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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/38-3

11:40 a.m., May 13, 2019

3. Morocco—2019 Article IV Consultation

Documents: SM/19/93 and Correction 1; and Correction 2; and Correction 3; and Correction 4; and Supplement 1; SM/19/94

Staff: Blancher, MCD; Kramarenko, SPR

Length: 52 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	W. Nakunyada (AE), Temporary
	A. Olhaye (AF), Temporary
	R. Morales (AG), Temporary
	G. Johnston (AP)
	F. Fuentes (BR), Temporary
	Y.Liu (CC), Temporary
	P. Moreno (CE)
L. Levonian (CO)	
R. Kaya (EC)	
	P. Rozan (FF), Temporary
	K. Merk (GR)
	M. Siriwardana (IN)
D. Fanizza (IT)	
	Y. Saito (JA)
	M. Daïri (MD)
	M. Choueiri (MI), Temporary
	H. Etkes (NE), Temporary
	J. Sigurgeirsson (NO)
	L. Palei (RU)
	B. Alhomaly (SA), Temporary
	Z.Mahyuddin (ST), Temporary
	C. Wehrle (SZ), Temporary
S. Riach (UK)	
	P. Pollard (US), Temporary

G. Tsibouris, Acting Secretary
V. Sola, Summing Up Officer
L. Briamonte, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Communications Department: W. Amr, N. Mombrial. Fiscal Affairs Department: B. Sarr. Finance Department: M. Kida, S. Matai. Legal Department: K. Kwak. Middle East and Central Asia Department: J. Azour, V. Bazinas, N. Blancher, M. El Qorchi, T. Koranchelian, I. Lukonga, J. Noah Ndela Ntsama. Monetary and Capital Markets Department: M. El Hamiani Khatat. Strategy, Policy, and Review Department: V. Kramarenko, B. Mircheva,

F. Raei. World Bank Group: A. Haddad. Executive Director: J. Mojarrad (MD), M. Raghani (AF). Senior Advisors to Executive Directors: P. Braeuer (GR), S. Potapov (RU), C. Williams (CO). Advisors to Executive Directors: F. Al-Kohlany (MI), K. Badsi (MD), L. Cerami (IT), A. Grohovsky (US), M. Mulas (CE), K. Osei-Yeboah (MD), I. Skrivere (NO), A. Zaborovskiy (EC), S. Alavi (MD).

3. MOROCCO—2019 ARTICLE IV CONSULTATION

Mr. Daïri submitted the following statement:

We thank staff for their balanced report and broadly agree with their main conclusions and recommendations. We welcome the greater attention given this year to authorities' views by reporting them at the end of relevant sections of the report, a practice that should become the standard.

Overview

In a global environment characterized by sub-par growth and fraught with uncertainty and risks, the Moroccan authorities continue to strengthen the economy's performance and resilience while preserving social stability and cohesion. Growth is projected in the staff report to stabilize at about 3 percent in 2018-19, and to accelerate to 3.8 percent in 2020 and 4 ½ percent by 2024, and inflation should remain subdued. Exports continued to grow strongly in 2018 but the current account deficit increased, reflecting higher energy prices and investment goods imports and lower grants, while reserves remain adequate at more than 5 months of imports, reflecting strong FDI and private borrowing. The deficit is projected to decline to 4 percent of GDP in 2019 and to stabilize at 3 percent or less starting in 2021, with reserves strengthening gradually over the medium term.

The authorities broadly agree with staff outlook and characterization of risks facing the economy. They agree that the current policy mix of accommodative monetary policy and slower fiscal consolidation is appropriate, given subdued inflationary pressures and current level of output gap. They are confident that past and ongoing structural reforms will lead to higher growth over the medium term. They see the impact on Morocco of tighter global financial conditions and security tensions in the region as moderate, as observed in the recent past, and the impact of protectionism and retreat from multilateralism as medium or low, given the structure of Morocco's trade and the authorities' diversification efforts.

Fiscal Policies and Reforms

Maintaining fiscal and debt sustainability while creating fiscal space for infrastructure, human development, and social protection of vulnerable groups is a key priority. The authorities remain committed to achieving their medium-term target of 60 percent debt-to-GDP ratio, helped by the announced privatization program. The increase in the fiscal deficit in 2018 was due to exogenous factors, as explained in the report. The 2019 Budget targets the same deficit as in 2018, but projected privatization revenue would reduce financing needs and help maintain the debt ratio at about the current level. The authorities are confident that stronger revenue collection efforts and tighter control of non-priority spending will help reduce the fiscal deficit and the debt ratio further. To mitigate the impact on growth, the decline in investment spending, compared to 2018, will be offset by the recourse to institutional and private investors which have indicated their interest in implementing and financing some projects originally in the budget pipeline and subsequently excluded from fiscal projections, without any impact on public or publicly-guaranteed debt. The recent decisions under the social dialogue are already covered by budget contingent funds.

The authorities intend to launch a comprehensive tax reform focused on broadening the tax base by reducing exemptions and distortions, reducing informality, improving compliance, and rendering the system simpler, more equitable, and more growth-friendly. The National Tax Conference (Assises Fiscales) held early this month, with participation from all stakeholders, issued a number of recommendations which will be the basis for drafting a framework law to guide tax reform over the next 5 years. The reform will also include local and parafiscal taxes, with the ultimate objective of a unified tax code. It is expected that half the revenue from broadening the tax base will be allocated to increase social spending and the other half to reduce tax rates.

Important structural fiscal reforms and initiatives are underway to reorient spending to priority infrastructure and social spending and enhance efficiency and quality service delivery. A draft reform of civil service is being finalized, work is ongoing on implementation of PIMA recommendations to enhance investment efficiency, and the decentralization program is advancing. The authorities are also making good progress toward consolidation of the fiscal and debt aggregates at the level of the general government, which is expected to better inform fiscal policy making. The authorities are working with World Bank assistance toward improving coordination, efficiency, and targeting of social protection programs, using a social registry under preparation. However, while poverty has significantly declined, it is crucial to properly identify vulnerable groups, which should not be limited to low income groups but also include many middle-class citizens at risk of falling into poverty.

Monetary, Exchange Rate, and Financial Policies

In a context of moderate inflation, slow, although gradually improving economic activity and credit growth, and satisfactory level of reserves, Bank Al-Maghrib (BAM) has maintained an accommodative policy stance, with a particular attention to meeting SME needs. The draft central bank law enhancing its independence and broadening its role to include financial stability and financial inclusion, which was subsequently enriched by the introduction of the emergency liquidity assistance, is at the final phase of adoption by parliament.

The safeguards mission conducted last January concluded that BAM safeguards remain strong in the areas of internal and external audit and internal controls. While BAM governance compares favorably with many peers, the mission suggested further improvements to align it with best international practice. The authorities agreed with the mission that these would be considered after adoption of the revised central bank law expected during this parliamentary session. The mission and BAM also agreed that the transition to IFRS standards would be implemented in the context of the national accounting system convergence project underway.

This first phase of the transition to flexible exchange rate regime was successful, with a gradual deepening of the interbank market and the exchange rate remaining well within the band without central bank interventions since March 2018. The authorities will seize the most appropriate opportunity to move to the second phase, while strengthening communication, in particular with SMEs, to increase awareness of the risks from greater exchange rate fluctuations and available hedging instruments. The authorities take note of staff assessment that the external position is moderately weaker than implied by fundamentals and desirable policies, an improvement over the previous assessment. However, they note that the current account model preferred by staff pointing to a moderate overvaluation results in a large residual of -3.6 percent (from -1.6 percent in the 2017 Article IV report), which cannot be explained only by worker-employer relations, while the two other models lead to opposite findings. They would therefore have preferred a more nuanced assessment.

The authorities continue to strengthen the supervisory and regulatory framework in line with FSAP recommendations. Supervisory capacity continues to be improved; IFRS9 was introduced for banks in 2018; a regulatory framework for conglomerates is under preparation; the macroprudential and crisis resolution frameworks are being enhanced; and Moroccan banks' presence abroad is being closely monitored in cooperation with host supervisors. The law on secured transactions adopted last month would promote off-court claims recovery, reduce NPLs, and increase bank willingness to lend, in particular for SMEs. The authorities are committed to further strengthening the AML/CFT framework in line with MENAFATF recommendations and to enhance supervision. A law published in March 2018 introduced compulsory exchange of information with foreign partners, in line with best international practice.

The National strategy for financial inclusion approved last month aims at addressing the significant gaps in access to financial services, and specific measures have already been adopted targeting SMEs, the youth, women, and the rural population. The recent increase in the cap on microcredit, in line with staff advice, will help develop the system further. A reform of the law on cooperatives adopted last November aims at easing procedures for their creation to meet the needs of a large segment of the population, while enhancing their governance and oversight. A Small Business Act is under preparation to address the constraints facing SMEs. The credit guarantee scheme will be revamped to simplify the system by reducing the number of windows from 12 to 2, expanding its coverage to all SMEs, and incentivizing good governance.

Structural Reforms

The authorities agree that the current pace of economic growth is not fast enough to significantly improve living conditions and reduce unemployment which is still high, in particular among the youth and women. They remain strongly committed to promoting higher, private sector-led, job-rich and inclusive growth by further improving the business climate, strengthening competitiveness, governance, and efficiency in public service delivery, upgrading human resources, and reforming the labor market while strengthening social protection of the vulnerable and reducing social, regional and gender inequalities.

Morocco gained 9 ranks in the 2019 Doing Business Indicators (60^{th} out of 190) and a cumulative 55 ranks since 2011 when it ranked 115 out of 183. The main progress was in starting a business, registering property, trading across borders, and resolving insolvency. Recently-adopted revisions to corporate laws are intended to enhance protection of minority shareholders, while the establishment in 2018 of a Mediator's office should promote off-court dispute settlement. A reform of the regional investment promotion centers was adopted in February 2019, to be followed by a new investment charter under preparation. Moreover, as per a law adopted in November 2018, all legal procedures for starting a business should be accomplished electronically, and an electronic platform for this purpose was established by law last January. With the recent appointment of its Chair and Board of Directors, the Competition Council has become operational.

The public enterprise sector's overall performance is positive, although with pockets of vulnerability. While preparing a draft law strengthening SOE governance, the authorities decided that it was time to reconsider the role of the SOE sector to better assess where public presence is needed and efficient, focus public enterprises on their core mandate, and sell nonstrategic assets to reduce public debt and finance priority infrastructure and social spending. In this context, a privatization program with an estimated yield of some $4 billion will be carried out during 2019-23 (half of the proceeds recurring to the budget and half to an investment fund). The program would also help revitalize the stock market and promote FDI. The list of SOEs or their assets open to privatization was amended last January to include those slated for privatization this year, and members of the transfer and evaluation committees have been appointed, with the first privatization expected to be completed in the summer. The authorities are also in the process of establishing a framework for assessing and mitigating fiscal risks in SOEs with the benefit of a recent TA mission.

Cognizant of the need to alleviate liquidity pressures of private and public enterprises, the authorities have accelerated the payment of accumulated tax credits. They have also taken the necessary regulatory and budgetary measures to preclude their recurrence. Efforts have also been made toward restoring good payment culture and practices in the private sector.

The authorities attach high priority to further strengthening public governance and fighting corruption. Their strategy covers a wide range of reforms, much of which have been implemented recently through appropriate legislation and regulation and others are under active preparation. The newly established anti-corruption agency (ICPC) will monitor implementation of and reporting on the program.

Improving education is critical to increase employment opportunities and productivity, in view of the significant gap in quality, despite the relatively high level of public spending in this area. A draft framework law for education, vocational training and scientific research submitted to parliament in September was tabled for discussion during a special parliamentary session last month but no agreement on the draft could be reached. The Government intends to seek parliamentary approval of the draft during this spring session after consultation with social partners.

The authorities are cognizant of the importance of reforming the labor market to increase its efficiency, including by enhancing flexibility while improving protection of employees to boost employment, in particular for the youth and women. The protracted discussions with partners under the social dialogue were not conducive to reaching agreement on labor market reform. Now that the social dialogue has been concluded, discussions on this important reform may resume soon. While the authorities appreciate staff analysis and recommendations on the sequencing of structural reforms, the pace and sequence of sensitive reforms need to be assessed with due consideration to political economy realities so as to preserve social cohesion.

Conclusion

The authorities have significantly accelerated the pace of structural reform over the last two years. They remain firmly committed to maintaining macroeconomic and financial stability and strengthening resilience. They look forward to continued support from their partners, including in the context of Fund valuable advice and technical assistance and the PLL arrangement, and are grateful for their support.

Ms. Pollard and Mr. Grohovsky submitted the following statement:

Economic growth in Morocco has continued in recent years, combined with an improved outlook and decline in external vulnerabilities. While some reform efforts have been taken, more reforms are needed to consolidate gains and put the economy on a sustainable footing. Redoubled efforts to strengthen the fiscal and external positions, while fixing structural impediments, are necessary for growth and to help Morocco continue to meet the PLL criteria.

Fiscal policy remains an area where further progress could be made. We welcome the tax reform proposals and efforts to hold down the wage bill, although further measures could be undertaken, including merit-based career progression and more flexible salary structures. With strong growth the authorities should move quickly and use the current window to ensure that deficits are reduced to levels that put debt-to-GDP on a steadily declining path. We believe there is scope to push debt levels below the 60 percent of GDP debt target in the medium term, and efforts should be continued even if the consolidation of public sector statistics results in lower debt levels. Further, could staff elaborate on the timing of the first of three large sovereign bond issuances that are set to take place between 2019 and 2022?

Growth-enhancing structural reforms are also needed to help bring down debt ratios. We note that the debt reduction path is predicated on growth rates above 4 percent a year. While these rates seem achievable, they could be facilitated or even increased by tackling longstanding challenges to economic activity. We commend the authorities' recent efforts to improve the business environment and welcome the ongoing focus on governance and corruption, public sector transparency and efficiency, and reversing the decline in female labor force participation. In addition to improving the debt picture, these reforms will help boost employment, tackling one of the most persistent problems in recent years.

We also welcome efforts and the authorities' stated commitment to transition toward exchange rate flexibility. Increased flexibility can be a useful component of strengthening the external position, facilitating current account adjustment and allowing for a build-up of reserves to adequate levels under various metrics. However, we would have welcomed more concrete information from the authorities on their plans this year and next to continue the transition. We note that the authorities wish to "wait for the opportune moment to move" but it is not clear what the authorities are looking for. Could staff opine on what conditions they think would allow for further progress and what their ideal timeline is?

Finally, we continue to call for the authorities to work with staff on a way to communicate an exit from the PLL at the end of the program, provided conditions warrant. The authorities should use the remaining time under this arrangement to fix the issues mentioned above, which will help ensure that the economy is on a sound footing when the PLL expires at the end of 2020.

Ms. Levonian and Mr. Weil submitted the following statement:

Thank you to staff for their report, including a timely Selected Issues note on promoting job-rich growth, and to Mr. Daïri for his helpful buff statement. Growth slowed in 2018 due to weak growth in the services sector, and the current account deficit widened due to energy prices, but on balance Morocco has strengthened its overall macroeconomic resilience. The fiscal stance remains broadly appropriate, inflation remains low and expectations are well-anchored, the gradual transition towards a flexible exchange rate regime continues, and progress has been made to upgrade the financial policy framework. However, there is still much structural work to be done to achieve a private sector-led growth model that is inclusive of women and youth. Morocco stands to benefit from improved efficiency of public spending in several key areas, including social programs and the public sector. Key risks to monitor include slower than expected Euro-area growth and oil price volatility. On the domestic front, a key risk is a slower than expected pace of reform, particularly given the ambitious structural reform agenda.

Public debt remains sustainable and on a downward path but there is room to better manage public spending. Higher global butane prices and grant underperformance led to a slowdown in fiscal consolidation in 2018, but the authorities continue to be guided by reasonable medium-term debt and deficit objectives. They are supported in these efforts by a privatization program that appears to be progressing well. We agree with staff that tax reforms should be pursued to help meet fiscal objectives, particularly given the vulnerability of public finances to exogenous factors, such as energy prices and grant underperformance. In this regard, we welcome the authorities' intention to launch comprehensive tax reforms to broaden the tax base, as outlined in Mr. Daïri's buff statement. Improving the efficiency of public spending could also provide the authorities with fiscal space to pursue much needed structural reforms. Areas of focus for efficiency improvements include social programs, which are poorly coordinated, fragmented and can be regressive, as well as the public sector where Moroccan taxpayers may not be receiving value for the high public sector wage bill.

Structural reforms are needed to make growth more inclusive and to improve the competitiveness of the business environment. With youth under- or unemployment as high as 50 percent in urban areas, Morocco should prioritize the adoption of active labor market policies. The authorities can also support youth employment by addressing disappointing outcomes in education, including in vocational training where, surprisingly, graduates face higher unemployment rates than general education graduates. We would have welcomed a comprehensive strategy to address high female unemployment and declining female labor participation rates. We do however welcome the authorities' 2019 National Strategy for Financial Inclusion, which should support greater female economic participation through increased financial inclusion and literacy. We support staff's priorities to reform the business environment, in particular facilitating SME access to financing, reducing payment delays, reactivating the Competition Council, and strengthening anti-corruption measures. What policies is Morocco pursuing to reduce female unemployment and reverse declining female labor force participation rates?

We look forward to the upcoming review of the Precautionary Liquidity Line (PLL). Despite overall risks being tilted to the downside, domestic tensions have subsided and the pressure on Morocco's external position is expected to ease with lower global oil prices. Morocco has strengthened its overall macroeconomic resilience. Against this backdrop, we look forward to a gradual PLL exit strategy being outlined in the forthcoming staff report in consideration of the risk environment, Morocco's external position, and oil price projections.

Mr. Mahlinza and Mr. Jappah submitted the following statement:

We thank staff for the informative set of reports and Mr. Daïri for his insightful buff statement.

We commend the Moroccan authorities for the steadfast reform implementation which has strengthened economic resilience in recent years. Over the medium term, growth prospects are expected to improve benefitting from sound fiscal and monetary policies, and an improved investment environment that supports competitiveness. Nevertheless, weaker- than-expected euro-area growth, uncertainty in global trade, geo-political risks, and delays in the implementation of key structural and financial sector reforms could pose downside risks to growth. We agree with the thrust of staff's appraisal and offer the following comments.

Achieving the government's medium-term fiscal and debt targets is conditioned on sustained fiscal consolidation and improved public investment efficiency. In this regard, we commend the authorities' efforts in maintaining fiscal sustainability through strong VAT collections and the containment of public expenditures. Going forward, implementation of the key recommendations of the just-ended national conference on taxation, which aims to increase the efficiency and fairness of the tax system, should be prioritized. We take note of the authorities' medium-term plans for greater reliance on PPPs. Could staff comment on the authorities' capacity to manage risks associated with the new investor-led innovative financing mechanism for new projects? Further, we welcome the ongoing reforms to strengthen SOE governance and performance as well as the adoption of transparent criteria for the transfer of public resources to the regions.

We positively note the continued efforts to modernize the banking system, as evidenced by the solid implementation of Basel III and FSAP recommendations. However, risks to the sector emanate from the expansion of Moroccan banks across the continent and concentrated credit exposures. Within this context, we welcome the increased collaboration with regional and host-country authorities to strengthen bank supervision; the move towards a risk-based and forward-looking supervisory framework; enhancement of the macroprudential and crisis resolution frameworks; and the introduction of new legal frameworks to address elevated NPLs. Further, we take note that a draft BAM law incorporating some past safeguards recommendations is being considered in parliament. We wonder whether it would not be expedient to include the latest assessment recommendations onto the same draft law, rather than submit additional amendments at a later stage. Staff comments are welcomed.

Sustained structural reform implementation remains critical to consolidate gains and promote higher and more inclusive growth. In this respect, we commend the authorities for the significant improvements in the Doing Business rankings. We also welcome the full operationalization of the Competition Council, including the appointment of the Chair and Board of Directors. This notwithstanding, more efforts are needed to address high unemployment, especially amongst the youth, eliminate labor market rigidities and pursue a more transparent and flexible regulatory framework, improve private sector competitiveness, and raise potential growth. On this premise, we see merit in strengthening vocational education and unlocking investment opportunities through the simplification of administrative procedures and development of quality institutions, including the newly- established anti-corruption agency, ICPC, to address corruption and money-laundering. The establishment of the ICPC should facilitate the implementation of the National Strategy Against Corruption, launched in 2015.

Mr. Fachada and Mr. Fuentes submitted the following statement:

We thank staff for the reports and Mr. Daïri for his comprehensive statement. Economic activity in Morocco slowed down in 2018, driven by lower agriculture growth and weak external demand. Against this background, authorities have maintained macroeconomic and social stability supported by an adequate policy mix and a strong commitment to reform. Sustained consumption growth and a rise in private investment and tourism are expected to support non-agricultural growth in 2019-20. Nonetheless, medium-term prospects would benefit from the continuation of a steady and adequately sequenced structural reform agenda to improve macroeconomic resilience and promote more inclusive growth.

Authorities remain committed to fiscal sustainability. Fiscal consolidation was temporarily interrupted by exogenous factors in 2018 but it is expected to resume this year. In this context, the preservation of capital spending in the 2019 budget and beyond is critical to support infrastructure. All in all, we welcome the authorities plan to accelerate tax reforms focused on broadening the tax base, reducing exemptions and streamlining the tax system, and their commitment to reducing the debt-to-GDP ratio to 60 percent in the medium term.

Transition to greater exchange rate flexibility should be carefully managed. Authorities are conscious of the benefits of a market-determined exchange rate for external sector sustainability and monetary policy effectiveness and remain committed to follow through with the process. In that vein, efforts aimed at deepening the foreign exchange market have started to bear fruit and have contributed to prevent a significant move of the currency. We commend the prudent approach adopted by the central bank, undertaking a well-structured communication strategy to ensure that economic agents are fully aware of the potential risks inherent to this transition process, as mentioned by staff.

Ongoing economic diversifying should remain a priority. Reliance on agricultural production continues to be a source of high GDP growth volatility in Morocco. The authorities have gradually fostered greater participation of the private sector in the economy to stabilize growth and support job creation. Actions taken to improve public sector efficiency, promote competition and increase financial inclusion are equally contributing to this objective. Yet, addressing lingering weaknesses in the business and competition environment are critical to boost entrepreneurship and open new opportunities for SMEs.

Steadfast progress in labor market reform is important to boost potential output and support improvement in social outcomes. While unemployment has slightly declined in 2018, it remains persistently high, particularly among the youth. Low female labor force participation and high informality remain key structural strongholds to be tackled by reform. Additional measures geared towards elevating labor productivity should be supported by more efficient spending in the access and quality of education. Against this background, we encourage authorities to continue the implementation of the National Employment Strategy and strengthen active labor market policies.

Mr. Inderbinen and Ms. Wehrle submitted the following statement:

We welcome the Moroccan authorities' improved policy and reform implementation over the recent years. Important reform steps have been achieved regarding the pension system, energy subsidies, the fiscal framework, the business environment, and the financial sector. These reforms have led to an increase in macro-economic resilience.

Further progress towards fiscal consolidation is needed to meet the medium-term debt-to-GDP objective. We take note that staff deems the current policy mix of accommodative monetary policy and slower fiscal consolidation adequate. However, we would like to point out that Morocco has underperformed in the fiscal area under the current PLL and that the fiscal position has improved less than expected under previous arrangements. We caution against slowing fiscal consolidation and underline the importance of ensuring that medium-term debt objectives are not deferred further. While the authorities believed that a debt ratio below 60 percent of GDP by 2021 would be feasible in 2016, the current DSA does not project such a level until 2024. We also note that the forthcoming change in the coverage of public sector statistics is not yet included in this assessment. Does staff have estimates of the impact of the change in coverage on public debt levels?

The current environment seems favorable to the transition to a fully flexible exchange rate regime. The Dirham has seen very limited fluctuations since early 2018 in an environment of increased EMDE currency volatility, and BAM has not intervened in the foreign exchange market since March 2018. Moving to the second phase of the transition to a flexible exchange rate would also help absorb potential external shocks and improve external competitiveness.

Structural reforms will be key to raise economic growth. In the fiscal area, improving the efficiency and fairness of the tax system should be a priority. We take note of the organization of a national conference on taxation this month. In what ways will the Fund be involved in tax reform? Reigning in the wage bill, ensuring transparency in the fiscal decentralization process, reforming SOEs, and implementing the PIMA recommendations would also help support longer-term growth. Moreover, we welcome that the authorities intend to strengthen governance through greater transparency, accountability, and the increasing use of electronic systems. The establishment of the anti-corruption agency is an important first step. We encourage the authorities to further strengthen the AML/CFT framework to address the findings of the recent MENAFATF assessment.

We encourage the authorities to speed up reforms to make growth more inclusive. Reducing inequalities and youth unemployment will be important to prevent a recurrence of the social tensions seen in 2017 and 2018. The steps initiated by the authorities to improve social program targeting and strengthen the business environment are useful. However, we note that Morocco continues to lag behind EMDE peers in many important social indicators and that female labor force participation is low and declining. Reform efforts to increase human capital and generate job opportunities, as well as to reduce inequalities, need to be intensified.

Mr. Saito and Mr. Minoura submitted the following statement:

We thank staff for the comprehensive reports and Mr. Daïri for his informative statement. We commend that macroeconomic vulnerabilities have been reduced under the four successive Precautionary Liquidity Line (PLL) arrangements. We also welcome that improved fiscal management and economic diversification have strengthened the resilience of Morocco's economy in recent years. Having said that, economic growth has not been robust enough and unemployment remains high. Against this background, we concur with staff's appraisal that sustained reform efforts are needed to achieve higher and more inclusive growth. As we broadly concur with the thrust of the staff appraisal, we will limit our comments to the following points:

Fiscal Policy

We agree with staff that fiscal consolidation will remain essential over the medium term to reduce public debt and preserve fiscal space for social and growth-enhancing spending. While the current accommodative fiscal policy stance remains appropriate in a context of subdued economic growth, the authorities' further efforts to accelerate tax reforms, including broadening the tax base and simplifying VAT and corporate taxation are needed to achieve the target of public debts to 60 percent of GDP in the medium term. In addition, continued efforts on public wage containment, careful implementation of fiscal decentralization and strengthened SOE's oversight are key priorities. In this light, it is a welcome step that a revised draft law to strengthen the governance and oversight of SOEs is planned to be submitted to parliament and the privatization plan will be started in 2019.

Monetary and Exchange Rate Policy

Given moderate inflation and subdued economic and credit growth, we share the staff's view that the current accommodative monetary policy stance is appropriate. We positively take note that a January 2019 safeguards assessment mission found that Bank-Al-Maghrib (BAM) has maintained strong operational controls. We also welcome that the draft central bank law incorporating past safeguards recommendations is at the final phase of adoption by parliament. Nevertheless, we take note that the latest assessment recommends further amendments to the BAM law on aspects related to autonomy and governance, and would like to hear staff's more specific explanation on what elements of the draft central bank law need to be strengthened.

We also concur with staff that continued efforts on the transition to greater exchange rate flexibility will strengthen external resilience. In this light, we welcome the authorities' strong commitment to continue the exchange rate transition and encourage to keep a well-structured communication strategy. Regarding a transition schedule, while staff recommended using the current window of opportunity to continue with the transition to a flexible exchange rate regime, the authorities plan to wait for the opportune moment to move, in the context of a well-structured communication strategy to ensure that economic agents are fully aware of the potential foreign exchange risks. We would like to know staff's view on the authorities stance on a transition schedule.

Structural Reform

We commend that Morocco's Doing Business ranking picked up recently reflecting the authorities' initiatives including the new bankruptcy law and the dematerialization of administrative procedures, and encourage the authorities' further efforts to implement reforms on the education system, the labor market, and the business environment to achieve higher and more inclusive growth. More efforts are needed to improve labor force participation and reduce unemployment, particularly among the youth and females. We would like to know reasons why female labor force participation is declining, despite women's improved access to education and public services. In addition, noting that low labor mobility and limited access to education, credit and affordable childcare exist behind the gender/generational gaps, we would also appreciate it if staff could elaborate more on possible policy measures to address the gaps. At the same time, deepening financial inclusion is critical to enhance opportunities for SME development and middle-class entrepreneurship. In this regard, we welcome that the new financial inclusion strategy approved in March 2019, which aimed at greater financial access for SMEs by increasing financial education, expanding electronic payment infrastructures and credit bureau coverage, and relaxing constraints on microcredit activities.

Mr. Sigurgeirsson and Ms. Skrivere submitted the following statement:

We thank staff for the comprehensive set of reports and Mr. Daïri for the informative buff statement. We broadly share staff's appraisal and offer the following comments on the structural reform agenda, fiscal policy, and financial sector issues for emphasis.

A strong commitment to implementing a comprehensive structural reform agenda will be key to enhance Morocco's growth prospects and strengthen economic resilience. We recognize that considerable progress has been made over the past years on improving the business environment. Nevertheless, further reforms will be needed to improve the functioning of the labor market and spur job creation, strengthen the link between education spending and the quality of outcomes, as well as to improve female labor force participation. We welcome staff´s useful analysis and policy recommendations on reform sequencing and prioritization provided in the Selected Issues Paper. We share staff's findings that a coordinated and well-sequenced structural reform package can yield greater benefits than if the reforms were implemented in isolation. While public protests have somewhat decreased, more efforts are needed to address the key reasons for these grievances, including improving governance, enhancing public sector transparency and accountability, and tackling the reasons behind perceptions of corruption.

We welcome the authorities' commitment to their medium-term fiscal targets. Gradually improving the fiscal balance and bringing the deficit to around 3 percent of GDP should result in a lower public debt burden without unduly weakening growth prospects. In addition to contained public spending, a key element of fiscally sound policies would be a comprehensive tax reform that broadens the tax base and reduces distortions. Could staff provide an update on the results of the National Tax Conference that was held in early May?

Morocco's financial system is resilient, but continued progress is needed to address remaining deficiencies. NPL levels remain relatively high, and we welcome the recent improvements in the legal framework that will help address this issue. We urge the authorities to address the weaknesses identified in the AML/CFT framework to avoid FATF listing. Could staff share the outcome of the MENAFATF Plenary discussion in April?

We note that another Board meeting on Morocco is scheduled a month from now. Has staff considered whether merging the two discussions (Article IV consultation and the first review under the PLL) into one could have been more efficient?

Mr. Kaya and Mr. Zaborovskiy submitted the following statement:

We thank staff for the well-written report and Mr. Daïri for his insightful buff statement. Preserving macroeconomic stability and advancing structural reforms remain critical for Morocco to further build up policy buffers, reduce vulnerabilities, and boost growth potential. We commend the authorities' sound policy mix and encourage them to use the current window of opportunity, ensured by the Precautionary Liquidity Line arrangement with the Fund, to strengthen the Moroccan economy's resilience and promote higher and more inclusive growth. We agree with the thrust of staff's appraisal and would like to make following remarks for emphasis.

Growth-friendly fiscal consolidation, and safeguarding priority investment and social spending remain essential to lower the public debt-to-GDP ratio. We welcome the authorities' commitment to reducing public debt to 60 percent of GDP over the medium term. Since staff mentioned that this objective may be affected by the forthcoming change in the coverage of public sector statistics (page 13, footnote 6), we welcome further elaborations on the methodological issues behind this revision. The balanced combination of fiscal consolidation measures, debt management efforts, and growth-enhancing structural policies allow public debt to be put on a firm downward path and create room for priority spending. The quality of fiscal measures is paramount for the success of this strategy and we are encouraged by the authorities' fiscal reform efforts outlined in the buff statement. We are also comforted that the budget objectives seem achievable in 2019 and encourage the authorities to further strengthen fiscal risks management and advance the medium-term budget framework.

Greater exchange rate flexibility, although cautiously introduced, could be instrumental in absorbing external shocks and preserving price competitiveness, while safeguarding FX reserves. The initial experience with a wider band of the dirham fluctuation seems to be positive, as volatility has been contained without extensive recourse to central bank foreign reserves. We note staff's conclusion that, notwithstanding the somewhat weakened external position, the current window of opportunity allows for a further gradual transition towards a more flexible exchange rate regime. In this context, we would like staff to elaborate more on the differences with the authorities in the External Balance Assessment results interpretation, including the large, unexplained residual. Could staff further clarify how "the complimentary structural tools" (page 41, para 4) have been used to explain it? We agree that a well-structured communication strategy, broad outreach to various constituencies, trainings, and other efforts remain critical to ensure a smooth transition process towards greater exchange rate flexibility.

Advancing a risk-based and forward-looking supervisory framework helps ensure financial stability. We positively note the authorities' progress in upgrading the financial sector policy framework in line with the 2015 FSAP recommendations. However, the notable cross-border expansion of Morocco's banks, as well as relatively high non-performing loan (NPL) levels, warrant vigilant monitoring and advanced supervision. We positively note the recently approved legislation facilitating off-court claims recovery and NPL resolution, as mentioned in Mr. Daïri's buff statement. Taking on board the recommendations of the latest safeguard assessment mission could further strengthen the central bank's autonomy and governance framework. We echo staff's call on the authorities to steadfastly address the weaknesses identified in Morocco's AML/CFT framework.

Well-sequenced structural reforms are essential to unleash economic growth and promote job creation. We welcome the analysis staff presented in the Selected Issues Paper, which shows the sizable effect of labor and product market reforms on growth and employment in Morocco. However, as suggested by the literature and observed in practice, these reforms may have short-term negative effects which are usually offset by longer-term gains. In this context, the due attention should be given to the targeted social safety nets to be in place when implementing such reforms. A fine balance between centralized and de-centralized systems to provide targeted social support should be found considering the ongoing fiscal decentralization in the country. We also agree that political realities should be taken into account when designing and implementing a comprehensive reform package; however, the timeliness of reforms remains critical to enhance the resilience of the economy and avoid building up vulnerabilities.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the detailed reports and Mr. Daïri for his informative buff statement. Morocco has benefitted from the reforms implemented under four successive two-year Precautionary Liquidity Line (PLL) arrangements over the last several years. Consequently, the country's macroeconomic vulnerabilities have reduced despite a challenging external environment, for which authorities deserve credit. Although growth has weakened in 2018 mainly due to lower agriculture growth, it is expected to pick up gradually to 4.5 percent in the medium-term. Headline inflation remains subdued with well anchored inflation expectations. Social tensions have been subsided, supported by measures taken to accelerate social programs and investment projects. Unemployment has declined, but only slightly.

Going forward, staff report has identified several important challenges. High unemployment, particularly among youth and women, and promotion of job-rich and inclusive growth through well-sequenced structural reforms remain among the key challenges. Hence, we urge authorities to accelerate the pace of reforms to strengthen macroeconomic resilience durably, to achieve higher and inclusive growth to create employment, and strengthen buffers against a future downturn. We broadly concur with the staff's assessment and would like to make following remarks for emphasis.

We positively note the authorities' commitment to strengthen the budget to reduce government debt to 60 percent of GDP in the medium-term. Accelerated tax reforms are important to increase revenue and preserve fiscal space for social and growth-enhancing spending amidst underperforming grants. The buff Statement indicates that the National Tax Conference (NTC) was held in early May 2019. Could staff broadly comment on the outcome of the NTC, which will be the basis for drafting a framework law to guide tax reforms to increase the revenue? This would be complemented by raising efficiency, including in public investment through better coordination in project planning and execution, as well as in social programs. Privatization receipts are expected to continue to reduce public financing needs. Could staff comment on the social response to the announced privatization program?

We agree with staff that the current accommodative monetary policy is appropriate, given the moderate inflation and subdued economic and credit growth. The adoption of new Central Bank Law will reinforce the independence of the Bank Al-Maghrib (BAM) with a broadened role to include financial stability and financial inclusion. We would welcome staff's comments on the progress in transiting towards the envisaged inflation targeting framework in Morocco.

Staff assesses that the external position is moderately weaker than implied by fundamentals and desirable policies. The external sector could benefit from the expected increase in exports, partly related to the flexible exchange rate in the medium-term, supported by the steadfast implementation of reforms while closely monitoring the impact of volatile oil prices. As elaborated in the buff Statement, authorities' commitment to implement the second phase towards greater exchange rare flexibility while strengthening communication is reassuring.

Morocco's banking system is well-capitalized, and their liquidity position is favorable. We commend the significant progress in upgrading the financial policy framework, including implementing Basel III and FSAP recommendations. However, non-performing loans (NPL), credit concentration and expansion in Africa, present risks. In particular, the rapid expansion of Moroccan banks, domestically as well as in Africa, and increasing complexity of the financial sector, pose additional risks. Hence, we agree with staff on the need for continued efforts to upgrade the financial sector policy framework. Like staff, we encourage the authorities to strengthen Morocco's AML/CFT framework by addressing already identified weaknesses.

Structural reforms need to continue, particularly in the labor market and education system, to support growth process. As indicated in Box 3, a coordinated set of reforms to reduce hiring costs and entry barriers for firms will be more effective in boosting growth and job creation, going forward. We support the authorities' efforts to improve education and skill development. More efforts are imperative to increase low and declining female labor force participation. The progress in improving the business environment, which has led to a steady movement upwards in the Doing Business Rankings, is commendable. The ongoing reforms would help increase the business climate further while diversifying the production base. We welcome the recent appointment of the Chair and Board of Directors of the Competition Council, enabling its operations.

With these remarks, we wish Moroccan authorities all success in their future endeavors.

Mr. Johnston and Mr. David submitted the following statement:

We thank staff for their comprehensive set of reports and Mr. Daïri for his informative buff statement. Morocco is one of the better performers in North Africa and we commend the authorities on their ongoing efforts to improve fiscal management and economic diversification. Successive Precautionary and Liquidity Line arrangements have assisted the authorities to strengthen buffers and pursue their reform agenda, but more remains to be done to build macroeconomic resilience and facilitate inclusive growth.

The national tax conference is a positive step around which a consensus could form on future reforms. The key tax priorities from staff include a number of sensible suggestions like broadening tax bases and better enforcement, which are both good tax policy and would help raise revenue to meet the 60-percent-of-GDP debt target. We are a little confused by the statement that a slower fiscal consolidation remains appropriate but at the same time the authorities should increase tax revenue by 0.7 percent by next year. Could staff expand on their thinking?

Morocco has a vibrant financial system, whose banks are well capitalized, have favorable liquidity positions and are continuing to expand their footprint in Africa. The strength of these banks is important for regional integration within the Maghreb, given the significant cross-border expansion. We welcome the authorities' efforts in enhancing the supervisory framework in Morocco and in co-operating with other jurisdictions. We also commend the authorities on their efforts to strengthen financial sector resilience and soundness, including by implementing 2015 FSAP recommendations and IFRS9 requirements, introducing new legal frameworks for bankruptcy and collateral, and acting on the recent AML/CFT assessment.

We thank staff for the selected issues paper which provides a road map for structural reforms aimed at job-rich growth. We agree that a coordinated set of reforms that reduces hiring costs and entry barriers for firms is preferable. However, the authorities may have to sequence reforms carefully, given completing priorities, capacity constraints and expected delivery timelines. Efforts are already ongoing in many areas to improve the business environment, increase public sector efficiency and address governance issues. The youth unemployment rate remains stubbornly high, at over 25 percent. Do staff think this is mainly an issue of skills mismatches (e.g., young people leaving school without work-ready skills) or of labor market rigidities? On governance, we agree that communication around the national corruption strategy will be important to build public understanding and buy-in, including for the work of the anti-corruption agency.

Mr. Mozhin and Mr. Potapov submitted the following statement:

We thank staff for a set of insightful reports and Mr. Daïri for his informative buff statement. The authorities have made important progress in reducing domestic vulnerabilities and preserving macroeconomic stability over the recent years. Building on recent progress, further efforts are needed to boost growth potential, improve the business environment, reduce unemployment, promote inclusion, and strengthen labor markets. We note that the authorities broadly agree with staff on the analysis of current developments and long-term challenges, as well as on policy recommendations.

According to staff, the current mix of accommodative monetary policy and slower fiscal consolidation is appropriate due to subdued inflationary pressures and the ongoing slowdown in the euro area. GDP growth prospects are favorable, as it is projected to reach 3 percent this year and move gradually to its potential of 4.5 percent by 2024. Inflation is projected to slow down to 0.6 in 2019 and to stabilize at around 2 percent over the medium term. The fiscal deficit has been reduced over the recent years, and staff assess public debt as sustainable. The current account deficit is expected to narrow to around 3 percent over the medium term. The ARA metric adjusted for capital controls points to a sufficient level of foreign exchange reserves.

According to staff's DSA, public debt remains sustainable and resilient to various shocks. Nonetheless, its level has been climbing up over the recent years. Public debt was at about 65 percent of GDP in 2018 vis-a-vis 56.5 percent of GDP in 2012. Against this background, we welcome the authorities' plans to reduce public debt to 60 percent of GDP and fiscal deficit to around 3 percent of GDP over the medium term. The authorities are well advised to design a comprehensive tax system and civil service reforms, as well as strengthen public investment management and monitoring of fiscal risks. Could staff elaborate on any contingency fiscal plans in case of slower growth, revenue shortfalls, or expenditure overruns? Could staff also comment on the impact of the expected change in the coverage of public sector statistics (from central to general government) on the level of public debt?

We agree with staff that a more flexible exchange rate regime will help improve external competitiveness of the Moroccan economy. Staff argue that the overall conditions for the introduction of greater exchange rate flexibility remain in place, including sufficient external and fiscal buffers, financial sector resilience, and limited currency risk exposures. At the same time, changes in the monetary policy regime under the current more volatile global financial conditions and heightened uncertainty could trigger substantial market pressures with adverse implications for financial stability. Against this background, we welcome the authorities' cautious approach to further changes in the exchange rate regime. We also highlight the need for a well-structured communication strategy.

We welcome the authorities' focus on improving governance, reducing inequalities, enhancing human capital, and addressing the weaknesses in the business and competition environment. Strengthening AML/CFT framework and SOE governance will be important steps in this area. The privatization plan can lead to a more efficient role of the state in the economy. We agree with staff that more efforts are needed to reduce youth unemployment and adress the size of the informal economy. At the same time, the comprehensive financial inclusion strategy can support greater financial access for SME. We also welcome the authorities' attention to the country's ranking in the World Bank's Doing Business indicators, which is instrumental for advancing necessary structural reforms.

Mr. Di Tata and Mr. Morales submitted the following statement:

We thank staff for the well-written report and Mr. Daïri for his informative buff Statement.

In recent years Morocco has embarked on a process of continuous reforms, which has contributed to reduce vulnerabilities. These reforms have been accompanied by prudent policies that have helped maintain macroeconomic stability. However, weaker agricultural growth, following two years of strong production, explains a deceleration of economic activity and some increase in headline inflation in 2018. Still, inflation has been contained, with core inflation slightly above one percent. Unemployment declined slightly, although not for youth and female labor, as shown in Figure 1 of the staff report. Social tensions arising in 2017 associated with demands for better access to public services and a negative reaction to higher gas prices have abated.

We commend the authorities for their commitment to contain the fiscal deficit at 3.7 percent of GDP in 2019, including through measures to compensate for revenue losses from the introduction of progressive corporate taxation. Complemented by prudent spending management, the fiscal stance has remained neutral, as measured by the cyclically-adjusted primary deficit. Going forward, an additional fiscal effort is necessary to maintain fiscal and debt sustainability while creating fiscal space for infrastructure, human development, and social protection of vulnerable groups (all government priorities, as indicated in Mr. Daïri's statement). The focus should be on accelerated tax reforms to achieve the objective of reducing public debt to 60 percent of GDP over the medium term. In this regard, we welcome the authorities' plans to frame future tax reforms within a multi-year framework and encourage them to continue with their efforts to broaden the tax base, including by reducing exemptions and enhancing enforcement. In addition, structural fiscal reforms to reorient spending towards priority infrastructure and social spending would contribute significantly to making growth more inclusive.

We agree with staff that greater exchange rate flexibility would make Morocco's economy better positioned to absorb shocks. In this regard, we welcome the authorities' decision to widen the dirham fluctuation band to +/-2.5 percent around the reference parity, from +/-0.3 percent previously. Stability in the foreign exchange market suggests that supply and demand of foreign exchange are in balance, as described in Box 1. Moreover, the interbank foreign exchange market shows increasing turnover, despite banks holding long foreign exchange positions. On a related matter, could staff explain the reason why banks have tripled their net open position in the last two years, as indicated in Table 6? A more flexible exchange rate regime would also allow the central bank to take more decisive steps towards introducing a fully-fledged inflation targeting regime. However, as the authorities have indicated, a well-structured communication strategy would be necessary to avoid market disruptions.

We welcome Morocco's progress in enhancing banks' consolidated risk management for cross-border activities. The ongoing expansion of Moroccan banks in Africa is a source of diversification but entails new vulnerabilities that need to be addressed. We would appreciate additional information on the scale of operations of Moroccan banks abroad relative to their total assets and on how these operations have evolved in recent years? Regarding financial access, as illustrated in Annex V, despite relatively high bank intermediation, progress on financial inclusion has been modest. Micro-credit represents only 0.6 percent of GDP and the finance gap for micro, small and medium enterprises is larger than in peer economies. In addition, households have low access to financial services, with only 29 percent of the adult population holding accounts in financial institutions. The National Strategy for Financial Inclusion launched in early 2019 would provide an opportunity to address key challenges hampering progress on this front, including the low use of mobile and digital payments, lack of incentives for bank penetration, and insufficient credit scoring systems. We would welcome a description by staff of the current credit ceilings and interest rate caps hampering financial inclusion that are referred to in Annex V, paragraph 6.

The recent improvement in Morocco's business environment is commendable but more remains to be done. Morocco moved up in the World Bank's Doing Business ranking to 60 in the world in 2019, from 115 in 2011. Key actions explaining this improvement include the dematerialization of administrative procedures, a new bankruptcy law, and the implementation of a competition council. However, further decisive steps are needed to raise total factor productivity significantly and bring down unemployment. In this regard, we find the analysis in Box 3 quite useful in highlighting the measures that could have more impact on this front, including more flexible contracts, alignment of the minimum wage with labor productivity, narrowing of skill mismatches, and lower entry barriers for firms. We agree with the staff's conclusion that a coordinated set of reforms would be more effective in boosting growth and job creation than isolated actions.

We encourage the authorities to continue improving governance in all fronts. In particular, the implementation of the new information access law, the roll out of digital platforms, and the efforts under way to promote e-government are steps in the right direction. Regarding fiscal decentralization, we welcome the adoption of transparent criteria for the transfer of public resources to regions and encourage the authorities to remain vigilant in this area, given their increasing magnitude. Additional key measures include the prompt approval of the law to strengthen SOE governance and oversight and the adoption of the Public Investment Management Assessment (PIMA) recommendations regarding coordination of project planning and execution, legal safeguards to operationalize public-private partnerships, and better risk management.

We welcome the authorities' commitment to implementing the National Strategy Against Corruption. The forthcoming strategy implementation report would be a good opportunity to raise awareness of the progress made to reinforce public trust and encourage a vigilant attitude to tackle corruption and money-laundering challenges. We commend the authorities for the decisive steps already taken in this area, including the strengthening of the legal framework, the activation of the anti-corruption agency, and improvements in the asset declaration system. We also welcome the authorities' intention to introduce legislation on illicit enrichment, and to further strengthen the AML/CFT framework in line with the recent assessment by MENAFATF.

With these comments, we wish the Moroccan authorities every success in their future endeavors.

Mr. Merk and Mr. Braeuer submitted the following statement:

We thank staff for its comprehensive set of reports and Mr. Daïri for his informative buff statement. We mostly concur with staff's recommendations. Supported by a generally positive policy and reform implementation, macroeconomic vulnerabilities have been reduced in recent years despite a challenging external environment. At the same time, risks to the outlook remain somewhat tilted to the downside. Against this backdrop, staff rightly calls for continued fiscal consolidation efforts to secure fiscal sustainability and for accelerating the implementation of the structural reform agenda including strengthening governance and combatting corruption. To increase resilience to shocks, further progress towards greater exchange rate flexibility remains of the essence. Since we are in broad agreement with staff's assessment, we would like to emphasize only the following aspects:

On fiscal policy, we agree with staff that accelerated tax reforms are needed to bring the overall deficit to three percent of GDP and meet the medium-term debt-to-GDP objective. In this context, staff rightly accentuates that creating and preserving fiscal space for much-needed social and growth-enhancing spending requires bold measures to increase efficiency and fairness of the tax system.

Notwithstanding achievements in strengthening the business environment, more efforts are needed to raise human capital, to foster more job opportunities and to reduce inequality. Morocco's educational system continues to be among the lowest performing compared with EMDE peers. Unemployment, in particular among the youth and women, remains high and female participation in the labor force is low and declining. Against this background, we encourage the authorities to press ahead with reforms aiming at improving the quality of the education system, the functioning of the labor market, and ensuring that social programs are well-targeted at the most vulnerable. We welcome the authorities' reform commitment in the context of the G20 Compact with Africa (CwA) initiative and we encourage our partners in the G20 to further increase engagement in the CwA.

We welcome the selected issues paper on macroeconomic effects and most appropriate sequencing of structural reforms. We would like to underline that according to staff's findings labor and product market reforms are most effective in promoting job-rich growth when implemented simultaneously. If reforms need to be sequenced, however (e.g., due to capacity or political constraints), staff's analysis suggests the need to prioritize – at least in the short run – either faster boosting output through product market reforms or reducing unemployment through labor market reforms more quickly. In this context, we note that staff tends to recommend prioritizing labor market reforms in order to reduce the unemployment rate faster in the case of Morocco. However, this assessment rests in our view to a large degree on the fact that in the model simulation the increase in formal employment outpaces the number of potential layoffs leading to the absence of (short-term) adjustment costs as often found in the literature (in particular in periods of slack). We note that "several robustness checks were performed to ensure that the main findings are not sensitive to the assumptions made to calibrate the steady state" but still wonder how sensitive staff's findings are to the calibration of some model parameters such as the assumed firing probabilities or the elasticity of substitution between goods from the formal and informal sector. Further elaboration by staff would be welcome.

We look forward to the upcoming review of the Precautionary Liquidity Line (PLL). Given the continued progress made in reducing macroeconomic vulnerabilities and enhancing the resilience of the Moroccan economy, we encourage staff and authorities to consider and implement more decisive steps towards a timely exit from the PLL.

Mr. de Villeroché, Ms. Riach, Mr. Castets, Mr. Hemingway and Mr. Rozan submitted the following joint statement:

We would like to thank staff for their clear and focused report, including the selected issues note, as well as Mr. Daïri for his comprehensive buff statement. Morocco has started to diversify its economy while maintaining an adequate fiscal policy and has led a series of important reforms over the past years. Poverty has been reduced substantially. The country is now at a turning point, in the sense that it needs to sustain higher and more inclusive growth. This will require substantial institutional reform, including substantially upgrading the education system, as well as reforms to encourage a vibrant private sector ecosystem and a business environment conducive to investment and contestability. We share staff's main conclusions and wish to offer the following comments.

Even though the country has implemented a series of important reforms over the past few years, growth has not yet reached the level sufficient to provide economic opportunities to every Moroccan, nor to substantially reduce unemployment, especially among the young. We share staff assessment on the needs for a sustained reform agenda over the medium term, especially since risks remain tilted to the downside, in a context of regional uncertainties, lower growth prospects among its European neighbors and volatile financial conditions. We also note the significant size of the informal economy in Morocco (staff estimate at 11 percent of GDP); reducing informality has the potential to raise wages and productivity, while also generating potentially significant tax receipts. The authorities should therefore use the current policy momentum to implement key fiscal and structural reforms.

The current pace of fiscal consolidation continues to be appropriate, though we stress the need to accelerate tax reforms. The country has been able to maintain control over its fiscal deficit, and has implemented some welcome fiscal reforms, such as more progressive corporate taxation and reining in public spending. Going forward, building up adequate buffers will require broadening the tax base, simplifying VAT and corporate tax, and better enforcement and raising of property tax. We commend authorities for organizing a national conference on taxation to raise the public interest and ownership of these matters and would welcome further details on the elaboration of the 5-year action framework mentioned in the buff statement. We believe accelerated tax reform should be accompanied by coordinated social spending to ensure a progressive distributional impact and protect the poorest and most vulnerable. We also encourage authorities to maintain adequate control over fiscal risks, particularly those related to SOEs, PPPs and local government. In this regard, we would welcome staff comments as to the prioritization of future PPP projects. Finally, we understand that a recent agreement between government and trade unions has led to an increase of the minimum wage and of the public sector wages. We would welcome staff comments on its budgetary impact.

We note that monetary policy has remained accommodative and that inflation is moderate. The forthcoming adoption of a draft law enhancing the independence of the Central Bank and its role in financial supervision is a very positive step. We encourage the authorities to continue on their path to greater exchange rate flexibility, to preserve buffers and increase the competitiveness of the economy, which will prove useful if an external downside risk were to materialize. We share the authorities' view that finalizing this transition will require a well-structured communication strategy as well as training and outreach. We share the staff assessment that the financial sector remains resilient, and we support current efforts to enhance the stress testing and macroprudential policy framework. We also encourage authorities to address AML/CFT framework deficiencies. Finally, the comprehensive financial inclusion strategy recently launched is very positive, and follows recent positive legislative changes on collateralization.

We welcome efforts described in the report to make the public sector more transparent and accountable. The implementation on the National Strategy Against Corruption will be a milestone, and adequate communication will reinforce public trust. Reforming the public sector will also create opportunities for the private sector, in terms of contestability, business opportunities and ease of doing business. We emphasize the effective implementation of legislated reforms will be key to realizing their potential benefit. In this regard, we commend authorities for operationalizing the Competition Council, and we hope to be informed in due time on its activities and decisions. We also encourage authorities to continue making progress on fiscal decentralization, SOE governance and oversight, and public investment management. In this regard, we would welcome staff comments on the current privatization program and, in particular, whether the list of companies currently targeted will effectively make way for a more strategic approach to the role of the public sector, as described in box 2. Reinforcing inclusion and fighting inequalities is necessary; though social programs appear sizeable, their efficiency appears underwhelming. The middle class appears vulnerable, and regional inequalities are high. We encourage authorities, with the help of development partners, to step up their efforts in this regard. Finally, we are concerned that Morocco has witnessed a sustained drop in the already low female participation rate. We would welcome specific comments on this diagnostic and policy levers that could be used to address this.

We would like to thank staff for their very useful analysis of implementation modalities and impact of labor market and product market reforms. Unemployment remains high and labor regulation displays rigidities; the education system has important inefficiencies that hamper human capital formation; and the product market has high barriers to entry. Combined reforms of the labor and product market would bring significant positive impact over the medium term, as would improvements to the education system. Nevertheless, we would welcome further details on the distributional impact of labor market reforms on the different categories of the population, to help the policy response to possible negative consequences.

Mr. Mouminah, Mr. Alkhareif and Mr. AlHafedh submitted the following statement:

We thank staff for the comprehensive set of reports and Mr. Daïri for his insightful buff statement. We are in broad agreement with the thrust of staff assessment and recommendations and would like to make the following comments for emphasis.

We take positive note of Morocco’s sound economic fundamentals and institutional policy framework. Despite the current global environment, higher uncertainty, and elevated risks, the authorities continue to strengthen the economy’s performance and resilience while making notable progress in reducing domestic vulnerabilities in recent years. They have demonstrated a long track record of implementing sound macroeconomic policies and we are encouraged by their renewed commitment to maintaining such policies and accelerating the reform momentum in the coming years. In this context, we agree with staff that the current policy mix is appropriate.

Against this background, we look forward to the upcoming review of the Precautionary Liquidity Line (PLL). We believe that the PLL continues to provide additional safeguards against external shocks and underpin the ongoing reforms to enhance economic resilience and foster stronger and more inclusive growth. At the same time, we are encouraged by the authorities' firm commitment to maintaining macroeconomic and financial stability and strengthening resilience.

We agree with staff that further progress towards fiscal consolidation will help absorb the potential impact of fiscal risks. As higher-than-expected fiscal deficits could result from slower growth, the continued implementation of tax reforms is needed to bring the fiscal deficit to about 3 percent of GDP. In this context, we take positive note of the authorities' intention to launch the comprehensive tax reforms resulting from the recent National Tax Conference, which focus on broadening the tax base and making the system simpler and more growth-friendly. Furthermore, we look forward to the implementation of other structural fiscal reforms and initiatives that are underway to reorient spending to priority infrastructure and social spending.

The financial system is resilient, and we look forward to the approval by parliament of the BAM's new draft law to upgrade the financial sector policy framework. In this context, we seek staff's elaboration on the level of alignment between the new draft law and the 2015 FSAP recommendations? And what further amendments to the BAM law is staff proposing for consideration later?

Finally, we encourage the authorities to continue their labor market reform agenda to promote employment, particularly for the youth. In this regard, we welcome the efforts to improve the business environment and financial inclusion, illustrating the authorities' commitment to move toward more private sector-led growth and job creation. We look forward to sustaining the implementation of reforms to facilitate job creation and to improve the quality of education outcomes and vocational training.

With these comments, we wish the authorities further success.

Mr. Geadah and Mr. Al-Kohlany submitted the following statement:

We thank staff for their comprehensive reports and Mr. Daïri for the informative buff statement. Morocco has sound economic fundamentals, institutional policy frameworks, and policies. These factors helped to strengthen macroeconomic resilience, enhance the business environment and governance, and substantially reduce poverty in recent years. The authorities implemented difficult reforms, especially regarding the pension system, energy subsidies, fiscal framework, business environment, and the financial sector. Although economic activity weakened slightly in 2018, there is an upside growth potential going forward as structural reforms yield results and lead to productivity gains. We broadly concur with the staff appraisal.

In a context of subdued economic and credit growth and low inflation, staff rightly acknowledge that the combination of slower fiscal consolidation and accommodative monetary policy is appropriate. In the medium term, fiscal consolidation efforts should continue, as indicated in the staff report. This consolidation would be facilitated by improvements in tax collection and tax policy and administration. To this end, and as noted by Mr. Daïri, the National Tax Conference is an important step to build consensus around the needed tax reforms and help anchor future tax reforms within a multi-year framework. The framework would ensure a stable and predictable tax environment and help harmonize the different tax provisions.

Morocco's financial sector is well capitalized, liquid, and resilient. However, staff indicates that risks stemming from large credit exposures remain despite strict regulatory limits. We welcome the ongoing steps to enhance the financial sector framework in line with FSAP recommendations, including new legal frameworks for bankruptcy and collateral regimes, which should help reduce NPLs. We note the progress in enhancing banks' consolidated risk management for cross border activities, in collaboration with host countries, to maximize bank diversifying operations and profit opportunities, while minimizing the potential for risk transmission.

We support the authorities' move toward greater exchange rate flexibility. We commend them for initiating this transition in January 2018 and note that they have not intervened in the foreign exchange market since March 2018. The authorities' gradual and orderly approach in transitioning to a more flexible exchange rate regime is appropriate, with due consideration to constraints and risks. We also share the authorities' observation with respect to the uncertainty around the external sector assessment and their preference for a more nuanced assessment, based on the EBA current account approach, particularly considering the large unexplained residual and conflicting results arising from the different methods.

We take note of the authorities' commitment to improve labor market efficiency and to increase women and youth labor participation, guided by the measures in the National Employment Strategy, as indicated in the buff statement. Improving the labor market will help improve Morocco's competitiveness, unlock the economy's potential, and reduce unemployment. We concur with the SIP's findings on the importance of a well sequenced and coordinated set of reforms aimed at reducing hiring costs and entry barriers for growth and job creation. Nonetheless, we agree with Mr. Daïri that the pace and sequence of sensitive reforms need to be assessed with due consideration to political economy and social realities.

Mr. Moreno and Ms. Mulas submitted the following statement:

We thank staff for its complete and insightful report and informative paper. We also thank Mr. Daïri for its candid buff statement. We welcome the section on raising growth and inclusion, including a specific reference on inequalities, and the table on inclusive growth indicators which we find very illustrative and complete. We encourage staff to standardize this table in country reports. Staff's comments are welcomed.

Staff's growth projections are higher than national projections. Compared to its December 2019 projections (PLL report) staff has reviewed GDP growth down to a 3 percent in 2019 (-0.3) with risks titled to the downside. However, the state statistics and planning body, Haut-Commisssariat au Plan (HCP) or the Bank al Maghrib (BAM) expect a further slowdown in 2019. HCP preliminary data in the first quarter of 2019 shows a 2.3 percent year-on-year growth with weaker than expected performance in the agricultural sector that seems to have weighted on activity due to the poor rainfall at the beginning of the year. Could staff elaborate on the difference in 2019 growth estimates?

Sound macroeconomic policy and the PLL are crucial to mitigate downside risks. As staff notes, significant external risks cloud the outlook, such as trade tensions, geopolitical risks, high oil prices, tension in financial markets and weaker growth in the euro area. On the domestic side, social tensions have waned thanks to the acceleration of social programs and investment, but they could surge again if the underlying causes of popular discontent, such as corruption, a weak judiciary, and the widespread inequality are not fully addressed. Therefore, we encourage authorities to continue implementing key reforms to foster growth and reduce inequalities, particularly by improving the coordination of social programs and by addressing middle class vulnerabilities. The role of PLL is also important to continue bolstering economic confidence in Morocco, as well as to support authorities' reform agenda.

We welcome that authorities are committed to maintaining fiscal and debt sustainability while creating fiscal space for human development, social protection of vulnerable groups, and infrastructure. While we support the need to address social and investment spending, we deem necessary to stabilize the fiscal deficit at around 3 percent of GDP by 2020 to gradually reduce public debt. Therefore, we welcome authorities' objective to launch a comprehensive reform to increase the efficiency and fairness of the tax system. Staff notes that this reform could imply an increase in tax revenues of about 1.6 percent of GDP over the medium term. The National Tax Conference to guide tax reform is a constructive development that can raise ownership among stakeholders. The forthcoming privatization program will also be key to lower government financing needs and to improve the performance of SOEs. Could staff advice on the progress regarding the calendar and process of the privatization program? Could the list of SOEs eligible for privatization be further expanded? The DSA update considers that Morocco's public debt remains sustainable and that public debt is generally resilient to shock; however, gross financing needs have exceeded the benchmark of 15 percent of GDP in 2014. Against this background, the PLL plays a major role as it strengthens Morocco's ability to access financing.

We encourage the authorities to continue with financial sector reform. Morocco's financial system is resilient, but relevant vulnerabilities remain. We note that some of the FSAP recommendations have already been implemented; however, many of the immediate or near-team recommendations are still in progress. Further efforts are needed, particularly to improve the crisis management and bank resolution frameworks. We strongly encourage authorities to step up their efforts to address the weaknesses of AML/CFT measures as they risk being categorized as a country with strategic deficiencies by the FATF.

The transition to the second phase of flexible exchange rate needs to be adequately calibrated and communicated. While we support the transition to a more flexible exchange rate regime, further and faster flexibilization could be assessed based on Morocco's integration in the global value chain and its oil dependency. Therefore, we support authorities in their intention to seize the most appropriate opportunity to move to the second phase, while strengthening communication, particularly to SMEs, to increase awareness of the risks from greater exchange rate fluctuations and available hedging instruments.

Structural reforms are necessary to improve Morocco's external competitiveness and to boost inclusive growth. Staff projects that the current account deficit will decline in 2019 to 4 percent of GDP, and to 2.8 percent of GDP over the medium term, driven by strong export growth in phosphates as well as the aeronautics and automotive sectors, among others. We welcome this trend which would reflect that the diversification strategy is bearing fruits. To maintain this positive development, we encourage authorities to foster structural reforms, particularly by improving the education system and labor market functioning, to improve its competitiveness and inclusive growth. Improving external competitiveness is the adequate way to address the current trade deficit, rather than taking protectionist measures.

Further efforts are needed to increase female participation in the labor market. Staff notes that despite women's improved access to education and public services, female participation in the labor force is low and declining. Could staff elaborate on the underline causes of this trend? We also note that Morocco performs worse than EMDE average in all gender indicators but one in the table of inclusive growth indicators. To address this outstanding challenge, we agree with staff on the need for further efforts to improve female schooling and increase access to affordable childcare.

Mr. Fanizza, Ms. Mahasandana, Mr. Rashkovan, Mr. Etkes, Ms. Cerami and Ms. Ong submitted the following joint statement:

We thank staff for the comprehensive set of papers and Mr. Daïri for his informative buff statement. We welcome Morocco's progress toward greater economic resilience and strongly support the ongoing reforms to boost growth and inclusiveness. We broadly agree with staff's appraisal and recommendations and offer a few comments for emphasis.

We share staff's view that a slower fiscal consolidation continues to be appropriate. Despite the recent slowdown in fiscal consolidation, largely due to exogenous factors, the fiscal deficit is expected to improve, helped by recent fiscal reforms and projected privatization receipts. We welcome the authorities' envisaged comprehensive tax reform and the focus on reorienting spending on infrastructure and social spending.

We commend the authorities for the successful transition to a more flexible exchange rate regime. The dirham has remained broadly stable following the widening of the fluctuation band around the reference parity, suggesting that the previous EBA had overstated the extent of the REER overvaluation. Nevertheless, the CA EBA model still indicates a moderate overvaluation of the REER, while the REER model indicates undervaluation. As "Directors highlighted the importance of using … results from all EBA models" in the context of the ESR 2018, we believe that the Fund should better highlight the inherent uncertainty of the external sector assessment, particularly given the conflicting signals in Morocco's case. Therefore, we share Mr. Daïri's doubts on the reliability of the CA model's estimated overvaluation of the REER and would welcome staff's elaboration of their assessment. We also see scope for more clarity over the breakdown of domestic and external policy gaps, in order to better inform the policy discussion. We also urge staff to carefully communicate their findings in a way that would not undermine the envisaged second phase of liberalization.

With greater exchange rate flexibility, monetary policy needs to play a more active role. The monetary policy stance has appropriately remained accommodative, amidst low inflation and moderate credit growth. We encourage the authorities to swiftly adopt the new central bank law and to consider further improvements of the central bank governance in line with staff's recommendations. Consistent with the transition to a more flexible exchange rate regime, the central bank stopped intervening in the foreign exchange market. While international reserves have declined slightly, the decline should be viewed in the context of lower intervention needs under a more flexible exchange rate regime. We therefore caution against the mechanical use of the standard metric to judge the adequacy of the reserve position. While we agree with staff that the conditions for continuing the transition to greater foreign exchange flexibility are met, we would have appreciated further analysis of the monetary policy implications. Could staff elaborate on what measures are being taken by the central bank in preparation to the transition toward a fully-fledged inflation targeting regime?

Progress in economic reforms has been remarkable but further efforts are needed to raise human capital and reduce inequalities, particularly in the rural areas. Morocco has successfully implemented several important reforms, as also evidenced by the large gains achieved in the Doing Business Indicators. Nonetheless, large gaps remain in the business environment, quality of education, rural development, and labor force participation, which declined by about 5 percent points since the mid-2000s. Staff recommend a mix of product and labor market reforms aimed at reducing firm's entry costs and hiring costs, based on their estimated impact on growth and employment. As well explained in the Special Issue Paper, the two sets of reforms listed in table 1, are mutually reinforcing and hence would be most effective if enacted jointly. However, staff also considered them separately and in sequence, and concluded that given the remarkable progress in improving the business environment in recent years and the urgency of promoting inclusive growth, labor market reforms should be prioritized. We agree with this recommendation, which unfortunately has not been sufficiently explained in the report or highlighted in the staff appraisal. Improving labor outcomes is of utmost importance, particularly in a context of past social tensions, and continuing downward trend in labor force participation for more than a decade. Moreover, as staff note in the SIP, the typical short-term adjustment costs associated with labor market reforms would likely be negligible in the case of Morocco, given the high level of informal employment. Regarding the list of recommended reforms that could reduce formal firms' hiring costs, we appreciated the focus on better education and training, while we regret the lack of specific measures to boost women labor force participation, despite the very low level also in comparison to regional countries. What measures would staff recommend for reducing the gap in women labor force participation?

Mr. Raghani, Mr. N'Sonde and Mr. Olhaye submitted the following statement:

We thank staff for a comprehensive report and Mr. Daïri for his informative buff statement.

We take positive note of the resilience of the Moroccan economy as evidenced by the improved macroeconomic situation—thanks to adroit policy implementation—and greater economic diversification. The authorities' commitment to their policy agenda and package of reforms notably related to the pension system, energy subsidies, business environment, financial sector and greater exchange rate flexibility has been essential to reducing vulnerabilities over the last few years. Activity has remained buoyant last year despite lower agricultural output, and prospects remain favorable. Current diversification efforts, coupled with increased regional integration, should help the Moroccan economy ward off risks associated with adverse global trade developments. We encourage the authorities to remain steadfast on their policy and reform agenda, with the view of achieving stronger and more inclusive growth and reduce unemployment, especially for the youth.

The recent progress made by the authorities on both revenue-enhancing measures and spending control bodes well for their objective of maintaining fiscal and debt sustainability going forward. We commend the authorities for the inroads made in containing public spending and reducing public debt while maintaining the fiscal space needed for critically important social and growth-supporting outlays. Building on the achievements to date, the authorities' commitment to a deficit of 3.7 percent of GDP this year is within reach, with adequate contingency measures to address any possible shortfalls in grant inflows. Can staff provide further insights on the key takeaways from the recent national conference on taxation? Against the backdrop of expected lower fiscal deficits and improved growth dynamics brought about by public investment and ongoing structural reforms to improve productivity gains, we agree that the authorities should achieve their goal of gradually reducing public debt as a ratio of GDP over the medium-term.

We share the view that the current accommodative monetary stance, in tandem with growth-friendly fiscal consolidation is appropriate while the envisaged flexible exchange rate regime should serve as an effective shock absorber, the transition to which should be gradual and prudently managed and communicated. The monetary policy stance is justified on grounds of moderate inflation and well-anchored inflation expectations. The authorities' commitment to, and preparatory steps toward greater exchange rate flexibility are noteworthy. We agree with the view that a progressive and orderly exchange rate regime transition is warranted to allow economic agents to comprehend the potential foreign exchange risks. We encourage staff to remain engaged with the authorities and continue to provide technical assistance as the transition advances.

We share the view that the financial sector remains sound and ongoing efforts to strengthen the regulatory and supervisory frameworks are broadly appropriate to fend off potential financial stability risks. We are pleased to note that the financial sector is profitable, capital buffers are adequate and IFRS9 introduced last year requires, among others, banks to improve their provisioning practices. While close attention should continue to be paid to non-performing loans (NPLs) and credit concentration, it is worth noting that provisioning levels stand at about 70 percent, which is reassuring. Furthermore, the authorities' measures to reduce NPLs, notably the recent adoption of legal frameworks for bankruptcy and collateral regime are welcome. Enhancements to their consolidated risk management framework for cross-border activities, including increased data exchange, improved role of supervisory entities, strengthened AML/CFT framework, and closer collaboration with host countries—are other steps in the right direction. We note staff concern that the expansion of Moroccan banks in Africa could be a channel of risk transmission. Can staff elaborate on this premise considering that such development offers not only profit prospects but also diversification opportunities which should lower risk? Staff comments will be appreciated.

We encourage the authorities to build on their recent progress in enhancing governance and public sector efficiency, promoting private sector development and improving the business environment to attract investments, increase growth prospects and reduce inequalities. We welcome the first implementation report on the National Strategy Against Corruption that will be published this year and aims to reinforce the judiciary system with the view to curb corruption and money-laundering. We look forward to the adoption of the draft laws to bolster SOE governance and oversight. We are also heartened by the authorities' action to scale up education and vocational training, increase youth and women's labor force participation rates and improve targeting of social programs. They should pursue their plan to foster access to public services with the view to reduce regional disparities and make further dents into inequalities.

With these remarks, we wish the Moroccan authorities all the success on their policy and reform endeavors.

Mr. Sun and Ms. Liu submitted the following statement:

We thank staff for the informative set of reports and Mr. Daïri for his helpful buff statement. We agree with the thrust of staff's appraisal and would limit our comments to the following for emphasis.

Morocco's macroeconomic resilience has strengthened with the business environment significantly improved in recent years. Although economic activities weakened in 2018 due mainly to the lower growth in the tertiary sector and the challenging external environment, medium-term growth is projected to accelerate with support from continued reform implementation. Nevertheless, the outlook remains tilted to the downside due to domestic and external risks. We therefore encourage the authorities to steadfastly implement the reform measures to further facilitate job creation and increase productivity while reducing inequalities.

We concur with staff and the authorities that the policy mix of accommodative monetary policy and slower fiscal consolidation remains appropriate, given the subdued economic growth, the output gap, and the challenging global environment. On the fiscal front, we welcome the authorities' renewed commitment to achieving the mid-term target of 60 percent debt-to-GDP ratio. We also welcome their efforts in controlling current spending and increasing reliance on PPP for new projects through an innovative financing mechanism. We encourage the authorities to continue fiscal reforms to increase efficiency and fairness of the tax system. In this regard, we support staff's suggestion to accelerate tax reform to secure fiscal sustainability and reduce fiscal risks, including by broadening the tax base, simplifying the VAT regime and cooperate tax rates, and reducing distortion.

On the exchange rate policy, we agree with staff that greater exchange rate flexibility can benefit the economy. In this context, we welcome the authorities' gradual transition to greater flexibility by widening the dirham's fluctuation band. Given the country-specific situations, the authorities' gradual approach for an orderly transition seems prudent. Meanwhile, there is a need to increase the awareness of FX fluctuation risks while having hedging instruments in place. A well-structured communication strategy, outreach, and training are also helpful for a smooth transition.

We commend Morocco's significant progress in the business environment with the Doing Business ranking rising from 128 in 2010 to 60 in 2019. The authorities have made great efforts in implementing the structural reforms, including the recent introduction of a new bankruptcy law and further streamlining of administrative procedures. Nevertheless, there is room for improvement in the labor market and education system to reduce regulatory rigidities and improve female schooling.

Morocco's banking system is well-capitalized and resilient with a favorable liquidity position. We welcome the progress in the implementation of the Basel III and FSAP recommendations, as well as the efforts to enhance banks' consolidated risk management for cross-border activities through data exchanges. To support business expansion of Moroccan banks in Africa, we encourage the authorities to continue to closely work with the host country and regional supervisors to ensure financial stability.

The Acting Chair (Mr. Furusawa) made the following statement:

Directors' gray statements commended the authorities' sound macroeconomic policies and progress in implementing reforms, which have improved the resilience of the Moroccan economy. They also noted that with global uncertainty and risks, continued reform efforts are needed to reach higher and more inclusive growth.

Mr. Daïri made the following statement:

I will make some comments and provide clarifications on some of the key issues raised by Directors. On the national tax conference, the authorities intend to prioritize among the large number of recommendations, drawing a roadmap for reform that will be the basis for the planned framework law, which will guide and anchor reforms over five years, starting from 2020.

On Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), the authorities recognize the weaknesses in the Moroccan framework highlighted in the Middle East and North Africa (MENA) Financial Action Task Force (FATF) evaluation report. However, the report also underscores the high-quality of Morocco’s contribution to international efforts against terrorism and terrorism financing. It also recognizes efforts by the Moroccan financial sector to comply with FATF standards and its close involvement in the rollout of prevention measures needed on each side. This being said, even before the evaluation, the authorities started preparation of the draft AML/CFT law to address weaknesses in the framework. The draft has now been finalized and will incorporate the recommendations of the FATF. A draft report and evaluation of AML/CFT risks and the main elements of the national strategy has also been prepared.

Under the oversight of the head of government office, structural action plans are being prepared to strengthen the effectiveness of the AML/CFT framework, and their implementation will start soon. With these efforts, Morocco expects to no longer be part of the list of countries under observation.

On the second phase of the transition to exchange rate flexibility, the Governor of the Bank of Al-Maghrib held a meeting last month with the heads of the banking and business communities, where they discussed the degree of preparedness of all parties for greater exchange rate fluctuation. It was clear from the discussion that small- and medium-sized enterprises (SMEs) in particular were not ready for greater exchange rate fluctuation, neither for the fluctuations between the U.S. dollar and the euro or between the dirham under the currencies more generally.

Along with stronger communication and training efforts, the authorities will monitor the situation closely and will consider a widening of the band as soon as they are satisfied with the degree of preparedness of economic engines, and following resumption of calls on banks’ foreign exchange. In view of the current expectation that these two conditions will be met in second half of the year, the move in the transition could be considered before year end.

Finally, on female labor force participation, this is regrettable, but part of the explanation is that the young move from being in the labor force to being at school, and there has been a significant improvement in school enrollment both for men and women, and there has been this balancing act. Of course, this is not the only reason. There are other reasons, and the authorities are strongly committed to addressing this issue in the context of the national employment strategy but also in the context of different strategies for empowering women that are being implemented.

With this, again, I thank Directors for their comments and recommendations, which I will faithfully convey to my authorities.

Mr. Fanizza made the following statement:

I would like to reaffirm our strong support for the authorities' reform efforts. We believe that the performance of the Moroccan economy and its progress have been nothing but short of remarkable. We have issued a joint gray statement, so I do not want to reiterate what we said in the paper, but I would like to say something. My main reaction is that we share Mr. Sigurgeirsson's comment on the fact that as much as we like talking about Morocco, we are going to talk again about Morocco next month. We thank the staff for the answer to the question that this is in line with the guidelines that are given to the Board for information, but maybe we have to change something in the guidelines. I do not believe it is efficient to repeat discussions on Morocco every three months because of the Precautionary and Liquidity Line (PLL).

Since I have a bit of time, I would like to raise an issue that concerns the staff's assessment of reserve adequacy, this idea that it has gone down somehow and is only 82 or 85 percent of what the model predicts. There is the regional model, which predicts that it is under a regime of fixed exchange rate. Now that we have some flexibility, I do not believe that the metric should be the same. One moves to a flexible exchange rate regime because one needs less buffer in external reserves.

We appreciate the selected issues paper on labor reform, on the timing and product market reform. However, in the staff report, we did not get a clear indication of the reasons behind the model's results. We would like the staff report to give a bit of flavor of why it comes out. We have a bit of an impression that the model is a black box.

Finally, we welcome the discussion on poverty reduction and also the emphasis on middle class, but for Morocco, the real issue of poverty is rural poverty and big divide between the urban population. With that, I wish the authorities the best.

Ms. Choueiri made the following statement:

We commend the authorities for their sound macroeconomic policies and progress in implementing reforms. I agree with Mr. Fanizza's assessment that their performance is remarkable. We appreciate the authorities' efforts aimed at balancing economic performance with preserving social stability, and we share their view in this regard that the pace and sequence of sensitive reforms need to be assessed with due consideration to political economy realities. This is important to preserve social cohesion.

Finally, in the staff report we welcomed the greater attention that was given to the authorities' views by reporting them at the end of each section, and we agree with Mr. Daïri that this should become the standard.

Mr. Merk made the following statement:

As we have issued a gray statement, I can focus my remarks on two aspects. First, notwithstanding achievements in strengthening the business environment, more efforts are needed to raise human capital to foster more job opportunities and reduce inequality. We encourage the authorities to press ahead with reforms aiming at improving the quality of the education system, the functioning of the labor market, and ensuring that social programs are well targeted at the most vulnerable.

In this context, we welcome the authorities' reform commitment in the context of the G20 Compact with Africa (CWA) initiative, and we encourage our partners in the G20 to further increase engagement in the CWA.

Second, given the continued progress made in reducing macroeconomic vulnerabilities and enhancing the resilience of the Moroccan economy, we encourage the staff and the authorities to consider more decisive steps toward a timely exit from the Precautionary and Liquidity Line (PLL), and like Ms. Pollard and Ms. Levonian, we look forward to the upcoming review of the PLL.

Ms. Pollard made the following statement:

I want to make two comments in addition to the points we made in our gray statement. First, we note that there was some disagreement between the staff and the authorities and among some chairs on the external sector assessment and the External Balance Assessment (EBA) results. We want to thank the staff for their detailed responses to the questions in the gray statements and particularly welcome the incorporation of structural issues in explaining the residual and would like to see more of this type of analysis in the external sector assessments in Article IV reports.

We also strongly support the continued move to greater exchange rate flexibility and welcome Mr. Daïri's comments and would also welcome any comments the staff can have on this process.

Finally, I want to pick up on a point raised by Mr. Fanizza based on Mr. Sigurgeirsson's point in his gray statement about the timing of the Article IV and the PLL review. We also agree that it would make sense to move those closer together and could actually see reason to have two Board meetings back to back, one on the Article IV consultation, and then the next one on the PLL since we do not expect that there will be much additional information to guide us on the review between now and June.

Mr. Daïri made the following statement:

I did not want to come back on the EBA, but in view of Ms. Pollard's comments on structural elements in the assessment, I would like to remind colleagues that the residual in the EBA under the current account model was -1.6 percent in the 2017 Article IV consultation. Now it has gone up to 3.6 percent, so how can one explain such a jump in the residual and say it is connected to structural problems? Structural problems by definition cannot change overnight like this, so there is really an issue here.

Mr. Alhomaly made the following statement:

Despite the elevated risk and uncertainty, Morocco continues to perform well, benefitting from sound macroeconomic policy and continuous reform implementation. Indeed, the authorities have a good track record of implementing sound policy, and we are reassured by their renewed commitment to maintaining such policy and accelerating the reforms.

We agree with the staff that further progress is needed on the fiscal side to mitigate the potential impact of fiscal risk, but we welcome the authorities' efforts to improve the business environment and financial inclusion, which illustrate their commitment to move toward more private sector-led growth.

Finally, we welcome the improvement in staff report to include adequate space to reflect the authorities' view. We believe this is important and should be a key practice going forward.

Mr. Rozan made the following statement:

We have co-signed a statement with Ms. Riach, so we will not go into details but would like to emphasize a few points.

First, Morocco's macroeconomic policies appear sound, and reforms have been implemented at a steady pace over the last few years, and it has allowed for the start of an economic diversification and export-led growth. The current monetary and fiscal policy stances appear warranted. Going forward, policies need to focus on rebuilding adequate buffers to weather possible downside risks, and this will require broadening the tax base. The results of the tax conference, as explained by the staff and presented by Mr. Daïri, are very positive in this regard.

In addition, and in due time, greater exchange rate flexibility will reinforce the adjustment capacity of the economy and has the potential to increase the competitiveness of the country. As regards the financial sector, the authorities should work expeditiously to address the deficiencies in the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework and the remarks of Mr. Daïri were helpful.

Second, we agree with the staff that the country should and could sustain higher level of growth and especially inclusive growth. This will require efforts to make the public sector more transparent, accountable, and efficient, and the steps that were described in the staff report were particularly helpful. We commend the authorities for operationalizing the Competition Council last November.

Third, the country needs a thorough reform of its education system to ensure that young Moroccans are given the best chances to succeed. On the issue of inequality, we recognize that the country has made significant progress in reducing poverty and in addressing the legal barriers to female employment; yet it has not fully translated into the labor market, and we encourage the authorities to continue to work with the staff to resolve this issue.

Fourth, we thank the staff for the interesting paper on the labor market and product market, which continue to display rigidities, and it was helpful to understand the specifics of the reform and how they could benefit the country as a whole.

Mr. Etkes made the following statement:

We thank the staff for the important and detailed report and selected issues paper as well as Mr. Daïri for his statement. We issued a joint statement, and we would like to add two remarks, one regarding the EBA. We share Mr. Daïri’s doubts about the results of the EBA analysis, and we believe that multiple models should be taken into account and preference should not be given to the current account model. We encourage the authorities to continue with timely liberalization of the foreign exchange market.

We would like to ask staff how they can communicate the results in a way that will not affect the redaction of policy, which I believe most of us advocate.

Regarding the labor market analysis, we welcome the detailed analysis of the labor market in the selected issues paper. The illuminating analysis uses extensively the unemployment rates, which are not very informative in the context where the labor force participation is changing significantly, like in the case of Morocco. In these cases, perhaps using the employment rate—the ratio of employed over the population—is more useful. Perhaps it is relevant to the Strategy, Policy, and Review Department (SPR) to incorporate in the toolkit the employment rate as an alternative measure for full employment rather than unemployment, and to allow country teams the flexibility to use the adequate variable for the relevant case.

Mr. Raghani made the following statement:

Like many Directors, we noted the remarkable economic performance achieved by Morocco, and we encourage the authorities to continue in this way. We have raised an issue about risk from Africa expansion of Moroccan banks, and we do not share the manner in which the staff presented this point. We need to be more nuanced as Africa is not one country, but there are many countries, and when diversifying activities, it is a good point as it allows one to diversify risks. I ask staff to elaborate on this issue.

The second point about exchange reform also has been recognized by many Directors and by the staff in their report. Reforming the exchange rate policy is very sensitive, very complex, we need to be very careful and encourage authorities to continue in their gradual approach in this matter I share the same opinion as Mr. Daïri on the result of current account models, and I ask staff to take into consideration the point made by Mr. Daïri regarding structural factors that need to be explained and clarified.

The last point is about also the timing of the meeting. I share the point made by Mr. Fanizza and Ms. Pollard on the schedule of meetings. We have the Article IV meeting in June. We expect to have a meeting on the PLL for Morocco.

Mr. Moreno made the following statement:

The main challenge in Morocco is stepping up social expenditures, and Mr. Daïri emphasized the importance of education, which is also part of social expenditures, and it is included in our new framework that we discussed a few weeks ago.

There is also an issue with the military spending. There is an uncertainty there whether it will be made mandatory or not. That would also increase the structural expenditures. There is also very high demand for social expenditures in general in the country. We find particularly important the efforts by the authorities to raise tax revenues. We welcome the tax conference. This is a welcome approach to increase ownership, but we wonder if this will be ambitious enough for the challenges on expenditure that the country raises for the future. I also note that the authorities have counted a lot on the privatization process, and we also stress that there is room to make it more transparent and to have a clearer timetable for the authorities' privatization strategy.

On the exchange rate, we side with the authorities in the sense that they want to follow a more gradual approach, and we sympathize with the authorities' views. Morocco is still highly oil dependent, and their industry structure is very dependent on import inputs in the value chain, so we are not sure that speeding ahead with a flexible exchange rate could facilitate a significant improvement in the current account, so we side with the authorities. We would also like to echo our colleague’s comments on the EBA.

We welcome the table on page 35 on inclusive growth indicators. This is a good example, and we would like to see a standard table in other Article IV reports.

On the debate on the PLL, maybe SPR can clarify. I understand that is the policy. I am not sure that they have to be separated. We find some value in having a specific Article IV meeting and then the PLL meeting, and that could be an issue of trying to bring them closer together, but it is two different issues that we are dealing with. We are fine. We could have the discussion. We want to change it. I am not sure there needs to be a discussion in the Board in order to change it.

Mr. Palei made the following statement:

Obviously, Morocco performs very well under the PLL, so it is a good or excellent performer. I understand Directors who would like to combine the discussions of the Article IV and PLL, however, it is not always the case in these situations. As I understand it, the staff guidance note is not obligatory or mandatory for the Board members, but it relies on an explicit decision by the Board. There was an involved discussion of this issue, and the Board explicitly asked to separate the discussion of Article IV reports as a prerequisite for a discussion on the PLL, and the same goes for Flexible Credit Line (FCL). I assume that SPR knows the background much better, but that is how I see it. We believe that it is necessary to keep them apart because the Article IV discussion allows one to focus on the shortcomings and achievements of various policies. Instead quoting the decision on the FCL or PLL and noting that the authorities have very strong macroeconomic frameworks, and everybody repeats it 10 times in a row, and all gray statements are the same, I think it is a good idea to have them separate.

On exchange rate policies, at the time of the approval of the PLL, the move toward greater flexibility of the exchange rate was one of the key recommendations for the authorities, and we note from the report and from Mr. Daïri’s statement that since March of last year, the authorities did not intervene in the foreign exchange market, which we welcome. But at the same time, we note that the authorities are rather careful in terms of transitioning to inflation targeting and the timing of this transition. In our opinion, it is related, and maybe if the authorities were to have more foreign exchange reserves, it would facilitate taking a bit more and moving faster to inflation targets and allowing more flexibility in the exchange rate. From this point of view, maybe one directional intervention, say purchase of foreign exchange on a monthly basis, preannounced and in the same amounts, would be useful for the authorities. This is something the staff could think about and discuss with the authorities.

Also, if the staff can elaborate on the timing of the move toward inflation targeting, it would be very useful.

The staff representative from the Middle East and Central Asia Department (Mr. Blancher), in response to questions and comments from Executive Directors, made the following statement:

I will take three or four questions that were raised on the process in the different Board meetings. We followed procedure as agreed by the Board, the spirit of it being that the PLL review should be informed by the assessment of the Board at the time of the Article IV conslutation, and so that is what we intend to do. One consideration to keep in mind, including for the next review, is the possibility of lapse-of-time approval of the review. We have a list of criteria that we could look at, and management perhaps could consider proposing to Directors that procedure in that case.

Second, there was a question about the exchange rate flexibility process and timeline and any differences between the authorities and the staff. On this, the fundamentals are really aligned between the staff and the authorities on the fact that the key preconditions for that reform to progress are in place. It is really a matter of nuance between the staff and the authorities. Obviously the authorities are closer to the agents, and they can see better than we do whether small- and medium-sized enterprises (SMEs) are prepared and other agents are familiar enough with the foreign exchange market developments, so I do not think we are very far. To some extent, we view the development of the foreign exchange markets and the pace of the transition and the fact that agents are familiar with more exchange rate volatility as a sort of chicken-and-egg issue. To some extent, the greater volatility will lead agents to use the foreign exchange instruments that will help them better manage the volatility. These markets are actually relatively deep in Morocco because, the dirham is anchored to a U.S. dollar basket, and so agents already need to manage the volatility between the dirham and the dollar or between the dirham and the euro. To some extent, great progress has already been made in developing the market and having agents used to it.

On the question of the EBA assessment, the comments from Directors are well taken. We will be extremely careful in our communication about the results, like we always try to be, and especially in the case of the EBA given the two-sided results we get from the different methodologies. We have tried to be cautious in the way we presented the results in the staff report. In paragraph 19, we clearly flagged the fact that there is an improvement from the assessment this year. We do not single out a particular number in that paragraph in the staff report, so we are already cautious. We also flag in the report, in the annex, all the numbers that are relevant, so we present all the evidence we have, including the residual of the analysis, which is relatively high this year. We put that clearly on the table, and we will make sure that our communication reflects that.

There was a question about nuancing our assessment of the financial sector developments and the Moroccan banks' expansion into Africa. In our recent responses we tried to highlight how we think about it. It is a factor of improved profitability, possible diversification from Moroccan banks, and it drives their current profitability very much.

We also see this as a cause for caution in our assessment because it is a source of risk. In many of those countries, local environments are riskier than they are in the domestic market in Morocco. Sometimes this is due to simple asset quality in general, or it is also a reflection of the concentration of credit exposures in those countries.

Also, that factor of risk transmission goes both ways. In some of those countries, in particular the smaller West African countries, the Moroccan banks have become systemically important in those markets. Some of them may have an aggregate, about a half of the deposit base in the country, so they are important banks in some of the countries. It is also another reason why we emphasized the need to be vigilant, and to improve the AML/CFT framework going forward.

There was also a question about the tax conference, whether it was ambitious enough. We are very supportive of all the reform priorities identified in that conference and that are highlighted by the authorities in a clear way. I think the key reason it is encouraging to us is that the authorities have made it clear that they will put this in the context of a framework law, and that is very important because it will guide the reforms that we expect in the coming years along these priorities. This was not the case in 2013, when there was a similar national tax conference, but then there was no framework law, and we saw some of these reforms be delayed more than we hoped for at the time. This is very encouraging—the fact that it is a multiyear framework law. Our projections on the fiscal side are reflective of the impact of those reforms that are expected in the coming year or two.

The staff representative from the Strategy, Policy, and Review Department (Mr. Kramarenko), in response to questions and comments from Executive Directors, made the following statement:

I would like to provide some clarification regarding policies for timing of the Article IV and the PLL review Board meetings. The Board in principle has endorsed the fact that timely Article IV considerations are important inputs for PLL eligibility discussions. In fact, generally positive assessment in the context of the Article IV discussions is an eligibility requirement for the PLL. In practical terms, the staff cannot finalize staff report for the review until the position of the Board as reflected in the summing up is clear. In practical terms, we believe that four to six weeks is the time needed to review the Board discussion and make sure that the country meets the generally positive assessment standard and to properly reflect additional advice from the Executive Board in the review staff report. There is this practical issue that we cannot have a review report until we have a summing up from the Board. Four to six weeks is not mentioned in any Board decision, but we believe it is a practical time window that is required to finalize the PLL report to assess the eligibility requirements. As the mission chief mentioned, in cases where performance is strong and the program is on track, maybe more frequent use of lapse-of-time considerations could be considered.

Mr. Moreno asked whether this was the first time the table of inclusive growth indicators was included in an Article IV report and whether this would become standard practice.

The staff representative from the Strategy, Policy, and Review Department (Mr. Kramarenko), in response to further questions and comments from Executive Directors, made the following additional statement:

It is not the first time. The Middle East and Central Asia Department (MCD) uses it in some countries, as a way to depict the operationalization of their strategy on inclusive growth in the context of Article IV consultations. It is becoming common practice among MCD countries, and we will consider experience with this practice and whether similar tables could be useful in other circumstances in other countries. But the circumstances are so specific to each specific country—in particular, inequality and inclusive challenges—that it is hard to impose a table that would fit all the circumstances. Most likely there would be a fair amount of tailoring even if a decision is made that such tables or similar tables would be useful as good practice.

Mr. Fanizza asked if there was an obstacle to conducting the review discussion on a lapse-of-time basis.

Ms. Pollard asked if the guidance note outlined the timing for when the review should take place. In the case of Morocco, the PLL was approved in December 2018, and given that it was a two-year program, she asked why the review did not take place in December 2019 instead of June 2019.

Mr. Merk remarked that his chair welcomed the discussion on the PLL and the review.

The staff representative from the Middle East and Central Asia Department (Mr. Blancher) noted that the reviews were supposed to take place every six months.

Mr. Daïri made the following concluding remarks:

I thank Directors for their comments. Morocco remains very committed to maintaining a sound policy framework and to further accelerate the pace of structural reforms, and both the staff and my buff statement indicated how important reforms have been carried out over the past two years.

This being said, the authorities are not in favor of lapse-of-time consideration, and it makes sense that any country wants to hear from their peers how they view the situation. There may be some nuances, and unfortunately the Transparency Policy does not give room for correcting many mistakes and many wrong assessments. We have sent many comments to staff. They have not taken them. They have not taken 99 percent of the comments. We believe that most of them were absolutely valid, so this is life. This is my big disappointment in the Board. I believe that the Transparency Policy has been too rigid and has opened the way to having one-sided views of the situation in any country. Unfortunately, even at the Board level we hesitate to bring these corrections to the Board. We do not want to embarrass the Board with detailed issues. But this is life. We cannot do anything about it for the time being, unless there is a review of the Transparency Policy.

As usual, the authorities intend to publish the staff report. We will have a further look at the selected issues paper to see if the comments that we have sent already were taken on board, and I hope that the staff will reconsider some of the additional comments that we made on the staff report.

The Acting Chair (Mr. Furusawa) noted that Morocco is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for implementing sound macroeconomic policies and welcomed the acceleration in reforms that has helped improve the resilience of the Moroccan economy and increase its diversification. Nevertheless, Directors noted the potential impact of global uncertainty and risks on the Moroccan economy and called for continued commitment to sustain sound policies in order to reach higher and more inclusive growth.

Directors encouraged the authorities to continue fiscal consolidation to preserve debt sustainability, while safeguarding priority investment and social spending in the medium term. They welcomed the ongoing control of public wage spending and the outcome of the May 2019 national tax conference, which will inform a comprehensive tax reform targeted at achieving greater equity and simplicity in the tax system. Directors supported further improvements in the efficiency and governance of the public sector through civil service reform, careful implementation of fiscal decentralization, strengthened state-owned enterprise oversight, and better targeting of social spending.

Directors noted that accommodative monetary policy remains appropriate in a context of moderate inflation and subdued economic and credit growth. They welcomed the beginning of the transition to greater exchange rate flexibility last year which will help the economy absorb potential external shocks and remain competitive. They encouraged the authorities to use the current window of opportunity to continue this reform in a carefully sequenced and well-communicated manner.

Directors noted that the banking sector system is sound and resilient, while stressing the need to remain vigilant given its increasing complexity and cross-border expansion. They also called for continued efforts to address weaknesses in the AML/CFT framework. Directors noted that adopting the central bank law and continuing to make the supervisory framework more risk-based and forward-looking will help further improve financial sector soundness. They welcomed the recent adoption of a comprehensive financial inclusion strategy, which will ensure that the financing needs of underserved groups and small and medium-sized enterprises are better addressed.

Directors stressed the importance of sustaining the pace of structural reforms to move toward a more private-sector-led and inclusive growth model while reducing inequalities and protecting the most vulnerable. Directors emphasized the need to revamp labor market policies and implement education reforms to help create job opportunities, especially for women and youth. While they welcomed the ongoing improvements to the business environment, Directors encouraged continued efforts to strengthen governance and fight corruption.

It is expected that the next Article IV consultation with Morocco will be held on the standard 12-month cycle.

APPROVAL: April 6, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook/Risks

1. ***HCP preliminary data in the first quarter of 2019 shows a 2.3 percent year-on-year growth with weaker than expected performance in the agricultural sector that seems to have weighted on activity due to the poor rainfall at the beginning of the year. Could staff elaborate on the +difference in 2019 growth estimates?***

- The main difference between staff projections and those made by the HCP is related to assumptions about agricultural growth. Specifically, staff's slightly more optimistic view is based on the combination of the impact of recent rains in April (which will partly offset the negative impact of poor rainfall earlier in the season), and of ongoing diversification within the agricultural sector toward less volatile, higher-value outputs (implying that trend growth would pick up more of the slack in 2019 caused by the projected decline in the cereal harvest).

Fiscal Policy

2. ***Could staff elaborate on any contingency fiscal plans in case of slower growth, revenue shortfalls, or expenditure overruns?***

- In case of slower growth or revenue shortfalls, potential fiscal savings could be achieved through (i) reduced subsidies spending, especially if international butane prices remain below the budget assumption (as is currently the case), or (ii) tighter control and under-utilization of budget appropriations for current spending, as happened in recent years. On the spending side, implementation of the Organic Budget Law continues to improve the fiscal policy framework, including by limiting the risk of expenditure overruns.

3. ***We are a little confused by the statement that a slower fiscal consolidation remains appropriate but at the same time the authorities should increase tax revenue by 0.7 percent by next year. Could staff expand on their thinking?***

- Slower fiscal consolidation (combined with accommodative monetary policy) remains appropriate for 2019 in an environment of moderate inflation, subdued economic and credit growth, and uncertainties about output slack (including because of weaker-than-expected growth in the euro area). Beyond 2019 and in the medium term, continued fiscal consolidation and tax reforms will be needed starting next year (when growth is expected to accelerate) to reduce public debt while preserving fiscal space for social and growth-enhancing spending. Staff projects that the expected acceleration of tax reforms could increase tax revenues by about 0.7 percent of GDP in 2020 and about 1.6 percent of GDP over the medium term.

4. ***Could staff provide an update on the results of the National Tax Conference that was held in early May?***

5. ***Could staff broadly comment on the outcome of the NTC, which will be the basis for drafting a framework law to guide tax reforms to increase the revenue?***

6. ***Can staff provide further insights on the key takeaways from the recent national conference on taxation?***

7. ***We commend authorities for organizing a national conference on taxation to raise the public interest and ownership of these matters and would welcome further details on the elaboration of the 5 year action framework mentioned in the buff statement.***

- Following the National Tax Conference held on May 3-4, 2019, the authorities announced some key principles and priorities that will guide tax reforms in the five years ahead (in the context of a framework law). These include: broadening the tax base while reducing tax rates and increasing social spending; preserving fiscal sustainability; reducing tax exemptions; simplifying the VAT regime and ensuring VAT neutrality; harmonizing national and local tax systems under a unified tax code; integrating the informal sector; continuing the fight against tax evasion and fraud; and better enforcing tax payments by the self-employed and liberal professions. The authorities also stressed the need to further improve the governance of the tax administration and generalize its digitalization. These priorities are in line with staff advice. The authorities intend to implement these reform priorities starting this year, in preparation for the 2020 budget.

8. ***In what ways will the Fund be involved in tax reform?***

- Staff will continue to provide detailed and consistent tax reform recommendations in the context of Article IV consultations, PLL reviews, and technical assistance missions. In the last Article IV consultation, the need for comprehensive tax reform was a key focus, and staff provided in-depth analysis of the macroeconomic and distributional effects of tax reforms. Based on the strong convergence between staff's recent recommendations and the outcome of the recent national tax conference, staff welcomes the authorities' priorities and the new framework law and will of course follow up on their implementation.

9. ***We understand that a recent agreement between government and trade unions has led to an increase of the minimum wage and of the public sector wages. We would welcome staff comments on its budgetary impact.***

- At the end of April, the government, labor unions and representatives of the business community reached agreement on several measures, including increases in the minimum wage (starting in July 2019) and in salaries and benefits of civil servants at lower grades. The fiscal impact of these decisions will be absorbed by contingent budget funds in 2019 and has already been integrated in staff's projections through an upward revision to projected wage and salaries spending from 2019 onward (relative to the time of the PLL request).

10. ***Regarding the forthcoming change in the coverage of public sector statistics (page 13, footnote 6), we welcome further elaborations on the methodological issues behind this revision.***

11. ***Could staff also comment on the impact of the expected change in the coverage of public sector statistics (from central to general government) on the level of public debt?***

12. ***Does staff have estimates of the impact of the change in coverage on public debt levels?***

- The authorities are in the process of finalizing the consolidation of government finance statistics (GFS) from budgetary central government to general government, which will align Morocco's public debt statistics with international standards, namely the Government Finance Statistics Manual (GFSM 2014). This has benefited from intense Fund TA support between 2017 and now. It has raised several accounting, methodological and practical issues (e.g., in processing of source data for extrabudgetary entities) that took time to address.

- Staff does not yet have a reliable estimate of the impact of the change in coverage on public debt levels. For example, the incorporation of some third-party deposits would add to the debt level, while netting out public debt holdings by entities that are part of general government may significantly reduce it. Fund TA in this area is still ongoing, and staff expects that the authorities will be able to produce first good estimates by the end of June this year.

13. ***Could staff advice on the progress regarding the calendar and process of the privatization program? Could the list of SOEs eligible for privatization be further expanded?***

14. ***We would welcome staff comments on the current privatization program and, in particular, whether the list of companies currently targeted will effectively make way for a more strategic approach to the role of the public sector, as described in box 2.***

- The authorities announced in late October 2018 a privatization program starting in 2019 and expected to last five years and yield about 4 percent of GDP. The list of public enterprises that can be divested was amended in late 2018, with the addition of enterprises in the tourism, hotel, and energy sectors. The authorities intend to adjust this list dynamically in the years ahead and will likely expand it further. As noted in Mr. Dairi's buff statement, the first privatization could be completed this summer.

- One of the authorities' objectives is to better align the role of SOEs with the strategic role of the state in the economy, as reflected for example in the divestment of certain public assets that are not part of the core mission of the SOEs that own them (for example, hotels owned by the national railway company).

15. ***Could staff comment on the social response to the announced privatization program?***

- Thus far, staff has not observed any significant social response to the recently-announced privatization program.

16. ***We would welcome staff comments as to the prioritization of future PPP projects***

- The prioritization of future PPPs is expected to reflect the alignment of the PPP legal framework with international practices and the implementation of recommendations from the 2018 Fund technical assistance on the management of budgetary risks related to PPPs. These recommendations focused in particular on integrating PPPs into public investment planning and risk management frameworks, strengthened accounting in public finance statistics, and the systematic use of risk analysis tools in project appraisal.

17. ***Could staff comment on the authorities' capacity to manage risks associated with the new investor-led innovative financing mechanism for new projects?***

- The design of the innovative financing mechanism is still being finalized, and staff does not yet have the full information needed to assess the extent to which the proposed framework will limit financial and fiscal risks. More broadly, the authorities are developing their capacity to analyze risks from PPPs and this new mechanism, including based on recommendations from recent Fund (FAD) technical assistance.

18. ***Could staff elaborate on the timing of the first of three large sovereign bond issuances that are set to take place between 2019 and 2022?***

- The authorities indicated to staff that they intend to issue sovereign bonds of about US$1-1.5 billion in 2019, 2020, 2022, and 2024. These assumptions are incorporated in staff's baseline projections.

Monetary, exchange rate and external sector policies

19. ***We look forward to the approval by parliament of the BAM's new draft law to upgrade the financial sector policy framework. In this context, we seek staff's elaboration on the level of alignment between the new draft law and the 2015 FSAP recommendations? And what further amendments to the BAM law is staff proposing for consideration later?***

20. ***We take note that the latest assessment recommends further amendments to the BAM law on aspects related to autonomy and governance, and would like to hear staff's more specific explanation on what elements of the draft central bank law need to be strengthened.***

- The draft BAM law incorporates past safeguard recommendations that are in line with the 2015 FSAP recommendations. The January 2019 assessment recommends further amendments related to BAM's autonomy and governance, specifically to: (i) eliminate the presence of government representatives that maintain de facto and de jure influence on the decision-making processes of BAM's board, contrary to best practice; (ii) further strengthen the governance structure to have board involvement in setting up executive bodies that will contribute to collegial decision-making; (iii) include provisions regarding the board's authority on the stability of the financial system, bank supervision, and oversight of payment and settlement systems; (iv) include explicit provision on publication of a full set of financial statements to enshrine this transparency requirement. These additional amendments could be pursued with Fund technical assistance.

21. ***We wonder whether it would not be expedient to include the latest assessment recommendations into the same draft law, rather than submit additional amendments at a later stage. Staff comments are welcomed.***

- The authorities expect that the new central bank law will be adopted in the current parliamentary session, following protracted discussions to reach agreement on it. Given the late stage in the approval process of the current draft, which incorporates past safeguards assessment recommendations, the authorities preferred not to reopen the discussion, but rather to consider the additional amendments recommended under the 2019 Safeguards evaluation once the law is adopted.

22. ***Could staff opine on what conditions they think would allow for further progress [on the exchange rate transition] and what their ideal timeline is?***

23. ***We would like to know staff's view on the authorities' stance on a transition schedule.***

- Staff's assessment is that key conditions are in place to move to the next phase of the exchange rate transition. While staff supports the authorities' cautious approach to the transition, staff also recommends proceeding gradually to the next phase without unnecessary delay, to ensure that the transition continues to be orderly, and to put the economy in a better position to absorb any potential external shocks.

- While further foreign exchange market deepening and familiarity by economic agents can support the exchange rate transition, in practice such deepening is also facilitated through greater increased exchange rate volatility. Furthermore, Moroccan economic agents are already required to manage exchange rate risks given that the dirham is anchored to a euro/dollar basket.

24. ***On a related matter, could staff explain the reason why banks have tripled their net open position in the last two years, as indicated in Table 6?***

- This surge in banks' open positions in mid-2017 took place in the run up to an expected widening of the exchange rate band. At that time, the dirham came under pressure as banks and importers sought to hedge against a potential depreciation. Since then banks, have maintained large long foreign exchange positions.

25. ***We would welcome staff's comments on the progress in transiting towards the envisaged inflation targeting framework in Morocco.***

26. ***Could staff elaborate on what measures are being taken by the central bank in preparation to the transition toward a fully-fledged inflation targeting regime?***

- In recent years, the authorities have prepared and put in place key operational requirements for the introduction of a fully-fledged inflation targeting regime, including in areas such as macro-modelling, forecasting and policy analysis systems, and communication with the public and financial markets. In doing so, they have benefited from intensive Fund technical assistance. The adoption of fully-fledged inflation targeting is envisaged as a late stage of the exchange rate transition, for which the authorities have not announced a specific timing, although they indicated that it could take several years.

27. ***We would like staff to elaborate more on the differences with the authorities in the External Balance Assessment results interpretation, including the large, unexplained residual. Could staff further clarify how "the complimentary structural tools" (page 41, para 4) have been used to explain it?***

28. ***We share Mr. Daïri's doubts on the reliability of the CA model's estimated overvaluation of the REER and would welcome staff's elaboration of their assessment.***

- In the case of Morocco, the EBA methodology is used for the estimation of the CA model and ES approach. The EBA methodology cannot be used for the estimation of the REER model because the data needed to construct the home bias variable, which are available for all EBA countries through the BIS, are not available for Morocco. In addition, the real short-term interest rate variable, which is also needed for the estimation of the REER regression, has a limited time span of 6 years for Morocco, which leads to biased results of the panel fixed effects regression. For these reasons, the EBA-light REER model is used in the case of Morocco, which is not fully comparable to the EBA models. More generally, since the current account is a less volatile variable than the REER, it is preferable to base the overall external assessment on the EBA current account model, especially when the current account and REER models provide conflicting signals.

- Regarding the structural tool, the unexplained residual for Morocco is almost fully explained by labor rigidities, as appears in the table and figure below:

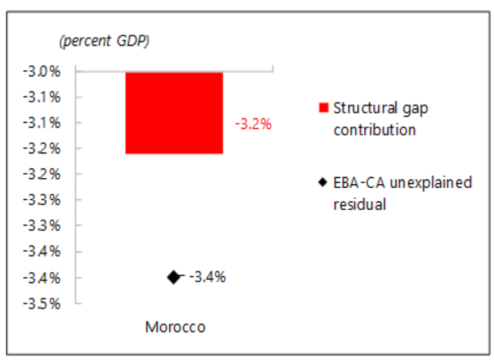
Data	
Country	Morocco
CA imbalance	Excess deficit
Market with relevant distortion 1/	Labor
EBA-CA unexplained residual	-3.4%
Policy recommendation 2/	Improve CLER
Structural indicator	0.34
Structural desired level (frontier)	0.96
Structural gap contribution	-3.2%

Source: WEF

1/ Distortion contributing to internal and external imbalances

2/ Policies that reduce excess external imbalances and boost domestic potential growth

Note: LPS denotes "licenses and permits system"; EPL denotes "employment protection laws"; SBP denotes "starting business procedures"; and CLER denotes "cooperation in labor-employer" relations.



29. ***We also see scope for more clarity over the breakdown of domestic and external policy gaps, in order to better inform the policy discussion.***

- The policy gap in Morocco is explained by the lose fiscal policy (actual fiscal balance is in more deficit than the "desirable" level), higher health spending than desirable, negative policy gap contribution from reserves, and positive policy gap contribution from credit gap. The numbers in the table report "total" policy gaps (p-p*), including both domestic and rest-of-the-world policy gaps. In the case of the fiscal policy gap, for example, it is fully attributed to a deviation of fiscal policy in Morocco relative to the p* for the rest of the world. That is, fiscal policy in Morocco is looser than the "desirable level" for the rest of the world while there is no domestic policy fiscal gap, which means that fiscal policy is at its desirable domestic level (p*).

	All (sum)		Fiscal Balance		Health Exp.		Δ Reserves		Credit		K-Controls	
	Total	dom.	Total	dom.	Total	dom.	Total	dom.	Total	dom.	Total	dom.
Morocco	1.5%	1.2%	0.6%	0.0%	-0.3%	-0.2%	-0.4%	-0.5%	0.8%	1.0%	0.8%	0.9%

Financial sector

30. ***We note staff concern that the expansion of Moroccan banks in Africa could be a channel of risk transmission. Can staff elaborate on this premise considering that such development offers not only profit prospects but also diversification opportunities which should lower risk? Staff comments will be appreciated.***

- Expansion in Africa provides diversification opportunities and supports greater profitability of Moroccan banks. At the same time, it is a potential channel of risk transmission given that (i) business conditions in host countries are often riskier, as reflected in higher NPLs ratios on these cross-border exposures than on domestic exposures, and (ii) local credit exposures tend to be concentrated on large borrowers, which accentuates the concentration risks already observed on the domestic market.

31. ***We would appreciate additional information on the scale of operations of Moroccan banks abroad relative to their total assets and on how these operations have evolved in recent years?***

- The international exposures of the three largest Moroccan banks (around two thirds of Morocco's banking assets) are concentrated in Africa. They represent about 20-30 percent of their total assets and a third of their profits. The growth of credit extended by these banks has been more rapid in African markets (e.g., around 16 percent in 2017) than in the domestic market. The expansion of Moroccan banks in Africa is expected to continue in the period ahead, based on reports of ongoing discussions about possible acquisitions in various countries on the continent.

32. ***We would welcome a description by staff of the current credit ceilings and interest rate caps hampering financial inclusion that are referred to in Annex V, paragraph 6.***

- In line with the 2015 FSAP recommendations related to financial inclusion, blanket ceilings on lending rates have been gradually increased. Micro-credit institutions already have a higher interest rate ceiling than banks (average interest rates are 18 percent vs. 15 percent for banks). In December 2018, the micro credit law was amended to allow higher ceiling for credit to micro-enterprises from USD5,000 to USD15,000. These measures will help financial institutions better manage risks and support expanded credit provision to underserved population segments.

33. ***Could staff share the outcome of the MENAFATF Plenary discussion in April?***

- The MENAFATF's April 2019 plenary discussed and approved Morocco's mutual evaluation report. Due to serious shortcomings identified in the report, Morocco will be placed under observation by the FATF. Absent sufficient progress, Morocco may be publicly identified by the FATF by October 2020 as having strategic weaknesses in its AML/CFT framework, and specific indications of the deficiencies that remain to be addressed will also be released.

Structural reforms

34. ***We welcome the section on raising growth and inclusion, including a specific reference on inequalities, and the table on inclusive growth indicators which we find very illustrative and complete. We encourage staff to standardize this table in country reports. Staff's comments are welcomed.***

- This table is increasingly being used for MCD countries as part of MCD's ongoing focus on operationalizing inclusive growth. SPR will discuss with area departments whether a standardized table could usefully be deployed across different sub-groups of the membership, recognizing that the specific indicators selected would depend both on country characteristics and data availability.

35. ***The youth unemployment rate remains stubbornly high, at over 25 percent. Do staff think this is mainly an issue of skills mismatches (e.g., young people leaving school without work-ready skills) or of labor market rigidities?***

- Education and labor market rigidities are both at the core of Morocco's employment challenge and relatively low productivity, and studies conducted by staff in recent years have found strong support for both factors. On the one hand, augmenting human capital by reducing the skills gap with respect to high-productivity sectors would support job creation in these sectors and boost growth. In one study, staff found that the education gap in Morocco relative to several benchmarks accounted for up to 1 percent lower growth per capita. On the other hand, another study by staff found that reforming labor markets could raise output by 2.5 percent and reduce unemployment by 2.2 percent over the medium term.

36. ***Staff notes that despite women's improved access to education and public services, female participation in the labor force is low and declining. Could staff elaborate on the underline causes of this trend?***

37. ***We would like to know reasons why female labor force participation is declining, despite women's improved access to education and public services. In addition, noting that low labor mobility and limited access to education, credit and affordable childcare exist behind the gender/generational gaps, we would also appreciate it if staff could elaborate more on possible policy measures to address the gaps.***

38. ***What measures would staff recommend for reducing the gap in women labor force participation?***

39. ***What policies is Morocco pursuing to reduce female unemployment and reverse declining female labor force participation rates?***

40. ***We are concerned that Morocco has witnessed a sustained drop in the already low female participation rate. We would welcome specific comments on this diagnostic and policy levers that could be used to address this.***

- There are several potential causes for the low level of female participation in the labor market. Women are often employed in the informal sector or in more traditional sectors that require low skills and are vulnerable to business cycle fluctuations (such as the textiles sector). Infrastructure is also an issue, particularly in rural areas, where transport conditions and family care burden are not always adequately addressed. The large and increasing gender gap in Morocco's labor market can also be attributed to social norms that influence the role of women in the professional sphere.

- Morocco has implemented measures over the past two decades to reduce gender inequality by expanding the rights of women with respect to guardianship, marriage, child custody, and divorce. Morocco launched the first gender budgeting initiative in the MCD region. More recently, the authorities have also implemented several strategies, including the national employment strategy, to support the employability, financial inclusion and autonomy, and education of women.

- Staff has recommended further measures to support greater female participation in the labor force, including: improved infrastructure for safe transportation to work; provision of child daycare services; increased schooling of girls, as well as literacy programs for women in rural areas and vocational training programs for all women; and, addressing inequalities with respect to inheritance rights, taxation, and paternity leave.

41. ***Combined reforms of the labor and product market would bring significant positive impact over the medium term, as would improvements to the education system. Nevertheless, we would welcome further details on the distributional impact of labor market reforms on the different categories of the population, to help the policy response to possible negative consequences.***

- The Selected Issues paper does not address distributional impacts of reforms (it only provides a reference to the SDN on *Macro-Structural Policies and Income Inequality in Low-Income Developing Countries*, IMF, 2017). In general, the proposed labor market reforms are shown to be very effective in boosting job creation with limited negative effects, which would help reduce unemployment and inactivity among vulnerable groups, including the youth and women, and reduced income inequality. In addition, to help workers transition between jobs and reduce informality, a more supportive unemployment benefits scheme would give workers more time to choose the formal sector where wages and productivity are higher.

42. ***We note that "several robustness checks were performed to ensure that the main findings are not sensitive to the assumptions made to calibrate the steady state" but still wonder how sensitive staff's findings are to the calibration of some model parameters such as the assumed firing probabilities or the elasticity of substitution between goods from the formal and informal sector. Further elaboration by staff would be welcome.***

- The firing probability parameter is data-driven as was estimated using data on the number of job losers and on the number of new entrants among the unemployed, as well as data on formal and informal employment. Regarding the elasticity of substitution between formal and informal goods we assumed it to be 1.5, which is in the range of usual values from the literature, but we also checked the robustness of our results with a unit elasticity.

Other

43. ***Has staff considered whether merging the two discussions (Article IV consultation and the first review under the PLL) into one could have been more efficient?***

- The PLL Guidance Note stipulates that: "The Board has endorsed the principle that the consideration of Article IV consultations be timed sufficiently early to allow the Board's most recent assessment of the member's policies to be fully integrated into the assessment of qualification in the context of the approval of or reviews under PLL arrangements. […] In practice, this would normally mean holding the Article IV discussion at least 4–6 weeks prior to a formal Board meeting for either the approval of, or review under, a PLL arrangement."