April 13, 2020
Approval: 4/20/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/107-3

12:25 p.m., December 17, 2018

3. Morocco—Request for an Arrangement Under the Precautionary and Liquidity Line

Documents: EBS/18/111 and Correction 1, and Correction 2, and Correction 3

Staff: Blancher, MCD; Kramarenko, SPR

Length: 1 hour, 2 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	I. Mannathoko (AE)
M. Raghani (AF)	
	J. Corvalan (AG), Temporary
N. Ray (AP)	
	B. Saraiva (BR)
	Y.Liu (CC), Temporary
	P. Moreno (CE)
L. Levonian (CO)	
R. Kaya (EC)	
	A. Castets (FF)
	K. Merk (GR)
	M. Siriwardana (IN)
	T. Persico (IT), Temporary
	Y. Saito (JA)
	M. Daïri (MD)
H. Beblawi (MI)	
	V. Rashkovan (NE)
	K. Virolainen (NO)
	S. Potapov (RU), Temporary
	R. Alkhareif (SA)
J. Agung (ST)	
	P. Trabinski (SZ)
	E. Meyers, Temporary (UK)
	P. Pollard (US), Temporary

G. Tsibouris, Acting Secretary
S. Maxwell, Summing Up Officer
M. Gislen, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Finance Department: K. Kitano. Legal Department: K. Kwak, D. Schwarz. Middle East and Central Asia Department: J. Azour, N. Blancher, M. El Qorchi, T. Koranchelian, J. Noah Ndela Ntsama, L. Ocampos Balansa. World Bank Group: K. Carey. Executive Director: D. Fanizza (IT). Alternate Executive Director: A. Guerra (CE). Senior Advisors to Executive Directors: A. Muslimin (ST), F. Fuentes (BR), N. Jost (NE), W. Nakunyada (AE), G. Preston

(AP), J.Weil (CO). Advisors to Executive Directors: B. Alhomaly (SA), O. Bayar (EC), P. Braeuer (GR), K. Carvalho da Silveira (AF), V. Djokovic (SZ), A. Grohovsky (US), G. Kim (AP), M. Mulas (CE), P. Rozan (FF).

3. MOROCCO—REQUEST FOR AN ARRANGEMENT UNDER THE PRECAUTIONARY AND LIQUIDITY LINE

Mr. Daïri submitted the following statement:

I thank staff for a well-balanced paper on Morocco's request for Board approval of a new PLL arrangement. The extensive Written Communication (WC) of the authorities and the well-drafted staff report describe in detail the recent macroeconomic and financial sector developments and prospects in Morocco as well as the policies being implemented for which the authorities are seeking Fund support under a new PLL arrangement. The authorities broadly share staff analysis and main conclusions and welcome their assessment that Morocco continues to meet the requirements of PLL eligibility. However, as clearly illustrated in the Written Communication, the authorities do not agree with staff that the reform momentum has weakened since the end-2016 elections. While reforms were slower in the first few months, since it took time to agree on a new coalition and form a new government, the reform effort subsequently accelerated and has reached a new momentum in recent months.

Policies and Reforms under the PLL

With Morocco's strong fundamentals and track record of sound policy implementation, the authorities see the PLL as a temporary additional buffer against shocks, while they continue to reduce vulnerabilities and strengthen resilience. Policies and reforms carried out since 2012 under three PLL arrangements have brought down the fiscal and current account deficits by one half and helped reduce fiscal, external, and financial sector vulnerabilities. They also helped, in an unfavorable global and regional environment, to maintain a relatively satisfactory growth pace even though insufficient to make a significant dent in unemployment, in particular among the youth, and in inequality. While the current growth outcome may be due in part to the delayed response of structural reforms, the momentum of reform will need to be further strengthened to achieve these objectives, and work is underway toward defining a new development model.

While macroeconomic developments under the third PLL through end-December 2017 were broadly in line with program targets, notwithstanding higher oil price, continued increase in oil prices in 2018 has put pressure on the budget and the external position. Grants are also expected to fall short of projections. The authorities plan to offset most of the additional spending and potential shortfalls in revenue and grants through savings on wages and other current spending, a large part of which have already been realized, to maintain the 2018 deficit at around its 2017 level of 3 ½ percent of GDP, while protecting public investment and social spending. While the impact of higher oil prices on the budget is estimated at about 0.4 percent of GDP in 2018, the impact on the external position is much larger at 1.3 percent of GDP, even though the increase in the current account deficit is projected at only 0.9 percent of GDP, mainly due to strong performance of exports of automobiles and phosphates and derivatives.

In the fiscal area, the reform of the subsidy system, along with tax policy and administration reform and improved control of the wage bill and other current spending have contributed to a halving of the fiscal deficit since 2012 to 3.6 percent of GDP in 2018. The new Organic Budget Law (OBL) has significantly strengthened the budgetary framework and reduced vulnerabilities. While the public debt to GDP increased initially, it has stabilized recently at some 65 percent of GDP and remains sustainable and resilient to various shocks. Continued sound fiscal policy implementation and debt management should help achieve the authorities' objective of lowering the debt-to-GDP ratio further to 60 percent over the medium term. As indicated in the Written Communication, the focus will be on continued tax policy and administration reform, further reducing the wage bill to below 10.5 percent of GDP over the medium term, including through civil service reform, and strengthened spending efficiency, while creating space for infrastructure and social spending.

The draft 2019 budget includes a number of tax measures increasing revenue by some 0.4 percent of GDP, including an increase in the minimum tax for loss making enterprises and in the tax on profits from property sales, and elimination of exemptions for enterprises and banks operating in offshore centers. A new Tax conference will be organized in May 2019 to discuss avenues for further reforms to enhance the system's efficiency, equity, and contribution to growth. Spending on education is significantly increased, including under the special program for teachers' hiring to reduce overcrowding of classes, better serve remote areas, and improve education quality, as are budget appropriations for health.

A major reform of social protection is underway to ensure consistency of the various programs and improve coverage and targeting. Resources for social protection are also being significantly strengthened. Major programs' funding (including the National Initiative for Human Development and the Royal Program against territorial and social disparities) is significantly increased under the draft 2019 budget. The number of school children benefiting from the Tayssir program (cash transfers to encourage school attendance) has been tripled 2019 budget (2.1 million instead of 0.7 million last year). Following implementation of the parametric reform of the public pension system, pension coverage has been extended to new categories, including non-affiliated workers in the private sector and self-employed. Compulsory health coverage is also being expanded, as is a government-financed health insurance program (RAMED) dedicated to the poor. Following the elimination of generalized energy subsidies in December 2015, except for LNG, reform of the subsidy system will be completed after the unified social registry is established by end-2019 as expected, with remaining subsidies to be replaced with well-targeted transfers to the poor. The unified social registry and the population registry being established will be used to improve targeting of social programs more generally.

Ongoing implementation of multiyear budgeting and strengthening of parliamentary control in line with the OBL will further enhance spending efficiency and prioritization, reduce procyclicality, and improve fiscal transparency. Prudent, efficient and transparent budgetary management principles of the OBL have been extended to territorial authorities under a new organic law to improve service delivery and efficient use of resources, and implementation of the recently adopted decentralization Charter will help achieve further advances in this direction.

The ongoing reform of SOEs to improve oversight and strengthen their governance and performance is being broadened, including through a major overhaul of their business to improve resource allocation by better aligning their activities with their core mandate. A new SOE law will be presented to parliament during the April 2019 session. The risk management system will be reformed to improve coverage and promote consistency in assessing and mitigating fiscal risks not only for SOEs but across the whole public sector, drawing on the Fund's recent technical assistance. An ambitious privatization program will support greater involvement of the private sector in the economy while contributing to improving productivity, lowering public debt, revitalizing the capital market, and attracting FDI. In this regard, a law expanding the list of SOEs eligible for privatization was adopted by the house of representatives last Tuesday.

Monetary policy has been successful in maintaining inflation at less than 2 percent over the past decade. It remained accommodative in recent years, in view of the more moderate non-agricultural activity, reflecting lower partner countries' growth, while vigilant to signs of inflationary pressures. The monetary policy framework was modernized, with Fund technical assistance, including in preparing for a transition to a more flexible exchange rate regime. The new central bank law strengthening its independence and expanding its role to include financial stability and financial inclusion is expected to be adopted by end-2018. The authorities are comforted by the smooth start of the transition to a more flexible exchange rate regime since January, with the exchange rate remaining around the middle of the band without any central bank intervention since March. This bodes well for a gradual strengthening of the role of this instrument as a shock absorber. The authorities welcome staff indication that the exchange rate is broadly in line with fundamentals.

The financial system is sound and well-capitalized, and NPLs are moderately elevated but well-provisioned. Financial sector regulation and supervision is being upgraded in line with best international practices to reduce macro-financial stability risks and improve the sector's resilience and contribution to growth, while strengthening financial inclusion. Following the introduction of IFRS 9 in January, banks have already completed the new provisioning requirement and are required to gradually strengthen their capital over a 5-year period as allowed by the Basel Committee. Risks to Moroccan banks operating in other parts of Africa under the subsidiary model are limited, and the authorities are closely monitoring these risks in close coordination with host supervisors. Concentration risks under the tight regulatory limits are also closely monitored. SMEs' access to finance is being strengthened, with collateral requirement lower than MENA average, and a national financial inclusion strategy is being developed.

Macroeconomic and financial policies are supported by a broad range of structural reforms aimed at improving the business climate, enhancing productivity, strengthening governance, and reducing labor market rigidities. Morocco continues to make significant progress under the Doing Business Indicators, ranking 60 in the 2019 report against 69 in 2018 (and 115 in 2011), and the authorities are on track for meeting their goal announced last year of reaching the 50th rank by 2020. Among the main recent improvements is the easing of insolvency procedures following the amendment of the Commerce Code. Efforts at improving governance and fighting corruption are ongoing, and the first report of the national anti-corruption committee is expected to be published early 2019. Following the recent appointment of a new Chair of the Competition Council, the other members will be appointed shortly for early activation of the Council, which will go a long way toward strengthening business and consumer confidence. A new agency for investment development and promotion of exports created end-2017 from the merger of 3 agencies along with new regional investment centers to be created under a draft law before parliament will implement the government's strategy in these areas. In addition to improving alignment of education and training to labor demand, the main pillars of the National Employment Strategy adopted end 2017 include strengthening of active labor market policies and improvement in the functioning of the labor market. Industrial policies aimed at greater economic diversification by developing new high value-added, export-oriented sectors and attracting foreign direct investment have significantly strengthened export potential and the resilience of the economy. Agricultural policies have helped strengthen the sector's performance and develop new activities with a positive impact on the economy and exports and reduced dependence on cereals production and vulnerability to drought. Further major reforms are planned in this sector, aimed at facilitating land ownership for small farmers which will help promote investment by easing access to finance. Ongoing efforts to further improve public investment project selection and oversight and developing infrastructure, including through PPPs, will improve resource use and competitiveness. A draft law on PPPs, in line with best international practices, is before parliament.

The lengthening of payment delays both by the public and the private sector, and the accumulation of VAT credits have complicated liquidity management, with the final burden often falling on SMEs. The authorities are addressing resolutely this phenomenon which is endangering the payment culture and undermining business confidence. The government introduced late payment penalties for public institutions and the private sector, and has instructed public agencies to accelerate bill payment. After initial steps to reduce VAT credits, it launched a major initiative this year aimed at repaying the backlog of VAT credits over a 5-10 year period with a view to their eventual elimination, with all new credits to be paid the same year.

PLL Issues

Despite the materialization of the risks identified in the 2016 PLL, which turned out to be more severe than under the adverse scenario, the authorities refrained from drawing under the facility, consistent with their declared intention to treat it as precautionary. Moreover, no decision was taken on whether to renew the PLL before its expiration in July 2018. Expiration of the PLL and its nonrenewal did not have an adverse market impact, reflecting confidence in the economy's fundamentals, as also confirmed by Morocco's continued favorable ratings and spreads, even during episodes of global market turbulence. With oil prices rallying again, and risks to the global economy increasing, including from trade and geopolitical tensions, tighter financial conditions, and higher uncertainty, the authorities decided in mid-October to request a new PLL as an additional buffer against shocks, in particular since the comfortable reserves buffer up to 2016 declined in 2017-18 due to the oil price increase. However, after initially considering an access level of 280 percent of quota (equivalent to $3.5 billion), as under the third PLL, the authorities decided to reduce their request to 240 percent of quota ($3 billion) in line with their intention to continue reducing reliance on the PLL instrument and exit the facility as soon as conditions permit. The authorities intend to continue to treat the PLL as precautionary.

Conclusion

The authorities are comforted by the main achievements so far, including maintaining relatively robust growth with low inflation, fiscal and debt sustainability, and broadly adequate external buffers. However, they are cognizant of the key challenge of safeguarding these achievements while also setting the foundations for stronger and more inclusive growth to accelerate job creation and further improve living conditions. They are committed to continue with sound policy implementation and strengthen the reform momentum to achieve their medium-to long-term objectives, in close consultation with the Fund. In the process, they will attach high priority to safeguarding social stability and cohesion and maintaining public support to their policies, including through a broad consultative process with social partners and adequate social protection of the poorest segments of society. They look forward to Board approval of their request.

Mr. Beblawi and Ms. Abdelati submitted the following statement:

We thank staff for a well-articulated report and Mr. Dairi for his informative buff statement.

We agree that the past three PLLs have helped to provide useful insurance in support of Morocco's efforts to build resilience and promote growth. We also agree that Morocco has maintained sound policies and continues to meet the PLL qualification criteria. We can support the duration and access level under the proposed PLL. We take note of the strengthened economic performance, following two good agricultural years, and commend the authorities for reducing the fiscal deficit in 2017 and continuing with export diversification.

First, staff notes that Morocco has weathered the recent market turmoil quite well, although more could be done to secure macroeconomic resilience. We note that sovereign spreads have not changed significantly in 2018 despite the increase in EMBI spreads, reflecting strong confidence in the country's economic policy frameworks. Monetary policy has successfully maintained inflation at below 2 percent over the past decade, and financial sector regulation and supervision is being upgraded. We agree with staff that banks should further strengthen their regulatory capital to absorb the impact of IFRS9.

Second, the fiscal position improved in 2017, but higher oil prices and moderate revenue performance have limited the consolidation gains compared to what was planned under the 2016 PLL. This reflects to a great extent external factors, and we are reassured that debt is projected to continue to decline. The current deficit is not far from the targeted level of 3 percent of GDP and public debt is not far from the targeted level of 60 percent of GDP, while the levels of investment and social spending were preserved in the 2018 budget.

Third, Morocco remains a strong performer in terms of export growth and diversification. Although, the current account deficit has been greater than projected since 2016, continued export diversification is a laudable achievement, where exports are driven by emerging manufacturing sectors. We commend the authorities for the strong ratings on the business environment and competitiveness compared to peers. However, staff states that reform implementation has been slow since 2016 and points to limited progress in improving labor market functioning and the education system. We note that measures have been identified for implementation in 2018-19, and that staff consider further steps needed.

The charts in Figure 5, based on a number of sources, sometimes give an inconsistent picture and this raises again questions about the reliability of some Third-Party Indicators. For example, staff considers reforms in education a priority, especially improving the quality of vocational training and better evaluating teachers' performance. However, the Global Competitiveness Indicators on the same page point to relatively strong education indicators compared to peers. Similarly, another chart identifies resolving insolvency as an important area for reform, while staff refers to recent reforms that improved the insolvency regime. Could staff comment on these apparent inconsistencies?

With these remarks, we wish the authorities continued success.

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

We thank staff for the comprehensive report and Mr. Daïri for his informative statement. We commend that macroeconomic vulnerabilities have been reduced in recent years under the last three arrangements and the economic activity remains robust. We also welcome that Morocco keeps sound economic fundamentals and institutional policy framework. Having said that, we understand that Morocco continues to face the elevated external risks and needs to address remaining vulnerabilities and strengthen buffers. As Morocco continues to meet the Precautionary and Liquidity Line (PLL) qualification criteria, we support the authorities' request for the new PLL arrangement. As we broadly agree with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

We concur 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. In this light, we welcome that the government is committed to pursue fiscal adjustment and reduce public debt to about 60 percent of GDP. To achieve the target, we encourage the authorities' further efforts to accelerate tax reforms, including broadening the tax and simplifying VAT and corporate taxation. On the spending side, public wage containment, careful implementation of fiscal decentralization and strengthened SOE's oversight are key priorities. In this regard, it is an important step that a draft law to strengthen the governance and oversight of SOEs and to improve their performance is submitted to parliament during the April 2019 session. Regarding the pace of fiscal consolidation, we take note of the staff's suggestion that a slowdown in fiscal consolidation in 2018-19 would be an appropriate response to the temporary impact of higher oil prices. Amid the recent drop in oil prices, have staff changed the views on the pace of fiscal consolidation?

Monetary and Exchange Rate Policy

In a context of moderate inflation and subdued non-agricultural activities and credit growth, we share the staff's view that the current accommodative monetary policy stance is appropriate. We take note that the draft central bank law has been submitted to the upper chamber and should be adopted by the end of 2018. We appreciate it if staff could elaborate more on details of the new central bank law and staff's evaluation on it.

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.

Structural Reform

We encourage the authorities' further efforts to implement reforms on the education system, the labor market, and the business environment to boost productivity. Although Morocco's Doing Business ranking picked up recently, reflecting ongoing efforts to strengthen the local business environment, Morocco's total factor productivity (TFP) remains stagnant. While we note of several impediments including those in the education system and the labor market, could staff elaborate more on remaining impediments in the business environment that have hindered Morocco's TFP growth? Against this background, we commend the authorities' recent reform implementation including the new bankruptcy law and the dematerialization of administrative procedures. At the same time, deepening financial inclusion is critical to enhance opportunities for SME development and middle-class entrepreneurship. Reducing youth unemployment and strengthening the targeting and efficiency of social spending remain high priorities.

Access Level and Exit Strategy

While we positively take note that the access level would be lower than in the 2016 PLL arrangement reflecting the improved balance of external risks, we reiterate the importance of the authorities' timely and clear communication with regard to the exit strategy. We agree with the staff that the authorities' policies will be instrumental to continue reducing fiscal and external vulnerabilities and strengthening the economy's resilience, which should position Morocco well for exiting the PLL once global and regional risks subside. In this regard, it is encouraging that the authorities remain committed to maintain strong policy and reform implementation and intend to continue reducing reliance on the PLL instrument and exit the facility as soon as conditions permit. We urge staff to keep close communication with the authorities regarding the exit strategy and its conditions.

Mr. Lopetegui and Mr. Corvalan Mendoza submitted the following statement:

We support the Moroccan authorities' request of a successor Precautionary and Liquidity Line (PLL) arrangement. Three previous PLLs served the country well to improve socio-economic indicators and strengthen its institutional framework. Further work is needed to cement what was accomplished until now to enhance the capacity to deliver good quality public services. We thank staff for the report and Mr. Daïri for his comprehensive buff statement.

Rising human capital and improvement in the labor market might take time. Unemployment levels are obstinately high, particularly for the youth (27 percent) and graduates (17 percent). For the latter, it is a troublesome outcome to observe that educated people are not finding a job. Social tensions are still present in the country and, according the staff report, social demand for less corruption, better access to health and more jobs is rising. We take positive note of the authorities' actions to respond to these social demands, such as accelerating social programs and deploying investment projects, as well as efforts to strengthen public accountability from their actions.

Public Investment Management Assessment (PIMA) implementation seems critical. For a country that urgently requires more investments in health, education, and public infrastructure, PIMA recommendations become handy to tackle current social tensions. Nevertheless, its deployment will require capacity development and more financial resources. We strongly support the authorities' efforts to enhance the mechanism to safeguard the sustainability of the budget in the medium term and the improvement in the quality of expenditure. It caught our attention that two rating agencies downgraded Morocco's sovereign rating last month because of the slower pace of fiscal consolidation expected for this year and 2019. We would appreciate staff's further thoughts on this recent event and the impact on the credibility of the successor program.

We strongly support the authorities' commitments to strengthen the institutional capacity of the central bank and take positive note of their willingness to let the exchange rate float gradually, as it was initiated in January 2018, and the lack of intervention in the foreign exchange market since March 2018. This mechanism will reinforce the commitment of the central bank to implement, in the coming years, an inflation-targeting regime. This policy path will send the correct message to domestic and foreign investors on the direction of the economy.

Continued efforts to close the gap in the financial sector are important. Improvement in the quality of regulation and supervision of the system will pay-off in the future, to promote the correct intermediation of savings into investment and consumption. Given that non-performing loans are high and the collateral requirements for small and medium-sized enterprises are also high; could staff share some ideas how to tackle this issue? We wonder if it is a matter of the new bankruptcy law that still needs implementation, or related to credit bureau deficiencies, or some frictions in the judicial system. These types of bottle necks in the domestic financial market could easily be expanded to a bigger market, taking into consideration the continued expansion of Moroccan banks in Africa and the complexity it brings to home regulators and host countries' supervisory agencies.

The exit strategy is coherent with the authorities' action plan. Box 3 clearly shows the declining trend of the PLL access levels from 2012 to 2018. It is continuously decreasing from a potential usage of USD 6.2 billion in 2012 to a requested USD 3 billion today. This trend makes perfect sense with the strengthening of the institutional capacity of the country to better absorb domestic and external shocks.

With these comments, we wish the people of Morocco every success in their future endeavors.

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

Macroeconomic conditions have remained positive in Morocco. Although some vulnerabilities persist, external stress has declined relative to the previous program in both the baseline and downside scenario, as noted in the external economic stress index. In this context, we agree that Morocco continues to meet the criteria for another PLL, at this time, and support the authorities' request. However, after some initial progress, reform efforts have recently slowed. Greater progress will be needed during the next two years, particularly on fiscal issues, than was the case during the previous PLL.

Despite solid economic growth, debt levels have continued to rise since 2012 and progress on further consolidation has stalled. With a positive economic outlook, we strongly encourage the authorities to pursue more aggressive fiscal consolidation than recommended by staff, in order to strengthen buffers against a future downturn. Could staff elaborate on their decision to not push for a fiscal deficit target of less than 3 percent and a public debt target of less than 60 percent of GDP over the medium term, particularly given the projection of increasing growth and improving cyclically-adjusted and structural balances? Tax reforms, expenditure control, privatizations, and better targeting of social spending could also provide an assist and we welcome the efforts to establish a social registry in 2019-20.

In contrast to fiscal policy, we commend the progress made in widening the trading band for the dirham and the authorities' commitment to continue the transition to greater flexibility, while continuing to keep inflation low and stable. Given that reserves remain around the threshold of various adequacy measures, increased flexibility should help protect buffers and allow a steady build-up of reserves over time. Stronger overall macroeconomic policies would also contribute to exchange rate stability, within the more flexible framework.

We were also pleased to see that bank supervision is improving in line with the 2015 FSAP recommendations. We encourage the authorities to ensure banks build additional capital buffers as IFRS 9 is phased in and work to resolve NPLs which remain high, albeit well-provisioned for. This is the qualification area most likely to slip from "performing strongly" to "not substantially underperforming," so continued vigilance is required.

Finally, we welcome that access has declined from the previous PLL and the authorities' stated intention to continue reducing reliance on the PLL, as indicated in Mr. Daïri's buff statement. This decline in access is consistent with the reduction in downside risks as in earlier arrangements and the idea that use of these facilities should be temporary to assist countries in building buffers. Given that this is Morocco's fourth PLL, and provided that the risk environment remains stable, the authorities should work with staff on a way to communicate an exit from the PLL at the end of this program. Additionally, the authorities could consider other Fund instruments under various scenarios.

Mr. Trabinski and Mr. Djokovic submitted the following statement:

We support the two-year arrangement under the Precautionary and Liquidity Line with Morocco. We thank staff for their comprehensive paper, and Mr. Dairi for his informative gray.

We agree that Morocco continues to meet the PLL qualification criteria. The PLL arrangement should enable the authorities to progress with reforms in order to strengthen macroeconomic resilience and achieve higher and more inclusive growth. Morocco has a track record of sound policies and has met the PLL qualification criteria since 2012. The business environment has improved; and, importantly, the authorities have initiated the transition toward increased exchange rate flexibility earlier this year. We note that Morocco has not drawn on the last three arrangements and intents to treat the proposed arrangement as precautionary. We also note that the level of PLL access has been declining since 2012, signaling a trend towards exit from Fund support.

We note the slight underperformance in two qualification areas. First, on fiscal policy, underperformance appears to be structural. The fiscal position has improved less than expected under the previous arrangements. This has led to a continued increase in public debt over the past years. Furthermore, the fiscal deficit is expected to exceed the authorities' target for this year. Against this background, we question the merits of maintaining a slower fiscal consolidation path and to implement further adjustment only later on. Overall, the PLL should be viewed as an opportunity to durably strengthen Morocco's fiscal position. Moreover, regarding the external criterion, we note that Morocco's reserves will remain below 100 percent of the ARA metric over the program.

The authorities should lay out a clear path to exit from Fund support. This path would be a strong signal of the progress made. During the last PLL review, the authorities noted that improved economic conditions should enable an exit from the PLL arrangement once the exogenous risks have been reduced. Macroeconomic conditions in the country are expected to remain strong and external pressures under the baseline have, overall, largely abated in recent years. The good progress in implementing reforms has significantly increased Morocco's ability to weather external shocks. In this context we regard the exit criterion "if and when global and regional risks subside" as vague. Therefore, we encourage the authorities to introduce a well-communicated exit strategy going forward. This would help to anchor market expectations and ensure a gradual withdrawal.

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

Thank you to staff for their report, and to Mr. Daïri for his helpful buff statement in which he explained the motivation behind the Moroccan authorities' request for a fourth Precautionary Liquidity Line (PLL) arrangement. We agree with staff and the authorities that Morocco's balance of payments remain vulnerable to external shocks, especially oil price volatility.

We support Morocco's request for a fourth PLL arrangement at an access level of 240 percent of quota as a safeguard against external risks. The authorities have treated successive PLL arrangements as precautionary, and we welcome their intention to only draw on a new PLL in the event of severe exogenous shocks. Reduced access is a welcome sign of ongoing plans to exit the facility, and a reflection of the progress made to strengthen Morocco's fiscal and external buffers and transition towards a flexible exchange rate regime to help absorb shocks. Absent a major change to the external risk environment, Morocco should continue down a path of gradual exit from the PLL, particularly given that markets did not react to the expiration of the last PLL arrangement.

Work remains to implement structural reforms that will create inclusive growth. We acknowledge the difference of views between staff and the authorities on the pace of structural reforms since late 2016 but also note that both parties strongly agree that there is work to be done. The authorities could prioritize those reforms that will address high levels of youth unemployment and increase female labor force participation rates, which includes taking steps to support education and skills training. The business environment would be much improved with greater competition, particularly from SMEs. The achievement of these structural reforms will depend on public support, government will, and on having sufficient fiscal room to maneuver. References to the PLL supporting the authorities' program to foster inclusive growth, the arrangement helping to move towards a new growth model that is broad based and inclusive, and the inclusion of structural reforms as achievements under the PLL (box 1) could all imply that the PLL itself drives increased inclusion/structural reform. Are structural policy outcomes in Morocco considered to be linked to PLL program design?

We agree with staff that medium-term fiscal consolidation is essential to reduce public debt and accommodate social spending while minimizing impacts on growth. To boost revenues, the authorities are encouraged to consider those tax reforms that can both broaden the tax base and reduce distortions in the tax system. Public financial management reforms will improve the efficiency of public spending, including enhancing the targeting of social spending.

Oil price volatility is the number one risk to Morocco's current account and may warrant greater analysis in the staff report. Staff's observation of trends in the price of Brent crude show the volatility of this benchmark. That volatility was exemplified by a nearly 30 percent fall in prices over the last two months. While it would be inadvisable to anchor the PLL in uncertain oil price projections, staff might consider including a sensitivity analysis of Morocco's external position under a range of oil price scenarios. This could be useful companion analysis to the existing assessment of access based on a multifaceted downside scenario, which includes an oil price increase among other shocks.

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

We thank staff for the report and Mr. Dairi for his informative statement. Since 2012, successive Precautionary and Liquidity Line (PLL) arrangements have supported Morocco's macroeconomic performance and reform implementation. Notwithstanding economic fundamentals and the macroeconomic policy framework remain sound, similar risks prevalent in the onset of the 2016 PLL persist, mainly characterized by challenging geopolitical and regional security conditions, lower expected growth in the euro area, and more volatile financial conditions for emerging market economies. Therefore, we believe further PLL support will provide valuable insurance against shocks, while bolstering ongoing efforts to improve resilience. Against this background, we support Morocco's request for a new two-year PLL arrangement and provide specific comments for emphasis and discussion.

Morocco has benefitted from PLL access and continues to meet qualification criteria for a successor arrangement. Overall, progress attained under past access to the precautionary facilities have helped Morocco cope with vulnerabilities and support investor confidence amid consistent reform implementation. Over the six years through 2018, macroeconomic adjustment and the structural transformation of Moroccan economy have been notable as forcefully described in Mr. Dairi's useful statement. Furthermore, the country continues to perform strongly in three of five PLL qualification areas (financial sector soundness and supervision, monetary policy, and data adequacy), and does not substantially underperform in the remaining two areas (external position and market access, and fiscal policy). We believe a new PLL arrangement will give authorities the opportunity to continue progress toward strengthening the external buffers, supporting fiscal sustainability, and promoting a private sector-led growth model.

Higher budget deficits in 2018–19 are not expected to derail medium term fiscal consolidation. Authorities' efforts to strengthen the fiscal framework and exercise great expenditure restrain have driven a steady reduction of the budget deficit and stabilize public debt. However, exogenous factors decelerating corporate tax revenue and grant flows in a context of higher oil prices and steeper domestic subsidies, are holding back this trend in the near term. Staff projections suggest fiscal adjustment will resume in 2020 and stabilize the deficit at around 3 percent of GDP, while debt-to-GDP ratio is expected to converge to 60 percent over the medium term. In any case, important structural challenges remain to reach the proposed targets and secure fiscal sustainability, including securing the financial sustainability of public pensions, simplifying the VAT system, streamlining tax exemptions and elevating the efficiency of social expenditure.

Despite progress, renewed efforts to secure steadfast reform implementation, particularly in the labor market, are critical to boost potential growth and make it more inclusive. We associate ourselves with the proposed reforms focused on diversifying the economy, improving education, and strengthen governance, which are key factors for accelerating medium term growth. At the same time, structural impediments in the labor market remain a major hurdle to growth that limit the contribution of labor and prevent the economy from reaching its potential. In addition, institutional factors and distortions in the labor market continue to play a significant role in the decline of Morocco's total factor productivity (TFP) growth over the last decade. Addressing these bottlenecks is warranted to cut down unemployment, particularly among the youth, reduce income and regional inequalities, and fight poverty more effectively.

Authorities continue to treat the arrangement as precautionary. The proposed reduction of access compared to previous arrangements, both in absolute terms and in percent of quota, is a welcome development that provides strong evidence of authorities' commitment to gradually exit the facility. Moreover, both the duration and access level recommended by staff is consistent with the size and the potential persistence of downside risks as evaluated in the adverse scenario. Similar to previous arrangements, the proposed access to PLL carries low risk to the Fund. Even in the event of a drawing, risks would be further mitigated by the country's relatively low external debt levels and debt service obligations. In any case, we would expect that even if the external environment remains challenging, Morocco's continued strengthening of its resilience should reduce the need for PLL support in the future.

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

We thank staff for the well written report and Mr. Daïri for his informative buff statement. We support the Moroccan authorities' request for the new PLL arrangement that should be instrumental in strengthening the economy's resilience to external shocks and promoting higher and more inclusive growth. We agree with staff's assessment that Morocco is eligible for the PLL. It is also encouraging that the authorities are planning to treat the new PLL as precautionary.

Under the previous PLL arrangements, the authorities have made important progress in reducing domestic vulnerabilities and preserving macroeconomic stability. At the same time, Morocco faces elevated external risks related to a more challenging external environment, global policy uncertainty, and higher oil prices. Further boosting growth potential and sustaining non-agriculture output require continuing improvements in the business environment, education systems, financial inclusion, and labor markets. Staff mentioned "euro area growth" among the key downside risks to Morocco's economic outlook and rightly attributed the highest weight in the External Stress Index to developments in Morocco's key trading partners. Against this background, we would appreciate staff's additional elaboration on how the ongoing slowdown in the large economies in the European Union could impact the external position and growth prospects in Morocco.

According to staff, the current mix of accommodative monetary policy and slower fiscal consolidation is appropriate due to the temporary impact of higher oil prices. Inflation is projected to remain around 1-2 percent over the medium term. GDP growth prospects are favorable, as it is projected to reach 3.1 percent this year and move gradually to its potential of 4.5 percent by 2023. The fiscal deficit has been reduced over the recent years, and staff assess public debt as sustainable.

Although the current account deficit is expected to widen somewhat to 4.5 percent of GDP in 2018, it remains close to its average level under the previous PLL arrangements. Moreover, the ARA metric adjusted for capital controls points to a sufficient level of foreign exchange reserves (figure 4, page 16). At the same time, we would appreciate staff's additional comments on the key reasons behind the expected drop in international reserves in absolute terms and in percent of the not-adjusted ARA metric (from 93 percent in 2017 to around 85 percent in 2018).

Despite the authorities' intentions to reduce public debt under the previous PLL arrangements, its level has been climbing up. Public debt was at about 65.1 percent of GDP in 2017 vis-a-vis 56.5 percent of GDP in 2012. We also note that the outlook for Morocco's sovereign rating has been downgraded by two rating agencies due to the expected deviation from the fiscal adjustment plan. Against this background, we encourage the authorities to resume fiscal consolidation, as economic conditions strengthen. The authorities are well advised to design comprehensive tax and civil service reforms, as well as strengthen the effectiveness of PFM, SOEs, and public spending. Could staff provide more details on the authorities' privatization plans and any contingency plans in case of shortfalls in privatization proceeds?

We agree with staff that a more flexible exchange rate regime will help improve external competitiveness of the Moroccan economy. In this context, we welcome the authorities' decision to widen the dirham fluctuation band to 2.5 percent (from 0.3 percent) on either side of the reference parity. Staff argue that the overall conditions for the introduction of greater exchange rate flexibility remain in place. At the same time, changes in the monetary policy regime in the current more volatile global financial conditions could trigger substantial market pressures with adverse implications for financial stability. Are there sufficient safeguards for mitigating these risks? Could staff elaborate on the REER developments on the basis of the EBA methodology?

Staff's justification for the proposed access level raises several questions. The new adverse scenario assumes a simultaneous materialization of downside risks that result in a smaller size of shocks than under the 2016 PLL (Box 3, p. 28). This looks somewhat counterintuitive to us, as the more challenging external environment with higher oil prices and weaker growth outlook for the euro area could now be less favorable for Morocco. Comments are welcome. As a related matter, we would also appreciate staff's comments on why the threshold for international reserves in terms of the ARA metric has been decreased from 90 to 80 percent under the calculation of potential financing gap. We recall that in the 2014 and 2016 PLL arrangements staff used the threshold of 90 percent of the Fund's ARA metric.

Staff could have presented the options for an exit strategy in greater detail. The exogenous risks for the Moroccan economy could be long-lasting, and, in our opinion, the PLL arrangement should provide the authorities time for accumulating buffers to face any type of shocks. However, the proposed PLL arrangement targets the low level of international reserves of 90 percent of the Fund's ARA metric, even below their average level over the recent years. In our view, larger external buffers are warranted for Morocco to reach the exit from the PLL. Staff may want to comment.

We welcome the program's focus on addressing governance vulnerabilities that can lead to corruption. Clearing the large stock of VAT credits and reporting publicly on the progress in the national governance strategy would be important steps in this area. We also welcome the authorities' attention to the country's ranking in the World Bank's Doing Business indicators. Going forward, it is important to complement staff's analysis of possible governance vulnerabilities in Morocco by using reliable sources of information, including a body of knowledge derived from the Fund's own experience, including its analysis of fiscal transparency, Public Investment Management Assessment (PIMA), VAT c-efficiency, as well as additional inputs from the World Bank. It is also paramount to include a disclaimer about substantial shortcomings of the perception-based third-party indicators, such as the 2017 Worldwide Governance Indicators on control of corruption and government effectiveness (page 19).

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

We thank staff for the report and Mr. Dairi for his comprehensive buff statement. We commend the authorities for having enhanced the resilience to adverse economic developments and consent to their request for a PLL arrangement. However, more decisive steps towards an exit from the PLL could have testified to Morocco's economic resilience, thereby sending a signal of strength. This is an opportunity the authorities risk missing in the currently (still) benign environment of global growth.

We agree with staff on the policy priorities going forward, including (i) continuing fiscal consolidation efforts to secure fiscal sustainability over a longer time horizon, (ii) accelerating the implementation of the structural reform agenda and steadfastly strengthening public governance and combatting corruption, (iii) making further progress towards greater exchange rate flexibility to deal with external shocks, as well as (iv) continuing to enhance financial sector soundness.

We agree with staff that the formal qualification criteria for a PLL are broadly met, although the staff rightly points to the elevated current account deficit and the continuing challenges in the fiscal area.

Considering that over the last years Morocco has proven to be sufficiently robust to deal with unfavourable periods, the country would have been well-positioned to exit from the PLL. Progress was made in enhancing the resilience of the Moroccan economy and overall, the Moroccan authorities performed broadly well in terms of buttressing macroeconomic stability and implementing structural reforms when compared with regional peers, even though the pace of reform implementation needs to be significantly stepped up.

At the very least the current juncture would have provided a good opportunity to send a credible signal of a future exit from the Fund's financial support by more substantially lowering access and/or shortening the duration below the maximum length. We encourage staff and authorities to consider and implement more decisive steps towards a timely exit in the context of future reviews under the new arrangement. This would also help assuage concerns about the long-term use of the Fund's precautionary facilities, given Morocco's nearly uninterrupted access to IMF resources since 2012. Staff comments would be welcome. While taking note of the moderately reduced access level proposed by staff, we would have seen scope for a much more pronounced reduction of access. We note that the estimated total shock of 8.4 billion USD would be covered by 36 percent through the upcoming PLL arrangement. In comparison, the adverse shock estimated at the 2016 request of 13.3 billion USD was only planned to be covered by 27 percent through the previous PLL arrangement. We therefore wonder why the implied fraction of a severe shock being covered by the arrangement should be increased compared with the prior situation and despite an overall enhanced resilience. Staff comments would be welcome.

Also, we do not fully share staff's analysis regarding external risks, which we consider to be manageable. Besides rather vague and all-encompassing remarks on general geopolitical risks and global policy uncertainties, staff emphasizes higher oil prices and a worsening of the situation in the euro area as relevant external downside risks to Morocco. While acknowledging that high oil prices can put a considerable strain on the economy, oil price pressures eased most recently and even the price peak during this summer is well below the level experienced in the period of 2011-2014 when Morocco had more limited buffers at its disposal. Also, the improvement of the economic situation and stability of the euro area since the first PLL arrangement could have been better taken into account. Finally, Morocco has proven to be remarkably resilient to recent emerging market turmoil as indicated by sovereign spreads that have shown a decreasing correlation over time with the emerging market segment and were seemingly unaffected by the expiration of the last PLL arrangement.

We welcome the authorities' intention to increase pace and coordination of structural reforms and appreciate their 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.

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

We thank staff for the detailed report on the request for an arrangement under the Precautionary and Liquidity Line (PLL) and Mr. Daïri for his informative buff statement. Morocco has used three PLLs since 2012 and the latest arrangement expired in July 2018. We positively note the Moroccan authorities' assessment that previous PLL arrangements have served well for their country as a valuable insurance against external risks while helping to reduce fiscal, external and financial sector vulnerability and sending positive signals to market participants. We agree with staff's assessment that Morocco continues to meet the PLL qualification criteria. This achievement is presumably based on the policies implemented with the support of previous PLLs. Hence, it is encouraging that PLLs have served its intended purpose and we commend the Moroccan authorities' commitment to sustaining sound policies under these arrangements.

Morocco's macroeconomic conditions remain broadly positive. Growth has rebounded, and inflation remains subdued. However, although the budget deficit has declined, the fiscal situation needs improvement and the external position has also weakened. Social tensions have increased since 2017. In this context, we agree with the need for continued efforts to build on the progress so far by accelerating reforms to enhance resilience and strengthen buffers, while promoting inclusive growth to address structural issues, such as unemployment and social inclusion. Hence, we support the request for a successor arrangement, based on staff's assessment and remaining vulnerabilities of the country. We limit our comments to the following points for emphasis.

We encourage the authorities to continue with steadfast implementation of reforms to raise potential growth and make it more inclusive to reduce social and spatial disparities. We positively note the improvements in the Doing Business Ranking in Morocco. However, the achievement of more private sector-led growth requires further improvement in the business environment and diversifying the production base. We also noted the constraints faced by SMEs in terms of competitiveness. We would welcome staff comments on the long time that it has taken to operationalize the Competition Council set up in 2014 and the plans to continue its work with the recent appointment of its Chair. The relatively high unemployment, particularly among youth, requires long term structural reforms to improve employment, including for women. Hence, we support the authorities' efforts to improve the functioning of the labor market, including reforms in the education and skill development sector.

More financial resources are essential to meet capital and social expenditures to tackle current social tensions. Hence, we fully support the authorities' measures to strengthen the budget to reduce the public debt to GDP ratio over time, while securing priority investment and social spending to provide social protection to vulnerable with improved coverage and targeting. We also emphasize the continued allocation of appropriate resources to meet the demand for better access to health service, education and other public infrastructures, amplified by social tensions. In addition, sustained efforts to boost the non-oil revenue mobilization through further reforms in tax policy and administration and keep expenditure under control while managing its quality and efficiency, are important to maintain the consolidation gains. Sound public financial management will also help safeguard the sustainability of the fiscal operations. We would welcome staff comments on the recently adopted Decentralization Charter.

Monetary policy has been accommodative, given the moderate inflation and subdued credit growth but the vigilance on emerging risks is essential. It is encouraging to see that the adoption of new Central Bank Law is progressing. It will reinforce the independence and institutional capacity of the Bank Al-Maghrib (BAM), while facilitating the transition toward the envisaged inflation targeting framework.

The external sector position has weakened recently. Staff assesses that underlying current account deficit remains relatively high but is broadly in line with fundamentals. We commend the introduction of greater exchange rate flexibility since January 2018, which would improve external competitiveness and help in better managing the external account with strengthened absorption capacity to external shocks. We also note that exchange rate fluctuations have been very limited since January 2018. In this context, we would welcome staff’s comments on the next phase of the actions to sustain greater exchange rate flexibility.

Morocco’s banking system is well-capitalized, sound and resilient. Although the NPL ratio remain elevated, provisioning levels are comfortable. We note that bank supervision is moving to a more risk-based and forward-looking approach. Continuous improvement in supervisory capacity, adoption of regulations for financial conglomerates and promoting strong market risk management practices, particularly in the context of the transition to a more flexible exchange rate regime, remain key priorities. The planned national financial strategy is a step forward to improve financial inclusion.

Finally, we positively note the authorities’ intention to treat the new arrangement as precautionary and the gradual reduction in the access level. We urge authorities to use the PLL arrangement to put the Moroccan economy on a sounder footing with more resilience to shocks and improve the prospects for an eventual exit from the PLL arrangement in a timely and orderly manner. Staff comments are welcome.

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

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

We thank staff for a comprehensive report and Mr. Dairi for an insightful buff statement.

Morocco continues to register robust growth, underpinned by strong economic fundamentals and sound policy frameworks. Further, they continue to meet the qualification criteria for PLL. Accordingly, we support the authorities request for a new arrangement under the PLL to further enhance economic resilience and reset the growth model to achieve diversified, accelerated, and inclusive growth.

Medium-term fiscal consolidation is required to further reduce public debt and preserve fiscal space. In this regard, we commend the authorities' efforts to contain expenditure, but remain concerned with revenue underperformance in 2018. Against this background, we urge the authorities to intensify revenue mobilization efforts by implementing further tax reforms, including streamlining exemptions, strengthening VAT collections and improving corporate taxation. We welcome measures to further reduce the public wage bill, implement subsidy reforms, and strengthen spending efficiency. Additional reforms are however, required to better-target social expenditures. In this vein, we are encouraged by the on-going work supported by the World Bank, to develop a unified population and social registry. We take note of the authorities' plans to issue sovereign bonds in early 2019 and underscore the need to preserve debt sustainability. In view of the existence of fiscal space, could staff clarify the opportune time for the authorities to leverage these buffers to boost growth and social outcomes?

Adequate capital buffers remain important to help banks absorb losses emanating from the introduction of the IFRS9. To this end, we urge the authorities to prioritize the re-capitalization of banks and continue efforts to upgrade loan classification and provisioning practices. Further, we consider intentions to clear VAT credits and expand credit bureau coverage as essential to improve corporate balance sheets and improve banks' asset quality. Could staff clarify whether the adoption of syndicated lending has been effective in reducing concentrated credit exposures? While we appreciate the expansion of banking operations to other African countries, we emphasize the need for continued collaboration with regional supervisors to closely monitor and mitigate potential cross-border risks. In addition, greater focus on mitigating AML/CFT risks to reduce pressure on the termination of correspondent banking relationships (CBRs), is required. Meanwhile, we are encouraged by the authorities' plans to upgrade monetary policy and transition to greater exchange rate flexibility. At the same time, we welcome progress made towards strengthening central bank independence.

Sustained structural reform efforts remain essential to strengthen economic resilience, raise growth potential, reduce youth unemployment and address inequalities. In this vein, we welcome the country's doing business reforms that have culminated in improved investment ranking. However, given the expected FDI inflows coupled with other capital goods imports for key infrastructure projects, we would have expected staff's medium-term growth projections to be even higher. Staff comments are welcome. Furthermore, we underline the need for continued efforts to improve SME competition, simplify investment procedures, and implement measures to promote financial inclusion. We also support the authorities' plans to strengthen the governance and oversight framework for state-owned enterprises (SOEs) while aligning their business models with core mandates. In addition, on-going reforms aimed to improve education outcomes and reduce labor market rigidities should be sustained. We also view current efforts to extend the portfolio of assets that can be used as collateral, including moveable assets, as important to tackle impediments to SMEs' access to finance. Recognizing the divergent views on the reform momentum as highlighted in the buff Statement, could staff clarify why they differ with the authorities?

Finally, we take note that the authorities have expressed an interest in a two-year arrangement, with lower access levels than the previous PLL. We encourage the authorities to continue monitoring global and regional risks and to communicate their exit strategy.

Mr. Rashkovan and Mr. Jost submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Daïri for his informative buff statement. Based on Morocco's track record of sound policies and the authorities' commitment to reforms going forward, and given the enduring geopolitical and security risks and more volatile global financial condition, we support their request for a PPL. We broadly concur with staff's recommendations and notably agree on the importance to continue developing human capital, reducing social and spatial disparities and addressing high youth unemployment standing at around 25 percent. The following points are for emphasis.

As on previous occasions, we would like to highlight the importance of a clear and gradual exit strategy that prevents the unnecessary prolonged use of precautionary arrangements. In this sense, we welcome staff's assessment that Morocco is well positioned for exiting the PLL once global and regional risk subside. In addition, while the pace of the reduction of access levels appears to be decelerating, it is encouraging that the amount of the PLL request has been lowered over the course of time. Such gradual reductions in connection with an exit plan can be positively interpreted by the financial markets. We agree with staff on the importance of communication.

Staff notes that international reserves are projected to reach about 90 percent of the ARA metric by the end of the PLL. We note that international reserves already amounted to 93 percent of the ARA metric in 2017 and are projected to decline to 85 percent in 2018. At the same time, the third review under the PLL assumed a reserve coverage of 95 percent in 2018. Could staff comment on the causes of this shortfall? Considering these developments, we underscore the importance of the measures taken by the Moroccan authorities to further increase exchange rate flexibility.

Given that fiscal efforts remain necessary–including regarding the public wage bill–we welcome the authorities' plans to stabilize the deficit and put debt trajectories on a declining path. The fact that both the gross financing needs and debt levels are projected to trend downwards, following the increases of recent years, is welcome. We take note of the impact that higher fossil fuel prices had on fiscal developments, notably via still existing energy subsidies. We thank Mr. Daïri for his explanations that necessary reforms of the subsidy system are expected to be completed by end-2019 and remaining subsidies are expected to be replaced with targeted transfers to the poor. We encourage the authorities to continue their efforts on this socially sensitive issue.

In the report, staff refers to the authorities' efforts to strengthen the governance and oversight of SOEs, such as consolidating SOE balance sheet data, which is a commendable step. Similarly, the report mentions FAD's technical assistance on assessing and mitigating "SOE-related fiscal risks", which we explicitly welcome. The staff report also mentions plans to clear VAT credits due to public and private enterprises, amounting to around 4 percent of GDP. While we take positive note of staff's assessment that public debt levels, standing at 65 percent, remain sustainable, the DSA does not seem to refer to SOE's balance sheet impact on the overall fiscal position or risks to the debt trajectory. We would like to use the opportunity to ask staff whether fiscal data from SOEs have been considered in the DSA? Does staff consider implicit liabilities in SOEs (or PPPs) to pose a risk to the fiscal position or debt developments? If yes, is staff in a position to provide an order of magnitude?

As staff, we see value in promoting a more transparent, accountable and effective public sector, as it will likely build confidence and, in turn, attract private investment. Here, we welcome the plans to strengthen the oversight role of the Parliament and the Cour des comptes, as well as the planned operationalization of the Competition Council. Similarly, we commend the authorities' efforts to address governance vulnerabilities including illicit enrichment. We appreciate the efforts within the 2017 PIMA exercise and concur with staff that the authorities should aim at implementing key recommendations contained therein in order to increase the efficiency of infrastructure spending. Similarly, the effectiveness of social spending should be closely monitored and increased in order to protect the poor and reduce inequalities. Overall, we would like to commend the authorities' commitment to reforms in this context.

Mr. Virolainen and Ms. Gunnarsdottir submitted the following statement:

We thank staff for the report and Mr. Daïri for the informative buff statement. We support Morocco's request for a new PLL arrangement given the risks in the external environment and as Morocco continues to meet the qualification criteria. We welcome the authorities' intention to treat the PLL as precautionary. The authorities have generally implemented sound policies and the previous PLLs have been a good anchor in that regard. We welcome the written communication provided by the authorities in the appendix highlighting the commitment to their reform agenda. We agree with the thrust of the staff appraisals and the proposed focus under the PLL but offer the following comments for emphasis.

Steadfast implementation of the reform agenda going forward will be crucial to continue to enhance the country's resilience and readiness to exit this arrangement once conditions allow, preventing a prolonged use of the instrument. We welcome the decrease in the access level from the previous arrangement to 240 percent of quota, signaling a step towards an exit as external risks have decreased somewhat. We encourage the authorities to continue to work towards an exit of the PLL over the period of this arrangement and to consider a well communicated exit strategy. The most important way to achieve this is to continue to increase the resilience of the Moroccan economy. Following through with the fiscal consolidation and structural reform agenda will be crucial in this regard, with focus on revenue mobilization and rationalization of expenditures. We look forward to the outcome of the 2019 national conference on taxation with the aim of designing a tax reform strategy. Expenditures need to be prioritized towards accelerating the necessary structural reforms while sustaining social spending. In this context, enhancing the education system as well as labor market reforms to reduce structural unemployment continue to be key. Furthermore, better targeting of social spending is needed and we take note of the work underway in this regard, as noted in the buff statement.

Additional steps should be taken towards a more flexible exchange rate regime to improve the economy's competitiveness and enhance its shock absorption capacity. We welcome the smooth start of this transition. Staff comments on when the next steps can be taken would be welcome, i.e. what are the necessary conditions for that?

We welcome the Organic Budget Law under implementation as it will reinforce public accountability. A more transparent and accountable public sector will be beneficial to decrease civil unrest, the perception of corruption, and to attract more private sector investment. We also welcome the ongoing efforts at improving governance and fighting corruption in Morocco, which will in turn further enhance the business environment.

Further efforts to enhance the financial sector are needed. Risks associated with the high level of non-performing loans need careful monitoring and banks' capital position should be enhanced according to plan. Improving financial inclusion is also of importance.

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

We would like to thank staff for their comprehensive report, as well as Mr. Daïri for his insightful buff statement.

We concur with the staff's assessment of improving macroeconomic conditions in recent years. Morocco continues to meet the PLL qualification criteria, and the level of access requested appears in line with the stress scenario and the current level of risks, in an environment where external risks are elevated. The PLL will continue to support the authorities' reform efforts aiming at ensuring stronger and more inclusive growth. We therefore support the request for a precautionary and liquidity line for Morocco and wish to offer the following comments:

Regarding fiscal policy, we note the slowing down of fiscal consolidation in 2018, mainly due to exogeneous factors. Further fiscal consolidation will be necessary in the coming years, to ensure that debt remains on a downward trajectory and to allow for sufficient policy space to fund critical development needs. Raising the level of public revenues is warranted, and we are encouraged by the steps proposed in the draft 2019 budget. Staff recommends raising existing taxes. However, it seems equally important to broaden the tax base - could staff elaborate on the possibility for such policy reforms to happen? In addition, we understand that the privatization process will be important to ensure that fiscal targets are reached. Could staff share the timetable for these privatizations? Staff also mentions that donor support has been delayed in 2018, which is having a direct effect on the deficit. Does staff have an indication of whether donor commitments will be disbursed before end-2018?

Regarding monetary and external sector issues, we concur with staff's assessment that Morocco performs strongly, thanks to low and stable inflation. We encourage authorities to continue their efforts towards increased exchange rate flexibility, which will help Morocco's resilience to shocks. In addition, financial sector soundness and supervision appears to be strong, even though some clouds have appeared on the horizon, including a higher number of NPLs (which are provisioned at a comfortable level) and the shift towards riskier investment locations in Africa. Ensuring larger credit access will be key, particularly for SMEs. We have taken note of the significant level of collateral required of SMEs in Morocco. Has staff looked at the possibility of developing a similar framework as the one recently developed in Egypt with WBG assistance (movable collateral registry project)? Finally, the economy is showing strong signs of export diversification, which will support a stronger current account.

The PLL should be taken as an opportunity to support the authorities' structural reform agenda. The reforms outlined in the buff statement are promising. As inclusion appears to be a key issue that the authorities wish to tackle, it will be particularly important to continue to enhance social transfers, to ensure they are well targeted and enhance the standards of living of their recipients on a durable basis. Authorities should be commended for improving the business environment over the years. Further efforts will be needed, for instance on payment delays and the labor market. We strongly welcome the recent nomination of a president for the Competition Council, and hope that this important institution will soon be operational. Finally, public sector governance should continue to be improved, including through the implementation of the anti-corruption strategy.

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

We thank staff for the informative reports and Mr. Daïri for his helpful buff statement. We support the proposed decision for the approval of a new two-year PLL arrangement of SDR 2.1508 billion. We broadly agree with the thrust of the staff's appraisal and limit our comments to the following for emphasis.

The Moroccan economy has continued to improve, supported by a satisfactory agricultural sector performance and sound macroeconomic policies. The three successive PLL arrangements, which provided useful insurance against external risks, helped strengthen fiscal and external buffers in a challenging external environment, sending positive signals to the markets. We take positive note that important reforms were implemented during the third PLL arrangement, in particular the pension reform and greater exchange rate flexibility.

The overall balance of risks remains tilted to the downside. Delays in implementing fiscal consolidation and structural reforms could reduce fiscal space and contribute to social tensions. Oil prices, euro area growth, and geopolitical risks and global policy uncertainty could significantly affect the Moroccan economy. If these risks materialize, they would adversely affect the recent improvement in macroeconomic conditions. In this regard, we believe a new PLL arrangement would support the authorities to enhance macroeconomic resilience, improve economic fundamentals and put the economy on a more broad-based and inclusive growth path. We also agree with staff that Morocco continues to meet the qualification criteria for a PLL arrangement.

We encourage the authorities to continue fiscal reforms and consolidation to reduce public debt and preserve fiscal space for social and growth-enhancing spending to bring down the public debt. We also concur with staff that several reforms are needed to secure fiscal sustainability and reduce fiscal risks, including a comprehensive reform of the tax system to increase fairness, simplification and reduce distortions, while boosting tax collection to better withstand unanticipated shortfalls in revenues, such as grants. This should be complemented by civil service reform to generate long-term savings while improving the efficiency and quality of public services. Meanwhile, risks from fiscal decentralization and public enterprises should be contained.

We concur with staff that accelerated structural reforms are needed to achieve higher and more inclusive growth. Staff's spider diagrams about structural reforms gave us a straightforward profile of Morocco's performance in the areas of doing business, global competitiveness, labor market, financial development as well as education. Further efforts are needed to improve the overall business climate and competitiveness, building on the current progress.

Taking into account the gradual introduction of the International Financial Reporting Standard IFSR9, which requires banks to upgrade their loan classification, strengthen provisioning, and increase capital, we encourage the authorities to closely monitor asset quality. While we take positive note of the continued expansion of Moroccan banks in Africa, the supervisory authorities should remain vigilant about transmission of risks. In this regard, we encourage the authorities to continue to engage with the hosts African countries to deepen supervisory collaboration to ensure regional financial stability.

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

We thank staff for the informative report and Mr. Daïri for his helpful buff statement. We concur with staff that Morocco continues to meet the Precautionary and Liquidity Line (PLL) criteria and thus, support the authorities' request for a new arrangement under the PLL. We welcome the authorities' intent to treat the new arrangement as precautionary and consider the reduction of the access level to 240 percent of Morocco's quota from the originally proposed 280-percent level as a positive step towards a developing strategy for exiting the PLL. We encourage the authorities to devise – in cooperation with staff – an actionable exit strategy and tailor the communication efforts accordingly.

Thanks to its broadly sound macroeconomic fundamentals, Morocco's economy has recently demonstrated remarkable resilience in the face of a series of shocks. Given the elevated state of global risks, we welcome the authorities' commitment to fiscal consolidation, which is essential to put debt firmly on a downward trajectory and create space for growth-enhancing capital spending. We agree that a comprehensive reform of the tax system should include the alignment of reduced and standard value-added tax rates, less tax exemptions, improved tax collection, the lowering and simplification of corporate tax rates, and higher property tax. We underscore the need to address the fiscal risks stemming from state-owned enterprises, tackle the bloated public wage bill, as well as implement the recommendations of the recent Public Investment Management Assessment. We support the authorities' steps to improve the coverage and targeting of social spending, which will contribute to consolidation efforts and help mitigate the impact of other reforms on the vulnerable segments of society. Concurrent with such improvements to the social protection scheme, we encourage the authorities to redouble their efforts to gradually phase out fuel and basic commodity subsidies.

Morocco performs strongly in the monetary policy area, as demonstrated by low and stable inflation. We also commend the authorities for transitioning to greater exchange rate flexibility and encourage further progress in this regard. The initial experience with a wider band seems to be positive, as volatility has been contained without extensive recourse to central bank foreign reserves. The further liberalization of the exchange rate regime would contribute to the resilience of the economy, help protect reserve buffers, and expedite the convergence to the current account norm.

The recent acceleration of the structural reform momentum is a welcome development. One particular objective of the PLL arrangement is to support the authorities' endeavour to secure a stronger, more sustainable, and inclusive growth. Therefore, we would encourage the authorities to make the most of this two-year period and set the necessary reforms in motion so as to ensure that medium-term targets are met and that economic vulnerabilities are reduced. We very much welcome the steps to improve the business environment, as demonstrated by the impressive upgrades in Morocco's World Bank Doing Business indicators. We encourage the authorities to complement this progress with a set of mutually reinforcing reforms of the labor market, education and vocational training, as well as governance, as they are key to enhancing Morocco's growth potential and growth inclusiveness. We would like to highlight the importance of measures to boost female labor force participation, as only a quarter of women over the age of 15 are economically active.

Mr. Tan and Mr. Anwar submitted the following statement:

We thank staff for the well-articulated report and Mr. Dairi for his helpful buff statement.

We support the approval of a new two-year PLL arrangement for Morocco, which continues to meet the PLL qualification criteria. In this context, we commend the country's improved macroeconomic conditions and the authorities' continuing commitment to sound policies and reforms despite the very challenging environment, marked by increasing social tensions, a pick-up in oil prices and lower grants. Going forward, the outlook remains susceptible to external and internal challenges, stemming from elevated geopolitical and security risks, more volatile global financial conditions, delays in implementing key fiscal and structural reforms, and high unemployment and inequalities. With the support of a successor arrangement, we encourage the authorities to accelerate reform implementation to improve economic fundamentals and policy frameworks, and foster higher and more inclusive growth.

We welcome the authorities' commitment in reducing unemployment. Since 2017, unemployment has declined slightly but remains high for the youth and women. In this regard, the staff report has outlined the labor market reforms to increase youth participation in labor markets. Comparatively, there was limited information on providing women with equal economic opportunities. According to the World Bank data, Morocco's ranking (which has remained in the bottom 20 for the past few years) in terms of female labor force participation is 165 among 181 countries. In this light, it would be useful for the authorities if a more complete staff assessment can be provided in the future to promote a dynamic and inclusive labor market. Meanwhile, staff's comments are welcome on the key challenges and potential options to increase female labor force participation.

Greater vigilance is warranted to closely monitor and manage the high NPL stock. While Morocco has a relatively sound financial system, we note that non-performing loans (NPLs) have been rising since 2010 and reached 7.7 percent in September 2018. Notwithstanding that provisioning levels are currently acceptable at 70 percent, liquidity conditions have deteriorated. At the same time, there are potential risks emanating from large credit exposures and the international expansion of Moroccan banks. Several empirical studies consider NPLs as the main source of systemic risk in the banking and financial sector. We would appreciate staff's comments on any measures to bring these NPL down on a timely basis, specifically for private business and household loans?

We look forward to tangible progress from the authorities' ongoing efforts to promote financial inclusion. Morocco has finalized a national strategy for financial inclusion, stating specific objectives and measures to increase financial penetration and reduce financial disparities among population segments. This is a key step toward improving access to financial services for the unbanked. We also note positively that the new central bank law will reinforce Bank Al-Maghrib's independence and expand its mandate with a view to promoting financial inclusion such as by giving priority to micro-enterprises and SMEs.

With these comments, we wish the authorities all the success in their endeavors.

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

We thank staff for a comprehensive report 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 a challenging external environment, the authorities have made notable progress in reducing domestic vulnerabilities in recent years. The authorities 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 period ahead. While we note that the country does not face a financing gap in the baseline scenario, thanks to the continued implementation of sound policies, the balance of payments remains vulnerable to external shocks. In this respect, we agree that Morocco continues to meet the PLL qualification criteria.

Against this background, we support the approval of the authorities' request for a successor PLL arrangement. The authorities' intentions to continue reducing reliance on the PLL instrument, as reflected in progressively reduced access levels, as well treating the PLL arrangement as precautionary are welcome. We expect the new two-year arrangement to provide additional safeguards against external shocks and underpin the ongoing reforms to enhance economic resilience and foster stronger and more inclusive growth.

We agree with staff that the policy mix of still-accommodative monetary policy and slower fiscal consolidation is appropriate at the current juncture. Taking into consideration the comfortable level of international reserves, the moderate inflation environment and the slow recovery of non-agricultural activity and credit growth, coupled with the need to mitigate the downside risks in the current external environment, we consider the implementation of such policy mix is justified. Going forward, we take positive note of the envisaged wide-ranging reforms, outlined in the Written Communication, including in the areas of tax policy and administration and wage bills. We also look forward to the planned overhaul of the tax system, benefiting from the recommendations of the tax conference that will be held in May 2019.

We are encouraged by the ongoing reforms to strengthen public enterprises' performance and oversight and improve the business environment. In this context, we seek staff's elaboration on the progress made in advancing the privatization agenda so far and the envisaged ways for implementation. We would also welcome staff's elaboration on the ongoing Fund's technical assistance to strengthen the oversight of state-owned enterprises and mitigate their fiscal risks.

Finally, we encourage the authorities to press ahead with their labor market reforms to promote employment, particularly among the youth. In this regard, we welcome the authorities' efforts to support education and vocational training and address skill mismatches. We look forward to sustaining the implementation of the national plan adopted last April to promote employment for the period 2018-2019 and to the launching of the planned reform to strengthen the contribution of the agricultural sector to job creation.

With these comments, we wish the authorities further success.

Mr. Raghani and Mr. Carvalho da Silveira submitted the following statement:

We thank staff for the well-written report and Mr. Daïri for the helpful buff statement.

We commend the Moroccan authorities for the solid progress made in tackling fiscal and external vulnerabilities and entrenching macroeconomic stability over the years under the Precautionary and Liquidity Line (PLL) arrangements. While the outlook is for continued expansion, external shocks continue to pose important downside risks to the economy. These include energy prices, volatility in global financial markets, geopolitical tensions, amongst others. Against this backdrop, and the fact that Morocco continues to meet the qualification criteria for accessing the PLL resources, we support the authorities' request for a new two-year PLL arrangement. The new arrangement will serve as an important insurance and support to the authorities' reform agenda aimed at addressing remaining structural bottlenecks to stronger macroeconomic resilience and inclusive growth.

We broadly agree with staff's assessment and the authorities' policy priorities going forward, and therefore would like to offer the following comments.

We welcome Morocco's sound public finances and sustainable public debt, and encourage the authorities to pursue their fiscal consolidation efforts to keep debt on a downward path. We take note of the authorities' commitment to preserving fiscal sustainability through a combination of revenue-enhancing and spending control measures. In this view, we concur that the tax system should be revamped notably by eliminating exemptions while streamlining corporate tax and VAT. To further reduce the wage bill, the reform of the civil service should be implemented, and appropriate mechanism introduced to mitigate risks from fiscal decentralization, as recommended by staff. With regards to state-owned enterprises (SOEs), we praise the authorities' intention to strengthen their governance, oversight and performance through a draft law to be submitted to the parliament in 2019. That said, we would appreciate further details on the forthcoming privatization plan. Given the fact that sixty percent of public investment is realized by SOEs, we also encourage the authorities to continue to implement the recommendations of the 2017 Public Investment Management Assessment (PIMA).

We share the view that the current monetary policy stance is appropriate and welcome the fact that the transition to a more flexible exchange rate regime is advancing well. We encourage the authorities to continue to make progress in their gradual transition to such exchange rate regime and to complement it with a clear communication strategy, in order to anchor expectations and help the economy weather potential external shocks while remaining competitive.

We concur that the financial sector is healthy and well-capitalized. The authorities should continue the efforts underway to consolidate gains of the financial system. In this respect, we note with satisfaction that loan classification and provisioning rules are now aligned with the International Financial Reporting Standards (IFRS 9), and that both the macroprudential and resolution frameworks as well as the international supervisory cooperation on AML/CFT and correspondent banking relationships (CBRs) will be strengthened. Can staff provide an update on the evaluation of

Morocco's AML/CFT regime, based on the revised Financial Action Task Force (FATF) standard? We note the encouragement given by the authorities to support usage of syndicated lending to disperse risks and alleviate large credit exposure. Nonetheless, we would appreciate staff's comments on the reason for the persistence of risks associated to large credit exposure. Non-performing loans (NPLs) should also continue to be addressed thoroughly.

Noticeable progress has been made in advancing the structural reform program, in particular in the ease of doing business and in governance. We agree that further efforts need to be geared towards tackling the still existing structural bottlenecks in the education and training system; labor market participation of youth and women; and access to finance for small and medium-sized enterprises (SMEs). Improving the efficiency of social programs will be essential to protect the most vulnerable populations. Going forward, we encourage the authorities to continue to implement their reform strategy to support job creation and boost competition; and explore the full potential of financial technologies in fostering financial inclusion.

Lastly, we note that prospects for program exit have improved, as the access level of the requested PLL arrangement continues to decrease. We take notice of the fact that the authorities did not draw on the facility although the risks identified in the 2016 PLL have materialized, as underscored by Mr. Daïri in his buff Statement. This highlights the role of the PLL as a successful insurance tool for Morocco and commend the authorities for this achievement.

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

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

We thank staff for its insightful report and Mr. Daïri for his informative buff statement.

Morocco's three successive Precautionary and Liquidity Line (PLL) arrangements have supported the authorities' reform agenda since 2012. Policies and reforms carried out since 2012 have brought down the fiscal and current account deficits by one half and helped reduce fiscal, external and financial sector vulnerabilities. Likewise, the authorities are committed to continue with the reform agenda placing greater attention to social spending and structural reform. We commend authorities for their commitment and achievements.

We support the proposed new PLL arrangement given that Morocco has maintained sound policies and continues to meet the PLL qualification criteria. Morocco is subject to important downside risks that will not disappear in the short term: trade tensions, geopolitical risks, the evolution of oil prices, tension in financial markets and the slowdown in the growth of its main export markets. Staff notes that Morocco performs strongly in three out of five PLL qualification areas, including the financial one. Staff also mentions in its reports that bank capitalization may need to be strengthened, and non-performing loans (NPL), credit concentration, and international expansion, remain significant risk factors. Considering the increasingly volatile global financial conditions, we deem necessary to strengthen efforts to further enhance financial sector soundness to ensure that this area remains performing strongly in the future. Regarding the "not substantially underperforming" areas, we urge authorities to keep on implementing sound policies and accelerate the pace of reforms, especially in the fiscal area. We agree with the two-year duration of the PLL to provide the necessary time to address the structural challenges of the economy.

We welcome that authorities remain committed to a sustainable fiscal path and a track record of sound public finances. In 2017, Morocco continued its policy of fiscal consolidation that started in 2011. However, fiscal consolidation will slowdown in 2018 and 2019. While we agree that the fiscal path for 2018–19 is needed to accommodate the temporary impact of higher oil prices and address social and investment spending, we deem necessary to stabilize the fiscal deficit around 3 percent of GDP by 2020 to gradually reduce public debt. In this endeavor, due to the need to address social and investment spending, we support the implementation of large-scale reforms to boost the tax system's efficiency, fairness, and its contribution to growth. The forthcoming privatization program will also be key to lower government financing needs and to improve the performance of SOEs, including by refocusing their activities on core missions. Therefore, we welcome the recent law expanding the list of SOEs eligible for privatization to ensure that the privatization program is implemented in due time. Staff's comments regarding the calendar and process of the privatization program are welcome.

The external sector position has recently weakened. The current account deficit is expected to widen to 4.5 percent in 2018 from 3.6 percent in 2017, despite sustained exports of phosphate and industrial products. Staff notes that two thirds of the current account deficit deterioration would be caused by energy prices. While we support the transition to a more flexible exchange rate regime, further and faster flexibilization could be assessed based on Morocco's economic structure integration in the value chain and characterized by its oil dependency.

Structural reforms need to be fostered, especially for improving the education system and labor market functioning. We commend authorities for the outstanding progress made in improving the business climate, which lead to a leap of 9 places up the Doing Business 2019 ranking. However, staff notes that limited progress has been made in improving the education system and labor market functioning. Even though unemployment has declined slightly since 2017, it remains high for the youth and women. Could staff advise on the key steps to unlock job opportunities for the youth and women in the National Employment Strategy, and if further measures should be considered?

Over the long run, we deem necessary to foster Morocco's economic diversification to reduce risks and encourage growth. The economy continues to be strongly dependent on the agricultural sector (around 40 percent of employment and 14 percent of GDP). Against this background, we deem necessary to foster diversification towards other sectors, particularly the automotive and aeronautics, which have recently received important investments. To this end, we urge fostering structural reforms to improve competitiveness and making the Competition Council operational to limit anti-competitive behaviors and monopolies.

Mr. Fanizza and Mr. Persico submitted the following statement:

We thank staff for the well-written report and Mr. Daïri for his quite useful buff statement. We strongly support the authorities' request for a new Arrangement Under the Precautionary and Liquidity Line (PLL), because we find Morocco's progress in economic reform has been remarkable, particularly in light of the regional context. We will limit our remarks to the following points:

We share the staff's views that Morocco continues to meet the PLL qualification criteria. However, we understand that, under the third PLL arrangement, the country experienced adverse shocks of a larger-than-envisioned extent without drawing on it, showing significant resilience. With this favorable track record, we would have expected Morocco could qualify for a Flexible Credit Line (FCL), which would have constituted a natural development after completing three PLLs successfully. Could staff explain why an FCL arrangement would not be a useful tool to provide insurance against shocks in support of the authorities' reform efforts? What would it take for Morocco to qualify for an FCL?

We understand from Mr. Dairi's buff that reform efforts have accelerated during the year. This is at a variance with the staff's view that reforms have slowed down since 2016. Could staff explain this different assessment? We believe the authorities should be commended for the new momentum in their reform effort, following the formation of a new government, which may have slowed things down.

Staff's assessment that Morocco "does not substantially underperform in the external position and market access area" seems to reflect the fact that external reserves have been on average at 95 percent of the Assessing Reserve Adequacy metric during the last three years. Our impression is that Morocco fully complies with the other three criteria. We would appreciate it if the staff could comment on the way in which they weighted the four different criteria to come up with their assessment.

We concur with staff that slower fiscal consolidation is advisable, while sustained efforts should continue to improve tax administration and public management. We welcome the authorities' commitment to safeguard social spending while creating fiscal space for pursuing strategic investment. We welcome the authorities' decentralization project, as it can lead to better access public services at the local level. We are wondering whether the authorities plan to further modify the subsidies on the consumption of butane gas to target them better and limit their budgetary costs.

We encourage the authorities to continue in their efforts to mitigate money laundering and terrorist financing risks should continue, as they could also help improve correspondent banking and remittance flows.

We wish the authorities the best in their reform efforts.

Mr. Ray and Mr. Kim submitted the following statement:

We thank staff for their informative report. We also thank Mr. Daïri for his informative buff statement. The Moroccan authorities have a track record of sound policy management, supported by three successive PLL arrangements. Morocco continues to meet the qualification criteria for access to the PLL and we support a new two-year PLL arrangement. We add some comments particularly on exit plans and access level in order for the PLL to be evaluated as a further useful precautionary lending facility of the Fund.

We are aware of the downside risks that are confronted by Morocco and the role of the new PLL in managing those risks. We note that the authorities refrained from drawing on the previous facilities, consistent with their declared intention to treat it as precautionary. We also note that the authorities decided to request a new PLL as an additional buffer against oil prices rallying, trade and geopolitical tension, tighter financial condition, and higher uncertainties.

We welcome the continued reduction in access levels under the PLL since 2012 in line with abating risks and stronger domestic policies. This past performance signals strong prospects of exit from the PLL, that said, we would prefer if a more granular and forward-looking exit strategy is developed. We encourage the authorities to expedite their plans to develop and communicate a clear exit strategy and encourage staff to ensure exit strategies accompany precautionary arrangement requests. The PLL guidance note states that a key purpose of the exit strategy is to provide a positive signal on the strength and resilience of the economy, so it is an important component of the instrument's success. We recognize that it is difficult to craft an exit strategy that is state contingent yet clearly sign posted, but still see value in staff continuing to do more to better define the key features of exit strategies and road maps. We would welcome staff's views on what an exit strategy could look like for Morocco.

We also acknowledge that the access level has been assessed by the staff given potential balance of payments needs in adverse scenario. We note that the gross international reserves of Morocco have increased, and the size of potential shocks has shrunk relative to the case of the third PLL in Box 3. On the other hand, the size of the PLL as a percentage of shock, which had been decreasing, has increased to 36 percent. We would like to ask staff's view on those inconsistencies.

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

I join Directors in commending the authorities for the sound policy implementation under the previous Precautionary and Liquidity Line (PLL) arrangement, which has improved the Moroccan economy's prospects and resilience. The outlook is favorable, although a challenging external environment has posed downside risks. Directors mentioned in their gray statements the need for continued fiscal consolidation and to accelerate structural reforms to evoke higher and more inclusive growth.

On the PLL, Directors have agreed that Morocco continues to meet the qualification criteria and welcomed the lower access level and the authorities' intention to treat the arrangement as precautionary.

There is also an emphasis on the need for a timely and well-communicated exit strategy from the PLL as soon as conditions allow.

Mr. Daïri made the following statement:

I understand that the PLL format and the drafting of the report is based on the previous Article IV consultation and the views of the Board at that time. It is not surprising that there may be some disconnect in terms of reform implementation because, going back to one year earlier, I do not believe that the PLL request format gives time and space for the staff to enter into the details of the reform implementation.

I have done this, and I am ready to do it. I have three or four pages. I could read all the reforms that have been introduced. I would not like to impose this on the Board, but if the Board wishes me to do it, I will do it, with pleasure.

I thank Directors for their insightful comments and advice and their expressions of support for Morocco's request.

I wish to limit my intervention to comment on the staff's indication that reforms have slowed down and the authorities' exit strategy.

Following a five-month delay in their agreement on a new coalition government, after the general elections in October 2016, the reform momentum has accelerated under the new government, with new momentum reached in 2018. Progress was achieved in a number of key areas. New priorities have been added, and their implementation started. However, several rounds of discussions with trade unions have not allowed consensus on some key reforms in the labor market and the civil service, with trade unions demanding large wage increases as a condition for such reforms. The authorities will continue to engage trade unions and business representatives to achieve agreement on a social pact on a triennial basis while preserving macroeconomic stability.

I do not want to list the details. If colleagues are interested, I will do it. But for the time being, I will discuss the exit strategy.

The authorities are eager to exit the PLL as soon as external risks subside. There was a five-month time during which there was no PLL and there were no adverse impacts either domestically or externally. But things got worse. Oil prices, in particular, reached their peak at the time the authorities made their request for a new PLL.

They have demonstrated a strong commitment to treat the facility as precautionary, even when the economy was subject to major shocks, and will continue to do so, and have continued to reduce access to well below the normal access limits.

Meanwhile, they continue to strengthen the economy’s resilience and build domestic and external buffers to face shocks, including by strengthening the role of exchange rate policy as a shock-absorber, as conditions permit.

Mr. Alkhareif made the following statement:

We have issued a detailed gray statement, in which we expressed our support for the authorities’ request for a PLL. We would like to raise the following points for emphasis.

First, the Moroccan authorities deserve to be commended for a long track record of implementing sound macroeconomic policies and structural reforms. We expect the new PLL arrangement to support the authorities’ ongoing economic reforms, which are expected to improve economic resilience against external shocks and improve the inclusiveness of growth. We encourage the staff to work with the authorities in areas related to improving employment opportunities for females and youth, as well as ensuring successful implementation of social programs.

As Mr. Daïri mentioned in his introductory remarks, the PLL access has been continually declining over time. This, if anything, is a sign of strength and the successful implementation of its reforms. We also appreciate the authorities’ indication that the PLL would be treated as precautionary.

With these remarks, we wish the Moroccan authorities continued success.

Mr. Merk made the following statement:

We strongly commend the authorities for having enhanced their resilience to adverse economic developments, and we consent to the PLL arrangement.

We welcome the reduction in access. That is a step in the right direction. However, more decisive steps toward an exit from the PLL could have testified to Morocco’s economic resilience; thereby, sending a signal of strength.

Lastly, we welcome the authorities’ intention to increase the pace and coordination of structural reforms and appreciate their reform commitment in the context of the G20 Compact with Africa initiative. We encourage our partners in the G20 to further increase their engagement in the compact.

Mr. Castets made the following statement:

Morocco continues to meet the PLL qualification criteria. Therefore, we support the request for a new PLL, which will help the country face a possible deterioration of external risks and will ensure that it will continue to implement the needed structural reforms. In particular, the support provided through the PLL should help the authorities progress the flexibilization of the foreign exchange regime.

I would like to comment on the exit strategy mentioned by some Directors. We would like to state again that it should be contingent on performance. In particular, it depends on the analysis of both external and domestic risks.

Turning more specifically to remarks on the Moroccan economy, we would like to commend the authorities for the progress made over the recent years and say that we share the overall positive assessment presented by the staff. The challenge is to move toward a growth model that would ensure enhanced private sector traction and broader inclusion of the Moroccan population, as well as further diversification.

The country should place a priority on reducing the public deficit and creating the needed fiscal space to ensure that the population can reap the benefits from the growth.

We generally encourage the authorities to further their efforts to enlarge the tax base to contain public wages and to enhance public enterprise governance and oversight.

Finally, on structural reforms, they will continue to be pursued, including through enhancing the business environment and deepening financial inclusion, to the benefit of small- and medium-sized enterprises (SMEs). We also encourage the authorities to look at ambitious labor market reforms to tackle the still high level of unemployment.

Mr. Rashkovan made the following statement:

Based on Morocco's track record of implementing sound policies, the authorities' commitments to reform going forward, and given the geopolitical and global financial situation, we support their request for a PLL.

We also thank Mr. Daïri for his reassurance on the authorities' exit strategy from the PLL. We believe that Morocco's past and future efforts will contribute to a successful exit.

Given that fiscal efforts remain necessary, including regarding the public wage bill, we welcome the authorities' plans to stabilize their deficit and put the debt trajectory on a declining path.

We thank Mr. Daïri for his explanations that necessary reforms of the subsidy system are expected to be completed by the end of 2019 and the remaining subsidies are expected to be replaced with targeted transfers to the poor. We understand the political sensitivity of phasing out full subsidies.

We see value in promoting a more transparent, accountable, and effective public sector, as it will likely build confidence and, in turn, attract private investments. We welcome the plans to strengthen the oversight role of the parliament and the Court of Auditors, as well as their planned operationalization of the Competition Council.

Similarly, we commend the authorities' efforts to continue addressing governance vulnerabilities, including fighting illicit enrichment. We appreciate their efforts within the 2017 Public Investment Management Assessment (PIMA) exercise and concur with the staff that the authorities should aim at implementing the key recommendations contained therein.

In general, we commend the authorities' commitment to reform Morocco.

Mr. Saito made the following statement:

As Morocco continues to meet the criteria, we support the authorities' request for a new PLL arrangement. It is encouraging that the authorities remain committed to maintaining strong policy and reform implementation and intend to continue reducing their reliance on the PLL arrangement and will exit the facility as soon as conditions permit, as Mr. Daïri noted. We encourage the staff to maintain close communications with the authorities regarding their exit strategy and its conditions.

In addition to these general remarks, I would like to offer one additional comment on the presentation of the adverse scenario. We positively take note of the reduced access level, reflecting the improved balance of external risks. However, it is not entirely clear how the staff derived the adverse scenario assumptions and how the assessments of the improved balance of external risks are reflected in those assumptions. While we appreciate the staff's explanation in Box 3, we encourage the staff to provide a more granular explanation of the appropriateness of the access levels, including the rationale for adverse scenario assumptions in similar cases for other countries going forward.

Mr. Kaya made the following statement:

The resilience demonstrated by Morocco in the face of the recent bouts of stress is a testament to the authorities' sound macroeconomic policies and the economy's strong fundamentals. We consider this strong performance to be an indication of the ability of Morocco's economy to stand on its own feet after six years of support under three successive PLL arrangements. Nevertheless, we sympathize with the authorities' preference to retain the buffers provided by another PLL arrangement. In view of Morocco's continued eligibility for the ex-ante qualification criteria, we support the request. We also welcome the authorities' intent to treat the new arrangement as precautionary and consider the reduction of their access level to 240 percent of quota, from the original 280 percent, to be a positive step toward exiting the PLL.

We appreciate the authorities' resolve to continue to pursue a sound policy mix, aimed at further increasing the resilience of the Moroccan economy. Transitioning to greater exchange rate flexibility and pursuing fiscal consolidation are the two key elements of such a sound policy mix. We are reassured by the authorities' determination in this regard, as was highlighted by Mr. Daïri's buff statement. We underscore the importance of improving the coverage and targeting of social spending, which will not only contribute to fiscal consolidation efforts but also will help to mitigate the impact of other reforms on the vulnerable segments of the society.

Concurrent with the improvements to the social protection scheme, we encourage the authorities to redouble their efforts to gradually phase out fuel and basic commodity subsidies.

On that note, we acknowledge that the tone of the staff report, particularly pertaining to the fiscal and external balances, is cautiously optimistic in view of the recent decline in oil prices. Should global energy prices stay where they are today, Morocco, as a net oil importer, would benefit from that. Nevertheless, we are somewhat puzzled that this operation has not been applied strictly in recent cases of oil-exporting economies. In one recent case of an oil exporter, for which the Board endorsed and Extended Fund Facility (EFF) 10 days ago, the staff preferred to adhere to the World Economic Outlook (WEO) oil price assumption. We are questioning this approach. I will quote the staff's response.

"It is too early to conclude that the recent oil price decline will persist throughout 2019. However, if market developments in the coming weeks point to a persistent price decline, staff will liaise with the authorities on the implications for the economy, as per the letter of intent, and advise proper policy reactions to them. Under current program policies, staff's preliminary assessment indicates that oil prices permanently below US$68 per barrel would create challenges to meet the reserve and debt targets. The full implication for fiscal and other program targets will be assessed by the time of the first review. The program could then be redesigned."

Clearly, the program design was based on high oil prices. We believe such examples highlight the need to improve the consistency in program design for oil exporting and importing countries, and we would appreciate the Strategy Policy and Review Department's (SPR) comments in this regard.

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

Ms. Pollard made the following statement:

We issued a gray statement, where we agreed that Morocco met the qualifications for the PLL. We welcome that access has declined, once again, in line with the reduction in downside risks, and that the authorities have committed to exiting from the PLL as soon as conditions permit.

I do not want to repeat our gray statement, but one question has arisen, which is somewhat similar to the issue Mr. Kaya raised, but is more related to the baseline.

In assessing external conditions, the staff uses the external economic stress index, as indicated in Box 2 on page 25. However, looking at this index, we were struck by the fact that the external stress index is currently above zero and we were not sure what that meant. I went back to the January 2014 paper, where it indicates that a score above zero suggests that stress variables are currently better than their historic norms. I would like to hear the staff's explanation of what this means. If stress variables are better than their historic norms and the adverse scenario is quite close to zero, then how does that mesh with the assessment that risks are still elevated? What else is factored into that consideration?

Mr. Moreno (CE) made the following statement:

We have stated our support for the PLL and the extension. I also welcome the explanations made by Mr. Daïri. Access has declined. There was a window of five months where the authorities did not use the facility, and the external risks have tightened globally, particularly for Morocco. We believe the PLL is warranted.

As we did in the October meeting, we would like to insist on a few issues.

First, and echoing Mr. Kaya's comments, related to the strong oil dependency of Morocco, there are two main structural challenges. One of them is their high oil dependency and the other one is the public sector governance that will have to be taken into account in the program.

On the fiscal side, we also believe this is something that will have to be followed closely by the staff. The need mainly comes from the expenditure side—social expenditures, education expenditures, military expenditures. I understand they are going to make military service mandatory. Like

Mr. Castets, we would encourage the authorities to consider enlarging the tax base to maintain the consolidation path.

Finally, on the structural reforms, I would not ask Mr. Daïri to go ahead with the list that he proposed, but we also believe that it is key for the success of the program. One of the issues that we pointed out last time was the competition council. Apparently, the president has already been named, but the setup of the institutional framework was a prerequisite. Now it is important that the new competition authority starts working for the market.

Ms. Levonian made the following statement:

I thank the staff and Mr. Daïri for his buff statement. I will be brief. I will simply provide our key takeaway.

We support a new PLL for Morocco and welcome the move to reduce access since the informal discussion held in October as a sign of gradual exit. However, we associate ourselves with the views of Mr. Ray, Mr. Kim, and several others who have made this point. We would welcome a more specific exit strategy. We understand the challenges of developing an exit strategy for a program that is state-contingent; but as Mr. Daïri outlined in his buff statement, markets did not punish Morocco when the PLL expired in July 2018. This seems like an interesting piece of information to quantify the uncertain impact of the risks facing Morocco.

Perhaps such an exit strategy could begin with the staff undertaking more analysis of the risks facing Morocco and specifically the sensitivity of Morocco's external position to oil prices, which others have mentioned. With that, I wish the authorities well.

Mr. Agung made the following statement:

We have issued a gray statement supporting the approval of the new two-year PLL arrangement for Morocco, which continued to meet the PLL qualification criteria.

We commend the country's improved macroeconomic conditions and the authorities' continuing commitment to sound policies and reform, despite the challenging environment.

We also welcome that the authorities continue to treat the PLL as a temporary additional buffer against shock. The aim of the program to support

Morocco in promoting stronger, more inclusive and pro-jobs growth to further strengthen their economic resilience and fiscal and external buffers, as well as the robustness of the financial system, is very appropriate, giving confidence in post-program resilience.

Going forward, we welcome the authorities' commitment to step up their reform efforts to reduce vulnerabilities and to achieve the medium-term and long-term objective.

With that, we wish the authorities success in their future endeavors.

Mr. Saraiva made the following statement:

Morocco is a very good performer under the PLL, and we fully support its request for a new arrangement. It continues to meet the qualification criteria. Even in the two remaining criteria in which it does not perform strongly, it misses by a narrow margin. The overall performance is very good. It reflects the sound macroeconomic management by the Moroccan authorities, even with the slightly higher budget deficits that we are seeing this year and partly next year, which are mostly due to exogenous shocks. They are being coped with in the right manner within the program.

I want to make a digression because I believe the Fund's precautionary programs have been extremely successful. They have enhanced resilience locally but also with positive spillovers to regional stability and even to a broader asset class of emerging markets. Our assessment of the use of the Fund's precautionary facilities is extremely positive.

I do understand the concerns expressed by several Directors about the exit strategy, but I do not think we should be too obsessed with it. As Mr. Castets has said, exit should continue to be contingent upon the dissipation of risks and the building up of buffers. What is important is that the program includes the steps necessary to raise the buffers so that a country can take the first opportunity as the overall environment improves.

In the case of Morocco, the PLL provides additional insurance for shocks; but also, it can play an important role in supporting the move toward a floating exchange rate. Morocco has taken steps in that direction. I take note of the fact that the dirham basically has not floated. It has stayed stable, even after the broadening of the band. But I should just highlight that one of the features of a flexible exchange rate regime is the way in which one absorbs shocks in a better way. We should not fear the floating but create the conditions to avoid a disruptive movement. The program with the Fund provides this additional confidence to the macroeconomic framework and also this additional layer of buffers to give comfort to the Moroccan authorities to keep proceeding in the direction of a flexible exchange rate regime.

Ms. Mannathoko commended the authorities for their strong policy implementation. She agreed with Mr. Castets and others that the PLL exit should be state-contingent. She noted that Morocco remained eligible for the PLL and that the authorities were monitoring the risks and had even lowered their access level. On a fundamental level, prevention was better than a cure. It might end up costing less to have a precautionary line available in case of need, as opposed to waiting to react to a crisis at some point in the future. She remarked that so long as Morocco was eligible, her chair would support its access to the PLL.

Mr. Trabinski made the following statement:

We support Morocco's request for a PLL arrangement, as the country meets the PLL qualification criteria and is performing strongly in most of the areas. As we issued a gray statement, we would like only to emphasize two particular points.

First, we encourage the authorities' further progress in privatization. In this regard, privatization should be well thought through and conducted within the broader strategic framework that would indicate sectors and prioritize the whole process.

Second, we perceive the gradual decline in access in subsequent program requests of the Moroccan authorities as an indication of an exit. Yet like other chairs, we would like to encourage the authorities to communicate a clearer exit strategy. With that, we wish the authorities all the best.

Mr. Virolainen made the following statement:

We issued a gray statement supporting Morocco's request for a new PLL arrangement, and I want to highlight a few points for emphasis.

I welcome the authorities' intention to treat the PLL as precautionary and the reduction in the access level to 240 percent of quota, signaling a step toward an exit. I encourage the authorities to continue to work toward an exit and prepare a well-communicated exit strategy. Key to successfully reducing reliance on and eventually exiting the PLL arrangement is to continue to increase the resilience of the Moroccan economy by following through with the fiscal consolidation and structural reform agenda.

On the structural reforms, improving the business environment, enhancing the education system, and reforming the labor market are the key. I would particularly encourage the authorities to address the large gender gap in the labor market.

I welcome the Moroccan authorities' commitment to sound policies and wish them all the best in their reform efforts.

Mr. Fanizza made the following statement:

I will not repeat what we said in the gray statement, except that the authorities' reform efforts stand out, particularly in a regional context. This is a country that has gone a long way, and we would like to see these efforts generalized to the region because this is exactly what is needed. I would like to express our support for the authorities. The Fund should do as much as possible to provide encouragement and to help them in that process.

I have a question for the staff along lines of Mr. Saraiva's comments. Look, 95 percent of the assessing reserve adequacy metric (ARA) is adequate. It is an observation consistent with an access level of 240 percent of quota. The staff must have a confidence interval around the metric. If not, why does the staff say that the performance is not sufficient? If there is a 5 percent interval on the estimate, 95 percent is equivalent. Point estimates are irrelevant. What matters is the probability distribution.

I wonder whether we are using an approach that is not based on any complacent judgment on the policy that the country is following, but instead we just at the indicators with an approach which does not take account all factors. I would like to have a better idea of how the metric is computed.

With that, I wish the Moroccan authorities the best. It is a country that has huge potential. It is a key country for the region and for Africa.

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:[1]

> I thank Directors for their comments and questions. I would like to first address one issue raised by Directors, which is the role of the arrangement in improving the prospects for a timely and orderly PLL exit. I will make three points in this area.
>
> First, the external position has been weakened by the increase in oil prices in 2017 and 2018. The economy has been resilient. Reserves remain at a comfortable level, and the authorities did not draw on the previous PLL arrangement. Still, reserves declined and reached a relatively low point of about 85 percent of the ARA metric, or about 5.2 months of imports this year. This buffer should be strengthened to absorb any large external shock in the period ahead, and the PLL arrangement may play a role in this context.
>
> Second, several factors would support a timely exit strategy and a communication strategy about exit. One is that the access level continues to decline, which is a strong signal that the economy is in a better position to absorb external shocks. Another factor is that the exchange rate transition will reinforce this resilience. We believe that it should progress without unnecessary delay.
>
> Third, more broadly, the policies and the reforms supported by this arrangement are expected to place the economy on a path of reduced deficits, declining public debt, higher growth, and increasing domestic and external resilience over the medium term.
>
> The impact of the recent oil price decline, if it is confirmed, may also facilitate and accelerate the PLL exit, depending on the future changes and other external risk factors. We will incorporate this in the first review; but to illustrate, the impact of the lower oil prices under the just-revised WEO assumptions is that reserves would reach about 6 months of imports by 2021, instead of 2023 under the current baseline, and 98 percent of the ARA metric by 2023, instead of 93 percent.
>
> A Director asked about the external stress index and the related discussion about access. In Box 2 in the staff report, the external stress index

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

is negative in the downside scenario but is less negative than at the time of the 2016 PLL request. The key reasons for that are that the oil price increase is lower under the shocks, under the downside scenario, and also that the euro area downturn is less sharp than at the time of the 2016 PLL. However, reserves are lower because of the oil price shock that happened in 2017 and 2018, so access is slightly lower as a result of that.

Finally, there was a question about the 95 percent criteria for qualification and performance in the external area. We do not apply those criteria in a mechanical way, and it is a judgment that we exercise in terms of assessing the qualification and the performance under that criteria. Basically, the reasons why we come to the conclusion are explained in our written responses. It is not just 95 percent per se.

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:

There was a question about the consistency of WEO assumptions in oil-exporting and oil-importing countries, and I understand the challenges that it poses for program design. There was a significant decline in oil prices. It has happened over the recent weeks. Given the fact that some staff reports were issued based on the understandings reached with the authorities ahead of Board discussions, some of those WEO forecasts could not have been reflected in the staff report, and some staff reports could have been issued before the WEO prices were revised. That being said, given the fact that oil prices are volatile, it is important that programs in both oil-importing and oil-exporting countries include sufficient contingencies and sufficient adjustors. The authorities discussed with the staff their plans for how to react to sudden changes in oil prices. In the case of Morocco, the information on the impact of oil prices was provided. The staff's advice is clear, that if oil prices turned out to be lower-than-forecasted based on the current WEO, it is advisable that the authorities achieve the debt target faster than indicated by the previous scenario.

Ms. Pollard remarked that Box 2 of the staff report showed a baseline scenario and a downside scenario. The baseline—depicted by the blue line—went sharply below zero in 2008 and 2009, and had been above zero since 2015. The 2014 report on the external stress index suggested that when that line was above zero, it meant that current baseline risks were below their normal level, so the risks were better than their historical level. She asked the staff to confirm whether she had interpreted the figure correctly.

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:

> The line of the baseline reflects the model assessed risks, relative to the long-term average. In this case, the sample is relatively long, it takes 15 to 20 years of data.
>
> In the case of Morocco, one has to take into account the fact that the geopolitical risks that are quite important are totally outside the model. There is a disclosure in Box 2 that geopolitical risks are not captured. One would think that if we take into account geopolitical risks, maybe the situation is a bit worse than portrayed by the index.
>
> Another point that was made by the mission chief is that because it is a precautionary arrangement, if the contingency scenario or the access scenario materializes, we will be in the negative territory. The risks would be way below.
>
> We do not take the way below zero. These are the blue rectangles. If the drawing scenario materializes, then the stress would be below the historical averages, which would maybe justify the drawing.
>
> But we do not take the mechanical approach, given the fact that an important factor is not invited in the model, and that is recognized in the last sentence of Box 2.

Mr. Daïri made the following concluding statement:

> I will comment on a few points for clarification, and then I will go straight ahead to a brief conclusion.
>
> I want to assure colleagues that the authorities are eager to strengthen revenue performance, and the planned national conference in May would provide an opportunity for setting priorities and their strategy in this area.
>
> On project selection and the PIMA recommendations, the authorities are preparing to implement these recommendations, including a requirement that all projects must be based on ex ante socioeconomic evaluation, with due regard to their impact on employment, reducing regional disparities, and improving the living conditions of the population.

On International Financial Reporting Standards (IFRS) norms, the authorities, at the time of the introduction of IFRS, have ensured that all new loan classifications and provisioning are in place. The authorities gave the usual delay—accepted by the Basel Committee—for completing the recapitalization for the system. The financial supervisors and the banks are on track to meet their requirements here.

I would also mention the introduction of Islamic banks and the sukuk, and the amendment of the securitization law. This opens a new window for more development of the financial sector and more financial inclusion.

On SOEs, enough has been said on this major reform of the principles governing the government's ownership in this sector and freeing resources for better use by limiting SOEs' role to their core mandate.

Regarding the privatization program, Morocco has robust experience with privatization. In the mid-1990s, there was a large privatization program that yielded about 12 percent of GDP. The structures in the Ministry of Finance are well organized to develop and implement a strong privatization program, which should not only free up resources for other uses, private users, but also help revitalize the capital markets and attract FDI.

On social protection, there is a lot ongoing to strengthen social protection. The new development is this drive to improve their targeting and to have a more consistent system that is harmonized across the various initiatives. The launch of the social security registry would be important. On other areas of social protection, Morocco has extended the pension system to reach categories that were not covered, and the same with the basic health coverage.

On gender inequality, a law was adopted in 2018, which created an authority for gender parity, with a focus on promoting a culture of equality, identifying and monitoring all forms of discrimination affecting women, and proposing corrective measures to establish genuine gender parity.

On the anticorruption strategy, work is going on, progress is being made. The first report on the anticorruption strategy will soon be published. The "green number" offered to citizens has allowed them to report on the attempts of some officials to get bribes. Some arrests have taken place, and prosecution and convictions have followed.

On the Competition Council, the Chair and all 12 members of the Competition Council have been appointed. The council is now ready to start its work to help foster competition and the rule of law in the conduct of business.

On the loss on the level of reserves that has been mentioned by Mr. Saraiva and Mr. Fanizza, I would like to remind Directors that the decline in oil reserves was largely linked to the speculation that affected the dirham in mid-July at the time when some banks and other operators thought that the dirham would be made flexible. There was a loss of reserves of about US$3 billion, which went from the central bank to the banking system. It is still in the country. It has not moved. But it so happens that the foreign assets of the banking system are not included in the reserves. If there was flexibility to recognize that the assets are still there, and the reserves are there, and that these assets can help finance the current account—which is true—the assessment of the external position would be much better.

To conclude, I thank Directors for their insightful comments and advice, which I will faithfully convey to my authorities. I also thank the staff for their useful interactions with the authorities and their report and also for their responses to Directors' questions and comments.

Morocco is embarking on a new phase of its development, aimed at putting the economy on a stronger, job-rich growth path, while ensuring that it benefits all segments of society, including the underprivileged, and all regions. This will require an acceleration of the ongoing reforms and the initiation of new ones to enhance productivity, financial inclusion, and the efficient use of resources, to improve governance and public service delivery, and tap potential sources of growth, including from SMEs and those excluded from the labor market, particularly women.

The authorities are committed to maintaining sound macroeconomic and financial policies to support their reform efforts, including by bringing the public debt ratio down to the targeted 60 percent of GDP over the medium term. They are grateful to management and the Board for their continued support.

The following summing up was issued:

Executive Directors commended the authorities for implementing sound policies under the 2016 Precautionary and Liquidity Line (PLL) arrangement. In particular, they welcomed the strengthening of the fiscal policy and institutional frameworks and the start of the transition to greater exchange rate flexibility. Directors noted that economic growth rebounded in 2017 and 2018, and inflation remained low while the external position weakened due to the sharp pick-up in oil prices. They considered that growth is expected to accelerate gradually in the medium term, subject to improved external conditions and steadfast reform implementation. However, they also noted that the external environment remains subject to significant downside risks, such as heightened geopolitical risks, slow growth in Morocco's main trading partners, and global financial market volatility.

Directors concurred that a successor PLL arrangement will provide valuable insurance against external shocks and support the authorities' policies to strengthen the economy's resilience and promote higher and more inclusive growth. They agreed that Morocco continues to meet the qualification criteria for an arrangement under the PLL and welcomed the lower access level under the new arrangement, as well as the authorities' intent to treat the arrangement as precautionary. They emphasized that the authorities' exit strategy should be well communicated in a timely manner, building on strengthened macroeconomic buffers and policy space, and subject to a reduction in external risks.

Directors considered that the authorities' policy package appropriately addresses Morocco's economic challenges. They welcomed the authorities' continued commitment to sound policies and supported accelerated reform implementation. Directors encouraged continued fiscal consolidation to lower the public debt-to-GDP ratio while safeguarding priority investment and social spending in the medium term. They also underscored the benefits of a comprehensive approach to tax reform aimed at broadening the tax base and promoting greater equity and simplicity, sound fiscal decentralization, comprehensive civil service reform, strengthened state-owned enterprise oversight, and better targeting of social spending. Directors stressed the need to continue the transition to greater exchange rate flexibility to enhance external resilience. They noted that adopting the central bank law and continuing implementation of the 2015 Financial Sector Assessment Program recommendations will help improve financial sector soundness. Efforts to deepen financial inclusion were also encouraged.

Directors stressed the importance of building on recent achievements and sustaining the pace of reforms to further improve the business environment, including through continued efforts to strengthen governance. They supported the authorities' intentions to take further steps toward a more private-sector-led and inclusive growth model. In this context, Directors emphasized the need to revamp labor market policies and accelerate implementation of education reforms, which will help to create jobs, especially for the young and women.

The Executive Board took the following decision:

Morocco—Request for an Arrangement Under the Precautionary and Liquidity Line

1. Morocco has requested a Precautionary and Liquidity Line arrangement in an amount equivalent to SDR 2.1508 billion for a period of twenty-four months from the date of the approval of this decision.

2. The Fund approves the Precautionary and Liquidity Line arrangement for Morocco set forth in EBS/18/111, 12/3/18.

3. The Fund waives the limitation in Article V, Section 3(b)(iii). (EBS/18/111,12/03/18).

Decision No. 16460-(18/107), adopted
December 17, 2018

APPROVAL: April 20, 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. ***Given the expected FDI inflows coupled with other capital goods imports for key infrastructure projects, we would have expected staff's medium-term growth projections to be even higher. Staff comments are welcome.***

- Staff's medium-term growth projections already factor in the impact of expected FDI inflows and ongoing infrastructure projects, especially in the automotive and aeronautic industries. One issue is that some of these investments remain import-intensive and that the level of their integration with the local economy needs to increase further to support greater local SME development, job creation and economic growth. Regarding infrastructure projects, the high public investment levels in Morocco have been associated with relatively low efficiency and impact on growth. The implementation of reforms to improve the business environment for SMEs and the efficiency of public spending (e.g., based on the recent PIMA recommendations) should thus help improve medium-term growth prospects.

Fiscal Policy

2. ***Staff recommends raising existing taxes. However, it seems equally important to broaden the tax base - could staff elaborate on the possibility for such policy reforms to happen?***

- Staff has indeed recommended broadening the tax base as part of a comprehensive strategy to make the tax system more fair and equitable (see analysis of the distribution effects of tax reforms presented in the 2017 Article IV Consultation). Key reform priorities include reducing tax exemptions and better enforcing tax payments from the self-employed and liberal professions. The authorities are making progress in these areas, but further efforts are needed and expected, including in the context of the forthcoming National conference on taxation, in which the Fund will participate.

3. ***Staff also mentions that donor support has been delayed in 2018, which is having a direct effect on the deficit. Does staff have an indication of whether donor commitments will be disbursed before end-2018?***

- The bulk of grants is expected from Gulf Cooperation Council (GCC) countries, as part of a multiyear support program. For 2018, the authorities revised down expected grant revenues to 0.6 percent of the GDP (against 0.7 percent in the budget). They are confident that these revenues will be disbursed before the end of the year.

4. ***We are wondering whether the authorities plan to further modify the subsidies on the consumption of butane gas to target them better and limit their budgetary costs.***

- The authorities plan to reduce subsidies on butane gas and have been considering various options to achieve this. However, they intend to implement this reform only once the social registry has been introduced, which is expected in 2019-20. Such a registry will allow to better target social programs on the population groups that are most vulnerable to a reduced butane gas subsidy. Staff is monitoring progress in this area in collaboration with the World Bank and will report to the Board accordingly.

5. ***Regarding the pace of fiscal consolidation, we take note of the staff's suggestion that a slowdown in fiscal consolidation in 2018-19 would be an appropriate response to the temporary impact of higher oil prices. Amid the recent drop in oil prices, have staff changed the views on the pace of fiscal consolidation?***

- A decline in butane gas prices in the period ahead (together with international oil prices) could reduce subsidy spending and generate annual fiscal savings of up to 0.3 percent of GDP in 2019. Staff's view is that the authorities should use such savings to converge faster to their public debt objective of 60 percent of GDP (i.e., by 2023).

6. ***Could staff elaborate on their decision to not push for a fiscal deficit target of less than 3 percent and a public debt target of less than 60 percent of GDP over the medium term, particularly given the projection of increasing growth and improving cyclically-adjusted and structural balances?***

- The exogenous shocks that slowed fiscal consolidation in 2018 led to a medium-term consolidation path that is somewhat higher than previously projected. One reason is the need to maintain a gradual adjustment path to protect the (non-agricultural) growth recovery, which remains sluggish. The authorities also stressed that projecting a deficit below 3 percent of GDP was not realistic given the pressing need to maintain elevated levels of social and public investment spending in the period ahead. Finally, under the projected consolidation path, the government's decision to proceed with privatizations will help finance the deficit without weakening fiscal sustainability and policy space. As a result, public debt is now projected to reach 60 percent of GDP by 2024 (instead of 2023).

7. ***Two rating agencies downgraded Morocco's sovereign rating last month because of the slower pace of fiscal consolidation expected for this year and 2019. We would***

appreciate staff's further thoughts on this recent event and the impact on the credibility of the successor program.

- These recent downgrades are important reminders that market participants closely monitor Morocco's fiscal policy implementation, but also exchange rate reform and growth prospects more broadly. At this point, market confidence remains strong, as reflected in the favorable evolution of sovereign spreads. The authorities remain firmly committed to keep the course of key reforms, including fiscal consolidation and sustainability, especially in the current environment. The proposed program confirms the authorities' commitment.

8. ***In view of the existence of fiscal space, could staff clarify the opportune time for the authorities to leverage these buffers to boost growth and social outcomes?***

- Morocco has some fiscal space, reflecting moderate gross financing needs, a balanced debt composition, and manageable medium and long-term adjustment needs. A small portion of this fiscal space will be leveraged in 2018-19 to preserve social spending. Going forward, increased policy space will be needed to absorb potential shocks to the economy while preserving social and pro-growth expenditures. Several reforms, including tax reforms, and continued public wage containment will be essential to secure such policy space. A key priority is also to boost public spending efficiency, including by implementing the PIMA recommendations and improving the targeting of social programs.

9. ***We would also welcome staff's elaboration on the ongoing Fund's technical assistance to strengthen the oversight of state-owned enterprises and mitigate their fiscal risks.***

- An FAD technical assistance mission to Morocco took place last month to help strengthen the authorities' management of fiscal costs and risks related to SOEs and Public Private Partnerships (PPPs). At the request of the authorities, the mission reviewed the tools and strategy in place to better manage SOEs operational risks (e.g. strategic plans, sectorial policies) and provided recommendations to better monitor, manage and report those risks, and to support the ongoing revision of the government's shareholder policy and portfolio strategy.

10. ***We would like to use the opportunity to ask staff whether fiscal data from SOEs have been considered in the DSA? Does staff consider implicit liabilities in SOEs (or PPPs) to pose a risk to the fiscal position or debt developments? If yes, is staff in a position to provide an order of magnitude?***

- The DSA attached to the staff report focuses on central government and the debt figures do not incorporate SOE debt. At the authorities' request, a Government Finance Statistics (GFS) technical assistance project is ongoing to extend the coverage of public finance statistics beyond the central government to the general government, i.e., including extrabudgetary and social security units. This TA also entails incorporating third party deposits at the Treasury and netting out intra-governmental claims in public debt data. The implication for DSA will be assessed once updated debt figures become available. Currently, staff does not consider that implicit liabilities in SOEs (or PPPs) pose a major risk to the fiscal position.

11. ***Could staff provide more details on the authorities' privatization plans and any contingency plans in case of shortfalls in privatization proceeds?***

12. ***We seek staff's elaboration on the progress made in advancing the privatization agenda so far and the envisaged ways for implementation.***

13. ***We would appreciate further details on the forthcoming privatization plan.***

14. ***Staff's comments regarding the calendar and process of the privatization program are welcome.***

15. ***Could staff share the timetable for these privatizations?***

- The authorities announced in late October 2018 a multi-year privatization program to help improve the performance of SOEs and refocus them on core activities. The program will start in 2019 and is expected to last 5 years and to yield about 4 percent of GDP on total. Half of this amount will be allocated to the Hassan II Fund (which supports new industrial investment projects), and the other half will reduce government financing needs, i.e., by 0.4 percent of GDP per year during 2019-21, and by 0.2 percent of GDP per year during 2022-24. A bill supporting this privatization program has been adopted and the cabinet approved a list of public enterprises that could be divested. The list includes enterprises in the tourism, hotel, energy, and telecommunication sectors.

16. ***We would welcome staff comments on the recently adopted Decentralization Charter.***

- The deconcentration charter adopted by the Cabinet in October 2018 will be implemented in 2019. It will help clarify local competences, introduce transparent criteria for intergovernmental transfers, mitigate contingent liability risks, and, in the longer term, enhance local taxation. It also asserts Governors as representatives of the government and coordinators of public policies at the local level.

Monetary, Exchange Rate and External Sector Policies

17. ***We appreciate it if staff could elaborate more on details of the new central bank law and staff's evaluation on it.***

- The draft incorporates important elements that reinforces the independence and expands the institutional capacity and mandate of Bank Al-Maghrib (BAM), while facilitating the transition toward further exchange flexibility and promoting financial inclusion. The new central bank law will also strengthen the emergency liquidity assistance (ELA) regime by better differentiating BAM's ELA function from government solvency support.

18. ***We would welcome staff's comments on the next phase of the actions to sustain greater exchange rate flexibility.***

19. ***Staff comments on when the next steps can be taken would be welcome, i.e. what are the necessary conditions for that?***

20. ***Changes in the monetary policy regime in the current more volatile global financial conditions could trigger substantial market pressures with adverse implications for financial stability. Are there sufficient safeguards for mitigating these risks?***

- The next phase in the transition towards exchange rate flexibility is expected to consist in a further widening of the dirham fluctuation band.

- While such a transition cannot be entirely without risks, staff and the authorities agree that all key pre-conditions are in place, and that Morocco is moving from a position of strength due to fiscal and external buffers, a resilient financial sector, and restrictions on capital outflows by residents.

21. ***Could staff elaborate on the REER developments on the basis of the EBA methodology?***

- While Morocco's current account deficit has deteriorated, the current account norm is has also increased because of the global impact of higher international oil prices for the larger part of 2018. This should leave the current account gap roughly unchanged, suggesting an external position and REER level broadly in line with fundamentals.

22. ***We would appreciate staff's additional comments on the key reasons behind the expected drop in international reserves in absolute terms and in percent of the not-adjusted ARA metric (from 93 percent in 2017 to around 85 percent in 2018).***

23. ***Staff notes that international reserves are projected to reach about 90 percent of the ARA metric by the end of the PLL. We note that international reserves already amounted to 93 percent of the ARA metric in 2017 and are projected to decline to 85 percent in 2018. At the same time, the third review under the PLL assumed a reserve coverage of 95 percent in 2018. Could staff comment on the causes of this shortfall?***

- The main cause of this drop in reserves in 2018 compared to earlier projections is the increase in international oil prices which, together with still elevated capital goods imports, led to a larger current account deficit than expected. Lower net external public borrowing and the postponement of a bond issuance from 2018 to 2019 also contributed.

Financial Sector

24. ***Given that non-performing loans are high and the collateral requirements for small and medium-sized enterprises are also high; could staff share some ideas how to tackle this issue? We wonder if it is a matter of the new bankruptcy law that still needs implementation, or related to credit bureau deficiencies, or some frictions in the judicial system.***

25. ***Several empirical studies consider NPLs as the main source of systemic risk in the banking and financial sector. We would appreciate staff's comments on any measures to bring these NPL down on a timely basis, specifically for private business and household loans?***

- A range of reforms are needed to help reduce NPL levels over time. The authorities recently strengthened the role of credit bureaus and introduced a new legal framework for collateral execution, which should help increase recovery rates and accelerate NPL resolution. On the demand side, improvements to the macroeconomic and business environment, including the elimination of VAT payment arrears and more dynamic credit provision to SMEs, will be important to reduce NPL ratios. The authorities are also exploring ways to introduce securitization instruments to remove distressed assets from bank balance sheets, with support from the IFC. Finally, the introduction of IFRS 9 will lead banks to upgrade their loan classification and provisioning practices.

26. ***Has staff looked at the possibility of developing a similar framework as the one recently developed in Egypt with WBG assistance (movable collateral registry project)?***

- The authorities have finalized a draft law on moveable assets that would extend the array of assets that can be pledged as collateral to facilitate access to credit, particularly to SMEs. This draft law will be presented soon to parliament.

27. ***Could staff clarify whether the adoption of syndicated lending has been effective in reducing concentrated credit exposures?***

28. ***We would appreciate staff's comments on the reason for the persistence of risks associated to large credit exposure.***

- Ratios of large exposures to Tier 1 capital averaged about 340 between 2010-14, and were reduced below 300 percent, including due to the introduction of stricter supervisory practices and the requirement that corporate groups prepare consolidated financial statements including all existing debt. The greater reliance on syndicated lending encouraged by the authorities is an additional measure that will need to be evaluated over time. More broadly, the persistence of large credit exposures also reflects the structure of Morocco's economy, including the dominance of large groups in several sectors and of the lack of SME dynamism, as reflected in credit market developments.

29. ***Can staff provide an update on the evaluation of Morocco's AML/CFT regime, based on the revised Financial Action Task Force (FATF) standard?***

- The assessment of Morocco's AML/CFT regime based on the revised *Financial Action Task Force* (FATF) standard is expected to be published in 2019. A poor showing in the report in terms of technical compliance and effectiveness, could potentially result in the country being recommended to enhanced FATF monitoring. In line with this new standard, bank supervision is moving to a more risk-based and forward-looking approach in this area and BAM has been strengthening its capacity to assess AML/CFT risks, including cross-border risks in the context of the banking sector's expansion in Africa.

Structural Reforms

30. ***Recognizing the divergent views on the reform momentum as highlighted in the buff Statement, could staff clarify why they differ with the authorities?***

31. ***We understand from Mr. Dairi's buff that reform efforts have accelerated during the year. This is at a variance with the staff's view that reforms have slowed down since 2016. Could staff explain this different assessment?***

- Staff's assessment is that a reform slowdown has taken place between the general elections in late 2016 and 2018, including due to the protracted transition to a new government in 2017. This is consistent with the Executive Board's assessment during the last Article IV consultation, concluded in early 2018. A broad range of fiscal and structural reforms were affected, such as tax reforms and the implementation of national strategies for education and employment, and against corruption. In several key areas, the introduction of specific action plans, legislations, or progress reports has been delayed. This being said, as highlighted in the staff report, the authorities have recently taken important steps to accelerate reforms, including in the areas of education, the business environment (see next question), and public governance.

32. ***We would welcome staff comments on the long time that it has taken to operationalize the Competition Council set up in 2014 and the plans to continue its work with the recent appointment of its Chair.***

- It is not clear why it took so long to move forward with this reform. Staff has long argued that among key reforms to improve the business environment for SMEs, this was a "low hanging fruit" which could both be implemented relatively easily and have strong impact. The Council has now become operational with the appointments of its chair (in November 2018) and its members (a few days ago) and will be able to apply a new legal arsenal (including penalties and sanctions) to address instances of anti-competitive behaviors raised by operators or self-identified.

33. ***Staff's comments are welcome on the key challenges and potential options to increase female labor force participation.***

- The gender gap in Morocco's labor market is particularly large. Female labor force participation rate does not exceed 25 percent (compared to about 70 percent for men) and has been declining over the past decade. Explanations include the lower level of education of women, cultural and social norms, poor transport infrastructures in rural areas, and the fact that women are often employed in low-skill or informal sectors, which makes them more vulnerable and potentially excluded from social safety nets.

- Previous staff analyses have identified the following potential options to raise female labor force participation in Morocco (2016 Article IV staff report): (i) investing in child care facilities and safe transportation; (ii) removing gender discriminatory tax practices; (iii) enhancing the impact of gender budgeting efforts; and (iv) introducing cash transfers targeted at enrolment in secondary education for girls.

34. ***Could staff advise on the key steps to unlock job opportunities for the youth and women in the National Employment Strategy, and if further measures should be considered?***

- The 2015 National Strategy for Employment includes measures aiming to boost youth employment and to increase female labor force participation, including the creation of a labor market observatory to facilitate skills matching, efforts to support education and vocational training, and the strengthening of active labor market policies targeting the youth. However, as noted in the staff report, these measures need to be accompanied by further labor market improvements, such as more flexible hiring and firing regulations to better integrate youth and women in the labor market.

35. ***Although Morocco's Doing Business ranking picked up recently, reflecting ongoing efforts to strengthen the local business environment, Morocco's total factor productivity (TFP) remains stagnant. While we note of several impediments including those in the education system and the labor market, could staff elaborate more on remaining impediments in the business environment that have hindered Morocco's TFP growth?***

- Although the business environment in Morocco has significantly improved in recent years, there remain important obstacles for firms (especially SMEs) to invest, expand, and create jobs, thereby further contributing to TFP growth. These obstacles include: (i) weaknesses in public governance, such the existence of large VAT repayment delays (which the authorities have started to clear) and, more broadly, pervasive payment delays in the economy, (ii) access to finance, as credit to SMEs has been stagnant in recent years and collateral requirements are relatively high; (iii) weak competition practices that hinder SME development and business creation; and, (iv) corruption which firms identify as a major obstacle to doing business.

36. ***The charts in Figure 5, based on a number of sources, sometimes give an inconsistent picture and this raises again questions about the reliability of some Third-Party Indicators. For example, staff considers reforms in education a priority, especially improving the quality of vocational training and better evaluating teachers' performance. However, the Global Competitiveness Indicators on the same page point to relatively strong education indicators compared to peers. Similarly, another chart identifies resolving insolvency as an important area for reform, while staff refers to recent reforms that improved the insolvency regime. Could staff comment on these apparent inconsistencies?***

- Figure 5 (top left chart) shows that Morocco performs relatively well compared to peers in terms of overall business climate and competitiveness. However, looking at specific dimensions of competitiveness, Morocco's score is low in terms of the quality of education (middle right chart), e.g., 43 percent for the quality of vocational training (ranked 101st) and 20 percent for teacher's critical thinking (ranked 138th). Regarding the insolvency regime, staff highlighted the progress achieved in 2018 with the introduction of a new bankruptcy law (paragraph 23 and Figure 5), which took Morocco's Doing Business score in this area from 34 percent (ranked 134th) in 2017 to 53 percent (ranked 71st) in 2018. Further progress could be made in these areas to further strengthen investor confidence and achieve Morocco's objective of integrating the top 50 of the Doing business ranking in 2020.

Program-Related Issues

37. ***Could staff explain why an FCL arrangement would not be a useful tool to provide insurance against shocks in support of the authorities' reform efforts? What would it take for Morocco to qualify for an FCL?***

- Morocco's economic and policy fundamentals are assessed as *sound* but not *very strong* by the IMF's Executive Board. This reflects the fact that Morocco only performs strongly in three out of the five PLL qualification areas – and does not substantially underperform in the other two, namely the fiscal and external sectors.

38. ***Staff's assessment that Morocco "does not substantially underperform in the external position and market access area" seems to reflect the fact that external reserves have been on average at 95 percent of the Assessing Reserve Adequacy metric during the last three years. Our impression is that Morocco fully complies with the other three criteria. We would appreciate it if the staff could comment on the way in which they weighted the four different criteria to come up with their assessment.***

- In the 2018 PLL Guidance Note a strong reserve position is defined as: "The core indicator requires reserves to have been greater than 100 percent of the unadjusted Assessing Reserve Adequacy (ARA) metric on average over three (the current and the two previous) years, and not below 80 percent in any of these three years." Morocco's external reserves have averaged around 95 percent of the ARA metric over 2015-17, and 92 percent of the ARA metric over 2016-18. This is not a "very strong performance" for this crucial component of the external position assessment, especially considering that the current account is characterized by a large trade deficit and is very susceptible to oil price changes.

39. ***We would appreciate staff's additional elaboration on how the ongoing slowdown in the large economies in the European Union could impact the external position and growth prospects in Morocco.***

- A slowdown in the European Union contributes to lower exports, lower remittances and tourism revenues, and lower FDI for Morocco, with negative impact on growth and the external position. Staff assumes, as in the previous PLL, an export elasticity of 5 vis-à-vis euro area growth (i.e., a 1 percent drop in the latter would cause a 5 percent decrease in Morocco's exports).

40. ***The new adverse scenario assumes a simultaneous materialization of downside risks that result in a smaller size of shocks than under the 2016 PLL (Box 3, p. 28). This looks somewhat counterintuitive to us, as the more challenging external environment with higher oil prices and weaker growth outlook for the euro area could now be less favorable for Morocco. Comments are welcome.***

- The euro area growth downturn in the downside scenario is informed by the October 2018 WEO, where the downside risk is associated with a 0.5 percent drop in euro area growth (against 1 percent in 2016).

- Under current baseline projections, the higher oil price level for 2018 (than in 2016) reflects the realization of one of the main risks under the 2016 PLL downside scenario. Starting from a higher baseline, the magnitude of the oil price shock in the current downside scenario is lower than in the 2016 PLL downside scenario.

41. ***As a related matter, we would also appreciate staff's comments on why the threshold for international reserves in terms of the ARA metric has been decreased from 90 to 80 percent under the calculation of potential financing gap. We recall that in the 2014 and 2016 PLL arrangements staff used the threshold of 90 percent of the Fund's ARA metric.***

42. ***The proposed PLL arrangement targets the low level of international reserves of 90 percent of the Fund's ARA metric, even below their average level over the recent years. In our view, larger external buffers are warranted for Morocco to reach the exit from the PLL. Staff may want to comment.***

- The 80 percent ARA metric level used in the calculation of the potential financing gap is the minimum reserve threshold in the latest PLL Guidance Note. In the medium term, the 90 percent target appears realistic considering that in the upcoming years capital and intermediate goods imports are expected to rise to help expand an industrial base necessary for sustained growth outside the agricultural sector. With a strong export base, and greater exchange rate flexibility, a reserve level hovering above 90 percent should support confidence in external sustainability.

43. ***The estimated total shock of 8.4 billion USD would be covered by 36 percent through the upcoming PLL arrangement. In comparison, the adverse shock estimated at the 2016 request of 13.3 billion USD was only planned to be covered by 27 percent through the previous PLL arrangement. We therefore wonder why the implied fraction of a severe shock being covered by the arrangement should be increased compared with the prior situation and despite an overall enhanced resilience. Staff comments would be welcome.***

44. ***We note that the gross international reserves of Morocco have increased, and the size of potential shocks has shrunk relative to the case of the third PLL in Box 3. On the other hand, the size of the PLL as a percentage of shock, which had been decreasing, has increased to 36 percent. We would like to ask staff's view on those inconsistencies.***

- The reason why a higher share of the shock would be covered by PLL resources (as opposed to a reserves drawdown) in the proposed PLL arrangement is the need to maintain reserves above a reserves threshold defined in terms of ARA metric level (80 percent) if shocks materialize. While the access level has decreased vis-à-vis the last PLL arrangement due to the improved balance of external risks, reserves are lower than in 2016 *relative to the minimum threshold*: 85.3 percent of ARA metric against a threshold of 80 percent in 2018, and 98.6 percent of ARA metric against a threshold of 90 percent in 2016.

45. ***References to the PLL <u>supporting</u> the authorities' program to foster inclusive growth, the arrangement <u>helping</u> to move towards a new growth model that is broad based and inclusive, and the inclusion of structural reforms as achievements <u>under</u> the PLL (box 1) could all imply that the PLL itself drives increased inclusion/structural reform. Are structural policy outcomes in Morocco considered to be linked to PLL program design?***

- The objectives of the new PLL arrangement with Morocco are to provide insurance against external shocks and to support the authorities' policies to strengthen the economy's resilience and foster higher and more inclusive growth. The authorities and staff agree that achieving these objectives will require implementing structural reforms in key macro-critical areas. The PLL arrangement does not drive itself structural policy outcomes, but rather supports the reform agenda set by the authorities for the duration of the arrangement. More specifically, boosting growth and inclusiveness is a key priority for the authorities, which would also contribute to the PLL's objective of strengthening macroeconomic stability.

46. ***We encourage staff and authorities to consider and implement more decisive steps towards a timely exit in the context of future reviews under the new arrangement.***

This would also help assuage concerns about the long-term use of the Fund's precautionary facilities, given Morocco's nearly uninterrupted access to IMF resources since 2012. Staff comments would be welcome.

47. ***We urge authorities to use the PLL arrangement to put the Moroccan economy on a sounder footing with more resilience to shocks and improve the prospects for an eventual exit from the PLL arrangement in a timely and orderly manner. Staff comments are welcome.***

48. ***We would welcome staff's views on what an exit strategy could look like for Morocco.***

- Staff will respond to this question during the Board meeting.