

# AFRICAN DEVELOPMENT BANK



Reference No.:  
Distribution:

Language: English  
Original: French

## Financial Sector Development Support Programme – Phase II

Country: Kingdom of Morocco

### APPRAISAL REPORT

August 2011

Appraisal Team E	Team Leader:  Team Members:       Sector Director: Country Director: Division Manager: Resident Representative:	Mr. E. DIARRA, Principal Financial Economist, OSGE.2  Mr. A. BA, Principal Country Economist, ORNB Mr. W. DAKPO, Principal Coordinator, ORPF.1 Ms. L. DADE, Principal Coordinator, ORPF.2 Mr. A. BENBARKA, Principal Investment Officer, OPSM.2 Mr. M. DAMAK, Principal Credit Risk Officer, FFMA.2 Mr. B.S. BARRY, Principal Country Programme Officer, MAFO Mr. C. MBENG MEZUI, Financial Economist, ORNB Ms. P. CISSE, Financial Expert (Consultant), OSGE.2 Mr. A. TARSIM, Economist (Consultant), OSGE.2  Mr. I. LOBE NDOUMBE, Director, OSGE Mr. N. MATONDO-FUNDANI, Director ORNB Mr. J. MUKETE, Division Manager, OSGE.2 Ms. A. ABOU-ZEID, Resident Representative, MAFO
Peer Reviewers  ?		Mr. H.K. KOUASSI, Lead Macroeconomist, OSGE.2 Mr. K.R. EGUIDA, Principal Country Economist, DZFO Ms. S. CHINIEN, Principal Economist, OSGE.1 Ms. T. TRIKI, Principal Research Economist, EDRE.1 Ms. S. KAYODE-ANGLADE, Financial Analyst, FTRY.4

## Table of Contents

LIST OF TABLES - LIST OF BOXES - LIST OF FIGURES	ii
LIST OF ANNEXES - LIST OF TECHNICAL ANNEXES	ii
FISCAL YEAR - CURRENCY EQUIVALENTS	ii
ABBREVIATIONS AND ACRONYMS	iii
LOAN INFORMATION	iv
PROGRAMME SUMMARY	v
PROGRAMME LOGICAL FRAMEWORK	vii
<b>I – THE PROPOSAL</b>	<b>1</b>
<b>II – COUNTRY AND PROGRAMME CONTEXT</b>	<b>1</b>
2.1 Government’s Development Strategy and Medium-Term Priorities	1
2.1 Recent Economic and Social Developments, Prospects, Constraints and Challenges	2
2.2 Status of Bank Portfolio	4
<b>III – RATIONALE, MAIN ELEMENTS OF PROGRAMME DESIGN AND SUSTAINABILITY ISSUES</b>	<b>5</b>
3.1 Linkages with the CSP, Assessment of Country Preparedness and Underlying Analytical Elements	5
3.2 Donor Collaboration and Coordination	6
3.3 Results and Lessons from Similar Operations	6
3.4 Linkages with Other Bank Operations	7
3.5 Bank’s Comparative Advantages	7
3.6 Good Practice Principles for the Application of Conditionality	7
<b>IV – PROPOSED PROGRAMME</b>	<b>7</b>
4.1 Programme Goals and Objectives	7
4.2 Programme Components and Expected Outcomes	8
4.3 Financing Requirements and Arrangements	17
4.4 Programme Beneficiaries	17
4.5 Impact on Gender	18
4.6 Impact on the Environment	18
4.7 Impact on the Business Environment	18
<b>V – IMPLEMENTATION, MONITORING AND EVALUATION</b>	<b>18</b>
5.1 Implementation Arrangements	18
5.2 Monitoring and Evaluation Arrangements	19
<b>VI – LEGAL INSTRUMENTS AND AUTHORITY</b>	<b>19</b>
6.1 Legal Instruments	19
6.2 Conditions Precedent to Bank Group Intervention	19
6.3 Compliance with Bank Group Policies	19
<b>VII – RISK MANAGEMENT</b>	<b>20</b>
<b>VIII – RECOMMENDATION</b>	<b>21</b>

---

This report was prepared by Mr. E. DIARRA, Principal Economist OSGE.2, following joint missions with the World Bank to Rabat in June and August 2011. It also received inputs from experts from ORNB, MAFO, ORPF, OPSM, FTRY and FFMA Departments, and two Financial Sector Specialists, as well as discussions with the World Bank team.

**List of Tables**

Table 1:	Budget Balance and Financing Requirements	17
----------	---	----

**List of Boxes**

Box 1:	Measures Precedent to PADESFI Presentation to the Board of Directors	17
--------	--	----

**List of Annexes**

Annex 1:	Financial Sector Development Policy Letter	3
Annex 2:	Matrix of Programme Measures	6
Annex 3:	Note on Relations with the IMF	5

**List of Technical Annexes**

Technical Annex 1	Presentation of Morocco's Banking Sector
Technical Annex 2	Conditions Precedent to Budget Support
Technical Annex 3 :	Fiduciary Risk Appraisal and Mitigation Measures
Technical Annex 4	Appraisal of Morocco's Procurement System
Technical Annex 5	Key PADESFI-I Achievements
Technical Annex 6	Technical Note on the Cities without Slums (VSB) Programme
Technical Annex 7	National Guarantee System in Morocco
Technical Annex 8	Technical Note on Microcredit in Morocco
Technical Annex 9	Venture Capital Activities in Morocco
Technical Annex 10	Insurance and Reinsurance Market in Morocco
Technical Annex 11	Note on the Casablanca Finance City Project
Technical Annex 12	The Moroccan Financial Market
Technical Annex 13	Technical Note on the Business Environment
Technical Annex 14	Trend of Key Macroeconomic and Financial Indicators

**Fiscal Year**

January - December

**Currency Equivalentents**

(August 2011)

UA 1	=	Moroccan Dirham (MDH) 12.52
UA 1	=	Euro (EUR) 1.12
UA 1	=	US Dollar (USD) 1.60

### Abbreviations and Acronyms

ACAPS: Insurance and Reinsurance Control Authority	GDP: Gross Domestic Product
ADB: African Development Bank	IGF: General Inspectorate of Finance
AMMC: Moroccan Financial Market Authority	IMF: International Monetary Fund
BAM: Bank Al-Maghrib (Central Bank of Morocco)	INDH: National Human Development Initiative
BCP: <i>Banque Centrale Populaire</i>	IPO: Initial Public Offering
BNDE: <i>Banque Nationale pour le Développement Economique</i>	IVT: Treasury Bond Intermediary
CAM: <i>Crédit Agricole du Maroc</i>	LOF: Organic Finance Law
CCG: Central Guarantee Fund	MAROCLEAR: Central Custodian
CDG: Deposit and Management Fund	MDH: Moroccan Dirham
CDVM: Securities Ethics Board	MEF: Ministry of Economy and Finance
CEC: Credit Institutions Committee	MIC: Middle Income Country
CFC: Casablanca Finance City	OPCR: Venture Capital Investment Organizations
CIF: Cost Insurance and Fret	OPCVM: Undertakings for Collective Investment in Transferable Securities
CIH: Housing and Hotel Credit Fund	PARAP: Public Administration Reform Support Programme
CMI: Interbank Credit Card Centre	PARCOUM: Medical Coverage Reform Support Programme
CNCA: National Agricultural Credit Fund	PASFI: Financial Sector Support Programme
COMOFI: Monetary and Financial Code	PEA: Equity Savings Plan
CPIA: Country Policy and Institutional Assessment	PEE: Education Savings Plan
CR: Venture Capital	PEL: Housing Savings Plan
CSP: Country Strategy Paper	PESF: Financial Sector Assessment Programme
DAPS: Department of Insurance and Social Security	PFI: Public Financial Institutions
E-Gov: E-government	SBVC: Casablanca Stock Exchange Company
EPIP: Country Policy and Institutional Assessment	SICAV: Open-end Investment Company
EU: European Union	VSE: Very Small Enterprise
FBCF: Gross Fixed Capital Formation	SME: Small- and Medium-size Enterprise
FCPR: Venture Capital Mutual Investment Fund	UA: Unit of Account
FDI: Foreign Direct Investments	VAT: Value Added Tax
FOGARIM: Real Estate Guarantee Fund	VSB: Cities without Slums

## LOAN INFORMATION

### Client Information

---

**BORROWER:**

KINGDOM OF MOROCCO

**EXECUTING AGENCY:**

Ministry of Economy and Finance  
(Treasury and External Finance Department)

### Financing Plan

Source	Amount	Instrument
ADB	EUR 224 million	ADB Loan
World Bank	USD 200 million (to be confirmed)	IBRD

### Information on ADB Financing

Loan currency	Euro
Type of interest rate:	Floating base rate with a free fixing option
Base rate (Floating)	6-month Euribor
Contractual Margin	60 basis points (bps)
Lending Margin:	Bank lending margin in relation to the 6-month Euribor. This margin is revised every year on 1 January and 1 July.
Commitment fee	In the event of disbursement delays compared with the initial schedule (specified in the loan agreement), a commission of 25 bps per annum will be applicable to the undisbursed amounts. This fee will increase by 25 bps every six months up to a maximum of 75 bps per annum.
Other fees	None
Tenor	20 years maximum
Grace period	5 years maximum

Activities	Date
1. Concept Note Approval	27 July 2011
2. Loan Agreement Negotiations	4 October 2011
3. Board Presentation	23 November 2011
4. Effectiveness	November 2011
5. Disbursement of the First Tranche	December 2011
6. Supervision	May 2012
7. Mid-Term Review	May 2012
8. Disbursement of the Second Tranche	December 2012
9. Supervision	December 2012
10. Completion Report	March 2013

## **PROGRAMME SUMMARY**

### **Programme Overview**

1. Programme Name: Financial Sector Development Support  
Programme – Phase II (PADESFI - II)

- Geographic coverage: Nationwide
- Overall duration: 12 months
- Programme cost: Not applicable
- Financing: EUR 224 million (ADB)  
USD 200 million (to be confirmed) (World Bank)
- Programme type: Budget support

2. PADESFI-II is a continuation of PADESFI-I (cost = USD 162 million), approved by the Bank in December 2009. The outcomes of PADESFI-I were positive, given that the programme helped to raise the population's bank access rate to 50% and to ease access to credit for SMEs, within a more conducive framework characterized especially by reduced portfolio at risk for both the banking and microcredit sectors. The Bank loan will be disbursed, as with PADESFI-I, in two tranches over the period 2011-2012. The first tranche of EUR 134 million will be disbursed by end-2011 upon fulfilment of the conditions precedent. The second tranche of EUR 90 million will be disbursed in 2012, after a programme review and the fulfilment of specific conditions relating thereto. The first tranche is justified by the short-term need to speed up the reforms initiated during the first phase of the programme (PADESFI-I) and lay the groundwork for the reforms recently introduced in the second phase. For its part, the second tranche will enable the Bank to maintain dialogue with the Government in implementing the other programme reforms.

### **Expected Programme Outcomes and Beneficiaries**

3. PADESFI-II's goal is to create the required conditions for inclusive economic growth by developing the financial sector. Its specific objective is to strengthen the financial sector, particularly by enhancing its governance and improving access of the population and enterprises to financial services, as well as diversifying financial instruments.

4. The overall expected outcomes following the programme implementation are: (i) improvement of the population's access to financial services; (ii) improvement of access of enterprises to financing; (iii) strengthening of the financial market and insurance sector control mechanism; and (iv) deepening of the financial market.

5. The programme's end beneficiaries are the Moroccan people as a whole, who will enjoy improved living standards as a result of sustainable economic growth that will generate employment and income. The intermediate beneficiaries are: (i) the private sector and semi-public sector which, through the reforms, will have easier access to financial services that will foster their growth; (ii) households as economic agents, whose bank use rate will further improve as a result of greater coverage of the national territory by the banking networks, in addition to easier access to loans, especially for the acquisition of housing. Thus, facilitating access to credit, especially for SMEs, VSEs and households, not only in general terms but also in terms of spatial coverage, will help to generate income and create jobs, thereby encouraging more inclusive growth.

### **Needs Assessment and Relevance**

6. The programme is necessary for the following main reasons: (i) Morocco's effort to diversify its economy requires mobilization, on a sound basis, of substantial resources to finance the required investments; (ii) the turbulence of the international financial system calls for greater vigilance in financial sector governance through the implementation of credible norms and standards that could prevent systemic crises and maintain financial stability; and (iii) it is necessary to continue the rehabilitation and deepening of the financial sector in light of the national and international socio-economic context.

7. The programme is intended to accelerate reforms in the Moroccan financial sector. It addresses the challenges which the Government intends to meet, as soon as possible, with the coordinated support of the Bank and the World Bank, with a view to consolidating and expanding the achievements of the first phase of the programme (PADESFI-I) and the gains of the four financial sector adjustment programmes (PASFI I to PASFI IV).

8. The programme adopted is relevant: The main conditions of success of the programme have been fulfilled: proper ownership of the programme by the country; close coordination and risk sharing with the co-financier; fulfilment of the general and technical prerequisites for this type of programme; compliance with good practice principles for the application of conditionality, including the implementation of measures precedent to submission of the programme to the Board of Directors; and design of a results-based monitoring and evaluation mechanism. PADESFI's area of intervention, namely the financial sector, is relevant to the priorities of the Government's Programme as reflected in the Development Policy Letter, and to those of the CSP 2007–2011 for Morocco.

### **Bank's Value Added**

9. With about ten years of experience in financial sector reforms in Morocco following the series of four financial sector adjustment programmes, the Bank has drawn relevant lessons which have been shared with the co-financier and used in formulating this programme. Moreover, in order to amplify the outcomes of the previous programme, the Bank financed, under MIC grants, two institutional support projects, respectively for the Securities Ethics Board (CDVM) and the Central Guarantee Fund (CCG) currently in progress. As part of this programme, the Bank will also support the preparation of the Monetary and Financial Code with a MIC grant. In so doing, it will bring substantial value added to this programme.

### **Institution and Knowledge Building**

10. PADESFI-II will contribute to institution building of the public administration and private sector, including associations. In particular, the preparation of the Monetary and Financial Code and various draft texts examined for programme formulation contribute to knowledge building. The same applies to the sharing of experience acquired in other countries.

## RESULTS-BASED LOGICAL FRAMEWORK

Country and Programme: Morocco – Financial Sector Development Support Programme – Phase II (PADESFI-II)						
Programme Objective: Create the requisite conditions for inclusive economic growth. Its specific objective is to strengthen financial sector development.						
	RESULTS CHAIN	PERFORMANCE INDICATORS			MEANS OF VERIFICATION	RISKS/ MITIGATION MEASURES
		Indicators (including ISC)	Baseline Situation in 2010	Target in 2012		
<b>IMPACT</b>	The financial sector is developed and contributes to the financing of the economy	Average real GDP growth rate Overall rate of bank use Proportion of private sector credit compared with total credit to the economy	3.8% 50 53%	5% 55% 55%	Reports by the Ministry of Economy and Finance (MEF); Bank Al-Maghrib (BAM)	
<b>OUTPUT</b>	1. Improved access by the population to financial services	Number of State-backed social housing loans  Proportion of micro-credit granted to women and share of such credit for rural areas compared with the total amount of micro-credit	63,065  49% 38%	80,000  55% 40%	Reports by the Central Guarantee Fund (CCG) and/or MEF data	<b>Risk</b> - An unfavourable international economic situation hampering the achievement of the expected programme impacts  <b>Mitigation Measures</b> -Strategic Watch Committee for economic issues
	2. Easier access to funding by businesses	Number of VSEs benefiting from the VSE guarantee product  Volume of investment in venture capital Proportion of bank-held non-performing loans	Product unavailable  MDH 7.3 billion	250  MDH 9 billion	CCG report and/or MEF data	
	3. Strengthening of financial sector governance	Proportion of bank-held non-performing loans  Insurance penetration rate (premiums/GDP)	4.8% 2.8%	Maintain below 5% 3%	BAM reports DAPS report	
	4. Deepening of the capital market	Stock market capitalization (in MDH billion)	MDH 579 billion	At least MDH 579 billion	CDVM report	
<b>OUTCOMES</b>	<b>COMPONENT 1. IMPROVEMENT OF THE POPULATION'S ACCESS TO FINANCIAL SERVICES</b>					<b>Risks</b> - Change of direction after the next elections - Social claims related to the sub-regional socio-political climate that could increase the budget deficit - Delays in the file review process due to the busy schedule of the Government and Parliament held up by the constitutional reforms to be put in place swiftly
	1. a – Improve access of households to social housing funding	Postal Bank housing loan  Social housing loan guarantee product (Cities without Slums)	Product available not Product available not	Loan granted by end-2011 Product launched by end-2011	Postal Bank reports CCG reports and/or MEF data	
	1. b – Encourage long-term savings by households	Implementing decrees of the new long-term savings products (PEL, and PEE, PEA)	Instruments non-existent	Instruments adopted by end-2012	MEF decrees	
	1. c – Strengthen the microcredit sector	Strategic study on the development of the microfinance sector  Amendment to the microfinance law  Membership of the Credit Bureau by microcredit associations (MCAs)	Study under preparation  Former law Membership by a limited number of MCAs	Completed by end-2011  Transmitted to Parliament by end-2011 Membership by end-2011	Strategic study  MEF transmission letter BAM reports	

RESULTS CHAIN	PERFORMANCE INDICATORS			MEANS OF VERIFICATION	RISKS/ MITIGATION MEASURES	
	Indicators (including ISC)	Baseline Situation in 2010	Target in 2012			
	Information system in microcredit associations	Information system not available	Set up by end-2012	BAM reports	<b>Mitigation Measures</b> - Relevance of the reforms to the current socio-political context, and therefore high-level commitment to implement the structural reforms of the financial sector, and the strong programme ownership by the authorities. - High demand for reform reflected, among other things, in the 71% rate of participation in the constitutional reform - Principle for the preservation of the balance of State finances enshrined in the constitution (Article 77) and continuation of reforms to improve the management of public resources (imminent adoption of the draft of the new organic budget law - LOF)	
<b>COMPONENT 2. IMPROVEMENT OF ACCESS TO FINANCING FOR BUSINESSES</b>						
2. a – Improve access of VSEs to credit	VSE guarantee product	Available product	Launched by end-2012	CCG report		
2. b – Develop venture capital activities	Bill on venture capital	Former law	Adopted by end-2012	Draft law		
<b>COMPONENT 3. STRENGTHENING OF THE FINANCIAL SECTOR GOVERNANCE MECHANISM</b>						
3. a – Strengthen financial sector supervision.	Bill on the Moroccan Capital Market Authority	Law on the CDVM and the information required of corporate bodies issuing securities (former law)	Adopted by end-2012	Draft law		
	Bill on the establishment the Insurance Authority	Bill in process of adoption	Adopted by end-2012	Draft law		
	New banking law	Former law	Submitted by end-2012	MEF transmission letter		
	Bill on the Statute of Bank Al-Maghrib	Former Statute	Submitted by end-2012	MEF transmission letter		
3. b – Facilitate access to financial information	Monetary and Financial Code	Code non-existent	Prepared by end-2014	Monetary and Financial Code		
<b>COMPONENT 4. DEEPENING OF THE FINANCIAL MARKET</b>						
4. a – Diversify the financial instruments	Bill on covered bonds	Text non-existent	Transmitted to the SGG by end-2012	Bill		
	General Regulations of the Futures Market Management Company	Regulations non-existent	Prepared by end-2012	General Regulations of the Futures Market Management Company		
	Draft legislative framework governing the real estate investment funds (PCI)	Framework non-existent	Prepared by end-2012	Draft legislative framework		
4. a – Boost the financial market	Implementing decree of the law on the Statutes of the Casablanca Finance City	Existing text	Adopted by end-2011	Implementing decree		
	Draft Statutes of the Stock Exchange	Former statutes	Prepared by end-2012	Draft Statute		
	Bill on the initial public offering	Former law	Adopted by end-2012	Bill		
	Bill on third-party asset management	Text non-existent	Transmitted to the SGG by end-2012	Bill		
	Format for securities lending agreement	Format non-existent	Prepared by end-2012	Format adopted		
Financing: ADB Loan: EUR 224 million; World Bank Loan: USD 200 million.						

**DATION OF MANAGEMENT**  
**TO THE BOARD OF DIRECTORS CONCERNING A PROPOSAL**  
**FOR A LOAN TO THE KINGDOM OF MOROCCO TO FUND THE FINANCIAL**  
**SECTOR DEVELOPMENT SUPPORT PROGRAMME – PHASE II**

**I THE PROPOSAL**

1.1 **Management hereby submits the following recommendation concerning a UA 200 million loan (equivalent to EUR 224 million) to the Kingdom of Morocco to finance the second phase of the Financial Sector Development Support Programme (PADESFI-II).** This is a sector budget support to be implemented from December 2011 for a 12-month period ending 31 December 2012. It is a continuation of Phase I of the Programme started in 2009, the achievements of which it intends to consolidate and deepen. The operation is also a continuation of the series of four financial sector adjustment programmes that the Bank and other multilateral donors, particularly the World Bank and European Union, have supported. PADESFI-II is based on the strategic orientations of Government's medium-term development programme. Its design has taken into account the principles of the Paris Declaration on Aid Effectiveness and those of good practice principles for the application of conditionality. It complies with the Bank's strategy for Morocco.

1.2 **The preparation of the Programme in June and its appraisal in August 2011 were carried out in close collaboration with the World Bank, which continues to be the co-financier.** The Programme aims to help create the requisite conditions for inclusive economic growth. It is intended to consolidate and deepen the reforms introduced during PADESFI-I by means of the same four main thrusts: (i) improvement of bank use among the population; (ii) improvement of access to financing for businesses; (iii) strengthening of the finance sector governance mechanism; and (iv) deepening of capital markets. The range of measures supported by the Programme is presented in the reform matrix (Annex 2).

**II COUNTRY AND PROGRAMME CONTEXT**

**2.1 Government's Development Strategy and Medium-Term Priorities**

2.1.1 **The Government's medium-term economic and social programme for 2007-2012 aims to deepen macroeconomic and sector reforms to boost economic growth** and enhance the economy's capacity to resist external shocks. It is divided into three key strategic focus areas, namely: (i) improvement of governance and the business climate; (ii) strengthening of competitiveness and regional integration by upgrading infrastructure; and (iii) human development and strengthening of the social sectors with a view to improving the living conditions of the population. These general strategic orientations are supplemented by a series of detailed medium- and long-term sector strategies geared towards providing investors and various operators with the required visibility in terms of the potential and development prospects of the sectors concerned (energy, agriculture, water, industry, phosphates, tourism, handicraft, sea fishing, offshoring, domestic trade, and logistics).

2.1.2 **Recent analyses have shown that the performance of Morocco's public finance management system as a whole is relatively reliable.** The medium-term priorities regarding governance reform concern, in particular, enhancing public administration efficiency in terms of public resource management through its modernization, improvement of the business

environment, deepening of financial sector reforms, strengthening of the independence and efficiency of the judiciary, development and extension of decentralization, devolution, regionalization and the fight against corruption. Moreover, on the Bank's internal rating scale, Morocco falls in the "Very Low Risk" category, with a stable outlook.

**2.1.3 In the financial sector in particular, Government policy mainly aims** to: (i) improve the financial inclusion of households; (ii) facilitate access of SMEs/VSEs to sources of financing; (iii) strengthen the supervision, control and dynamism of the financial sector; (iv) encourage micro-credit; and (v) ensure greater territorial coverage in terms of access to financing for both households and SMEs/VSEs. By virtue of its objectives and components, PADESFI-II will address these Government concerns. The development policy letter in Annex 1 of this Report provides further details on these priorities.

## **2.2. Recent Economic and Social Developments, Prospects, Constraints and Challenges**

### *Recent macro-economic and social trends*

**2.2.1 Morocco continues to enjoy a high level of political stability, buoyed by the strengthening of the democratization** process initiated since the coming to power of His Majesty King Mohammed VI, through implementation of political governance reforms. The reforms have enabled Morocco to gradually establish modern political structures, a transparent electoral system and an increasingly vibrant civil society. However, the resulting broadening of the scope of freedoms has not left the Kingdom unscathed by the wave of protests that have rocked countries of the sub-region since early 2011. Nevertheless, the constitutional reform widely approved by referendum on 1 July 2011 should help ease tensions. The reform aims to strengthen the principle of checks and balances, and deepen democracy.

**2.2.2 Traditionally dependent on agriculture, Morocco's economy began to diversify its structure over the past decade.** Its growth derives increasingly from the secondary and tertiary sectors. However, diversification of growth sources is yet to attain levels where it could unleash the economy's full production and export potential. This situation poses major challenges that Morocco will need to address in order to strengthen its position as a growth pole in the sub-region. The deepening of structural reforms, supported by the implementation of sector strategies (the National Pact for Industrial Emergence and the Green Morocco Plan, etc.) should accelerate the transformation of the economy towards diversified exports - additional sources of economic growth.

**2.2.3 Morocco has made significant economic advances, thanks to the implementation of consistent macroeconomic policies, sustained structural reforms and sector strategies hinged on structuring projects.** These advances have resulted notably in a less volatile economic growth with greater resilience to external shocks. Over the 2004-2010 period, Morocco experienced growth averaging 4.8%, almost twice the average for the 1990's (2.5%), despite an unfavourable environment characterized particularly by higher energy prices, slower global growth and a drought year in 2007. Moreover, the restrictive monetary policy, coupled with efforts to consolidate public finances and improve sector competitiveness, helped to keep inflation at moderate levels. Inflation stood at 2.5% in 2009, remained at 1% in 2010 and is expected to stabilize at around 1.4% in 2011 and 2012.

**2.2.4 The budgetary position, which had improved in 2007 and 2008 with surpluses of 0.6% and 0.4% of GDP, respectively, recorded deficits of 2.2% and 4.6% of GDP in 2009 and 2010, in that order.** This development, which offset a drop in revenue from 24.3% of GDP in 2008 to 20.2% in 2010, was due to the combined effects of: (i) the exceptional nature of revenue in 2008; (ii) the implementation of tax reform measures designed to reduce the tax burden on enterprises and households, as part of efforts to contain the effects of the crisis; and (iii) the renewal of the compensation aspect of the State budget to support the people's purchasing power. Thus, the outstanding debt went from 47.3% of GDP in 2008 to 47.1% in 2009 and 50.2% in 2010.

**2.2.5 Morocco's external position has remained strong, despite being weakened by the effects of the successive crises of 2008 and 2009.** The improving trend of the current account continued in 2010 with a deficit of 4.3% of GDP, compared to 5.4% in 2009, and is expected to continue in 2011 and 2012 to reach 4.6% and 3.2%, respectively. This reflects not only the resumption of exports but also the rebound in tourism and remittances from Moroccans living abroad (MRE) which, in 2010, accounted for 7.1% and 7.8% of GDP, in that order.

**2.2.6 On the social front, the economic progress achieved and the implementation of the National Human Development Initiative (INDH) from 2005 had a positive impact on human development indicators.** The participatory approach to the implementation of several projects designed for people in precarious circumstances achieved significant progress in improving the living conditions of the population between 2005 and 2010, and thus attaining the Millennium Development Goals (MDGs), especially with the decline in poverty rates, during this period from 14% in 2001 to 9% in 2010. However, while the progress made in the fight against poverty is real, further efforts are necessary particularly in education and health.

**2.2.7 With the strong growth, unemployment rate has remained below a national average of 10%, but shows great geographic, inter-generational and gender disparities.** The crisis notwithstanding, unemployment rate dipped from 9.8% to 9.1% between 2007 and 2009, but remained high among young people aged 15 to 24 (31.8% in 2009) and university graduates (17.8%). Measures for promoting employment in response to current social expectations should be finalized in the fourth quarter of 2011.

### *Outlook, Constraints and Challenges*

**2.2.8 The medium-term growth prospects should remain good:** 5% in 2011 and 2012, especially following efforts to strengthen the resilience of the economy by continuing the reforms initiated and supporting domestic demand. The budget situation should improve steadily, with deficits of 4% and 3.5% in 2011 and 2012, respectively, reflecting the positive effects of budget reforms, coupled with better payroll control. In terms of competitiveness, Morocco's efforts are beginning to pay off as shown by its two-spot gain (from 75 to 73 between 2009/2010 and 2011/2012) in the rankings of the Africa Competitiveness Report. However, to achieve greater diversification of the country's economy, these efforts need to be sustained and consolidated.

**2.2.9 In this connection, the Government intends to be more decisively committed to diversifying the economy, strengthening its competitiveness and improving the business climate.** To this end, it will need to keep up its support for financial sector development by ensuring better financial inclusion of households and enterprises, and strengthening sector governance. Such measures should further contribute to the mobilization of adequate resources to finance productive investment and create jobs, with greater emphasis on peri-urban and rural areas.

## *Financial Sector: Current Situation and Challenges*

**2.2.10 Morocco's financial sector comprises the banking sector and the non-banking financial sector, including the insurance and reinsurance sector, the capital market, microcredit institutions and other financial services such as venture capital/investment capital.** Regarding the banking sector, the overall balance sheet of banks stood at MDH 859 billion in 2010, up by 3.7% from 2009 and representing 112% of GDP. Similarly, the banks managed to whittle down non-performing loans on their balance sheets so that in 2010 the latter represented only 5% of overall outstanding claims. The detailed description and analysis of the various sub-sectors of the financial sector are presented in Technical Annex 1.

**2.2.11 The Financial Sector Evaluation Programme (PESF) implemented in 2008 by the World Bank and the IMF records significant progress achieved by the financial sector in Morocco.** The report concludes that banks in Morocco are stable, profitable, adequately capitalized, and show greater resilience to external shocks. Thanks to its solidity and its limited exposure to external financial markets, the Moroccan financial system was only slightly affected by the crisis. However, there are still challenges to be addressed to improve the financial sector's contribution to economic development. The said evaluation recommends, in particular: (i) further reinforcement, improvement, deepening and supervision of the financial sector; and (ii) better preparation of financial institutions for risk management due to major potential variations in exchange and interest rates.

**2.2.12 The implementation of all the measures agreed upon under PADESFI-I<sup>1</sup> by the Moroccan authorities** has led to the achievement of significant outputs in terms of improving access to banking services (from 30% in 2009 to 50% in 2010), access to financing for businesses, and also in terms of boosting the banking and insurance sector and the financial market<sup>2</sup>. The preliminary findings of the IMF's 2011 Article IV Consultations of July 2011, while noting that the Moroccan financial sector had developed significantly, emphasized the need to continue reforms and consolidate the gains, particularly by mobilizing additional resources to maintain growth in the sector.

**2.2.13 In light of this appraisal, the transformation and deepening of the long-term financial market as well as the control of bank risk management are among the major challenges facing the financial sector.** PADESFI-II will help to address these challenges by consolidating the gains of PADESFI-I.

## **2.3 Status of Bank Portfolio**

**2.3.1 According to the 2011 Portfolio Performance Review, the Bank's portfolio in Morocco has 28 active operations for a total of UA 1.88 billion.** The breakdown of the portfolio by sector shows the predominance of the infrastructure sector (energy, transport, water and sanitation), which accounts for more than 80% of on-going commitments and confirms the significant role of the Bank in the financing of these sectors in Morocco. The volume of Morocco's commitments ranks the country among the Bank's major borrowers. In sum, portfolio performance has developed positively with an overall average score of 2.7 out of 3, compared with 2.6 in 2009. The overall portfolio disbursement rate increased to 50% at end-March 2011, compared with 34% in the 2009 review. The portfolio includes neither potentially problematic projects nor problematic projects. On the whole, the Bank's active operations in Morocco are running very satisfactorily and no active loan is performing poorly.

<sup>1</sup> PADESFI-I measures are set out for information in Annex 2.

<sup>2</sup> The outcomes of PADESFI-I are described in Annex 8.

### **III RATIONALE, MAIN ELEMENTS OF PROGRAMME DESIGN AND SUSTAINABILITY**

#### **3.1 Linkages with the CSP, Assessment of Country Preparedness and Underlying Analytical Elements**

3.1.1 *Linkages with the CSP:* The CSP covering the period 2007-2011 focuses on the following three pillars: (i) improvement of the governance system; (ii) development and upgrading of economic and corporate infrastructure; and (iii) promotion of human development. However, after the CSP mid-term review in 2009, the Bank and Moroccan authorities agreed to focus on the first two pillars. PADESFI-II is consistent with the guidelines of this strategy, which underscore the strengthening of the governance system and upgrading of economic and corporate infrastructure. Moreover, the proposed operation is also in line with the guidelines of the Bank's draft Country Strategy Paper 2012-2016 currently being prepared.

3.1.2 *Conditions precedent to the implementation of budget support:* **Morocco had a CPIA rating of 4.2 in 2010, and it also meets the required preconditions both at the general and technical level (Technical Annex 2). Generally,** the country enjoys political and economic stability, and the Government's commitment to carrying out reforms is constantly demonstrated. At the economic level, Morocco's performance has been remarkable over the past few years and, on the technical front, the country also meets the basic requirements concerning the existence of a medium-term programme, the public finance management system and institutional capacity. **Moreover, Morocco is rated as "Very Low Risk" with a stable outlook on the Bank's internal rating scale. This rating was confirmed in April 2011 during the Regional Member Countries' annual rating exercise.** It reflects Morocco's resilience to the global financial and economic crisis, and the recent socio-political turmoil in North Africa. However, maintaining the rating at its current level will depend on the country's ability to continue to implement the reforms necessary to consolidate its fiscal and external positions. Lastly, an unanticipated contagion of socio-political instability in Morocco could have a negative impact on its rating. In addition, the Bank's Financial Management Department (FFMA) carried out a risk assessment mission in Morocco in September 2011, the results of which will be reported to the Board in the form of a note on country risk.

3.1.3 *At the fiduciary level, based on the assessment of the fiduciary framework of the operation conducted jointly by the Bank and the World, the overall fiduciary risk is deemed low and adequate to support PADESFI-II.* This assessment is based on the latest analyses of public finance management, procurement and the corruption level (see Technical Annexes 3 and 4). The national procurement system is considered generally satisfactory. Recent assessments by the Bank and other donors have concluded that Morocco's regulatory framework is generally consistent with internationally accepted fundamental principles (economy, equity and transparency). Furthermore, the international ratings agency, Standard & Poor's, in July 2011, confirmed the BBB<sup>3</sup> (*investment grade*) rating with a stable outlook awarded to Morocco, which reflects the country's progress at both the economic and political level.

---

<sup>3</sup> Fitch also assigns the same rating and Moodys assigns Baa2 rating with a stable outlook.

3.1.4 ***Institutional capacity: The Government has in previous programmes shown its capacity to mobilize development partners on programmes over which it has a thorough grasp, thus showing proof of a capacity for ownership and coordination of such programmes.*** The Ministry of Economy and Finance, in charge of managing this programme, has the high-level technical skills required to satisfactorily conduct the planned reforms. It also holds systematic consultations with all stakeholders, especially the Central Bank and the CDVM, for the design and implementation of reforms. However, given the complexity of some of these reforms, such as monetary and financial coding, Morocco could need external technical assistance to provide the required supplementary expertise. The Bank will support the country in this area through a project funded with a MIC grant.

3.1.5 ***Analytical work: Programme design drew from the results of the analytical work undertaken recently by the Bank, the country and other external organizations and partners.*** These include the CSP 2009-2011 Mid-Term Review, the study on the national guarantee system conducted by the Government, and the report of the Financial Sector Assessment Programme of the IMF and the World Bank in 2008<sup>4</sup>.

### 3.2 Donor Collaboration and Coordination

3.2.1 ***Coordination with the World Bank, PADESFI-II co-financier, is in line with the guidelines of the Paris Declaration on Aid Effectiveness by basing the same reforms on a matrix of joint measures.*** Programme review and supervision will be carried out jointly with the co-financier, using the same approach as for PADESFI-I. Generally, the Moroccan authorities, through the Treasury and External Finance Department, are responsible at their level for harmonizing the interventions of various donors in different sectors, and ensuring their alignment with the country's reform priorities. Moreover, the Bank and the World Bank provide the authorities supplementary technical support in the area of reform implementation. Indeed, while the Bank will provide technical assistance for monetary and financial coding – a structuring measure under PADESFI-II - the World Bank will assist in establishing covered bonds as a new financial instrument in Morocco.

### 3.3 Results and Lessons from Similar Operations

3.3.1 ***The Bank has financed several budget support programmes in Morocco***<sup>5</sup>. The completion reports prepared for most of these programmes showed the country's good performance in implementing the said programmes and high level of ownership by the authorities of measures agreed under these programmes. Thus, the reforms envisaged under PADESFI-I were all implemented, but the programme experienced delays attributable to the adoption of a text by the Council of Ministers. This difficulty related to the lengthy legislation approval process, stems mainly from the political will to carry out reforms in a participatory manner involving all stakeholders. The design of PADESFI-II took these key lessons into account, especially in the reform identification and sequencing process. This approach helps to ensure the effective implementation of reforms. Furthermore, in order to develop the sector in a harmonious and comprehensive manner, PADESFI, from its first phase, encompassed the financial, banking, insurance, micro-credit and capital market sectors. Hence, the second phase of the programme was designed to address the same concern by continuing to support identical thrusts as those of the first phase (Technical Annex 5).

<sup>4</sup> The detailed list of the analytical work is given in Technical Annex 11.

<sup>5</sup> Four phases of the Financial Sector Support Programme, PASFI I to IV; four phases of the Public Administration Support Programme, PARAP I to IV; two phases of the Medical Coverage Support Programme, PARCOUM I and II; and the Education System Emergency Plan Support Programme.

### 3.4 Linkages with Other Bank Operations

3.4.1 **PADESFI-II is consistent with other on-going Bank operations in Morocco, contributing to the development of the private sector and the strengthening of competitiveness.** In addition, the proposed programme, which aims to strengthen governance and deepen the financial sector, is an appropriate framework for creating an enabling environment for improving the business climate. As such, the programme's impact will consolidate the gains of the Public Administration Reform Support Programme (PARAP) in terms of the administrative, economic and financial governance, including administrative simplification and e-Gov.

### 3.5 Bank's Comparative Advantages

3.5.1 The Bank's experience in supporting financial sector reforms in Morocco since the launch of PASFI-I in 1992 has given it a comparative advantage in this area in Morocco, thus enabling it to forge a strong partnership with the Moroccan authorities. Moreover, the Bank has strengthened this comparative advantage with the significant leverage it brought to PADESFI-I by financing, with resources from the *Middle Income Countries Technical Assistance Fund (MIC-TAF)*, two technical assistance projects in 2010 (the projects relate, respectively, to the reform of the national guarantee system and improvement of financial market supervision<sup>6</sup>). Specifically, these projects will help to amplify the impact of reforms identified under PADESFI-II in terms of SME/VSE establishment and job creation, as well as the alignment of the Moroccan financial stabilization mechanism with international standards. Regarding value added under this programme, the Bank will assist the authorities in preparing the Monetary and Financial Code, which is a programme measure, through a technical assistance project funded from MIC-TAF resources.

### 3.6 Good Practice Principles for the Application of Conditionality

3.6.1 **Good practice principles for the application of conditionality, including those related to ownership, coordinated responsibility framework, adaptation of this framework to the context, choice of disbursement conditions to guarantee the outcomes and predictability of financial support, were taken into account in the design and formulation of PADESFI-II.** The Bank and the World Bank, co-financiers of the proposed programme, had sustained consultations during various programme preparation missions with a view to strengthening the synergy and coherence of their respective interventions. These consultations are supported by the country's strong ownership of the programme as characterized by the Government's commitment to tackle the challenges of the financial sector.

## IV PROPOSED PROGRAMME

### 4.1 Programme Goal and Objectives

4.1.1 **The goal of PADESFI-II is to create the requisite conditions for sustainable economic growth. Its specific objective is to strengthen the development of the financial sector by consolidating and deepening the gains of PADESFI-I.** Its operational objectives are to: (i) improve the population's access to financial services; (ii) facilitate access of businesses to financing; (iii) strengthen private sector governance; and (iv) deepen the financial market.

---

<sup>6</sup> These are: the National Guarantee System Reform Support Project and the Financial Market Control and Supervision Support Project.

## 4.2 Programme Components and Expected Outcomes

### COMPONENT 1: IMPROVE THE POPULATION'S ACCESS TO FINANCIAL SERVICES

4.2.1 As part of efforts to improve the population's access to financial services, PADESFI-II reforms aim to: (i) improve the access of households to funding for housing purposes; (ii) encourage long-term household savings; and (iii) strengthen the microcredit sector. The reforms implemented during the first phase of the programme have helped to substantially improve access to banking services and rehabilitate the portfolio of microcredit associations. The second phase will focus on facilitating the access of households to loans, especially real estate loans, promoting long-term household savings and defining a relevant and viable strategic framework for microcredit activity.

#### Sub-Component 1-a: Improve the Access of Households to Financing for Housing Purposes

4.2.2 **Context:** The bank use rate in Morocco was estimated at 30% in 2008, with significant disparities between rural areas and urban zones where it is around 60%. Under these circumstances and without bank accounts, a high proportion of the population was consequently excluded from bank loans, particularly housing loans. Therefore, it was necessary initially to improve the rate of bank access with special emphasis on peri-urban and rural areas – an approach that was successfully implemented by the previous programme (PADESFI-I). The idea now is to facilitate the access of households to loans. As part of the fight against poverty and social exclusion, the reforms to be implemented should allow access to social housing for a substantial part of the population, especially the inhabitants of peri-urban and rural areas, including slums. Regarding the latter, the Government launched the "Cities without Slums" (VSB) programme in 2006 aimed at completely eradicating slums by 2012 (see Technical Annex 6).

4.2.3 **PADESFI-I Achievements:** To improve the rate of bank access in Morocco, the reforms initiated under PADESFI-I focused essentially on restructuring *Poste Maroc* (Barid Al-Maghrib) to create the Postal Bank (Bank Al-Barid), one of whose key objectives is to facilitate household access to financial services. In this respect, since it effectively began operations in June 2010, and through a competitive policy in terms of proximity, cost and services provided, the Bank Al-Barid has recorded the opening of 682,458 new accounts in one year, of which 75% in rural areas, throughout its network of 1,785 branches, including 943 own branches. These impressive results have increased the banking rate in Morocco from 30% in 2008 to 50% in 2010. The goal is to achieve a rate of 60% by 2013.

4.2.4 **Challenges:** With this process of **increased bank use** well underway, including in rural and peri-urban areas, it is now advisable to facilitate the access of target populations to financial services. To this end and for the well-being of the target population, efforts should be geared towards establishing a range of products designed to meet their basic needs, especially with regard to affordable housing.

4.2.5 **Recent Actions:** Bank Al-Barid has begun introducing new products to meet the population's banking service needs, including the grant of overdraft since April 2011. To develop its housing loan services on a sound basis, it has signed a three-year assistance agreement with a local bank. Moreover, based on an agreement between the Government and

CCG, the VSB Programme - as part of the "Damane Assakane" Fund by the Real Estate Guarantee Fund (FOGARIM) - is supporting a product that guarantees housing loans for households with low or irregular income, covering up to 70% of such loans<sup>7</sup>. Specifically, to support the program VSB, the Government and CCG agreed to introduce a special product extending guarantee coverage to 80% of the loan for beneficiaries of this programme (Technical Annex 7).

**4.2.6 Programme Measures:** To promote household access to housing loans, the measures adopted include: (i) launch of the "housing loan" product by Al-Barid Bank (Postal Bank) (*condition precedent to Board presentation*); and (ii) the amendment of the agreement between the State and the Central Guarantee Fund with regard to the "Damane Assakane" Fund's introduction of a special product for the population targeted by the "Cities without Slums" (VSB) programme.

**4.2.7 Expected Outcomes:** The implementation of these measures should lead to: (i) an increase in the banking rate from 50% in 2010 to 55% in 2012; and (ii) an increase in the number of guaranteed housing loans from 63,065 in 2010 to 80,000 in 2012.

### **Sub-Component 1-b: Encourage Long-Term Household Savings**

**4.2.8 Context:** The Moroccan financial market has received a boost from institutional investors that participate significantly in financing the economy. However, 2010 was marked by a sharp drop in the growth rate of aggregate savings. This phenomenon also resulted in the stagnation of life insurance. Furthermore, in 2010, the assets of Morocco's financial system accounted for 200% of national GDP, and medium- and long-term loans made up 60.3% of bank loan portfolios. In contrast, customer medium- and long-term deposits (term deposits and savings accounts) accounted for only 41% of the total, reflecting the exposure of banks to a major transformation risk.

**4.2.9 Challenges:** The challenge for Moroccan authorities still consists in effectively harnessing the huge savings generated nationwide and channelling them towards productive and structural economic investment. Thus, while implementing reforms to facilitate household access to credit, including housing loans, other reforms will need to be undertaken to encourage greater household savings.

**4.2.10 Recent Actions:** In the 2011 Finance Law, the Moroccan Government introduced provisions to encourage long-term savings. These include tax exemptions for income from savings plan following the amendment of Section 68 of the General Tax Code. Three types of savings plans were concerned: housing (PEL), education (PEE) and equity (PEA). The procedure for implementing savings plans are yet to be established by regulation.

**4.2.11 Programme Measures:** The Government plans to adopt edits issued by the Minister of Economy and Finance relating to: (i) the Housing Savings Plan (PEL); (ii) the Education Savings Plan; and (iii) the Equity Savings Plan (PEA) (*condition precedent to disbursement of the second tranche*).

**4.2.12 Expected Outcomes:** The number of participants in the new savings plans is expected to exceed 10,000 in the first year of rolling out these products.

---

<sup>7</sup> Overall, 61,833 households received FOGARIM- guaranteed loans amounting to MDH 9 billion, or an average of MDH 145,540 per household

### **Sub-Component 1-c: Strengthen the Microcredit Sector**

4.2.13 **Context:** To facilitate the population's access to financing, the Moroccan Government in 2004 initiated an ambitious reform of the microcredit sector. The sector's main weaknesses included the significant increase in delinquency from 2008, an inadequate level of governance, low levels of supervision, and an unsuitable (or even non-existent) risk control and management mechanism, and non-diversified products (Technical Annex 8).

4.2.14 **PADESFI-I Achievements:** PADESFI-I provided support for the establishment of a regulatory framework aimed at improving the governance of AMCs and enhancing their sustainability through increased involvement of BAM in the active supervision of the sector. Thus, the positive trend recorded in the rehabilitation of the sector has continued. The implementation of a risk management policy (information sharing, use of Credit Bureau services, tightening of provisioning conditions) has helped to reduce the portion of portfolio-at-risk (PAR 30 d) which, at end-2010, was about 7% of gross loans, with a drastic drop in interest rate swaps, the target being to stay below the 9% threshold.

4.2.15 **Challenges:** Improving information and risk management in credit operations remain major challenges for the Moroccan financial sector. In this regard, there is a need to broaden the scope of the Credit Bureau and ensure the reliability of its data to further reduce the rate of non-performing loans. Moreover, the authorities should have a strategic vision that defines policy priorities for the development of the microfinance sector, in light of the reforms already in process, and the re-configuration of the sector resulting from the institutional transformation to be introduced, and the ensuing strategic linkages.

4.2.16 **Recent Actions:** A study on the development strategy for the microfinance sector was commissioned by the National Federation of Microcredit Associations and is being finalized. Moreover, a draft law amending and supplementing Law No. 18-97 relating to microcredit was prepared. This reform allows the indirect distribution of microcredit through an AMC or a credit institution authorized for that purpose, and governed by the provisions of Law No. 34-03 relating to credit institutions and similar bodies. In the latter case, the capital of the credit institution may be held wholly or partially by AMC. The new law also allows mergers and takeovers between AMCs, but subject to approval by the Minister of Finance, after consultation with the Microcredit Advisory Board.

4.2.17 **Programme Measures:** Under this programme, the Government is considering, among other options, to: (i) complete the study on the microcredit sector development strategy; (ii) submit to Parliament the bill amending Law No. 18-97 relating to microcredit (*condition precedent to Board presentation*); (iii) sign Credit Bureau membership contracts for microcredit associations representing 90% of the outstanding credit of the sector; (iv) establish an information mechanism in microcredit associations belonging to the "Solidarity Microfinance Network".

4.2.18 **Expected Outcomes:** The expected outcome of implementing these reforms are: (i) increase of the proportion of women receiving microcredit from 49% in 2010 to 55% in 2012; (ii) increase of the portion of outstanding loans granted in rural areas from 38% in 2010 to 40% in 2012; and (iii) registration with the Credit Bureau of 90% of outstanding microcredit.

## COMPONENT 2: IMPROVE ACCESS OF BUSINESSES TO FINANCING

4.2.19 To improve the access of businesses to financing, the reforms envisaged under PADESFI-II are intended to: (i) improve access of VSEs to credit; (ii) develop venture capital activities for the benefit of businesses; and (iii) enhance the mobilization of household savings to finance businesses. The reforms implemented during the first phase of the programme led to the revitalization the national guarantee system to facilitate SME access to credit and stimulate venture capital activities through the establishment of a public-private investment fund. This second phase of the programme will lay greater emphasis on financing VSEs and mobilizing savings to better finance enterprises and strengthen the regulatory framework of venture capital activities.

### Sub-Component 2-a: Improve VSE Access of to Credit

4.2.20 **Context:** SME and VSE financing instruments remain highly limited. Despite the strides made by the Postal Bank, it is not poised to serve the corporate market for the time being, and remains focused on individuals and rural areas.

4.2.21 **PADESFI-I Achievements:** PADESFI-I has strengthened the governance of the Central Guarantee Fund (CCG) and developed a new range of products tailored to the life-cycle needs of businesses. To support private sector development in other major economic centres of Morocco, despite their remoteness from the economic and administrative capitals, CCG has also opened two regional business centres (Agadir and Tangier) to assist economic operators with their administrative procedures. This new guarantee mechanism made it possible to double CCG's outstanding guarantee commitment between 2008 and 2010, and contributed to the increase in the proportion of loans granted to SMEs, compared with the total corporate loans, from 18% in 2008 to 24% in 2010.

4.2.22 **Challenges:** CCG must now develop guarantee products suited for VSEs. For enterprises wishing to expand their activities, the average CCG-guaranteed loan is in excess of MDH 3.5 million, which is well above the funding needs of VSEs (with a turnover of less than MDH 3 million). Moreover, given that these guarantees are State-contingent debts, they should be granted after due consideration to avoid any budget risks.

4.2.23 **Recent Actions:** To address the issue of VSE financing, a general guarantee product for loans of less than MDH 1 million, regardless of their maturity and purpose, is under review by the Ministry of Finance and CCG.

4.2.24 **Programme Measures:** The planned reforms relate essentially to the launching of a new VSE guarantee product (*condition precedent to the disbursement of the second tranche*).

4.2.25 **Expected Outcomes:** The introduction of this new guarantee product tailored to the specific needs of VSEs and the revamping of the SME guarantee system under the first phase of the programme should lead to following outcomes: (i) an increase in the proportion of outstanding credit to businesses in the overall outstanding credit to the economy from 53% in 2010 to 55% in 2012; and (ii) the number of VSE credit guarantees reaches 250 during the first year of rolling out the new CCG product.

## **Sub-Component 2-b: Develop Venture Capital Activity**

4.2.26 **Context:** Law No. 41-05 of 14 February 2006 governs the operations of venture capital investment organizations (OPCR). OPCRs include venture capital companies (SCRs) and mutual investment funds (FCPR). OPCRs must invest at least 50% of their funds in SMEs as defined under the 2002 SME Charter. As a mechanism that provides a credible alternative for business financing, OPCRs deserve greater attention. Yet, their importance in the Moroccan economy remains limited mainly on account of the inflexible eligibility conditions (Technical Annex 9).

4.2.27 **PADESFI-I Achievements:** Due to the constraints observed in the venture capital sector, the Government of Morocco undertook, under PADESFI-I, to appeal for public-private partnership aimed at promoting venture capital investment in SMEs. In this regard, it set up, through CCG, a public-private capital investment fund designed for this purpose and whose management was entrusted to two private operators. The State already provided an initial MDH 70 million as its contribution to the fund.

4.2.28 **Challenges:** Article 1 of Law No. 53-00 of 23 July 2002 relating to the Charter of Small- and Medium-sized Enterprises provides the defining criteria of SMEs in Morocco. These criteria are repeated particularly in connection with eligibility for OPCR investment under Law No. 41-05. However, the definition of SMEs under Law No. 53-00 applies to relatively small enterprises engaged in capital investment activities. Therefore, it is advisable to streamline the venture capital scheme by providing greater contractual freedom and eliminating venture capital eligibility thresholds, which could subsequently be specified by regulation in response to market trends.

4.2.29 **Recent Actions:** Law No. 41-05 relating to venture capital activities is being amended specifically to remove the constraints regarding the types of enterprises eligible for OPCR assistance. This gives OPRCs the leeway to be more active in financing businesses.

4.2.30 **Programme Measures:** As part of the programme, the Government plans to: (i) transmit to the General Secretariat of the Government the bill amending Law No. 41-05 relating to venture capital investment organizations (*condition precedent to Board presentation*); and (ii) ensure adoption of the said bill by the Council of Ministers.

4.2.31 **Expected Outcomes:** It is expected that the volume of venture capital investment will increase from MDH 7.3 billion in 2010 to MDH 9 billion in 2012.

## **COMPONENT 3: STRENGTHEN THE FINANCIAL SECTOR GOVERNANCE MECHANISM**

4.2.32 Concerning strengthening of the financial sector governance mechanism, PADESFI-II reforms are intended to: (i) strengthen the supervision of the capital market as well as the banking and insurance sectors; and (ii) further facilitate access to financial information. As regards the capital market and the insurance sector, given that the first phase of the programme laid the groundwork for a new regulatory and control framework that is in line with international standards through the adoption of new bills by the Council of Ministers, this second phase of the programme will strive to continue the institutional process for the adoption of those bills. With regard to banking regulation and supervision, this programme will seek to revise the laws governing the sector to ensure greater alignment with the requirements of the national and international financial environment.

### **Sub -Component 3a: Strengthen the Supervision of the Financial Market as well as Banks and Insurance Companies**

4.2.33 **Context:** Until now, financial and insurance markets are placed respectively under the supervision the Securities Ethics Board (CDVM) and the Department Insurance and Reinsurance Department (DAPS) (Technical Annex 10), since the latter is a department within the Ministry of Economy and Finance. As far as banking regulation and supervision are concerned, a milestone was achieved in 2006 with the adoption of a new banking law and the new statutes of Bank Al-Maghrib, giving greater powers to BAM over banking regulation and supervision, as well as total independence from the Executive. However, in view of the wide variety of financial instruments currently in force, as well as the deregulation of the financial sector, the need to contain the risks in this sector and the Government's ambition to make Casablanca an international financial hub, it was deemed necessary to provide Morocco with supervisory bodies which, by virtue of their independence and ability to ensure market transparency, would boost investor confidence.

4.2.34 **PADESFI-I Achievements:** To meet this important need, two bills were drafted and submitted to the Council of Ministers: the first concerns the establishment of the Moroccan Financial Market Authority (AMMC) and the second relates to establishment of the Insurance and Reinsurance Control Authority (ACAPS). These two instruments confirm the independence of both institutions from the Executive and grant them greater powers in the performance of their duties to ensure convergence on the best international standards. Regarding the banking sector, supervision by BAM helped to limit the exposure of Moroccan banks to external factors by ensuring careful provisioning and maintaining an average return of 10 to 15%. Moreover, following the PADESFI-I recommended measures, the Treasury has concluded an agreement with BAM to manage the former's cash flow, which is placed first on the repo market and then on the banking market, including 7-day advances to banks. These efforts have been instrumental in smoothening the curve of the interbank rate, with a daily trading volume of MDH 340 million and a level of 3.25% at end-August 2011. However, the money market is still narrow, accounting for less than 10% of bank transactions.

4.2.35 **Challenges:** One of the major challenges is to continue the process of institutional review of the two bills relating to the AMMC and ACAPS until their adoption by Parliament. Furthermore, to strengthen BAM's supervisory powers over credit institutions and similar bodies, the statutes of this Institution should be amended. So too should the Banking Act in order to incorporate the new provisions, particularly those concerning the activities of investment banks and payment methods (electronic banking, mobile banking). In this regard, customer protection should be considered a new priority by adopting provisions that meet international standards. As for the issue of financial stability, macro-prudential supervision should be strengthened by establishing a Coordinating and Systemic Risk Monitoring Committee, in line with the recommendations of the Financial Sector Assessment Programme (FSAP) for 2008. Similarly, the microcredit sector should be placed entirely under BAM's control, as far as approvals and supervision are concerned.

4.2.36 **Recent Actions:** The Council of Ministers recently adopted the bills. Furthermore, the Programme-Contract defining the commitments of the public and private parties to ensure sustainable development of the insurance sector has also been signed. Work and consultations have begun on the new bills on banking and BAM statutes.

4.2.37 **Programme Measures:** The Government plans to transmit to Parliament: (i) the bill relating to the Moroccan Financial Market Authority (AMMC); and (ii) the bill relating to the establishment of the Insurance and Reinsurance Control Authority (ACAPS). In addition, it intends to transmit to the Secretariat General of the Government: (i) the bill relating to the BAM statutes; and (ii) the banking bill.

4.2.38 **Expected Outcomes:** The major outcomes expected for 2012 are: (i) maintaining the rate of non-performing bank-held loans below 5% in 2012 (4.8% in 2010); and (ii) raising the insurance penetration rate from 2.8% in 2010 to 3% in 2012.

### **Sub-Component 3-b: Facilitate Access to Financial Information**

4.2.39 **Context:** The process of reforming Morocco's financial sector has led to the adoption of several laws and regulations, most of which were amended to suit the changing needs of the national economy and meet the requirements of openness to the international market. Due to the successive reforms, the body of law applicable to the Moroccan financial sector currently comprises widely scattered texts which date from various periods, making it less accessible and unintelligible.

4.2.40 **Challenges:** It is necessary to develop a Monetary and Financial Code (COMOFI) that assembles and reclassifies all laws and regulations using a precise methodology, so as to facilitate their use by the general public as well as national and international operators and investors. The Bank has been requested to support the Government in preparing this Code.

4.2.41 **Recent Actions:** The Government and the Bank have begun discussions to develop the technical assistance project to be financed from a MIC grant.

4.2.42 **Programme Measures:** The Government intends to launch monetary and financial coding (*condition precedent to disbursement of the second tranche*).

4.2.43 **Expected Outcomes:** Improved visibility of the financial sector should attract greater investment in the sector and increase its contribution to GDP by at least 1% in 2012, compared with 2010.

## **COMPONENT 4: DEEPEN THE FINANCIAL MARKET**

4.2.44 To deepen the financial market, PADESFI-II reforms are intended to: (i) diversify financial instruments; and (ii) boost the financial market. In this regard, the first phase of the programme has already resulted in the preparation of a number of core texts that are at various levels of the adoption process, including: (a) the bill relating to long-term financial instruments market; (b) the bill amending and supplementing the law on the Stock Exchange for the purpose of opening the stock exchange capital to institutions other than brokerage firms, currently the only shareholders; and (c) the bill on securities lending for better support of such operations. During the second phase of the programme, focus will essentially be on continuing the institutional review of new legislation governing specific financial operations and instruments.

### **Sub-Component 4-a: Diversify Financial Instruments**

4.2.45 **Context:** The Moroccan market already offers a relatively wide range of financial instruments, compared with other countries of the region. The Casablanca Stock Exchange is

the second largest financial centre in Africa after Johannesburg. The authorities intend to maintain the momentum and further diversify the offer, while ensuring investor security. In this regard, several projects have already been initiated, including: (i) the establishment of a futures market, which should allow the development of new financial instruments beneficial not only to institutional investors but to enterprises and individuals as well; (ii) broadening the scope of securitization; and (iii) introduction of covered bonds. Thus, the proposed launch of a futures market will allow investors to hedge themselves against the risk of changes in exchange rates and asset prices, making financial instruments more attractive and meaningfully supplementing the mechanism required for the Casablanca Finance City (CFC) project (Technical Annex 11). The amendment of the securitization law has broadened the scope of securitization while introducing measures to enhance investor protection and strengthen CDVM's role in market supervision and control. For its part, the proposed introduction of covered bonds in Morocco aims, firstly, to enable banks to mobilize long-term resources and at low cost and, secondly, to provide them with an asset/liability management tool. Other avenues are being explored to develop real estate investment schemes, especially to mobilize resources for industrial and commercial real estate.

**4.2.46 PADESFI-I Achievements:** The key reform carried out under PADESFI-I was the adoption of the bill on the futures market. In addition, the number of lines issuing Treasury bonds was reduced beyond the agreed threshold, from 200 lines in 2007 to 157 in 2010.

**4.2.47 Challenges:** The introduction of innovative, albeit fairly complex products, calls for the adoption of more stringent legislation, particularly in terms of operations control and penalties against offenders, to ensure the security and integrity of the market of these instruments. For example, a number of texts relating to the bill on the futures market, such as the General Regulations of the Futures Market Management Company, are yet to be drafted.

**4.2.48 Programme Measures:** The Government proposes to: (i) prepare and transmit to stakeholders the bill on covered bonds; (ii) submit to the Secretariat-General of the Government the bill on bonds; (iii) prepare and transmit to stakeholders the General Regulations of the Futures Market Management Company; and (iv) prepare and submit to stakeholders a proposed legislative framework for real estate investment funds (OPCI).

**4.2.49 Expected Outcomes:** Essentially, it is expected that the number of lines issuing treasury bonds would be further reduced from 157 in 2010 to 155 in 2012.

#### **Sub-component 4-b: Boost the financial market**

**4.2.50 Context:** To boost the financial market and assert Morocco's regional leadership, the authorities have established an attractive framework for financial activities by adopting the law on the statutes of Casablanca Finance City in order to attract businesses specializing in this sector and strengthen market institutions such as the Casablanca Stock Exchange. The proposed opening up of the Stock Exchange capital to other operators in the financial sector, such as banks and insurance companies, is aimed at contributing to the institutional strengthening of financial market structures (Technical Annex 12).

**4.2.51 PADESFI-I Achievements:** One of the major achievements of PADESFI-I is the adoption, by the Government, of the bill amending the Stock Exchange Law. This amendment should allow the opening up of the capital of the Casablanca Stock Exchange Management Company to other institutions and not solely to brokerage firms. Furthermore, the current practice of lending and borrowing securities on the basis of an agreement and not within a

legislative and regulatory framework constitutes a hindrance to market transparency and efficiency. Consequently, under PADESFI-I, a bill relating to securities lending transactions was passed by the House of Representatives in 2010.

**4.2.52 Challenges:** The creation of the international financial hub is expected to optimize the flow of capital into the region and, ultimately, generate 2 percentage points of GDP growth. Indeed, the CFC targets major domestic and foreign financial institutions wishing to operate regionally and internationally from the Casablanca Stock Exchange Centre, where they may want to set up their regional or international headquarters. Similarly, the proposed establishment of AMMC will lead to immediate changes in the legislation on initial public offering (IPO) of stocks due to the separation of the legislation governing the Moroccan Financial Market Control Authority from that governing initial public offering. Moreover, as part of these major structural changes, the conditions for third-party asset management (collectively or by mandate) should be reviewed. Lastly, concerning the lending of securities, the provisions adopted by the new law should be operational, especially with regard to the existence of the securities lending agreement format.

**4.2.53 Recent Actions:** The CFC project is governed by Law No. 44-10 adopted by Parliament and the 2011 Finance Law granting tax benefits to CFC-eligible companies. Statutory instruments are also being prepared to accompany the various reforms necessary for implementing this financial hub, including opening up the capital of Casablanca Stock Exchange and transforming it into a stock exchange of regional dimension in North and West Africa. In this regard, a bill was drafted to introduce amendments for improving the effectiveness of the regulatory authority's intervention and enhancing the security and integrity of initial public offering operations.

**4.2.54 Programme Measures:** The measures under this sub-component comprises: (i) the adoption of the implementing decree on Law No. 44-10 concerning the status of Casablanca Finance City (CFC) by the Council of Ministers (*condition precedent to Board presentation*); (ii) the preparation and transmission of the draft statute of the Stock Exchange to stakeholders (*condition precedent to disbursement of the second tranche*); (iii) the submission of Bill No. 54-08 relating to initial public offering (IPO) to the Secretariat-General of Government; (iv) the submission of the IPO bill to the Council of Ministers; (v) the submission of the bill on third-party asset management to the Secretariat-General of Government; and (vi) the preparation of the securities lending agreement format.

**4.2.55 Expected Outcomes:** Essentially, it is expected that market capitalization would at least stabilize in 2012 at its 2010 level, i.e., at about MDH 579 billion.

**4.2.56 Status of Implementation of Programme Reforms:** Following dialogue, the Government undertook to implement a package of measures prior to presenting the programme to Bank Group Board of Directors. The agreed measures were not only forward-looking, but also highly structural, laying the groundwork for carrying out other reforms provided for in each programme component. These measures are set out in Box 2 below.

**Box 1: Measures Precedent to PADEFI Presentation to the Board of Directors**

*Measure No. 1:* Launching of the “housing loan” product by Al-Barid Bank (Postal Bank) (§4.2.6);  
*Measure No. 2:* Transmission of the bill amending Law No. 18-97 relating to microcredit to Parliament (§4.2.17);  
*Measure No. 3:* Transmission of the bill amending Law No. 41-05 relating to venture capital investment organizations to the Secretariat-General of the Government (§4.2.30);  
*Measure No. 4:* Adoption of the implementing decree on Law No. 44-10 relating to the statutes of Casablanca Finance City (CFC) by the Council of Ministers (§4.2.54).

**4.3 Financing Requirements and Arrangements**

4.3.1 According to estimates, the financing requirements of the Treasury of the Kingdom of Morocco for 2011-2012 should amount to about MDH 57.4 billion, or about EUR 5.4 billion (see table below). These needs will be covered by Morocco's own resources and external resources. External resource needs should amount to MDH 21.5 billion or EUR 1.93 billion. These external financing needs should be covered by external drawings on investment project and reform programme loans. The current Bank loan, amounting to EUR 224 million, or about UA 200 million, represents almost 11.6% of the external financing needs for 2011-2012.

**Table 1**  
**Morocco: Budget Balance and Financing Requirements,**  
**2011-2012 (in MDH billion)**

Headings	2011	2012	Total
<b>Total Revenue (excluding Hassan II Funds) comprising:</b>	<b>202.9</b>	<b>219.8</b>	<b>422.7</b>
Tax revenue	187.9	203.7	391.6
Non-tax revenue	14.3	15.4	9.7
<b>Net Expenditure and Loans (excluding Hassan II Funds) comprising:</b>	<b>235.2</b>	<b>250.7</b>	<b>485.9</b>
Current expenditure	165.7	177.6	343.3
Capital expenditure	47.5	49.3	96.8
<b>Overall balance (commitment basis, excluding Hassan II Funds)</b>	<b>-32.3</b>	<b>-30.9</b>	<b>-63.2</b>
Arrears variation	0.0	0.0	0.0
Other revenue	2.9	2.9	5.8
<b>Financing Gap</b>	<b>29.4</b>	<b>28.0</b>	<b>57.4</b>
Domestic financing	19.11	16.8	35.9
External financing	10.3	11.2	21.5

Source: Ministry of Economy and Bank staff estimates (August 2011)

**4.4 Programme Beneficiaries**

4.4.1 The end beneficiaries of the programme are the entire Moroccan people. They will derive benefits in terms of standard of living when conditions are created for sustainable economic growth. Other beneficiaries are members of the poorest social strata who will have access to financial services tailored to their needs, including State-guaranteed social housing loans. These people, particularly rural women, will also benefit from improved access to microcredit<sup>8</sup>. The programme will also benefit the private and semi-public sectors as they will have easier access to financing, thanks to the availability of long-term resources on the financial market and the improved efficiency of the national guarantee system.

<sup>8</sup> Since its inception, this sector has created more than 2,000 direct permanent jobs and tens of thousands of indirect jobs.

#### 4.5 Impact on Gender

**One of the objectives of PADESFI-II is to strengthen the microfinance sector by improving the governance of associations engaging in the activity and also through the formulation of a strategic vision for the sector's development.** It has been shown that 66% of microcredit beneficiaries in Morocco are women. They borrow from microcredit associations to finance small productive projects in the agricultural and handicrafts sectors mostly in rural areas. Thus, the impact of the measures adopted under PADESFI-II to facilitate access to social housing and promote microcredit will be significantly felt by Moroccan women, whose participation in the development process will thus be steadily strengthened.

#### 4.6 Impact on the Environment

**This is a budget support programme dealing exclusively with the financial sector.** It will have no environmental impact and has been classified under Category III.

#### 4.7 Impact on the Business Environment

**By focusing on improving access to financing for SMEs/VSEs, modernizing the guarantee scheme and risk management as well as strengthening the supervision of the banking, insurance and financial market sectors, PADESFI-II will contribute to the development of an enabling environment for private sector activities.** Facilitating SME/VSE access to financing is all the more important given that this factor would surely improve the business environment in Morocco. Furthermore, developing financial markets and promoting the Casablanca Finance City will attract new investment and strengthen the activities of institutions operating in the region.

### V IMPLEMENTATION, MONITORING AND EVALUATION

#### 5.1 Implementation Arrangements

**5.1.1 *Institution Responsible:* The Ministry of Economy and Finance (Department of the Treasury and External Finance)** will be responsible for programme implementation. This Department satisfactorily implemented the first phase of PADESFI as well as previous financial sector support programmes. The institution in charge will involve other stakeholders in implementing the reforms. In short, the programme design and implementation will be based on a participatory and graduated approach. This entails, for a given reform proposal: (i) broad consultations with the stakeholders involved (BAM, banks, microcredit associations, DAPS, insurance companies, CDVM, financial market actors, real estate companies, professional associations, etc.) to determine the key points of the reform project; (ii) preparation and submission to the project stakeholders (see Matrix of Measures in Annex 2); (iii) placing the project on the Government website for public consultation; and (iv) the adoption process.

**5.1.2 *Financial Management:* Due to the nature of the operation, the resources will be used in compliance with national public finance regulations.** The Ministry of Economy and Finance (MEF) will be responsible for the administrative, financial and accounting management of these resources.

5.1.3 **Disbursements:** The EUR 224 million loan will be disbursed in two tranches of EUR 134 million and EUR 90 million, subject to fulfilment by the Borrower of the related general and specific conditions as mentioned in § 6.2 below. The Bank and the World Bank have undertaken to align their support with the 2011 and 2012 budget cycles. At the Borrower's request, the Bank will disburse the funds into a designated bank account opened by the Government with Bank Al-Maghrib. The Borrower will ensure that once the deposit is made into that account, equivalent funds in local currency are transferred to the Treasury's current account, which is the State budget account. Within 30 days following each disbursement, the Ministry of Economy and Finance will furnish the donor with a transfer confirmation letter indicating that the total loan amount has been received and paid into the Single Treasury Account, together with the notice of the transactions issued by Bank Al-Maghrib. The flow of funds (including foreign exchange) will be subject to standard public finance procedures.

5.1.4 **Procurement of goods and services:** Since the programme deals with budget support, its implementation does not directly involve the procurement of goods and services.

5.1.5 **Audits:** Given that the funds are fungible with the State budget, their use will be audited by Morocco's Court of Accounts (audit of State budgets for 2011 and 2012), which should be published within the timeframes stipulated in the new Organic Law.

## 5.2 Monitoring and Evaluation Arrangements

The macroeconomic monitoring framework and the agreed matrix of measures will be the common monitoring and evaluation frameworks for PADESFI-II (Annexes 2 and 4). The MEF will be responsible for data collection and coordination of the monitoring/evaluation. It will put the information at the Bank's disposal. At least one joint supervision mission will be undertaken during programme implementation to assess the progress achieved in that regard. A mid-term review mission will be undertaken prior to the disbursement of the second tranche. At the end of the programme, a completion report will be prepared jointly with the Government.

## VI. LEGAL INSTRUMENTS AND AUTHORITY

### 6.1 Legal Instruments

The legal instrument to be used for the programme is the Loan Agreement. Parties to this Agreement are the African Development Bank and the Government of the Kingdom of Morocco.

### 6.2 Conditions Precedent to Bank Group Intervention

#### 6.2.1 *Conditions Precedent to Programme Presentation to the Board*

Based on the dialogue with the Government, it was agreed that the latter will implement the measures precedent to programme presentation to the Bank's Board of Directors. These conditions are indicated in Box 1 (§ 4.2.56).

#### 6.2.2 *Conditions Precedent to Loan Effectiveness*

Loan effectiveness will be subject to fulfilment of conditions stipulated in Section 12.1 of the General Conditions Applicable to Loan Agreements.

### 6.2.3 *Conditions Precedent to Disbursements*

Disbursement of the two tranches will be subject to positive assessment of the programme's macroeconomic framework by the Bank and fulfilment of the following two conditions precedent to disbursement:

#### *Conditions Precedent to Disbursement of the First Tranche of EUR 134 million*

- (i) Forward to the Bank evidence of the existence of a Treasury account opened with Bank Al Maghrib (Central Bank of Morocco) acceptable to the Bank and intended to receive the loan resources (§ 5.1.2);

#### *Conditions Precedent to Disbursement of the Second Tranche of EUR 90 million*

- (i) Adoption of edicts issued by the Minister of Economy and Finance relating to: Housing Savings Plan (PEL), Education Savings Plan (PEE), and Equity Savings Plan (PEA) (§4.2.11);
- (ii) Launching of a new guarantee product for VSEs (§4.2.24);
- (iii) Launching of monetary and financial codification (§4.2.42);
- (iv) Preparation and transmission of the statutes of the Stock Exchange to the project's stakeholders (§4.2.54).

### 6.3 **Compliance with Bank Group Policies**

The core Bank Group directives and other guidelines applicable under this Programme are as follows: (i) Directives on Policy-based Lending Operations (2008); (ii) Directives on Development Budget Support Loans (2004); and (iii) Directives on Financial Product Pricing Flexibility for MICs (2009). No waiver for any of these directives is requested under this proposal.

## VII **RISK MANAGEMENT**

7.1 **The major risks likely to affect the programme implementation could come from external shocks related to:** (i) the unfavourable global economic situation; (ii) the current political and social context in North Africa which could lead, in response to the social (and particularly wage-related) demands, to budget deficit and therefore a "slippage" in public finances; and (iii) a shift in focus after the coming elections might mean a heavier schedule for Government and Parliament, which could slow down the implementation of certain reforms.

7.2 *With regard to the risk resulting from adverse global economic situation*, the Strategic Watch Committee, established since 2009, plays a crucial role in implementing emergency measures to mitigate the impact of these risks on the national economy. *As for the risk of deterioration in public finances*, the principle of preserving the balance of State finances is established at the highest level, that is, by the new Constitution (Article 77). In this context, further reforms to improve the management of public resources, including the forthcoming adoption of the new finance organic law in preparation, is an important mitigating factor. Lastly, *concerning risks related to the shift in focus and the heavy*

*schedule of the Government and Parliament*, the relevance of programme objectives and the urgent need for their implementation against the backdrop of the current political and social situation, have generated high-level commitment by the authorities, which should keep the reforms and their lead time on track.

## **VIII. RECOMMENDATION**

8.1 It is recommended that the Board approve an African Development Bank loan not exceeding EUR 224 million (UA 200 million) to the Government of the Kingdom of Morocco for financing the second phase of the Financial Sector Support Programme (PADESFI-II).

## **DEVELOPMENT POLICY LETTER**



### **THE MINISTER**

#### **Financial Sector Development Support Programme: Development Policy Letter Mr President,**

The Kingdom of Morocco is determined to pursue the reform of its financial sector to enable it to meet the funding needs of the economy, which is undergoing profound change.

The current decade has been characterized by an extensive and structuring reform process that has helped to consolidate the legislative and regulatory framework governing the financial sector, improve conditions for funding the economy, and enhance the efficiency and strength of the banking sector and the financial market.

Significant progress has also been recorded in risk monitoring and management in order to guarantee greater integrity and security for our financial system.

Although there have been many and extensive reforms, the fact that the development process has speeded up, growth and employment rates have increased, and the standard of living of citizens has improved requires this momentum to be pursued with a new generation of reforms that will consolidate our achievements, enable the completion of activities already initiated and usher in new measures to strengthen our overall coherence as well as stimulate the on-going modernization process.

Conscious of these imperatives, the Government of the Kingdom of Morocco is determined to step into a new phase in its financial sector development process through a new generation of reforms as part of the four main areas of focus adopted in the Financial Sector Development Support Programme (PADESFI-I), which include:

- 1- Increasing the population's access to financial services;
- 2- Increasing corporate access to funding;
- 3- Strengthening the financial sector governance mechanism; and
- 4- Boosting the financial market.

Based on the abovementioned four main areas, the reforms may be detailed as follows:

**(1) Increasing the population's access to financial services:**

Although tangible results have been achieved in increasing the population's access to financial services, particularly as a result of improved management of the microcredit sector and the establishment of the Postal Bank (Bank Al-Barid) which offers, among others, financial services that are tailored to the needs of low-income population segments, there is need for additional efforts and supporting measures to meet the desired financial inclusion. Accordingly, the following three main types of measures have been envisaged:

- Improving household access to the funding of low-cost housing by launching a "real estate credit" product through Bank Al-Barid and instituting a guarantee product aimed at people targeted by the "Cities without Slums" Programme;
- Developing long-term savings by individuals through the introduction of organized savings facilities, namely the "Equity Savings Plan" (PEA), "Housing Savings Plan" (PEL), and "Education Savings Plan" (PEE). These facilities, which benefit from the tax incentives laid down in the 2011 Finance Law, should contribute to strengthening the mobilization of long-term savings, increasing the liquidity of banks, and stimulating the stock market, while facilitating access to housing and training for a substantial segment of the population; and
- Enhancing governance and risk management by microcredit associations by amending the law governing the microcredit sector, completing the study to outline a development strategy for the sector, increasing the membership of associations of the "Credit Bureau" in order to improve their credit risk management, and setting up an information system for associations that are members of the "Microfinance Solidarity Network".

**(2) Increasing corporate access to funding:**

The mechanism governing corporate access to funding has been improved through the completion of the national guarantee system reform and the improvement of the financial information system through the establishment of the "Credit Bureau".

The continuation of the process entails carrying out a number of measures aimed at:

- Increasing access to credit for very small enterprises by instituting a guarantee product for such enterprises to provide them with development funding; and
- Developing venture capital to assist enterprises by amending the law governing the sector.

**(3) Strengthening the financial sector governance mechanism**

One of the goals of the financial sector modernization process was to strengthen the integrity and security of the financial sector which, in particular, led to an increase in the powers and independence of the regulatory authorities. Consequently, bills have been prepared to amend instruments governing the financial and insurance market supervisory authorities.

Concerned about pursuing such a strategy which will protect our financial sector against various forms of risks that may jeopardize its strength, the Government plans to:

In the banking sector: (i) amend the law governing the sector, which was adopted in 2006 to promote the establishment of appropriate supervisory mechanisms and to introduce rules governing the stability policy and crisis management; (ii) amend the statutes of the Central Bank to further strengthen its independence and enable it to consolidate its payment systems management prerogatives.

Moreover, the financial sector reform has led to the integration and amendment of several legislative and regulatory instruments, and has rendered the legal framework applicable to Morocco's financial sector which is difficult to access. As a result, government authorities undertook to draft a Monetary and Financial Code, which will help to facilitate access to financial information.

#### **(4) Stimulating the financial market**

The capital market modernization process has been characterized by the willingness to respond fully to the requirements of an effective regulation that will enable the development of new financial instruments, in line with the demands of a rapidly developing market and in compliance with the best international standards and practices.

The adoption of the law governing Casablanca Finance City (CFC), which aims at transforming Casablanca into a regional financial centre and promoting the modernization and growth of the national financial sector, is a crowning achievement of reform efforts undertaken to date.

The reform process will continue in several areas, including:

Preparing bills on secure bonds to enable operators to invest in safer securities, real estate investment funds, citizens' participation in savings, and third-party asset management. The bills will help to diversify financial instruments, improve the quality of financial information and stimulate Morocco's financial market.

Similarly, implementation instruments will be developed for the law governing Casablanca Finance City to enable the establishment of the institutions provided for in that law, particularly the commission responsible for granting the CFC status.

We want to thank you for your valuable support in the implementation of this ambitious programme. Please accept, Mr President, the assurances of my highest consideration.

**Mr. Donald KABERUKA**

**President of the African Development Bank**

**Angle des trois rues : Avenue du Ghana, Rue Pierre de Coubertin,**

**Rue Hedi Nouira – BP 323 – 1002**

**Tunis Belvédère - Tunisia -**

**MOROCCO – Financial Sector Development Support Programme II – PADESFI-II**  
**MATRIX OF JOINT MEASURES WITH THE WORLD BANK**  
**(PADESFI-I INDICATIVE MEASURES)**

Data Sources: DS; Institutions Responsible: IR

(\*) Measure precedent to Programme presentation to the Board of Directors; (\*\*) Condition precedent to disbursement of the second tranche.

Sub/components	PADESFI-I Measures (2009-2010)	PADESFI-II - Tranche 1 (December 2011)	PADESFI-II - Tranche 2 (December 2012)	Targeted Output Indicators	Targeted Impact Indicators	Data Sources and Institutions Responsible
<b>COMPONENT 1. IMPROVEMENT OF THE POPULATION'S ACCESS TO FINANCIAL SERVICES</b>						
<b>1. A – IMPROVE ACCESS OF HOUSEHOLDS TO FINANCING AND SOCIAL HOUSING</b>	Grant of approval to Bank Al-Barid (Postal Bank) by Bank-Al-Maghrib  Entry into operation of the Postal Bank	Launch of the "housing loan" product by Bank Al-Barid (Postal Bank) (*)		Bank Al-Barid begins granting housing loans by end-2011	The banking rate of the economy reaches 55% in 2012 (50% in 2010)	DS: MEF letter confirming the launch of the housing loan product by the Postal Bank IR: ME/Postal Bank
		Amendment to the agreement between the State and the Central Guarantee Fund relating to the "Damane Assakane" Fund, for the establishment of a special product for the population targeted by the "Cities without Slums" (VSB) Programme		The agreement relating to the "Damane Assakane" Fund is amended to allow the establishment of a special product for the population targeted by the "Cities without Slums" (VSB) Programme by end-2011	The number of guarantee-backed housing loans rises from 63,065 in 2010 to 80,000 in 2012	DS: Agreement between MEF and CCG as amended IR: MEF
<b>1. B – ENCOURAGING HOUSEHOLD SAVINGS</b>			Adoption of edicts issue by the Minister of Economy and Finance relating to: - the Housing Savings Plan (PEL) - the Education Savings Plan (PEE) - the Equity Savings Plan (PEA) (**)	Edicts issued by the Minister of Economy and Finance relating to PEL, PEE and PEA savings plans are adopted by end-2012	The number of savers participating in the new savings plans exceeds 10,000 in the first year of product launch	DS: Edicts by MEF IR: MEF
<b>1. C – STRENGTHEN THE MICROCREDIT SECTOR</b>	Adoption by monetary authorities of regulations on the classification of and provisioning for the non-performing loans of	(*) Transmission to Parliament of the bill amending Law No.18-97 on microcredit (*)		The bill amending Law No.18-97 relating to microcredit is passed in Parliament by end-2011	Proportion of women receiving micro-credit reaches 55% in 2012, compared	DS:MEF letter confirming to the transmission IR: MEF

Sub/components	PADESFI-I Measures (2009-2010)	PADESFI-II - Tranche 1 (December 2011)	PADESFI-II - Tranche 2 (December 2012)	Targeted Output Indicators	Targeted Impact Indicators	Data Sources and Institutions Responsible
	microcredit associations.				to 49% in 2010	
	Putting in place of regulations governing risk management and microcredit associations by monetary authorities	Completion of the study on the microcredit sector development strategy		The study on the microcredit sector development strategy is completed by end-2011	The proportion of microcredit granted in rural areas reaches 40% of the total sector assets in 2012, compared with 38% in 2010	DS: The microcredit sector strategy study IR: MEF
		Signing of the Credit Bureau membership contracts of microcredit associations, representing 90% of the sector's outstanding credit		The Credit Bureau membership contracts of microcredit associations representing 90% of the outstanding credit of the sector are signed by end-2011	90% of the outstanding microcredit is registered at the Credit Bureau (50% in 2010)	DS: IR: BAM
			Establishment of an information system in microcredit associations belonging to the "Microfinance Solidarity Network "	Information systems in microcredit associations belonging to the "Microfinance Solidarity Network" are put in place by end-2012		DS: MEF letter confirming that the information systems are in place IR: MEF
<b>COMPONENT 2. IMPROVEMENT OF ACCESS OF BUSINESSES TO FINANCING</b>						
<b>2. A – IMPROVE ACCESS OF VSES TO CREDIT</b>	Establishment of a new Board of Directors of the Central Guarantee Fund, including private sector representatives and an Audit Committee  Adoption of a range of guarantee products tailored to meet the lifecycle-related needs of enterprises and opening of		Launch of a new VSE guarantee product (**)	The CCG initiates the VSE guarantee product by end-2012	Outstanding credit to (non-financial) enterprises stands at 55% of the total outstanding credit to the economy in 2012, compared to 53% in 2010	DS: MEF letter confirming the launch of new guarantee products IR: MEF

Sub/components	PADESFI-I Measures (2009-2010)	PADESFI-II - Tranche 1 (December 2011)	PADESFI-II - Tranche 2 (December 2012)	Targeted Output Indicators	Targeted Impact Indicators	Data Sources and Institutions Responsible
	two regional offices of the Central Guarantee Fund					
	Conduct by the Credit Bureau of at least one reporting test with the declarants.				The number of guarantees granted to VSE credit reaches 250 in the first year of introduction of the new CCG product	
	Start-up of Credit Bureau activities					
<b>2. B – DEVELOP VENTURE CAPITAL ACTIVITIES FOR THE BENEFIT OF ENTERPRISES</b>	Government undertaking to set up a public-private investment fund	Transmission of the bill amending Law No. 41-05 relating to venture capital investment to the Secretariat-General of the Government (*)		The bill amending Law No. 41-05 relating to venture capital investment is transmitted to the Secretariat-General of the Government by end-2011	The volume of venture capital investment reaches MDH 9 billion in 2012, compared to MDH 7.3 billion in 2010	SD: DS: MEF letter confirming transmission to the SGG IR: MEF
	Effective of State contribution to the public-private investment fund		Adoption of the bill amending Law No. 41-05 relating to venture capital investment bodies by the Council of Ministers	The Council of Ministers adopts the bill amending Law No. 41-05 relating to venture capital investment bodies by end-2012		DS: MEF letter confirming the adoption by the Council of Ministers IR: MEF
<b>COMPONENT 3. STRENGTHENING OF THE FINANCIAL SECTOR GOVERNANCE MECHANISM</b>						
<b>3. A – STRENGTHEN SUPERVISION OF THE FINANCIAL SECTOR</b>	Submission of a bill on the Financial Market Authority to the Secretariat-General of the Government		Transmission of the bill on the Moroccan Financial Market Authority (AMMC) to Parliament	The bill on the Moroccan Financial Market Authority (AMMC) is transmitted to Parliament by end-2012		SD: MEF letter confirming the transmission of the text to Parliament IR: MEF
	Submission of a bill relating to the establishment of an Insurance and Reinsurance Control Authority to the Secretariat-General of the Government		Transmission of the bill establishing the Insurance and Reinsurance Control Authority (ACAPS) to Parliament	The bill establishing the Insurance and Reinsurance Control Authority (ACAPS) is transmitted to Parliament by end-2012	The insurance penetration rate (premiums/GDP) stands at 3% in 2012, compared to 2.8% in 2010	SD: MEF letter confirming the transmission of the text to Parliament IR: MEF
	Signing of a programme					

Sub/components	PADESFI-I Measures (2009-2010)	PADESFI-II - Tranche 1 (December 2011)	PADESFI-II - Tranche 2 (December 2012)	Targeted Output Indicators	Targeted Impact Indicators	Data Sources and Institutions Responsible
	contract between the State and insurance professionals					
			Transmission of the bill amending BAM's statutes to the Secretariat-General of the Government	The bill to amend the BAM's statutes is transmitted to the Secretariat-General of the Government by end-2012	The rate of bank-held non-performing loans is kept below 5% in 2012 (4.8% in 2010)	DS: MEF letter confirming the transmission to the SGG IR: MEF
			Transmission of the banking bill to the Secretariat-General of the Government	The banking bill is transmitted to the Secretariat-General of the Government by end-2012		DS: MEF letter confirming the transmission to the SGG IR: MEF
<b>3. B – FACILITATE ACCESS TO FINANCIAL INFORMATION</b>		Preparation of the terms of reference for the drafting of the Monetary and Financial Code		The terms of reference for the drafting of the Monetary and Financial Code are prepared by end-2011	The financial sector's share in GDP increases by at least 1% in 2012, compared to 2010	SD: The Bank-approved terms of reference IR: MEF
			Launching of monetary and financial coding (**)	Monetary and financial coding is launched by end-2012		DS: MEF letter transmitting the minutes of the first meeting of the Coding Project Steering Committee IR: MEF
<b>COMPONENT 4. DEEPENING OF THE FINANCIAL MARKET</b>						
<b>4. A – DIVERSIFY FINANCIAL INSTRUMENTS</b>		Preparation and transmission to stakeholders of the bill on covered bonds		The bill on covered bonds is prepared and submitted to stakeholders by end-2011		DS: MEF letter confirming the transfer of the bill to

Sub/components	PADESFI-I Measures (2009-2010)	PADESFI-II - Tranche 1 (December 2011)	PADESFI-II - Tranche 2 (December 2012)	Targeted Output Indicators	Targeted Impact Indicators	Data Sources and Institutions Responsible
						stakeholders. IR: MEF
			Transmission of the bill on covered bonds to the Secretariat-General of the Government	The bill on covered bonds is transmitted to the Secretariat-General of the Government by end-2012		DS: MEF letter confirming the transmission to the SGG IR: MEF
	Adoption of a bill on the financial futures market by the Council of Ministers		Preparation and transmission of the draft General Regulations of the Futures Market Management Company to stakeholders	The draft General Regulations of the Futures Market Management Company are prepared and submitted to stakeholders by end-2012	The number of Treasury bond issuing lines is reduced from 157 in 2010 to 155 in 2012.	DS: MEF letter confirming the transmission of the draft General Regulations of the Futures Market Management Company to stakeholders IR: MEF
			Preparation and submission of a draft legislative framework for real estate investment funds (OPCI) to stakeholders	The draft legislative framework for collective real estate investment funds (OPCI) is prepared and submitted to stakeholders by end-2012		DS: MEF letter confirming the transfer of the draft legislative framework to stakeholders. IR: MEF
<b>4. B – BOOST THE FINANCIAL MARKET</b>		Adoption of the implementing decree of Law No. 44-10 relating to the Status of Casablanca Finance City (CFC) by the Council of Ministers (*)		The implementing decree of Law No. 44 - 10 relating to the statutes of Casablanca Finance City (CFC) is adopted by the Council of Ministers by end-2011	Stabilization of market capitalization in 2012 at its 2010 level at least, that is, at roughly MDH 579 billion	DS: MEF letter confirming the adoption of the decree by the Council of Ministers IR: MEF
	Submission of the bill amending and supplementing the Dahir on the Stock Exchange Law  Adoption of the bill amending and		Preparation and transmission of the draft Stock Exchange statutes to stakeholders (**)	The draft Stock Exchange statutes are prepared and submitted to stakeholders by end-2012		SD: MEF letter confirming the transmission of the draft statutes to stakeholders. IR: MEF

Sub/components	PADESFI-I Measures (2009-2010)	PADESFI-II - Tranche 1 (December 2011)	PADESFI-II - Tranche 2 (December 2012)	Targeted Output Indicators	Targeted Impact Indicators	Data Sources and Institutions Responsible
	supplementing the Dahir on the Stock Exchange Law by the Council of Ministers					
		Transmission of Bill No. 54-08 relating to the initial public offering (IPO) to the Secretariat-General of the Government		Bill No. 54-08 relating to the initial public offering (IPO) is transmitted to the Secretariat-General of the Government by end-2011		SD: MEF letter confirming the transmission to the SGG IR: MEF
			Presentation of the IPO bill to the Council of Ministers	Bill No. 54-08 relating to the initial public offering (IPO) is presented to the Council of Ministers by end-2012		SD: MEF letter confirming the presentation to the Council of Ministers IR: MEF
			Transmission of the Government of the bill on third-party asset management to the Secretariat-General	The bill on third-party asset management is transmitted to the Secretariat-General of the Government by end-2012		DS: MEF letter confirming transmission to the Council of Ministers IR: MEF
	Adoption of the bill relating to securities lending operations by the Council of Ministers		Preparation of the draft format of the securities lending agreement	The securities lending agreement format is drawn up by end-2012		DS: MEF letter confirming the preparation of the agreement format IR: CDVM

**NOTE ON RELATIONS WITH THE IMF**

**Preliminary Conclusions of the 2011 Consultations under Article IV**  
July 2011

A mission from the International Monetary Fund (IMF) visited Rabat from July 7 to 19, 2011 to conduct Article IV discussions. The mission wishes to thank the Moroccan authorities for their excellent cooperation and the highly constructive discussions.

1. **Morocco has successfully met major challenges in the past two years.** Thanks to sound macroeconomic policy and political reforms, Morocco was well-equipped to address the 2009 international crisis and to respond to the social unrest which has emerged in many countries in the Middle East and North Africa (MENA) region since early 2011. In this challenging environment, Morocco has performed well economically and has seen its social indicators improve.

2. **The relatively favorable medium-term outlook would be further improved if macroeconomic policies were reoriented toward achieving high and sustainable rates of growth.** In fact, the major challenge for Morocco remains that of achieving a GDP growth rate that will help reduce unemployment and improve living standards, while ensuring medium-term macroeconomic stability. Since early 2011, declining growth among Morocco's main trading partners and rising commodity prices have complicated efforts to manage macroeconomic stability. Although in 2011 the Moroccan government implemented short-term policies to address these constraints, in 2012 the government is expected to consider reorienting public expenditure and achieving a fiscal sustainability while fostering inclusive and sustainable growth in the medium term.

**I. RECENT DEVELOPMENTS**

**3. Morocco's overall economic performance has been sound overall:**

- *Strong performance by nonagricultural GDP:* driven by the strong performance in the manufacturing sector, nonagricultural GDP grew by 4.5 % in 2010 offsetting the contraction in the primary sector. The continued strong performance in the nonagricultural sector—including the tourism sector—and a more robust agricultural output are expected to raise overall GDP growth in 2011 to about 4½-5 percent.
- *Inflation remains firmly under control.* Average inflation in 2010 remained at the very moderate level of 1 percent. In 2011, a good agricultural year and the fact that prices of certain foodstuffs and petroleum products held steady despite rising international prices, are expected to help limit the increase in the average inflation to around 1½ percent.
- *Growth in credit continued against a backdrop of declining liquidity.* Credit to the economy grew by 7.4 percent in 2010. During the first five months of 2011, growth in credit slowed down, while banks' resources were supported by the mobilization of market resources even though customer deposits fell slightly. This trend may be due to the contraction of systemic liquidity as a result of a decrease in foreign assets and a larger-than-usual increase in currency in circulation during

the first five months of 2011. However, based on expected growth in GDP and M3, credit could increase by around 6.2 percent in 2011. The authorities estimate credit to increase by 6-8 percent in 2011. The IMF staff projection (approximately 6.2 percent) is within this range.

- *A slight deterioration in the external balance due to a terms-of-trade shock.* The mission estimates that the current account deficit may increase to about 5 percent of GDP at end- 2011. Although Moroccan exports, including phosphates and its derivatives, have performed well, and tourism receipts and transfers from Moroccans living abroad have grown, this may not offset the increase in imports caused by rising international food and oil prices. Gross international reserves are expected to decline slightly at end-2011, while remaining comfortable, at slightly above 5 months of imports of goods and services.
- *A worsening budget deficit caused by the sharp increase in expenditures.* The budget deficit may reach 5½-6 percent of GDP due to an increase in expenditures amounting to 3 percent of GDP relative to the 2011 budget, largely due to an increase in food and fuel subsidies.

## II. INTERNATIONAL CONTEXT AND MEDIUM-TERM OUTLOOK

4. **The international economic recovery in 2010 to some extent supported the revival of growth in Morocco; yet new risks emerged in 2011.** While global growth continues to be strong, growth it seems to be slowing down in a number of countries in the Euro zone, Morocco's main trading partner. Furthermore, persistently high commodity prices, the regional context, and global financial stability add uncertainties to the economic outlook.

5. **Morocco is expected to continue recording sound economic performance.** Growth in nonagricultural GDP is expected to reach about 5 percent and to contribute to overall GDP growth, which is forecasted to attain 4½-5 percent in 2011. In the medium term, the growth rate may reach 6 percent, mainly depending on the continued implementation of structural reforms and the maintenance of macroeconomic stability. In this regard, the authorities intend to bring the medium-term budget deficit down to around 3 percent of GDP, which would bring total Treasury debt to about 50 percent of GDP. This should slow down the pace of imports, in particular of energy products (thanks in part to more rational consumption patterns) and of consumer goods, which could help to bring the current account deficit down to about 2½ percent of GDP in 2016.

## III. MACROECONOMIC AND STRUCTURAL POLICIES

### A. Fiscal policy

6. **In 2011, the increase of certain types of expenditures in response to social demands will lead to an increase in total expenditure by 1½ percent of GDP.** Maintaining price stability for certain food and fuel products in the context of sharply rising international commodity prices will increase the cost of subsidies for these products to about 5½ percent of GDP in 2011, considerably in excess of the 2.1 percent of GDP estimated in the 2011 budget. Furthermore, rising civil service wages could push up the wage bill by 0.2 percent of GDP, reaching 10.7 percent of GDP.

7. **Counterbalancing measures on the revenue and expenditure side of more than 2 percent of GDP, will allow to achieve a budget deficit of around 5.7 percent of GDP in 2011.**

Given the importance of demonstrating the government's determination to maintain fiscal sustainability, the mission believes that there is little room for further measures to increase government expenditure. Revenue efforts were intensified and higher than budgeted revenue were collected at end June 2011 –mainly from indirect taxes. These efforts should continue in the second half of the year and should enhance revenue collection by 1 percent of GDP compared to the 2011 budget. Consequently, total revenues are expected to remain almost unchanged compared to 2010, at around 25 percent of GDP. On the expenditure side, all budget entities have been requested to economize 10 percent of their budget allocations for some nonessential current expenditure items. Moreover, budgeted transfers to some public entities with treasury surpluses will be reduced without affecting their spending capacity. The latter two measures are expected to generate savings of over 1 percent of GDP relative to the 2011 budget. In addition, if elections are held in 2011, the cost of the elections will be absorbed in the existing budget envelope.

**8. After containing fiscal expansion in 2011, the authorities are preparing to implement fiscal consolidation measures starting in 2012.** The authorities intend to pursue a fiscal consolidation plan to bring the deficit down to 3 percent of GDP in the medium term, which would be in line with a debt to GDP ratio converging to about 50 percent of GDP. In addition, Article 77 of the new constitution and the draft organic budget law for 2012 outline the principle of safeguarding fiscal stability. In the absence of corrective measures, the budget deficit could reach 6½-7½ percent of GDP and consequently public debt will continue to rise.

**9. To achieve this fiscal objective, the authorities are prepared to resume and expedite the following reforms:**

- *Raise revenue.* The authorities intend to pursue their resource mobilization efforts by: (i) broadening the tax base; and (ii) improving tax administration. Nontax revenues would also be expected to improve as publicly owned enterprises benefit from the economic recovery and augment their contribution to the budget. The mission believes that a VAT reform should be designed to ensure constant or rising VAT receipts. These and other reforms will maintain or even increase revenues in spite of the decline in customs receipts due to continued trade liberalization.
- *Manage and rationalize expenditure.* A civil service reform is expected to bring the wage bill down to about 10 percent of GDP in the years ahead. Furthermore, a reform of fuel subsidies, replacing universal subsidies with targeted transfers, would significantly reduce the burden on the budget and would eliminate the vulnerability of public finances with respect to fluctuations in international commodity prices while rationalizing consumption.
- *Enhance expenditure efficiency.* The authorities also intend to improve the efficiency of public investment by improving project selection procedures and allowing greater private sector participation, including in public infrastructure. This approach, combined with the subsidy reform, would generate greater fiscal space for enhancing social spending, particularly in health and education.
- *Ensure the sustainability of the public pension system.* According to the latest actuarial projections, public pension plans will soon have to begin using their capital base to finance pension payments; this underscores the need for reforms to ensure the financial sustainability of the public pension system. Phasing in gradual

increases in the retirement age and in contributions, coupled with a review of the basic wage used to calculate pensions, would give the pension funds some years of financial sustainability prior to introducing a broader reform of the pension system. A broader reform would include a combination of a pay-as-you-go system and a funded system encompassing a mandatory and an optional component.

#### IV. MONETARY AND EXCHANGE POLICY

10. **Monetary policy has kept inflation in line with the objectives set by Bank Al-Maghrib (BAM).** The fact that rising international prices for certain commodities did not pass through also helped to preserve price stability. In the context of a fixed exchange rate and partial capital controls, efficient liquidity management by BAM helped keep the overnight interest rate (operational target) close to the BAM benchmark rate which has remained unchanged at 3.25 percent since March 2009. Beginning in 2008, BAM lowered reserve requirements from 16½ to 6 percent, and in April 2011 withdrew passbook savings accounts from the reserve base, freeing up DH 4.6 billion for banks.

11. **The monetary authorities have the tools and capacity to implement the transition to a formal inflation targeting system with a more flexible exchange rate.**

BAM has the necessary independence, expertise, statistical resources, range of instruments, as well as comfortable exchange reserves. Bank supervision for risk management is effective and foreign currency exposure is at a low level. However, the authorities believe that managing this transition requires ensuring fiscal sustainability and maintaining financial stability. Additional requirements entail more active interbank markets for local currency and foreign exchange as well as reforms of the operational framework for foreign exchange policy to govern active interventions by BAM on the exchange market. The mission considers that in the short term, the foreign exchange market could be further developed by broadening the central bank spread from 0.6 percent to at least 2 percent (the IMF standard for conventional peg regimes) to encourage the development of interbank foreign exchange transactions.

12. **Fund staff analysis of Morocco's real exchange rate based on the three CGER methodologies yields mixed results.** This analysis finds that the deviation from the equilibrium rate varies widely among the three methodologies used. However—and despite the fact that the real effective exchange rate depreciated by about 4 percent in 2010—the mission believes that trends in the current account balance since 2007 could point to eroding external competitiveness in the Moroccan economy. A flexible exchange rate regime and further structural reforms would help support competitiveness and provide greater economic policy space.

#### V. FINANCIAL SECTOR

13. **Morocco's financial sector has made considerable headway, but it would need to mobilize additional resources to keep growing.** The banking sector is important, exceeding 120 percent of GDP, supported by the deposits of Moroccans living abroad and the establishment of banking networks in Africa by Moroccan banks. The Casablanca stock exchange is now one of the most capitalized and diversified in terms of sectors in Africa. The authorities have taken steps to promote access to banking and savings services in order to support bank's deposit mobilization which has slowed down, and to develop markets (development of the rates curve and securitization) to facilitate the asset and liability management of banks, whose resource utilization rates exceed 100 percent on average.

14. **The policy of strengthening core capital has been a success.** The solvency ratio of the system had risen to 12.3 percent at end-2010, up from 11.8 percent in 2009, and NPLs steadily declined from 6.1 percent of total loans in 2008 to 4.8 percent in 2010. However, credit quality appears to have slipped since 2009 as indicated by the increase in the cost of risk. Efforts to strengthen core capital will continue, in particular for those institutions that have failed to reach the threshold of 9 percent of exposures as targeted by BAM.

## VI. SOCIAL AND STRUCTURAL POLICIES

15. **The authorities are continuing their efforts to implement an ambitious program of structural reforms to enhance the competitiveness of the economy.** The favorable economic performance recorded over the past decade is largely attributable to reforms in key economic sectors (such as the financial sector and public enterprises), and to efforts to improve the business climate, which need to be strengthened. The authorities are continuing to implement reforms designed to create a more dynamic private sector and ensure that private investment makes a more effective contribution to growth. These efforts should facilitate greater economic diversification, create jobs, and lower unemployment. Although significant progress has been made in this area, unemployment is at 9 percent and remains very high among young people, graduates, and women. In this context, reforms designed to enhance labor market flexibility are essential. Furthermore, at end-2009, in partnership with the private sector, the authorities created the National Committee for the Business Environment [*Comité National de l'Environnement des Affaires (CNEA)*] to expedite efforts to identify and implement reforms pertaining to the business climate. Moreover, a new legal framework is being developed to promote the creation of public-private partnerships (PPPs).

16. **The authorities have continued to support consistent social policies which have helped to lower the poverty rate by 6 ½ percent between 2000 and 2008, while improving social indicators.** These efforts should be strengthened through a reorientation of fiscal policies which should provide more leeway for raising health and education spending. Furthermore, these social policies are designed to achieve a more equitable distribution of wealth and regional development. In this context, it is important to mention the success of the National Human Development Initiative and the recent extension of medical coverage to include disadvantaged populations (the RAMED medical insurance program). These efforts should be pursued in the context of the advanced stage achieved by the regionalization process.

17. **Constitutional reform will enhance efforts to strengthen structural reforms and foster medium-term growth.** The new constitution will help develop a legal and institutional framework to consolidate progress in regard to governance, fiscal transparency, the business climate, private sector development, and gender equality. Such policies are expected to support the standard of living while enhancing potential growth.

## VII. CONCLUSION

18. **The sound macroeconomic policies put in place over the past decade have equipped Morocco to respond to recent crises.** Nonetheless, in order to achieve a high and sustainable growth rate in the medium term, the authorities should adopt strong measures to reorient fiscal policy and continue efforts to improve the business climate. As in the past, IMF staff stands ready to support the government's reform efforts and maintain ongoing dialogue.