helped reduce fiscal and external vulnerabilities. Noting Morocco's high unemployment rate and the downside risks to the outlook, Directors advised sustaining reforms to continue rebuilding policy buffers and promote higher and more inclusive growth.

Directors supported efforts to strengthen the public finances and support both fiscal and external sustainability. They welcomed the reduction of energy subsidies in 2013 while increasing social protection to the most vulnerable, and encouraged the authorities to sustain such efforts. They advised that revenue and spending should be reoriented to better support growth and inclusiveness in 2014 and beyond, through reforms aimed at broadening the tax base, reviewing tax incentives and exemptions, reforming the VAT system, moderating the public wage bill, and reforming the pension system.

Directors welcomed the adoption by the Council of Ministers of the new Organic Budget Law as a step toward the establishment of a modern and improved fiscal framework. They called for strengthening the provisions of the draft law pertaining to fiscal discipline, coverage and expenditure control, in line with international best practice, and looked forward to the law's timely approval ahead of the preparation of the 2015 finance law.

Directors underscored that consolidation of Morocco's external position hinges on improving its external competitiveness. They stressed the critical importance of structural reforms in this area. They noted that a move toward a more flexible exchange rate regime, in coordination with other macroeconomic policies, would also help and would increase the economy's resilience to external shocks. In this regard, Directors welcomed the Fund's provision of technical assistance to the Bank Al-Maghrib (BAM) to help prepare for a smooth transition to more exchange rate flexibility. They recommended further reforms to strengthen the business climate, transparency, and the judiciary system and to improve the functioning of the labor market in order to attract private investment and promote strong job growth.

Directors supported BAM's efforts to strengthen banking supervision and regulatory arrangements, including gradual adherence to the Basel III norms, as well as closer monitoring of the banking sector's international expansion. They underscored the importance of financial deepening and increased access to credit for small and medium-sized enterprises for fostering sustained growth.

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Morocco: Selected Economic Indicators, 2012–17

	2012	2013 PLL1/	2013 Rev.2/	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.
		(Annual percentage change)					
Output and Prices							
Real GDP	2.7	5.1	4.5	3.9	4.9	5.2	5.4
Real primary GDP	-7.2	13.6	17.0	-1.0	4.5	4.5	5.0
Real non-primary GDP	4.6	3.7	2.4	4.8	5.0	5.3	5.5
Consumer prices (end of period)	2.6	2.3	0.4	2.5	2.5	2.5	2.5
Consumer prices (period average)	1.3	2.3	1.9	2.5	2.5	2.5	2.5
		(In percent of GDP)					
Investment and Saving							
Gross capital formation	35.3	34.3	34.7	35.3	35.3	35.4	35.5
Of which: Nongovernment	29.7	30.0	29.5	30.7	29.9	29.9	30.1
Gross national savings	25.6	27.1	27.2	28.8	29.7	30.6	31.3
Of which: Nongovernment	25.9	26.8	25.9	27.6	26.8	26.9	27.0
		(In percent of GDP)					
Public Finances							
Revenue	28.7	27.5	27.9	27.4	28.1	28.1	28.2
Expenditure	36.1	33.0	33.4	32.4	32.4	31.7	31.2
Budget balance	-7.3	-5.5	-5.4	-4.9	-4.3	-3.6	-3.0
Primary balance (excluding grants)	-5.0	-4.0	-3.6	-2.8	-2.7	-1.9	-1.4
Cyclically-adjusted primary balance (excl. grants)	-4.7	...	-3.4	-3.3	-2.6	-1.9	-1.4
Total government debt	60.2	61.8	61.7	62.5	62.4	61.5	60.1
		(Annual percentage change; unless otherwise indicated)					
Monetary Sector							
Credit to the private sector 3/	4.8	6.1	3.6	5.6	6.2	6.9	6.9
Base money	-0.5	11.5	9.8	4.6	5.5	6.5	6.0
Broad money	4.5	5.5	3.9	4.6	5.5	6.5	6.0
Velocity of broad money	0.8	0.8	0.9	0.9	0.9	0.9	0.9
Three-month treasury bill rate (period average, in percent)	3.2	...	...	...	...	...	...
		(In percent of GDP; unless otherwise indicated)					
External Sector							
Exports of goods (in U.S. dollars, percentage change)	-0.8	3.3	1.8	9.1	7.3	7.0	6.3
Imports of goods (in U.S. dollars, percentage change)	1.6	0.7	0.7	6.8	5.2	5.1	5.2
Merchandise trade balance	-20.9	-18.7	-19.0	-18.1	-17.1	-16.2	-15.6
Current account excluding official transfers	-10.0	-8.2	-8.0	-7.5	-6.7	-5.7	-5.2
Current account including official transfers	-9.7	-7.2	-7.4	-6.5	-5.7	-4.8	-4.2
Foreign direct investment	2.4	3.2	2.9	2.9	3.0	3.1	3.1
Total external debt	29.8	31.3	30.9	31.5	31.6	30.6	29.2
Gross reserves (in billions of U.S. dollars)	17.5	18.7	19.3	20.0	21.1	22.4	23.7
In months of next year imports of goods and services	4.2	4.3	4.3	4.3	4.3	4.3	4.3
In percent of short-term external debt (on remaining maturity basis)	1251.8	1332.0	1374.5	1427.1	1508.7	1601.2	1691.2
Memorandum Items:							
Nominal GDP (in billions of U.S. dollars)	96.1	104.8	105.5	115.1	125.1	136.0	146.7
Unemployment rate (in percent)	9.0	8.9	8.9	...	...	...	...
Population (millions)	32.5	32.9	32.9	33.2	33.5	33.8	34.2
Net imports of energy products (in billions of U.S. dollars)	-12.4	-11.6	-12.2	-13.0	-12.9	-12.9	-12.9
Local currency per U.S. dollar (period average)	8.6	...	8.4	...	...	...	...
Real effective exchange rate (annual average, percentage change)	-1.0	...	0.1	...	...	...	...

Sources: Moroccan authorities; and IMF staff estimates.

1/ Refers to the macro framework for the 2nd review in CR/13/302.

2/ Revised macro framework.

3/ Includes credit to public enterprises.

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Statement by Mohammed Daïri, Alternate Executive Director for Morocco
January 31, 2014

Recent economic developments

In a continued unfavorable external environment, including sluggish growth in Europe, Morocco's main trading partner, and high international fuel prices, the Moroccan authorities succeeded in fully reversing the deterioration in the external and fiscal positions of 2012, making additional inroads toward external and fiscal sustainability, reducing vulnerabilities, and strengthening the economy's resilience and investor confidence. In the process, they have demonstrated unwavering commitment to macroeconomic stability and pro-growth structural reforms, and a high level of program ownership, which remained strong even during the prolonged transition to a new government coalition in mid-2013. The authorities are confident that Morocco's well-grounded political and social stability, strong fundamentals, and good track record of policy implementation remain unblemished, and will continue to underpin the achievement of their goals of high and inclusive growth and strong job creation.

Growth in 2013 is estimated at 4.8 percent, reflecting mainly the impact of good weather conditions on agricultural production, with non-agricultural GDP slowing down significantly since the fourth quarter of 2012, as a delayed impact of the recession in Europe. Inflation remained low at less than 2 percent. The deterioration in the current account deficit in 2012 was more than fully reversed, with the deficit declining from 9.7 percent of GDP to 7.4 percent. The very good performance of high value-added exports of emerging sectors, and broadly stable imports, including energy, along with an increase in tourism and workers' remittances and higher grants, more than offset the decline in phosphates products and other nonagricultural exports. With a significant increase in FDI, the reserve position strengthened further to 4.3 months of imports. Continued commitment to fiscal discipline and to reducing vulnerabilities, and reduced uncertainties after the change in the government coalition have helped strengthen confidence, as evinced by continued favorable market conditions and strong FDI, and recent signs of an economic recovery. The authorities are projecting growth to remain robust at 4 percent in 2014, under the assumption of an average agricultural production and a rebound in nonagricultural growth following stronger confidence and firmer external demand.

Fiscal consolidation

The authorities' commitment to fiscal consolidation has been demonstrated by their success in meeting the 5.5 percent of GDP deficit target for 2013 (the most recent outcome is 5.4 percent), notwithstanding the significant slowdown in nonagricultural GDP (which is crucial for tax revenue) and the 0.3 percent shortfall in grants compared to program projections. This is a remarkable achievement that put the fiscal stance back on track for meeting the authorities' medium-term deficit target of 3 percent of GDP by 2017. This improvement owed much to the measures taken by the authorities in mid 2012 and in 2013

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to reduce the subsidy bill, as described in the following section, and to strong expenditure control, including on wages, goods and services, and investment spending. Despite slowing nonagricultural growth, the authorities took the bold decision in April 2013 to reduce the capital budget by 15 billion DH (25 percent of total new appropriations) to protect the deficit target, in view of the shortfall in tax revenue and larger-than-projected carry-over from 2012. However, despite the authorities' efforts to improve nontax revenue, and in view of continued shortfall in tax revenue and lower-than expected grants, they decided to moderate capital spending growth further to achieve the end-year deficit target by cancelling investment appropriations uncommitted by end-October. Nevertheless, total capital spending in 2013 was 1 percent of GDP higher than projected under the PLL-supported program, and declined only marginally compared to 2012, leading to improved budget composition.

The authorities are committed to reducing the fiscal deficit further to 4.9 percent of GDP in 2014. The 2014 budget includes measures aimed at broadening the tax base by gradually lifting tax exemption of large agriculture enterprises and bringing the informal sector into the tax net, reducing distortions in the VAT by addressing the issue of tax credits and gradually moving toward a two-rate VAT, and strengthening resources earmarked for social protection and cohesion. Continued control of current spending will allow for increased appropriations for priority social sectors, which account for 53 percent of the budget, and investment. Timely approval of the budget, despite the late formation of the new government, and the introduction of an adjuster to the capital budget to account for the size of carry-overs would smooth budget execution and reduce uncertainty for the private sector.

Reducing key fiscal vulnerabilities

Structural fiscal reforms, as described below, and the strengthening of budget monitoring and forecasting through greater internal coordination, and improved data availability in response to the 2012 fiscal outcome were instrumental in achieving the 2013 fiscal deficit target and significantly reducing vulnerabilities. The indicative character of wage appropriations and the unrestricted carry-over of capital budget appropriations were addressed by administrative order of the Head of Government for 2013. These measures were renewed for 2014.

The draft Organic Budget Law (OBL) was approved by the Council of Ministers on January 20, 2014, clearing the way for its submission to Parliament. Implementation of the new OBL is expected to be rolled over a 5-year period. The staff papers highlight the significant role that the new OBL will play in modernizing and strengthening the budget framework and reducing vulnerabilities, including those mentioned above. The papers also indicate areas where the draft could be improved to strengthen the framework further. The authorities are grateful to FAD staff for their comments and suggestions in this regard. They intend to take the opportunity of the discussion of the draft in parliament to draw on these comments and suggestions toward aligning the new OBL with best international practices, with due consideration to Morocco's constitutional and other constraints.

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The subsidy system is another key vulnerability that the authorities are successfully addressing. As no consensus could be reached on transforming the universal subsidies into a system of cash transfers, they developed a new strategy that appeared more politically and socially acceptable. It combines a reduction of vulnerabilities through partial indexation of some petroleum products; elimination of subsidies on the least socially sensitive ones and gradual reduction for others, with an appropriate safety net to protect the poor and; the extension of existing conditional social support programs focused on education and basic health. In this regard, the authorities wish to underscore that the reduction of subsidies to 4.7 percent of GDP in 2013, down from 6.6 percent in 2012, was not exclusively nor even primarily due to international price declines as indicated in the report, but most notably to the domestic price hikes in 2012-13, combined with the price indexation mechanism, including their impact in moderating consumption, and improved availability of hydroelectric and other non-fuel energy. The ongoing investments in solar and wind energy and the re-adaptation of thermal power plants to coal will help reduce oil dependency. The authorities' policies, including the measures taken this January and those already publicly announced for 2014, will bring the subsidy bill to the budgeted level of 3.7 percent of GDP this year. They remain confident that their medium-term objective of bringing untargeted subsidies down to 3 percent of GDP will be met.

Other structural fiscal reforms

With regard to tax reform, and as indicated above, the authorities have started implementation of the key recommendations of the national conference on taxation (Assises Fiscales) held last April, with the objective of simplifying the system, broadening the tax base, and enhancing equity and competitiveness. In this regard, the gradual introduction of agriculture in the tax net, starting this year, is a milestone, although its revenue implications are likely to be modest in the short term.

The parametric reforms of the main public pension system have been identified, as indicated in the Written Communication. Implementation is to start under the next budget to be followed by a more comprehensive reform of the system. Finally, the authorities' objective of bringing down the wage bill to 11 percent of GDP in the medium term is on track and should be helped by the planned reform of the civil service with World Bank assistance, which should also improve efficiency, governance, and the quality of service delivery.

Monetary and financial policies

The outstanding performance of Bank Al-Maghrib (BAM) in maintaining low inflation over the past three decades, and Morocco's resilience to recent global turbulence, attest to the appropriateness of the current monetary regime under the exchange rate peg. The small overvaluation of the dirham calculated by staff has been reduced further and should not guide policies in view of the high degree of uncertainty in such calculations. Moreover, there is no sign of loss of competitiveness. On the contrary, recent development in FDI-financed, high value-added exports provide evidence of improved competitiveness, as recognized by

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staff. The authorities are nevertheless considering moving to greater exchange rate flexibility along with the resulting adaptation of the monetary policy framework. They look forward to the upcoming TA mission to discuss options for an exchange rate policy that could better serve Morocco and the modalities for its implementation, along with the other policy requisites for such a move. Over the past several years, BAM has already significantly strengthened its analytical and forecasting capabilities and enhanced transparency of its decision making process, in preparation for an eventual move to a different monetary policy framework. In this regard, BAM is grateful to the Fund for its high quality technical assistance.

In 2013, BAM focused on filling the liquidity shortage created by the 2012 decline in foreign assets, and is extending refinancing facilities to banks to encourage credit to very small, small, and medium-sized enterprises. BAM considers that tighter credit conditions are not the main factor for lower credit growth. This slowdown is due mainly to subdued demand and a wait-and-see attitude resulting from uncertainties in Europe and the transition to a new government, even though banks were more vigilant in extending credit to some sectors faced with excess supply conditions, such as real estate.

The financial sector remains sound, with improved bank capitalization and profitability and reduced high loan exposures and connected lending. The moderate increase in NPLs reflects the slowing economic activity and is expected to be reversed soon. BAM is in the process of implementing Basel III requirements, as indicated in the staff papers. It is also closely monitoring the expansion of Moroccan banks in other countries in Africa in close cooperation with host supervisors.

Promoting high and more inclusive growth

Improving the business climate to achieve higher growth and employment is an overarching objective of the authorities. Their recent efforts in this area have translated into a gain of 27 places in Morocco's ranking under the Doing Business indicators between 2011 and 2014. The authorities are working actively toward further improving this rating, with some measures already included in the 2014 budget, as indicated above. A major reform of education has been prepared to help rationalize the system and upgrade human resources and skills, with implementation under way. The roadmap for a comprehensive reform of the justice system has been approved and its implementation has started. The introduction in 2014 of a limited unemployment benefit financed by businesses and employees, with an initial limited contribution of the budget, should help reach consensus on greater labor market flexibility. Several active labor market policies and training initiatives are being reinforced to help employability and reduce unemployment, in particular among the young, with much of the focus in this area on supporting SMEs. Several initiatives are also being launched to better integrate the informal sector into the modern economy. In this regard, the authorities were surprised by the indication in Figure 3 that the informal sector in 2008 in Morocco was the highest among selected 18 advanced and emerging market countries, reaching some 45 percent. A survey conducted by the independent Planning Commission estimated this share at 14.3 percent in 2007, down from 16.3 percent in 1999.

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