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Iraq Elections: Unrealized Geopolitical Risk Could Unfold in May

With the recent move by the Iraqi parliament to approve Prime Minister Haider al-Abadi's proposal to hold national elections on May 12, we are highlighting what we view as potentially unrealized geopolitical risk in Iraq's Kurdish region heading into the election. We view the political uncertainty around the upcoming election as potentially impacting crude production along with ancillary company risk/reward for those with exposure in the region. On January 21, Iraq's Supreme Federal Court ruled that elections must be held within the timeframe specified by the Iraqi constitution. Sunni and Kurdish lawmakers had called for delaying the vote to allow the return of hundreds of thousands of Iraqis displaced by the fight against the Islamic State.

The outcome of the May election will be critically important in rebuilding and attracting reinvestment in Iraq, along with ensuring energy interests in the region remain secure. Tensions between the central government in Baghdad and the Kurdistan Regional Government (KRG) soared last year after the latter held a referendum for independence in September – an issue we highlighted as one to watch with potentially up to 400,000 bbls/pd of crude production at risk within the impacted area.

Abadi's action in reclaiming the disputed territories from the Kurdish forces secured him widespread popularity, so much so in our view that Abadi will likely claim victory on May 12th. However, to remain firm on this stance as a campaign platform, he is unlikely to come to the table and negotiate with the Kurds beforehand. This sets up a potentially volatile geopolitical risk scenario in the region heading into the May election. We highlight the following key takeaways on the forthcoming Iraq elections:

- 1. Potential supply risk (bullish crude):** crude oil exports from northern Iraq have dropped significantly – from 700,000 bbls/pd to 300,000 bbls/pd since the independence referendum in September. Many of the cuts occurred at fields controlled by the government. We estimate a total of 400,000 bbls/pd of total crude production in the disputed regions could be impacted
- 2. Payment risk:** KRG revenue streams from oilfields now controlled by Iraqi military forces likely means significant cuts to KRG oil-related funds. This is not likely to improve before the election given the strong support for Abadi's actions in reclaiming the territories.
- 3. Budget cuts at KRG:** with the status quo vis-à-vis KRG independence likely set to continue through the election, we may see additional cuts to oil revenues allocated to the KRG from the Iraqi parliament. Following the referendum last September, the Iraqi parliament proposed cutting the regions share of the budget from 17% to 12.6%
- 4. Iran/Iraq Relations:** Iran will continue to exert influence over Iraq, in direct opposition to US interests in the region espoused by President Trump.

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