International Monetary Fund

Morocco and the IMF

Press Release:
IMF Executive Board Approves US$6.2 Billion Arrangement for Morocco under the Precautionary Liquidity Line
August 3, 2012

Morocco: Letter of Intent

July 27, 2012

The following item is a Letter of Intent of the government of Morocco, which describes the policies that Morocco intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Morocco, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

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REQUEST FOR A PRECAUTIONARY CREDIT LINE ARRANGEMENT

Rabat, Morocco
July 27, 2012

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Ms. Lagarde,

1. We welcome the recent approval by the International Monetary Fund of the Precautionary and Liquidity Line (PLL) as a new financial instrument designed for countries with sound fundamentals and policies, but moderate vulnerabilities. This line can operate as insurance fulfilling immediate financing needs if external shocks or an unexpected deterioration of the international environment.

2. Morocco has sound economic fundamentals and a track record of sound policies. In a difficult external environment, Morocco's economic performance was broadly satisfactory. Growth averaged 4½ percent during 2009-11; inflation remained around 1 percent; and reserve coverage remained comfortable. Unemployment markedly declined from 13.6 percent in 2000, stabilizing at around 9 percent in 2011, even though youth unemployment remains high. The financial system is sound and remained resilient to the global financial crisis and more recently, to the financial turmoil in Europe. Morocco's investment grade sovereign debt rating has been reconfirmed, reflecting its strong economic performance in a difficult external environment

3. Even though Morocco does not currently have a balance of payments need, we continue to face risks arising from uncertainties in the global economy, particularly regarding the potential for adverse developments in Morocco's main trading partners and international oil prices. While we remain committed to following strong policies and to responding appropriately to any deterioration in the external environment, these risks could cause a widening of the trade deficit and a significant reduction in foreign reserves, and may undermine our growth and employment strategy.

4. In this context, a PLL arrangement would support our economic strategy by enhancing investor confidence and supporting macroeconomic stability, including by providing rapid access to resources in the event of external shocks or a worsening international situation which puts pressure on the balance of payments. We would like to request that the IMF approve a precautionary PLL arrangement covering 24 months in the amount of SDR 4.12 billion (700 percent of quota), with a maximum of 2.35 billion SDRs (400 percent of quota) available during the first twelve months of the agreement. We intend to draw only in the event of unforeseen external shocks or a worsening of the international outlook relative to current assumptions.

5. In line with the government program adopted by Parliament in January 2012, and the macroeconomic stability principle enshrined in our constitution adopted July 1, 2011, the government pursues economic and financial policies to boost growth and reduce

unemployment, while continuing to strengthen our fiscal and external sustainability. The objective of the Government's program is to increase the rate of real GDP growth to 5½ percent over the period 2012–16, based on three main drivers, namely supporting domestic demand, promoting private sector development, and the continued implementation of structural reforms and sectoral strategies. With regard to reducing unemployment, mainly among the young, the government will intensify its efforts to strengthen the adequacy of training needed for economic sectors and the ongoing active labor market programs.

6. In terms of fiscal policy, the government program envisages a steady reduction of the budget deficit to about 3 percent of GDP by 2016, by strengthening the rationalization and efficiency of public spending, as well as revenue optimization. As envisaged in the Government program, particular emphasis is given to the rationalization and efficiency of public spending. In this context, a draft decree which aims to modernize regulations governing public procurement is being adopted. At the same time, a project to redesign the organic budget law introducing program budgeting and a focus on a results-based framework is being developed. The reform of the subsidy system is also one of the priorities of the government to improve the system of protection of vulnerable populations by targeting these expenses, and to reduce expenses to preserve spending on public investment. In this context, we intend to hold before the end of the year a broad consultation with our economic partners and civil society to determine the best strategy to reform the subsidy system in order to improve social protection and reduce its cost to a sustainable level in line with our fiscal consolidation objectives. In addition, we intend to redesign compensation in the public sector to better link it with performance. This reform will be implemented in parallel with that of the pension system in order to ensure its long-term sustainability. Regarding the optimization of revenue, a global strategy encompassing tax revenues, revenues from government property and from monopolies is under consideration within the government. The objective is to broaden the tax base, improve collection, streamline tax and property expenditures, and raise the value of the private assets of the state, while maintaining a climate conducive to private sector activity. On this basis, the fiscal deficit (excluding privatization revenues, including grants) should be reduced from 6.9 percent of GDP in 2011 to 6.1 percent in 2012 and 5.3 percent in 2013.

7. In terms of monetary policy the statute governing Bank Al-Maghrib (BAM) enacted in 2006, establishes price stability as its fundamental mission, and gives adequate independence in defining and conducting monetary policy. The Board of BAM will continue to ensure price stability over the medium term, while following closely the changing internal and external environment, particularly any risks that may put pressure on prices. As part of the implementation of monetary policy, BAM will continue to provide the necessary liquidity to ensure appropriate financing of the economy. The effective management of liquidity has always allowed the money market rate to remain close to the policy rate on a daily basis. To address structural liquidity needs, BAM has gradually reduced the reserve requirement ratio from 16 ½ to 6 percent. Banks now have a satisfactory level of reserves providing a safety margin in case of need. As for interest rate, the Central Bank will continue its efforts to strengthen capacity and instruments for effective regulation of the money market. Indeed, BAM now utilizes long-term repos in its interventions. In this context, it also expanded the collateral required for lending to banks. In addition, BAM will offer banks a broader range of refinancing instruments to adjust their balance sheets such as securitization and covered bonds. In this regards, it will continue to monitor the implementation of refinancing plans adopted by some banks, in order to ensure credit growth is supported by stable resources that

are better suited for their use. It will also ensure that banks hold appropriate liquidity buffers on their balance sheets and adopt plans to deal with liquidity crises.

8. BAM will continue to monitor the health of the banking system through strong regulation and effective supervision. To this end, it will gradually adhere to the norms of Basel III, in particular those relating to capital adequacy and liquidity. BAM has already increased the Tier 1 capital to risk-weighted asset ratio to 9 percent and the regulatory capital adequacy ratio to 12 percent, which will take effect in June 2013. It will then carry out the reform of the liquidity ratio towards international standards. Starting from 2013, banks will be required to comply with stricter rules on risk diversification. Nonperforming loans (NPLs) of banks have fallen from 6 percent at the end of 2010 to 5.1 percent at the end of May 2012. BAM will maintain its requirements for adequate funding of such loans. In addition, BAM will strengthen its micro-prudential surveillance in the context of the risk-based approach. In parallel, the Ministry of Finance, BAM and other regulators are strengthening their coordination in order to preserve financial stability.

9. We will maintain a fixed exchange rate relative to a euro-dollar basket for the time being, which has contributed to economic stability in the last decade. We will continue to maintain an adequate level of international reserves. In particular, gross international reserves are expected to stabilize in the second half of 2012 at about four months of imports, mainly due to lower international oil prices, combined with an increase in export volumes of phosphates and derivatives, the export production of new industrial plants, and a pick-up in tourism receipts. Moreover, the government's financing strategy comprises the possibility of accessing international financial markets.

10. In summary, our sound economic fundamentals and institutional policy framework, and our track record of sound policies recognized by the positive assessment of the Executive Board of the IMF in the context of our most recent Article IV consultations, as well as our commitment to such policies in the future, provide sufficient assurance that we will respond appropriately to deal with any potential problem of financing of the balance of payments.

11. We will provide the Fund all needed information to monitor economic and policy developments under the requested PLL arrangement, including in relation to the indicators listed in Attachment II and Table 1. We will also observe the standard criteria related to trade and exchange restrictions, bilateral payments arrangements, multiple currency practices, and non-accumulation of external debt payments arrears, in accordance with requirements under the PLL.

12. We believe that the policies contained in this communication are adequate to achieve our economic goals supported by the PLL, and will take any additional measures that may be necessary for this purpose. Morocco will engage with the Fund in accordance with relevant Fund policies, towards the success of our economic policies.

/s/	/s/
Nizar Baraka	Abdellatif Jouahri
Minister of Economy and Finance	Governor of Bank Al-Maghrib

Table 1. Morocco: Quantitative Indicative Targets

	2011	2012	2013
	12/31	10/30	4/30
	Actual		
Indicative targets 1/			
Net international reserves (NIR) of Bank Al-Maghrib (BAM) (floor, end of period (eop) stock, in millions of U.S. dollars (US$))	20,268	16,752	16,557
Fiscal deficit (ceiling, cumulative since beginning of fiscal year, eop in millions of dirham)	-55,776	-41,601	-18,556
Memorandum item:			
Adjustor on NIR (in millions of U.S. dollars) 2/		1,095	928
Adjustor on the fiscal deficit (in millions of dirham) 3/		0	3,248

1/ Evaluated at the program exchange rate (end-April 2012 8.429 MAD/US$) for the years 2012 and 2013.

2/ The adjustors are specified in the Technical Appendix. Accordingly, the floor on NIR of BAM will be adjusted downward in the event of a shortfall of official grants and budget support loans relative to projections.

3/ The adjustors are specified in the Technical Appendix. Accordingly, the fiscal deficit ceiling will be adjusted upward in the event of a shortfall of budget support grants relative to projections.

Table 2. Morocco: Schedule and Terms Under the Precautionary and Liquidity Line Arrangement

		Indicative targets 1/		Credit Available 4/			
Review Date	Conditions for access	Central government fiscal deficit, ceiling, cumulative since beginning of fiscal year (eop in millions of dirham) 2/	Net international reserves (NIR) of Bank Al-Maghrib (BAM), floor, eop stock, in millions of U.S. dollars (US$) 3/	Million SDR 5/	Million Dollars 6/	Percent of Quota, cumulative	Percent of Total Access
August 3, 2012 7/	Board approval of the PLL	-55,776	20,268	2,352.8	3,543.3	400	57
February 2, 2013	First review, based on October 30, 2012 indicative targets	-41,601	16,752	2,352.8	3,543.3	400	57
August 2, 2013	Second review, based on April 30, 2013 indicative targets	-18,556	16,557	4,117.4	6,200.8	700	100
February 2, 2014	Third review, based on October 30, 2013 indicative targets	To be set in the second review	To be set in the second review	4,117.4	6,200.8	700	100
Total				4,117.4	6,200.8	700	100

Source: Fund Staff estimates.

1/ Evaluated at the program exchange rate (end-April 2012 8.429 MAD/US$) for the years 2012 and 2013.

2/ The adjustors are specified in the Technical Appendix.

3/ The adjustors are specified in the Technical Appendix.

4/ Credit available assuming no purchase.

5/ Additional access equivalent to 300 percent of quota will be available on August 3, 2013.

6/ SDR/Dollar Exchange rate of 0.664016 as of July 17, 2012.

7/ Corresponds to the date of approval of the PLL arrangement.

ATTACHMENT

TECHNICAL APPENDIX

1. Under the first year of the PLL arrangement, quantitative indicative targets as defined in Table 1 of our written communication will be set for end-October 2012 and end-April 2013. They include:

- Floor on the level of net international reserves (NIR) of Bank Al-Maghrib (BAM), as defined in Table 1, calculated as an end-of-period stock. The exchange rate that will be used to monitor NIR during the first year of the program is Moroccan dirham (MAD) 8.4291 per U.S. dollar, the rate prevailing on April 30, 2012. Foreign currency accounts denominated in currencies other than the U.S. dollar and monetary gold will be valued in U.S. dollars at the exchange rates and gold prices prevailing on April 30, 2012. BAM will report to the IMF the level of NIR and gross international reserves (GIR) no later than one week after the end of each week both at the program exchange rates and at the market exchange rates.

- Ceiling on the level of the fiscal deficit of the central government defined as revenues, including grants, less expenditure less net acquisition of nonfinancial assets as reported in the GFSM 2001 format, calculated as a cumulative flow from January 1 of each year. The central government is defined as all budgetary units of the central government. It includes the general government budget, special-treasury accounts and autonomously managed government services. The Ministry of Economy and Finance will report to the IMF in monthly and cumulative flows from January 1 of each year the fiscal deficit, including grants, but excluding net acquisition of shares and other equity (privatization receipts) and the relevant budget aggregates (revenues, expenditures, etc.) for each month before the end of the following month.

2. The indicative targets on NIR will be adjusted downward (upward) by the amount below (above) official grants and loans received by the central government from bilateral and multilateral agencies relative to program projections, and the ones on the fiscal deficit will be adjusted upward (downward) by the amount below (above) budgetary grants received by the central government from bilateral and multilateral agencies relative to program projections as indicated in Table 1 of our written communication.

3. Regarding the continuous zero ceiling on the accumulation of new external payment arrears during the duration of the arrangement, the payment arrears are defined as external debt-service obligations (principal and interest) that have not been paid at the time that are due as specified in the contractual agreements, on central government and central government-guaranteed debt. Overdue debt and debt-service obligations that are in dispute will not be considered as external payment arrears.

4. The reviews by the Executive Board will be completed by no later than February 2, 2013 for the first review, August 2, 2013 for the second review, and February 2, 2014 for the third review.

Table 1. Definition of GIR and NIR of BAM
for the purpose of monitoring indicative targets

Gross international reserves are defined as the sum of:

- Foreign currency assets in convertible currencies held abroad, and as vault cash that are under the direct and effective control of BAM, readily available for intervention in the foreign exchange market or the direct financing of the balance of payments;
- The reserve position of Morocco in the IMF;
- Holding of SDRs; and
- Monetary gold.

Excluded from the definition of GIR are:

- Foreign currency assets that are in any way encumbered or pledged, including, but not limited to, reserve assets used as collateral or guarantee for third-party external liabilities;
- Foreign currency assets in nonconvertible currencies and precious metals other than gold;
- Foreign currency claims on entities incorporated in Morocco;
- Any other foreign currency claims on residents; and
- Capital subscriptions in international institutions.

NIR is defined as GIR less:

- All outstanding liabilities of Morocco to the IMF, excluding SDR allocation; and
- Foreign currency liabilities in convertible currencies to nonresidents and contingent commitments to sell foreign exchange arising from transactions in derivative assets, including forward contracts, foreign currency swaps, and other futures market contracts.
