



MONETARY POLICY REPORT

Document prepared
for the Bank Board

25 December 2007

بنك المغرب

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LIST OF ABBREVIATIONS AND SYMBOLS USED

AWI	:	Average Wage Index
BAM	:	Bank Al-Maghrib
CLI	:	Cost of Living Index
CNSS	:	National Social Security Fund
GFCF	:	Gross fixed capital formation
GDP	:	Gross Domestic Product
HCP	:	High Commission for Planning
IMF	:	International Monetary Fund
INAC	:	Institute for Analysis and Economic Condition
MASI	:	Morocco All Shares Index
OCP	:	Office Chérifien des Phosphates
CIH	:	Crédit Immobilier et Hôtelier
CAM	:	Crédit Agricole Marocain
OMPIC	:	Moroccan Industrial and Commercial Property Office
VAT	:	Value Added Tax

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PRESS RELEASE

MEETING OF BANK AL-MAGHRIB BOARD

1. The Bank Al-Maghrib Board held its quarterly meeting on 25 December 2007.
2. At this meeting, the Board examined the recent development of the economic, monetary and financial situation and the forecasts made by the Bank staff in the framework of the Monetary Policy Report of the last quarter of 2007.
3. The available data show that the year-on-year rise of the cost of living index was 1.4% in November 2007, against 3.5% a year earlier, while underlying inflation dropped from 2.8% to 1.9%. For 2007 as a whole, the data examined come in confirmation of the Monetary Policy Report of September, suggesting the continuation of the inflation trajectory around 2%. Therefore, inflation is expected to reach 2.1% in 2007, as opposed to 3.3% in 2006.
4. By the third quarter of 2008, inflation is projected to remain in line with the price stability objective, with an average forecast of about 2.3%, under the assumption of the non-occurrence of one or several risk factors.
5. The major risks regarding future inflation developments remain on an upward trend. The main uncertainties in connection with these forecasts are linked to the price of oil and imported agricultural commodities, to the evolution prospects of output and incomes, as well as to the continued rapid progression of M3 aggregate and bank loans. Moreover, the potentially unstable international environment also remains a risk factor given the volatility of money and exchange markets, in a context characterized by the continuing mortgage market crisis, as well as the recent rising inflationary pressures and the slowdown of growth in OECD countries.
6. The Board also noted that even though the interbank rate has seen upward pressures, particularly with respect to foreign exchange market operations at the beginning of the fourth quarter, the increase of Bank Al-Maghrib's interventions level for several weeks now has allowed bringing this rate to a level close to the key rate.
7. In this context, the Board decided to keep the key rate at 3.25%. Furthermore, given recent trends on the money market, marked since last February by the shift from a situation of excess liquidity and withdrawal operations by Bank Al-Maghrib to an increasingly high level of central bank money injections, the Board decided as well to reduce the monetary reserve rate from 16.5% to 15% starting 1 January 2008.
8. Considering all this data, Bank Al-Maghrib will continue to remain highly cautious about the factors underlying inflationary risks.
9. The Board also examined the three-year budget forecasts and approved the 2008 budget.

10. The Board agreed on the schedule of its meetings for the year 2008 as follows:

- 25 March 2008
- 17 June 2008
- 23 September 2008
- 23 December 2008

Rabat, 25 December 2007

OVERVIEW

At the end of November, the evolution of price indices showed a slowdown of inflation compared to the same period of the previous year. In fact, the rise in the cost of living index stood at 1.4% on a year-to-year basis, as opposed to 3.5% in November 2006, whereas underlying inflation fell from 2.8% to 1.9%. The considered data for the whole year 2007 confirm the September Report forecasts. Thus, inflation is expected to reach 2.1%, against 3.3% in 2006.

After a growth deceleration in 2007, estimated at 2.3%, pressures on demand are projected to remain moderate in 2008. The adopted scenario is based on an average cereal harvest of 60 million quintals. In these conditions, the agricultural output gap is expected to remain negative during the first two quarters before turning positive in the last two quarters 2008. Given the performance levels of non-agricultural activities, forecast to continue along the same trend of 2007, the overall output gap is expected to be very slightly positive in 2008.

With regard to import prices, in a context characterized by a relative acceleration of world inflation, pressures on prices excluding energy will remain relatively moderate. Following a 7% annual rise in 2007, the increase of import prices, excluding energy, is expected to drop to 4% in 2008. This is mainly driven by the prices of agricultural products and commodities.

As for monetary data, money supply growth rate remains high, reaching 18.9% on a year-to-year basis at the end of October, compared to 14.9% a year earlier. The volume of additional money creation is a risk factor, closely monitored by the central bank, especially as it is linked to the strong expansion of all loan categories, particularly real estate loans.

However, the main risks to the future evolution of inflation are still on the upside. The fan chart forecast shows a slight upward asymmetry. At the external level, these risks are associated with the increasing uncertainties about the future evolution of oil and agricultural products and commodity prices. They are also related to the impact of the economic slowdown in our main partner countries, affected in particular by the subprime market crisis. Internally, these risks are linked to the rapid growth of M3 aggregate and bank loans, and above all to the uncertainties relating to the application of oil prices indexation mechanism.

Under the assumption of the non-materialization of the main risk factors, inflation over the next four quarters (as from the fourth quarter of 2007 to the third quarter of 2008) is expected to remain in line with the price stability objective, averaging nearly 2.3%. With regard to underlying inflation, the forecast suggests an annual rate below 2%.

1. OVERALL DEMAND TREND

Economic activity, sustained by increasing investment, slightly improved in the second half of 2007, in spite of an unfavourable international environment marked by soaring commodity prices, rising oil prices and an economic slowdown in our main trading partner countries. In this context, year-on-year growth rate appears to have increased by approximately 2.1%. GDP growth would speed up during the fourth quarter of 2007 to reach 3.6%. This increase would be attributable to the secondary sector's buoyancy, driven by the dynamism of building and public works sector, as well as to the improvement of tertiary activities.

1.1 Output

In an unfavourable international environment, economic growth is expected to stand at 2.1% in the third quarter of 2007. This trend should speed up in the fourth quarter, reaching 3.6%.

Suffering from adverse weather conditions, the agricultural sector's added value is thought to have dropped by 17.5% in the third quarter 2007. This decrease has been intensified by the contraction of animal production on account of livestock feed scarcity. However, given the more favourable weather conditions in the fourth quarter 2007, agricultural GDP would record a more moderate drop of about 8%.

Non-agricultural GDP is projected to consolidate the good performance reported in the first half of 2007. This dynamism would continue in the third and fourth quarters 2007, with an increase of about 5.8%.

After a 2% growth in the third quarter 2007, due to the contraction of foreign demand, the added value of the extractive industry is expected to increase at a quicker pace of around 3.5% on a year-to-year basis in the fourth quarter.

Concurrently, the added value of the "electricity and water" branch would grow respectively by 7.7% and 3%, year-on-year, in the third and fourth quarters of 2007.

The performance of the industrial activity, excluding oil refining, is expected to improve, with a respective rise of 3.9% and 5.1%. Furthermore, the outcome of the business survey conducted by Bank Al-Maghrib shows an average rate of output capacity utilization of around 77% in October. In addition, overall orders received were up and the outlook for the three forthcoming months is favourable, in particular for the electrical, electronic, textile and leather industries.

Table 1.1: Year-on-year quarterly GDP growth at 1998 chained prices per major branch of activity

Branches	2007 (*)				
	Q I	Q II	Q III	QIV(p)	Average
Agriculture	-18.0	-20.9	-17.5	-8.0	-16.2
Non agricultural GDP (**)	5.5	6.2	5.8	5.8	5.9
Fishing	-5.0	6.7	-4.6	2.5	-0.2
Extractive industry	5.3	6.9	2.0	3.5	4.4
Industry (excluding oil refining)	4.1	4.7	3.9	5.1	4.5
Oil refining and other energy products	-11.6	2.9	4.3	2.5	-0.7
Electricity and water	6.2	3.9	7.7	3.0	5.2
Building and public works	9.3	12.0	9.8	10.5	10.4
Trade	4.6	4.8	5.3	5.5	5.0
Hotels and restaurants	8.1	3.0	5.8	3.5	5.1
Transportation	4.4	4.1	4.0	4.5	4.2
Post and telecommunications	6.5	9.5	12.2	7.0	8.8
Financial activities and insurance	13.0	13.9	14.1	12.0	13.2
Services to businesses and personal services	5.3	5.8	6.4	4.0	5.4
General government and social security	2.5	3.3	3.7	3.5	3.2
Education, health and social action	3.8	4.4	4.4	4.7	4.3
Taxes on products net of subsidies	10.5	10.8	6.7	10.7	9.7
Gross Domestic Product	1.9	1.7	2.1	3.6	2.3

Sources : INAC, and BAM estimates.

(*) Quarterly national accounts are henceforth prepared according the new national accounting system of 1993 at chained prices, base year 1998.

(**) Including fishing and taxes on products net of subsidies.

Under the effect of higher foreign orders for car, electronic and metallurgical industries, the growth pace of mechanical, metallurgical, electrical and electronic industries should remain strong. Likewise, chemical and para-chemical industries are expected to benefit from increased external sales of fertilizers and pesticides.

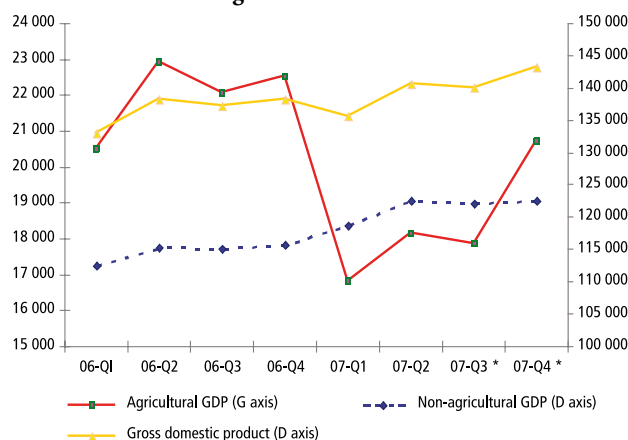
Cement output is projected to continue its growth thanks to the dynamism of the building and public works sector. Taking advantage of the expansion of basic infrastructures, the construction of new towns, the programme for the fight against shantytowns and the steady growth of demand for new housing, the outlook for the building and public works sector remains positive for the third and fourth quarters 2007, with growth rates in the region of 9.8% and 10.5% respectively.

As regards the services sector, tourist arrivals were up by 14%, reaching 6.3 million tourists, of whom 2.9 million were Moroccans living abroad, while the number of overnight stays in classified hotels was up by 4%. These rises partially explain the 5.8% year-on-year increase, in the third quarter, of the added value of the hotel and restaurant industry, which should show a rise of about 3.5% in the fourth quarter of 2007.

Owing in particular to the improvement in air transport, up by 11.4% in the third quarter of 2007, the transportation sector should remain on its upward trend, its growth rate moving from 4% in the third quarter to 4.5% in the fourth quarter. Likewise, the added value of the post and telecommunications branch is expected to grow on a year-to-year basis by 12.2% in the third quarter and 7% in the fourth quarter of 2007.

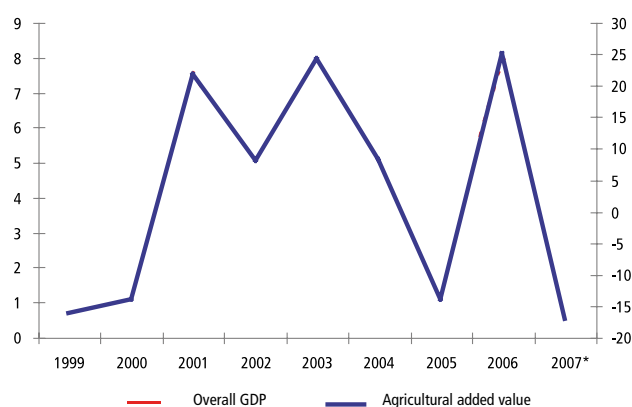
Under the assumption of a more favourable 2007-2008 crop year and the dynamism of secondary and tertiary activities, overall GDP should register a rise of about 3.6% in the fourth quarter of 2007, thus bringing the annual growth rate to nearly 2.3%.

Chart 1.1: Quarterly growth of overall agricultural and non agricultural GDP



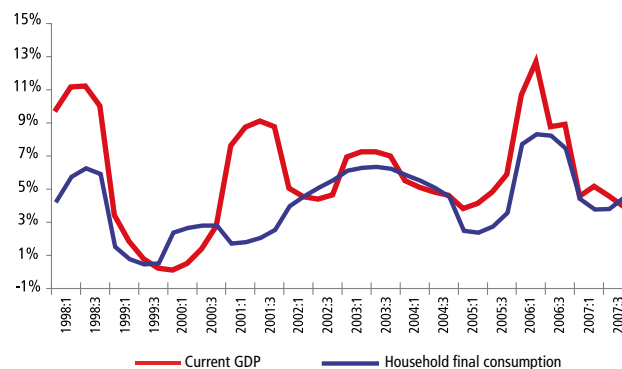
Source: HCP and BAM estimates.

Chart 1.2: Growth rates of GDP and agricultural added value



Source: HCP and BAM estimates.

Chart 1.3: Year-to-year quarterly growth of current GDP and of household final consumption



Sources: HCP, and BAM estimates.

1.2 Consumption

National final consumption is expected to rise on a year-to-year basis by 4.8% and 5.3% respectively during the third and fourth quarters of 2007.

On account of the drop in local output, food imports expanded by 61.9% at the end of October. In particular, cereal supplies grew in value more than twofold.

Final household consumption during the third and fourth quarters of 2007 is expected to decelerate, growing by 3.7% and 4.4% respectively, as opposed to 8.1% and 7.3%.

For 2007 as a whole, final household consumption should grow by 4% despite the moderate income levels in rural areas (cereal production estimated at 23.5 million quintals). It would be mainly sustained by the improvements on the labour market (slight drop in unemployment rate in the third quarter of 2007), growing remittances by Moroccans living abroad and the 42.8% increase in consumer loans at the end of October 2007.

As concerns general government final consumption, it rose by about 8% in the first half of 2007, in connection with the 18% increase in operating expenses. This pace is expected to continue over the last two quarters of 2007, to stand at 8.2% and 7.9%, respectively.

1.3 Investment

Investment remained buoyant thanks to the infrastructure projects currently underway, the easing of interest rates and the improvement of the business environment.

Gross fixed capital formation is expected to increase, on a year-to-year basis, by 10.3% and 10.5%, respectively, in the third and fourth quarters of 2007.

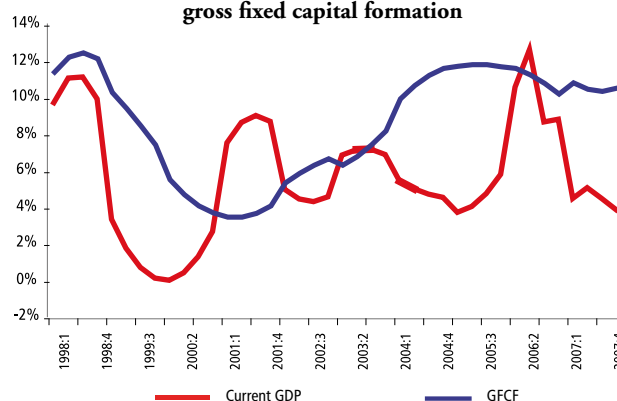
For 2007 as a whole, gross fixed capital formation is projected to grow by 10.5%. This expansion partly reflects the boom in building and public works investments owing to the major infrastructure projects, the lower interest rates on real estate loans and the high housing demand. This situation was confirmed by the 22.2% year-on-year increase in real estate loans at the end of October 2007.

Table 1.2: Quarterly evolution of domestic demand components

	2006		2007(E)			
	III	IV	I	II	III	IV
National final consumption	7.2	6.7	5.1	4.8	4.8	5.3
Resident households	8.1	7.3	4.3	3.7	3.7	4.4
General government	4.5	4.9	7.8	8.1	8.2	7.9
GFCF	10.7	10.2	10.8	10.4	10.3	10.5

Sources : HCP, and BAM estimates.

Chart 1.4: Year-on-year quarterly growth of current GDP and gross fixed capital formation



Sources: HCP, BAM estimates.

The dynamism of investment is also reflected by the 18.2% increase in finished products imports as well as the 36.4% growth as at the end of October 2007 of equipment credits. Moreover, receipts from foreign private investments and loans reached 26.1 billion dirhams, representing an increase of 8.4%.

Regarding the number of certificates of incorporation issued by the OMPIC, it rose by 19% at the end of September 2007. Business creation projects largely concern the sectors of services, trade, building and public works, and industry.

In addition, the Investment Commission had approved, from January through November 2007, 76 investment projects for a total amount of 68 billion dirhams, thus enabling the creation of nearly 43,000 jobs.

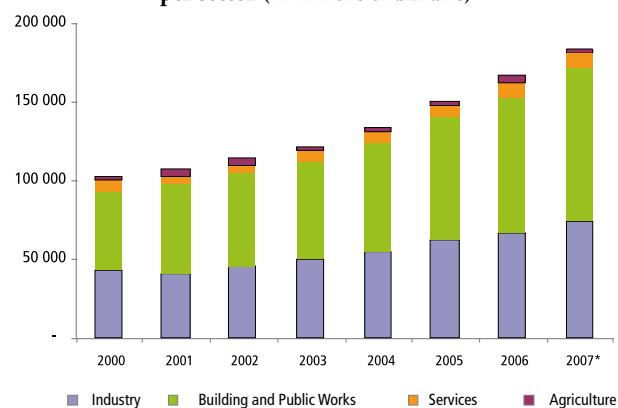
1.4 Foreign Trade

In a context of slower world trade and Eurozone growth rate since the beginning of 2007, the downturn of foreign demand for Morocco led to a moderate rise in exports which increased by 2.3% in the third quarter on a year-to-year basis. Concurrently, imports rose by 17.6%, mainly due to higher prices of industrial commodities and some food products, in particular wheat, corn and milk. This situation led to the widening of the trade deficit by 32.1% and to the decline of the cover rate from 48.8% to 42.4% in one year.

The increase in exports covers a 25.6% rise in the sales of the OCP group, notably on the back of higher prices on the world market and the decrease of the other exports both in volume and value.

The rise of imports in the third quarter of 2007 is attributed to greater purchases of food products, resulting from the drop in the domestic supply. Likewise, imports of capital and consumer goods grew steadily. The energy bill also rose in connection with higher purchases of refined oil products.

Chart 1.5: Annual growth of gross fixed capital formation per sector (in millions of dirhams)



Sources: HCP and BAM estimates.

2. PRESSURES ON OUTPUT CAPACITY

Bank Al-Maghrib's estimates show that overall GDP remained below its potential level in the second and third quarters of 2007. On the other hand, for the non-agricultural output gap, estimates showed positive values above those reported in the same periods of 2006. In addition, the output capacity utilization rate in the industrial sector started an upward trend as from September, which could push industrial product prices upwards. Overall, the development of these indicators suggests the occurrence over the forthcoming quarters of pressures on prices. These would yet be cushioned by the deceleration of the labour unit cost, taking account of the stability of the legal minimum wage and the wage index slowdown.

2.1 Pressures on capacity

Given the pace of economic growth, estimated at 1.7% in the second quarter against 7.9% in 2006, overall GDP remained below its potential level. In fact, according to the estimates of Bank Al-Maghrib, the overall output gap reached -1.8% in the second quarter. Similarly, overall GDP is projected to rise by 2.1% in the third quarter, which would keep the overall output gap at almost the same level as in the second quarter (-1.7%).

However, GDP growth, excluding agriculture and fishing, accelerated to reach 6.2% in the second quarter of 2007, as opposed to 4.4% in the same period of 2006. This upward trend should continue in the third quarter with an expected growth rate of 6.5%. Therefore, the non-agricultural output gap in the second quarter of 2007 was estimated at 3.2%, thus representing 2.7 points more than in the second quarter of last year. For the third quarter of 2007, the non-agricultural output gap is forecast to reach 2.3%, above the 1.2% rate reported a year earlier. This rise in the non-agricultural output gap suggests the existence of pressures on prices over the next two quarters.

According to the latest available findings of Bank Al-Maghrib's monthly business survey, the industrial output capacity utilization rate started to accelerate in September and October when it reached 73% and 77% respectively, after a seasonal drop in August due to the holiday period. This development affected all the industrial branches covered by the survey. The highest rates were reported in electrical and electronic industries (82%), chemical and para-chemical industries (80%) and textile and leather industries (74%). Given the normal inventories level, any additional demand may cause an upward pressure on finished industrial products' prices in the next quarter.

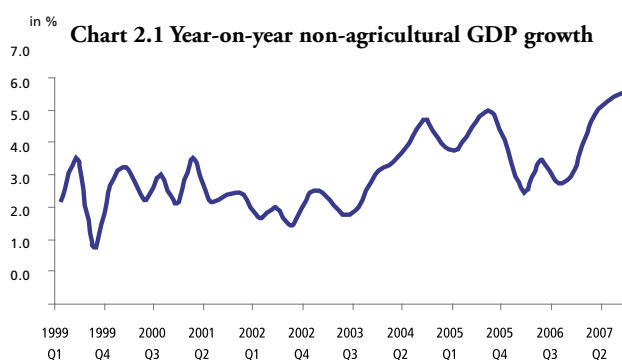
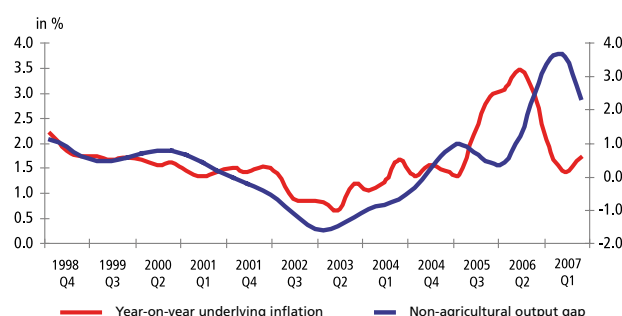
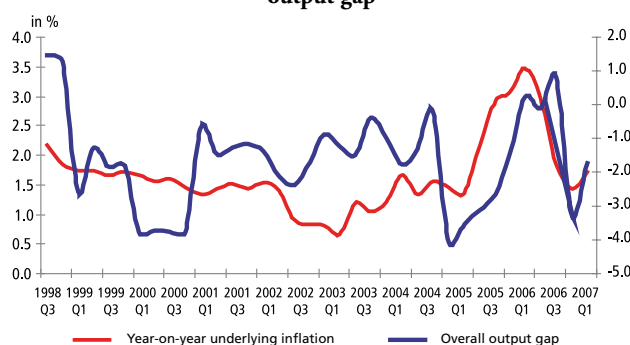


Chart 2.2 Non-agricultural output gap and underlying inflation



Source: HCP, Bank Al-Maghrib estimates

Chart 2.3 Underlying inflation and lagged overall output gap



Source: HCP, Bank Al-Maghrib estimates

Apparent labour productivity in non-agricultural activities continued its upward trend in the second and third quarters of 2007, thanks to the non-agricultural GDP growth which was more rapid than that of urban employment.

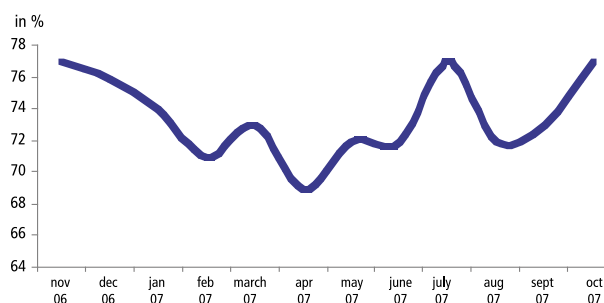
2.2 Pressures on the labour market

In the third quarter of 2007, the labour market was characterized by a net job creation of 111,000 jobs against 221,000 in the same period of the previous year. This negative performance chiefly concerned urban areas (from 161,000 jobs in 2006 to 48,000 in 2007), whereas net job creation in rural areas slightly increased from 60,000 to 63,000 posts, as job losses in agriculture were compensated in rural areas by the creation of new employment opportunities in non-agricultural activities. In terms of sectors, only agriculture suffered job losses, estimated at 20,000, on the back of a poor crop year. On the other hand, all sectors registered net job creations, totalling 132,000, including 65,000 new jobs in the services sector, 41,000 in industry and 26,000 in building and public works.

Considering the drop in the activity rate, especially in urban areas, the national unemployment rate fell from 10.1% to 9.9% between the third quarters of 2006 and 2007. This evolution covers a fall in rural unemployment rate (from 3.9% to 3.5%) and a quasi stagnation in urban areas, at a still high level (from 16% to 15.9%).

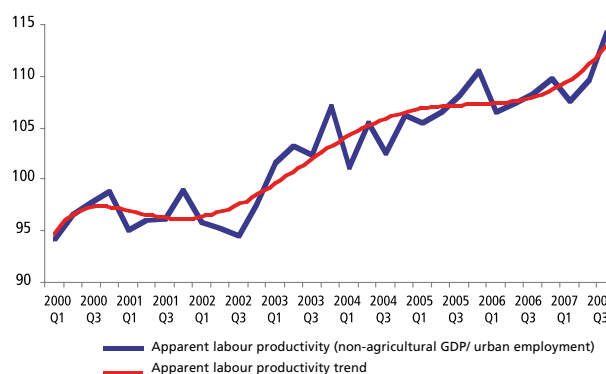
With regard to wages, the quarterly index (Average Wage Index), calculated by the HCP on the basis of the CNSS data, rose by 4% in the second quarter of 2007 against 7.4% a year earlier. In real terms, this index grew by 2.4% as compared to 3.6% the

Chart 2.4 Industrial output capacity utilization rate



Source: BAM

Chart 2.5 Apparent labour productivity (Base 100=1998)



Source: HCP, Bank Al-Maghrib estimates

Table 2.1 Labour market indicators

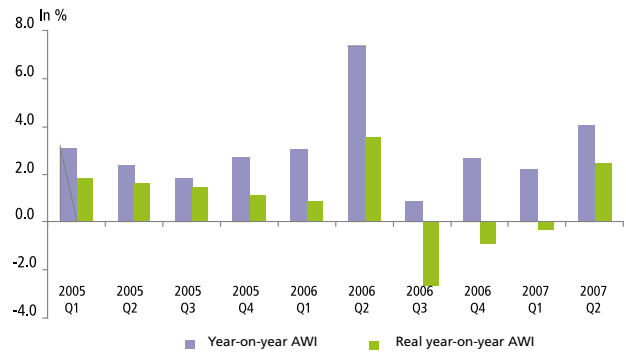
	2004	2005	2006	2007
Rate in %	Q3	Q3	Q3	Q3
National active population ¹	3.9	1.0	1.4	0.8
Urban active population ¹	3.4	0.5	1.6	0.8
National occupied active population ¹	5.6	0.4	2.3	1.1
Urban occupied active population ¹	5.5	0.4	3.5	1.0
National employment rate	46.0	45.2	46.2	45.8
Urban employment rate	37.5	36.7	37.9	37.3
National unemployment rate	10.9	10.9	10.1	9.9
Urban unemployment rate	17.5	17.6	16.0	15.9
National activity rate	51.4	50.8	51.4	50.8
Urban activity rate	45.4	44.6	45.1	44.4

Source : HCP

(1) : Year-on-year change.

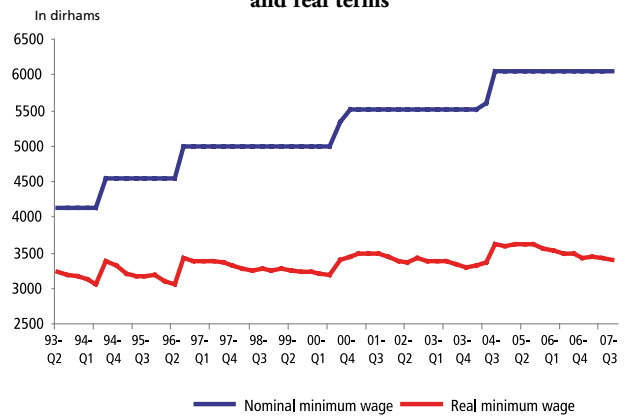
previous year. Considering the 2.1% increase in apparent labour productivity, the real unit cost of labour rose by 0.3%, more slowly than in the same period of the year before.

Chart 2.6 Private sector Average Wage Index (AWI) in nominal and real terms (year-on-year)



Source: HCP, CNSS.

Chart 2.7 Quarterly minimum wage in nominal and real terms



Source: Ministry of Employment

3. IMPORT PRICES

The upward trend of consumer goods import prices, which started in the third quarter of 2006, intensified in the second quarter of 2007. This trend pushed inflation upwards in Morocco by the end of the third quarter of 2007. Nevertheless, the inflationary impact of higher oil and commodity prices in the second quarter of 2007 was mitigated by a number of measures taken by the Government.

3.1 World inflation

At the end of October 2007, the majority of the world's largest industrialized economies reported inflation rates above those of the previous year, except for Japan.

In fact, in the United States, consumer prices increased in October by 3.5% year-on-year after a 2% rise in the previous month. Likewise, inflation in the Eurozone stood at 2.6%, its highest level in two years.

Over the forthcoming quarters, risks to inflation will remain on the upside. They are mainly linked to the evolution of oil and agricultural commodity prices on the international markets.

3.2 Oil prices

Oil prices continued their upward trend in October. Indeed, crude oil average price reached \$82.2 a barrel in October, which represents a monthly rise of 6.9% against 9.6% a month earlier. At the end of the first ten months of 2007, the average barrel price rose by 3.2% to stand at \$67.3.

Pump prices were not affected by the soaring international oil prices, due to the intervention of the Subsidization Fund. Consequently, domestic prices remained unchanged.

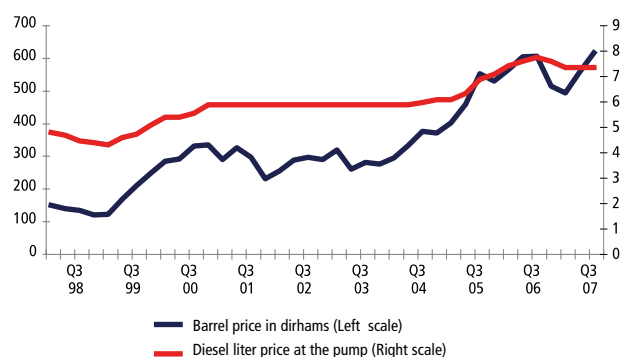
Concerns about the insufficient world supply, the low U.S. dollar which stimulates oil demand, as well as the geopolitical tensions in the Middle East are all factors influencing prices evolution. According to the International Monetary Fund forecasts, the average annual price of crude oil is expected at \$68.52 a barrel at the end of 2007 and at \$75 throughout 2008. However, given the recent trends, prices could possibly exceed this level.

Table 3.1 Recent evolution of world inflation on a year-to-year basis

	2005	2006	2007	Forecasts	
	Oct	Oct	Oct	2007	2008
United States	4.3	1.3	3.5	2.7	2.3
Eurozone	2.5	1.6	2.6	2.0	2.0
France	1.8	1.1	2.0	1.6	1.8
Spain	3.5	2.5	3.6	2.5	2.8
Japan	-0.8	0.4	0.3	0.0	0.5

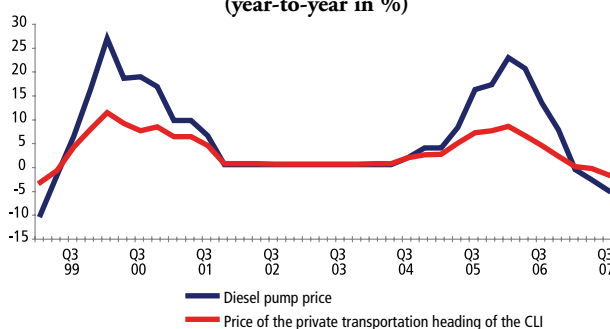
Sources: International Monetary Fund and Eurostat

Chart 3.1 World oil price and pump price in Morocco



Source: IMF, Ministry of Energy and Mining

Chart 3.2 Fuel pump price and transportation price (year-to-year in %)



Source: Ministry of Energy and Mining

3.3 Import prices

In addition to oil, the international prices of commodities excluding energy picked up. In fact, metals price index saw an uninterrupted rise since April 2006, reaching its highest level in May 2007 as a result of the price rise in most metals.

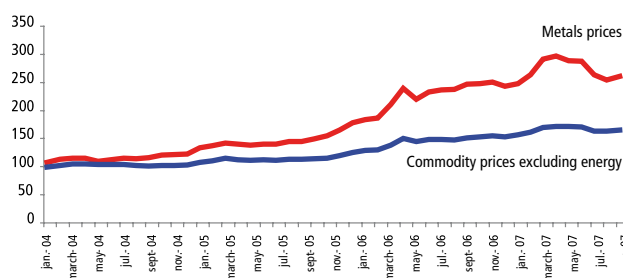
On the other hand, agricultural commodity prices, particularly those of vegetable oils and cereals, remained high during 2007. In fact, the upward trend of wheat prices on the international markets, which stabilized over the period from October 2006 through May 2007, markedly accelerated as of June 2007. Hence, the average price of imported wheat ton grew by 45% in the first ten months. However, the effect of this rise was mitigated by the government's different measures relating to subsidization and customs duties reduction.

Table 3.2 Domestic selling prices of oil products

Products (Dh/Litre)	April 2006	Sept. 2006	Oct. 2006	Jan. 2007	Apr. 2007	Jul. 2007	Oct. 2007
Premium gasoline	10.51	11.07	10.5	10.25	10.25	10.25	10.25
Regular gasoline	-	-	-	-	-	-	-
Lamp oil	7.46	-	-	-	-	-	-
Diesel oil	7.46	7.98	7.47	7.22	7.22	7.22	7.22
Diesel 350	9.34	9.93	9.38	9.13	9.13	9.13	9.13
Industrial fuel (Dh/Ton)	3307	3374	3174	2874	2874	2874	2874

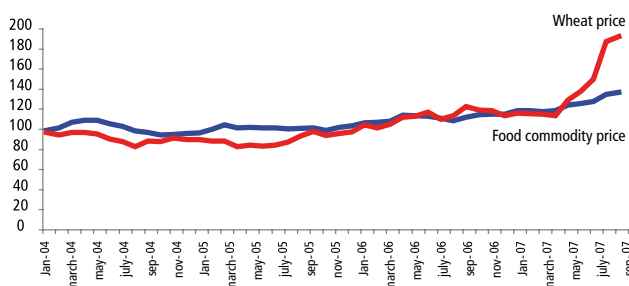
Sources: Ministry of Energy and Mining.

Chart 3.3 Price indices for metals and commodity excluding energy



Source: IMF

Chart 3.4 Price indices for food commodity and wheat on the international market



Source: IMF

4. MONETARY CONDITIONS AND ASSET PRICES

Following the quarterly evaluation of the economic and monetary situation as at 25 September 2007, the Board decided to keep unchanged the Bank's intervention rates while continuing to closely monitor the inflation outlook.

Conditions on the monetary market generally tightened in the third quarter as well as in October and November 2007.

The increased liquidity shortage on the money market led to continued uptrend of interbank rate, marked particularly by an acceleration in October and early November, due to the exceptional rise in demand for liquidity as a result of extensive foreign currency purchases from Bank Al-Maghrib. Rates for short-term Treasury bills and those for bank deposits were also up.

The drop in lending rates continued, due to interbank competition, in particular with regard to consumer and real estate loans, albeit at a less pronounced pace.

Though rapid, annual growth of monetary aggregates slowed, except for sight deposits whose rise speeded up under the effect of the development of real estate and financial transactions.

In addition, the growth gap between money supply and non-agricultural economic activity was smaller from one quarter to another. Nevertheless, the outstanding money surplus remains large and is indicative of medium-term inflationary risks.

With regard to the prices of financial and real estate assets, they grew at the end of the third quarter, a trend that reversed in late November 2007 with respect to stock exchange prices.

4.1 Monetary conditions

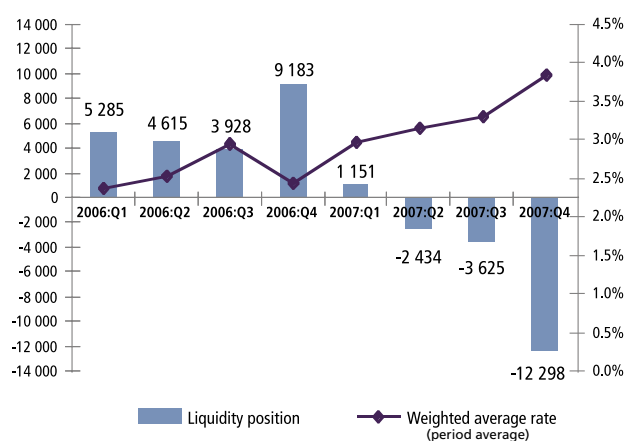
4.1.1 Liquidity and implementation of monetary policy

During the third quarter of 2007, bank cash holdings contracted substantially, mainly under the effect of a 3.9 billion dirhams liquidity withdrawal caused by the autonomous factors. However, the increase in reserve requirements, which contributed largely to the liquidity crunch in August, following the application of the monetary reserve rule to CAM and CIH, slowed down in September 2007 compared to the pace observed since the beginning of the year.

Money circulation increased by 6.8 billion dirhams during the summer and Treasury transactions caused a liquidity withdrawal of 1.1 billion, mainly due to the privatization of 4% of Maroc Telecom's capital. This privatization operation generated a total amount of 4.6 billion dirhams, half of which was allocated to the Hassan II Fund for Economic and Social Development.

On the other hand, foreign asset transactions led to the injection of 4 billion dirhams. In spite of the general expansionary effect of foreign assets, the third quarter of 2007 saw an acceleration of currency sales by Bank Al-Maghrib totalling 15 billion dirhams. Their effect on liquidity was yet offset by the peak in foreign banknotes repurchases usually occurring

Chart 4.1 Average quarterly evolution of liquidity position (in millions of dirhams) and of weighted average rate (%)



in summer, the amount of which reached 19 billion dirhams.

Moreover, given the restrictive impact of the autonomous factors, the interbank market remained a bank market during the third quarter of 2007. Actually, the average market liquidity position¹ showed a deficit of 3.6 billion dirhams against 2.4 billions in the second quarter of 2007.

In the last quarter of 2007, the liquidity shortage on the money market increased due to the accumulated delays in constituting bank cash holdings as well as to the restrictive effect of autonomous factors, especially currency transactions. Reserve requirements also contributed to the shrinking of bank cash holdings by 1.9 billion dirhams, particularly on account of the higher deposits needed to guarantee share acquisitions on the Casablanca Stock Exchange primary market.

In October and November 2007, foreign asset operations gave rise to the withdrawal of 3.2 billion dirhams from bank cash holdings, given the continuing currency sales totalling 8.4 billion dirhams. These sales were partially compensated by the repurchase of foreign banknotes for an amount of 5.2 billion dirhams.

Currency purchases by commercial banks reflect the increase in the volume of spot and forward transactions by customers, due to:

1. Nervous international market and particularly the euro-dollar parity;
2. Soaring oil prices maintained by rising world demand (China), the substantial drop in oil inventories and the geopolitical conflicts.

Treasury operations had an expansionary effect of 2.9 billion dirhams on bank cash holdings, due in particular to Treasury debt payment. Indeed, Treasury assets amounted to 37.5 billion dirhams, including 10.5 billions for reimbursement of public domestic debt. Liabilities, on the other hand, totalled 34.6 billion dirhams, including 1.9 billion for banks' subscription to Treasury bills. In the fourth quarter of 2007, subscription to the Treasury bills of the Hassan II Fund for Economic and Social Development totalled 6.3 billion dirhams.

Chart 4.2 Liquidity position (in millions of dirhams) and interbank money market weighted average rate

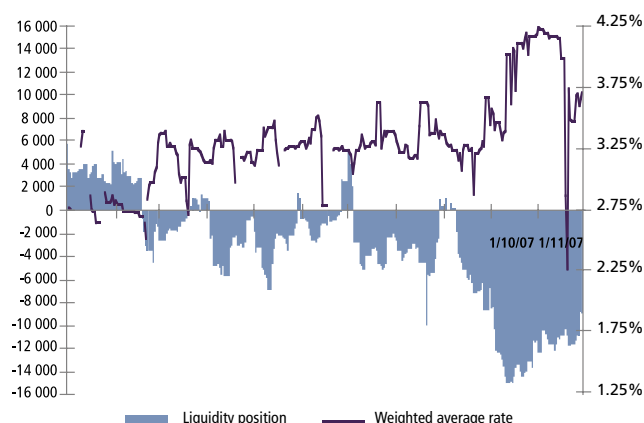


Chart 4.3 Reserve requirements increases (in millions of dirhams)

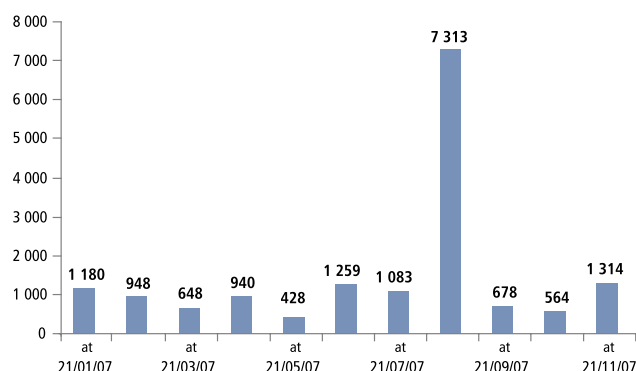
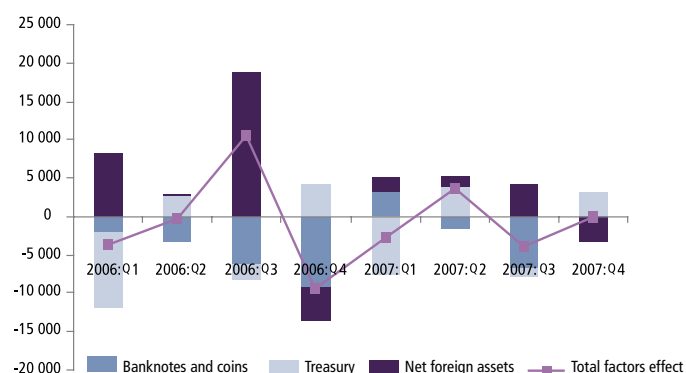


Chart 4.4 Evolution of liquidity factors effect (in millions of dirhams)



¹ Liquidity position = Banks balance – Reserve requirements +/- Bank Al-Maghrib interventions

At the tender of 9 October, the Treasurer of the Kingdom issued bills worth 1 billion dirhams for the benefit of Bank Al-Maghrib as part of the securitization of the fourth tranche of the agreed advance. This operation had but a neutral effect on liquidity.

The return flow of fiduciary money, which began in September following the holiday period, continued during October and November 2007, with an expansionary effect of 263 million dirhams on banks' cash holdings.

Given the impact of bank liquidities on foreign exchange operations, Bank Al-Maghrib decided to temporarily limit the liquidity injection through the 7-day advance tool, which it kept at 10 billion dirhams between 11 October and 14 November 2007. To make up for the market residual liquidity deficit, banks resorted to 24-hour advances for an average daily amount of 3.3 billion dirhams between 1 October and 14 November 2007.

Therefore, the money rate on the interbank money market stood at 3.86% on average, with an increase of 54 basis points compared to the previous quarter.

As of 14 November, Bank Al-Maghrib decided to gradually ease the interbank rate with a view to bringing it down to a level compatible with 3.25%.

Overall, the daily average of central bank liquidity injections amounted to 13 billion dirhams in October and November 2007, including 10.5 billion (81%) through weekly calls for tenders and 2.5 billion (19%) via standing facilities.

Furthermore, the annual mean of the weighted average rate on the interbank money market remained very close to the 7-day advance rate, standing at 3.29% from January to November 2007.

The volatility of interbank rate, measured by its standard deviation, rose by 25 basis points, up from 0.15% in the third quarter of 0.40% in the fourth one. Given the increasing volatility of the weighted average rate, interbank market activity contracted, as the average volume exchanged on the market dropped from 1.2 billion to 806 million from one quarter to the next.

Chart 4.5 Bank Al-Maghrib interventions on the money market (millions of dirhams)

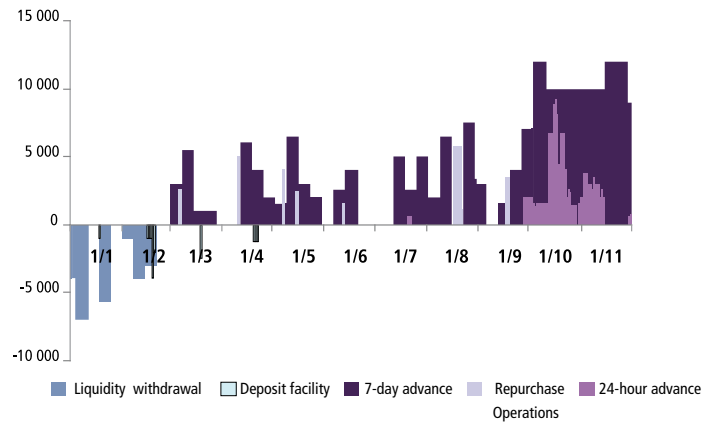


Chart 4.6 Evolution of the average and standard deviation of the interbank market weighted average rate

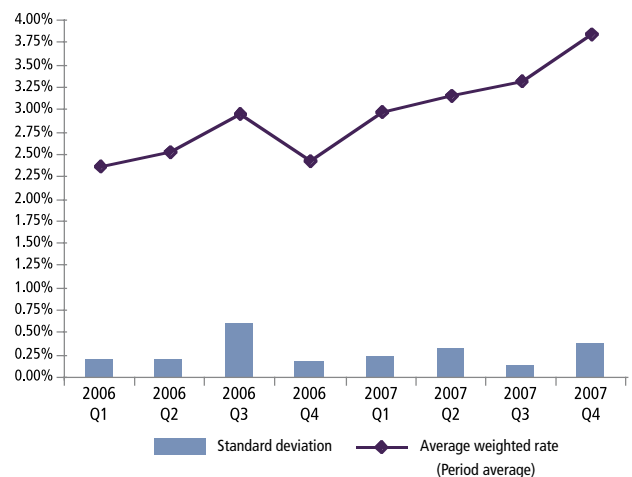
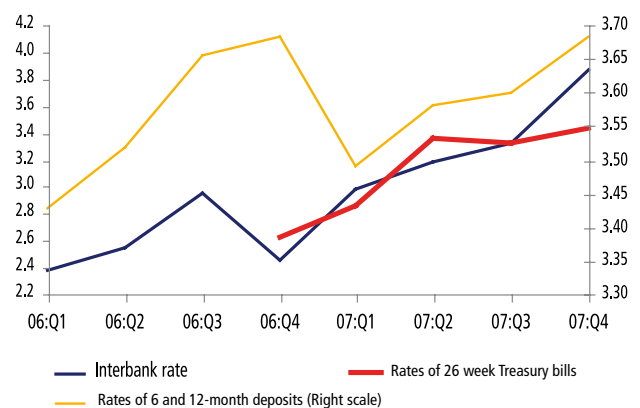


Chart 4.7 Evolution of short-term rates



4.1.2 Interest rates

Reflecting the tightened money market, the weighted average rate of overnight operations kept increasing in the third quarter of 2007 and in October and November, with the marked exception of the easing observed in the second half of November.

Concurrently, the trends in short-term Treasury bills were marked by substantial rises at the end of the third quarter. The same trend was observed at the October and November issues, in particular for 13 and 26-week maturities.

As regards subscriptions to medium and long-term Treasury bills, their volume was small and their interest rates increased in comparison to the last issues of 2007.

The weighted average rate for time deposits rose again in October after the increase observed in the second and third quarters (Table 4.3). Given the rise in the interbank rate, 6-month deposit rates, which are closely linked to the evolution of the overnight rate, reached their highest level since the end of 2002, at 3.68%. In turn, the 12-month deposit rate, whose evolution is more rigid and less affected by short-term variations of banks refinancing cost, stabilized in October at the same level observed in the third quarter.

Overall, lending rates dropped slightly from one quarter to the next, except for those applied to equipment loans which increased again, yet not as high as in the second quarter.

The downward trend of rates on consumer and real estate loans, which continues to reflect the fierce competition among banks on these segments, slowed in the third quarter. As to rates on cash facilities, which were highly volatile in the past, they saw no significant variations between the second and third quarters (Table 4.4).

4.1.3 Currency, credit and liquid investments

M3 evolution

The annual growth pace of M3 showed a slight slowdown, from 19.4% in the second quarter to 18.5% in the third quarter of 2007. In October, this rate saw no meaningful changes.

Table 4.1 Short-term Treasury bills rates

	2006				2007			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4*
13 weeks	2.65	2.62	-	2.52	2.73	3.30	3.29	3.40
26 weeks	-	2.78	-	2.62	2.85	3.34	3.32	3.42
52 weeks	3.06	3.00	-	-	2.97	2.88	3.40	3.41

* The fourth quarter of 2007 corresponds to the arithmetic average of October and November data

Table 4.2 Medium and long-term Treasury bills rates

	2006				2007			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4*
2 years	3.29	3.24	3.16	2.99	2.96	-	3.59	3.58
5 years	3.91	3.75	3.56	3.23	3.14	-	-	4.00
10 years	4.51	4.26	4.11	3.52	3.40	-	-	-
15 years	5.20	4.71	-	3.72	3.65	-	-	-

* This refers to the arithmetic average of October and November data.

Graphique 4.8 Rates of secondary market Treasury bills

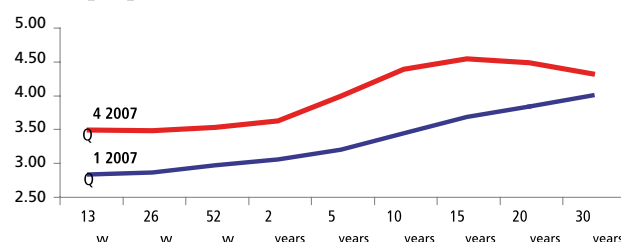


Table 4.3: Borrowing rates* (time investments)

	2006			2007			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
6 months	3.43	3.42	3.64	3.26	3.52	3.41	3.68
12 months	3.62	3.76	3.70	3.65	3.63	3.69	3.69
Weighted rate	3.52	3.65	3.68	3.49	3.58	3.60	3.68

* The quarterly data are arithmetic averages of the monthly data. The last quarter of 2007 corresponds to October data

Given the continuing high level of non-agricultural GDP growth, the additional monetary surplus, which is a leading indicator of inflation, slightly contracted in the third quarter of 2007 (Chart 4.10).

However, the level of monetary holdings remains high but its impact on prices could be put into perspective, in the light of the analysis of the demand determinants for the most M3 liquid components.

In fact, the recent expansion of sight deposits with banks, which accounts for more than 50% of M3 annual rise, is partially linked to the acquisition of financial and real estate assets, which went up in the last quarters. In addition, time series analysis over a long period shows that a part of bank money surplus, compared to the level required to accompany the development of real transactions, could be attributable to lower opportunity cost and to the dynamism of financial transactions during recent years.

In turn, time investments by resident individuals and Moroccans living abroad fell back from one quarter to the next (Table 4.6), thus reflecting the scope of transfers to bank money.

Altogether, the monitoring of the evolution of M3 components and the real and financial determinants of their demand confirms the important volume of cash holdings pending allocation. The portion of cash held as sight accounts occasionally increases by the volume of subscriptions to newly listed shares. This volume is fuelled by transfers from interest-bearing investments and cash facilities.

Bank loans

At the end of the third quarter of 2007, the growth rate of bank loans stayed at a high level of 25.5%, after the acceleration observed in the second quarter. This situation is attributed to the strength of non-agricultural economic growth and the importance of real estate and financial transactions which seem to fuel the increase of real estate loans and cash facilities.

The latter, which remain the main loan category contributing to monetary growth, saw a hike of 29.4%, which was nonetheless below the 33.3% recorded a quarter earlier. On the other hand, annual growth in real estate loans accelerated, reaching a historic level of 34.4%.

**Chart 4.9 Evolution of M3 and its components
(on a year-to-year basis in %)**

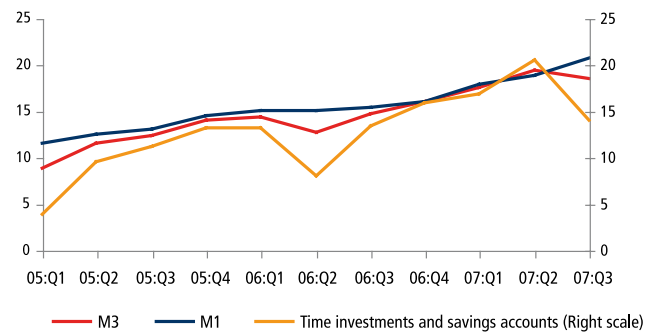


Table 4.4 Lending rates*

Weighted average rate	March 07**	June 07**	Sept.07
Cash facilities	6.12	6.38	6.32
Equipment loans	5.86	7.15	7.36
Real estate loans	5.70	5.27	5.21
Consumer loans	8.27	7.49	7.02
Total	6.25	6.41	6.36

* Data of the quarterly survey on interest rates

** Revised figures

**Table 4.5 Growth of money and non-agricultural GDP
(in real terms)**

	2006					2007			
	Q1	Q2	Q3	Q4	Average	Q1	Q2	Q3	Average
Year-to-year growth									
M3	12.1	8.6	10.6	11.8	10.8	14.4	17.5	15.2	15.7
M1	12.7	10.9	11.2	11.9	11.7	14.8	17.0	17.3	16.4
Non-agricultural GDP	3.5	4.4	3.2	4.9	4.0	5.5	6.2	6.1	5.9
Growth gap between money and non-agricultural GDP									
M3	8.5	4.2	7.4	6.9	6.8	8.9	11.3	9.1	9.8
M1	9.1	6.4	8.0	7.0	7.6	9.3	10.8	11.2	10.4

**Table 4.6 Changes of non-financial agents' bank deposits
(in %)**

	06:T4	07:T1	07:T2	07:T3	
	<i>Quarterly change</i>				
Sight deposits	Non-financial businesses	1.4	9.8	4.5	6.6
	Individuals	4.2	6.2	6.2	7.2
	Moroccans living abroad	1.0	3.3	4.3	6.9
	<i>Year-to-year</i>				
Sight deposits	Non-financial businesses	13.7	21.0	19.3	24.1
	Individuals	18.7	21.8	24.2	26.1
	Moroccans living abroad	13.0	14.6	14.2	16.3
<i>Quarterly change</i>					
Time deposits	Non-financial businesses	12.2	6.9	13.4	3.6
	Individuals	2.2	8.5	-0.2	-3.9
	Moroccans living abroad	4.1	1.4	-0.3	-2.2
	<i>Year-to-year</i>				
Time deposits	Non-financial businesses	18.6	19.5	56.2	40.9
	Individuals	3.3	16.6	13.9	6.2
	Moroccans living abroad	4.5	3.6	4.4	2.9

Analysis of the structure of real estate loans shows a rise in the share of non-financial firms and Moroccans living abroad since early 2006, to the detriment of resident individuals. This might be indicative of the importance of real estate loans granted to developers in connection with the dynamism of the building sector. It also reflects the rise in demand for real estate assets by Moroccans living abroad, which resulted in the net decline in their contribution to the growth of interest-bearing investments with banks (Chart 4.14).

The expansion of consumer loans has remained at an exceptionally high level of 40% year-on-year, reflecting the dynamism of household consumption in urban areas and the intensification of competition between banks leading to the easing of lending conditions.

Likewise, the increase in equipment loans slowed rather slightly from one quarter to the next, dropping from 23.2% to 21.4% owing to the continued growth of investment expenditure.

Other sources of money creation

The annual increase in net foreign assets slowed again in the third quarter of 2007, from 12.3% to 11.1%, mainly due to the widening trade deficit. The drop in their contribution to money creation, as against that of bank loans, is therefore confirmed.

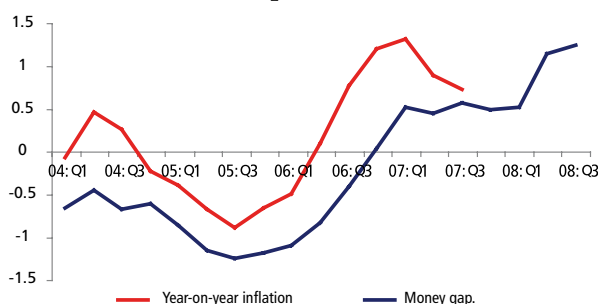
In October, these assets grew by nearly 10.9% on a year-to-year basis compared to 9.6% in September 2007.

Net claims on Government increased at an annual pace of 17.8% in the third quarter of 2007, more rapidly than in the two previous quarters due to the rise in the issue of Treasury bills as of July. In October, their level was above 15.4% compared to the same month in 2006.

It should be highlighted that net claims on Government show wide quarterly fluctuations, which nonetheless have no long-term impact on monetary aggregates, their outstanding amounts being stable over a long period (Chart 4.17).

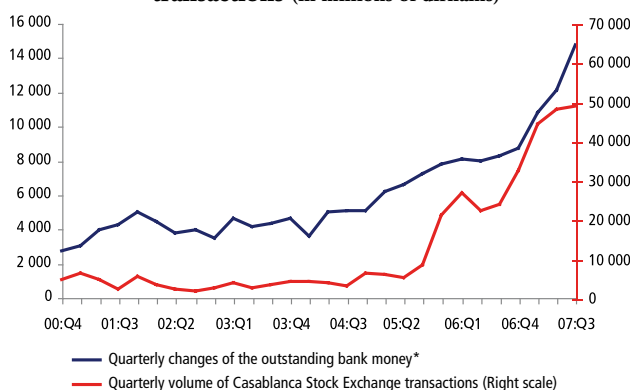
Finally, the evolution of money creation sources was marked by the drop of net foreign assets in favour of domestic loans. This trend might become more pronounced over the next quarters due to the

Chart 4.10 Surplus money growth and moving average inflation of four quarters. (Standardized data)



* The monetary growth, projected a year ahead in this chart, is obtained by the gap between the growth rate of the money supply and that of non-agricultural GDP in real terms.

Chart 4.11 Bank money and volume of stock exchange transactions (in millions of dirhams)



* Four-quarter moving average

Chart 4.12 Annual growth of bank loans (quarterly data in %)

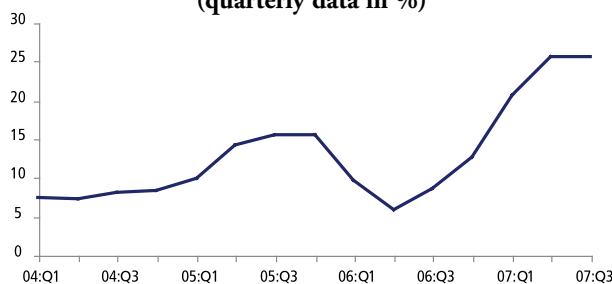
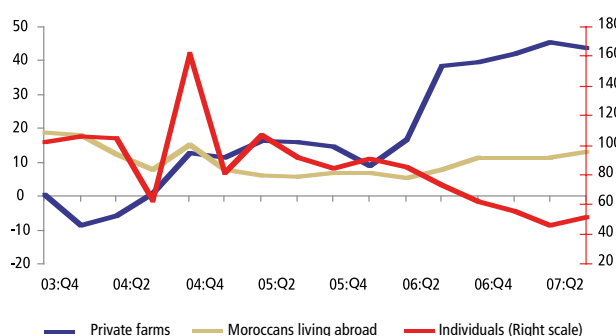


Chart 4.13 Contribution of non-financial agents to annual growth of real estate loans (in %)



impact of the new liberalization measures related to residents' financial operations, which came into force last August.

4.1.4 Exchange rates

At the end of the third quarter of 2007, the dirham exchange rate saw the same trend as in the previous quarter. It appreciated on average by 1.65% compared to the dollar while it dropped by 0.35% against the euro, as opposed to the previous quarter. However, the dirham depreciated by 0.17%, 0.31% and 0.91%, respectively against the pound sterling, the Swiss franc and the Japanese yen.

This evolution continued in October and November 2007. The national currency, on average, rose by 4.23% against the dollar and depreciated by 0.85% against the euro.

Concurrently with this change, the nominal effective exchange rate of the dirham, calculated on the basis of bilateral exchange rates with Morocco's principal trading partners, depreciated by 0.17% compared to its level in the previous quarter, suggesting more pressures on imported goods prices.

Chart 4.14 Contribution of Moroccans living abroad to annual growth of interest-bearing deposits and real estate loans (in %)

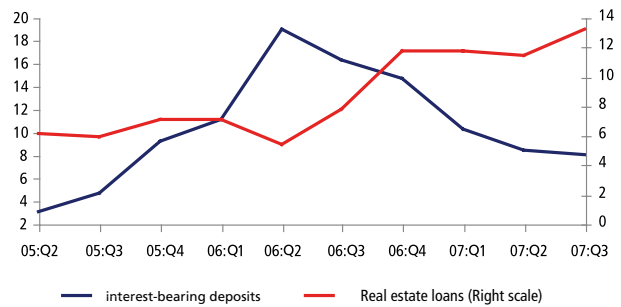


Chart 4.15 Annual growth of the main bank loan categories

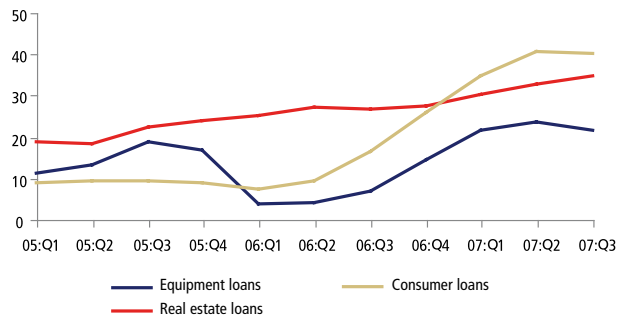


Chart 4.16 Annual growth of net foreign assets (in %)

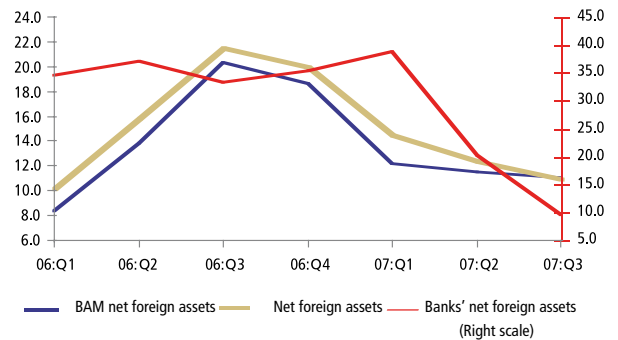
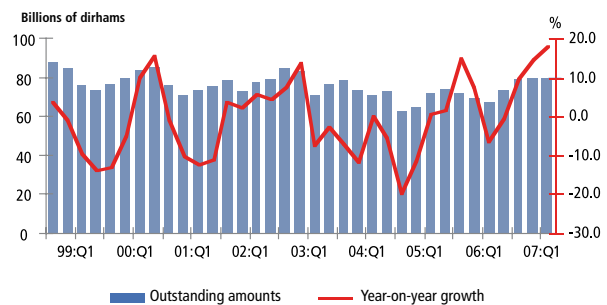


Chart 4.17: Quarterly changes of net claims on the Government (in %)



Given the favourable situation of the inflation differential, the real effective exchange rate of the dirham showed a depreciation of 0.23% after that of 0.97% recorded in the previous quarter.

4.2 Asset prices

At the end of the third quarter of 2007, stock exchange prices saw a favourable trend, the MASI index having risen by 11.76% compared to June and capitalization by 16.41% compared to the previous quarter, reaching 575.58 billion dirhams. This stock exchange performance is attributable to the appreciation of most securities and the impact of new market listings. In turn, the volume of transactions increased by 40.84% compared to the year's second quarter, standing thus at 72.28 billion dirhams.

Chart 4.18: Contribution of creation sources to M3 annual growth (in %)

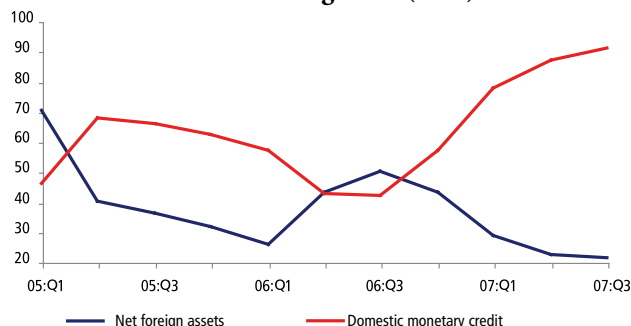
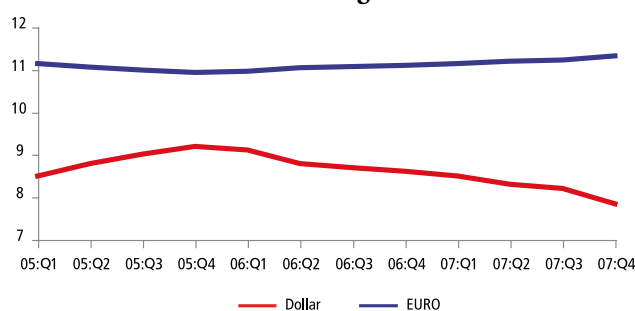
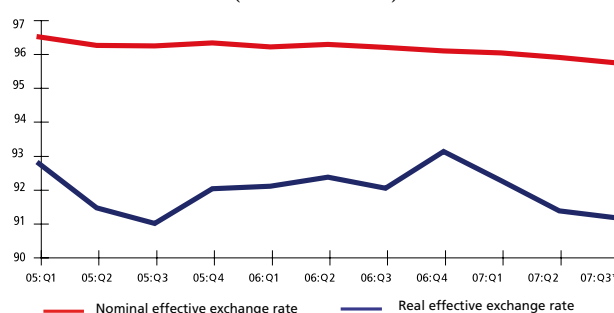


Chart 4.19: Bilateral exchange rate of the dirham*



* The fourth quarter of 2007 corresponds to the arithmetic average of October and November data

Chart 4.20: Effective exchange rate (Base 100 in 2000)



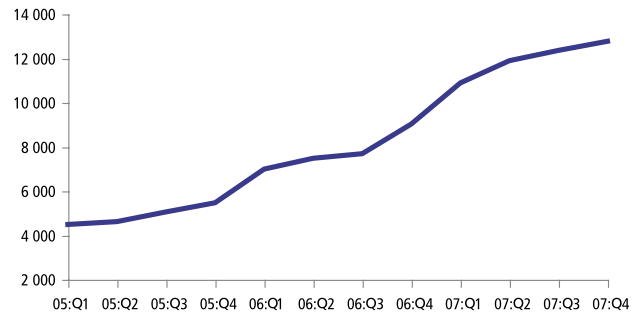
* Preliminary data
Source : BAM estimates.

At the beginning of the last quarter of the year under review, the pace of growth of the main stock exchange indicators slowed down. In fact, at the end of November 2007, the MASI index fell by 1.06% compared to the end of September and market capitalization was up by only 1.45%, reaching nearly 584 billion dirhams.

The Price Earning Ratio (PER) was up from 20.5 to 22.9 from one quarter to the other, which reflects a disconnection between corporate results and the stock prices trend.

Real estate prices appear to continue their upward trend, particularly in large urban areas, boosted by strong domestic and foreign demand as well as easing financing conditions.

Chart 4.21: Masi indices* (monthly averages)



* The fourth quarter of 2007 corresponds to the arithmetic average of October and November data.

5. RECENT INFLATIONARY TRENDS

In November, the cost of living index slowed down, registering a year-on-year rise of 1.4% compared to 3.5% in the previous year. Over the first eleven months of 2007, average inflation stood at 2.0%, compared to 3.3% in the same period of 2006.

In fact, starting from the second quarter of 2007, the inflationary effects of higher oil and basic commodity prices were mitigated by a number of measures taken by the Government. In addition, this deceleration was due to lower communication costs and slowing price rises for the “heating, lighting and water” as well as “other goods and services” headings.

Over forthcoming quarters, pressures on prices could go upwards, particularly due to the risk of the repercussion of the higher price of oil and basic products on domestic price levels and the acceleration of pressures on output capacity.

Situation at the end of 2007

Consumer prices

On a year-to-year basis, the cost of living index registered a rise of 1.4% as opposed to 3.5% a year earlier, while underlying inflation fell from 2.8% to 1.9%. This deceleration is due, in particular, to the 16.4% fall in the costs of “communications”, as opposed to a rise of 0.7% in the previous year, as well as to the slowdown in the costs of “heating, lighting and water”, “public transport” and “other goods and services” which dropped from 6.3% to 0.7%, 7.4% to 0.1% and 2.7% to 1.4%, respectively. Also contributing to this trend were the prices of “dairy products”, down from 2.6% to 1.5% and of “fats” down from 14.3% to 12.7%, the year 2006 having seen a readjustment of VAT inducing a rise in the prices of these products.

The slowdown in prices occurred in spite of the higher prices of “cereals and cereal-based products”, which jumped from 0.2% to 9.9% from one year to the next, and the accelerating rise in the prices of “clothing” and “leisure activities and culture”, from 1.1% to 1.5% and from 1% to 1.4%, respectively.

Further, the decrease in the overall cost of living index was larger than that of the underlying inflation index, due to changes in private transport costs as well as in administered fresh produce prices. In fact, the prices of meat dropped by 4.4% and fresh vegetables by 1.1%, while the cost of private transport fell by 0.9%. In addition, tobacco and sugar prices evolved by 0% instead of 4.7% and by 1.6% against 10.4%, respectively.

Chart 5.1 Year-on-year inflation and underlying inflation

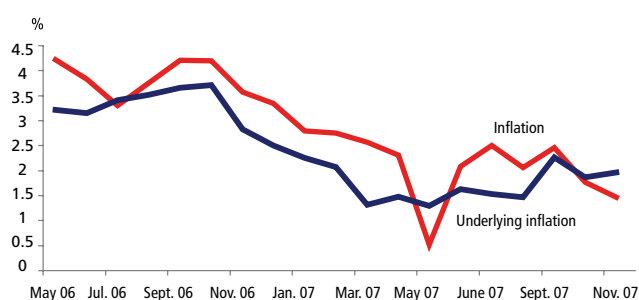


Table 5.1 Inflation and underlying inflation

	Year-on-year quarterly growth			Year-on-year monthly growth				
	2006 quarters			2007 quarters				
	I	II	III	I	II	III	November 2005	November 2006
Inflation	2.1	3.7	3.7	2.6	1.6	2.3	3.5	1.4
Underlying inflation ^(E)	2.9	3.0	3.5	1.8	1.4	0.7	2.8	1.9

(E) BAM estimates on the basis of HCP data

Furthermore, the effect of higher oil and basic products' prices as of the second quarter of 2007 was mitigated by the measures taken by the Government. Thanks to the intervention of the Subsidization Fund, it was possible to avoid the ramifications of soaring oil and cereals prices on world markets.

The inflationary effects of local scarcity of certain basic products caused by drought were attenuated by:

- Reducing customs duties on durum and soft wheat from 95% to 55% and from 60% to 30%, respectively;
- Removing the compensatory premium on wheat from the European Union and the United States;
- Reducing import duties on UHT milk from 102% to 2.5% from 15 August until 15 October 2007 and on powdered milk from 60% to 35% between 26 June and 31 December.

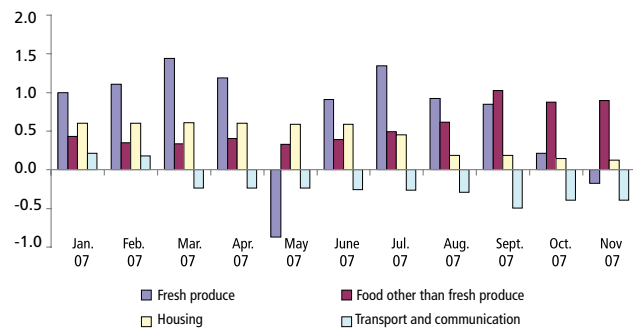
Producer prices

In October 2007, the industrial producer price index rose by 1.7% instead of 1.8% last September. The headings that contributed most to this rise were "coking and refining" where prices grew by 5.5% as opposed to a 0.4% drop in the previous month, as well as "the food industry" where prices rose by 0.8%. As to the producer price index, excluding oil refining, it increased by 0.4% against 2.7% in the previous month.

On a year-to-year basis, the producer price index, excluding oil refining, accelerated, in comparison to the same period of the preceding year, from 1.9% to 3.6%. This trend is mainly attributable to chemical industries where the prices rise jumped from 2.4% to 13.4%, to the increase of prices in metallurgical industries by 9% instead of 4.7% as well as to the 4.7% rise in the costs of the "manufacturing of other non metal mineral products", as opposed to a drop of 0.6%.

According to the results of the monthly business survey conducted by Bank Al-Maghrib with industrial sector firms, industrialists' expectations with regard to prices evolution over the next three months remain on an upward trend, especially with finished product inventories remaining at their

Chart 5.2 Contributions of the main components of the CLI on a year-on-year basis



6. INFLATION OUTLOOK

This section outlines the inflation evolution deemed to be the most probable (central forecast) over the next four quarters, and examines the main associated risks (balance of risks). Therefore, the scenario of the central forecast is dependent on the assumptions and developments expected for a series of variables affecting activity and inflation. Under the assumption of the non-occurrence of the main identified risk factors, the evolution of inflation over the four forthcoming quarters remains in line with the price stability objective, with an average forecast of approximately 2.3%. At the end of 2007, inflation is expected to reach 2.1%, in line with the forecasts of the last Monetary Policy Report. In the first quarter of 2008, we forecast inflation to hover around 2.5%, mainly driven by the cyclical rise in food prices. This rate is expected to drop slightly as of the second quarter of 2008 (2.4%), to stand at nearly 2.1% at the end of the third quarter. Compared to the previous Report, inflation forecast was slightly revised upwards. However, the risks and uncertainty surrounding the central forecast for inflation still trend upward. Externally, these risks are linked to the growing uncertainty about the future developments of hydrocarbon and agricultural products and commodity prices. Internally, they are associated with the uncertainty about maintaining the freeze on the indexation mechanism of oil products price, the rapid changes in the M3 aggregate and bank loans, as well as the mounting pressures on wages.

6.1 Baseline scenario assumptions

6.1.1 International environment

The recent downward revision of growth prospects for OECD countries suggests a slowdown of economic growth in our main Eurozone partner countries. This trend, which began in the fourth quarter of 2007, is likely to persist until the second quarter of 2008. In fact, average growth of this organization's member countries should fall from 2.7% in 2007 to 2.3% in 2008. Although this drop essentially concerns the United States, where growth forecasts for 2008 have been revised downwards from 2.5% to 2%, the growth forecast of the Eurozone was also reduced from 2.3% to 1.9%.

The underlying causes of this slowdown are mainly related to the recent financial turmoil in the American subprime mortgage market and the drop in consumption and investment following the credit market crunch. These effects add to the rise in oil prices and the euro's appreciation. Nevertheless, medium term outlook remains positive thanks to an extended period of global expansion, solid corporate balance sheets as well as the rapid intervention of the major central banks (Fed, ECB and BoE).

On the basis of these developments, we assume in our central scenario a 1.8% growth rate in our main partner countries (Germany, Spain, France and

Italy), representing a marked slowdown compared to the 2.5% forecast of the last Monetary Policy Report. It is worth mentioning that this growth rate is calculated on the basis of an average weighted by these countries' respective shares in Morocco's foreign trade.

In the Eurozone, the underlying inflation rates increased gradually but constantly over the past two years and overall inflation is considerably up, reaching 3% in November of this year. The ECB has recently raised its inflation forecast by 0.5% for 2008 and inflation is expected to stand at 2.5% in the thirteen countries of the Eurozone. Nevertheless, the so far controlled wage hikes, the euro appreciation and the tightening of credit conditions tend to ease the inflationary pressures attributable to higher oil and food prices. In this context, the ECB has favoured the status quo, as it did not raise its key rate fixed at 4%.

As opposed to the previous Monetary Policy Report, we now expect a 0.25% drop in interest rates in the Eurozone by the second quarter of 2008.

Against a backdrop of relative acceleration in world inflation, pressures on import prices, excluding energy, remain relatively moderate in Morocco. After an annual increase of 7% in 2007, growth of import prices, excluding energy, is expected to fall back in 2008, to reach 4%. This rise is mainly driven by agricultural products and commodities' prices.

6.1.2 National environment

In addition to a significant rain shortage, the national economy had to face in 2007 a general rise in hydrocarbon prices and a surge in cereal prices on the international markets. The effect of these rises on the national economy was yet restrained by the prices subsidization system. Economic growth is expected to reach 2.3% in 2007, mainly driven by the performance of non-agricultural sectors (5.8%).

The drop in the added value of the agricultural sector for 2007 (estimated at 18%), due to a poor cereal harvest, should not however overshadow the positive performance of some other branches of this sector, such as citrus fruits and early fruits and vegetables. In fact, the latter increased markedly at the end of June 2007, compared to the previous year. Nonetheless, this year's rain shortage sparked an acceleration of cereal and milk imports, whose international prices have soared, as well as a rise of more than 12% in fresh vegetables prices. Under the assumption of better weather conditions, these developments would be cushioned at the end of the year and agricultural GDP would moderately drop by 8% on a year-to-year basis in the fourth quarter.

The scenario for 2008 counts on an average cereal output of 60 million quintals, equal to a 14% increase in agricultural GDP. Under these conditions, the agricultural output gap is expected to remain negative in the first two quarters, before turning positive in the last two quarters of 2008. The performance of non-agricultural sectors is forecast to follow the same trend as in 2007. Therefore, the overall output gap is projected to be very slightly positive in 2008.

In 2007, labour market gave rise to moderate inflationary pressures. Net job creation in the third quarter amounted to 111,000 posts, against 221,000 in the same period of the previous year. It mainly concerned services, industry and building and public works. As a result, the unemployment rate fell only very slightly from 10.1% to 9.9%. Conversely, the Quarterly Wage Index, calculated by the HCP, shows a 2.4% rise in real wages in the

second quarter against 3.6% in 2007. For 2008, growth of employment, excluding in agriculture, is forecast to continue. The minimum wage readjustment, which may take place following the ongoing negotiations between the Government and trade unions, would eventually exert further wage pressures and therefore contribute to higher labour force costs.

After having reached a new record of \$99.29 per barrel on 26 November, oil prices have significantly fallen over the last days, losing more than \$10 in just a few sessions. Fears about dwindling hydrocarbon demand, due to declining activity in OECD countries, is possibly behind this trend. Furthermore, the lessening of geopolitical tensions in the Middle East, resulting from the recent revelations concerning the Iranian nuclear programme, may have contributed to this drop. Although still fragile and hesitant, the current market trend seems to withstand the decision of OPEC countries to freeze their production quotas and the announced drop of 8 million barrels of American crude stocks.

The evolution of oil prices for the year 2008 remains uncertain, the markets being characterized by extreme and persistent volatility, thereby reflecting market participants' uncertainty. Thus, Goldman Sachs, the leading investment bank in energy markets, henceforth expects oil price to average nearly \$95 a barrel next year.

In Morocco, prices of oil products on the local market have not been impacted by global markets turmoil in 2007 on account of the freeze of the indexation mechanism. Thus, Treasury expenditure for oil products subsidization has been rising substantially, growing by 21% in 2007, to reach 10.3 billion dirhams, against 12% in 2006. Under the Finance Act of 2008, the subsidization budget for oil products including butane is expected to amount to 8.7 billion dirhams on the basis of an optimistic scenario of \$75 a barrel, or a 50% increase compared to the 2007 Finance Act. However, a simulation based on a barrel at \$90 shows that subsidization expenses would reach 13 billion dirhams just for oil products, excluding

butane, or an extra cost of 49% compared to the forecasts of the 2008 Finance Act.

A price level of more than \$75 on the international market should therefore lead to an increase in domestic fuel price, provided the indexation mechanism is fully applied. However, we expect that the differential between the international price and the reference price of the 2008 Finance Act would continue to be supported in 2008, even though this may eventually lead to a sharp increase in budgetary expenditure.

For this forecast, we hence assume the continuation of the subsidization mechanism currently in force (freeze of the indexation mechanism), the cost of which is supported by the budget. The central forecast therefore assumes the stagnation of diesel pump price at its current level of 7.22 dirhams a litre for 2007. However, an alternative scenario of a rise of diesel pump prices by about 5% in the third quarter of 2008 is taken into account in order to evaluate risks to inflation resulting from the uncertainties about the evolution of oil prices in 2008.

6.2 Inflation outlook and balance of risks

Under the assumption of the non-occurrence of the main risks discussed below, the central forecast for the next four quarters remains in line with the price stability objective. Accordingly, inflation would very probably reach 2.1% at the end of 2007, against 3.3% a year earlier. This would confirm the forecasts of the last Monetary Policy Report. The slowdown of inflation in 2007 is essentially attributed to the falling growth pace of fats prices, as 2006 saw an upward readjustment of VAT on these products. It is also due to lower telecommunications prices and less important increase rate of public transport prices. The underlying inflation should, in turn, fall from 3.2% in 2006 to 1.6% at the end of 2007.

For the forecast horizon (the next four quarters), the central scenario indicates an average inflation of approximately 2.3%. For the first quarter of 2008, we expect an inflation rate of about 2.5%,

basically driven by the cyclical rise of food prices. This rate is projected to drop slightly as from the second quarter of 2008, (2.4%), to stand at around 2.1% at the end of the third quarter (see Table 6.1). With regard to the forecasts published in the 25 September 2007 edition of the Monetary Policy Report, inflation projections for the first and second quarters of 2008 were slightly revised upwards from 2.2% to 2.5% and from 2.0% to 2.4%, respectively. Several scenarios (pessimistic, optimistic and intermediate) were developed to assess the probable evolution of underlying inflation during 2008, which makes it possible to determine a forecast interval. This simulation suggests an annual rate hovering between 1.7% and 2.0% for 2008.

Table 6.1 Inflation forecast for 2007-2008

Year-on-year	2007		2008		Average 2007	Average forecast horizon
	4 th quar.	1 st quar.	2 nd quar.	3 rd quar.		
Inflation forecast	2	2.5	2.4	2.1	2.1	2.3

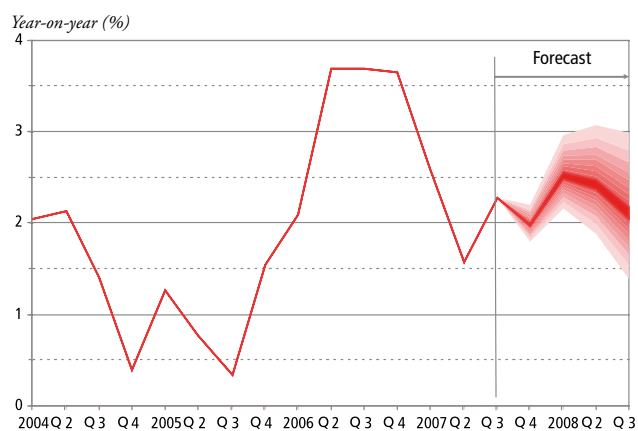
(P) BAM forecasts

These forecasts have been developed on the basis of assumptions deemed the most probable. However, there are many sources of uncertainty, attributed to the future development of exogenous variables as well as to the forecasting models, which may impact the projected inflation on an upward or downward trend.

Analysis of the balance of risks allows determining an asymmetric forecasting range depicted in the form of a fan chart. This is a probabilistic evaluation of the uncertainty zones surrounding the central forecast (see Chart 6.1).

The fan chart of this forecast suggests a slight upward asymmetry, though to a lesser degree than that shown by the fan chart presented in the Monetary Policy Report of last September. Such upward asymmetry of the fan chart implies a probable inflation pick-up, compared to the central forecast. This asymmetry ensues from the risks linked to the uncertainties surrounding the development of the international economic situation (increased uncertainties about the future development of oil prices and agricultural product and commodity prices). It is also the result of the risks linked to the national environment (uncertainties about maintaining the freeze of the indexation mechanism of oil products' prices, the rapid growth of M3 aggregate and bank loans, and the increasing pressures on wages). The materialization of one or more of these risks could push inflation above the central forecast, with a rate included (with a 90% probability) within the range forecast depicted by the fan chart.

Chart 6.1 CLI projections for 2007 Q4 - 2008 Q3
Quarterly data



(*) The chart represents the confidence interval with regard to the inflation projection derived from the baseline scenario (dark red): confidence intervals from 10% to 90% are also shown. Each interval addition of the same colour, on both sides of the central scenario, increases by 10% the probability that inflation will fall within the area delimited by these intervals. Therefore, if we take into consideration the range delimited by the fifth interval around the central outlook, this is equivalent to having a 50% chance that inflation will fall within this range in the future.

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