65174

MOROCCO – Sustainable Access to Finance Development Policy Loan

Loan No. 7844-0-MA

Release of the Second Tranche–Full Compliance

1. This memorandum summarizes the progress made under the Sustainable Access to Finance Development Policy Loan (DPL) to the Kingdom of Morocco. The Bank approved the two tranche US$200 million loan to the Government of Morocco on 26 January, 2010, and the loan agreement was signed and declared effective on 15 February, 2010 and 4 March, 2010 respectively.

2. The following memorandum notes that all prior actions required for the release of the second tranche have been met by the borrower as outlined in the Loan Agreement. Compliance with all prior actions was verified by World Bank supervision missions and collection of supporting evidence.

3. The memo describes the macroeconomic policy framework of the Borrower, and ensures that it is appropriate and is consistent with the objectives of the Program.

KINGDOM OF MOROCCO
Sustainable Access to Finance Development Policy Loan (Loan No. 7844-MA)
Release of the Second Tranche – Full Compliance

Tranche Release Document

I. Background

1. **Morocco has made substantial progress in developing its financial sector.** The total assets of Moroccan financial institutions have grown significantly and exceed 200 per cent of GDP, a ratio that is well above the level predicted by Morocco's per capita income. This progress in financial development has been the result of sound macroeconomic policies and important financial sector reforms earlier in the decade, which positioned Morocco to take advantage of favorable conditions (e.g. abundant liquidity and global economic growth). These financial reforms were supported by the Bank through a Financial Sector Development Policy Loan in 2005, and included the restructuring of state-owned financial institutions, the strengthening of the regulatory framework and the improvement of financial infrastructure.

2. **While the financial system has grown significantly, access remains insufficient and new risks have emerged**. The rapid growth of financial institutions has expanded the frontiers of finance and contributed to Morocco's growth performance. However, despite significant improvements, the financial system is not yet providing services to segments of low income individuals and SMEs. Moreover, this rapid growth has also generated new risks in the banking and insurance sectors that need to be effectively managed. In the microcredit sector, an industry characterized by very low default rates, the rapid growth combined with inadequate governance and risk management resulted in portfolio problems. The global financial crisis added importance to further reforms, for having produced a credit slowdown that typically affects the most vulnerable sectors. Moreover, the global crisis has also shown the need to strengthen financial infrastructure and regulation to ensure that further access gains are sustainable.

3. **In response to these challenges, the Government launched a new financial reform program supported by the Sustainable Access to Finance DPL that addresses effectively the dual objectives of access and stability**. It includes four mutually reinforcing pillars which build on major improvements in the soundness and risk management capacity of financial institutions. The first pillar contains measures that promote access to households while the second pillar comprises measures to enhance access to small and medium enterprises. The launch of a credit bureau and revised partial credit guarantee mechanisms will allow further progress in access and improved risk management. The third pillar strengthens the resiliency of the financial system through further improvements in financial regulation and supervision. It will allow an early identification of risks and will avoid a repeat of the difficulties experienced by the microcredit sector. The fourth pillar, capital market development, contributes both to access and stability. It promotes competition to banks which will encourage them to go down market, and will make new information and instruments available therefore making further gains in long term financing (e.g. mortgage loans or investment credits) possible.

4. **The Sustainable Access to Finance Loan has contributed to Morocco's reform efforts, both financially and technically**. First, it has contributed to a balanced financing

package, helping the Government meet its larger borrowing requirements resulting from the global crisis, while avoiding excessive pressures on the domestic financial market. Second, it has supported an important reform that contributes to growth and poverty alleviation. Third, it allows the Bank to remain engaged in the design of more challenging reform components, contributing to their quality. Finally, the Moroccan reform provides important lessons for other countries, for recognizing explicitly the need to combine the objectives of access and stability.

II. Recent Economic Developments

5. **The macroeconomic policy framework of the Borrower is appropriate and is consistent with the objectives of the Program**. Overall, the sound macroeconomic policies undertaken in recent years, and efforts to implement new reforms both in the economic and political domains put Morocco in a position to surmount the effects of the global crisis and of internal social movements.

6. **The Moroccan economy continues to fare relatively well.** Growth was estimated at around 5 percent in the first half of 2011, mostly driven by domestic demand, and is expected to keep its momentum for the rest of the year albeit at a slower pace. Inflation has been under check at less than 1 percent by end July (food inflation is higher at 1.4 percent).

7. **The Moroccan economy is facing challenges**: (i) Unemployment, especially among the youth, remains a critical concern (urban unemployment increased to 13.5 percent in the second quarter 2011 from 12.7 percent a year earlier, with a particularly sharp deterioration for young people), (ii) Budget deficit is expected to increase to between 5.5 and 6 percent of GDP in 2011 instead of the budgeted 3.6 percent of GDP fueled by historically high subsidies. Financing the expected budget deficit will not be an issue in 2011, thanks to substantial revenues from privatization operations and the relatively moderate debt stock of the central government. While Morocco's indebtedness remains under control (the central government debt is projected to rise to around 52 percent of GDP in 2011 from 50.3 percent in 2010), the current universal subsidy system may threaten the medium term fiscal sustainability, (iii) the slowing growth of Morocco's main trading partners is exacerbating the weaknesses of the balance of payments. The structurally high trade deficit is expected to deteriorate further to 22 percent of GDP in 2011 with the current account deficit also deteriorating to around 6.7 percent of GDP (from 4.3 percent of GDP in 2010). As a result, Morocco's net international reserves have declined by US$786 million since the beginning of 2010 to US$22.3 billion at the end of June 2011 (5.2 months of imports).

8. **Inflation continues to be low (0.8 percent at end July 2011)**. Credit growth slowed down substantially to 6.6 percent in July 2011 (year on year) instead of 11 percent twelve months before. The Central Bank has not changed its policy rate in recent years at 3.25% but has been increasingly providing liquidity to the system (directly, including recently through long term repos, and indirectly thanks to sharply reduced reserve requirements).

12. **Medium term prospects are globally good, provided the new government taking office after the November 2011 elections moves forward with needed reforms to improve economic productivity and consolidate public finances**. In the wake of the Arab Spring, a new constitution has been adopted in Morocco by referendum in July 2011 which sets the basis for

more open and democratic society and will be followed by elections in late November 2011. It is assumed that the new Government will sustain the reform momentum of the last few years, achieve the ambitious public investment programs it devised, and continue to implement the main sector strategies it launched, thus consolidating further economic diversification, growth potential, and domestic demand. It also makes the (currently somewhat optimistic) assumption that the world economy will slowly recover from the current crisis to allow the on-going export promotion strategies to achieve their targets and contribute to growth. Under these conditions, growth rates will improve from the moderate 3.7 percent for 2010 to around 5 percent in 2013. Should the underlying sources of growth assumed above be slow to materialize, growth prospects would have to be adjusted downward. Moreover, there is a potential risk that even pre-crisis growth levels might not be sustainable over the medium term if internal demand remains the key driver of growth. Sound monetary and budget policies will help maintain inflation at relatively low levels. Current account deficits are expected to slowly improve over the medium term, assuming the government scales up its reforms to enhance economic productivity and diversification. In addition, progressively shifting to a more flexible exchange regime would contribute to improve the external competitiveness of the Moroccan economy. The higher current account deficits would put pressure on external financing, but will remain manageable, as it is expected that improvements in the business environment will attract new FDIs.

Base-line Medium Term Macroeconomic Indicators

			Est.	Projections		
	2009	**2010**	**2011**	**2012**	**2013**	**2014**
Growth Rates in percent						
Real GDP	4.8	3.7	4.5	4.8	5.0	5.3
Real private consumption	4.6	2.2	9.1	5.4	6.7	6.4
Real Gross Domestic Investment	4.3	-1.5	2.3	3.4	3.8	4.1
Export Volume (GNFS)	1.1	3.6	5.1	8.2	7.3	7.6
Import Volume (GNFS)	-6.0	3.3	7.0	5.5	7.0	7.6
GDP deflator	1.5	0.6	1.5	1.9	2.0	2.0
Ratios to GDP						
Gross Domestic Investment	35.6	35.1	34.1	34.1	33.7	33.3
Fiscal Balance	-2.2	-4.6	-5.5	-4.5	-3.9	-3.7
Central Government Debt	47.1	50.3	51.9	52.2	52.0	51.5
of which foreign	10.7	12.1	13.5	15.2	15.5	15.3
Current Account balance	-5.4	-4.3	-6.7	-5.4	-4.7	-4.1
FDI, gross	1.6	0.8	0.7	3.4	4.6	5.8
External Debt (public and private)	26.2	28.0	32.0	32.5	32.0	31.2

Source: Moroccan Government and Staff estimates

III. Progress against Tranche Release Criteria

Condition 1: Barid Al Maghrib, the Post Office, shall have transferred its financial services to Al Barid Bank.

9. **The condition has been met.** The contract (« traité d'apport ») signed on 24 December 2010 indicates that financial services will be transferred from Barid Al Maghrib to Al Barid bank as soon as three conditions are met: independent valuation of assets transferred by Deloitte, approval of the transfer by Al Barid Bank extraordinary general assembly and subscription by Barid Al Maghrib of new shares issued by Al Barid Bank for an amount equivalent to the value

of the assets transferred. In the statement of their opinion on the 2010 financial statements of Al Barid bank dated 31 May 2011, its external auditors (KPMG and Deloitte) confirm that financial services were transferred from Barid Al Maghrib to Al Barid bank at the end of 2010.

Condition 2: The Credit bureau activities shall have been broadened, as demonstrated by the receipt at the Central Bank of data from microcredit associations accounting for at least 50% of loans granted by microcredit associations.

10. **The condition has been met.** The credit bureau signed contracts with microcredit associations significantly lowering their consultation fees compared to other financial institutions (especially for the smallest microcredit associations). This gave them additional incentives to report to the credit bureau, as they could afford to consult it and hence improve their risk management capabilities. In a letter dated 19 July 2011, the Central bank confirmed that 78% of loans granted by microcredit associations were reported to the credit bureau at the end of May 2011.

Condition 3: Bank Al Maghrib shall have performed an on-site inspection of the Central Guarantee Fund (Caisse Centrale de Garantie), to assess inter alia the adequacy of governance, internal control and risk management.

11. **The condition has been met.** Bank Al Maghrib carried out an inspection of the Caisse Centrale de Garantie focused on its governance and risk management. In a letter dated 22 June 2011, Bank Al Maghrib informed the Managing Director of the Caisse Centrale de Garantie of the key conclusions of its inspection.

Condition 4: The Council of Government shall have adopted the draft law establishing a new and independent insurance and pension supervisory authority (Autorité de Contrôle des Assurances et de la Prévoyance Sociale).

12. **The condition has been met.** The draft law establishing a new and independent insurance and pension supervisory authority (« Autorité de Contrôle des Assurances et de la Prévoyance Sociale ») was adopted by the Council of Government on 25 August 2011.

Condition 5: The Council of Government shall have adopted the draft law establishing a new capital market authority (Autorité des Marchés des Capitaux), with strengthened legal, operational and financial independence and enforcement powers.

13. **The condition has been met.** The draft law establishing a new capital market authority (« Autorité des Marchés des Capitaux »), with strengthened legal, operational and financial independence and enforcement powers was adopted by the Council of Government on 25 August 2011.

Condition 6: The Minister of Economy and Finance shall have issued an Order (Arrêté) changing the reference rate of the variability of interest rates of floating rate credits from Treasury bills to a reference rate linked to short term instruments, fostering better public debt management.

14. **The condition has been met.** The Minister of Economy and Finance issued an Order (Arrêté) on 17 March 2010 modifying the reference rate of the variability of interest rates of floating rate credits from Treasury bills to a reference rate linked to short term instruments. This

order was published in the official gazette (Bulletin officiel) on 6 May 2010. The index for new floating rate loans is the annual change in the average weighted interbank rate observed over the previous semester (i.e. a reference rate linked to short-term instruments). Banks have to offer three options to their customers for existing floating rate loans: (i) keep the index previously used, (ii) use the new index defined in this 2010 order or (iii) switch to a fixed rate.

Condition 7: The Ministry of Economy and Finance shall have submitted for comments to relevant stakeholders a draft law creating covered bonds.

15. **The condition has been met.** The Ministry of Economy and Finance set up a working group gathering key stakeholders which was tasked with the preparation of a draft covered bond law. The Head of Treasury sent on 6 June 2011 the draft covered bond law the working group prepared for comments to relevant stakeholders: Chairman of the banking industry association (« Président du Groupement Professionnel des Banques Marocaines »), Head of banking supervision (« Directeur de la supervision bancaire de BAM »), Head of capital market supervision (« Directeur Général du Conseil Déontologique des Valeurs Mobilières »), Head of insurance supervision (« Directeur des Assurances et de la Prévoyance sociale »), Managing Director of the Caisse de Dépôt et de Gestion (« Directeur Général de la Caisse de Dépôt et de Gestion »), Managing Director of Maghreb Titrisation (« Directeur Général de Maghreb Titrisation »), Chairman of the insurance industry association (« Président de la Fédération Marocaine des Sociétés d' Assurance et de Réassurance »), Managing Director of the Caisse Marocaine des Retraites (« Directeur de la Caisse Marocaine des Retraites »).

IV. Conclusion and Recommendation

16. In view of the overall performance and progress with the implementation of the program supported by the Loan, and in compliance with the specific conditions of release as described in Section B of Schedule I of the Loan Agreement, the Bank has informed the Borrower of the availability of the second tranche in the equivalent of US$66.2 million.