Economic Analysis

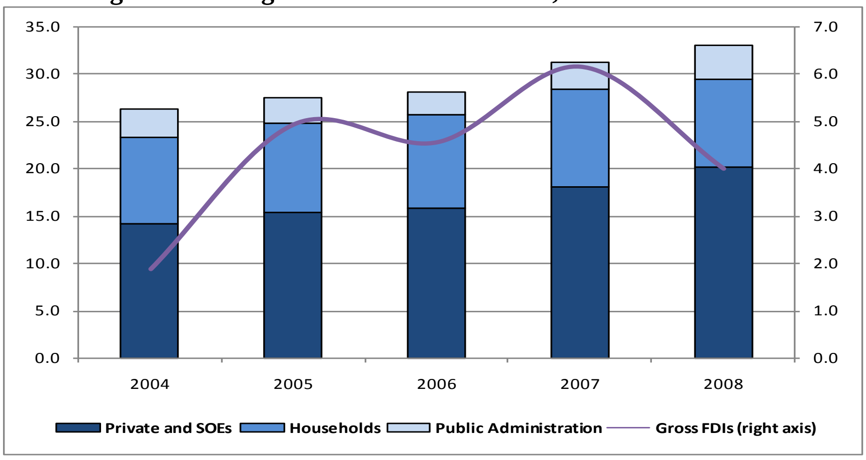
I. Progress over the last decade

1. **Since 2001, Morocco managed to shift the growth pattern to a higher level and posted continuous solid performance.** Economic growth averaged 5.1 percent over the period 2001-08, a little less than double of the average rate of the 1990s (2.8 percent). The good growth performance allowed income per capita to almost double over the last decade to reach US$2,850 in 2008.

2. **Sound macroeconomic policies and sustained structural reforms mostly explain the strengthening of growth.** Since 2005, Morocco maintained sound fiscal policies and continued to address fiscal risks, leading to the consolidation of public finances. As a result, the budget ran surpluses in 2007 and 2008 (averaging 0.3 percent of GDP). Furthermore, the government adopted a prudent debt strategy that allowed the central government debt to steadily decline to 47.3 percent of GDP in 2008 from 62 percent in 2005. In addition, the government pursued appropriate monetary policy geared toward maintaining low and stable inflation (an average 2.5 percent since 2005) and enhanced financial sector supervision. It also deepened its integration into the world economy through the signing of many FTAs. Overall, these efforts have led to a stable macroeconomic stance, stronger public finances, and a sound financial sector. On the basis of these achievements Morocco gained investment grade rating in 2007 from one rating agency, which further reinforced the confidence of investors, both domestic and foreign.

3. **Morocco designed and is implementing specific sector strategies to increase investment and productivity in sectors of the economy with high growth potential and with the participation of the private sector.** Investment in dynamic sectors has increased and is strengthening the fundamentals of the economy. While gross investment hovered around 25 percent of GDP on average in the 1990s, it has been increasing rapidly in the 2000s, to reach an outstanding rate of 36.3 percent of GDP in 2008. The private sector and SOEs contributed the most to the consolidation of investment (61 percent of the total), followed by households (28 percent) and Public administration (11 percent). Rising FDIs (annual increase of 8 percent over the last five years) also contributed to reinforce gross investment. Most of the FDIs have been channeled to five sectors: telecommunications (22 percent of the total), new industry sectors (20.9 percent), tourism (17.8 percent), real estate (16.5 percent), and banking (5.9 percent). Together, these sectors benefited from 83 percent of FDIs. Not surprisingly, most of these sectors posted high growth rates over 2001-08, of which telecommunications (up 12.4 percent), real estate and construction (up 7.6 percent), financial services (up 6.9 percent), and mechanical and electrical industries (up 6 percent). These higher investment rates geared to dynamic sectors led to improved diversification and growth potential of the Moroccan economy, and reduced volatility[1].

Figure 1. Rising Gross Fixed Investment, In Percent of GDP



Source: Moroccan Government and World Bank Staff calculation

[1] The standard deviation of GDP growth rates in the 2000s is three and half times less than in the 90s.

Figure2-7. Macroeconomic Achievements Over the Last Decade

Figure 2. Growth shifted to higher path and is less volatile and less dependent on agriculture (In percent)

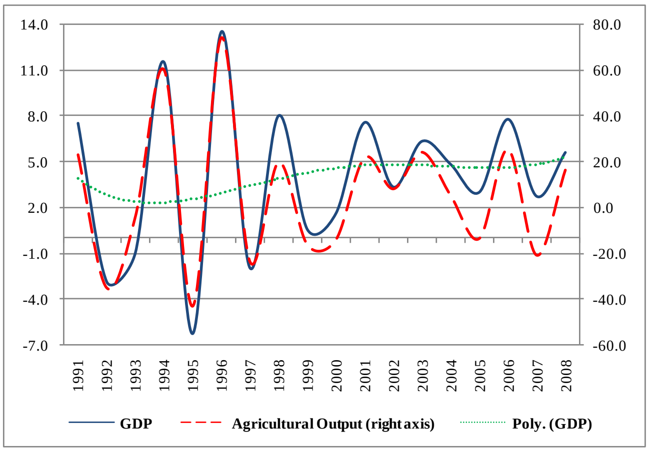


Figure 3. Unemployment declined. (In percent)

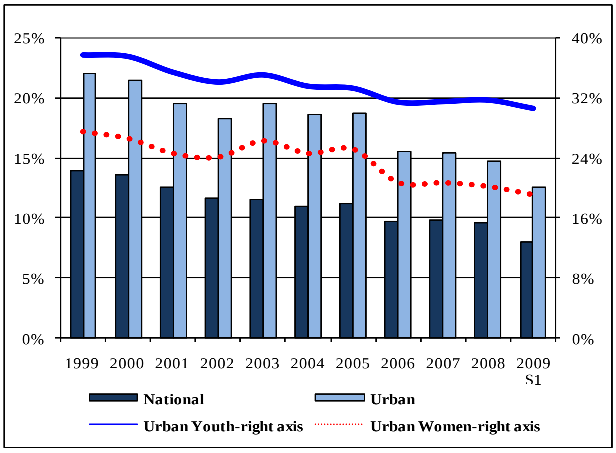


Figure 4. External position is solid with vulnerability in trade, (in percent of GDP)

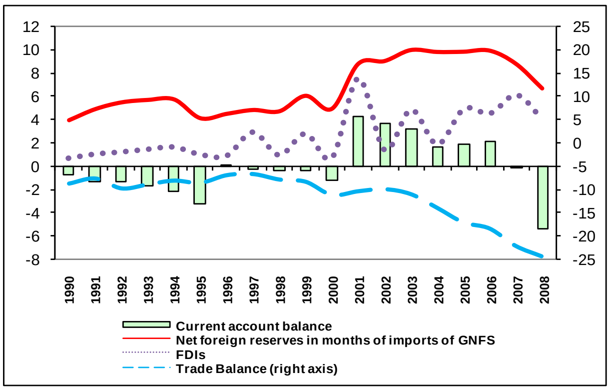


Figure 5. Public Finances have improved (In percent of GDP)

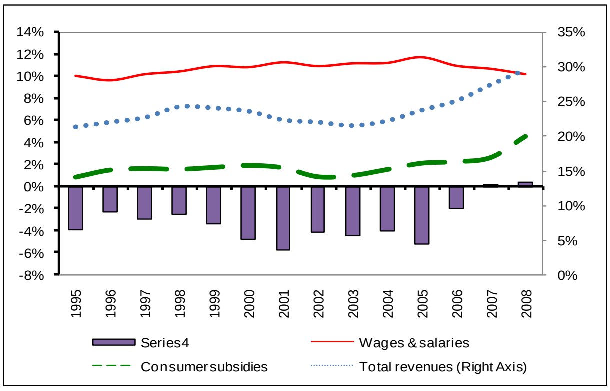


Figure 6. Inflation remains subdued (In percent)

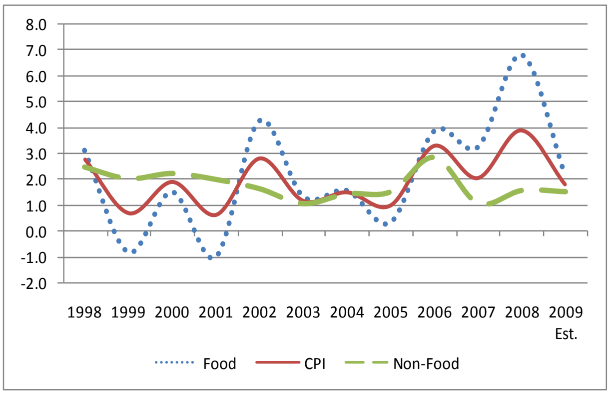
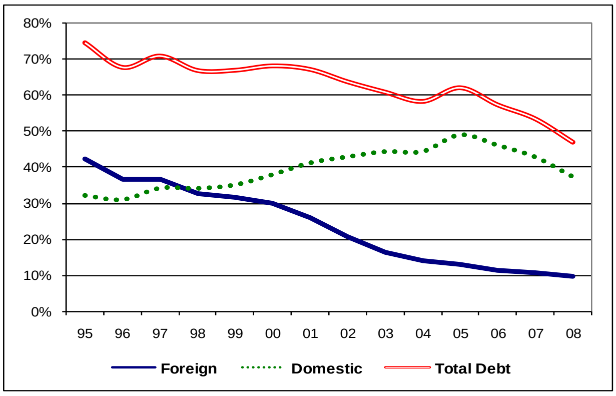


Figure 7. Central Government debt is declining and sustainable, (in percent of GDP)



Source: Moroccan Government and World Bank Staff estimates

4. **Morocco has increasingly integrated in the global economy, but there is ample room for improvement.** Indeed, while the share of trade relative to GDP has increased over the last decade, it remains low, accounting on average for only 76 percent of GDP over 2004-08 compared to 108 percent in Tunisia and 146 percent in Jordan. This is mostly explained by low export share (22.4 percent of GDP). In addition, the ongoing global crisis revealed vulnerabilities in the structure of exports leading to lost market shares and increasing trade deficits.

Table 1. Trade as a Proportion of GDP: International Comparisons

Country	**Average, 2004-08 (%)**
Egypt	65
Jordan	146
Lebanon	140
Morocco	**76**
Tunisia	108

Source: Staff calculations based on World Bank DDP Database

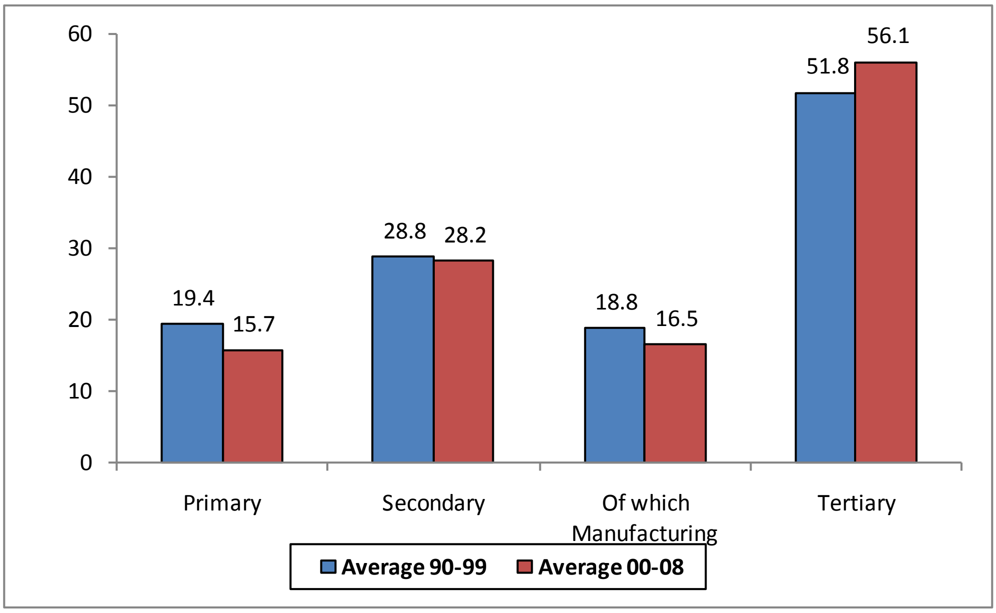
5. **The reforms of the 2000s, and the growth achieved, have increased employment.** Unemployment shrank to around 9.6 percent in 2008, down from a high 14 percent in late 90s although questions remain over the quality of the jobs currently available to large segments of the population. Indeed, since 2000, the overwhelming majority of the new jobs were filled by individuals without higher education. Most jobs (especially in the informal and agricultural sectors) are low in productivity, in skills, and in wages. And while unemployment is high among educated youth, there are signs of shortages of skilled labor in emerging sectors. Despite ongoing education reforms, the skill composition of the labor force does not seem to match the new demand arising from the economy's structural transformation.

6. **Reforms triggered positive changes in the Moroccan economic structure.** The most outstanding structural change has been the shrinking of the share of the primary[2] sector by 3.5 percentage points of GDP[3] to reach an average of 15.7 percent over 2001-08. This share is still high compared to leading transition economies, but the downward trend is encouraging. Consequently, GDP growth has become more resilient to the uncertainties of the agricultural sector. The weight of the services sector, averaging 56.1 percent of GDP, also benefited from reform efforts gaining 4.3 percentage points compared to the nineties, driven by the dynamic telecommunication sector and other services provided to businesses and households. On the negative side, manufacturing has been lagging behind, losing the pace to other non-agricultural sectors. As a result, its share in GDP declined to an average 16.5 percent since 2001, down from 18.8 percent in the 90s.

7. **The contraction of manufacturing denotes a weakness of the economy that reduces its productive capacity and hinders its long term growth and development.** This weakness stems from the slow structural transformation in the manufacturing sector, which explains the modest results of Moroccan exports. The latter continue to be concentrated around relatively less diversified, low knowledge, low value-added, traditional products. As a consequence, exports do not fully benefit from trade dynamics of Morocco's trade partners and thus have been unable to fulfill their potential for contributing to growth and job creation.

[2] Agriculture, Forest, and Fisheries.
[3] GDP at factor cost.

Figure 8. Changes in the Economic Structure
(Sectoral shares in percent of GDP)



Source: Moroccan Government and World Bank Staff calculation

II. The Challenge of Further Enhancing Growth

8. **The positive growth experience of the last decade is not sufficient and consensus is broad on the need for growth acceleration over the next decade.** Structural reforms have been initiated but more needs to be done for their benefits to be fully realized. Liberalizing transport, energy, and telecommunications, strengthening the financial sector, and selectively opening the trade regime have contributed to the dynamism of the nonagricultural sector, especially since 2004. The economy is more resilient to shocks, both internal and external. It has withstood fairly well the rising oil prices and the end of the multi-fiber agreement, which hit the Moroccan textile industry. However, more is required to unleash a process of quality jobs creation and further poverty reduction.

9. **Morocco's last two decades of growth have been mainly driven by internal demand and its limits are now apparent.** International experience with growth episodes shows that domestic-led growth alone is insufficient to sustain high growth rates. The contribution of net exports of goods and non-factor services has been increasingly negative as evidenced by deteriorating trade deficits. The main factor that explains this outcome is that most past policies have favored the production of non-traded goods and services with high import inputs. In this context, most of domestic and foreign investment concentrated on sectors of non-tradable goods and services geared towards domestic markets. This is the case for real estate, telecommunications, retail and whole sale services, transport, and financial services. In addition, the existence of supply-side rigidities, especially those of mismatched skills and rigid labor markets, and a constraining business environment, hamper investment in high value-added competitive sectors. Lastly, the trade regime features an anti-export bias that still favors rent-seeking protected activities in a fairly small domestic market.

10. **Low productivity continues to underlie Morocco's growth path and low wages (especially in the private sector).** Morocco invested no less than 6 percent of GDP in education for many years, and considerable resources went to physical capital accumulation associated with basic infrastructure but had limited total factor productivity improvements. According to international experience, reaching and sustaining annual GDP growth above 6 percent requires not only growing investment but also sizable productivity gains. Sustaining productivity growth requires increasing labor and capital mobility from low to high value added firms—and reallocating capital and labor from stagnant agricultural subsectors to higher productivity sectors, either in or outside agriculture.

11. **Low value added exports constrain further potential for growth.** Since the late 1970s the composition of the export package has had minor changes, and the value added (sophistication) of Moroccan exports has been rather stagnant. The trade structure has broadly evolved toward finished export goods (especially garments) for the European Union market and semi-finished products (fertilizers and phosphoric acid), and it has moved away from traditional agriculture and phosphate rock exports. Still, export performance has lagged behind Morocco's competitors. This underperformance is explained not by external factors, such as unfavorable terms of trade, the phase-out of the multi-fiber arrangement, or higher oil prices. It is attributable largely to domestic factors, especially gaps in competitiveness and diversification. A well established finding in the economic literature is the strong relationship between rapid growth and export diversification. Morocco cannot sustain faster growth by exporting the same goods in greater volumes or of better quality.

A. Policies for Faster Growth

12. **To ensure that the economy can further leap to a higher and sustainable growth path, Morocco will need to continue to pursue economic reforms that accelerate the economic transformation toward higher value added and more diversified products and rely more on trade in world markets as an additional source of growth.** The ongoing structural reforms in the trade and financial sectors and in energy, water, and roads transportation need to be further consolidated. In addition, targeted investments in vocational and higher education, more open competition in services and better integration into global production chains are necessary ingredients to foster higher growth.

13. **The development of an export-led strategy should begin by making stronger efforts to eliminate the current anti-export bias of the economy.** Protectionism raises the cost of goods that all Moroccans consume and reduces the range of products. It reduces investment and its productivity—directing capital away from competitive, export oriented industries toward obsolete sectors—and it reduces job creation. Continuing to deepen trade reform would help to rebalance the growth strategy away from the limited domestic market toward the unlimited international market. It would accelerate the economy's structural transformation, while improving Morocco's overall international ranking on several key business indicators making Morocco more attractive to FDIs. It is then necessary to continue to streamline the tariff regime, revise trade-restrictive nontariff measures, open domestically focused services to competition, reduce port and transportation costs, and improve coordination among border agencies.

14. **Further opening the financing sector with effective prudential supervision will improve competition and result in new instruments, better practices, and lower intermediation costs.** To date, financial sector reforms have been impressive in Morocco, but there is room for further improve the growing demand for long term finance as well as ensuring that SMEs and citizens at large have wider access to financial services. At the same time, in an increasingly complex financial environment, further strengthening of the supervisory infrastructure would bolster the development of the sector.

15. **Consolidation of the ongoing reforms in the water and energy sectors is necessary to secure vital inputs.** Increasing water scarcity call for a change in policy from one based on securing supply to one based on management, conservation, water productivity, and the regulation of services. The government has to limit overall water consumption to safe levels, taking into account major declines in water availability associated with climate change. This will particularly affect irrigated agriculture, which will need to adapt to lower water availability by changing technology and adopting new cropping patterns. The government has committed to long-term measures that address many of the problems, and these should continue or accelerate. Improvements depend on coordinated reforms in water, agriculture, and other sectors. For energy reform, measures to promote an efficient and low-cost electricity sector are essential to improving competitiveness and attracting investment. The government's energy strategy is correctly focusing on attracting private capital to the electricity sector, improving energy efficiency, accelerating the liberalization of petroleum distribution and electricity,

developing wind energy and infrastructure to diversify the fuel mix, and tightening petroleum and air quality standards.

Box 1. Private sector development and Employment

The need for a faster structural transformation of the private sector. From an average of 3 percent yearly during the nineties, non-agricultural output has been growing at around 5 percent on average over the recent years. The most dynamic sectors have been the services, real-estate and tourism, while industrial growth has lagged other emerging countries (3.6 percent a year, compared to an average of 6.2 percent among emerging economies). This pattern questions the sustainability of the recent growth acceleration: no emerging economy has been able to sustain high growth over long periods of time without a profound structural transformation of its economy made of increased manufacturing exports and a more diversified and more technologically sophisticated private sector. This transformation is not yet happening at a large scale in Morocco.

The need for a more competitive and dynamic private sector is all the more pressing that the Moroccan economy will need to increase its job creation rates significantly to absorb the new entrants in the labor market. Since the end of the nineties, the unemployment rate has been decreasing steadily. Job creation by the private sector has indeed accelerated. Nevertheless, a large part of the decline in unemployment is also due to low and declining participation rates (51 percent of the adult urban population in 2007-08, compared to 65.5 percent on average in 2007 for lower-middle income countries). The job creation challenge remains central in Morocco, and some 4 million new jobs will need to be created by the year 2020. To reach that objective, net job creation should double in the coming years, compared to the 2000-2007 average of 100,000 jobs per year. To reach levels comparable to other emerging economies—both in terms of labor growth and labor productivity growth—the growth rate of the Moroccan non-agricultural economy should converge to about 7 percent per year. This additional growth will need to come from a stronger, more dynamic and more diversified private sector.

16. **Agriculture remains a key sector for promoting growth and for narrowing the socioeconomic gap between the two Moroccos**. But little has been done to address the core problems: weak investment incentives, low quality products, and little diversification away from low value added products. The sector is associated with stagnant rural output, limited employment generation, and low incomes. As currently outlined by the *Plan Maroc Vert*, goals of reform would be to increase jobs and incomes in rural areas. This would come from a shift to higher value crops and related development of off-farm economic activity (agro-processing, tourism, services) and would need inter alia a better rural road network. Such a shift would contribute to social and political stability in the medium term as well as to export-led growth.

17. **The ongoing fiscal consolidation and the overall public sector management reform are crucial for broadening the fiscal space.** To increase availability of public resources for its priority public investments, the country is implementing a fiscal consolidation strategy with five main elements: reforming the tax regime, reducing the public wage bill, reducing energy subsidies, replacing food subsidies with targeted support to vulnerable groups, and introducing performance-based budgeting. The bias toward excessive direct taxation in Morocco’s tax regime remains a major constraint on growth and the business environment. The tax bias has been relatively attenuated by the recent cuts in top tax rates on corporate and personal incomes. At the same time, consolidation of the on-going modernization of the public administration will contribute to the overall reform agenda by strengthening its institutional underpinning. The nascent reform of the subsidy system, the main vulnerability of public finances, will also need to be advanced. The rising budgetary impact of higher world prices of food and fuels further emphasized the inefficiency and the unsustainable nature of the Moroccan universal subsidy system. The outlays of the cereals and fuels subsidy system almost doubled in 2008 compared to 2007. Relative to GDP, they represented 4.6 percent up from 2.7 percent the previous year. Subsidies would have been higher in the absence of the downturn of world prices concomitant to the unfolding of the global crisis.

III. Recent Economic Performance

18. **In light of the global economic crisis, growth performance in Morocco has been good.** Economic growth in 2008 reached 5.6 percent compared with 6.8 percent expected in the Budget Law 2008, but better than the low 2.7 percent of the previous year. This performance is mainly due to a good agricultural output, which gained 16.3 percent benefiting from favorable rain conditions compared to a drop of 20.8 percent of the previous drought-stricken year. This shows that agricultural variations due to weather conditions still affect GDP growth, albeit with less intensity than in the past. The non-agricultural sector remained robust, but less than projected as the negative impact of the global crisis started to infiltrate progressively the Moroccan real economy. Growth of non-agricultural output edged down to 4.2 percent over 2008 compared to 6.5 percent registered the previous year. This growth performance was mostly driven by activities of non-traded goods and services that largely depend on domestic demand.

19. **Data for 2009 show that the economy has suffered only moderately from the effects of the global economic slowdown that started in late 2008.** Growth edged down to 3.7 percent in the first quarter but has rebounded to 5.4 percent in the second quarter and further to 5.6 percent in the third quarter. This growth momentum is mainly due to a very good harvest, a firming of domestic demand, and, to a lesser extent, slight recovery of external demand for some manufacture products and tourism.

20. **The unemployment rate continued to decline over 2009. It fell to 9 percent over the first three quarters compared to 9.5 percent the previous year.** In urban areas, unemployment remains high (13.8 percent); it is even higher for youth (31.6 percent), female (20.1), and educated people (18.7 percent). In rural settings, however, unemployment is low (4 percent), given the high prevalence of non-paid family-aid jobs (accounting for 43 percent of rural jobs). A good harvest, dynamic services and construction sectors, and declining participation rates explain the drop of unemployment in an unfavorable external environment. Services and construction are benefiting from higher domestic demand fueled by recent wage increases, tax reductions, higher public investments, and rising credits. Together, agriculture, services and construction sectors created 132,600 net jobs. In contrast, hit by receding external demand, 30,600 jobs were lost in industry. The decline in participation rates (from 50.9 to 50.2 percent) also contributed to the improvement in employment. Participation rates remain low compared to similar countries, especially for women (26.3 percent) and, as stated earlier, the quality of jobs remains an issue.

21. **Public finances continue to be well managed globally despite the impact of the global crisis on the budget.** The steady reform efforts of expenditure and tax management (Box 3) and sound debt management over the last few years have been critical in maintaining public finances on a sustainable path. These reforms translated into better control of the government's consumption, enhanced tax collection, and declining public debt. In this context, Public Finances were in slight surplus in 2007 (02 percent of GDP) and in 2008 (0.4 percent of GDP), which is outstanding given the impact of record high subsidies. Estimates of the Budget law 2010 show that the budget deficit would be limited to around 2.7 percent of GDP in 2009 despite falling revenues impacted by the global crisis and the introduction of the stimulus package to respond to the crisis. This outcome is mainly explained by large savings on subsidies– which would plummet by 62 percent– and controlled government expenditures, of which the wage bill in spite of wage revalorization.

22. **The Government has implemented a stimulus package to help the most affected sectors and support the income of the population (Box 2).** The income support package includes an increase of 10 percent in the wages of civil servants at the lower end of the salary scale and the Minimum Wage for private sector employees. The wage revalorization was implemented in two steps, the first increase of 5 percent in July 2008 and the second one in July 2009. In addition, effective January 2009, the marginal income tax was cut from 42 percent to 40 percent, and was cut further to 38 percent January 2010 as envisaged in the Budget Law 2010. At the same time, the upper end of the exempt income bracket was extended. Direct support measures for affected firms included financial relief (guarantees on loans; rescheduling of debt; help with export insurance) as well as

subsidies for training and marketing. Economic stimulus was also provided through some monetary easing (details are in the subsequent paragraphs).

Box 2. Fiscal stimulus packages and outcomes

The Government has implemented several measures to help affected firms cope with the decline of external demand. Early in 2009, the government set up a high level Council for Strategic Monitoring (CSM), comprising concerned ministers as well as representatives of the business community and banking sector, to follow developments related to the ongoing global crisis. The CSM targeted the export sector for support through measures that:

- Provide guarantees for up to 65 percent for working capital loans;
- Finance up to 80 percent of costs of promotion campaigns and market surveys;
- Extend insurance risk coverage for exports;
- Facilitate rescheduling the repayment of long term debt;
- Ease regulations affecting imports covered by the temporary admission scheme;
- Provide training and logistics in partnership with business associations; and
- Ease regulations pertaining to the payment of social insurance by employers in eligible cases (applying to firms that have had a 20 percent loss but continue to retain employees).

Subsequently specific support programs have been designed for tourism and remittances and investment of Moroccan workers working abroad.

Data as of mid-December 2009 show that 59 percent of the demand for support concerned social insurance made by some 421 firms, of which 379 firms are operating in the textiles sector and 34 in automotive equipment. At the same time, 115 firms benefited from loan guarantees (of which 107 are textiles firms), and 134 firms benefited from training, of which 111 firms from the textiles sector and 20 from automotive equipment.

Measures to help low income households were included in the 2009 and 2010 Budget Laws. For the most part, they consisted of tax relief and wage increases for selected groups. Specific measures included the following:

- The marginal income tax was cut from 42 percent to 38 percent and tax rates hitting the other income brackets revised downward while the upper limit of the tax-exempt bracket was increased by 25 percent;
- Salaries of civil servants at the lower end of the pay scale were increased by 10 percent (5 percent in July 2008 and 5 percent in July 2009);
- For private sector employees, the minimum wage was raised by 10 percent (5 percent in July 2008 and 5 percent in July 2009);
- Minimum pension payments were increased by 20 percent and family allowances by 33 percent.

Economic stimulus was also provided through monetary easing. Reserve requirements for banks were cut in steps from 15 percent to 10 percent by July 2009 and then to 8 percent in October 2009. The Central Bank also cut its policy rate by 25 basis-points March 2009.

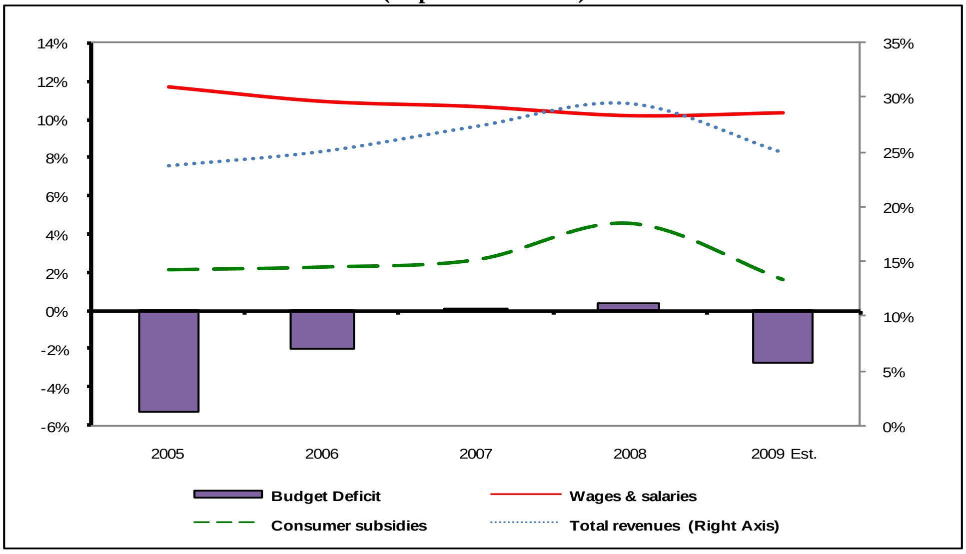
23. **Steady implementation of the Public Administration Reform (PAR) programs resulted in subdued recurrent expenditures, including a continued decline in the wage bill relative to GDP.** The main measure to control the wage bill consisted of the successful early retirement program (ERP) started in 2005 and subsequent measures to limit hiring to the actual needs, while targeting them mostly to the education and health sectors. Although the size of the central government reached its level of pre-reform, its skills mix, its geographic and sectoral coverage, and its age structure improved significantly, which should also improve its efficiency. Without the ERP, these achievements would not have been possible. The combined effect of these measures translated into declining wage bill, which, in 2008 edged down to 10.2 percent of GDP compared to 10.7 percent the previous year (and 11.7 percent in 2005). In 2009, it would virtually stay at the same level as in 2008 (10.3 percent of GDP), despite wage revalorization for low-income civil servants as part of the fiscal stimulus package to alleviate the effects of the global crisis.

Box 3. Fiscal reform is yielding promising results

The fiscal reform launched in 2005 has been increasingly gaining momentum over time. Its main objectives have been to (i) generate resources equitably while ensuring their sustainability, (ii) reduce the tax burden on the low and middle-income households, (iii) reduce distortions of the incentive regimes, and (iv) modernize and reinforce tax administration. The progress made so far on all these fronts is yielding promising outcomes. Indeed, tax rates of direct taxation have steadily been declining and the exonerated bracket of the income taxation has widened. The VAT has been streamlined through reducing the number of rates and abolishing the unproductive tax holidays. These achievements translated into wider tax base and lower tax burden on businesses and households, thanks to the sound accompanying measures taken by the government to mitigate the short-term effect of the fiscal reform on revenues. Two actions are worth mentioning: The first one relates to the efficient tax administration resulting from measures to enhance collection efforts and fight tax fraud. The main measures taken to this end include more and targeted tax controls and tax recovery effort through streamlined, procedures. Strengthening technical and administrative capacities of the staff also contributed to this outcome. The second action focused on expanding the tax base through enhanced communication with taxpayers, efficient control to fight tax evasion, and streamlined incentive system with the abolition of unproductive and distorting fiscal expenditure measures.

24. **The sound fiscal management contributed to further reduce the central government's debt.** Reflecting the good performance of public finances and sound active debt management, the debt stock of the central government declined to 47.3 percent of GDP in 2008, down by more than 6.2 percentage points relative to 2007. Most of the decline is explained by the important drop in domestic debt, which fell by 5.5 percentage points to reach 37.3 percent of GDP, while foreign debt was reduced by 0.7 percentage point to 10 percent of GDP.

Figure 9. Public Finances Remain Sustainable Despite the Impact of the Global Crisis
(In percent of GDP)

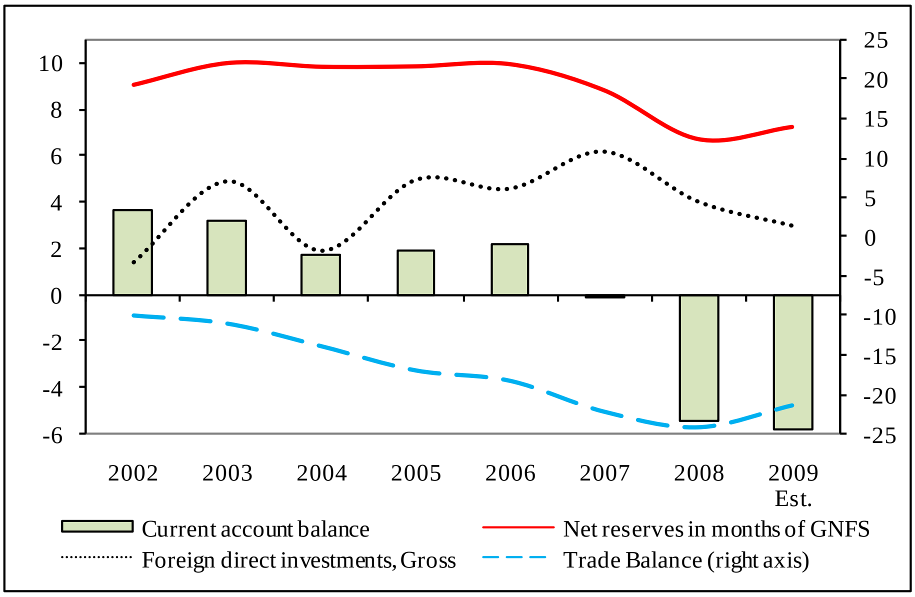


Source: Moroccan Government and World Bank Staff estimates

25. **The government and the central bank showed continued commitment to fight inflation**. Domestic inflation stood at 3.9 percent in 2008 as compared to 2 percent registered in 2007. The rapid acceleration of prices of food in 2008–which account for almost 45 percent of household consumption–explains most of the inflation that year, whereas non-food prices moved relatively slowly thanks to partial pass-through of the high imported fuels prices. In effect, food inflation reached an average of 6.8 percent over 2008, an unprecedented rate since 1995. However, helped by declining world prices through 2009 and ample domestic food supply, inflation subsequently declined to 1.2 percent over January-November 2009 (y-o-y).

26. **The external position remains solid despite the sudden deterioration of the current account due to the impact of the global crisis**. For the first time since the 1980s, the current account ran large deficits in 2008 (5.2 percent of GDP) and over the first three quarters of 2009 (5 percent of GDP). This follows comfortable surpluses over the period 2001-06 (average surplus of 2.8 percent of GDP) and a quasi-balance in 2007 (a deficit of 0.1 percent of GDP). The worsening of the current account is principally explained by the impact of the global crisis on workers' remittances and tourism receipts that before have been compensating the rising trade deficits. Consequently, net foreign reserves declined by US$ 2.64 billion (or down 9.8 percent) end 2008 to edge down to US$ 24.3 billion, representing 6.6 months of imports, down from 8.8 months in 2007. However, they slightly improved by end November 2009 gaining US$ 327 million since end 2008. Owing to declining imports, the net reserves improved to a comfortable level of 8.1 months of imports of goods and non-factor services.

Figure 10. The Recent Deterioration of the Current Account Mirrors the Deterioration of the Trade Deficit
In Percent of GDP



Source: Moroccan Government and World Bank Staff estimates

27. **The on-going global crisis revealed once again the weaknesses embodied in the Moroccan trade structure.** The trade deficit deteriorated to alarming levels of 24.3 percent of GDP in 2008, up from 22.3 percent of GDP in 2007 (and only 11 percent in 2000). It improved over the period January-September as imports declined more than exports in nominal terms; but it is still high (20.2 percent of GDP). The high trade deficit is mainly a volume effect rather than a price effect because Morocco actually benefited from positive terms of trade since while the price of oil and food imports increased so did the price of key Moroccan exports such as phosphate products and agri-food. The bad performance of exports reflects their low diversification and lack of competitiveness. This explains largely why Moroccan exports were not able to benefit fully from the many FTAs it signed over the last decade such as those with the EU, the USA, and Turkey.

28. **Monetary and exchange rate policies remained appropriate.** In 2008, the central bank (BAM) resorted to raising the cost of money (plus 25 basis points in September 2008) to contain soaring credit and inflation. Subsequently, it relaxed its policy to enhance liquidity in the face of the global crisis as liquidity tightened and inflationary pressures started to ease over the second half of 2008 through 2009. Thus, BAM relaxed gradually the money reserve rate reducing it from 15 to 12 percent January 2009, and then to 10 percent July 2009. Recently, BAM decided to cut it further to 8 percent in October 2009 to ease the pressure on liquidity. It has also cut its policy rate by 25 basis points in March 2009. Despite these relaxed policies, money supply slowed to 4.9 percent (y-o-y) by end November 2009, compared to 10.8 percent end December 2008. Credit to the private sector

continued to increase but at a slower pace, especially for equipments (up 25.9 percent, y-o-y), consumption (up 19.2 percent), and construction (up 11.7 percent). At the same time, the stock of non-performing loans slightly declined by 0.2 percent.

IV. Medium Term Prospects and Debt Sustainability

29. **Sound macroeconomic and fiscal policies, as well as efforts to improve sector productivity and competitiveness put Morocco in a better position to maneuver with less damage through the moderate effects of the global crisis, while being in a position to benefit from the recovery of the world economy (Table 2)**. The decision of the government to continue its reform efforts and revamp its sector strategies along the targeted sector fiscal stimulus should allow the Moroccan economy to expect good prospects over the medium term. Meanwhile, economic growth is expected to be around 5 percent in 2009 mostly owing to the outstanding agricultural output and a moderate contribution from the dynamic non-agricultural activities such as construction, finance services, telecommunication, and tourism.

30. **Growth prospects in the medium term are good**. It is assumed that the government will sustain the reform momentum of the last few years, achieve the ambitious public investment programs it devised, and continue to implement the main sector strategies it launched–thus consolidating further economic diversification, growth potential, and domestic demand– and that the world economy will slowly recover from the current crisis to allow the on-going export promotion strategies to achieve their targets and contribute to growth. Under these conditions, growth rates will improve from the low 3 percent projected for 2010[4] to around 5.2 percent in 2013. Should the underlying conditions of growth be slow to materialize, growth prospects would have to be adjusted downward. Moreover, there is a reasonable risk that even pre-crisis growth levels might not be sustainable over the medium term if internal demand remains the key driver of growth.

31. **Sound macroeconomic policies would help contain inflation at low levels**. Inflation should be around 2.5 percent in 2009, mainly determined by food inflation, and remain subdued at around 2 percent thereafter.

Table 2. Base-line Medium Term Macroeconomic Indicators

		Projections				
	2008	**2009**	**2010**	**2011**	**2012**	**2013**
Growth Rates in percent						
Real GDP	5.6	5.0	3.0	4.4	5.1	5.2
Real private consumption	9.4	8.0	2.6	3.6	4.0	3.7
Real Gross Domestic Investment	11.7	4.6	4.7	5.0	5.2	5.5
Export Volume (GNFS)	-1.1	-9.3	6.5	7.2	7.6	8.0
Import Volume (GNFS)	10.9	-4.4	5.5	5.1	5.6	5.5
GDP deflator	5.9	2.5	2.2	2.0	1.9	1.9
Ratios to GDP						
Gross Domestic Investment	36.3	33.6	34.2	34.4	34.4	34.5
Fiscal Balance	0.4	-2.7	-4.5	-2.9	-2.4	-2.2
Central Government Debt	47.3	46.2	47.6	46.8	45.4	43.9
Current Account balance	-5.2	-5.8	-5.3	-4.8	-4.1	-3.2
FDI	2.3	1.5	2.6	2.7	2.8	2.9
External Debt	23.4	24.7	25.7	25.4	24.6	23.4

Source: Moroccan Government and World Bank Staff estimates

32. **After a temporary higher deficit in 2010, the fiscal stance should remain sound over the medium term, with fiscal deficits under the targeted threshold of 3 percent of GDP, benefiting**

[4] The low growth in 2010 is mainly explained by normal agricultural output translating into a negative growth rate for agriculture after an outstanding growth in 2009.

from the ongoing fiscal reform and more targeted social programs, as well as a better-controlled wage bill. The budget deficit is expected to edge up to 4.5 percent of GDP in 2010 before gradually dropping to around 2.2 percent by 2013. Reaching this outcome implies maintaining momentum of the ongoing tax reform to broaden the tax base, improve the efficiency of the VAT, strengthen tax administration, and remove unproductive tax exemptions in order to reduce the high tax expenditures. These measures would offset the negative impact of the reduced top rates on corporate and personal income taxes. Under these assumptions, revenues are projected to stabilize at around 25 percent of GDP instead of an average 27 percent of GDP during the last years. On the expenditure side, the consolidation of public finances relies on four critical measures: deepening of fiscal reform, achievement of oil and food subsidies reform, continued tight control of the wage bill evolution, and an active debt management. Under these conditions, public debt will stabilize in 2010 at almost the same level as that of 2008 (47.6 percent of GDP) before following a downward trend to decline to less than 44 percent of GDP in 2013.

33. **The financing needs stemming from higher budget deficit in 2010 and declining deficits over the medium term are easily financed through domestic market as well as from increased drawings on external loans** (Table 3). In this context, external financing would improve its contribution, although domestic financing would remain the main source of funding. Indeed, since 2006, net external financing reversed its long negative trend to turn positive, reflecting the government's strategy to slightly change the debt composition in favor of external borrowing. This financing strategy would ease the pressure on domestic financial markets and prevent any crowding out of the private sector's investment now that the money market is less liquid than was the case over the last years. At the same time it is consistent with the objective to maintain a comfortable level of foreign reserves.

Table 3. Morocco: Financing Requirements of the Central Government
(In percent of GDP)

		Projections				
	2008	**2009**	**2010**	**2011**	**2012**	**2013**
Financing required	**9.4**	**10.3**	**12.0**	**10.4**	**9.9**	**9.4**
Budget deficit (+)	-0.4	2.7	4.5	2.9	2.4	2.2
Amortization	9.7	7.6	7.5	7.5	7.4	7.2
Domestic	8.3	6.8	6.7	6.7	6.5	6.3
External	1.4	0.8	0.9	0.8	0.9	0.9
Total Financing available	**9.4**	**10.3**	**12.0**	**10.4**	**9.9**	**9.4**
Domestic financing	6.1	8.0	9.1	8.2	7.8	7.6
External disbursement	2.0	2.1	2.0	1.3	1.2	1.0
Others (Privatization, capital grants, …)	1.3	0.2	0.9	0.9	0.8	0.8

Source: Moroccan Government and World Bank staff estimates

34. **The Government's debt strategy is to diversify financing sources and take on a greater proportion of external financing.** Three main factors underpin the decision of the government to reinforce its external sources of funding, especially multilateral and concessional. The first is linked to Morocco public debt maturity structure. The maturity of public debt has fallen in recent years and will fall further given that the central government mostly financed its needs through issuing T-bills of up to 1 year in the domestic market. The main reason behind this choice is to avoid affecting long-term floating rates for Banks' domestic lending to the private sector, especially housing credit, as they are indexed to primary market rates on long-term securities (10 and 15 year bonds). The second relates to the higher balance of payments needs although the level of foreign reserves remains relatively comfortable. The third is due to the current higher borrowing requirements of the Budget, in a context of tightening liquidity of the domestic financial markets after a long period of an over-liquid money market. Consequently, additional external lending is consistent with prudent debt management which fosters improved terms of debt, while maintaining a comfortable level of foreign reserves and at the same time avoids pressure on domestic financial markets.

35. **A comprehensive public debt sustainability analysis shows that the fiscal framework is robust to downside risk in the medium term** (Figures 11-12). Public debt under the two main shocks proved sustainable over the medium term[5]. Under alternative scenarios, six other shocks to the baseline scenario are simulated[6], and public debt sustainability is preserved in all of them. Under these shocks, public debt would slightly increase in 2010 and, for a few shocks, in 2011 as well, before steadily declining over the medium term.

Figure 11. Public Debt Remains Sustainable Under the Main Shocks Scenarios In Percent of GDP

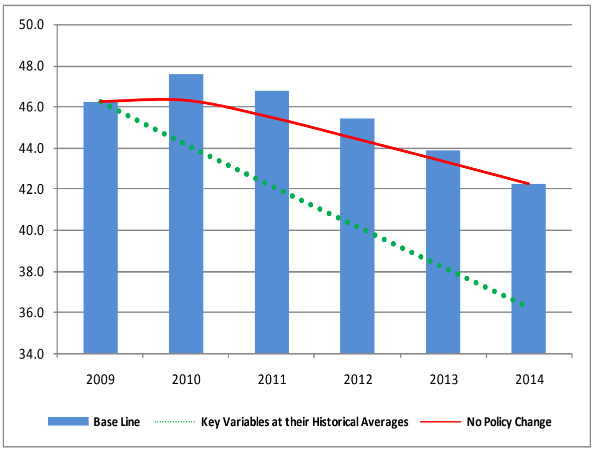
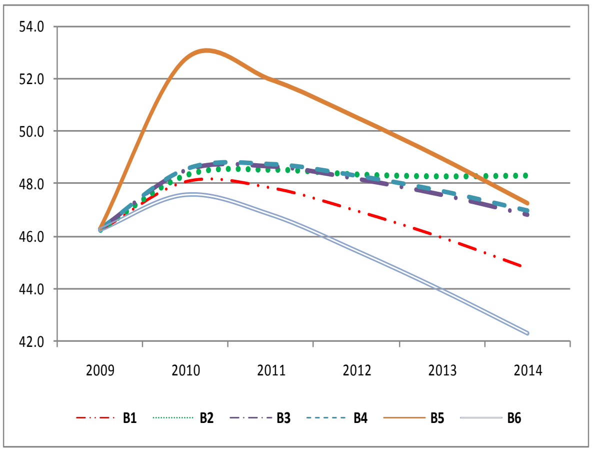


Figure 12. Public Debt Remains Sustainable Under Alternative Scenarios In Percent of GDP



Source: World Bank Staff estimates using IMF debt sustainability framework

36. **The external position is expected to remain sustainable over the medium term**. The current account is expected to slightly deteriorate in 2009 before following a slight downward trend over the medium term to edge down to 3.2 percent of GDP in 2013, as the impact of reforms and sector strategies take hold. Indeed, the balance of payments is expected to progressively improve, with lower trade and current account deficits, which would benefit from improved export potentials and a recovery of tourism activities and workers' remittances. This scenario assumes that Morocco would reap the fruits of its continued reform efforts, its sound macroeconomic and fiscal policies, and targeted sector strategies that entail higher public investments, which would translate into higher private investments, including FDIs, and progressive gains in competitiveness of its exports, including tourism. In this context, external debt is expected to follow an inverted U path edging up to 25.7 percent of GDP in 2010 from 24.7 percent of GDP in 2009 before steadily dropping to 23.4 percent of GDP by 2013 while gross foreign reserves will stay at an average of 6.2 months of imports.

37. **The declining financing requirements of the Balance of payments don't constitute a serious concern given the sound economic fundamentals, the country's low external debt stock, and the ample foreign reserves** (Table 4). As the current account deficits are projected to steadily improve in the medium term, there are no constraints on financing them through multilateral and bilateral credit lines along other private capital flows, including FDIs. The latter are expected to gradually improve, attracted by an improved business environment and the opportunities offered by important structural projects and the devised privatization program of the country.

[5] The two main shocks are A1. Key variables are at their historical averages; and A2. No policy change (constant primary balance).

[6] The alternative shocks are: B1. Real interest rate is at baseline plus one standard deviations; B2. Real GDP growth is at baseline minus one-half standard deviation; B3. Primary balance is at baseline minus one-half standard deviation; B4. Combination of B1-B3 using one-quarter standard deviation shocks; B5. One-off 30 percent real depreciation in 2010; B6. Increase in "other debt-creating flows" in 2010 of 10 percent of GDP. Standard deviations for B1 and B2-B6 are calculated over the last ten years, while for B2, "GDP shock", it is calculated over the last five years, as GDP is increasingly less volatile after the high fluctuations registered in the early 2000s. If the simulation were to be based on the average standard deviation of GDP calculated over the last ten years the "GDP shock" scenario would be non sustainable. .

Table 4. Morocco: External Financing Requirements
(in percent of GDP)

		Projections				
	2008	**2009**	**2010**	**2011**	**2012**	**2013**
Financing Requirements	**8.2**	**5.9**	**7.2**	**6.0**	**5.7**	**5.3**
Current account deficit (+)	5.2	5.8	5.3	4.8	4.1	3.2
Long term amortizations	3.9	2.0	2.0	1.9	2.0	1.9
Reserves Changes of Monetary Auth.	-0.9	-1.9	-0.2	-0.7	-0.4	0.1
Financing sources	**8.2**	**5.9**	**7.2**	**6.0**	**5.7**	**5.3**
Official capital grants	1.3	0.2	0.4	0.4	0.4	0.4
Private investment, (FDI+Portfollio) (net)	2.1	1.5	2.6	2.8	2.9	3.0
Long term disbursements	5.1	4.1	4.1	2.9	2.5	2.0
Other capital flows	-0.3	0.1	0.0	-0.1	-0.1	-0.1

Source: Moroccan government and **World Bank** staff estimates

V. Key Risks to the Outlook

38. **Morocco is confronted with uncertainties on the timing, speed and shape of the recovery process from the global crisis.** While there are encouraging signs of a possible end to the crisis, it is too early to predict how the global economy will emerge from the recession particularly in the EU, the key international partner for Morocco**.** Consequently it is yet unclear to what extent Morocco economy will continue to be confronted with the impact of the economic slowdown on its exports, remittances, ability to attract FDIs and sustainability of its public stimulus program. The associated economic risks can be partly mitigated through continued strong macroeconomic management and Morocco's track record suggests that it is well placed to face the uncertainties of the current situation.

39. **Morocco remains vulnerable to drought and adverse climate changes.** The dependency of Morocco agriculture on rain-fed yields, particularly for poor and vulnerable farmers, coupled with increased water scarcity and adverse evolution of climate changes in the medium and long run continue to pose social and economic concerns. These concerns are being mitigated through the new agricultural strategy (Plan Maroc vert) under implementation, which seeks to improve agricultural sector productivity and growth potential through favoring conditions for enhanced private investment with a focus on more adapted farming to the semi-arid weather conditions.

Table 5. Selected Macroeconomic Indicators

	2001	2002	2003	2004	2005	2006	2007	2008	2009 Est.
Real sector	(Annual percentage change)								
Real GDP	7.6	3.3	6.3	4.8	3.0	7.8	2.7	5.6	5.0
Real agriculture GDP	21.7	8.1	24.1	5.2	-13.5	25.3	-20.8	16.3	28.0
Real non-agriculture GDP	5.7	3.2	3.6	4.7	5.6	5.4	6.5	4.2	1.7
GDP sectoral composition	(In percent of GDP)								
Agriculture	14.8	14.9	16.1	15.2	13.3	15.7	12.6	13.4	18.1
Non-agriculture	85.2	85.1	83.9	84.8	86.7	84.3	87.4	86.6	81.9
Industry, Constr., Energy, & fishing	29.4	28.9	29.1	29.6	29.6	28.4	28.5	31.6	28.3
Services	55.9	56.1	54.8	55.2	57.1	56.0	59.0	55.0	53.6
Money and prices	(Annual percentage change)								
CPI inflation	0.6	2.8	1.2	1.5	1.0	3.3	2.0	3.9	2.5
Broad money	14.1	6.4	8.7	7.8	14.0	17.0	16.1	10.8	8.0
Investment & saving	(In percent of GDP)								
Total investment	26.1	25.9	27.4	29.1	28.8	29.4	32.5	36.3	33.6
Gross national savings	30.4	29.6	30.5	30.8	30.7	31.6	32.4	31.1	27.8
Central Government	-1.2	-0.1	-0.7	-0.3	-2.2	1.6	3.2	4.2	2.5
Private and other Public sectors	31.6	29.7	31.2	31.2	32.9	30.0	29.2	26.9	25.3
Government finance	(In percent of GDP)								
Revenue (excl. privatization receipts)	22.4	22.1	21.6	22.2	23.8	25.1	27.4	29.5	25.0
Tax	20.4	20.4	19.8	20.0	21.7	22.2	24.9	27.2	22.8
Non-Tax	2.0	1.6	1.8	2.2	2.1	2.9	2.5	2.3	2.2
Total expenditure (excl. Special Acc)	28.7	26.7	26.4	26.8	29.9	27.6	28.7	30.8	28.3
Current	23.5	22.2	22.3	22.6	26.0	23.5	24.1	25.3	22.5
of which wage bill	11.3	10.9	11.2	11.2	11.7	10.9	10.7	10.2	10.3
Capital	5.1	4.5	4.1	4.2	3.9	4.1	4.6	5.5	5.8
Overall balance (deficit(-))	-5.7	-4.1	-4.4	-4.0	-5.2	-2.0	0.2	0.4	-2.7
Incl. Privatization receipts	-3.0	-4.0	-3.1	-3.0	-3.9	-1.5	0.7	0.4	-2.7
Central Gov. debt stock	67.1	63.7	60.8	58.2	62.1	57.3	53.5	47.3	46.2
External sector (US$, million)	(In millions of U.S. dollars)								
Current account	1,606	1,477	1,592	964	1,130	1,412	-70	-4,637	-5,369
Exports of goods and services	11,166	12,199	14,236	16,619	18,809	21,700	27,268	33,430	27,425
Imports of goods and services	12,282	13,314	15,953	19,843	22,757	26,121	34,610	46,267	40,344
Net reserves of CB	8,587	10,277	13,983	16,477	16,242	20,573	24,416	22,408	20,806
Gross total reserves (months of imports)	9.2	9.4	10.4	10.2	10.3	10.4	9.2	6.9	7.4
Current account balance (% of GDP)	4.3	3.7	3.2	1.7	1.9	2.2	-0.1	-5.2	-5.8
Memorandum items:									
Nominal GDP (MAD billion)	426.4	445.4	477.0	505.0	527.7	577.3	616.3	688.8	741.3
Exchange rate, average, (MAD/US$)	11.30	11.02	9.57	8.87	8.87	8.80	8.19	7.75	8.02
GDP (in billion US$, Average rate)	37.7	40.4	49.8	56.9	59.5	65.6	75.2	88.9	92.4
Unemployment rate	12.5	11.6	11.6	11.0	11.2	9.7	9.8	9.6	9.0
Urban Unemployment rate	19.5	18.3	19.6	18.7	18.7	15.5	15.4	14.7	14.0

Source: Moroccan Government and World Bank Staff estimates