April 2013
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Morocco: 2012 Article IV Consultation and First Review Under the Two-Year Precautionary and Liquidity Line—Staff Report; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Morocco.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2012 Article IV consultation with Morocco and First Review under the Two-Year Precautionary and Liquidity Line, the following documents have been released and are included in this package:

- The staff report for the combined 2012 Article IV consultation and First Review under the Two-Year Precautionary and Liquidity Line, prepared by a staff team of the IMF, following discussions that ended on December 18, 2012, with the officials of Morocco on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 17, 2013. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its February 1, 2013, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- A statement by the Executive Director for Morocco.

The documents listed below have been or will be separately released.

Written Communication sent to the IMF by the authorities of Morocco*
Selected Issues Paper

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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MOROCCO

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION AND FIRST REVIEW UNDER THE TWO-YEAR PRECAUTIONARY AND LIQUIDITY LINE

January 17, 2013

KEY ISSUES

Background: Morocco's overall solid economic performance has been challenged by the deterioration of the situation in Europe, high oil and food prices and, in 2012, lower-than-average agriculture production, heightening pressures on the public and external accounts. Looking ahead, external pressures are not expected to abate and risks are tilted to the downside. In this context, sustained implementation of the authorities' economic agenda will be crucial to preserving Morocco's performance and making further progress toward higher and more inclusive growth.

PLL review: The authorities' program, supported by the Precautionary and Liquidity Line (PLL), is on track; staff's assessment is that Morocco continues to meet the qualification criteria for a PLL. Both end-October 2012 quantitative indicative targets were met. The authorities' economic strategy of prudent monetary and financial policies, fiscal consolidation, and structural reforms to increase competitiveness, potential growth, and employment, remains appropriate. However, in the context of a challenging environment, there is increased urgency in moving ahead with the reforms, in particular that of the subsidy system. Also, more flexibility in the exchange rate is increasingly needed to address external pressures. More investment in human capital and basic infrastructure is necessary to promote inclusive growth.

Article IV consultation: Discussions focused on: (i) ensuring continued fiscal sustainability; (ii) strengthening competitiveness; (iii) fostering higher and more inclusive growth; and (iv) maintaining the stability of the financial sector.

Staff views: Staff recommends the conclusion of the 2012 Article IV consultation and the approval of the first review under the PLL.

Approved By
Adnan Mazarei and James Roaf

The staff team comprised Mr. Dauphin (head), Ms. Garcia Martinez, Mr. Kalonji, Ms. Mazraani (all MCD), Mr. Versailles (FAD), Mr. Furceri (RES) and Mr. Leichter (SPR). Discussions took place in Rabat and Casablanca December 5-18, 2012. The mission met the Governor of the Central Bank Mr. Jouahri, the Minister of Economy and Finance, Mr. Baraka, the Minister of Labor and Professional Training, Mr. Souhail, the Minister Delegate of the Public Service and Modernizing the Public Administration, Mr. El Guerrouj, the Minister Delegate of the Budget, Mr. Azami Al Idrissi, and other senior officials and representatives of the private sector and civil society. Mr. Dairi (OED) participated in most of the meetings. Morocco has not introduced or intensified exchange restrictions and has not introduced or modified multiple currency practices in line with Article VIII.

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CONTEXT[1]

1. **Morocco's solid performance has been challenged by a combination of domestic vulnerabilities and external shocks.** Morocco has a track record of strong macroeconomic policies that, over the past decade, helped deliver solid growth, low inflation, comfortable external reserves, financial deepening, and poverty reduction, despite stubbornly high youth unemployment. However, the economy's own rigidities, social pressures, and repeated external shocks from the global crisis and commodity prices have led to a significant erosion of fiscal and external buffers. Furthermore, in 2012, growth was dragged down by a lower-than-average harvest resulting from low rainfall.

2. **The PLL continues to support the authorities' efforts to rebuild buffers and address medium-term challenges by providing insurance against external risks**. The authorities intend to continue to treat the PLL as precautionary and to draw on it only in the event of unforeseen external shocks or a substantial worsening of the international outlook relative to current assumptions. Their economic strategy supported by the PLL, which aims at ensuring fiscal sustainability and increasing competitiveness, potential growth, and employment, remains appropriate.

3. **The program is on track but, with a weaker environment, the economic outlook hinges on the sustained delivery of reforms**. Morocco continues to meet the qualification criteria for the PLL. Performance at end-October 2012 was in line with indicative targets on the central government fiscal deficit and net international reserves (NIR). In the context of a deteriorating short-term outlook for the external sector and risks still heavily tilted to the downside, prompt implementation of the program's policies remains essential for the authorities to achieve their objectives. At the top of that agenda is continued progress in addressing short- and longer-term fiscal issues, including pursuing fiscal consolidation. There is a need for a reform of the general subsidy system, including a better targeting of social protection. Further product and labor market reforms, investment in human capital and infrastructure, increased access to financial services, and improvement of the business climate are needed to boost competitiveness, potential growth, and employment. Moving toward a more flexible exchange rate would help enhance the economy's ability to absorb shocks and preserve competitiveness. However, the timing of such a move should be carefully coordinated with other macroeconomic policies, especially a shift toward a new monetary policy framework.

4. **In the context of political transition and high social demands, effective communication is important to sustaining reforms.** During a period of political transitions in many countries in the region, a new constitution adopted in July 2011 paved the way for broad-ranging political reforms, including a strengthened role for the head of government and parliament, as well as for local elected officials as part of a move toward greater decentralization. A new coalition government took office in January 2012, led by the Justice and Development Party, a moderate Islamist party, and also

[1] This report is supplemented by selected issues papers on (i) Inclusive Growth in Morocco: Stylized Facts and Policies; and (ii) Fuel Subsidies in Morocco: International Experience and Possible Ways Forward.

comprising long-time government parties such as the Istiqlal (Independence) Party. The challenge for the government is to sustain the delivery of difficult reforms, in a context of high expectations and a volatile regional environment. Under these circumstances, good communication and a high-quality social dialogue will be key to success.

5. The 2012 Article IV consultation focused on the main medium-term policy challenges. Discussions centered on (i) ensuring continued fiscal sustainability; (ii) strengthening competitiveness; (iii) fostering higher and more inclusive growth; and (iv) maintaining the stability of the financial sector.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

6. The economy's recent performance has continued to be affected by a deteriorating external environment and poor rainfall. Output growth in 2012 is estimated to have slowed to 3.2 percent, mostly due to a lower-than-average cereal crop.[2] However, real nonagricultural GDP growth is expected to have remained relatively robust at around 4.5 percent, with the negative impact of weak external demand from key trading partners—notably the EU—being more than offset by robust domestic consumption. Despite significant increases in the price of several subsidized energy products in June 2012, which were part of the government's effort to contain the fiscal cost of subsidies, headline inflation remained low at 1.6 percent (y-o-y) in November, as second-round effects of the price increases have not yet fully materialized. Core inflation (excluding food and transport) was close to zero due to the large negative contribution of lower communication tariffs. Unemployment has hovered around 9 percent since 2010 and remains particularly high among the youth, at almost 18 percent. Overall, macroeconomic performance has been broadly in line with the original framework of the PLL, but the current account deteriorated significantly more than anticipated, although reserves have stabilized at the expected level.

Selected Economic Indicators, 2012–13

	PLL 1/	Rev. 2/	PLL 1/	Rev. 2/
	2012		2013	
Real GDP, percent	2.9	3.2	5.5	4.5
Real nonagricultural GDP, percent	4.7	4.5	5.0	4.5
Inflation, percent	2.2	1.3	2.5	2.4
Fiscal deficit, percent of GDP	-6.1	-6.1	-5.3	-4.7
Current account incl. official transfers, percent of GDP	-7.4	-8.8	-4.5	-6.3
Gross reserves, billions of U.S. dollars	17.9	17.5	18.8	18.4
In months of next year imports of goods and services	4.0	4.1	3.9	4.1

Sources: Moroccan authorities; and IMF staff estimates.

1/ Refers to the initial macroframework in CR/12/239.

2/ Revised macroframework.

[2] However, the decline in agriculture production is not as strong as was anticipated under the initial PLL framework, which will lead to a smaller rebound, and therefore to lower real GDP growth in 2013.

7. The 2012 fiscal deficit is expected to have contracted in line with PLL projections. Based on data as of November 2012, it is estimated that the combination of measures taken in 2012, notably the increases in energy-administered prices in June and the control of nonessential spending, have helped reduce the deficit from 6.8 percent of GDP in 2011 to about 6 percent of GDP in 2012.[3] Both revenue and total expenditure were in line with the government's objectives. While the subsidy bill is expected to have reached about 6.2 percent of GDP, lower-than-projected investment spending kept outlays for the whole year within target. The lower investment resulted from the late adoption of the 2012 budget and delays in the expected receipt of grants from the EU and GCC, which will finance investment in 2013 rather than in 2012 as originally planned.

8. Weak external demand and high oil prices in 2012 have continued to put pressure on the current account. The strong adverse impact of weak external demand and higher commodity prices resulted in a further deterioration of the current account in 2012, with the deficit now projected to increase to 8.8 percent of GDP from 8 percent of GDP in 2011, as opposed to contracting slightly as expected under the initial PLL framework. Higher international oil prices pushed up energy-related imports, while the worse-than-projected deterioration in the European economy weighed more heavily on exports, tourism and, particularly, remittances. Furthermore, the poor cereal harvest boosted food imports in late 2012. While gross international reserves (GIR) fell steadily in 2011 and most of 2012, they reversed this trend in the last quarter of 2012 and stabilized, as expected, at around four months of imports, supported by the issuance of a US$1.5 billion sovereign bond in December.

9. The central bank responded to a tightening of monetary conditions by increasing liquidity injections. Lower international reserves had a substantial restrictive impact on bank liquidity, contributing to slowing credit growth to 7 percent in 2012 from 9.9 percent in 2011. While the policy interest rate has remained unchanged at 3 percent since March 2012, the central bank, Bank Al-Maghrib (BAM), broadly doubled the daily average of its liquidity injections compared to 2011 to help fill the liquidity shortage. It extended eligible collateral for its repo facilities to shares of mutual funds backed by mortgages and loans to small and medium enterprises (SMEs), and softened the eligibility criteria for certificates of deposits. In September 2012, it also cut its reserve requirements for banks by two percentage points to 4 percent.

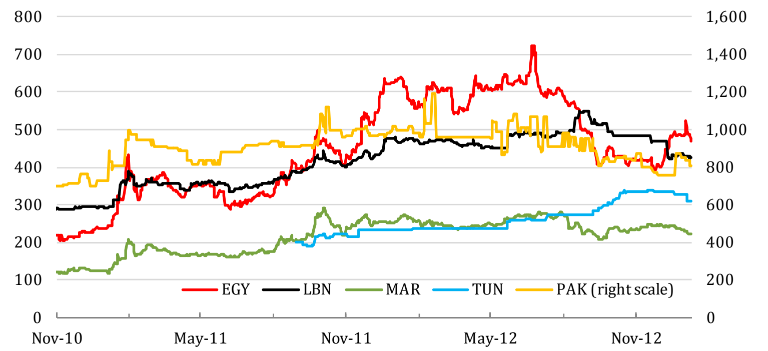
10. The financial sector has remained sound overall. In June 2012, the ratio of regulatory capital to risk-weighted assets ratio reached 12.2 percent at the aggregate level, and nonperforming loans (NPLs) remained stable and low at 5 percent of total loans. The low reliance of domestic banks on external funding has shielded them from deleveraging in Europe. However, banks' deposit–to-loan ratio has been steadily decreasing since 2007 because the pool of available deposits can no longer accommodate the growing size and pace of lending activities. The problem is exacerbated by the narrow domestic debt markets and limited resort to external funding. In response, banks are

[3] Staff estimates that the increases in the price of fuel products in June contributed to a saving of 0.7 percentage point of GDP in 2012 and will save 1.1 percentage point of GDP in 2013.

enlarging their funding sources by expanding securitization instruments, increasing their financing in foreign currencies via subsidiaries, and extending their collateral eligible under BAM monetary operations.

11. Morocco has enjoyed favorable market conditions, supported by the PLL. Morocco's five-year market credit default swap spread remains among the lowest in the region. It fell by 16 basis points on August 6, 2012 following the PLL announcement and by 40 basis points overall in the month of August. The recent sovereign bond issuance at low spreads, long maturity, and overall lower yields than obtained by other established emerging markets, (US$1 billion was issued at a 10-year maturity and a 4.25 percent yield and US$0.5 billion at a 30-year maturity and a 5.5 percent yield) was largely oversubscribed. Its success confirmed the market's confidence, despite the change in S&P's rating outlook from neutral to negative in October 2012.[4]

Credit Default Swap Spreads: Oil Importers
(Basis points)



Sources: Bloomberg LP; Markit; and national authorities.

12. The outlook will be supported by the authorities' planned fiscal consolidation, structural reforms and a prudent monetary policy. Growth is expected to accelerate somewhat in 2013 (to 4.5 percent) on account of a rebound in agriculture. Inflation will increase because of the increase in administered domestic energy prices but is expected to remain low at about 2½ percent. The current account deficit is expected to contract by more than two percentage points of GDP in 2013, as a result of the significant reduction in the fiscal deficit, lower global energy prices, a recovery in agriculture, and recent investments in export-oriented sectors, but will remain larger than projected at the time of the PLL approval, due to a base effect and a less favorable global growth outlook. Over the medium term, the authorities' economic strategy, based on fiscal consolidation, structural reforms, and prudent monetary policy, is expected to gradually promote higher growth and reduce the current account deficit. The program framework is based on a gradual and relatively conservative increase of real GDP growth to close to 6 percent in the medium term. This is in line with the initial PLL framework, but remains lower than what steadfast implementation of ambitious structural reforms could deliver to help make a significant dent in unemployment, as discussed below.

[4] On November 7, Fitch reaffirmed its assessment of the Moroccan outlook as stable, provided that the subsidy reform is implemented.

13. Risks to the outlook have risen and are tilted to the downside. The baseline scenario of steadily improving macroeconomic performance is vulnerable to significant external and domestic risks (see Risk Assessment Matrix below):

- *Europe*. In the short term, a worsening of the recession in Europe or, in the medium to long term, a period of prolonged stagnation, would have sizeable real spillovers to growth and the balance of payments, although financial spillovers are expected to remain limited.

- *Oil prices*. Morocco is vulnerable to a spike in international oil prices, which would further increase the fiscal and current account deficits and reduce growth.

- *Slower-than-needed pace of reforms.* The authorities are committed to implementing difficult reforms. However, and in the context of ongoing tensions in the region, there is a risk that political or social difficulties may undermine the pace of the needed reforms.

Morocco: Risk Assessment Matrix 1/

Source of risk	Up/Down side	Likelihood	Impact	Policy response
Strong intensification of the euro area crisis	↓	Medium	High	Prudent fiscal policy and moderately accommodative monetary policy
Protracted period of slow European growth	↓	Medium	High	Allow more flexibility in the exchange rate to stabilize reserves; implement the structural reform agenda.
World oil and food price shock	↓	Low	High	Adjust upwards domestic oil product prices; diversify energy sources; consider strategies against oil price volatility.
Slower-than-needed pace of reforms	↓	Low/Medium	High	Communicate proactively on the case for, and directions of, reforms to help build consensus.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The RAM reflects staff's views on the source of risks and overall level of concern as of the time of discussions with authorities.

MAIN CHALLENGES AND POLICY DISCUSSIONS

A. Rebuilding Fiscal Buffers, Ensuring Medium-Term Fiscal Sustainability

14. The authorities are committed to ensuring fiscal sustainability. The 2013 budget is consistent with the medium-term fiscal objective of achieving a deficit of 3 percent of GDP by 2016 through the implementation of policy reforms, both on the revenue and expenditure sides. The authorities plan to launch a broad tax reform that should help tax revenues remain broadly stable in percent of GDP, despite losses in customs revenues following trade liberalization. On the expenditure side, key elements of the government's strategy are: (i) reforming the subsidy system; (ii) moderating the public wage bill; and (iii) reforming the public pension system.

15. The 2013 budget envisions a more ambitious fiscal consolidation than initially planned under the PLL. The government's budget includes a larger reduction of the deficit than in the original PLL framework (1.4 percent vs. 0.8 percent of GDP), bringing the deficit in 2013 to 4.7 percent of GDP. Staff supports this fiscal stance, as it will help address the deterioration in the external sector. However, staff noted that a large part of the additional effort to reduce the deficit comes from lower public investment, and expressed concerns about the potential impact on growth. The authorities agreed with staff that the composition of the fiscal consolidation should be as growth-friendly as possible. They intend to increase the efficiency of public investment by better prioritizing high value-added projects aimed at increasing productivity and potential growth. As in 2012, the budget deficit is expected to be met through a mix of domestic and external official and market financing.

16. The authorities plan to undertake significant tax policy reform. Morocco enjoyed a strong revenue performance in 2005–08. But this intake proved to be temporary, resulting from the exceptional performance of the real estate and stock markets, and the finance, telecom, and natural resource sectors, which all boomed during that period. The tax-to-GDP ratio fell considerably in 2009 and has stabilized since then at around 24 percent of GDP. Against this background, staff supports the authorities' intention to accelerate tax reforms, with a view to broadening the tax base. A national conference on tax policy will be held in early 2013, for which the authorities have requested technical assistance from the Fund. The conference is expected to consider reforms of the taxation of the agricultural sector, the simplification of the tax code and streamlining of procedures, the reduction of the number of VAT rates, the reduction in the number of special regimes and loopholes, and the strengthening of tax administration. In addition, the 2013 budget introduces tax measures to support the development of SMEs (see paragraph 6 of the authorities' written communication (W.COM.-¶6 in Appendix I)). It also introduces new taxes on net corporate profits, high-income earnings, tobacco and profits of land sales to contribute to a Solidarity Fund created in 2012. The fund is to finance new social programs or the extension of existing ones, mostly on health and education (W.COM.-¶8).

17. The authorities aim to reduce the government wage bill to less than 11 percent of GDP over the medium term. While the compensation of employees will increase in 2013 in nominal terms, mainly due to regular grade promotions and the creation of about 24,000 new posts in education, health, and security, it is expected to decline by 0.3 percent of GDP, with no new across-the-board public wage increases being planned, in a departure from previous practice.[5] Over the medium term, the authorities plan to limit the creation of new posts to cover priority needs, including by not systematically filling positions freed by retiring civil servants. The authorities also intend to gradually introduce a system of performance-based salary increases (W.COM.-¶7).

18. The authorities are preparing to reform the subsidy system, aiming to reduce its cost to 3 percent of GDP by 2016. Staff and the authorities concur that the current system of generalized subsidies on most energy and some food products needs to be reformed, as it is an ineffective way to support the poor and a drain on the budget. Consistent with their intention at the time of the PLL approval, the authorities plan to limit the subsidy cost to about 4½ percent of GDP in 2013, as reflected in the 2013 budget, and have been actively preparing to reform the system. To this end, as part of a consultative process on the reform, three technical commissions have worked with economic partners and civil society on (i) evaluating the macroeconomic impact of possible reforms; (ii) formulating proposals to revise the price structures of subsidized products; and (iii) developing an alternative targeted social protection scheme. Several options are being considered to reduce the cost of subsidies, such as gradually liberalizing industrial fuel, revising the price formula for distribution costs, limiting the usage of subsidized butane gas to consumers, gradually revising the prices of diesel and gasoline, and gradually reducing the coverage of some food subsidies. Moreover, the government has stepped up its public communication on the cost of subsidies, including through a full annex on this issue to the 2013 budget law. The authorities intend to conclude their broad consultations on the options for reforms in the first quarter of 2013, so the final decisions could be made rapidly and the reform start soon after (W.COM.-¶8).

19. The gradual subsidy reform will be accompanied by a better-targeted system to protect the vulnerable groups. The authorities' overall objective remains to increase the pass-through from international prices to domestic retail prices gradually, while replacing universal subsidies with a targeted package of social protection. These will include the programs on education and health financed by the Solidarity Fund, as well as a nation-wide program of unconditional cash transfers targeting the poorest segments of society and possibly the lower middle class and financed by the savings from the reduction in the universal subsidies. The targeting commission has been actively working with the World Bank on the design of a generalized system that would build on existing programs by finalizing the creation of a unique register, determining benefits, and preparing a communication campaign.

20. Staff welcomed the important steps already taken, while stressing the urgent need to move ahead with full implementation of the subsidy reform. The mission agreed with the authorities that the reform of the current system should be progressive and move in parallel with

[5] The increases in the total wage bill in 2011 and 2012 were mostly driven by an across-the-board wage increase in May 2011.

the rolling out of a better-targeted social protection scheme. Nonetheless, it stressed that the current system makes the fiscal position more vulnerable to shocks to the international price of oil and exchange rate, and that therefore the implementation of the reform needed to be initiated without delay.[6] On pricing, it noted that between the current system of flat subsidies and fully liberalized prices, the authorities could consider intermediate pricing mechanisms allowing an automatic adjustment of domestic prices to international prices while smoothing the impact of the volatility of world prices (an objective that the authorities are pursuing by exploring hedging options, in consultation with the World Bank). Staff also stressed the importance of a well-planned communication strategy to explain the need for and directions of the reforms.

21. The position of the general government is better than that of the central government but, to ensure fiscal sustainability, pensions and decentralization require attention. Staff's assessment, based on data up to 2011, is that the general government (which includes the central government, nonmarket public institutions, social security funds, and local governments) has historically been in a better overall fiscal position than the budget of the central government. Two factors explain this: (i) transfers from the budgetary central government to extrabudgetary units and local governments have been partly saved by the recipient entities, and (ii) social security funds as a whole had surpluses averaging 0.5 percent of GDP until 2011.[7] However, the projected actuarial deficit of the pension system may worsen the broader fiscal situation over the medium to long run if not managed properly. Furthermore, the government's intended move towards greater fiscal decentralization needs to be managed carefully to safeguard against the fiscal risks of such a process.

General Government Finance, 2006–11

(Percent of GDP)

	2006	2007	2008	2009	2010	2011
Revenue	33.2	36.8	38.4	35.2	33.6	35.2
Expense	27.7	29.2	29.7	27.7	29.9	32.6
Investment	4.3	4.5	5.4	5.9	5.5	5.9
Overall balance of the general government	**1.2**	**3.1**	**3.3**	**1.6**	**-1.8**	**-3.3**
Debt 1/	58.3	54.6	48.4	48.3	51.5	54.9
Memorandum item:						
Overall balance of the central government	**-2.0**	**-0.1**	**0.7**	**-1.8**	**-4.4**	**-6.8**

Sources: Moroccan authorities; and IMF staff estimates.

1/ The general government debt is on a gross unconsolidated basis.

6 See the selected issues paper on Fuel Subsidies in Morocco: International Experience and Possible Ways Forward.

7 Beyond the general government, the broader public sector also includes some 281 enterprises that are wholly or partially publicly owned, covering a wide range of sectors such as education, health, agriculture, mining, housing, infrastructure, and telecommunications. In 2011, their value added increased by 16 percent, contributing about 10 percent of total GDP.

General Government Finance, 2011
(Percent of GDP)

	Revenue 1/	Expense 1/	Investment 1/	NLB 2/	Debt 3/
General government	35.2	32.6	5.9	-3.3	54.9
Central government	33.6	30.3	4.6	-1.3	53.7
Budgetary central government	27.8	18.8	4.5	4.5	53.7
Extrabudgetary units	0.4	6.9	0.1	-6.6	0.0
Social security funds	5.4	4.6	0.0	0.8	0.0
Local government	1.6	2.2	1.3	-2.0	1.2

Source: Moroccan authorities; and IMF staff estimates.

1/ Revenue, expense, and investment exclude grants and interests received from/paid to other general government units.
2/ The net lending and borrowing (NLB) subsector component does not correspond to the net lending and borrowing for that sector because grants have been excluded.
3/ The general government debt is on a gross unconsolidated basis.

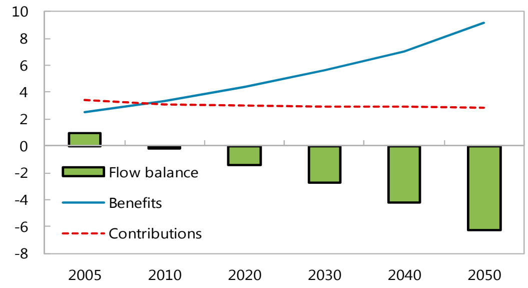
- **Pensions.** Morocco's demographic transition and its relatively high pension benefits make the current system financially unsustainable, with large deficits projected over the medium to long term (Box 1). Under plausible demographic and labor market assumptions, pension expenditure would rise from 3 percent of GDP in 2011 to almost 10 percent by 2050, while contributions would remain broadly flat. The main civil service pension fund (*Caisse Marocaine de Retraites*) is expected to be in flow deficit from 2012 onwards and, absent reforms, may deplete its reserves by 2020. The authorities agreed that the pension system needs urgent reforms. They have prepared parametric and institutional options to restore the viability of the system while increasing its relatively low coverage (27 percent of the labor force in 2010). The technical commission for pension reform, instituted in 2003, provided formal recommendations at the end of 2012. Welcoming this preparatory work, the mission urged the authorities to move quickly to the implementation phase, noting that, at a minimum, parametric reforms would need to be put in place rapidly (W.COM.-¶8).

- **Decentralization.** Advanced regionalization is a key element of the recent constitutional reform and a priority for the current legislature. The government is working on an organic law to transfer more executive powers to the regional councils, following recommendations of an advisory committee on this matter. Staff noted that transferring fiscal power to local entities may in principle help improve spending efficiency, but that international experience shows that decentralization entails fiscal risks and needs to be well managed to be undertaken in the most fiscally responsible way (Annex). The authorities concurred and saw the reform as progressive, with a gradual implementation over the coming years (W.COM.-¶9). Staff expressed the Fund's readiness to provide technical assistance in this area.

Box 1. Morocco: The Pension System

The finances of the pension system are not sound. Projections up to 2050 show that contributions would remain essentially flat, while spending would increase steadily, driven by the relative generosity of the pension system (even though pension coverage is very low) and adverse demographic trends. The two pension funds covering public servants are already in flow deficit, with reserves of one of the two projected to be exhausted in the next decade.

Financial Situation of the Pension System
(Percent of GDP)



Sources: Moroccan authorities; and IMF staff estimates.

Overview of the Moroccan Pension System at End-2011

Pension scheme	CMR	RCAR	CNSS	CIMR
Status	Public	Public	Public	Private
Coverage	civil servants and military	employees of public enterprises, local government, and contractuals	private sector employees	optional complementary scheme for private sector employees
Financing mode	PAYG, defined benefit	mixed (funded and PAYG), defined benefit	PAYG, defined benefit	PAYG, defined contribution (points system)
Contribution rate (employee / employer)	20% (10% / 10%)	18% (6% / 12%)	11.9% (4% / 7.9%)	6% to 12%
Active contributors	887,559	191,975	2,544,000	283,567
Beneficiaries	466,199	104,584	412,606	135,890
Contributions (millions of dh)	18,687	2,011	6,506	4,900
Benefits (millions of dh)	16,895	3,549	7,286	3,400
Reserves	74,120	84,009	30,870	24,900
Financial products	3,260	2,877	981	1,500
Replacement rate (avg.)	0.83	0.57	0.54	0.12

Source: Moroccan authorities.

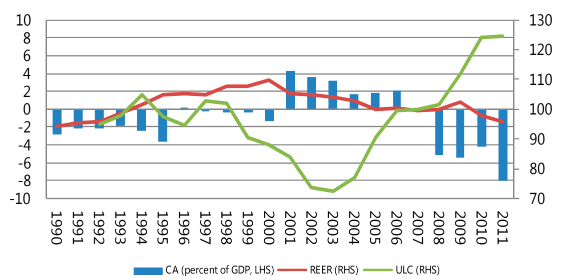
Reform options have been debated since 2003. A technical committee, which includes representatives from the pension funds, social partners, and the government, recently concluded the work started about a decade ago. Based on its findings, three reform options are being considered: (i) parametric reforms within the current architecture, (ii) a system with two pillars (one public, one private), and (iii) one fully integrated system. In the first instance, parametric reforms consisting of a combination of increasing the retirement age, reducing benefits, and increasing contribution rates are urgently needed, even though they would not fully resolve the financial situation of the respective funds. A restructuring of the current system, including merging some of the existing funds and extending their coverage, would also contribute to restoring financial soundness if accompanied with a parametric reform. In all scenarios, it is probable that some recapitalization of the most troubled public sector fund will be needed.[1/]

1/ Such recapitalization would be unlikely to affect the sustainability of public debt, as illustrated by the shock on contingent liability in the public Debt Sustainability Analysis (DSA) (Figure 3).

B. Rebuilding External Buffers, Strengthening Competitiveness

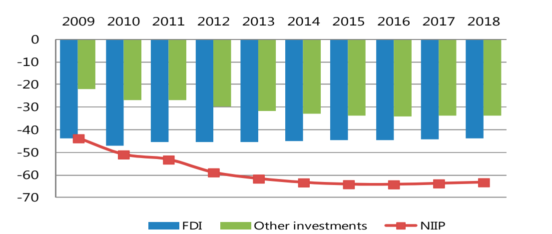
22. **Morocco's external position has been deteriorating over the past few years, following an extended period of strength.** Gross international reserves averaged close to eight months of imports during 2001–08, but have fallen to about four months of imports since then as the current account balance moved into deficit. The fall in the current account balance has been accompanied by a rapid increase in unit labor costs (ULCs) consistent with a loss in competitiveness, although the CPI-based real effective exchange rate was depreciating. The negative net international investment position (NIIP) is projected to increase to 59 percent of GDP in 2012, with private and public debt-creating flows expected to become increasingly important in financing the current account deficit over the medium term. External debt remains well below the average for emerging markets. It is projected to peak at 27½ percent of GDP in 2013 and steadily fall to under 25 percent of GDP by 2017.

Current Account, REER and Unit Labor Costs



Source: IMF data.

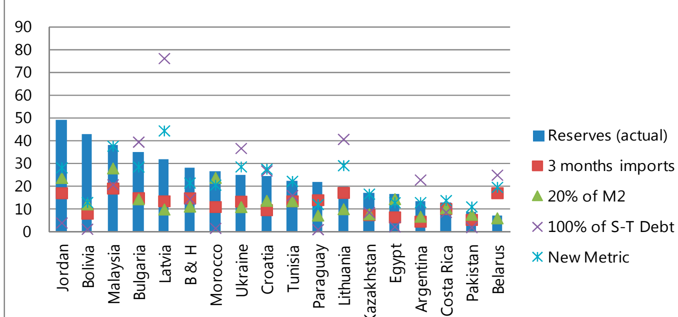
Net International Investment Position and Key Components
(Percent of GDP)



Source: IMF staff estimates.

23. **Protracted weaknesses in the external environment has continued to put pressure on the balance of payments and external buffers.** The more than US$6 billion of reserve losses over the past two years have been driven, in part, by rising oil prices and the downturn in Europe. Reserve levels have fallen from over 100 percent of the Fund's emerging market reserve metric to a projected 87 percent at end-2012, but remain broadly adequate considering existing capital controls, which partially insulate it from capital account vulnerabilities.[8] However, EU countries account for more than half of Morocco's exports and over 80 percent of remittances with over one quarter of exports and half of remittances concentrated in Spain and France alone, making them particularly exposed to near-term uncertainties in Europe.

International Reserves Relative to Adequacy Metrics for Fixed Exchange Rate EMs
(End-2011, in percent of GDP) 1/



Source: IMF staff estimates.
1/ If the bar is above metric indicator, the level of reserves is considered adequate using the metric.

[8] Assessing Reserve Adequacy, IMF Policy Paper, February 14, 2011.

24. There is evidence of some external sector misalignment. The Fund's pilot External Balance Assessment (EBA) current account-regression methodology suggests that the dirham is overvalued (Box 2). However, the external stability methodology under EBA and CGER-type methods do not find evidence of significant overvaluation.[9] On balance, staff considers that these results, combined with rapid reserve losses and the downward trend in the current account balance, provide evidence of some degree of overvaluation.

Box 2. Morocco: External Balance Assessment

Two of the three methodologies under the Fund's new External Balance Assessment (EBA) were applied to Morocco. EBA estimates the degree of external misalignment using three methods: (i) the current account regression-based analysis, (ii) the external sustainability analysis, and (iii) the real effective exchange rate (REER) regression-based analysis.[1] Only the first two methods were applied to Morocco as not all necessary data were available to apply the third one.

Under the ***current account method***, Morocco is found to have a current account "gap" of about -3.7 percent of GDP (i.e., a larger deficit than expected, given the country's key characteristics), suggesting that the dirham is overvalued. The contribution of various macroeconomic policies to the external misalignment, which is based on estimates of "policy gaps" in the areas of fiscal policy, social spending, reserves policy, and capital controls is shown in the enclosed table. It is assessed based on the current policy stances of Morocco (as well as of its trading partners) relative to their optimal/target policy stances.

Summary of the Current Account Method's Findings
(Projections for end-2012, percent of GDP)

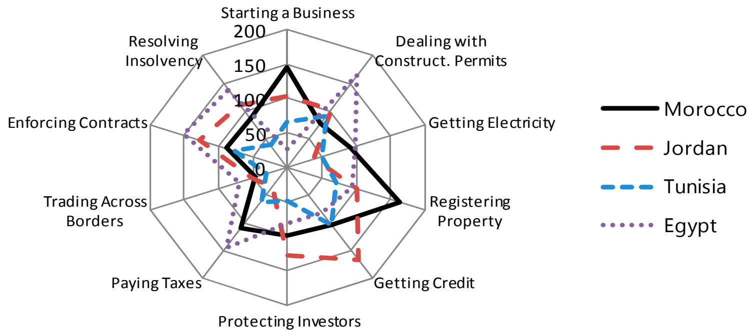
(1)	Cyclically-adjusted CA	-6.5
(2)	Current account "norm"	-2.8
(3)=(1)-(2)	Current account "gap"	-3.7
	Contribution of identified policy gaps	
(4)	Fiscal policy	0.3
(5)	Social protection	0.1
(6)	Reserves policy	-0.4
(7)	Capital controls	0.7
(8)=(4)+(5)+(6)+(7)	*Total*	0.6
(9)=(3)-(8)	Residual	-4.3

The ***external sustainability analysis***, which relies on medium-term projections of the current account rather than the current cyclically-adjusted value, finds less significant evidence of external misalignment with a current account gap of only -0.5 percent of GDP.

1/The new EBA methodology is outlined in a background note published on the IMF's external website.

[9] This includes the standard Consultative Group on Exchange Rate Issues (CGER) macro-balance and real exchange rate methodologies and CGER-type methodology which accounts for remittances, aid, and FDI in computing the current account norm (Beidas-Strom and Cashin, 2011, WP/11/195).

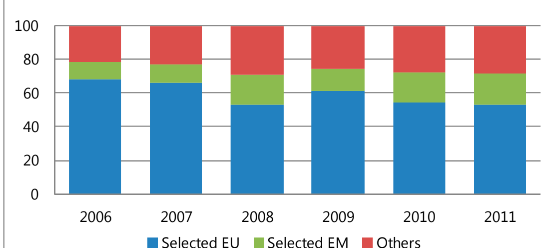
World Bank Ease of Doing Business Subindices
(Lower scores show greater competitiveness)



25. Structural reforms to increase export diversification and competitiveness, and continued fiscal consolidation are needed to support external sustainability. Morocco has proven that it is an attractive destination for FDI. Recent important investments in the automobile and aerospace industries are expected to boost exports in 2013 and contribute to a reversal of the recent downward trend in the current account balance.[10] The ongoing effort to lower the fiscal deficit to 3 percent of GDP by 2016 will also contribute to reducing the savings-investment imbalance in the short and medium terms. Further progress in strengthening the business environment (including streamlining of procedures, reforming the judiciary system, and fighting corruption), improving education and training programs, and reforming the labor, product, and financial markets are needed to further increase FDI and boost competitiveness.[11]

26. The authorities agreed that urgent measures are needed to address external pressures. They noted that the recent downward pressures on the current account and reserves were largely driven by high commodity prices and a downturn in Europe. In this environment, they stressed that the 2013 budget made strengthening competitiveness a priority as part of the government's comprehensive strategy to boost exports. They welcomed the rebound in

Geographical Distribution of Exports 1/
(Percent of total exports)



1/ EUs: France, Spain, UK, Germany, Italy, Portugal, Netherlands, Belgium, and Poland. EMs: Brazil, Russia, India, China, Singapore, Turkey, Lithuania, Mexico, and Argentina.

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[10] The recently-inaugurated plant of the French automaker Renault in Tangier will expand production in 2013 for both the domestic and export markets. In addition, the Canadian-based aircraft maker Bombardier is expected to start production of aircraft components in 2013 at its Casablanca facility.

[11] The 2013 World Bank Doing Business Indicators ranks Morocco 97th out of 183 countries, down from 93rd in 2012 (but up from 115th in 2011).

tourism receipts observed since October 2012 and expected it to continue in 2013 as tourists from traditional and new markets return. The authorities are confident that the coming onstream of ongoing or recently-completed projects, such as off-shoring agreements and public-private partnerships with major international companies, will help boost exports in the period ahead, thereby mitigating some of the external pressures. They also anticipate an increase in financial services exports as Moroccan banks continue to expand abroad. They noted that planned fiscal measures incentivizing investment and reducing tax-related labor costs, combined with continued efforts to improve the business environment, access new export markets, and develop alternative sources of energy will further contribute to reducing the current account deficit over the medium term. In this context, they emphasized the continued trend of greater geographic diversification of exports, including exports to Sub-Saharan Africa.

27. The fixed exchange rate regime has provided an important nominal anchor for the economy, but more flexibility is increasingly needed. The recent loss in reserves in the face of rising energy prices and weak external demand underscores the vulnerability of the fixed exchange rate regime to external developments. More flexibility in the exchange rate is increasingly needed to help preserve Morocco's competitiveness and better equip the economy to respond to external shocks. Staff emphasized that early implementation of prerequisites will be essential for a successful reform of the exchange rate regime and the monetary framework. The authorities recognized that increased exchange rate flexibility would allow the economy to better respond to shocks and support competitiveness, but considered that it was unlikely to have a large impact on exports in the current context of weak external demand and that fiscal consolidation, including a reduction in subsidies, was a prerequisite for exchange rate regime and monetary framework reforms. They were also concerned about the possible increase in imported inflation (W.COM.-¶12).

C. Fostering Higher and More Inclusive Growth

28. Morocco has made substantial progress in increasing inclusive growth over the past decade, but additional efforts are needed. Morocco's social indicators have improved over the past decade. Higher economic growth, lower unemployment, better health and educational outcomes, better access to basic infrastructure, and a marked reduction in poverty rates are tangible evidence of the progress made in fostering inclusive growth. Additional efforts are, however, needed to increase potential growth, further improve educational outcomes, and reduce the high youth unemployment and inequalities in the distribution of income and access to health care, particularly across regions.[12]

29. The urgency of implementing growth and employment-enhancing structural reforms has increased. Given the strong trade linkages with European countries, a protracted downturn in euro area countries is likely to have significant short- and medium-term effects on Morocco's growth performance. Against this background, and given the limited space for macroeconomic

[12] See selected issues paper on Inclusive Growth in Morocco: Stylized Facts and Policies.

policy to boost demand in the short term, the need for trade and financial liberalization, structural reforms in labor and product markets, and greater access to finance has arguably grown more urgent. Potential gains from such structural reforms in employment and growth could be large. Staff estimates that, with an ambitious reform agenda, the overall potential growth gain from undertaking a full range of reforms might exceed two percentage points over the medium term. Similarly, labor and product market reforms may have sizeable effects in reducing overall and youth unemployment over the medium term. The authorities' planned reforms, aimed at boosting competitiveness and potential growth, accelerating private sector-led development by facilitating transparency in the business environment, including by focusing on SMEs, and reforming the labor market, are therefore welcome.[13] They have also put in place a number of initiatives to support professional training, help the insertion of new graduates into hiring firms, and foster entrepreneurship and self-employment.

30. While higher growth and employment are prerequisites to reducing poverty, strengthening social policies and increasing safety nets are also needed. Creating fiscal space to increase resources for spending on health, education, and basic infrastructure is key to improving outcomes and reducing disparities in access to health and education between different income groups and between rural and urban areas. The increase in budgetary resources available for the social sector will be obtained through savings from the subsidy reform and the new taxes financing the Solidarity Fund as discussed above. Improvement in the quality of spending (including investment in infrastructure, health, and education) and other efforts on revenue will also help.

D. Maintaining Adequate Monetary Conditions and Preserving the Stability of the Financial Sector

31. The current monetary policy stance is appropriate within the existing monetary and exchange rate frameworks. BAM has been successful in keeping inflation in check. It is committed to closely monitoring potential pressures from imported or domestic prices and taking all necessary measures to ensure continued price stability. Facing a significant decline in systemic liquidity, it has managed banks' liquidity needs to keep the overnight rate close to its benchmark interest rate while ensuring an adequate pace of credit growth (W.COM.-¶10). While a liquidity deficit remains, staff is of the view that BAM's current monetary stance is appropriate. This is because monetary policy should guard against potential second-round effects on inflation of domestic energy price increases, the nonagricultural output gap is only moderately negative, and further monetary policy loosening would likely exacerbate pressures on the current account and lead to further downward pressure on foreign reserves. As discussed above and in previous staff reports, the monetary framework will need to evolve in line with a move toward a more flexible exchange rate.[14]

32. The financial sector has proven resilient to the crisis, and BAM is further strengthening regulation and supervision in line with new international standards. At the aggregate level,

[13] See Box 1 on planned structural reforms to increase potential growth and employment in Morocco—Request for an Arrangement under the Precautionary and Liquidity Line (CR/12/239).

[14] See Morocco—Staff Report for the 2011 Article IV Consultation (CR/11/341).

capital adequacy and profitability ratios have remained appropriate. BAM is committed to fostering the health of the banking sector through enhanced regulation and supervision, including the gradual adherence to Basel III norms on capital adequacy and liquidity. BAM has increased the Tier 1 capital to risk-weighted asset ratio requirement to 9 percent and the regulatory capital adequacy ratio to 12 percent, effective June 2013. The new definition of capital by the Basel Committee will be adopted in April 2013. Regarding the liquidity coverage ratio, a draft law is expected to be finalized once the final text is published by the Basel Committee. However, a transitory period will be observed before this ratio becomes fully operational. To strengthen macro-prudential supervision, mechanisms to better monitor systemic risk are being considered as part of ongoing reviews of the central bank statute and the Banking Act. A systemic risk map has been elaborated with technical assistance from the Fund, and work will continue in this area (W.COM.-¶11).

33. The authorities are seeking to further deepen the financial sector. The financial sector is large, with assets exceeding 110 percent of GDP. The three largest banks account for two-thirds of the sector. Although it is relatively well-developed, the sector needs to mobilize additional resources to further expand and maintain adequate credit growth. Overall, staff supports the authorities' and the sector's strategic directions for the development of the sector, which include:

- *Access to finance*. The authorities are seeking to make finance accessible to a larger part of the population by promoting the development of products and services more adapted to their needs and by improving financial literacy. The development of Islamic finance, for which a framework is being prepared as part of a new banking law, is expected to help in that respect. The authorities have also taken measures to extend micro-credit activity. They target a ratio of financial access of two-thirds of the population by end-2014, up from 54 percent at present.

- *Credit to SMEs.* To improve SMEs' access to credit, BAM, in coordination with the General Confederation of Moroccan Enterprises (CGEM), is taking measures to strengthen financial transparency and risk assessment tools, improve dissemination of information and advice on banking services, and better adapt collateral instruments to the needs of SMEs.

- *Internationalization*. Already present in 23 countries, the largest banks are further expanding their presence in Africa while increasing reliance on borrowing on international markets as a source of funding. During its discussions with BAM, staff noted that financial expansion comes with new challenges for banking supervision. Staff welcomed BAM's close monitoring of these activities and its efforts to strengthen domestic supervision and coordination with supervisory agencies in recipient countries.

- *Financial hub*. The authorities are planning to further develop Casablanca as a financial sector center to operate as a regional hub for financial activities. Staff noted that such a strategy would be supported by greater flexibility in the exchange rate and openness in the capital account.

- *FSAP*. The authorities expressed interest in an update of the 2008 FSAP, which could provide a useful basis for making further progress on the authorities' agenda. The mission strongly supports this interest.

34. Morocco is currently listed by the Financial Action Task Force (FATF) as a jurisdiction with strategic anti-money laundering and combating the financing of terrorism (AML/CFT) deficiencies. While significant progress has been made, the criminalization of terrorism financing is still inadequate and Morocco is at risk of being elevated to a higher level in the FATF list. This could lead to additional scrutiny by foreign financial institutions and potential negative consequences for the domestic financial sector. The authorities indicated that they are in the process of undertaking the necessary legislative changes in line with international standards.

PROGRAM-SPECIFIC ISSUES

35. The program is on track. The end-October 2012 quantitative indicative targets on the central government fiscal deficit ceiling and NIR floor were both met. The proposed revised end-April 2013 and new end-October 2013 targets are consistent with the planned fiscal consolidation efforts and stabilization of reserves at an adequate level.

36. Morocco continues to meet the qualification criteria for a PLL. It continues to have sound economic fundamentals and institutional policy frameworks, is and has a track record of implementing sound policies, and remains committed to such sound policies in the future. Morocco performs strongly in three out of the five areas (financial sector and supervision, monetary policy, data adequacy) while not substantially underperforming in the two other areas (fiscal policy, and external position and market access):

- **Morocco has a record of sound public finances over a prolonged period, despite the recent challenges.** Morocco's fiscal policy had been prudent until 2011 when rising international oil prices led to a widening of the central government fiscal deficit.[15] In 2012, the authorities took significant measures that helped reduce the deficit to about 6 percent of GDP, including an increase in domestic energy-related prices. They met their end-October 2012 fiscal deficit target. They are committed to a consolidation path consistent with bringing the deficit to 3 percent of GDP in 2016 through a combination of measures (notably tax reform, moderation of the wage bill, and subsidy reform) that will improve long-term fiscal sustainability. The 2013 budget confirms these commitments, and implies a significantly larger reduction in the deficit than initially anticipated under the PLL. Staff assesses the public sector debt to be sustainable.[16]

[15] However, the deficit of the general government was only about half that of the central government in 2011.

[16] The coverage of the public sector in the public sector debt sustainability analysis is that of the central government (Table 8 and Figure 3) as data on the accounts of the general government come with a long lag. Nevertheless, at end-2011, the gross debt stock of the general government was only ½ a percentage point of GDP higher than that of the central government. Furthermore, the results of the DSA show that public debt continues to be sustainable under

(continued)

- **Pressures on Morocco's external position mostly stem from exogenous shocks; market access at very favorable terms was reconfirmed with the recent bond issuance.** External pressures continue to be a concern and resulted in a widening of the current account deficit in 2012. However, the external debt remains low and reserve levels have stabilized in the last quarter of 2012 and remain broadly adequate. The successful issuance of a US$1.5 billion bond in December 2012 at very favorable terms has helped support external buffers and clearly demonstrates continued market access. Looking ahead, the authorities' program of sustained fiscal consolidation and structural reforms to boost competitiveness, notably by improving the business climate and professional training, and fostering access to new markets, will help reduce the current account deficit and underpin external sustainability. The exchange rate regime continues to be consistent with the fiscal-monetary mix: while the deterioration in fiscal and external positions has weakened the appropriateness of the exchange rate regime in relation to the fiscal-monetary policy mix, the authorities are taking actions to ensure fiscal sustainability and restore the consistency of the policy mix.

- **Morocco's monetary policy is credible and transparent and, in combination with exchange rate policy, has a strong record of keeping inflation low and stable.** Monetary policy has kept inflation low at 1.3 percent in 2012. BAM has been effective at anchoring inflation expectations by influencing the overnight interest rate and adjusting the reserve requirement rate as needed, while maintaining a fixed exchange rate against a basket of dollar and euro.

- **The financial sector has remained sound overall, supported by effective supervision.** The tier 1 capital ratio is well above 9 percent, and NPL ratios continue to be stable and low. BAM has been active in providing the necessary liquidity. BAM is committed to continuing to foster the health of the banking sector through enhanced regulation and supervision, including the gradual adherence to Basel III norms relating to capital adequacy and liquidity.

- **Morocco subscribes to the Special Data Dissemination Standard (SDDS).** Data provision has been appropriate in all sectors.

37. Were Morocco to draw the entire amount available under the PLL, it would be well-positioned to repay the Fund. This positive assessment is based on the following rationales: i) access would be slightly below the median and significantly below the mean exposure of recent exceptional access cases, and far below the access of recent crisis resolution programs, as discussed in the staff report for the PLL request;[17] ii) Fund credit would represent a modest share of Morocco's low external debt, and the reserve coverage ratio would be comfortable; and iii) external debt service would increase moderately over the medium term and would be manageable under staff's

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a contingent liability shock of 10 percent of GDP (far above the estimated recapitalization cost of the public sector pension system), hence suggesting that a broadening of the coverage of the public sector would not alter the assessment of debt sustainability.

[17] Morocco—Request for an Arrangement under the Precautionary and Liquidity Line (CR/12/239).

baseline medium-term macroeconomic projections, as well as adverse scenarios around this baseline, which could result, for instance, from the materialization of risks flagged in the risk assessment matrix (Table 10).[18]

38. The safeguards assessment of BAM, which is substantially complete, found an overall robust safeguards framework, including strong control mechanisms. However, under the current legal system, the effectiveness of these mechanisms is reliant on continuing to have strong staff in key positions. Staff is therefore of the view that current existing good practices and key safeguards should be formally enshrined in the new central bank law that is being prepared. Steps are also needed to enhance financial reporting. As a first step, the authorities have improved transparency through the publication of a full set of audited annual financial statements. Measures recommended by the assessment have no implications for the completion of the first review, and will be monitored going forward.

STAFF APPRAISAL

39. Morocco's extended period of sound economic performance has been challenged by a combination of domestic and external shocks. Morocco has enjoyed sustained growth, low inflation, and a stable financial sector over the past decade. However, a widening of the fiscal deficit in the face of social pressures and a worsening external environment have eroded fiscal and external buffers. In addition, in 2012, growth was dragged down by a lower-than-average harvest. Inflation remains subdued despite domestic energy price increases, while unemployment has remained high, especially among the youth.

40. The PLL program is on track and its design remains adequate, but the outlook hinges upon the sustained and timely delivery of important reforms. Morocco continues to meet the qualification criteria for the PLL. Both end-October 2012 quantitative indicative targets were met. The PLL continues to support the authorities' economic program, which aims to ensure fiscal sustainability, increase competitiveness, potential growth, and employment through structural measures, and maintain prudent monetary and financial policies. However, in the context of a deteriorating external outlook and risks heavily tilted to the downside, prompt, consistent, and sustained implementation of the policies underpinning the PLL are needed for the authorities to achieve their objectives. The key reforms are socially and politically difficult, but delays would only contribute to increasing existing vulnerabilities. At the top of the agenda is continuing to address short and longer-term fiscal issues, through measures that include fiscal consolidation supported by a reform of the general subsidy system and better targeting of social protection, as well as reforms to boost competitiveness, potential growth and employment.

41. Staff supports the authorities' fiscal consolidation path, within which space needs to be created for higher and more efficient social spending. The authorities' fiscal strategy is in line

[18] Under the most extreme shocks, the DSA shows that the external debt would remain low and sustainable reflecting Morocco's capacity to repay the Fund even under an adverse scenario (Figure 4).

with their commitment to maintain fiscal sustainability and support external adjustment. The 2013 budget implies a larger reduction of the deficit than originally expected under the PLL. Staff considers that this is consistent with the more difficult external position and uncertain global environment. Staff highlighted the need to ensure that the composition of fiscal consolidation continues to support growth objectives, notably by maintaining an adequate level of productive investment. Within the authorities' planned fiscal medium-term path, space needs to be created for higher spending on education, health, and basic infrastructure. In that context, the authorities' planned tax policy reform rightly aims at widening the tax base.

42. On the expenditure side, there is urgency to move ahead with the reforms of the costly and inefficient subsidy system and of the pension system. Staff supports the authorities' plan to gradually reduce the government's wage bill as a share of GDP. It welcomes their commitment to improving the targeting of subsidies and reducing their cost to 3 percent of GDP over the medium term, starting with a reduction of the subsidy bill to about 4½ percent of GDP in 2013. Staff stressed that the current system makes the fiscal position more exposed to external shocks and that its reform should start without delay. Staff underlined the need for an explicit and well-communicated strategy, which should include gradual price adjustments and mitigating measures to protect the poorest sectors of the population. After years of preparation and debate, the reform of the pension system is also urgently needed to ensure its viability while extending coverage to the large share of the population currently without coverage. Looking ahead, staff notes that it will be important that the planned decentralization be conducted with appropriate fiscal safeguards.

43. There is a need to strengthen competitiveness and better equip the economy to respond to external shocks. Morocco's external position has been deteriorating over the past few years. Gross international reserves have fallen as the current account deficit widened. The PLL has played an important role as insurance against external shocks. However, in the absence of adjustments, continued pressures on the current account would erode buffers and exacerbate external misalignment. Staff considers that the planned fiscal consolidation and structural reforms to improve the business climate and increase export diversification will help underpin external sustainability. Investment in education and training is also needed. Moving towards a more flexible exchange rate is increasingly needed to enhance the economy's ability to absorb shocks and preserve competitiveness. Such a move should be carefully coordinated with other macroeconomic policies, while the shift toward a new monetary policy framework is also being prepared.

44. Over the past decade, Morocco has made substantial progress in increasing potential growth and making it more inclusive, but additional efforts are needed. Morocco's social indicators have improved over the past decade, but additional efforts are needed to increase potential growth, improve educational outcomes, and further reduce youth unemployment and inequality in the distribution of income and access to health care. The authorities' planned reforms aimed at boosting potential growth, accelerating private sector-led development, and reforming the labor market, are welcome in this regard.

45. Monetary policy has remained appropriate. BAM has been successful in controlling inflation while undertaking monetary policy actions to address the deterioration of bank liquidity, although the tightness of liquidity conditions was not fully alleviated. However, further monetary stimulus is not warranted at this time as it would likely exacerbate pressures on the current account and lead to a further deterioration of foreign reserves, and monetary policy should guard against the second-round effects of increases in domestic prices of subsidized products.

46. Staff supports BAM's efforts to continue strengthening regulation and supervision while fostering the development of the financial sector. The financial sector has remained sound overall, but further development will hinge on its ability to adapt its funding strategies. Staff welcomes BAM's plan to further strengthen financial regulation and supervision. It also supports the direction of further financial sector development and deepening, noting in particular that greater financial access is needed to foster higher and more inclusive growth. However, staff notes that financial development, including international expansion, may come with new challenges for banking supervision. Staff supports the authorities' interest in an update of the 2008 FSAP.

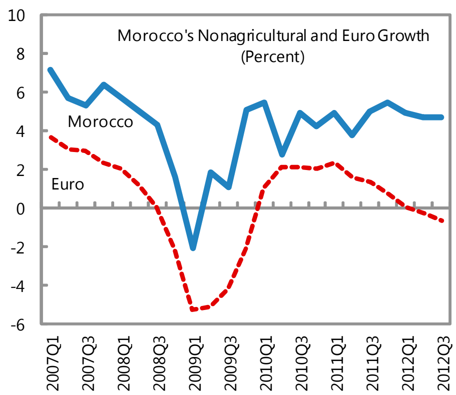
47. The PLL has supported the authorities' efforts to rebuild buffers and address medium-term challenges by providing insurance against external risks. The adoption of the PLL also helped improve market conditions. Staff welcomes the authorities' intention to continue treating the PLL as precautionary.

48. Staff's assessment is that Morocco continues to qualify for the PLL and that the program is on track. Furthermore, the authorities are committed to continuing their overall sound policies while addressing remaining vulnerabilities. Staff therefore recommends the completion of the first review, subject to the Board's assessment in the context of the 2012 Article IV consultation presently discussed that Morocco's policies are generally positive.

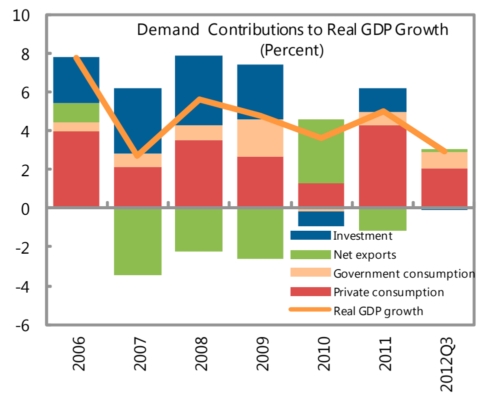
49. In accordance with the policy for PLL countries, the next Article IV consultation is proposed to take place on the standard 12-month consultation cycle.

Figure 1. Morocco: Real and External Developments

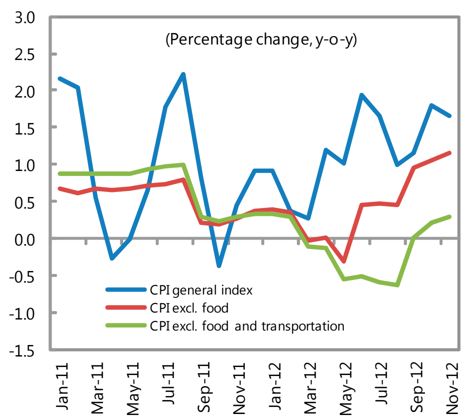
Despite the slowdown in the euro zone, nonagricultural growth remained resilient...



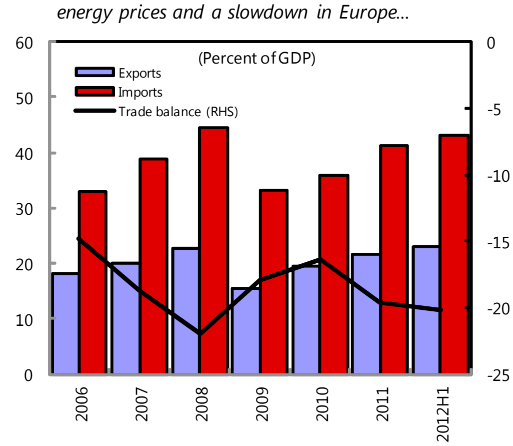
...supported by domestic demand.



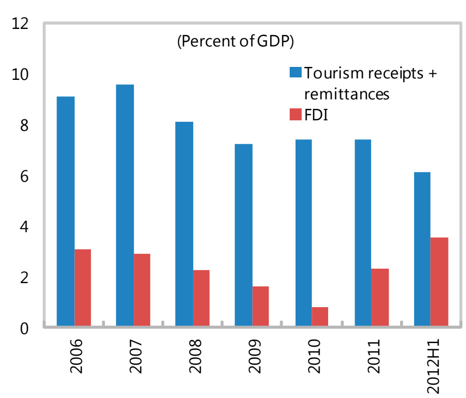
Inflation remains low.



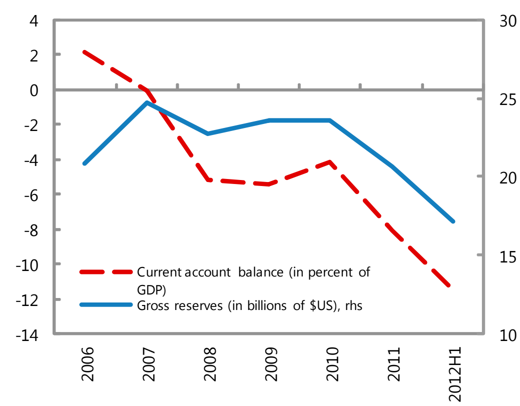
Imports grew faster than exports, due to higher energy prices and a slowdown in Europe...



...and weak remittances and tourism receipts were only partially offset by FDI inflows,...

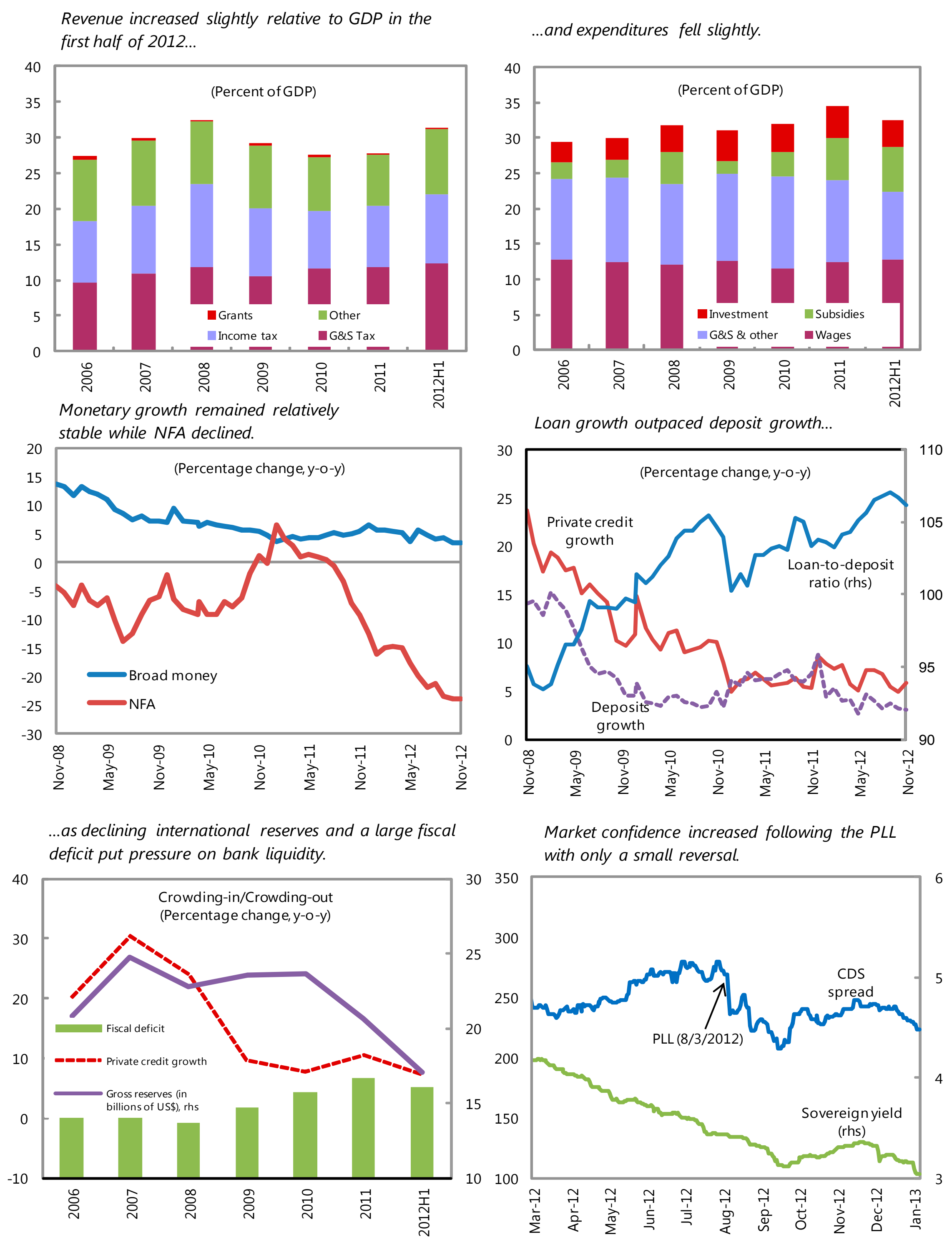


...leading to a widening of the current account deficit and a decline in reserves.



Sources: Moroccan authorities; and IMF staff estimates.

Figure 2. Morocco: Fiscal and Financial Market Developments



Sources: Moroccan authorities; and IMF staff estimates.

Table 1. Morocco: Selected Economic Indicators, 2010–18

	2010	2011	2012 PLL 1/	2012 Rev. 2/	2013 PLL 1/	2013 Rev. 2/	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
	(Annual percentage change)										
Output and Prices											
Real GDP	3.6	5.0	2.9	3.2	5.5	4.5	4.8	5.0	5.4	5.7	5.8
Real nonagricultural GDP	4.9	5.0	4.7	4.5	5.0	4.5	4.7	5.0	5.4	5.8	5.9
Consumer prices (end of period)	2.2	0.9	2.5	2.3	2.5	2.5	2.5	2.5	2.5	2.6	2.6
Consumer prices (period average)	1.0	0.9	2.2	1.3	2.5	2.4	2.5	2.5	2.5	2.6	2.6
	(In percent of GDP)										
Investment and Saving											
Gross capital formation	35.0	36.0	35.0	36.1	35.1	36.6	37.4	37.8	38.2	38.4	38.8
Of which: Nongovernment	31.2	31.5	29.9	31.9	29.3	31.8	31.9	32.1	32.4	32.6	32.9
Gross national savings	30.9	27.9	27.7	27.3	30.6	30.4	31.7	32.6	33.4	33.9	34.3
Of which: Nongovernment	28.9	28.5	28.3	28.4	29.3	29.4	29.5	29.5	29.7	29.9	29.9
	(In percent of GDP)										
Public Finances											
Revenue 3/	27.5	27.8	28.3	27.7	28.1	28.2	28.3	28.2	28.2	28.1	28.2
Expenditure	31.9	34.6	34.4	33.8	33.3	32.9	32.4	31.7	31.2	30.7	30.6
Budget balance	-4.4	-6.8	-6.1	-6.1	-5.3	-4.7	-4.1	-3.5	-3.0	-2.7	-2.4
Primary balance (excluding grants)	-2.3	-4.7	-4.3	-3.8	-4.1	-3.4	-2.7	-2.0	-1.5	-1.1	-0.8
Total government debt	51.3	54.4	56.9	58.2	57.8	59.0	59.0	58.4	57.0	55.2	53.3
	(Annual percentage change; unless otherwise indicated)										
Monetary Sector											
Credit to the private sector 4/	7.5	9.9	8.0	7.0	8.3	8.0	...	...	...	...	...
Broad money	4.8	6.5	6.2	3.3	6.8	7.9	...	...	...	...	...
Velocity of broad money	0.9	0.8	0.8	0.9	0.8	0.8	...	...	...	...	...
Three-month treasury bill rate (period average, in percent) 5/	3.4	3.5	3.2	3.2	...	...	...	...	...	...	...
	(In percent of GDP; unless otherwise indicated)										
External Sector											
Exports of goods (in U.S. dollars, percentage change)	26.7	21.0	7.0	-3.5	15.6	10.4	8.1	5.6	6.5	6.9	7.1
Imports of goods (in U.S. dollars, percentage change)	7.7	25.4	3.4	-1.6	7.0	5.9	5.0	5.4	5.9	6.8	7.6
Merchandise trade balance	-16.4	-19.6	-19.7	-20.0	-17.9	-18.8	-17.8	-17.5	-17.1	-16.8	-16.7
Current account excluding official transfers	-4.4	-8.4	-8.1	-8.9	-5.9	-7.9	-6.8	-6.4	-5.8	-5.4	-5.3
Current account including official transfers	-4.1	-8.0	-7.4	-8.8	-4.5	-6.3	-5.7	-5.3	-4.8	-4.5	-4.5
Foreign direct investment	0.8	2.3	2.5	2.2	2.7	2.8	2.8	2.9	3.0	3.0	3.0
Total external debt	24.7	23.6	24.4	26.4	23.9	27.5	27.1	26.6	25.9	24.6	23.8
Gross reserves (in billions of U.S. dollars)	23.6	20.6	17.9	17.5	18.8	18.4	18.8	19.7	21.3	22.6	24.6
In months of next year imports of goods and services	5.7	5.1	4.0	4.1	3.9	4.1	4.0	4.0	4.0	4.0	4.1
In percent of short-term external debt (on remaining maturity basis)	1,546	1,222	1,094	1,037	1,144	1,091	1,112	1,168	1,259	1,339	1,455
Memorandum Items:											
Nominal GDP (in billions of U.S. dollars)	90.8	99.2	98.2	97.5	104.8	104.8	112.2	120.4	129.7	140.6	152.6
Unemployment rate (in percent)	9.1	8.9	...	...	...	...	...	...	...	...	...
Net imports of energy products (in billions of U.S. dollars)	-8.1	-11.2	-11.3	-11.8	-10.5	-11.5	-11.4	-11.3	-11.2	-11.1	-11.1
Local currency per U.S. dollar (period average)	8.4	8.1	...	...	...	...	...	...	...	...	...
Real effective exchange rate (annual average, percentage change)	-4.1	-1.7	...	...	...	...	...	...	...	...	...

Sources: Moroccan authorities; and IMF staff estimates.

1/ Refers to the initial macroframework in CR/12/239.
2/ Revised macroframework.
3/ Includes changes in the balance of other special treasury accounts.
4/ Includes credit to public enterprises.
5/ Most recent data for 2012.

Table 2. Morocco: Budgetary Central Government Finance, 2010–18

(Billions of dirhams)

	2010	2011	2012 PLL 1/	2012 Rev. 2/	2013 PLL 1/	2013 Rev. 2/	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Revenue	210.4	223.0	239.6	232.8	257.3	253.8	273.8	293.8	317.2	343.1	373.8
Taxes	179.0	191.0	205.3	202.6	219.9	212.5	230.0	247.5	269.3	292.1	319.5
Taxes on income, profits, and capital gain	62.7	68.4	72.4	72.6	78.0	76.2	83.0	89.5	97.8	106.2	116.6
Taxes on property	8.7	9.1	10.5	10.9	11.2	12.3	13.2	14.3	15.4	16.8	18.2
Taxes on goods and services	88.6	95.2	100.1	100.3	107.4	104.5	113.2	122.0	132.9	144.4	158.1
Taxes on international trade and transacti	13.6	13.7	13.2	13.9	14.2	14.5	15.2	16.0	16.9	18.0	19.3
Other taxes	5.6	4.7	9.1	4.9	9.0	4.9	5.3	5.7	6.2	6.7	7.3
Grants	1.9	1.3	4.9	1.2	10.9	11.2	11.9	11.9	11.9	11.9	11.9
Other revenue	29.5	30.7	29.4	29.0	26.5	30.2	31.9	34.4	36.0	39.1	42.4
Expense	214.3	241.4	248.6	249.0	252.1	252.3	259.8	270.7	285.7	304.6	327.0
Compensation of employees	88.6	99.4	106.2	106.2	110.5	110.6	112.9	117.4	123.8	131.9	141.8
Use of goods and services	19.1	20.2	24.0	23.6	30.2	30.2	31.2	32.8	35.5	39.1	39.8
Interest	17.6	18.2	20.2	20.2	22.0	22.4	25.2	27.2	29.2	30.5	32.2
Subsidies 3/	27.2	48.8	51.6	52.3	39.4	40.0	36.7	35.4	33.7	34.2	37.1
Grants	29.2	29.1	29.7	29.8	33.0	32.3	34.4	37.0	39.9	43.3	47.0
Other expense	32.6	25.6	16.9	16.9	16.9	16.8	19.4	20.8	23.6	25.6	29.2
Net acquisition of nonfinancial assets	29.5	36.1	43.0	35.2	53.5	43.7	53.2	59.4	65.3	70.8	78.2
Net lending / borrowing (overall balance)	-33.4	-54.5	-52.1	-51.3	-48.3	-42.2	-39.2	-36.3	-33.9	-32.4	-31.4
Net lending / borrowing (excl. grants)	-35.3	-55.9	-57.0	-52.5	-59.2	-53.3	-51.1	-48.2	-45.7	-44.3	-43.2
Change in net financial worth	-33.4	-54.5	-52.1	-51.3	-48.3	-42.2	-39.2	-36.3	-33.9	-32.4	-31.4
Net acquisition of financial assets	0.0	-1.8	-3.2	-3.2	-3.7	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.0	-1.8	-3.2	-3.2	-3.7	0.0	0.0	0.0	0.0	0.0	0.0
Shares and other equity	0.0	-5.6	-3.2	-3.2	-3.7	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	33.4	52.8	48.9	48.1	44.6	42.2	39.2	36.3	33.9	32.4	31.4
Domestic	17.5	47.0	36.7	33.1	42.2	24.0	30.9	28.3	26.3	31.2	23.8
Currency and Deposits	-14.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Securities other than shares	24.8	37.4	42.0	38.3	42.2	24.0	30.9	28.3	26.3	31.2	23.8
Other accounts payable	6.9	9.9	-5.3	-5.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Loans	15.9	5.8	12.1	15.1	2.4	18.2	8.3	8.0	7.6	1.2	7.6
Memorandum Item:											
GDP	764.0	802.6	847.7	841.6	917.0	900.6	967.5	1,042.0	1,125.8	1,221.1	1,325.1

Sources: Ministry of Economy and Finance; and IMF staff estimates.

1/ Refers to the initial macroframework in CR/12/239.
2/ Revised macroframework.
3/ Includes cash transfers related to the subsidy reform.

Table 3. Morocco: Budgetary Central Government Finance, 2010–18
(Percent of GDP)

	2010	2011	2012 PLL 1/	2012 Rev. 2/	2013 PLL 1/	2013 Rev. 2/	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.	2018 Proj.
Revenue	27.5	27.8	28.3	27.7	28.1	28.2	28.3	28.2	28.2	28.1	28.2
Taxes	23.4	23.8	24.2	24.1	24.0	23.6	23.8	23.8	23.9	23.9	24.1
Taxes on income, profits, and capital gain	8.2	8.5	8.5	8.6	8.5	8.5	8.6	8.6	8.7	8.7	8.8
Taxes on property	1.1	1.1	1.2	1.3	1.2	1.4	1.4	1.4	1.4	1.4	1.4
Taxes on goods and services	11.6	11.9	11.8	11.9	11.7	11.6	11.7	11.7	11.8	11.8	11.9
Taxes on international trade and transacti	1.8	1.7	1.6	1.7	1.6	1.6	1.6	1.5	1.5	1.5	1.5
Other taxes	0.7	0.6	1.1	0.6	1.0	0.5	0.5	0.5	0.5	0.5	0.5
Grants	0.2	0.2	0.6	0.1	1.2	1.2	1.2	1.1	1.1	1.0	0.9
Other revenue	3.9	3.8	3.5	3.4	2.9	3.3	3.3	3.3	3.2	3.2	3.2
Expense	28.0	30.1	29.3	29.6	27.5	28.0	26.9	26.0	25.4	24.9	24.7
Compensation of employees	11.6	12.4	12.5	12.6	12.1	12.3	11.7	11.3	11.0	10.8	10.7
Use of goods and services	2.5	2.5	2.8	2.8	3.3	3.4	3.2	3.2	3.2	3.2	3.0
Interest	2.3	2.3	2.4	2.4	2.4	2.5	2.6	2.6	2.6	2.5	2.4
Subsidies 3/	3.6	6.1	6.1	6.2	4.3	4.4	3.8	3.4	3.0	2.8	2.8
Grants	3.8	3.6	3.5	3.5	3.6	3.6	3.6	3.6	3.5	3.5	3.5
Other expense	4.3	3.2	2.0	2.0	1.8	1.9	2.0	2.0	2.1	2.1	2.2
Net acquisition of nonfinancial assets	3.9	4.5	5.1	4.2	5.8	4.8	5.5	5.7	5.8	5.8	5.9
Net lending / borrowing (overall balance)	-4.4	-6.8	-6.1	-6.1	-5.3	-4.7	-4.1	-3.5	-3.0	-2.7	-2.4
Net lending / borrowing (excl. grants)	-4.6	-7.0	-6.7	-6.2	-6.5	-5.9	-5.3	-4.6	-4.1	-3.6	-3.3
Change in net financial worth	-4.4	-6.8	-6.1	-6.1	-5.3	-4.7	-4.1	-3.5	-3.0	-2.7	-2.4
Net acquisition of financial assets	0.0	-0.2	-0.4	-0.4	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.0	-0.2	-0.4	-0.4	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Shares and other equity	0.0	-0.7	-0.4	-0.4	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	4.4	6.6	5.8	5.7	4.9	4.7	4.1	3.5	3.0	2.7	2.4
Domestic	2.3	5.9	4.3	3.9	4.6	2.7	3.2	2.7	2.3	2.6	1.8
Currency and Deposits	-1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Securities other than shares	3.3	4.7	5.0	4.6	4.6	2.7	3.2	2.7	2.3	2.6	1.8
Other accounts payable	0.9	1.2	-0.6	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Loans	2.1	0.7	1.4	1.8	0.3	2.0	0.9	0.8	0.7	0.1	0.6

Sources: Ministry of Economy and Finance; and IMF staff estimates.
1/ Refers to the initial macroframework in CR/12/239.
2/ Revised macroframework.
3/ Includes cash transfers related to the subsidy reform.

Table 4. Morocco: Budgetary Central Government Balance Sheet, 2010–18
(Billions of dirhams)

			PLL 1/	Rev. 2/	PLL 1/	Rev. 2/	Proj.				
	2010	2011	2012		2013		2014	2015	2016	2017	2018
Net financial worth	-382.4	-428.9	-474.8	-481.9	-522.4	-524.0	-563.7	-600.6	-634.6	-667.0	-698.3
Financial assets	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Domestic	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Currency and deposits 3/	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	384.4	430.9	476.8	483.9	524.4	526.0	565.7	602.6	636.6	669.0	700.3
Domestic	292.1	331.3	374.3	369.7	416.5	393.6	424.5	452.9	479.1	510.3	534.1
Securities other than shares 3/	292.1	331.3	374.3	369.7	416.5	393.6	424.5	452.9	479.1	510.3	534.1
Foreign	92.3	99.6	102.5	114.2	107.9	132.4	141.1	149.7	157.5	158.7	166.2
Loans 3/	92.3	99.6	102.5	114.2	107.9	132.4	141.1	149.7	157.5	158.7	166.2

Sources: Moroccan authorities; and IMF staff estimates.

1/ Refers to the initial macroframework in CR/12/239.

2/ Revised macroframework.

3/ Data for the remaining instruments are currently not available.

Table 5. Morocco: Balance of Payments, 2010–18

(In billions of U.S. dollars, unless otherwise indicated)

			PLL 1/	Rev. 2/	PLL 1/	Rev. 2/			Proj.		
	2010	2011	2012		2013		2014	2015	2016	2017	2018
Current account	-3.7	-8.0	-7.2	-8.6	-4.7	-6.6	-6.4	-6.4	-6.3	-6.4	-6.8
Trade balance	-14.9	-19.4	-19.3	-19.5	-18.7	-19.7	-20.0	-21.1	-22.1	-23.6	-25.6
Exports, f.o.b.	17.8	21.5	23.0	20.8	26.6	22.9	24.8	26.2	27.9	29.8	31.9
Agriculture	3.2	3.3	3.2	3.0	3.4	3.1	3.2	3.4	3.5	3.7	3.9
Phosphates and derived products	4.2	6.0	6.7	5.7	7.4	6.0	6.4	6.7	7.2	7.8	8.4
Imports, f.o.b.	-32.6	-40.9	-42.3	-40.3	-45.3	-42.7	-44.8	-47.2	-50.0	-53.4	-57.5
Energy	-8.1	-11.2	-11.3	-11.8	-10.5	-11.5	-11.4	-11.3	-11.2	-11.1	-11.1
Capital goods	-7.8	-8.4	-9.0	-8.6	-9.9	-9.5	-10.4	-11.4	-12.6	-13.9	-15.5
Food products	-3.5	-4.8	-4.9	-4.9	-5.2	-4.5	-4.6	-4.6	-4.6	-4.7	-4.9
Services	5.1	5.4	5.5	5.4	6.0	5.9	6.6	7.2	7.8	8.6	9.3
Tourism receipts	6.7	7.3	7.0	6.9	7.2	7.1	7.5	7.8	8.2	8.6	9.0
Income	-1.3	-2.0	-2.0	-2.2	-2.1	-2.5	-2.5	-2.6	-2.6	-2.6	-2.6
Transfers	7.3	8.1	8.7	7.7	10.1	9.7	9.6	10.1	10.6	11.3	12.0
Private transfers (net)	7.0	7.8	8.0	7.6	8.7	7.9	8.3	8.8	9.3	10.0	10.7
Workers' remittances	6.4	7.2	7.1	6.7	7.6	6.8	7.1	7.6	8.1	8.7	9.5
Official grants (net)	0.2	0.3	0.7	0.1	1.4	1.7	1.3	1.3	1.3	1.3	1.3
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	5.4	5.6	4.6	5.4	5.7	7.6	6.8	7.4	7.9	7.8	8.9
Direct investment	0.7	2.3	2.5	2.2	2.9	2.9	3.1	3.5	3.9	4.3	4.6
Portfolio investment	0.1	-0.2	0.1	-0.2	0.1	0.0	0.2	0.2	0.3	0.3	0.3
Other	4.6	3.6	2.1	3.5	2.8	4.6	3.5	3.7	3.7	3.2	3.9
Private	2.0	1.9	1.2	1.0	1.4	1.5	1.7	2.0	2.0	2.2	2.2
Public medium-and long-term loans (net)	2.5	1.7	0.9	2.4	1.4	3.1	1.8	1.7	1.7	1.0	1.8
Disbursements	3.8	3.2	2.5	4.1	2.9	4.8	3.7	3.6	3.6	3.6	3.6
Amortization	-1.3	-1.5	-1.6	-1.6	-1.6	-1.7	-1.8	-1.9	-1.9	-2.6	-1.9
Reserve asset accumulation (-increase)	-1.2	2.4	2.6	3.2	-1.0	-1.0	-0.4	-1.1	-1.6	-1.4	-2.1
Errors and omissions	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
					(Percent of GDP)						
Current account	-4.1	-8.0	-7.4	-8.8	-4.5	-6.3	-5.7	-5.3	-4.8	-4.5	-4.5
Trade balance	-16.4	-19.6	-19.7	-20.0	-17.9	-18.8	-17.8	-17.5	-17.1	-16.8	-16.7
Services	5.6	5.4	5.6	5.5	5.7	5.7	5.9	6.0	6.1	6.1	6.1
Income	-1.4	-2.1	-2.1	-2.2	-2.0	-2.4	-2.2	-2.1	-2.0	-1.8	-1.7
Transfers	8.0	8.2	8.8	7.9	9.6	9.2	8.5	8.4	8.2	8.0	7.9
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	5.9	5.7	4.7	5.5	5.5	7.2	6.1	6.2	6.1	5.5	5.8
Direct investment	0.8	2.3	2.5	2.2	2.7	2.8	2.8	2.9	3.0	3.0	3.0
Portfolio investment	0.1	-0.2	0.1	-0.2	0.1	0.0	0.2	0.2	0.2	0.2	0.2
Other	5.0	3.6	2.2	3.5	2.7	4.4	3.1	3.1	2.9	2.3	2.6
Memorandum items:											
Current account balance excluding official grants (percent	-4.4	-8.4	-8.1	-8.9	-5.9	-7.9	-6.8	-6.4	-5.8	-5.4	-5.3
Terms of trade (percentage change)	-9.2	2.2	-0.4	-1.2	0.5	0.1	-0.1	-0.2	0.4	0.2	0.1
Gross official reserves 3/	23.6	20.6	17.9	17.5	18.8	18.4	18.8	19.7	21.3	22.6	24.6
In months of prospective imports of GNFS	5.7	5.1	4.0	4.1	3.9	4.1	4.0	4.0	4.0	4.0	4.1
Debt service (percent of export of GNFS and MRE) 4/	5.4	5.4	5.5	6.4	4.7	6.4	6.3	6.2	6.0	6.6	4.9
External public and publicly guaranteed debt (percent of	22.7	23.4	23.1	24.8	22.6	26.1	25.9	25.5	25.0	23.7	23.1
DHs per US$, period average	8.4	8.1	8.6	8.6	…	…	…	…	…	…	…
GDP ($)	90.8	99.2	98.2	97.5	104.8	104.8	112.2	120.4	129.7	140.6	152.6
Oil price (US$/barrel; Brent)	79.0	111.0	106.5	112.8	95.8	105.7	101.2	98.4	95.6	93.2	90.9

Sources: Ministry of Finance; Office des Changes; and IMF staff estimates and projections.

1/ Refers to the initial macroframework under CR/12/239.

2/ Revised macroframework.

3/ Excluding the reserve position in the Fund. As of 2009, reserves include the new SDR allocation.

4/ Public and publicly guaranteed debt.

Table 6. Morocco: Monetary Survey, 2010–13

	2010	2011	2012 PLL 1/	2012 Rev. 2/	2013 PLL 1/	2013 Rev. 2/
			(Billions of dirhams)			
Net foreign assets	192.5	168.4	163.8	137.8	157.8	149.2
Monetary authorities	187.7	166.7	160.9	137.5	154.4	148.3
Of which: Gross reserves	197.3	177.1	155.9	147.8	164.4	158.6
Deposit money banks	4.8	1.7	2.9	0.3	3.3	0.9
Net domestic assets	705.8	788.2	860.1	850.4	935.8	917.1
Domestic credit	719.9	803.6	880.0	864.0	954.9	931.0
Net credit to the government	85.7	106.9	127.1	118.4	139.8	125.5
Banking system	85.7	106.9	127.1	118.4	139.8	125.5
Bank Al-Maghrib	3.5	2.2	2.0	2.1	1.7	1.8
Of which: deposits 3/	-4.0	-3.4	-3.5	-3.5	-3.8	-3.8
Deposit money banks	82.2	104.6	125.1	116.3	138.0	123.7
Credit to the economy	634.2	696.8	752.9	745.7	815.1	805.5
Other liabilities, net	14.1	15.4	19.9	13.6	19.1	14.0
Broad money	898.3	956.7	1,023.9	988.2	1,093.5	1,066.3
Money	549.5	586.8	634.0	624.5	671.0	670.9
Currency outside banks	144.7	158.3	166.9	166.0	180.5	177.6
Demand deposits	404.8	428.5	467.1	458.5	490.5	493.3
Quasi money	331.7	348.3	365.8	362.2	380.5	376.7
Foreign deposits	17.1	21.6	24.0	15.5	42.0	18.7
			(Annual percentage change)			
Net foreign assets	-0.1	-12.5	-3.0	-18.2	-3.7	8.3
Net domestic assets	6.3	11.7	8.1	7.9	8.8	7.8
Domestic credit	6.8	11.6	8.4	7.5	8.5	7.8
Net credit to the government	2.4	24.6	11.0	10.8	10.0	6.1
Credit to the economy	7.5	9.9	8.0	7.0	8.3	8.0
Broad money	4.8	6.5	6.2	3.3	6.8	7.9
			(Change in percent of broad money)			
Net foreign assets	0.0	-2.7	-0.5	-3.2	-0.6	1.2
Domestic credit	5.4	9.3	7.1	6.3	7.3	6.8
Net credit to the government	0.2	2.4	1.3	1.2	1.2	0.7
Credit to the economy	5.1	7.0	5.8	5.1	6.1	6.1
Other assets net	-0.5	-0.1	-0.4	0.2	0.1	0.0
Memorandum items:						
Velocity (GDP/M3)	0.85	0.84	0.83	0.85	0.84	0.84
Velocity (non-agr. GDP/M3)	0.73	0.72	0.77	0.74	0.78	0.73
Credit to economy/GDP (in percent)	83.0	86.8	88.8	88.6	88.9	89.4
Credit to economy/non-agr GDP (in percent)	96.3	101.2	101.7	102.2	102.2	103.2

Sources: Bank Al-Maghrib; and IMF staff estimates.
1/ Refers to the initial macroframework under CR/12/239.
2/ Revised macroframework.
3/ Includes Fonds Hassan II.

Table 7. Morocco: Financial Soundness Indicators of the Banking Sector, 2005–June 2012

(Percent, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011	2012 June
Regulatory capital 1/								
Regulatory capital to risk-weighted assets 2/	11.5	12.3	10.6	11.2	11.8	12.3	11.7	12.2
Tier 1 capital to risk weighted assets	10.0	11.0	9.2	9.6	9.2	9.7	9.6	10.0
Capital to assets	7.7	7.4	6.9	6.9	7.2	8.3	8.1	8.1
Asset quality								
Sectoral distribution of loans to total loans								
Industry	21.9	19.9	19.6	15.9	15.8	16.4	16.8	17.2
Agriculture	5.4	4.8	4.8	6.9	6.0	6.1	5.8	5.9
Commerce	7.5	6.7	6.4	6.5	7.0	6.7	6.6	6.4
Construction	6.2	7.4	10.1	15.9	14.1	13.3	13.9	13.5
Tourism	2.9	2.3	2.5	2.6	3.2	2.9	2.8	2.7
Finance	10.2	11.4	14.0	13.1	12.4	12.1	11.3	10.9
Public administration	3.4	3.1	2.8	3.0	4.3	5.0	4.8	4.6
Transportation and communication	5.4	5.9	5.2	4.5	4.2	4.0	4.1	4.5
Households	26.0	28.6	28.4	26.5	27.6	28.1	27.6	28.5
Other	11.1	9.9	6.2	22.7	5.8	5.4	5.7	5.8
FX-loans to total loans	1.9	2.7	2.3	2.4	2.5	2.5	3.5	2.8
Credit to the private sector to total loans	92.7	93.1	94.0	93.3	91.0	91.0	92.0	91.0
Non Performing Loans (NPLs) to total loans	15.7	10.9	7.9	6.0	5.5	4.8	4.8	5.0
Specific provisions to NPLs	67.1	71.2	75.2	75.3	74.1	70.1	68.7	67.0
NPLs, net of provisions, to Tier 1 capital	57.2	30.3	20.1	13.9	12.7	12.2	12.9	13.4
Large exposures to Tier 1 capital	388	381	413	314	376	336	354	353
Loans to subsidiaries to total loans	...	6.5	7.0	6.4	6.7	6.1	6.0	6.0
Loans to shareholders to total loans	...	1.3	1.9	2.0	1.0	1.1	1.0	1.5
Specific provisions to total loans	10.5	7.8	5.9	4.5	4.0	3.4	3.5	3.3
General provisions to total loans	1.2	0.9	0.9	1.0	0.5	0.5	0.5	0.6
Profitability								
Return on assets (ROA)	0.5	1.3	1.5	1.2	1.2	1.2	1.1	1.2
Return on equity (ROE)	6.3	17.4	20.6	16.7	15.2	14.2	13.4	14.0
Interest rate average spread (b/w loans and deposits)	4.8	4.7	4.4	3.2	3.1	3.3	3.3	3.4
Interest return on credit	6.1	6.1	5.8	5.8	5.8	5.7	5.7	5.6
Cost of risk as a percent of credit	1.5	0.5	0.6	0.4	0.5	0.5	0.5	0.6
Net interest margin to net banking product (NBP) 3/	80.1	75.8	75.9	78.1	76.7	76.3	75.8	78.5
Operating expenses to NBP	50.0	48.4	46.5	47.8	47.5	46.4	47.9	44.2
Operating expenses to total assets	2.3	2.2	2.0	1.7	1.7	1.8	1.8	1.7
Personnel expenses to non-interest expenses	53.1	50.7	52.3	51.9	49.7	49.1	49.4	50.1
Trading and other non-interest income to NBP	19.6	23.9	24.1	21.9	23.3	23.7	24.2	21.5
Liquidity								
Liquid assets to total assets	29.0	27.0	23.6	24.4	17.3	12.0	11.7	10.3
Liquid assets to short-term liabilities	40.2	36.8	30.7	24.7	23.0	16.0	16.1	14.4
Deposits to loans	144.9	146.0	135.2	113.0	108.0	104.0	99.0	95.0
Deposits of state-owned enterprises to total	3.7	4.6	3.9	5.1	4.8	5.2	4.8	3.4
Sensitivity to market risk								
FX net open position to Tier 1 Capital	18.1	8.0	9.4	7.6	15.6	12.1	12.1	3.0

Source: Bank Al-Maghrib.

1/ Financial Soundness Indicators (FSIs) are calculated according to guidelines of the IMF FSIs compilation guide, 2004.
2/ For 2007, the ratio is computed following Basel II standards. According to Basel I, it would have been 12 percent.
3/ Net Banking Product (NBP)=net interest margin-commissions paid+commissions received.

Table 8. Morocco: Public Sector Debt Sustainability Framework, 2007–17

(Percent of GDP, unless otherwise indicated)

		Actual					Projections					
		2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
1	**Baseline: Public sector debt 1/**	54.6	48.2	48.0	51.3	54.4	**58.2**	**59.0**	**59.0**	**58.4**	**57.0**	**55.2**
	of which: foreign-currency denominated	10.7	9.9	10.8	12.1	12.4	13.6	14.7	14.6	14.4	14.0	13.0
2	Change in public sector debt	-4.8	-6.4	-0.3	3.3	3.1	3.8	0.9	0.0	-0.7	-1.3	-1.8
3	Identified debt-creating flows (4+7+12)	-5.4	-5.6	-0.8	2.2	2.7	3.8	0.9	0.0	-0.7	-1.3	-1.8
4	Primary deficit	-3.0	-3.4	-0.6	2.1	4.5	3.7	2.2	1.4	0.9	0.4	0.2
5	Revenue and grants	29.9	32.5	29.3	27.5	27.8	27.7	28.2	28.3	28.2	28.2	28.1
6	Primary (noninterest) expenditure	26.9	29.2	28.7	29.6	32.3	31.4	30.4	29.7	29.1	28.6	28.2
7	Automatic debt dynamics 2/	-1.6	-2.6	-0.8	1.0	0.1	-0.1	-1.3	-1.5	-1.6	-1.8	-2.0
8	Contribution from interest rate/growth differential 3/	-0.6	-3.1	-0.5	0.3	-0.2	-0.1	-1.3	-1.5	-1.6	-1.8	-2.0
9	*Of which:* contribution from real interest rate	0.9	-0.4	1.7	2.0	2.2	1.5	1.2	1.2	1.2	1.1	1.1
10	*Of which:* contribution from real GDP growth	-1.5	-2.7	-2.2	-1.7	-2.4	-1.6	-2.5	-2.6	-2.8	-2.9	-3.0
11	Contribution from exchange rate depreciation 4/	-1.0	0.5	-0.3	0.7	0.3	...	...	...	...	...	...
12	Other identified debt-creating flows	-0.8	0.3	0.6	-0.9	-1.9	0.2	0.0	0.0	0.0	0.0	0.0
13	Privatization receipts (negative)	-0.8	0.0	0.0	0.0	-0.7	-0.4	0.0	0.0	0.0	0.0	0.0
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
15	Other (specify, e.g. bank recapitalization)	0.0	0.3	0.6	-0.9	-1.2	0.6	0.0	0.0	0.0	0.0	0.0
16	Residual, including asset changes (2-3) 5/	0.6	-0.8	0.5	1.2	0.4	-0.1	0.0	0.0	0.1	0.0	0.0
	Public sector debt-to-revenue ratio 1/	182.6	148.3	163.8	186.3	195.7	210.2	209.4	208.6	207.0	202.5	196.6
	Gross financing need 6/	14.3	7.7	13.4	15.2	15.4	13.2	14.0	13.3	12.7	12.1	12.1
	Billions of U.S. dollars	10.8	6.8	12.2	13.8	15.2	12.8	14.6	14.9	15.3	15.6	17.0
	Scenario with key variables at their historical averages 7/						**58.2**	**57.9**	**57.6**	**57.4**	**57.1**	**56.9**
	Scenario with no policy change (constant primary balance) in 2012-2017						**58.2**	**59.8**	**62.9**	**65.8**	**68.3**	**70.5**
	Key Macroeconomic and Fiscal Assumptions Underlying Baseline											
	Real GDP growth (percent)	2.7	5.6	4.8	3.6	5.0	3.2	4.5	4.8	5.0	5.4	5.7
	Average nominal interest rate on public debt (percent) 8/	5.6	5.4	5.3	5.0	4.7	4.6	4.6	4.7	4.8	4.8	4.8
	Average real interest rate (nominal rate minus change in GDP deflator, percent)	1.7	-0.4	3.8	4.4	4.6	3.0	2.2	2.2	2.2	2.3	2.2
	Nominal appreciation (increase in US dollar value of local currency, percent)	9.6	-4.8	3.0	-5.9	-2.6	...	...	...	...	...	...
	Inflation rate (GDP deflator, percent)	3.9	5.9	1.5	0.6	0.1	1.6	2.4	2.5	2.5	2.5	2.6
	Growth of real primary spending (deflated by GDP deflator, percent)	5.6	14.4	3.0	6.9	14.6	0.1	1.3	2.6	2.6	3.7	4.5
	Primary deficit	-3.0	-3.4	-0.6	2.1	4.5	3.7	2.2	1.4	0.9	0.4	0.2

Sources: IMF country desk data; and staff estimates.

1/ Public sector includes central government only.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

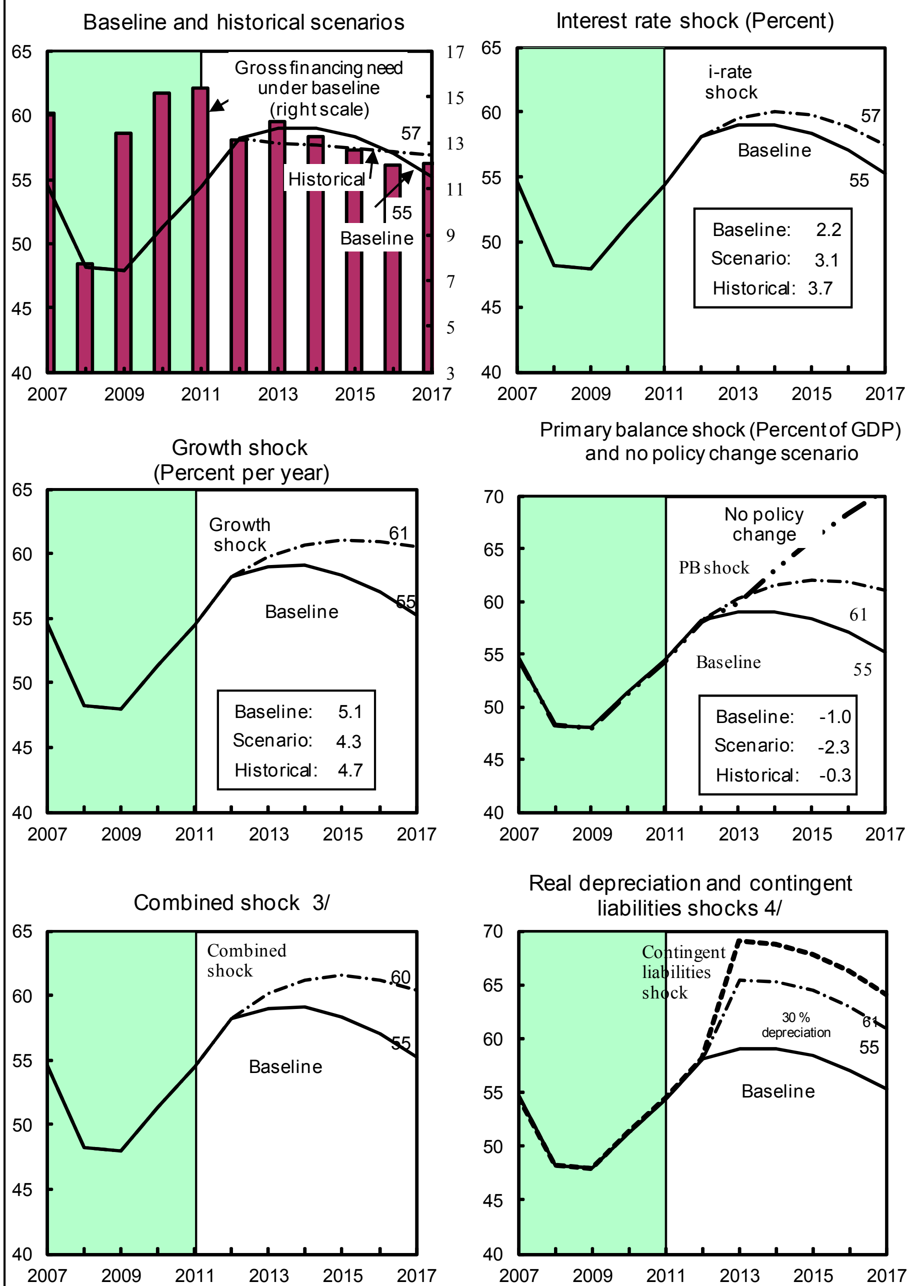
5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium- and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

Figure 3. Morocco: Public Debt Sustainability: Bound Tests 1/ 2/
(Public debt in percent of GDP)



Sources: IMF country desk data; and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
4/ One-time real depreciations of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 9. Morocco: External Debt Sustainability Framework, 2007–17

(Percent of GDP, unless otherwise indicated)

	Actual					Projections					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Baseline: External debt	23.7	20.6	23.3	24.7	23.6	**26.4**	**27.5**	**27.1**	**26.6**	**25.9**	**24.6**
Change in external debt	-0.2	-3.1	2.7	1.4	-1.1	2.7	1.1	-0.3	-0.5	-0.7	-1.3
Identified external debt-creating flows (4+8+9)	-5.7	-0.5	3.4	3.2	3.9	6.1	2.4	1.5	0.9	0.3	-0.1
Current account deficit, excluding interest payments	-0.8	4.3	4.6	3.4	7.3	7.8	5.3	4.7	4.3	3.9	3.7
Deficit in balance of goods and services	9.8	14.4	12.0	10.8	14.2	14.5	13.2	12.0	11.5	11.0	10.7
Exports	36.2	37.6	28.9	33.4	35.7	35.3	35.8	35.9	35.5	35.1	34.6
Imports	46.0	52.1	40.9	44.2	49.9	49.8	49.0	47.9	47.0	46.1	45.3
Net non-debt creating capital inflows (negative)	-2.8	-2.1	-1.6	-0.9	-2.1	-2.0	-2.8	-3.0	-3.1	-3.2	-3.3
Automatic debt dynamics 1/	-2.1	-2.8	0.4	0.8	-1.3	0.2	-0.1	-0.3	-0.3	-0.4	-0.5
Contribution from nominal interest rate	0.9	0.9	0.9	0.8	0.8	1.0	1.0	1.0	1.0	0.9	0.8
Contribution from real GDP growth	-0.6	-1.1	-1.0	-0.8	-1.1	-0.8	-1.1	-1.2	-1.3	-1.3	-1.4
Contribution from price and exchange rate changes 2/	-2.5	-2.5	0.5	0.9	-1.0	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	5.6	-2.6	-0.7	-1.8	-5.0	-3.3	-1.3	-1.8	-1.5	-1.0	-1.2
External debt-to-exports ratio (in percent)	65.4	54.7	80.5	73.9	66.1	74.7	76.7	75.4	74.9	73.8	71.0
Gross external financing need (in billions of US dollars) 4/	2.2	6.5	6.2	5.1	9.6	10.3	8.4	8.3	8.4	8.3	9.0
Percent of GDP	2.9	7.3	6.8	5.6	9.6	10.6	8.0	7.4	6.9	6.4	6.4
Scenario with key variables at their historical averages 5/						**26.4**	**22.0**	**17.2**	**13.1**	**9.7**	**6.4**
Key Macroeconomic Assumptions Underlying Baseline											
Real GDP growth (percent)	2.7	5.6	4.8	3.6	5.0	3.2	4.5	4.8	5.0	5.4	5.7
GDP deflator in US dollars (change in percent)	11.6	11.9	-2.4	-3.7	4.1	-4.7	2.7	2.2	2.2	2.2	2.6
Nominal external interest rate (percent)	4.4	4.4	4.3	3.3	3.4	4.0	4.1	3.8	3.8	3.7	3.5
Growth of exports (US dollar terms, percent)	25.7	22.6	-21.4	15.4	16.9	-3.0	8.9	7.6	5.9	6.6	7.0
Growth of imports (US dollar terms, percent)	32.5	33.7	-19.7	7.8	23.5	-1.9	5.6	4.9	5.2	5.7	6.6
Current account balance, excluding interest payments	0.8	-4.3	-4.6	-3.4	-7.3	-7.8	-5.3	-4.7	-4.3	-3.9	-3.7
Net non-debt creating capital inflows	2.8	2.1	1.6	0.9	2.1	2.0	2.8	3.0	3.1	3.2	3.3

Sources: IMF country desk data; and IMF staff estimates.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

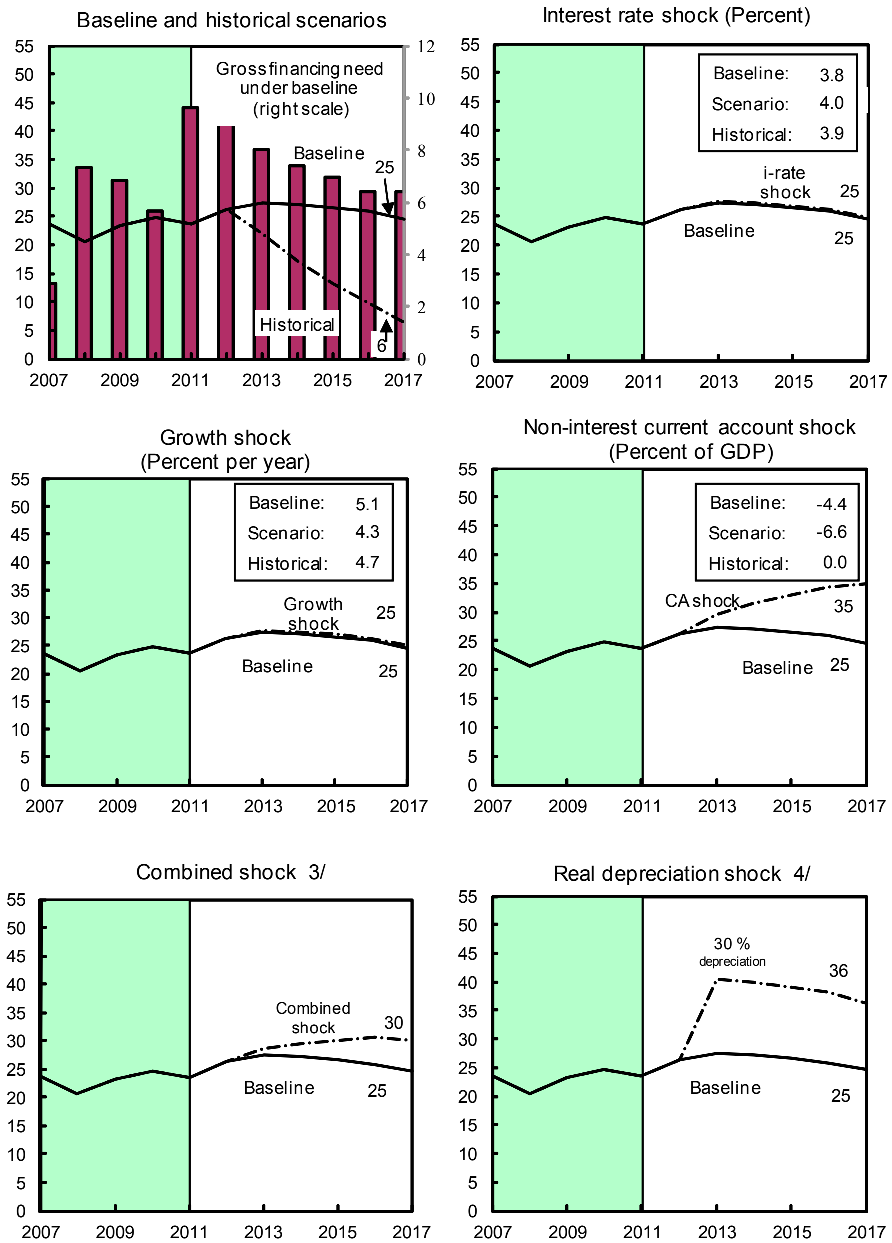
2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

Figure 4. Morocco: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: IMF, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2013.

Table 10. Morocco: Capacity to Repay Indicators 1/

		Projections					
	2012	2013	2014	2015	2016	2017	2018
Exposure and repayments (in SDR million)							
GRA credit to Morocco	0.0	4117.4	4117.4	4117.4	3014.5	955.8	0.0
(In percent of quota)	0.0	700.0	700.0	700.0	512.5	162.5	0.0
Charges due on GRA credit	0.0	43.0	42.4	42.4	40.2	23.2	4.2
Debt service due on GRA credit	0.0	43.0	42.4	42.4	1143.1	2081.9	960.1
Debt and debt service ratios							
In percent of GDP							
Total external debt	26.4	33.5	32.7	31.8	29.5	25.6	23.8
Public external debt	24.8	32.1	31.5	30.7	28.5	24.8	23.1
GRA credit to Morocco	0.0	6.0	5.6	5.2	3.6	1.0	0.0
Total external debt service	2.7	2.8	2.7	2.6	3.8	5.0	3.0
Public external debt service	2.2	2.5	2.5	2.4	3.7	4.4	3.4
Debt service due on GRA credit	0.0	0.1	0.1	0.1	1.4	2.3	1.0
In percent of gross international reserves							
Total external debt	146.7	190.4	195.6	194.2	179.6	159.2	148.0
Public external debt	138.3	182.7	188.4	187.6	174.0	154.0	143.1
GRA credit to Morocco	0.0	34.3	33.6	32.0	21.8	6.5	0.0
In percent of exports of goods and services							
Total external debt	74.7	101.9	106.8	111.3	111.0	104.7	105.7
Public external debt	70.4	97.8	102.8	107.6	107.5	101.2	102.3
GRA credit to Morocco	0.0	18.4	18.4	18.4	13.4	4.3	0.0
In percent of total external debt							
GRA credit to Morocco	0.0	18.0	17.2	16.5	12.1	4.1	0.0
In percent of public external debt							
GRA credit to Morocco	0.0	18.8	17.9	17.1	12.5	4.2	0.0
Memorandum items:							
Nominal GDP (in billions of U.S. dollars)	97.5	104.8	112.2	120.4	129.7	140.6	152.6
Gross international reserves (in billions of U.S. dollars)	17.5	18.4	18.8	19.7	21.3	22.6	24.6
Exports of goods and services (in billions of U.S. dollars)	34.4	37.5	40.3	42.7	45.5	48.7	52.1
Quota (in billions of SDRs)	588.2	588.2	588.2	588.2	588.2	588.2	588.2

Source: IMF staff estimates and projections.

1/ Assumes full drawings of available financing at first review under the PLL and full drawing of remaining access at second review under the PLL. The Moroccan authorities have expressed their intention to treat the arrangement as precautionary.

ANNEX. FISCAL DECENTRALIZATION

1. Decentralization is a key element of the recent constitutional reform. The goal is to empower regional councils and formalize their roles in order to foster more inclusive development. An advisory committee (Consultative Commission for Regionalization) was appointed by the King in January 2010 to prepare, in consultation with various stakeholders, a roadmap for a new model of decentralization. This would be the basis for an organic law to transfer more executive powers to democratically elected regional councils.

2. The concept of a decentralized state in not new in Morocco. Morocco already operates under a system in which regions have some autonomy, and raise some of their own revenue while also receiving transfers from the central government. Currently, the regions' own resources from local taxes account for about 40 percent of their total revenue. Central government transfers to regional councils represent half of their revenue and consist of 30 percent of VAT receipts, one percent of corporate tax receipts and one percent of income tax receipts overall.[1] However, the distribution of those resources amongst respective regions involves a cumbersome process that has generated disparities between regions. Broadly speaking, the allocation of resources consists of three types of flows: (i) lump sum transfers based on size and population which are mainly used to finance recurrent spending; (ii) special allocations to finance investment spending; and (iii) incentive funding based on past (local) revenue collected. There are also differentiated rules between provinces, municipalities, rural versus urban areas, etc., which render resource allocation even more complex and, in some cases, exacerbate inequalities.

3. The Consultative Commission proposed a number of significant reforms. They include: (i) democratizing of the regional councils, which are to be elected through universal suffrage; (ii) improving governance at the regional level; (iii) transferring competencies from the central government to local councils; and (iv) systematically involving regional councils in the elaboration and implementation of development strategies and in the discussions on large infrastructure projects affecting their region. In addition, given large disparities between regions in terms of human capital, a plan to bring up to speed regions that are lagging behind would be proposed. Furthermore, a mechanism of equalization between regions is proposed. To support these efforts, two new funds are being proposed, one for capacity-building and one for regional solidarity. The former is to be funded by the central government and to aim at addressing shortcomings of regions in infrastructure, human development, and basic social services within a 12-year horizon.[2] The latter is to consist of contributions from regions based on their own resources with the aim of reducing resource inequality. In addition, it is recommended that the government increase transfers to help regional councils fulfill their development objectives. Specifically, the proposal calls for: (i) higher regional taxes (without significantly increasing the national tax burden); (ii) increased borrowing

[1] In addition, the state transfers 13 percent of receipts of the tax on insurance contracts, along with proceeds from a special assistance fund.

[2] The estimated overall cost needed to fund the regional capacity-building program is between 15 and 25 percent of GDP, to be funded in tranches from the budget over 12 years.

capacity for regions; (iii) an increase from 1 percent to 5 percent of the shares of proceeds from corporate and income taxes allocated by the state to regions; (iv) an equal repartition between the central government and the regions of registration fees and special taxes on motor vehicles; and (v) the eligibility of regions for VAT receipts with respect to investment.

4. Although fiscal decentralization can improve the efficiency of allocation and the quality of provided goods and services, international experience shows that if not soundly designed it can also pose risks to macroeconomic stability.

- **Benefits and Costs.** The main benefits from decentralization rest largely in improvements in the allocation of public goods and services, as subnational governments enjoy a comparative advantage in accounting for the diversity of preferences. In addition, decentralization can increase efficiency by increasing competition and accountability, and by allowing experimentation in the provision of public goods and services. At the same time, decentralization could pose risk to macroeconomic stability by: (i) reducing the effectiveness of automatic stabilizers and limiting the ability to conduct discretionary stabilization policies; (ii) creating moral hazard problems and leading to overspending, low revenue collection, and higher fiscal deficits; (ii) undermining the quality of public goods and services when geographic and functional mobility of civil servants is limited; (iii) weakening economic activity by increasing spending volatility and fiscal uncertainty; and (iv) decreasing the strength of governance.

- **Empirical evidence.** Empirical studies seeking to quantify the relationship between measures of fiscal decentralization and macroeconomic variables have yielded contradictory findings, with results varying according to the definition of fiscal decentralization used, time, and country coverage. While this ambivalence is partly due to difficulties in compiling comparable measures of fiscal decentralization across countries, there is a common consensus that it is the design of intergovernmental fiscal relations that affects efficiency and growth, as well as macro-stabilization.

- **Policy lessons for a sound design.**[3] While the optimal design of decentralization depends on each country's specific circumstances including macroeconomic, institutional constraints, and preferences, some general lessons can be drawn from international experiences:

  (i) Decentralization should start with a clear definition of the role of each level of government in the provision of services, to avoid duplication, waste, and loss of accountability.

  (ii) The sequencing of decentralization should be appropriate, with resources made available to subnational governments pari passu with the assignment of spending

[3] See "Macro Policy Lessons for a Sound Design of Fiscal Decentralization," IMF Fiscal Affairs Department (2009).

responsibilities. In this context, it is important to define ex ante the resource envelope devoted to subnational governments that would allow them to carry out their spending assignments with an adequate level of efficiency.

(iii) The pace of decentralization should be linked to the capacity of subnational governments to carry out effectively the functions assigned to them. In particular, increased devolution of expenditure functions should be conditioned on compliance by the subnational governments with a minimum set of public finance management (PFM) requirements, and asymmetric arrangements should be considered during the starting phase when capacity varies across subnational levels.

(iv) Investments in capacity-building and the improvement of PFM at the subnational level are a prerequisite to ensuring that the potential efficiency gains of decentralization are achieved.

(v) Control by the central government over a portion of subnational resources should be considered, to promote accountability of those governments to their constituents, as well as fiscal responsibility. To enforce any form of control, availability of relevant information is crucial, including, information on debt and contingent liabilities. Limits to subnational borrowing are also needed in most cases to ensure adequate fiscal discipline.

(vi) Intergovernmental transfers should be considered, to offset resulting vertical imbalances and to moderate horizontal imbalances within each level of government.

(vii) Complementary policy reforms, such as in the civil service and regulatory frameworks, should be envisaged when the geographic and functional mobility of civil servants (including providers of health and education services) is limited.

APPENDIX I. WRITTEN COMMUNICATION

Rabat, Morocco
January 17, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Ms. Managing Director:

1. Morocco continues to pursue sound economic policies. Despite the deterioration in the international environment, Morocco's economic fundamentals remain strong, and recent performance has been consistent with the government's economic program supported by the Precautionary and Liquidity Line (PLL). While Morocco continues to face risks relating to uncertainties in the world economy, the authorities remain committed to implementing the economic policies described in the letter sent on July 27, 2012, with a view to achieving their short- and medium-term macroeconomic objectives.

2. Low rainfall and a worsening external environment have slowed growth in 2012 and increased the pressures on the external accounts. The slowdown in the first three quarters of the year was mostly due to a lower-than-average agricultural harvest. However, the continued support of domestic demand is expected to keep nonagricultural GDP growth strong at 4.5 percent. Inflation has remained subdued and the unemployment rate stable at about 9 percent. The banking system remains sound and monetary conditions have been supportive of economic activity. In 2012, imports rose more quickly than exports, owing to high food and energy prices and to the continued deterioration of the economic situation in Europe. In addition, tourism receipts and remittances were also affected. Nevertheless, the effort to consolidate public finances has helped to limit the worsening of the savings investment balance. Reserves stabilized at an adequate level and were recently strengthened following a $1.5 billion bond issuance on the international financial market. The success of this issuance and the retention of the "investment grade" rating for Morocco are a sign of investors' confidence in the Moroccan economy.

3. Morocco is not faced with immediate balance of payments needs, but the persistence of an unfavorable external environment will likely continue to create pressures on reserves. The Moroccan authorities' program includes a comprehensive set of economic policies and structural reforms to deal with such pressures. Fiscal consolidation and the prudent stance of monetary policy should help to reduce the current account deficit in the near term. The reforms under way, which aim to increase the functioning of the product and labor markets, and the measures to promote training and education, combined with the accelerated implementation of sectoral strategies, will help improve potential growth and external competitiveness and ensure medium-term sustainability of the external accounts. In the current uncertain economic environment, the PLL arrangement serves Morocco's needs well, and Morocco will continue to treat this arrangement as precautionary, unless unforeseen external shocks or a substantial worsening of the international environment relative to current assumptions require additional financing to meet an urgent balance of payments need.

4. The 2012 budget was implemented in line with government objectives. Revenue and expenditure have been on track to meet our targeted fiscal deficit reduction in 2012. The cumulative deficit at end-October was DH 41.0 billion, slightly below the indicative target of DH 41.6 billion. The measures taken in June to raise the prices of certain subsidized petroleum products, as well as savings in operating expenses and the rationalization of investment expenditure, together with a sustained effort in revenue collection, will help to bring the 2011 deficit from 6.8 percent of GDP down to about 6 percent of GDP in 2012.

5. The government's strategy with regard to public finances is to rebuild fiscal space while promoting competitiveness and stronger, more inclusive growth. The objective is to reduce the deficit to 4.7 percent of GDP in 2013 and lower it further to 3 percent by 2016, in line with the government's program.

6. On the revenue side, the government intends to continue reforming tax policy to widen the tax base, reduce the number of special regimes, close tax loopholes, and improve the fairness of the tax system, while strengthening tax administration and encouraging the integration of the informal sector. The 2013 budget introduces tax measures to reduce the tax burden on small and medium-sized enterprises with a view to supporting their development and promoting employment in the private sector, and measures to strengthen revenues intended to finance social cohesion programs, such as those described in paragraph 8 below. The tax conference, "*Assises Fiscales*" scheduled for

early 2013 will provide the opportunity to organize a broad debate with social and economic partners to establish the guidelines for tax reform.

7. On the expenditure side, the government's aim is to continue to contain the wage bill to reduce it to below 11 percent of GDP in the medium term. Accordingly, the government intends to limit the creation of budgetary posts to cover the administration's priority needs. Additionally, a remuneration system based on job type and performance will be established in the medium term, replacing the current system based on a grading scale. Efforts to maintain strong public investment will continue, while stressing the need for rationalization and improvement of its efficiency.

8. The government's objective in the area of social protection is to gradually reduce universal subsidies in favor of a system based on direct monetary transfers and other social safety net measures targeting poor and vulnerable members of the population, while progressively increasing international price pass-through of currently subsidized products. In this context, in consultation with the economic sectors concerned and with civil society, three ministerial technical committees carried out the following: (i) an assessment of the macroeconomic impacts of various reform options, (ii) a review of targeting options for social transfers, and (iii) an identification of options for revision of price structures. The conclusions of this technical work will form the basis for a broad consultation to be organized during the first quarter of 2013, with political parties and labor unions to help shape the reform of the system, such that the final decisions can be made swiftly and the reform can start in 2013. In order to strengthen the resources allocated to social protection, the 2013 budget includes a new tax on net corporate profits, on high income earners, as well as taxes on tobacco, insurance contracts, and the delivery to self of residential premises. The 2013 budget has a budget allocation for subsidies of DH 40 billion in 2013, equivalent to 4.5 percent of GDP, in line with the government's aim to reduce these expenditures to 3 percent of GDP in the medium term. The government also intends to swiftly complete consultations with the social and economic partners, with a view to deciding on the terms of the pension system reform that will ensure its sustainability and increase its coverage.

9. As part of the Advanced Regionalization, a draft organic law is currently being prepared to transfer additional executive powers to elected regional councils, to enhance the efficiency of spending and to promote a balanced development of the regions. A road map will be developed covering the implications of the regionalization program for the budget, with a view to establishing

the appropriate coordination, financing, and institutional arrangements while preserving the stability of public finances.

10. Inflation has remained low to date, despite the increase in domestic administered prices for various energy products in June 2012. Bank Al-Maghrib continues to closely monitor any potential external or domestic price pressures, and remains steadfastly committed to taking all necessary measures to ensure price stability in the medium term. In response to growing liquidity needs, resulting mostly from the fall in net external assets, the Bank reacted by injecting liquidity primarily through seven-day advances and longer-term (three-month) repurchase agreements. In addition, and given the persistence of the banks' liquidity squeeze, the Board of Bank Al-Maghrib cut the minimum reserve ratio from 6 percent to 4 percent at its September 2012 meeting. By the same token, the collateral was widened to include all certificates of deposit as well as paper representing loans to very small enterprises (VSEs) and small and medium-sized enterprises (SMEs). The Bank will continue to supply the liquidity necessary to ensure appropriate financing of the economy. In addition, it will further strive to encourage banks to use a broader range of refinancing instruments to adjust their balance sheets. The Bank will continue to monitor closely the implementation of refinancing plans adopted by some banks, in order to ensure that credit growth is supported by stable resources that are better suited for their use. It will also ensure that banks hold sufficient liquidity buffers on their balance sheets and adopt appropriate contingent plans to deal with liquidity crises.

11. Bank Al-Maghrib will continue to monitor the soundness of the banking sector and to strengthen it with strong regulation and effective supervision. Accordingly, it will progressively align the prudential framework with the new Basel III standards. In this regard, it raised the solvency ratio to 12 percent and stipulated a Tier 1 ratio of 9 percent to be implemented in June 2013, and will review the definition of capital in accordance with the new Basel III rules starting from the second quarter of 2013. The Bank will also reform the short-term liquidity ratio to bring it into line with international standards. The ratio of nonperforming loans to total loans remained stable at 5.2 percent at end-November 2012 and Bank Al-Maghrib will continue to ensure that such loans are sufficiently provisioned. In addition, the reform of the central bank charter and the banking law provides for new arrangements with regard to financial stability. The central bank and the other financial sector regulators continue to strengthen coordination in this area. They have agreed on a crisis management protocol and are working to establish a macroprudential framework. With this

prospect in view, the safeguard assessment mission to the Bank found that the reforms of the central bank charter and the banking law incorporated the necessary financial stability provisions.

12. The fixed exchange rate regime of the dirham against a euro/dollar basket has contributed to economic stability over the past ten years by providing an important nominal anchor. However, the maintenance of reserves at an adequate level could be jeopardized by the persistence of an increasingly difficult external economic environment. After trending downward, reserves have stabilized at about four months of imports. The authorities will continue their endeavors to maintain reserves at an appropriate level through structural reforms to enhance external competitiveness, and to attract foreign investment by continuing the process of fiscal consolidation, and turning to international financial markets when necessary. In due course, the Moroccan authorities believe that increased flexibility in the exchange rate would provide greater scope for the economy to respond efficiently to external shocks and to strengthen competitiveness. Nevertheless, it will be essential to strengthen medium-term fiscal sustainability in advance, specifically by reforming the subsidy system and completing the preparation of the transition to a new monetary policy framework.

13. The levels of central government deficit and net international reserves are in line with the indicative targets at end-October 2012; we will continue to ensure that we meet the targets for end-April and end-October 2013 specified in Table 1 attached. We have also observed and will continue to observe the standard criteria related to trade and exchange restrictions, bilateral payments arrangements, multiple currency practices, and the nonaccumulation of external debt payment arrears, in accordance with requirements under the PLL.

14. In sum, we continue to pursue sound economic policies and remain steadfastly committed to ensuring macroeconomic stability and external and fiscal sustainability in the medium term, as well as to responding appropriately to any adverse shocks. Given that the economy remains exposed to external risks, the insurance provided by the PLL remains important to support Morocco's economic strategy. The descriptions in this letter, together with the letter dated July 27, 2012, requesting approval of a PLL arrangement, outline the main themes of our economic program, on the basis of which we are requesting completion of the first review under the PLL.

/s/	/s/
Nizar Baraka	Abdellatif Jouahri
Minister of Economy and Finance	Governor of Bank Al-Maghrib

Table 1. Morocco: Quantitative Indicative Targets

	12/31/2011	10/30 PLL	10/30 Adj.	10/30 Actual	4/30 PLL	Rev.	10/31
		2012			2013		2013
Indicative targets 1/							
Net international reserves (NIR) of Bank Al-Maghrib (BAM) (floor, end-of-period (eop) stock, in millions of U.S. dollars (US$))	20,268	16,752	16,603	16,603	16,557	16,682	16,881
Fiscal deficit (ceiling, cumulative since beginning of fiscal year, eop in millions of dirham)	-54,545	-41,601	-41,601	-40,952	-18,556	-15,915	-33,772
Memorandum item:							
Adjustor on NIR (in millions of U.S. dollars) 2/		1.095		946	928	1.238	2.292
Adjustor on the fiscal deficit (in millions of dirham) 3/		0		316	3.248	3.223	6.446

Source: IMF staff estimates.

1/ Evaluated at the program exchange rate (end-April 2012 8.429 MAD/US$) for the years 2012 and 2013.

2/ The adjustors are specified in the Technical Appendix of July 27, 2012. Accordingly, the floor on NIR of BAM will be adjusted downward in the event of a shortfall of official grants and budget support loans relative to projections. The adjustors for 2013 are cumulative from end-October 2012.

3/ The adjustors are specified in the Technical Appendix of July 27, 2012. Accordingly, the fiscal deficit ceiling will be adjusted upward in the event of a shortfall of budget support grants relative to projections. The adjustors for 2013 are cumulative from end-December 2012.

INTERNATIONAL MONETARY FUND

MOROCCO

January 17, 2013

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION AND FIRST REVIEW UNDER THE TWO-YEAR PRECAUTIONARY AND LIQUIDITY LINE—INFORMATIONAL ANNEX

Prepared By

The Middle East and Asia Department
(in Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of November 30, 2012)

I. Membership Status

Joined April 25, 1958; Article VIII

II. General Resources Account

	SDR Million	Percent Quota
Quota	588.20	100.00
Fund holdings of currency	517.75	88.02
Reserve position in Fund	70.45	11.98

III. SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	561.42	100.00
Holdings	308.38	54.93

IV. Outstanding Purchases and Loans

None

V. Latest Financial Arrangements (In millions of SDR)

Type	Date of arrangement	Expiration Date	Amount Approved	Amount Drawn
PLL	08/03/2012	08/02/2014	4,117.40	0.00
Stand-by	01/31/1992	03/31/1993	91.98	18.40
Stand-by	07/20/1990	03/31/1991	100.00	48.00
Stand-By	08/30/1988	12/31/1989	210.00	210.00

VI. Projected Payments to Fund

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming			
	2013	2014	2015	2016
Principal				
Charges/interest	0.21	0.21	0.21	0.21
Total	**0.21**	**0.21**	**0.21**	**0.21**

VII. Exchange Rate Arrangement and Exchange System

Morocco maintains an exchange system that is free of restrictions on the making of payments and transfers on current international transactions. However, Morocco maintains certain restrictions relating to Iraq and the Federal Republic of Yugoslavia (Serbia and Montenegro), pursuant to UN Security Council Resolutions. These are subject to notification to the Fund in accordance with Decision 144 (52/51). The exchange rate is freely determined in the interbank foreign exchange market, which was created in 1996. Bank Al-Maghrib (BAM) intervenes in the market to maintain the exchange rate within its target range, defined around a fixed central rate. Morocco has a conventional peg arrangement. The current exchange rate of the Moroccan dirham is pegged to a basket of currencies comprising the euro and the U.S. dollar, with respective weights of 80 and 20 percent. BAM fixes daily rates for the rated currencies on the basis of variations on the value of the basket. Rates for most currencies quoted in Morocco are established on the basis of the daily dirham-euro rate and the cross rates for those currencies in relation to the euro in the international exchange markets. As of January 2, 2013, the SDR/dirham exchange rate was SDR 1=MAD 9.60.

VIII. Article IV Consultation

Morocco is on the standard 12-month cycle. The last Article IV consultation was concluded by the Executive Board on October 5, 2011. The discussions for the 2012 consultation were held in Rabat and Casablanca during December 5-18, 2012.

IX. Technical Assistance

MCM	Peripatetic visits—Accounting, internal rating and bank supervision	2007–09
MCM	Stress Testing and Macroprudential Analysis.	January 27–February 2, 2009
STA	National Accounts Statistics	April 19–30, 2009
FAD	Recent Revenue Developments: Analysis and Implications to Fiscal Policy	September 22–October 5, 2009
STA	Monetary and Financial Statistics	March 1–March 11, 2010
MCM	Stress Testing and Macroprudential Analysis	February 9–February 18, 2011
STA	Monetary and Financial Statistics	March 30–April 12, 2011
MCM	Strengthening Macroprudential Analysis.	June 21-29, 2012
FIN	Safeguards assessment mission	October 16-24, 2012

X. FSAP update

The latest update of the Financial Sector Assessment was performed in November 2007. The findings were discussed with the authorities during the May 2008 Article IV mission and discussed by the Board on July 23, 2008.

XI. Resident Representative

None

RELATIONS WITH THE WORLD BANK GROUP

JMAP Implementation, FY11

As of January 2, 2013

Title	Products	Provisional timing of missions	Expected delivery date
A. Mutual Information on Relevant Work Programs			
Bank work program in next 12 months	a. Development Policy Lending on: Trade and Competitiveness Solid Waste III Plan Maroc Vert II Urban Transport Sector II Education II Climate Change Transparency and Accountability I Financial Sector II		FY13 FY13 FY13 FY13 FY13 FY14 FY14 FY14
	b. Investment Lending: GEF Social and Integrated Agriculture (grant financing)		FY13
	c. Sector work • Poverty & Labor market analysis • Improving the governance of provision of social services to citizens • Public Expenditure Review (PER) on health and education, Justice, and climate Change • Climate Change Adaptation & Mitigation Strategy • Assessment of Climate Change Impacts on Water Resources Management • Trade & EU Integration		
	d. Technical assistance • Subsidy Reform and Cash Transfer Program • Programmatic Employment • Youth Strategy and Employment • Urban Integrated Risk Management and Strategy		

	• Introduction to Covered Bonds • Clean Energy (Phase 2) • Reliable Interest Rate Benchmarks • Financial capability survey • Community-Based Disaster Risk Management • Business Environment • Macro-econometric modeling • E-governance and broadband Governance		
IMF work program in next 12 months	Review mission TA mission FAD Tax reform TA mission MCM: a joint ADMDI-Deauville Initiative mission TA mission LEG: AML/CFT TA mission STA : Monetary and Financial Statistics	June 2013 1Q, 2013 1Q, 2013 March 2013 April 2013	
B. Requests for Work Program Inputs			
Fund request to Bank	Developments on subsidies and pension reforms Developments on decentralization	As needed As needed	
Bank request to Fund	Assessment of macroeconomic stance and prospects Request for assessment letters to DPLs Data sharing	Semiannual (and on ad hoc basis if requested) At least 4 operations predicted Ongoing	Following Article IV and staff visits
C. Agreement on Joint Products and Missions			
Joint products in next 12 months	Continuous close coordination on the reform agenda	Ongoing	

STATISTICAL ISSUES

As of January 2, 2013

I. Assessment of Data Adequacy for Surveillance	
General: Data provision is adequate to conduct effective surveillance.	
National accounts: Real sector data are adequate for surveillance.	
Government finance statistics: Fiscal data are adequate for surveillance.	
Balance of payments statistics: External sector data are adequate for surveillance.	
Monetary and financial statistics: They are adequate for surveillance.	
II. Data Standards and Quality	
Morocco has been a SDDS subscriber since December 2005.	The results of a data ROSC mission were published in April 2003 (Country Report No. 03/92).

Morocco—Table of Common Indicators Required for Surveillance
(As of December 31, 2012)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo items: Data Quality – Methodological soundness[8]	Memo items: Data Quality – Accuracy and reliability[9]
Exchange Rates	12/31/12	12/31/12	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/21/12	12/28/12	W	W	W		
Reserve/Base Money	11/30/12	12/21/12	M	M	M	LO, O, LNO, LO	LO, LO, O, O, LO
Broad Money	11/30/12	12/21/12	M	M	M		
Central Bank Balance Sheet	11/30/12	12/21/12	M	M	M		
Consolidated Balance Sheet of the Banking System	11/30/12	12/21/12	M	M	M		
Interest Rates[2]	12/31/12	12/31/12	D	D	D		
Consumer Price Index	11/30/12	12/20/12	M	M	M	O, LO, O, O	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2011	09/28/12	A	A	A	LO, LNO, LO, O	O, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3]– Budgetary Central Government	11/30/12	12/15/12	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q3, 2012	12/31/12	Q	Q	Q		
External Current Account Balance	Q2, 2012	12/01/12	Q	Q	Q	LO, LO, LO, LO	LO, LO, O, LO, LNO
Exports and Imports of Goods and Services	10/30/12	12/01/12	M	M	M		
GDP/GNP	Q3, 2012	12/31/12	Q	Q	Q	LO, LNO, LO, LO	LNO, LO, O, O, LNO
Gross External Debt	Q2, 2012	12/31/12	Q	Q	Q		
International Investment Position [6]	2011	06/30/12	A	A	A		

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, and domestic financing by instrument (currency and deposits, securities, loans, shares, and other accounts payable)

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

[8] Reflects the assessment provided in the data ROSC published on April 4, 2003, and based on the findings of the mission that took place during January 16–30, 2002, for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[9] Same as Footnote 8, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 13/13
FOR IMMEDIATE RELEASE
February 5, 2013

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2012 Article IV Consultation with Morocco

On February 1, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Morocco.[1]

Background

Morocco has a track record of strong macroeconomic policies that, over the last decade, contributed to solid growth, low inflation, comfortable external reserves, financial deepening, and poverty reduction. These favorable developments have helped Morocco cushion the impact of the international crisis and respond to pressing social needs. In the context of political transitions in many countries in the region and high social demands, a new constitution was adopted in July 2011 in order to pave the way for broad-ranging political changes and reforms, including strengthened roles for the head of government and Parliament. Morocco's positive record helped it qualify last August for a 24-month arrangement under the Precautionary and Liquidity Line (PLL), which aims to provide insurance against external shocks. More recently, this performance has been challenged by a deteriorating external environment and, in 2012, poor rainfall. Growth is expected to slow in 2012 to 3.2 percent, largely due to a lower-than-average cereal crop, but nonagricultural GDP growth is projected to remain robust at around 4.5 percent. Headline inflation has remained subdued at 1.6 percent (year-on-year) in November 2012, despite significant increases in the prices of several subsidized energy products in June, as part of the government's effort to contain the fiscal cost of subsidies. Core inflation (excluding food and transport) was close to zero due to the large negative contribution of lower

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

communication tariffs. Despite relatively strong growth, unemployment has remained around 9 percent since 2010.

The fiscal deficit should decline to about 6 percent of GDP in 2012, thanks to a combination of measures notably the increase in some energy-administered prices in June and the control of nonessential spending. Delays in the adoption of the 2012 budget and in disbursement of external grants resulted in lower-than-projected investment. This, in turn, helped offset the subsidy bill that reached about 6.2 percent of GDP. The 2013 budget envisions a further reduction of the deficit by 1.4 percent point of GDP to 4.7 percent of GDP. For the medium term, the authorities aim at a deficit below 3 percent of GDP.

The current account deficit is expected to increase to 8.8 percent of GDP in 2012 as import growth, pushed by energy-related imports, outpaced slow export growth. Tourism receipts and remittances are projected to fall slightly relative to 2011, reflecting the deterioration in the European economy. While gross international reserves (GIR) fell steadily in 2011 and most of 2012, they stabilized at around four months of imports in the last quarter. The issuance of a US$1.5 billion sovereign bond at favorable terms in late 2012 provided additional support in this regard.

Monetary conditions have remained broadly supportive. Lower international reserves had a substantial restrictive impact on bank liquidity, contributing to slowing credit growth to 7 percent in 2012. To help fill the liquidity shortage, the central bank stepped up its liquidity injection, including by extending eligible collateral for its repo. The policy interest rate was cut by 0.25 percentage point to 3 percent in March 2012 and has remained unchanged since then. In September 2012, it also cut its reserve requirements for banks by 2 percentage points to 4 percent.

Morocco's social indicators have improved over the past decade. Higher economic growth, lower unemployment, better health and educational outcomes, better access to basic infrastructure, and a marked reduction in poverty rates are tangible evidence of the progress made in fostering inclusive growth. However, unemployment remains high particularly among the youth. The authorities' reform agenda includes measures to boost potential growth, tackle inequalities in the distribution of income and access to health care, particularly across regions as well as reduce unemployment.

Executive Board Assessment

Executive Directors commended the authorities for their overall sound macroeconomic policies, which, over the past decade, have helped deliver solid growth, low inflation, and poverty reduction despite continued high youth unemployment. This strong performance has been challenged recently by external and domestic shocks in a context of pressing social demands. Directors agreed that the authorities' program of fiscal consolidation, prudent monetary and financial policies, and structural reforms to boost competitiveness and inclusive growth and rebuild shock buffers is appropriate to deal with these challenges. They emphasized that the outlook hinges on the timely and sustained implementation of the reform agenda.

Directors welcomed the fiscal consolidation envisioned in the 2013 budget and beyond to help maintain external and fiscal sustainability, while emphasizing that consolidation should be as growth-friendly as possible. They welcomed the steps being taken toward reforming the subsidy system, and called on the authorities to move ahead resolutely in this area to aid medium-term fiscal adjustment and better assist the most vulnerable groups of the population. Directors also stressed the importance of moving ahead with pension reform to ensure the system's viability. They encouraged a careful approach to fiscal decentralization so as not to increase fiscal risks. They welcomed plans to lower the ratio of the government wage bill to GDP and accelerate tax reforms. Directors concurred that clear communications and high-quality social dialogue will be key to successful implementation of the fiscal reform agenda.

Directors considered the current monetary policy stance to be appropriate. They encouraged the authorities to move toward greater exchange rate flexibility to enhance external competitiveness and the economy's ability to absorb shocks, in coordination with other macroeconomic and structural policies.

Directors called for stepped-up efforts to foster higher and more inclusive growth, including by boosting youth employment and reducing inequalities in income and in access to health care and education. They underscored the importance of structural reforms to enhance external competitiveness and diversify the export base. They welcomed planned reforms to improve the business climate and promote small and medium-sized enterprises, both crucial to accelerate private-sector-led growth.

Directors noted that the financial sector remains sound overall. They commended the authorities' efforts to further strengthen financial regulation and supervision, particularly in light of increasing international exposure of Moroccan banks. In this regard, they welcomed the authorities' interest in a Financial Sector Assessment Program update. Directors encouraged the authorities to strengthen legislation against money laundering and terrorism financing, and to intensify reforms to promote financial development and deepening.

Directors agreed that Morocco continues to meet the qualification criteria for a Precautionary and Liquidity Line (PLL) arrangement. They noted that the arrangement provides useful insurance against exogenous shocks and that the program supported by the PLL is on track. Directors welcomed the authorities' intention to continue to treat the PLL as precautionary.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Morocco: Selected Economic Indicators, 2010–18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
	(Annual percentage change)								
Output and Prices									
Real GDP	3.6	5.0	3.2	4.5	4.8	5.0	5.4	5.7	5.8
Real nonagricultural GDP	4.9	5.0	4.5	4.5	4.7	5.0	5.4	5.8	5.9
Consumer prices (end of period)	2.2	0.9	2.3	2.5	2.5	2.5	2.5	2.6	2.6
Consumer prices (period average)	1.0	0.9	1.3	2.4	2.5	2.5	2.5	2.6	2.6
	(In percent of GDP								
Investment and Saving									
Gross capital formation	35.0	36.0	36.1	36.6	37.4	37.8	38.2	38.4	38.8
Of which: Nongovernment	31.2	31.5	31.9	31.8	31.9	32.1	32.4	32.6	32.9
Gross national savings	30.9	27.9	27.3	30.4	31.7	32.6	33.4	33.9	34.3
Of which: Nongovernment	28.9	28.5	28.4	29.4	29.5	29.5	29.7	29.9	29.9
	(In percent of GDP)								
Public Finances									
Revenue 1/	27.5	27.8	27.7	28.2	28.3	28.2	28.2	28.1	28.2
Expenditure	31.9	34.6	33.8	32.9	32.4	31.7	31.2	30.7	30.6
Budget balance	-4.4	-6.8	-6.1	-4.7	-4.1	-3.5	-3.0	-2.7	-2.4
Primary balance (excluding grants)	-2.3	-4.7	-3.8	-3.4	-2.7	-2.0	-1.5	-1.1	-0.8
Total government debt	51.3	54.4	58.2	59.0	59.0	58.4	57.0	55.2	53.3
	(Annual percentage change; unless otherwise indicated)								
Monetary Sector									
Credit to the private sector 2/	7.5	9.9	7.0	8.0	...	...	...	...	...
Broad money	4.8	6.5	3.3	7.9	...	...	...	...	...
Velocity of broad money	0.9	0.8	0.9	0.8	...	...	...	...	...
Three-month treasury bill rate (period average, in percent) 3/	3.4	3.5	3.2	...	...	...	...	...	...
	(In percent of GDP; unless otherwise indicated)								
External Sector									
Exports of goods (in U.S. dollars, percentage change)	26.7	21.0	-3.5	10.4	8.1	5.6	6.5	6.9	7.1
Imports of goods (in U.S. dollars, percentage change)	7.7	25.4	-1.6	5.9	5.0	5.4	5.9	6.8	7.6
Merchandise trade balance	-16.4	-19.6	-20.0	-18.8	-17.8	-17.5	-17.1	-16.8	-16.7
Current account excluding official transfers	-4.4	-8.4	-8.9	-7.9	-6.8	-6.4	-5.8	-5.4	-5.3
Current account including official transfers	-4.1	-8.0	-8.8	-6.3	-5.7	-5.3	-4.8	-4.5	-4.5
Foreign direct investment	0.8	2.3	2.2	2.8	2.8	2.9	3.0	3.0	3.0
Total external debt	24.7	23.6	26.4	27.5	27.1	26.6	25.9	24.6	23.8
Gross reserves (in billions of U.S. dollars)	23.6	20.6	17.5	18.4	18.8	19.7	21.3	22.6	24.6
In months of next year imports of goods and services	5.7	5.1	4.1	4.1	4.0	4.0	4.0	4.0	4.1
In percent of short-term external debt (on remaining maturity basis)	1,546	1,222	1,037	1,091	1,112	1,168	1,259	1,339	1,455
Memorandum Items:									
Nominal GDP (in billions of U.S. dollars)	90.8	99.2	97.5	104.8	112.2	120.4	129.7	140.6	152.6
Unemployment rate (in percent)	9.1	8.9	…	...	...	...	...	...	...
Net imports of energy products (in billions of U.S. dollars)	-8.1	-11.2	-11.8	-11.5	-11.4	-11.3	-11.2	-11.1	-11.1
Local currency per U.S. dollar (period average)	8.4	8.1	…	...	...	...	...	...	...
Real effective exchange rate (annual average, percentage change)	-4.1	-1.7	…	...	...	...	...	...	...

Sources: Moroccan authorities; and IMF staff estimates.

1/ Includes changes in the balance of other special treasury accounts.

2/ Includes credit to public enterprises.

3/ Most recent data for 2012.

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International Monetary Fund
Washington, D.C. 20431 USA

The IMF Executive Board Completes the First Review Under Precautionary and Liquidity Line Arrangement for Morocco

The Executive Board of the International Monetary Fund (IMF) on February 1, 2013 completed the first review of Morocco's performance under an economic program supported by a two-year Precautionary Liquidity Line (PLL) arrangement and reaffirmed Morocco's continued qualification to access PLL resources.

The PLL was approved on August 3, 2012 in an amount equivalent to SDR 4,117.4 million (about US$6.3 billion, 700 percent of quota, see Press Release No. 12/287). The access under the arrangement in the first year is equivalent to SDR 2.4 billion (about US$3.6 billion, or 400 percent of quota), rising in the second year to cumulatively SDR 4.1 billion (about US$6.3 billion).

The PLL arrangement will continue to support the authorities' home-grown reform agenda aimed at achieving higher and more inclusive economic growth by providing a useful insurance against external shocks. The PLL was introduced to meet more flexibly the liquidity needs of member countries with sound economic fundamentals and strong record of policy implementation but with some remaining vulnerabilities.

The IMF's Executive Board welcomed the authorities' intention to continue treating the arrangement as precautionary.

Following the Board's discussion, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, issued the following statement:

"Over the past decade, Morocco's overall sound macroeconomic policies helped deliver solid growth, low inflation, and poverty reduction, despite continued high youth unemployment. This extended period of sound economic performance has been recently challenged by a worsening of the external environment and a below-average harvest, even though the nonagricultural GDP growth remained robust and inflation low. Against this backdrop, the authorities' economic strategy is built appropriately on fiscal consolidation, structural reforms and prudent monetary and financial policies. Sustained implementation will be key to rebuilding buffers, preserving macroeconomic stability and achieving stronger and more inclusive growth.

“The arrangement under the Fund’s Precautionary and Liquidity Line (PLL), which the authorities intend to continue to treat as precautionary, has provided Morocco with an insurance against external risks and supported the authorities’ economic strategy.

“The authorities’ fiscal strategy, including the 2013 budget, is in line with their commitment to maintain fiscal sustainability and support external adjustment. As part of this strategy, it will be important to move ahead with the reforms of the general subsidy system and the pension system and to better target social protection. Fiscal space needs to be preserved to support higher and more inclusive growth.

“Efforts to strengthen competitiveness and better equip the economy to respond to external shocks are a priority. The planned fiscal consolidation and structural reforms, such as those to improve the business climate and professional training, will help underpin external sustainability. Morocco is encouraged to move toward greater exchange rate flexibility to enhance external competitiveness and the economy’s ability to absorb shocks, in coordination with other macroeconomic and structural policies.

“Over the past decade, substantial progress has been made in improving social indicators. However, sustained further efforts are still needed to increase growth and make it more inclusive, notably by boosting employment, in particular of the youth, reducing income inequalities, and increasing access to health care and education.”

Statement by Mohammed Daïri, Alternate Executive Director for Morocco
February 1, 2013

My authorities wish to thank Mr. Dauphin and his team for the excellent and fruitful dialogue during the discussions on the Article IV consultation and the first review of the PLL, and for the well-written staff report and useful Selected Issues Paper. They are grateful to management and the Board for their continuous support and invaluable advice.

Recent economic developments and prospects

Despite an unfavorable environment, Morocco has maintained macroeconomic stability and solid nonagricultural growth performance. After demonstrating strong resilience to the global and the euro area crises over 2008-11, reflecting the strength of its fundamentals and policies and the peaceful political transition, Morocco was adversely affected in 2012 by several shocks, including a drought-related decline in agricultural production, a worsening of the economic situation of its main partners in the euro area, and further increase in world petroleum and other commodity prices. As a highly oil import-dependent country and a large wheat importer, Morocco has been severely hit by the unusual combination of high commodity prices and low world growth. Against this background, the new Cabinet that took office in January 2012 announced an economic medium-term program aimed at achieving higher and more inclusive growth while preserving macroeconomic stability. In recognition of Morocco's demonstrated track record of strong policies and the authorities' continued commitment to reform, notwithstanding the difficult international environment and the pressing social demands, this program was supported by the IMF under the PLL, with the objective of providing insurance against a further deterioration of the international environment.

Implementation of the authorities' program in 2012 was broadly satisfactory. Nonagricultural GDP growth was maintained at 4 ½ percent, with total GDP growth at 3 percent. Inflation remained very low at 1.3 percent, despite the mid-year increase in petroleum prices, which has not led to second round effects due to wage restraint. Unemployment stabilized at 9 percent, even though it remained unacceptably high among the youth. Improved weather conditions and continued solid performance of nonagricultural sectors should help a recovery of GDP growth to 4 ½ percent in 2013, with inflation remaining within a range of 2 to 2.5 percent.

The protracted slowdown in the euro area, which had limited impact on Morocco until 2011, affected more significantly the balance of payments in 2012. Exports declined in US dollar terms, although part of the shortfall compared to PLL projections stemmed from lower international prices for phosphates and derivatives and the drought-driven decline in agricultural exports. Excluding these exogenous shocks, total exports remained broadly unchanged from 2011, with significant contribution from the automobile sector, following the entry into production of the new factory. Energy imports increased, in line with international oil prices, but total imports are estimated to be lower-than-projected under the PLL. Workers' remittances and tourism receipts declined, with lower receipts from some euro area countries mitigated by stronger flows from other regions. While the current account deficit is estimated at around 9 percent of GDP, instead of 7.2 percent under the PLL, part of the deterioration was due to lower-than-expected grants, since agreements with GCC donor countries were not completed by end-2012 as envisaged. With FDI remaining broadly unchanged at some 2 percent of GDP, gross reserves declined, while import coverage remained at 4 months of imports, as a result of lower projected imports.

Morocco's strong fundamentals and policies in an unfavorable environment were also recognized by the international capital markets, with its sovereign risk rating maintained at investment grade, and CDS spread remaining moderate and declining further after the announcement of the PLL. This enabled Morocco to raise $1.5 billion in the international bond markets at very favorable terms, 1/3 of which at a 30-year maturity, with the issuance several times oversubscribed and prevalence of US funds. Government access to markets has helped attenuate the impact of the deterioration in the current account on reserves and provides a benchmark for private borrowers.

The staff report also highlights the important progress made in improving social indicators and inclusiveness, with noteworthy progress in per capita GDP growth, employment, education and health indicators, access to infrastructure, and poverty alleviation. The authorities are cognizant of the important remaining challenges. They are strongly committed to strengthen growth and employment outcomes, with particular emphasis on youth and female employment, improve labor participation and social protection, and reduce income inequalities.

Fiscal policy

The authorities demonstrated strong determination to achieve their fiscal objectives for 2012. In addition to increasing energy prices in June, they strengthened revenue collection and increased expenditure prioritization by further reducing nonessential expenditures and greater selectivity in capital spending to preserve key social and growth-enhancing programs. While the end-year data are not yet available, the fiscal deficit, excluding grants, is estimated to decline in 2012, both in relation to 2011 and to the projections under the PLL.

In line with the 3 percent of GDP target by 2016, the 2013 budget, the first to be presented by the new Government, aims at reducing the deficit further to 4.8 percent of GDP, half a percentage point lower than the target under the PLL. It includes a number of new tax measures to support SMEs and mobilize resources for social programs, as detailed in the Written Communication. Current expenditures are projected to decline, reflecting the envisaged reduction in the cost of subsidies and the moderate wage policy. Capital expenditures will increase by more than half a percentage point of GDP compared to the expected 2012 outcome which, along with better selectivity, should improve their growth impact.

The main objectives of the authorities' tax policy reform are to enhance revenue mobilization by broadening the tax base and reducing exemptions, strengthening administration, and improving compliance and equity, including through better customer relations and enhanced audit capacities, while promoting efficiency and competitiveness. This will be crucial for the achievement of the authorities' fiscal consolidation objectives and for creating space for key infrastructure and social spending. It should also help offset the significant impact of the gradual elimination of tariffs on imports under the association agreement with the EU, which was just completed in 2012, as well as the ongoing reduction in corporate and income tax rates to bring these more in line with other emerging markets' levels. A national conference on tax reform (Assises Fiscales) scheduled in early 2013, involving the main stakeholders and tax experts, to which the Fund has been invited, will provide the opportunity to discuss the challenges facing the tax system and the roadmap for reform.

In line with their objective of reducing the fiscal burden of the subsidy system and improving its targeting, the authorities have just completed, in close consultation with the economic sectors concerned and civil society, a comprehensive technical work aimed at assessing the macroeconomic impact of various reform options and the related targeting and pricing options. On the basis of this technical work a broad consultation involving trade unions, political parties, and other stakeholders will be organized in the first quarter of 2013 to reach a consensus on the reform strategy.

The authorities are also cognizant of the risks stemming from the pension system. They are determined to take the necessary measures to restore its viability and reduce the related fiscal risks while broadening its coverage. Actuarial studies and identification of options for reform have been completed and made public, and broad consultations with social partners expected in early 2013 will help draw a roadmap for reform.

The Advanced Regionalization program aims at deepening the democratic process and promoting regional economic development by giving greater executive powers to elected regional bodies. It should help in better assessing local needs and setting priorities, enhancing spending efficiency and control, and mobilizing own resources. The program provides for a contractual framework for sharing spending responsibilities and revenue, and emphasizes good governance and public expenditure management. To meet human resource needs, the civil service legislation will be reviewed to facilitate staff redeployment to the regions. The authorities are cognizant of the potential fiscal risks linked to decentralization. In this regard, utmost importance will be given to preserving fiscal and debt sustainability at the state and the regional levels, and implementation will be gradual.

Monetary and financial policies

Bank Al-Maghrib remained vigilant in responding to the economy's financing needs following the tighter bank liquidity stemming from the decline in foreign assets, while closely monitoring inflation and external developments as well as financial stability. In response to the difficult environment and in the absence of inflationary pressures that would threaten medium term price stability, the central bank's Board reduced the policy rate by 25 bps to 3 percent in March 2012, and maintained it at the same level in its subsequent meetings. The central bank increased its liquidity injections and broadened eligibility to its facilities, including to SMEs. In its September meeting, the Board reduced the reserve requirement by two percentage points to 4 percent. While broad money growth moderated to 3.4 percent in November from 6.5 percent in 2011, credit to the economy increased by 5.6 percent.

The central bank continued to enhance the soundness of the banking system through stronger regulation and effective supervision. It closely monitored banks' liquidity and the refinancing plans agreed with some banks, and encouraged the banks to diversify refinancing instruments and adopt appropriate contingent plans to deal with liquidity crises. The ratio of NPLs has stabilized at a low level and the central bank is taking the necessary action to ensure that their provisioning remains adequate. Cooperation with other supervisors is being strengthened to preserve financial sector stability. As elaborated in the authorities' Written Communication, Bank Al Maghrib is progressively aligning the prudential framework with the new Basel III standards, with significant advances already implemented or to take effect in June 2013. It is also closely monitoring Moroccan banks' growing presence in Africa, in close coordination with host countries' supervisors. The central bank is also giving high priority to further improving financial inclusion by expanding access to banking services and establishing an observatory for very small enterprises. Further progress in deepening and strengthening the stability of the financial system, a gradual move to exchange rate flexibility and further capital account liberalization, along with continued strong policy implementation, will be crucial for successful establishment of Casablanca Finance City as a regional financial hub. The authorities are in the process of introducing the necessary legislative changes to fully comply with international AML/CFT standards.

The Safeguards Assessment mission has recognized the robustness of Bank Al-Maghrib safeguards framework and the strong control mechanism. The central bank is grateful for the useful discussions and recommendations, some of which have already been implemented, while others are addressed in the draft new central bank law. It will give due consideration to other recommendations, some of which are still being discussed with the mission.

External sector and exchange rate policies

The authorities are cognizant of the risks from the unfavorable external environment and are working to strengthen the resilience of the economy, reduce vulnerabilities, and rebuild fiscal and external buffers. They are not overly worried about the decline in foreign reserves in the short term, since the current level, supported by the PLL, is adequate to face unanticipated external shocks, and while attentive to the cost of holding reserves, they have ample room to rebuild reserves further if needed, in view of the low external debt and the favorable market sentiment toward Morocco. This being said, they consider that fiscal consolidation will be crucial for strengthening the external position and the reserves cushion.

While the authorities agree with staff that the pegged exchange rate system has served the economy well so far by providing a useful nominal anchor, the authorities are of the view that a move to more exchange rate flexibility is contingent on a number of conditions. Among the key preconditions are: putting the budget position on a firmer path toward fiscal sustainability, including by removing the key vulnerability arising from the untargeted subsidy system; further deepening the capital markets; and further strengthening the monetary policy framework. They are working in earnest toward meeting these conditions to allow a smooth transition to the new system.

The authorities do not see strong evidence of an appreciation of the real exchange rate. They note that, in addition to the usual uncertainties attached to this type of calculations, only the current account method used by staff suggests some overvaluation of the currency, whereas the very small overvaluation estimated under the external sustainability analysis falls well within the margin of error. In this regard, the authorities underscore the importance of the appropriate timing for a move to more exchange rate flexibility, including a more responsive international environment.

Enhancing competitiveness and the business climate

The authorities attach high priority to enhancing competitiveness, which they are seeking mainly, in addition to sound macroeconomic policies, through increased labor productivity, with better education and vocational training, wage moderation, and improved business climate. In this regard, significant efforts are being made in developing infrastructure, streamlining regulations, strengthening the rule of law and the judiciary, fighting corruption, and ensuring fair competition and a level playing field, including through further product market liberalization. Progress in these areas and other related issues will be monitored by a recently established high level Competiveness Committee involving government and private sector participants. The major solar and windmill power projects underway, as well as a program aimed at enhancing energy efficiency, along with clearer price signals, should help reduce dependency on energy imports and related vulnerabilities. The authorities are encouraged by the success of their efforts at diversifying the economy and exports, and the strong interest expressed by major foreign investors in the Moroccan economy, as evidenced by the mega projects being implemented in high value-added sectors such as aviation and the automobile industry, as well as the progress made in accessing new export markets. Ongoing strategic partnership discussions with GCC countries will open new possibilities for enhanced trade and FDI.

Conclusion

Staff has provided strong evidence of Morocco's continued qualification to the PLL, with the program implemented as envisaged, including compliance with the indicative indicators for the fiscal deficit and net international reserves for end-October, and the authorities' continued commitment to program objectives. In view of the risks from the still uncertain external environment, the authorities request Board approval of their request for completion of this first PLL review. They remain firmly committed to staying the course of sound policy implementation to achieve their broader economic and social objectives under their medium term program. In this regard, they consider maintaining social peace and stability, as crucial for the success of their reform efforts. The authorities will continue to treat the PLL as precautionary.