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EX POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2014 PRECAUTIONARY AND LIQUIDITY LINE ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MOROCCO

The following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- This **Ex-Post Evaluation of Exceptional Access Under the 2014 Precautionary and Liquidity Line Arrangement** with Morocco, prepared by the IMF staff. It is based on the information available at the time it was completed on July 11, 2017.
- A **Statement by the Executive Director** for Morocco.

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IMF Executive Board Concludes the Ex-Post Evaluation of the Second Precautionary and Liquidity Line Arrangement for Morocco

On August 1, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Ex Post Evaluation (EPE) of exceptional access under the 2014–16 Precautionary and Liquidity Line (PLL) arrangement. (The Executive Board also concluded the second review of Morocco's economic performance under a program supported by a two-year PLL arrangement—see Press Release No. 17/309).

The PLL facility, which was introduced in 2011, provides financing to meet actual or potential balance of payments needs of countries with sound policies, and is intended to serve as insurance or help resolve crises under wide-ranging situations. Fund policy calls for an EPE within one year of the end of an arrangement with exceptional access.

Executive Board Assessment

Regarding the ex post evaluation of the second (2014–16) PLL arrangement, Directors considered that it effectively supported the authorities' reform program, providing them with a backstop against potential exogenous shocks. Directors concurred that the authorities met their objective of reducing vulnerabilities, and that the arrangement supported reforms to strengthen macroeconomic stability by continuing to reduce fiscal and current account deficits. They noted, however, that growth turned out to be lower than expected and, while unemployment declined, much remained to be done to ensure higher and more inclusive growth. Directors agreed that the arrangement was consistent with the PLL qualification standards and the requirements under the exceptional access policy. With the benefit of hindsight, Directors also noted some useful lessons learned about program design and implementation, particularly the need to rely on more realistic economic growth projections and the conclusion that with strong ownership, parsimonious conditionality can be effective in delivering on program commitments.

INTERNATIONAL MONETARY FUND

MOROCCO

July 19, 2017

EX POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2014 PRECAUTIONARY AND LIQUIDITY LINE ARRANGEMENT

EXECUTIVE SUMMARY

The Executive Board approved a two-year Precautionary and Liquidity Line (PLL) arrangement with Morocco in July 2014. The arrangement followed the 2012–14 PLL arrangement, and sought to build on the progress made in the previous two years. The authorities kept their objective of strengthening macroeconomic stability and promoting stronger and more job-rich growth. They committed to use the backstop provided by the PLL-supported program to help continue reducing vulnerabilities in the fiscal and external sectors, notably by reducing the fiscal and current account deficits. Per the authorities' request, access was lower than under the previous PLL arrangement, equivalent to 550 percent of quota (about SDR 3.24billion).

The PLL arrangement with Morocco was successful in helping to reduce vulnerabilities. Fiscal balances improved, and the fiscal objective—a gradual reduction of the budget deficit to 3 percent of GDP by 2017—appropriately balanced the need to bring the debt-to-GDP ratio down closer to 60 percent in the medium term, while allowing for necessary investment and social spending. Subsidy reform, a notable success of the first PLL-supported program, also continued. Several reforms were implemented to address the public payroll, but the need for a comprehensive civil service reform and further pensions reform remained. The adoption of the Organic Budget Law (OBL) was a further notable achievement. External balances strengthened, helped by falling oil prices; reserves increased; and the economy saw a welcome compositional shift in exports towards higher-value-added products. This progress saw Morocco be assessed as performing strongly in the external position and market access area by the time of the successor August 2016 PLL arrangement.

Growth however turned out to be lower than envisaged. Although it is difficult to precisely account for the underperformance, an important contributory factor was over-optimism about the positive impact of structural measures as well as difficulties in forecasting volatile agricultural output. Unemployment declined between 2014 and 2016, but much remained to be done—particularly on youth unemployment—to ensure higher and more inclusive growth.

The macroeconomic strategy, program design and financing were in line with Fund policy, including the Exceptional Access Policy. The level of access was appropriate and well justified, exit from the 2014–16 PLL arrangement was properly signaled, and the phasing of access was in accordance with Fund policy. The parsimonious use of conditionality was appropriate.

Several lessons arise from this evaluation.

- The case of Morocco demonstrated that with strong ownership, parsimonious conditionality can be effective in delivering on program commitments.

- The need for more realism in growth projections, and for the projected increase in the potential growth rate to have been better motivated in staff reports by elaborating on the link between investment, productivity, and implementation of the reform agenda. More conservative growth assumptions would also have brought into sharper focus the need for further measures to support higher and more inclusive growth, and would have facilitated a more realistic discussion of the fiscal strategy.

- The somewhat counterintuitive phasing of access for Morocco under the PLL-supported program that saw access increasing in the second year of the program even as vulnerabilities were addressed. This reflected a delicate balance between balance of payments need and safeguards considerations.

- Going forward, to achieve higher and more inclusive growth, Morocco will require continued strong policies and accelerated fiscal and structural reforms.

Authorized for distribution by
The Middle East and Central Asia Department and the Strategy, Policy, and Review Department

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INTRODUCTION AND CONTEXT

1. **The Executive Board approved a two-year Precautionary and Liquidity Line (PLL) arrangement with Morocco in July 2014.**[1] Access under the PLL-supported program was equivalent to 550 percent of quota (about SDR 3.24 billion), with 500 percent of quota (about SDR 2.95 billion) available in the first year. The Moroccan authorities indicated that they planned to treat the PLL arrangement as precautionary, and did not intend to draw on it except in the event of unforeseen exogenous shocks, or a significant worsening of the world economy.

2. **The 2014 PLL arrangement was the successor to the 2012–14 PLL arrangement, which was approved in August 2012.** Sound macroeconomic policies strengthened Morocco's economic policy buffers in the run-up to the 2008 global financial crisis, allowing it to weather the crisis relatively well. The 2012 PLL arrangement was adopted, however, as the authorities faced a difficult international environment, challenged by a series of exogenous shocks—stemming from weak growth in Morocco's trading partners and from international oil prices. The 2012–14 PLL arrangement was aimed at supporting the authorities' economic strategy by providing insurance against external risks and by strengthening investor confidence. It targeted gradual fiscal consolidation to strengthen fiscal and external buffers and reduce macroeconomic vulnerabilities.

3. **The PLL arrangement approved in July 2014 sought to build on the progress made in the previous two years.** The authorities kept their objective of strengthening macroeconomic stability and promoting stronger and more job-rich growth. They committed to use the insurance provided by the PLL-supported program to help continue reducing vulnerabilities in the fiscal and external sectors, notably by reducing the fiscal and current account deficits, which would contribute to increasing reserves and strengthening resilience. The authorities requested a reduction in access relative to the first arrangement—moving from 700 percent of quota down to 550 percent—as potential financing requirements were expected to be smaller than under the first PLL arrangement, reflecting the strengthening of the economy's self-reliance achieved by the authorities' program and a moderation in external risks (Table 1). As the PLL arrangement came to an end in July 2016, the authorities requested a successor third arrangement, with a further reduction in access, which was approved by the Executive Board on July 22, 2017.

4. **An ex-post evaluation of exceptional access (EPE) under the 2012 PLL-supported program was discussed by the Executive Board in July 2015**.[2] In their discussion, Executive Directors considered that the 2012–14 PLL arrangement appropriately provided temporary insurance against exogenous shocks and signaled Morocco's sound economic fundamentals to meet potential balance-of-payments needs at a time of significant external risks. They agreed that the arrangement was consistent with the PLL qualification standards and requirements under the exceptional access

[1] See "Morocco: Request for an Arrangement Under the Precautionary and Liquidity Line and Cancellation of the Current Arrangement" (CR/14/241, 8/5/14).
[2] See "Morocco: Ex Post Evaluation of Exceptional Access Under the 2012 Precautionary and Liquidity Line Arrangement" (CR/15/231).

policy, while commending the authorities for not drawing on the arrangement in spite of external economic headwinds. Directors concurred that the authorities' policies helped reduce fiscal and external vulnerabilities, with subsidy reform as a major achievement. Directors noted that Morocco still faced a number of medium-term policy challenges at the end of the arrangement given external risks and remaining vulnerabilities. With the benefit of hindsight, Directors also noted some useful lessons learned with regard to program design and implementation (Box 1). The EPE also emphasized policies to spur potential growth and reduce the unemployment rate, including an additional focus on labor market reforms (including on removing impediments to job creation), in addition to freeing up fiscal space for public investment spending and other pro-growth reforms. The EPE recommended that pension reform should kick in high gear and subsidy reform be finalized, the latter together with further strengthening of the social safety net.

Table 1. Morocco: Precautionary Arrangements

Date of Approval	Duration	Access
August 3, 2012	24 Months	Total 700 percent of quota (SDR 4.1bn), of which: - Year 1: up to 400 percent of quota available - Year 2: additional 300 percent of quota
July 28, 2014	24 Months	Total 550 percent of quota (SDR 3.2bn), of which: - Year 1: up to 500 percent of quota available - Year 2: additional 50 percent of quota
July 22, 2016	24 Months	Total 280 Percent of quota (SDR 2.5bn), of which: - Year 1: up to 140 percent of quota available - Year 2: additional 140 percent of quota

5. This report builds on the detailed assessment made in the 2015 EPE. Where possible, it does not repeat that analysis, particularly where there were no significant developments since that evaluation. For example, the 2015 EPE provided a comprehensive account of the context for Morocco's first PLL-supported program, as well as the appropriateness of the PLL instrument for Morocco (the 2015 EPE noted that "*While a precautionary stand-by arrangement (SBA) would also have provided insurance and policy support, and was available to Morocco, such an arrangement would not have met the needs of Morocco in similar ways. In effect, a precautionary SBA would not have reflected the ex-ante sound fundamentals as strongly as the PLL arrangement*"), which remain accurate and is therefore not repeated here. In coming to a view on whether the justifications presented at the outset of the program were consistent with Fund policies, and in reviewing performance under the program, this evaluation focuses on policies and developments that changed since the last EPE and that were critical for program success. These are primarily fiscal, external, and growth issues. The coverage of monetary, financial sector, and data adequacy issues in the 2015 EPE remain broadly relevant and are not covered in detail here. The Moroccan authorities broadly share the conclusions of this report, and their detailed views are contained in Annex I.

Box 1. Key Conclusions and Possible Lessons from the EPE for the 2012–14 PLL Arrangement

The 2012–14 PLL arrangement was an appropriate instrument for Morocco's needs. The authorities' policies helped maintain macroeconomic stability and reduce fiscal and external vulnerabilities, and the decision not to draw on the PLL arrangement was commendable.

Notwithstanding the significant macroeconomic achievements, a number of policy challenges remained:

- The unemployment rate was not reduced as envisaged, the outturn for public debt was higher than envisaged, and public spending was not reallocated in favor of investment;
- In retrospect, identification of contingencies for current spending could have made for a more robust fiscal consolidation and helped preserve space for pro-growth spending;
- Faster progress on a number of structural reforms, including in particular the OBL and pension reform, would have been desirable;
- It will remain important to keep wage bill moderation and restraint on other, non-essential, current spending high on the policy agenda;
- Pension reform is becoming more urgent; achieving results quickly will require strong political commitment;
- On policies to spur potential growth and reduce the unemployment rate, additional focus on labor market reforms would be warranted, in addition to freeing up fiscal space for public investment spending and other pro-growth reforms.

Reform of the monetary policy framework and allowing flexibility in the exchange rate will likely become more pressing as the economy opens up further. It was however appropriate to focus first on reducing fiscal and external vulnerabilities while laying the foundations to adapt monetary and exchange rate policy to changing circumstances. The PLL arrangement request could have assessed whether there were potential vulnerabilities in a few additional areas. These included: whether the weaknesses in budget monitoring and expenditure controls uncovered with the end-2012 fiscal slippages might have possibly been flagged sooner; and the macroeconomic or supervisory implications of the rapid regional expansion of Moroccan banks in Africa in the preceding years.

DID THE PLL ARRANGEMENT MEET ITS OBJECTIVES?

6. **The PLL instrument is designed to provide financing to meet actual or potential balance of payments needs of countries with sound policies.** It is intended to serve as a backstop or help resolve crisis under a wide range of situations. In Morocco's case, it was used to support the objectives of the authorities' reform program—to strengthen macroeconomic stability by continuing to reduce vulnerabilities in the fiscal and external sectors through reducing fiscal and current account deficits—and to promote stronger and more job-rich growth, by providing them with a backstop against potential exogenous shocks.

7. **The PLL arrangement was successful in helping to reducing vulnerabilities but much remained to be done to ensure higher and more inclusive growth (Table 4 and Figure 10).** To monitor progress, quantitative indicative targets (Table 5) were reported throughout the

arrangement on net international reserves and the fiscal deficit. These targets were met, with one exception being the end-September 2014 fiscal indicative target. The PLL was not drawn upon. Against this backdrop of strong implementation relative to the indicative targets, four program design topics stand out as warranting a more detailed consideration: (i) was the fiscal strategy appropriate? (ii) did the Organic Budget Law (OBL) improve the budget framework? (iii) was growth and employment performance as strong as expected? and (iv) did the PLL arrangement help improve external competitiveness?

A. Was the Fiscal Strategy Appropriate?

8. The 2014 PLL arrangement envisaged a further reduction in fiscal vulnerabilities through medium-term consolidation while preserving growth. The authorities' objective was to achieve a fiscal deficit of 3 percent of GDP by 2017 that would help gradually reduce the public-debt-to-GDP ratio to 60 percent by 2019. Fiscal adjustment was to be achieved mainly through expenditure rationalization—notably the reduction in subsidies and the gradual moderation of the public payroll—while making space for higher pro-growth, pro-equity spending on investment in infrastructure and human capital. Several structural reforms accompanied these efforts. The tax reform strategy did not place a large weight on additional revenue mobilization, with Morocco already having one of the highest tax-to-GDP ratios in the region. In line with the recommendations of the April 2013 national tax conference, reforms to the tax system sought to gradually widen the tax base, contain tax expenditures, and improve its overall fairness and competitiveness. The civil service pension reform launched in June 2014 was to reach a first milestone in 2015 with the adoption of parametric changes aimed at improving and prolonging the viability of the Caisse Marocaine de Retraites (CMR). In parallel, the budgetary framework was to be strengthened through the adoption of a new OBL.

9. Fiscal balances improved during the second PLL arrangement. The end-2016 fiscal deficit envisaged at the end of the arrangement (July 2016) was 3.5 percent, down from 4.9 percent in 2014 and was in line with the program target. The cyclically-adjusted primary balance was also estimated to have improved by 1.6 percent of GDP by 2016, reflecting improvements in discretionary policy (Table 2). However, the actual end-2016 deficit was considerably higher due to tax revenue shortfalls, higher capital spending, and higher subsidies. While the end-September 2014 deficit indicative target was missed by 0.7 percent of GDP, mostly reflecting a frontloading of transfers to public entities, reimbursement of VAT credits, and higher spending on investment, the 2014 annual fiscal deficit objective of 4.9 percent of GDP was met. The authorities also took corrective action in 2015 in the face of unforeseen declines in grants and VAT revenues on imported goods by rationalizing expenditures and increasing non-tax receipts. All other indicative fiscal targets were comfortably met.

Table 2. Morocco: Deviation from Fiscal Targets

	2013		2014		2015		2016			2014-2016		
	Base 1/	Act 2/	Prog	Act 2/	Prog	Act 2/	Prog	Proj 3/	Act 2/	Target /5	Realized /5	Dif.
			(1)	(2)			(3)	(4)		(3)-(1)	(4)-(2)	
Revenue	**28.3**	27.8	**27.9**	28.1	**28.1**	26.7	**28.2**	26.9	26.2	0.2	-1.2	-1.4
o/w tax revenue	**22.9**	22.3	**22.7**	22.1	**23.1**	21.3	**23.3**	21.7	21.5	0.7	-0.4	-1.1
o/w grants	**0.7**	0.7	**1.3**	1.5	**1.1**	0.5	**1.0**	1.1	1.0	-0.4	-0.4	0.0
Expenditure	**33.8**	32.9	**32.9**	32.9	**32.4**	30.9	**31.6**	30.4	30.4	-1.2	-2.5	-1.3
o/w compensation of employees	**12.9**	12.6	**13.0**	12.7	**12.7**	12.1	**12.1**	12.3	11.9	-0.8	-0.4	0.4
o/w subsidies	**4.8**	4.6	**3.5**	3.5	**2.4**	1.4	**1.7**	1.2	1.4	-1.8	-2.4	-0.5
o/w investment	**6.8**	6.6	**6.2**	6.9	**7.3**	7.3	**7.8**	6.8	7.8	1.6	-0.1	-1.7
o/w goods and services	**2.3**	2.4	**2.7**	2.6	**2.7**	2.6	**2.6**	2.6	2.6	-0.1	0.0	0.1
Budget balance	**-5.5**	-5.1	**-4.9**	-4.9	**-4.3**	-4.2	**-3.5**	-3.5	-4.1	1.5	1.3	-0.2
Primary budget balance 4/	**-3.6**	-3.2	**-2.9**	-3.6	**-2.6**	-1.9	**-1.8**	-1.9	-2.4	1.1	1.7	0.6
Cyclically adjusted primary balance 4/	**-3.5**	-3.0	**-3.4**	-3.0	**-2.6**	-1.6	**-1.8**	-1.6	-2.2	1.6	1.4	-0.2
Total government debt	**63.9**	61.7	**65.5**	63.5	**65.7**	64.1	**65.0**	64.4	65.1	-0.5	1.0	1.5
Memo: Real GDP	**4.4**	4.5	**3.5**	2.6	**4.7**	4.5	**5.0**	1.8	1.1	1.5	-0.7	-2.2

Source: IMF staff
1/ Projections at the time of the 2014 PLL request.
2/ Actuals for year 2016 performance reported at the first review of the 2016 PLL arrangement (May 2017).
3/ Projections for year 2016 performance as of July 2016.
4/ Excluding grants.
5/ Results may not add up precisely due to rounding.

10. **Subsidy reform continued and represented a major achievement for the authorities' program**. Following the elimination of gasoline and fuel subsidies in February 2014 and diesel subsidies in January 2015, a full liberalization of liquid fuel products took place in December 2015 as planned. These actions, helped by falling international oil prices, resulted in a reduction in subsidy spending of 2.3 percentage points of GDP between 2014 and 2016. The liberalization of fuel prices not only contributed to fiscal consolidation, but also marked an important structural reform going forward by shielding the budget from international oil price volatility.

11. **Fiscal policy was directed towards ensuring job-rich growth.** In this regard, social protection for the most vulnerable groups was broadened. This was primarily achieved through the Social Cohesion Fund in the context of programs such as RAMED (health sector) and TAYSSIR (education sector). Investment spending over-performed from a programmed 6.2 percent of GDP in 2014 to 7.3 percent of GDP in 2015. For 2016, the projected end-program performance suggested an investment deceleration to 6.8 percent of GDP, or 1 percentage point of GDP less than envisaged by the program, but the end-2016 result met the initial spending target of 7.8 percent of GDP.

12. **Several reforms were also implemented to achieve the objective of bringing the public payroll below 11.5 percent of GDP in the medium term**. These included the introduction of contractual employment and increased personnel mobility across ministries. In turn, the wage bill declined from 12.7 percent of GDP at the end of 2014 to 11.9 percent of GDP two years later. However, a comprehensive reform of the civil service is still needed to generate savings on public wage spending while increasing the efficiency of public services. Although with a delay, progress was made on pensions reform, where the reform of the civil service pension system was adopted in June 2016, even against the background of elections, and implementation began in September 2016. A broader structural reform will be needed to ensure the sustainability of the overall pension

system, including through the merging of the existing funds into one public and one private fund, as envisioned at the beginning of the PLL arrangement.

Figure 1. Morocco: Comparison of 2014 and 2016 Public DSA Risk Assessment 1/

	2014					2016				
Debt Level	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Gross Financing Needs	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt Profile	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Sources: CR/14/241; and CR/16/265.
1/ DSA: Debt Sustainability Analysis.

13. Overall, the fiscal strategy appropriately balanced the need to bring down the debt-to-GDP ratio in the medium term with the need for investment, social protection, and inclusive growth. The PLL arrangement did not target a reduction in public debt over the period 2014–16. Instead, the focus was on putting the debt-to-GDP ratio on a downward path after its expected peak in 2015, gradually reducing it toward 60 percent of GDP by 2019. Total public sector debt increased broadly in line with objectives during the period of the arrangement, and risks to gross financing needs and the debt outlook improved (Figure 1). Implicit in the strategy was that the envisaged fiscal consolidation would have a limited impact on growth, because an assumed relatively low fiscal multiplier of current expenditures in Morocco.[4] Although it was explained in the 2015 Article IV report, this assumption could have been covered more prominently in the staff reports related to the PLL arrangement. The staff reports could have also discussed in more detail the composition of investment spending in infrastructure and human capital that accompanied the program.

14. A critical discussion of the tax performance under the PLL arrangement would have been beneficial. Although the reform package sought to be revenue neutral, the tax-to-GDP ratio declined during the PLL arrangement, reaching an estimated 21.7 percent of GDP by mid-July 2016 compared to a programmed 22.7 percent of GDP in 2014, resulting in less fiscal space for social and investment spending. In part, this development is explained by an acceleration of VAT refunds consistent with the objectives of the reform, but more analysis would have been needed to understand the full range of determining factors, whether related to tax administration or policy design.

[4] Staff analysis indicates that fiscal multipliers for Morocco are relatively small: the impact multiplier varies between 0.095 and 0.3, and the cumulative impact is estimated to be around 0.6. Overall, the analysis tends to suggest that well-designed fiscal consolidation (i.e., tilted to public consumption) would reduce public debt with limited contractionary effect on growth (See Box 2 in CR 16/35, 11/30/15).

B. Did the Organic Budget Law Improve the Budget Framework?

15. The adoption of the OBL in 2015 was a positive step in strengthening the budget framework. The OBL brought substantial improvements through several new features, such as the introduction of multi-year and program budgeting, a fiscal "golden rule" (limiting new borrowing to the financing of investment spending and debt amortization), performance management, and strengthened transparency. The OBL also introduced provisions that make binding the ceilings on the wage bill and limit the carry-over of investment appropriations from one budget to another, therefore addressing the weaknesses that caused the end-2012 fiscal slippages.

16. Most of the OBL provisions entered into force in January 2016. This includes those provisions related to fiscal performance management and transparency, and parliamentary oversight and approval. The remaining provisions, including for multi-year budget and programming, making ceilings on wage expenditure appropriations binding, and limiting the carryover of investment appropriations, are to be gradually introduced by 2020. Therefore, the regulatory measures taken since 2013 to limit risks related to the carryover of investment appropriations and the wage bill are being rolled over until the relevant provisions in the new OBL take effect.

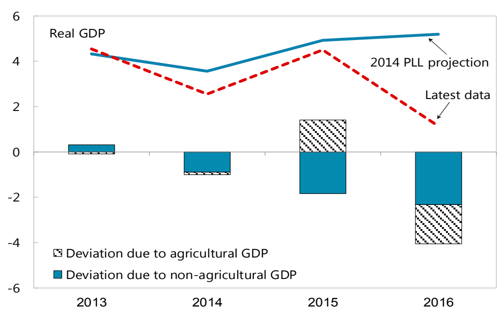
17. To further reduce fiscal risks, some OBL provisions could have been more aligned with international best practice. Potential vulnerabilities remain with respect to possible fiscal slippages on investment spending which could have been reduced, for example, by imposing a lower limit on the roll-over of credit appropriations (the law allows for a 30 percent limit compared to 3–5 percent internationally). A rule with a more comprehensive fiscal target could also be more effective in helping achieve broad fiscal objectives than a golden rule which focuses on limiting borrowing for investment purposes. The authorities have, however, taken steps to address potential SOE-related fiscal risks outside of the OBL framework. In this context, enactment of the draft law to reinforce the governance and oversight of SOEs will be an important step forward.

C. Was Growth and Employment Performance as Strong as Expected?

18. The authorities put forward a significant program of measures to help promote job-rich growth. To improve the business environment, emphasis was placed on streamlining administrative procedures for enterprises, improving investor protection by amending the law on limited-liability companies, strengthening public-private partnerships, and implementing measures to ensure the smooth application of the new procurement code. The authorities also unveiled a new national industrial acceleration program, which sought to foster the further development of new industries. Economic governance was to be improved by the entry into effect of a Competition Council, as well as reforms of the judicial system to boost independence and effectiveness and to improve transparency. The government revamped its active labor market policies and initiated a discussion with social partners on how to make the labor code more supportive of job creation while promoting adequate work conditions.

19. Growth however turned out to be lower than envisaged. Real GDP growth averaged 2.7 percent during 2014–16, about 2 percentage points lower than the projected 4.6 percent at the start of the arrangement (Figure 2). Although it is difficult to precisely account for the underperformance, an important contributory factor was over-optimism about the positive impact of past structural measures on growth, and the potential increase in output from the new industries. Difficulties in projecting volatile agricultural output also likely contributed. Although their effects are uncertain, and may operate with lags, the analysis below suggests that fiscal and external developments are unlikely to have contributed as significantly. While the external economic and trade environment remained subdued, particularly in the Euro Area, it was not weaker-than-expected as projected growth of about 1.6 percent turned out higher—at an average 1.9 percent during the period.[5] Oil price developments were also favorable, with assumptions of US$103 per barrel during 2014–16, against actual oil prices averaging US$65 per barrel (Table 3). Fiscal policy was also unlikely to have played a significant role in growth underperformance, given the gradual consolidation path and relatively low fiscal multipliers.

Figure 2. Morocco: Real GDP Growth, 2013–16
(Annual percent change, realized vs. 2014 PLL request projections)



Sources: Authorities' data and IMF staff calculations.

Table 3. Morocco: Selected External Factors
(Program figures and outturn)

	2014	2015	2016
Oil prices (Brent, $/bbl)			
At PLL prog. request	108.0	103.0	98.2
Actual 1/	98.9	52.4	44.0
Deviation from program	-9.1	-50.6	-54.1
Growth Euro area partners (annual percent change)			
At PLL prog. request	1.32	1.61	1.72
Actual 1/	1.38	2.27	2.05
Deviation from program	0.05	0.66	0.33

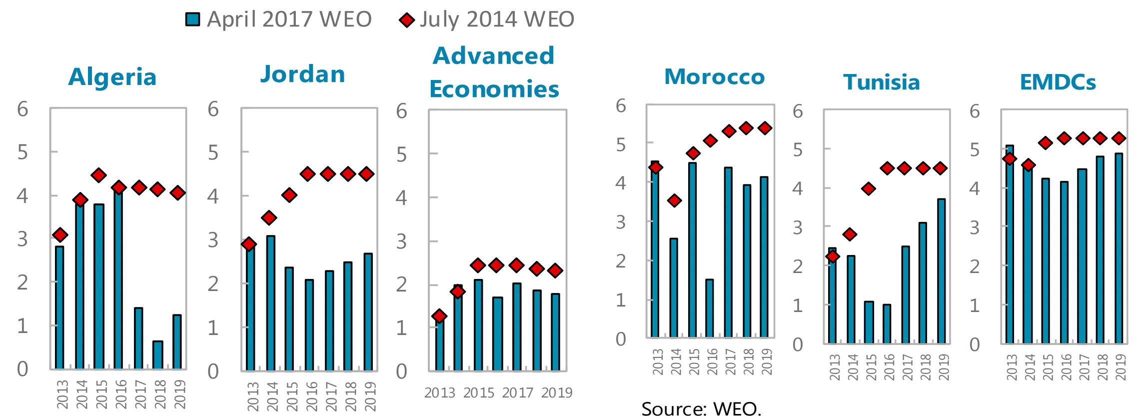
Source: WEO.
1/ As of the April 2017 World Economic Outlook.

20. Over-optimism in growth forecasts was not unique to Morocco. While oil price developments and regional circumstances have likely had different impacts across countries, over-optimism in growth forecasts has been prevalent in many years in other regional oil importers and a wider group of advanced, emerging, and developing countries (Figure 3). In Morocco's case, there could have been more discussion about factors that would contribute to the increase in potential growth. The envisaged increase could have been better motivated by elaborating on the supply side drivers of growth, and the assumed link between investment, total factor productivity and the reform agenda. This would have allowed a clearer sense of how the impact of previously implemented structural reforms—and the pace of implementation of new reforms—would affect growth prospects and debt dynamics. More conservative growth projections would have also facilitated a more realistic discussion of the fiscal strategy, including whether further fiscal stimulus would have been appropriate. However, if the public sector debt sustainability analysis (DSA) in 2014

[5] Staff analysis suggests that a downturn of about 1 percent in Europe would decrease Morocco's potential output by about 0.3 percent within the year, and by about 0.65 percent three years out. See Box 1 in "Morocco: Selected Issues" (CR/13/110, 05/08/13).

had used actual GDP growth during 2014–16 (2.7 percent) and 3.5 percent for the subsequent three years, then the projected public debt-to-GDP ratio by 2019 would have been about 7 percentage points higher than that projected at the time of the request for the PLL arrangement.

Figure 3. Selected Countries: Real GDP Growth: Projections vs. Actuals



Source: WEO.

21. Unemployment declined between 2014 and 2016, but much remained to be done to ensure higher and more inclusive growth. The authorities' objective of promoting more job-rich growth was partially met as unemployment decreased, but labor force participation remained low, especially among women. Broader indicators of poverty and living standards improved in recent years, reflecting sustained economic growth and policy action, including increased public spending on health, better access to sanitation, and greater reach of financial services. Nevertheless, poverty persisted, particularly in rural areas, and youth unemployment remained high. The 2016 Article IV Consultation[6] emphasized that high youth unemployment, inadequate education outcomes, and gender gaps are the barriers to higher and more inclusive growth.

22. The business environment also improved but much remained to be done to increase competitiveness and business opportunities. While Morocco improved its relative position in the World Bank's "Doing Business[7]" rankings, key reforms were however still needed, including making the Competition Council operational and fighting corruption through a concerted implementation of the recently adopted national strategy.

D. Did the PLL Arrangement Help Improve External Competitiveness?

23. The second PLL arrangement aimed at continuing structural reform efforts to improve competitiveness. Specifically, and as described above, the authorities highlighted that potential growth would be lifted by enhancing competitiveness, the business climate, and governance,

[6] See "Morocco: 2016 Article IV Consultation" (CR/17/36, 2/3/2017).

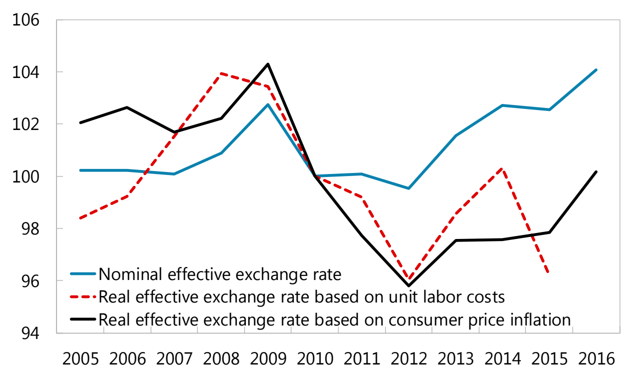
[7] See http://www.doingbusiness.org/.

including through improved export performance and FDI inflows. A move to a more flexible exchange rate was not envisaged to occur within the program timeframe, and IMF staff assessed that a 10 percent increase in the minimum wage, spread over two years, was unlikely to impact competitiveness.

24. Price competitiveness improved modestly during the arrangement. Gains in competitiveness were reflected in a depreciation of the ULC-based real effective exchange rate (REER) in 2015, suggesting that the minimum wage increase had not had a material impact (Figure 4). While a steady nominal effective appreciation countered gains in price competitiveness during the arrangement, by late-2015 the real exchange rate was assessed as broadly in line with fundamentals,[8] erasing the moderate overvaluation at the start of the arrangement.

Figure 4. Morocco: Effective Exchange Rates

(Index, 2010 = 100)



Sources: IMF's Information Notice System, Morocco Ministry of Trade and Industry, UNIDO, World Economic Outlook, and IMF staff calculations.

25. However, while the external balance strengthened as a share of GDP, this largely related to declining import prices, driven by lower oil prices. The economy saw a compositional shift in the goods export basket toward higher-value-added manufacturing exports such as automobiles (Figure 5).[9] This was in line with the program strategy of broadening the range of industries. In addition, Morocco's world export share increased gradually (Figure 6). However, while export volume growth remained robust, export prices did not pick up, and overall exports of goods and services remained broadly unchanged as a share of GDP. Hence, the 3.8 percentage point of GDP improvement in the current account over two years from the second quarter of 2014 was largely related to a declining value of imports, owing to the significant drop in oil prices, prompting a decline in the 12-month sum of energy imports during June 2014 to June 2016 that exceeded the decline in total imports (Figure 5 and Table 3).

.

[8] See "Morocco: 2015 Article IV Consultation" (CR/16/35, 2/8/2016).

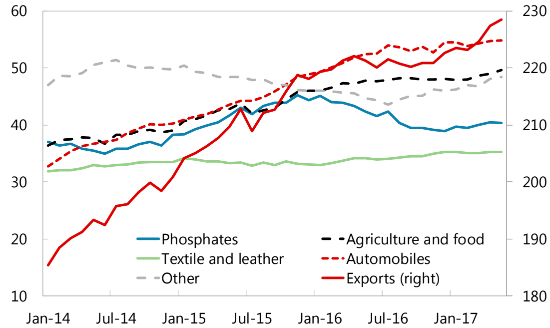
[9] See "Morocco: Selected Issues" (CR/17/65, 3/1/2017).

Figure 5. Morocco: Assessing the External Balance

Exports shifted toward higher-valued-added products.

Exports

(12-month rolling sum; billions of Dirhams)

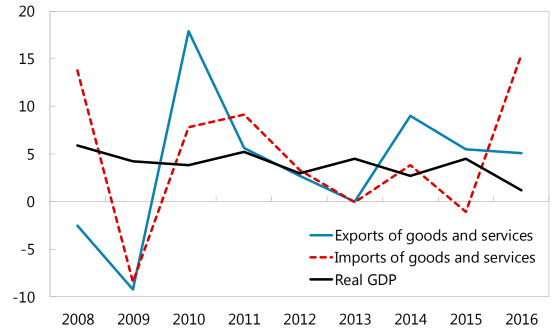


Sources: Office des Change and IMF staff calculations.

But while export volume growth remained solid,...

Growth Rates of GDP, Export, and Import Volumes

(Percent)

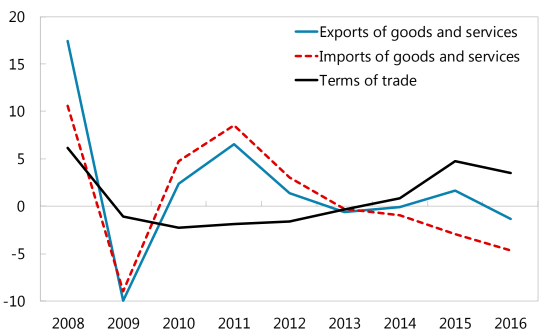


Sources: Haut Commissariat Au Plan.

...export prices provided little support.

Growth Rates of Deflators

(Percent)

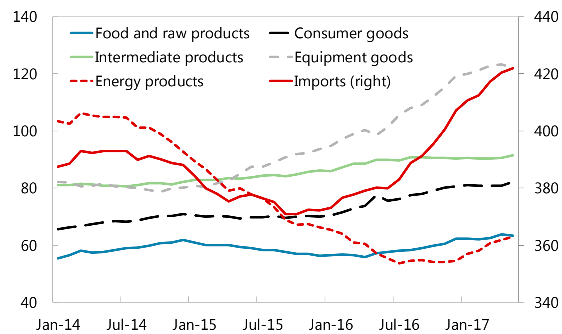


Sources: Haut Commissariat Au Plan.

Lower energy imports reduced overall imports.

Imports

(12-month rolling sum; billions of Dirhams)

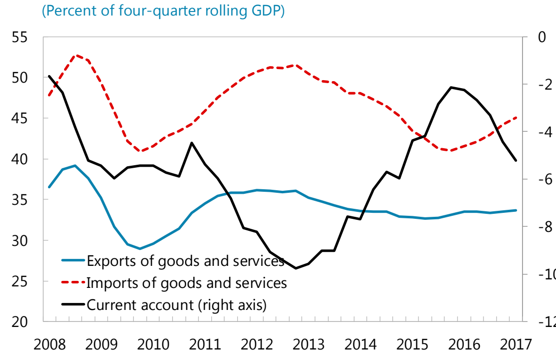


Sources: Office des Change and IMF staff calculations.

In turn, the current account improved as imports declined.

Current Account and Trade

(Percent of four-quarter rolling GDP)

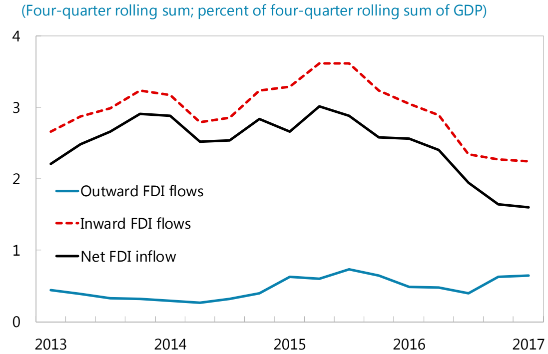


Sources: Haver Analytics and IMF staff calculations.

And FDI inflows did not permanently strengthen.

Foreign Direct Investment Flows

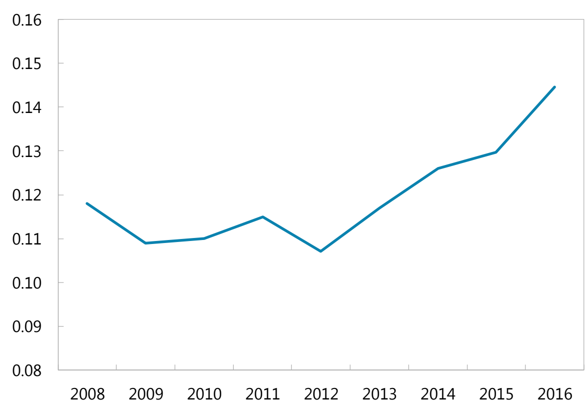
(Four-quarter rolling sum; percent of four-quarter rolling sum of GDP)



Sources: Haver Analytics and IMF staff calculations.

Furthermore, while FDI inflows strengthened during 2014 and into 2015, supporting exports, by the end of the program, the four-quarter sum of inward FDI had declined about ¾ percentage point of GDP from its peak in 2015. That said, improvements in competitiveness may take time to materialize and would also likely arise as reform efforts continue.

Figure 6. Morocco: Share of World Exports
(Percent)



Sources: Haver Analytics and IMF Direction of Trade.

CONSISTENCY WITH FUND RULES AND PRACTICES

26. This evaluation finds that the macroeconomic strategy, program design, and financing were in line with Fund policy, including the Exceptional Access Policy. This section discusses the assessment of Morocco's PLL qualification, external risks and access—including the implementation of the exceptional access criteria—the authorities exit strategy, and the use of conditionality.

A. Qualification

27. Staff assessed that Morocco met the PLL qualification standards at the time of the request and at each of the three reviews. A PLL arrangement can be approved[11] if the Fund assesses that the member (i) has sound economic fundamentals and institutional policy frameworks; (ii) is implementing—and has a track record of implementing—sound policies, and (iii) remains committed to maintaining such policies in the future. In addition, a member's qualification for a PLL arrangement is assessed in the following five areas, requiring strong performance in most areas and no substantial underperformance in any of the areas: (i) the external position and market access; (ii) fiscal policy; (iii) monetary policy; (iv) financial sector soundness and supervision; and (v) data adequacy. In turn, the qualification under the five areas is assessed by taking into account a set of

[11] "Selected Decisions and Selected Documents of the IMF, Thirty-Eighth Issue, prepared by the Legal Department of the IMF

nine underlying criteria.[12] Consistent with the previous PLL arrangement, staff noted strong performance in the monetary policy area in light of low and stable inflation; the financial sector area, considering well-capitalized banks and further strengthening of supervision in line with Basel III standards; and the data adequacy area as a subscriber to the Special Data Dissemination Standard. In addition, it was assessed that Morocco did not substantially underperform in the external and fiscal areas. With the program generally on track for the duration of the arrangement, it was assessed that Morocco continued to qualify for a PLL arrangement also at each of the three reviews.

28. Continued qualification of Morocco was appropriate, not least considering the improvement in fundamentals during the first PLL arrangement. While Morocco had yet to perform strongly in two areas by the time of request for the second PLL arrangement, there had been a notable advancement. In the external sector area, the current account deficit had narrowed from 9.7 percent of GDP in 2012 to 7.6 percent of GDP in 2013 and was further narrowing. In addition, the overvaluation of the dirham had moderated.[13] At the time of request for the August 2016 PLL arrangement, Morocco was assessed to perform strongly in the external position and market access area. In the fiscal policy area, the still-high fiscal deficit at 5.5 percent of GDP in 2013 had been reduced by about to 2 percentage points of GDP in one year and, as noted above, fiscal balances improved during the course of the arrangement. As such, qualification for a successor PLL arrangement as well as continued qualification at each of the three reviews was appropriate.

B. External Risks and Access

29. At the time of request for the second PLL arrangement, external risks remained elevated but had moderated relative to the first arrangement. The April 2014 World Economic Outlook noted that relative to six months earlier, the balance of risk for global growth had improved but that important downside risks remained and that new risks had emerged, particularly for emerging markets where downside risks had increased. In the case of Morocco, external risks related to (i) a protracted period of slower growth in trading partners, in particular Europe, which could reduce FDI inflow and weaken remittances, tourism, and exports; (ii) a surge in global financial market volatility, which could hamper access to international capital markets and reduce portfolio and FDI flows; and (iii) geopolitical risks in the Middle East and Ukraine/Russia, which could result in higher oil prices and thereby worsen the current account. Overall, however, and relative to two years earlier when the first PLL arrangement was approved, the balance of risks was assessed as somewhat more favorable.

[12] The nine underlying criteria are (1) a sustainable external position; (2) a capital account position dominated by private flows; (3) a track record of steady sovereign access to international capital markets at favorable terms; (4) a reserve position that is relatively comfortable when the PLL arrangement is requested on a precautionary basis; (5) sound public finances, including a sustainable public debt position; (6) low and stable inflation, in the context of a sound monetary and exchange rate policy framework; (7) sound financial system and the absence of solvency problems that may threaten systemic stability; (8) effective financial sector supervision; and (9) data transparency and integrity.

[13] See "Morocco: 2013 Article IV Consultation" (CR/14/65, 3/6/2014). The staff report for the 2013 Article IV Consultation noted that the "exchange rate assessment continues to show some evidence of moderate overvaluation of the dirham, tough less than a year ago."

30. On the back of attenuated external risks and improved fundamentals, the authorities requested a reduction in access. In addition to the assessment of some moderation in external risks, the authorities noted that fundamentals had strengthened: The budget deficit had been reduced by 1.2 percentage points of GDP between 2011 and 2013 and the current account deficit narrowed 2.2 percentage points of GDP in 2013. Furthermore, international reserves increased markedly toward the end of the first PLL arrangement on the back of bond issuances by both the sovereign and a state-owned enterprise. In turn, international reserves reached 97 percent of the Fund's Assessing Reserves Adequacy (ARA) metric in June 2014 (without considering capital controls), close to the lower bound of the recommended level of between 100 and 150 percent of the metric. Thus, the authorities requested a 21 percent reduction in access to 550 percent of quota[14] (about USD 5 billion) from 700 percent of quota (about USD 6.2 billion) in the 2012 PLL arrangement.

31. The level of access was in accordance with the four exceptional access criteria. The Fund may approve access in excess of normal limits, provided that the four substantive criteria, listed below, are met. This ex post evaluation agrees with staff's assessment that all four criteria were fully met at the time of approval of the arrangement and at each of the three reviews.

- *Criterion 1. The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account, resulting in a need for Fund financing that cannot be met within the normal limits.* Met. Morocco did not face an actual balance of payment need at the time of request for the PLL arrangement. However, the adverse access scenario illustrated how a potential financing gap at exceptional access levels could arise, prompted by a materialization of external downside risks. As external risks remained elevated during the arrangement, the level of access continued to be in accordance with this criterion.

- *Criterion 2. There is high probability that the member's public debt is sustainable in the medium term.* Met. At the start of the arrangement, Morocco's public debt at below 65 percent of GDP was projected to peak in 2015. Stress tests indicated that under the standard shocks, debt ratios would remain sustainable over the medium term. While a modest increase in general government debt was still envisaged in 2016 by the end of the program, the debt sustainability analysis showed a notable improvement on the back of declining deficits.

- Criterion 3. The member has prospects of gaining or regaining access to private capital markets within a timeframe and on a scale that would enable the member to meet its obligations falling due to the Fund. Met. Morocco had on several occasions during the first PLL arrangement accessed international capital markets. With the program generally on track during the second arrangement, it was appropriate to continue to assess that, if needed, Morocco could access international capital markets within a timeframe and on a scale to be able to meet its potential obligations to the Fund.

[14] Quota references are based on the size of quotas at the time of approval of the 2014 PLL arrangement.

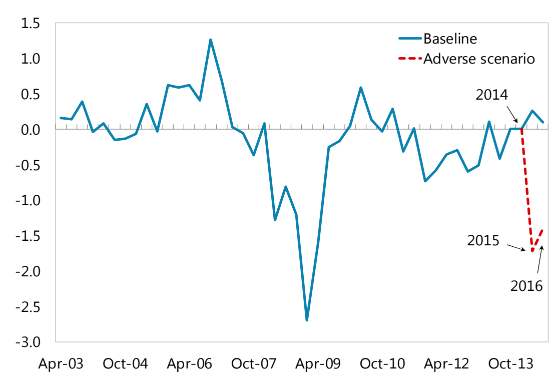
- *Criterion 4. The policy program of the member provides a reasonably strong prospect of success, including not only the members' adjustment plans but also its institutional and political capacity to deliver that adjustment.* Met. With the qualification criterion of sound economic fundamentals and institutional policy frameworks fulfilled at the time of request for the arrangement and at each of the reviews, as well as a continued improvement in public sector deficits during the arrangement, exceptional access was in accordance with this criterion.

32. Phasing of access allowed for maximum access in the first year, increasing to the full amount of access in the second year. Access under PLL arrangements was capped at a maximum of 500 percent of quota during the first year, with the remainder becoming available at the beginning of the second year of the arrangement. Consistently, the access scenario pointed to a potential financing gap of 494 percent of quota in the first year, increasing to 543 percent of quota in the second year. As such, the *quantitative* financing needs scenario was well aligned with the phasing under the program. In addition, frontloading of access to the limit allowed under the PLL instrument provided the maximum backstop against external risks. While not clearly specified in the report, the quantitative access scenario reveals that the potential financing gaps in the two years were determined over a rolling 12-month window as permitted for estimating precautionary balance of payments needs. This resulted in two separate access scenarios in the two years of the arrangement that nonetheless originated from the same underlying shocks.

33. To support access decisions, an external economic stress index (ESI) became required in 2014. The ESI was implemented in response to the 2014 review of the Flexible Credit Line (FCL), the PLL, and the Rapid Financing Instrument (RFI)[15] with the aim of assessing external risks and supporting access decisions. The index describes the evolution of external economic conditions through a weighted sum of variables that capture external risks, where weights correspond to the economic size of the corresponding balance of payments vulnerability.

Figure 7. Morocco: External Economic Stress Index

(Negative values indicate above-average stress)



Source: IMF staff calculations.

34. Morocco's ESI indicated that external conditions had improved, in line with the assessment at the time of program inception but that downside risks remained. The ESI for Morocco was implemented at the time of the first review under the arrangement. Variables in the

[15] IMF Policy Paper, January 2014.

ESI were (i) growth in the euro area to capture the risk of slower growth in trading partners; (ii) the emerging markets volatility index (VXEEM) to capture global financial volatility; and (iii) oil prices to capture the risk of an increase in these. The baseline ESI was computed using WEO projections and pointed to a gradual improvement in external economic conditions during 2012–13 (Figure 7). The downside scenario was computed based on a euro area growth slowdown scenario (as per the 2013 spillover report) as well as on an estimate of the potential impact on oil prices of a geopolitical crisis (as per the 2014 spillover report). Assumptions on the change in the VXEEM in the downside scenario were not specified in the staff report but included a one standard deviation increase above the average value.

35. However, the presentation of the evolution of risks during the arrangement was not complete. Three issues stand out, which limited transparency. First, the weights applied to the external variables were changed within the PLL arrangement without explanation.[16] While the change in weights may not have had material importance in the case of Morocco, it nonetheless has the potential for complicating an assessment of relative risks over time. Second, while the ESI baseline (i.e. the external variables) was appropriately updated with the latest WEO projections, the downside scenario became increasingly outdated as shocks in the second and third reviews remained unchanged from the original ones. While this likely reflects a lack of updated results from the given spillover reports, alternatives could have been used. For example, the October 2014 WEO estimated that secular stagnation could result in a 0.5 percentage point decline in growth in advanced economies relative to the baseline. Third, the omission of a description of the shock to the emerging markets volatility index resulted in an incomplete presentation of assumptions in the downside scenario.

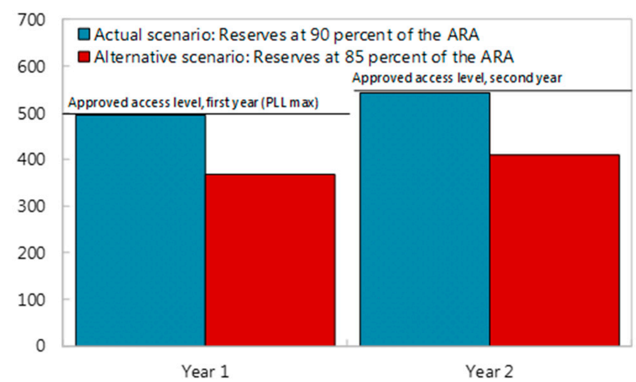
36. The PLL policy on phasing of access led to a counterintuitive outcome when applied to the 2014–2016 PLL arrangement with Morocco. The phasing was in accordance with Fund policy and was aligned with the quantitative access scenario.17 However, despite having a track-record of implementation under the higher access (700 percent of quota) 2012–2014 PLL arrangement—and with vulnerabilities being addressed during the first year of the 2014–2016 arrangement—application of the PLL policy meant that Morocco's access increased again from 500 percent of quota in the first year, to 550 percent in year two. While recognizing the need to safeguard Fund resources—which points to the appropriateness of an initial access limit for the instrument—the PLL policy appears somewhat counterintuitive in the context of a country with back-to-back declining access arrangements that is addressing its vulnerabilities. While the irregular access path was not a significant issue for Morocco—with the increase being only 50 percent of quota—there could be broader policy implications for other countries, particularly as such a situation implies a greater drawdown of reserves if an exogenous shock hits in year one of the successor arrangement.

[16] Flexible Credit Line—Operational Guidance Note, June 2015.

[17] In accordance with the PLL Decision at the time of the 2014 PLL request, access under one- to two-year PLL arrangements was capped at a cumulative 1000 percent of quota, net of scheduled PLL repurchases. An initial amount of up to 500 percent of quota could be made available upon approval for the first year, and the remaining amount made available at the beginning of the second year of the arrangement, subject to completion of relevant semi-annual reviews (Precautionary and Liquidity Line—Operational Guidance Note, June 2015).

37. Further discussion of the assumed reserve drawdown would have been beneficial. The financing gap was defined as the remaining financing needs after drawing down reserves to a level corresponding to 90 percent of the Assessing Reserve Adequacy (ARA) metric. This allowed for a larger reserve buffer in the adverse scenario than what had been assumed in the first PLL arrangement, where reserves were allowed to fall to 85 percent of the ARA metric. In addition, accounting for capital controls would put reserve adequacy well into the recommended adequacy range. Allowing a drawdown to 85 percent of the ARA under the second PLL arrangement would have reduced the financing needs by USD 1.1 billion and USD 1.2 billion in the two years, respectively. Such a scenario would have corresponded to access of 410 percent of quota instead of the requested 550 percent of quota (Figure 8). A clear discussion of the change in assumption on the reserve drawdown from the first arrangement would therefore have been warranted and improved transparency in access considerations. That said, considering the *pace* of reserve drawdown would also be important in access discussions. Hence, the gradual reduction in access that was approved by the IMF's Executive Board likely facilitated a smooth exit strategy with lower risk of adverse market reaction.

Figure 8. Morocco: Financing Gap in Adverse Scenarios
(Percent of 2014 quota)



Sources: IMF country Report No. 14/241 and IMF staff calculations.

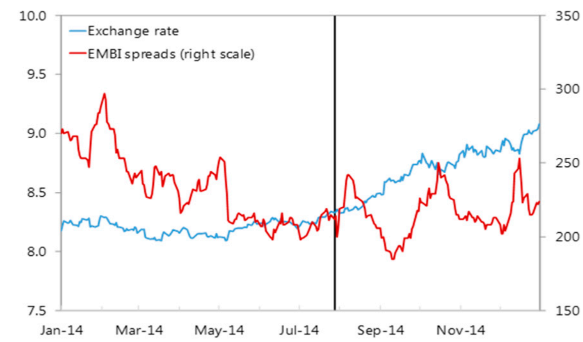
C. Exit Strategy

38. In line with PLL guidelines, the authorities clearly indicated their intention to exit from the PLL-supported program as external risks receded. The PLL guidance note,[18] completed after the approval of Morocco's 2014 PLL arrangement, stated the need for referring to exit expectations in the authorities' written communication. Indeed, this was fulfilled with the authorities' mention that "*continued strengthening of the economy's resilience, including by further reducing the fiscal and external deficits and strengthening the reserve position, is expected to position Morocco well for exiting the PLL, once the exogenous risks to which the economy is exposed have significantly declined.*" Furthermore, the authorities' request for a reduction in access was a clear signal of their intent to gradually exit from the PLL.

[18] Precautionary and Liquidity Line—Operational Guidance Note, June 2015.

39. The reduction in access was not associated with adverse market reaction, pointing to a well-communicated gradual exit. The approval of the 2014 PLL arrangement with lower access was announced through a press release on July 28, 2014. EMBI spreads for Morocco narrowed on the day of announcement and was 12 basis points lower two days later (Figure 9). As such, the process of gradually exiting from the PLL at the time of the second arrangement was in line with Fund policy and was successful from a signaling perspective.

Figure 9. Morocco: Reaction to Reduction in Access
(Exchange rate: Moroccan Dirham per USD; spreads: basis points)



Source: Bloomberg.

D. Focus of Conditionality

40. The parsimonious use of ex-post conditionality was appropriate. A PLL arrangement is subject to ex ante conditionality in the form of the qualification assessment. Furthermore, as stated in the PLL Decision, PLL arrangements with duration of one to two years shall have ex-post conditionality that includes indicative targets, as well as standard performance criteria.[19] Under the Guidelines on Conditionality, arrangements may also include other performance criteria, prior actions, and structural benchmarks when critical for program success. In the case of Morocco, it would have been reasonable to discuss the use of additional conditionality in the context of passing the OBL in a timely manner. Furthermore, given the lower than expected growth performance, additional ex-post conditionality could have been considered on measures necessary to boost investment and raise productivity. However, at no point during the arrangement did performance suggest that the use of additional conditionality would be critical for the authorities to successfully implement their program. Furthermore, given the authorities' strong ownership of the program—evidenced through the corrective actions taken during this and the first PLL arrangement—additional ex-post conditionality was not needed and could have been counterproductive.

CONCLUSIONS AND LESSONS

41. The 2014–16 PLL arrangement with Morocco helped reduce vulnerabilities. It supported the authorities' reform program, providing them with a backstop against potential exogenous shocks. The authorities met their objective to reduce vulnerabilities, as the arrangement supported reforms to strengthen macroeconomic stability by continuing to reduce fiscal and current account deficits. Growth however turned out to be lower than expected, and while unemployment declined between 2014 and 2016, much remained to be done to ensure higher and more inclusive growth.

[19] Standard performance criteria are continuous performance criteria related to trade and exchange restrictions, bilateral payment agreements, multiple currency practices, and non-accumulation of external debt payment arrears.

42. Fiscal balances improved. The fiscal objective—a gradual reduction of the budget deficit to 3 percent of GDP by 2017—appropriately balanced the need to bring the debt-to-GDP ratio down closer to 60 percent in the medium term, while allowing for necessary investment and social spending. Subsidy reform, a notable success of the first PLL-supported program, also continued. Several reforms were implemented to address the public payroll and the pensions system, but the need for a comprehensive civil service reform remained. Although one indicative target was missed, strong corrective actions were taken by the authorities when needed to ensure that their program remained on track.

43. The adoption of the OBL was a notable achievement. The OBL substantially improved the budget framework through several new features, such as the introduction of multi-year and program budgeting, a fiscal 'golden rule', performance management, and strengthened accountability. However, some provisions could have been more aligned to international best practice.

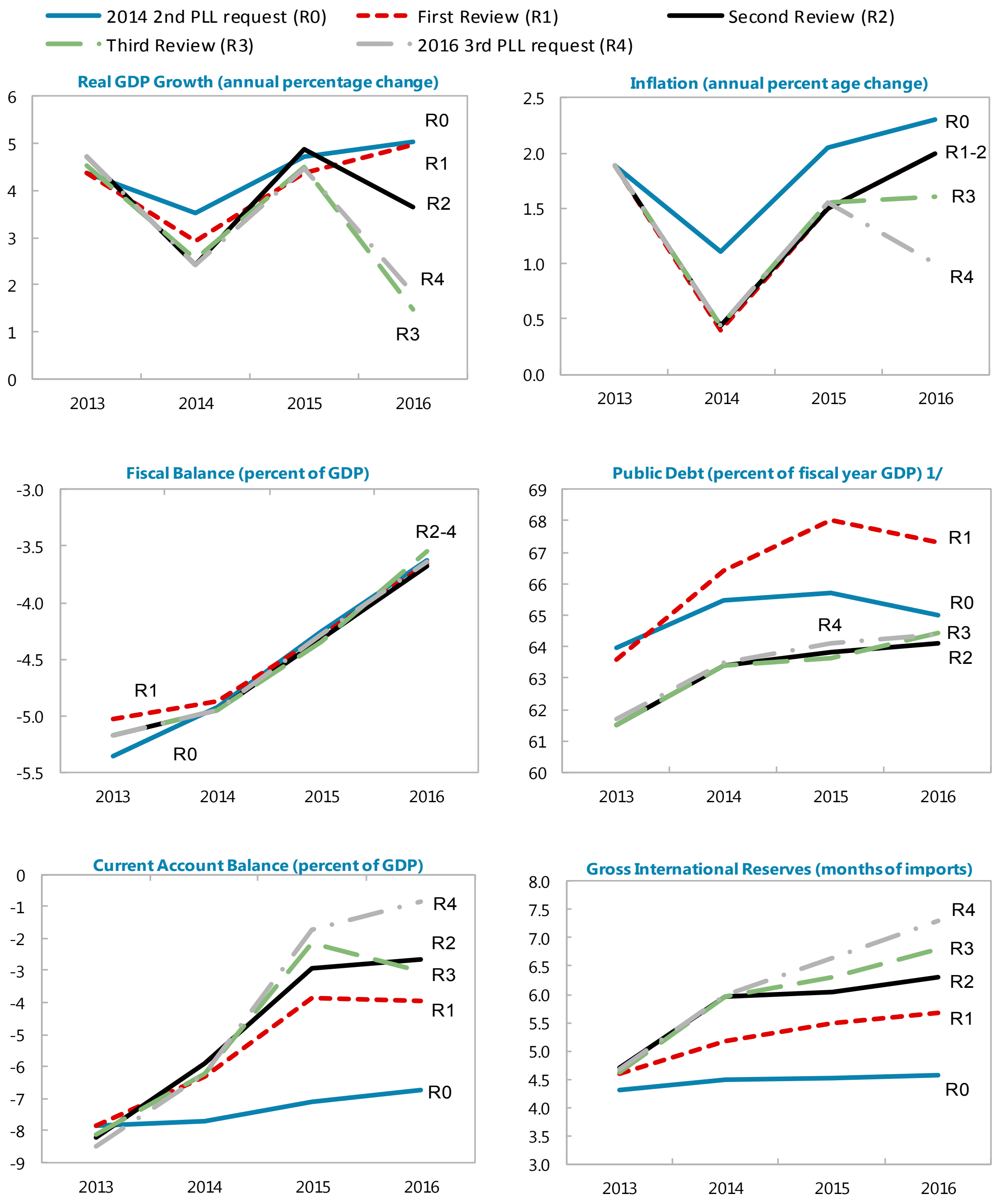
44. External balances strengthened. The current account deficit improved by 7.5 percentage points of GDP during 2012–15, while reserves were built up to be 94 percent of the Fund's ARA metric—and accounting for capital controls would put reserve adequacy well into the recommended adequacy range. While the initial overvaluation of the REER had been erased by the end of the arrangement, competitiveness gains were however quite modest. The economy saw a welcome compositional shift in exports towards higher-value-added products, such as automobiles. Nonetheless, the current account improvement as a share of GDP was largely related to the significant drop in oil prices.

45. The macroeconomic strategy, program design, and financing were all in line with Fund policy, including the exceptional access policy. The level of access was appropriate and well justified, exit was appropriately signaled, and the phasing of access was in accordance with Fund policy. The case of Morocco demonstrated that with strong ownership, parsimonious conditionality can be effective in delivering on program commitments.

46. An important lesson from this evaluation is the need for greater realism in growth projections. In the case of Morocco, the projected increase in the potential growth rate could have been better motivated in the staff reports by elaborating on the link between investment, productivity and implementation of the reform agenda, which would have allowed a clearer sense of how reform implementation could affect growth prospects. This was done in the 2016 Article IV staff report, and the recently-developed toolkit on macro-structural issues that is currently being piloted in the Fund, could also help support future work in this area. More conservative growth assumptions would also have brought into sharper focus the need for further measures to support higher and more inclusive growth, and would have facilitated a more realistic discussion of the fiscal strategy. With hindsight, this would have been particularly valuable given the underperformance of revenue outcomes. Going forward, to achieve higher and more inclusive growth, Morocco will require continued strong policies and accelerated fiscal and structural reforms.

47. The phasing of access under the PLL arrangement was also somewhat counterintuitive. While recognizing the need to safeguard Fund resources, the case of Morocco shows that the phasing policy can lead to an irregular access path in the context of a country with back-to-back declining access arrangements that is addressing its vulnerabilities.

Figure 10. Morocco: Projections and Outturns for Selected Indicators, 2014–16



Source: Authorities' data and IMF staff estimates.
Note: GDP was rebased between the first and second reviews.

Table 4. Morocco: Selected Economic Indicators, 2012–22

	2012	2013	2014	2015	2016 PLL 1/	2016 Art. IV	2016 Rev.	2017 PLL 1/	2017 Art. IV	2017 Rev.	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.
(Annual percentage change)															
Output and Prices															
Real GDP	3.0	4.5	2.6	4.5	1.8	1.5	1.1	4.8	4.4	4.5	3.0	4.1	4.2	4.5	4.6
Real agriculture GDP	-9.1	17.2	-2.2	12.8	-10.5	-9.8	-9.8	13.7	10.8	13.9	-0.3	6.6	6.4	6.4	6.8
Real non-agriculture GDP	4.7	2.9	3.2	3.5	3.5	3.0	2.6	3.6	3.5	3.2	3.5	3.7	3.9	4.2	4.3
Consumer prices (end of period)	2.6	0.4	1.6	0.6	1.2	1.5	1.8	1.3	1.2	1.1	1.7	2.0	2.0	2.0	2.0
Consumer prices (period average)	1.3	1.9	0.4	1.5	1.3	1.6	1.6	1.3	1.2	1.1	1.7	2.0	2.0	2.0	2.0
(In percent of GDP)															
Investment and Saving															
Gross capital formation	35.0	34.8	32.2	30.2	30.2	31.2	31.3	30.7	32.1	32.3	33.3	34.0	34.5	34.7	35.6
Of which: Nongovernment	29.6	29.8	26.8	24.7	25.2	26.0	25.6	25.7	27.4	27.1	27.7	28.2	28.6	28.6	29.3
Gross national savings	25.7	27.2	26.3	28.1	29.0	28.3	26.9	29.3	29.8	29.0	30.6	31.5	32.5	33.4	34.6
Of which: Nongovernment	26.1	25.8	24.3	25.0	25.8	25.0	23.7	25.0	26.7	25.9	26.1	26.1	26.7	27.1	27.9
(In percent of GDP)															
Public Finances															
Revenue	28.0	27.8	28.1	26.7	26.9	26.7	26.2	27.5	26.0	26.1	26.9	27.6	27.8	27.9	28.0
Expenditure	35.2	32.9	32.9	30.9	30.4	30.2	30.4	30.5	29.1	29.6	29.9	30.1	29.9	30.1	30.2
Budget balance	-7.2	-5.1	-4.9	-4.2	-3.5	-3.5	-4.1	-3.0	-3.0	-3.5	-3.0	-2.5	-2.1	-2.1	-2.1
Primary balance (excluding grants)	-4.8	-3.2	-3.6	-1.9	-1.9	-1.8	-2.4	-1.3	-1.4	-1.8	-1.4	-0.4	-0.1	-0.4	-0.3
Cyclically-adjusted primary balance (excl. grants)	-5.0	-3.0	-3.0	-1.6	-1.8	-1.6	-2.2	-1.3	-1.3	-1.8	-1.3	-0.3	-0.1	-0.7	-0.9
Total government debt	56.5	61.7	63.5	64.1	64.4	64.3	65.1	63.8	63.8	64.3	63.9	62.1	60.2	58.9	57.5
(Annual percentage change; unless otherwise indicated)															
Monetary Sector															
Credit to the economy	4.8	3.8	2.5	2.0	4.5	4.8	4.3	...	5.1	6.5	...	...	...	...	...
Base money	-0.5	9.0	6.2	5.7	5.5	6.0	5.0	...	6.0	6.0	...	...	...	...	...
Broad money	4.5	3.1	6.2	5.7	5.5	6.0	5.0	...	6.0	6.0	...	...	...	...	...
Velocity of broad money	0.9	0.9	0.9	0.9	0.8	0.8	0.8	...	0.8	0.8	...	...	...	...	...
Three-month treasury bill rate (period average, in percent)	3.4	3.4	2.5	...	...		...	...	...	...	...	...	...	...	...
(In percent of GDP; unless otherwise indicated)															
External Sector															
Exports of goods and services (in U.S. dollars, percentage change)	-0.1	4.5	7.4	-7.0	4.4	3.0	2.9	6.7	5.4	5.9	6.6	7.6	7.6	7.7	7.5
Imports of goods and services (in U.S. dollars, percentage change)	2.2	4.3	1.0	-16.5	4.5	6.1	9.6	6.5	3.9	2.8	4.8	5.0	5.8	6.1	5.9
Merchandise trade balance	-22.3	-20.5	-18.8	-14.6	-14.3	-15.9	-17.2	-14.4	-15.8	-16.7	-16.4	-15.6	-15.2	-14.9	-14.4
Current account excluding official transfers	-9.6	-8.3	-7.7	-2.6	-2.3	-3.8	-5.3	-2.3	-3.3	-4.3	-3.6	-2.7	-2.1	-1.5	-1.0
Current account including official transfers	-9.3	-7.6	-5.9	-2.2	-1.2	-2.9	-4.4	-1.4	-2.3	-3.3	-2.7	-2.5	-1.9	-1.3	-1.0
Foreign direct investment	2.4	2.8	2.8	2.6	2.5	2.0	1.6	2.4	2.1	1.8	2.2	2.3	2.4	2.5	2.5
Total external debt	28.5	29.3	33.4	34.1	32.6	32.8	34.8	32.1	31.9	35.1	34.7	33.9	34.0	33.1	33.2
Gross reserves (in billions of U.S. dollars)	17.4	19.0	20.5	23.0	26.7	25.7	25.4	30.2	27.6	26.3	28.1	30.3	33.4	37.5	42.3
In months of next year imports of goods and services	4.3	4.6	6.0	6.1	7.1	6.8	6.6	7.6	6.9	6.5	6.6	6.7	7.0	7.3	8.5
In percent of Fund reserve adequacy metric 2/	75.6	74.3	79.9	94.7	102.8	99.5	99.4	109.6	101.7	97.6	98.7	100.5	104.8	111.1	119.3
In percent of CA deficit and ST debt at rem. mat. basis	156.5	188.7	247.5	523.3	697.6	463.0	388.0	846.7	605.7	468.2	557.0	613.3	761.6	988.8	1249.7
Memorandum Items:															
Nominal GDP (in billions of U.S. dollars)	98.3	106.8	109.9	100.6	104.9	103.6	102.96	111.1	106.6	105.0	109.4	115.6	122.4	129.6	137.3
Output gap (percentage points of GDP)	0.9	-0.8	-0.3	1.0	...	-2.0	-2.0	...	0.8	0.8	-0.9	0.1	0.0	0.0	1.0
Unemployment rate (in percent)	9.0	9.2	9.9	9.7	...	...	...	...	...	...	...	...	...	...	...
Population (millions)	32.5	32.9	33.2	33.5	33.8	33.8	33.8	34.2	34.2	34.2	34.5	34.8	35.1	35.4	35.7
Population growth (in percent)	1.04	1.02	0.99	0.98	0.97	0.97	0.97	0.95	0.95	0.95	0.95	0.93	0.92	0.90	0.88
Net imports of energy products (in billions of U.S. dollars)	-12.4	-12.2	-11.0	-6.8	-5.7	-5.7	-5.6	-6.4	-6.4	-6.3	-6.4	-6.5	-6.7	-6.9	-7.0
Local currency per U.S. dollar (period average)	8.6	8.4	8.4	9.8	9.8	...	...	...	...	...	...	...	...	...	...
Real effective exchange rate (annual average, percentage change)	-2.0	1.8	0.0	0.3	2.3	...	...	...	...	...	...	...	...	...	...

Sources: Moroccan authorities; and IMF staff estimates.
1/ Refers to the macro framework for the 3rd PLL arrangement in CR/16/265.
2/ Based on revised ARA weights.

Table 5. Morocco: Quantitative Indicative Targets 1/

Second PLL request (CR/14/241, 7/28/14)	**2014**	**2015**
	Sept. 30	**Mar. 31**
Indicative targets		
Floor on stock of NIR of Bank Al-Maghrib (BAM) (end of period (eop))	20,310	20,492
Ceiling on fiscal deficit (cumulative since beginning of fiscal year, eop)	-32,768	-10,556

First review of the second PLL arrangement (CR/15/44, 1/23/2015)	**Sept. 30, 2014**			**Mar. 31, 2015**		**2015**
	PLL	**Adj.**	**Real.**	**PLL**	**Rev.**	**Sept. 30**
Indicative targets						
Floor on stock of NIR of Bank Al-Maghrib (BAM) (eop)	20,310	19,975	21,552	20,492	21,071	21,602
Ceiling on fiscal deficit (cumulative since beginning of fiscal year, eop)	-32,768	-31,107	-37,337	-10,556	-15,600	-30,200

Second review of the second PLL arrangement (CR/15/209, 7/24/2015)	**Mar. 31, 2015**			**Sept. 30, 2015**	
	PLL	**Adj.**	**Real.**	**PLL**	**Rev.**
Indicative targets					
Floor on stock of NIR of Bank Al-Maghrib (BAM) (eop)	21,071	20,085	22,105	21,602	23,316
Ceiling on fiscal deficit (cumulative since beginning of fiscal year, eop)	-15,600	-18,783	-8,581	-30,200	-30,200

Third review of the second PLL arrangement (CR/16/38, 1/12/16)	**Mar. 31, 2015**			**Sept. 30, 2015**		
	PLL	**Adj.**	**Real.**	**PLL**	**Adj.**	**Real.**
Indicative targets						
Floor on stock of NIR of Bank Al-Maghrib (BAM) (eop)	21,071	20,085	22,105	23,316	22200	24875
Ceiling on fiscal deficit (cumulative since beginning of fiscal year, eop)	-15,600	-18,783	-8,581	-30,200	-38772	-26861

1/ Amounts on NIR are in millions of U.S. dollars, those on fiscal deficit are in millions of dirham.

Annex I. Views of the Authorities

The Moroccan authorities thank Mr. Gregory and his team for an interesting and well-focused report on the Ex-Post Evaluation of the Precautionary and Liquidity Line (PLL) Arrangement approved on July 2014, and broadly agree with its main conclusions.

The report indicates that the 2012–14 PLL arrangement was aimed at supporting the authorities' economic strategy geared at strengthening macroeconomic stability and promoting stronger and inclusive growth, by providing insurance against external risks.

The report also highlights the improvement of Morocco's macroeconomic fundamentals under the 2014 PLL and the continued eligibility of Morocco to this facility.

The Moroccan authorities would like to make the following comments:

- The report's reference to over optimism in growth projections is not well founded. Indeed, to confirm this statement, there is a need for a comprehensive comparison of the exogenous assumptions (partners' growth, commodity prices, including oil and phosphates, exchange rates, climate conditions) with actual developments. Moreover, non-agricultural growth decelerated during the PLL period, losing almost one percentage point compared to its pre-2013 trend, mainly due to the slowdown in domestic demand, notably investment. It would therefore have been desirable to shed more light on the various factors that contributed to this deceleration, in particular those relating to fiscal consolidation. This will be key to understanding the shortfall in growth and would also help us to set a path of fiscal consolidation in the medium term that is compatible with the objective of strengthening nonagricultural growth.

- The report asserts that the external balance has strengthened considerably. However, competitiveness gains were assessed to be relatively modest by reference to the ratio of exports to GDP which remained virtually stable over the period. In this regard, it should be emphasized that competitiveness is a relative concept, as this ratio has declined for all competitors, especially since world trade has slowed considerably over the period. Moreover, this conclusion should be reconsidered insofar as the majority of competitiveness indicators have improved during this period, such as the volume index of world demand addressed to Morocco and the country's absolute market share in world trade, while the exchange rate has remained broadly in line with fundamentals.

Statement by Mr. Mohammed Daïri, Alternative Executive Director on Morocco
August 1, 2017

My Moroccan authorities are grateful to staff for the interesting discussions and the concise reports for the second Precautionary and Liquidity Line (PLL) review and the ex-post evaluation (EPE) of exceptional access under the 2014–16 PLL.

Precautionary and Liquidity Line Review

Macroeconomic indicators are improving significantly in 2017. After a disappointing cereal crop in 2016, more favorable weather conditions in 2017 have led to as strong recovery in agriculture GDP, while non-agriculture GDP is recovering from its slowdown last year, raising projected total growth in 2017 to 4.8 percent, its highest level since 2011 (up from 1.2 percent in 2016). Credit to the economy is recovering, supported by accommodative monetary policy and effective transmission, while the financial system remains sound and well supervised. Inflation should decline to less than 1 percent, and the current account deficit to 4 percent of GDP, notwithstanding higher oil import prices. Continued strong FDI should help maintain reserves at a comfortable level despite large Moroccan investments abroad. These favorable developments have led to improved market sentiment, with Morocco’s sovereign spreads much lower and declining much faster than EMBI average.

The new government, which took office in early April 2017, confirmed its commitment to continue with the policies and reforms under the program. The authorities take positive note of staff indication that the program remains on track and that Morocco continues to meet the PLL qualification criteria, performing strongly in four out of the five qualification areas (external position and market access, financial sector and supervision, monetary policy, and data quality), while not substantially underperforming in the fiscal policy area. In view of the short time elapsed since the first review, this statement will be brief and will only address a few issues.

Fiscal Performance and Policies

The new government’s fiscal policy is in line with the objectives announced under the PLL as revised during the first review. The fiscal deficit is projected to decline, as agreed, to 3.5 percent of GDP in 2017 from 4.1 percent last year, and to fall further to the PLL target of 2.1 percent of GDP in 2021. The public debt to GDP ratio is expected to decline from 64.7 percent in 2016 to 63.2 percent in 2017 (against 64.3 percent projected under the PLL), putting it on a firm declining trend to reach the medium-term target of under 60 percent of GDP by 2021. In this regard, the deviation from the target for 2020 set in the PLL is minimal (0.5 percent of GDP) and does not indicate a weakening of fiscal consolidation.

The authorities are confident that their fiscal targets for 2017 and beyond will be achieved. After meeting the adjusted March 2017 indicative target with a wide margin, fiscal developments through June are also much more favorable than projected, with significant overperformance in tax collection and current spending control, including on wages, which should continue over the near to medium term and bodes well for achieving fiscal targets. In this regard, continued efforts at modernizing tax administration and simplifying procedures (including e-filing), have been instrumental in improving tax collection. Moreover, tax revenue for 2018-21 does not include the impact of new measures, and it is expected that new tax measures, which will be identified and discussed by the cabinet in time for the mandatory presentation of the draft 2018 budget to parliament by October 20, will provide additional room for maneuver for achieving the authorities' fiscal objectives for 2018 onward, while creating more space for priority spending.

Structural Reforms

Structural fiscal reforms continue to be at the heart of the authorities' program, with focus on the priority areas identified in the PLL, including continued implementation of the Organic Budget Law as per the agreed schedule; further progress in tax reform in line with the recommendations of the 2013 National Conference; additional steps in subsidy reform to improve targeting and reduce costs; implementation of responsible decentralization; improving management and assessment of public investment as well as oversight and performance of public enterprises; and reform of the civil service. The Written Communication (¶7-9) highlights recent progress in these areas since the government took office, including the adoption of a series of decrees on governance and oversight of subnational entities, as well as the finalization of the draft law on public enterprise oversight and its submission to the Secretary General of the Government.

The authorities are committed to accelerating structural reforms to strengthen competitiveness, increase growth potential, and reduce unemployment. As elaborated in the Written Communication (¶14) and in Box 1, key priorities include further improving the business environment, reforming education and public administration, establishing good governance, and promoting human development and inclusiveness. The recent adoption by the government of the revised central bank charter should enhance its independence and effectiveness in monetary policy and its role in financial stability. A draft law is under preparation to translate the recently adopted Vision for education reform into specific guidelines and objectives.

All in all, while recognizing that the pace of implementation could have been faster absent the delay in the change of government, the authorities' commitment to reform remains strong. They broadly agree with the main reform priorities identified in the report, which are in line with the government program. The next Article IV consultation and third review of the PLL mission in October will provide the opportunity for more in-depth discussion on the new government's reform agenda.

Transition to Exchange Rate Flexibility

After completion of the preparatory work on transition to more exchange rate flexibility, including an intensive communication strategy, supported by valuable Fund technical assistance, the authorities planned to start the transition by end-June 2017. However, demand for hedging from some market participants soared to an unexpected level, notwithstanding repeated assurances that the current level of the exchange rate is in line with Morocco's solid fundamentals and that there is no risk of currency depreciation at the current juncture. This increased hedging has led to a significant decline in official reserves, with concomitant increase in commercial banks' foreign assets. The postponement by the government of the start of the transition and the indication that the initial widening of the band will be limited have helped alleviate these pressures. Official reserves have stabilized and should start to recover, helped by the favorable seasonal pattern of tourism and workers' remittances, and as options bought by market participants expire. The authorities remain committed to moving to a more flexible exchange rate regime, and will announce the start of the transition at the appropriate time.

Ex Post Evaluation of Exceptional Access

The authorities share the conclusions of the EPE, including the significant improvement in Morocco's fundamentals and reduction in vulnerabilities under the 2014–2016 PLL. As highlighted in Annex I, they are of the view that while growth turned out to be lower than expected, it is difficult to link this shortfall to over-optimism in growth projections. More analysis will be needed in particular to assess the extent to which the impact of fiscal consolidation on growth may have been underestimated. Discussion of the impact of structural reforms on growth is also important, but is fraught with uncertainty regarding the time needed for these reforms to deliver their full effect. Finally, while they take note of the report's indication of the considerable improvement in external balances over 2012–15, they do not share staff indication that gains in competitiveness were modest, pointing to the significant diversification of exports to new sectors and new regions, despite the sharp slowdown in world trade volume.

Conclusion

The authorities are grateful for the Fund's support, advice, and technical assistance. They are firmly committed to staying the course of sound policies and reforms to unlock the economy's potential and achieve higher and more inclusive and job-rich growth. They will continue to reduce the economy's vulnerabilities and strengthen its resilience. In this regard, they are committed to achieving the objectives of the PLL which has proven to be a useful instrument and which they will continue to treat as precautionary. They will assess the need for continued close engagement with the Fund under precautionary arrangements at the expiration of the current PLL, and will carefully consider available options in this area.