**Morocco's Economic Prospects and Challenges**[1]
9-30-2010

**Morocco's economy was affected by the global recession in 2009, but the impact was moderate and localized.** GDP growth slowed to 4.9%, down from 5.6% in 2008. The global recession affected Morocco's economy primarily through its close economic relationship with Europe. The EU (especially France and Spain) accounts for 55% of Morocco's total external trade, 81% of its tourism receipts and 91% of its remittance inflows. In the first half of 2009 compared to the first half of 2008, the deceleration of growth in the EU caused both Moroccan exports and FDI to decline by 34%, while tourism receipts fell by 14% and remittance inflows by 12%. Non-agricultural GDP grew by only 2.6% in 2009, against 3.9% in 2008). The impact of the recession was tempered by structural reforms that increased the share of non-agricultural sectors over the past decade, by sound economic management that gave the government room to increase spending in 2009 and by a strong financial sector largely isolated from international financial markets. In addition, an exceptional harvest caused the agricultural sector, which accounts for 15-19% of GDP[2], to perform spectacularly in 2009, almost doubling its growth from 2008 (30.6% vs. 16.3%). The performance of the agricultural sector, which employs 42% of the labor force, had a strong positive effect on both GDP growth and private consumption. Private consumption continued to grow in 2009, although more slowly than in 2008 (4.0% vs. 6.0%).

**Growth is expected to slow down further in 2010 and 2011 due to timid growth in the EU and drastically weaker agricultural growth.** The Economist Intelligence Unit (EIU) expects the Moroccan economy to grow by 4.2% in 2010 and 3.8% in 2011. This forecast is strongly influenced by the pace of economic recovery in the EU, where growth is projected at only 0.8% in 2010 and 1.1% in 2011 after a decline of 4.0% in 2009. Slow growth in the EU will depress Moroccan exports as well as private consumption as fewer remittances are sent back by the 20% of Morocco's labor force who work in the EU. Slow agricultural growth – forecast at 0.5% in 2010 and 3.5% in 2011 - is also expected to lower GDP growth, partly through a negative effect on private consumption. Private consumption is expected to grow by 3.9% in 2010 and 3.8% in 2011. Although the share of the primary sector in Morocco's GDP has declined since 2000, it remains substantial and exposes the economy to the vagaries of the weather. Growth in gross fixed investment, which fell to 2.5% in 2009 after running at 11.5% in 2008, should amount to 4.2% and 5.0% in 2010 and 2011, respectively.

1 Thibaut Muzart, Management Systems International, under ME/TS's Alliances, Analyses, and Program Support (AAPS) buy-in to EGAT's Business Growth Initiative. The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

2 The EIU gives the former number, the *CIA World Factbook* the latter.

**The government has adjusted its spending to stimulate the economy in 2009-2010, causing the deficit to rise**. In response to the crisis, the government raised civil servant salaries at the bottom of the pay scale by 10%, decreased the marginal income tax, increased public investment in infrastructure and provided support to enterprises in certain sectors (including, for example, guaranteeing up to 65% of working capital loans and providing training and logistics in partnership with business associations). Spending from the subsidy fund – the Caisse de Compensation – amounted to an estimated $1.89 billion. The increase in the wage bill was limited by hiring cuts and the effects of the early retirement program implemented since 2005. However, the government incurred an estimated deficit equivalent to 2.1% of GDP in 2009 (down from a small surplus of 0.4% the previous year) as revenues decreased by 9.7% due to lower economic activity. In 2010, the budget deficit is expected to widen to 4% of GDP, as spending is expected to rise by approximately 6.7% while revenues will decrease marginally. Subsidies are expected to rise to approximately $3.02 billion and the government plans to spend significantly on capital investments. In 2011, the deficit should amount to 3.8% of GDP, as lower growth in public expenditures (3.2%) is forecast to be offset by a 3.82% increase in revenue. Plans have been made to reform the subsidy fund by making it more targeted. The government announced that spending on subsidies would not exceed 2% of GDP in 2011.

**Prices barely increased in 2009 and are expected to rise only slightly in 2010 and 2011.** Inflation averaged 1% in 2009 as food prices fell. Prices are expected to rise moderately in 2010 and 2011 (at rates of 2.4% and 2.6%, respectively). The money supply will grow slowly as deposits from Moroccan residents abroad will be modest and government subsidies will help keep the price of food and energy low. The strength of wheat production will affect the volume of grain imports. The dirham is expected to depreciate against the dollar in 2010-2011, which will raise prices.  A poor wheat harvest and currency appreciation could both add to government spending on food subsidies.

**Interest and exchange rates have been well managed and authorities are gradually moving toward a more flexible framework.** In 2009, the central bank (Bank al-Maghrib) lowered its key policy rate by 25 basis points (to 3.25%) and reduced capital requirements from 15% to 8% (and then to 6% in March 2010), as low inflation provided some room to stimulate the economy over concerns about the small amounts of liquidity in the banking system. In mid to late 2011 the central bank is expected to raise its policy rate to keep foreign investments in Morocco attractive in the face of monetary policy tightening (an increase in interest rates) in developed countries. The exchange rate is pegged to a basket of currencies in which the Euro and the dollar are weighted at 80% and 20% respectively and the central bank intervenes in the money market to keep the interest rate within a band. In 2010 and 2011, the dirham is expected to depreciate against dollar but appreciate against the Euro. The most recent IMF Article IV report concluded that in November 2009 the exchange rate was in line with fundamentals (neither overvalued nor undervalued) and had contributed to macroeconomic stability. The central bank has been preparing to move gradually toward a more flexible monetary and exchange rate framework in order to better adapt to changes in the external environment and to focus on targeting inflation, and has made this a medium-term objective. The IMF's Article VI report considers that Morocco has fulfilled most of the preconditions for such a move, while advocating for a careful sequencing of the changes.

**The current account deficit is projected to rise in 2010 before narrowing slightly in 2011.** The current account deficit is expected to increase by 52%, to $7.6 billion in 2010 (against $5.0 billion the previous year) due to an increase in the commodity imports bill (in part as a result of a weaker dirham and higher oil prices) and a lower surplus in the services balance, even though the current transfers balance (due to higher remittance inflows) and income balance are expected to improve. In 2011, the current account deficit is expected to decrease by approximately 8% to $7.04 billion, as the trade deficit slightly shrinks and the balances on services, income and current transfers improve. The external balance will depend heavily on the extent to which economies in the EU will recover in the short- to mid-term, since they are the main source of remittance inflows, tourists and demand for exports.

**Morocco has relied principally on internal demand for its growth.** Morocco's trade to GDP ratio has been lower than those of its neighbors, averaging 74% over 2004-2008 and declining to 49% in 2009 (the ratio is 108% in Tunisia and 146% in Jordan). This can be explained by policy and investment biases towards non-tradable goods that require significant imports. The sophistication of Morocco's exports has changed little and export volumes have continued to underperform compared to its competitors, principally because of low competitiveness and export diversification. In recent years, the manufacturing sector's contribution to GDP has shrunk in favor of the services sector, and concerns remain about productivity in the manufacturing and export sectors, which are characterized by low technology, value-added, technological use and skills. The World Bank observes that in addition to policy biases, lack of skills in the most competitive sectors, a constraining business environment and a rigid labor market all contribute to the low competitiveness of Moroccan exports and prevent Morocco from taking full advantage of growth opportunities associated with trade.

**The quality of employment opportunities poses problems for poverty reduction.** Although absolute poverty fell from 15% in 2001 to 9% in 2007, the World Bank's Country Partnership Strategy for Morocco (2010-2013) notes that vulnerability to poverty is high. In fact, if the population vulnerable to poverty is counted, one-quarter of the population is either poor or at risk of being poor. In this context, the World Bank estimates that by the year 2020, approximately four million new jobs – double the average in 2002-2007 – will need to be created to respond to new entrants in the labor market. In addition, since 2000, job creation has consisted largely of low-wage, low-skill jobs in the informal and agricultural sectors, where job insecurity is high. With current and predicted unemployment rates - of 9.6% in 2008, 9.1% in 2009, 9.8% in 2010, and 9.6% in 2011 - the prospects for improving the economic and social well being of the poorest segments of the population are dim.

**The government seeks to make agriculture a centerpiece of its economic and social development strategy.** The Plan Maroc Vert (Green Morocco Plan), officially presented to King Mohammed VI in 2008, aims to achieve this objective by the year 2020. Currently, traditional agriculture is practiced on 80% of cultivated lands in non-irrigated semi-arid areas. Investments in production factors are insufficient, access to credit is poor, productivity is low, plots are small (70% of farm plots are smaller than five hectares) with complex land titling procedures the sector is poorly organized with few linkages. In the face of these constraints, the Green Morocco Plan seeks to optimize value chain linkages; replace low value crops (e.g.: grain) with high value crops such as olives, saffron and almonds; provide technical assistance to farmers; and encourage product diversification. Funding is expected to be provided by the state, donors, private and foreign investors. The plan's specific objectives are to achieve food security, raise farmers' incomes, preserve natural resources and integrate the agricultural sector in the national and international markets. The Green Morocco Plan is considered a welcome initiative in the face of the current limitations of Morocco's agricultural sector and it appears to have been viewed favorably by investors. As of April 2010, approximately $1.2 billion – including funding from the World Bank and Belgium – had been invested. In June 2010, the World Bank signed an agreement for a $70 million loan for an agricultural project designed to contribute to the plan.

**Government support is visible in numerous other development areas.** The second phase of the Émergence program, Émergence II, was created in February 2009 to consolidate the outcomes of Émergence and provide impetus for growth along five pillars until 2015. The first is encouraging FDI in agribusiness, leather, off shoring, electronics, aeronautics, car parts and textiles industries by encouraging private and foreign investments. The second aims to support SMEs through technical assistance and improving access to finance. The third targets skill building by upgrading curricula in tertiary education. The fourth focuses on improving the business environment. The fifth and last pillar seeks to promote Moroccan industry as a high-return investment. This year will also see the end of the first phase of the Initiative Nationale pour le Développement Humain (INDH), launched in 2005, which aims to improve social indicators and combat poverty and vulnerability using a participatory approach coordinated across various government agencies. Other programs include the Plan Azur (tourism, ends in 2010), Programme Najah (education, ending in 2012), Santé Vision (health, ending in 2012), Halieutis (fisheries, ending in 2020) and national water strategy (until 2030). The World Bank considers these strategies to be well formulated and some, such as Émergence and Azur, have attracted foreign investment.

**Donor support is abundant.** On July 13th the EU and Morocco signed a $724 million cooperation agreement to assist Morocco along five priority axes: social development, economic modernization, institutional reforms, human rights protection and environmental policy. Morocco is also the highest recipient under the European Neighborhood Policy (ENP), which provided €654 million in 2007-2010 in assistance for various development initiatives. The 2010-2013 Country Partnership Strategy (dated December 2009) reveals confirmed lending for a total of $600 million in 2010 (twice the volume in 2006-2009) and another $600 million in 2011, contingent on World Bank lending capability. In addition, current joint EU-World Bank financing for Morocco exceeds $900 million.

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