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The Effectiveness of Interest Rates on Monetary Policy in Iraq for The Period (2003-2023)

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Abstract: The interest rate plays a significant role in economic activity and is considered one of the most important indicators used to analyze the movement or direction of the macroeconomy. It is used as a tool to influence economic activity through monetary policy. Economic theory often assumes that the interest rate affects an individual consumer's decision to allocate their income between current consumption and savings. It is also assumed that the interest rate influences an individual's decisions regarding the components of their financial asset portfolio in general. For example, it influences the decision to choose between purchasing real estate, holding bonds, or keeping a savings deposit in a bank. According to economic theory, the interest rate also affects the volume of investment. Furthermore, the interest rate is considered one of the intermediate or operational tools of monetary policy, and sometimes it is the ultimate goal of monetary policy. The path of monetary policy in implementing and achieving this ultimate goal passes through the channel of the interest rate as an operational objective. The interest rate, which was administratively set in Iraq before 2003 and until early 2004, is now floating or freely determined by market forces. At that time, the monetary authority used interest rates as a direct monetary tool to curb monetary and financial imbalances in the economy. The interest rate structure was characterized by prevailing rigidity and a failure to account for the continuous rise in the general price level. This rendered the banking system ineffective in attracting domestic savings due to the emergence of negative real interest rates. However, after the Central Bank was granted independence in managing its monetary policy tools to achieve its objectives under its new law, and after interest rates were freely determined by market forces, interest rates became one of the intermediate or operational tools of monetary policy. The path of monetary policy in implementing and achieving its ultimate goal now passes through the interest rate as an intermediate objective.

Keywords: Interest rate, Monetary policy, Exchange rate.

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1. Introduction

One of the most significant challenges facing the Iraqi economy over the years has been the banking sector, which constitutes the cornerstone of the economy. For many years, the structure of domestic interest rates in the Iraqi economy has been characterized by stagnation and a failure to account for the continuous rise in the general price level. This has rendered the banking system ineffective in attracting domestic savings and directing them towards investment. Furthermore, the administrative setting of interest rates has created a financial constraint [1]. Consequently, monetary policy has naturally relied on interest rates as a direct monetary tool to curb monetary and financial imbalances in the economy. This has led to a multitude of opinions and ideas regarding the necessity of liberalizing interest rates according to requirements appropriate to the direction of the economy, thus making the central bank's role paramount in this area. Following the

political and economic events and transformations after 2003, Iraq adopted an economic stabilization program supported by the International Monetary Fund [2]. This economic reform imposed a new reality on the Iraqi economy by moving towards a market economy. Interest rates were also affected by this process. Since the issuance of the Central Bank of Iraq Law No. (56) of 2004, interest rates have been liberalized, and all forms of financial restraint, represented by the previous credit plans imposed by the Central Bank on the free allocation of credit resources among different economic sectors, have been removed. The new legislation aimed to encourage the Central Bank of Iraq to rely on indirect means and market signals in allocating monetary resources and credit and redirecting them to influence economic activity. Accordingly, monetary policy has relied on interest rates, using them as an intermediary tool to achieve policy objectives, namely the stability of the monetary and financial markets [3].

The research problem stems from the weak effectiveness of interest rates in influencing monetary policy, especially when interest rates are administratively set, as their impact is very limited.

The study is based on the hypothesis that there is a reciprocal influence between monetary policy and interest rates. Interest rates represent an intermediate and sometimes ultimate goal of monetary policy. Under a liberalized monetary system, interest rates function effectively to achieve the ultimate goal of monetary policy, which is often the stability of the money and financial markets [4].

This research aims to answer the question: Has the central bank, as the highest monetary authority, succeeded in using interest rates as a nominal stabilizer during the period in which it gained independence in using the tools that help it achieve its objectives, particularly interest rates?

The research adopted a descriptive-analytical approach to clarify the nature of both monetary policy and interest rates, and to analyze the impact of interest rates and the extent to which they achieve the objectives of monetary policy [5].

2. Materials and Methods

The Theoretical Framework of Interest Rates

Changes in interest rates have a significant impact on individuals, financial institutions, and the economy as a whole. This is because they affect not only consumers' spending and saving preferences but also the investment decisions of business owners. Furthermore, some of these variables play a major role in influencing interest rates; that is, they both affect and are affected by them. This influence can be direct or indirect. Interest, in general, is a payment made in exchange for the use of money. In any case, the interest rate is an extremely complex phenomenon, representing one of the most intricate problems in economic theory.

First Requirement: The Concept of Interest Rates

Economists offer a range of definitions for interest rates, including, but not limited to, that it is "the price that borrowers must pay to obtain present purchasing power in exchange for future purchasing power". Interest is what is paid for using money, and the interest rate is the amount paid per unit of time. In other words, people must pay for the opportunity to borrow money, and the cost of borrowing money, measured in monetary units annually for each unit borrowed, is the interest rate. Interest is defined as the amount due on a specific sum borrowed for a period of time (usually one year), while the interest rate is the percentage of the interest amount relative to the original sum. The interest rate is also defined as the cost of debt financing (borrowing), which is the price paid by the borrower to obtain a sum of money allocated for lending, which is characterized by scarcity, for an agreed-upon period. It is calculated by dividing the agreed-upon interest rate for a year.

The second requirement: The interrelationship between the interest rate and some economic variables.

First: The interest rate and the balance of payments.

This is a two-sided summary of transactions and a method for organizing cash receipts and payments in exchange for those international transactions of a country during a specific period. It consists of several accounts, the most important of which are the current account, the long-term and short-term capital accounts, and the balance of official reserves transactions, among others. The role that the interest rate plays on the balance of payments is very effective indirectly, through its impact on investment. It is clear that a producer will decide to invest if the marginal efficiency of capital the investment is greater than the interest rate.

Second: Interest Rates and Inflation

Inflation has a number of definitions. The easiest and the most understandable on the consumer side is that it is a rising trend in the prices of consumer goods. This implies that the inflation process is dynamic, but not a state of rest. The intensity of inflation may be quantified as the rate of movement of a price index in a given time. Inflation can be of various kinds; genuine inflation, where the aggregate demand is not matched by a similar increase in production rates leading to an increase in prices; creeping inflation, where the increase in prices is slow; suppressed inflation, where government policies impose controls and restrictions to curb spending and increase in prices; and hyperinflation where a rapid increase in the circulation of monies in the market and the prices are increasing very fast.

Third: Interest Rates and Exchange Rates

The exchange rate is simply the price of one country's national currency in terms of another country's currency (such as the US dollar), or it is one of two currencies that are exchanged for one unit of the other currency. The relationship between the interest rate and the exchange rate is evident through the main factors affecting exchange rates, the most important of which are changes in domestic and foreign interest rates.

The most prominent of these factors are...

1. **Changes in the value of exports and imports:** If the value of a country's exports increases relative to the value of its imports, the value of its currency tends to rise. Naturally, an increase in the currency's value will stimulate imports and discourage exports. Conversely, if domestic demand for foreign imports increases, the country's currency will tend to depreciate.
2. **Inflation rate variations:** A high inflation rate in a national economy leads to a decrease in the value of the national currency relative to other currencies. This affects the exchange rate, resulting in an increase in the number of units of the national currency that can be exchanged for one unit of a corresponding foreign currency.
3. **3- Interest rates, which are the focus of our current discussion,** as interest rates have an indirect effect on exchange rates. A decrease in interest rates with the availabilities of the investment opportunities leads to an increase in demand for capital for the purposes of investing it. Investment is achieved, national economy is stimulated, the investment multiplies to achieve the strength of national economy which leads to the improvement in value of national currency against other currencies. On the other hand, a rise in interest rates lead to avoid from borrowing from investors, and this results in a decline in investment and a decrease in economic growth, which leads to the opposite results that reduce the strength of the national economy, and this is reflected in the value of the national currency against other currencies.

Fourth: Interest Rate and Velocity of Money

Several factors influence the velocity of money, such as economic cycles, saving and spending habits, regularity of income receipt, expectations of future income, and other factors. Changes in the interest rate are among these. The prevailing interest rate movements in the money and financial markets have a significant impact on the velocity of money. When interest rates on liquid non-cash financial assets, such as time deposits, savings deposits, certificates of deposit, and bonds, are high which usually occurs during times of economic prosperity individuals tend to reduce their cash balances. This is to say that they will be more ready to give money away so long as the price remains high thereby driving up the velocity of money. The fact that the demand of money is inversely related

to the interest rate is the reason why an increase in the interest rate reinforces the motivation of using financial assets as a form of wealth preservation rather than cash balances. This replacement leads to a reduction in the cash people would like to hold leading to an increase in the velocity of money. The opposite occurs when interest rates on non-cash financial assets fall. Cash preference, which occurs during economic recessions, is expected to increase in such situations. Individuals tend to favor cash because the cost of giving it up is low, and they insist on holding onto it as long as the interest rate sacrifice is minimal. In other words, individuals are unwilling to part with cash as long as the cost of holding it is low, which reduces the velocity of money. That is, the velocity of money increases with rising interest rates and decreases with falling interest rates.

Fifth: Interest Rate and Budget Deficit

Governments at all levels may incur a budget deficit at some point. However, local governments are legally obligated to balance their current budgets. They may borrow to carry out capital improvements. Governments may also achieve budget surpluses at other times. It should be noted here that the central bank does not usually finance the deficit directly, but rather through open market operations. It enters as a buyer of government bonds held by the private sector at the same time that the treasury issues new bonds to the open market. Thus, these new bonds flow into the market to find demand equivalent to the new money provided by the central bank. However, financial asset traders and others who sold their government bonds to the central bank find that they now have more deposits in the banking system. Banks also find that they have additional cash reserves. That is, this new monetary base provided both banks and non-bank sectors with means to increase demand for bonds.

3. Results

The Mechanism of Monetary Policy Transmission via the Interest Rate Channel

Monetary policy is a crucial component of a nation's overall economic policy. The concept and objectives of monetary policy vary according to the development of different economic schools of thought. Central banks adopt specific strategies to achieve their monetary policy objectives. This strategy begins with selecting a monetary policy tool, followed by the initial objective, then the intermediate objective, and finally the ultimate objective. One of the most important intermediate objectives is the interest rate, as the interest rate channel serves as the traditional conduit for the transmission of monetary policy's effects to the desired goal [6].

First Requirement: The Concept of Monetary Policy

There are numerous definitions of monetary policy and its place within economic policy, given its active role in driving the financial cycle and regulating the money supply.

1. Definition of Monetary Policy:

The monetary policy refers to a collection of actions that are incorporated by the central bank to control the money supply in an attempt to attain a combination of economic goals. It is a broad rule or perception that influences the minds of policymakers in arriving at a decision. These are policies that outline the depth of decision-making, and that the decision will match and add to the accomplishment of the objectives [7].

Kent saw it as the toolkit that is used by monetary management to regulate the supply of money to meet certain economic objectives and to attain full employment [8].

2. The Importance of Monetary Policy within Economic Policy:

As per various economic theories, in particular, the modern ones, the primary role of monetary policy is to assist in maintaining stability of the economy. The impact of monetary policy is mainly on domestic prices. Concerning the monetary policy and economic growth relation, the majority of the aforementioned studies have emphasized that the contribution of monetary policy on economic growth via the money injection is the short-run one [9].

In the long run however, such shocks are forecasted by economic actors. Thus, an increased money supply will only lead to an increase in the general price level in the long

run. Thus, in contrast to fiscal policy which is one of the economic growth drivers (and much ink has been spilt in the applied literature on this issue), monetary policy is there to ensure economic stability on which growth rests [10].

Reforms in the field of monetary policy are associated with all policies that help enhance the effectiveness of monetary policy in achieving its main goals, the most important of which is price stability. Many research sets concur that monetary policy should primarily set price stability to create a stimulating environment for the long term growth of the economy that is conducive to build confidence of economic actors and maintain the level of consumption and investment.

On the other hand, studies also agree that monetary policy should not be preoccupied with reducing fluctuations in output levels, as these are often primarily attributed to real factors related to the supply side, stemming mainly from structural imbalances or technological developments, rather than nominal factors related to the demand side. Therefore, monetary policy intervention to address these fluctuations may harm economic equilibrium [11].

Monetary policies, especially in developing countries, are among the most significant causes of internal and external economic imbalances, alongside other economic variables. If the most important objective of monetary policy is to achieve a degree of economic stability within a framework of balanced growth, this implies a close relationship between economic activity and monetary policy. This is evident in the connection between economic problems, such as unemployment, inflation, and low national employment, and monetary solutions [12].

The second requirement: The mechanism of monetary policy transmission via the interest rate channel according to Keynesians and monetarists.

The traditional interest rate channel is considered the transmission of monetary policy's impact to the growth objective. Contractionary monetary policy (a decrease in the money supply) leads to an increase in the nominal interest rate. Under the Keynesian assumption of price rigidity in the short run, the real interest rate rises, increasing the cost of capital and limiting investment demand in the production sector [13]. The central bank can employ the aforementioned monetary policy tools by either increasing or decreasing the growth rates of the money supply, which is reflected in the interest rate. This is because the interest rate is essentially the price of money, determined by supply and demand factors, of which the central bank controls the supply side. It is well-known that monetary policy uses open market operations to control the money supply. The central bank increases the money supply by entering the open market, for example, by purchasing securities [14]. Economic actors then attempt to spend this money on bonds or other interest-bearing assets, leading to an increase in their price and consequently a decrease in the interest rate, given the inverse relationship between bond prices and the interest rate, investment spending in the macroeconomy is also linked to interest rates, as investors consider interest rates to be the cost of financing their investment and consumption expenditures. Therefore, a rise in interest rates is considered a rise in the cost of investment and consumption, which prompts businesses and individuals to reduce these expenditures. Conversely, a decrease in interest rates is considered a decrease in the cost to investors, which motivates them to expand their investments. In short, monetary expansion reduces interest rates and thus increases investment spending and even consumption spending. In terms of aggregate supply and aggregate demand analysis, an increase in investment will lead to an increase in aggregate demand, and of course, these changes in aggregate spending or aggregate demand lead to changes in income (total output). Changes in employment and unemployment are directly linked to changes in production. According to the aggregate demand and aggregate supply model, changes in aggregate demand will also lead to changes in the price level, which leads to changes in inflation rates [15].

Analysis of the Impact of Monetary Policy in Iraq

The role of monetary policy in the economy is explained by the consideration of monetary variables (money supply, exchange rate, and interest rate) as instruments, on

which monetary policy is based for the fulfillment of its goals. This analysis also shows the role of policy in defining economic problems and finding solutions to them [16].

1. **The Evolution of Broad Money Supply (2003-2023):** The assumption on which monetary policy has been based in Iraq up until 2003, which was in line with the needs of the budget deficit financing structure through the set-up of a link between the money supply growth rate and the financing of the budget deficit, has resulted in a unique phenomenon in the Iraqi economy history. As a result of this development, the Central Bank of Iraq together with the rest of the banking sector got hold of assets in the form of an enormous stock of treasury bills. These bills were used as a source of expansion and the issuance of money, validating the monetary authority's reliance on the fiscal policy effect in generating fundamental money supply. This was compared with the Central Bank of Iraq's holding of these accumulated assets in the form of government debt instruments which formed the major part of its entire investment portfolio. The year 2003 recorded an increase in the money supply rate to reach 6,953,420 million dinars with an annual growth rate of 79.63%. This increase is due to the reappraisal of the Iraqi dinar's exchange rate after the Third Gulf War. On the other hand, the growth rate was slow in the year 2005, with a percentage of 19.83%, because of the independence of the Central Bank after the promulgation of the Central Bank Law No. 56 of 2004, which was aimed for fighting inflation. Differently, the broad money supply grew continuously over the period from 2006 to 2011 [17].

In 2012, the growth of the money supply was at a low level, as annual growth reached (-15.2%) compared with the previous year. The low growth was caused by the monetary stability attained in the Iraqi economy, which can be traced back to the Central Bank's attempt to balance growth between the monetary and the real sectors. In 2013 and 2014, the money supply had different rates of growth, (6.04%) and (28.2%) respectively. This difference was due to the reduction in oil revenues and the economic recession caused by terrorist activities by ISIS in 2014 and to the reduction in net foreign assets. During the year 2015, there was a general decline of the oil prices, which was demonstrated in a drop in the state's general budget revenues, since oil revenues are the main source of revenues. Consequently, the Ministry of Finance limited its sales of dollars to the Central Bank, which consequently influenced the reduction of the money supply to (82595) and its growth rate (-8.9%) [18].

The year 2016 witnessed an expansion in the money supply, increasing by 6.6% compared to 2015. This was attributed to the expansionary effect of net government debt, resulting from the government's reliance on domestic borrowing to meet the financing needs of the general budget through the issuance of treasury bills and bonds to finance part of the budget deficit. External factors also contributed to an increase in the money supply during 2017 by 1.5% compared to 2016. This increase was driven by the rise in the average price of a barrel of oil during that year, reaching \$49.3 per barrel compared to \$36 per barrel in the previous year [19]. The money supply continued to rise at varying rates in 2018 and 2019, registering growth rates of 6.2% and 7.8% respectively. This was due to the growth of one of its main components, namely the narrow money supply, while other deposits suffered a decline due to the increase in grants provided by the government to the unemployed. As a result of the protests that occurred in 2019, the money supply increased significantly in 2020, reaching 13.7%, a net result of narrow money supply growth despite a decrease in other deposits and increased public spending on medical supplies during the COVID-19 pandemic, as well as grants provided to families during the curfew. The broad money supply continued to rise in 2021, reaching a growth rate of 14.2% [20]. This increase resulted from narrow money supply growth, which was attributed to higher rates of salary payments to public sector employees and increased public confidence in the banking sector following these higher rates. In 2022, the money supply increased compared to the previous year, registering a growth rate of approximately 16.9%, due to banks pursuing ineffective deposit attraction policies. This necessitates the Central Bank adopting certain policies and procedures that Banks are motivated to attract deposits and control the money supply outside the banking system, which limits the efficiency and effectiveness of monetary policy during crises. As for the last year, the

growth rate decreased significantly and reached (7.01). This is attributed to the increase in narrow money supply despite the decrease in other deposits and the shift towards electronic payment, at a time when the use of paper currencies poses many risks, including forgery and theft, in addition to the increase in issued currency resulting from the increase in public spending after the implementation of the general budget (Table 1). On the other hand, the disturbances in the exchange market led to a decrease in individuals' desire to save [21].

Table 1. The development of the broad money supply in Iraq for the period (2003-2023)

Annual Change Rate (%)	Broad Supply (Million Dinars)	Year	Annual Change Rate (%)	Broad Supply (Million Dinars)	Year
28.2	90,728	2014	—	695,342	2003
-8.9	82,595	2015	-82.4	122,540	2004
6.6	88,082	2016	19.8	146,840	2005
1.5	89,441	2017	-85.6	21,080	2006
6.2	95,390	2018	27.9	26,956	2007
7.8	103,441	2019	29.5	34,920	2008
13.7	119,906	2020	24.4	45,443	2009
14.2	139,885	2021	38.9	60,386	2010
16.9	168,291	2022	30.4	72,178	2011
7.01	180,976	2023	-15.2	75,466	2012
—	—	—	6.04	87,707	2013

Source: Central Bank of Iraq, General Directorate of Statistics and Research, *Annual Bulletin*, various years.

2. **Analysis of the Exchange Rate in Iraq for the Period (2003-2023):** The Iraqi economy faced a set of internal and external factors. The internal factors included the accumulated deficit in the state budget and the increase in the money supply through the issuance of new currency to cover the deficit due to the flawed economic policies followed at that time, as well as the disruption of the production apparatus after 1991 due to the destruction of the infrastructure of the Iraqi economy. As for the external factors, they included the economic sanctions that deprived Iraq of important economic resources, in addition to preventing it from benefiting from its funds deposited in foreign banks through the freezing of those funds [22]. The value of the Iraqi dinar witnessed a significant decline during 2003 as a result of the start of military operations against Iraq. This resulted in an increase in the exchange rate of foreign currencies against the dinar as a result of the Central Bank's failure to follow the fixed rate. Furthermore, with respect to the parallel exchange rate, it fell and recorded a negative growth rate (-1.07%) [23]. Regarding to the year 2004, it saw a decrease in the official and the parallel exchange rates with a growth rate of 2004; as for the year 2005, both the official and the parallel exchange rates witnessed a positive growth at 1.1% and at 1.31% respectively, while in the year 2006, the official exchange rate decreased by 60.5% as shown in Table 2.

Official exchange rate has been experiencing a rate of decline in the period 2006-2009, which recorded negative rates of growth of 0.14%, 14.45%, 4.94% and 1.93% respectively. On the other hand, the parallel exchange rate has registered positive growth in 2006 and negative growths until 2009 with rates of 0.2%, 14.10%, 5.05% and 1.75% respectively. This decline in exchange rates was the outcome of the intervention by the central bank to increase the value of the local currency through foreign currency auctions through a managed float system [24]. Also, in 2010 and 2011, the official exchange rate was still not changed and remained on the same level 1170 dinars/dollar, while the parallel exchange rate showed a positive growth of 0.25% and 0.93% respectively. In 2012 the official exchange rate was 1166 dinars per dollar, which denotes the negative growth rate of 0.34%. The parallel exchange rate had increased in 2012 due to an increase in demand for dollars due to the crisis in Iran and the economic sanctions imposed on Iran. Therefore, the foreign currency auction rendered the country suspicious of smuggling cases between Iraq and Iran, and increased the money laundering activities in Iraq. The official exchange rate was stable in 2013 and 2014 due to measures taken by the Central Bank to limit the sale of

dollars. In 2015, the official exchange rate rose to 1190 dinars per dollar representing an increase of 2.06% for the year, whereas the parallel exchange rate increased 2.72%. The exchange rate has remained uniform. The official exchange rate did not change in 2016 and 2017, and has remained stable until 2019. This was as a result of a number of political and financial factors and variables which took place during the period and caused a challenge and a shock to the monetary authority's ability in maintaining the price stability in the country [25]. These factors started with the fall in oil prices and the consequent fall in public budget revenues, followed by fall in the incomes of foreign currencies to the central bank [25]. This was compounded by the intervention of the Ministry of Finance and the Parliament which imposed conditions and policies not in accordance with the objectives of monetary policy. In 2020, the exchange rate increased greatly to 1450. 21.8% (growth rate). This was a result of the dual crisis that the Iraqi economy experienced: the spread of the COVID-19 pandemic and the decline in oil prices on one hand, and on the other hand, economic, political, and financial transformations (exchange rate fluctuations, the monetary policy adopted, and the security and preventative situation). The sanctions imposed on regional countries along with Iraq directly and indirectly affected the Iraqi economy, its foreign exchange market, and the economic reform processes ("White Paper Reforms"). During the years 2021-2022, the exchange rate rose to 1460 for both years, with a growth rate of 0.7% in 2021. This was attributed to increased demand from individuals for medical treatment or travel abroad following a gradual increase in international transportation, and the rise in crude oil prices due to increased energy demand and the approval of the state budget, which led to a rise in public expenditures. In the last year (2023), as shown in Table 2, the official exchange rate witnessed a significant decrease compared to previous years, reaching 1326 with a negative growth rate of 9.2%. This was a result of implementing the new mechanism (the electronic platform) to regulate and control the sales window operations. Foreign currencies, in addition to a decrease in dollar sales for the purpose of bolstering bank accounts for remittances abroad, and rising interest rates, led to a reduction in demand for the dollar and consequently a decrease in exchange rates [26].

Table 2. Exchange Rate Development in Iraq for the Period (2003-2023)

Year	Official Rate	Exchange	Annual Change Rate (%)	Parallel Exchange Rate	Annual Rate (%)	Change
2003	1,836		590,633.6	1,936	—	
2004	1,453		-60.5	1,453	-24.95	
2005	1,469		1.10	1,472	1.31	
2006	1,467		-0.14	1,475	0.20	
2007	1,255		-14.45	1,267	-14.10	
2008	1,193		-4.94	1,203	-5.05	
2009	1,170		-1.93	1,182	-1.75	
2010	1,170		0.00	1,185	0.25	
2011	1,170		0.00	1,196	0.93	
2012	1,166		-0.34	1,233	3.09	
2013	1,166		0.00	1,232	-0.08	
2014	1,166		0.00	1,214	-1.46	
2015	1,190		2.06	1,247	2.72	
2016	1,190		0.00	1,275	2.24	
2017	1,190		0.00	1,258	-1.33	
2018	1,190		0.00	1,211	-3.88	
2019	1,190		0.00	1,202	-0.75	
2020	1,450		21.8	1,240	3.06	
2021	1,460		0.7	1,471	15.7	
2022	1,460		0.0	1,482	0.7	

4. Conclusion

1. Changes in interest rates have a significant impact on individuals, institutions, and the economy as a whole. This is because they affect consumers' spending and saving preferences, as well as the investment decisions of business owners. Several economic variables also influence interest rates, and these variables collectively constitute the determinants of interest rates.
2. Expectations regarding future inflation rates play a role in influencing monetary interest rates. Therefore, during periods of high inflation, interest rates incorporate an inflation premium. While expansionary macroeconomic policies may temporarily lower monetary interest rates, their continued implementation leads to inflation and higher interest rates.
3. Monetary policy has a set of intermediate and operational objectives. Intermediate objectives serve as signals for monetary policy action and a communication tool with the public. Operational objectives are tactical goals that the monetary authority can influence more effectively in the short term. Although the central bank cannot directly use policy tools to influence intermediate objectives, it can influence operational objectives through monetary reserves and short-term interest rates, which affect the movements of intermediate variables.
4. The Central Bank was granted independence in managing its monetary policy tools to achieve its objectives as defined by Law No. 56 of 2004. This law also designated it as the entity responsible for combating inflation and reducing its levels. This principle forms the basis upon which monetary policy operates, and accordingly, the Central Bank had to prioritize its policy of combating inflationary activities using its available tools.
5. Domestic interest rates gained attention after the Central Bank of Iraq achieved relative success in halting the collapse of the local currency's exchange rate. This led it to issue a directive to liberalize domestic interest rates. However, it overlooked the essential requirements for the success of this decision, including controlling inflation rates and building up foreign currency reserves.
6. Raising the policy interest rate is a largely sound economic measure, stemming from the core principles of monetary policy. The underlying objective is that the majority of the money supply in the Iraqi economy is held by individuals. Since deposits in commercial banks represent the area where the central bank applies its monetary policy tools, this area must be expanded to make these tools more effective. There is no better tool than the interest rate to achieve this.

5. Recommendations

1. The banking sector is at a crossroads, especially given the political and economic developments in Iraq. Improving the banking sector's performance is difficult due to several obstacles that continue to hinder its operations. This vital sector cannot address all the challenges without removing the restrictions imposed upon it. 2. Emphasize the importance of gradually liberalizing domestic interest rates, starting with interest rates between the central bank and commercial banks, then between commercial banks themselves, and finally between commercial banks and borrowers and lenders. The economic logic underlying financial reform favors a gradual approach to implementation, highlighting the necessity of achieving macroeconomic stability as a crucial prerequisite for success.
2. It is essential to avoid interfering in the central bank's operations and to refrain from lending to the government without thorough due diligence, as this impacts the money supply and, consequently, interest rates.
3. Adhere to the principles of interest rate risk management and oversight as outlined in Basel II, which can significantly facilitate the work of commercial bank boards in mitigating the risks they face due to interest rate fluctuations.

4. Work to activate the role of interest rates in the Iraqi economy, given their fundamental role in stimulating economic activity and reflecting its resilience in the face of other challenges.

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