



The Role of the Central Bank in Monetary Stability: Iraq as a Case Study (2004-2024)

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Abstract: This research aims to address a highly important issue, which is monetary stability, a goal pursued by most of the world's economies. When monetary stability is achieved, development can accelerate significantly due to the absence of economic problems such as inflation, unemployment, and others. The study also examines the role that the central bank can play through monetary policy tools in achieving the desired monetary stability. It addressed the emergence of central banks and their development stages, as well as identifying their key characteristics, objectives, and functions. The study also examined monetary stability, its importance, and introduced its main indicators, along with how to calculate monetary stability indicators. Furthermore, the study covered the establishment of the Central Bank of Iraq, its development stages, objectives, major achievements, and how monetary policy tools are used by the central bank in Iraq to influence monetary stability and attempt to support this stability. Finally, the indicators of monetary stability and the monetary excess index in Iraq for the period (2004–2024) were calculated, and many conclusions were reached, as well as several important recommendations were established to achieve monetary stability.

Keywords: Central Bank of Iraq, Monetary Stability, Monetary Policy.

Introduction

The central bank is considered one of the most important financial institutions in the monetary and financial structure of all countries in the world. It is not an ordinary bank; it leads the banking system because it is the only one capable of issuing and destroying money, and it also has the ability to influence commercial banks' capacity to issue deposit money. It has a fundamental impact on the money supply, interest rates, exchange rates, inflation, unemployment, and more.

The Central Bank of Iraq, like central banks in all countries, seeks to achieve numerous goals, the most important of which is monetary stability. The Central Bank of Iraq has gone through two main phases: the first phase was before 2003, when it was subordinate to the government and merely an institution tasked with issuing currency only to cover government expenses and the costs of successive wars. The second phase, after 2003, saw the Central Bank of Iraq gain full independence, allowing it to perform its true role with multiple objectives beyond just issuing currency. It began to focus on macroeconomic issues, monetary stability, supervising the banking system and payment

systems, and overseeing the financial system on a broad scale. Despite the Central Bank of Iraq's attempts to use its monetary policy tools to achieve monetary stability, it faced numerous challenges, including the government's employment policies, adjustments to the salary scale, increased imports, and higher demand for foreign currency to cover these imports. All these reasons have reduced the ability of the Central Bank of Iraq to achieve monetary stability, which was clearly evident through the calculation of monetary stability indicators and inflation indicators in Iraq during the period (2004-2024).

Importance of the research

1. The importance of the research comes from the significance of the Central Bank of Iraq and the roles it performs.
2. The importance of monetary stability and its role in driving economic development and social welfare.

Research problem

Has the Central Bank of Iraq been able during the period (2004-2024) to achieve the monetary stability it seeks through the use of monetary policy tools.

Research hypothesis

The study assumes that the Central Bank of Iraq can achieve monetary stability, which is considered one of the most important objectives it seeks to attain.

Research methodology

To achieve the research objectives, the inductive and deductive methods were used for the indicators and tools of monetary policy in Iraq for the period (2004-2024) to understand their impact on monetary stability, as well as relying on bulletins and data issued by the Ministry of Finance, the Ministry of Planning, and the Central Bank of Iraq, resulting in several conclusions and numerous recommendations.

1. The Central Bank (Origin, Definition, Characteristics, Functions, Objectives)

A. Origin and Definition of Central Banks

1) Origin of Central Banks

The term 'central bank' is composed of two words, 'bank' and 'central'. Regarding the word 'bank', its origin is from the word 'Benko', which means the counter placed in front of the money changer while practising their profession. Over time, its use came to mean the exchange and financial transactions carried out over the counter.

Central banks emerged after the establishment of commercial banks, which appeared before the seventeenth century, due to the economic conditions at that time not requiring central banks. Commercial banks at that time were allowed to issue money but struggled in their banking operations without guidance or oversight. Hence, the need arose to establish central banks to take responsibility for the banking system and monopolise the issuance of currency. Additionally, some governments' need to borrow from banks increased their desire to deal with a single bank, which later became the central bank, responsible for

controlling the credit volume of all types of commercial banks, monitoring currency, and implementing the state's financial policy. Countries realised the importance of central banks and began establishing them.

Before the twentieth century, there was no specific concept of central banking; rather, this concept developed gradually as central banks were originally commercial banks whose functions evolved until they reached the functions of the modern central bank.

Some of the earliest central banks to have emerged historically include the following:

- 1) The central bank of Sweden, considered the first central bank in history, began as the first state-owned institution in 1656. Initially a commercial bank, it was granted the authority to issue currency in 1701 and also given the authority to issue 'financing notes'. In 1789, the National Debt Office Bank was established to issue government currency, and in 1897 a law was passed making the Swedish central bank the sole legal authority entitled to issue currency.
- 2) Bank of England: It was established in 1694 due to England's need for funds as a result of its war with France, and the government's aim at the time was to borrow for war requirements from wealthy merchants. In 1697, the English Parliament passed a law granting the Bank of England a monopoly and the right to issue banknotes. The 1826 Act made the Bank of England the legal and actual monopoly for issuing notes, and in 1946, the Bank of England Act nationalised the Bank of England, making it state-owned.
- 3) The Central Bank of France: It was established in 1800 due to the recession France faced during the French Revolution, and its main purpose was to issue currency. Initially, it was a joint-stock company, then the government took control by appointing a governor and two assistants.
- 4) The Dutch central bank was established in 1814 and was authorised to issue currency. Its capital was owned by investors, but the chairman of its management board was appointed by the government and the members were elected by the shareholders.
- 5) The Austrian central bank was established in 1817 due to the deterioration of the monetary system and a significant decrease in the value of the Austrian currency, prompting the government to establish a central bank to address the decline and control currency issuance.
- 6) The Norwegian bank was established in 1817 as a joint-stock company with private capital until the King of Norway appointed the governor and his deputy, while its management and directors were elected by a legislative body and were granted the privilege of issuing currency.
- 7) The National Bank of Denmark: Established in 1818 with private capital to take over the functions of the state bank founded in 1813 for the purpose of withdrawing depreciated banknotes, it was granted the right to issue currency and regulate monetary policy (6).
- 8) The National Bank of Belgium: Established in 1850 as the sole national bank with the right to issue currency, it is a private joint-stock company but the governor is appointed by the state to implement government financial and banking policy.
- 9) The Bank of Spain: Established in 1856, it was one of the Spanish banks with the right to issue currency and conduct trade.

- 10) Bank of Russia: It was established in 1860 as a state bank with the aim of unifying currency circulation as well as providing loans to the Russian Empire, and it was exclusively authorised to issue banknotes.
- 11) Bank of Germany: It was established in 1876 when the unified German currency and the Reichsbank were issued, and although it was privately owned, the shareholders did not have real influence over it as power was in the hands of the Reich Chancellor.
- 12) Bank of Japan: The Bank of Japan was established in 1882 as a central bank with the aim of restoring monetary stability due to the disturbances caused by the expansion of commercial banks issuing banknotes.
- 13) Bank of Italy was established in 1893 through the merger of three of the largest banks at the time, and its ownership belonged to the owners of the three banks who merged to form the Bank of Italy. It continued operating as a joint-stock company until it was granted the sole authority to issue currency in 1920.
- 14) The United States Federal Reserve was established as the central banking system of the United States in 1914.
- 15) The International Financial Conference held in Brussels in 1920 issued a recommendation that all countries that had not yet established a central bank should start creating one as quickly as possible for the benefit of international cooperation, and South Africa, Peru, Colombia, Albania, Guatemala, and Ecuador began establishing central banks in the years 1921, 1922, 1923, 1925, 1927, and 1928 respectively.
- 16) As for the Arab countries, the first central bank was established in Egypt in 1898 under the name of the National Bank of Egypt, which was an Egyptian joint-stock company granted the right to issue currency and conduct banking operations.

2) Definition of the Central Bank

The names and definitions of banks vary according to differing perceptions of their importance and functions. Different names have been given to these banks around the world. In the United States, it is called the Federal Reserve System; in India, it is called the Reserve Bank; in France, it is called the Bank of France; and in some countries, it is called the Monetary Institution. However, the prevailing name remains the central bank. Various definitions of central banks have been provided, including:

- 1) Vera Smith defined central banks as the banking system in which there is a single bank with full authority over the issuance of cash. Vera Smith emphasized in her definition the function of issuing cash.
- 2) The central bank is a central monetary institution that performs the function of a bank or financial agent for the government and is responsible for managing the monetary system in the country. It comes at the top of the country's monetary system.
- 3) Sam Wilson also defined it as the bank that regulates the pumping of money through the arteries of economic life, determines the level of interest rates, and manages monetary affairs in the country.
- 4) It is also known that it is the institution that is responsible for managing the expansion and contraction in the volume of money, i.e. regulating the supply of money, in order

to achieve general welfare and also ensure the stability of the state's banking system as the monetary authority.

- 5) De Kock also defined it ((DEKOCK as the bank that codifies and determines the monetary and banking structure in a way that achieves the greatest benefit for the national economy by performing multiple functions such as codifying the currency, managing the state's financial operations, and maintaining the cash reserves of commercial banks, managing the state's foreign currency reserves, Serving commercial banks by re-discounting commercial papers, acting as a lender to commercial banks, and completing clearing work between commercial banks Organizing and controlling credit in a manner consistent with the requirements of the national economy to achieve monetary policy objectives. This definition is considered a comprehensive definition of the functions of the central bank, unlike previous definitions, most of which focused on one function and two functions of the central bank.

B. Functions of the Central Bank

The central bank has many functions, including:

- 1) Cash issuance: The Central Bank is responsible for the process of issuing cash and maintaining the value of the local currency, as well as controlling inflation rates by controlling and restricting the supply of cash according to the economic situation. The Central Bank issues cash according to the economic needs of the country and in a manner that serves the goal of maintaining the stability of the value of the issued currency and maintaining price levels.
- 2) Contributing to the formulation of monetary and banking policy. This means that he is responsible for monetary policy and supervises banking and credit policy and its organization. This means directing banks with regard to interest rates, the extent of credit expansion, and their programs to organize credit and achieve economic stability.
- 3) The Central Bank, the state bank and its financial advisor: The Central Bank participates with the government in setting and implementing the general economic policy of the state, so these banks cannot be managed independently of the policy drawn up by the state to achieve general economic interests. This explains the condition of state ownership of the Central Bank to ensure cooperation and homogeneity between it and the government authority. The Central Bank is considered a financial advisor to the state and an important source of credit.
- 4) The Central Bank The Bank of Banks: The Central Bank provides commercial banks with the same treatment that commercial banks provide in their dealings with the public. Just as commercial banks grant loans and keep deposits of individuals, central banks also grant loans to commercial banks, but when needed and during crises. This function is represented by (keeping the balances of commercial banks, the function of the last resort, the Central Bank is a credit monitor).
- 5) The Central Bank is the bank for holding the country's reserves of gold and foreign currencies: The central bank in many countries has become a central bank for conversion, as it obtains the surplus of foreign currencies when the balance of payments

is in the country's favor, and assets of gold and foreign currencies help avoid tremors that national currencies may be exposed to, and are also used to maintain stable exchange rates.

- 6) **The Central Bank Credit Management:** The credit function is of utmost importance in terms of economic activity and the activities of banking institutions due to the role they play in providing and mobilizing funds in all investment and economic fields. Credit is defined as the process of providing individuals, institutions and establishments in society with the necessary funds, provided that it pledges to pay those funds, their interest, the currencies due on them and the expenses in one payment or in installments on specific dates.

C. Characteristics and Objectives of Central Banks

1) Characteristics of a Central Bank

The central bank has special characteristics that illustrate its unique nature and reflect its importance as a central bank. These characteristics include:

- 1) The central bank issues what is called legal tender, meaning it converts real assets into monetary assets and monetary assets into real assets.
- 2) The goal of the central bank differs from that of commercial banks or private enterprises in terms of profit-making, as it is generally accepted in all economic activities that the main aim is to achieve profit, whereas the central bank aims to achieve the overall economic good.
- 3) The central bank is considered a public entity affiliated with the state, which is the prevailing approach in most countries of the world.
- 4) The central bank maintains the bank accounts of government departments and institutions with the same functions normally performed by commercial banks for their clients, and in this regard, it is considered more efficient than governmental bodies due to its transactional flexibility on one hand, its strong connections with monetary institutions on another hand, and its ability to collect, disburse, transfer, and settle on the third hand.
- 5) The central bank occupies a leading position at the top of the banking system due to its supreme regulatory authority over commercial banks and its ability to create and destroy legal tender unlike any other.
- 6) The central bank deals with local and foreign financial and monetary institutions.
- 7) The central bank bears the responsibility of protecting the country's financial and economic stability.
- 8) The central bank is the sole institution in the monetary and banking system of each country, and it is inconceivable to have multiple issuing units with some independence from one another. In every national economy, there is only one central unit responsible for issuing currency and supervising credit, although there are some countries that follow a system of multiple central banks.

2) The Objectives of Central Bank

Economists have differed in reporting the main objectives of the central bank, but they agreed that the most important objectives are:

- 1) Working to achieve a high level of employment.
- 2) Working to achieve the best economic growth rates.
- 3) Maintaining the overall financial stability of the economy and the financial performance stability of the banking sector in particular.
- 4) Maintaining monetary stability in the economy.
- 5) Using appropriate monetary tools and policies to provide the necessary liquidity to the banking system.
- 6) Enhancing prudent banking supervision over banks without hindering their activity.
- 7) Developing the mechanisms and supervisory capacities of central banks over banks.
- 8) Complete familiarity and full knowledge of the composition of banking products and the way they are structured, including the procedures and internal policies followed in banks for managing all types of risks.
- 9) The necessity of maintaining the highest possible level of coordination and integration between monetary policy and fiscal policy.
- 10) Enhancing the safety of the banking system by strengthening the ability of banking institutions to compete domestically and internationally.
- 11) Improving and developing banking legislation to ensure an appropriate banking environment capable of keeping pace with global developments and changes in the banking industry.

2. Monetary stability

Achieving monetary stability is considered essential for the continuity of any economic, financial or monetary activity, and the study of monetary stability aims to identify the main methods and rules that provide the economic, financial or monetary entity with a programme to achieve stability within the framework of measures proposed by the International Monetary Fund.

A. Definition of Monetary Stability

There are several definitions of monetary stability, including:

- 1) Monetary stability refers to stability in prices, such as interest rates, product prices, and exchange rates across time and place, within a framework that seeks to uphold market freedom. This means there should be a fixed proportionality between national output and the money supply, so that any increase or decrease in the money supply corresponds to a similar increase or decrease in national output.
- 2) Monetary stability is synonymous with price stability and refers to a stable level of prices or a low level of inflation, not to stable individual prices. There is no doubt that changes in relative prices play a crucial and beneficial role in economic adjustment and decision-making by individual actors, whether companies or households, and part of the costs of inflation may be associated with the fact that these relative price signals will collapse more and more as inflation rates rise.

- 3) Monetary stability is defined as the general price level and the stability of the exchange rate of the dinar, along with the enhancement of an appropriate interest rate structure. Monetary stability is considered one of the most important pillars of an environment that attracts both domestic and foreign investment, with these investments serving as the main driver of economic activity. Thus, the role played by the central bank in growth is considered indirect.
- 4) Monetary stability refers to the stability of the general price level or the acceptance of an acceptable rate of inflation, meaning that exchange rates, interest rates, and the general price level remain at levels that do not experience significant fluctuations, as such fluctuations can lead to major economic shocks.
- 5) It is also defined as: price stability within the framework of market freedom, which means a constant proportion between the money supply and the national output, and any increase or decrease in the money supply not matched by a corresponding increase or decrease in national output will disrupt this stability.

B. Importance and Standards for Achieving Monetary Stability

1) Importance of Monetary Stability

Monetary stability is important for various aspects and sectors of the economy, including the following:

- 1) Investors and fixed-income earners: Monetary stability helps local investors maintain stable prices for their products and thus stable profit rates, while their commitments remain fixed. As for fixed-income earners, they benefit from the stability of their real income, which reduces the need to demand higher wages, resulting in economic stability.
- 2) Production Structure: When monetary stability occurs, there is stability in the general level of prices, wages and profits, which encourages capital and labour to engage in investment and productive activities that form the cornerstone of economic growth, at the expense of non-productive activities such as speculation.
- 3) The internal monetary system: Inflation indicates the failure of money to perform its neutral functions, which include serving as a medium of exchange, a store of value, and a measure of value. When monetary stability occurs, the opposite happens, as the market shifts from consumption to savings due to stable prices and the increased value of money, enhancing its function as a store of value. This is also accompanied by a stable growth rate in the money supply and liquidity, leading to higher interest rates, which help attract savings.
- 4) The external sector of the economy: The economy enjoys monetary stability, meaning its internal monetary system is stable, and this is reflected in its external sector and also affects the behaviour of the balance of payments, as the approximation or equality of exports with imports attracts capital inflows.

C. Criteria for Achieving Monetary Stability

Achieving monetary stability requires a set of criteria, including the following:

- 1) Achieve a relative balance between real flows and cash flows, as any increase in the monetary mass that is not matched by an increase in real (commodity) flows leads to an inflationary gap.
- 2) Ensure harmony between the rate of supply growth and public expenditure requirements, especially in consumer spending, and enhance the effectiveness of bank credit provided by the banking system to all sectors to increase the volume of commodity supply and mitigate waves of inflation.
- 3) Necessity to stabilise and maintain prices in the local market and preserve an exchange rate system that aligns with the needs of the domestic economy.
- 4) Control private banks and programme their banking activities so that they are directed towards increasing and expanding the productive capacity of the private sector rather than solely for profit.
- 5) Assist in maintaining the workforce and achieving internal and external balance.

D. Indicators for Measuring Monetary Stability

There are several indicators for measuring monetary stability, the most important of which are:

1. Indicator of the relationship between changes in the money supply and changes in the gross domestic product:

It is a quantitative measure resulting from the analysis of the money supply to achieve economic goals. This measure relies on the money supply and its development to reflect the changes occurring in the means of payment in the economy, in addition to the real GDP and its development to indicate the volume of transactions taking place in society. This criterion can be expressed in a simplified manner as follows:

$$B = \frac{\Delta M \setminus M}{\Delta Y \setminus Y}$$

B = Monetary Stability Coefficient

M / Δ M = Rate of Change in Means of Payment

Y / Δ Y = Rate of Change in Gross Domestic Product

The value of the coefficient indicates the level of monetary stability within the economy, and this value is an indicator of three levels. If the coefficient value equals one, it indicates the presence of monetary stability.

If the coefficient value is greater than one, it indicates monetary instability with the presence of inflationary pressures.

If the coefficient value is equal to or less than one, it indicates a lack of monetary stability amid deflationary pressures

2. Indicator of the relationship between the rate of change in the quantity of bank credit and the rate of change in gross domestic product:

- If the monetary stability index equals one, it means that the increase in credit quantity matches the increase in GDP, indicating that the economy enjoys monetary stability.
- If the index is greater than one, this indicates the presence of inflation, and the strength of the inflation depends on how close or far the value is from one.
- If the index is less than one, it means the economy is in a state of contraction, and the strength of the contraction depends on the proximity or distance from the negative value of the stability coefficient. In both cases, whether greater than one or less than one, it indicates the absence of monetary stability.

This indicator can be measured using the following equation:

$$B = \Delta B.C / B.C / \Delta Y / Y$$

Whereas:

B = Stability Coefficient

$\Delta B.C / \Delta B$ = Rate of Change in the Quantity of Bank Credit

$\Delta Y / \Delta Y$ = Rate of Change in Gross Domestic Product

3. Money Supply Change Index to Price Index Change:

- If the result of measuring this indicator equals one, the country's economy is in a state of economic stability.
- If the result of the measurement is greater than one, the economy is experiencing inflationary pressures, and the intensity of inflation depends on how close or far it is from one.
- If the indicator result is less than one, the economy is experiencing contraction, and the intensity of the contraction depends on its proximity to or distance from one.
- This indicator can be measured using the following equation:

$$B = \Delta M / M / \Delta P / P$$

Whereas:

B = Monetary Stability Coefficient

$M / \Delta M$ = Rate of Change in Money Supply

$P / \Delta P$ = Rate of Change in Price Index

4. Excessive Monetary Index:

This indicator refers to the modern quantity theory of money, which posits that changes in the money per unit of output cause changes in the general price level, and that price stability is only achieved when monetary authorities provide the optimal amount of money as proposed by Milton Friedman (M. FRIEDMAN). This optimal amount offsets the effect of changes in national output and money supply or its velocity to maintain the general price level of the base period. Assuming the demand for money or its velocity remains constant, the money per unit of output must also remain constant to maintain the general price level of the base period. Proponents of the modern quantity theory of money attribute

inflationary forces to the money per unit of output exceeding its optimal level, resulting in an excess of money that drives inflationary price increases. This indicator is calculated using the following equation.

$$M_{ext} = Q_0 Y_t - M_t$$

Whereas:

M_{ext} = Excess monetary value

Q_0 = Average per unit of real GDP of money supply in circulation in the base year at a given price level

Y_t = Gross domestic product at constant prices in the year

M_t = Actual money supply in circulation in the year

3. The Central Bank of Iraq and its Role in Monetary Stability

A. The Central Bank of Iraq (Establishment, Function, and Objectives)

1) Establishment of the Central Bank of Iraq

The Iraqi financial and banking system is considered one of the oldest monetary and banking systems in the Arab and developing countries. In 1890, the first modern bank in Iraq was established, the Ottoman Bank, followed by the opening of the Eastern Bank in 1912 and then the Shahanshahi Bank in 1918.

When Iraq was part of the Ottoman Empire, transactions were conducted in the Turkish pound alongside the Indian rupee in southern Iraq, and when the British entered Iraq in 1916, Iraq was integrated into the Indian monetary system managed by the British, and the rupee became the main currency in circulation at a rate of (1 dinar = 13.33 rupees).

The use of the rupee continued until 16 March 1932, when the Iraqi Currency Committee issued the first Iraqi banknotes. Law (40) was enacted in 1933, prohibiting the circulation of the Indian rupee from 1 October 1933, marking the beginning of the establishment of the national monetary system in Iraq. In 1935, the Agricultural and Industrial Bank was established, and due to the extent of its operations, it was split in 1946 into two separate banks: the Agricultural Bank and the Industrial Bank.

In 1947, Law No. (43) was issued, which established the (Iraqi National Bank) to operate as a central bank with a capital of five million Iraqi dinars, half of which was paid at the time of establishment and the remaining half kept as a reserve guaranteed by the Treasury. Thus, Iraq became the first Arab country to establish a central bank for issuing currency and exercising broad monetary control. It was later renamed the (Central Bank of Iraq) under Law No. (72) of 1956 to assume the functions of currency issuance, monetary management, acting as the government's financial agent, maintaining its accounts, and holding its foreign currency reserves. The Central Bank issued its first series of banknotes bearing its name on 17/9/1950, and its capital was increased to 15 million Iraqi dinars.

The Real Estate Bank was established in 1948 to finance the purchase of houses by individuals, the Mortgage Bank in 1959, and the Cooperative Bank in 1956. In 1959, the currency was switched from the British pound to the US dollar at a rate of 1 dinar = 2.8 dollars. On 14 July 1964, all banks and insurance companies were nationalised. Following the decline in the value of the dollar in 1971 and 1973, the value of the Iraqi dinar became

3.3378 dollars per dinar. By 1987, the banking system consisted of the Central Bank of Iraq, Rafidain Bank, Agricultural Bank, Industrial Bank and Real Estate Bank.

Due to the deterioration of Iraq's economic conditions caused by the wars fought in the early 1980s and the early 1990s, several measures were issued, including Resolution No. 12 of 1991, which allowed the establishment of private banks, starting with two banks in 1992 and reaching 17 banks by 2003.

By 2004, the new Central Bank Law No. (56) was issued, which had as its main principles the independence of the Central Bank of Iraq, addressing the issues faced by the banking sector, developing it, and strengthening its supervision. This ended the era of the Central Bank's subordination to the government that lasted from its establishment in 1947 until 2003, commencing a period of independence from 2004.

The Iraqi currency underwent several stages: the royal edition featuring King Faisal, which lasted until 1958; the edition with the republican emblem, which lasted until 1978; and the international edition known as the Swiss edition, which lasted until 1990. Due to the economic sanctions imposed on Iraq, the Central Bank printed banknotes at the Al-Nahrain Printing House, which lacked security features, using ordinary paper. After 2003, the Central Bank withdrew these banknotes and issued new ones in seven denominations, printed with high security features, continuing to print and develop these features to prevent counterfeit.

2) Functions of the Central Bank of Iraq

Among the most important functions of the Central Bank, as outlined in Article 3 of the Central Bank of Iraq Law No. 56 of 2004, are the following :

1. Striving to achieve and maintain domestic prices, promoting and maintaining a stable and competitive market-based financial system, and fostering sustainable growth, employment, and prosperity in Iraq.
2. Formulating and implementing monetary policy, including exchange rate policy.
3. Holding and managing all official foreign reserves in Iraq.
4. Holding gold and managing the government's gold reserves.
5. Providing services as the government's financial advisor and agent.
6. Providing liquidity services to banks.
7. Issuing and managing the Iraqi currency.
8. Collecting and disseminating data on the banking, financial, and economic system.
9. Issuing licenses and permits to banks and regulating and supervising banks.
10. Establishing, supervising, and promoting effective and sound payment systems.
11. Opening and maintaining accounts with foreign central banks and international financial organizations.
12. Performing any additional tasks or transactions that may arise during the performance of the duties stipulated in this law.

3) The Objectives of Central Bank of Iraq

The Central Bank of Iraq seeks to achieve several objectives, including:

1. Price targeting, where the Central Bank of Iraq adopted an inflation targeting policy after 2003.
2. Economic growth targeting, where the Central Bank of Iraq called for targeting sustainable economic growth through lending to medium and small projects, initiating loans for agricultural, industrial and housing projects, working to lift restrictions on foreign transfers to encourage foreign investment, actively participating in the economic reform programme with the International Monetary Fund, and working to establish a fund to finance investments.

B. The Role of the Central Bank of Iraq in Influencing Monetary Stability through Monetary Policy Tools (2004-2024)

The Central Bank of Iraq played a significant role in influencing monetary stability through monetary policy tools, as follows:

1. The Impact of the Legal Reserve Ratio on Monetary Stability in Iraq for the Period (2004-2024):

The Central Bank of Iraq played an active role in commercial banks through the mandatory legal reserve, which imposes a percentage of deposits to be kept with private banks as one of the traditional monetary policy tools to protect public deposits from liquidity risks that banks may face, and it also serves as a means to control a significant proportion of liquidity by managing banks' ability to create money and extend credit. Figure (1) shows the legal reserve ratio imposed by the Central Bank of Iraq during the study period. It can be observed from the table that the Central Bank of Iraq unified the ratios in 2004 and set them at 25%, with commercial banks retaining 20% with the Central Bank and 5% in their own cash reserves. This ratio continued until 2009. In 2010, the Central Bank of Iraq decided to reduce the legal reserve ratio on deposits to 15% to encourage investment, with 10% remaining at the Central Bank and 5% in commercial bank reserves, in line with the Central Bank's policies and to support economic development and provide liquidity to commercial banks. The Central Bank maintained this ratio until 2019. In 2020, it decided to reduce the legal reserve ratio to 13% to support commercial banks in providing the necessary liquidity to face the dual crisis affecting the Iraqi economy, namely the COVID-19 crisis and falling oil prices. In 2021, the Central Bank restored the legal reserve ratio to 15% due to the improvement in the country's economic and social conditions after the COVID-19 pandemic, and this ratio continued until 2024.

2. The impact of the rediscount rate on monetary stability in Iraq for the period (2004-2024)

The discount rate is considered one of the most influential economic tools that the central bank possesses on the volume of credit provided by commercial banks. It is one of the most important tools used to reduce inflation and control the money supply. It refers to the interest rate on the funds that the central bank lends to commercial banks to cover their

liquidity needs, which they use for the purpose of granting credit to individuals and institutions. Table No. (1) shows the rediscounting rate set by the Central Bank of Iraq for the period from (2004-2024). The discount rate in 2004 was (6%) and continued to rise to reach its highest rate in 2007, which was (20%), to combat inflation and limit the banks' rush to grant credit and reduce the money supply. Then it returned to decrease in 2011 to reach (6%) and continued at this rate until 2015. Then the Central Bank reduced this rate again in 2016 to (4.33%) and in 2017 it decreased to (4%) and continued until 2021. Then it returned to decrease to reach (2.5%) until 2024, which is the lowest rate of the rediscounting rate, in order to affect the ability of commercial banks to grant bank credit. When the economy goes through a state of recession and investment projects are slow, the Central Bank reduces this rate to support the ability of commercial banks to grant credit.

3. The impact of inflation on monetary stability in Iraq for the period (2004-2024)

Inflation is considered an important indicator reflecting the effectiveness of monetary policy, as a lower inflation rate indicates strong monetary stability. Table 1 shows the inflation rates in Iraq for the period from 2004 to 2024, and it can be observed from the table that there has been a decrease in inflation rates, indicating the effectiveness of monetary policy in Iraq.

4. The impact of the exchange rate on monetary stability

The exchange rate is one of the most important indicators of monetary policy as it affects the balance of payments through exports and imports. The exchange rate experienced significant stability following the Central Bank's intervention through the currency selling window. Table 1 shows considerable fluctuations in exchange rates as a result of the Central Bank of Iraq's intervention to achieve monetary stability.

5. The impact of unemployment on monetary stability in Iraq for the period (2004-2024)

Iraq witnessed a rise in unemployment rates in 2004 and thereafter due to the chaos resulting from the occupation, the collapse of state institutions, and the dissolution of many of them such as media and defence, in addition to the dismissal of thousands of employees in security institutions. Table (1) illustrates the unemployment rates for the period from 2004 to 2024, and it can be observed from the table that unemployment rates are continuously increasing, which is attributed to several reasons including population growth as well as the weakness of the private sector and its inability to absorb the annually growing workforce, with job opportunities being mostly limited to the public sector. The unemployment rates ranged between 8-9% during the period from 2004 to 2013, 10-14% from 2014 to 2019, and 15-16% from 2020 to 2024, highlighting the impact of unemployment on monetary stability, as unemployment is one of the most important indicators of monetary policy.

6. The impact of the money supply on monetary stability

One of the responsibilities of the Central Bank of Iraq is the proper management of the money supply as it is an important indicator of other economic variables and has a direct impact on the daily life of the ordinary citizen. Any exaggeration or increase in the money

supply has negative effects on monetary stability and consequently on economic performance. The measures used for the money supply include the narrow concept (M1), which consists of net currency in circulation outside the banking sector and demand deposits, and the other concept is the broad money supply (M2), which represents the narrow money supply plus quasi-money (bank deposits, government bonds, corporate bonds, stocks, investment funds, certificates of deposit, fixed deposits, and capital markets). Table 2 shows the narrow and broad money supply and their growth rates for the period 2004–2024, revealing the significant development in the money supply during the study period.

7. The impact of open market operations on monetary stability

Open market operations refer to the central bank's buying and selling of treasury bills, government bonds, and financial instruments with the aim of influencing excess reserves in commercial banks, which affects the volume of credit, the money supply, investment demand, and establishes a stable relationship between interest rates in both the money market and the capital market, with actions taken in a parallel and coordinated manner to influence credit and investment levels. These operations also aim to overcome any seasonal fluctuations in the money supply due to market factors. One of the most important operations conducted by the Central Bank of Iraq is the sale of foreign currency at its currency selling window, as shown in Table (3), which illustrates the purchases and sales of foreign currency by the Central Bank of Iraq for the period (2004-2024). The table shows an increase in foreign currency purchases and sales due to higher oil revenues and increased import demand.

Table 1. Legal Reserve Ratio, Rediscounting Ratio, Inflation Rate, Exchange Rate and Unemployment Rate in Iraq for the period (2004-2024)

Year	Legal reserve ratio%	Discount rebate percentage	Inflation rate%	Exchange rate at dinar per dollar	Unemployment rate%
2004	25	6.0	26.9	1453	8.7
2005	25	7.0	5.3	1472	8.6
2006	25	10.42	53	1467	8.4
2007	75	20	12	1254	8.6
2008	75	16.75	12	1139	8.5
2009	25	8.83	-6.37	1170	8.4
2010	15	6.25	3.37	1170	8.3
2011	15	6	6.0	1170	8.2
2012	15	6	6.09	1166	8
2013	15	6	1.88	1166	9.2
2014	15	6	2.24	1166	10.6
2015	15	6	2.3	1187	10.8
2016	15	4.33	0.6	1182	13
2017	15	4	0.2	1184	13.5
2018	15	4	0.4	1182	14.1
2019	15	4	-0.2	1182	15.8
2020	13	4	0.6	1192	16.2

Year	Legal reserve ratio%	Discount rebate percentage	Inflation rate%	Exchange rate at dinar per dollar	Unemployment rate%
2021	15	4	6.0	1450	15.5
2022	15	2.5	5.0	1450	15.5
2023	15	2.5	4.4	1312	15.4
2024	15	2.5	-12.3	1310	15.5

Source: Ministry of Planning, Central Statistical Organization, Annual Bulletins for various years (49)

Data from the Central Bank of Iraq for various years (50)

Data from the World Bank for various years (51)

Table 2. Narrow and Broad Money Supply with Growth Rates in Iraq (2003-2004)

Year	Narrow money supply M1 (billion dinars)	Growth rate%	Broad money supply M2 (billion dinars)(Growth rate%
2004	12.219	111	12.254	76.2
2005	13.795	12.6	14.684	19.8
2006	17.521	27	21.080	43.5
2007	28.808	64.6	26.956	27.8
2008	42.859	48.7	34.920	29.5
2009	45.270	5.6	45.438	30.1
2010	53.810	18.8	60.386	32.1
2011	58.698	9	72.178	19.5
2012	63.391	8	75.466	4.5
2013	73.259	15.5	87.679	16.1
2014	66.231	-9.6	90.728	3.4
2015	57.888	-12.6	82.595	-8.9
2016	62.591	8.2	88.082	6.6
2017	65.691	4.9	92.857	5.4
2018	67.161	2.2	95.391	2.7
2019	78.253	16.5	103.441	8.4
2020	88.861	13.5	119.906	15.9
2021	110.137	24	139.886	16.6
2022	145.242	31.8	168.291	20.3
2023	165.156	13.7	180.976	7.5
2024	147.981	-10.4	176.972	-2.2

Source: Ministry of Planning, Central Statistical Organization, Annual Bulletins for different years (52)

Table 3. Sales and Purchases of the Foreign Currency Sale Window in Iraq for the Period (2004-2024) Million Dollars

Year	Sales	Growth rate%	Purchases	Growth rate%
2004	6,008	-	10.402	-
2005	10,463	74.15	14.930	43.53
2006	11,175	6.80	16.912	13.77
2007	15,980	43.00	28.113	66.23
2008	25,869	61.88	45.850	63.09
2009	33,992	31.40	23.026	-49.77
2010	36,171	6.41	41.004	78.07

Year	Sales	Growth rate%	Purchases	Growth rate%
2011	39,798	10.03	51.003	24.38
2012	48,649	22.24	57.006	11.76
2013	53,231	9.42	62.000	8.77
2014	54,463	2.31	47.515	-23.36
2015	44,304	-18.65	32.450	-31.70
2016	33,524	-24.33	25.653	-21.00
2017	42,201	25.88	40.355	57.42
2018	47,133	11.69	52.299	27.59
2019	51,100	8.41	58.900	12.62
2020	44,080	-13.74	30.730	-47.82
2021	37,094	-15.85	45.997	49.68
2022	46,808	26.18	53.355	15.99
2023	56,103	19.86	64.000	19.95
2024	77,652	38.41	68.654	7.27

C. Measuring and Analyzing Monetary Stability Indicators in Iraq for the Period (2004-2024)

1. Calculating and Analyzing the Monetary Stability Index in Iraq for the Period (2004-2024)

This indicator reflects changes in the money supply and changes in GDP. When the percentage change in the money supply equals the percentage change in GDP, it indicates monetary stability. However, if the percentage change is higher or lower than the percentage change in GDP, it indicates inflationary or deflationary trends in the national economy. Table (4) shows the value of the monetary stability index for the period (2005-2011). The table shows that the index value was high during the period (2005-2011) due to the higher rate of change in the money supply compared to the rate of change in GDP, which led to a higher index value. In the period (2012-2019), the index was low as a result of monetary policy aimed at reducing the money supply and not increasing it to avoid inflationary pressures. This was accompanied by a decrease in oil revenues and the destruction of infrastructure by terrorism during that period, in addition to government spending being directed towards sustaining the war against terrorism. This led to an economic recession that contributed to lower growth. The ratio between the money supply and output reflects the deflationary pressures that affected the degree of monetary stability during that period. We conclude from this that the monetary stability index was low in Iraq, as it was far from one, which means there was no monetary stability due to the presence of deflationary and inflationary effects in the Iraqi economy during the research period.

Table 4. Monetary Policy Index in Iraq for the Period (2004-2024) as a Percentage

Year	Money supply (M1) Million dinars (1)	Rate of change in money supply ² %	Gross Domestic Product (GDP) at constant prices, base year 2007 (million dinars) ³	Rate of change in GDP % ⁴	Monetary Stability Index (4/2) ⁵
2004	10148626	-	101845262.4	-	-
2005	11399125	12.3	103551403.4	1.7	7.2
2006	15460060	35.6	109389941.3	5.6	6.4
2007	21721167	40.5	111455813.4	1.9	21.3
2008	28189934	29.7	120626517.1	8.2	3.6
2009	37300030	32.3	124702075.0	3.4	9.5
2010	51743489	38.7	132687029.6	6.4	6.0
2011	62473929	20.7	142700217.0	7.5	2.8
2012	63735691	2.0	162587533.1	13.9	0.1
2013	73830964	15.8	174990175.0	7.6	2.1
2014	72692448	-1.5	175335399.6	0.2	-7.5
2015	69613150	-4.2	183616252.1	4.7	-0.9
2016	75523952	8.4	208932109.7	13.8	0.6
2017	76986584	1.9	201059363.1	-3.8	-0.5
2018	77828984	1.1	199129298.5	-0.1	-11
2019	86771000	11.4	199129298.5	7.2	1.6
2020	103353556	19.1	188112265.8	-11.9	-1.6
2021	119944017	16	198337848.9	5.4	2.9
2022	146487925	22.1	214123653.6	7.9	2.8
2023	160318372	9.4	215232183.6	0.5	18.8
2024	156134678	-2.6	211906340.0	-1.5	1.7

Source: Central Bank of Iraq, General Directorate of Statistics and Research, Annual Statistical Bulletin, for various years. (54), Columns 4 and 5 are compiled by the researcher.

2. Calculating and Analyzing the Excess Money Index in Iraq for the Period (2004-2024)

This indicator is used to calculate the amount of cash exceeding the optimal level to maintain price stability. The average share of the produced unit from the gross domestic product was calculated from the amount of cash in circulation, taking 2004 as the base year, with this average assumed constant over the research period. Then, the optimal amount of cash is calculated by multiplying the GDP with the base value for each year of the study, and by subtracting the money supply (1M) from the optimal amount of cash, we obtain the indicator. Table No. (5) shows the monetary excess indicator for the period from 2004 to 2024 in Iraq. The table shows that the value of the indicator is continuously increasing, rising from 1,080,486.31 in 2005 to 65,493,419.91 in 2019, reflecting the monetary authorities' excessive issuance of currency, which led to a significant increase in aggregate demand for goods and services exceeding the actual total supply, thus contributing to higher local price levels.

Monetary policy also responded to the increase in the money supply due to the rise in aggregate demand on one hand and the financing of development operations on the other, especially after 2003 due to the collapse of Iraq's economic infrastructure, as well as

in response to the increase in current and investment public spending. From the above, we conclude that the monetary excess indicator took an upward trend in Iraq as a result of the authorities and the central bank excessively issuing currency, leading to significant increases in aggregate demand beyond the real aggregate supply, thereby contributing to the rise in the monetary excess indicator, raising local price levels, and ultimately resulting in the absence of monetary stability.

Table 5. Excess Money Index in Iraq for the Period (2004-2024) as a Percentage

Year	Cash Offer M1 1	Gross Domestic Product (GDP) at constant prices, base year 2007 2	Optimal cash amount 3	Index of Excessive Money Supply (3-1) 4	Excessive cash flow (2/4) 5
2004	10148626	101845262.4	10148626	-	-
2005	11399125	103551403.4	10318638.69	1080486.31	1.04
2006	15460060	109389941.3	10900434.41	4559625.59	4.17
2007	21721167	111455813.4	11106293.40	10614873.60	9.52
2008	28189934	120626517.1	12020131.12	16169802.72	13.40
2009	37300030	124702075.0	12426250.28	24873779.72	19.95
2010	51743489	132687029.6	13221931.06	38521557.94	29.03
2011	62473929	142700217.0	14219720.17	48254208.83	33.92
2012	63735691	162587533.1	16201441.55	47534429.45	29.24
2013	73830964	174990175.0	17437333.83	56393630.17	32.23
2014	72692448	175335399.6	17471734.60	55220713.40	31.49
2015	69613150	183616252.1	18296900.87	51316249.13	27.95
2015	75523952	208932109.7	20819562.84	54704389.16	26.18
2017	76986584	201059363.1	20035063.31	56951520.69	28.33
2018	77828984	199129298.5	19842737.19	57986246.91	29.12
2019	86771000	199129298.5	21277580.09	65493419.91	30.67
2020	103353556	188112265.8	18744917.32	84608638.7	44.97
2021	119944017	198337848.9	19763871.22	100180145.8	50.50
2022	146487925	214123653.6	21336887.27	125151037.8	58.44
2023	160318372	215232183.6	21447349.47	138871022.5	64.52
2024	156134678	211906340.0	21115937.46	135018740.5	63.71

Source: Central Bank of Iraq, General Directorate of Statistics and Research, Annual Statistical Bulletin, for various years. (56) Columns 3, 4, and 5 are the researcher's work.

Conclusions

The research findings indicate that the Central Bank of Iraq enjoys complete independence, as stipulated by Central Bank Law No. 56 of 2004. This demonstrates that monetary policy is an effective tool at the disposal of the Central Bank to address imbalances that may occur at the monetary level by influencing the money supply. The Central Bank's independence also leads to sound management of monetary policy, free from government pressure and interference in monetary affairs.

On the other hand, the findings also show that monetary policy is unable to achieve the desired monetary stability in the Iraqi economy due to several structural deficiencies.

This means that the Central Bank's role is no longer limited to specific functions related to commercial banks, but has become fundamental in formulating the country's economic policy. Therefore, the Central Bank is considered the authority that oversees and implements monetary policy in accordance with political and economic objectives.

The Central Bank also acts as the bank of banks and the state's financial advisor. Consequently, monetary policy in Iraq has faced numerous obstacles, including an increase in the money supply, a balance of payments deficit, external debt, and inflation. This means that the monetary stability index continued to fluctuate between declines and increases due to the mismatch between the money supply and GDP growth, with deflationary pressures prevailing.

The absence of a clear economic vision, the lack of a defined direction for the Iraqi economic system, weak management, and a lack of coordination between economic objectives and activities all contributed to limiting the effectiveness of monetary policy tools and reducing their role in achieving monetary stability. This indicates that open market operations had a weak impact on monetary stability due to excessive foreign currency sales. Consequently, the required reserve ratio remained constant for most of the study period, and therefore its impact on monetary stability was minimal. Furthermore, the discount rate also had a weak impact on monetary stability. Thus, the calculation of the excess money supply index reveals a surplus in the money supply exceeding the needs of the Iraqi economy. This surplus was a response to public finances rather than an increase in production.

Recommendations

The research proposes several important recommendations, including the need to continue supporting and strengthening the independence of the Central Bank of Iraq. It also emphasizes the importance of coordinating efforts between macroeconomic and monetary policies to implement economic reforms across all sectors, aiming to eliminate structural imbalances in the economy.

Furthermore, it suggests that monetary policy should work diligently to control the large money supply and achieve a balance between it and GDP. This leads to the need for the monetary authority to develop financial and monetary markets to enhance their capacity to absorb indirect measures. The Central Bank of Iraq must actively participate in formulating, preparing, and financing economic plans.

It is also crucial to focus on activating monetary policy tools to ensure their effectiveness in achieving monetary stability. Additionally, it is essential to avoid excessive issuance of new currency and to work on reducing public spending to curb the phenomenon of increased public expenditure.

Therefore, the Central Bank of Iraq must adopt a future-oriented approach that necessitates its continued support for the Iraqi dinar and maintaining the exchange rate to attract foreign investment and drive economic growth. This includes diversifying sources of production and national income, ensuring the independence of natural and human resources, and increasing investment to raise GDP, thereby mitigating the impact of the

money supply and achieving monetary stability. Furthermore, banking reforms should be expedited in accordance with international standards to enable the banking sector to contribute to financing development and encouraging investment. The private sector should also be encouraged and supported to play its role in the economic development process.

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