Morocco

Solid fundamentals to cope with the shock

The Moroccan economy will see significant consequences from the coronavirus pandemic. Tourism has been at a standstill since March and will remain so until May at the earliest. The automotive sector and remittances from the Moroccan diaspora will also be hit by the crisis in Europe. However, and provided that the situation improves in the second half of the year, Morocco should be able to avoid recession. Macroeconomic fundamentals are solid and the country will benefit from a substantial fall in oil imports. Moreover, the authorities have reacted swiftly to dampen the shock.

The Moroccan economy had been expected to see a return to more dynamic growth, after a mixed picture in 2019. Initially expected at 3.5%, economic growth has been revised downward to 2.3% by the Central Bank. Given the size of the shock that lies ahead, this could prove optimistic, even though we believe that the economy is likely to avoid recession this year. The authorities have reacted swiftly, and Morocco has only limited exposure to the turmoil in financial and commodity markets. Provided that there is a recovery in the second half of the year, real GDP growth could reach 0.5% in 2020, the lowest level in twenty years. However, forecasts are subject to big uncertainties.

Economy under pressure: the authorities act swiftly

In addition to a new fall of around 3% in the value added of the agricultural sector (12%-13% of GDP, 1/3 of employment) due to unfavourable weather conditions, the economy will also suffer from the effects of the coronavirus pandemic. Tourism has been at a standstill since March. Two-thirds of the tourist season comes from June onwards. But with 80% of tourists (excluding the Moroccan diaspora) coming from Europe, the losses will be significant in a sector that accounts for more than 8% of GDP, which is the highest level in the region (Chart 2). Channels of transmission will go beyond the sole tourism sector. Europe accounts for 60% of the Kingdom's exports, 68% of remittances from Moroccans living abroad and more than 70% of foreign investment. The automotive sector, which is now Morocco's leading source of exports, is particularly vulnerable, even though its development is not compromised.

A marked deceleration in non-agricultural growth is thus expected this year. However, it should not collapse. A monitoring committee has been established to respond to the effects of the pandemic. Deferrals of social contribution payments until end-June have already been announced, as have fixed-rate compensation payments for employees of companies in difficulty. Consideration is also being given to measures to help workers in the informal sector. This will be financed from a special fund of nearly MAD 30 billion (2.5% of GDP), of which MAD 10 billion will be provided by the government and the remainder by voluntary contributions.

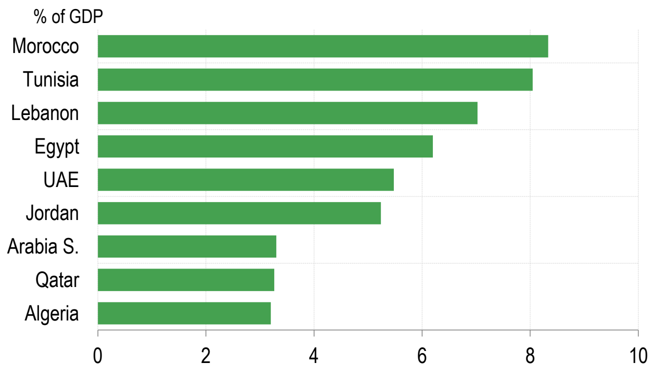
The Central Bank has also cut its policy rate by 25 basis points to 2%, and has introduced a series of measures that will triple the refinancing capacity of banks. With inflation fluctuating at around 1%, the monetary authorities have room for manoeuvre for further policy easing.

1- Forecasts

	2018	2019	2020e	2021e
Real GDP growth (%)	3.0	2.4	0.5	3.0
Inflation (CPI, year average, %)	1.8	0.3	0.7	1.2
Fiscal balance / GDP (%)	-3.7	-4.0	-5.0	-4.0
Current account balance / GDP (%)	-5.5	-4.6	-5.9	-4.1

e: BNP Paribas Group Economic Research estimates and forecasts

2- Contribution of the tourism sector to the economy



Source: WTTC

Other supportive factors should also be taken into consideration, notably the solidity of the financial system whose activity is funded thanks to a large base of domestic deposits and which has only a limited exposure to the tourism sector (less than 2% of outstanding loans). Banks look also well capitalized to cope with rising credit risk despite poor asset quality (the non-performing loan ratio is 8%). Above all, macroeconomic fundamentals are sufficiently robust to absorb a temporary shock.

External accounts: a manageable shock

With 15% of foreign-currency receipts generated by the tourism sector, automotive exports accounting for 27% of exports and remittances from the Moroccan diaspora representing 13% of current account receipts, pressure on external accounts will be strong. But as an oil importer, Morocco will also benefit from the marked fall in the price of the Brent. Even assuming a Brent close to USD40/barrel on average in 2020 (and thus a recovery in the second half of the year), imports of oil products would fall by more than 2 points of GDP, which would help to mitigate somewhat the deterioration of the current account deficit (5.9% of GDP in 2020 against 4.6% in 2019). At this level, the coverage of financing requirements could prove difficult, given the downward pressure on foreign direct investment. Net FDI flows fluctuate around 2% of GDP. Furthermore, a larger current account deficit cannot be ruled out. However, external account stability does not look threatened.

External debt is moderate at 45% of GDP, of which two-thirds have been taken out by the government or state-owned companies (with government guarantees) at long-term maturities. External debt of the private sector reaches only 7.5% of GDP and is mainly in the form of trade credits (70% of the total). In contrast to many other emerging economies, Morocco is thus largely insulated from the turmoil in international financial markets. Morocco's sovereign spreads have widened since the end of February but remain relatively low (Chart 3). However, a fresh eurobond issue, following that in November 2019, remains in the realm of the hypothetical given the current high levels of risk aversion towards emerging markets.

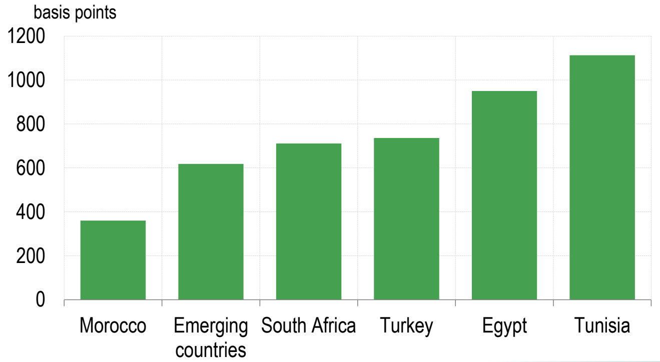
Forex reserves remain comfortable. At the end of 2019, they stood at USD25.3 billion, or the equivalent of 5.4 months of imports of goods and services. This is also three times the stock of short-term debt. In addition, the authorities went just to announce that they will draw on the IMF's Precautionary and Liquidity Line (PLL). Renewed in December 2018 for two years, the PLL makes a total of USD 3 billion available. This is not a loan but an insurance to protect an economy against an exogenous shock, which means that external public debt will be not impacted.

Greater exchange rate flexibility could also help to absorb the shock. The dirham's fluctuating band has been widened in early March from +/- 2.5% to +/-5%. Since the start of the reform in January 2018, the dirham has been remarkably stable and the Central Bank has virtually stopped intervening in the interbank market. Initial information suggests that this is still the case even if emerging pressures on the MAD suggest that monetary authorities could resume their interventions. That's said, any depreciation of the MAD would remain modest. Furthermore, the vulnerability of the economy to exchange rate fluctuations is reduced thanks to low inflation and the moderate external indebtedness of the government and corporates.

Spending cuts likely to help public finances

The situation in the public finances does not give cause for major concern, even though a reallocation of spending, or even cuts, look inevitable. The latest estimates of the Central Bank now assume a budget deficit of 4% of GDP in 2020, from an initial estimate of 3.8%. However, this slight increase of 0.2 points of GDP does not take account of the measures that the government might take to prop up the economy, starting with the allocation of MAD10 billion (0.8% of GDP).

3- Sovereign spreads



Source: JP Morgan

Civil service recruitment has already been frozen, other than for the health and interior ministries. Energy subsidies will also fall as gas prices come down. Even so, with subsidies accounting for barely 5% of total government spending, the potential gains in this area are limited. The greatest flexibility is to be found in capital expenditure. With a budget of MAD70 billion (21% of total spending), a 10% cut in CAPEX would reduce spending by 0.6 points of GDP. Therefore, we are not expecting a significant worsening of the budget deficit (5% of GDP).

The government will also continue to benefit from favourable conditions to meet its financing needs. The local debt market is captive with negligible participation of non-resident investors, and liquid. Despite central government debt of 65% of GDP, interest payments are moderate at 2.4% of GDP and 11% of tax receipts. Around 80% of central government debt is denominated in MAD.

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