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EX POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2012 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** summarizing the views of the Executive Board, as expressed during its July 24, 2015 discussion of the Second Post-Program Monitoring and Ex Post Evaluation of Exceptional Access Under the 2012 Precautionary and Liquidity Line Arrangement.
- This Ex Post Evaluation of Exceptional Access Under the 2012 Precautionary and Liquidity Line Arrangement with Morocco, prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on July 8, 2015.
- A **Statement by the Executive Director** for Morocco.

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July 24, 2015

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IMF Executive Board Completes the Second Review of the Current PLL Arrangement for Morocco and the Ex Post Evaluation of the First PLL

On July 24, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the second review of Morocco's economic performance under a program supported by a two-year Precautionary and Liquidity line (PLL) arrangement and the Ex Post Evaluation of exceptional access (EPE) under the 2012-14 PLL arrangement.

The current PLL arrangement was approved in July 2014. (See Press Release No. 14/368). Access under this arrangement in the second year is equivalent to SDR 3.2351 billion (US$5 billion, or 550 percent of Morocco's quota at the IMF). Morocco's first 24-month PLL arrangement was approved on August 3, 2012, with an access equivalent to 700 percent of the quota.

The PLL arrangement has provided insurance against external risks. The Moroccan authorities are treating the arrangement as precautionary, as they did with the 2012-14 PLL, and do not intend to draw under the arrangement unless Morocco experiences actual balance of payments needs from a significant deterioration of external conditions.

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.

Following the Executive Board discussion on Morocco, Mr. Min Zhu, IMF Deputy Managing Director and Acting Chair of the Board, made the following statement regarding the second review of the current arrangement:

"Morocco's overall economic performance has been strong. Following a slowdown in 2014, growth is expected to pick up in 2015. Policy action has helped reduce fiscal and external vulnerabilities and significant progress has been achieved on reforms. In an environment that remains subject to important downside risks, sustaining the momentum will be important to reduce remaining vulnerabilities and achieve higher and more inclusive growth.

“The arrangement under the Fund’s Precautionary and Liquidity Line (PLL), which the authorities continue to treat as precautionary, has provided insurance against external risks. The program remains on track.

“Fiscal developments have been consistent with the authorities’ objective to reduce the deficit to 4.3 percent of GDP in 2015. Progress continued on the subsidy reform, while support to the most vulnerable has expanded. The recent adoption of a new organic budget strengthens the fiscal framework. The timely adoption of the pension reform will be key to ensure the viability of the system.

“Progress has also been made in upgrading the financial policy framework, including by moving to Basel III standards and implementing the new banking law. An important further step should be the timely adoption of a new central bank law. Ongoing work toward a more flexible exchange rate regime and a new monetary policy framework, in coordination with other macroeconomic and structural policies, is welcome.

“Morocco’s external position has continued to improve owing to strong export performance and lower oil prices. Further progress on structural reforms, including improving the business environment, governance, transparency and the job market will help strengthen competitiveness, growth and employment and enhance the economy’s resilience to shocks.”

Regarding the ex post evaluation of the first PLL arrangement, 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 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.

INTERNATIONAL MONETARY FUND

MOROCCO

July 7, 2015

EX POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2012 PRECAUTIONARY AND LIQUIDITY LINE ARRANGEMENT

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

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The two-year Precautionary and Liquidity Line (PLL) arrangement with Morocco approved in August 2012 aimed to provide insurance and signal that the authorities' policies were sound and that Morocco had adequate financial resources to draw upon, should external risks materialize. 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. Macroeconomic vulnerabilities increased in the run-up to the PLL arrangement, stemming from weak growth in Morocco's trading partners and from international oil prices. To address those vulnerabilities, the authorities envisaged a gradual reduction in fiscal and current account deficits. And in a context of domestic and regional tensions, the reform agenda also sought to support higher potential growth (including through a reallocation of fiscal spending to favor investment spending), strengthen the social safety net, and reduce unemployment. In that vein, the fiscal strategy appropriately balanced the trade-off of strengthening buffers and supporting growth. The authorities intended to treat the PLL arrangement as precautionary. The PLL arrangement was cancelled—without having been drawn upon—and the Executive Board approved a new 24-month PLL arrangement with lower access in July 2014.

The Ex-Post Evaluation confirms that the 2012–14 PLL arrangement was consistent with the PLL qualification standards and requirements under the exceptional access policy at the time of the PLL arrangement request in August 2012 and at the subsequent reviews. Access was motivated by a scenario that simulated the impact of a plausible combination of adverse external demand and supply shocks, and resulting estimated financing needs were large enough to justify exceptional access to Fund resources. Risks to the Fund from the full purchase of the amount available under the PLL arrangement were manageable.

The authorities' policies helped maintain macroeconomic stability and reduce fiscal and external vulnerabilities, in spite of unfavorable external developments. Inflation was low but growth was not strong enough to make a dent in the unemployment rate. Subsidy reform stands out as a major achievement, especially in light of the difficult regional socio-political context. This reform was at the center of the significant reduction in fiscal and external current account deficits. Thanks to strong policy actions, the twin deficits were significantly reduced from 2013 onwards and international reserves were replenished. The consolidation was achieved in spite of external headwinds—from adverse developments in global oil prices and weak growth in European trading partners, with weaker phosphate exports also weighing on the current account deficit—and relatively weak GDP growth.

Notwithstanding the significant macroeconomic achievements under the 2012–14 PLL arrangement, a number of policy challenges remained to be fully addressed. 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. The end-2012 fiscal slippage, which resulted in the end-2012 target for the fiscal deficit being missed by more than 1 percent of GDP, highlighted the need to address weaknesses in budget monitoring and forecasting, and in expenditure controls. Coming close after the start of the program, the slippage and its causes necessitated strong and credible actions to ensure continued PLL qualification and keep the program's objectives within reach. 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. Also, faster progress on a number of structural reforms, including in particular the Organic Budget Law and pension reform, would have been desirable (and was expected). Going forward, it will remain important to keep wage bill moderation and restraint on other, non-essential, current spending high on the policy agenda, which is important to reduce the deficit towards the medium-term target, reverse the trend for the debt ratio, and free up fiscal space for investment. Moreover, pension reform is becoming more urgent; achieving results quickly will require strong policy 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 appropriate to focus first on reducing fiscal and external vulnerabilities while laying the foundations to adapt monetary and exchange rate policy to changing circumstances. As Moroccan financial and capital markets continue to internationalize and broaden their potential as engines for growth, it will become more pressing to allow greater flexibility in the exchange rate. Such flexibility could act as a shock absorber, mitigate risks, and give the monetary authorities more autonomy in monetary policy conduct.

In retrospect, the PLL arrangement request could have assessed whether there were potential vulnerabilities in a few additional areas. The PLL arrangement request noted Morocco's sound institutional framework but did not include an in-depth discussion or formal assessment. It remains an open question whether the weaknesses in budget monitoring and expenditure controls uncovered with the end-2012 fiscal slippages might have possibly been flagged sooner, perhaps in the context of Art. IV consultations, through available diagnostics of public financial management, or while assessing progress with the Organic Budget Law. And, given the rapid regional expansion of Moroccan banks in Africa in the preceding years, the PLL arrangement request could have assessed whether there were any potential macroeconomic or supervisory vulnerabilities including those related to AML/CFT stemming from this relatively new development. The 2015 FSAP Update provided an opportunity to take stock of potential vulnerabilities and identify areas where the regulatory framework may need further reform.

As a result of external risk factors and remaining vulnerabilities, the authorities did not "Exit" from the PLL by the end of the 2012–14 PLL arrangement and a successor arrangement with lower access was approved. Although fiscal and external consolidation had progressed and external stress factors appeared to have abated somewhat, there were remaining fiscal and external vulnerabilities by mid-2014. Addressing those will require progress on several policy fronts as identified above.

INTRODUCTION

1. **The Executive Board approved Morocco's request for a 24-month arrangement under the PLL on August 3, 2012.**[1] Access under the PLL arrangement was equivalent to 700 percent of quota (about SDR 4.12 billion), with 400 percent of quota (about SDR 2.35 billion) available in the first year of the arrangement. The Moroccan authorities indicated that they planned to treat the PLL arrangement as precautionary and intended to draw only in the event of unforeseen external shocks or a worsening of the international outlook relative to program assumptions. All three reviews of the PLL-supported program were completed (on Feb. 1, 2013; Jul. 31, 2013; and Jan. 31, 2014, respectively). The PLL arrangement was cancelled—without having been drawn upon—and a new 24-month PLL arrangement was approved by the Executive Board on July 28, 2014.[2]

2. **Fund policy calls for an ex post evaluation (EPE) within one year after the end of an arrangement with exceptional access.**[3] The EPE aims to: (i) determine whether the justifications—including on the macroeconomic strategy, program design, and financing—presented at the outset of the program were consistent with Fund policies (including exceptional access policies) and (ii) review performance under the program compared to objectives.[4,5] Fund staff discussed the draft EPE report with the authorities during a staff visit to Rabat in June 2015. The authorities' views are included in the Annex to this report.

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[1] See "Request for an Arrangement Under the Precautionary and Liquidity Line" (CR/12/239, 8/13/12).

[2] The successor arrangement has access of 550 percent of quota (about SDR 3.24 billion), with 500 percent of quota (about SDR 2.94 billion) available in the first year of the arrangement (see CR/14/241, 08/05/14).

[3] "See Ex post Evaluations of Exceptional Access Arrangements—Revised Guidance note (IMF Policy Paper; February 25, 2010)." Normal access limits for arrangements supported by the General Resource Account (GRA) are 200 percent of quota annually and 600 percent of quota cumulatively (net of scheduled repurchases). Access above those limits is exceptional access.

[4] The comparison in this EPE report of outturns to program objectives uses full-year comparisons for 2012–14, even though the first half of 2012 was not covered by the PLL arrangement and part of the second half of 2014 was covered by the successor PLL arrangement. Where relevant, this report compares end-2014 projections at the time of the cancellation of the PLL arrangement (in July 2014) to initial projections.

[5] In May 2015, the Moroccan authorities released new national accounts data with base year of 2007. As a result, this report uses the data for realizations with the 2007 base year, while the initial PLL arrangement used data which had 1998 as the base year. The different base years affect the comparability of the outturn against original projections. Moreover, the data for realizations in this report incorporate a shift in the balance of payments methodology to the IMF's 6th Balance of Payments Manual (BPM6). Compared with the old presentation, this change relates mainly to temporary imports and re-exports which are now reported, on a net basis, as an export of services (instead of on gross basis, as gross imports and exports respectively, previously).

CONTEXT

3. **Sound macroeconomic policies strengthened Morocco's economic policy buffers in the run-up to the 2008 global financial crisis.** Real non-agriculture GDP growth averaged about 5 percent in 2003–07 and inflation was low, with modest current account surpluses helping to build a comfortable foreign reserves position (Figure 1). Reforms during this period included liberalizing the transport, energy, and telecom sectors; strengthening the financial sector; and opening up the trade regime. Strong revenue performance and prudent spending helped turn the fiscal balance into a modest surplus, with public debt falling as a percentage of GDP. Monetary policy was accommodative in the context of subdued inflation. Starting in about 2005 and continuing after the global financial crisis, the Moroccan banking sector expanded its international presence rapidly, notably in sub-Saharan Africa.[6] A Financial Sector Assessment Program (FSAP) Update in 2008 found that Morocco's banks were stable, profitable, adequately capitalized, and resilient to shocks.[7] The FSAP Update called for putting in place the prerequisites for further economic and financial sector liberalization (including the preconditions for inflation targeting), and continuing to help prepare financial institutions for a more open economic and financial system.

4. **With strong policy buffers in place, Morocco weathered the early adverse effects of the 2008 global financial crisis and the slowdown in the Euro area.** The current account widened sharply in 2008 (Figure 1), in part because of a spike in global oil prices (Text table). The following year, Morocco was affected by a sharp contraction in economic activity in its trading partners, in particular the Euro Area—notwithstanding the gradual increase in diversification of its trade flows over the preceding decade (Figure 2). The fallout on domestic activity was felt through declines in exports, tourism receipts, remittances, and FDI flows; and resulted in a widening of the current account deficit and reemergence of a fiscal deficit. As a result, non-agriculture growth slowed to about 1½ percent in 2009. The impact from the global turbulence through financial channels was limited thanks to limited exposure to international financial markets. The authorities responded with a moderate loosening of fiscal and monetary policies. The authorities issued a €1 billion Eurobond in September, 2010.

Morocco: External Environment, 2005–11

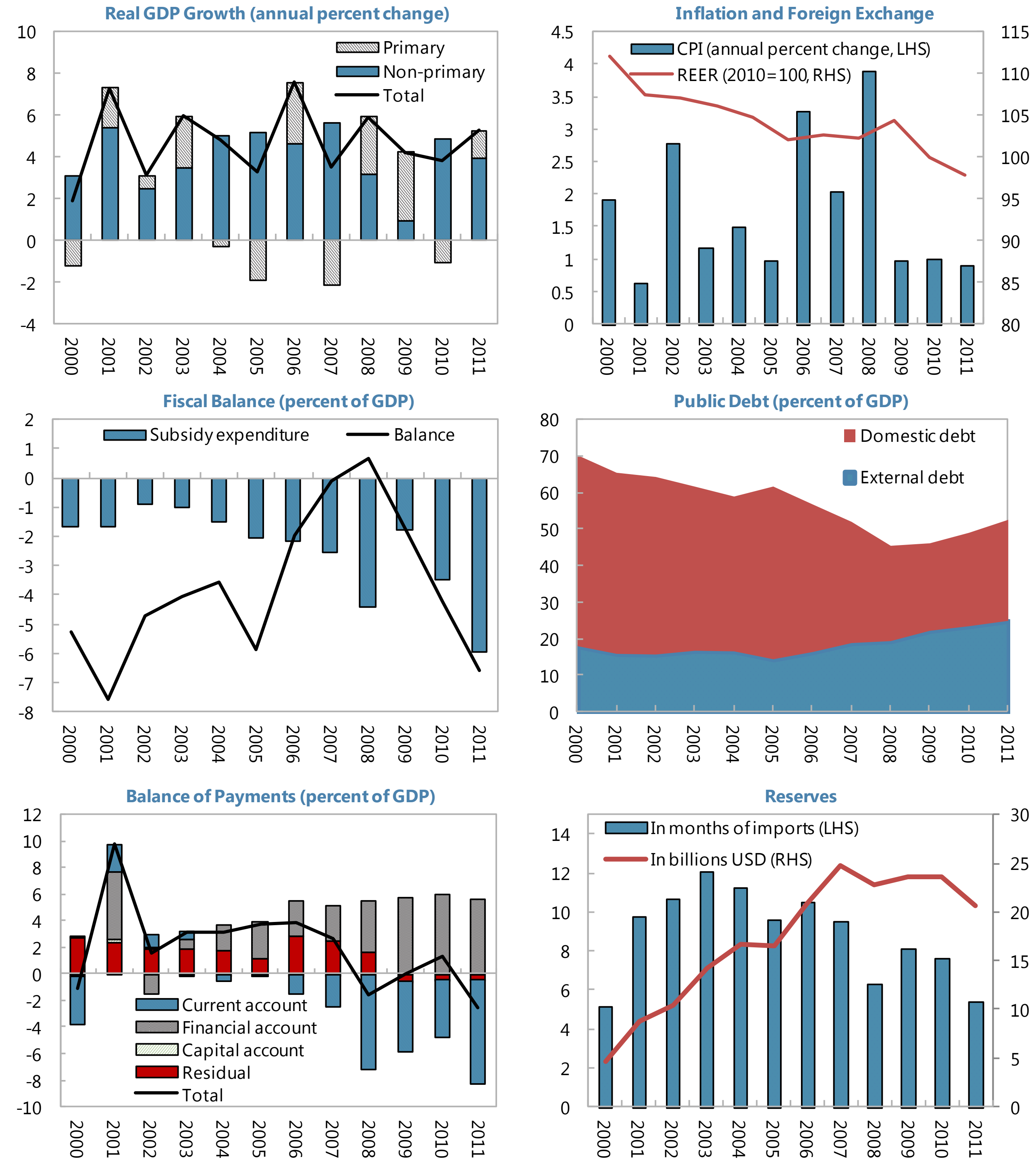
	2005	2006	2007	2008	2009	2010	2011
Oil prices (Brent, $/bbl)	54.4	65.4	72.7	97.7	61.9	79.6	111.0
Growth Euro area partners (ppts)	1.7	3.2	3.0	0.5	-4.5	2.0	1.6

Source: WEO.

[6] A Selected Issues Paper prepared for the 2014 Art. IV Consultation (and building on the Pan-African Cross-Border Exercise, PACBE) provides additional information on the expansion of Moroccan banks in Sub-Saharan Africa, as well as BAM's supervisory actions and challenges (see CR/15/106, 05/08/15).

[7] See IMF Country Report No. 08/333, October 2008.

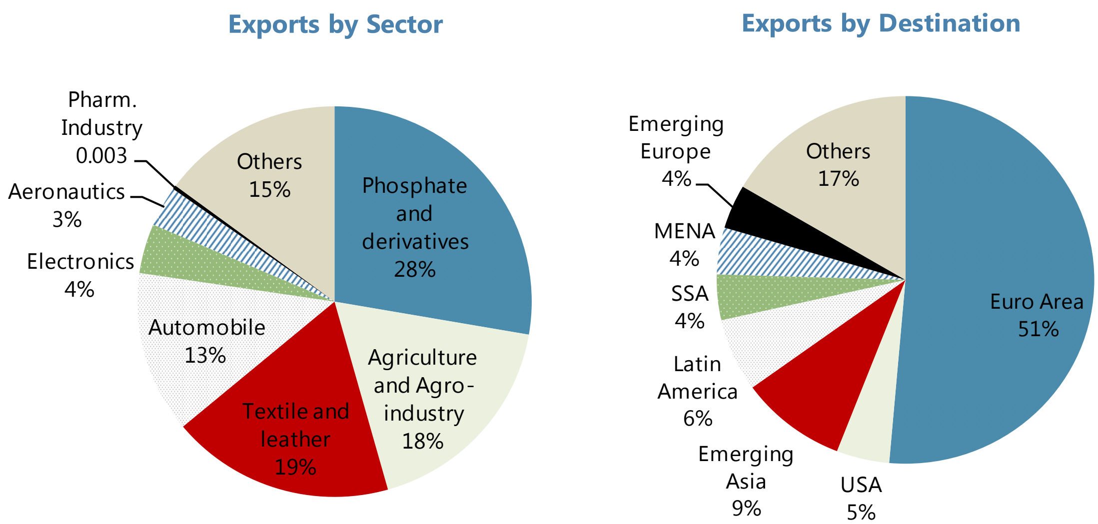
Figure 1. Morocco: Macroeconomic Performance, 2000–11



Sources: Authorities' data, and IMF staff estimates.

5. Socio-political tensions in the regional context of the "Arab Spring" and high international oil prices eroded macroeconomic buffers further in 2011. A political reform process initiated in 2011 following the "February 20" social movement resulted in a new constitution in July and elections in November 2011. Meanwhile, growth in Europe continued to be sluggish and international oil prices started rising again. Social tensions prompted the government to increase fiscal spending, including on fuel and food subsidies and on wages, to offset the impact of rising international oil and food prices on the less fortunate. These factors contributed to a further widening of the fiscal and current account deficits in 2011, with the subsidies reaching 6 percent of GDP, the public wage bill exceeding 12 percent of GDP (high compared to peers; see Figure 3), and international reserves falling.[8] In the context of continued low inflation, the central bank (Bank-al-Maghrib, BAM) gradually loosened monetary policy to respond to a tightening in liquidity conditions.

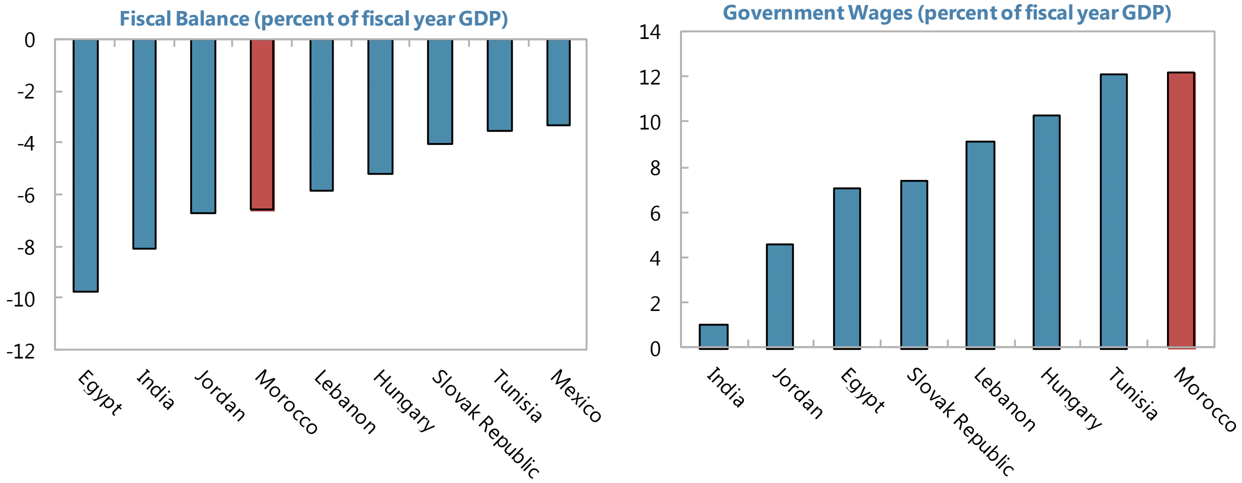
Figure 2. Morocco: Export Composition, 2011



Source: Office des Changes (Morocco).

[8] The bulk of the cost of the generalized subsidy system went to subsidizing petroleum products (gasoline, diesel, industrial fuel oil, butane, and fuel oil for electricity generation), and the remainder to wheat flour and sugar. For a detailed discussion on subsidies, see the Selected Issues Paper in CR/13/110, 05/08/13 and Box 2 in CR/15/43, 02/23/15).

Figure 3. Cross-Country Comparison: Fiscal Sector, 2011



Sources: April 2015 WEO, Moroccan authorities, and IMF staff estimates.

6. **The Moroccan authorities raised domestic fuel prices in mid-2012.** High global oil prices continued to adversely affect Morocco's international reserves and fiscal position in the first half of 2012. In June 2012, the authorities increased domestic prices of gasoline, diesel, and fuel oil by 20 percent, 14 percent, and 27 percent, respectively. These measures, taken at the risk of reviving social pressures, aimed to maintain fiscal and external sustainability and were part of a broader reform agenda to improve the targeting and effectiveness of social protection.

PROGRAM DESIGN

A. Program Objectives and Design

7. **The PLL arrangement with Morocco approved in August 2012 aimed to provide insurance and signaling, and targeted gradual fiscal consolidation to strengthen fiscal and external buffers and reduce macroeconomic vulnerabilities.** The PLL arrangement was expected to provide insurance against shocks and signal that the authorities' policies were sound and that Morocco had adequate financial resources to draw upon. The authorities indicated their intention to treat the PLL arrangement as precautionary, and draw on the PLL arrangement only in the event external risks materialized. The authorities envisaged a gradual reduction in fiscal and current account deficits to address vulnerabilities stemming from Morocco's trading partners and/or international oil prices (Table 1), which would then also allow international reserves to be rebuilt and reverse the upward trend on the public debt ratio. And, in a context of domestic and regional tensions, the reform agenda also sought to support higher potential growth, strengthen the social safety net, and reduce unemployment.

Table 1. Morocco: Selected Economic Indicators, 2012 PLL Arrangement Request

	2011	2012	2013	2014	2015	2016
		Projections				
	(Annual percentage change)					
Output and Prices						
Real GDP (market price)	4.9	2.9	5.5	5.1	5.3	5.6
Consumer prices (period average)	0.9	2.2	2.5	2.5	2.5	2.5
	(In percent of GDP)					
Public Finances						
Revenue	27.6	28.3	28.1	27.5	27.3	26.7
Expenditure	34.5	34.4	33.3	32.1	31.0	29.9
Compensation of employees	12.2	12.5	12.1	11.7	11.3	10.8
Use of goods and services; grants	6.3	6.3	6.9	6.8	6.7	6.6
Subsidies	6.1	6.1	4.3	3.8	3.4	3.0
Budget balance	-6.9	-6.1	-5.3	-4.6	-3.8	-3.2
Cyclically adjusted fiscal balance	-5.0	-4.4	-4.0	-3.9	-3.8	-3.2
Cyclically adjusted fiscal balance, excluding grants	-5.1	-5.0	-5.2	-5.0	-4.9	-4.2
Total government debt	54.3	56.9	57.8	58.1	57.5	56.3
	(In percent of GDP; unless otherwise indicated)					
External Sector						
Current account excluding official transfers	-8.4	-8.1	-5.9	-5.0	-4.8	-4.7
Total external debt	23.6	24.4	23.9	23.4	22.7	22.1
Gross reserves (in billions of U.S. dollars)	20.6	17.9	18.8	20.3	21.6	22.8
In months of next year imports of goods and services	4.9	4.0	3.9	4.0	4.0	4.0

Sources: Moroccan authorities; and IMF staff estimates.

8. **The authorities' medium-term macroeconomic objectives were to lift potential growth and reduce unemployment.** Potential growth was expected to increase by one percentage point to 5½ percent and the unemployment rate to fall to 8 percent by 2016. To that end, the authorities intended to improve the business climate and economic governance; strengthen ongoing trade reform; develop highly productive economic sectors; develop alternative energy sources; and encourage a shift from the informal to the formal sector. While the envisaged growth impact of those measures was hard to quantify (and this was not attempted in the PLL arrangement request), it appeared that the growth target was ambitious. It exceeded average annual non-agriculture growth over 2000–08, and meeting it required swift implementation of pro-growth measures (including ramping up of public investment spending), in addition to relatively quick dissipation of external risk factors. The authorities also aimed to reduce structural unemployment and increase labor force participation rates, by strengthening ongoing labor market programs, improving labor market flexibility, and reducing hiring costs.

9. **The fiscal deficit was expected to fall gradually as a result of spending restraint, with subsidy and wage reform at its core, and the macroeconomic framework envisaged realigning spending composition towards investment.** The authorities envisaged:

- Reducing the fiscal deficit by 2.3 percentage points of GDP by end-2014 (from 6.9 percent of GDP at end-2011), half of which would be reflected in improvements in the cyclically-adjusted fiscal balance, and to about 3 percent of GDP by end-2016.

- Maintaining tax revenues broadly constant in percent of GDP, with the authorities' revenue strategy focusing on keeping a tax climate that was conducive to growth. Reforms were mainly aimed at improving the efficiency of the taxation system and supporting competitiveness. Staff advised the government to make sure that gains from broadening the tax base were solid before considering lowering tax rates. Grants were expected to increase during the PLL arrangement period, including from the GCC countries, which would help cushion the impact of a reduction in the fiscal deficit on growth (the cyclically-adjusted fiscal balance excluding grants was expected to remain relatively constant).

- Reforming the subsidy system, with the objective of halving subsidy outlays by 2016, and accompanying this with better targeting of social protection to vulnerable groups.

- Rationalizing non-essential recurrent spending and moderating the wage bill (starting in 2013). The macroeconomic framework envisaged using such additional fiscal space to improve basic infrastructure which, along with improvements in the efficiency of investment spending, would bolster growth.

- Implementing structural reforms in the fiscal area, including modernizing regulations governing public procurement, redesigning the organic budget law (OBL), and overhauling the pension system.

10. Fiscal consolidation was expected to put external and public debt ratios on a declining trajectory starting in 2015. The external debt ratio (almost entirely public) was expected to peak at about 24½ percent of GDP in 2012, and the public debt ratio at about 58 percent of GDP in 2014. The gradual reduction in the debt ratio over the medium term was to be achieved via a reduction in the primary fiscal deficit and a pick-up in real GDP growth.

11. Taken together, the fiscal strategy appropriately balanced the trade-off of strengthening buffers and supporting growth in a difficult socio-economic and external environment. The strategy appropriately identified wages and subsidies as core elements of the consolidation effort, given their size and contribution to vulnerabilities. The envisaged wage moderation was expected to yield only modest results (0.5 percent of GDP) over 2012–14, which made reaching the target feasible in spite of a difficult socio-economic context. Moderation of current spending, along with higher grants, would create additional fiscal space to ramp up pro-growth investment spending while also reducing the overall fiscal deficit. That said, the PLL arrangement request could have laid out in greater detail the envisaged reform strategy—given that subsidy and wage reform take time to implement—and whether there were any possible contingency plans to ensure the robustness of the fiscal consolidation plan, including in the event growth turned out lower than anticipated.

12. Monetary policy would ensure price stability while supporting growth, in the context of a pegged exchange rate. The authorities envisaged eventually moving to formal inflation targeting, with a more flexible exchange rate, once the proper preconditions (such as stronger fiscal buffers and, specifically, subsidy reform) were in place. The authorities were nevertheless less committal in the PLL arrangement request, stating that they planned to maintain the peg to the euro-dollar basket "for the time being." The authorities' gradual approach to adapting the monetary policy and exchange rate regime was appropriate, given the presence of significant external risks and the focus of the reform program on first strengthening buffers, while laying further groundwork with the help of Fund TA.

13. BAM committed to monitoring the health of the banking system through strong regulation and effective supervision. The central bank would gradually implement Basel III norms. It also intended to maintain its requirements for adequate funding for nonperforming loans (NPLs) and strengthen micro-prudential surveillance. The authorities also intended to further develop capital markets, with plans to develop Casablanca into a major regional financial center.

14. Macroeconomic policies aimed to strengthen the external position. The current account deficit was expected to be halved by end-2014 and settle around 3½ percent of GDP over the medium term. The improvement in the savings/investment balance would come from fiscal consolidation (notwithstanding an increase in public investment), the expansion of new industrial plants, and the coming-on-line of large-scale FDI-financed projects. The gradual fiscal consolidation, steady FDI inflows, and higher potential growth, would help keep the ratio of external debt to GDP in the range of 22–24 percent of GDP over the medium term.

15. Gross international reserves would be rebuilt. Gross international reserves were expected to stabilize in the second half of 2012. The PLL arrangement targeted maintaining a level of gross international reserves of at least 85 percent of the Fund's reserve adequacy (ARA) metric. While such coverage would be below the level for end-2011 (when reserves were close to 100 percent of the ARA metric), this was considered adequate given the non-convertibility of the Dirham and existing capital controls limiting foreign exchange outflows.[9]

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[9] For a country with a fixed-exchange rate, the reserve metric is defined as the sum of (i) short-term debt (30 percent); (ii) medium- and long-term debt and equity liabilities (15 percent); (iii) broad money (10 percent); and (iv) exports of goods and services (10 percent). For details, see *Assessing Reserve Adequacy* (IMF Policy Paper, February 2011). This paper suggests that coverage in the region of 100–150 percent of the metric would be adequate for a typical country. However, the weight of M2 could be reduced where effective capital controls are in place that would prevent capital flight (page 28). The recent Board paper on reserve adequacy, discussed at the Board after the expiration of the 2012–14 PLL arrangement with Morocco, introduced an *adjusted* ARA metric which incorporates halving the weight of broad money used in the metric (see *Assessing Reserve Adequacy—Specific Proposals*, IMF Policy Paper, April 2015).

16. Program monitoring included two quantitative indicative targets (ITs) and standard performance criteria. The ITs, to be assessed at end-April and end-October, were (i) a ceiling on the fiscal deficit and (ii) a floor on net international reserves of BAM.[10] The IT on the fiscal deficit included an adjustor on budgetary grants, and the IT on net international reserves on official grants and loans. The choice of these targets was appropriate given the vulnerabilities that the program aimed to address. Program documentation included a number of other indicators that facilitated program monitoring, such as the cyclically-adjusted balance (later in the program supplemented by the cyclically-adjusted primary balance excluding grants) and reserve metrics. The program also included standard continuous performance criteria.[11] There were no prior actions or structural benchmarks.

B. How was Access Determined?

17. Access was motivated by a scenario that simulated the impact of a plausible combination of adverse external demand and supply shocks. The adverse scenario built on the two most immediate risks identified in the April 2012 WEO: a renewed escalation of the euro area crisis and a sharp increase in the price of oil triggered by heightened geopolitical uncertainty.[12] Morocco was vulnerable to such adverse developments, with exports and FDI depending on developments in Europe, and with energy products making up about one quarter of merchandise imports.

18. Estimated financing needs resulting from the adverse scenario were large enough to justify exceptional access to Fund resources. The analysis assumed that the two shocks would be transmitted to Morocco through lower growth, a widening current account deficit (lower exports and transfers, higher oil imports), and lower FDI. Financial spillovers were not expected to be significant. The adverse scenario set a target for international reserves at 85 percent of the Fund's ARA metric, which was deemed sufficient for a country with a peg and with capital controls in place, such as Morocco, while not undermining the credibility of the peg. Taken together, the cumulative financing need over two years was estimated at about US$6.0 billion, of which about US$3.6 billion in the first year. These amounts broadly corresponded to the access and phasing requested under the PLL arrangement. The scenario did not assume additional policy adjustments or alternative sources of financing to cover potential financing needs, while the staff appraisal noted that the PLL arrangement could facilitate access to international markets.

[10] Table 5 has the targets and outturns for the ITs at each of the reviews.

[11] These cover trade and exchange restrictions, bilateral payment arrangements, multiple currency practices, and external arrears.

[12] Specifically, relative to baseline projections the program assumed an oil price increase of US$10 and US$8 per barrel, and a decrease in Morocco's trading partners' growth by 4 and 2½ percentage points, respectively, in the first and second year of the program.

19. Risks to the Fund from the full purchase of the amount available under the PLL arrangement were manageable. The risk assessment specified as the main sources of risk to the Fund that (i) the authorities would be unable to introduce the necessary reforms, particularly a permanent reduction and rationalization of subsidies and transfers, in the context of social pressures; and (ii) exogenous shocks, particularly from Europe, could be greater and more protracted than previously expected. These were made "manageable" by early Fund engagement, strong ownership, and sound historic policy execution of the authorities, as well as the low level of total external debt. If drawn, it was estimated that the amount of Fund credit made available under the PLL arrangement would have increased external public debt to about 29 percent of GDP. Cross-country comparison suggested that this level of external public debt was in line with other Fund precautionary arrangements at the time. Total public debt was assessed to be relatively high and was seen as a potential risk, but one that the program aimed to address. Nevertheless, the staff report for the PLL arrangement request could have usefully submitted the adverse scenario (with drawing) to a full DSA evaluation, as this would have further complemented the risk assessment.

20. "Exit" prospects were considered high provided external risks diminished. The authorities envisaged that a reduction of external risk factors and the envisaged policies to strengthen fiscal and external buffers, including to support growth, would make for high exit prospects by the end of the 2012–14 PLL arrangement. Staff concurred that the authorities' intended policies would reduce medium-term vulnerabilities.

DID THE PROGAM ACHIEVE ITS OBJECTIVES?

A. Context—Evolution of Risks

21. External risk factors turned out less favorable than anticipated. The risk of higher oil prices loomed throughout the period of the arrangement. The risk stemming from Europe shifted from a near-term risk of a sharp slowdown to that of a medium-term risk of a protracted period of slow growth (Table 6). In the latter part of the PLL arrangement, a surge in global financial market volatility emerged as a new risk. Ex post, global oil prices in 2012–14 exceeded expectations by an average of US$8½ per barrel annually, in fact close to the oil price shock of the adverse scenario included in the PLL arrangement request (Text table). Growth in EU area trading partners was more sluggish than expected (by an average of 1 percent annually), but not as dramatically as in the adverse scenario.

Morocco: External Environment, 2012–14

	2012	2013	2014
Oil prices (Brent, US$/bbl)			
At PLL prog. request	106.50	95.80	91.60
Actual 1/	111.96	108.84	98.94
Deviation from projection	5.46	13.04	7.34
Euro area partners'growth (annual percent change)			
At PLL prog. request	-0.17	0.98	1.72
Actual 1/	-0.90	-0.46	0.84
Deviation from projection	-0.73	-1.44	-0.88

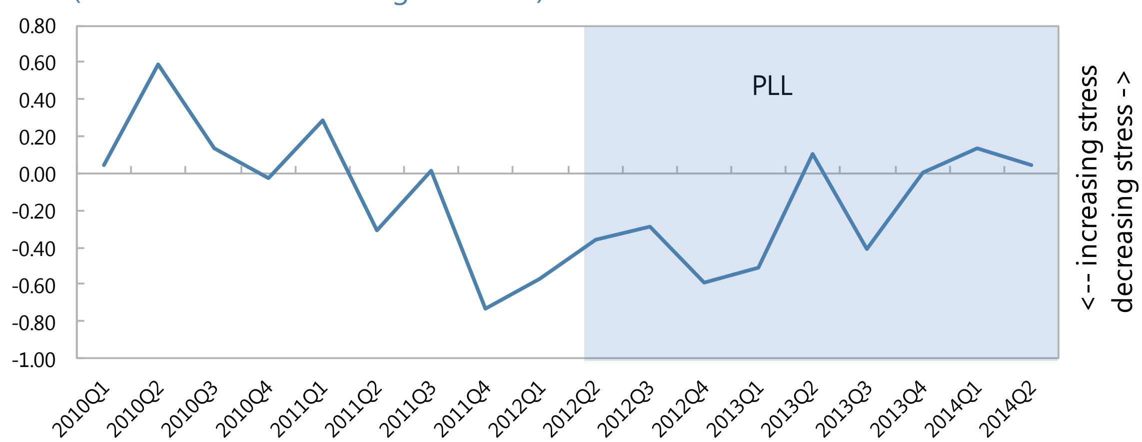
Sources: WEO, and the 2012 PLL request macroframework.
1/ Figures are from the April 2015 WEO.

22. Domestically, a slower-than-needed pace of reforms resulting from regional socio-political tensions remained the most prominent risk. It was assessed that such tensions could potentially hinder progress in moderating the wage bill and reforming the general subsidy system, which would in turn reduce fiscal space and increase debt. In effect, the political uncertainty from a cabinet reshuffle initiated in summer 2013 delayed policymaking in some areas, until the formation in October 2013 of a new coalition government.

23. External stress from the main risk factors appeared to ease towards the end of the PLL arrangement. At the conclusion of the 2014 review of the FCL and PLL, Directors endorsed the introduction of an "external stress index" (ESI) to inform the discussion of the external environment facing a member.[13] While Morocco's 2012–14 PLL arrangement predates the concept of an ESI, for illustrative purposes staff reconstructed an ESI ex post covering the 2012–14 PLL arrangement, based on methodology discussed in Box 1 of the first review of the 2014–16 PLL arrangement for Morocco (see CR/15/44, 02/23/15). Applied to Morocco, the ESI covers the main contributors to external shocks from the Global Risk Assessment Matrix (G-RAM): growth in Europe, global oil prices, and volatility of capital flows (incl. the "taper tantrum" flare-up in mid-2013). The illustrative ESI suggests some abating of external stress (text figure).

Morocco: PLL External Stress Indicator, 2010Q1-2014Q2

(Lower values indicate higher stress)



Source: Authorities' data and IMF staff estimates.

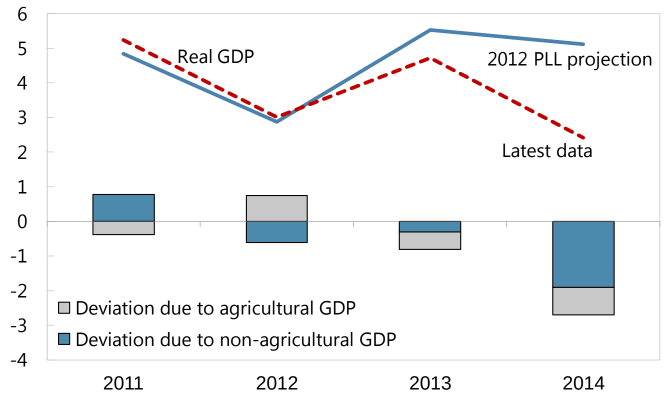
[13] See Press Release No. 14/352, 07/21/14.

B. Macroeconomic and External Sector Developments

24. The overall macroeconomic environment remained stable, but with lower growth than expected. Average annual inflation was below two percent in 2012 through 2014, in part because of lower food prices, a stable exchange rate, and relatively tight domestic liquidity conditions. Real growth in the non-agriculture sector, while 4.7 percent in 2012, was only about 3 percent on average in 2013–14, well below the 5.0–5¼ percent envisaged at the start of the PLL arrangement (Text figure).[14] Part of the shortfall in growth can be attributed to the weaker external environment.[15] The growth outturn was not strong enough to make a dent in the unemployment rate, which remained at about 9 percent. International reserves were rebuilt and by end-2014 stood at 95 percent of the ARA metric and 5.9 months of imports.

Morocco: Real GDP Growth, 2011-14

(Annual percentage change, realized vs. 2012 PLL request projections)



Sources: Authorities' data, and IMF staff estimates.

25. The current account deficit improved significantly, albeit by less than expected. From a savings/investment perspective, subdued private-sector savings were an important determinant of the underperformance of the current account compared to program projections, and the government fiscal consolidation accounted for much of the improvement through 2014. The current account deficit initially rose to 9.5 percent of GDP in 2012, against a projection of 7.4 percent of GDP. It improved steadily in 2013–14 but not by enough to compensate for the 2012 slippage and, as a result, was on average nearly 2½ percent of GDP above initial projections (Figure 4).

26. Staff analysis suggests that the weaker outturn for the current account was mainly due to external shocks. Much of the underperformance in the current account was due to lower exports of phosphates and transfers (notably workers' remittances), and, to a lesser degree, tourism receipts. Non-phosphate exports proved more resilient and actually increased over 2012–14 in percent of GDP. Increased oil imports due to high oil prices were more than offset by declines in other imports (Table 2). A staff analysis to quantify the main factors for the weaker outturn for the current account suggests that external shocks—notably from phosphate prices, oil prices, and trading partner growth—contributed much of the shortfall. On the domestic side, relatively lower growth reduced

[14] See also Figure 9 at the end of this paper for a comparison of projections and outturn for a selected set of macroeconomic variables.

[15] 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 CR/13/110 (05/08/13).

imports, while the lower-than-expected fiscal consolidation is estimated to have contributed about half a percent of GDP to the underperformance of the current account.

Table 2. Morocco: Balance of Payments—Deviation from 2012 PLL Arrangement Projections

	2011		2012		2013		2014		2011–14		
	Base 1/	Act. 2/	Prog. 1/	Act. 2/	Prog. 1/	Act. 2/	Prog. 1/	Act. 2/	Target	Realized	Dev.
	(1)	(2)					(3)	(4)	(3)-(1)	(4)-(2)	
	(Percent of GDP)										
Current account	**-8.0**	**-7.9**	**-7.4**	**-9.5**	**-4.5**	**-7.9**	**-3.7**	**-5.5**	**+4.3**	**+2.4**	**-1.9**
Balance of goods and services	-14.2	-13.8	-14.1	-15.1	-12.1	-14.5	-11.4	-12.2	+2.7	+1.6	-1.2
Trade balance	-19.6	-21.0	-19.7	-22.3	-17.9	-20.5	-17.1	-18.6	+2.5	+2.4	-0.1
Exports, f.o.b.	21.7	15.8	23.4	17.3	25.4	17.1	25.5	18.1	+3.8	+2.3	-1.5
o.w. Phosphates and derived	6.0	5.9	6.9	5.7	7.1	4.1	7.2	4.1	+1.2	-1.8	-3.0
Imports, f.o.b.	-41.2	-36.8	-43.1	-39.6	-43.2	-37.5	-42.6	-36.7	-1.3	+0.1	+1.4
Energy	-11.2	-11.0	-11.6	-12.6	-10.0	-11.3	-9.1	-10.0	+2.1	+1.0	-1.1
Other imports	-30.0	-25.8	-31.6	-27.1	-33.2	-26.2	-33.5	-26.7	-3.4	-0.9	+2.5
Services	5.4	7.2	5.6	7.2	5.7	6.0	5.7	6.4	+0.3	-0.8	-1.0
o.w. Tourism	7.4	7.2	7.2	6.8	6.8	6.4	6.5	6.4	-0.9	-0.8	+0.1
Income	-2.1	-2.0	-2.1	-2.3	-2.0	-1.5	-1.8	-2.3	+0.3	-0.3	-0.6
Transfers	8.2	7.9	8.8	7.8	9.6	8.1	9.5	9.0	+1.3	+1.1	-0.2
o.w. Workers' remittances	7.2	7.0	7.2	6.9	7.2	6.4	7.2	6.2	-0.0	-0.8	-0.8
Capital account	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**+0.0**	**+0.0**	**+0.0**
Financial account	**5.7**	**5.6**	**4.7**	**6.3**	**5.5**	**8.8**	**5.1**	**7.9**	**-0.5**	**+2.3**	**+2.8**
Direct investment	2.3	2.4	2.5	2.4	2.7	2.8	2.6	2.9	+0.3	+0.5	+0.2
Portfolio investment	-0.2	-0.2	0.1	1.6	0.1	1.2	0.1	2.9	+0.3	+3.1	+2.8
Other	3.6	3.5	2.2	2.3	2.7	4.8	2.5	2.2	-1.1	-1.3	-0.2
Private	1.9	1.8	1.2	1.0	1.4	2.6	1.3	1.0	-0.6	-0.8	-0.2
Public	1.7	1.7	0.9	1.3	1.3	2.2	1.2	1.2	-0.5	-0.5	+0.0
Reserve asset accumulation (- increase)	2.4	2.1	2.6	1.3	-1.0	-1.1	-1.4	-0.9	-3.8	-3.0	+0.8

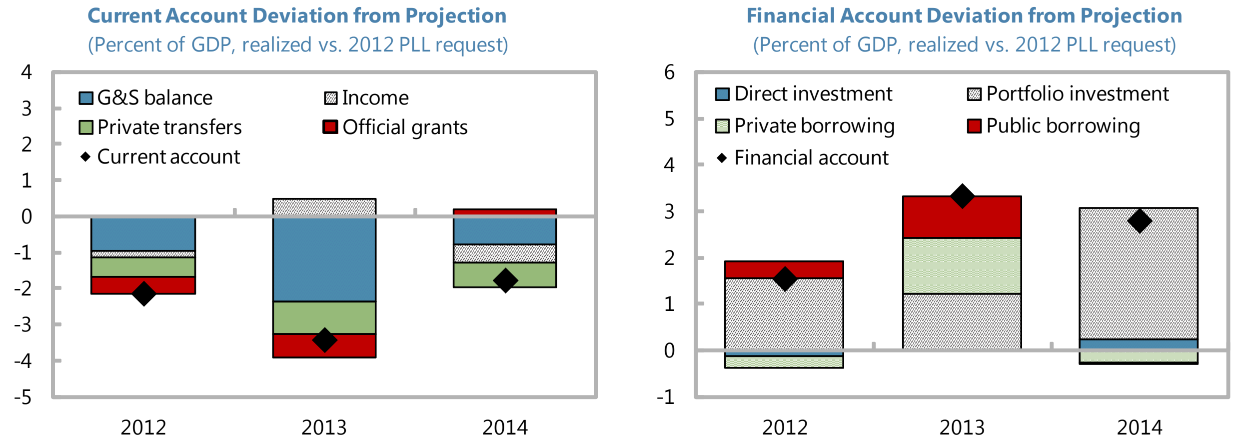
Sources: Ministry of Finance; *Office des Changes;* and IMF staff estimates and projections.

1/ Projections from the 2012 PLL request.

2/ Using national accounts with base year 2007.

27. Gross international reserves were rebuilt because of higher public and private borrowing. The underperformance in the current account was offset by higher net inflows in the financial account (Figure 4). Foreign direct investment was largely in line with expectations. But external borrowing was stronger than expected, resulting in a ratio of external debt to GDP of 30.4 percent of GDP by end-2014, exceeding initial projections by about 7 percentage points of GDP (Figure 5). Additional borrowing reflected continued market access, with the authorities tapping the international bond market for US$1.5 billion in December 2012, US$750 million in May 2013, and €1 billion in June 2014. The state-owned phosphate office (OCP) raised US$1.8 billion in Eurobonds in April–May, 2014. Morocco continued to benefit from relatively low sovereign spreads. Morocco continued to have lower sovereign bond spreads than the emerging markets group and regional peers (Figure 5). Results from a cross-country event study, discussed in the January 2014 review of the PLL and FCL facilities, suggest that the PLL arrangement with Morocco could have contributed to lower spreads, although the result was not found to be statistically significant.[16]

Figure 4. Morocco: Current and Financial Account Performance, 2012–14

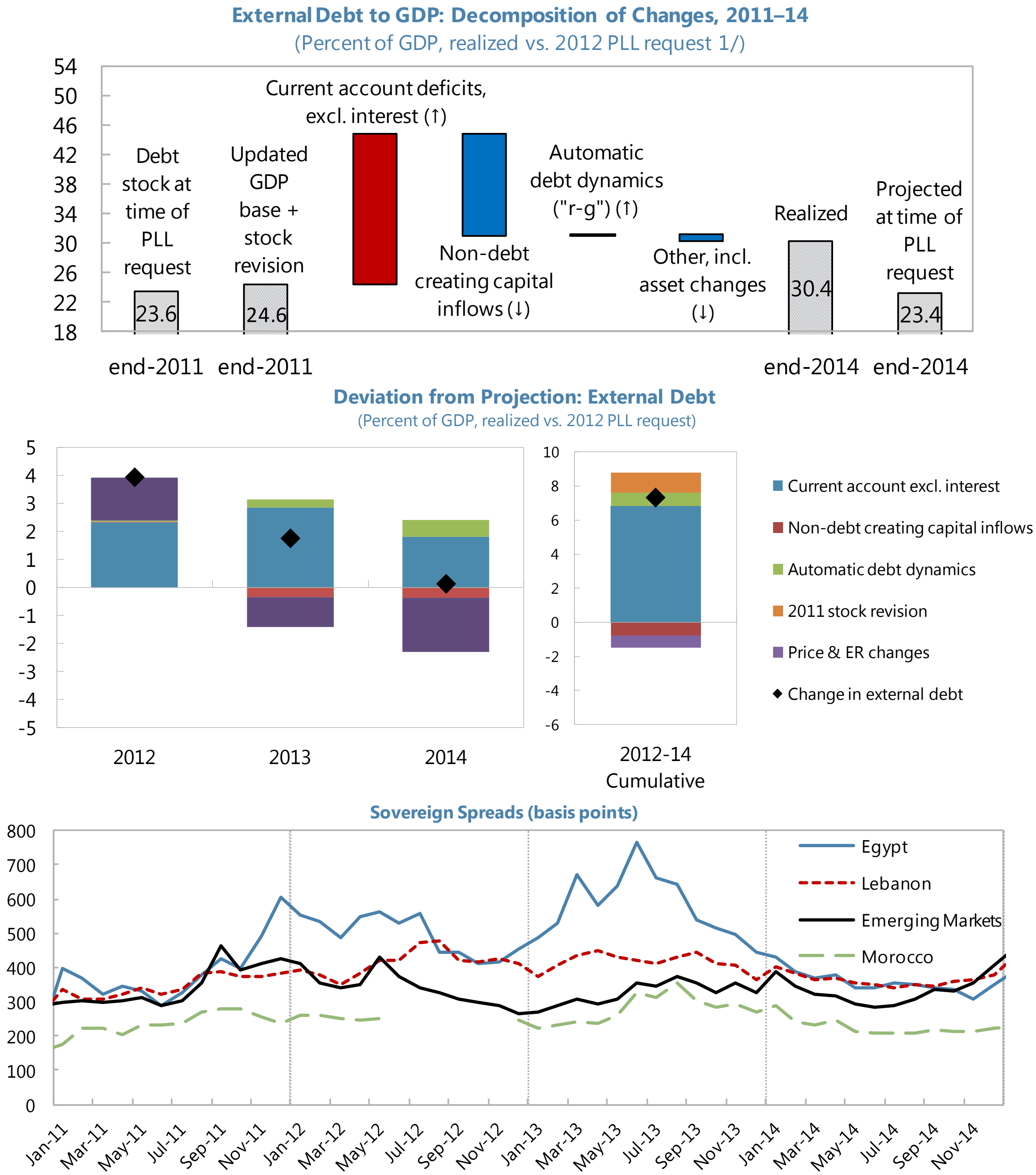


Sources: Authorities' data, and IMF staff estimates.

28. **Even though the PLL arrangement's "adverse" scenario materialized in part, the authorities did not draw on available amounts.** As noted above, some of the assumed external shocks embedded in the "adverse scenario" at the time of the PLL arrangement request materialized, including higher global oil prices and lower growth in Europe. In fact, the 2013 outturn for the trade deficit was close to that of the original adverse scenario, suggesting that the original impact analysis was plausible. The main difference with the adverse scenario is that, on the financing side, FDI held up better than expected and that additional external borrowing covered the financing needs. With the benefit of hindsight, the initial adverse scenario may have been overly pessimistic in the ability of Morocco to continue accessing financial markets (and performance under the PLL arrangement may have supported such access); nevertheless, such a case was harder to make *ex ante* in light of the relatively fragile external environment at the time.

[16] See Box 2 in "Review of the Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument (IMF Policy Paper, January 2014)."

Figure 5. Morocco: External Debt Profile, 2011–14



Sources: Authorities' data, IMF staff estimates, and Bloomberg.

1/ This ratio is based on debt and GDP in dollar terms as a period average.

C. Fiscal Developments

29. The fiscal deficit was reduced, after an initial slippage in 2012. The reduction in the deficit was achieved mainly thanks to a sharp reduction in subsidy spending, with additional contributions from non-tax revenue (Table 3). The government met the end-October 2012 ITs but missed the end-year projection for the fiscal balance by more than 1 percent of GDP (see also below). In 2013, the government missed the revised fiscal deficit IT at end-October 2013, but the end-year outturn was nonetheless more than two percentage points of GDP smaller than in 2012. The fiscal deficit also fell in 2014, putting the fiscal deficit on track to achieve the medium-term target of 3 percent of GDP by 2017, one year later than initially planned. Both the end-2012 slippage and the subsequent reduction in the fiscal deficit are reflected in the cyclically-adjusted fiscal balance, suggesting a dominant impact of policies rather than the business cycle.

30. The end-2012 fiscal slippage exposed some institutional weaknesses in budget execution. The main contributors to the end-2012 slippage were overruns on wages (0.3 percent of GDP), subsidies (0.3 percent of GDP), and capital transfers (0.6 percent of GDP).[17] About two-thirds of the overrun was due to underestimation of expenditure still in the pipeline, and the remainder from expenditure made in December of 2012. These overruns highlighted the need to address weaknesses in budget monitoring and forecasting, and in expenditure controls; in particular: (i) that wage ceilings adopted in budget laws were not binding and could be amended throughout the year; (ii) that unspent appropriations for investment could be carried over across budget years; and (iii) that unspent balances on special treasury accounts could be automatically rolled over across budget years.

31. Coming relatively close after the start of the program, the slippage and its causes necessitated strong and credible actions to ensure continued PLL qualification and keep the program's objectives within reach. In response, the authorities set up committees to monitor budget execution and transfers, and issued directives to ensure the wage bill became binding and to limit the risk of a carryover of unspent investment appropriations, all in anticipation of the submission of the new OBL to parliament expected later that year. The authorities also met the end-April 2013 fiscal target and committed to a new end-2013 fiscal target, which was somewhat higher because some spending could not be easily reversed (e.g., from the full-year impact of earlier wage measures) and tax revenues were expected to be weaker than expected. The authorities also took additional action on subsidy reform. Taken together, these actions demonstrated the authorities' strong commitment to the program and prevented the need for introducing targeted prior actions or structural benchmarks.

[17] Data reported at the time of the second review of the PLL arrangement in July 2013. For additional information, see also see Box 1 and paragraph 19 of CR/13/302, 09/27/13.

Table 3. Morocco: Deviation from 2012 PLL Arrangement Fiscal Targets

	2011		2012		2013		2014		2011-14		
	Base 1/	Act.	Prog. 1/	Act.	Prog. 1/	Act.	Prog. 1/	Act.	Target	Realized	Dev.
	(1)	(2)					(3)	(4)	(3)-(1)	(4)-(2)	
	(Percent of GDP)										
Revenue	**27.6**	**27.2**	**28.3**	**28.0**	**28.1**	**27.7**	**27.5**	**28.0**	**-0.1**	**+0.8**	**+0.9**
Taxes	23.6	23.0	24.2	23.9	24.0	22.3	23.7	22.0	+0.1	-1.0	-1.1
Grants	0.2	0.2	0.6	0.1	1.2	0.7	1.1	1.5	+0.9	+1.3	+0.4
Other revenue	3.8	4.0	3.5	4.1	2.9	4.8	2.7	4.5	-1.1	+0.5	+1.6
Total Expenditures	**34.5**	**33.8**	**34.4**	**35.3**	**33.3**	**32.9**	**32.1**	**33.0**	**-2.4**	**-0.8**	**+1.6**
Current expenditures	29.9	28.6	29.3	29.9	27.5	27.8	26.4	27.6	-3.6	-0.9	+2.6
Compensation of employees	12.2	12.2	12.5	12.8	12.1	12.5	11.7	12.7	-0.5	+0.5	+1.0
Use of goods and services	2.8	2.7	2.8	2.5	3.3	2.4	3.2	2.6	+0.4	-0.2	-0.6
Interest	2.3	2.2	2.4	2.4	2.4	2.6	2.4	2.8	+0.1	+0.5	+0.4
Subsidies	6.1	6.0	6.1	6.5	4.3	4.6	3.8	3.5	-2.3	-2.4	-0.1
Grants_E	3.4	3.8	3.5	4.2	3.6	4.2	3.6	4.5	+0.1	+0.7	+0.5
Other expense 2/	3.1	1.7	2.0	1.4	1.8	1.5	1.7	1.6	-1.4	-0.1	+1.3
Net acquisition of nonfinancial assets 2/	4.6	5.2	5.1	5.4	5.8	5.1	5.8	5.4	+1.1	+0.1	-1.0
Overall Fiscal Balance	**-6.9**	**-6.6**	**-6.1**	**-7.3**	**-5.3**	**-5.2**	**-4.6**	**-4.9**	**+2.4**	**+1.6**	**-0.7**
Cyclically Adj. Fiscal Balance	**-5.0**	**-6.7**	**-4.4**	**-7.4**	**-4.0**	**-5.6**	**-3.9**	**-5.9**	**+1.1**	**+0.9**	**-0.2**
Cyclically Adj. Fiscal Balance, excl. grants	**-5.1**	**-6.9**	**-5.0**	**-7.5**	**-5.2**	**-6.3**	**-5.0**	**-7.4**	**+0.2**	**-0.5**	**-0.6**
Memorandum item:											
Current expenditures, excl. subsidies	23.8	22.6	23.2	23.4	23.2	23.2	22.6	24.1	-1.3	+1.5	+2.8
Current primary expenditures, excl. subsidies	21.6	20.4	20.9	20.9	20.8	20.6	20.2	21.3	-1.4	+0.9	+2.3

Source: Ministry of Finance and Privatization and IMF staff estimates.

1/ Projections from the 2012 PLL request.

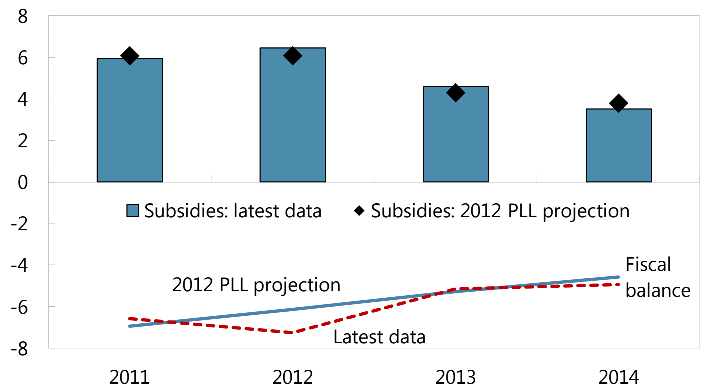
2/ Following recommendations of a TA mission in early 2013 and in line with GFSM 2001 guidelines, some elements previously recorded under "Other expense" were reclassified as "Net acquisition of nonfinancial assets". The data on the 2011 outturn (i.e. "Actual") incorporate these revisions.

32. Overall revenue exceeded program expectations, in spite of a shortfall in tax revenues from relatively weaker economic growth. The shortfall in tax revenue was more than offset by higher non-tax revenue, while higher grants also contributed. The authorities held a consultative National Tax Conference in April 2013 to build consensus on reforms and help shape their strategy and action plan. The 2014 budget introduced measures to remove exemptions on large agricultural firms, reform the VAT regime, and better enforce tax payments by self-employed and liberal professions.

33. The expected reallocation of spending in favor of investment did not occur, in part because of difficulties in containing non-subsidy current spending, notably the wage bill. The program envisaged a gradual moderation in non-subsidy current spending over 2011–14, freeing up fiscal space for a similar increase in investment spending. The wage bill (as a percentage of GDP) was expected to gradually decline from 2013 onwards and fall below 12 percent of GDP in 2014, thanks to a stabilization of the public workforce and improved payroll control and monitoring systems. However, the wage bill reached 12.7 percent of GDP in 2014. Investment spending fell short of targets in 2013 and 2014, which helped achieve the envisaged reduction in the fiscal deficit.

34. Subsidy reform was a major accomplishment. The subsidy bill initially continued to rise through 2012 to 6.5 percent of GDP, in spite of the mid-2012 increases in domestic prices for some fuel products (Text table and Table 4). Strong measures, especially from the second half of 2013 onwards, succeeded in reducing the subsidy bill to 3.5 percent of GDP by end-2014. These included: (i) the introduction of a partial indexation system for the prices of gasoline, diesel, and industrial fuel in mid-August 2013; (ii) the removal of subsidies on gasoline and industrial fuel oil in February 2014, and on fuel oil for electricity generation in June 2014; (iii) step reductions of the per-unit subsidy on diesel in February, April, and July 2014 (and, subsequently, its elimination in January 2015). Quotas for subsidized wheat were reduced in 2013. Transparency in implementation and accompanying measures to strengthen the social safety net may have helped to build the necessary consensus in pushing through such politically difficult reforms. The remaining elements in the subsidy reform agenda were wheat, sugar, and, especially, butane (which may also be the most sensitive).

Morocco: Fiscal Balance and Subsidy Expenditure, 2011–14
(Percent of GDP, realized vs. 2012 PLL projection)

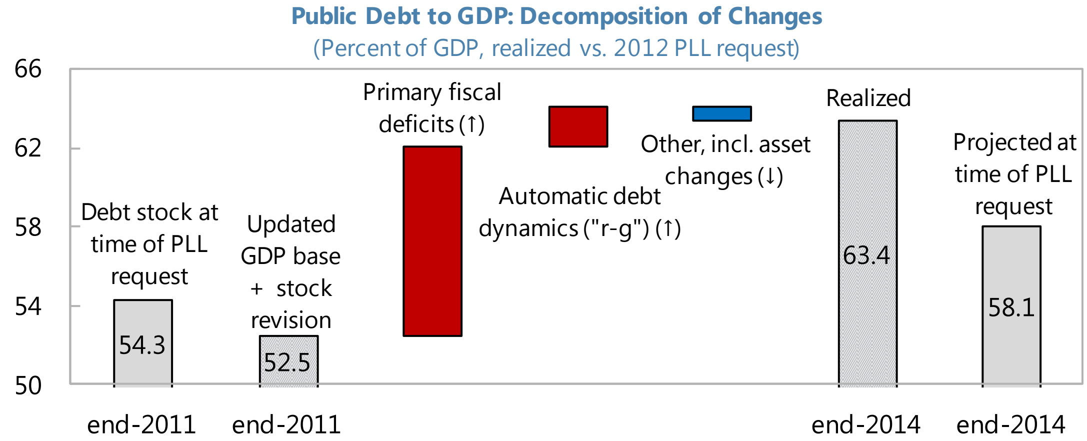


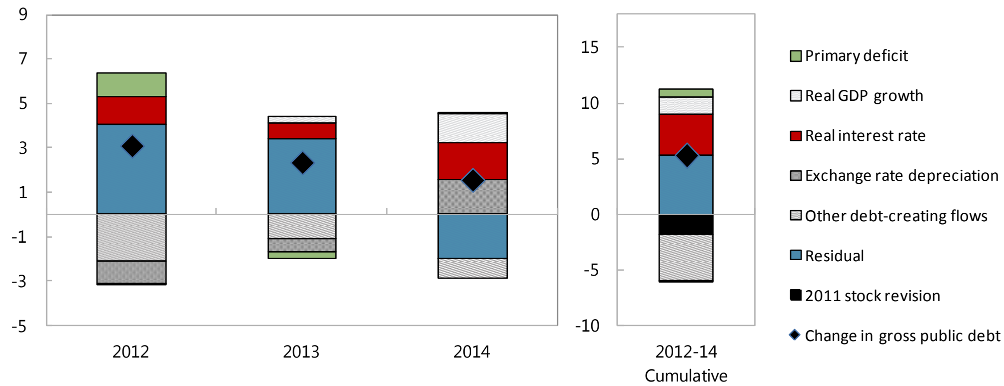
Sources: Authorities' data, and IMF staff estimates.

35. Progress was also made in strengthening the social safety net and improving targeting of vulnerable groups. The authorities extended coverage of the education allowance and medical insurance programs (TAYSSIR and RAMED) financed by the Solidarity Fund. In February 2014, the authorities introduced two new programs for social support, one for public transportation and another targeting low-income widows.

36. Public debt remained sustainable but was higher than initially expected. The ratio of public debt to GDP for 2014 reached about 63½ percent of GDP, an increase of nearly 11 percentage points of GDP from end-2011 and over 5 percentage points of GDP higher than projected at the time of the 2012 PLL arrangement request (Figure 6). The increase in the debt ratio was mainly due to primary fiscal deficits and relatively weak automatic debt dynamics ("r-g" dynamics). Risks to the debt outlook had also increased somewhat, mainly because gross financing needs exceeded the relevant benchmark of 15 percent later in the arrangement (Figure 7). The DSA conducted at the time of the new PLL arrangement request in July 2014 concluded that public debt remained sustainable, was resilient to various shocks, and presented moderate vulnerabilities. Nonetheless, keeping the debt sustainable would require continuing with fiscal policy along a path of medium-term fiscal consolidation and pursuing reforms to increase potential growth, while also carefully managing the maturity profile of debt.

Figure 6. Morocco: Public Debt Profile, 2011–14





Sources: Authorities' data and IMF staff estimates.

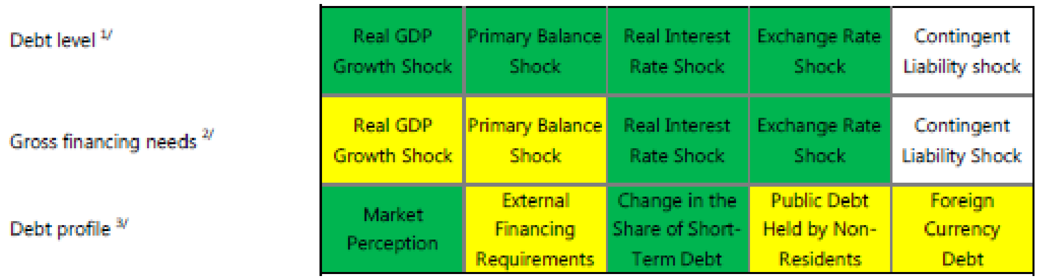
Table 4. Morocco: Subsidized Products and Social Safety Nets: Costs and Policy Actions, 2012–14
(In percent of GDP, unless otherwise indicated)

	2012	2013	2014
Subsidized products	**6.5**	**4.6**	**3.5**
Energy	**5.6**	**3.9**	**2.9**
Super	0.2	0.1	0.0
	On June 2, 2012, price increase by 20% (gasoline).	Domestic prices indexed to world prices, starting September 2013.	Subsidy removed starting February 2014.
Diesel	2.6	1.7	1.0
	On June 2, 2012, price increase by 14%.	Domestic prices indexed to world prices, starting September 2013. Hedging contract covering Sept-Dec. 2013.	Per-unit subsidy reduced gradually in 2014.
Industrial fuel	0.3	0.2	0.0
		Domestic prices indexed to world prices, starting September 2013.	Subsidy removed starting February 2014.
Fuel for electricity generation	0.5	0.4	0.4
	On June 2, 2012, price increase by 27% (fuel oil)	Electricity company gradually shifting production away from fuel	Subsidy removed in June, replaced by a lump sum subsidy
Fuel special	0.4	0.2	0.2
Butane	1.7	1.4	1.4
Food	**0.8**	**0.7**	**0.6**
Wheat	0.2	0.3	0.3
		Quotas of subsidized wheat reduced by 6 percent in May 2013.	
Sugar	0.6	0.4	0.4
Targeted social safety net	**...**	**...**	**0.2**
Tayssir (education allowances)	406,000 beneficiaries	460,000 beneficiaries	466,000 beneficiaries
Ramed (basic medical insurance)	2,540,830 beneficiaries	6,017,177 beneficiaries	7,516,127 beneficiaries
Support for public transportation	...	...	Introduced in 2014
Support to low-income widows	...	...	Introduced in 2014

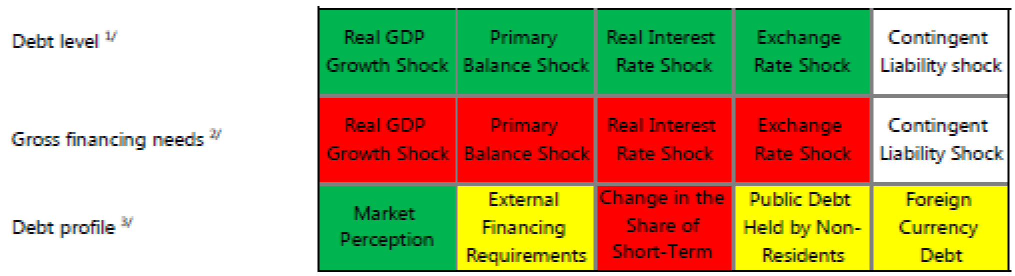
Source: Moroccan authorities.

Figure 7. Morocco: Public DSA—Evolution of Risk Assessment (Heatmap)

Public DSA at 2013 Art. IV Consultation (CR/14/65, 03/06/14)



Public DSA at cancellation of the PLL arrangement and request for new PLL arrangement (CR/14/241, 08/05/14)



Source: Morocco 2013 Article IV Consultation and 2014 Request for An Arrangement Under the Precautionary and Liquidity Line and Cancellation of the Current Arrangement staff reports.

1/ The cell is highlighted in green if debt burden benchmark of 70 percent is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15 percent is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmark. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment assessment benchmarks are: 200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

37. The authorities made progress on other structural reforms in the fiscal area, albeit sometimes with delays. In retrospect, faster progress on passage of the OBL would have been desirable (and was expected), as this was a core component of the broader modernization plan for the budget framework. Moreover, fast passage of the OBL would have given further assurances that the weaknesses in budget monitoring and expenditure controls uncovered with the end-2012 fiscal slippage were being durably addressed. Pension reform could also preferably have progressed at a faster pace; the PLL-supported program could possibly have laid out a set of intermediate steps to track progress in this area.

- *Organic Budget Law (OBL).* The draft OBL was adopted by the Council of Ministers in January 2014, and by the first and second chambers of Parliament in July and November 2014, respectively.[18] The OBL has a number of new features, such as the introduction of multi-year and program budgeting, a fiscal "golden rule" (limiting new borrowing to financing of investment spending and debt amortization), performance management, and strengthened transparency. It also introduced tighter rules regarding special Treasury accounts and addressed weaknesses made apparent in the end-2012 fiscal slippages, by making wage expenditure appropriations binding and limiting the carry-over of investment appropriations. While welcoming these improvements, staff assessed that some provisions could have been stronger in order to reduce fiscal risks (e.g., an escape clause for the golden rule, tighter restrictions on the creation of special treasury accounts, reporting and budget control of state-owned enterprises).

- *Pension reform.* Staff and the authorities agreed that the pension system was in need of urgent reform to bring it back on sound financial footing but implementation suffered delays.[19] A technical commission provided recommendations at the end of 2012. The first step of the authorities' strategy, a proposal on a parametric reform of the main public pension fund was launched in June 2014. It proposed modifications regarding the statutory retirement age, contribution rates, and retirement benefits, and was expected to extend the viability of the fund by about eight years. The proposed reforms went through a consultative process and were expected to be adopted in 2015 for implementation the following year. The second step would involve a broader structural reform, including merging the four pension funds into two funds.

D. Monetary, Financial Sector, and Exchange Rate Developments

38. Inflation was low, and credit and money growth relatively weak. Inflation remained low and stable throughout the PLL arrangement period. Credit to the economy was initially projected to grow at about 8 percent annually (in 2012–13), but the outturn was 2½–5 percent (Figure 8). Broad money growth was also slower than expected. Relatively tight liquidity conditions on the supply side resulted from lower net foreign assets (in 2012), while demand was subdued because of relatively weaker non-agricultural GDP growth.

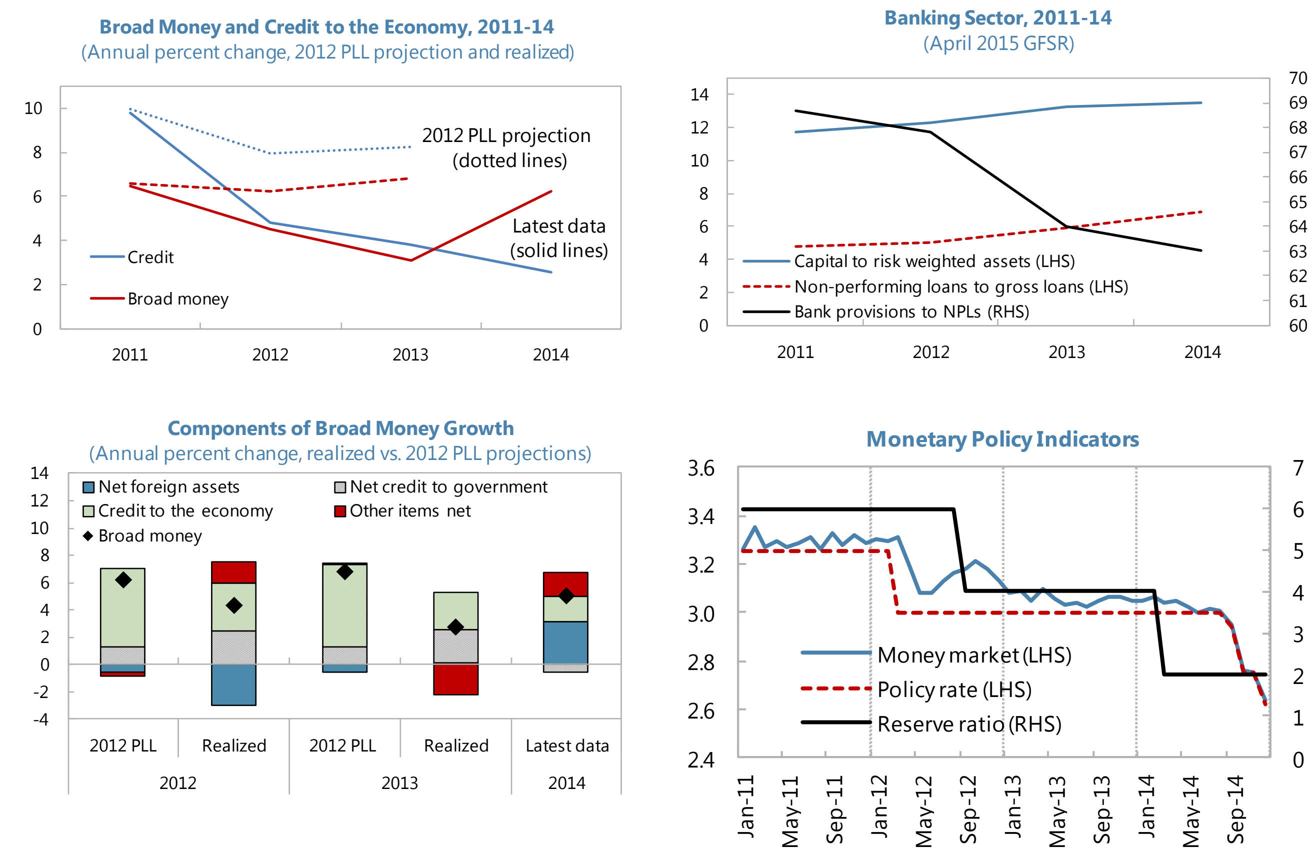
39. With low inflation, monetary policy aimed to support growth and financial sector liquidity. BAM was vigilant for possible second-round effects from increases in domestic fuel prices. BAM's quarterly analyses and forecasts during 2013 indicated that the balance of risk to medium-term inflation was neutral, but there were concerns about slower non-agricultural growth and tight

[18] The OBL's adoption by Parliament in November 2014 fell outside the period under consideration for this EPE. The Constitutional Council subsequently ruled some provisions in the OBL unconstitutional. A revised OBL, addressing comments by the Constitutional Council, was adopted by Parliament on April 28, 2015 and validated by the Constitutional Council on May 18.

[19] The status of the pension system was discussed in depth at the time of the 2012 Art. IV Consultation (see CR/13/96, 04/05/13).

credit. The key policy rate was maintained at 3 percent from March 2012 through the end of the PLL arrangement in July 2014. (The policy rate was subsequently cut in September and December 2014, each time by 25 basis points.) BAM reduced the required reserve ratio twice, first from 6 percent to 4 percent in September, 2012, and again in March 2014, by another two percentage points. Along with recovering international reserves, these actions helped ease liquidity conditions. In December 2013, BAM also established a new refinancing mechanism to support credit to small enterprises, particularly those operating in the industrial sector or whose production is export-oriented.

Figure 8. Morocco: Monetary and Financial Indicators, 2011–14



Sources: 2015 Financial Soundness Indicators, authorities' data, and IMF staff estimates.

40. Morocco continued to modernize the financial supervisory and regulatory framework. Nonperforming loans (NPL) were manageable but edged up over time, from 4.8 percent at end-2011 to about 6.9 percent at end-2014. Regulatory capital to risk-weighted assets of the banking sector increased steadily. BAM strengthened banking supervision in line with Basel III by taking a number of measures. The ratio of Tier-I capital to risk-weighted assets was increased to 9 percent and the regulatory capital adequacy ratio to 12 percent, effective June 2013. Also, regulations for implementing the new definition of prudential capital and the liquidity coverage ratio (LCR) in line with Basel III standards were adopted in August 2013. The new definition of prudential capital entered into force in January 2014; at the same time, the LCR was introduced with the expectation that it would enter into force in July 2015. As a result of progress in improving its AML/CFT regime, Morocco was no longer subject to the Financial Action Task Force's monitoring process. Progress was also made with new banking and central banking laws (the former was adopted by Parliament in November 2014, the latter is under revision). The authorities expressed early on in the program their interest in an update of the 2008 FSAP; this update took place in April 2015.[20]

41. Reflecting the cross-border expansion of operations of Moroccan banks, BAM increased coordination with regulatory and supervisory agencies in host countries. Among those initiatives, as indicated in its 2013 Annual Report, BAM (i) established new reporting to monitor the financial health of subsidiaries of Moroccan banking groups abroad; (ii) introduced quarterly follow-up with the supervisory authorities of some host countries; (iii) conducted onsite inspection of a couple of subsidiaries of Moroccan banks in SSA, jointly with the host countries' supervision authorities; (iv) began discussions with host countries' supervisory authorities for the establishment of colleges of supervisors for Moroccan cross-border banking groups; and (v) enacted a new code of ethics for Moroccan banking groups operating in Africa.

42. The authorities indicated their intention to transition to a more flexible exchange rate regime over the medium term, once supportive policies were in place. The dirham continued to be pegged to a euro/dollar basket with 80/20 weights. At the time of the PLL arrangement request, staff assessed that the exchange rate regime was consistent with the fiscal-monetary policy mix and, while the deterioration in Morocco's fiscal and external positions (including the continued loss of reserves) had weakened the appropriateness of the exchange rate regime in relation to the fiscal-monetary policy mix, the authorities had taken actions to restore the fiscal sustainability and consistency of the policy mix. The authorities and staff agreed that exchange rate flexibility would provide a tool to deal with external shocks, strengthen competitiveness, and promote trade diversification. It would also facilitate integration of Morocco in the world economy including a more open capital account, for example with the internationalization of the Moroccan banking sector and the development of the Casablanca Finance City. The authorities stressed that such a move would be appropriate once supportive macroeconomic policies were in place, and these

[20] The Financial System Stability Assessment (FSSA) report is expected to be discussed by the Executive Board later in the year together with the next Article IV Consultation.

would include an improved fiscal position with a reduced subsidy bill, as well as a new anchor for monetary policy.[21] The Fund provided technical assistance (TA) to help the authorities prepare for greater exchange rate flexibility and modernize the monetary policy framework.[22]

E. Other Structural Reforms

43. The government implemented policies to strengthen Morocco's attractiveness as an investment destination. As a result of the reform agenda driven by a national committee chaired by the head of government, Morocco moved up in the ranking on the World Bank's Doing Business indicators. Initiatives included:

- Revising the public procurement decree, strengthening of the independence of the Competition Council, and broadening of the mandate of the Economic, Social, and Environmental Council.
- Introducing an action plan to improve the business environment, with steps to streamline administrative procedures for enterprises, improve investor protection by amending the law on limited-liability companies, strengthen public-private partnerships, and implement the new procurement code.
- Announcing a new national industrial acceleration program in April 2014, with the objective of increasing the contribution of the industrial sector to GDP and job creation, especially in the food-processing, automobile, aviation, and off-shoring sectors.
- Launching reform of the judicial system, to boost judicial independence, effectiveness, and transparency.

44. The authorities also sought to tackle unemployment through active labor market policies, but the unemployment rate stayed stubbornly high, which may suggest that, even with real GDP growth lower than envisaged, more could have been done. Government actions aimed to review existing support programs, set up an employment observatory, improve access to vocational training, and strengthen labor market intermediation agencies. Fund staff supported these actions and noted that existing programs seemed to leave aside some crucial impediments to job creation, such as those related to hiring and firing costs. In that regard, staff pointed to the results of a benchmarking exercise which found that potential growth in Morocco could be

[21] On April 13, 2015, the Moroccan authorities decided to revise composition of the weights in the currency basket from 80/20 to 60/40, in order to better reflect the changing international transactions. The press release announcing this change noted that this was to be a first step in the transition to a more flexible exchange rate regime.

[22] For example, in 2013 Morocco received TA on macroeconomic modeling, which helped the authorities strengthen their analytical capacity for inflation forecasting, a key ingredient in the efforts to prepare for the adoption of an inflation targeting framework. In 2014, IMF teams provided several rounds of TA both on improving monetary frameworks through inflation targeting and on exchange rate flexibility.

0.5 percentage point higher if Morocco achieved a benchmark score on the restrictiveness of employment protection legislation.[23]

CONSISTENCY WITH FUND RULES AND PRACTICES

A. Was Exceptional Access Justified?

45. Morocco met requirements under the exceptional access policy at the time of the PLL arrangement request in August 2012 and at each of the three reviews.

- *Criterion 1 (exceptional balance of payments pressures on the current or the capital account).* Staff's ex ante adverse scenario (discussed above) pointed to the potential that external financing needs would exceed normal access limits. The adverse scenario was based on an unusual yet plausible combination of exogenous demand and supply shocks. Staff did not reassess potential balance of payment needs during the subsequent three reviews. Nonetheless, the main risks of slower European growth and higher global oil prices remained, so that the initial adverse scenario continued to be relevant. Indeed, global oil prices turned out to be higher, and growth in Europe lower, than anticipated at the time of the PLL arrangement request, affecting the twin deficits and non-agriculture growth for Morocco.

- *Criterion 2 (high probability of public debt sustainability over the medium term).* This report concurs with the assessment that public debt would remain sustainable over the medium term and resilient to shocks, with vulnerabilities appearing for the most part moderate. At the time of the program request, the public DSA indicated that public debt was moderate and likely to be sustainable over the medium term. The ratio of gross public debt to GDP was expected to peak at 58.1 percent of GDP in 2014 and trend down over the medium term as a result of the fiscal consolidation and pick-up in growth. The outturn for debt was less favorable than initially projected, and risks stemming from the relatively high gross financing needs have risen. The latest estimates suggest that the debt ratio would peak at 64.1 percent of GDP in 2016, a level nearly 8 percentage points of GDP higher than initially expected for that year. External debt is also higher than initially projected but remains relatively low.

- *Criterion 3 (good prospects of regaining access to private capital markets).* Morocco had market access at the time of the program request. It continued to have market access during the program period, as reflected by successful sovereign bond issuance on favorable terms.

- *Criterion 4 (a reasonably strong prospect of the program's success taking into account adjustment plans and institutional and political capacity to deliver adjustment).* The authorities maintained all along a track record of implementation of sound macroeconomic policies and the political and

[23] See discussion and Box 1 in the staff report for the 2013 Art. IV Consultation (CR/14/65, 03/06/14) and the Selective Issues Paper on inclusive growth prepared for the 2012 Art. IV Consultation (CR/13/110, 05/08/13).

institutional capacity to deliver on the program's policy plans, providing strong prospects of program success. (See also discussion below in paragraphs 47–48.) In the course of program, the authorities demonstrated their ability and willingness to adjust policies to respond to emerging challenges and to meet the objectives of their PLL-supported program. Specifically, in response to end-2012 slippages, the authorities implemented measures to reduce the deficit at a faster pace, and delivered on subsidy reform despite a difficult socio-economic context.

B. Was the Arrangement Consistent with PLL Qualification Rules?

46. This EPE confirms that the PLL arrangement met the PLL qualification standards at the time of the request and at each of the three reviews. Specifically, Morocco met the overarching "soundness" criteria and was assessed to expect to perform strongly in three of the five qualification areas—while not substantially underperforming in the two other qualification areas. Moreover, none of the disqualification circumstances were applicable. These elements are discussed below.

Overarching: Sound economic fundamentals, institutional frameworks, and policies

47. Morocco had established a track record of implementing sound policies and remained committed to maintaining such policies in the future. The authorities were committed to reducing vulnerabilities during the PLL arrangement period through policies to strengthen the fiscal and external positions, including by reforming the subsidy regime and continuing to make Morocco an attractive and competitive investment destination. At the conclusion of the 2011 Article IV Consultation, Executive Directors "commended the authorities for their sound macroeconomic policies and structural and political reforms that have helped Morocco weather the global crisis and respond to pressing social needs."[24] Similarly, at the conclusion of the 2012 Art. IV consultation, Executive Directors "commended the economy's resilience in the face of significant external shocks and challenging domestic conditions, and welcomed recent measures that successfully helped reduce fiscal and external vulnerabilities. [...] Directors supported efforts to strengthen the public finances and support both fiscal and external sustainability."[25]

48. More discussion of the soundness of the institutional policy frameworks would have been desirable. The PLL arrangement request in August 2012 noted Morocco's sound institutional framework (and listed a number of new institutions set up in 2012 under the new constitution) but did not have an in-depth discussion. The soundness of the institutional policy frameworks was evident by the presence and track record of sound macroeconomic policies, and structural and political reforms that had helped Morocco navigate the global crisis in the presence of regional socio-political challenges. Nevertheless, the end-2012 slippages revealed some weaknesses in budget monitoring and expenditure controls which could potentially have challenged continued PLL

[24] See Figure 10 for a cross-country comparison of key macroeconomic indicators for Morocco with other emerging markets, covering 2011 and 2014.

[25] See Public Information Notice No. 11/133 (November 3, 2011) and Press release No. 14/37 (January 31, 2014).

qualification had they not been addressed. The authorities' actions to fix these shortcomings (and the progress during the PLL arrangement leading up to the adoption of the OBL) were evidence of continued PLL qualification in this area. The in-depth assessment and discussion of the policy and institutional framework at the time of the first review of the second PLL arrangement, including a quantitative assessment using data for 2007–12, further confirmed the soundness of the institutional policy framework.[26]

Qualification areas

49. Morocco performed strongly in the three areas of monetary policy, financial sector soundness and supervision, and data adequacy; and did not substantially underperform in the two areas of fiscal policy and a sustainable external position, including market access.

- *Area 1: External position and market access.* At the time of the PLL arrangement request, Morocco faced moderate external vulnerabilities, on the basis of the widening current account deficit and ongoing downward pressures on reserves, due in part because of high oil prices and weak demand from Europe. The assessment made at the time of the request noted mitigating factors such as a sufficient level of international reserves, increasing export diversification as a result of a welcoming business environment, and policies aimed at strengthening the fiscal and external position. This assessment was tested by fiscal slippages that also contributed to the current account deficit reaching 9.5 percent of GDP at end-2012. However, stepped-up actions in the fiscal area, notably on subsidy reform, along with positive results from export diversification, helped in significantly narrowing the current account deficit in 2013. The exchange rate peg had contributed to stable macroeconomic conditions over the years and was deemed consistent with the fiscal-monetary policy mix, which envisaged a gradual fiscal consolidation. Although the appropriateness of this mix was considered weakened by the twin deficits, the planned strengthening of fiscal and external balances were expected to, and did, help address those concerns. Finally, Morocco continued to have access to international financial markets (the authorities tapped those marked on a number of occasions during 2010–14).

- *Area 2: Fiscal policy*. Morocco moderately underperformed in the area of fiscal policy. Fiscal performance had been prudent with modest fiscal deficits and a declining debt-to-GDP ratio, but these trends were reversed in part because of ballooning subsidy costs. The authorities committed to reducing fiscal vulnerabilities by targeting a fiscal deficit of 3 percent over the medium term, consistent with a declining debt ratio. The end-2012 fiscal slippage was a setback to which the authorities responded by furthering reforming subsidies and strengthening

[26] Consistent with the proposals adopted during the Review of the FCL, PLL, and RFI in 2014, the 1st Review of Morocco's 2014 PLL included indicators of institutional and policy quality based on data for 2007–12. These indicators suggested that Morocco was above average on counter-cyclical fiscal policy, about average on anti-corruption and government effectiveness, and below average on counter-cyclical monetary policy. See figure and discussion in paragraph 9 of CR/15/44, 02/23/15.

expenditure controls, the latter as an intermediate step to adopting an OBL. In the end, the reduction in the fiscal deficit and the structural reform of the subsidy system succeeded in reducing fiscal vulnerabilities. However, and against the background of headwinds from the external environment which also affected real GDP growth, this achievement was tempered somewhat by limited progress in reversing the trend on the debt ratio and in reallocating spending in favor of investment, including moderating the wage bill. As a result, and while the debt outlook remained sustainable, fiscal vulnerabilities were not reduced as much as originally planned.

- *Area 3: Monetary policy*. Staff assessed Morocco as a strong performer in the area of monetary policy. This was based on the track record of BAM in achieving low and stable inflation, the ability of monetary policy to affect monetary conditions in the context of an exchange rate peg with limited capital mobility, and the widely accessible information provision by BAM on monetary statistics, policy instruments, and decisions. Inflation remained low throughout the PLL arrangement and BAM applied its tools to support growth. BAM was engaged in a program of adapting its monetary policy framework (including possibly moving to inflation targeting) as the economy was expected to further open up over time, which would also involve gradually allowing more exchange rate flexibility, once the conditions were ripe. The Fund supported BAM in this area with TA. A shift in the monetary policy and exchange rate regime entailed risks which were not explicitly assessed. However, the authorities' approach, which was to move gradually—given the presence of external risks and the focus of the reform program on first strengthening buffers along with the presence of capital controls—mitigated such risks, all while also laying further groundwork with the help of Fund TA.

- *Area 4: Financial sector soundness and supervision*. Morocco was assessed to have a strong performance in this area. The financial sector was considered sound and resilient, and the banking sector among the deepest in the region. Non-performing loans edged up but remained manageable, and the banking sector seemed adequately capitalized. Given the rapid regional expansion of Moroccan banks in Africa, an area not yet covered by the 2008 FSAP, the PLL arrangement request could have included an assessment whether there were any potential vulnerabilities (including from supervisory challenges) stemming from this relatively new development. The authorities requested an FSAP update, which was conducted in Spring 2015.

- *Area 5: Data adequacy*. Morocco was assessed to be a strong performer in this area, with data provision deemed appropriate in all sectors.[27] The country also subscribes to the Special Data Dissemination Standard (SDDS).

[27] In that regard, the end-2012 fiscal slippage reported shortly after the completion of the first review was attributed in part to weaknesses in budget monitoring and expenditure controls, and not to data issues.

Disqualification circumstances

50. This review also confirms that none of the four circumstances that would lead to PLL disqualification applied to Morocco. These include (i) sustained inability to access international capital markets, (ii) the need to undertake a large macroeconomic or structural policy adjustment (unless such adjustment has credibly been launched before approval), (iii) a public debt position that is not sustainable in the medium term with a high probability, or (iv) widespread bank insolvencies. The authorities tapped international capital markets on comparatively attractive terms. As discussed above, the authorities' fiscal program appropriately balanced the trade-off of strengthening buffers and supporting growth, especially given the difficult socio-economic and external context. Nevertheless, contingency plans to ensure the robustness of the fiscal consolidation plan could have been considered, including in the event the ambitious growth targets turned out lower than expected. The debt position, albeit with a debt ratio higher than expected by the end of the program, remained sustainable. There were no bank insolvencies.

CONCLUSIONS AND POSSIBLE LESSONS

51. The 2012–14 PLL arrangement was an appropriate instrument for Morocco's needs. The PLL arrangement met the authorities' needs of providing insurance against exogenous shocks and signaling Morocco's sound economic fundamentals (albeit with some remaining vulnerabilities) to meet potential balance of payments needs at a time of significant risks stemming from the external environment. The authorities planned to use the PLL arrangement to support their policies to reduce vulnerabilities, in particular by gradually reducing the fiscal and current account deficits (while also increasing investment spending) and strengthening the reserves buffer. 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.

52. The authorities' policies helped maintain macroeconomic stability and reduce fiscal and external vulnerabilities. The subsidy reform stands out as a major achievement, especially in light of the difficult regional socio-political context. These reforms were at the center of the significant reduction in fiscal and external current account deficits. Thanks to strong policy actions, and notwithstanding an early slippage, the twin deficits were significantly reduced from 2013 onwards. The fiscal consolidation was achieved in spite of external headwinds—from adverse developments in global oil prices and weak growth in European trading partners, while falling prices for phosphates also weighed on the current account deficit—and relatively weak GDP growth. In addition to the reduction in the current account deficit, international reserves were replenished (albeit through additional borrowing) which helped reduce external vulnerabilities and strengthen the scope for self-insurance against shocks.

53. The decision not to draw on the PLL arrangement in spite of external economic headwinds is commendable. By relying on market financing rather than drawing on available PLL arrangement balances, the authorities could continue to use the PLL arrangement as a signaling device of sound macroeconomic fundamentals and policies, even while keeping the PLL arrangement's insurance function available to Morocco in case market conditions were not benign.

54. Notwithstanding the significant macroeconomic achievements under the 2012–14 PLL arrangement, 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. Also, faster progress on a number of structural reforms, including in particular the OBL and pension reform, would have been desirable (and was expected). The OBL was a core component of the broader modernization plan for the budget framework, and fast passage would have given further assurances that the weaknesses in budget monitoring and expenditure controls uncovered with the end-2012 fiscal slippage were being durably addressed. Going forward, it will remain important to keep wage bill moderation and restraint on other, non-essential, current spending high on the policy agenda, which is important to reduce the deficit towards the medium-term target, reverse the trend for the debt ratio, and free up fiscal space for investment. Moreover, 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 (including on removing impediments to job creation), in addition to freeing up fiscal space for public investment spending and other pro-growth reforms.

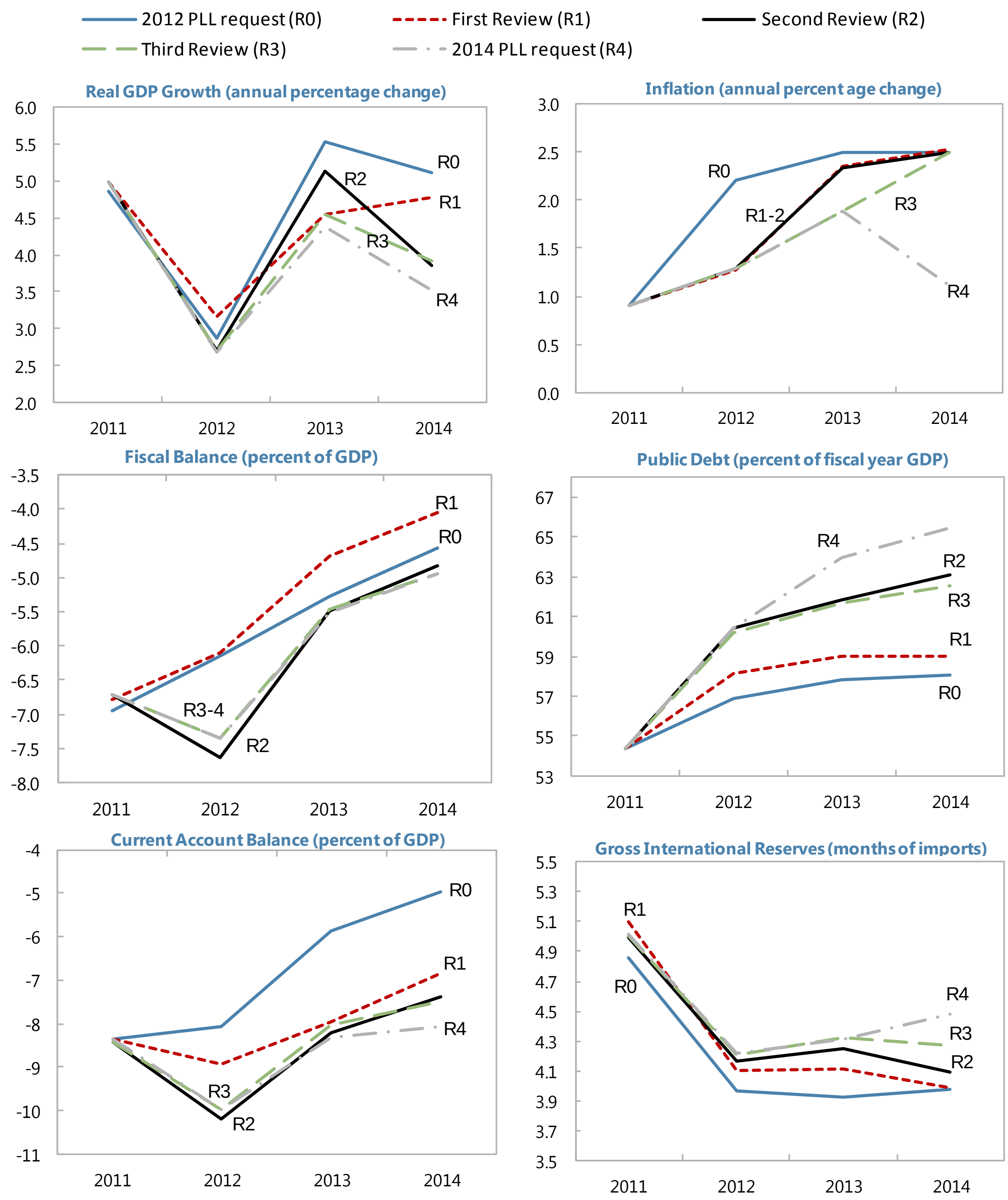
55. Reform of the monetary policy framework and allowing flexibility in the exchange rate will likely become more pressing as the economy opens up further. It was appropriate to focus first on reducing fiscal and external vulnerabilities while laying the foundations to adapt monetary and exchange rate policy to changing circumstances. The monetary authorities correctly focused on supporting growth in a context of low inflation and weak external conditions, and on capacity building in the areas of monetary policy modernization and exchange rate regime (both with Fund support). Going forward, as Moroccan financial and capital markets continue to internationalize and broaden their potential as engines for growth, it will become more pressing to allow greater flexibility in the exchange rate. Such flexibility could act as a shock absorber, mitigate risks, and give the monetary authorities more autonomy in monetary policy conduct.

56. In retrospect, the PLL arrangement request could have assessed whether there were potential vulnerabilities in a few additional areas. The PLL arrangement request noted Morocco's sound institutional framework but did not include an in-depth discussion or formal assessment. It remains an open question whether the weaknesses in budget monitoring and expenditure controls uncovered with the end-2012 fiscal slippages might have possibly been flagged sooner, perhaps in the context of Art. IV consultations, through available diagnostics of public financial management, or in assessing progress with the OBL. And, given the rapid regional expansion of Moroccan banks in Africa in the preceding years, the PLL arrangement request could have assessed whether there were any potential macroeconomic or supervisory vulnerabilities including those related to AML/CFT stemming from this relatively new development. The 2015 FSAP Update provided an opportunity to take stock of potential vulnerabilities and identify areas where the regulatory framework could need further reform.

57. As a result of external risk factors and remaining vulnerabilities, the authorities did not "Exit" from the PLL by the end of the 2012–14 PLL arrangement, and the authorities requested a successor PLL arrangement at lower access levels. Although fiscal and external consolidation had progressed and external stress factors appeared to have abated somewhat, there were remaining fiscal and external vulnerabilities by mid-2014.[28] As discussed above, while the authorities' policies succeeded in reducing fiscal and current account deficits, and international reserves were rebuilt, there remained a number of medium-term policy challenges to further reduce vulnerabilities, bolster growth, improve governance, and tackle unemployment. Addressing those medium-term challenges will require progress on several fronts, as discussed above. On the fiscal side, further strengthening of fiscal buffers would be achieved through moderation in the wage bill and other non-essential current spending. Pension reform should kick in high gear and subsidy reform be finalized, the latter together with further strengthening of the social safety net. In terms of the monetary policy framework, adaptation of the monetary policy framework to meet evolving needs will be accompanied by more exchange rate flexibility. Finally, increasing potential growth will require continued focus on structural measures, including in the area of labor market reform.

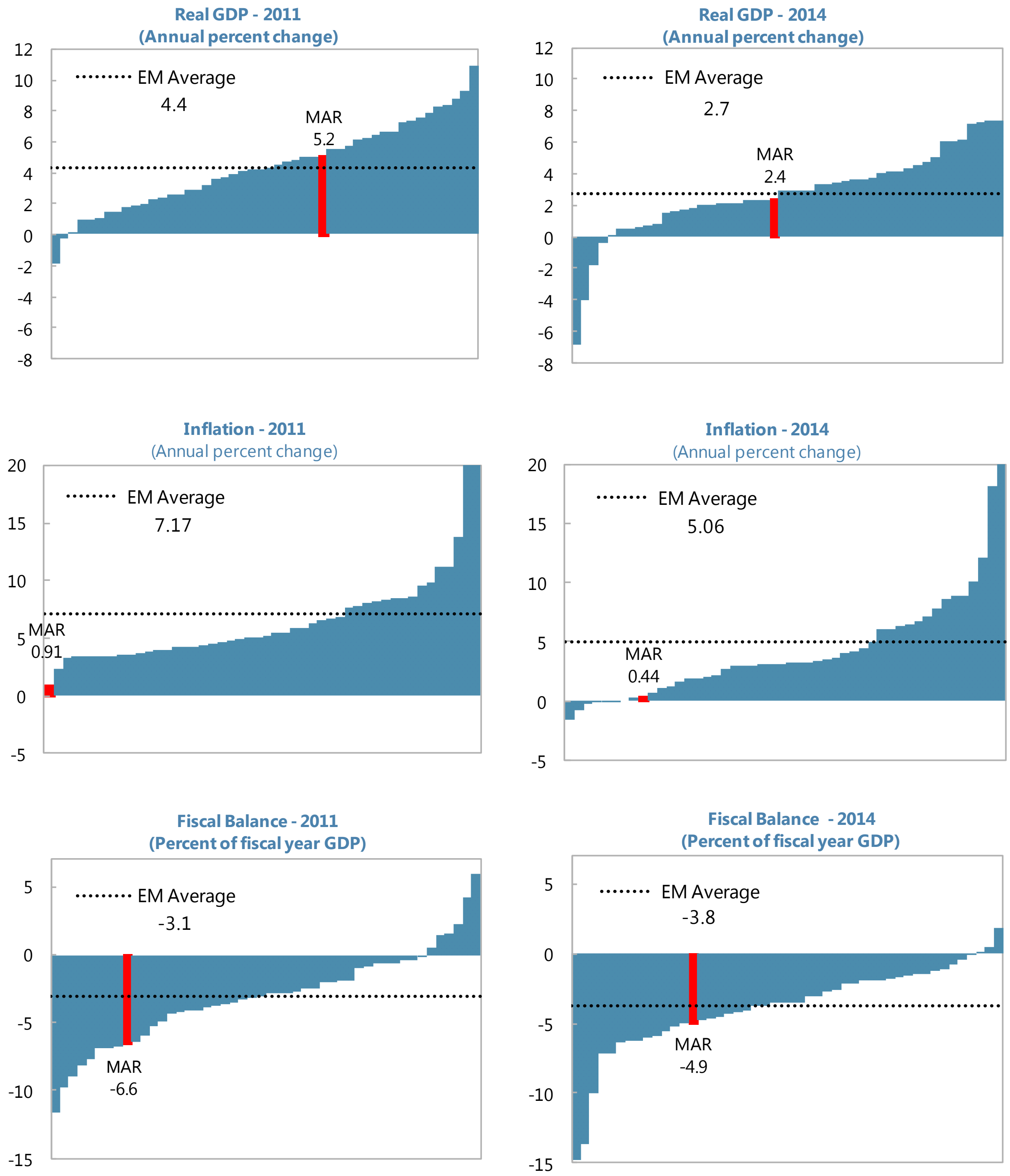
[28] See CR/14/241 (08/05/14) for details.

Figure 9. Morocco: Projections and Outturn for Selected Indicators by Report, 2011–14



Sources: Authorities' data, and IMF staff estimates.

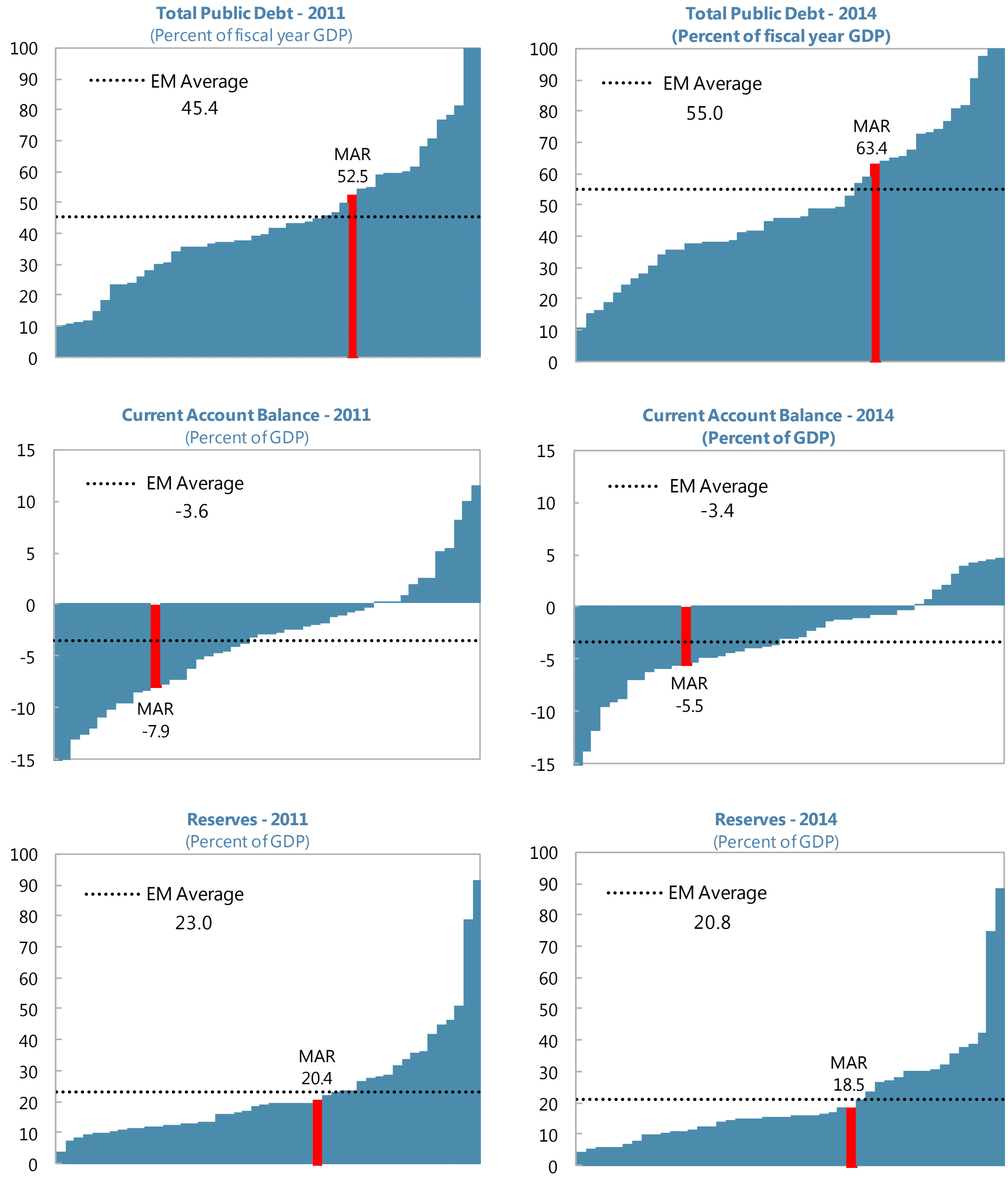
Figure 10. Morocco: Macroeconomic Indicators: Cross-Country Comparison, 2011–14



Sources: April 2015 WEO, and IMF staff estimates.

Note: The comparison includes 48 emerging and developing countries as defined in the April 2015 WEO Statistical Appendix.

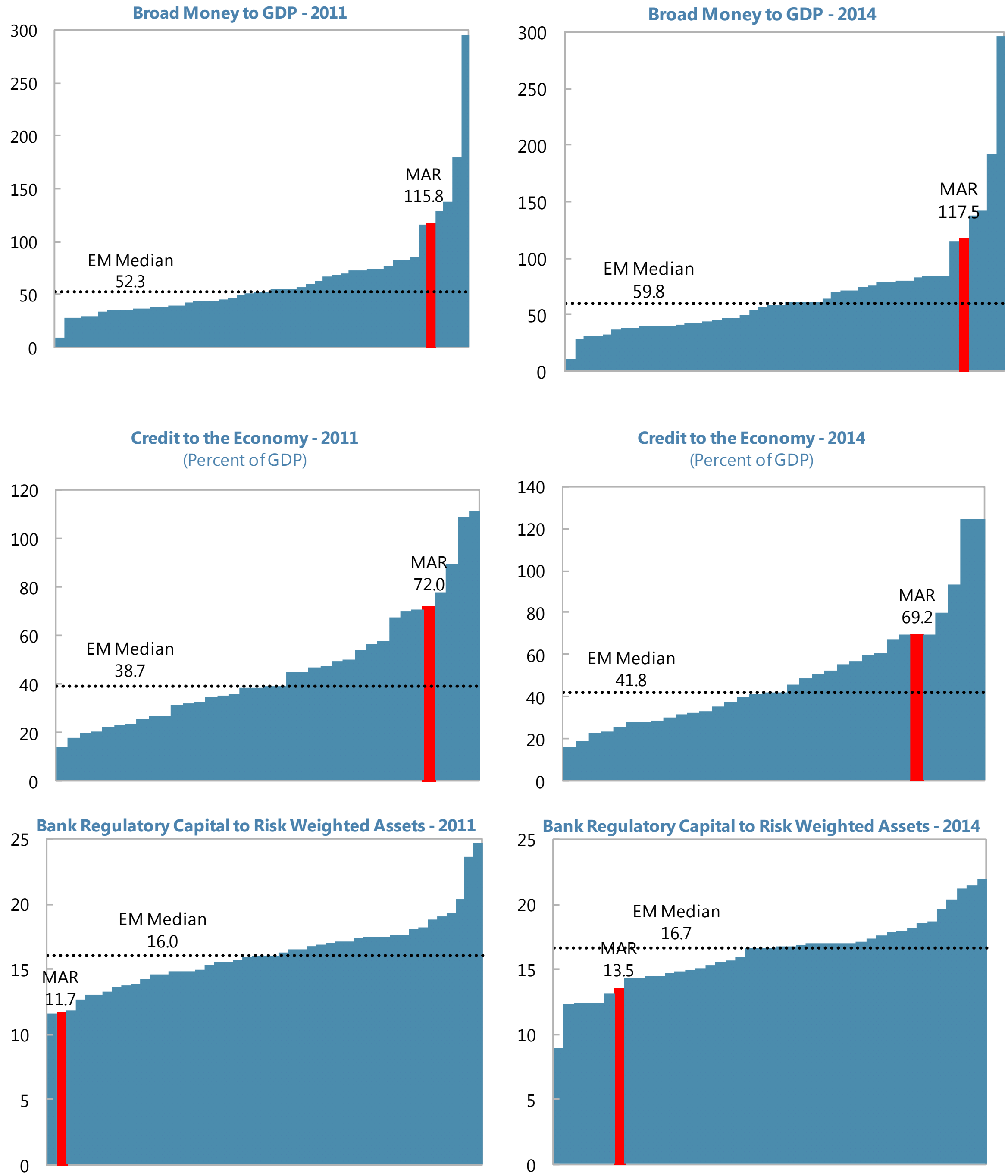
Figure 10. Morocco: Macroeconomic Indicators: Cross-Country Comparison, 2011–14 (continued)



Sources: April 2015 WEO, and IMF staff estimates.

Note: The comparison includes 48 emerging and developing countries as defined in the April 2015 WEO Statistical Appendix.

Figure 10. Morocco: Macroeconomic Indicators: Cross-Country Comparison, 2011–14 (concluded)



Sources: April 2015 WEO, April 2015 GFSR Financial Soundness Indicators; and IMF staff estimates.

Note: The comparison includes 48 emerging and developing countries as defined in the April 2015 WEO Statistical Appendix.

Table 5. Morocco: Quantitative Indicative Targets 1/

PLL request (CR/12/239, 08/13/12)	**2011**	**2012**	**2013**
	End-Dec.	**Oct. 30**	**Apr. 30**
Indicative targets			
Floor on stock of NIR of Bank Al-Maghrib (BAM) (end of period (eop))	20,268	16,752	16,557
Ceiling on fiscal deficit (cumulative since beginning of fiscal year, eop)	-55,776	-41,601	-18,556

First review of the PLL arrangement (CR/13/96, 04/05/13)	**2011**	**Oct. 30, 2012**			**Apr. 30, 2013**		**Oct. 31, 2013**
	End-Dec.	**PLL**	**Adj.**	**Real.**	**PLL**	**Rev.**	
Indicative targets							
Floor on stock of NIR of Bank Al-Maghrib (BAM) (eop)	20,268	16,752	16,603	16,603	16,557	16,682	16,881
Ceiling on fiscal deficit (cumulative since beginning of fiscal year, eop)	-55,776	-41,601	-41,601	-40,952	-18,556	15,915	-33,772

Second review of the PLL arrangement (CR/13/302, 09/27/13)	**Apr. 30, 2013**			**Oct. 31, 2013**	
	1st Rev.	**Adj.**	**Real.**	**1st Rev.**	**Rev.**
Indicative targets					
Floor on stock of NIR of Bank Al-Maghrib (BAM) (eop)	16,682	15,948	17,228	16,881	17,100
Ceiling on fiscal deficit (cumulative since beginning of fiscal year, eop)	-15,915	-18,830	-18,635	-33,772	-41,000

Third review of the PLL arrangement (CR/14/66, 03/06/14)	**Oct. 31, 2013**		
	1st Rev.	**Adj.**	**Real.**
Indicative targets			
Floor on stock of NIR of Bank Al-Maghrib (BAM) (eop)	17,100	16,255	17,500
Ceiling on fiscal deficit (cumulative since beginning of fiscal year, eop)	-41,000	-44,195	-46,793

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

Table 6. Morocco: Statement of Risk Factors, 2012–14 1/

	Upside or downside risk	Presence and likelihood of materialization (if RAM included)					Impact (only if RAM included)			
		PLL Request Jul. 2012	First Review Jan. 2013	Second Review Jul. 2013	Third Review Jan. 2014	Cancellation and New PLL Request Jul. 2014	PLL Request Jul. 2012	First Review Jan. 2013	Second Review Jul. 2013	Third Review Jan. 2014
External risks										
Trading partner growth										
Marked deterioration in advanced-market trading partner economies, especially euro area	↓	√								
Strong intensification of the euro area crisis	↓		√ (M)					H		
Protracted period of slow European growth	↓		√ (M)	√ (H)	√ (H)	√		H	H	H
Commodity prices										
Shock to international oil/food prices	↓	√								
World oil and food price shock	↓		√ (L)					H		
Global oil shock triggered by geopolitical events (driving oil prices to US$140 per barrel)	↓			√ (L)					H	
Commodity price volatility (higher oil prices in particular) from geopolitical risks in Middle East and in Ukraine/Russia	↓					√				
Financial markets										
Surge in global financial market volatility (related to UMP exit), leading to economic and financial stress	↓				√ (H)	√				M
Domestic risks										
Slower-than-needed pace of reforms	↓	√	√ (L/M)	√ (M)	√ (L)	√		H	H	H
Higher agricultural output	↑			√ (M)		√			M	

Source: Morocco staff reports.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in staff's view). The relative likelihood of risks is the staff's subjective assessment of the risks surrounding the baseline ("Low" (L) is meant to indicate a probability below 10 percent, "Medium" (M) a probability between 10 and 30 percent, and "High" (H) a probability of 30 percent or more). The RAM reflects staff's views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Table 7. Morocco: Selected Economic Indicators, 2009–14

	2009	2010	2011	2012	2013	2014
Output and Prices						
Real GDP	4.2	3.8	5.2	3.0	4.7	2.4
Real agriculture GDP	26.0	2.3	5.7	-9.1	17.9	-2.5
Real non-agriculture GDP	1.6	4.0	5.2	4.7	3.0	3.1
Consumer prices (end of period)	-1.6	2.2	0.9	2.6	0.4	1.6
Consumer prices (period average)	1.0	1.0	0.9	1.3	1.9	0.4
Investment and Saving						
Gross capital formation	35.0	34.1	35.8	35.0	34.7	33.7
Of which: Nongovernment	30.7	30.3	30.5	29.6	29.6	28.3
Gross national savings	29.7	29.7	27.9	25.5	26.8	28.2
Of which: Nongovernment	25.3	27.7	27.6	25.9	25.3	26.2
Public Finances						
Revenue	28.7	26.8	27.2	28.0	27.7	28.0
Expenditure	30.4	31.1	33.8	35.3	32.9	33.0
Budget balance	-1.8	-4.3	-6.6	-7.3	-5.2	-4.9
Primary balance (excluding grants)	0.2	-2.3	-4.5	-4.9	-3.3	-3.7
Cyclically-adjusted primary balance (excl. grants)	0.4	-2.0	-4.5	-5.0	-3.0	-3.1
Total government debt	46.1	49.0	52.5	58.3	61.5	63.4
Monetary Sector						
Credit to the private sector 1/	10.4	7.5	9.8	4.8	3.8	2.5
Base money	-4.9	1.2	5.7	-0.5	9.0	6.2
Broad money	7.0	4.2	6.4	4.5	3.1	6.2
Velocity of broad money	0.9	0.9	0.9	0.9	0.9	0.9
Three-month treasury bill rate (period average, in percent)	3.7	3.3	3.4	3.4	3.4	2.5
External Sector						
Exports of goods and services (in U.S. dollars, percentage change)	-15.8	14.1	17.0	0.4	4.0	7.3
Imports of goods and services (in U.S. dollars, percentage change)	-19.4	6.8	23.4	2.2	4.3	0.6
Merchandise trade balance	-20.2	-18.4	-21.0	-22.3	-20.5	-18.6
Current account excluding official transfers	-5.7	-4.6	-8.2	-9.8	-8.6	-6.9
Current account including official transfers	-5.3	-4.4	-7.9	-9.5	-7.9	-5.5
Foreign direct investment	1.6	1.1	2.4	2.4	2.8	2.9
Total external debt	23.3	25.0	26.1	28.5	29.2	32.7
Gross reserves (in billions of U.S. dollars)	23.6	23.6	20.6	17.5	19.3	20.4
In months of next year imports of goods and services	7.6	6.2	5.3	4.3	4.7	5.9
In percent of Fund reserve adequacy metric			111.2	88.1	91.0	95.0
Memorandum Items:						
Nominal GDP (in billions of U.S. dollars)	92.9	93.2	101.4	98.3	107.2	110.0
Unemployment rate (in percent)	9.1	9.1	8.9	9.0	9.2	9.9
Population (millions)	31.5	31.9	32.2	32.5	32.9	33.2
Net imports of energy products (in billions of U.S. dollars)	-6.7	-8.1	-11.2	-12.4	-12.2	-11.0
Local currency per U.S. dollar (period average)	8.1	8.4	8.1	8.6	8.4	8.4
Real effective exchange rate (annual average, percentage change)	2.0	-4.1	-1.7	-1.1	0.2	-1.2

Sources: Moroccan authorities; and IMF staff estimates.

Annex I. Views of the Authorities

The Moroccan authorities are broadly in agreement with the conclusions of the Ex-Post Evaluation Report on the Precautionary and Liquidity Line (PLL) Arrangement of July 2012. The report duly underscored the suitability of the macroeconomic policies implemented in the period before and after the global economic crisis and their contribution to Morocco's largely satisfactory economic performance, despite unfavorable conditions at the international and regional levels.

As the report indicates, the policies implemented with the support of the PLL contributed to the preservation of macroeconomic stability and a reduction in fiscal and external vulnerabilities, in spite of a challenging and uncertain external environment. The considerable reduction in fiscal and current account deficits, continued containment of inflation, and further strengthening of foreign exchange reserves have created an enabling environment for strong and sustainable growth. Thus, although there was no need to draw on the PLL arrangement, the arrangement effectively fulfilled Morocco's needs during 2012–14, serving as an insurance policy against external risks and a signaling device to Moroccan economic agents, as well as to the country's international partners and investors.

While in agreement with the report's conclusions, the Moroccan authorities wish to make the following comments:

- The element of political risk mentioned in the report, particularly with regard to its potential impact on the ability of authorities to implement reforms and, consequently, in terms of risks for the IMF's own resources, reflects more the overall assessment of the prevailing socio-political conditions in some countries in the region rather than a specific analysis of the situation in Morocco. The fact that the Moroccan authorities succeeded in maintaining undisrupted its long-standing political stability and implemented significant political and economic reforms during a period of regional turbulence attests to the overestimation of this risk factor.
- The 2012 fiscal slippage , rather than reflecting a weakening of the institutional and policy framework, is largely attributable to circumstantial factors arising during 2012, namely:
  - Delays in the adoption of the 2012 budget law resulting from the transition to a new government, a shift that gave rise to changes in the behavior of fiscal aggregates in relation to their usual profile and trends, and prevented accurate projections of budget execution, particularly with respect to the pace of investment budget execution;
  - An increase in oil prices in excess of the assumptions under the PLL arrangement, which led to an increase in subsidy expenditures amounting to one-third of the deficit overrun, despite the significant increases in domestic prices implemented mid-year;
  - Social pressures arising from regional developments that exerted significant impact on public financial management in 2011 and 2012, with earlier than expected implementation in 2012 of wage increases decided in 2011, thereby limiting capacity to contain the wage bill.

  At the time it submitted its request for the PLL arrangement, the government was aware of the fiscal vulnerabilities stemming from the indicative nature of personnel expenditures and the carry forward of investment appropriations, and had already prepared a draft Organic Budget Law (OBL) with provisions aimed at reducing these vulnerabilities. Notwithstanding the timeframe required for the adoption of the new OBL, the fiscal regulations implemented by the government in 2013, which were rolled over the following years in anticipation of the enactment of the OBL, contributed to a significant reduction in the vulnerabilities observed in 2012. In addition, budget execution monitoring was strengthened considerably as a result of the establishment of ad hoc high-level committees.

- Government spending on wages, subsidies, other goods and services, and transfers was successfully contained on the whole. With respect to wage expenditure in particular, the government considerably reduced the net creation of new positions as well as the pace of increases of the salaries of government employees. However, regular statutory promotions of employees, combined with an economic environment that was less favorable than anticipated, characterized by a slowdown in economic growth and very low levels of inflation, reduced the impact of the measures to contain wage expenditures as a proportion of GDP. The incompressible nature of these and some other expenditures has limited the capacity of the government to increase investment appropriations while remaining in line with the budget deficit target.
- It should be noted that most public investments are carried out by public enterprises in strategic infrastructure projects, and these investment expenditures are not consolidated in the fiscal position. Moreover, investment challenges in Morocco are more of a qualitative than quantitative nature, as the rate of investment in Morocco is among the highest in emerging countries but the efficacy of investments continues to be limited. As a result, and bearing in mind budgetary constraints, the government has, in recent years, prioritized improved streamlining of public investment, including through selecting investment projects that stand to be the most profitable in terms of their impact on growth. In this regard, in the written communication accompanying the PLL request sent in July 2012, the Moroccan authorities emphasized their intention to improve the selectivity and efficacy of public investment and to preserve the level of investment expenditure, without mentioning an increase in this expenditure. In fact the total budgetary investment expenditure, which includes the capital budget as well as capital transfers to public enterprises, increased by 0.3 percent of GDP from 2012 to 2014, the period covered by the PLL arrangement.
- The recent changes in the stock and profile of public debt, which remains sustainable, should be viewed in light of the objectives of the proactive financing strategy adopted by the authorities, which aims to preserve the liquidity conditions of the domestic market and meet the requirements for appropriate financing of the economy, as well as to maintain an adequate level of foreign exchange reserves. The Treasury's increasing reliance on external financing has been made possible by the relatively low level of external debt and favorable conditions on the international financial market. This policy has been successful since interest rates on the domestic market declined appreciably in 2014 and the conditions for financing the Treasury, particularly in terms of maturities and interest rates, have improved markedly, while freeing additional resources for the financing of private investment.

Statement by Mohammed Daïri, Alternate Executive Director for Morocco
July 24, 2015

Second Review of the Precautionary and Liquidity Line

On behalf of my Moroccan authorities, I thank staff for their hard work and the useful exchange during this second review of the PLL-supported program and for the clear and concise report. The authorities concur with staff assessment and recommendations, which are broadly in line with their own reform agenda and priorities. They also reiterate their deep appreciation for the useful technical assistance provided by the Fund's MCM and RES departments, and thank management and Executive Directors for their support.

Performance under the program continues to be strong, despite weak recovery of the global economy and the Euro area in particular. Growth is projected to increase from a revised 2.4 percent in 2013 to 4.9 percent in 2015, reflecting the impact of more favorable weather conditions and a gradual recovery in non-agricultural GDP. However, it is still well below the pre-global crisis level and is not sufficient to reverse the recent increase in unemployment, which was close to 10 percent in 2014 and particularly high among the youth. Inflation has remained low at 2 percent in May on a year-to-year basis.

External sector developments are better than projected under the first review, despite lower tourism receipts linked to regional security incidents. The current account deficit is estimated to decline from 5.5 percent to 2.8 percent of GDP in 2015, reflecting lower oil and food imports but also continued strong performance of automobile exports and a recovery in exports of phosphates and derived products. With FDI remaining at 2.5 percent of GDP, gross reserves are projected to reach the equivalent of 6 months of imports or 147 percent of the Fund's adjusted ARA metric at end-2015, and external debt-to-GDP ratio should decline to 32 percent of GDP in 2015 and continue falling thereafter. The March 2015 indicative target on reserves was met with a comfortable margin, leading to a significant upward revision of the September 2015 target.

Fiscal developments are also favorable. The overall deficit declined in the first 5 months of 2015 by close to 40 percent compared to last year. Revenue increased, underpinned by strong non-tax revenue, notwithstanding shortfalls in grants and VAT on imports. Expenditure declined, driven by lower subsidies and wage outlays, whereas investment spending remained broadly unchanged from 2014. The indicative fiscal target for end-March was also met with a wide margin. The authorities are confident that the 2015 fiscal deficit objective of 4.3 percent of GDP will be met, and will take additional measures if necessary to achieve it. Moreover, with binding constraints on non-interest recurrent spending, any revenue gains or savings on such spending will be used to support economic activity through accelerated investment execution, as indicated in the Written Communication (¶4).

The authorities are firmly determined to continue with their medium-term fiscal consolidation program and to resist spending pressures during the upcoming elections. They reiterate their intention to reduce the deficit further to 3.5 percent of GDP in 2016, consistent with their objective of 3 percent of GDP in 2017. This will be achieved through further progress under the tax reform to broaden the base and reduce exemptions and distortions, continued wage moderation, and improved public spending prioritization, transparency, and efficiency in line with the modernized budget and public financial management framework under the new OBL.

The authorities have reservations regarding the inclusion of short-term domestic debt at original maturity in gross financing needs (GFNs), which is the main reason for this indicator exceeding the 15 percent of GDP benchmark under the DSA. Indeed, with a large pool of domestic financial resources, mainly in non-banks, and in view of existing capital controls on outflows by residents, rollover risks of short-term domestic debt in Morocco are minimal. The authorities look forward to a review of the DSA framework to take similar circumstances into consideration in computing GFNs, as has been done in the adjusted ARA metric.

Monetary policy continues to aim at maintaining price stability while ensuring adequate financing of the economy to support the recovery. Bank liquidity has improved following the latest cut in the reserve requirement and the increase in foreign assets. The support systems established by BAM in favor of very small, small and medium-sized enterprises have been successful in significantly improving their access to credit. The revised draft central bank charter, which aims at strengthening its independence and broadening its mandate, is being finalized and will soon be presented to the cabinet for approval and submission to parliament.

BAM continues to strengthen its analytical and forecasting capacity to prepare for the transition to a new monetary framework and greater exchange rate flexibility. The authorities increased the weight of the US Dollar in the currency basket to which the Dirham is pegged to better reflect the currency composition of foreign flows. Drawing on Fund technical assistance, they are considering available options for more exchange rate flexibility, and are assessing in particular the degree of preparedness of businesses to operate in an environment characterized by greater interest rate and exchange rate volatility. They expect to be in a position to discuss these options and relevant issues with staff during the Article IV discussions later this year.

Further progress is being made in strengthening financial regulation and supervision, including through implementation of Basel III standards. The preliminary findings of the FSAP mission that visited Morocco late April are that banks are adequately capitalized and profitable, with stable funding sources, and that the banking system is resilient to severe adverse shocks and large deposit withdrawals. Moreover, while NPLs have increased recently, mainly reflecting a slowdown in some sectors, they are well provisioned. The mission also found that the risk from severe distress in Sub-Saharan Africa subsidiaries is marginal. The authorities thank the FSAP team for their high quality work and broadly concur with their conclusions. They look forward to further discussion with the team on some of their findings and recommendations so that the FSSA could be brought before the Board along with the Article IV consultations report.

The authorities are strongly committed to their structural reform agenda to achieve higher and more inclusive growth and reduce unemployment, while strengthening the social safety net to mitigate the impact of the reforms on the poor, and improving the scope and reach of various social support mechanisms to address the needs of the vulnerable population. Continued efforts are being made to improve the business climate, upgrade infrastructure, increase financial inclusion, strengthen competitiveness, and improve employment opportunities and labor productivity, including by reforming education and vocational training, enhancing the effectiveness of employment support mechanisms, and raising female participation in the labor force. The recently-announced National Employment Strategy will guide policies in this crucial area.

Following the successful reform of the subsidy system, the adoption of the new OBL is a milestone in strengthening and modernizing the fiscal framework, enhancing transparency and accountability, and reducing fiscal vulnerabilities. It will permanently address the weaknesses in budget implementation and monitoring which led to the 2012 expenditure overrun. With regard to pension reform, consultations with trade unions on the government's proposals have taken more time than expected. While seeking to reach a consensus with social partners, the government is cognizant of the importance of this reform, and is firmly determined to move the process forward as soon as possible.

The authorities appreciate the support provided by the PLL. They welcome staff assessment that Morocco continues to meet PLL eligibility and exceptional access criteria. While they remain committed to their ambitious program, they attach high importance to maintaining social peace and cohesion and reducing regional, gender, and income disparities.

Ex Post Evaluation

The authorities welcome the Ex Post Evaluation of Exceptional Access (EPE) under the 2012-14 PLL and thank Mr. Geiregat and his team for the well-written report. As indicated in their response to the draft report, the authorities broadly concur with the conclusions of the EPE, in particular the usefulness of the PLL in providing an insurance against exogenous shocks in a weak and uncertain global environment, and the confirmation that Morocco met the PLL qualification standards and requirements under the exceptional access policy. The fact that despite social pressures and unfavorable external environment, the authorities succeeded in maintaining macroeconomic and financial stability, significantly reducing fiscal and external vulnerabilities, and strengthening policy buffers is a testament to their unwavering commitment to their program.

Important progress was also made on the structural reform agenda. In this regard, the delay in the adoption of the OBL was due to the broad consultation with interested parties and civil society, as well as with the IMF, in the finalization of the draft. It also resulted from the time needed to amend the law adopted in November 2014 in order to address the comments subsequently made by the Constitutional Council. Despite this delay, the 2016 budget will be prepared in accordance with the new OBL, as anticipated.

PLL exit was contingent on a significant improvement in the external environment and reduction in Morocco's vulnerabilities. Vulnerabilities have declined significantly by mid-2014, in particular as a result of the subsidy reform, the strengthening of external buffers, and the administrative measures taken to prevent recurrence of the 2012 budget overruns pending the adoption of the OBL. However, the external environment deteriorated instead of improving, in particular in view of lower Euro area partners' growth, which was three percentage points lower than projected by staff over 2012-14, affecting growth, the BOP, and fiscal revenue. Oil prices were also higher than projected, and the impact on the budget was compounded by the appreciation of the US Dollar against the Euro, as the latter accounted for 80 percent of the currency basket to which the Dirham is pegged. The decline in world demand and prices for phosphates and derived products also significantly impacted the BOP, while also affecting fiscal revenue through lower tax and dividend payments.

Notwithstanding these external headwinds, the authorities continued with implementation of their program. They borrowed from international capital markets to further build external buffers, keeping the PLL as an insurance against future risks and a signal to markets. By the end of the arrangement in mid-2014, and in view of the significant downside risks from the international environment and the remaining, albeit reduced vulnerabilities, the authorities decided to request a new PLL arrangement with lower access.

Staff views on the challenges that lie ahead and the way forward as summarized in ¶57 are fully in line with the authorities' program. Ongoing improvement of the business climate, along with sound macroeconomic policies and further strengthening of the fiscal and monetary policy frameworks and the financial system, should help enhance competitiveness and private sector confidence and catalyze FDI, building on Morocco's strong fundamentals and long-standing political and social stability.