

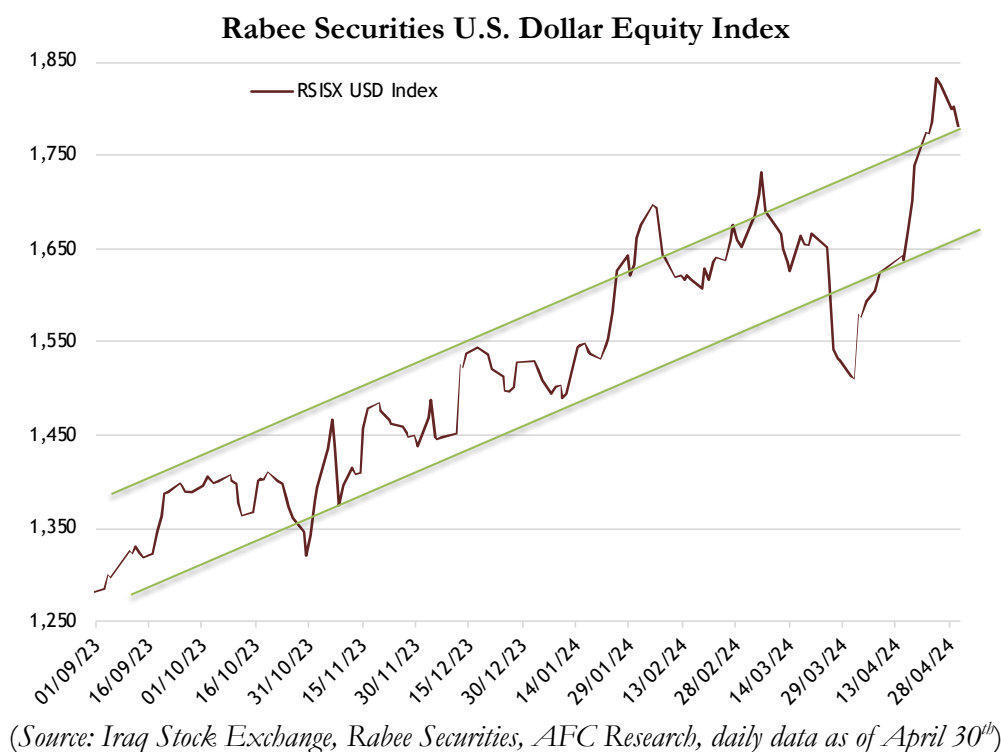
“Middle East Conflict Widens, Iraq’s Equity Market Rallies”

Ahmed Tabaqchali, May 4th, 2024

The equity market, as measured by the Rabee Securities U. S. Dollar Equity Index (RSISX USD Index), was up 17.8% for the month and up 16.6% for the year.

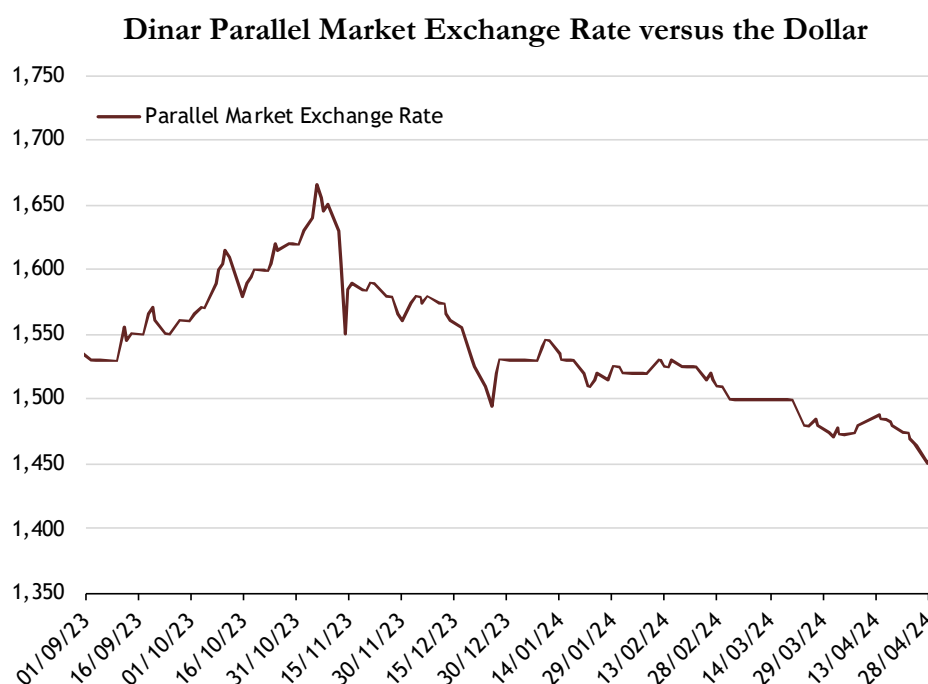
The much-feared widening of the current Middle East conflict became a reality at the start of the month with the alleged Israeli attack on the Iranian Embassy Complex in Syria on April 1st. Iranian vows to retaliate sparked fears of a violent escalation of the tensions that were simmering over the last few months. However, Iraq’s stock market rallied on the event and continued to rally despite the realisations of these fears with Iran’s attack on Israel on April 13th and Israel’s alleged attack on Iran on April 19th – the RSISX USD Index’s increase for the month peaked at 21.1% before profit taking pared these gains to an increase of 17.8% as the month came to an end. As discussed here recently in “[Markets Continue to Look Through Tensions](#)” and prior to that in “[Assessing the Risks of a Wider Middle East Conflict](#)”, the Iraqi stock market is discounting the developments that were driving the transformation of the economy, and that were already in place prior to the onset of the conflict in early October, and that it has discounted, and continues to discount, a contained conflict. These were discussed in the market outlook for 2024 in “[What Next after a Gangbuster Year ???](#)” with the [strong net profit results](#) for 2023 for the top-quality banks in the country reflecting these very same [developments](#) that would drive the transformation of the economy by accelerating the adoption of banking and bring about a transformation of the sector and its role in the economy.

Specifically, the markets’ response to this widening of the Middle East conflict, were expressed by the Iraqi stock market, Iraq’s currency market, and global oil prices. Firstly, the RSISX USD Index is up 27.2% from just before the start of the conflict to April 30th April - in particular, it is up 2.6% since Israel’s alleged attack on Iran and up 9.8% since the earlier Iranian attack on Israel (chart below).



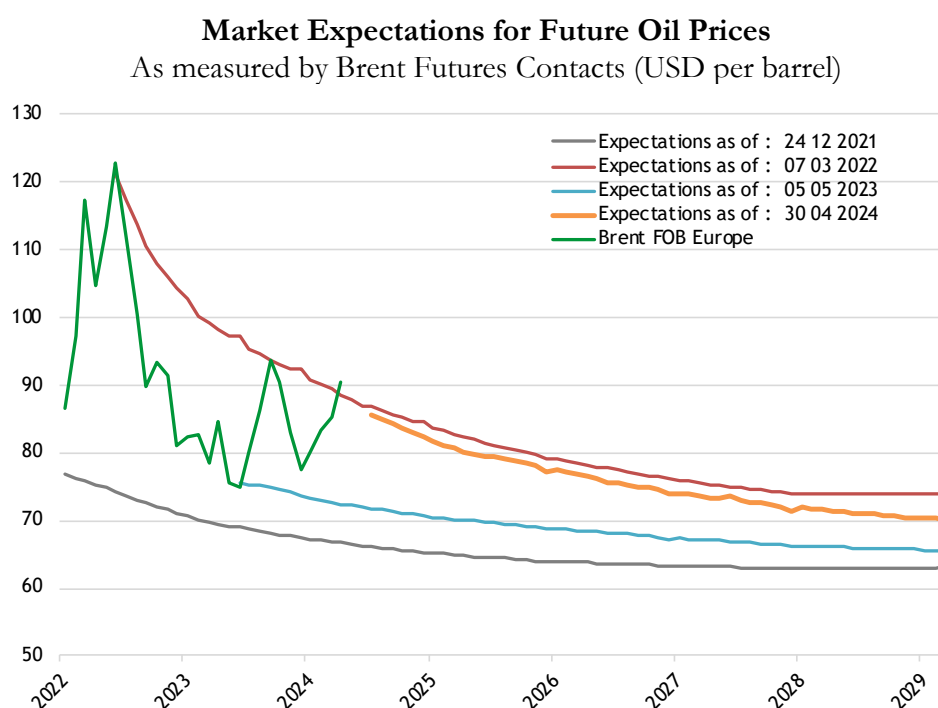
Secondly, the currency market, similarly to the stock market, was discounting the same dynamics that were driving the transformation of the economy, and that were already in place prior to the onset of the conflict in early October. Specifically, for the currency market, these were initiated by the Central Bank of Iraq’s (CBI) latest procedural requirements for its provisioning of U.S. dollars for cross-border transfers introduced in mid-November

2022, which led to a dollar supply-demand mismatch and consequently to the depreciation of the parallel market price of the Iraqi dinar versus the dollar (*). After bottoming in early November, the parallel market price of the Iraqi dinar versus the dollar appreciated by 12.4% by the end of April (chart below).



(Source: Iraqi Central Statistical Organization, Iraqi Foreign Exchange Houses, Asia Frontier Capital Research, data as of April 30th)

Thirdly, current oil market expectations, as measured by Brent crude futures contracts as of April 30th (yellow line-chart below), are near the top of a range bound on the upper end by expectations of supply fears following the invasion of Ukraine (red line-chart below), and on the lower end by those at the end of 2021 (grey line-chart below). Thus, while higher than what they were in the last few months, nevertheless are still discounting a contained conflict. Iraq's extreme leverage to oil prices would translate to more fuel for the government's [expansionary budget](#) should these expectations remain at these elevated levels.



(Source: Wall Street Journal, US Energy Information Administration, AFC Research, data as of April 30th)

Notes

(*) Background to the currency's upheaval: -

A complete background and detailed information on the CBI's provisioning of dollars for cross-border transfers, the relationship between the official exchange rate and the parallel market rate of the dinar versus the dollar is provided by the author's research piece for the [LSE Middle East Centre](#) "[A Fistful of Dinars: demystifying Iraq's dollar auction](#)".

The controversies & conspiracy theories surrounding it fail to take into account the economy's key structural imbalances: dependence on oil export revenues, while demand for goods & services is met through imports handled by a largely informal private sector. Which means that the government's oil revenues are the economy's major source of dollars, & the private sector depends on the auction as a significant source of dollars to pay for these imports. As such, it is the inherent imbalances in the economy's structure that led to contradictory & unsustainable compromises within the functioning of the auction, and not unsubstantiated conspiracies.

It concludes that the measures undertaken post-November 2022 helped resolve most of the compromises that bedevilled the auction in the past. However, lasting change requires addressing the economy's structural imbalances head-on. The piece comes with charts & tables to support its arguments; diagrams to simplify the main points it makes, & extensive footnotes that provide further explanations & technical information.

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