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BULLETIN

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IRAQ'S OUTPUT STEADY BUT NOT ITS POLITICS

Iraq's southern crude exports slipped in June to 3.175 million b/d, with some predicting that export volumes will stabilize around that level for the balance of the year.

Uncertain Political Outlook

Little else in Iraq is expected to stabilize. The deadly July 3 bomb blast in the upscale Karrada district of Baghdad is a political blow to Prime Minister Haidar al-Abadi. His motorcade was pelted with stones when he visited the scene later that day. He announced tighter security precautions, including a halt to the use of fake bomb detectors--three years after a Briton was jailed for his role in the fraudulent scheme. Abadi's Interior Minister tendered his resignation today. Meanwhile, Moqtada Sadr threatens to mobilize his followers once again.

The Fallujah Respite

Politically, the country was preoccupied last month with the battle for Fallujah. It began on May 22 and culminated before the end of June with the liberation of the city. Prior to the start of the battle, Abadi had been besieged by both demands for reform of the corrupt political fabric and resistance to these demands by those with a lucrative stake in the *status quo*. He was under intense pressure to name a new cabinet of unaffiliated technocrats, but only was able to win parliamentary approval to replace five of his ministers. That approval came after twelve raucous days in April, marked by rebellious members staging sit-ins and voting to oust the speaker and elect a new one. The supposedly-ousted speaker then led a session in a separate hall inside the parliamentary building where other members voted for the five new ministers.

On June 28, Iraq's highest court ruled both sessions unconstitutional, citing articles protecting equal rights and the freedom of speech and assembly. The court ruling takes Abadi back to square one in his confrontation with the different parliamentary factions. The five new ministers--for electricity, health, higher education, labor and water resources--are thus in limbo. The parliament is expected to reconvene by mid-July after the Ramadan recess. It may reaffirm the five new ministers.

IMF Arrangement

Abadi's cabinet also took steps last month towards securing a Stand-By Arrangement with the IMF valued at \$5.4 billion over three years. An arrangement with the IMF is seen as a seal of approval which could pave the way for an international bond issue at palatable interest rates as well as other loans from the likes of the World Bank. The SBA needs to be approved by the IMF's Executive Board before an initial \$600 million can be disbursed. The Board has no meeting to discuss Iraq posted on its public schedule yet, but Baghdad expects the Board to authorize the arrangement as early as this week.

Parliamentary Role

On June 12, Abadi's cabinet voted to approve conditions suggested by the IMF staff. The conditions have not been made public, but there have been many press reports that they included a requirement that Iraq pay its arrears to IOCs working in Iraq by the end of this year. In addition, Central Bank Governor Ali al-Allaq told the press in mid-April that Iraq would have to implement measures to reduce spending and increase revenue by raising electricity prices and income taxes. The Parliament granted the cabinet authority to negotiate the conditions with the IMF earlier this year, but it may have to submit a revised budget for approval. Any subsidy cuts and tax hikes will be controversial.

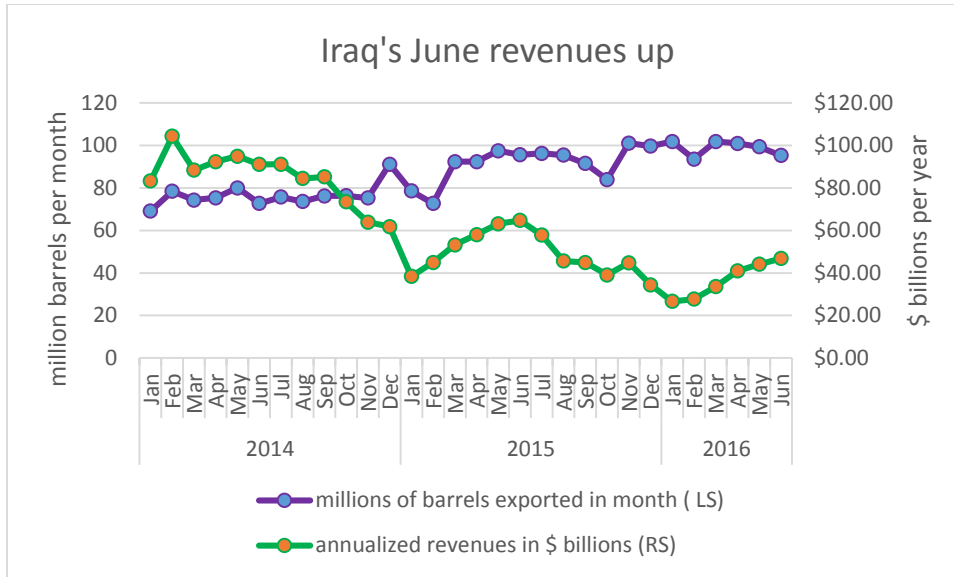
Foreign Military Finance

Iraq's success in Fallujah is likely to encourage major IMF shareholders, like the U.S., to weigh in with the Board to approve the SBA. The U.S. signaled confidence in the Abadi government when its Ambassador in Baghdad, Stuart Jones, signed a declaration of intent to provide \$2.7 billion in Foreign Military Finance on June 29. The loan would give Iraq 8 ½ years to pay for ammunition and maintenance of tanks and fighter jets. Until now, Israel and Egypt had been the major recipients under the FMF program. Iraq will become the second-largest recipient after Israel's \$3.1 billion share if Congress approves.

To date, the Abadi government has been reasonably successful in preventing the Iran-backed Shi'a militias from slaughtering large numbers of the Sunni Arab residents of Fallujah who fled the city after ISIS was routed there. But publicity about the plight of some 80,000 refugees from the city, now interred in camps in the barren desert, may offset the credit that Abadi would otherwise reap for inflicting a major defeat on ISIS. Today, UN High Commissioner for Human Rights Zeid Ra'ad Al Hussein said there was a list of 643 missing men and boys, as well as of 49 others believed to have been summarily executed or tortured to death while in the initial custody of the Iran-backed Kata'ib Hezbollah.

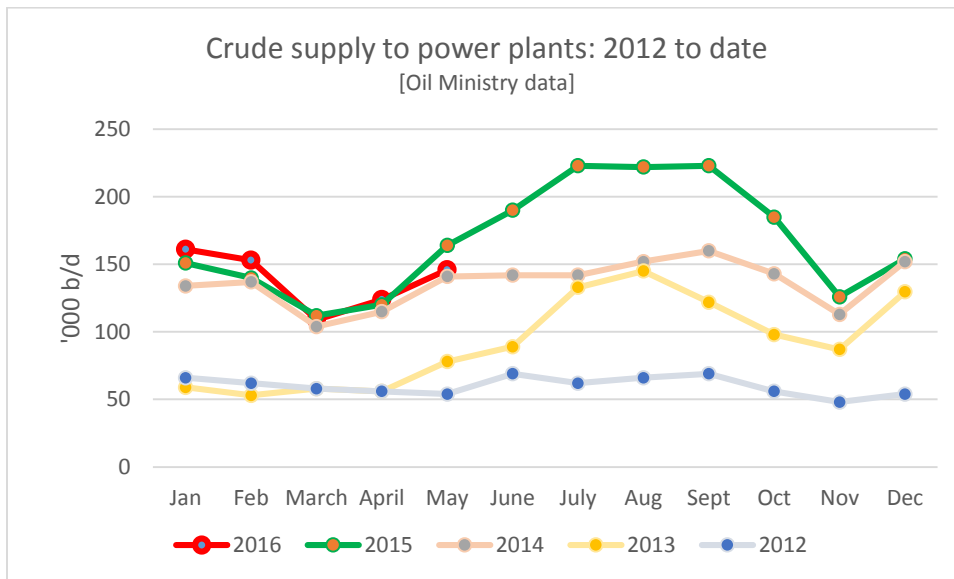
Juggling Debt Payments

Iraq has been juggling to postpone debt payments ever since oil prices started falling precipitously in late 2014. The more it does so, the less it will be considered credit-worthy for new loans. Late last week, the Central Bank said it would seek to postpone until 2019 annual payments of about \$800 million on a total of \$9 billion it owes to Paris



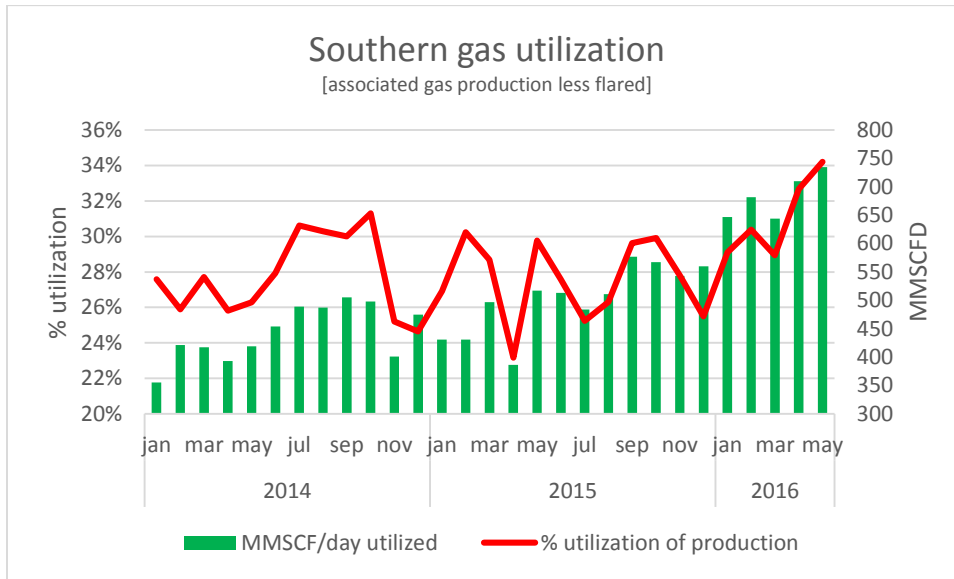
Direct Use of Crude

June production data won't be available until later this month, but increased direct burn of crude in power plants is likely to impinge on export levels through September. Increases in Mideast crude burns during the summer are incorporated in the global balances prepared by the IEA and other leading forecasters.

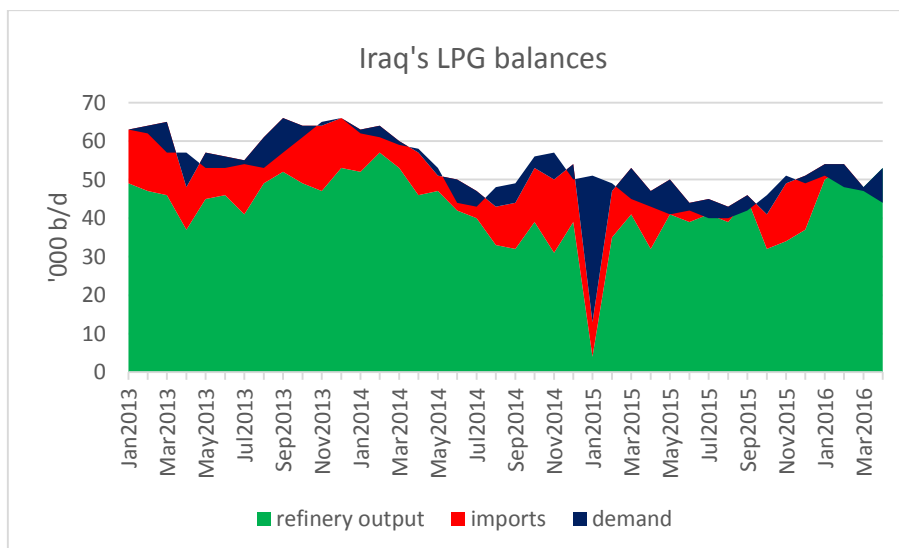


Summer crude burns in Iraq this year may be mitigated by greater availability of methane (sales) gas from the Basra Gas Company. BGC gathers and processes associated gas from West Qurna 1, Zubair, Rumaila and Majnoon. The volume of gas processed has doubled since early 2014 and the percentage of gas captured for use rose over 34% in May. However, the southern fields were still flaring about 240,000 b/d of associated gas. If

harnessed, the flared gas would be more than enough to displace all the direct burn crude (about 170,000 b/d last year) and add an incremental 2% of NGLs to the volume of crude exports.



Increased processing of the gas has begun to yield exports of condensate and LPG. Over a 60-day period from late March to late May, Iraq exported three cargoes of condensate at a rate of about 4,000 b/d. Iraq is to export its first cargo of LPG, about 23,000 barrels, in the next day or so. Iraq imported about 14,000 b/d of LPG in 2013, but a decline in demand and an increase in refinery output of the product has all but eliminated imports this year. Output from gas plants--as opposed to refinery output--has long met a small portion of Iraq's domestic demand, according to Iraq's JODI data. As BGC increases the volumes of processed gas, exports of LPG should rise in tandem.



Need for Political Stability

Although the properties of individual gas resources can vary greatly, Saudi Aramco produces about 130 barrels of NGLs for every 1 million cubic feet of raw gas it processes. After extracting the liquids, it is left with about 680,000 cubic feet of sales gas and 68,000 cubic feet of ethane. If Iraq can continue to reduce the percentage of flared gas, it has the potential to add around 10% to the volumes of hydrocarbons Baghdad is now exporting. That would help stabilize its revenue base and cover the liabilities it is accruing in new debt and debt payment postponements. But it sorely needs political stability to make it through this challenging period.