	1,9	73885000	15,9
2014	145,9	2,2	72692448	-1,6
2015	148	1,4	65435435	-9,9
2016	148,7	0,5	75523952	15.4
2017	149,1	0,2	76986584	1.9
2018	149,7	0,4	77828984	1.1
2019	148.7	0.2	86771000	11.5
2020	149.6	0.6	103353556	19.1

Source: Central Bank of Iraq, official statistical website.

Decrease in the value of the dinar and high inflation rates

Since the introduction of the first Iraqi currency in 1931, the country has adopted a fixed exchange system for its monetary policy, which it stuck to until 2003, despite changes in the international monetary system and the Iraqi economy. The true challenge to the façade of exchange rate stability emerged in the 1990s, when the United Nations Council imposed an economic blockade on Iraq in the wake of its war with Kuwait, which stopped the flow of foreign reserves into the nation as a result of the sanctions being lifted. The government was forced to finance its fiscal deficit by adhering to a policy of deficit financing as a result of the increase in public spending to rebuild what the war had destroyed and the decrease in public revenues. This

led to the new monetary issuance policy (deficit financing) being linked with the fiscal deficit, which in turn caused the size of the monetary supply to grow at rates GDP growth was first reflected in an increase in the general level of prices, which was followed by an increase in inflation rates; however, following the events of 2003 and the Central Bank's independence under Law No. 56 of 2004, which marked a significant and radical change in monetary policy, this coincided with the return of oil exports after... removing the economic embargo on it and introducing a new national currency that complies with international standards. The currency selling window, formerly known as an auction, was introduced by the Central Bank as a means of maintaining exchange rate stability. It aided in bringing the value of the local currency into stability. Additionally, the Central Bank had responsibility for securing the foreign exchange supply. currency in a way that pays for import duties on products and services, meets domestic demand for foreign currency, and removes excess local currency to preserve its value. This is accomplished by purchasing and selling foreign money through the currency sale window.

Based on the fact that the exchange rate represents the variable that has the greatest impact on macroeconomic variables such as inflation, real wages, imports, and exports, its value plays a decisive role in achieving monetary stability. The Central Bank of Iraq's adoption of a fixed exchange rate of 1,200 dinars per US dollar has contributed significantly to achieving monetary stability for many years, but there are repeated calls to reconsider the current rate, and this requires evaluating the fixation price to show the extent of its impact on price stability and the trade balance.

Economic discussions in general, and monetary policies in particular, are characterized by the fact that all the viewpoints put forward are correct in theory, but the difference in that is the factor of timing and priority. The correct theory does not necessarily mean that it is appropriate, and that any theory and any correct theory seems to be... Suitable temporal and spatial conditions, while they may not be suitable for application in other different temporal and spatial conditions, and whoever becomes the timing and priority factors next to them, will become correct and appropriate. In the end, what is correct and appropriate, and not just correct, will prevail, just as the angle from which it is viewed differs. The value of the dinar's exchange rate and its role in the economy has led to repeated controversy with every crisis, as monetary policy makers view the exchange rate as the decisive factor in achieving price stability, and that this stability in itself is considered an exceptional advantage enjoyed by the Iraqi economy that enables the Central Bank to achieve it. He believes that other active institutions must seize the advantage of price stability to achieve economic growth and take economic and administrative measures in important sectors to enhance the advantage of price stability, while opponents see fixing at the current value as an exaggerated value that has led to transforming Iraq into a swamp for foreign goods and thus a tendency to... The cost of imports, which discouraged local industries that could replace imported goods.

Therefore, changing the exchange rate followed in that window will have two effects: financial, represented by a change in dinar government revenues, and monetary, represented by a change in price levels, and then inflation rates.

Reducing the dinar exchange rate helps increase government revenues from the dinar, and thus enables it to cover or reduce the financial deficit in its budget (if any), as well as reducing

consumerism in the economy, due to the high prices of imported goods, especially since the economy is very dependent on it. On imports to cover this volume of total demand on the one hand, increasing the ability of some local products to compete as well as the possibility of increasing that production on the other hand, as lowering the dinar exchange rate represents an implicit tax borne by the poor segments of society before the rich ones, while it is difficult to change that. The price is rising in the absence of a budget deficit and the stability of price levels, so what is the point of changing it? Although such a measure was adopted in light of consultations between decision-makers for the two policies (financial and monetary), it was not and will not be the ideal solution and the ideal tool for achieving consistency between the two policies above, and this is what was observed in the reality of the Iraqi economy at the end of 2020 after the reduction of the dinar exchange rate. Sold to the Ministry of Finance to 1,450 dinars/dollar after it was 1,182 dinars/dollar before the reduction, and despite the observations on some government roles that were exercised on the independence of the Central Bank, which pushed the Iraqi economy into the furnace of stagflation and increased rates of poverty and famine in the country, The central bank's ability to control price levels was weak, as inflation rates rose to four times what they were a few months before the reduction, as the inflation rate at the beginning of 2020 reached approximately (0.9%), and as a result of the reduction in the dinar's exchange rate, the inflation rate rose to reach approximately (5.4%). At the end of the first half of 2021, reaching 7.5% at the end of 2023, in addition to the widening of the gap between the official and market rates of local exchange, as there is nothing worse than the dominance of these two rates in the economy, which resulted in the loss of the credibility of the monetary policy that It has worked hard for a long time to establish its foundations, in addition to the fact that it will soon lose the tool of expectations that is the essence of this policy. It is clear from the table (2) how wide the exchange gap in the economy is.

Table (2) The exchange rate gap in Iraq for the period 2020-2022

Years		market exchange rate	Window exchange rate	exchange gap
2020	Q1	1197.7	1182	15.66667
	Q2	1232	1182	50
	Q3	1224.7	1182	42.66667
	Q4	1280	1182	98
2021	Q1	1470	1460	10
	Q2	1607	1460	147
	Q3	1652	1460	192
	Q4	1704	1460	244
2022	Q1	1610	1319	291
	Q2	1523	1310	213
	Q3	1512	1310	202
	Q4	1498	1310	188

Source: Central Bank of Iraq, official statistical website

Monetary policy measures to control inflation

The Central Bank of Iraq exercises a crucial role in managing inflation in Iraq. As the country's monetary authority, it is responsible for implementing monetary policies that help maintain price stability and promote economic growth. It sets monetary policy, monitors inflation, regulates the banking sector, manages foreign exchange reserves, and promotes financial inclusion. However, the central bank faces many challenges in carrying out this role. These include the volatile political and security situation in the country, the economy's dependence on oil exports, and limited financial infrastructure. Despite the challenges it faces, the central bank works to maintain price stability and support... Economic growth in Iraq. The Central Bank's measures to reduce inflation can be stated as follows:

1 - After the exchange market witnessed a significant rise in the value of the dollar, especially after the US Federal Bank imposed restrictions and placed precise requirements in front of outlets selling the dollar in the foreign currency auction at the Central Bank of Iraq to control its smuggling operations to neighboring countries, the exchange rate in Iraq rose from 1470 dinars. For one dollar, it reached approximately 1600 dinars and sometimes increased, amid fears of new jumps in light of the government's inability to force it to retreat. Especially with the inability of the Central Bank administration to control inflation, which led to a change in that administration at the beginning of 2023, which took it upon itself to work to improve the value of the dinar, officially, by adjusting its value and setting its price at 1320 dinars per dollar.

2 - Monetary policy sought to use its previously mentioned tools to control inflation by beginning to use the foreign currency selling window more widely, financing foreign trade for real traders while providing the necessary incentives to use documentary credits instead of bank transfers to cover imports at a lower exchange rate and a limit of (1305) dinars per each. dollars, which motivates importers to use these credits.

3 - Restructuring the financial sector in general, by raising the capital ceilings for banks from 250 billion to 400 billion dinars, while giving the banks a period of time until the end of 2024. Banks can increase the capital in the form of three payments, provided that each payment is not less than 50 billion, in addition to Increasing the operating capital of foreign bank branches by no less than (60%) of the operating capital within a maximum period of 12/31/2024. In the event of failure to comply with this, the banks must merge, or the regulatory authority must use its authority to acquire or liquidate those banks. Not to mention the decision to merge C-class exchange companies as well.

4 - Full compliance with the instructions of the US Federal Reserve, the regulations for combating money laundering and terrorist financing, and the provisions of the Central Bank's supervision of banks, through the electronic platform, which at the beginning of its work witnessed many difficulties that led to the reluctance of some to enter into it, while the implementation rate in the electronic platform developed and rose from 20% to 95%, and this gave reassurance that entering the platform provides speed and security, in addition to that entering the electronic platform in the external transfer process spares all parties from the risks of being exposed to local and international sanctions, with increased supervision on some merchants who are unable to work in an organized atmosphere, enter the platform and take measures. legal rights against them, and that the Central Bank is attempting to combat this issue

in tandem with the government to encircle these groups that are being identified and monitored; additionally, the Central Bank's dollar sales, of which 90% are for remittance and external transfer purposes, are going ahead without a hitch and at the official rate; however, the issue is with the monetary component. This amounts to 10% of daily internal sales since it is adequate to cover passengers' demands. However, some are attempting to gain control by taking money away from travelers, which puts pressure on the system and raises the price of cash, and these parties have been identified and the government is working to repel them and follow legal procedures against them.

5 - Raising the policy price levels to 7.5% instead of 4%, in addition to raising the mandatory reserve ratio from (15%) to (18%) in a step towards withdrawing the monetary mass from the market in accordance with its need, which generates a state of stability in price levels and then reduces Inflation rates.

6 - Expanding the use of financial inclusion, as the Central Bank worked to enhance financial inclusion in Iraq. It has launched initiatives to increase access to financial services, such as mobile banking, microfinance, and the use of electronic payment tools. This reduces the levels of money supply in the economy and thus price rates, leading to moderate rates of inflation.

7 - This bank seeks to develop the interbank trading market with the aim of enhancing the process of transmission of the impact of monetary policy. The ongoing banking reforms and the development of the electronic payment system in coordination with the Iraqi government are among the basic requirements for providing support to revitalize the private sector and promote sustainable economic development. In addition to the role of the Central Bank of Iraq in continuing to provide appropriate tools to finance foreign trade, and improving the compliance environment with requirements for combating money laundering and terrorist financing, which will contribute to achieving the objectives of monetary policy and greater financial and monetary stability in the country.

The policies of the Central Bank of Iraq were able to control inflation rates, which declined from their peak of 7% at the beginning of this year to reach 4% by the end of the year, with its stability, due to the strict monetary policy, the raising of the Iraqi dinar exchange rate against the dollar, and the return of foreign trade financing to Its nature.

Conclusion

The Iraqi exchange market witnessed a significant rise in the value of the dollar, especially after the US Federal Bank imposed restrictions and placed precise requirements on outlets selling the dollar at the foreign currency auction at the Central Bank of Iraq to control its smuggling operations to neighboring countries. The exchange rate the US in Iraq rose from 1470 dinars per dollar to It is approximately 1,600 dinars and sometimes more, amid fears of new increases in light of the government's inability to force it to retreat. Especially with the inability of the Central Bank administration to control inflation, which led to a change in that administration at the beginning of 2023, as the value of the currency had a major role in influencing inflation rates, as its stability contributed to the decline in inflation rates in the country, in addition to the possibility of the currency selling window in Sterilization of the monetary supply left a positive impact on inflation rates, while the decline in that value had the greatest impact on increasing inflation

levels. In addition, the monetary policy followed by the Central Bank with its various tools contributed a major role in improving the value of the currency and reducing inflation rates in the country.

Recommendations

Working to continue the Central Bank's policy of meeting foreign trade financing and increasing its supervisory role in adhering to international instructions and standards for combating money laundering and terrorist financing in order to prevent the sanctions and restrictions that may be imposed by the US Federal Reserve that could limit the activity of the financial sector in Iraq, as well as intensifying efforts in Establishing and enhancing financial inclusion in Iraq. In order to reduce the use of cash in circulation and replace it with electronic payment tools, this is a step towards helping regulatory authorities know the sources of funds and track their path to strengthen the foundations of combating suspicious operations.

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