MOROCCO

A DELICATE BALANCING ACT

Despite rapid support measures, the economy will not escape a severe recession this year. With the abrupt halting of tourism activity, the drop-off in exports to Europe and the collapse of domestic demand in Q2, GDP will contract by about 6%. Although there are high hopes that a good agricultural harvest will fuel a rebound in 2021, the recovery of non-agricultural activities will take time. In contrast, Morocco's macroeconomic stability does not seem to be threatened. But growing pressure on public finances leaves the authorities very little manoeuvring room.

As the spread of the virus has intensified again in recent weeks, the Moroccan authorities are still trying to strike the right balance between the health emergency and the economic crisis. The stimulus plan announced during King Mohammed VI's speech illustrates this strategy. The announced stimulus is massive at MAD 120 bn (11% of GDP), but the way in which it will be implemented should help limit the impact on public finances. More than 60% of the plan consists of state-backed loans. Like for the Covid fund, private and institutional investors will cover two-thirds of the new investment fund (MAD 45 bn). Monetary policy support consists of the rapid mobilisation of conventional tools, but the central bank refuses to intervene directly to finance the Treasury. In an unstable environment, this determination to preserve macroeconomic stability is reassuring. Even so, the prospects of a growth rebound after the 2020 shock are still uncertain.

A MARKED SLUMP IN ACTIVITY

Already undermined by a 5% contraction in agricultural added value due to unfavourable weather conditions in Q1 2020, the Moroccan economy was then hit by a spectacular drop-off in Q2 GDP. According to the High Commission for Planning, GDP contracted 14.9% year-on-year (see chart 1). With the early introduction of lockdown measures, domestic demand collapsed: investment plummeted 17.4% y/y and household consumption declined 21.2%, despite extremely low inflation (which averaged 0.5% in the first seven months of the year). Furthermore, being dependent on the European market and having a large tourism sector, Morocco had to cope with a powerful external shock. Excluding oil refining, the manufacturing output index contracted 21.4% y/y in Q2, which can be largely attributed to the difficulties of export supply chains, and automobiles in particular (-57%). Value added in the "hotel and restaurants" sector plummeted 90%, slashing growth by 2.3 percentage points. Despite the good performance of financial services, the tertiary sector (50% of GDP) felt by 14.9% in Q2.

Although the second half is expected to see an improvement thanks to the lifting of lockdown measures since June, the full-year recession is bound to be severe at 5.8%. Moreover, the risks are on the downside, as illustrated by the lockdown measures that were recently reintroduced in Casablanca.

Yet the downturn could have been much worse without the authorities' rapid intervention. The central bank lowered its key rate from 1.5% from 2.25% prior to the crisis, and commercial banks are no longer required to make deposits as part of mandatory reserves. By implementing state-backed loans combined with the easing of provisioning rules in exchange for loan restructuring and extended loan payments, the banks continue to support the economy. At the end of July, bank lending was up 5.8% year-on-year, and this momentum was largely fuelled by greater needs for corporate cash flow. Nearly 60% of the increase in loans outstanding since March were for liquidity loans. Despite greater pressure on bank liquidity, corporate borrowing conditions have improved (the average lending rate fell by 33 basis points to 4.58% in the first six months of the year) and there has not been a surge in non-performing corporate loans (+12% y/y compared to +17% for non-performing household loans at the end of July).

FORECASTS

	2018	2019	2020e	2021e
Real GDP growth (%)	3.1	2.5	-5.8	4.6
Inflation (CPI, year average, %)	1.8	0.2	0.8	1.2
Central. Gov. balance / GDP (%)	-3.8	-3.8	-7.5	-5.6
Central. Gov. debt / GDP (%)	65.2	65.0	76.1	78.0
Current account balance / GDP (%)	-5.5	-4.1	-6.8	-5.9
External debt / GDP (%)	44.3	45.6	53.8	52.6
Forex reserves (USD bn)	22.6	25.3	27.0	25.4
Forex reserves, in months of imports	4.9	5.3	6.9	6.0
Exchange rate USDMAD (year end)	9.6	9.6	9.5	9.3

TABLE 1

e: ESTIMATES AND FORECAST
SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

ECONOMIC GROWTH

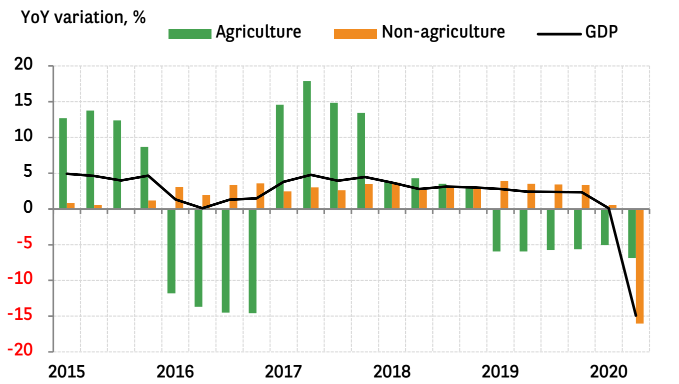

CHART 1

SOURCE: HCP

A SOLID EXTERNAL POSITION DESPITE TOURISM DEBACLE

The authorities also acted prudently by drawing on the IMF's entire USD 3 bn Precautionary and Liquidity Line (PLL) in early April. This operation swelled foreign reserves by 13% (see chart 2), which eased the pressures emerging on the dirham (MAD). In March, the currency fluctuation band was widened to +/- 5% around a basket of currencies comprising 60% of euro and 40% of US dollar. Although MAD immediately depreciated by 5-6% against the two benchmark currencies, it has stabilised since April within the fluctuation band without any central bank intervention. With foreign reserves now covering more than seven months of imports, Morocco's external position seems to be solid to face up to potential pressures.

The expected shock has not materialised yet. Although the main sources of foreign currency plummeted in the first seven months of the year, with exports down 17% and tourism revenues down 44%, imports also contracted 17% under the double impact of the downturn in domestic demand and oil prices. Even excluding energy, the trade deficit shrank by 10%. Nonetheless, the trade balance is bound to deteriorate as demand picks up, and the shortfall in tourism revenues is expected to reach 4% of GDP. Remittances by the Moroccan diaspora have also been resilient, declining only 3.2%, but caution is needed here, too. The current account deficit is expected to near 7% of GDP in 2020. With foreign direct investment in a slump, the authorities have decided to tap again the international financial markets to make up for the financing needs not covered by the massive aid from international donor funds. As expected, the Eurobond issuance of EUR 1 bn has got a warm welcome by international investors. Despite a greater mobilisation of external financing, the external debt remains under control (54% of GDP in 2020).

PUBLIC FINANCES: SWELLING DEBT IS STILL MANAGEABLE

Public finances have come under significant pressure. In the first eight months of the year, fiscal and non-fiscal receipts contracted by 8% and 14%, respectively. Although spending was virtually flat thanks to cutbacks in energy subsidies and tighter control of investments, the budget deficit widened by 50% compared to August 2019, and an Amended Finance Bill had to be passed for the first time since 1990.

The deficit is now expected to reach 7.6% of GDP, up from an initial target of 3.8%, even though most of the stimulus plan was financed through the MAD 33.7 bn Covid fund, two thirds of which is comprised of grants. Government debt is expected to increase by more than 10 points to 76% of GDP. There are also fiscal risks contingent on the financial situation of state-owned companies that have also been hit by the crisis. State-backed external debt amounted to 15.5% of GDP in 2019, but this figure is not included in the scope of government debt.

Nonetheless, the deterioration in Moroccan public finances is still manageable since the government continues to benefit from favourable financing conditions. Despite significant issuance on domestic debt market since the beginning of the year, the yield on Treasury notes has never been so low, which should allow it to maintain the interest payment at less than 13% of government revenue. Moreover, the structure of the debt is not risky, with 78% denominated in MAD.

HAS THE 2021 RECOVERY ALREADY BEEN JEOPARDISED?

It is hard to evaluate the rebound capacity of the Moroccan economy. Although there are hopes for a better agricultural harvest in 2021 after two difficult years, non-agricultural activities are expected to turn around only gradually at best. According to the central bank's latest estimates, tourism revenues could double in 2021 if the health crisis permits, but this would still be 60% below the 2019 level. It also seems very hypothetical that industrial activity could return to normal, although the upturn in automobile production at the new PSA plant should help boost exports. More importantly, there are numerous doubts about the health of Morocco's economic fabric.

FOREX RESERVES

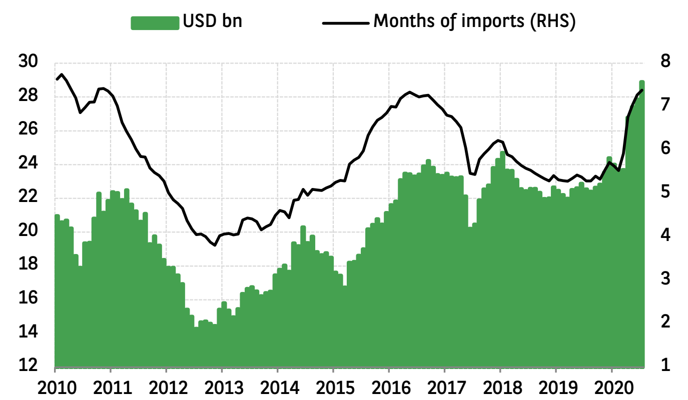

CHART 2 SOURCE: CENTRAL BANK, OFFICE DES CHANGES

Emergency measures have certainly helped buffer the shock, but they will not prevent an upturn in business failures as the various support measures wind down. The central bank recently conducted a stress test in which the non-performing loan ratio was expected to rise to 9.9% at end-2020 and 10.8% at end-2021, compared to 7.6% in 2019 (and 8.2% in July 2020). The financial system's stability is not in jeopardy, but the monetary authorities have warned that a new stress test will be conducted by the end of the year to take into account an evolving situation. In other words, we cannot rule out an even sharper increase in the non-performing loan ratio. Household behaviour is another unknown. Although the rise in unemployment was relatively mild in Q2 (+1.8 points to 12.3%), especially in urban areas (+0.5 points), the concomitant 10-point drop in the household confidence index to an all-time low seems to reflect a sharp deterioration in living conditions.

One last unknown is the scope of the recovery plan. Growth dynamics were already modest before the economic shock of the pandemic, despite a high investment rate from both public and private sectors. The effectiveness of public spending generally goes hand-in-hand with the implementation of structural reforms, but they can be postponed during times of hardship. In any case, the authorities will have very little manoeuvring room as government debt begins to reach high (but still manageable) levels. The government's determination to preserve the country's investment grade status is also likely to encourage moderation.

Stéphane ALBY
stéphane.alby@bnpparibas.com