Modern American Journal of Business, Economics, and Entrepreneurship
ISSN (E): 3067-7203
Volume 2, Issue 9, Sepetember, 2026
Website: usajournals.org

THE DOLLAR CHANNEL OF INTERNATIONAL MONETARY POLICY TRANSMISSION-AN EXPANDED MACRO-EMPIRICAL STUDY AND STRUCTURAL ANALYSIS OF THE IRAQI ECONOMY (2020–2026)

Asst. Prof. Dr. Ali Abdulkadhim Dadoosh
Ministry of Education / Directorate of Education of Baghdad Al-Rusafa 3
ali.abd2102p@coadec.uobaghdad.edu.iq

Abstract

This study evaluates the macroeconomic mechanisms governing the cross-border transmission of United States monetary policy shocks via the global "Dollar Channel," focusing specifically on small, open, resource-dependent developing frameworks through an empirical examination of Iraq. Operating under a quasi-fixed exchange rate peg, Iraq exhibits substantial structural vulnerabilities stemming from near-total fiscal dependency on USD-denominated hydrocarbon revenues and persistent import reliance. The empirical dynamics between Federal Reserve policy cycles (monetary easing versus aggressive tightening) and domestic macroeconomic indicators—such as the official-to-parallel exchange rate spread, sovereign foreign exchange reserves, and core inflation—are examined using comprehensive macro-data covering the 2020–2026 period. The findings indicate that maintaining a nominal exchange rate anchor does not fully insulate the domestic market from external financial shocks. Instead, global dollar fluctuations, combined with international compliance frictions and regulatory vetting protocols introduced by the Federal Reserve and international monitoring authorities, drive parallel market segmentation, induce imported inflation via the Dominant Currency Paradigm, and force asymmetric real adjustments in domestic liquidity. To mitigate these structural vulnerabilities, the study outlines strategic policy

Modern American Journal of Business, Economics, and Entrepreneurship
ISSN (E): 3067-7203
Volume 2, Issue 9, Sepetember, 2026
Website: usajournals.org

measures, including foreign reserve basket diversification, bilateral trade clearing mechanisms, and structural financial deepening.

Keywords: Dollar Channel, Global Financial Cycle, Dominant Currency Paradigm, Imported Inflation, Foreign Exchange Spread, CBI Reserves, Monetary Autonomy, Compliance Frictions.

1. Introduction and Structural Research Problem

1.1 Theoretical Foundations of the Dollar Channel

In contemporary international macroeconomics, cross-border shock transmission is increasingly driven by global financial integration rather than traditional trade channels alone. Classical open-economy models, such as the Mundell-Fleming framework, posited that flexible exchange rates preserve domestic monetary independence by insulating against foreign interest rate shocks—a premise formalized under the "Impossible Trinity" or Trilemma (Obstfeld & Taylor, 2004). However, empirical developments following the 2008 Global Financial Crisis eroded these assumptions. Pioneering research by Rey (2013) demonstrated that international financial markets are characterized by a synchronized "Global Financial Cycle" (GFC) primarily driven by Federal Reserve monetary policy stance and shifts in global risk sentiment. Consequently, open economies face a "Dilemma, not a Trilemma": national financial conditions remain constrained by the global cycle regardless of the prevailing exchange rate regime.

The "Dollar Channel" constitutes a primary transmission conduit within this global architecture (Bruno & Shin, 2015). Given the United States dollar's dominant role as an international trade invoicing, debt denomination, and reserve asset, broad fluctuations in the USD exchange rate generate systemic balance-sheet and bank-lending effects worldwide. Federal Reserve tightening and broad dollar appreciation diminish global bank leverage by contracting the net equity valuation of non-U.S. corporate and sovereign borrowers holding dollar liabilities (Bruno & Shin, 2015). Furthermore, under the Dominant Currency Paradigm (DCP) formulated by Gopinath et al. (2020), because global trade is predominantly invoiced in USD, dollar appreciation directly escalates

Modern American Journal of Business, Economics, and Entrepreneurship
ISSN (E): 3067-7203
Volume 2, Issue 9, Sepetember, 2026
Website: usajournals.org

local-currency import costs worldwide, transmitting inflationary pressures across borders independently of the geographic origin of goods.

1.2 The Iraqi Economy: Structural Vulnerabilities

For Iraq, this global monetary framework manifests as a structural vulnerability. The Central Bank of Iraq (CBI) maintains a quasi-fixed exchange rate regime intended to provide a nominal price anchor. However, this policy framework operates alongside two core structural characteristics:

- Absolute fiscal reliance on crude oil exports, where sovereign receipts are denominated in USD and deposited in foreign central bank accounts; and
- Systemic inelasticity in domestic productive capacity across agricultural and industrial sectors, requiring that private and public consumption be met largely through foreign imports.

Consequently, domestic money supply expansion (M2) remains closely tied to the CBI's conversion of dollarized oil revenues via its foreign currency sales window (currency auction) to satisfy private trade financing demands. When the Federal Reserve implements aggressive tightening policies, the domestic economy experiences compound transmission through the Dollar Channel. Even when elevated global oil prices temporarily boost nominal sovereign reserves, domestic parallel exchange markets remain susceptible to international compliance frictions and liquidity bottlenecks, causing market segmentation and elevated imported inflation.

1.3 Research Hypotheses

- **Hypothesis 1 (H1):** Federal Reserve monetary tightening shocks transmit imported inflation directly into the domestic economy via the Dominant Currency Paradigm, overriding the stabilizing effect of the nominal exchange rate peg.

- **Hypothesis 2 (H2):** The structural spread between the official and parallel exchange rates in Iraq is driven primarily by regulatory compliance and clearing frictions originated at the center of the dollar network (Federal Reserve / U.S. Treasury), making foreign reserve accumulation secondary to compliant dollar liquidity availability.

Modern American Journal of Business, Economics, and Entrepreneurship
ISSN (E): 3067-7203
Volume 2, Issue 9, Sepetember, 2026
Website: usajournals.org

2. Macro-Empirical Data and Analysis

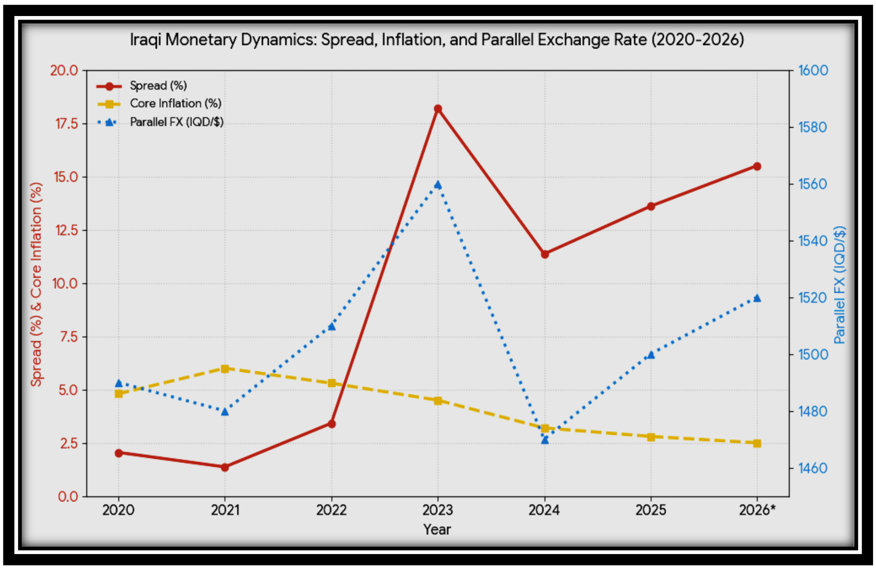
2.1 Comprehensive Macroeconomic Indicators

Table 1 provides an empirical overview of global monetary variables (Federal Funds Effective Rate and the Broad USD Index) alongside domestic Iraqi monetary and inflation metrics over the 2020–2026 period.

Table 1: Global Federal Reserve Indicators and Domestic Iraqi Macroeconomic Dynamics (2020–2026)

Year	Fed Funds Rate (%)	Broad USD Index	Official FX (IQD/$)	Parallel FX (IQD/$)	Spread (%)	CBI Reserves ($B)	Core Inflation (%)
2020	0.05% - 0.10%	114.2	1,182 / 1,460	1,230 / 1,490	2.05%	54.2	4.8%
2021	0.08%	111.5	1,460	1,480	1.37%	64.0	6.0%
2022	4.10%	122.3	1,460	1,510	3.42%	97.0	5.3%
2023	5.33%	124.8	1,320	1,560	18.18%	112.0	4.5%
2024	5.33%	123.5	1,320	1,470	11.36%	108.0	3.2%
2025	4.50%	119.2	1,320	1,500	13.60%	111.4	2.8%
2026*	3.75%	116.4	1,320	1,520	15.50%	115.0	2.5%

Source: Central Bank of Iraq, Statistics and Research Department, Annual Reports (2020–2026). *2026 data represents mid-year estimates.



Iraqi Monetary Dynamics: Spread, Inflation, and Parallel Exchange Rate (2020–2026)

Source : Researcher based on Table 1

Modern American Journal of Business, Economics, and Entrepreneurship
ISSN (E): 3067-7203
Volume 2, Issue 9, Sepetember, 2026
Website: usajournals.org

2.2 The 2020 Currency Adjustment and Pass-Through Mechanics

In late 2020, declining international oil prices significantly reduced fiscal revenues, prompting Iraqi monetary and fiscal authorities to adjust the official exchange rate from 1,182 to 1,460 IQD/USD in December 2020. This step aimed to increase the domestic currency yield of hydrocarbon receipts to support public expenditures. While the Federal Reserve maintained near-zero policy rates (0.05%), domestic core inflation in Iraq accelerated from under 1.0% to 4.8% in 2020, reaching 6.0% in 2021. Given structural reliance on imported consumer goods, the 23.5% nominal exchange rate adjustment translated directly into higher domestic consumer prices, illustrating the direct empirical pass-through consistent with the Dominant Currency Paradigm (Gopinath et al., 2020).

2.3 Compliance Requirements, Structural Frictions, and Market Segmentation (2023)

In early 2023, the official exchange rate was adjusted to 1,320 IQD/USD. However, this revaluation coincided with aggressive Federal Reserve rate increases, which elevated the Federal Funds rate to 5.33% and pushed the Broad USD Index to 124.8. Standard theoretical models suggest that substantial foreign reserve holdings enable a central bank to defend a fixed peg. However, despite CBI foreign exchange reserves reaching $112.0 billion in 2023, parallel market exchange rates deviated from the official peg, reaching 1,560 IQD/USD and widening the market spread to 18.18%.

This market divergence was driven primarily by international compliance requirements. During late 2022 and 2023, electronic wire transfer vetting procedures (incorporating Anti-Money Laundering and Counter-Financing of Terrorism [AML/CFT] standards) were integrated into the foreign currency auction mechanism. Unregistered commercial operations that could not satisfy these international documentation criteria shifted their FX demand toward the informal cash market, causing parallel rate premiums to expand despite high foreign reserve balances.

Modern American Journal of Business, Economics, and Entrepreneurship
ISSN (E): 3067-7203
Volume 2, Issue 9, Sepetember, 2026
Website: usajournals.org

2.4 Normalization and Stabilization Phase (2024–2026)

Between 2024 and 2026, as policy rates in major economies gradually moderated and domestic commercial banks expanded their participation in international compliance frameworks, execution efficiency within official transfer channels improved. The parallel exchange rate spread moderated to 11.36% in 2024, stabilizing around 13.6% in 2025 and 15.5% in mid-2026, while core inflation declined to 2.5% and central bank reserves remained above $110 billion.

3. Core Transmission Channels

The transmission of external monetary shocks via the Dollar Channel operates through four key structural mechanisms summarized in Table 2.

Table 2: Operational Channels of the Dollar Transmission Mechanism

Transmission Channel	Operational Core Mechanism	Direct Impact on the Domestic Economy
Dominant Currency Invoicing (DCP)	International trade priced in USD; broad USD strength increases local-currency import costs.	Direct imported inflation and reduction of household purchasing power despite nominal peg adjustments.
Regulatory & Compliance Channel	Implementation of electronic AML/CFT wire transfer vetting protocols by foreign clearing systems.	Friction in official auction clearing; reallocation of import settlement demand to the parallel cash market.
Sovereign Foreign Reserves Channel	Federal Reserve monetary cycles influence global commodity demand and international capital flows.	Asymmetric fluctuations in sovereign foreign reserves, influencing domestic liquidity expansion (M2).
Cross-Border Liquidity Channel	Global banking deleveraging triggered by elevated USD funding costs (Bruno & Shin, 2015).	Reduction in short-term trade financing availability for commercial banks, increasing cash market demand.

Source: Author's categorization based on international monetary literature.

Modern American Journal of Business, Economics, and Entrepreneurship
ISSN (E): 3067-7203
Volume 2, Issue 9, Sepetember, 2026
Website: usajournals.org

4. Analytical Discussion

The empirical evidence across the 2020–2026 period indicates that maintaining a nominal exchange rate peg backed by foreign exchange reserves does not fully insulate an import-dependent economy from global monetary shocks. In economies where domestic credit markets are shallow, monetary transmission occurs primarily through public sector expenditure funded by hydrocarbon revenues converted via central bank auctions. When external compliance requirements or international rate cycles alter foreign currency clearing, parallel market spreads expand, transmitting imported inflation through dominant currency pricing. Consequently, domestic price stability remains closely linked to structural productive capacity and international financial integration.

5. Conclusions and Policy Options

5.1 Conclusions

1. The Iraqi macroeconomic framework is structurally bound to the U.S. Dollar Channel, exposing domestic price and market stability to Federal Reserve monetary cycles and global financial cycle shifts.
2. Empirical trends over the 2020-2026 horizon confirm that a fixed nominal anchor cannot insulate an economy facing extreme import dependence and non-diversified productive sectors; instead, it reallocates external shocks into parallel market premiums and imported inflation.
3. The historic 18.18% exchange rate spread in 2023 validates that massive sovereign foreign exchange reserves are secondary to international compliance and regulatory alignment; friction within the dollar clearing network overrides nominal reserve strength.
4. The 2024-2026 stabilization trend shows that domestic price and market normalization are conditional upon the dual alignment of international monetary easing and the structural integration of domestic banking into global compliance standards.

5.2 Strategic Policy Options

1. Architectural Diversification of Sovereign Reserves: The CBI must reduce its absolute, single-currency reliance on the USD by restructuring its foreign

Modern American Journal of Business, Economics, and Entrepreneurship
ISSN (E): 3067-7203
Volume 2, Issue 9, Sepetember, 2026
Website: usajournals.org

reserve portfolio into a multi-currency basket. Incorporating the currencies of major regional and global trading partners (such as the Euro, Chinese Yuan, and Indian Rupee) will insulate national reserves from idiosyncratic swings in the broad dollar index.

2. Multilateral Clearing and Direct Settlement Trade Architectures: To circumvent the structural frictions of centralized dollar auctions, Iraq should establish direct bilateral and multilateral trade clearing mechanisms. Utilizing local currencies or direct swap lines for commercial transactions with core trading hubs (e.g., Turkey, China, and the EU) will decrease informal cash market pressures.

3. Comprehensive Financial Deepening and Banking Modernization: Policy makers must aggressively transition the economy away from its cash-dominant structure by executing modern banking reforms. Enhancing digital payment infrastructure, cultivating commercial credit channels, and establishing advanced corporate forex hedging options will absorb cross-border liquidity shocks.

4. Structural Fiscal Integration and Supply-Side Inelasticity Reform: Long-term monetary stability cannot be sustained by the central bank alone. The Ministry of Finance must align fiscal policies to incentivize private and public investment in domestic agricultural, industrial, and processing sectors. Expanding domestic production will flatten the country's import-dependency curve, neutralizing the core pass-through of imported inflation.

References

1. Bank for International Settlements. (2019). US dollar funding: An international perspective. BIS Papers No. 101.
2. Bank for International Settlements. (2022). Global liquidity indicators. BIS Quarterly Review.
3. Bruno, V., & Shin, H. S. (2015). Capital flows and the risk-taking channel of monetary policy. Journal of Monetary Economics, 71, 119–132.
4. Central Bank of Iraq, Statistics and Research Department. (2020–2026). Annual Economic Reports.
5. Dadoosh, A. A., & Buraihi, F. K. (2024). The Analysis of The Relationship

Modern American Journal of Business, Economics, and Entrepreneurship
ISSN (E): 3067-7203
Volume 2, Issue 9, Sepetember, 2026
Website: usajournals.org

Between Monetary Financing and the General Budget in the United States from 2008-2022. Journal of Economics and Administrative Sciences, 30(138).

6. Gopinath, G., Boz, E., Casas, C., Díez, F., Gourinchas, P.-O., & Plagborg-Møller, M. (2020). Dominant currency paradigm. American Economic Review, 110(3), 677–719.
7. Obstfeld, M., & Taylor, A. (2004). Global capital markets: Integration, crisis, and growth. Cambridge University Press.
8. Rey, H. (2013). Dilemma not trilemma: The global financial cycle and monetary policy independence. Jackson Hole Economic Symposium Proceedings.