MOROCCO

Highlights

- **Growth has slowed in the first half of 2018 due to a drop in agricultural output.** Fiscal consolidation continued and the fiscal deficit narrowed, but public debt remained above 60 per cent of GDP at the end of 2017.
- **Morocco's car industry is growing.** Affordable labour, political stability, access to the European market and a series of tax incentives have attracted European carmakers since 2012, and the industry is now the major source of exports.
- **Structural reforms have advanced, albeit with some delays.** The transition to a more flexible exchange rate regime and to inflation targeting, originally planned for 2017, started in January 2018.

Key priorities for 2019

- **Conditions for private sector investment should improve.** Adopting a clear strategy to promote investments is essential, targeting both local and foreign companies. In addition, appointing all the members of the Competition Council should be a priority in order for it to start functioning.
- **Diversifying the country's economic activity is essential.** The current reliance on agriculture often results in macroeconomic volatility. Morocco should use its proximity to Europe and explore more export opportunities.
- **Policy interventions are needed to lessen the socioeconomic divide between rural and urban communities.** Health, unemployment and poverty are major sources of insecurity for citizens and should be addressed by the government through decentralisation, promoting access to services, and promoting sustainability in agriculture and infrastructure.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	2.7	4.5	1.1	4.1	3.0
Inflation (average)	0.4	1.6	1.6	0.8	2.4
Government balance/GDP	-5.2	-4.5	-4.2	-3.5	-3.2
Current account balance/GDP	-6.0	-2.2	-4.2	-3.6	-4.3
Net FDI/GDP [neg. sign = inflows]	-2.8	-2.6	-1.5	-1.6	-1.7
External debt/GDP	33.3	33.9	34.6	33.5	34.6
Gross reserves/GDP	19.8	22.8	25.0	23.0	23.3
Credit to private sector/GDP	83.9	80.2	81.3	82.1	n.a.

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Macroeconomic performance

The economy is slowing in 2018. GDP grew by 2.8 per cent in the first half of 2018, down from 4.0 per cent in the same period in 2017. Falling agricultural output was the main factor behind the lower growth rate. Nevertheless, total economic production grew, aided by a 3.1 per cent growth in the non-agricultural sector in the same period. In per capita dollar terms, GDP continued to grow steadily by 1.4 per cent on average per year, but Morocco remains a lower-middle-income country. In the first quarter of 2018 the unemployment rate decreased to 10.5 per cent, from 10.7 per cent a year earlier.

Fiscal consolidation continued. The fiscal deficit narrowed to 3.5 per cent of GDP in 2017 – down from 4.2 per cent in 2016 – thanks to stronger tax revenues and a contained wage bill combined with lower public investment, and despite weaker non-tax revenues and grants and higher spending on subsidies and transfers. This trend continued in the first quarter of 2018 due to a 2.4 per cent drop in total spending, despite lower tax revenues. Meanwhile, public debt marginally decreased to 64.5 per cent of GDP at the end of 2017, the lowest by regional standards.

Inflation has accelerated during 2018. The inflation rate rose to 2.7 per cent in April, the highest level since 2013, before easing to 1.7 per cent in August. The acceleration was driven by the impact of the review of the consumer price index (CPI) basket structure in March as well as significant increases in volatile food and regulated prices. The central bank's decision to keep interest rates unchanged since March 2016 at 2.25 per cent led real interest rates to turn negative between March and June 2018, before edging positive again to 0.5 per cent in August.

The current account deficit declined to 3.6 per cent of GDP in 2017, down from 4.2 per cent in 2016. This was due to increased exports following Europe's strong economic recovery, increases in remittances and higher grants from the Gulf Cooperation Council. Moreover, the number of foreign tourists arriving in Morocco increased by 10 per cent year-on-year in the first seven months of 2018, partially due to the alleviation of visa requirements for Chinese citizens which started in mid-2016, allowing a 90-day stay on entry. On the capital account, foreign direct investment also rose slightly to 1.6 per cent of GDP, from 1.5 per cent in 2016, and was highly concentrated in the automotive sector; it remains lower than its historical levels, but better than Morocco's peers.

Growth is expected to slow in 2018. The current forecast is 3.0 per cent GDP growth in 2018, influenced by the negative base effect following favourable weather conditions for agriculture in 2017. In 2019 growth is forecast to rise to 3.5 per cent, supported by a number of factors, including the continued recovery in tourist arrivals, an increase in foreign direct investment, greater competitiveness from the move to a more flexible exchange rate regime, a rebound in services and manufacturing, stronger export growth – especially in the automotive and aeronautics industries-, and expanded mining capacity. The sustained growth is predicated on continuing reforms to improve the business environment and boost productivity, and diversifying the economy away from agriculture. Downside risks include delays in implementing reform, possible declines in the prices of phosphates, wheat and vegetables, weak growth in trading partners, and the vulnerability of agricultural activity to weather and price developments.

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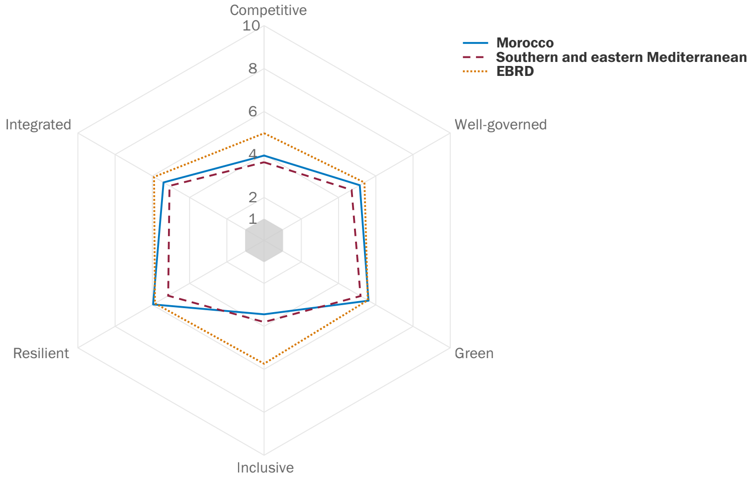
Assessment of transition qualities (1-10)



Major structural reform developments

A new central bank law has been introduced. The new law passed in July 2018, having been approved by the government a year earlier. The law will enhance the central bank's independent status and improve communication between the central bank and the Ministry of Finance, with the aim of bringing about a more harmonious monetary policy.

The central bank adopted a more flexible exchange rate. From January 2018 the dirham has been allowed to fluctuate within a 5.0 per cent band (±2.5 per cent), much higher than the former 0.3 per cent band. This move comes as part of the government's monetary policy reform aimed at improving the competitiveness of the economy and is in line with the IMF programme.

Sugar subsidies are being reduced. As part of the 2018 budget the government announced the progressive removal of sugar subsidies by 2019, saving an estimated 0.3 per cent of GDP. The government has reiterated 2020 as the target date to replace across-the-board subsidies on all remaining products with a targeted compensation mechanism, which at this stage remains fragmented across different social transfer programmes. The shift to a unified transfer programme will be based on the implementation of a national population register, a centralised social register and the assignment of a unique identification number to all nationals to better target transfers.

Morocco and the European Union (EU) have initialled a new fisheries agreement. The agreement was initialled in July 2018 after three months of negotiations, five days after the expiry of the precedent agreement. The new agreement should come into force by the end of 2018. It allows EU vessels to access the Moroccan fishing zone. The level of mandatory landings and fishing categories will remain unchanged.

The Moroccan government announced tax breaks to new industrial firms. In July 2018 the government announced exemptions from corporate tax for five years for firms established after June 2017. The measure covers 24 sectors, including manufacturing, food, textiles and pharmaceuticals, and aims to encourage investment, especially in the slowly growing, non-agricultural sector.

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Morocco continued to develop its economic and political ties with sub-Saharan Africa. In June 2018 the Moroccan and Nigerian governments signed a joint declaration detailing the next steps for the finalisation of a 5,660 km gas pipeline project launched in 2016. Morocco has been expanding its political and economic influence in sub-Saharan Africa over the past decade. The presence of Moroccan firms in this area is growing; a local subsidiary of a Moroccan renewable energy company will soon start to build the first photovoltaic solar plant in Côte d'Ivoire, an opportunity to expand to a market where solar power could prove a valuable tool in mass electrification.

Morocco's car industry is growing. Since Renault's investment in 2012, the sector, which was non-existent in the 2000s, has benefited from affordable labour, political stability, access to the European market, and a series of tax incentives. In July PSA Peugeot-Citroën announced a new production line in Morocco, set to produce up to 90,000 cars by 2020. The car production industry has been strengthening in recent years, with automotive exports now outstripping phosphates, historically the major source of foreign exchange.

Several obstacles continue to hinder Morocco's business environment. These include shortages of highly skilled labour and inefficient bureaucracy, which continue to slow the pace of project implementation. Moreover, regional disparities and non-inclusive economic growth risk are exacerbating social tensions, including over-high levels of unemployment.