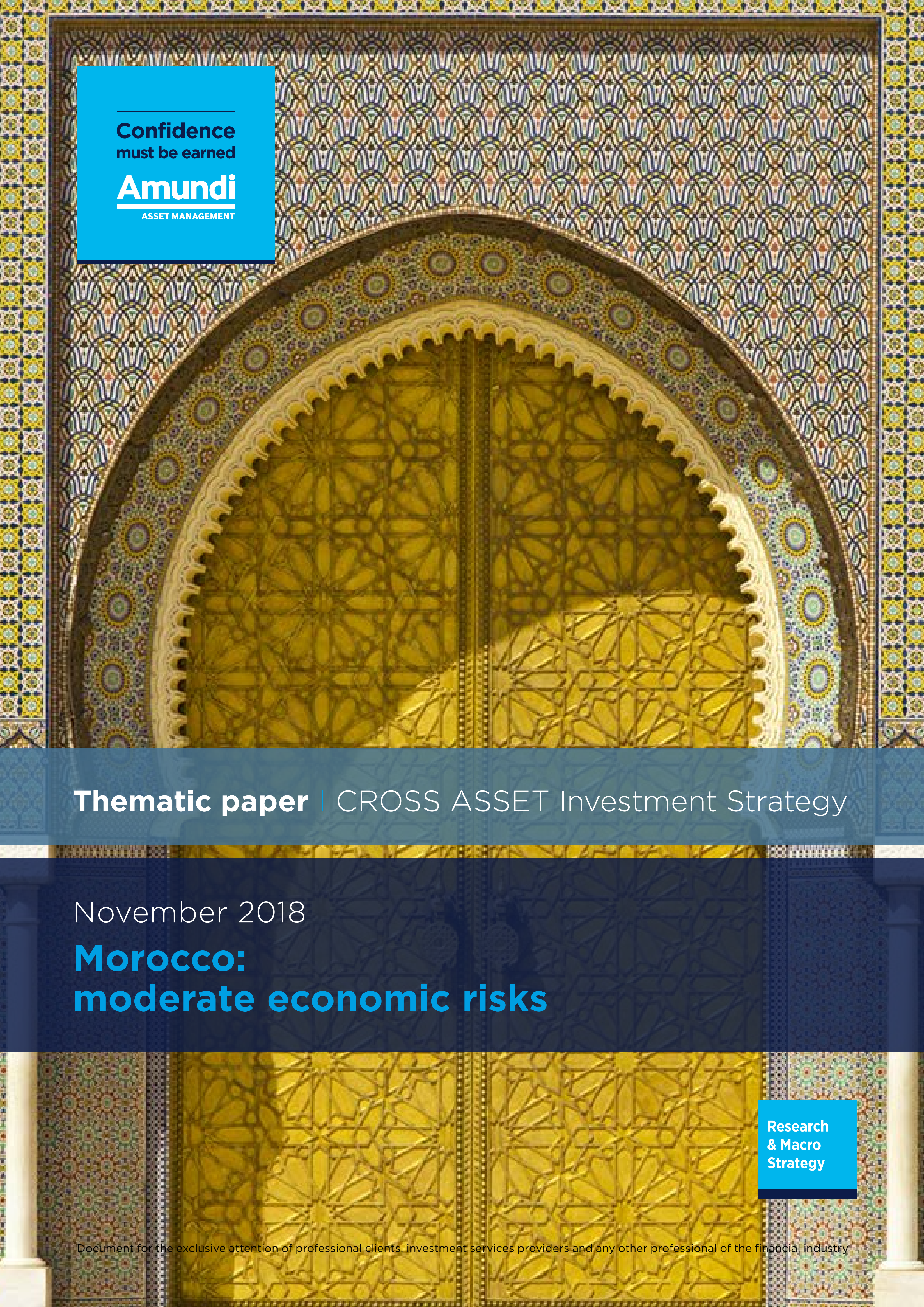

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Thematic paper | CROSS ASSET Investment Strategy

November 2018

Morocco: moderate economic risks

Research & Macro Strategy

Morocco: moderate economic risks

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The essential

Growth is expected to slow down compared to 2017 but should stabilise at around 3% this year and in 2019. Several years of fiscal consolidation have borne fruit. The public deficit is expected to improve again, but is unlikely to fall below 3.5% of GDP. The current account is expected to deteriorate slightly, and in an environment of declining external financing, could hamper the dirham's move to a flexible exchange rate regime. But all in all, even though Morocco needs some major structural reforms to support inclusive growth, in the short term the macroeconomic situation is solid and risks are moderate.

Growth should stabilise at around 3% this year and in 2019

"After a very buoyant 2017, growth is slowing down."

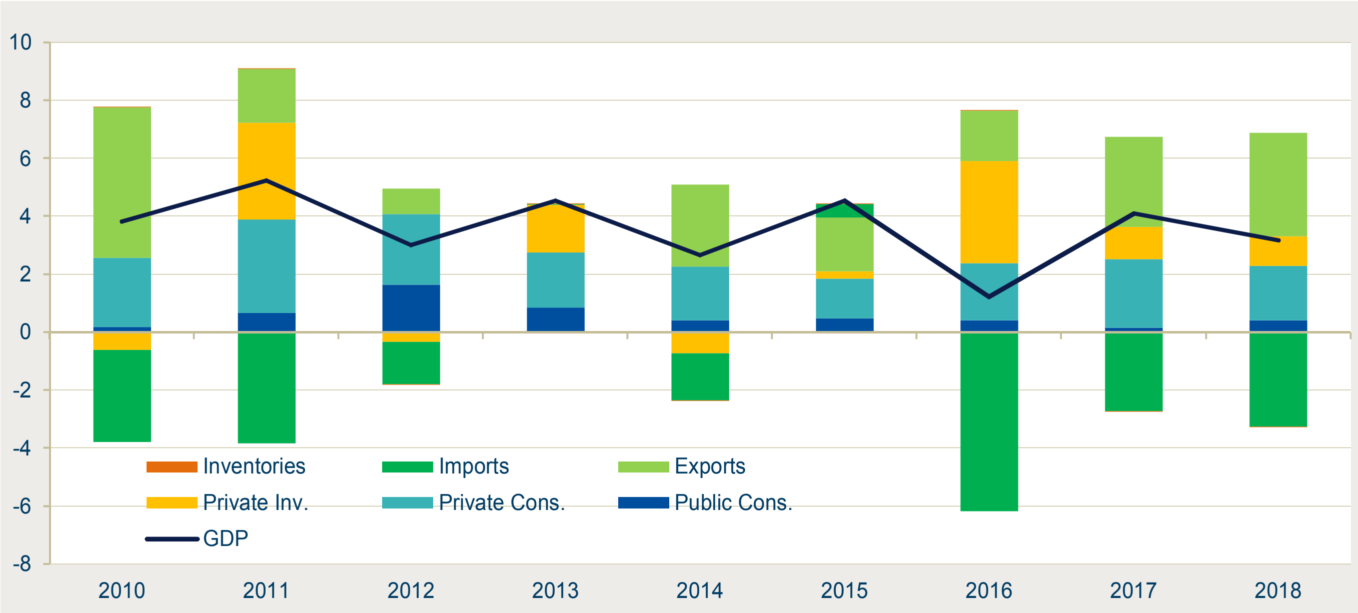
In 2017, Moroccan growth was above 4% (see GDP and its components chart). The Moroccan authorities estimate that GDP growth should reach 3.5% this year and in 2019 thanks to a marked rebound in the agricultural sector, which accounts for 14% of GDP and is a major contributor to activity and employment in rural areas. The IMF is a little less optimistic and forecasts a 0.9pp decrease compared to 2017, for growth of 3.2% this year and in 2019.

Investment supported by a relatively accommodative monetary policy is an increasingly important part of GDP (35%). However, it is expected to slow down slightly in 2018-2019, as will private consumption. Indeed, although the manufacturing sector grew by 3% yoy in the second quarter of this year, driven by the automotive and aeronautic sectors, the mining and construction sectors underperformed. High oil prices are increasing production costs and therefore consumer prices, which is limiting the growth of both private investment and consumption.

In 2017, exports increased by almost 9%, driven by strong European demand. This pace is expected to slow down somewhat over 2018-2019 as growth eases in the eurozone. Imports are expected to grow faster than in 2017, slightly reducing the contribution of trade to growth.

Unemployment benefited from buoyant growth and stood at 9% in the second quarter, 1pp below the IMF forecast. However, this figure covers only the first half of the year and a slight deterioration of the labour market cannot be ruled out in the second half of the year, especially as the services sector and more specifically tourism is likely to decelerate. Beyond the numbers, what is important is a downward trend in unemployment over the next two years. However, it should be noted that this figure conceals some serious inequalities: unemployment in rural areas stands at nearly 15%, while among young people, the figure exceeds 40%.

1/GDP and its components



Source: Datastream, Amundi Research ; Data as of 09/11/2018

Despite high volatility in food prices, inflation should remain contained

After rising sharply over the first months of the year on the back of the increase in food prices, inflation decreased in September at 1% yoy (see Inflation chart) thanks to very good harvests. As a yearly average, inflation is 2.1%, which is relatively close to the IMF forecast of 2.4% for this year. The IMF forecasts a sharp deceleration in price increases in 2019 with inflation at 1.4%. Moroccan prices are very dependent on trends in food prices and therefore the weather. As such, they can be relatively volatile. However, over the last several years, they have rarely exceeded the upper limit of the target set by the Moroccan central bank (2.3%). The likelihood of a tightening of monetary policy is therefore rather low.

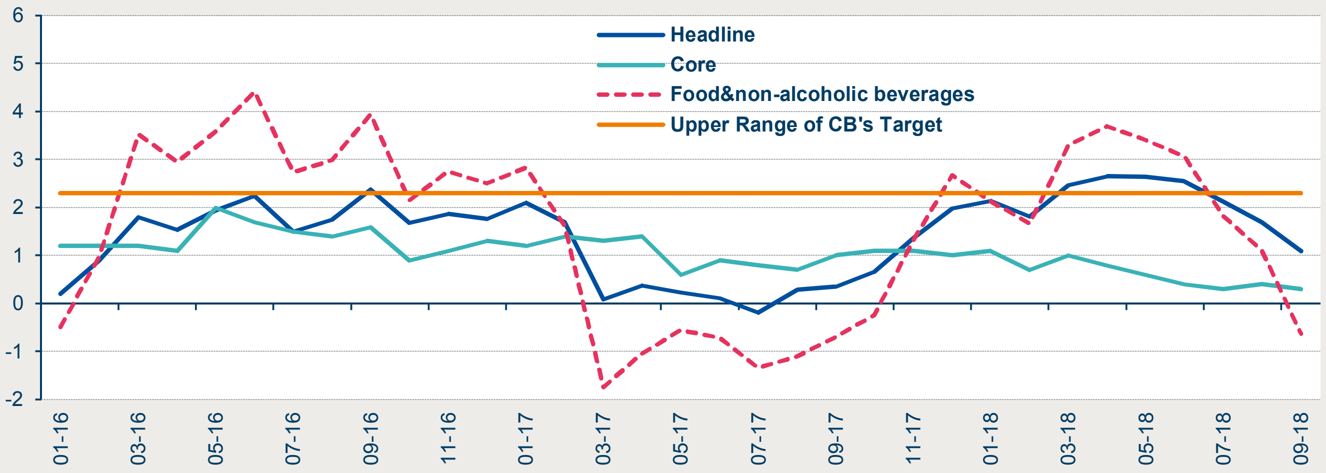
> **"Inflation remains very dependent on the volatility of food and oil prices."**

The Moroccan authorities decided to modify the dirham's exchange rate regime. Currently anchored to a basket[1] of currencies (it currently fluctuates within a ±2.5% range), the dirham should be gradually transitioned to a flexible exchange rate regime. Although the Moroccan authorities ensure that the dirham is in equilibrium, they remain very cautious nonetheless, conditioning the transition to a fully flexible exchange rate regime on the strength of the economy, control of inflation, amounts of foreign exchange reserves available etc. Under such circumstances, without a transition deadline, there are no concerns over this matter at the moment.

Other factors will undoubtedly condition this reform, in particular the continuation of fiscal consolidation initiated more than five years ago and the stability of the external debt.

[1] *60% Euro and 40% USD*

2/Inflation



Source: Datastream, Amundi Research; Data as of 09/11/2018

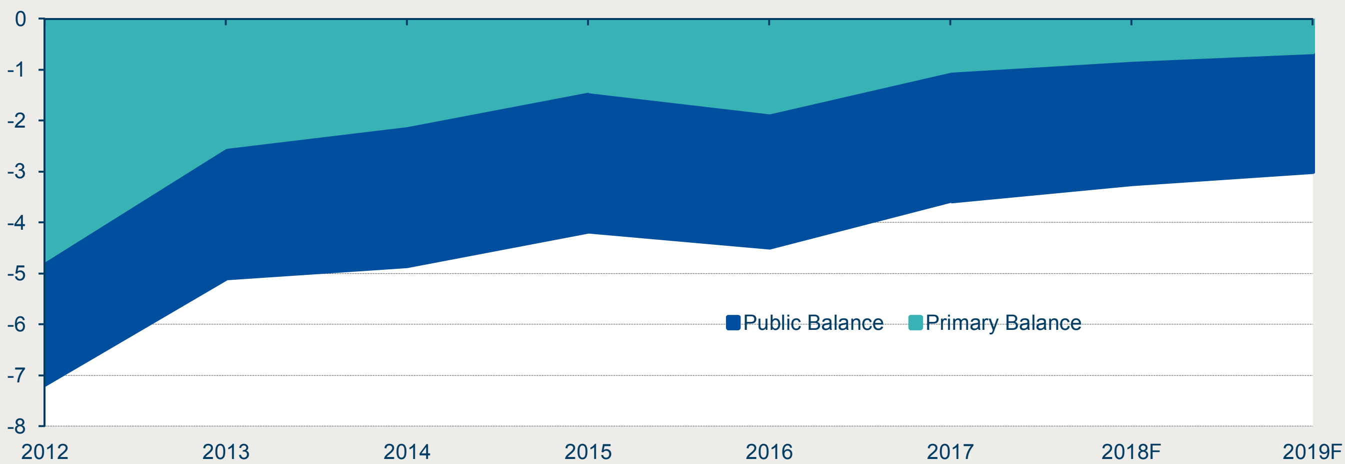
Budget consolidation implemented for several years is becoming more difficult

In 2012, the public deficit reached record levels, representing more than 7% of GDP (see Public Balance chart). Six years of fiscal consolidation (sharp drop in spending, reform of energy system subsidies, pension reform, tax reform) have borne fruit. The IMF estimates that this year, the public deficit could be only 3.2%. The Moroccan authorities, on the other hand, are a little less optimistic and foresee a deficit for the year equivalent to that of September, namely 3.6% of GDP, in light of a higher energy bill, higher-than-expected infrastructure investment spending and lower tax revenues.

According to IMF forecasts, the government deficit is expected to reach its target of 3% in 2019. If we take into account the State subsidies that are still substantial, the slowdown in growth and the need to fund the education and healthcare spending announced this summer, this forecast does not seem credible and we estimate that we should expect the deficit to stabilise in 2019 at its level of 2018. However, we think that the slippage will be minor and not will have a limited impact on the public debt, which should be able to stabilise at around 65% of GDP.

> “In a less supportive environment, fiscal consolidation efforts are pausing.”

3/Public Balance (% of GDP



Source: Datastream, Amundi Research; Data as of 09/11/2018

The current account is deteriorating but the Moroccan external position remains solid

Even though the external debt did not exceed 50% of GDP in 2017, according to data from the World Bank, and remittances from migrants are a significant and stable source of income for the country (8% of GDP), the current account deficit is growing (see the Balance of Payments chart) and could hamper the changeover to a flexible exchange rate. Indeed, after having improved in 2017 (3.6%), it is expected to once again widen in 2018 due to the smaller increase in exports than imports, high oil prices and slower growth, mentioned at the beginning of this text. The IMF forecasts a widening of the current account deficit of nearly 1pp to 4.3% of GDP this year and a further deterioration in 2019 of 0.2pp.

In addition, direct investment flows have halved since 2015 and represented only 1.5% of GDP at the end of the second quarter of this year. Foreign exchange reserves also declined over the same period. Today they cover less than six months of imports compared to eight in 2015.

These developments are not dramatic but will certainly be scrutinised by the markets. Any slippage of the current account deficit towards the fateful threshold of 5% of GDP and/or any reduction in FDI will limit the Moroccan authorities' room for manoeuvre as they transition towards a flexible exchange rate regime.

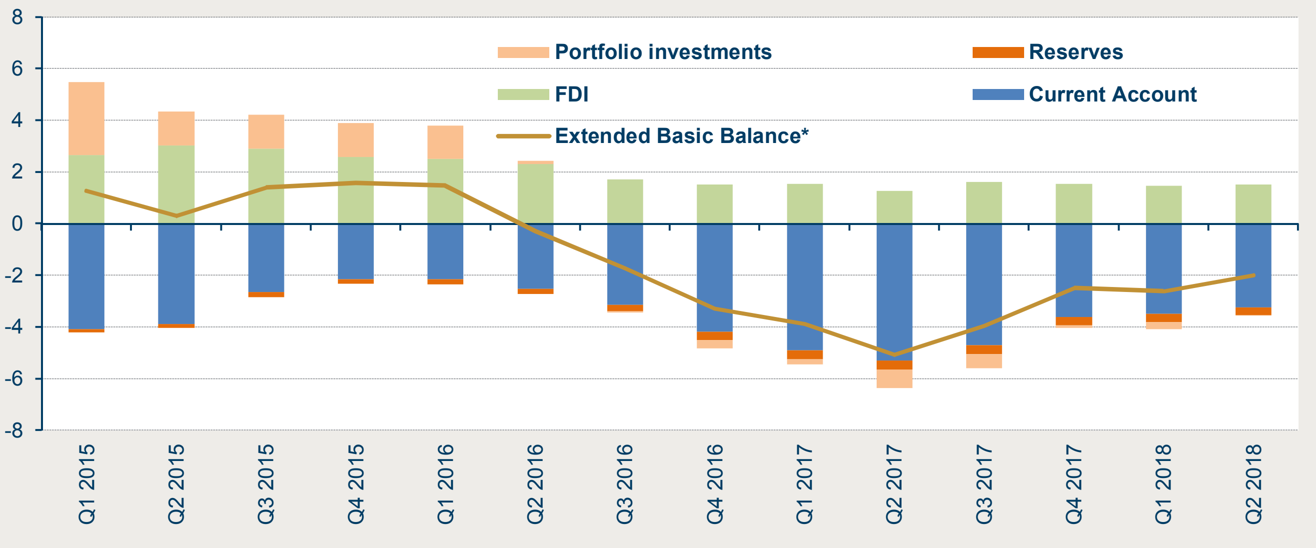
> "The current account deficit is growing but the sources of funding have not dried up."

Moderate economic risks in the short term

Despite a deterioration of the economic fundamentals compared to 2017, in the short term, the risks relating to the Moroccan economy appear relatively moderate. Indeed, in the absence of a major external shock, growth will be solid, inflation contained and monetary policy is not likely to undergo any marked tightening. Improvement of the public accounts will pause temporarily but the risks of slippage appear limited. The external position could deteriorate slightly but no funding issues are expected.

In the medium term, the outlook should be favourable. In the coming years, growth will remain dependent on developments in the agricultural sector. However, efforts to diversify the economy to other sectors and the flexibility of the dirham are expected to be medium-term support factors for the country's competitiveness and exports.

4/**Balance of Payments (% GDP,sa)**



*=CA+FDI+PI+reserves

Source: Datastream, Amundi Research; Data as of 09/11/218

Economic Indicators	2011	2012	2013	2014	2015	2016	2017	2018	2019
Real GDP Growth (YoY %)	5.2	3.0	4.5	2.7	4.6	1.1	4.1	3.2	3.2
Inflation eop (YoY %)	0.9	2.6	0.4	1.6	0.6	1.8	1.9	2.4	1.4
Unemployment Rate (%)	8.9	9.0	9.2	9.9	9.7	9.9	10.2	10.0	9.8
Public Debt (% GDP)	52.5	56.5	61.7	63.3	63.7	64.9	65.1	64.4	63.8
Fiscal Balance (% GDP)	-6.6	-7.2	-5.1	-4.8	-4.2	-4.5	-3.6	-3.2	-3.0
Current Account (% GDP)	-7.6	-9.3	-7.6	-5.9	-2.1	-4.2	-3.6	-4.3	-4.5
Gross Ext. Debt (% GDP)	30.9	33.8	36.2	43.1	44.2	47.1	46.2	na	na
External Reserves (months of imports)	6.2	5.0	5.5	5.8	8.0	8.0	7.7	7.0	6.7
MAD per USD eop	8.57	8.46	8.16	9.06	9.92	10.12	9.35	na	na

Sources: Datastream, Amundi Research, data as of 09/11/18

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