INTERNATIONAL MONETARY FUND

Staff Country Reports

November 2006
IMF Country Report No. 06/413

Morocco: 2006 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice 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 the 2006 Article IV consultation with Morocco, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 21, 2006, 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 August 23, 2006. 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 staff statement of October 11, 2006 updating information on recent developments;

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its October 11, 2006 discussion of the staff report that concluded the Article IV consultation; and

- a statement by the Executive Director for Morocco.

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

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INTERNATIONAL MONETARY FUND

MOROCCO

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Morocco

Approved by Amor Tahari and Matthew Fisher

August 23, 2006

- **This report is based on discussions held in Rabat during June 7-21, 2006**. The staff team consisted of Mr. Fanizza (head), Ms. Allain, Messrs. Bouhga-Hagbe and Söderling, and Ms. Martin (EP) (all MCD).
- **Counterparts**: The mission met with Minister Fathallah Oualalou (Finance and Privatization), Minister Mustapha Mechahouri (External Trade), Minister Mohamed Boussaid (Modernization of Public Services), Governor Abdellatif Jouahri (Bank Al-Maghrib, BAM), and other government officials. The mission also met with the head of the Finance Commission of the House of Representatives, and with representatives from the banking sector. Mr. Daïri, Alternate Executive Director for Morocco, joined the meetings.
- **Context of past surveillance**: In recent years, the Fund and the authorities have generally agreed on broad policy priorities—maintaining macroeconomic stability, undertaking fiscal consolidation, liberalizing trade and strengthening the financial sector. Fund staff has also encouraged the authorities to consider a gradual transition to a flexible exchange rate regime. The authorities have generally favored a more gradual approach to reform implementation than the Fund, in part to allow for time to build a consensus around the reform agenda. The concluding statement of the 2006 Article IV mission was the first to be published on the websites of the Ministry of Finance and of the central bank.
- **Morocco's currency, the dirham, is pegged to a basket of currencies dominated by the Euro**. Morocco accepted the obligations of Article VIII, sections 2(a), 3 and 4, in 1993.
- Morocco subscribed to the Special Data Dissemination Standard (SDDS) in December 2005.

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Executive Summary

- Morocco has started to reap the benefits of its reform efforts, but raising living standards to the levels observed in other emerging economies still constitutes a challenge. Structural reforms have enhanced the overall productivity of the economy and heightened its resilience to shocks. The macroeconomic environment, characterized by low inflation and a comfortable reserves position, is sound, although the fiscal position remains a concern for the medium term.
- **Macroeconomic conditions are strengthening, and there are no short-term policy concerns**. Growth is picking up and the current account is expected to record its sixth consecutive surplus in 2006. The central bank has so far succeeded in preventing protracted excess liquidity conditions from generating inflationary pressures. Recent evidence suggests that the dirham, which is pegged to a currency basket dominated by the euro, is not misaligned.
- **Banking conditions have improved**. The authorities have implemented many of the key recommendations of the 2003 Financial Sector Stability Assessment. In particular, the restructuring process of the two troubled state-owned banks is almost complete.

Key Issues and Policy Discussions

- **Fiscal consolidation remains the top policy priority**. The authorities have started implementing their medium-term fiscal strategy, and the debt-to-GDP ratio has declined. Looking forward, the success and credibility of the fiscal consolidation strategy will depend on the authorities' ability to curb wage bill growth, and reduce the fiscal cost of oil and food subsidies. Tax reform is a priority, not only for revenue collection, but also to reduce distortions and improve the business climate.
- **The 2007 budget should send a strong signal on the authorities' commitment to fiscal consolidation**. A deficit target of 3.5 percent of GDP appears within reach.
- **Inefficiencies in the financial intermediation mechanism persist**. The measures implemented by the central bank to improve the availability, accuracy and transparency of financial information are helpful in this regard. Further developing alternative financing instruments—such as stock and bond markets—and improving the mobilization of institutional savings could also enhance financial intermediation.
- **Morocco's integration in the world economy is deepening**. Morocco has made considerable progress in trade liberalization; next steps include tackling remaining obstacles to trade and increasing trade in services. The sectoral reforms taken to prepare the economy to the challenges of globalization are producing results; nevertheless, it is important to ensure that sectoral incentives do not create distortions. Staff supports the authorities' intention to prepare for an eventual transition to a more flexible exchange rate regime. The central bank has started strengthening the monetary policy framework, possibly with a view to adopting inflation targeting in the medium term. Further fiscal consolidation and development of monetary and exchange markets would help also ensure an orderly transition from the current currency-basket peg of the dirham.

I. Introduction

1. Morocco has started to reap the benefits of its reform efforts, but the growth momentum needs to be sustained to transform Morocco into a buoyant emerging-market economy and raise its living standards. Growth is becoming less dependent on agricultural conditions, private investment is increasing, and inflation remains subdued. The short-term outlook is favorable, and there are no major macroeconomic risks. However, Morocco's per-capita income is still lower than in more dynamic emerging market countries, and unemployment remains high in urban areas.

2. The 2006 Article IV discussions focused on three key elements of the authorities' growth-accelerating strategy: (a) achieving medium-term fiscal consolidation; (b) enhancing the efficiency of financial intermediation; and (c) deepening Morocco's integration in the global economy.

3. Morocco continues to enjoy political stability, and the process of political and social reform initiated by King Mohammed VI is taking hold. The implementation of the King's National Human Development Initiative has moved social issues to the center of the policy agenda. The general elections scheduled for 2007 are unlikely to alter the authorities' commitment to market-oriented reforms.

II. Achievements and Key Challenges

Morocco's main challenge is to capitalize on recent achievements and to accelerate growth to levels compatible with substantial poverty reduction and lower unemployment.

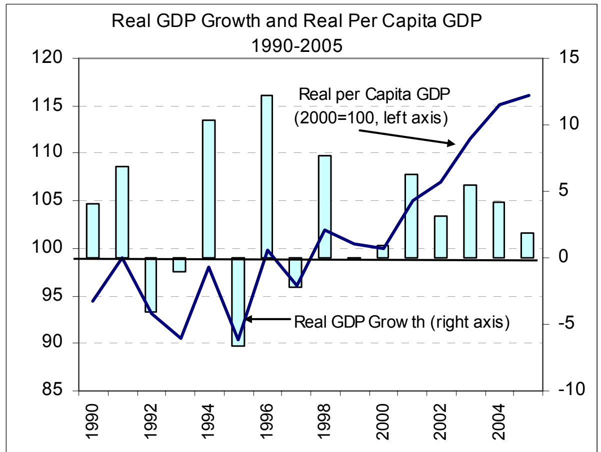
4. The reform efforts undertaken since the mid-1990s have started to bear fruit.

- The macroeconomic environment is sound, with low inflation and a comfortable external position, although the fiscal position remains a concern for the medium term.
- The authorities have successfully privatized and liberalized the telecommunications, energy and transportation sectors. Moreover, Morocco has significantly liberalized its trade regime and strengthened its financial sector. These reforms have enhanced the overall productivity of the economy, and heightened its resilience to shocks.[1] Despite three adverse shocks—a drought, the dismantling of the Agreement on Textile and

[1] These evolutions reflect the upward trend in total factor productivity growth in the nonagricultural sector (for details, see IMF Country Report No. 05/419).

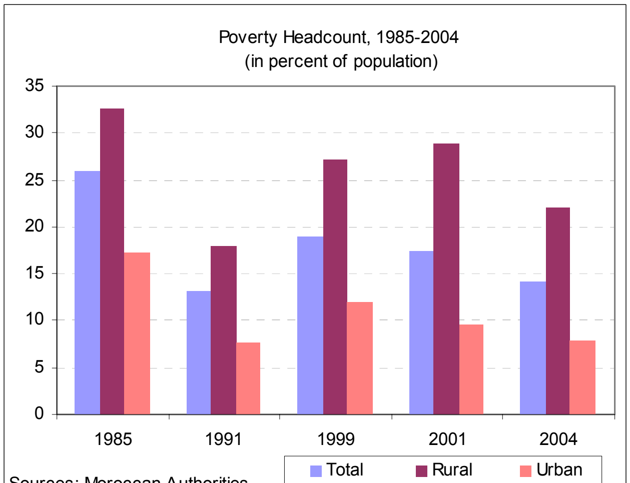
Clothing (ATC), and the upsurge in energy costs—nonagricultural GDP grew by more than 5 percent in 2005.

- Real per-capita GDP started to rise in 2000, putting an end to the previous decade's stagnation. Poverty has declined, but remains high, particularly in rural areas. Despite labor supply pressures, the unemployment rate fell below the 10 percent threshold in the first quarter of 2006 for the first time in 35 years.

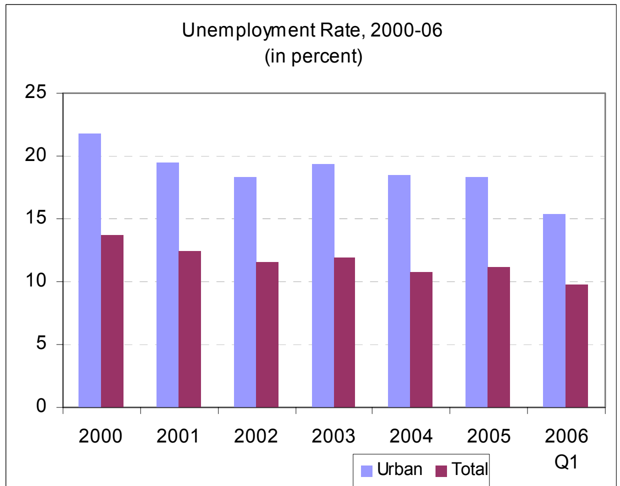


Sources: Moroccan authorities, and Fund staff calculations.

5. **The authorities agree that the time is ripe to tackle the remaining impediments to growth**. Despite progress achieved, raising living standards to the levels observed in other emerging economies constitutes a challenge. The authorities feel that the current favorable economic environment provides a window of opportunity to accelerate the reform process.



Sources: Moroccan Authorities.



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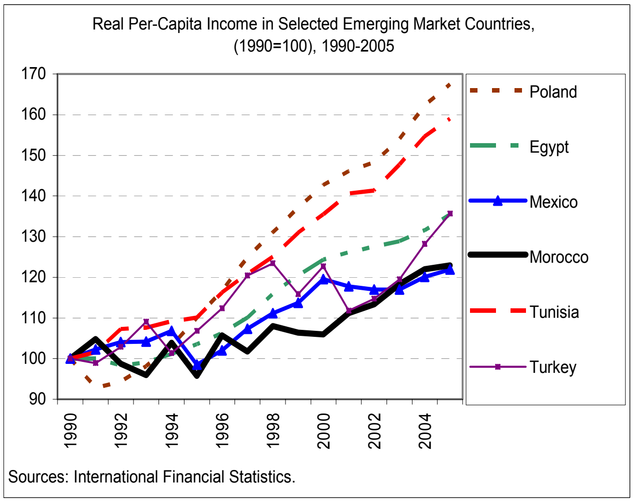
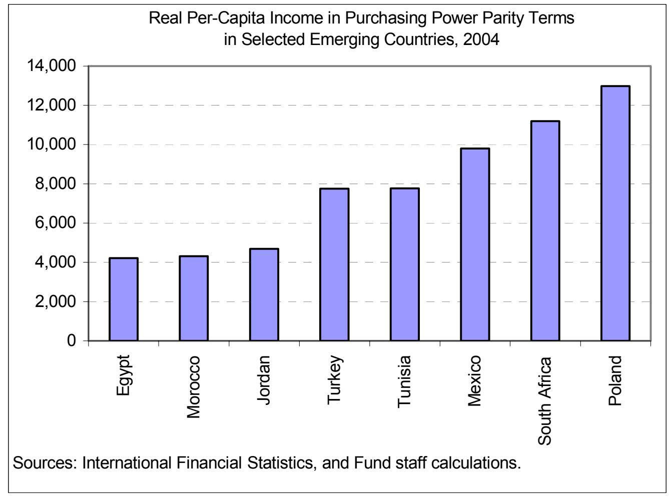


Sources: International Financial Statistics.

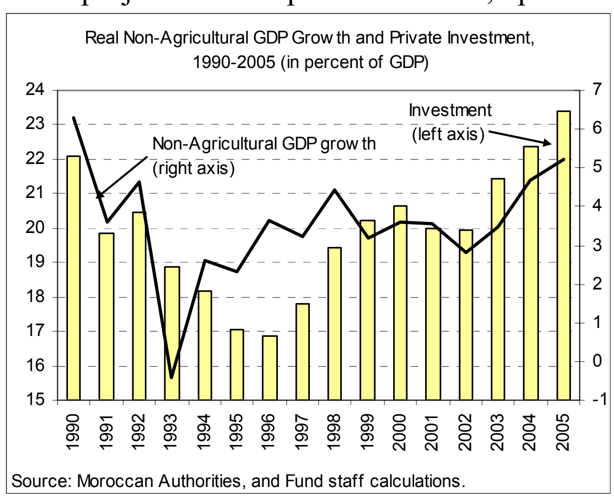


Sources: International Financial Statistics, and Fund staff calculations.

III. Economic and Financial Backdrop

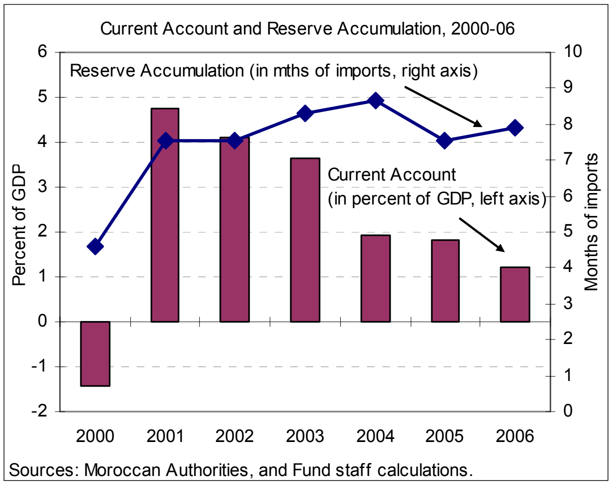
6. **Macroeconomic conditions are strengthening, and there are no short-term policy concerns**.

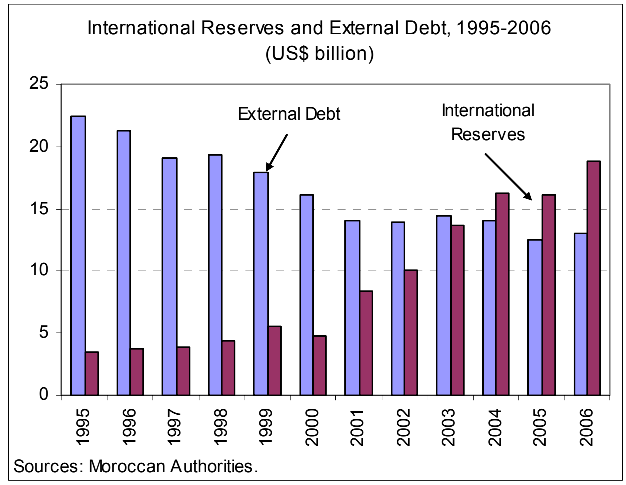
- **The recovery is taking hold**. Real growth is projected at 7.3 percent in 2006, up from 1.7 percent in 2005, reflecting a bumper crop and continued strong activity in the construction and tourism sectors. Available indicators point to a recovery of private investment.



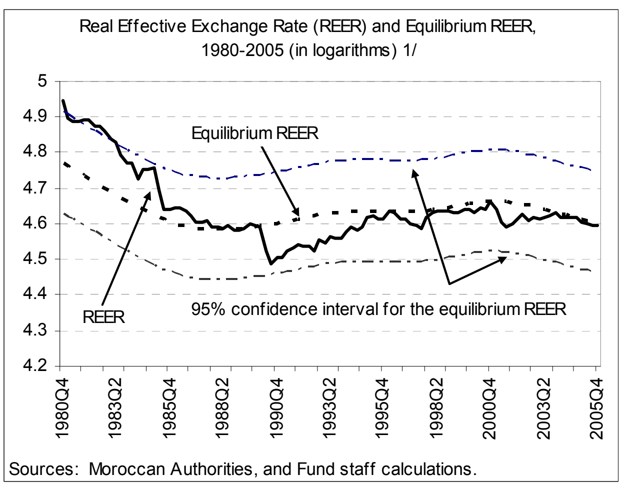
Source: Moroccan Authorities, and Fund staff calculations.

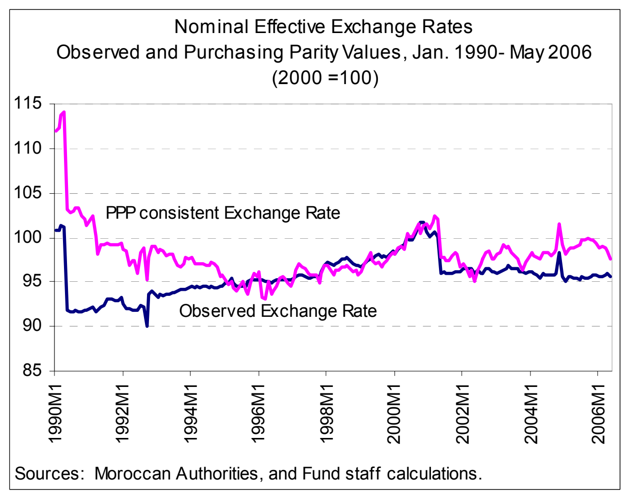
- **The current account is expected to record its sixth consecutive surplus in 2006**. After a modest drop in 2005 following the dismantling of the ATC, textile exports are quickly recovering. This improvement, combined with continued strong tourism receipts and workers' remittances, will offset the upsurge in the energy bill. External reserves remain high ($18.4 billion as of end-July 2006) and exceed the total stock of external debt. The standard debt sustainability analysis indicates that external vulnerabilities are limited.





- **Recent evidence suggests that the dirham is not misaligned**. A favorable inflation differential with the EU has prevented a real effective appreciation despite the euro's strength vis-à-vis the US dollar.





1/ The equilibrium exchange rate of the dirham is estimated as the exchange rate consistent with balance of payment equilibrium. For details, see IMF Country Report No. 05/419.

- **Monetary policy has adequately managed the excess liquidity conditions, and price pressures remain subdued**. Significant slack in economic activity persists in spite of the recent upswing in domestic demand.[2] Consumer prices are expected to increase by 2.5 percent in 2006, up from 1 percent in 2005, reflecting mainly higher energy prices. The new statutes of the central bank (*Bank Al-Maghrib*, BAM),

[2] Morocco's employers' association estimates the capacity utilization rate at around 70 percent.

promulgated in early 2006, institutionalize its independence in the conduct of monetary policy and enshrine price stability as its core mandate. In this context, BAM has continued to strengthen the operational framework for monetary policy, notably by incorporating repos in its policy toolkit and building a portfolio of government securities. BAM's recent decision to favor seven-day deposit auctions to mop up excess liquidity has helped better anchor inflation expectations and halted the decline in interbank interest rates, consistent with the ongoing recovery of domestic demand.[3] The publication of a press release upon the completion of BAM's board meetings also heightened the transparency of monetary policy.

- **The fiscal position is improving but the public debt stock remains high**. Despite a buoyant revenue performance, the fiscal deficit is likely to be close to the budget target of 4.1 percent of GDP (down from 5.9 percent in 2005) because of continued expenditure pressures—stemming from high oil and food subsidies due to increased international prices, the restructuring of the two public banks, transfers to the civil servants' pension fund, and new wage concessions, mostly in the education and health sectors.[4] Standard fiscal sustainability analysis indicate that Morocco's public debt is mostly sensitive to output shocks.

- **The financial sector has strengthened and remaining fragilities in the public banks are being addressed**. The authorities have implemented many key recommendations of the 2003 Financial Sector Stability Assessment. The 2006 banking law broadens BAM's supervisory authority to nonbank financial institutions. The write-off of a substantial number of nonperforming loans has strengthened the balance sheet of the banking sector. The restructuring process of the two troubled state-owned banks is almost complete. As a result, their capital-adequacy ratio should improve in 2006, and satisfy the minimum requirement by 2007.

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[3] Until May 2006, BAM had mopped up liquidity mainly through its 24-hour deposit facility, which pays a lower interest rate.

[4] This is the fiscal deficit on a commitment basis, excluding expenditures from the special investment fund, *Fonds Hassan II*, which are projected to reach 0.7 percentage points of GDP in 2006.

Banking Sector Financial Soundness Indicators	2001	2002	2003	2004	2005
Capital Adequacy Ratio	12.6	12.2	9.3	10.2	11.5
of which: commercial banks	15.3	15.3	13	13.5	14.2
Gross Non-Performing Loans (percent of gross loans)	16.8	17.2	18.1	19.4	15.7
of which: commercial banks	10.7	11.2	12.3	12.4	9.6
Provisions (percent of non-performing loans)	52.9	54.7	54.9	59.3	67.1
of which: commercial banks	69.8	71.5	71.5	72.2	74
Liquidity Ratio	...	123.1	122.3	120.8	101.3
Return on Assets (ROA)	0.9	0.3	-0.2	0.8	0.5
of which: commercial banks	1.1	0.6	0.5	0.9	1.2
Return on Equity (ROE)	10.2	1.9	-2.1	10.9	6.3
of which: commercial banks	12.7	6.4	6.4	10.7	14.1

Source: Moroccan Authorities.

7. **The medium-term outlook is favorable**. Nonagricultural GDP is projected to grow by 5.5 percent on average over the next five years, with annual inflation at 2 percent.[5] This scenario is consistent with a modest increase in total factor productivity, in line with the trend observed during the last cycle.[6] Despite strong remittances flows (8.6 percent of GDP on average in 2006–11), the pickup in economic activity is expected to turn the current account surplus into a small deficit in the outer years.[7] Private investment is projected to increase, while fiscal consolidation should strengthen public savings.

[5] Agricultural GDP projections are based on historical performance and small productivity improvements.

[6] See IMF Country Report No. 05/419.

[7] For an analysis of the determinants of remittances in Morocco, see J. Bouhga-Hagbe, *A Theory of Workers' Remittances With An Application to Morocco* (IMF WP/04/194) and *Altruism and Workers' Remittances: Evidence from Selected Countries in the Middle East and Central Asia* (IMF WP/06/130).

Morocco: Medium-Term Projections 2005-11
(Percentage change from the previous period, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011
Real GDP	1.7	7.3	3.3	5.1	5.3	5.4	5.5
Real non-agricultural GDP	5.2	5.1	5.2	5.4	5.5	5.7	5.8
Total Domestic Demand	4.1	10.5	6.5	6.9	7.4	7.7	7.9
CPI Inflation	1.0	2.5	2.0	2.0	2.0	2.0	2.0
Unemployment Rate 1/	11.0	8.2	8.4	7.5	6.5	5.5	4.4
Savings-Investment Balances 2/							
Private	4.7	1.6	-0.3	-0.7	-1.5	-2.3	-3.2
Public	-2.9	-0.4	0.6	1.2	1.9	2.4	2.7
Current Account Balance 2/	1.8	1.2	0.2	0.5	0.5	0.1	-0.5
Trade Balance 2/	-15.7	-16.9	-18.2	-18.0	-18.1	-18.5	-18.9
Exports	20.6	20.5	20.6	20.7	20.7	20.8	20.9
Imports	-36.3	-37.3	-38.7	-38.7	-38.9	-39.3	-39.8
Non-factor Services Balance 2/	8.3	9.0	9.1	9.3	9.5	9.6	9.7
Income and Transfers Balance 2/	9.2	9.1	9.3	9.2	9.2	9.0	8.7

Sources: Moroccan Authorities and Fund staff estimates.
1/ In percent of the labor force.
2/ In percent of GDP.

IV. THREE KEY ISSUES FOR GROWTH

In the absence of major macroeconomic risks, policy discussions focused on three key elements of the authorities' strategy for sustained job-creating growth: (a) achieving medium-term fiscal consolidation; (b) enhancing the efficiency of financial intermediation; and (c) deepening Morocco's integration in the global economy, including further trade reform and the design of a medium-term strategy for exiting the currency-basket peg of the dirham.

A. Fiscal Consolidation and Medium-Term Fiscal Strategy

Background

8. **Fiscal consolidation is the authorities' top policy priority**. Sizeable privatization flows and abundant liquidity have allowed Morocco to finance its past deficits with relative ease. The dwindling of potential sources of privatization proceeds and the still high level of public debt require an acceleration of the consolidation effort. By cementing private sector confidence, creating the fiscal space for productive public expenditure and cushioning the impact of exogenous shocks, fiscal consolidation is also key to support Morocco's transformation into a vibrant emerging-market economy.

9. The authorities pointed out that they have started to implement their medium-term fiscal consolidation strategy, which relies on a mix of expenditure and revenue measures. On the expenditure side, their strategy rests on:

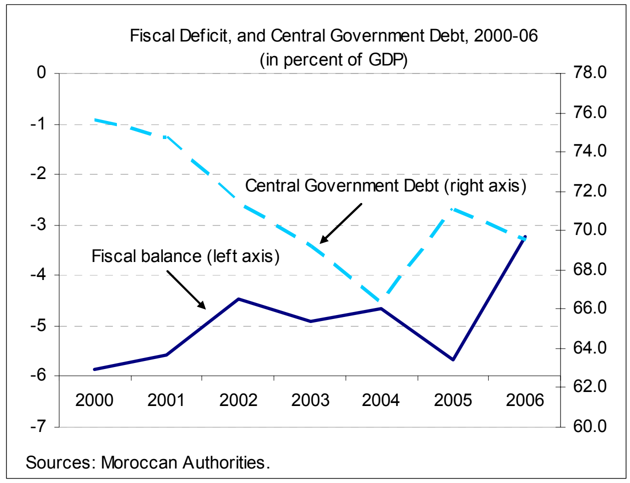
- Reducing wage bill growth;

➢ Reducing the fiscal cost of energy subsidies by gradually adjusting domestic petroleum prices to international prices;

➢ Gradually replacing inefficient food subsidies with targeted support to vulnerable groups; and

➢ Switching to performance-based budgeting within a medium-term expenditure framework.

On the revenue side, the objectives are to improve the transparency and efficiency of the tax system, particularly of the VAT, and strengthen domestic revenue mobilization to offset revenue losses from continued trade liberalization.



10. **The government debt-to-GDP ratio has declined steadily since the turn of the century**. This reflects in part the impact of privatization. The downward trend halted in 2005, following the financing of one-off operations linked to the early retirement scheme for government employees (*Départs Volontaires à la Retraite*, DVR, 2.5 percent of GDP), and the acknowledgement of old arrears to the public pension fund (*Caisse Marocaine de Retraite*, CMR, 2.4 percent of GDP). The debt-to-GDP ratio is expected to resume its decline in 2006.

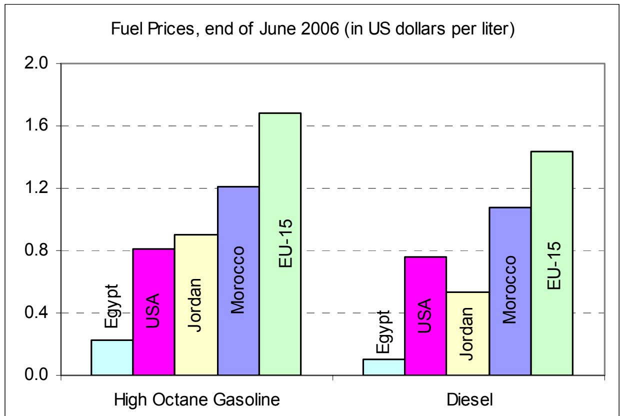
Authorities' Views and Policy Intentions

11. The authorities believe that sustainable expenditure savings are only possible if the overall efficiency of public spending improves. As a consequence, they have adopted a gradual approach to fiscal consolidation.

- **A broad civil service reform will help to gradually curb wage bill growth**. Successful implementation of the DVR and a continued no-new-net hiring policy should reduce the wage bill by 1.4 percent of GDP to 12.2 percent of GDP in 2006. Going forward, the adoption of merit-based promotions and remunerations and the harmonization of civil service statutes would prevent ad hoc wage adjustments, which boosted the wage bill in the past.

- **Upstream sectoral reforms are a prerequisite for the reform of the subsidy system**. The authorities believe that the current subsidy system is inefficient. They

have initiated discussions on a comprehensive reform of the energy sector, with World Bank support, which will help reduce the fiscal cost of energy subsidies (1.6 percent of GDP in 2005). The authorities plan on continuing to gradually align consumer prices with international prices in order to allow for their eventual liberalization. They pointed out that, following the three increases (totaling 22 percent on average) that have taken place since 2005, domestic prices for petroleum products are high by international standards. The authorities are designing a strategy to reduce the cost of food subsidies (0.8 percent of GDP in 2005) by better targeting them to the most vulnerable groups. In view of the importance of the subsidy system for social cohesion, the authorities stressed the need to build a consensus around this strategy.



Sources: Moroccan Authorities and French Ministry of Finance.

- **By establishing a level-playing field and reducing distortions, the ongoing reform of the tax system should durably improve revenue collection**. The authorities have started to simplify the tax system and increase its transparency by presenting the first report on tax expenditures with the 2006 budget, and by publishing a tax procedure, as well as a tax assessment and collection manual. They have also prepared a medium-term plan to reduce the number of VAT rates, and started to broaden its base with the 2006 budget.

The 2005 Early Retirement Program

➢ **Objectives**: Reduce the size of the civil service and curb wage bill growth.

➢ **39,500 employees (8 percent of the civil service) left** under the voluntary program. Three-quarters of those leaving the civil service were older than fifty.

I. **Program cost:** DH 11. 4 billions (2.5 percent of GDP), to be recouped in less than 3 years in the form of wage bill savings. The government will also transfer DH 2 billions each year to the pension fund during 2006–09 to compensate for forgone contributions.

➢ **Expected net total gain**: DH 17 billions (3.7 percent of GDP) in net present value terms.

12. The authorities' medium-term objective is to reduce the fiscal deficit to 3 percent of GDP and to bring the public-debt-to-GDP ratio below 60 percent.

- The 2007 budget law will seek a deficit reduction of about ½ a percentage point of GDP.

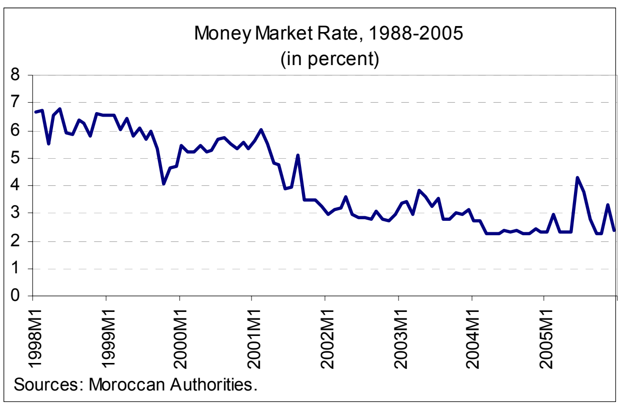
- In the medium-term, the wage bill should decrease from 13.5 percent of GDP to less than 10 percent in 2011, and the budgetary cost of subsidies would be halved, reaching 1.3 percent of GDP in 2011. This reduction in current spending would create room for substantially higher capital spending. The increased efficiency of domestic tax collection should help offset the revenue shortfall stemming from trade liberalization, leaving the tax revenue intake broadly unchanged.

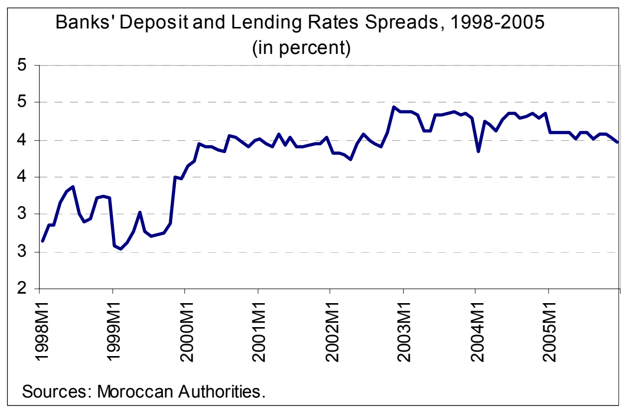
- The resulting improvement in the primary balance would be the main driving force behind the reduction on the public debt-to-GDP ratio.

B. Enhancing Financial Intermediation

Background

13. The increase in banking spreads in a context of monetary easing points to inefficiencies in the financial intermediation mechanism. Banking sector assets rose by almost 30 percentage points of GDP over the last decade to reach 94 percent of GDP in 2005. As monetary conditions eased, the interbank and deposit rates fell by over 400 basis points, but the spread between banks' deposit and lending rates increased between 1998 and 2005.



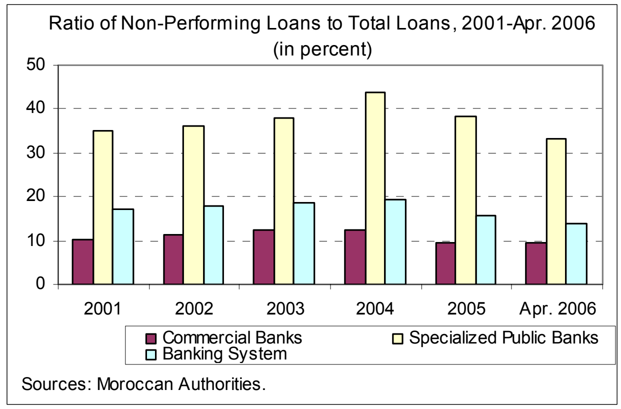


Authorities' Views and Policy Intentions

14. **The authorities stressed that the ongoing reforms have already increased the economy's capacity to absorb liquidity**. The recent upsurge in certain types of credit—particularly in the real estate sector—attests to this improvement.

- The presence of a sizeable portfolio of nonperforming loans weighed heavily on the cost of credit in the past. The recent cleaning up of banks' balance sheets has helped alleviate this problem.

- The steady decline of bank financing of the Treasury over the last years, coupled with continued efforts to achieve fiscal consolidation, has also prompted banks to expand their lending to the private sector.



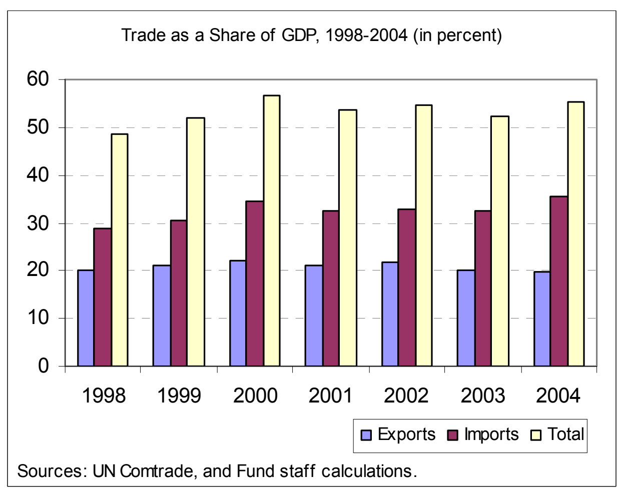
15. **The authorities have started to implement specific measures to enhance financial intermediation**.

- BAM has sought to improve the availability, accuracy, and transparency of the financial information available to potential lenders by (a) standardizing the minimum data required to process loan applications; (b) helping banks to develop their practice of internal rating systems; and (c) merging existing information on credit risk into a privately managed centralized database accessible to all credit institutions. BAM has also launched a bank survey in order to improve its monitoring of the changes in credit conditions.

- The Treasury is strengthening the performance of existing guarantee funds to facilitate access to credit, particularly for small and medium enterprises.

C. Deepening Integration in the World Economy

Background



16. **Morocco has made considerable progress in trade liberalization**. Most of the provisions of the free trade agreement with the European Union (EU), Morocco's main trading partner, have been implemented; the agreement will be fully implemented by 2012. More recently, the authorities have signed several new regional and bilateral free-trade agreements. The agreement signed in 2005 with Tunisia, Egypt, and Jordan (Agadir agreement), which came into effect in mid-2006, allows for cross rules of origin among the four partners vis-à-vis the EU. Bilateral free-trade agreements with Turkey and the USA entered into force on January 1, 2006. However, trade flows have not increased very much, showing that obstacles to trade persist, and multilateral tariffs remain high.

17. The authorities have also taken a number of steps to prepare the economy to the challenges of globalization.

- The strengthening of infrastructure—particularly highways and ports—and liberalization efforts in the electricity, transport and telecommunications sectors are expected to generate substantial productivity gains, and enhance Morocco's attractiveness to investors.

- The authorities have also designed a number of sectoral reforms. The *Plan Azur* has supported the expansion of the tourism sector. The *Plan Emergence*, finalized at end-2005, aims both at modernizing the existing industrial sectors, such as the textile industry, and facilitating the expansion of new industrial sectors and service activities. In an effort to foster the development of offshoring activities, the authorities have implemented a broad range of incentives, including tax incentives, and the outfitting of four offshore zones.

- The authorities have indicated their intention to prepare for a possible exit from the currency-basket peg of the dirham.

Authorities' Views and Policy Intentions

18. The authorities are determined to maximize the benefits of existing free trade agreements.

- To align market conditions with those prevailing in the EU and comply with EU requirements, the authorities have adopted legislation on the recognition of norms, industrial property, and consumer protection.

- To reduce the risk of trade diversion, the authorities have lowered MFN tariffs on goods already freely traded with the EU.

- Following the November 2005 Algiers conference on trade facilitation in the Maghreb, co-organized with the Fund, an action plan to facilitate payment arrangements, combat smuggling, and harmonize trade regulations and rules of origin on a region wide scale should be approved in 2006. The regional conference on financial integration in the Maghreb, to be held in Rabat at end-2006, will complement these efforts.

19. Increasing trade in services is the next step in the liberalization strategy.

- Morocco has already submitted a proposal for the liberalization of services to the World Trade Organization.

- The country has participated to the launching of the framework protocol for the liberalization of services within the Euromed following the March 2006 Marrakesh meeting.

20. **The existing currency-basket peg of the dirham has served the Moroccan economy well, and remains appropriate**. Going forward, a gradual move toward a flexible exchange rate could help ensure the success of Morocco's integration in the world economy.

The authorities have already taken steps to prepare for a possible move to more exchange rate flexibility.

- The Ministry of Finance and BAM are working together to explore issues related to the exchange rate regime, the deepening of exchange and financial markets, and foreign exchange regulations.

- BAM is further strengthening the monetary policy framework, possibly with a view to adopting inflation targeting in the medium term. In this context, it has engaged in analytical research on various fronts to enhance its understanding of money demand, the monetary policy transmission mechanism, and to fine tune its inflation projections, including through the development of a core inflation indicator. The authorities have expressed their interest to organize a regional conference on inflation targeting in 2007, in cooperation with the Fund.

V. STAFF APPRAISAL

21. ***Achievements***. Morocco is reaping the rewards from the structural reforms it has put in place during the last decade. Per capita income has been rising steadily since the beginning of the century, nonagricultural growth is taking off, and macroeconomic conditions remain stable.

22. ***Challenges.*** Morocco needs to sustain and improve upon its recent good economic performance to raise living standards, absorb the increasing labor supply, and lower poverty, which remains unacceptably high. The authorities should not miss the opportunity of a broadly favorable environment to step up the reform efforts. The objective is to transform Morocco into a vibrant emerging-market economy by tackling the remaining impediments to growth.

23. ***Outlook and Risks***. The recovery in economic activity seems well underway, and there are no signs of overheating. Over the medium term the main risks are largely policy related. The productivity gains necessary to further lift nonagricultural growth may not materialize unless the momentum in structural reforms is sustained. Leaving the remaining vulnerabilities unaddressed, particularly on the fiscal side, may harm the credibility of public policies and make Morocco less attractive to investors.

24. ***Fiscal Consolidation.*** Recent fiscal developments are encouraging, but highlight the need to bring spending under tighter control. In fact, higher-than-envisaged outlays on wage increases and energy and food subsidies have fully absorbed the gains from the strong revenue performance. Looking forward, the success and the credibility of the fiscal consolidation strategy will depend on avoiding that new wage concessions erode the savings that the early retirement program should generate. Energy and food subsidies constitute a heavy budgetary burden that Morocco cannot afford. Staff welcomes the intention to overhaul the subsidy system in the context of broader reforms. Nevertheless, immediate action is needed to curb the cost of these subsidies, given the prospects for both international oil and sugar prices. The authorities should continue to gradually raise retail energy prices and put a ceiling on the subsidy spending for sugar consumption. The strong revenue

performance reflects significant improvements in tax administration that have offset the revenue impact of lower external tariffs. However, this favorable outcome should not slow down the pace of tax reform. Reforming the tax system remains a priority not only to mobilize resources, but also to limit the distortions created by a complex tax system and improve the business environment.

25. ***The 2007 budget***. The 2007 budget should send a strong signal on the authorities' commitment to fiscal consolidation by locking in wage bill savings, limiting outlays for subsidies, and maintaining the strong revenue performance. A deficit target of 3.5 percent of GDP appears within reach and consistent with the medium-term objective of bringing the government debt-to-GDP ratio below 60 percent.

26. ***Monetary Policy***. BAM has so far succeeded in preventing protracted excess liquidity from generating inflationary pressures. However, as the recovery takes hold, it will have to continue to monitor inflation developments closely and take action if needed. In this sense, the recent decision to use seven-day deposit auctions to mop up liquidity appears appropriate to bring to a halt the decline in interbank interest rates, which would have not been justified by the ongoing recovery. Staff welcomes BAM's increased independence and its efforts to enhance its analytical capabilities in view of the possible adoption of an inflation targeting framework over the medium term.

27. ***Exchange Rate.*** The currency-basket peg of the dirham has helped Morocco to preserve macroeconomic stability. However, staff supports the authorities' intention to prepare for the possible transition to a more flexible exchange rate regime. This transition would help to integrate Morocco in the global economy by avoiding the risks of either an overvalued or an undervalued exchange rate as the economy faces external shocks and undergoes structural transformation. To ensure an orderly transition, the authorities should achieve further fiscal consolidation, and continue to develop monetary and exchange markets. Moreover, a strong monetary policy transmission mechanism will require absorbing the existing liquidity overhang. Targeted measures toward further capital account liberalization could help develop the foreign exchange market. Fund technical assistance could be provided to help the authorities in designing a detailed strategy for further liberalizing capital flows, including the supporting reforms and the appropriate sequencing.

28. ***Financial Intermediation.*** The reform of the financial sector has achieved significant results and financial sector vulnerabilities have abated. Enhancing the functioning of the judiciary system to expedite the recovery of claims and harmonizing tax and prudential provisioning rules could further buttress the banking system. The further development of alternative financing instruments, such as stock and bond markets, could encourage banks to work more with small and medium enterprises and enhance the efficiency of financial intermediation. Moreover, enhancing the mobilization of institutional savings could help to lengthen the maturity of the resources available to finance the economy. The planned regional conference on financial integration in the Maghreb, organized with Fund assistance, will constitute a good venue to exchange views on the best practices on these issues in the region.

29. ***The Plan Emergence.*** The wide array of measures taken to better adapt the Moroccan economy to the challenges of globalization appear to have already borne fruits, notably for offshoring activities. Nevertheless, it is important that sectoral incentives do not further complicate the tax system and create distortions.

30. ***Trade Liberalization.*** Progress toward multilateral liberalization needs to complement the ongoing bilateral and regional liberalization efforts to minimize trade and investment diversions. The coming into effect of the Agadir agreement should allow Morocco to exploit the benefits of cross rules of origin in the region vis-à-vis the EU. Staff welcomes the authorities' intention to implement the action plan to reduce remaining obstacles to trade, as agreed at the Algiers conference on trade facilitation in the Maghreb.

31. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. Morocco: Selected Economic Indicators, 2003-07
(Quota: SDR 588.20 million)
(Population: 30.1 million; 2005)
(Per capita GDP: US$1,712; 2005)
(Poverty rate: 15 percent; 2004)
(Main exports: textiles, phosphates; 2005)

	2003	2004	2005	2006	2007
			Prel.	Proj.	
Output and Prices		(Annual percentage change)			
Real GDP (market prices)	5.5	4.2	1.7	7.3	3.3
Nonagricultural Real GDP (market price)	3.5	4.7	5.2	5.1	5.2
Consumer prices (end of period)	1.8	0.5	2.1	2.5	2.0
Consumer prices (period average)	1.2	1.5	1.0	2.5	2.0
Investment and Saving		(In percent of GDP)			
Gross capital formation	24.1	25.0	25.9	25.6	25.7
of which: Non-government	21.4	22.4	23.4	23.1	23.3
Gross national savings	27.7	27.0	27.8	26.8	25.9
of which: Non-government	26.6	25.3	28.1	24.7	23.3
Public Finances		(In percent of GDP)			
Revenue (including grants)	24.8	25.7	27.7	26.8	26.4
Expenditure 1/	30.5	30.7	34.7	31.4	30.2
Budget balance (commitment basis) 1/	-5.4	-4.8	-6.4	-4.7	-3.9
Budget balance (commitment basis) 2/	-5.0	-4.6	-5.9	-4.1	-3.6
Budget balance (including grants) 1/	-5.2	-4.5	-6.0	-4.3	-3.5
Primary balance (including grants) 2/	-0.7	-0.3	-1.7	0.0	0.5
Total government debt 3/	68.9	65.8	70.5	66.8	66.5
Total government debt 4/	69.2	66.3	71.6	67.7	67.2
Monetary Sector	(Annual percentage change, unless otherwise indicated)				
Credit to the private sector	8.3	7.2	13.1	7.5	9.3
Base money	13.6	12.1	9.2	8.2	7.6
Broad money	8.6	7.7	14.0	8.2	7.6
Velocity of broad money (level)	1.11	1.09	0.99	1.00	0.98
Three-month treasury bill rate (period average, in percent)	3.3	2.5	2.5	…	…
External Sector	(In percent of GDP, unless otherwise indicated)				
Exports of goods (in US$, percentage change)	11.8	13.1	7.4	9.9	8.1
Imports of goods (in US$, percentage change)	20.1	25.2	14.2	14.0	11.5
Merchandise trade balance	-9.9	-13.0	-15.7	-16.9	-18.2
Current account balance excluding official transfers	3.4	1.7	1.5	0.9	-0.1
Current account balance including official transfers	3.6	1.9	1.8	1.2	0.2
Foreign direct investment	5.3	1.7	3.8	2.2	1.8
Total external debt	35.1	30.8	29.0	26.1	24.6
Gross reserves (in millions of U.S. dollars)	13,716	16,298	16,080	18,768	20,044
In months of next year imports of goods and services	8.3	8.7	7.5	7.9	7.8
In percent of short-term external debt (on remaining maturity basis)	576.3	823.6	909.9	1,033.7	889.0
Memorandum Items:					
Nominal GDP (in US$ billions)	43.8	50.0	51.6	57.2	61.4
Unemployment rate (in percent)	11.4	10.8	11.0	7.8	8.0
Net imports of petroleum products (in millions of US dollars)	963	1,639	2,701	3,590	4,021
Local currency per U.S. dollar (period average) 5/	9.57	8.87	8.87	...	...
Real effective exchange rate (annual average, percentage change)	-1.0	-1.2	-1.7	...	...
Stock market index (MASI)	3,944	4,522	5,539	...	...

Sources: Moroccan authorities and Fund staff estimates and projections.

1/ Including Fonds Hassan II
2/ Excluding Fonds Hassan II
3/ It includes the net position vis à vis the Central Bank outside statutory advances.
4/ Excludes the net position with the Central Bank outside statutory advances.
5/ For 2006, value as of July 31.

Table 2. Morocco: Balance of Payments, 2003-11
(In millions of U.S. dollars; unless otherwise indicated)

			Prel.	Proj.					
	2003	2004	2005	2006	2007	2008	2009	2010	2011
Current account	1,591	965	945	698	146	341	360	88	-332
Trade balance	-4,334	-6,485	-8,086	-9,647	-11,149	-11,891	-12,908	-14,177	-15,615
Exports, f.o.b.	8,762	9,912	10,644	11,698	12,641	13,698	14,772	15,980	17,365
Agriculture	1,825	1,757	2,106	2,198	2,363	2,559	2,784	3,049	3,345
Phosphates and derived products	1,241	1,564	1,818	2,077	2,250	2,439	2,582	2,734	2,923
Imports, f.o.b.	-13,095	-16,397	-18,730	-21,345	-23,790	-25,589	-27,680	-30,157	-32,980
Petroleum	963	1,639	2,701	3,590	4,021	4,276	4,620	5,023	5,471
Capital goods	3,131	3,936	4,149	4,676	5,143	5,699	6,331	7,054	7,883
Food products	1,194	1,534	1,746	1,705	2,265	2,194	2,146	2,183	2,259
Services	2,617	3,261	4,277	5,131	5,601	6,163	6,746	7,377	8,065
Tourism receipts	3,225	3,924	4,617	5,344	5,876	6,394	6,961	7,587	8,272
Income	-790	-676	-570	-587	-581	-591	-557	-534	-527
Transfers	4098	4864	5324	5800	6275	6660	7079	7422	7745
Private transfers (net)	4,017	4,727	5,152	5,621	6,056	6,374	6,700	7,042	7,399
Workers' remittances	3,612	4,218	4,593	5,086	5,495	5,795	6,105	6,432	6,776
Official grants (net)	81	137	171	179	220	286	379	380	346
Capital account	-10	-8	-5	-6	-6	-6	-6	-6	-6
Financial account	374	1,218	1,739	935	1,053	743	1,377	1,692	1,948
Direct investment 1/	2,302	864	1,946	1,281	1,121	1,255	1,406	1,575	1,765
Privatization	1,471	0	1,399	454	231	232	233	234	235
Portfolio investment 2/	8	578	-87	0	8	8	9	9	9
Other	-1,936	-223	-121	-346	-76	-520	-37	109	174
private 3/	-798	875	153	-176	32	30	28	62	92
Public medium-and long-term loans (net)	-1,139	-1,098	-274	-171	-108	-550	-65	47	82
Disbursements	1,409	977	1,534	1,474	1,580	1,576	1,509	1,514	1,578
Amortization	-2,548	-2,076	-1,808	-1,645	-1,688	-2,126	-1,574	-1,468	-1,496
Reserve asset accumulation (-increase)	-1,643	-1,893	-2,361	-1,627	-1,193	-1,078	-1,731	-1,775	-1,611
Errors and omissions	-312	-282	-318	0	0	0	0	0	0
Memorandum items:									
Exports of goods' volume (percentage change)	-6.9	9.1	-0.9	8.7	6.9	7.9	7.4	7.7	7.9
Imports of goods' volume (percentage change)	5.9	6.2	13.5	8.9	9.9	8.1	8.6	8.8	8.9
Trade balance (in percent of GDP)	-9.9	-13.0	-15.7	-16.9	-18.2	-18.0	-18.1	-18.5	-18.8
Current account balance (in percent of GDP)	3.6	1.9	1.8	1.2	0.2	0.5	0.5	0.1	-0.4
Excluding official grants (in percent of GDP)	3.4	1.7	1.5	0.9	-0.1	0.1	0.0	-0.4	-0.8
Terms of trade (percentage change)	5.7	-12.9	7.4	-3.7	-0.3	1.0	0.8	0.4	0.3
Excluding oil	8.5	-12.5	12.6	-1.2	0.2	0.8	0.7	0.2	0.1
Gross official reserves 4/	13,716	16,298	16,080	18,768	20,044	21,205	23,010	24,864	26,554
(In months o next year's imports of goods and nonfactor services)	8.3	8.7	7.5	7.9	7.8	7.7	7.6	7.6	...
Debt service as percentage of export of goods, non-factor services and MRE 5/	18.8	13.6	10.7	9.0	8.6	9.5	7.2	6.4	6.0
External public and publicly guaranteed debt (US$, blns)	14.4	14.0	12.4	13.0	13.1	12.6	12.5	12.6	12.7
In percent of GDP	30.1	26.0	25.2	22.6	21.2	19.0	17.6	16.4	15.4
DHs per US$, period average	9.57	8.87	8.87	...	...	...	...	...	...
DHs per US$, period end	8.75	8.22	9.25	...	...	...	...	...	...
Oil price (US$/barrel)	28.9	37.8	53.4	66.5	69.8	68.5	67.5	66.8	66.0

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

1/ In 2005, a non resident company (Vivendi) sold part of its shares in Maroc Télécom to its Moroccan subsidiary.
2/ The increase in 2004 is due to a sale of government shares of Maroc Télécom in the Casablanca and Paris stock exchanges.
3/ Includes the loans that Moroccan banks gave in 2003 and will give in 2005 to the company (Vivendi) that bought part of Maroc Télécom in 2003 and additional shares in 2005.
4/ Excluding the reserve position in the Fund.
5/ Public and publically guaranteed debt.

Table 3. Morocco: Central Government Finance, 2003-11

			Prel.	Proj.					
	2003	2004	2005	2006	2007	2008	2009	2010	2011
				(in billions of dirhams)					
Revenue 1/	103.3	112.6	125.0	133.2	137.7	147.0	157.6	166.9	179.0
Revenue (excl. Fonds Hassan II) 1/	103.1	112.3	124.5	132.8	137.3	146.5	157.1	166.5	178.5
Tax revenue 1/	94.5	101.1	114.2	117.9	125.5	133.9	143.5	153.8	164.8
direct taxes	33.4	36.4	43.2	46.3	47.8	51.4	55.3	59.6	64.4
indirect taxes	41.9	44.3	48.2	51.2	56.3	60.4	65.4	70.7	76.7
import taxes	12.6	13.3	14.6	11.8	12.5	12.5	12.6	12.4	11.9
other tax revenues	6.6	7.1	8.1	8.5	8.9	9.6	10.3	11.0	11.9
Nontax revenue (excl. privatization, and Fonds Hassan II)	8.9	11.2	10.4	14.9	11.8	12.6	13.6	12.7	13.7
Expenditures and net lending (excl. Fonds Hassan II)	126.3	135.1	156.4	154.5	158.2	164.1	172.6	181.1	192.9
Current expenditures	98.4	105.1	126.7	122.5	123.6	126.5	130.7	134.4	140.3
Wages	53.2	56.6	62.0	61.0	62.0	63.2	64.5	66.4	69.1
Food and petroleum subsidies 2/	4.9	7.9	11.3	13.4	11.3	9.8	9.5	9.3	9.1
food	...	...	3.9	4.7	4.4	4.1	3.8	3.8	3.8
petroleum	...	...	7.4	8.7	6.9	5.7	5.6	5.5	5.4
butane gaz	...	...	2.0	2.5	2.1	2.3	2.4	2.6	2.8
Interest	17.4	17.6	17.3	18.8	19.7	20.8	21.8	22.5	23.2
Other current spending	22.9	23.1	36.1	29.4	30.7	32.7	35.0	36.1	38.9
Capital expenditures (budget) 3/	18.6	19.8	18.1	19.3	20.7	22.8	25.9	29.4	33.8
Road fund	1.2	1.6	1.9	2.0	2.1	2.3	2.4	2.6	2.8
Transfers to local governments 4/	7.8	8.8	9.8	10.7	11.7	12.5	13.6	14.7	16.0
Net lending	0.2	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Balance of other special treasury accounts	2.2	2.5	4.7	1.0	1.6	0.0	0.0	0.0	0.0
Overall balance (commitment basis, excl. Fonds Hassan II)	-21.0	-20.3	-27.2	-20.8	-19.3	-17.6	-15.5	-14.6	-14.3
Fonds Hassan II expenditures	1.8	1.2	2.5	3.5	2.0	2.0	2.0	2.0	2.0
Interest payments to Fonds Hassan II	0.0	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Overall balance (commitment basis, incl. Fonds Hassan II)	-22.5	-21.2	-29.2	-23.8	-20.8	-19.1	-17.1	-16.2	-15.9
Grants	0.5	1.3	1.8	1.9	2.2	2.8	3.6	3.6	3.3
Privatization and GSM revenues	12.0	10.4	13.8	5.0	2.0	2.0	2.0	2.0	2.0
Change in arrears	-1.3	2.1	-8.4	3.2	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis, incl. Fonds Hassan II , grant & privatization)	-11.3	-7.4	-22.0	-13.7	-16.6	-14.3	-11.5	-10.6	-10.6
Financing	11.3	7.4	22.0	13.7	16.6	14.3	11.5	10.6	10.6
Domestic financing	20.5	15.2	25.3	16.9	18.6	20.0	12.8	11.0	10.6
External financing	-9.2	-7.7	-3.3	-3.2	-2.0	-5.6	-1.4	-0.3	0.0
Memorandum items									
Current balance	4.9	7.5	-1.8	10.7	14.1	20.5	26.9	32.6	38.7
Primary balance (excl. grants)	-5.1	-3.7	-11.9	-5.0	-1.1	1.6	4.7	6.3	7.3
Primary balance (excl. Fonds Hassan II)	-3.6	-2.7	-9.8	-2.0	0.4	3.2	6.3	7.9	8.8
Primary balance (incl. grants and excl. Fonds Hassan II)	-3.1	-1.4	-8.0	-0.1	2.6	6.0	9.9	11.4	12.1
Primary balance (incl. grants and privatization)	7.3	8.1	3.7	1.9	3.1	6.4	10.3	11.9	12.5
Total Central Government debt (end period)	290.4	294.3	327.5	340.7	356.7	370.5	381.4	391.5	401.6
domestic 5/	211.5	223.9	258.5	274.9	292.9	312.3	324.6	335.0	345.0
external	78.9	70.4	69.0	65.8	63.8	58.2	56.8	56.5	56.5
GDP in billions of dirhams	419.5	443.7	457.6	503.4	530.6	568.8	610.7	656.5	706.5

Sources: Ministry of Finance and Privatization; and Fund staff estimates.
1/ Includes tariffs earmarked for food subsidies (*équivalents tarifaires)* and revenues of the road fund *(Fonds Routier)*
2/ Includes food subsidies financed from earmarked tariffs (*équivalents tarifaires*).
3/ Budgetary capital expenditures excluding Fonds Routier and investment spending by the Fonds Hassan II
4/ Corresponds to 30 percent of VAT revenue.
5/ Excludes the net position with the Central Bank outside statutory advances. Projections are based on the balance excluding Fonds Hassan II.

Table 4. Morocco: Central Government Finance, 2003-11

	2003	2004	Prel. 2005	Proj. 2006	2007	2008	2009	2010	2011
				(in percent of GDP)					
Revenue 1/	24.6	25.4	27.3	26.5	26.0	25.8	25.8	25.4	25.3
Revenue (excl. Fonds Hassan II) 1/	24.6	25.3	27.2	26.4	25.9	25.8	25.7	25.4	25.3
Tax revenue 1/	22.5	22.8	24.9	23.4	23.7	23.5	23.5	23.4	23.3
direct taxes	8.0	8.2	9.4	9.2	9.0	9.0	9.1	9.1	9.1
indirect taxes	10.0	10.0	10.5	10.2	10.6	10.6	10.7	10.8	10.9
import taxes	3.0	3.0	3.2	2.3	2.4	2.2	2.1	1.9	1.7
other tax revenues	1.6	1.6	1.8	1.7	1.7	1.7	1.7	1.7	1.7
Nontax revenue (excl. privatization, and Fonds Hassan II)	2.1	2.5	2.3	3.0	2.2	2.2	2.2	1.9	1.9
Expenditures and net lending (excl. Fonds Hassan II)	30.1	30.5	34.2	30.7	29.8	28.8	28.3	27.6	27.3
Current expenditures	23.5	23.7	27.7	24.3	23.3	22.2	21.4	20.5	19.9
Wages	12.7	12.7	13.6	12.1	11.7	11.1	10.6	10.1	9.8
Food and petroleum subsidies 2/	1.2	1.8	2.5	2.7	2.1	1.7	1.5	1.4	1.3
food	...	...	0.8	0.9	0.8	0.7	0.6	0.6	0.5
petroleum	...	...	1.6	1.7	1.3	1.0	0.9	0.8	0.8
butane gaz	...	...	0.4	0.5	0.4	0.4	0.4	0.4	0.4
Interest	4.1	4.0	3.8	3.7	3.7	3.6	3.6	3.4	3.3
Other current spending	5.5	5.2	7.9	5.8	5.8	5.8	5.7	5.5	5.5
Capital expenditures (budget) 3/	4.4	4.5	4.0	3.8	3.9	4.0	4.2	4.5	4.8
Road fund	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Transfers to local governments 4/	1.9	2.0	2.1	2.1	2.2	2.2	2.2	2.2	2.3
Net lending	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Balance of other special treasury accounts	0.5	0.6	1.0	0.2	0.3	0.0	0.0	0.0	0.0
Overall balance (commitment basis, excl. Fonds Hassan II)	-5.0	-4.6	-5.9	-4.1	-3.6	-3.1	-2.5	-2.2	-2.0
Fonds Hassan II expenditures	0.4	0.3	0.6	0.7	0.4	0.4	0.3	0.3	0.3
Interest payments to Fonds Hassan II	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Overall balance (commitment basis, incl. Fonds Hassan II)	-5.4	-4.8	-6.4	-4.7	-3.9	-3.4	-2.8	-2.5	-2.3
Grants	0.1	0.3	0.4	0.4	0.4	0.5	0.6	0.5	0.5
Privatization and GSM revenues	2.9	2.3	3.0	1.0	0.4	0.4	0.3	0.3	0.3
Change in arrears	-0.3	0.5	-1.8	0.6	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis, incl. Fonds Hassan II, grants & privatization)	-2.7	-1.7	-4.8	-2.7	-3.1	-2.5	-1.9	-1.6	-1.5
Financing	2.7	1.7	4.8	2.7	3.1	2.5	1.9	1.6	1.5
Domestic financing	4.9	3.4	5.5	3.4	3.5	3.5	2.1	1.7	1.5
External financing	-2.2	-1.7	-0.7	-0.6	-0.4	-1.0	-0.2	-0.1	0.0
Memorandum items									
Current balance	1.2	1.7	-0.4	2.1	2.7	3.6	4.4	5.0	5.5
Primary balance (excl. grants)	-1.2	-0.8	-2.6	-1.0	-0.2	0.3	0.8	1.0	1.0
Primary balance (excl. Fonds Hassan II)	-0.9	-0.6	-2.1	-0.4	0.1	0.6	1.0	1.2	1.2
Primary balance (incl. grants and excl. Fonds Hassan II)	-0.7	-0.3	-1.7	0.0	0.5	1.1	1.6	1.7	1.7
Primary balance (incl. grants and privatization)	1.7	1.8	0.8	0.4	0.6	1.1	1.7	1.8	1.8
Total Central Government debt (end period)	69.2	66.3	71.6	67.7	67.2	65.1	62.5	59.6	56.8
domestic 5/	50.4	50.5	56.5	54.6	55.2	54.9	53.2	51.0	48.8
external	18.8	15.9	15.1	13.1	12.0	10.2	9.3	8.6	8.0

Sources: Ministry of Finance and Privatization; and Fund staff estimates.
1/ Includes tariffs earmarked for food subsidies (*équivalents tarifaires)* and revenues of the road fund *(Fonds Routier)*
2/ Includes food subsidies financed from earmarked tariffs (*équivalents tarifaires*).
3/ Budgetary capital expenditures excluding Fonds Routier and investment spending by the Fonds Hassan II
4/ Corresponds to 30 percent of VAT revenue.
5/ Excludes the net position with the Central Bank outside statutory advances. Projections are based on the balance excluding Fonds Hassan II.

Table 5. Morocco: Monetary Survey, 2001-06

	2001	2002	2003	2004	2005	Proj. 2006
			(In millions of dirhams)			
Net foreign assets	101,678	110,460	127,083	144,309	165,509	180,506
Monetary authorities	98,993	104,170	121,973	135,269	149,837	164,834
Of which						
Gross reserves	96,640	101,760	120,012	133,934	148,730	163,726
Net Fund position	1,023	974	916	899	931	931
Deposit money banks	2,685	6,290	5,110	9,040	15,672	15,672
Net domestic assets	225,733	237,740	251,061	262,772	298,677	321,839
Domestic credit	294,257	305,944	323,629	334,509	368,513	391,011
Net credit to the government	85,610	89,470	89,098	83,068	84,180	85,228
Banking system	78,348	82,086	81,415	75,358	75,799	76,848
Bank Al-Maghrib	5,187	5,163	4,292	3,325	408	776
o/w deposits 1/	-10,806	-11,322	-13,801	-15,207	-13,591	-13,591
Deposit money banks	73,161	76,923	77,123	72,033	75,391	76,072
Treasury-IMF	-1,023	-974	-916	-899	-931	-931
Counterpart to deposits with CCP/treasury	8,285	8,358	8,599	8,609	9,312	9,312
Credit to the economy	208,647	216,474	234,531	251,441	284,333	305,783
Other liabilities, net	68,524	68,204	72,568	71,737	69,836	69,172
Money and quasi money	327,411	348,200	378,144	407,081	464,186	502,345
Money	243,117	264,863	290,784	319,340	364,137	394,071
Currency outside banks	66,025	69,556	74,890	79,715	89,305	96,646
Demand deposits	177,092	195,307	215,894	239,625	274,832	297,425
Quasi money	84,294	83,337	87,360	87,741	100,049	108,274
			(Annual percentage change)			
Net foreign assets	87.0	8.6	15.0	13.6	14.7	9.1
Net domestic assets	-2.8	5.3	5.6	4.7	13.7	7.8
Domestic credit	0.4	4.0	5.8	3.4	10.2	6.1
Net credit to the government	-7.4	4.5	-0.4	-6.8	1.3	1.2
Credit to the economy	4.0	3.8	8.3	7.2	13.1	7.5
Money and quasi money	14.2	6.3	8.6	7.7	14.0	8.2
			(In percent of beginning-of-period money stock)			
Net foreign assets	16.5	2.7	4.8	4.6	5.2	3.2
Domestic credit	0.4	3.6	5.1	2.9	8.4	4.8
Net credit to the government	-2.4	1.2	-0.1	-1.6	0.3	0.2
Credit to the economy	2.8	2.4	5.2	4.5	8.1	4.6
Other assets net	-2.7	0.1	-1.3	0.2	0.5	0.1
Memorandum items:						
Velocity (GDP/M3)	1.17	1.14	1.11	1.09	0.99	1.00
Velocity (non-agr. GDP/M3)	0.99	0.96	0.92	0.92	0.85	0.84
Credit to economy/GDP (in percent)	54.5	54.4	55.9	56.7	62.1	60.7
Credit to economy/non-agro GDP (in percent)	64.5	64.9	67.1	67.4	72.4	72.3
NPL/Gross loans (in percent)	16.8	17.2	18.1	19.4	15.7	...
o/w commercial banks	10.7	11.2	12.3	12.4	9.6	
NPLs net of provisions/Capital (in percent)	55.5	57.1	66.5	61.9	40.9	...
o/w commercial banks	19.9	18.7	23.3	20.5	15.9	...
Capital adequacy ratio (in percent)	12.6	12.2	9.3	10.2	11.5	...
o/w commercial banks	15.3	15.3	13.0	13.5	14.2	...
Liquid assets to total assets (in percent)	...	123.1	122.3	120.8	101.3	...
Domestic nonbank debt/GDP (in percent)	28.6	33.6	36.9	39.7	44.1	43.2
Credit to gov/dom debt (in percent)	48.8	46.8	42.4	37.5	33.2	31.5
Lending interest rate (in percent)	8.9	8.5	8.1	7.8	...	...
Deposit interest rate (in percent)	5.0	4.5	3.8	3.6	...	...
Money Market rates (in percent)	4.4	3.0	3.2	2.4	2.8	...
DHs per US$, period end	11.56	10.17	8.75	8.22	9.25	...

Source: Bank Al-Maghrib and staff estimates.

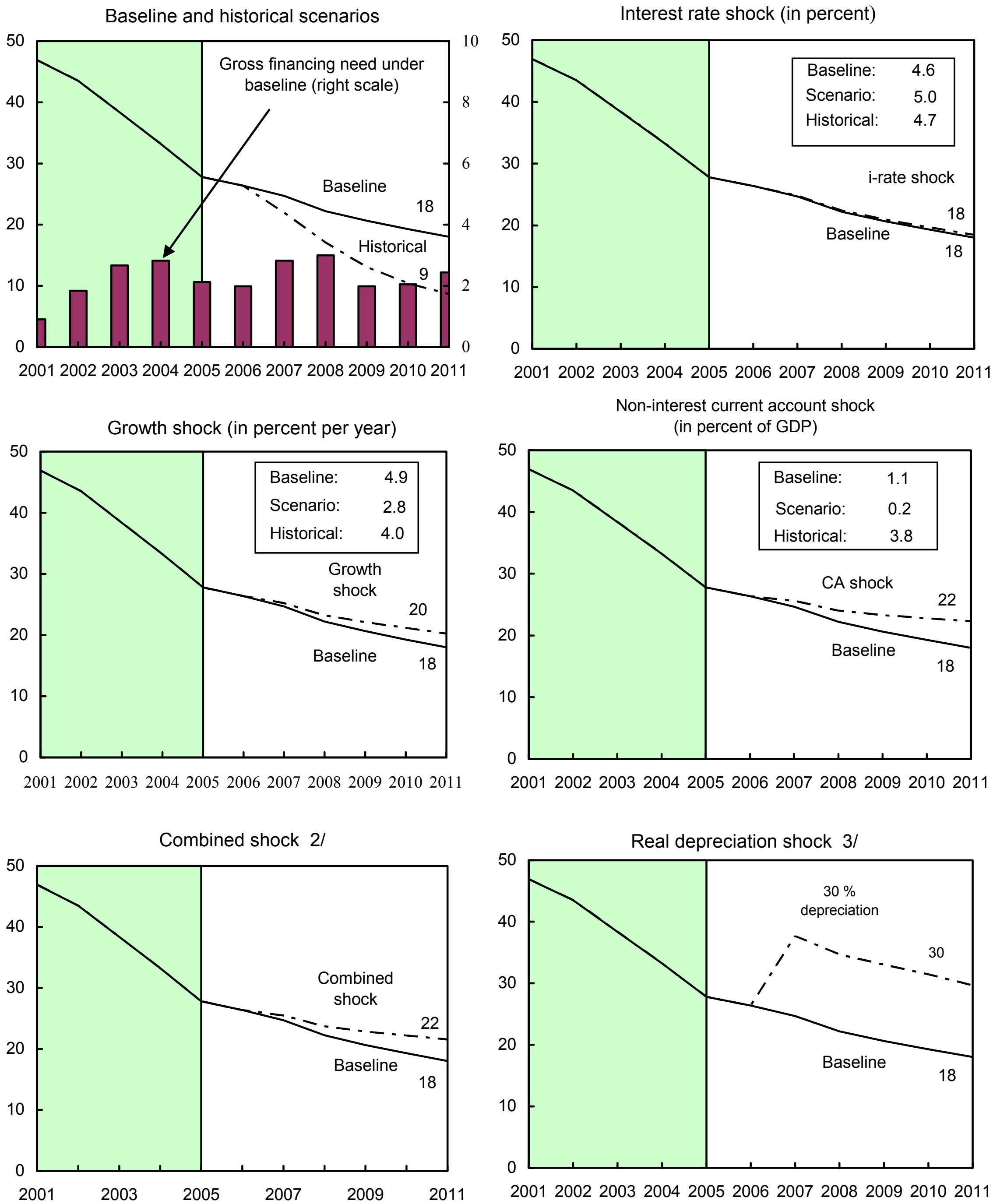
1/ Includes Fonds Hassan II

Table 6. Morocco: External Debt Sustainability Framework, 2001-11
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	46.9	43.5	38.4	33.2	27.8	**26.4**	**24.7**	**22.2**	**20.6**	**19.3**	**18.0**	**-5.1**
Change in external debt	-7.1	-3.4	-5.1	-5.1	-5.4	-1.4	-1.7	-2.5	-1.6	-1.4	-1.3	
Identified external debt-creating flows (4+8+9)	-13.7	-8.2	-16.6	-8.4	-6.6	-5.3	-2.9	-3.6	-3.6	-4.5	-5.1	
Current account deficit, excluding interest payments	-7.3	-6.1	-5.1	-3.1	-2.9	-2.3	-1.3	-1.6	-1.4	-1.0	-0.4	
Deficit in balance of goods and services	3.3	3.1	3.9	6.4	7.4	7.9	9.0	8.7	8.7	8.9	9.1	
Exports	32.9	33.8	32.5	33.2	36.3	36.9	37.4	37.7	37.9	38.2	38.5	
Imports	36.2	36.9	36.4	39.7	43.7	44.8	46.4	46.4	46.6	47.0	47.6	
Net non-debt creating capital inflows (negative)	-8.0	-1.3	-5.3	-1.7	-3.8	-2.2	-1.8	-1.9	-2.0	-3.4	-4.5	
Automatic debt dynamics 1/	1.7	-0.9	-6.2	-3.6	0.0	-0.8	0.3	-0.1	-0.1	-0.2	-0.2	
Contribution from nominal interest rate	2.6	2.0	1.5	1.2	1.0	1.0	1.1	1.0	0.9	0.9	0.8	
Contribution from real GDP growth	-3.3	-1.4	-2.0	-1.4	-0.6	-1.8	-0.8	-1.2	-1.1	-1.0	-1.0	
Contribution from price and exchange rate changes 2/	2.4	-1.4	-5.7	-3.3	-0.5	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	6.6	4.8	11.4	3.3	1.2	3.9	1.2	1.1	2.0	3.1	3.9	
External debt-to-exports ratio (in percent)	142.4	128.7	118.1	100.1	76.5	71.5	66.0	58.9	54.4	50.5	46.8	
Gross external financing need (in billions of US dollars) 4/	0.3	0.7	1.2	1.4	1.1	1.1	1.7	2.0	1.4	1.6	2.0	
in percent of GDP	0.9	1.8	2.7	2.8	2.1	2.0	2.8	3.0	2.0	2.1	2.4	
Scenario with key variables at their historical averages 5/						**26.4**	**21.9**	**17.0**	**13.1**	**10.4**	**8.6**	**-2.9**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.3	3.2	5.5	4.2	1.7	7.3	3.3	5.1	5.2	5.4	5.5	
GDP deflator in US dollars (change in percent)	-4.3	3.2	15.0	9.5	1.4	3.2	4.0	2.4	2.4	2.3	2.3	
Nominal external interest rate (in percent)	4.9	4.5	4.1	3.6	3.2	4.2	4.4	4.5	4.6	4.6	4.6	
Growth of exports (US dollar terms, in percent)	6.9	9.2	16.7	16.7	12.9	12.4	8.9	8.6	8.3	8.6	8.9	
Growth of imports (US dollar terms, in percent)	-2.1	8.4	19.8	24.4	13.7	13.4	11.3	7.6	8.2	8.9	9.3	
Current account balance, excluding interest payments	7.3	6.1	5.1	3.1	2.9	2.3	1.3	1.6	1.4	1.0	0.4	
Net non-debt creating capital inflows	8.0	1.3	5.3	1.7	3.8	2.2	1.8	1.9	2.0	3.4	4.5	

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.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

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



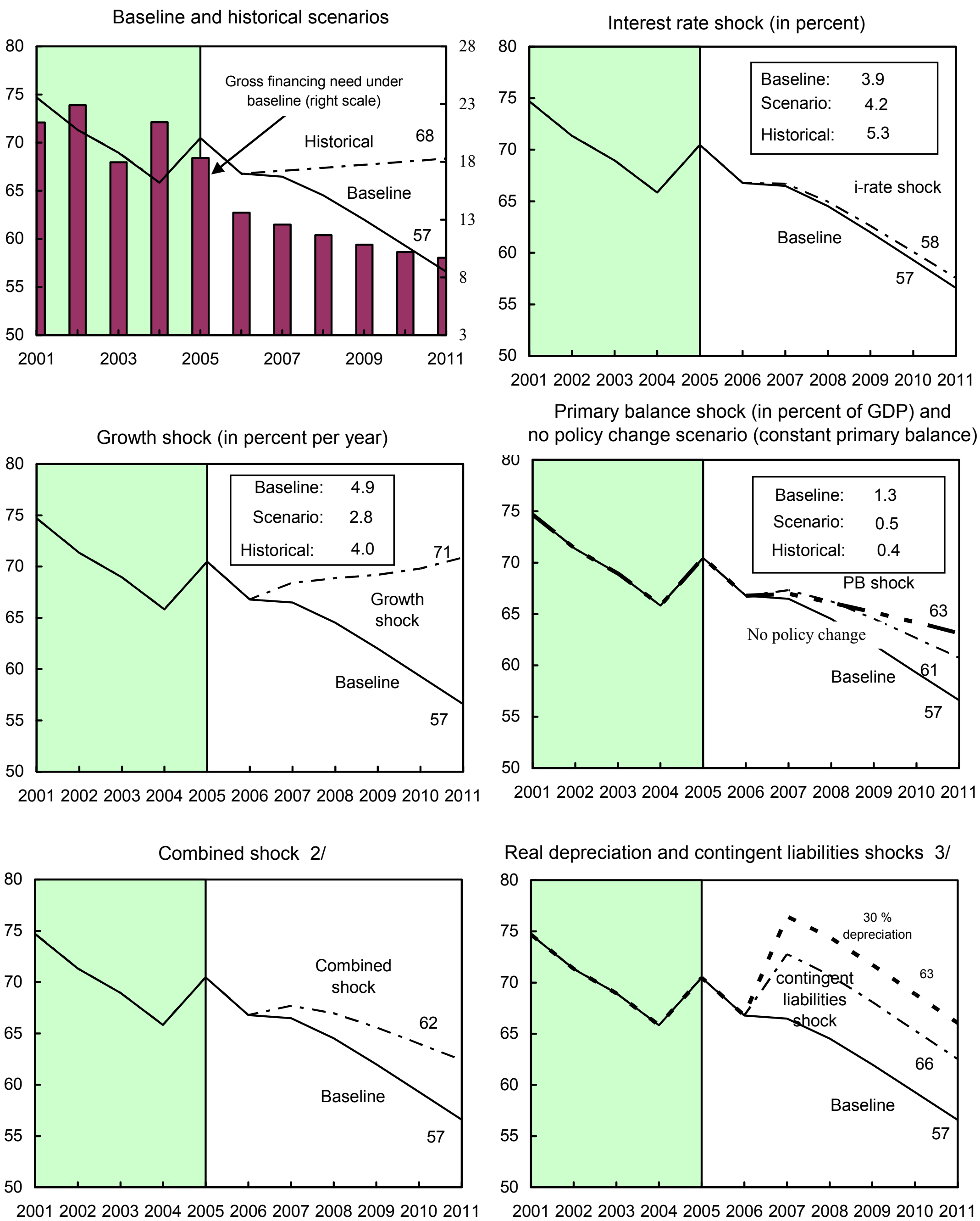
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2006.

Table 7. Morocco: Public Sector Debt Sustainability Framework, 2001-11
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	74.7	71.3	68.9	65.8	70.5	**66.8**	**66.5**	**64.5**	**62.0**	**59.3**	**56.6**	**-1.2**
o/w foreign-currency denominated	28.9	23.3	18.8	15.9	15.1	13.1	12.0	10.2	9.3	8.6	8.0	
Change in public sector debt	-6.1	-3.3	-2.4	-3.1	4.6	-3.7	-0.3	-1.9	-2.5	-2.7	-2.7	
Identified debt-creating flows (4+7+12)	-3.3	-2.1	-4.9	-2.9	2.9	-3.6	-0.6	-2.2	-2.8	-2.9	-2.9	
Primary deficit	1.1	-0.1	0.7	0.3	1.7	0.0	-0.5	-1.1	-1.6	-1.7	-1.7	
Revenue and grants	25.1	25.1	24.8	25.6	27.6	26.8	26.3	26.2	26.3	25.9	25.7	
Primary (noninterest) expenditure	26.2	25.0	25.4	25.9	29.4	26.8	25.8	25.2	24.7	24.2	24.0	
Automatic debt dynamics 2/	1.7	-1.8	-2.7	-0.9	1.8	-2.7	0.3	-0.8	-0.9	-0.9	-0.9	
Contribution from interest rate/growth differential 3/	-1.2	1.6	0.4	0.2	1.8	-2.7	0.3	-0.8	-0.9	-0.9	-0.9	
Of which contribution from real interest rate	3.5	3.9	4.2	3.0	2.9	2.0	2.4	2.3	2.3	2.2	2.1	
Of which contribution from real GDP growth	-4.7	-2.3	-3.7	-2.8	-1.1	-4.7	-2.1	-3.2	-3.2	-3.1	-3.0	
Contribution from exchange rate depreciation 4/	2.9	-3.5	-3.2	-1.1	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	-6.1	-0.2	-2.9	-2.3	-0.6	-1.0	-0.4	-0.4	-0.3	-0.3	-0.3	
Privatization receipts (negative)	-6.1	-0.2	-2.9	-2.3	-3.0	-1.0	-0.4	-0.4	-0.3	-0.3	-0.3	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	2.4	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-2.8	-1.2	2.5	-0.2	1.7	0.0	0.3	0.3	0.3	0.2	0.2	
Public sector debt-to-revenue ratio 1/	297.8	284.0	278.5	257.2	255.1	249.6	252.9	245.8	235.5	228.8	219.9	
Gross financing need 6/	21.4	22.9	18.0	21.4	18.3	13.6	12.6	11.7	10.8	10.2	9.7	
in billions of U.S. dollars	7.3	8.3	7.9	10.7	9.5	7.8	7.7	7.7	7.7	7.8	8.0	
Scenario with key variables at their historical averages 7/						**66.8**	**67.1**	**67.4**	**67.7**	**68.0**	**68.3**	**0.5**
Scenario with no policy change (constant primary balance) in 2005-2010						**66.8**	**67.0**	**66.1**	**65.2**	**64.2**	**63.1**	**-1.3**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.3	3.2	5.5	4.2	1.7	7.3	3.3	5.1	5.2	5.4	5.5	
Average nominal interest rate on public debt (in percent) 8/	6.6	6.1	6.1	6.1	5.9	5.8	5.9	5.9	5.9	5.9	6.0	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	4.8	5.5	6.2	4.6	4.5	3.3	3.9	3.9	3.9	3.9	4.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-8.1	13.7	16.2	6.5	0.0	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	1.8	0.6	-0.1	1.5	1.4	2.5	2.0	2.0	2.0	2.0	2.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	4.1	-1.5	7.3	6.2	15.2	-2.2	-0.4	2.7	3.2	3.1	4.9	
Primary deficit	1.1	-0.1	0.7	0.3	1.7	0.0	-0.5	-1.1	-1.6	-1.7	-1.7	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
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 $r - \pi (1+g)$ 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.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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



Sources: International Monetary Fund, 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2006, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

ANNEX: SUMMARY OF ANNEXES

The full annexes to this report can be viewed in Cyber Docs on the Fund's intranet and on the secure extranet for Executive Directors and member officials.

Fund Relations

Morocco has no outstanding purchases or loans. The latest financial arrangement—a Stand-By facility—expired on March 31, 1993. Morocco has a conventional peg arrangement; the central exchange rate of the Moroccan dirham is pegged to a basket of currencies representing Morocco's principal trading partners. The 2005 Article IV consultation was concluded by the Executive Board on August 29, 2005 (IMF Country Report No. 05/418).

Relations with the World Bank Group

As of August 2006, the World Bank's portfolio in Morocco consists of 13 operations with a total net commitment of $823.7 million and an undisbursed balance of $549.3 million. Recent loans targeted the housing sector, rural water supply and sanitation, rural roads, and the financial and public administration sectors. The quality of the portfolio has improved over the last five years, and is generally satisfactory. The last Country Assistance Strategy (CAS) report was approved by the Bank Board in May 2005; its main objectives are to: (a) improve competitiveness and the investment climate; (b) increase access to basic services by the poor and marginalized groups; (c) improve the efficiency of the education system; and (d) improve water management and access to water services and sanitation.

Statistical Issues

Morocco subscribed to the Special Data Dissemination Standard in December 2005, and its data provision for surveillance purposes is adequate overall. The authorities are working on rebasing the national accounts from 1980 to 1998, and the new series of accounts covering the years 1998–2004 should be released during 2006. The planned inclusion of free trade zones and offshore banks will significantly improve the quality of balance-of-payment statistics.

ANNEX I. FUND RELATIONS

As of July 31, 2006

I. **Membership Status:** Joined April 25, 1958

II. **General Resources Account:**	SDR Million	Percent Quota
Quota	588.20	100.0
Fund Holdings of Currency	517.76	88.02
Reserve position in Fund	70.45	11.98

III. **SDR Department:**	SDR Million	Percent Allocation
Net cumulative allocation	85.69	100.0
Holdings	42.32	49.38

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
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 Obligations to Fund:** (SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal					
Charges/Interest	0.78	1.67	1.67	1.67	1.67
Total	0.78	1.67	1.67	1.67	1.67

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 representing Morocco's principal trading partners. In 2001, the authorities changed the basket of currencies by increasing the weight of the Euro to better reflect the weight of external trade with EU countries. 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 August 18, 2006, the SDR/dirham exchange rate was SDR 1=DH 12.87.

Article IV Consultation

Morocco is on the 12-month cycle. The last discussions of the Article IV consultation were held in Rabat during April 25-May 10, 2005, and were concluded by the Executive Board on August 29, 2005.

Technical Assistance

February 16–29, 2000: STA—following up on government finance statistics improvement

November 7–22, 2000: FAD—advising on improving the design of the tax system and its administration

January 16-30, 2002: STA—ROSC Data Module Mission

February 9–20, 2004: MFD—Monetary Framework

May 17–24, 2004: FAD—Modernizing the tax system and its administration.

June 28–July 7, 2004: FAD—ROSC Fiscal Module.

2004: MFD—Peripatetic visits—internal credit rating system.

Resident representative: None

ANNEX II. FINANCIAL RELATIONS WITH THE WORLD BANK

(As of August 7, 2006)

32. The Country Assistance Strategy (CAS) was approved by the World Bank Board on May 19, 2005. It plans to contribute to the broad goals of accelerating sustainable employment-generating growth and reducing poverty and marginalization. It will focus upon four objectives: (a) improve competitiveness and the investment climate; (b) increase access to basic services by the poor and marginalized groups; (c) improve the efficiency of the education system; and (d) improve water management and access to water services and sanitation.

33. The World Bank's current portfolio in Morocco consists of 13 operations, with a total net commitment of US$823.7 million and an undisbursed balance of US$549.3 million. Bank lending is a mix of investment loans, SWAPs, and development policy loans (DPL). Recent loans include Housing Sector DPL (US$150 million); Financial Sector DPL (US$200 million); Rural Water Supply and Sanitation (US$60 million); Public Administration Development Policy Loan (US$120 million); and Rural Roads II (US$60 million).

34. For FY06, disbursements for DPLs and investment projects amount to US$214.2 million and US$60.2 million, respectively. The disbursement ratio for investment projects has improved, and is currently at 14.5%. The quality of the portfolio has generally been satisfactory and there are no risky projects. Despite recent improvements in the quality of the portfolio, institutional capacity for project implementation still needs to be strengthened. A participatory Country Portfolio Performance Review (CPPR) is planned for end-2006 in order to accelerate disbursement and to reassess progress made on key actions agreed upon to improve project and portfolio management.

35. A new Country Economic Memorandum (CEM), done in collaboration with Fund staff, was finalized in March 2006 and has been largely discussed with the Government. Dissemination is ongoing with wide participation from the private sector, academia and civil society. The preparation of the CEM came in response to a request from the Government to identify the major constraints to growth and devise a growth and competitiveness enhancing agenda. It is in line with the CAS objectives to support the Government's reforms for a private environment conducive to faster growth and increased employment creation.

36. Prospects for lending are significantly improving and specific requests have been made for budget support and investment projects. Projects under preparation include: an Energy Sector DPL (US$100 million), Water DPL (US$100 million), National Human Development Initiative (US$200 million), Oum Er Rbia Water Resource Conservation (US$60 million), Meknes Local Development (US$30 million), and Public Administration Reform III DPL. The Bank and the Moroccan authorities are also discussing a possible follow-up operation to address the growth constraints identified by the CEM.

37. Other recent analytical and advisory work includes studies on Housing, Competitiveness and ICT, Water Sector, Trade and Transport, and Wheat, Flour Compensation Reform. The Investment Climate Assessment was disseminated in March 2006 and as a follow-up the bank is launching work on land tenure as a constraint to private sector development and investment. Current studies include: Employment and Skills Development, Housing PSIA, Urban Transport, Doing Business and ICT, Land Markets and Growth, Decentralization and EU Neighborhood. The Bank is also providing strong support with participatory approaches (Programmatic Economic and Sector Work-PESW) for Tertiary Education, Public Administration Reform, Poverty, and Water.

ANNEX III. STATISTICAL ISSUES

Available economic and financial data have been provided to the staff on a regular basis and most of these data are also published or made available on publicly accessible web sites. Data provision is adequate for surveillance purposes.

A data ROSC mission, which took place in January 2002, carried out a review of the macroeconomic statistics. As the authorities maintained a strong interest in subscribing to the SDDS, the mission also identified areas to be strengthened to meet the SDDS requirements. A subsequent mission (April–May 2005) noted that the authorities meet most of the SDDS requirements in terms of coverage, periodicity, and timeliness. The mission proposed an action plan to address the remaining issues, which enabled Morocco to subscribe to the SDDS in December 2005.

Real sector

The Statistical Office is working on rebasing national accounts from 1980 to 1998 and on bringing it in conformity with the *System of National Accounts 1993*. This reform program has made good progress and the first series of accounts for 1998–2000 has been finalized. The new series of accounts covering the period 1998–2004 will be released during 2006 once the work on the years 2001–04 is completed. The revision of the consumer price index is also planned to be completed during 2006, with updated weights based on the results of the 2001 household budget survey. A consistent monthly time series for the producer price index (with weights derived from the 1997 annual survey) are available.

Government finance

Central government finance data are generally available with a few months lag. *GFS* data reported for publication in the *GFS Yearbook* are not timely (the most recent data relate to 2005), and their coverage is limited to the budgetary central government, the Moroccan pension fund, and the National Social Security Fund. The reporting of data for the central government on a monthly or quarterly basis for publication in *IFS* is irregular. A technical assistance STA mission in February 1999 and a follow-up mission in February 2000 advised on improvements in the compilation of both central and local government statistics and assisted the government in establishing appropriate consolidation procedures for a presentation of general government data. Substantial progress has been made by the Accounting Office for the compilation of local government data and their consolidation with central government budgetary data. The actual use of those source data for general government compilation may require further clarification of responsibilities between various directorates. Regarding the monthly *Treasury's Expenditure and Revenue Table*, the data ROSC recommended some reclassifications (e.g. transfers and privatization), to maintain the *Fonds Hassan II* within the coverage of the table, and, for dissemination purposes, to complement the table with more details and data on financing and to improve the format of dissemination. The SDDS mission prepared an action plan for the production of data on the consolidated general government operations.

Monetary and financial statistics

Bank Al-Maghrib disseminates monetary and financial and other macroeconomic statistics to the general public primarily through its website (www.bkam.ma). The statistical part of the site includes web-based versions of the Bank's weekly, monthly, quarterly, and annual publications. The degree of detail in the breakdown of financial assets and liabilities by resident institutional sector could be more extensive; at present, this problem is reflected in the lack of precision in some of the monetary aggregates, including credit indicators.

Balance of payments

The ROSC mission found that in general the balance of payments data are in line with the concepts and definitions set out in the fifth edition of the *Balance of Payments Manual (BPM5)*. However, further work is needed to implement certain recommendations on scope, classification, and basis for recording. Thus, recent measures to exclude the effects of changes in exchange rates from the valuation of transactions in reserve assets should be continued, and transactions in foreign currency assets and liabilities of intermediary banks at their correspondent banks should be excluded from transactions in reserve assets. Also, the *Office des Changes* (OC) is planning to treat operators in free trade zones as residents. Offshore banks located in Morocco should also be considered residents. The OC lacks a firm legal basis for compiling and disseminating balance of payments statistics, relying for the time being exclusively on customs and exchange control data. These data are gradually to become less available and too limited as liberalization proceeds and as participation of foreign investors in the economy increases. The OC has initiated legislative measures that would give it access to statistical data collected directly from economic operators, to record, among other things, private foreign debt, and more generally of the international investment position. Furthermore, the ROSC mission recommended the introduction of quarterly surveys of enterprises and other agencies to improve the scope, classification, and valuation of balance of payments transactions, in particular for goods for processing, transportation services, and financial transactions. Since May 1998, the OC has been publishing, on its internet site, monthly statistics on trade, tourism, private transfers, and incoming foreign direct investment in accordance with the *BPM5*. The quality of balance of payments statistics will significantly improve with the planned inclusion of free trade zones and offshore banks located in Morocco or in its economic territory.

The latest BOP and IIP information received from Morocco, and published in the IFS, relates to quarterly BOP data for 2004 and annual IIP data for 2004. Furthermore, Morocco reports on a regular basis international liquidity data to STA for publication in the *IFS*.

MOROCCO: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF AUGUST 7, 2006

	Date of latest observation	Date received	Frequency of Data6	Frequency of Reporting[6]	Frequency of publication[6]	Memo items: Data Quality – Methodological soundness[7]	Memo items: Data Quality – Accuracy and reliability[8]
Exchange Rates	07/31/06	08/04/06	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	06/30/06	07/28/06	W	W	W		
Reserve/Base Money	05/30/06	7/15/06	M	M	M	LO, O, LNO, LO	LO, LO, O, O, LO
Broad Money	05/30/06	7/15/06	M	M	M		
Central Bank Balance Sheet	05/30/06	7/15/06	M	M	M		
Consolidated Balance Sheet of the Banking System	05/30/06	7/15/06	M	M	M		
Interest Rates[2]	06/30/06	7/15/06	D	D	D		
Consumer Price Index	06/30/06	07/28/06	M	M	M	O, LO, O, O	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	03/31/05	05/31/05	...	...	...	LO, LNO, LO, O	O, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	03/31/05	05/31/05	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	03/31/05	05/31/05	A	A	A		
External Current Account Balance	03/31/05	05/31/05	M	M	M	LO, LO, LO, LO	LO, LO, O, LO, LNO
Exports and Imports of Goods and Services	03/31/05	05/31/05	M	M	M		
GDP/GNP	03/31/06	05/31/06	Q	Q	Q	LO, LNO, LO, LO	LNO, LO, O, O, LNO
Gross External Debt	03/31/05	05/31/05	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic non-bank financing.
[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] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published on April 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).
[8] Same as Footnote 7, 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.

Statement by the IMF Staff Representative
October 11, 2006

1. This statement provides additional information that has become available since the circulation of the staff report. It does not change the thrust of the staff appraisal.

2. **Recent data suggest that the economic recovery is gaining momentum**. At end-June, real GDP had grown by 8.5 percent year-on-year, boosted by a good harvest and robust non-agricultural growth. The external position continues to strengthen. International reserves reached $19.8 billion at end-August, up from $16 billion at end 2005, significantly higher than projected. Preliminary data point to higher-than-anticipated tourism receipts as one of the main factors behind this surge. The trade balance remains in line with staff projections; in particular, Morocco's main exports, textiles, continue to recover from their 2005 decline in the wake of the end of the Agreement on Textiles and Clothing. The recent strengthening of the revenue performance, which may lead to a more favorable fiscal outcome for the year as a whole, underscores the strength of the recovery. Investment and domestic demand are also picking up, reflecting increased private sector confidence in the Moroccan economy. The overall unemployment rate dropped to 7.7 percent in the second quarter of 2006, its lowest level in more than two decades. Inflationary pressures remain contained, with average inflation reaching 2.4 percent year-on-year at end-August.

3. **On September 2, 2006, the authorities increased the retail price of petroleum products by about 5 percent on average**. The authorities estimate the international price level at which domestic retail prices would no longer be subsidized at $60 per barrel, up from $56 before this latest increase.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 06/115
FOR IMMEDIATE RELEASE
October 13, 2006

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

IMF Executive Board Concludes 2006 Article IV Consultation with Morocco

On October 11, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Morocco.[1]

Background

Macroeconomic conditions continue to strengthen and the 2006 outlook is favorable, with increased private sector confidence in the Moroccan economy. A bumper crop and continued strong activity in services and construction are ushering in a recovery, following a slowdown in growth in 2005 caused by unfavorable weather conditions. The external current account is expected to record its sixth consecutive surplus. Strong tourism receipts, workers' remittances and the recovery of textile exports will offset the upsurge in the energy bill. External reserves, at more than US$18 billion, continue to exceed the total stock of public external debt. Price pressures remain subdued, and recent evidence suggests that the dirham is not misaligned.

The fiscal position is improving but the ratio of public debt to GDP, though declining, remains high. Despite a buoyant revenue performance, the fiscal deficit is likely to be close to the 2006 budget target of 4.1 percent of GDP (down from 5.9 percent in 2005) because of continued expenditure pressures stemming mainly from oil and food subsidies (1.6 percent and 0.8 percent of GDP in 2005, respectively). The authorities have started to implement their medium-term fiscal consolidation strategy, which aims at reducing the fiscal

[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.

deficit to 3 percent of GDP and bring the public-debt-to-GDP ratio below 60 percent. The successful 2005 voluntary early retirement scheme should help curb wage bill growth. Following the three increases that have taken place since 2005, the authorities plan on continuing to gradually align domestic prices of petroleum products with international prices. They are also designing a strategy to reduce the fiscal cost of food subsidies by better targeting them to the most vulnerable groups.

Monetary policy has adequately managed the excess liquidity conditions, and the central bank continues to strengthen the operational framework for monetary policy and its transparency.

Banking sector conditions have improved following significant write-offs of nonperforming loans and the near completion of the restructuring of two state-owned banks. The authorities have also taken steps to improve the availability, accuracy and transparency of financial information in order to strengthen financial intermediation.

Morocco has made considerable progress in trade liberalization; next steps include tackling remaining obstacles to trade and increasing trade in services.

Morocco subscribed to the Special Data Dissemination Standard in December 2005, and continues to improve the quality and dissemination of statistical data and increase the transparency of economic policy. The authorities published the recent staff mission statement and intend to publish the 2006 Article IV Staff Report.

Executive Board Assessment

Directors agreed with the thrust of the staff appraisal. They commended the authorities on their implementation of sound macroeconomic policies and structural reforms. Directors noted that, in recent years, these policies had supported the acceleration of non-agricultural growth in an environment characterized by low inflation and comfortable international reserves, and the steady rise of per capita income.

Directors viewed that, with macroeconomic conditions strengthening, short-term prospects are favorable. They shared the authorities' view that the current sound macroeconomic environment provides an opportunity to capitalize on recent achievements and advance the reform process in order to accelerate growth to levels that would support an increase in employment and a substantial reduction in poverty. To this end, Directors supported a strategy of medium-term fiscal consolidation, enhancing the efficiency of financial intermediation, and deepening Morocco's integration into the global economy.

Directors noted that fiscal consolidation should be the top policy priority. They agreed that Morocco's fiscal strategy for gradually reducing the deficit to 3 percent of GDP over the medium term is appropriate. Directors welcomed the ongoing reform of the tax system and noted that a simpler and more transparent tax system and strengthened administration would help broaden the tax base and increase revenue. While they congratulated the authorities on the success of the 2005 early retirement program for civil servants, Directors stressed that the credibility of the fiscal strategy will depend on the authorities' ability to curb

wage bill growth and reduce the fiscal cost of oil and food subsidies. Directors urged the authorities to seize the opportunity of the 2007 budget to send a strong signal on their commitment to fiscal consolidation.

Directors supported the authorities' intention to prepare for a possible transition to a more flexible exchange rate regime. They welcomed the increased independence of the central bank, and the central bank's efforts to strengthen the monetary policy framework, with a view to possibly adopting inflation targeting in the medium term. In this context, Directors stressed the importance of further fiscal consolidation and development of money and exchange markets.

Directors commended the authorities for having taken measures to strengthen the financial sector, in line with the 2003 Financial Sector Stability Assessment, and welcomed the emphasis placed on improving the efficiency of financial intermediation. They found that the measures implemented by the central bank to improve the availability, accuracy, and transparency of financial information were helpful in this regard. Directors encouraged the authorities to develop further alternative financing instruments, such as stock and bond markets. They looked forward to the adoption of the draft anti-money laundering law that was submitted to parliament.

Directors welcomed Morocco's progress achieved in trade liberalization, including active participation in regional integration efforts, and supported the authorities' policies to further integration in the world economy. They agreed that appropriate next steps would be to tackle remaining obstacles to trade and increasing trade in services.

It is expected that the next Article IV consultation with Morocco will take place on the standard 12-month cycle.

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.

Table 1. Morocco: Selected Economic Indicators, 2001-07
(Quota: SDR 588.20 million)
(Population: 30.1 million; 2005)
(Per capita GDP: US$1,712; 2005)
(Poverty rate: 15 percent; 2004)
(Main exports: textiles, phosphates and derivatives; 2005)

	2001	2002	2003	2004	2005 Prel.	2006 Proj.
Output and Prices	(Annual percentage change)					
Real GDP (market prices)	6.3	3.2	5.5	4.2	1.7	7.3
Nonagricultural Real GDP (market price)	3.6	2.8	3.5	4.7	5.2	5.1
Consumer prices (period average)	0.6	2.8	1.2	1.5	1.0	2.5
Investment and Saving	(In percent of GDP)					
Gross capital formation	22.9	22.7	24.1	25.0	25.9	25.6
of which: Non-government	20.0	19.9	21.4	22.4	23.4	23.1
Gross national savings	27.6	26.8	27.7	27.0	27.8	26.8
of which: Non-government	27.3	25.0	26.6	25.3	28.1	24.7
Public Finances	(In percent of GDP)					
Revenue (including grants)	25.1	25.1	24.8	25.7	27.7	26.8
Expenditure 1/	34.4	30.1	30.5	30.7	34.7	31.4
Budget balance (commitment basis, excl. privatization) 2/	-6.2	-4.7	-5.0	-4.6	-5.9	-4.1
Overall balance (cash basis, incl. privatization) 1/	-4.8	-4.1	-2.7	-1.7	-4.8	-2.7
Total government debt 3/	74.7	71.3	68.9	65.8	70.5	66.8
Monetary Sector	(Annual percentage change, unless otherwise indicated)					
Credit to the private sector	4.0	3.8	8.3	7.2	13.1	7.5
Base money	22.7	5.0	13.6	12.1	9.2	8.2
Broad money	14.2	6.3	8.6	7.7	14.0	8.2
Velocity of broad money (level)	1.17	1.14	1.11	1.09	0.99	1.00
Three-month treasury bill rate (period average, in percent)	4.8	3.0	3.3	2.5	2.5	…
External Sector	(In percent of GDP, unless otherwise indicated)					
Exports of goods (in US$, percentage change)	-3.7	9.8	11.8	13.1	7.4	9.9
Imports of goods (in US$, percentage change)	-4.6	7.2	20.1	25.2	14.2	14.0
Merchandise trade balance	-8.9	-8.5	-9.9	-13.0	-15.7	-16.9
Current account balance excluding official transfers	4.7	3.8	3.4	1.7	1.5	0.9
Current account balance including official transfers	4.8	4.1	3.6	1.9	1.8	1.2
Foreign direct investment	8.0	1.3	5.3	1.7	3.8	2.2
Total external debt	48.0	40.1	35.1	30.8	29.0	26.1
Gross reserves (in US$ millions)	8,359.9	10,008.9	13,716	16,298	16,080	18,768
In months of next year imports of goods and services	7.5	7.5	8.3	8.7	7.5	7.9
Memorandum Items:						
Nominal GDP (in US$ billions)	33.9	36.1	43.8	50.0	51.6	57.2
Unemployment rate (in percent) 4/	12.5	11.6	11.4	10.8	11.0	7.7
Net imports of petroleum products (in US$ millions)	1,282	1,167	963	1,639	2,701	3,590
Local currency per U.S. dollar (period average) 5/	11.30	11.02	9.57	8.87	8.86	...
Real effective exchange rate (annual average, percentage change)	-4.1	-0.3	-1.0	-1.2	-1.7	...

Sources: Moroccan authorities and Fund staff estimates and projections.

1/ Including Fonds Hassan II

2/ Excluding Fonds Hassan II

3/ It includes the net position vis à vis the Central Bank outside statutory advances.

4/ For 2006, as of end-June.

5/ For 2006, as of end-September.

Statement by Mohammed Daïri, Alternate Executive Director for Morocco
October 11, 2006

The Moroccan authorities are grateful to staff for the high quality of their work and the excellent policy dialogue during the Article IV discussions. They appreciate the concise and well-focused report and broadly agree with staff's analysis and key policy recommendations. They also thank management and the Board for their continued support.

The relentless efforts of the authorities in strengthening the economy's fundamentals and its resilience and improving the investment climate so as to increase growth and employment continue to bear fruit. Indeed, sound macroeconomic policies and resolute implementation of a broad range of structural reforms have contributed to improved economic performance. In 2005, the economy managed to withstand 3 major shocks: a severe drought, the dismantling of textiles quotas, and the sharp increase in oil prices. While agricultural GDP declined by 18 percent, the overall growth performance turned out to be higher than expected (1.7 percent as against 1 percent), as a result of higher nonagricultural GDP growth, confirming increased resilience to weather conditions. The effect of the dismantling of textile quotas was significant, although the initial decline in textile exports moderated thereafter. Finally, the oil import bill increased by 51 percent (with an additional cost equivalent to 3 percent of GDP). Despite the significant external shocks, the current account surplus increased to 2.2 percent of GDP—thanks to strong performance of tourism and workers remittances—and foreign reserves increased further to reach US$16.2 billion, covering 9 months of imports of goods and services or 130 percent of total external debt. The fiscal deficit increased to 5.9 percent of GDP mainly due to the one-off expenditure related to the voluntary retirement program (DVR, 2½ percent of GDP). Excluding the DVR, the overall deficit declined to 3.5 percent of GDP from 4.6 percent in 2004. With skillful monetary policy in the context of the large liquidity from foreign inflows, inflation further declined to 1 percent despite increases in the domestic oil prices.

Economic performance improved further in 2006, reflecting continued adherence to sound policies and favorable weather conditions. GDP growth is estimated to exceed 7 percent, with non-agricultural GDP growing by 5 percent, and the external current account and overall balance of payments positions are expected to strengthen further than was anticipated during the Article IV discussions, with tourism receipts increasing significantly to take over workers remittances as the main foreign exchange source after exports and a recovery of textile shippings. Fiscal developments are also much better than anticipated and, with firm control of expenditure and significantly improved revenue performance, compared to budget estimates—and to the projections made during the Art IV discussions—the fiscal position is expected to improve further in 2006. Following an exceptional increase in 2005 associated with the recognition of past government arrears to the civil service pension fund and the upfront cost of the DVR, the debt-to GDP ratio should resume its downward trend. Moreover, unemployment dropped significantly, reaching in the second quarter of 2006 its lowest level in decades. While inflation has trended upwards slightly, following increases in domestic energy prices, it is the authorities' firm intention to keep it under control.

The significantly improved tax revenue performance is a major achievement that is expected to facilitate the authorities' fiscal consolidation efforts. In 2005 alone, tax revenue increased by close to 2 percent of GDP and the trend is continuing in 2006, as evidenced by data through August, reflecting significant improvements in tax administration and policy, in line with Fund's technical assistance recommendations, and stronger economic activity. While most of the revenue gains were realized at the domestic tax level, in particular in direct taxes and the VAT, performance of taxes on international trade was also noteworthy in the context of continued tariff reductions under Morocco-EU and other free-trade agreements. The significant reduction in the Budget's dependence on privatization revenue is also noteworthy since it improves revenue predictability. On the expenditure side and despite its short term budgetary cost, the DVR program will have a positive effect of close to 4 percent of GDP in net present value terms, with a reduction in the wage bill (net of additional pension outlays) in 2006 and over the medium-term. The authorities' response to the large increase in international oil prices was gradual, with temporary suspension of the price indexation system, requiring temporary budget support, followed by step increases in domestic prices. The indexation system has now been reinstated for most products and the September-2006 increase (the fourth since mid-2005) brought the domestic price structure for these products in line with the prevailing international price. Domestic prices were reduced in early October in consistence with the indexation formula and the decline in world prices. A strategy for the energy sector will be developed with World Bank support.

The authorities are firmly committed to their medium-term fiscal consolidation strategy and are confident that their target of reducing the fiscal deficit to 3 percent of GDP by 2009 will be achieved, especially in view of recent progress in this area. The draft 2007 budget is consistent with this strategy, with a deficit excluding privatization below 4 percent of GDP . They stand ready to take action, if needed, to achieve their medium-term target, which is crucial for long-term fiscal sustainability. Key elements of the strategy are: continued improvement in tax revenue mobilization through further tax policy and administration reform, including a reduction in exemptions, which should also allow some tax rate reductions to improve the incentive structure; reducing the wage bill to a more sustainable level, including through a policy of no new hiring on a net basis, harmonization of civil service statutes, and adoption of merit-based promotion systems; and reforming the food subsidy system to reduce its cost and improve its targeting. Additionally, budget transparency, monitoring, and prioritization will be further strengthened, including through performance-based budgeting, and the coverage of fiscal accounts will be expanded to include local government.

Prudent monetary policy has been successful in managing the high liquidity generated by the large tourism and workers' remittance inflows and in maintaining low inflation without unduly constraining private sector financing. Following enactment of the new central bank Charter in early-2006, which enhanced its independence, Bank Al-Maghrib (BAM) is implementing its strategic plan, including modernizing and upgrading its organization and human resources and strengthening the monetary policy framework, with assistance from the Fund and other central banks. The objective is to improve efficiency of monetary policy and to prepare for a possible move to formal inflation targeting. Transparency of monetary policy

has also been enhanced through publication of a communiqué following meetings of the BAM's Board meetings, as prescribed under the new Charter.

The authorities concur with staff assessment that the current exchange rate regime continues to serve the economy well and remains appropriate and that there is no sign of misalignment of the dirham. Nevertheless, they remain open to considering the possibility of moving to a more flexible exchange rate regime once all prerequisites are in place. These include, in particular, further progress in fiscal consolidation, improving the soundness of the financial sector and deepening of financial and exchange markets, and completion of the on-going strengthening of the monetary policy framework.

The soundness of the financial sector has been significantly improved in line with FSAP recommendations. The recently enacted banking law strengthens the supervisory and regulatory authority of BAM and extends its coverage. The write-off of a significant share of non-performing loans against accumulated provisions has helped reduce their burden on financial intermediation and improve banks' balance sheets. The restructuring program of the two public specialized banks is near completion and the two institutions have significantly improved their financial performance and are expected to comply fully with prudential requirements by June 2007, as originally planned. A draft law on money laundering has been submitted to parliament and is expected to be adopted soon. To help assess recent progress in strengthening the financial sector and draw a roadmap for future reforms, the authorities have requested the Fund and the Bank to conduct a new FSAP in mid-2007.

The authorities agree with staff on the importance of efficient financial intermediation for achieving their growth objectives. BAM has launched a number of initiatives, in close consultation with the banking sector, aimed at improving access to credit for small- and medium-sized enterprises (SMEs), including through greater transparency and information sharing and by encouraging development of rating systems. It is the authorities' firm intention to continue to monitor the situation closely, keeping in mind the need to secure conditions for efficient intermediation in a competitive and market-based environment while preserving the soundness of the financial system. A survey of bank conditions will be conducted on a regular basis. Recent declines in lending rates and fees to levels more in line with current liquidity conditions attest to improved competition and bode well for a sustainable decline in banking spreads. The Treasury is also reviewing existing guarantee schemes in favor of SMEs in order to improve their effectiveness. Recent successful IPOs launched by a number of private corporations in the domestic stock market attest to increased competition in financial services.

A higher growth trajectory is crucial for a significant and durable improvement in the standards of living and further reducing unemployment and poverty. Cognizant of the major contribution of past reforms to the recent positive performance, the authorities are firmly committed to stay the course and to accelerate the reform process where necessary. In this regard, they will continue to give highest priority to improving the business climate by reducing red tape and streamlining administrative procedures, enhancing the rule of law and protecting property rights, and improving governance. While progress in this area has been noteworthy, as recognized in the 2007 World Bank Doing Business Report, there is no room

for complacency and the task ahead remains challenging. Similar attention is given to upgrading and developing human resources and infrastructure, with significant private sector involvement. Major infrastructure projects underway such as Tanger-Med (an integrated port and economic development zone in the North) and tourism development zones, are expected to be completed by 2008 and should have significant economic and social positive externalities. To allow the Moroccan economy to reap the full benefits of the free-trade agreements with the EU and the US, new agreements have been concluded with regional partners so as to mobilize complementarities, while unilateral cuts in MFN (nonpreferential) tariffs should contribute to reducing the risk of trade diversion. The authorities consider that the Maghreb region provides important opportunities for enhanced trade and investment flows that could significantly improve the growth performance in member countries and they are grateful to the Managing Director for his involvement in and support to recent initiatives aimed at improving economic cooperation within the region.

The key sources of growth have been identified, and agreements between the authorities and business representatives have been concluded in tourism (Plan Azur) and industry (Plan Emergence), announcing medium-term investment and outcomes targets, identifying the needed reforms, and establishing appropriate mechanisms for limited government support, mainly in the areas of access to land and vocational training. This cooperative approach, which has been successful so far, should be extended to cover other sectors with high growth potential, including the IT. Liberalization of the air transport sector, including an Open Sky agreement with the EU, has significantly contributed to the recent surge in tourism.

Improving social conditions and further reducing poverty and social disparities are among the highest priorities. The target of 100,000 social housing units per year has been exceeded, contributing to a significant alleviation of the housing deficit and to a high level of activity in construction; also many of the MDGs are likely to be achieved ahead of schedule. The National Initiative for Human Development launched by H.M. King Mohammed VI has been instrumental in defining the poverty alleviation and social strategy and galvanizing moral and financial support for its implementation.

The authorities are confident that, with continued sound macroeconomic policy and structural reforms and maintenance of social consensus, together with further progress in political and social reform, the large potential of the Moroccan economy could be better mobilized to the benefit of its entire population. They are comforted by the recent improved economic performance and the growing signs of confidence within the business community and the public at large. They will strive to preserve and consolidate recent gains in order to achieve a higher and more sustainable growth path.